Pillar 3 Disclosure

Year ended 31 December 2018

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Introduction

Buckinghamshire Building Society (the Society) seeks to ensure that the interests of its members and other stakeholders are protected by having a sufficient amount of capital set aside at all times. 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.

The Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) are the regulatory framework governing the amount and nature of capital financial institutions are required to maintain. The regulations are collectively known as CRD IV, the implementation of which is overseen by the Prudential Regulatory Authority (PRA) in the United Kingdom. The Society is therefore subject to the provisions of the CRD, including the guidance about what disclosure requirements institutions must satisfy around risk management, capital resources and adequacy, asset encumbrance and remuneration policies and practices.

The CRD sets out three main areas, known as "Pillars", each deal with a different aspect of the rules. An explanation of the three pillars is set out below:

- **Pillar 1** - sets out the minimum levels of capital that have to be maintained. The calculation of Pillar 1 is based on the size of an institution and its risk characteristics. Larger firms calculate their Pillar 1 requirements using an internal ratings based (IRB) model which allows an internal assessment of risk weightings to be applied to assets. As a small firm the Society operates under the Standardised approach which uses prescribed risk weightings as set out in the CRD for credit risk. The Society uses the basic indicator approach for operational risk, which requires a capital level based on an average of the previous three years net income.
- **Pillar 2** - is focussed on an internal assessment of risks that are not fully covered by Pillar 1 or are not within the scope of Pillar 1. The review of Pillar 2 is documented in the Society's Internal Capital Adequacy Assessment (ICAAP) which is approved annually by the Board and is subject to review by the PRA. Pillar 2 also includes the Capital Conservation Buffer, which is prescribed in the CRD, and the Countercyclical Capital Buffer (CCyB) which is set in the UK by the Financial Policy Committee (FPC). These buffers are required to ensure the Society will meet its capital adequacy requirements even under periods of economic stress.
- **Pillar 3** - covers the disclosure requirements of the CRD and is satisfied by the publication of this document. This document provides details of the principal business risks faced by the Society, the Society's approach to management of these risks and gives a breakdown of the capital amounts calculated under the Pillar 1 provisions. This document is also required to provide details concerning the remuneration of certain staff that have been assessed as being subject to the requirements of the Remuneration Code.

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

Unless otherwise stated all financial information contained within this document has been drawn from the Society's Annual Report and Accounts as at 31 December 2018.

Risk Management Policies and Objectives

The Society's risk management process is a continuous cycle of identifying, assessing, controlling, monitoring and reporting of risk. The process is dependent upon all staff playing their part and taking personal responsibility for doing the right thing. The Society fosters a proactive, risk aware, risk management culture.

At an operational level risk is managed through the three lines of defence structure which is defined below:

First line of defence - Operate key controls

The Society has an Internal Control Framework designed by each Department to identify, measure and manage risk within risk appetite. Risk Owners maintain adequate key control documentation to evaluate how key controls are operating. Key responsibilities include:-

- Assessing and managing risks within regulatory requirements as they change;
- Prompt reporting, managing and learning from incidents;
- Embedding controls in policies, procedures and training;
- Implementing control checks and monitoring; and
- Validating that controls are operational and effective.

Second line of defence - Key control reviews

The Risk & Compliance function provides risk management expertise, independent challenge and support for the Board, management and staff. Oversight involves review of all key controls and associated documentary evidence of how they are operating on an annual basis. Other independent assurance work is carried out in accordance with the risk based Combined Assurance Plan as approved by the Audit Committee. The CRO has a direct reporting line to the CEO with a dotted line to the Board Chairman and the Chair of the Risk Committee. Key responsibilities include:-

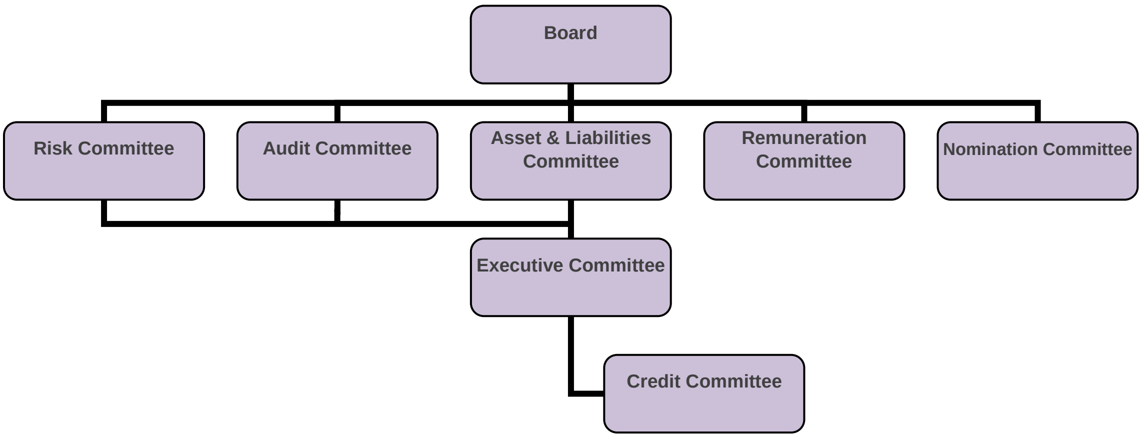
- Creation and maintenance of Risk Management Framework & Appetite;
- Balance challenge and support of the first line of defence;
- Provide oversight and leadership on risk matters; and
- Report to the Board and its Committees.

Third line of defence - Audit

- **Internal Audit** - the Internal Audit function is responsible for independently reviewing the effectiveness of the internal control environment utilising a risk-based work programme. Internal Audit provides advice, benchmarking and training to assist in the continuous improvement of the control framework. To ensure further independence this function has been outsourced to RSM Risk Assurance Services LLP.

- **External Audit** - the External Audit function carries out annually the Statutory Audit particularly focussed on matters that impact financial reporting and provide independent assurance of financial statement accuracy.

The Board and Senior Management take the lead in embedding a risk-aware culture and a strong internal control environment. The Board is accountable for the adequacy of risk management within the Society and has designed the Society's governance structure to effectively manage this responsibility.



Risk Committee

The Risk Committee is a Board Committee whose purpose is to ensure that the approach to identification and management of risk is adequate, cost effective and integrated. Oversight includes ensuring operation within Risk Appetite; ensuring effective stress and scenario testing is carried out; assessing and recommending to the Board for approval, the Individual Capital Adequacy Assessment Process (ICAAP), Risk Management Framework & Appetite and a number of Policies; and facilitating identification of emerging risks within a supportive, risk aware culture. The Committee has 7 members, comprised of 4 non-executive directors (NEDs), plus the Chief Executive Officer (CEO), Finance Director (FD), Operations Manager (OM) and Chief Risk Officer (CRO). The outsourced Internal Audit function provides independent advice where required.

Audit Committee

The Audit committee is a Board Committee responsible for monitoring the integrity of the Society's financial statements; overseeing the external audit relationship; providing oversight of internal controls and compliance reporting; monitoring the effectiveness of internal audit and providing oversight of whistleblowing, fraud and bribery prevention. The outsourced internal audit function reports to the Committee. The terms of appointment of the internal and external audit processes are overseen by the Committee. The Committee has 3 members, all of which are NEDs.

Remuneration Committee

The Remuneration committee is a Board Committee responsible for determining remuneration policy across the Society. The Committee has 3 members, all of which are NEDs.

Nomination Committee

The Nomination Committee is a Board Committee responsible for ensuring the Directors and senior management have appropriate skills, experience, and competencies to perform their roles; to develop and consider succession plans for Board and key management roles; to make recommendations to the Board for the selection of new Directors and senior managers; and make recommendations regarding Governance requirements. The Nomination Committee has 8 members, comprising all 6 NEDS, the CEO and the FD.

Assets & Liabilities Committee (ALCO)

ALCO is a Board Committee responsible for ensuring liquidity and funding adequacy; suitability of interest rate basis risk and maturity mismatch controls; and ensuring suitability of Treasury investments and controls. ALCO recommends the Individual Liquidity Adequacy Assessment Process (ILAAP) and the Financial Risk Management Policy to the Board and sets the parameters within which Senior Management can price products. The Committee has 6 members, of which 3 are NEDs, plus the CEO, FD and CRO.

Executive Committee (ExCo)

ExCo is a Management Committee focusing on operational and business risks, supporting the CEO in directing and coordinating the day-to-day management of the business:

- Monitoring, managing and communicating progress and actions to achieve Strategy;
- Allocating and prioritising resources; human, physical and financial;
- Developing, pricing, launching and managing products and services; and
- Establishing and maintaining effective internal and external relationships.

The Committee has 8 members, comprising the CEO, FD, CRO, Head of Lending (HoL), Operations Manager, Head of People and Culture, IT Manager and Society Secretary to ensure adequate representation of all parts of the business.

Credit Committee

The Credit Committee is a management committee whose purpose is to review mortgage cases outside Lending Policy or exhibiting specific risk characteristics. The Committee also considers changes to Lending Policy and reviews arrears performance. The Committee has 6 members, comprising the CEO, FD, CRO, HoL, Money Laundering Reporting Officer and Senior Underwriter.

Principal risks

The Society's Risk Appetite is designed to promote sound decision making that recognises the consequential impact. The Board debates, refines and approves a set of parameters consistent with achieving the Strategic Plan. Management operates within these limits and reports performance in relation to the key risk indicators, trends and management actions where needed. The Risk Appetite Statement is reviewed when significant changes occur within the business or the external environment. The Risk Appetite Statement is refreshed at least annually.

The principal risks to which the Society is exposed and which are continually assessed and managed by the Board and Management are as listed below.

Credit Risk

Credit risk arises from two main areas:-

- if mortgage holders are unable to meet payments on their mortgage and ultimately default on their loan; and
- if a treasury counterparty is unable to settle its financial or contractual obligations to the Society.

The Board has set a Risk Appetite designed to avoid losses by targeting a balanced portfolio of mortgage assets that match expertise and experience of underwriters. At an operational level, mortgage credit risk is managed through a combination of adherence to the Society's Lending Policy and strict underwriting procedures. The Society's Lending Policy contains detailed limits as to the amount and type of lending the Society can undertake in both the current year as well as the overall mortgage book. These limits ensure the structure of the mortgage book is consistent with the Society's risk appetite. The Society is on the Limited Approach to Lending with an extension.

Ongoing review and control of credit risk is managed by Credit Committee, ExCo and Risk Committee. The Risk Committee will report any relevant matters to the Board. These Committees receive detailed information focusing on:-

- Arrears and forbearance;
- Proportion of the overall book and 12 months rolling lending in each of niches including owner occupied, buy to let (BTL) and commercial lending;
- Indexed loan to value;
- Affordability; and
- Repayment type.

In addition to the above, the Risk and Compliance function will perform credit reviews focussing on various aspects of recent and back book lending.

Treasury counterparty risk is managed by only investing in counterparties with high credit ratings, in other building societies and in successful challenger banks following a detailed individual risk assessment by ALCO. In addition, the Society limits exposures to particular counterparties, types of investment or countries. These limits, together with a range of other mitigating processes and controls, are documented in the Society's ILAAP.

Ongoing review and control of treasury credit risk is managed by ExCo and ALCO who receive detailed information focusing on:-

- Approved counterparty list;
- Exposures to approved counterparties;
- Credit ratings of approved counterparties; and
- Country exposures.

Capital risk

This is the risk that the Society has insufficient capital to cover stressed losses or to meet regulatory requirements. The Society conducts an assessment of capital adequacy covering all risks to determine the level of capital required to support current and future risks in the business, including any changes in business volumes, mix of assets and multiple stress scenarios. This assessment is approved by the Board and monitored monthly. The assessment is utilised by the regulators to set the Society's capital requirements as Total Capital Requirement (TCR) previously referred to as Individual Capital Guidance. At the present time the Society has capital that significantly exceeds the regulatory requirements.

Interest Rate risk including Market Risk

Interest rate 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 is on the "Matched" Treasury approach under PRA SS20/15 guidelines. This means that it has to match the interest rate profile of both its assets and liabilities, and can only take limited interest rate risk subject to tight limits set by the Board, and only then to the extent that the PRA is satisfied that the Society has the requisite risk management capability. In addition to interest rate risk the PRA Supervisory Statement also provides guidance on treasury management which is discussed under Liquidity and Funding Risk below. Management of interest rate risk is predominantly set out in the Society's ILAAP. Control of interest rate risk exposure is managed by ExCo and ALCO who will receive information focussing on:-

- Proportion of the both assets and liabilities on fixed rates;
- Matching reports both static and forward looking;
- Report highlighting exposure to various basis categories for example base rate, LIBOR, fixed and administered; and
- Sensitivity analysis highlighting the impact of changing interest rates.

Liquidity and Funding Risk

Liquidity and Funding 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 and overhead costs.

Control of liquidity and risk is managed by ExCo and ALCO who will receive information focussing on:-

- Quantity of high quality liquid assets (HQLA);
- Level of liquidity coverage ratio (LCR);
- Level of on and off balance sheet treasury assets compared to overall funding balance;
- Maturity profile of funding book; and
- Results of cash flow stress tests.

In addition to LCR the regulator provides further guidance through the PRA Supervisory Statement SS20/15. The Society operates under the "Matched" Treasury approach and complies with the guidance regarding the type and volume of treasury deposits and wholesale borrowing.

Operational Risk

This relates to the risk of loss arising from inadequate or failed internal processes or systems, human error or external events. The management of operational risk is set out within the Society's various policies and procedures. All such risks are identified, assessed and closely. It is the responsibility of each business area, supported by the Risk Department, to understand how operational risk impacts them and to put in place appropriate controls or take other mitigating actions.

Business Risk

This is the risk to the Society of failing to achieve sufficient long term profitability to maintain sustainable capital adequacy. The Society mitigates this risk by preparing a business plan that it believes to be robust and achievable and then by stress testing this plan to assess the impact of various adverse market conditions. The business plan for the forthcoming year has agreed review points where the Board can assess actual performance and decide if any actions are required. The key indicators the Board use to assess business risk are as follows:-

- Capital and liquidity adequacy;
- Net interest margin;
- Management expense and cost income ratios;
- Profit before tax;
- Mortgage book growth; and
- Total asset growth.

Concentration Risk

Concentration risk is the risk arising from the lack of diversification in the Society's business. As a regional building society the business is concentrated in residential mortgage lending funded by retail savings and this represents product concentration. Concentration risk can also occur due to large exposure to an individual or group of connected individuals that are affected by a common issue (e.g. geographical location). The Society's mortgage business is sourced from throughout England and Wales, with 60% of total being in London and the South East. Approximately 10% of our savings are sourced from members living in local post codes.

Concentration risks are managed through the application of Board approved lending and financial risk management policies, containing limits suitable for the current economic climate. The policies and limits are regularly reviewed and monitored to ensure they remain in line with the Society objectives.

Conduct Risk

Conduct Risk is the risk of detrimental outcomes to customers derived from staff interaction throughout the product lifecycle. The risk to the Society is that we suffer reputational damage, a loss or do not benefit from an opportunity because of consumer detriment. Conduct risk comprises high-level principles of treating customers fairly, specific regulatory requirements, wider legal provisions, any relevant codes of practice and statements from the FCA.

By striving to deliver good outcomes, we will build our brand and make our relationship with members a source of competitive advantage. The Society's Conduct Risk Policy is the key policy. The Society's focus on our motto of "Doing the Right Thing" is evidence of our approach to conduct risk.

Pension Obligation Risk

Pension risk arises from a potential pension liability. The Society does not provide a defined benefit scheme for staff so there is no risk in this category.

Capital Resources

The Capital Resources of the Society are calculated under the Capital Requirements Directive. The Total Own Funds are comprised of:-

- Retained earnings and revaluation reserves accumulated by the Society, less a deduction for intangible assets (capitalised software costs), representing Tier 1 Capital; and
- General credit adjustments (collective impairment provisions for bad and doubtful loans), included in Tier 2 Capital.

Reserves are eligible to be treated as capital only after the annual accounts have been independently assessed by the Society's auditors, therefore the Society's capital will be updated annually following the financial year end.

The Society's Own Funds as at 31 December 2018, including the audited profits of 2018, stood at £23,741k and are broken down in the table below.

	2018 £000
Common Equity Tier 1 (CET1) capital: instruments and reserves	
Retained earnings	23,526
Accumulated other comprehensive income	223
Common Equity Tier 1 (CET1) capital before regulatory adjustments	23,749
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets	(115)
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(115)
Common Equity Tier 1 (CET1) capital	23,634
Tier 1 (T1) capital	23,634
Tier 2 (T2) capital: instruments and provisions	
Credit risk adjustments	107
Tier 2 (T2) capital before regulatory adjustments	107
Tier 2 (T2) capital	107
Total own funds (T1 + T2)	23,741
Total risk weighted assets	88,157
Capital ratios and buffers	
Common Equity Tier 1 (as a percentage of total risk exposure amount)*	26.8%
Tier 1 (as a percentage of total risk exposure amount)	26.8%
Total own funds (as a percentage of total risk exposure amount)	26.9%
Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1)(a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	8.635%
Of which: capital conservation buffer requirement	1.875%
Of which: countercyclical buffer requirement	1.0%
Common Equity Tier 1	21.140%

* *The Tier 1 capital ratio presented in the Annual Report and Accounts at 25% is based on information presented to the PRA as at 31 December 2018 which excluded the 2018 profit*

The above tier 1 capital ratio compares to a regulatory requirement of 13.76% (8.0% regulatory minimum plus 5.76% institution specific buffer set by the PRA).

The reconciliation of own funds to the Society's Annual Report and Accounts is below (references to the Annual Report and Accounts are shown in brackets.

	2018 **£000**
Reserves (Balance sheet)	23,749
Less Intangible assets (Note 18)	(115)
CET1 capital	23,634
Collective impairment provision (Note 15)	107
Tier 2 capital	107
Regulatory capital	**23,741**

Requirement for Capital

Capital is required primarily to protect the Society from losses. Losses will mainly result following repossession of property which does not cover the loan balance from mortgage customers that have been in arrears. However other risks can result in losses such as a treasury counterparty default, changes in interest rates that may result in a reduction in net interest margin to a point where overheads are not covered.

A strong capital position also provides confidence to our members and to our regulators, and supports the Society's long term objectives of sustainable growth, targeting optimum profitability generating sufficient earnings to invest in the services our customers require.

Capital Adequacy Assessment

The Society aims to maintain its capital strength above the Board agreed requirement, which is higher than the minimum required by the PRA. In order to do this, the Society needs to generate, and retain, profits that will add to the general reserves, the Society's main source of capital. The generation of capital is targeted to exceed an agreed return but is not aimed at maximisation.

Strategy and Planning

The Society considers its strategic priorities regularly and produces a five-year strategic plan; this is reviewed by the Society's Board at least annually. The Strategic plan includes the financial plan for the forthcoming year's business activities which takes account of the Board's risk appetite and also current and changing economic conditions. The plan considers the impact of the planned activities on the Society's capital resource. The plan also considers various adverse business and economic scenarios (stress tests). Capital resource is measured against these various stress scenarios.

Capital Adequacy Assessment Process

The Society prepares an Internal Capital Adequacy Assessment Process (ICAAP), which focuses on ensuring the capital resources of the Society are sufficient to support its plan both in normal and stressed conditions. The ICAAP is aligned to the strategic plan and the combination of both ICAAP and strategic plan ensure that the Society maintains sufficient capital to support its planned business objectives.

The ICAAP process involves reviewing risks relating to the Society's assets and operations and making an assessment of capital required to mitigate any material financial impact of those risks. Included in the process is a detailed assessment of the results of the Society's stress tests based on a number of economic scenarios. Scenarios include (but are not limited to) reduced business volumes, adverse interest rate margin, negative house price inflation (HPI), and increased default rates.

Finally the Board approves the capital assessment taking into account any areas where they may feel the regulatory calculations do not adequately capture the full risk exposure and then use internal models to determine if any extra capital is required.

Lending & Business Decisions

The Society translates its overall risk appetite for credit risk into a range of individual lending limits controlling the exposures to be taken by the Society. The performance against these limits is monitored monthly.

Pricing

The Society's mortgage pricing models include a capital assessment and are used to provide guidance as to the level of interest rate required to ensure an appropriate level of return is achieved.

Risk Weighted Exposure and Operational Risk Capital

The Society calculates its Pillar 1 capital requirement under the "Standardised Approach" for credit risk. Standardised risk weightings are applied to each asset class resulting in a risk weighted asset (RWA), the minimum capital requirement is 8% of RWA.

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, the minimum capital requirement under Pillar 1 being 15% of the average net income calculation.

The Pillar 1 capital requirement as at 31 December 2018 is set out below:

	Exposure	**Risk weighted assets**	**Minimum capital requirements**
	2018	**2018**	**2018**
	£000	**£000**	**£000**
Credit risk (excluding counterparty credit risk)	**259,246**	**79,275**	**6,342**
Of which: standardised approach	259,246	79,275	6,342
Of which: Treasury assets	44,753	1,564	125
Central government	36,932	-	-
Institutions	7,821	1,564	125
Of which: Loans and advances to customers	198,841	72,864	5,829
Commercial property	3,153	3,054	244
Residential property	194,367	68,489	5,479
Exposures in default	1,321	1,321	106
Of which: Other exposures	15,652	4,847	388
Fixed and other assets	2,632	2,588	207
Mortgage commitments	13,020	2,259	181
Counterparty credit risk	**300**	**182**	**15**
Of which: mark to market	95	19	2
Of which: original exposure	205	41	3
Of which: CVA		122	10
Operational risk		**8,700**	**696**
Of which: basic indicator approach		8,700	696
Total	**259,546**	**88,157**	**7,053**

The reconciliation between total credit risk exposures and total assets per the Annual Report and Accounts is shown in the table below:

	2018 £000
Total credit risk exposures per above	259,546
Less: collective impairment provision not deducted	(107)
Less: off balance sheet items	(13,225)
Total assets per Annual Report and Accounts	**246,214**

Counterparty credit risk

The derivatives used by the Society in managing its interest rate risk exposures are interest rate swaps. These are used to protect the Society from exposures arising principally from fixed rate mortgage lending. There is a risk that the counterparty to the interest rate swap is unable to settle its financial or contractual obligations to the Society. This is classed as Counterparty credit risk. This risk is managed by use of Board approved minimum counterparty credit ratings and maximum counterparty limits as well as cash collateralisation.

To calculate the capital requirements for this risk, the Society has adopted the Mark-to-Market method where interest rate contracts with positive market values are assigned an additional capital amount based on their residual maturity and notional value of the individual contracts.

Capital buffers

- Capital conservation buffer – this is an additional amount of capital required above the Pillar 1 capital requirement to be drawn on in times of stress. As at 31 December 2018 institutions in the UK are required to hold 1.875% of risk weighted assets. This will rise to 2.5% from 1 January 2019.
- Countercyclical capital buffer (CCyB) – is an additional amount of capital required above the Pillar 1 capital requirement to absorb potential losses, to enhance resilience and contribute to a stable financial system. For credit exposures in the UK, the Financial Policy Committee sets the rate for the CCyB. As at 31 December 2018 this rate was 1%. The Society does not hold any non-UK credit exposures, so does not hold any other CcyB amounts.
- Other buffers – the Society is not classed as having a globally systemic importance and therefore, does not meet the criteria for these buffers. Nor does the Society meet the criteria for the Systemic Risk Buffer. The Society's Minimum Requirement for own Funds and Eligible Liabilities (MREL) is set to be equal to regulatory capital requirements, no additional capital is required for this purpose.

Credit Risk - Mortgages

The Society regards as "past due" any mortgage or loan account where three or more monthly repayments have not been made at the accounting date. Arrears of mortgage repayments are monitored closely and the Society has performed well in comparison with national arrears and possession statistics. A detailed geographical analysis including "past due" and "performing" exposures is set out below.

	Secured on residential property			Secured on land			
	Past due balance £000	Performing balance £000	Total balance £000	Past due balance £000	Performing balance £000	Total balance £000	Total balance all loans to customers £000
Outer Metropolitan Area	246	44,573	44,819	-	1,124	1,124	45,943
Greater London	434	41,897	42,331	-	1,444	1,444	43,775
Outer South East	-	29,802	29,802	-	-	-	29,802
South West	99	20,569	20,668	-	-	-	20,668
North West	362	10,675	11,037	-	-	-	11,037
West Midlands	-	13,758	13,758	-	-	-	13,758
East Anglia	-	5,777	5,777	-	-	-	5,777
East Midlands	38	9,127	9,165	-	-	-	9,165
Yorkshire And Humberside	84	7,997	8,081	-	-	-	8,081
Wales	57	5,591	5,648	-	-	-	5,648
North	-	5,347	5,347	-	-	-	5,347
	1,320	**195,113**	**196,433**	**-**	**2,568**	**2,568**	**199,001**

A maturity analysis, based on contractual maturity, of loan types is shown in the table below. Loans to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis.

	Total balance £000	Not more than 3 months £000	More than 3 months but not more than 1 year £000	More than 1 year but not more than 5 years £000	More than 5 years £000	Total arrears balance £000	Specific loss provision £000
Loans past due							
Residential mortgages - owner occupied	1,321	16	48	665	592	67	-
Residential mortgages - buy-to-let	-	-	-	-	-	-	-
Commercial mortgages	-	-	-	-	-	-	-
Total past due	**1,321**	**16**	**48**	**665**	**592**	**67**	**-**
Performing loans	197,680	1,462	5,532	32,973	157,714	-	162
Total loans	**199,001**	**1,478**	**5,580**	**33,638**	**158,306**	**67**	**162**

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. The accounting policy the Society follows for calculating impairment provisions is stated in Note 1 of the 2018 Annual Report and Accounts. A breakdown of the movements on the impairment provisions on loans and advances to customers is shown in Note 15 of the 2018 Annual Report and Accounts. The table below shows a summary of the movements in the impairment provisions.

	As at 1 January 2018	Charge/ (Release)	Written off	Recovered	As at 31 December 2018
	£000	£000	£000	£000	£000
Collective provision	86	21	-	-	107
Individual provision	238	(56)	(20)	-	162
Total	**324**	**(35)**	**(20)**	**-**	**269**

For capital adequacy purposes, collective impairment provisions are regarded as an addition to Tier 2 capital.

Credit Risk – Treasury

The purpose of the Society's ILAAP is to ensure that the Society has sufficient liquid assets to meet its obligations as they fall due. This overarching requirement informs policy limits for the amount and quality of treasury assets.

The methodology for establishing counterparty limits involves consideration of the background rating information and balance sheet data relevant to the counterparty. The Society's policy is to measure counterparties against three main ratings agencies; counterparty is acceptable if it achieves a minimum rating against two of the ratings agencies. For challenger banks that do not have a credit rating a detailed individual risk assessment is made by our Assets and Liabilities Committee taking into account detailed internal data supplied by the prospective counterparty and audited accounts. Unrated peer group building societies are assigned a counterparty limit assessed on the individual society published balance sheet data.

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 FD 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.

For capital adequacy purposes, the Society has nominated Moody's as its external credit rating agency to determine the credit quality step (CQS) of its treasury portfolio.

Risk weighting by credit quality step

Credit quality step	**CQS1**	**CQS2**	**CQS3**	**CQS4**	**CQS5**	**CQS6**	**Unrated**
Moody's rating short-term	Prime-1	Prime-2	Prime-2	Prime-3	Not prime	Not prime	
Moody's rating long-term	Aaa - A3	A2 - A3	Baa1 - Baa3	Baa1 - Baa3	Ba1 - Ba3	<= B1	
Exposure class							
Sovereign	0%	20%	50%	100%	100%	150%	-
Corporates	20%	50%	100%	100%	150%	150%	-
Institutions	20%	50%	50%	100%	100%	150%	20%

Treasury risk weightings

	CQS1 £000	CQS2 £000	Unrated £000	Total £000
Exposures subject to 0% risk weighting	36,890	-	-	36,890
Exposures subject to 20% risk weighting	4,312	-	3,507	7,819
Exposures subject to 50% risk weighting	-	-	-	-
Exposures subject to 100% risk weighting	-	-	-	-
Total exposure	**41,202**	**-**	**3,507**	**44,709**
Risk weighted asset value	**862**	**-**	**701**	**1,563**

Asset encumbrance

Article 100 of the Capital Requirements Regulation (CRR) requires institutions to report the level of their asset encumbrance. Asset encumbrance is a claim against an asset by another party, often in the form of security interests given on assets by a borrower to a lender. The Society's assets can be used to support collateral requirements for secured funding or central bank operations. Encumbrance benefits the Society as it provides cheaper and more stable funding.

The information disclosed below is based on the median values of quarterly data based on a rolling twelve month period. Therefore, the results below may not be directly comparable to those shown in the December 2018 Annual Report and Accounts.

	Encumbered assets		Unencumbered assets	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000
Loans on demand	-	-	42,185	-
Debt securities	-	-	1,250	1,217
Loans and advances other than loans on demand	30,630	-	172,078	-
Other assets	-	-	2,429	-
Total assets	**30,630**		**217,942**	

The Society is a member of the Term Funding Scheme and as at 31 December 2018 had drawings totaling £18m. These drawings are collateralised by an encumbered pool of residential mortgages with the carrying value of £31.1m at 31 December 2018. These mortgages remain fully owned and operated by the Society.

The Society has access to the Bank of England Discount Window Facility (DWF) and has a pool of residential mortgages pre-positioned to provide collateral for any future drawings. The carrying value of this pool of mortgages as at 31 December 2018 was £6.5m. As from 25 March 2019 the balance on this pool of mortgages has been increased to £18.8m.

Liquidity risk

The Society's business model is based on long term mortgage lending which is financed mainly by retail funding that is contractually short term. This therefore requires the Society to maintain sufficient quantity and quality of liquid assets with appropriate access characteristics.

The Society's ILAAP ensures that it always holds a highly prudent level of liquid assets so that it can meet these obligations. As well as holding relatively high levels of liquid assets, the Society also has contingency funding plans in place to cope with any sudden or extreme outflows, and carries out regular stress tests to ensure the robustness of these plans.

The assessment of the appropriate balance of liquid assets which is documented in the ILAAP is informed by both the LCR, considered as the Pillar 1 requirement, and an internal analysis considered as the Pillar 2 requirement. In combination both the Pillar 1 and 2 assessments satisfy the overall liquidity adequacy rule that states the Society must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

The LCR is calculated by dividing the value of HQLA, held as a liquidity buffer, by the forecast net cash outflows under stress over 30 calendar days. From January 2018 the minimum requirement for the LCR ratio is 100%. The Society's LCR has been significantly above this level since inception and is expected to continue at this higher level

The table below shows the summary information for the calculation of the LCR based on a simple average for each quarter. As at 31 December 2018 the Society's LCR was 323%.

Quarter ended	**31 Mar 2018 £000**	**30 Jun 2018 £000**	**30 Sep 2018 £000**	**31 Dec 2018 £000**
Liquidity buffer	37,006	33,007	33,081	36,235
Net cash outflows	6,958	5,758	8,000	9,870
Liquidity coverage ratio	532%	573%	414%	367%

Market risk including interest rate risk

The main activities of the Society that expose it to interest rate risk are:-

- Issue of fixed rate savings business;
- Fixed rate mortgage lending;
- Fixed rate treasury lending; and
- Management of the investment of capital and other non-interest bearing liabilities.

To limit the extent to which the Society is affected by interest rate changes, the Society has adopted the "Matched" approach under PRA sourcebook guidelines. This means that it has to match the interest rate profile of both its assets and liabilities. The matching is managed by using natural hedges between fixed rate savings business and fixed rate mortgages, and by the use of derivative financial instruments (vanilla over the counter interest rate swaps).

Derivatives are not used in trading activity or for speculative purposes.

Management of interest rate risk is predominantly set out in the Society's ILAAP, and is controlled by ExCo and ALCO who will receive information focussing on interest rate gap limits (both point in time and forward looking), basis risk and interest rate sensitivity analysis.

Operational risk

The principal operational risks of the Society at the current time are cyber security, financial crime, HR resilience and risks associated with how our staff interacts with customers throughout the product lifecycle.

The Society has a robust control framework in place including insurance policies, disaster recovery and business continuity plan. The Risk Committee considers a range of metrics and reports from management to ensure that the Society continues to operate within this framework to maintain operational resilience and protect members and staff.

Evaluation of capital required to cover Operational Risk is calculated under the "Basic Indicator Approach" which determined as 15% of the average net income over the previous three years.

Year ended 31 December	2016	2017	2018	Average	Capital requirement @ 15%
	£000	£000	£000	£000	£000
Net income	4,563	4,489	4,867	4,640	696

Leverage ratio

Basel III requires the calculation and disclosure of the Society's leverage ratio which provides a non risk-based measure to supplement the risk-based capital adequacy assessment. The leverage ratio is a measure of Tier 1 capital as a proportion of on and off-balance sheet assets. The ratio does not distinguish between the credit quality of loans and acts as a primary constraint to excessive lending in proportion to the Society's capital. The minimum ratio must be 3% which came into force on 1 January 2018.

The Society's leverage ratio as at 31 December 2018 was 9.3% as shown in the tables below.

Leverage ratio common disclosure	2018 £000	
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets but including collateral)	246,116	
Asset amounts deducted in determining Tier 1 capital	(8)	
Total on-balance sheet exposures (excluding derivatives and SFTs)		246,108
Replacement cost associated with all derivatives transactions	98	
Add-on amounts for PFE associated with all derivatives (mark-to-market method)	205	
Total derivatives exposures		303
Off-balance sheet exposures at gross notional amount	13,020	
Adjustments for conversion to credit quality amounts	(6,510)	
Other off balance sheet exposures		6,510
Total leverage ratio exposures		**252,921**
Tier 1 capital		**23,634**
Leverage ratio		**9.3%**

Summary reconciliation of accounting assets and leverage ratio exposures	2018 £000
Total assets per published Annual Report and Accounts	246,214
Adjustments for derivative financial instruments (mark-to-market method)	205
Adjustments for off-balance sheet items	6,510
Other adjustments	(8)
Leverage ratio total exposure measure	**252,921**

Split of on balance sheet exposures excluding derivatives

	2018
	£000
Banking book exposures, of which:	
Exposures treated as sovereigns	36,932
Institutions	7,820
Secured by mortgages on immovable property	194,372
Retail exposures	3,146
Exposures in default	1,321
Other exposures (e.g. equity, securitisations and other non-credit obligation assets)	2,525
	246,116
Trading book exposures	-
Total on-balance sheet exposures	**246,116**

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. This is balanced by the management of the Society to attract and retain appropriate capability and talent.

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. In addition to financial position and business performance the level of variable pay is dependent on a number of measures that focus on the following:-

- Members
- Employees
- Systems and controls risk management

The 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 members are afforded the opportunity to express their views on the Directors Remuneration Report through an advisory vote at the AGM.

The Board has identified that those personnel whose professional activities have a material impact on the Society's risk profile, and are classed as Material Risk Takers, are the Non-Executive Directors, Executive Directors, the MLRO and 7 others.

Information pertaining to the scope and decision making process of the Remuneration Committee can be found in the Corporate Governance Report in the Society's Annual Report and Accounts.

Information on the remuneration policy of the Non-Executive Directors and Executive Directors and their salary and fees can be found in the Directors Remuneration Report in the Society's Annual Report and Accounts.

The total remuneration of the other Material Risk Takers for the year ended 31 December 2018 was £498k (fixed remuneration: £471k, variable remuneration: £27k).