Capital Requirements Directive

Pillar 3 Disclosures

31 December 2019

Contents

1. OVERVIEW

1.1 Background

The Basel Committee on Banking Supervision (BCBS) introduced the Basel II framework (Basel II) which was implemented in the EU at the beginning of 2007.

On 1 January 2014, the Basel Committee replaced the Basel II framework with the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD), commonly known as the Capital Requirements Directive IV (CRD IV), introducing a revised definition of capital resources and included additional capital and disclosure requirements. The rules are enforced in the UK by the Prudential Regulatory Authority (PRA).

The aim of this reform was to create further resilience within the banking sector by improving the capability of financial institutions within the sector to absorb shocks generated by financial and/or economic stress. This improved resilience (of the banking sector) will help to prevent a cascade into the wider economy.

CRD IV sets out disclosure requirements, also known as 'Pillar 3' disclosures, complementing the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures requires Banks and Building Societies to publish key information about their underlying risks, capital and risk management and are aimed at promoting market discipline.

1.2 Basis and Frequency of Disclosures

This document details the Society's Pillar 3 disclosures as at 31 December 2019, with comparative figures for 31 December 2018 where relevant, and has been prepared to meet the disclosure requirements of CRD IV.

The Pillar 3 disclosure is based upon the Society's Annual Report and Accounts for the year ending 31 December 2019, unless otherwise stated. Pillar 3 disclosures are issued on an annual basis following publication of the Annual Report and Accounts in accordance with regulatory guidelines.

1.3 Location and Verification

These disclosures and the Annual Report and Accounts are published on the Society's website (www.thevernon.co.uk).

The disclosures have been reviewed by the Board's Risk & Compliance Committee and approved by the Board. The disclosures are not subject to External Audit; however, some of the information within the disclosures also appears in the Society's audited 2019 Annual Report and Accounts.

1.4 Scope of Application

The disclosure requirements in this document apply to Vernon Building Society Group ("the Society"), which is made up of the Society and its wholly owned subsidiaries, Vernon Financial Services Limited, The Mortgage Gateway Limited, Vernon Estates Limited and Vernon Property Services Limited.

All of these subsidiaries are dormant companies and are included in the Group's Annual Report and Accounts as at 31 December 2019.

1.5 Directors

A summary of the relevant experience of each of the Executive and Non-Executive Directors is given on page 19 of the 2019 Annual Report and Accounts.

Confirmation of directorships held is disclosed in the Annual Business Statement, which is available on page 80 of the 2019 Annual Report and Accounts.

A copy of the 2019 Annual Report and Accounts is available at www.thevernon.co.uk.

2. RISK MANAGEMENT OBJECTIVES AND POLICIES

2.1 Introduction

The Society recognises risk as a natural consequence of its business environment, as with any organisation. Through prudent management it aims to manage risk in a manner that supports the achievement of its strategic objectives, whilst protecting members' interests and its financial resources.

2.2 Risk Management Framework

The Society's Risk Management Framework operates under the "Three Lines of Defence" principle. The First Line of Defence is within departments where everyone has responsibility for risk management and ensuring adequate controls are in place to mitigate risk. The Second Line of defence is provided by oversight of the first line by the Second Line Risk department, supported by the Executive Committee (Exco) and RCC. The Third Line of defence is provided by Internal Audit and the Audit Committee, which are responsible for reviewing the effectiveness of the First and Second Lines of Defence.

The Risk Management Framework includes the use of Board approved risk appetite statements covering capital, liquidity, operational risk, credit risk, interest rate risk, and conduct risk. They set out key limits and escalation triggers. The risk position is reported to the Board monthly and risk appetites are formally approved annually.

The Risk Management Framework makes use of stress testing and scenario testing. Stress tests consider the potential outcomes for portfolios and for the Society in the event of stressed scenarios incorporating, for example, falling house prices and rising unemployment. Scenario tests consider the outcome in the event of a particular risk or event occurring, and are used to help evaluate the controls, and assess the adequacy of the Society's incident management and business continuity plans.

The key elements that form the Risk Management Framework are shown in the chart below:

Risk Management Framework

Risk Strategy
Details the Society's overarching principles with regard to the treatment of risks

Risk Management Framework Policy
Outlining how the Society expects risks to be managed

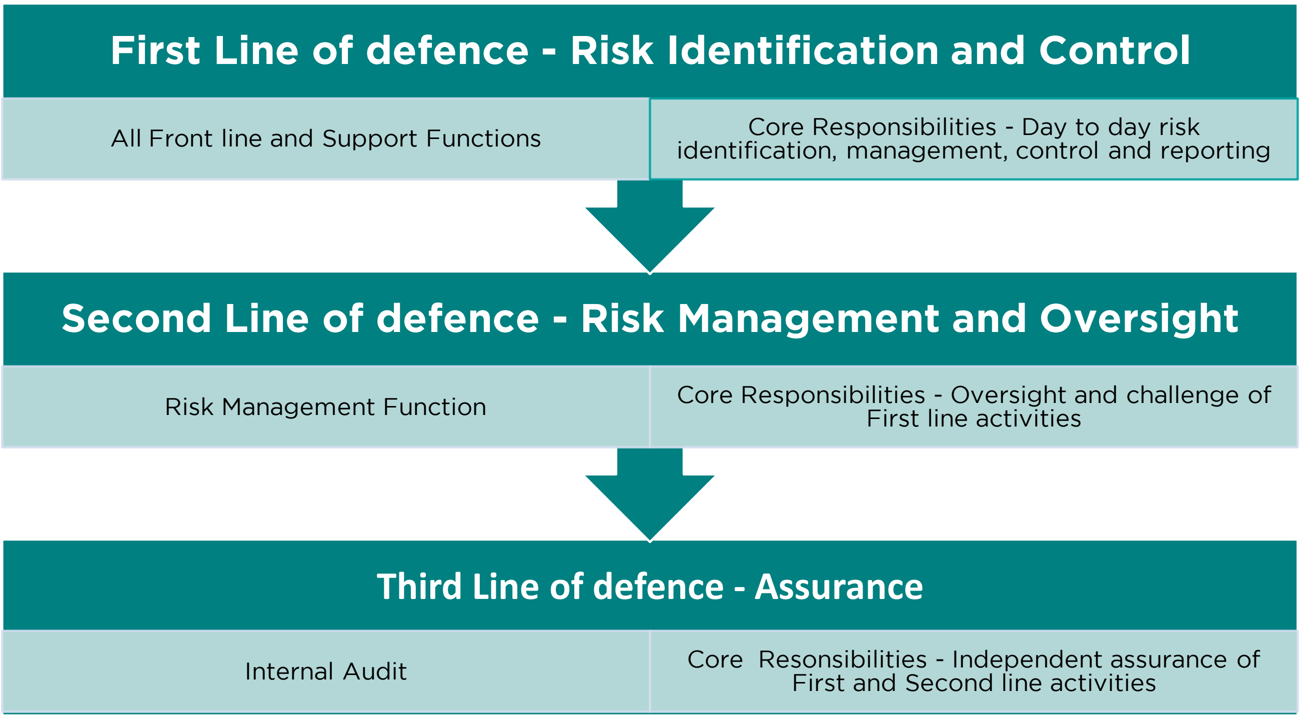
Risk Appetite Statements and Measures
Articulating the society's appetite to risk supported by operational limits

Principal Risk Policies
Defining the principles to follow in managing risks in each category

Capital Risk	Interest Rate Risk
Credit Risk – Mortgages	Credit Risk – Counterparty
Operational Risk	Liquidity Risk
Funding Risk	Conduct Risk
Strategic Risk	

Processes and Procedures
Providing direct guidance for the day to day management of risk in accordance with the principles defined in the Risk Policies

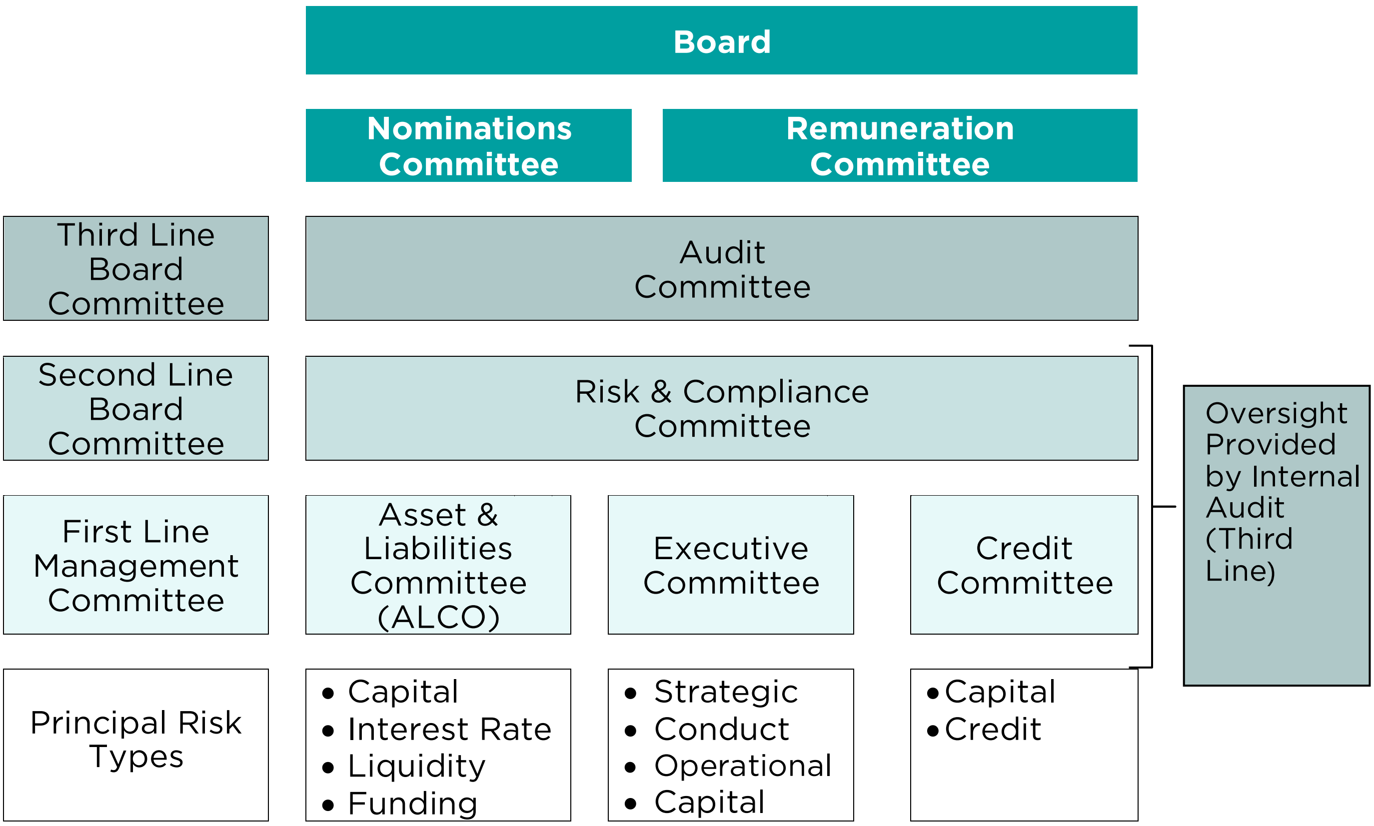
The Society operates a 'three lines of defence' approach to the allocation of responsibilities for risk identification and management, as illustrated in the following diagram:



2.3 Risk Management Organisation and Governance Structure

The Society's risk committee structure has been designed to support the identification and management of risk across the different risk types. The three 'management level' first line committees report to the Board Risk & Compliance Committee, whose responsibility it is to take a Society wide view of the overall exposure to risk.

The diagram below illustrates how the principal risks feed into the Society's committees and the three lines of defence framework for the Committees:



Detailed below are the current board and management level risk committees along with a summary of their respective remits:

<table>
<tr><th colspan="2">Board Audit Committee</th></tr>
<tr><td>Committee Members</td><td>Two Non-Executive directors only</td></tr>
<tr><td>Summary Terms of Reference</td><td>The Audit Committee’s key responsibilities are to:

• Financial reporting - monitor the integrity of the Annual Report and Accounts of the Society, review completeness and compliance with relevant accounting standards and other regulatory and legal requirements, consistency and appropriateness of critical accounting policies, taking into account the views of the external auditor, review and challenge of significant financial reporting judgements, review of the going concern statement and business viability assessment

• Internal control - review of the scope and effectiveness of the Society’s internal control systems including I.T. security and control, establishing the scope and frequency of Internal and External Audit reviews relating to the internal control environment.

• Internal Audit – the appointment and removal of the Internal Auditors, agreeing the internal audit plan and monitoring activity relative to the plan. The Committee reviews the effectiveness of the Internal Audit function including conformance with required Standards.

• External Audit - oversee the Society’s relationship with the External Auditors, consider and recommend their appointment and removal, assessment of their independence, objectivity and effectiveness, approval of terms and remuneration of audit services provided, approval of policy with regards to non-audit work.

• Compliance - Review the effectiveness of the system for monitoring compliance, Review the findings of any examinations, review the process for communicating the Code of Conduct.

• Ensuring that effective whistle-blowing arrangements in place.</td></tr>
<tr><td>Frequency</td><td>Quarterly with additional meetings for Annual Report and Accounts</td></tr>
</table>

Board Risk & Compliance Committee	
Committee Members	Two Non-Executive directors, Chief Risk Officer.
Summary Terms of Reference	The Risk & Compliance Committee's key responsibilities include: • Overseeing the Society's risk management and governance framework and the Society's overall risk profile. • Oversight of overall risk appetite, risk management strategy and framework, including oversight of both prudential and conduct risk appetites. • Oversight of compliance with risk policies. • Review and assessment of the adequacy of risk management information to monitor and control risks. • Approval of risk management of new initiatives and projects, and in particular the risks those initiatives and projects expose the Society to. • Consideration and approval of the top risks for the Society including low likelihood, high impact risks; and Approval of stress testing and scenario testing.
Frequency	Bi-Monthly with additional meetings if required

Executive Committee	
Committee Members	Chief Executive, Finance Director, Director of Operations, Director of Sales & Marketing, Director of IT, Chief Risk Officer
Summary Terms of Reference	The Executive Committee (ExCo) is responsible for "overlap" risks, risks that go across business areas, and in particular for; • conduct risks, • overall stress testing • approving compliance policy and monitoring compliance with policies, • conduct risk indicators, • business continuity policy
Frequency	Monthly

Asset & Liability Committee	
Committee Members	Chief Executive, Finance Director, Director of Operations, Director of Sales & Marketing, Chief Risk Officer
Summary Terms of Reference	The Asset and Liabilities Committee (ALCO) is responsible for all aspects of treasury risk management including; • liquidity risk, • interest rate risk, • counterparty credit risk, • balance sheet management.
Frequency	Monthly

Credit Committee	
Committee Members	Chief Executive, Finance Director, Director of Operations, Chief Risk Officer
Summary Terms of Reference	The Credit Committee (CredCo) is responsible for credit risk across the Society's retail and non-retail mortgage portfolios, including; • loan strategy, • limit monitoring, • risk indicators and stress factors, • annual reviews and breach reports, • monitoring risk trends on the portfolio, • stress testing.
Frequency	Monthly

2.4 Risk strategy

The Society continues to focus on the needs of savers and borrowers and a key part of the risk culture is to put the interests of current and future members, as a whole, first. The Society, within its risk appetite statements, has defined a range of quantitative and qualitative risk measures and limits within which it is prepared to operate. These measures and limits are designed to ensure the Society delivers acceptable returns and generates capital to support delivery of the business plan.

The Society's performance against these risk measures and operational limits, supported by a wide range of additional Key Risk Indicators, is reviewed regularly by the Society's Management Committees and the Risk & Compliance Committee.

The Society also uses stress testing as a key management tool to gain a better understanding of the resilience of the Society to external and internal shocks. These tests form a key part of the Society's capital and liquidity assessment and are designed to confirm that the Society has sufficient capital and liquid resources to support effective forward-looking strategic plans and to ensure the Society stays within its risk appetite.

The Society undertakes scenario tests to understand and manage the impact of the occurrence of these events and for more severe scenarios has developed a Recovery Plan that details the options available to the Society should it be adversely impacted a severe stress.

2.5 Risk appetite

The Society has set risk appetite statements for each principal risk type, and each sub type for Operational Risk. The statements relating to Capital, Funding & Liquidity Risk are based on survival of stresses and the stress testing is an integral part of the planning process to ensure the Society has sufficient capital and liquidity to carry out its strategic objectives. The business plan, as approved by the Board, is aligned with the risk appetite. Risk appetite statements for each of the principal risk categories, and sub-categories are reviewed annually and are approved by the Board.

2.6 Key prudential regulatory metrics

The prudential regulatory metrics that measure the primary risks to which the Society is exposed are summarised below. These are covered in greater detail throughout the document.

Available capital	**31 Dec 2019**	**31 Dec 2018**
Common Equity Tier 1 (CET1)	£22.8m	£22.3m
Tier 1	£22.8m	£22.3m
Total capital	£23.0m	£22.5m
Risk-weighted assets (RWA)		
Total RWA	£110.1m	£106.4m
Risk-based capital ratios as a percentage of RWA		
CET1 ratio	20.7%	21.0%
Tier 1 ratio	20.7%	21.0%
Total capital ratio	20.9%	21.2%
Additional CET1 buffer requirements as a percentage of RWA		
Capital conservation buffer requirement	2.5%	2.5%
Countercyclical buffer	1.0%	1.0%
CET1 available after meeting the minimum capital requirements	12.7%	13.0%*
Basel III leverage ratio		
Total Basel III leverage ratio exposure measure	£324.0m	£313.4m
Basel III leverage ratio	7.0%	7.1%
Liquidity Coverage Ratio (LCR)		
Total HQLA	£41.6m	£44.2m
Net liquidity outflow	£9.7m	£7.7m
LCR ratio	428.7%	576.6%
Net Stable Funding Ratio		
Total available stable funding	£288.4m	£280.5m
Total required stable funding	£167.0m	£161.4m
NSFR ratio	172.7%	173.8%

*The *CET1 available after meeting the minimum capital requirements* comparative has been adjusted, previously 16.5% has been disclosed which was the excess in CET1 over the 4.5% CET1 requirement.

2.7 Summary of Pillar 1 Requirements

The table below provides an overview of Risk Weighted Assets (RWA) and minimum capital requirements for Pillar 1 capital broken down by exposure class as at 31 December 2019. Pillar 1 credit risk exposures include balances which are off-balance sheet, such as undrawn credit commitments relating to mortgages not yet drawn down.

The capital requirement under the Standardised Approach is calculated as 8% of the risk weighted exposure amounts for each of the applicable exposure classes.

Exposure Class	31 Dec 2019 £m		31 Dec 2018 £m	
	RWA	Capital Requirement	RWA	Capital Requirement
Secured by mortgages on immovable property	90.1	7.2	87.0	6.9
Retail	1.9	0.2	-	-
Exposures in default*	1.1	0.1	1.2	0.1
Other items	3.1	0.2	2.5	0.2
Total Credit Risk (excluding Counterparty Credit Risk)	**96.2**	**7.7**	**90.7**	**7.2**
Central governments or central bank	-	-	-	-
Multilateral development banks	-	-	-	-
Institutions	3.7	0.3	5.8	0.5
Total Credit Risk (including Counterparty Credit Risk)	**99.9**	**8.0**	**96.5**	**7.7**
Operational Risk	9.9	0.8	9.8	0.8
Credit Valuation Adjustment (CVA)	0.2	-	0.1	-
Total RWAs / Pillar 1 Capital Requirement	**110.1**	**8.8**	**106.4**	**8.5**

*Exposures in default refer to those accounts greater than or equal to three months in arrears.

3. CAPITAL RESOURCES

From the 1 January 2014, the Basel III regulations more commonly known as CRD IV, has become part of European law. One of the objectives of the regulation is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress. This is to be achieved through increasing both the quality and quantity of regulatory capital firms will be required to hold. The Society meets this requirement by maintaining an appropriate level of retained profits as the Society does not issue capital instruments. The following table show the Society's capital resources as at 31 December 2019 on a CRD IV basis.

CRD IV Basis	2019 £m	2018 £m
Common Equity Tier 1 (CET1) Capital		
General Reserves	22.9	22.3
Available-for-sale Reserve	0.0	0.0
CET1 Capital before regulatory adjustments	**22.9**	**22.3**
Regulatory deductions	(0.1)	0.0
Total CET1 Capital	**22.8**	**22.3**
Tier 2 Capital		
Collective Provision	0.2	0.2
Total Tier 2 Capital	**0.2**	**0.2**
Total Capital	**23.0**	**22.5**
Risk weighted Assets		
- Credit Risk	100.1	96.6
- Operational Risk	9.9	9.8
Total risk weighted assets (RWA)	**110.1**	**106.4**
Capital Ratios and Buffers		
Capital Ratios		
- CET1	20.7%	21.0%
- Tier 1 ratio	20.7%	21.0%
- Total Capital ratio	20.9%	21.2%
Institution specific buffer requirement (CET1 requirement in accordance with Article 92 (1) (a) plus capital conservation and countercyclical buffer requirements)	8.0%	7.4%
- Of which: Capital Conservation Buffer Requirement	2.5%	1.9%
- Of which: Countercyclical Buffer Requirement	1.0%	1.0%
CET1 available after meeting minimum capital requirements	12.7%	13.0%*

*Adjusted comparative, as disclosed under table within section 2.6.

Common Equity Tier 1 Capital

The available-for-sale reserve is included in regulatory capital under CRD IV. Intangible assets and deferred tax assets that rely on future profitability and that arise from temporary differences are deducted from capital as required under the rules of CRD IV.

Tier 2 Capital

The Tier 2 capital includes collective impairment provisions.

3.1 Reconciliation of Regulatory Capital

A reconciliation of balance sheet capital to regulatory capital is presented below. The table essentially illustrates that adjustments for items not eligible for inclusion in CET Capital are negligible.

CRD IV Basis	2019 £m	2018 £m
Total Equity Attributable to Members as per the Statement of Financial Position	**22.9**	**22.3**
Adjustments for items not eligible for inclusion in CET1 Capital	-	-
Regulatory Capital	**22.9**	**22.3**

4. CAPITAL ADEQUACY ASSESSMENT

4.1 Capital Management

The Society's policy is to maintain a strong capital base to maintain member confidence and to sustain the future development of the business. The Board manages the capital and risk exposures to maintain capital in line with the Society's risk appetite.

The Society's risk appetite is set at a higher level than the regulatory requirements as, being a mutual, the Society has no access to external capital and it aims to meet the needs of its customers rather than maximise profitability and this can be achieved as long as an adequate capital position is maintained.

On an annual basis the Society performs a full reassessment of the capital requirements in normal conditions and in a stress, as part of its Internal Capital Adequacy Assessment Process (ICAAP) and uses this to inform the risk limits which are then reported to Board on a monthly basis. The ICAAP looks at the capital risk over a five year period.

4.2 Capital Requirements

The Society uses the Standardised Approach to calculate its credit risk weightings and the Basic Indicator Approach for Operational Risk.

Under the Standardised Approach the level of capital required against a given level of exposure to credit risk is calculated as:

Credit Risk capital requirement = Exposure value x Risk weighting* x 8%.

*The risk weighting applied will vary depending on whether the asset is retail or wholesale. For retail assets, variables such as loan to value and security will impact the risk weighting. Wholesale assets are dependent on counterparty, duration and credit rating.

The primary source for obtaining information on counterparties' creditworthiness is External Credit Assessment Institutions (ECAIs). Unrated counterparties may be approved by the Board.

Credit ratings are reviewed regularly and a list of relevant changes provided to the monthly Assets and Liabilities Committee (ALCO). Where ratings fall below the minimum criteria for a counterparty, the recommendation for managing the exposure will be escalated through ALCO.

For Operational Risk the Risk Weighted Asset (RWA) value is calculated by applying 15% to the Society's average net income over the previous three years.

The Credit Risk and Operational Risk capital requirements described above form up the Pillar 1 element to the CRD IV capital requirements.

The Society's minimum capital requirement under Pillar 1 (the sum of the Credit Risk and the Operational Risk capital requirements) as at 31 December 2019 is summarised in the table below:

Capital Requirements	31 Dec 2019 £m		31 Dec 2018 £m	
	Exposure	Capital	Exposure	Capital
Credit Risk - Loans & advances to customers - Wholesale lending - Other items	 261.7 58.9 3.3	 7.4 0.3 0.3	 242.5 68.2 2.7	 7.1 0.4 0.2
Operational Risk		0.8		0.8
Minimum Capital Requirement		**8.8**		**8.5**
Capital Resources (section 3)		23.0		22.5
Excess of own funds over minimum Pillar 1 capital		**14.2**		**14.0**

In addition, firms are required to hold additional capital in relation to risks not captured under Pillar 1, these are referred to as the Pillar 2A and Pillar 2B capital requirements. The table below summarises the constituent elements of the CRD IV capital requirements:

<table>
<tr><td>Pillar 1</td><td colspan="2">Basic capital requirement based on firm's risk weighted assets and is a minimum of 8%.</td></tr>
<tr><td>Pillar 2A</td><td colspan="2">Firm specific element based on risk weighed assets for risks not captured under Pillar 1. As at year end this is set at 0% (2018: 2.64%)</td></tr>
<tr><td rowspan="2">Pillar 2B</td><td>Capital Conservation buffer</td><td>Additional capital buffer to absorb losses in periods of economic and financial stress. Buffer based on firm's weighted assets. This buffer has been phased in between 2016 and 2019. The buffer requirement for 2018 was 1.875%, increasing to 2.5% from 1st January 2019.</td></tr>
<tr><td>Countercyclical buffer</td><td>Set by the Bank of England's Financial Policy Committee within a range of 0% and 2.5%. To ensure financial institutions build up capital in favourable economic conditions, which can be utilised in economic downturns. Buffer has been set at 1.0% of total RWA since 28 November 2018.</td></tr>
</table>

The total amount of capital the Society is required to hold against the assets held (Pillar 1 and Pillar 2A) is collectively referred to as its Total Capital Requirement (TCR). At 31 December 2019, the Society's Total Capital Requirement was set at 8.0% (2018: 10.64%) of risk weighted assets or £8.8m (2018: £11.3m).

4.3 Leverage Ratio

UK leverage framework

Under CRD IV, firms are required to calculate a leverage ratio (*CRR Leverage ratio*), which is not risk sensitive, to complement risk-based capital requirements. The leverage ratio measures the relationship between a firm's Tier 1 capital resources and its leverage exposure (total assets, plus certain off balance sheet exposures).

In the UK, the PRA has confirmed that all large banks and building societies must meet a 3% minimum leverage ratio at all times.

CRR Leverage Ratio	31 Dec 2019	31 Dec 2018
	£m	£m
Total Tier 1 Capital	22.8	22.3
Exposure:		
- Total Balance Sheet Assets	309.4	303.1
- Loan Impairment Provision	0.3	0.3
- Mortgage Pipeline	13.7	10.0
- Derivatives	0.5	0.4
- UK GAAP transition adj	n/a	n/a
CRR Leverage Ratio Exposure	**323.9**	**313.8**
CRR Leverage Ratio	7.0%	7.1%

Following recommendations from the FPC in 2016 the PRA has introduced the **UK Leverage ratio** to the leverage framework. It is calculated in the same way as the CRR Leverage ratio, as outlined below, but excludes eligible claims on central banks from the calculation of the leverage exposure measure. Eligibility includes claims with a residual maturity under 3 months. Bank and building societies will be required to meet a minimum UK Leverage ratio of 3.25%.

UK Leverage Ratio	31 Dec 2019	31 Dec 2018
	£m	£m
Total Tier 1 Capital	22.8	22.3
Exposure:		
- Total Balance Sheet Assets	309.4	303.1
- Less: eligible claims on central banks	(36.6)	(34.4)
- Loan Impairment Provision	0.3	0.3
- Mortgage Pipeline	13.7	10.0
- Derivatives	0.5	0.4
- UK GAAP transition adj	n/a	n/a
UK Leverage Ratio Exposure	**287.3**	**279.4**
UK Leverage Ratio	7.9%	8.0%

The FPC is undertaking a review of the UK leverage ratio framework, in particular, examining ways of managing the impact of the introduction of the UK Leverage exposure as the primary supervisory metric, so that the amount of capital required by firms to meet leverage requirements is not reduced by default.

5. MANAGEMENT OF RISKS

The Society aims to manage all risks that arise from its operations. The principal risk categories in the Society's business are Credit, Liquidity & Funding, Interest rate, Conduct, Operational, Capital and Strategic. The ways in which these risks are managed include:

- the use of forecasting and stress-testing models. These help in the development of business strategy;
- the production of key risk indicators to measure and monitor performance; and
- the monitoring and control of risks by management, and by the Board and its committees.

The definition and overview of each of the risk types is shown below.

Credit Risk

Credit risk is the risk of a customer or counterparty not meeting their obligations when they become due. Credit risk arises primarily from mortgage loans to customers and from investments of liquid assets as part of the Society's treasury operations.

The largest asset the Society has is its mortgage book and the risk of default in this area is managed by reference to a Board approved Lending Policy. The policy determines the criteria that must be met by any borrower along with lending limits to manage the overall book risk profile.

All mortgage cases are also individually underwritten by a team of experienced underwriters who will apply additional judgement when assessing new mortgage applications. The Society also takes mortgage indemnity insurance on all lending above 80% LTV, although, for prudence, no credit risk mitigation benefits have been taken from this insurance when assessing its Pillar 1 capital requirements.

The risk of counterparty default is managed through treasury policies with all counterparties being approved and monitored by the Board.

A component of credit risk is concentration risk, which arises where there is a concentration of exposures within the same category, whether it is geographical location, product type, industry sector or counterparty type.

The Society is primarily a residential mortgage lender and is exposed only to the UK market. An analysis of its portfolio of mortgages to individuals secured on residential property as at 31 December 2019 (see section 6.1 below) indicates that its main concentration risk is geographical, as by value 64% (2018: 72%) of its mortgages are in the immediate area around Stockport, the Society's core area of operation.

The Society has an exposure to commercial mortgages representing 2.92% of total mortgage balances (2018: 4.39%) and buy-to-let mortgages representing 16.61% of total mortgage balances (2018: 16.91%). The Society has not undertaken sub-prime lending. Exposures are monitored regularly by the Board to ensure that policy limits are not exceeded.

In addition to the capital provided under Pillar 1, capital is provided under Pillar 2 to cover mortgage losses that may arise in an economic downturn.

Further information on credit risk is provided in section 6 of this disclosure document.

Liquidity & Funding Risk

Liquidity risk is the risk that the Society is not able to meet its financial obligations as they fall due, including any unexpected cashflows that could arise under stress. This risk is managed by management of maturity mismatches and maintaining public confidence as both are required to manage liquidity.

The risks in scope of the Liquidity Policy are:

- quantum of liquid assets
- investment of liquid assets for maturity profile and credit risk
- realisation of liquid assets
- asset & funding concentration

Funding risk is the risk of higher funding costs or a lack of availability of funds and the risk arising from a maturity mismatch between funding and lending. The inherent problem the Society faces with regards to funding risk is the problem of maturity mismatches due to the long term nature of mortgage lending funded by shorter term borrowings. The Funding Policy aims to monitor and control the way in which both wholesale and retail funds are raised to reduce the exposure to the funding mismatch risk.

The Society currently has little asset encumbrance, which is a claim against a property by another party. From a financial perspective, such claims have traditionally taken the form of security interests, such as pledges, given on assets by a borrower to a lender. In other words, giving collateral encumbers assets.

The only encumbrance the Society has is for hedging derivatives, this totalled £1,041k as at 31 December 2019 (£200k at 31 December 2018).

Interest Rate Risk

Interest rate risk is the risk of loss of income from movements in interest rates in severe but plausible market rate movements. The risk is broken down into its component parts of:

- Repricing Risk – ability to manage margin between assets and liabilities
- Basis Risk – risk of different rates moving in an uncorrelated manner
- Prepayment Risk – risk of a different repayment profile than expected on fixed rate products

Exposure to this risk is controlled by managing the margin between assets and liabilities, through matching in the balance sheet and through the use, where appropriate, of hedging contracts with external counterparties, within limits set out in the Society's Structural Risk Policy.

Further information on interest rate risk is provided in section 7 of this disclosure document.

Strategic Risk

Strategic risk is the risk of failing to achieve corporate objectives. This risk is primarily managed by the Society's Board which meets regularly, typically monthly, allowing the Board to assess performance and any emerging barriers to achieving the corporate objectives. Society performance is regularly assessed against the Corporate Plan that the Society reassess at least annually but more regularly if necessary.

Conduct Risk

Conduct risk is the risk that actions or the failure to take actions results in member and/or customers suffering unfair outcomes. In order to ensure fair customer outcomes the Society has designed a Policy to address the following Key Conduct Risks:

- Customer Risk – relates to the ability of a customer to assess the Society's products and determine whether or not they meet their needs, as well as their expectations.
- Product Risk – relates to the Society's products' complexity, especially in the way in which they are documented and the levels of optionality they present to the customer.
- Sales Risk – relates to the distribution method and the point of sale as well as the advisory and underwriting process
- Service Risk – relates to the handling of a customer's needs post-sale and changes in circumstances for the customers during the products life-cycle.

The Society has developed an extensive suite of MI reports that cover off the key Conduct Risks using a tiered suite of measures. Monthly Conduct Risk Dashboards are reported to the Executive Committee (ExCo). The Conduct Risk Dashboards contain Primary Key risk Indicators, defined Secondary measures, along with any concerning adverse outcomes or trends identified within Tertiary measures, with onward reporting of the Key Risk Indicators to Risk & Compliance Committee.

Operational Risk

Operational risk is the risk of losses, customer detriment, or reputational damage due inadequate or failed internal processes, or systems, human error or external events. The Society operates a robust control environment to mitigate operational losses, including the maintenance of insurance policies. A Contingency Plan is in place to ensure that disruptions to the Society's business can be appropriately managed.

Operational risk is split into eleven sub-categories which are detailed below:

Regulatory, Legal and Accounting

The risk that the Society fails to comply with existing/future regulatory or legislative requirements, or that changes to these requirements have a negative impact on the Society’s business model. Legal risk also arises from the failure to design, enforce, adhere to or document effective contractual relationships.

Business Interruption

The risk that events or incidents occur which impact or disrupt the normal operations of the Society.

Financial Crime

The risk of Internal or external theft and fraud including theft of information, hacking damage, third party theft and forgery, money laundering, terrorist financing and bribery and corruption.

Third Party Management

The risk that the Society fails to effectively manage, oversee or derive value from third party relationships.

IT Operations & Development

The risk of failure to provide and maintain a robust technological infrastructure to support the delivery of operational and strategic objectives.

Information and Data Security

The risk of unauthorised access to Society or customer information, including through loss and cyber-attack.

Information Management

The risk of loss or failure arising from inaccurate, unavailable, or incomplete data.

Modelling

The risk of loss resulting from the adoption of incorrect modelling methodologies, inappropriate modelling assumption or inadequate governance and controls when models and spreadsheets are developed or updated.

People

The risk of loss or failure caused by human error, a lack of resource with skills and knowledge to deliver business objectives, or key person dependency.

Process & Change

The risk of loss or damage as a result of inadequate processes, change not being delivered successfully (delivery risk) and / or that the change deliverables adversely impact the Society's risk profile.

Physical Security

The risk that events or incidents occur which have the potential to cause harm to Society employees, customers or assets.

6. CREDIT RISK

As a Building Society, credit risk is most likely to arise through the inability of borrowers to repay their mortgage commitments (mortgage credit risk) or through the failure of a treasury counterparty or country (wholesale credit risk).

The Society primary business activities can be summarised as follows:

- Secured lending to retail customers
- Secured lending to business customers
- Deposit taking from retail customers

In addition the Society manages a liquid asset portfolio to manage its liquidity risks. The liquid asset portfolio is comprised of deposits made with the Bank of England and other banks and building societies, and unsecured investments issued by the UK Government and large banking organisations. The risks of the liquidity portfolio are managed through credit rating assessments and settling counterparty limits as discussed within section 6.3.

The tables below summarises the gross and net carrying values of the Society's assets exposed to credit risk. Defaulted exposures are those exposures that are past due more than 3 months. Loan impairment assessments are carried out for any asset with an impairment indicator, which will include any asset past due more than one month.

Credit quality of assets as at 31 Dec 2019	**Gross carrying value of**		**Loan impairment provision £m**	**Net values £m**
	Defaulted exposures £m	Non-defaulted exposures £m		
Loans and advances to customers	1.1	247.6	0.3	248.4
Loans and advances to credit institutions	-	16.6	-	16.6
Debt Securities	-	5.4	-	5.4
Total	**1.1**	**269.6**	**0.3**	**270.4**

Credit quality of assets as at 31 Dec 2018	Gross carrying value of		Loan impairment provision £m	Net values £m
	Defaulted exposures £m	Non-defaulted exposures £m		
Loans and advances to customers	1.2	231.4	0.3	232.3
Loans and advances to credit institutions	-	19.7	-	19.7
Debt Securities	-	14.3	-	14.3
Total	**1.2**	**265.4**	**0.3**	**266.3**

6.1 Mortgage Credit Risk

All retail credit risk is monitored by the Risk & Compliance and Credit Committees with day to day management delegated to the Director of Operations.

a) *Lending and Business Decisions*
The Society individually underwrites each mortgage to assess whether applications fit within its appetite for credit risk as documented in its Lending Policy. For residential and buy-to-let mortgages property values are indexed on a quarterly basis using regional house price movements. A limited amount of Corporate loans were historically advanced which were also individually underwritten in line with the Lending Policy.

b) *Pricing*
Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.

c) *Concentration Risk*
The design of retail products takes into account the overall mix of products, however, the Society has a regional concentration risk in its home area.

d) *Forbearance*
The Society has a range of forbearance options available to support customers who are experiencing financial difficulty. Full consideration is given to understand customers' individual circumstances to ensure that the options offered are appropriate and in the mutual interest of the customer and lender.

e) *Loan restructure*
By exception the Society might consider the restructure of a loan to support an adverse change in customer's circumstances. As with forbearance options referenced above, full consideration is given to understand customers' individual circumstances to ensure that a restructure is appropriate, in the customer's and lender's interest and is affordable and capable of enduring.

The table below details the minimum credit risk capital requirement by standardised exposure class at 31 December 2019 & 2018 broken down by exposure value.

Credit Risk Capital Requirement	31 Dec 2019		31 Dec 2018	
	Standardised Exposure (RWA) £m	Capital Requirement £m	Standardised Exposure (RWA) £m	Capital Requirement £m
Secured by mortgages on Residential Property	85.0	6.8	77.7	6.2
Secured by mortgages on commercial real estate	7.0	0.6	9.2	0.7
Past due items	1.1	0.1	1.2	0.1
Other loans	-	-	-	-
Total Loans & Advances to Customers	**93.1**	**7.5**	**88.1**	**7.0**

The following table show the residual maturities of all loans and advances exposures as at 31 December 2019.

31 December 2019 £m	<3months	>3months but <1 year	>1year but < 5 years	> 5 years	Total
Secured Residential Mortgages	2.1	5.5	45.9	185.6	239.1
Secured by Mortgages on Commercial Property	0.2	0.5	2.5	3.9	7.1
Past Due Items	-	0.1	0.1	0.4	0.6
Impaired	-	-	0.1	1.2	1.3
Total balances	**2.3**	**6.0**	**48.6**	**191.5**	**248.1**
Accounting Adjustments					3.0
Total Loans & Advances to customers					**248.4**

31 December 2018 £m	<3months	>3months but <1 year	>1year but < 5 years	> 5 years	Total
Secured Residential Mortgages	2.1	6.1	42.8	169.2	220.2
Secured by Mortgages on Commercial Property	-	-	1.1	6.7	7.8
Past Due Items	0.1	0.3	1.2	1.3	2.9
Impaired	-	-	0.3	1.4	1.7
Total balances	**2.2**	**6.4**	**45.4**	**178.6**	**232.6**
Accounting Adjustments					(0.2)
Total Loans & Advances to customers					**232.4**

A geographical analysis of the mortgage book is shown below, with analysis of loans past due or impaired. The mortgage book does not contain any restructured loans for the year ended 31 December 2019 or for the comparative period.

31 Dec 2019	Residential loans			Non-residential loans			Total
Region	Performing	Past due	Impaired	Performing	Past due	Impaired	
	£m	£m		£m	£m		£m
Main operating area	151.8	0.3	1.3	4.6	0.1	-	158.1
London and South East	22.8	-	-	-	-	-	22.8
North West	16.0	-	-	0.3	-	-	16.3
Midlands	15.6	0.1	-	0.8	-	-	16.5
Yorkshire	10.9	-	-	0.7	-	-	11.5
South	8.8	-	-	-	-	-	8.8
South West	5.7	-	-	0.7	-	-	6.4
East	2.1	0.1	-	-	-	-	2.2
Wales	3.3	-	-	-	-	-	3.2
North East	2.1	-	-	-	-	-	1.7
Other	-	-	-	-	-	-	-
Total Balances	**239.1**	**0.5**	**1.3**	**7.1**	**0.1**	**-**	**248.1**
Accounting Adjustments		3.0					
Total							**248.4**

31 Dec 2018	Residential loans			Non-residential loans			Total
Region	Performing	Past due	Impaired	Performing	Past due	Impaired	
	£m	£m		£m	£m		£m
Main operating area	157.3	1.3	1.7	5.8	1.6	-	167.7
London and South East	18.4	-	-	-	-	-	18.4
North West	10.5	0.2	-	0.3	-	-	11.0
Midlands	11.8	0.1	-	1.0	-	-	12.9
Yorkshire	8.0	-	-	0.1	-	-	8.1
South	4.5	-	-	-	-	-	4.5
South West	4.4	-	-	0.7	-	-	5.1
East	1.1	0.1	-	-	-	-	1.2
Wales	2.3	-	-	-	-	-	2.3
Scotland	0.4	-	-	-	-	-	0.4
North East	1.0	-	-	-	-	-	1.0
Other	-	-	-	-	-	-	-
Total Balances	**219.7**	**1.7**	**1.7**	**7.9**	**1.6**	**-**	**232.6**
Accounting Adjustments							(0.2)
Total							**232.4**

Analysis of loans and advances to customers by occupation type:

	31 Dec 2019	31 Dec 2018
	£m	£m
Owner Occupied	199.4	186.4
Buy to Let	41.5	36.7
Regional Social Landlords	-	-
Commercial	7.2	9.5
Total Balances	**248.1**	**232.6**

Analysis of loans and advances to customers by loan repayment type:

	31 Dec 2019	31 Dec 2018
	%	%
Repayment	50.76	55.09
Interest Only	49.24	44.91
Total	**100.00**	**100.00**

6.2 Mortgage Impairment

Mortgage Impairment

Provision is made for all incurred losses on loans and advances based upon the following
criteria.

Individual impairment provisions are made against mortgage loans to cover anticipated losses in respect of accounts that are in arrears or on concessions and where a probable loss has been identified. Anticipated losses on such accounts are calculated as the difference between the current achievable market value of the security, based on current valuations of the property, and the outstanding loan balance, after making appropriate allowance for costs of repossession, appropriate discounts on sale and any amounts recoverable under external loss insurance.

Collective provisions are made to reflect the probability that other loans may also be impaired at the balance sheet date, with the result that the amount outstanding may not be recoverable in full. The provision is based upon the Society's experience and external credit reference agency scores.

Of the total loans and advances to customers of £248.1m at 31 December 2019 (2018: £232.6m) only £1.3m required an individual impairment provision (2018: £1.7m). Balances one month or more past due totalled £0.6m at 31 December 2019 (2018: £2.0m), of these £0.5m (2018: £1.2m) were 3 or more months in arrears.

The resultant impairment charge is deducted from the appropriate asset values in the balance sheet.

The following table shows the movement in impairment provisions during the year:

Loans fully secured on	Residential property	Land	Total
	£000	£000	£000
Individual Provision			
At 1 January 2019	115	-	115
Provision for loan impairment	(37)	-	(37)
Provision utilised	-	-	-
At 31 December 2019	**78**	**-**	**78**
Collective Provision			
At 1 January 2019	191	10	201
Provision for loan impairment	31	(6)	25
Provision utilised	-	-	-
At 31 December 2019	**222**	**4**	**226**

6.3 Wholesale Credit Risk

The Society is also exposed to credit risk through its treasury operations. This risk arises from counterparties who may be unable to repay loans and other financial instruments that the Society holds as part of its liquidity portfolio.

Counterparty limits are established by the Society to manage its Counterparty Credit Risk (CRR) exposures and the inherent concentration risks (the risk of over exposure in a single entity or group). The counterparty limits are defined in the Treasury Operations Policy which uses Fitch ratings agency as its External Credit Assessment Institution (ECAI). Exposure limits for individual banks on the Society's list of authorised counterparties are set taking into account Fitch's Short Term and Long Term Ratings. No bank is included on the list unless it has, as a minimum, a Short Term rating of F2 and a Long Term rating of B. Exposures to unrated counterparties are approved by the board and are currently restricted to UK Building Societies. In addition to the use of Fitch ratings, market intelligence is used in assessing counterparty risk, in recognition that there may be a delay between a counterparty being in difficulty and this being reflected in a downgrading of its Fitch rating. A process is in place to reduce counterparty exposure limits, or to remove counterparties from the approved list, immediately without reference to the Board, but counterparties cannot be added without Board approval.

Limits are also set for diversification in terms of issuance, geography and sector.

Instruments used for risk management purposes include derivative financial instruments (derivatives), which are contracts whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates. The Society uses derivatives to limit the extent to which it is affected by changes in interest rates. Derivatives are not used in trading activity or for speculative purposes.

Exposures to counterparties in respect of derivatives are calculated using mark to market valuations and are included in the counterparty exposure limits for internal reporting.

Capital Requirements	31 Dec 2019 £m		31 Dec 2018 £m	
	Exposure	Capital	Exposure	Capital
Central Government or Central Bank	36.9	-	38.5	-
Financial Institutions	20.5	3.7	29.7	5.8
Total Wholesale Lending	**58.4**	**3.7**	**68.2**	**5.8**

The following table shows the breakdown of the Society's non-cash liquid assets by maturity, long term Fitch rating and Credit Quality Steps (CQS) as at 31 December 2019. CQS are an expression of the quality of asset exposures defined by the CRR for the purposes of the Standardised Approach.

31 December 2019 £m	CQS	<3months	>3months but <1 year	>1year but < 5 years	Total
AAA	1	-	-	4.9	4.9
AA+ to AA-	1	36.4	0.5	-	36.9
A+ to A-	2	9.2	0.6	-	9.8
BBB+ to B-	3	-	-	-	-
Unrated*	1	2.3	4.5	-	6.8
Total		**47.9**	**5.6**	**4.9**	**58.4**

31 December 2018 £m	CQS	<3months	>3months but <1 year	>1year but < 5 years	Total
AAA	1	-	-	5.9	5.9
AA+ to AA-	1	34.1	0.6	3.8	38.5
A+ to A-	2	8.3	1.0	-	9.3
BBB+ to B-	3	1.5	2.0	-	3.5
Unrated*	1	5.0	6.0	-	11.0
Total		**48.9**	**9.6**	**9.7**	**68.2**

* Unrated asset CQS ratings are the same as the central government in which institutions are exposed (as prescribed by CRR Article 121).

7. INTEREST RATE RISK

The Society uses derivative instruments for managing its risk of loss of income from movements in interest rates, principally from fixed rate mortgage lending, fixed rate savings products and fixed rate wholesale funding.

An interest rate swap is a contract to exchange one set of interest rate cash flows for another. Such swaps result in the economic exchange of interest rates. No exchange of principal takes place. Instead interest payments are based on notional principal amounts agreed at inception of the swap. The duration of the interest rate swap is generally short to medium term and their maturity profile reflects the nature of the exposures arising from the underlying business activities.

The Society applies fair value hedging techniques to reduce its exposure to interest rate risk as follows:

Activity	Risk	Fair value interest rate hedge
Fixed rate mortgage	Increase in interest rates	Society pays fixed, receives variable
Fixed rate savings bond	Decrease in interest rates	Society receives fixed, pays variable

The table below shows the derivative contracts held using the Mark to Market (MTM) method:

Market Values £000	31 December 2019		31 December 2018	
	Positive	Negative	Positive	Negative
Derivative in Fair Value Hedges	46	(635)	67	(158)
Derivatives not in hedge relationships	18	(14)	9	(26)
Total	**64**	**(649)**	**76**	**(184)**

Prepayment risk is the risk that the Society is no longer appropriately hedged as a result of unplanned prepayment of the underlying hedged instrument. The risk is monitored and assessed using a stress of twice the historic prepayment rates experienced by the Society. The Society prepayment risk limits are reviewed on a regular basis.

Repricing risk is monitored using assessments such as gap analysis and economic value movements. The results of these assessments are reviewed against agreed limits which are set out in the Structural Risk Policy which is approved by the Board. Exposures against these limits are monitored on a monthly basis and reported to ALCO.

The economic value stress test measures the effect of a parallel shift in interest rates of up to 2%. The Board has set a limit on the effect that a 2% parallel shift in interest rates can have on the Society's capital. This limit is the maximum *residual* exposure, after the effect of on- and off-balance sheet hedges is taken into account. Capital is provided accordingly under Pillar 2 within the ICAAP.

The sensitivity to this measurement (in terms of economic value) was:

£000	31 December 2019		31 December 2018	
	+2%	-2%	+2%	-2%
Economic Value	**(407)**	**440**	**(236)**	**249**

The table below summarises the impacts to Net Interest Income (NII) resulting from a 2% change in interest rates (over a 24 month horizon):

£000	31 December 2019		31 December 2018	
	+2%	-2%	+2%	-2%
Economic Value	**470**	**(470)**	**463**	**(463)**

8. LIQUIDITY & FUNDING RISK

The Society manages liquidity risk by holding an appropriate amount and composition of liquid assets in order to:

- Meet obligations as they fall due (sufficient to meet adverse cash flows under stressed conditions);
- Smooth out the effect of maturity mismatches; and
- Maintain public confidence in a stressed environment.

The Society's liquidity profile is to plan to hold sufficient liquid assets to be able to meet a severe but plausible stress and still meet the minimum regulatory liquidity level. The initial liquidity is held in HQLA, however the Society also holds secondary liquidity in other marketable assets. The liquidity profile depends on sources and uses of liquidity. The primary funding source is retail funding of which an appropriate proportion is held as HQLA or secondary liquidity.

The table below summarises the liquid asset levels in relation to the underlying funding, which is a primary metric used by the Society to assess liquidity risks.

Liquid asset level	31 Dec 2019	31 Dec 2018
Total Liquid Assets (£m)	57.3	68.4
Total Funding (£m)	285.5	279.7
Liquid Asset Level (%)*	20.1	24.4

*The Liquidity Asset Level reported above is based on the **period end total funding balance** and might differ slightly to calculation disclosed within the statutory report and accounts, which is based on the **average total funding balance for the period**.

The monitoring of the liquidity policy is performed regularly as set out in the Board approved risk appetite and policy statements. Compliance with these policies is reported on a monthly basis to the ALCO.

The Society manages funding risk by maintaining a diverse funding base and ensures compliance with applicable regulatory requirements. This in turn determines the overall level of liquidity to be maintained. The Society's Internal Liquidity Adequacy Assessment Process (ILAAP) is reviewed annually and approved by the Board. The ILAAP forms a central part of the Society's risk management and includes stress testing which analyses a range of severe yet plausible scenarios to confirm that the Society holds an adequate amount of available liquidity. Liquidity maturity analysis in the form of 'GAP' analysis is also performed as part of the ILAAP process, which are also included within the annual Report & Accounts.

The Society has also documented within its Recovery Plan metrics that would indicate an emerging market wide or Society specific stress event. The Plan includes a range of options available to the Society in the event of such a stress, such as contingency funding plans, to ensure an adequate level of liquidity is maintained.

Since October 2015, the Society has been required to be compliant with the Liquidity Coverage Ratio (LCR), which measures the amount of high quality liquid assets relative to estimated net stressed cash outflows within a 30 day period to be reported on a monthly basis. The table below shows the major components of the LCR for the year end and comparative period, which is well above the regulatory requirement of 100%.

LCR calculation component	31 Dec 2019	31 Dec 2018
Liquidity buffer (£m)	41.6	44.2
Net liquidity outflow (£m)	9.7	7.7
Liquidity coverage ratio (%)	428.7	576.6

The Society also calculates the Net Stable Funding Ratio (NSFR) on a monthly basis using the latest available guidance, which was 172.7% for the year end (2018: 173.8%), well above the regulatory requirement of 100%.

9. OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

The Society operates a Risk and Control Self-Assessment (RCSA) process which requires all areas of the Society to identify, assess, monitor and control their operational risks via an agreed framework and methodology. Gross risk for a process is documented and then net risk after applying the controls. This results in a remaining risk which is used to inform the ICAAP. The effectiveness of Key Controls are then assessed and reported on a regular basis by the teams operating the controls. The Risk & Compliance Function perform spot checks to ensure that controls are effective and are operating as required.

In addition a risk event log is maintained where risk events or near misses are documented so that any underlying causes can be identified and acted on.

The Executive Committee (ExCo) oversees operational risk from a first line perspective and review the controls and risk logs to identify any improvements required. The Risk & Compliance Committee monitors and oversees a range of management information and other reports on the operational risk exposures. It also reviews the results of the operational risk scenario analysis that is performed to inform the capital requirement in the ICAAP, alongside the remaining risk post controls.

The operational risk capital requirement is calculated using the Basic Indicator Approach, which is determined in relation to the Society's net income averaged over the previous three years.

The minimum (Pillar 1) capital requirement for operational risk at 31 December 2018 is summarised below:

£m	31 December 2019	31 December 2018
Basic indicator approach	**0.8**	**0.8**

10. REMUNERATION DISCLOSURES

The Society's objective in setting remuneration policies is to ensure that they are in line with its business strategy, risk appetite, long term objectives, and that remuneration is set at a level to retain and attract individuals of the calibre necessary to operate an organisation such as the Society.

The remuneration of the Executive Directors and other Material Risk Takers is determined by the Remuneration Committee. The committee consists of four Non-Executive Directors, their details are disclosed within the annual Report & Accounts (R&A).

A more detailed disclosure of the Society's remuneration processes is contained within the Remuneration Committee (RemCo) report which forms part of the R&A. The report summarises the primary risks and includes relevant disclosure on variable remuneration and performance assessment. The nature and amount of additional MRT related remuneration, such as severance payments, are also disclosed when relevant within the report.

In setting remuneration, the Committee takes account of fees and salaries payable, other benefits provided to Executive Directors and other MRT of building societies that are similar in size and complexity to the Society, and other organisations as are judged relevant.

The Committee believes that variable remuneration relating to financial and business performance is an appropriate part of a balanced remuneration package. The general approach to this, however, has been to set variable remuneration mindful of the need for robust risk management in order to ensure that the outcomes achieved are beneficial to the organisation over the long term. The Society does not pay guaranteed bonuses or signing on awards as part of the remuneration of its staff or directors. The Society does not provide any retained or deferred remuneration schemes.

The annual incentive scheme for 2019 was a Society wide scheme which involved an overall assessment of the Society's performance against budget with respect to profitability, management expenses and asset growth and attainment of individual performance related objectives. This was a non-contractual scheme with all payments being at the discretion of the Remuneration Committee, no elements of variable remuneration are guaranteed.

Remuneration Staff

The Remuneration Committee has determined that as at 31 December 2019, two Executive Directors, four other members of the Leadership Team and two others are designated as being MRT, as per the relevant European Banking Authority (EBA) regulatory technical standards; and are subject to both the PRA Remuneration rules and FCA SYSC 19D Dual Regulated Firms Remuneration Rules.

Information concerning the mandate of the Remuneration Committee and the decision making process it uses in determining the Remuneration Policy for the Executive Directors and MRTs, and information on the link between pay and performance, is contained in the Directors' Remuneration Report in the Society's Annual Report and Accounts 2019.

Non-Executive Directors

Information concerning the mandate of the Remuneration Committee and the decision making process it uses in determining the Remuneration Policy for the Non-Executive Directors is contained in the Directors' Remuneration Report in the Society's Annual Report and Accounts 2019.

The table below sets out the aggregate remuneration for all Material Risk Takers including all Non-executive Directors in relation to their services for the Society for the year ended 31 December 2019.

	31 December 2019			31 December 2018		
	No	Total remuneration £000	Of which variable	No	Total remuneration £000	Of which variable
Executive Directors	2	317	-	2	309	19
Non-executive Directors	5	146	-	5	165	-
Other Material Risk Takers	6	522	-	6	534	21
Total	**13**	**985**	**-**	**13**	**1,008**	**40**

11. ASSET ENCUMBRANCE

Under the Basel framework *encumbered assets* are defined as assets that the bank is restricted or prevented from liquidating, selling, transferring or assigning, due to regulatory, contractual or other limitations.

Article 100 of the CRR requires institutions to report to the competent authorities the level of all forms of asset encumbrance.

The majority of the Society's assets are unencumbered with the exception of assets pledged in relation to hedging derivatives. The assets pledged are in the form of cash deposits with the underlying counterparty. The table below summarises the Society's encumbrance as at the year-end with prior year comparative.

Asset Encumbrance	31 Dec 2019		31 Dec 2018	
	Fair value encumbered assets £m	Fair value unencumbered assets £m	Fair value encumbered assets £m	Fair value unencumbered assets £m
Loans & Advances to Customers	-	248.4	-	232.4
Loans & Advances to Credit Institutions	1.4	15.2	0.2	19.5
Debt Securities	-	5.4	-	14.3
Claims on central banks	-	36.6	-	34.4
Total Assets	**1.4**	**305.6**	**0.2**	**300.6**

12. CONTACTS

Should you have any queries regarding this document, please contact:

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13. GLOSSARY

Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Additional Tier 1 capital (AT1)	Capital that meets certain rules under CRD IV and which comprises the Society's PIBS but only under the transitional provisions.
Basel II	Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive and was implemented in the UK via the PRA/FCA Handbook.
Basel III	Basel III became effective in the UK on 1 January 2014 through CRD IV and sets out the details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Capital Requirements Directive (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It is made up of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), outlining the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms.
Common Equity Tier 1 capital (CET1)	CET1 capital consists of internally generated capital generated from retained profits, other reserves less intangible assets and other regulatory deductions. CET1 capital is fully loss absorbing.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Credit Quality Steps	A credit quality assessment scale as set out in CRR Articles 111 - 141 (Risk weights under the Standardised Approach to credit risk).
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.

Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates or stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rates.
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's, Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms.
Impairment	The term impairment is usually associated with a long-lived asset that has a fair market value less than the historical cost (or book value) of the asset.
Impaired loans	Loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or expect to collect them later than they are contractually due. Impaired loans are defined as those which are more than three months in arrears or in possession. However other indicators of impairment may result in provisioning for losses.
Interest Rate risk	The risk of loss of income from movements in interest rates in severe but plausible market rate movements.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Individual liquidity adequacy assessment (ILAA)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments.
Institutions	Treasury assets with financial institutions such as banks and building societies.

Leverage Ratio	The ratio of Tier 1 capital divided by the total exposures which includes on and off balance sheet items.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Minimum capital requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Basel III Pillar 1 requirements for credit, market and operational risk.
Multilateral Development Banks	Treasury assets with Multilateral Development banks. These are also knows as supranational institutions.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Other items	Other assets not included in other definitions.
Past due items	Loans which are 90 days or more in arrears.
Permanent interest bearing shares (PIBS)	Unsecured, deferred shares of the Society that are a form of Additional Tier 1 capital. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital.
Provisions	Amounts set aside to cover incurred losses associated with credit risks.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel III capital rules to reflect the degree of risk they represent.
Secured by Mortgages on Residential Property	Residential mortgages where LTV is less than or equal to 80%.
Secured by Mortgages on Commercial Real Estate	Secured business lending which is only made available to Small and Medium sized Enterprises.
Standardised Approach	The basic method used to calculate capital requirements for credit risk. In this approach the risk weighting used in the capital calculation are determined by specified percentages.

Tier 1 capital	A component of regulatory capital, it comprises CET1 and AT1.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Standardised basis), less certain regulatory deductions.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.