2018 RISK PROFILE DISCLOSURE DOCUMENT

CAPITAL REQUIREMENTS DIRECTIVE

PILLAR 3 DISCLOSURES

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1. Introduction

Hinckley & Rugby Building Society, in common with all other banks and building societies in the UK, is subject to the provisions of the Capital Requirements Directive IV (hereafter "CRD"). In the UK, the CRD is implemented by the Prudential Regulation Authority (PRA).

The CRD provides rules that determine how much capital institutions such as banks and building societies are required to maintain to protect the interests of their depositors, based on the characteristics of their business and their Boards' assessments of the risks they face. The CRD also contains provisions about disclosure requirements that institutions must satisfy around their capital positions and risk management processes.

The CRD is divided into three pillars, each dealing with a different aspect of the rules.

Pillar 1 specifies the minimum levels of capital that have to be maintained given the size of an institution and the risk characteristics that are either deemed to exist, following prescribed rules relating to the nature of the institution's assets and operations, or are ascertained by statistical analysis. Hinckley & Rugby Building Society meets the Pillar 1 requirements by applying the Standardised Approach (as specified within the CRD) to credit risk and the Basic Indicator Approach to operational risk.

Pillar 2a represents either additional capital that is required to cover fully the risks identified within Pillar 1, or capital provided against risks that are not within the scope of Pillar 1. Capital allocated under Pillar 2a is determined following an assessment of all the significant risks faced by an institution carried out by its Board. This review is documented as the Society's Internal Capital Adequacy Assessment Process (ICAAP) and is then subject to review by the PRA.

Pillar 2b is made up of a PRA buffer, Capital Conservation Buffer and Countercyclical Buffer, which are maintained to ensure the Society should meet all its capital adequacy requirements even in periods of economic stress. The Countercyclical Buffer in place in the United Kingdom at 30 November 2017 was set at 0%, however, in June 2017 forward notice of an increase to 0.5% with binding effect in June 2018 was set by the Financial Policy Committee. Further to this in November 2017 forward notice was given that the buffer will increase to 1% with binding effect in November 2018.

Pillar 3 covers the disclosure requirements of the CRD and is satisfied by the publication and on-going maintenance of this document. The document provides details on the principal business risks faced by the Society, the Society's approach to their management and gives a breakdown of the capital amounts calculated under the Pillar 1 provisions. The document is also required to provide details concerning the remuneration of certain staff who have been assessed as being subject to the requirements of the Remuneration Code.

In December 2016, the European Banking Authority (EBA) issued a guidelines to implement the reporting and disclosure changes to the Pillar 3 framework, these were reissued in June 2017. The guidelines initially applied only to globally and other systemically important institutions (G-SII and O-SII). The guidelines now apply to all institutions for disclosures at the end of 2017, however, the European Association of Co-operative Banks (EACB) advocates the application of the principle of proportionality to ensure that smaller institutions that are not active in the capital markets will not need to complete or disclose all the additional templates.

Unless otherwise stated, all financial data contained within this document is correct as at 30 November 2017 or, in the case of data extracted from regulatory returns submitted to the PRA, at 31 December 2017.

Due to the nature of the information disclosed in this document some data has been excluded for reasons of materiality, proprietary or confidentiality. Some financial information may also be excluded from this disclosure as it is included in more detail in the Statutory Accounts published on the Society's website.

The Society's PRA registration number is 206043.

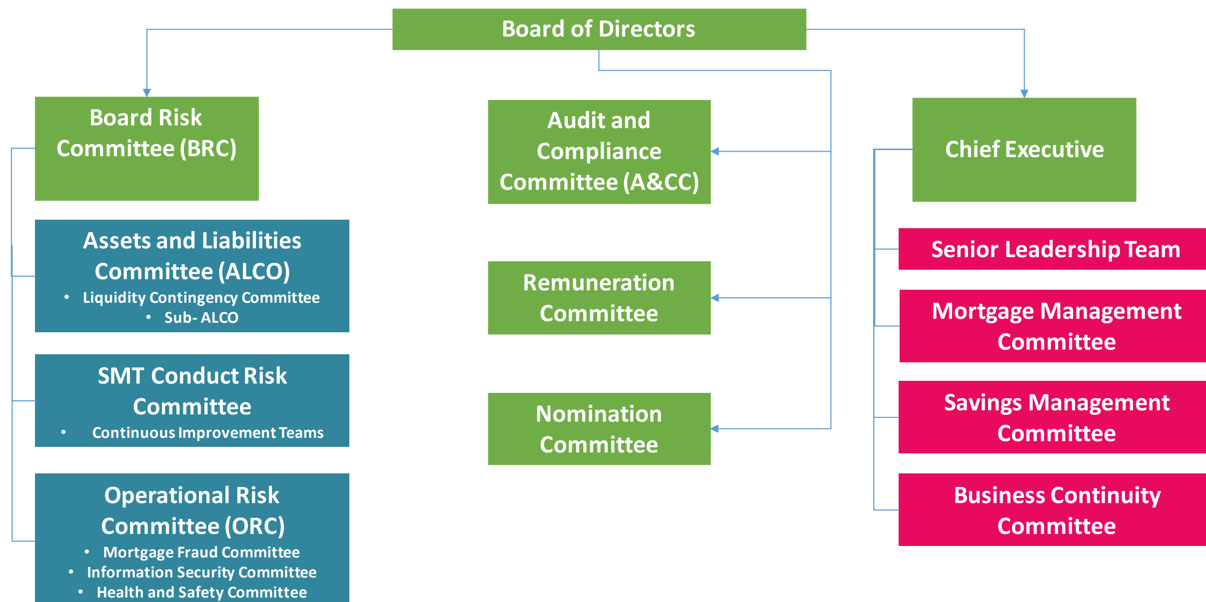
The principal office of the Society is: Upper Bond Street, Hinckley, Leicestershire LE10 1DG

Any queries or comments relating to this document should be addressed to the Society's Finance Director, Andrew Payton at a.payton@hrbs.co.uk.

2. Risk management policies and objectives

i. Risk Management Framework

Risk management is a process that is embedded into the management of the Society:



The Society operates under its Risk Management Framework a three lines of defence structure, defined as follows:

Oversight Board Audit and Compliance Committee Board Risk Committee			
1st Line of Defence	**2nd Line of Defence**	**3rd Line of Defence**	External audit
Preventative	**Reactive**		
Risk Ownership	**Risk Control**	**Risk Assurance**	
Society's operational staff who perform day-to-day risk management activities	Oversight functions and RSM Compliance	Internal Audit	
Control environment of the Society	A second, independent, review to provide assurance	Independent challenge of the process to levels of assurance	
Follow a risk process	Not directly involved in the operational task		

The key Board sponsor of the risk process is the Finance Director, working closely with the Chief Executive. The Board's understanding of the risks facing the business and its judgement on the appropriateness of the Society's response to them is informed by the breadth of its members' experience and the quality of the management information presented to it.

The Key risks to the Society are as follows along with the management and committee structures in place to manage such risks:

Key Risk	First Line	Second Line	Third Line	
	Oversight: Board, Board Risk Committee and Audit and Compliance Committee			
Credit risk			Internal Audit	External Audit
- Mortgage credit risk	Mortgage Management Committee	ALCO and Compliance review		
- Credit risk within the treasury function	Sub ALCO	ALCO		
Interest rate risk	Sub ALCO	ALCO		
Liquidity risk	- Finance Director and Finance Department - Liquidity Contingency Committee - Sub-ALCO	ALCO		
Market risk	Sub ALCO	ALCO		
Operational risk (including Information security/Business continuity)	All business areas	- Operational Risk Committee -Business Continuity Committee - Information Security Committee		
Business and Strategic Risk	All business areas	Operational Risk Committee		
Concentration risk	-Mortgage Management Committee - Savings Management Committee - Sub-ALCO	Operational Risk Committee		
Pension Obligation risk	Finance department	- ALCO - Operational Risk Committee		
Conduct risk	All business areas	Conduct Risk Committee		

An overview of the Terms of Reference for the key Committees is as follows:

Board Risk Committee (BRC)	
Committee Members	All Board members
Summary Terms of Reference	• The Board Risk Committee is tasked with identifying the key risks facing the Society and determining their importance given their potential impact and likelihood of occurrence. • The Committee will also ensure that the Society's response to all identified key risks is appropriate. • Review and approval of the following documents: - Risk Management Framework (RMF) including Risk Appetite Statements and relevant Policy statements. - Risk Strategy Document - Statement of Key Risk Indicators provided to the Committee by executive management, including financial, operational and conduct risks - the Society's Internal Capital Adequacy Assessment Process (ICAAP) - the Society's Internal Liquidity Adequacy Assessment Process (ILAAP) - the Society's Recovery Plan and Resolution Pack (RRP) - the Society's Capital Requirements Directive Pillar 3 disclosures and policy document - the Society's Reverse Stress Test Framework prepared in accordance with the requirements of SYSC 20 • Ensure the principal risks identified by the RMF are adequately considered within the Society's internal audit programme
Frequency	Minimum 4 times a year – February, May, September and November (The Risk Pack is produced every month for Board Risk Committee members)

Audit and Compliance Committee (ACC)	
Committee Members	At least three non-executive directors under the chairmanship of one of their number being a non-executive director appointed by the Board. It may be attended by the Chairman, Chief Executive, Finance Director, Operations Director, the holder of SMF16 – Compliance Oversight (FCA), and other members of the Senior Management Team as appropriate for part of the meeting. The External Auditor, Internal Auditor and Compliance Advisers shall attend the meeting as required.
Summary Terms of Reference	• To monitor the integrity of the financial statements of the Society and any formal announcements relating to the Society's financial performance, • To review the Society's internal financial controls and internal control systems; • To monitor and review the effectiveness of the Society's Internal Audit function and to appoint and remove Internal Auditors, as appropriate; • To monitor and review the effectiveness of the Society's Compliance Monitoring function; • To make recommendations to the Board, for it to put to the members for their approval in general meeting, in relation to the appointment of the External Auditor • To report to the Board, identifying any matters in respect of which it considers that action or improvement is needed, and making recommendations as to the steps to be taken.
Frequency	4 times a year – January, April, June and September

Assets and Liability Committee (ALCO)	
Committee Members	Chief Executive, Finance Director, Operations Director, Head of Risk and Compliance, Financial Controller & Treasury Manager, Treasury and Regulatory Reporting Accountant and Business Risk Analyst Non executives are not members but may attend.
Summary Terms of Reference	• Approving the Society's treasury policy ensuring that it is consistent with the Board's expressed liquidity risk appetite. This is approved at least annually and more frequently if circumstances require it; • Manage the Society's interest rate risk • Review of the ILAAP; • Establishing a structure for the management of liquidity risk including its allocation to appropriate senior managers who have the authority and responsibility to manage liquidity risk effectively (including the establishment and maintenance of the Society's treasury policy); • Monitoring the Society's overall liquidity risk profile on a regular basis and being made aware of any material changes in the Society's current or prospective liquidity risk profile; and • Taking reasonable steps to ensure that liquidity risk is adequately identified, measured, monitored and controlled.
Frequency	6 times a year - February, April, June, August, October and December (ALCO pack summary is produced every month for Board)

Operational Risk Committee (ORC)	
Committee Members	Senior Management Team
Summary Terms of Reference	• ORC reviews all material risks faced by the Society at both an absolute level and after the impact of risk mitigation controls and ranks these risks accordingly. This ensures a good understanding throughout the business of the controls that are key to risk mitigation. A summary of this assessment is presented to the Board Risk Committee at least annually. • Processes are in place to ensure that all significant changes to procedures, systems, controls and products are assessed for their impact on the risks faced by the Society.
Frequency	At least three times a year – April, August and December

Conduct Risk Committee	
Committee Members	Senior Management Team
Summary Terms of Reference	• Developing and maintaining a culture through which all of the Society's customers, business partners and staff members are treated fairly and ensuring that the Society adheres to the FCA's Key Business Principles relevant to conduct as well as ensuring that the six Treating Customer Fairly outcomes defined by the FCA are achieved to deliver a fair deal and good outcome for customers. • Regularly reviewing appropriate quantitative and qualitative management information to identify actual or potential customer detriment and measure and monitor the effectiveness of the Society's commitment to treating its customers fairly and achieving good customer outcomes. • Analysis of complaints and customer expressions of dissatisfaction in order to identify root causes and any systemic issues, ensuring that these are addressed appropriately and that action is taken, where appropriate, to correct issues to prevent detriment from re-occurring
Frequency	Every month

The work of the Board, Board Risk Committee and Operational Risk Committee is subject to review by Deloitte, the Society's internal auditors and the ICAAP, ILAAP and Pillar 3 are also subject to periodic review by internal audit.

ii. Risk Measurement and Reporting

The Board's aim is that the Society should be run prudently and profitably. The provision and reporting of comprehensive risk data is essential in allowing management and the Board to understand the Society's risks and how they are changing, and to assess risk on a forward looking basis. A broad range of management information and risk data is used to identify, assess, monitor, manage and report on risk.

The Board's view is that in light of the capital currently available and the Society's current business plans (which envisage no significant change from the current strategy), the availability of capital should not be a constraining factor at any point during the current 3 Year Business Plan period. Further, the Board intends that the Society should always make annual profits sufficient to sustain its capital strength.

A comprehensive set of limits and trigger points is in place in relation to lending limits. Exposures against the limits and triggers points are reported to the BRC every month to measure performance against appetite and to consider the likely future trajectory of exposures against limits.

The Society uses a number of stress tests and scenarios to help inform management of the impact from high stress events. Stress testing forms an integral part of the corporate planning process to ensure the Society remains within risk appetite and has sufficient capital and liquidity to carry out its strategic objectives. These include stresses on the 3 year business plan for severe but plausible stress events (including a combination of events), credit risk for residential mortgages, treasury risk, pension obligation risk and reverse stress testing.

If market conditions make that corporate plan unachievable for a temporary period, the Board would ensure that the Society had a credible plan that demonstrated to its own and other stakeholders' satisfaction its ability to return to a sustainable level of profit.

Residential mortgage stress tests are undertaken quarterly to model the impact on the index-linked values of the properties in mortgage to the Society falling by agreed percentages. An assumed loss crystallisation rate is factored in for cases which are above 100% LTV in the stressed scenario after an addition of interest to allow for the time taken to sell the property. Within the residential mortgage stress test, buy to let portfolios are separately identified.

Liquidity stress tests are undertaken weekly and the results reported to ALCO and the Board. These stress tests are designed to highlight any shortfalls in the Society's liquidity holdings over a range of time horizons.

iii. Principal business risks and the Society's approach to their management and mitigation

a) Credit risk reporting

i) Credit risk within the mortgage book

As a building society the Society's principal purpose is making loans that are secured on residential property and funded substantially by its members.

The Society's Mortgage Lending Policy Statement sets out the basic principles of good lending practice that ensure that the Society's exposure to credit risk is minimised as well as documenting how it identifies, measures, monitors and controls credit risk, its risk appetite and its provisioning policy. It also describes the systems and controls that it uses to ensure that the policy is correctly implemented.

The Board reviews this lending policy at least once a year.

In particular, the Society reduces its exposure to credit risk by ensuring that:

- Its lending activities are within the capabilities, experience and expertise of the Society's Management.
- Risk is controlled at inception by sound underwriting procedures, exercised by individuals skilled in the type of lending mandated to them.
- The pricing of loans takes account of the risks.
- Adequate controls are in place to avoid imprudent concentrations of risk in special products, non-traditional areas of lending and higher risk categories in traditional areas of lending.
- Adequate procedures are in place for monitoring the performance of lending related to source, type, and period of origination and for ensuring that lending experience feeds into the formulation of policy for new lending.
- The frequency and quality of Management and Board information is sufficient to monitor and control lending activities effectively.
- No commercial lending is undertaken. A historic commercial loan that remains on the balance sheet (representing approximately 0.03% of all loans outstanding) is regularly reviewed by Management.
- Systems are in place for early and effective management of arrears cases and for managing the disposal of properties in possession.
- Prudent provisioning methodologies are used and actual provisions are regularly reviewed in the light of experience.
- Budgetary procedures are in place to assess and control the effect on current and future profitability of lending at fixed or capped rates, at a fixed margin over a market reference rate and of price incentivised lending.
- Systems are in place to combat mortgage fraud.
- Systems are in place to ensure compliance with regulatory codes.
- Where external advice is required, professional firms of solicitors, accountants, valuers and other types of adviser have experience in the type of transaction for which they have been instructed.

The Society's underwriting philosophy is risk averse with predominant emphasis on traditional residential lending for owner occupation, based on limits to loan to value (LTV) ratios, low income multiples (with proven affordability and sufficient borrower's net income after commitments) and with full verification of income and credit history. The Society operates a sliding scale for acceptable LTV ratios, with lower maximum loans as a percentage of the property value as LTV ratios rise.

The Society offers higher LTV (greater than 80% up to a maximum of 95%) residential loans and buy to let products at up to 75% LTV. These products take advantage of the higher margins currently available on loans of this type and are helping to maintain the Society's overall interest margin that has been placed under pressure by the current low interest rate environment. In the case of higher LTV residential loans, all such lending has the additional protection of mortgage indemnity policies which insure the Society against the additional risk inherent in these loans. Business volumes for higher LTV and buy to let loans are subject to prudent limits as a percentage of overall volumes and take account of both the critical importance of maintaining the society's existing low overall level of credit risk and of relevant PRA guidance. Buy to let lending is restricted to 35% of loans advanced in any rolling 12 month period and to 25% of total balances outstanding. Lending to individuals for owner occupation at LTVs >80% (with insurance, as the Society does not lend above 80% without insurance in place) will not exceed 25% of the total indexed book.

All lending is backed by a first charge on property in England and Wales, which has been independently assessed and valued by a competent qualified property surveyor.

ii) Credit risk within treasury operations

In addition to mortgage lending the Society is exposed to credit risk within its treasury operations. Establishing prudent counterparty limits with institutions of high credit quality helps to control this risk. The Assets and Liabilities Committee (ALCO) sets total exposure limits for individual institutions and groups of connected counterparties as well as country and sector limits. The level of exposures is reported daily to the Finance Director, who signs a confirmation weekly to note that no exposures exceed their relevant limits. Exposures against these limits are also reported monthly within the ALCO pack.

The Society would like to maximise the return it receives from its liquid assets. However, the rate of return is usually linked to the degree of risk and the Society's general outlook in its treasury operations is to be risk averse. At 30 November 2017 the Society held all of its liquid assets, apart from some relatively small balances held with commercial banks to facilitate day to day operations, as qualifying for High Quality Liquidity Asset (HQLA) buffer purposes. This approach has allowed the Society, whilst still being in compliance with the ILAAP requirements, to maintain its liquidity in line with the Board's Risk Appetite. It is recognised that most elements of liquidity will earn less than the cost of funding them but that this loss of earning capacity is an essential part of managing a building society.

A separate Treasury Policy Statement sets out the range of assets considered appropriate for the Society to hold as liquid assets.

b) Interest Rate Risk

Interest rate risk is the risk that income or expense arising from the Society's assets and liabilities may change adversely as a result of changes in interest rates. The Society's policy is to manage its exposure to this risk within prudent limits. It does this through a combination of matching assets and liabilities with offsetting interest rate characteristics and by the use of interest rate swaps and caps. Control of interest rate risk exposure is managed by the ALCO and, through that Committee, is reported to the Board Risk Committee and the Board. Interest rate risk arises from the different interest rate characteristics of the Society's mortgages, savings products and other financial instruments.

A particular category of interest rate risk is basis risk. This is the risk that assets and liabilities that are linked to different variable rate indices (such as Bank Base Rate and LIBOR) may not move in accordance with each other. This risk is managed by placing limits on the volumes of assets and liabilities not held at administered rates, which are subject to change at the Society's discretion. Administered rate balances and loans therefore provide the Society with an opportunity to reduce basis risk, subject to considerations around the fair treatment of customers and the commercial impact of implementing rate changes that have an adverse customer impact.

Static gap analysis is performed monthly and reviewed by ALCO. The table below shows the variation in net present value of the gap between assets and liability cashflows as a result of a 2% upward or downward shift in interest rates.

At 30th November 2017	£million
Impact of interest rate shift +2%	(0.5)
Impact of interest rate shift -2%	0.5

c) Liquidity risk

The Society specialises in long-term mortgage lending which is financed mainly by liabilities that are contractually short term. This pattern of business creates maturity mismatches which give rise to cashflow imbalances. There is an overriding need, therefore, for the Society to maintain sufficient assets in liquid form which will have the effect of smoothing out such maturity mismatches. If the Society is to meet all liabilities as they arise it must keep an appropriate amount and mix of liquidity to meet any sudden adverse cashflow and the level of liquidity held must be sufficient at all times to maintain public confidence that the Society can meet its commitments.

The Board and Senior Management carry out a regular, systematic review of policy, operational limits and authorities each year and on an ad hoc basis in response to market or statutory changes and any other financial considerations. It is recognised that effective liquidity risk management entails an informed Board, capable management and appropriate staffing and that the Board and Senior Management are responsible for understanding the nature and level of liquidity risk assumed by the Society and the tools used to manage that risk.

A full ALCO pack is produced each month, irrespective of whether there is an ALCO meeting.

The monitoring and control of the application of the approved treasury policy is in the day-to-day hands of the Finance Director and Financial Controller and Treasury Manager with daily reporting to the Chief Executive and with monthly reporting within the ALCO pack. In normal circumstances the Treasury and Regulatory Reporting Accountant executes deals with review by the Financial Controller and Treasury Manager. In the event of the Treasury and Regulatory Reporting Accountant being absent the Financial Controller and Treasury Manager would execute deals. The Finance Director also has a dealing mandate for emergency use.

The Chief Executive, the Finance Director, Head of Risk and Compliance and Financial Controller and Treasury Manager are responsible for overseeing the daily and long-term management of liquidity risk in line with the Treasury Policy Statement. Their responsibilities include:

- Overseeing the development, establishment and maintenance of procedures and practices that translate the goals, objectives and risk tolerances approved by the ALCO and the Board into operating standards;
- Adhering to the lines of authority and responsibility that the ALCO and the Board have established for managing liquidity risk;
- Overseeing the establishment and maintenance of management information and other systems that identify, measure, monitor and control the Society's liquidity risk; and
- Overseeing the establishment of effective internal controls over the liquidity risk management process.

In accordance with PRA Internal Liquidity Adequacy Assessment Instrument 2015 (“PRA 2015/49”) Section 2, 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. This is set out by the PRA as the *overall liquidity adequacy rule*, which states that:

1) the Society must ensure that:

   a) its liquidity resources contain an adequate buffer of high quality, unencumbered assets; and

   b) it maintains a prudent funding profile; and

2) the Society may not include liquidity resources that may be made available through emergency liquidity assistance from a central bank.

The PRA expects the Society to articulate the amount of risk it is willing to take and therefore the buffer of HQLAs held. There is no set guidance on this.

The Overall Liquidity Adequacy Rule (OLAR) is, therefore, to be set by the Board. It should be both quantitative and qualitative and in line with the Society’s risk appetite and is as follows:

The Society should at all times hold a buffer of HQLAs of the greater of the three following calculations:

i. ***LCR buffer:*** Equal or exceed the Liquidity Coverage Ratio (LCR) net liquidity requirement over the next 30 days ensuring the Society does not fall below 100% in the LCR calculation

ii. ***Stress test outflow buffer:*** At least the forecast liquidity outflow calculated in the latest 15% retail run over 30 days stress testing.

iii. ***90-day stress test buffer:*** At least the forecast liquidity outflow calculated in a 15% retail outflow over 90 days stress testing.

It is the Society's policy only to hold liquid assets of the types specified below. Compliance with this policy will also ensure compliance with the Supervisory statement SS20/15: Supervising building societies' treasury and lending activities ("Sourcebook") for societies identified as being on the extended approach to financial risk management.

	Sourcebook Limit	Society Limit
Bank of England Reserves Account	No limit	**No limit**
Bank call deposits	No limit	**Subject to individual counterparty limits agreed by Board / ALCO based on credit rating**
Bank term deposits	Max 15% SDL	**No exposure allowed**
Building society term deposits	Max 10%SDL	**No exposure allowed**
Local authority/regional government terms deposits	Max 10% SDL	**No exposure allowed**
Gilts < 5 years	No limit	**No maximum amount**
Gilts > 5 years	Max 5% SDL	**Max 5% SDL**
Supranational bonds < 5 years	Max 5% SDL	**No exposure allowed**
Treasury bills	No limit	**No limit**
Floating Rate Notes (FRN), Medium Term Note (MTN), fixed rate bonds < 5 years	Max 5% SDL	**No exposure allowed**
UK residential mortgage backed securities (senior securitised position only) and UK covered bonds (CRD compliant only)	Max 5% SDL	**No exposure allowed**
Designated money market funds	No limit	**No exposure allowed**
Qualifying money market funds	No limit	**No exposure allowed**
Reverse repo	Up to limits above	**Up to limits above for credit support collateral purposes only**

The Society has policies and processes for the measurement and management of its net funding position and requirements on an on-going and forward basis. Alternative scenarios are considered and the assumptions underpinning decisions concerning the net funding position are reviewed regularly.

The Society maintains a contingency funding plan, liquidity funding plan and a Recovery Plan and Resolution Pack (RRP). These plans include details of the steps the Society would take if faced by a liquidity contingency event of varying degrees of seriousness, ranging from moderate but extended withdrawals of retail or wholesale funds up to a full scale run on the Society.

A cash flow budget is prepared annually and updated at least monthly in the light of experience. Maturity dates for liquid assets are determined in accordance with the cash flow budget and the maturities of future investments adjusted in the light of changes in the budget and market performance. In addition to the annual cashflow budget longer-term cash flow planning forms part of the quarterly reviews of the full year projections for the current and following year and the annual review of the 3-year business plan.

All dealings in the wholesale money market are carried out in accordance with best practice as laid down in the UK Money Markets Code, with the exception of the provision of confirmation to counterparties. Confirmations are provided by post rather than electronically via a system such as SWIFT, as many of the Society's counterparties would not be able to access such confirmations.

The policies and rules within this policy statement are designed to meet the comprehensive needs of the Society. Where, in exceptional circumstances, it is considered necessary to override them then the Society's Chairman's or, failing that, the Senior Independent Director's authority is required.

The ILAAP is subject to submission and review by the PRA as part of their Liquidity Supervisory Review and Evaluation Process (L-SREP). As part of this review the PRA will assess if the High Quality Liquid Assets held, both quantity and quality, is adequate. It will be then for the Board and Management to implement any suggested changes.

The Society's control procedures around liquidity risk are also subject to annual review as part of the internal audit plan.

d) Market risk

Market risk is the risk that the value of or income arising from an institution's assets and liabilities varies as a result of changes in interest rates, exchange rates or other factors influencing their performance. Of these, only interest rates have a significant impact on the Society's financial results and therefore the only aspect of market risk to have a material bearing on the Society is interest rate risk.

The Society has a Board approved Treasury Policy Statement and the Board and Senior Management carry out a regular, systematic review of policy, operational limits and authorities each year and on an ad hoc basis in response to market or statutory changes and any other financial considerations. It is recognised that the effective management of interest rate risk entails an informed Board, capable management and appropriate staffing and that the Board and senior management are responsible for understanding the nature and level of interest rate risk assumed by the Society and the tools used to manage that risk. In addition to this the sub-ALCO meets several times a month to review hedging exposures and funding.

e) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems and from external events. The risk is managed by individual business areas that have a responsibility for putting in place appropriate controls. The procedure they follow to achieve this is that described under The Society's *Risk Management Framework* under section 2.i above.

f) Business risk and strategic risk

Business risk is the risk that the Society may not be able to carry out its business plan or its desired strategy and could therefore suffer losses if income falls.

This is a risk that every business faces. 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. In all stress conditions the Society will be looking firstly to ensure that its capital and funding positions remain strong and secondly that its performance falls within the boundaries specified within its stated risk appetite.

g) 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. There are further potential concentrations by geography and funding.

- Product concentration – 78.8% of the Society's lending portfolio is concentrated in very high quality prime residential mortgage loans. In addition, the Society does undertake limited amounts of lower LTV (up to 75%) buy to let lending (restricted to 35% of advances in any rolling 12 month period and 25% of total balances outstanding). All loans are individually underwritten with great emphasis placed on the customers' covenant to repay the loan.

In the case of higher LTV (greater than 80% up to a maximum of 95%) residential loans, all such lending has the additional protection of mortgage indemnity policies which insure the society against the additional risk inherent in these loans. Given this concentration in such high quality assets, the Society's view is that diversification into other types of mortgages would be more likely to increase risk rather than to reduce it.

- Geographic concentration – The Society is a regional building society and its retail funds come largely from within its core East and West Midlands operating area. However, its mortgage lending is widely spread throughout England and Wales, as shown in section 4.iii. The proportion of the Society's mortgages outstanding outside its core operating area is 75.5% of the total. This proportion of out-of-area lending has been increasing steadily for a number of years and this trend is likely to continue.

  The Society runs quarterly stress tests of its mortgage book, as part of its review of capital adequacy under the ICAAP process, to assess the impact of decreases in property values on LTV ratios. There is a modest concentration of 24.5% lending in its core operating area and also the South East and Greater London, which accounts for another 34.8% of loans outstanding by value. The Society further protects itself from potential house price "bubbles" in regional markets by reducing the amount it is prepared to lend, on a sliding scale, as LTV ratios increase.

- Funding concentration – The Society's non-retail funding represents 20.2% of shares and deposits at 30 November 2017. The Society considers this to be a modest amount compared to other lenders in the sector and the ratio is not expected to rise to over 25% at any point within the horizon of the current business plan. The funding is predominantly from the Bank of England for a 4 year term as well as a limited number of local authorities and other institutions. Wholesale counterparties, in particular local authorities, are sensitive to the perceived capital strength of the Society. The Society's capital position is very good, but as a small regional building society with no external credit rating the Society could be at risk if market conditions resulted in a withdrawal of confidence in the sector and a consequent reduction in the available funding.

  The Society's regular liquidity stress modelling shows that it could cope with any level of reduction in market wholesale funding, up to and including complete withdrawal.

- Retail savings geographic - A geographical analysis of the Society's investor base shows that 92.1% (holding 85.4% of the balances) live within easy reach of one of the Society's branches or agencies and are therefore likely to visit a branch or agency to make a withdrawal rather than use the post. The branch area is across 2 counties (Warwickshire and Leicestershire) but all products are offered nationally and the Society does attract funding from postal accounts. The online savers facility is also available, allowing savers to view accounts and request a transfer of funds to a nominated bank account. Retail accounts have previously been successfully marketed in a national campaign, bringing in funds via a postal account from outside the core branch area.

Despite being located in a reasonably small geographic area of Southern Leicestershire and North Warwickshire, customers who use the branch network are from a wide range of social and economic backgrounds and there is no one dominant industry, employer or social grouping that, if closed or changed, should cause a significant outflow of retail funding.

h) Pension obligation risk

The Society operates a defined benefit pension scheme. From 1 January 2010 the scheme closed to future accrual, although all benefits earned up to that date remain the liability of the scheme. The closure of the scheme to future accrual should limit the Society's exposure to fluctuations in the value of the scheme's assets relative to its liabilities, although this exposure will only reduce over an extended period as the scheme's liabilities are discharged. The Society uses a firm of professional pension and investment advisors to help it assess the risks in operating the scheme and to recommend an investment strategy to the scheme's trustees that is designed to reduce the risk of volatility while still maintaining adequate returns. Following a thorough review of the scheme's investment strategy carried out with the help of the advisors, the scheme trustees have adopted a largely liability driven investment strategy which seeks to invest in assets whose market movements will mirror changes in the value of scheme liabilities and thereby reduce the volatility of the scheme's performance.

KPMG also prepares a periodic stress test of the assumptions made about scheme performance, these include two set PRA scenarios and one Own Firm scenario. This is used to validate the amount of capital allocated under the Pillar 2 requirements.

i) Conduct Risk

Retail conduct of business comprises high-level principles of treating customers fairly, specific regulatory requirements, wider legal provisions, any relevant codes of practice and statements from the FCA. The directors believe that good business practice, high ethical standards and compliance with laws and regulations are all entirely compatible and the Society has a low appetite for all retail conduct of business risk, ensuring good outcomes for members in all our dealings.

The Society focuses on long-term customer relationships and has a culture that places our members at the heart of our business, underpinned by robust governance structures designed to identify, manage and reduce risks of unfair treatment.

Management information measuring retail conduct of business risk is reviewed regularly by a senior management committee which reports to the Board.

During the year, the Board Risk Committee also ensured that new business proposals were aligned with the Board's retail conduct of business risk appetite, so that risks to members were identified and appropriate actions put in place to mitigate and monitor such risks.

3. The Society's available capital resources

The breakdown of the Society's capital position at 30 November 2017 is presented in the following table. Reserves are eligible to be treated as capital once they have been independently assessed by the Society's auditors. Consequently, this figure is updated annually following the Society's financial year end.

	£ million
Tier 1 capital	
Regulatory CET 1 capital	40.0
Tier 2 capital	
Collective provision for the impairment of loans and advances to customers	0.4
Total capital available	**40.4**
Core Tier 1 as a percentage of Risk Weighted Assets	15.6%
Capital Ratio	15.8%

Reconciliation of Accounting and Regulatory Capital Resources	**£ million**
Reserves	40.74
Adjusted for: -	
Collective provision for the impairment of loans and advances to customers	0.4
Pension asset	(0.07)
Intangible assets	(0.71)
Regulatory Capital Resources	40.36

Note: This reconciliation differs from the disclosure in the Statutory Accounts due to the pension asset of £0.07m adjustment being revised.

Purpose of Capital

- To protect saving members against credit losses and other risks
- To support the Society's long term objective of maintaining member services through the trade cycle, including an ability to absorb short term trading losses

- To provide the necessary capital support for new mortgage business to attract new members and generate additional capital

It is the Society's stated intention that its capital position will be used to support the long term maintenance and development of its member interests through the payment of savings rates that ensure reasonable market returns to members and through a continuing commitment to the branch network and the maintenance of high levels of customer service.

The Society's statement of its risk appetite declares that the Society's objective is to operate the business such that availability of capital should not be a constraining factor at any point during the current business plan period. The Society ensures that this objective is met by the preparation of its Business Plan and through the use of an Internal Capital Adequacy Assessment Process.

- Business plan – The Society prepares an annual Business Plan that outlines its objectives for business growth, funding and profitability over the following three years. One of the key objectives within the plan is to ensure sufficient generation of capital through retained earnings to meet at least the minimum objective stated above. The Business Plan outlines the Society's strategic objectives for the next three years and translates them into detailed financial projections. The Plan is also stress tested to ensure that the minimum capital requirement would still be met under various alternative commercial scenarios.

- Internal Capital Adequacy Assessment Process – The CRD rules require the Society to prepare and maintain an Internal Capital Adequacy Assessment Process (ICAAP). The resulting document details the Society's capital requirements under both Pillar 1 and Pillar 2. Financial projections from the Business Plan form an input to the ICAAP and the assumptions made within them are stress tested to a level representing the most adverse business conditions that could reasonably be expected to prevail. This results in a minimum capital level that the Society's management and Board believe the business needs to hold. This minimum level includes a capital planning buffer designed to provide additional capital resources in the event of severe business stress.

The Society's ICAAP is subject to periodic review by the PRA. Based on their review of the document and subsequent discussions with management and the Board, they may revise the minimum capital required to be maintained by the Society if they feel that insufficient capital has been provided against particular business outcomes.

4. Capital Adequacy – Pillar 1 Capital allocations

i. Overall breakdown of amounts at 30 November 2017

The Society's assets are allocated risk based exposure amounts in line with the *Standardised Approach* of the Capital Requirements Directive (CRD). In addition, an evaluation of capital required to cover operational risk is calculated under the *Basic Indicator Approach* of the CRD. This requires that capital is set aside that is equivalent to 15% of the *relevant indicator*, which is the 3 year average of the Society's net interest income plus other income, but excluding insurance related income.

	Asset amount £ million	Risk weighted amount (RWA) £ million	Allocated capital at 8% of RWA £ million
Loans and advances to customers			
Commercial loans secured on property	0.2	0.2	**-**
Residential loans secured on property (includes 20% of offered commitment)	619.4	231.8	**18.6**
Past due residential loans	0.1	0.1	**-**
	619.7	**232.1**	**18.6**
Treasury and other assets			
UK government securities and balances with the Bank of England	111.4	-	**-**
Institutions	20.1	5.5	**0.5**
Other assets	6.3	6.4	**0.5**
CVA on swaps	-	0.2	**-**
	137.8	**12.1**	**1.0**
Total credit risk exposures and RWA	**757.5**	**244.2**	**19.6**
Basic indicator approach		13.1	**1.0**
Pillar 1 capital allocation			**20.6**
Pillar 2A requirement			**4.4**
Total Capital Requirement (TCR)			**25.0**

The table on the following page shows further analysis with respect to exposures by asset classes and risk weights at 31 December 2017. The difference in values between this and the table above is caused by different reporting items as well as the movement in balances between the two reporting periods.

Standardised approach – exposures by asset classes and risk weights (£ms) – 31st December 2017

		Risk weight																	
	Exposure class	0%	2%	4%	10%	20%	35%	50%	70%	75%	100%	150%	250%	370%	1250%	Others	Deducted	Total	Of which unrated
1	Central governments or central banks	108.2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	108.2	-
6	Institutions	-	-	-	-	13.3	-	6.8	-	-	-	-	-	-	-	-	-	20.1	-
8	Retail	-	-	-	-	-	-	-	-	35.1	-	-	-	-	-	-	-	35.1	-
9	Secured by mortgages on immovable property	-	-	-	-	-	624.4	-	-	-	0.2	-	-	-	-	-	-	624.6	-
10	Exposures in default	-	-	-	-	-	-	-	-	-	0.1	-	-	-	-	-	-	0.1	-
16	Other items	-	-	-	-	-	-	-	-	-	3.9	-	-	-	-	0.1	-	4.0	-
17	Total	108.2	-	-	-	13.3	624.4	6.8	-	35.1	4.2	-	-	-	-	0.1	-	792.1	-

ii. Leverage Ratio

The CRD IV framework requires firms to calculate a non-risk based leverage ratio which supplements the risk-based capital requirements. The Society calculates its Tier 1 capital on the basis that will apply when CRD IV is fully phased in, therefore, there is no difference between the transitional rules and full implementation.

At 30 November 2017 the leverage ratio for the Society was well above the 3% regulatory minimum at 5.35%. This is calculated as follows:

	£ million
Capital Measure	40.0
Asset measure	748.1

The capital measure is retained earnings adjusted for intangible assets and pensions. The Asset measure is Total Assets adjusted for deferred tax and the collective provision.

iii. Further details relating to loans and advances to customers

The residual maturity, geographic distribution, analysis of loans by repayment type and loan arrears are set out in full in the statutory accounts.
The Society's policy with respect to provisions for Impairment of loans and advances to customers is as follows:

Individual assessments are made of all mortgage loans that are in arrears or in possession or there is other objective evidence that all cash flows will not be received and an exposure to potential loss exists after realisation of security at a forced sale discount. Based upon these assessments an individual impairment reduction of these assets is made.

A collective impairment reduction is considered against those loans and advances to customers where objective evidence, including forbearance measures, indicates that it is likely that losses may ultimately be realised and thus a loss event has occurred. The impairment value is calculated by applying various factors to each loan. These factors take into account the Society's expectation of default and delinquency rate, loss emergence periods, regional house price movements and adjustments to allow for forced sale discounts, selling costs and any potential recovery of Mortgage Indemnity Guarantee (MIG).

In addition, the Society maintains a level of provision against losses that may have been incurred in the loan book but not reported and where problems in realising the Society's security may be anticipated due to factors such as problems with title, potential fraud within the loan application or buildings having been constructed on contaminated land.

Impairment provisions are made to reduce the value of impaired loans and advances to the amount that is considered to be ultimately received based upon objective evidence. Any increases or decreases in projected impairment losses are recognised through the Income and Expenditure Account. If a loan is ultimately uncollectable, then any loss incurred by the Society on extinguishing the debt is written off against the provision for loan impairment. Any subsequent recoveries of amounts previously written off are recognised through the Income and Expenditure Account.

At 30 November 2017 the collective provision for impairment losses on loans and advances was £0.4m. The comparative figure at 30 November 2016 was £0.4m. There were no individual provisions at 30 November 2017 (2016: £nil).

Changes in stock of defaulted loans and debt securities

		2017 £ million
1	Defaulted loans and debt securities at end of the previous reporting period	0.8
2	Loans and debt securities that have defaulted since the last reporting period	2.9
3	Returned to non-defaulted status	2.6
4	Amounts written off	-
5	Other changes	-
6	Defaulted loans and debt securities at end of the reporting period (1+2-3-4±5)	1.1

No debt securities were in default at any point during the year ended 30 November 2017.

iv. Further details relating to liquid assets placed with financial institutions

The risk weightings applied to liquid assets placed with financial institutions are determined with reference to the credit rating assigned by Moody's, the Society's nominated external credit assessment institution (ECAI).

Maximum exposure limits are assigned to each institution used by the Society for investment of liquid assets. Exposure limits are set and regularly reviewed by the Society's ALCO. Limits are set according to each institution's credit rating, the availability of any explicit government guarantees for that institution and its debt issues and ALCO's view of the institution's credit worthiness based on its published financial information, business profile and attitude to risk.

All counterparties are part of groups whose main country of incorporation is in Western Europe. Exposure to each counterparty is reviewed by the Finance Director regularly to ensure there has been no breach of individual counterparty limits.

Exposure to counterparties also takes account of any exposures resulting from derivative transactions undertaken by the Society for the purpose of interest rate risk management.

The following table sets out the total value of swaps held at 31 December 2017, their market value, exposure and associated risk weighted assets.

Analysis of counterparty credit risk (CCR) exposure by approach (£ million)

		a	b	c	f	g
		Notional	Replacement cost/current market value	Potential future exposure	EAD post CRM	RWA
1	Mark to market		1.0	13.3	14.3	5.0
2	Original exposure	339.0			-	-
11	**Total**					5.0

Credit valuation adjustment (CVA) capital charge (£ million)

		a	b
		EAD post CRM	RWA
	Total portfolios subject to the Advanced CVA capital charge		
1	(i) VaR component (including the 3×multiplier)	-	-
2	(ii) Stressed VaR component (including the 3×multiplier)	-	-
3	All portfolios subject to the Standardised CVA capital charge	0.02	0.2
4	Total subject to the CVA capital charge	0.02	0.2

5. 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.

Assets

The table overleaf shows components of our encumbered and unencumbered assets at 31 December 2017:

	Carrying value of encumbered assets £ million	Fair value of encumbered assets £ million	Carrying value of unencumbered assets £ million	Fair value of unencumbered assets £ million
Loans on demand	-		108.2	
Quoted UK Government stock	-	-	5.0	5.0
Loans and advances other than loans on demand*	212.2		408.7	
Other assets	0.2		6.0	

*this contains only mortgage assets

Collateral received

The EBA Guidelines allow competent authorities to waive the requirement to disclose template B subject to a firm meeting certain criteria. The Society meets the criteria and therefore Template B, Collateral received, is not disclosed.

Encumbered assets/collateral received and associated liabilities

	Matching liabilities, contingent liabilities or securities lent £ million	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £ million
Carrying amount of selected financial liabilities	0.5	0.2
Other sources of encumbrance	113.0	212.2
Total Sources of encumbrance	113.5	212.4

The table above summarises the encumbered assets for derivatives, margin calls on derivative contracts and TFS/ILTR funding.

6. Remuneration policies and practices

i. Background

The Society is required to comply with the Remuneration Code as set out in SYSC 19D and the PRA's Rulebook on Remuneration and to focus on remuneration policy which supports sound and effective risk management.

The purpose of this policy is to provide an overview of the approach taken by Society in relation to the management of remuneration.

ii. Governance arrangements

The Board is committed to ensuring that it adheres to the Remuneration Code. This is done in a manner which is appropriate to the Society's size, internal organisation and the nature, scope and the complexity of its activities.

The Board has established a Remuneration Committee.

The Committee:

- Is constituted in a way that enables it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk, capital and liquidity;
- Has a chairman and members that are on the Society's Board but who do not perform any executive function in the Society;
- Is responsible, together with the Society's Board, for ensuring that the Society's remuneration policy complies with the Remuneration Code and any other relevant guidance;
- Is responsible for the implementation of the Society's remuneration policy; and
- Takes into account the long-term interests of members, depositors and other stakeholders in the Society.

Composition:

- The Committee comprises all Non-Executive Directors.
- The Chief Executive can by invitation be in attendance at the Committee meetings to enable the Committee to consult on their proposals relating to other Executive Directors and non-Board members of the Senior Management Team.

Duties of the Committee:

- The Committee determines the remuneration of the Executive Directors and the Chairman of the Board.

- The Committee recommends and monitors the level and structure of remuneration for non-Board members of the Senior Management Team (including the Society's Secretary) and reviews the general level of remuneration for all other staff.
- The remuneration of the Non-Executive Directors other than the Chairman is determined annually by the Executive Directors and the Chairman of the Board in accordance with the Society's Rules.
- No Director or other member of the Senior Management Team is involved in any decision as to their own remuneration.

Meetings:

- Meetings are held at least annually to determine appropriate levels of remuneration for all members of the Senior Management Team. (including Executive Directors) for the twelve months following the start of the Society's financial year.
- Meetings are also held at any time it is felt necessary to review the remuneration package of an Executive Director or a member of the Senior Management Team or for determining the appropriate remuneration package for a new Executive Director or a new member of the Senior Management Team.

iii. Code staff

Code staff (the group of employees to whom all the Principles of the Code will apply) include all staff who have a material impact on the Society's risk profile, including a person who performs a significant influence function for the Society, a senior manager and material risk takers. A senior manager is defined in SYSC 19D as an individual employed by the firm to whom the governing body (or a member of the governing body) of the firm has given responsibility for management and supervision, and who reports directly to the governing body, a member of the governing body, the chief executive, or the head of a significant business group. All firms within the scope of the Code must collate their Code Staff list annually and update it as appropriate.

The Board considers that the following are Code Staff in accordance with the definition in SYSC 19D:

- Chief Executive
- Finance Director
- Operations Director
- Secretary and Solicitor
- Head of Risk and Compliance
- Money Laundering Reporting Officer
- Non-Executive Directors

iv. Compliance with the principles of the Remuneration Code

The Society complies with the principles of the Remuneration Code as follows:

- **Risk management and tolerance**

The Society's Remuneration Committee ensures that its remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk documented in the Society's Risk Appetite Framework approved by the Board Risk Committee.

The Society has a discretionary annual bonus scheme for Executive Directors and other members of the Senior Management Team. Non-executive directors do not participate in a bonus scheme. All bonuses are paid in cash in the year in which they are awarded. The relatively modest nature of the maximum bonuses payable under the scheme ensure that staff are not incentivised to take risks outside of the Board's stated risk appetite.

The maximum annual bonus payable under the discretionary annual bonus scheme is 15% of basic salary, with a maximum of 5% of basic salary payable based on the Society's performance against its Business Plan targets and a maximum of 10% of basic salary payable based on an individual's performance against their agreed objectives.

These maximum potential percentages are only available to the Chief Executive, Finance Director and Operations Director with lower maximum awards available to the Secretary and Solicitor and other non-Board members of the Senior Management Team.

Bonuses are recommended to the Remuneration Committee for approval based on documentation of performance against individual and Society wide performance objectives. The Remuneration Committee reviews performance against individual and Society wide performance objectives before reaching the decision to award a bonus. A key metric in the decision as to whether or not to award a bonus, and the scale of that bonus, is evidence that limits set down in the Society's Risk Appetite Framework have not been breached.

- **Supporting business strategy, objectives, values and long-term interests of the firm**

The Society ensures that its remuneration policy is in line with the business strategy, objectives, values and long-term interests of the Society.

The remuneration of all Executive Directors and non-Board members of the Senior Management Team (including the award of any discretionary bonuses) is determined after an annual review of performance against individual objectives set by the Board and a review of the Society's overall performance against business goals fully documented in the Board's Business Plan.

- **Profit-based measurement and risk adjustment**

The percentage of remuneration of Executive Directors and non-Board members of the Senior Management Team that is variable is relatively modest but nonetheless the Remuneration Committee uses qualitative judgements and common sense in the final decision about the performance related components of variable remuneration pools and takes into account all types of current and future operational, market, credit and liquidity risk.

The Remuneration Committee ensures that total variable remuneration is reduced where subdued or negative financial performance occurs and would not expect to award any variable remuneration in a year in which a loss is incurred.

The Society does not currently operate a long-term incentive plan but if it were to introduce one would be mindful of the guidance in SYSC 19D.

v. Disclosure of aggregate remuneration of Code staff for the year to 30 November 2017

	Number of staff	Fixed Pay £000s	Variable pay £000s	Total £000s	Proportion of variable pay to total pay
Executive Directors*	3	422	17	439	4%
Non-executive Directors**	8	198	0	198	0.0%
Other code staff***	3	145	5	150	3.45%
Total	**14**	**765**	**22**	**787**	**2.88%**

*One executive director appointed on 17th May 2017
** Two non-executive directors retired, and two new non-executives were appointed in March 2017
***One staff member transferred to being included as code staff in October 2017