HINCKLEY AND RUGBY BUILDING SOCIETY

Pillar 3
Disclosure document

30 November 2020

Contents

1 Introduction

1.1 Background

Hinckley & Rugby Building Society (the Society) is subject to the European Union Capital Requirements Directive (CRD) and Capital Requirements Regulations (CRR) implemented on 1 January 2014. The CRD and CRR, commonly known as CRD IV, provide for consistent capital adequacy standards for banks and building societies and an associated supervisory framework across the European Union and are implemented in the UK by the Prudential Regulation Authority (PRA).

The legislation sets out the rules that determine the amount of capital institutions must hold in order to provide security for members and depositors, based on the characteristics of their business and their Board's assessment of the risks they face.

The CRD comprises 3 main elements, or 'Pillars':

Pillar 1: Minimum regulatory capital requirements relating to credit, market and operational risks. The Society meets the minimum capital requirements by applying the Standardised Approach to credit risk and the Basic Indicator Approach to operational risk;

Pillar 2: Assessment of capital requirements by the Society through the Internal Capital Adequacy Assessment Process (ICAAP) and the PRA through the Supervisory Review and Evaluation Process (SREP) to determine whether additional capital should be held for specific risks not covered under Pillar 1; and

Pillar 3: Disclosure of information regarding risk exposures, the management of those risks and capital adequacy, in accordance with Part Eight of the CRR.

The Pillar 3 Disclosures are designed to promote market discipline through external disclosure of a firm's risk management framework and risk exposures.

1.2 Scope of application

This document sets out the Pillar 3 Disclosures for Hinckley & Rugby Building Society (PRA Firm reference number: 206043) only.

1.3 Basis and frequency of disclosures

Unless otherwise stated, all figures within this document are stated as at 30 November 2020.

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.

Disclosures are issued on an annual basis unless more frequent disclosure is deemed necessary by the Board. The disclosures are published in conjunction with the Society's Annual Report & Accounts.

1.4 Verification

These disclosures have been reviewed by the Society's Board Risk Committee and approved by the Board of Directors. The disclosures are not subject to external audit, except where they are equivalent to those prepared under accounting requirements for inclusion within the Annual Report & Accounts.

1.5 Further information

Any queries or comments relating to this document should be addressed to The Society Secretary, Hinckley & Rugby Building Society, Upper Bond Street, Hinckley, Leicestershire LE10 1NZ.

2 Risk management

This section sets out the Society's approach to risk management.

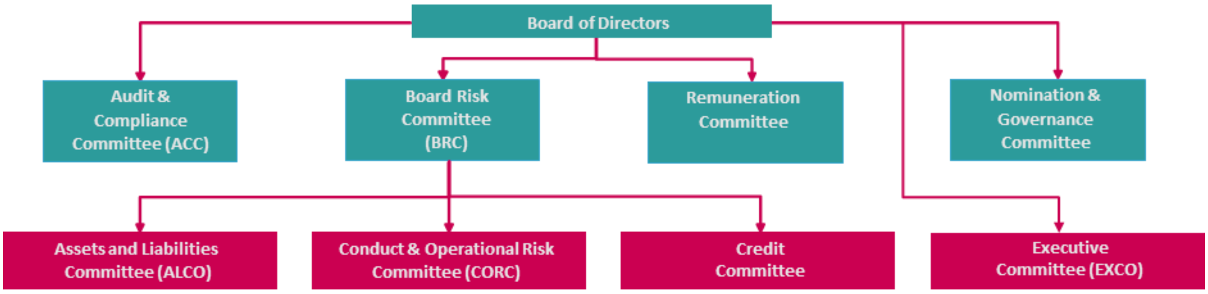
2.1 Risk management framework

The Board has implemented a risk management framework to mitigate the risks to which it is exposed. The framework comprises:

- a risk focused governance structure;
- risk appetite statements and risk management policies;
- procedures for the identification, monitoring and reporting of risks within defined risk limits.

In addition, the risk management framework incorporates the requirements of the PRA's Supervisory Statement 20/15 'Supervising building societies' treasury and lending activities'. In particular, the Society has adopted the Traditional lending approach and the Matched treasury approach to risk management, as defined in this statement.

2.1.1 Governance structure



The Board of Directors has established sub-committees to assist in the implementation and monitoring of the risk management framework, including the Audit & Compliance Committee, Board Risk Committee, Remuneration Committee and Nomination & Governance Committee.

In addition, the Society operates management committees with risk management responsibilities, including the Executive Committee, which reports directly to the Board, and the Assets & Liabilities Committee, Conduct & Operational Risk Committee, and the Credit Committee, which report to the Board Risk Committee.

The role of the Board and each committee is described below:

Board of Directors

The Board of Directors has responsibility for the overall risk management framework. The Board is responsible for setting and aligning the Society's strategy and risk appetite, and ensuring risk management is appropriate and functioning effectively. These duties also include the responsibility for aligning, within the ICAAP and ILAAP, the risk management framework and the financial disciplines of business planning, capital management and liquidity and funding management.

Board committees

- The Audit & Compliance Committee (ACC), a non-executive committee, has responsibility for ensuring that the Society's accounting and reporting systems provide accurate information, appropriate internal controls reflecting the Society's risk profile are in place and these are reviewed regularly, liaising with the external auditor, and monitoring the effectiveness of the compliance and internal audit functions.

- The Board Risk Committee, a non-executive committee, has responsibility for oversight, on behalf of the Board, of the Society's risk management framework, including the identification of risk, the monitoring of risks against appetite, and ensuring the management of risk is adequate and occurs in an integrated manner. This includes overseeing the operation of the ICAAP and ILAAP, monitoring the Society's overall capital adequacy, liquidity adequacy and exposure to risk, and ensuring that effective stress and scenario testing is carried out.

- The Remuneration Committee, a non-executive committee, has responsibility for determining, on behalf of the Board, the policy and the level of remuneration of the executive directors, senior management and the wider workforce. The committee also ensures that remuneration aligns with the long-term interests of the business and incentives towards excessive risk taking are eliminated.

- The Nomination & Governance Committee, a non-executive committee, has responsibility for leading the process for senior appointments, ensuring plans are in place for orderly succession to both the Board and senior management positions, and ensuring that the Board and senior management have the appropriate skills and experience to effectively manage the business and deliver the Society's strategy.

Management Committees

The Executive Committee, the Assets & Liabilities Committee (ALCO), the Conduct & Operational Risk Committee (CORC) and the Credit Committee are management committees and have responsibility between them for the day-to-day management of all risk categories:

- The Executive Committee is primarily responsible for implementing the strategy approved by the Board and managing strategic risks that arise, including those arising from change management.

- The ALCO is primarily responsible for the management of prudential risks, including liquidity risk, funding risk, interest rate risk (including basis risk), treasury counterparty credit risk, pension obligation risk and certain business risks, including those arising from margin management.

- The CORC is responsible for the management of conduct and operational risks, including information security and financial crime risks.

- The Credit Committee is responsible for managing the Society's retail credit risk arising from mortgage lending.

Three lines of defence model

While the Board of Directors is ultimately accountable for the risk management framework, all staff within the Society have responsibility for risk management.

The Society operates a 'three lines of defence' model, structured 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	GRC department	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		

- **First line of defence:** Line management within each business area is responsible for the identification, measurement and management of the risks within the Society's risk appetite, ensuring appropriate controls are in place and operating effectively.

- **Second line of defence:** The Governance, Risk & Compliance function provide risk management expertise, challenge and support to the Board, management and staff. Independent views are reported to the ACC and Board Risk Committee utilising management information from across the business, external intelligence and bespoke assurance activity in accordance with a risk-based work programme approved by the ACC.

- **Third line of defence:** The Internal Audit function is responsible for independently reviewing the effectiveness of the internal control environment. The Internal Audit function reports to the Chairman of ACC. The ACC approves the risk-based work programme of Internal Audit and receives reports of the results of the work performed.

External audit also reports to the ACC, providing independent assurance of financial statement risks and controls.

The Board sits above the three lines of defence and provides oversight to each line, setting the risk appetite for the Society and receiving reports from the ACC, Board Risk Committee, Remuneration Committee and the Nomination & Governance Committee, to enable it to obtain a holistic view of the Society's risk management framework.

2.1.2 Risk Appetite, Risk policy statements and risk limits

The Board has approved a risk appetite for each risk category to which the Society is exposed. This is set out in the Risk Appetite Statement document.

Risk policy statements, which articulate policy and risk limits in more detail for specific risk categories, have been implemented to manage the risks faced by the Society within the defined risk appetite.

The key policies include the Lending Policy, the Financial Risk Management Policy, which covers liquidity, funding, counterparty credit and interest rate risks, the Conduct Risk Policy, the Operational Risk Policy and the Remuneration Policy. These contain detailed criteria and risk limits within which the business is managed. The policies are reviewed in detail by the Board Risk Committee, and amendments approved by the Board on a regular basis to ensure they remain relevant and appropriate.

2.1.3 Risk identification, monitoring and reporting

The Society operates formal processes to identify, measure and report on risks to which it is exposed:

- Risk identification: The Society's Risk Register records all the key risks to which the Society is exposed. The risks and mitigating controls are monitored and updated by risk owners on a regular basis, who also confirm the effective operation of controls. Risks identified on the register are graded, according to their likelihood of occurrence and consequence before and after the effect of internal controls. New risks identified are communicated to the Society's Governance, Risk & Compliance department for inclusion on the Risk Register and allocation to a risk owner.

- Risk monitoring: The Executive Committee, ALCO, CORC and Credit Committee monitor risk metrics relating to their respective areas of responsibility. This is in addition to the monitoring and management of risks by risk owners within the first line of defence. Issues identified are escalated, if appropriate, to the Board Risk Committee and the Board.

- Risk reporting: The Chief Risk Officer identifies trends and produces an independent analysis of risk across all risk categories, including a risk heat map and key risk indicators. Any amber or red indicators are reported to the Board Risk Committee together with details of management actions. The Board Risk Committee reviews this risk information on a bi-monthly basis. The Board also receives a monthly report from the Chief Risk Officer, covering strategic risks to the Society.

2.2 Risk management policies and objectives

The Society is primarily a retailer of mortgage and savings products. Surplus funds are invested in liquid assets with a range of counterparties.

The Society identifies, assesses and controls risks that arise from these activities through the risk management framework as set out in section 2.1. The most significant risks to which the Society is exposed are:

- retail credit risk;
- treasury counterparty credit risk;
- operational risk;
- conduct risk;
- financial crime risk;
- business risk;
- liquidity risk;

- funding risk;
- interest rate risk (including basis risk);
- concentration risk; and
- pension obligation risk.

Details of these risks are set out below. The Society is exposed to market risk through interest rate risk and pension obligation risk as described below. The Society does not operate a trading book and all assets and liabilities are denominated in Sterling.

The Covid pandemic has impacted individuals and businesses, including the Society, and has increased the Society's risk profile. The pandemic itself and measures introduced by the UK Government to support the economy, create new credit, operational, conduct, and financial risks. These risks are being managed and will be monitored over time. The most material impact on the Society relates to credit risk and details of this are set out in section 2.2.1 and 5.

2.2.1 Retail credit risk

Retail credit risk is the risk that mortgage borrowers default on their obligation to repay the Society.

The risk is controlled by the Society's Board approved Lending Policy, which is regularly reviewed by the Credit Committee and the Board Risk Committee. The policy is translated into an underwriting process, which seeks to ensure that borrowers only assume a debt that they can afford to repay, thereby safeguarding both themselves and the Society. The policy also aims to promote the origination of a balanced portfolio of mortgage assets that matches the expertise and experience of underwriters.

Key controls set out in the policy to mitigate retail credit risk include:

- The setting and regular monitoring of applicable lending limits, including product, borrower and loan related limits, to avoid concentrations of exposures in higher risk lending categories.

- The setting of full underwriting criteria for each product category, designed to ensure the affordability of mortgage repayments using an affordability model, the adequacy of loan security and the creditworthiness of borrowers through the use of external credit checks.

- The assessment of all new mortgage applications by experienced staff who are accredited through a formal training and competence scheme. Mortgage applications are approved by staff with specific underwriting mandates.

- The use of qualified external property surveyors, solicitors and accountants as necessary to assist the assessment of mortgage applications.

- The prevention of mortgage fraud through thorough mortgage application assessment and use of external fraud prevention systems.

- The pricing of all new mortgage products using a model that incorporates an expected Probability of Default (PD) and Loss Given Default (LGD) to ensure that the return received appropriately reflects the risks involved.

- The use of mortgage indemnity policies to insure the Society against the risk of lending at higher Loan to Value (LTV) ratios and to provide specialist cover for self-build lending.

The Society has a separate Arrears Policy detailing the systems and controls relating to the processes for dealing with arrears and forbearance. Should borrowers find themselves in financial difficulty, the Society has established procedures to ensure that it responds appropriately, providing borrowers with a personalised plan designed to help get their mortgage back on track. A key factor of 2020 was working with borrowers who needed to defer mortgage payments, under the Financial Conduct Authority (FCA) recommended framework, due to the Covid lockdown and the associated income challenges. Approximately 10% of the Society's borrowers took up to six months' mortgage payment deferral and some will continue into 2021. At 30 November 2020, 38 borrowers continued to have their mortgage payments deferred and, unless they were in arrears prior to the payment deferral, these have not been treated as arrears cases. Further details are provided in Note 27 of the Annual Report & Accounts.

Possession is always a last resort and we will only take this action if we are unable to reach an agreement that will return a mortgage to an affordable and sustainable position, and have been unable to agree an alternative mortgage exit strategy, such as voluntary sale. Whether the Society incurs a loss because of taking possession, is critically dependent on the value realised from the property. The Society monitors the impact of house price movements by carrying out modelled stress tests of its mortgage book to take account of actual and projected movements in house price indices on the expected value of any properties taken into possession.

All mortgage lending is secured by a first charge on property in England and Wales. The portfolio is almost exclusively made up of retail mortgages split between owner occupied and buy to let loans.

Comprehensive credit risk management information is reviewed at the Credit Committee on a monthly basis and includes mortgage portfolio analysis, details of mortgage arrears, mortgage portfolio stress testing and lending limit monitoring. Oversight is provided by the Board Risk Committee, which is responsible for the oversight and challenge of risk management across the Society. It receives credit-related management information and an independent view of each risk category from the Chief Risk Officer at each meeting.

A detailed quantitative analysis of the Society's mortgage credit risk exposures is set out in section 5.

2.2.2 Treasury counterparty credit risk

Treasury counterparty credit risk is the risk that counterparties will be unable to repay loans and other financial instruments that the Society holds as part of its liquidity portfolio.

The Society holds treasury investments in order to meet liquidity requirements and for general business purposes. The Board of Directors has defined the Society's risk appetite for credit risk exposure to treasury counterparties by defining within the Financial Risk Management Policy the permissible instruments that can be used, the minimum counterparty credit ratings required and maximum counterparty and sector exposure limits. Any changes in policy are submitted to the Board Risk Committee for consideration before recommendation to the Board for approval.

Permissible counterparties include supranational bodies, the UK Government, UK banks and building societies. The limits for all rated counterparty exposures are linked to Moody's credit ratings in addition to management's own assessment. Unrated building societies are assessed by the Assets & Liabilities Committee (ALCO).

ALCO is responsible for monitoring adherence to the relevant Financial Risk Management Policy limits, with oversight provided by the Board Risk Committee, which is responsible for the oversight and challenge of risk management across the Society. It receives an independent view of each risk category from the Chief Risk Officer and has access to all ALCO papers.

The Society has no provisions for loan impairment against any treasury counterparties. A detailed quantitative analysis of the Society's treasury counterparty credit risk exposures is set out in section 5.

2.2.3 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. It includes risks arising from the management of health and safety, data protection and operational resilience.

These risks are managed as an integral part of the Society's operations. The Society's management is responsible for ensuring that appropriate processes and procedures are in place with effective controls to mitigate the operational risks identified.

In addition to effective controls, management also ensure that systems and processes are operationally resilient by having controls in place to reduce the likelihood and magnitude of operational incidents, and having clear plans and arrangements in place to respond to and recover from incidents.

The Society recognises the increased threat of cyber-attacks being faced across the financial sector and continues to ensure that it has an appropriate capability to detect and respond to cyber security issues effectively, safeguarding the organisation and its members. The Society strives to keep pace with market trends in the prevention and detection of potential attacks, to safeguard the business and protect its members' data and savings.

Management information relating to operational risk, the occurrence of risk events and near misses, as well as actions taken in response to such events, is monitored by CORC on a monthly basis. Oversight is provided by the Board Risk Committee, which is responsible for the oversight and challenge of risk management across the Society. It receives an independent view of each risk category from the Chief Risk Officer and has access to all CORC papers.

2.2.4 Conduct risk

Conduct risk is the risk of the Society's systems, policies or processes not delivering fair outcomes for its members.

The Board aims to ensure that good consumer outcomes arise from all customer interaction and to achieve customer satisfaction at all times. Where this does not occur, the Society will endeavour to rectify the outcome as appropriate.

The Society has a Conduct Risk Policy, which is reviewed in detail by the Board Risk Committee and approved by the Board, that sets out the high-level values and behaviours that staff are expected to demonstrate in all their dealing with customers throughout the product life-cycle. This includes treating customers fairly, and meeting regulatory requirements and best practice guidance from the FCA, including building the needs of vulnerable customers into the Society's processes and culture.

Management information measuring conduct risk is reviewed monthly by CORC, which reports to the Board Risk Committee, ensuring visibility of any customer detriment and adequate controls are implemented.

2.2.5 Financial crime risk

Financial crime risk is the risk of loss through crime to the Society or its members.

The Society maintains policies, procedures and systems to prevent, deter and detect potential and actual instances of financial crime or fraud. The Board has approved an Anti-Money Laundering and Counter Terrorism Policy that details the key controls that are required to be in place to mitigate financial crime risk given the Society's customer profile, and product and service offering. Regular training is undertaken by all staff to ensure the Society's Policy and related controls are fully understood, and to assist staff in identifying and reporting instances suspicious activity.

The Society's Money Laundering Reporting Officer (MLRO) is responsible for ensuring the Society's meets its money laundering requirements, and help the Society understand and comply with individual responsibilities and regulations.

2.2.6 Business risk

Business risk is the risk of loss or reduced income from failing to implement the Society's business plan. It can be caused by both internal and external factors, including competition, economic conditions or legislative change.

This risk has the potential to impact the financial strength of the Society and its ability to generate sufficient underlying profitability to keep the business viable. The Board and its committees mitigate this risk by:

- approving a business plan, including detailed financial and capital plans, that it believes to be robust and achievable;
- ensuring that a diverse range of mortgage and savings products are in place;
- stress testing this plan to assess the impact of various adverse market conditions and to identify areas requiring close monitoring;
- ensuring capital, liquidity and funding positions are adequate to enable the Society to survive severe but plausible stresses;
- regular monitoring of actual performance against the plan and its objectives, including business volumes, margin, other income, expenditure, and key performance and risk indicators;
- monitoring by the Board Risk Committee to ensure all key business risks are identified, monitored and reported, including reports provided by the Chief Risk Officer;
- reviewing and approv~~al~~ing of all key policy documents, including any changes to these policies, by the Board Risk Committee and the Board;

- approving all new product or service initiatives following an appropriate assessment of the risks involved; and

- monitoring of external markets, competitors and economic indicators.

At a management level, the Society's Executive Committee has the primary responsibility for implementing the business plan and monitoring business risk. Oversight is provided by the Board Risk Committee, which is responsible for the oversight and challenge of risk management across the Society.

2.2.7 Liquidity risk

Liquidity risk is the risk that the Society does not have sufficient financial resources to meet its liabilities as they fall due or can secure them only at an excessive cost.

The Society's policy is to hold sufficient assets in the form of readily realisable assets in order to:

- 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;

- smooth out the effect of maturity mismatches between assets and liabilities; and

- maintain the highest level of public confidence in the Society.

The Board of Directors has defined the Society's risk appetite, policy, systems and controls relating to the management of liquidity risk in the Financial Risk Management Policy. Any changes in policy are submitted to the Board Risk Committee for consideration before recommendation to the Board for approval. The key aspects of the control framework to mitigate liquidity risk are as follows:

- The setting and regular monitoring of applicable liquidity limits, including those covering the amount, instrument type and maturity of liquidity held;

- The monitoring of both short-term and long-term liquidity ratios, including the Liquidity Coverage Ratio and Net Stable Funding Ratio, to ensure that these are maintained above minimum levels;

- The holding of a high quality Liquid Assets Buffer, including deposits with the Bank of England;

- Monthly liquidity stress testing, to ensure that the level of the Liquid Assets Buffer and total liquidity held are sufficient to meet liabilities under severe but plausible stressed conditions; and

- A documented Recovery Plan that sets out the governance processes and the options available to the Society if it experienced a liquidity stress event. The Plan includes a menu of possible actions depending on the severity of the liquidity event.

The minimum level of the Liquid Assets Buffer is set in accordance with an Internal Liquidity Adequacy Assessment Process (ILAAP) that is reviewed by the Board Risk Committee and approved by the Board on an annual basis. The ILAAP incorporates severe but plausible stress testing linked to the Board's formal assessment of the liquidity risks to which the Society is exposed.

The ALCO monitors liquidity risk on a monthly basis, including management information on liquidity and funding limits, Liquid Asset Buffer levels and composition, liquidity stress testing results and liquid asset and wholesale borrowing maturity analysis. Oversight is provided by the Board Risk Committee, which is responsible for the oversight and challenge of risk management across the Society. It receives an independent view of each risk category from the Chief Risk Officer and has access to all ALCO papers.

The Liquidity Coverage Ratio is a measure of the Liquid Assets Buffer held by an institution to meet a stressed liabilities outflow over a 30 day period. The measure must meet a minimum regulatory requirement of 100%.

The table below sets out the Society's average quarterly Liquidity Coverage Ratio for the 12 month period ending 30 November 2020.

Quarter ending on	29 Feb 2020	31 May 2020	31 Aug 2020	30 Nov 2020
Liquid Assets Buffer (£m)	129.1	120.2	121.2	125.5
Total Net Cash Outflows (£m)	49.1	45.6	51.6	54.5
Liquidity Coverage Ratio (%)	262.6%	263.5%	235.0%	230.1%

2.2.8 Funding risk

Funding risk is the risk the Society does not have sufficiently diverse and stable funding to support new lending activities or replace funding withdrawals or maturities.

The Board of Directors has defined the Society's risk appetite, policy and controls relating to the management of funding risk in the Financial Risk Management Policy. The Board mitigates funding risk through:

- the setting of risk limits, to reduce exposure to maturity, sectors, counterparties and funding concentration risks;
- the spreading of funding across a range of retail savings products, with different tenures, interest rate characteristics and risk profiles; and
- the use of a range of wholesale funding sources, including a range of sectors, counterparty types, and tenures. This includes the use of the Bank of England funding schemes, where relevant.

The Society's funding profile and position against limits are monitored by ALCO on a monthly basis, with oversight provided by the Board Risk Committee.

2.2.9 Interest rate risk

Interest rate risk is the risk of reductions in net interest margin arising from unfavourable movements in interest rates due to:

- Mismatches between the dates on which interest receivable on assets and interest payable on liabilities are reset to market rates (Re-pricing mismatch); and
- The re-pricing of assets and liabilities according to different interest bases (Basis risk).

The main causes of interest rate risk are the imperfect matching of fixed rate mortgages and savings products. While the Society aims to match fixed rate assets with liabilities, it is not always possible to achieve exact matches due to the need to estimate initial customer demand for mortgage and savings products and the early repayment of mortgages.

The Society's policy is to manage its exposure to interest rate re-pricing mismatch risk and basis risk within approved limits set by the Board within the Financial Risk Management Policy. The Policy includes limits for the maximum impact of both parallel and non-parallel shifts in interest rates on the Society's economic value and net interest income, individual and cumulative interest rate gap limits, and net maximum net exposure limits to each interest rate basis. The Society manages interest rate risk through a combination of matching assets and liabilities with offsetting interest rate characteristics and using derivative financial instruments, including interest rate swaps, to reduce mismatches.

Historic and forward looking interest rate risk gap analyses, basis risk exposures and interest rate risk stress testing, using a range of parallel and non-parallel shifts in interest rates, are monitored by ALCO on a monthly basis. Oversight is provided by the Board Risk Committee, which is responsible for the oversight and challenge of risk management across the Society.

The table below shows the impact on the economic value of the Society of a 2% upward or downward shift in interest rates at 30 November 2020.

At 30 November 2020	**£m**
Impact of a parallel interest rate shift of +2%	(0.4)
Impact of a parallel interest rate shift of -2%	0.4

A detailed analysis of the Society's interest rate position at 30 November 2020 can be found in Note 27 of the Annual Report & Accounts.

2.2.10 Concentration risk

Concentration risk is the risk of loss due to large exposure to an individual or group of connected individuals that are affected by a common issue.

The Board has set limits for:

- Certain geographical concentrations of mortgage assets;
- The maximum value of large exposures to single or connected mortgage borrowers;
- Maximum exposures to specific mortgage products types and borrower categories;
- Maximum exposures to specific liquid asset categories; and
- Maximum exposures to treasury counterparty types and specific treasury counterparties.

Mortgage asset concentrations are monitored against limits monthly by the Credit Committee and liquid asset concentrations are monitored against limits monthly by ALCO, with oversight to both provided by the Board Risk Committee.

Details of certain asset concentrations are set out in section 5.

2.2.11 Pension obligation risk

Pension obligation risk is the risk to earnings and capital due to the Society, as the sponsoring employer, having to make significant contributions to its defined benefit pension scheme.

The Society's defined benefit scheme was closed to future accrual 1 January 2010. The Board uses the services of external professional pension and investment advisers regarding investment decisions, liability management and the on-going reduction of risk within the scheme.

While the scheme assets and liabilities are largely hedged for inflation and interest rate risk, the Society is exposed to:

- A fall in the market value of investments held reducing the fair value of scheme assets; and

- An increase in life expectancy increasing the present value of scheme liabilities.

An accounting valuation of the scheme was undertaken at 30 November 2020 by an independent actuary, in accordance with Financial Reporting Standard 102, and showed a pre-tax scheme surplus of £3.2m.

Despite the surplus, the Board, via ALCO and a separate Pension Oversight Committee, continues to regularly monitor the funding level of the scheme and consider opportunities for further de-risking of the scheme.

3 Capital resources (Own funds)

An analysis of the Society's capital resources at 30 November 2020 is presented in the following table. The Society's profit is eligible to be treated as capital once it has been independently verified by the Society's auditors. Consequently, this figure is updated annually following the approval of the Society's year-end Annual Report & Accounts.

Capital resources	30 Nov 2020 £m
Tier 1 capital (all Common Equity Tier 1 capital)	
General reserves	45.4
Less: Defined benefit pension asset (net of deferred tax)	(2.6)
Less: Intangible assets	(0.8)
Less: Deferred tax assets that rely on future profitability	(0.3)
Less: Prudent valuation adjustment	(0.0)
	41.7
Tier 2 capital	
Collective provision for the impairment of loans and advances to customers	0.5
Total regulatory capital	**42.2**
Total Risk Exposures	265.8
Common Equity Tier 1 ratio	15.7%
Total Capital Ratio	15.9%

A reconciliation of equity attributable to members per the Statement of Financial Position in the Annual Report & Accounts to regulatory capital is shown below:

Reconciliation of equity attributable to members per the Annual Report & Accounts to regulatory capital	30 Nov 2020 £m
Total reserves per the Statement of Financial Position	**45.4**
Less: Defined benefit pension asset (net of deferred tax liability)	(2.6)
Less: Intangible assets	(0.8)
Less: Deferred tax assets	(0.3)
Less: Prudent valuation adjustment	(0.0)
Add: Collective provision for the impairment of loans and advances to customers	0.5
Total regulatory capital	**42.2**

4 Capital requirements

4.1 Capital adequacy assessment process

The Society has adopted the Standardised Approach to credit risk and the Basic Indicator Approach to operational risk since 1 January 2008 to calculate the minimum Pillar 1 capital requirement.

In addition to the risks covered under Pillar 1 (credit, market and operational risks), all other material risks to which the Society is exposed were assessed as part of the Society's annual Internal Capital Adequacy Assessment Process (ICAAP). Financial and capital forecasts were prepared incorporating all current and planned strategic initiatives, products and services. Forecasts were also prepared to assess the impact on the Society's business and its profitability and capital position of operating under plausible downside stressed conditions.

Through the ICAAP, the Board has established an internal minimum capital requirement that is sufficient to support present and future capital requirements, withstand a severe but plausible stress and ensure the minimum regulatory requirement (Total Capital Requirement) is adhered to.

The ICAAP is undertaken at least annually, and more frequently should the Society's business plan, forecasts or risk profile materially change. The results are documented, reviewed by the Board Risk Committee and approved by the Board, and are assessed by the PRA as part of their supervisory review of the Society.

Compliance with capital requirements is monitored monthly by ALCO, the results of which are reported to the Board. The Society complied with and maintained capital above the regulatory minimums during the reporting period.

The ICAAP is integrated into normal business activities. The impact on capital requirements of new, and changes to existing, business processes, products and services are assessed. Strategic decisions are made following an assessment of their impact on capital, ensuring adequate capital is maintained at all times and used efficiently.

4.2 Pillar 1 capital requirement

The Society has adopted the Standardised Approach to credit risk to calculate its minimum capital requirement. 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%

Risk weightings for each exposure class are provided by the EU Capital Requirement Regulations. Mortgage asset risk weightings take into account Loan-To-Value (LTV) ratios, security type and arrears and impairment provision levels. Wholesale liquid asset risk weightings are dependent on counterparty credit rating and deposit duration.

The Society has adopted the Basic Indicator Approach to operational risk to calculate its minimum capital requirement. Under the Basic Indicator Approach the level of capital required is calculated as 15% of the Group's average net income (excluding insurance rebates and profit share income) over the previous 3 years.

The resulting Pillar 1 capital requirement is shown in the following table, analysed into its credit risk and operational risk components. For credit risk, the table shows the net credit risk exposure, the risk weighted exposure and the minimum capital requirement at 30 November 2020 by exposure class:

Exposure class	Net exposure £m	Risk weighted exposure £m	Capital requirement £m
Central governments or central banks	131.5	-	-
Institutions	14.2	3.9	0.3
Liquid assets	**145.7**	**3.9**	**0.3**
Secured by mortgages on immovable property	650.3	227.6	18.2
Retail (secured by residential real estate)	3.3	2.5	0.2
Exposures in default	1.7	1.7	0.1
Mortgage assets	**655.3**	**231.8**	**18.5**
Other assets	**9.5**	**9.5**	**0.8**
Off-balance sheet exposures:			
Institutions (derivatives)	0.5	0.3	0.0
Secured by mortgages on immovable property (pipeline)	30.3	2.8	0.2
Total off-balance sheet exposures	**30.8**	**3.1**	**0.2**
Total credit risk requirement	**841.3**	**248.3**	**19.8**
Operational risk		17.2	1.4
Credit valuation adjustment		0.3	0.0
Total Pillar 1 capital requirement		**265.8**	**21.2**

A reconciliation of total assets per the Statement of Financial Position in the Annual Report & Accounts to total credit risk exposures shown above of £841.3~~818.9~~m is ~~shown~~ set out below.

Reconciliation total assets in the Annual Report & Accounts to credit risk exposures	30 Nov 2020 £m
Total assets per the Statement of Financial Position	**814.0**
Less: Defined benefit pension asset (gross of deferred tax)	(3.2)
Less: Intangible assets	(0.8)
Add: Collective provision for the impairment of loans and advances to customers	0.5
Add: Off balance sheet exposures (derivatives and pipeline)	30.8
Total credit risk exposures	**841.3**

4.3 Total capital requirement

The PRA issues the Society with specific requirements as to the minimum capital the Society must hold. The table below sets out the total capital requirement and buffer requirements as they apply to the Society at 30 November 2020.

Capital requirement	% of Total Risk Exposures	30 Nov 2020 £m
Total risk exposures		265.8
Pillar 1 capital requirement	8.0%	21.2
Pillar 2A capital requirement	-	4.1
Total capital requirement		**25.3**
Capital Conservation Buffer	2.5%	6.7
Countercyclical Buffer	0.0%	-
Total		**32.0**

4.4 Leverage ratio

The CRD IV framework requires firms to calculate a non-risk based leverage ratio that supplements the risk-based capital requirements. As the Society's capital resources are the same using transitional and fully phased-in CRD IV definitions, the Leverage ratio calculated under both transitional and full implementation of CRD IV is the same.

At 30 November 2020, the leverage ratio for the Society was significantly above the 3% regulatory minimum at 5.1%. Details of the Society's leverage ratio calculation, as required by the CRR, are shown below.

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures	30 Nov 2020 £m
Total assets as per published financial statements	**814.0**
Adjustments for derivative financial instruments	0.5
Adjustment for off-balance sheet items (pipeline)	7.9
Other adjustments:	
Less: Defined benefit pension scheme asset (gross of deferred tax)	(3.2)
Less: Intangible assets	(0.8)
Add: Collective provision for the impairment of loans and advances to customers	0.5
Leverage ratio total exposure measure	**818.9**

Table LRCom: Leverage ratio common disclosure	Nov 2020 £m
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	813.9
Asset amounts deducted in determining Tier 1 capital	(3.5)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**810.4**
Replacement cost associated with all derivatives transactions	0.1
Add-on amounts for PFE associated with all derivatives transactions	0.5
Total derivative exposures	**0.6**
Off-balance sheet exposures at gross notional amount	30.3
Adjustments for conversion to credit equivalent amounts	(22.4)
Total off-balance sheet exposures	**7.9**
Tier 1 capital	**41.7**
Leverage ratio total exposure measure	**818.9**
Leverage ratio	**5.1%**

Table LRSpl: Split-up of on-balance sheet exposures (excluding derivatives and SFTs)	Nov 2020 £m
Total on-balance sheet exposures (excluding derivatives and SFTs)	**810.4**
Of which:	
Exposures treated as sovereigns	131.5
Institutions	14.1
Secured by mortgages on immovable properties	650.3
Retail	3.3
Exposures in default	1.7
Other exposures	9.5

5 Credit risk reporting

At 30 November 2020, all exposures shown in section 4.2 were solely concentrated in the UK.

5.1 Maturity analysis

The residual maturity of the exposures at 30 November 2020 is shown below. Mortgage assets represent exposures secured by mortgages on immovable property, retail exposures and exposures in default.

Residual maturity	Less than three months £m	Three months to one year £m	One year to five years £m	More than five years £m	No specific maturity £m	Total £m
Central governments or central banks	131.1	-	-	0.4	-	131.5
Institutions	10.8	-	3.4	-	-	14.2
Mortgage assets	6.8	16.6	108.4	523.6	(0.1)	655.3
Other assets	-	-	-	-	9.5	9.5
Total	**148.7**	**16.6**	**111.8**	**524.0**	**9.4**	**810.5**

5.2 Liquid assets

The primary source for obtaining information on wholesale counterparty creditworthiness is Moody's credit ratings, an external credit assessment institution (ECAI). Moody's credit ratings are applied to Society liquid asset exposures in order to establish their risk weighted value for capital adequacy purposes, in line with the Standardised Approach using credit quality steps as set out in the EU Capital Requirement Regulations.

The credit ratings of liquid asset exposures at 30 November 2020 were as follows:

Credit quality step	Moody's rating	Central government or central banks £m	Banks £m	Total £m
1	Aaa – Aa3	131.5	-	131.5
2	A1 – A3	-	14.2	14.2
3	Baa1 – Baa3	-	-	-
Unrated	-	-	-	-
Total		**131.5**	**14.2**	**145.7**

None of the Society's liquid assets at 30 November 2020 were past due or impaired.

5.3 Mortgage assets

The geographical distribution of mortgage asset exposures to UK customers at 30 November 2020 was as follows:

	Residential		Commercial		
Region	Performing £m	Past due £m	Performing £m	Past due £m	Total £m
South East	139.0	0.2	-	-	139.2
London	132.3	0.9	-	-	133.2
West Midlands	77.5	0.1	-	-	77.6
South West	63.6	0.2	-	-	63.8
East Midlands	61.0	0.1	0.2	-	61.3
North West	54.9	-	-	-	54.9
Yorkshire	52.6	0.1	-	-	52.7
East Anglia	32.4	0.1	-	-	32.5
Wales	23.6	-	-	-	23.6
North	16.5	-	-	-	16.5
Total	**653.4**	**1.7**	**0.2**	**-**	**655.3**

A mortgage is classified as past due when it is 3 months or more in arrears.

5.4 Asset encumbrance

The Society has pledged mortgage assets as collateral with the Bank of England, in order to participate in both the Sterling Monetary Framework and other schemes such as the Term Funding Scheme (TFS). The Society also enters into derivative financial contracts as part of its management of interest rate risk, for which collateral in the form of cash deposits is posted with the counterparty (shown as ‘Loans and advances (other)’ in the table below).

Details of the encumbered assets are set out below. In accordance with the CRR, the information disclosed is the median of the totals as at the end of each calendar quarter during the 12 months preceding 30 November 2020 rather than being the year-end position. As a result, values shown may differ from other information provided in this document.

Encumbered and unencumbered assets								
	Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
	£m	Of which notionally eligible EHQLA and HQLA £m	£m	Of which notionally eligible EHQLA and HQLA £m	£m	Of which EHQLA and HQLA £m	£m	Of which EHQLA and HQLA £m
Assets of the reporting institution	**160.2**	**157.9**			**671.6**	**286.9**		
Loans on demand	-	-			133.0	-		
Loans and advances (mortgages)	157.7	157.7			529.3	286.9		
Loans and advances (other)	2.5	0.2			-	-		
Other assets	-	-			9.3	-		

Sources of encumbrance		
	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	**78.9**	**160.2**

5.5 Impairment provisions

The Society's policy for impairment of loans and advances to customers consists of:

- Individual assessments of impairment of all mortgage loans that are in arrears or where other objective evidence exists that all cash flows will not be received; and

- Collective assessments of impairment of portfolios of mortgage loans that are not subject to individual impairment provisions, where there is objective evidence that credit losses have been incurred but not identified at the reporting date.

The Society regularly performs collective assessments of impairment. Objective evidence of impairment may include observable data indicating that there has been an adverse change in the payment status of borrowers in a portfolio, or national or local economic conditions that correlate with defaults on assets in the portfolio.

The table below details the Society's provisions as at 30 November 2020.

Provision for impairment losses on loans and advances	Loans fully secured on residential property		
	Individual provision £m	Collective provision £m	Total £m
At 1 December 2019	0.04	0.40	0.44
Movement	0.10	0.12	0.22
At 30 November 2020	**0.14**	**0.52**	**0.66**

Forbearance

A range of forbearance options are available to support customers who are in financial difficulty, if it can be demonstrated that this difficulty can be successfully overcome. The Society considers that if one or more of the options identified below can be agreed, this would always be preferable to taking possession of the customer's home. The main options offered are:

- Reduced monthly payment including interest only concession
- Payment holiday
- Extension of mortgage term
- Transfer to a new product which could help to reduce monthly payments

As noted in section 2.2, during 2020 the Society worked with a number of borrowers who needed to defer mortgage payments, under the Financial Conduct Authority (FCA) recommended framework, due to the Covid pandemic and associated income challenges. In line with FCA guidance, borrowers requesting payment deferrals were granted a payment holiday of up to six months. Only a small number of the borrowers who took a payment holiday during the current year remained on one at the year-end.

Further details of the Society forbearance strategy, and details of cases forborne at the year-end, are set out in Note 27 of the Annual Report & Accounts.

6 Remuneration disclosures

6.1 Remuneration Policy

The Society's remuneration policy and practice are designed to support the strategy and promote the long-term sustainable success of the Society. The committee exercises independent judgement and discretion when authorising remuneration outcomes, taking account of Society and individual performance and wider circumstances, and underpinned by the objective to promote the Society's long-term sustainable success. All remuneration schemes and policies are flexible enough to enable the committee to use discretion to override formulaic outcomes.

The Remuneration Committee reviews the Society's Remuneration Policy annually. In setting remuneration, the committee takes into consideration salaries payable and other benefits provided to executive directors and other senior management of building societies, that are similar in size and complexity, and other relevant organisations.

Non-executive director fees are reviewed annually by the Chief Executive and the Chairman of the Board. This review is based on comparable data from other building societies and similar financial service organisations. No director or individual is involved in setting their own remuneration. Remuneration comprises a basic fee, with supplementary payments for committee Chairs. Non-executive director fees are not pensionable, and the individuals do not participate in any incentive schemes or receive any other benefits. The remuneration of the Chairman of the Board is reviewed on an annual basis by the committee, again using comparable external data.

The remuneration for executive directors reflects responsibilities and roles within the Society. The overall policy of the Board, as recommended by the committee, is set out below:

- the remuneration of executive directors (consisting of basic salary, performance related bonus, pension arrangements and other benefits) should be competitive with those of other comparable organisations in the financial sector, in order to attract and retain high calibre individuals with the necessary skills and experience for the Society to succeed;

- part of the remuneration should be based on the Society's balanced scorecard performance in terms of financial, business and service performance compared to a range of objectives (including compliance with the Board's risk appetite), so as to encourage and reward behaviours which are in the long-term interests of the Society's members and other stakeholders; and

- performance reviews of the executive directors should be carried out at least annually, to assess their performance in meeting individual and strategic objectives.

Further information on the role of the Remuneration Committee in determining remuneration policy and practice is set out in the Remuneration Committee report within the Annual Report & Accounts.

6.2 Remuneration Code Staff and remuneration

It is the responsibility of the Society's Nomination & Governance Committee to identify Material Risk Takers (MRTs). The Remuneration Committee is responsible for setting the remuneration of the MRTs to ensure that their remuneration does not encourage inappropriate risk taking, and also to ensure they are rewarded appropriately and fairly to encourage enhanced performance and promote the long-term success of the Society. The Remuneration Committee maintains a list of the Society's MRTs, detailing their respective remuneration.

The Board considers MRTs to be those directors and staff whose professional activities have a material impact on the Society's risk profile. Accordingly, for the year ended 30 November 2020, 6 non-executive directors, 4 executive directors (including 2 directors who held office for part of the year), and 2 senior managers were designated as being MRTs in accordance with the Remuneration Code.

The following table sets out the aggregate remuneration for Remuneration Code staff for the period 1 December 2019 to 30 November 2020 and the number of beneficiaries.

	Number of staff	Fixed remuneration £000	Variable remuneration £000	Total remuneration £000
Non-executive directors	6	213	-	213
Executive directors	4	648	8	656
Other senior management	2	179	5	184
Total	**12**	**1,040**	**13**	**1,053**

Fixed remuneration includes, where applicable, pension contributions made by the Society on behalf of the employee and allowances in lieu of pension contributions, and the value of taxable benefits. Variable remuneration relates to an annual discretionary bonus in relation to the year-ended 30 November 2020 to be paid in March 2021.