PILLAR 3 DISCLOSURE

31 DECEMBER 2019

Leek United
BUILDING SOCIETY

Content

1. Introduction

Background

The Pillar 3 disclosure report is a summary statement designed to inform the reader of the risk management organisation and structure, and provide key information on capital, risk exposures and the general risk profile of the Society in accordance with the Capital Requirements Directive (CRD).

This framework represents the approach to capital adequacy for building societies governing the amount of capital required to be held by them in order to provide security for members and depositors. The Society seeks to ensure that it protects members' savings by holding sufficient capital at all times.

On 1 January 2014, the Basel Committee replaced the Basel II framework with the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD), commonly known as the Capital Requirements Directive IV (CRD IV), introducing a revised definition of capital resources and including additional capital and disclosure requirements. The rules are enforced in the UK by the Prudential Regulation Authority (PRA). On 27 June 2019, CRR II came into force amending CRR. As an amending regulation, the existing provisions of CRR apply unless they are removed by CRR II.

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

> **Pillar 1**: Minimum capital requirements, using a risk based capital calculation focusing particularly on credit and operational risk, to determine the capital resources requirement.
>
> **Pillar 2**: Internal Capital Adequacy Assessment Process (ICAAP), and Supervisory Review and Evaluation Process (SREP). The Board of the Society has undertaken an assessment of all of the key risks facing the Society and additionally has stress tested those risks to establish a level of additional capital to be held under Pillar 2.
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> **Pillar 3**: This document deals with the requirements under Pillar 3 (disclosure). The disclosures in this document meet the Society's obligations under Pillar 3 and are based on the CRD IV rules.

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

Scope of application

The disclosure requirements in this document apply to Leek United Building Society.

The statutory body responsible for the prudential supervision of the Society is the PRA and the PRA firm reference number is as follows:

PRA Number: 100014

The principal office of the Society is Leek United Building Society, 50 St. Edward Street, Leek, Staffordshire, ST13 5DL.

A list of all entities consolidated as part of the Society's results are set out below:

Group member	Activity
Leek United Building Society	Provision of mortgage and savings products, general insurance and financial services broking services.
Leek United Home Loans Ltd (Wholly owned subsidiary of Leek United Building Society)	Purchase and administration of mortgage portfolios. No purchases of portfolios have taken place in the last ten years and none are planned.
Leek United Financial Services Ltd (Wholly owned subsidiary of Leek United Building Society)	Provision of financial services up until 30 September 2016.
The Mortgage Outlet Ltd (Wholly owned subsidiary of Leek United Building Society)	Ceased trading on 31 December 2009.

There are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities among Leek United Building Society or its subsidiaries. In such circumstances, each individual Board must act with due regard to the interests of the relevant entity.

The Group adopted the 'Standardised approach' for Credit risk and the 'Basic Indicator Approach' for Operational risk. These approaches are explained in more detail in Section 4.

Basis and frequency of disclosures

The Society has in place a Pillar 3 Disclosure Policy that is subject to annual review and approval by the Board. It also has in place appropriate internal processes, systems and controls, including independent review by its second line risk function, to ensure that the disclosures are appropriate. This Pillar 3 document deals with the requirements for disclosure and the information provided here is in accordance with the rules and guidance contained in CRD IV and CRR. Unless stated otherwise, all data is as at 31 December 2019 (2018: 31 December 2018). This document will be updated at least annually and will be based on the Society's most recent audited financial statements.

A copy of the 2019 Annual Report and Accounts is available at www.leekunited.co.uk as is the Pillar 3 report.

These disclosures have been reviewed by the Audit Committee and approved by the Board. The disclosures are not subject to external audit; however, some of the information within the disclosures also appears in the Society's audited Annual Report and Accounts for the year ended 31 December 2019.

Governance Arrangements

Disclosure relating to governance arrangements under Article 435(1) of CRR, and in particular the declaration approved by the management body on the adequacy of risk management arrangements, are included in the Directors' Report on Corporate Governance on pages 25 to 30 of the 2019 Annual Report and Accounts.

Directors

A summary of the relevant experience of each of the Executive and Non-Executive Directors is given on pages 20 to 22 of the 2019 Annual Report and Accounts.

Confirmation of directorships held is disclosed in the Annual Business Statement, which is available on page 83 of the 2019 Annual Report and Accounts.

The policy regarding recruitment and diversity for selection of Directors is outlined on pages 31 and 32 of the 2019 Annual Report and Accounts.

2. Risk Management Policies and Objectives

The Board is committed to the traditional values of a mutual organisation. Central to these values are requirements to deliver the right outcomes for customers based on their needs. These core values also determine the Society's prudent approach to its business and its markets.

2.1. Business model

The Society's strategy is to operate using the traditional building society model, being the provision of mortgage finance for the purchase and improvement of both residential and buy to let property, alongside the funding of this through the Society's range of personal savings accounts from retail savers. The Society offers a mix of standard, discount and fixed rate mortgages, marketed through branches, direct sales and also via intermediaries. The Society holds prepositioned mortgage assets with the Bank of England and drawings have been made under the Term Funding Scheme during 2017-18, providing additional funding to support mortgage lending.

The Society provides an enhanced proposition via a whole of market Independent Financial Planning Service to existing and new members, through an arrangement with Wren Sterling. The service offering is primarily branch based face to face advice with some phone support. The Society also offers general insurance products, supplied by Royal Sun Alliance Insurance plc (RSA), to members.

The Society uses derivative financial instruments to manage and mitigate interest rate risk. Derivatives are used solely for this purpose and are not used for trading activity. The Risk Management Framework has been established to ensure that the Society has a strong robust risk management methodology and culture as part of the strategy to proactively manage risks in accordance with the Society's approach to risk.

With the exception of internal audit, which was fully outsourced to Deloitte LLP from mid 2016, and the services provided by Wren Sterling and RSA, the Society does not currently outsource any of its operations or functions. It is against this business model that the risk assessment has taken place.

Key metrics	**2019 £m**	**2018 £m**
Available Capital		
Common Equity Tier 1 (CET1) (£m)	66.4	65.5
Total Capital (£m)	66.8	65.9
Total Risk Weighted Assets (£m)	380.7	366.8
Risk based Capital Ratios as a % of RWA		
Common Equity Tier 1 ratio	17.4%	17.8%
Total Regulatory Capital ratio	17.5%	18.0%
Leverage Ratio		
Leverage ratio exposure measure (£m)	1,100.6	1,083.0
Leverage ratio	6.0%	6.0%
Liquidity Coverage Ratio	313%	251%

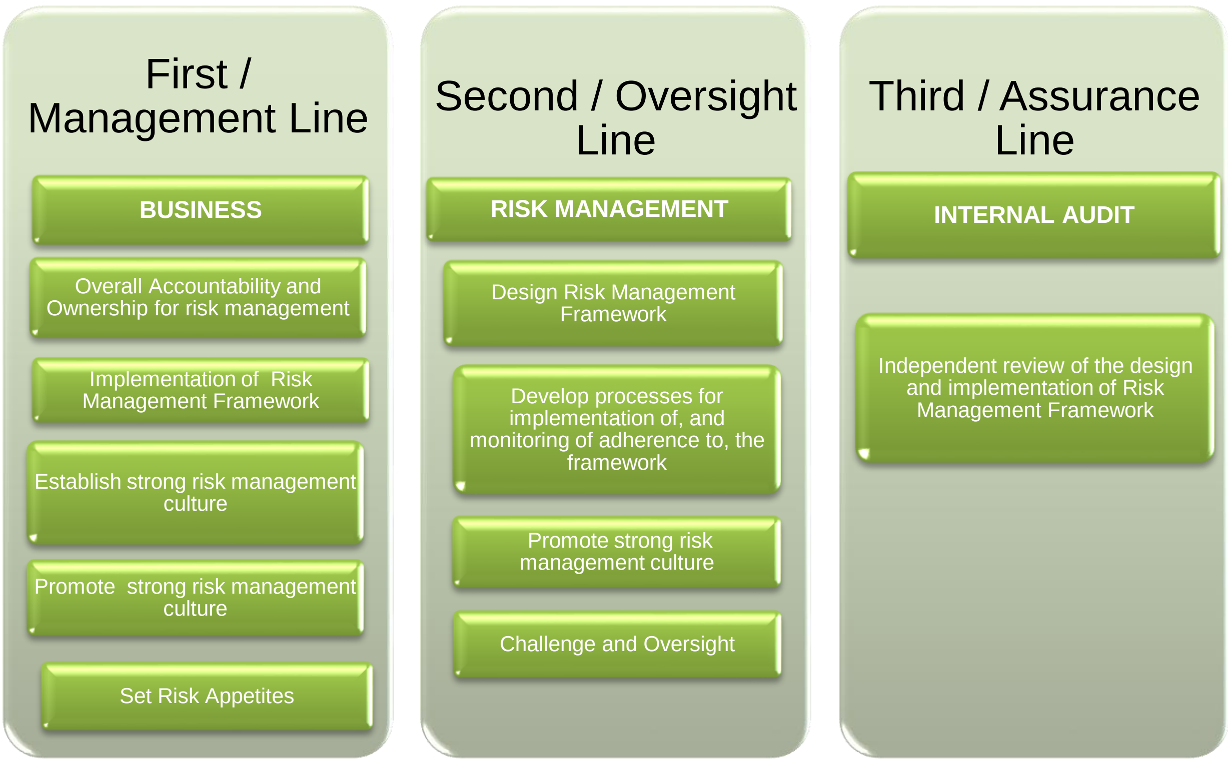
2.2. Risk Management Framework (RMF)

The Society's activities are governed by its constitution, principles and values. The Directors have also agreed a set of statements which describe the Board's risk appetite in terms of the principal risk categories: retail credit, strategic and capital, market, liquidity and funding, wholesale credit, conduct, pension, regulatory and legal and operational. Operational risk is further subdivided into financial crime, model and end user computing, financial reporting, information technology, product governance, data governance, people, third party supplier, change management and business continuity.

These Risk Appetite Statements enable the Board to formally communicate to the organisation the level of risk it is willing to accept to achieve Society objectives, both in terms of qualitative and quantitative measures. The Board's Risk Appetite Statement is as follows:

'As a mutual, Leek United Building Society operates so that the Board and Management are custodians of the interests of our members. Therefore we seek a prudent position in aggregate for our risk appetite acknowledging that the lower levels of risk will lead to lower levels of return. The suite of Risk Appetite Metrics quantifies this prudent approach across a range of risk categories with the aim to deliver sustainable member value for the Society.'

The final element of the framework is the formal structure for managing risk across the Group. This is based on the 'three lines of defence' model which is illustrated below.



2.3. Risk Governance Structure

The Board of Directors has overall responsibility for the Society's internal control system and for reporting its effectiveness to the members in the annual accounts. The Board is also responsible for establishing and overseeing the development of the culture of the Society and determining the nature and extent of the Society's risk appetites. The Board owns and approves both the overall and individual elements of the risk appetite for the Society including the Risk Management Framework (RMF).

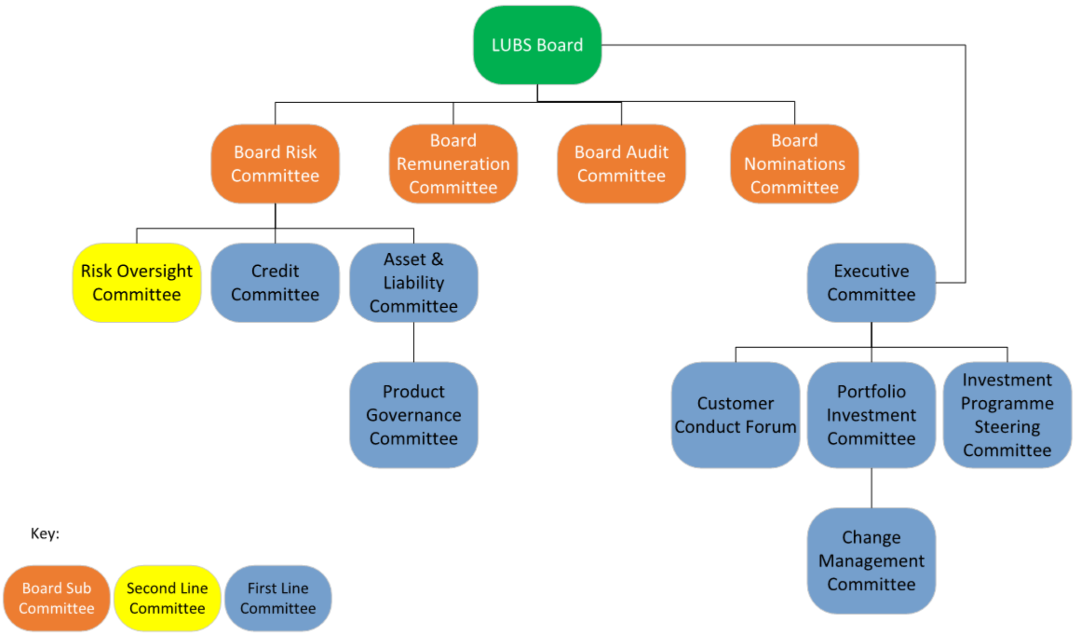
The Board has overall responsibility for ensuring the Society maintains adequate financial resources, both in terms of capital and liquidity, through review and approval of both the Society's ICAAP and ILAAP.

Supervision and direction is facilitated by the operation of a number of Board committees which meet regularly to consider issues specific to key business areas.

Management within each business area has day to day responsibility for the monitoring of risk within the framework and policies set by the Board.

The Board retains ultimate responsibility for ensuring that the Society operates within a framework of prudent and effective controls which enables risk to be assessed and managed, although the Board delegates certain responsibilities to the Board Risk Committee (BRC). These include overseeing and advising the Board on the current risk exposures of the Society and future risk strategy and overseeing all the principal risks as defined in the RMF, except pension risk which remains the responsibility of the Board. The BRC also review the effectiveness of the Society's internal controls and risk management systems and review the Society's overall risk assessment processes.

The diagram below illustrates the Society's risk management committee structure:



The Society's principal risks are managed through the following Committees:

Board	Board Risk Committee (BRC)	
	Risk Oversight Committee (ROC)	Asset & Liability Committee (ALCO)
Pension Risk	Operational Risk	Market Risk
	Conduct Risk	Liquidity and Funding Risk
	Regulatory and Legal Risk	Strategic and Capital Risk
	Retail Credit Risk	Wholesale Credit Risk

A summary of the role of the Board Committees and Management Committees follows:

The Board

The responsibilities of the Leek United Building Society Board include:

- Owning and approving the risk appetite for the Society.
- Determining the strategy and policies of the Society.
- Setting out the guidelines within which the business is managed and reviewing business performance.
- Ensuring that the Society operates within:
  - the Society rules
  - rules and guidance issued by relevant authorities including the PRA and FCA
  - all relevant laws
- Determining the nature and extent of significant risks and risk appetite.

The Board is required to meet at least nine times per year and met 11 times in 2019 (2018: 11 times).

Board Risk Committee

The Board Risk Committee (BRC), a sub-committee of the Board, assists the Board in carrying out its responsibilities relating to Risk and Compliance in the Society. It assists the Board in the oversight of the risk management framework to ensure there are adequate and effective controls in place for the identification, measurement, monitoring and reporting of risk in compliance with regulatory requirements.

BRC monitor the Society's key risk exposures against Board-approved risk appetites, in addition to reviewing current and emerging risks which could impact the delivery of the Society's corporate plan. The responsibilities of the BRC are as follows:

- To review the effectiveness of the Society's internal controls and risk management systems.
- To oversee and advise the Board on the current and emerging risk exposures of the Society and on future risk strategy.
- To oversee all the principal risks as defined in the Risk Management Framework, with the exception of pension risk which is directly overseen by the Board.

- To keep under review the Society's risk assessment processes which inform the Board's decision making, ensuring both qualitative and quantitative metrics are used and to review regularly and approve the parameters used in these measures and the methodology adopted.
- To set a standard for the accurate and timely monitoring of large exposures and certain risk types of critical importance.
- To advise the Board on proposed strategic transactions, ensuring that a due diligence appraisal of the proposition is undertaken, focussing in particular on risk aspects and the implications for the risk appetite and tolerance of the Society, taking independent external advice where appropriate and available.
- To review reports on any material breaches of risk limits and adequacy of the proposed actions.
- To review the Society's procedures for detecting fraud and the prevention of bribery.
- To review promptly all reports on the Society from the Chief Risk Officer (CRO).
- To review and monitor management's responsiveness to the findings and recommendations of the CRO.
- To ensure the CRO is given the right of unfettered direct access to the Chair of the Board as well as to the BRC.
- To give due consideration to laws and regulations, as well as other applicable rules, as appropriate.

During 2019, the Society continued to review and strengthen its risk and control environment, with the BRC overseeing the effectiveness of the RMF and reviewing the Operational Risk Framework (ORF). Operational Resilience has been a key focus for 2019, including the identification of key business services and any associated impact tolerances. During the year, the BRC reviewed the Society's principal risk policies of Liquidity & Funding Risk, Market Risk, Wholesale Credit Risk and Retail Credit Risk. It also reviewed the Society's Management Responsibilities Map to ensure this met the requirements of the Senior Managers & Certification Regime.

At 31 December 2019, the BRC comprised Richard Goddard (Chair), Keith Abercromby, Jane Kimberlin and John Leveson. The Executive Directors and CRO attend by invitation.

The BRC is supported by the Risk Oversight Committee (ROC), the Asset and Liability Committee (ALCO) and the Credit Committee (CC).

The ROC's main responsibility is to assess the management of operational and conduct risk together with legal and regulatory risk across the Society. Responsibilities of the ROC also include ensuring that both the Risk Management Framework and the Operational Risk Framework are embedded and that a robust risk culture exists across the Society.

The ALCO supervises the Group's treasury and financial risk management activities and advises and supports the Finance Director in carrying out his responsibilities, including the identification, management and control of the balance sheet risks and the overview and monitoring of relevant risk control frameworks. The management of market, liquidity and funding, strategic and capital, and wholesale credit risk has been delegated to the ALCO.

The CC oversees the effective credit risk management of the mortgage portfolio and ensures that the credit risk appetite framework is adhered to, in line with the agreed risk appetites.

Board Audit Committee

The Board Audit Committee (BAC), a sub-committee of the Board, has the following responsibilities:

- To review the effectiveness of the Society's first and second lines of defence and the internal controls and risk management systems which are used to identify, assess, manage and monitor financial and non-financial risks, to ensure compliance with the regulatory environment in which the Society operates.
- To review the adequacy and security of the Society's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The BAC shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.
- To review management's reports, and the Internal Auditor's reports, on the effectiveness of systems for internal financial control, financial reporting and risk management, including all aspects of the first and second lines of defence.
- To approve the appointment or removal of the supplier of Internal Audit services and to monitor the effectiveness of the supplier in its operation of the third line of defence.
- To monitor the integrity of the annual accounts of the Society, reviewing any significant financial judgements contained therein.
- To report to the Board on the content of the Annual Report, to determine if it is fair, balanced, and understandable and if it provides the information necessary for users to assess the Society's performance, business model and strategy.
- To review the Pillar 3 disclosure and recommend to the Board for approval.
- To make recommendations on the appointment, reappointment and removal of the External Auditor, via the Board, to the Society's members for consideration at the Annual General Meeting (AGM).
- To ensure that at least once every ten years, the external audit services contract is put out to tender to enable the BAC to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other firms.
- To develop and implement policy on the supply of non-audit services by the External Auditor to avoid any threat to auditor objectivity and independence, taking into account any relevant ethical guidance.

During 2019, the BAC reviewed the accuracy and completeness of the annual accounts in addition to reviewing reports from the Internal Auditor and satisfied itself on the independence and objectivity of the assurance provided. The Committee reviewed assurance plans from both the Risk & Compliance unit and Internal Audit along with the outcomes of their assurance work.

At 31 December 2019, the BAC comprised Keith Abercromby (Chair), Richard Goddard and Colin Kersley. The Executive Directors, the CRO and representatives from the internal and external auditors attend by invitation.

Board Remuneration Committee

The Board Remuneration Committee, a sub-committee of the Board, has the following responsibilities:

- To review and recommend to the Board the overarching Remuneration Policy for the Society as a whole.
- To determine the policy for Executive Director remuneration and to approve the total individual remuneration package for each Executive Director and member of senior

management. The attending members of management are not present when this matter is decided.

- To approve the overall increase that is appropriate in respect of the annual review of salaries.
- To set the fees payable to the Chair of the Board. The Chair of the Board is not present when this matter is decided.
- To recommend to the Board fees for other Non-Executive Directors and travel and associated expenses for all Non-Executive Directors.
- To approve the design of any incentive scheme proposed by the Chief Executive.
- To review contractual payments made to material risk takers on termination and any non-contractual payments made to other staff on termination.

During 2019, the Committee reviewed the Society's remuneration policy and approved the Directors' Remuneration Report. The Committee also approved the overall increase in respect of the annual review of salaries, approved the design of the 2020 incentive scheme, set the fees payable to the Chair of the Board (who was not present when this matter was decided), and recommended to the Board the fees for other Non-Executive Directors and travel and associated expenses for all Non-Executive Directors.

The Committee makes an annual report to members which can be found on page 41 of the Annual Report and Accounts. The report for the year ended 31 December 2019 considers the areas set out in the UK Corporate Governance Code relating to remuneration in so far as they are considered relevant to building societies and the FCA Remuneration Code. A revised Corporate Governance Code was issued in July 2018 which applies to accounting periods beginning on or after 1 January 2019.

The Committee is composed entirely of Non-Executive Directors and as at 31 December 2019, comprised John Leveson (Chair), Rachel Court and Jane Kimberlin. The Chief Executive, Finance Director and HR Director attend the Committee by invitation.

Board Nominations Committee

The Board Nominations Committee, a sub-committee of the Board, has the following responsibilities:

- To periodically review the structure, size and composition of the Board including a review of the skills, knowledge and experience mix of the members of the Board in order to ensure that such mix remains relevant to the business of the Society at all times.
- To give full consideration to succession planning for Directors and other senior executives, taking into account the challenges and opportunities facing the Society, and the skills and expertise that will be needed on the Board in the future.
- To ensure that appropriate arrangements are in place for the recruitment and selection of suitably qualified persons to act as Directors (both Non-Executive and Executive) of the Society.
- To identify any role, other than that of Director, for which the Committee deems it appropriate to assume responsibility for its recruitment and selection.

At 31 December 2019, the Committee comprised Rachel Court (Chair), Richard Goddard, Colin Kersley and Andrew Healy.

2.4. Principal Risks

The principal risks facing the Society and the procedures put in place to manage them are described below.

2.4.1. Retail Credit Risk

Retail credit risk is the risk of losses arising from a debtor's failure to meet their legal and contractual obligations, potentially arising from mortgage customers falling into arrears or insufficient security value.

The Society operates within appropriate policies and risk appetites and performance is monitored closely. Our prudent lending policy means our mortgage book is of high quality. Each application is individually underwritten to ensure that loans are affordable. This is evidenced by our low level of arrears.

Exposure to retail credit risk is primarily limited to the provision of loans secured on property within the UK. All mortgage loan applications are reviewed by an individual underwriter supported by the use of application scorecards and are assessed with reference to the Society's retail credit risk appetite statement, which is approved by the Board Risk Committee. Exposure to retail credit risk is carefully monitored by the Credit Committee, which reports to the Board Risk Committee.

Our risk appetite is as follows:

"The Society will adopt a prudent lending approach to our mortgage customers which will ensure that our default rates are low and do not impact on earnings or capital."

2.4.2. Wholesale Credit Risk

Wholesale credit risk is the risk of losses due to a wholesale Treasury counterparty being unable to meet their financial obligations. The Society's exposure to wholesale credit risk results from investments in financial instruments used to manage its liquidity portfolio, and from transactions to hedge its interest rate risk.

The Society's Treasury Policy Statement and operational limits set out the criteria and boundaries within which wholesale lending can be undertaken. Each counterparty is required to meet strict external ratings thresholds as well as satisfying internal assessments that consider balance sheet strength, reputational issues and the results of regulatory stress tests.

The risk from hedging transactions is mitigated by the placing and receiving of cash collateral equal to the exposure.

The primary source for obtaining information on wholesale asset counterparties' creditworthiness is External Credit Assessment Institutions (ECAIs). The Society uses ratings provided by Fitch.

The ALCO is responsible for approving credit limits on Treasury counterparties within the parameters set out in the Treasury Operating Limits document which is reviewed annually.

Our risk appetite is as follows:

"The Society will adopt a prudent approach to lending to wholesale counterparties which will ensure that default rates are low and there is no impact on earnings or capital."

2.4.3. Strategic and Capital

Strategic and capital risk is the risk that the strategic direction of the Society and decisions made result in a financial loss and have a detrimental impact on capital resources.

The Society has an established corporate planning process, which is subject to rigorous challenge which sets the overall direction for the Society. This is supported by conducting an Internal Capital Adequacy Process (ICAAP) at least annually to assess the Society's current and projected capital requirements. This demonstrates to the Board and regulators that the Society has sufficient capital for its business plans and the level of risk being taken. The Non-Executive Directors provide a robust level of challenge over Executive proposals.

Our risk appetite is as follows:

"The Society will ensure that the strategic direction delivers a sufficient return that enables it to deliver capital which provides long term growth as well as financial stability for our members."

2.4.4. Market Risk

Market risk is the risk of losses arising from changes in market rates or prices.

The main exposure for the Society is interest rate risk resulting from funding fixed rate mortgages with variable rate savings products. Additionally, the Society is exposed to basis risk whereby the interest rate on assets and liabilities with similar repricing periods move by varying degrees, eg assets linked to industry benchmarks funded by variable savings products.

The Society has limited appetite for market risk but acknowledges that, as a mortgage lender, it is not possible or practical to eliminate all risk. To restrict market risk as much as possible the Society has set clearly defined limits within which risk must be managed. These are closely monitored and reported to senior management and the Board on a monthly basis.

Interest rate risk is managed by utilising natural hedging opportunities that occur within the balance sheet or entering hedging transactions with external counterparties.

Our risk appetite is as follows:

"The Society will manage our interest rate and basis risk positions to ensure that losses due to adverse movements in market rates do not impact significantly over and above our forecast market expectations."

2.4.5. Liquidity and Funding Risk

Liquidity and funding risk is the risk that the Society is unable to meet its financial obligations as they become due and, as a consequence, is unable to support normal business activity and fails to meet liquidity regulatory requirements. There is potential risk to the level of liquidity from an extreme scenario of depositors withdrawing their funds.

The Society's Board has set strict limits in respect of liquidity, which exceed regulatory requirements. These, along with key early warning indicators, are monitored on a daily basis in order to highlight potential issues and allow timely management action.

Regular stress testing of severe, but plausible, scenarios is undertaken on a regular basis. This ensures that we remain prepared and have appropriate contingency measures in place.

The risk is managed principally by holding cash and other easily realisable liquid assets (high quality liquid assets) and managing funding maturities to avoid bunching, as well as ensuring availability to wholesale funding if required.

In order to manage this risk the Society operates a liquidity policy which ensures that liquid assets are appropriately invested to achieve a sensible balance between realisability and prudence. The policy also lays down strict guidelines on counterparty criteria and sector limits to ensure that liquid capital investments are of a high quality (see section 5.1.2 on Wholesale Credit Risk for more details). The Society performs stress tests to ensure that liquidity levels remain at operational levels in exceptional circumstances. Further information on the monitoring of liquidity and funding risk is contained in section 6.

Our risk appetite is as follows:

"The Society will maintain sufficient liquid resources, over and above the financial minimum, that give our members confidence that we have the ability to meet our financial obligations as they fall due. The Society will maintain sufficient retail deposits to fully support and fund retail lending at all times. The Society will additionally utilise wholesale or central bank funding when appropriate to support Treasury or liquidity holdings but will ensure that wholesale funding is managed such that an appropriate balance of funding from retail and wholesale sources is maintained. "

2.4.6. Conduct Risk

Conduct risk is the risk that the Society does not demonstrate that it is putting the customer's interest at the very heart of the business. This can manifest itself through literature that is confusing or misleading and through product terms & conditions that are unnecessarily restrictive or penal.

The Society, being a member owned organisation, is committed to upholding the highest standards and treating all members & customers fairly. The Board has set out a clear set of values that drives a culture and behaviours that puts the customer first.

In line with its stated appetite, the Society restricts its activities to areas where appropriate expertise is in place. Customer facing and operational departments provide first line management of conduct risk. All colleagues complete mandatory conduct risk training and there is a Board approved Conduct Risk Policy in place.

The Society undertakes first and second line monitoring of Conduct Risk and also has a Customer Conduct Forum as part of its Board approved governance committee structure. The Society maintains a Product Governance Policy which encompasses the need to offer products that meet the needs of our existing and new members.

Our risk appetite is as follows:

"The Society will ensure that we put our customers at the heart of our business operations to deliver an excellent customer service."

2.4.7. Pension Risk

Pension risk is the risk of financial deficit in the Society's defined benefit scheme. The possibility that the Society will have to pay more than expected into its employees' pension schemes which could be impacted by factors such as mortality rates, asset values and yield prices.

The defined benefit scheme is closed to further accrual. The Society works closely with the pension trustees to try and seek further de-risking opportunities as conditions allow.

The Society recognises its pension scheme deficit (on an accounting basis) within capital resources and additionally holds extra capital for pension risk stresses as part of its ICAAP.

Our risk appetite is as follows:

"The Society will ensure that it can meet our contractual and regulatory requirements so that it can meet its existing and future liabilities."

2.4.8. Operational risk

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

The Society manages these risks as an integral part of its operations, utilising controls, such as the Risk & Control Self-Assessment tool and the Risk Registers. Given the broad nature of operational risk, consideration has been given to each aspect of the risk and operational risk has been sub-divided into a number of secondary risk policies, all of which are managed with the same methodology as each of the principal risks.

The Society has disaster recovery and business continuity plans in place, that are also tested, to mitigate the impact of loss or damage to buildings, systems or staff caused by natural disaster or other event.

The Society maintains appropriate insurance cover which is reviewed on at least an annual basis.

The strategy for operational risk management is to establish consistent mechanisms and processes across the Society that deliver best practice operational risk management and associated benefits to the organisation, supporting our Vision Statement.

Our risk appetite is as follows:

"The Society will maintain efficient operational processes and controls to ensure that we can optimise our resources and reduce the impact of operational risks on the Society's performance and reputation."

2.4.9. Regulatory and Legal Risk

This is the risk of fines, public censure, limitation on business, or restitution costs, arising from failing to understand, interpret, implement and comply with UK and EU regulatory requirements.

The Society, as a mutual organisation, is committed to fulfilling all its regulatory, legal and social obligations. A robust process to monitor all regulatory change is in place, with regular updates provided to senior management and Board committees. The Three Lines of Defence model also provides oversight, challenge and independent assurance.

Our risk appetite is as follows:

"The Society will maintain a robust process to ensure that regulatory and statutory requirements are met within agreed timeframes."

2.5. Risk Measurement and Reporting

The provision and reporting of comprehensive data is essential in allowing management and 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.

Models are used to manage, model and measure key risks such as interest rate risk, basis risk and concentration risk. Other models allow forward looking margin risk scenarios to be run in order to assess the impact of different interest rate movements on net interest income. Exposures against policy triggers and limits are provided monthly to ALCO and reported to the next Board meeting.

A forward looking five year corporate plan is produced annually to measure the impact of current performance, future plans and liquidity and funding assumptions on future profit and loss, balance sheet, capital resource requirements and key financial ratios. The results of the plan are reported to the Board for approval.

A comprehensive set of limits and triggers is in place in relation to lending limits and exposures against the triggers and limits are reported monthly to the Risk Oversight Committee to measure against appetite and to consider the likely future trajectory of exposures against limits.

2.6. Stress Testing and Planning

The Board agrees a number of stress testing scenarios that the business uses to ensure the consideration of extreme but plausible events which could impact on the Society. The modelling of these scenarios helps the Society to understand the impact on profitability, balance sheet, capital and liquidity positions. Reverse stress tests are also undertaken in which scenarios are specifically designed to result in the business model being no longer viable.

Stress testing across the Society's principal risks forms an integral part of the corporate planning process, liquidity forecasting and capital planning.

The results of these stress tests feed into the ICAAP and the corporate planning process and inform the Society's risk appetite statements and measures.

Liquidity stress tests are undertaken monthly and the results reported to ALCO and the Board. These stresses are designed to highlight any shortfalls in the Society's liquidity holdings over a range of time horizons. Each of the tests sets assumptions for the run-off rates of retail funding.

The liquidity stress tests allow management and the Board to assess the impact of adverse scenarios upon liquidity and funding levels and are used in determining policy and contingency planning. The results of the tests are also used to further inform the Society's risk appetite, the framework of policy limits applied to Treasury positions and set the context for the risk assessments and contingency liquidity and funding plans within the ILAAP.

Margin risk scenarios are run regularly to model and evaluate the impact of adverse but credible changes in collective and individual interest rates on net interest income. The results of the analysis allow management and the Board to examine the effects of margin risk against the policy limit and, if necessary, provide sufficient lead time for corrective action to be taken.

The pension obligation stress test is undertaken annually by the scheme actuary and makes assumptions about discount rates, mortality rates, asset values and cash commutation.

A range of operational risk scenarios are created for the ICAAP covering a broad range of risks, with the potential financial impacts of these being assessed.

2.7. Principal Risks and Controls

The Society uses a number of strategies and processes to manage, hedge and mitigate risks arising from the business model.

In relation to residential mortgage credit risk, the basic form of mitigation is to undertake a thorough assessment of the borrower's ability to service the proposed mortgage at the initial pay rate and at a stressed rate. All mortgages are individually underwritten. All mortgage lending is supported by an appropriate form of valuation using an independent firm of valuers. Borrowers are subject to mortgage conditions that impose obligations on both parties but provide the Society with rights to enforce its security should it need to.

Where an advance exceeds 80% loan to value (LTV) of the purchase price or valuation of the property, whichever is the lower, Mortgage Indemnity Guarantee Insurance will be arranged. This partially indemnifies the Society, for a period of 7 years, against loss incurred as a consequence of exceeding normal lending limits. The period can be extended at a pre-agreed premium for a further 3 years should the Society choose to.

Treasury credit risk is mitigated by monitoring external credit ratings.

Liquidity and funding risk is mitigated by careful monitoring of the liquidity and funding position and through relevant information provided to ALCO. The Society aims to maintain sufficient liquid resources, over and above the financial minimum, that gives members confidence that we have the ability to meet obligations as they fall due.

The Society has prepositioned mortgage assets with the Bank of England allowing access, if required, to wholesale funding through the Sterling Monetary Framework (SMF). During 2017 and 2018, drawings have been made under the Term Funding Scheme (one of the schemes available under the SMF), providing funding to support mortgage lending.

Operational and conduct risks are mitigated through well-defined and documented policies and procedures through staff training. Risk and control registers are used to identify and capture significant risks and key controls and these are reviewed on an ongoing basis. Risk performance is regularly monitored and risk incident reports are submitted to ROC monthly and subsequently to BRC if required. The risk function meets with senior managers on a regular basis to review incidents and discuss the control environment.

The Society has disaster recovery and business continuity plans in place to mitigate the impact of loss or damage to buildings, systems or staff caused by natural disaster or other event. Where appropriate the Society also holds relevant insurances to mitigate operational risk.

The Society is exposed to interest rate risks through offering fixed rate mortgage and savings products. Where possible, fixed rate mortgages and savings are matched against each other. Where this is not possible, the Society uses derivatives (interest rate swaps) to offset the interest rate risks arising from these products. Exposures to interest rate risk and basis risk are monitored regularly. The effectiveness of the Society's hedging approach is assessed monthly through calculating the full impact of an interest rate stress. The results of this are presented to ALCO and the Board.

The Society monitors the continuing effectiveness of hedges and mitigates in a number of ways. Treasury positions are monitored on a daily and monthly basis and exposures are reported to ALCO and Board on a monthly basis. The Treasury Policy Statement and Treasury Operating Limits document are reviewed at least annually.

3. Capital Resources and Ratios

The objective of the CRD IV regulation is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress. This is to be achieved through increasing both the quality and quantity of regulatory capital firms will be required to hold.

The Society's capital resources consist of:

- Retained earnings, comprising accumulated profits and deductions relating to any pension fund deficit
- Accumulated other comprehensive income, comprising revaluation reserve and available for sale reserve
- Common Equity Tier 1 (CET1) deductions, comprising prudent valuation adjustment relating to assets held at market value and net book value of intangible assets
- Tier 2 capital, comprising collective mortgage impairment allowance

	31 December 2019 £m	31 December 2018 £m	Source based on reference letters of the balance sheet under the regulatory scope of consolidation
Common Equity Tier 1 capital: instruments and reserves			
Retained earnings	65.5	64.7	
Accumulated other comprehensive income (and other reserves)	1.1	1.0	
Common Equity Tier 1 capital before regulatory adjustments	**66.6**	**65.7**	
Common Equity Tier 1 capital: regulatory adjustments			
Prudent valuation adjustments	(0.1)	(0.1)	
Other intangibles other than mortgage servicing rights (net of related tax liability)	(0.1)	(0.1)	(a)
Total regulatory adjustments to Common Equity Tier 1	**(0.2)**	**(0.2)**	
Common Equity Tier 1 capital (CET1)	**66.4**	**65.5**	
Additional Tier 1 capital (AT1)	**-**	**-**	
Tier 1 capital (T1 = CET1 + AT1)	**66.4**	**65.5**	
Tier 2 capital: instruments and provisions			
Provisions	0.4	0.4	(b)
Tier 2 capital (T2)	**0.4**	**0.4**	
Total regulatory capital (TC = T1 + T2)	**66.8**	**65.9**	
Total risk weighted assets	**380.7**	**366.8**	

The net book value of intangible assets and the prudent valuation adjustment are deducted from CET1 and Tier 1 Capital. There are no deductions required from Tier 2 capital. Deferred tax assets of £0.1m (2018: £0.3m) are below the 10% CET1 regulatory threshold and so are risk weighted at 250%. There is no difference in the Society's capital resources under both the transitional and final rules.

The total CET1 capital figure of £66.4m (2018: £65.5m) comprises retained earnings, revaluation reserve, available for sale reserve, prudent valuation adjustments and intangible assets, as shown in the above table. The prudent valuation adjustment reflects 0.1% of the value of assets held at market value. The Tier 2 capital of £0.4m (2018: £0.4m) reflects the collective mortgage impairment allowance held.

Regulatory Capital Buffers

Under CRD IV, institutions are required to meet the following own funds requirements: a common Equity Tier 1 capital ratio of 4.5%, a Tier 1 capital ratio of 6% and a total capital ratio of 8%. These form the institution's Pillar 1 requirements. Pillar 2A covers risks that are not fully addressed by Pillar 1. In addition to the minimum capital requirements, CRD IV requires institutions to hold capital buffers that can be utilised to absorb losses in stressed conditions. All buffers must be met with CET1 resources.

The table below sets out capital ratios and the level of capital buffers required to be held:

	31 December 2019 £m	**31 December 2018 £m**
Common Equity Tier 1 (as a percentage of risk weighted assets)	**17.4%**	**17.8%**
Tier 1 (as a percentage of risk weighted assets)	**17.4%**	**17.8%**
Total capital (as a percentage of risk weighted assets)	**17.5%**	**18.0%**
Institution specific buffer requirement (capital conservation buffer plus countercyclical buffer requirements, expressed as a percentage of risk weighted assets)	**3.5%**	**2.875%**
Of which: capital conservation buffer requirement	2.5%	1.875%
Of which: bank specific countercyclical buffer requirement	1.0%	1.0%
Common Equity Tier 1 (as a percentage of risk weighted assets) available after meeting the Society's minimum capital requirements	**9.6%**	**10.0%**
Amounts below the thresholds for deduction (before risk weighting)		
Deferred tax assets arising from temporary differences (net of related tax liability)	0.1	0.3
Applicable caps on the inclusion of provisions in Tier 2		
Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	0.4	0.4
Cap on inclusion of provisions in Tier 2 under the standardised approach	4.4	4.3

Capital Conservation Buffer

The capital conservation buffer is designed to ensure that institutions build up capital buffers outside of times of stress that can be drawn upon if required. As at 31 December 2019, the capital conservation buffer was 2.5%.

Countercyclical Capital Buffer (CCyB)

The CCyB requires financial institutions to hold additional capital to reduce the build-up of systemic risk in a credit boom by providing additional loss absorbing capacity and acting as an incentive to limit further credit growth. Each institution's specific countercyclical buffer rate is a weighted average of the countercyclical capital buffers that apply in the jurisdictions where the relevant credit exposures are located. The Financial Policy Committee (FPC) is responsible for setting the UK CCyB rate (for credit exposures located in the UK), and has indicated that this will be set at 1% in normal economic conditions. As at 31 December 2019 the UK CCyB was set to 1%.

The following table shows the geographical distribution of credit risk exposures relevant for calculating the countercyclical capital buffer. Note: the table only includes private sector credit exposures and therefore does not include exposures to the Bank of England, central government or Multilateral Development Banks (all of which are risk weighted at zero).

Geographical breakdown	**Counter-cyclical capital buffer rate %**	**Exposure values and/or risk weighted assets used in the computation of the countercyclical capital buffer**		**Bank specific counter-cyclical capital buffer rate %**	**Counter-cyclical buffer amount £m**
		Exposure values £m	**Risk weighted assets £m**		
2019					
UK	1.0%	965.1	354.4		
Spain	-	1.0	0.5		
USA	-	-	-		
Sum[1]		**965.1**	**354.4**		
Total		**966.1**	**354.9**	**1.0%**	**3.5**
2018					
UK	1.0%	917.0	333.9		
Australia	-	8.0	1.6		
Netherlands	-	5.0	1.0		
Canada	-	5.0	1.0		
Germany	-	5.0	1.0		
Sweden	2.0%	5.0	1.0		
Spain	-	1.3	0.6		
Sum[1]		**922.0**	**344.9**		
Total		**946.3**	**340.1**	**1.0%**	**3.4**

[1] Sum includes exposures/risk weighted assets in jurisdictions with a non-zero countercyclical buffer rate

As at 31 December 2019, the total non-UK risk weighted asset exposure was less than 2%. The Society therefore applies the UK CCyB rate of 1.0% to all exposures and its weighted average countercyclical buffer rate is therefore 1% (2018: 1%).

The following table reconciles the total regulatory capital set out in the above table to the balance sheet reported in the published financial statements of the Society:

	Balance sheet as in published financial statements 31 December 2019 £m	**Under regulatory scope of consolidation 31 December 2019 £m**	**Refer-ence**
Assets			
Cash in hand and balances with the Bank of England	102.6	102.6	
Loans and advances to credit institutions	11.3	11.3	
Debt securities	125.7	125.7	
Derivative financial instruments	0.3	0.3	
Loans and advances to customers	848.7	849.1	
Of which: loans fully secured on residential property and land	*847.4*	*847.4*	
Of which: fair value adjustment for hedged risk	*0.9*	*0.9*	
Of which: effective interest rate adjustment	*0.8*	*0.8*	
Of which: individual impairment	-	-	
Of which: collective provision	*(0.4)*	-	*(b)*
Fixed assets	2.2	2.1	
Of which: tangible fixed assets	*2.1*	*2.1*	
Of which: other intangibles	*0.1*	-	*(a)*
Other assets	0.2	0.2	
Prepayments and accrued income	0.4	0.4	
Total assets	**1,091.4**	**1,091.7**	
Shares	873.2	873.2	
Amounts owed to credit institutions	132.3	132.3	
Amounts owed to other customers	16.2	16.2	
Derivative financial instruments	1.3	1.3	
Other liabilities	0.4	0.4	
Accruals and deferred income	0.5	0.5	
Provisions for liabilities	-	-	
Retirement benefit obligations	0.9	0.9	
Total liabilities	**1,024.8**	**1,024.8**	
General reserve	65.5	65.8	
Revaluation reserve	1.0	1.0	
Available for sale reserve	0.1	0.1	
Total reserves	**66.6**	**66.9**	

Details of the prudent valuation adjustments for all assets measured at fair value is set out below:

	Interest Rates	**Total £m**	**Of which: In the banking book £m**
Closeout uncertainty, of which:	(0.1)	(0.1)	(0.1)
Mid-market value	(0.1)	(0.1)	(0.1)
Total adjustment	(0.1)	(0.1)	(0.1)

The prudent valuation adjustment is comprised solely of closeout uncertainty for interest rates. This relates to the portfolio of fixed rate debt securities held for liquidity purposes and interest rate derivatives.

4. Capital Adequacy

Capital Management

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain the future development of the business. The Board manages the Society's capital and risk exposure to maintain capital in line with regulatory requirements. This is subject to regular stress tests to ensure the Society maintains sufficient capital for future possible events.

The Society's capital requirements are also monitored by the PRA.

Internal Capital Adequacy Assessment Process (ICAAP)

The Society's Internal Capital Adequacy Assessment Process (ICAAP) ensures that the capital resources of the Society are sufficient to support its business plan both in normal and stressed conditions.

The process reviews objectives and projects the capital requirement for all material risks, both in normal and stressed conditions, over the planning period. This ensures that the potential risk and associated capital requirements are consistent with the capital resources available. The ICAAP is submitted to the Board for approval with the necessary supporting stress testing. Having regard to the projected capital requirement within the ICAAP and Total Capital Requirement provided by the PRA, the Board sets a risk appetite and internal limit for the minimum amount of capital resources. This appetite is in excess of the level required by the PRA providing a further amount of capital above the required regulatory level.

The Society uses the standardised approach to calculate credit risk weightings. This is as follows:

Pillar 1 credit risk capital requirement = Exposure Value x Risk Weighting x 8%

The risk weighting applied will vary depending on whether the asset is retail or wholesale.

For retail assets, variables such as LTV and security will impact the risk weighting. Wholesale assets are dependent on counterparty, duration and credit rating.

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

Credit ratings are reviewed regularly and are reported to the monthly ALCO meeting. Consideration is given to selling holdings where ratings fall below the minimum criteria for a counterparty.

Overview of Risk Weighted Assets and Capital Requirements

The following table shows the Society's risk weighted assets and minimum capital requirements under Pillar 1 as at 31 December 2019:

	Risk Weighted Assets		**Minimum Capital Requirements**
	31 December 2019 **£m**	**31 December 2018** **£m**	**31 December 2019** **£m**
Credit risk (excluding counterparty credit risk)	354.9	340.0	28.4
Of which: standardised approach (SA)	354.9	340.0	28.4
Credit valuation adjustment (CVA)	0.8	1.8	0.1
Operational risk	25.0	25.0	2.0
Total	**380.7**	**366.8**	**30.5**

Minimum capital requirements relate to RWA multiplied by 8% to give Pillar 1 capital requirements. The capital resources of the Society at 31 December 2019 totalled £66.8m (2018: £65.9m). For operational risk the Society has adopted the Basic Indicator Approach (BIA) under Pillar I, which is based upon a 15% charge of the average of the last three years' net income.

A detailed breakdown of credit risk is provided in section 5.1 and operational risk is covered in section 5.2.

Leverage Ratio

The CRD IV framework requires firms to calculate a simple, transparent, non-risk based leverage ratio that is supplementary to the risk based capital requirements. The leverage ratio measures the relationship between Tier 1 capital resources (per Section 3) and the leverage exposure. For the Society, Tier 1 Capital is the same as Common Equity Tier 1 Capital.

The exposure measure is the total on and off balance sheet exposures, with off balance sheet items (e.g. mortgage pipeline) converted into credit exposure equivalents through the use of credit conversion factors resulting in a reduced exposure measure. The calculation is based on the balance sheet at 31 December.

The Basel Committee has set a minimum 3% leverage ratio.

The risk of excessive leverage is managed through regular monitoring and reporting of the leverage ratio. Given that the Society's balance sheet is focussed on residential mortgage lending, it is considered that the risk of material unexpected movements in the leverage exposure measure is limited.

Summary Reconciliation of Accounting Assets and Leverage Ratio Exposures	**31 December 2019 £m**	**31 December 2018 £m**
Total Assets per Published Financial Statements	1,091.4	1,071.4
Adjustments for Derivative Financial Instruments[1]	2.0	3.7
Adjustment for Off-Balance Sheet Items (ie conversion to credit equivalent amounts of off-balance sheet exposures)[2]	7.1	7.6
Other Adjustments[3]	0.1	0.3
Leverage Ratio Total Exposure	1,100.6	1,083.0
Leverage Ratio[4]	6.0%	6.0%

Note 1: Represents the positive fair value plus 'potential future exposure' of interest rate swaps
Note 2: Mortgage business offered is converted at a factor of 20% for capital and leverage purposes
Note 3: The balance sheet exposure represents the balance sheet assets in the audited financial statements, adjusted to exclude the collective mortgage impairment allowance of £0.4m (2018 £0.4m), the fair value of derivative assets which are included in the Derivative Financial Instruments exposure of £0.3m (2018: £nil) and intangible assets deducted from reserves of £0.1m (2018: £0.1m).
Note 4: For the Society, there is no difference between assessing capital and leverage under the transitional rules and the final rules.

At 31 December 2019 the leverage ratio of the Society was well above the 3% regulatory minimum of 6.0% based on the final rules. The ratio has remained stable, with growth in assets being matched by growth in Tier 1 Capital.

Leverage Ratio Common Disclosure	31 December 2019 £m	31 December 2018 £m
On-Balance Sheet Exposures (excluding derivatives and SFTs)		
On-Balance Sheet Items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	1,091.6	1,071.8
Asset Amounts deducted in determining Tier 1 Capital	(0.1)	(0.1)
Total On-Balance Sheet Exposures	**1,091.5**	**1,071.7**
Derivative Exposures		
Replacement cost associated with all Derivatives Transactions (ie net of eligible cash variation margin)	0.3	2.0
Add-on Amounts for Potential Future Exposures associated with all Derivatives Transactions (mark-to-market method)	1.7	1.7
Total Derivative Exposures	**2.0**	**3.7**
Other Off-Balance Sheet Exposures		
Off-Balance Sheet Exposures at gross notional amount	35.5	38.2
Adjustments for conversion to Credit Equivalent Amount	(28.4)	(30.6)
Other Off-Balance Sheet Exposures	**7.1**	**7.6**
Capital and Total Exposure Measure		
Tier 1 Capital	66.4	65.5
Leverage Ratio Total Exposure Measure	1,100.6	1,083.0
Leverage Ratio		
Leverage Ratio	6.0%	6.0%

Split-up of On Balance Sheet Exposures (excluding derivatives, SFTs and exempted exposures)	31 December 2019 £m	31 December 2018 £m
On-Balance Sheet Exposures (excluding derivatives, SFTs and exempted exposures), of which:	1,091.5	1,071.7
Banking book exposures, of which:	1,091.5	1,071.7
Exposures treated as Sovereigns	116.9	118.8
Multilateral Development Banks	17.2	17.2
Institutions	104.8	104.5
Secured by Mortgages of Immovable Properties	835.2	818.7
Retail Exposures	10.5	6.9
Exposures in Default	1.8	0.6
Other Exposures	5.1	5.0

Country by Country Reporting

CRD IV also introduced a requirement for country by country reporting. The objective of this is to provide increased transparency regarding the source of the financial institution's income and the locations of its operations.

The full Country by Country reporting disclosures for Leek United can be found in the Annual Report and Accounts.

5. Credit Risk and Operational Risk

As set out on page 9, the Society has nine principal risks being:

- Retail Credit risk
- Wholesale Credit Risk
- Liquidity and Funding risk
- Market risk
- Strategic and Capital risk
- Regulatory and Legal risk
- Conduct risk
- Pension risk
- Operational risk

Liquidity and Funding risk, Market risk, Strategic and Capital risk, Regulatory and Legal Risk, Conduct risk and Pension risk are discussed in detail in section 2. Liquidity and Funding risk is also covered in section 6.

Retail and Wholesale Credit risk and Operational risk are discussed further below.

5.1. Credit Risk

Credit risk is the risk of losses arising from a debtor's failure to meet their legal and contractual obligations, potentially arising from mortgage customers falling into arrears, insufficient security value or the default of a wholesale Treasury counterparty who becomes unable to meet their financial obligations.

The Society operates within appropriate policies and risk appetites and performance is monitored closely. Our prudent lending policy means our mortgage book is of a high quality. Each application is individually underwritten to ensure that loans are affordable. This is evidenced by our low level of arrears.

Where an advance exceeds 80% LTV of the purchase price or valuation of the property, whichever is the lower, Mortgage Indemnity Guarantee Insurance (MIG) will be arranged. This partially indemnifies the Society, for a period of 7 years against loss incurred as a consequence of exceeding normal lending limits. Prior to 1 December 2017, the threshold was set at borrowing exceeding 75% of the value of the property, for a minimum period of 10 years.

There is potential risk from the failure of a wholesale counterparty, however our Treasury policies also mean that we set tight criteria over where we are prepared to place excess funds. The criteria reflect long term ratings published by external credit rating agencies, which are an indication of a company's creditworthiness.

Credit risk weightings are determined by the "Standardised Approach" following the approach set out in Part 3, Title 2 in Chapter 2 of CRR.

The table overleaf details the minimum capital requirement by standardised credit exposure class at 31 December 2019:

As at 31 December 2019

Pillar 1 Capital Resource Requirement	**Exposure**	**Risk Weighted Assets**	**Minimum Capital Requirements**
Central Government and Bank of England	116.9	-	-
Multilateral development banks	17.2	-	-
Credit institutions	104.8	44.3	3.5
Total non-cash liquidity exposures	**238.9**	**44.3**	**3.5**
Non-residential and business - performing loans	0.2	0.1	-
Residential use - performing loans	845.4	300.0	24.1
Residential use – in default	1.8	1.8	0.1
Gross loans receivables	**847.4**	**301.9**	**24.2**
Fixed and other assets	5.5	5.0	0.4
Total on-balance sheet exposures	**1,091.8**	**351.2**	**28.1**
Total off-balance sheet exposures	9.1	3.7	0.3
Total Credit Risk Exposure	**1,100.9**	**354.9**	**28.4**

As at 31 December 2018

Pillar 1 Capital Resource Requirement	**Exposure**	**Risk Weighted Assets**	**Minimum Capital Requirements**
Central Government and Bank of England	119.5	-	-
Multilateral development banks	17.2	-	-
Credit institutions	104.5	38.6	3.1
Total non-cash liquidity exposures	**241.2**	**38.6**	**3.1**
Non-residential and business - performing loans	0.2	0.1	-
Residential use - performing loans	825.5	291.7	23.3
Residential use – in default	0.6	0.6	0.1
Gross loans receivables	**826.3**	**292.4**	**23.4**
Fixed and other assets	4.2	4.6	0.3
Total on-balance sheet exposures	**1,071.7**	**335.6**	**26.8**
Total off-balance sheet exposures	11.3	4.5	0.4
Total Credit Risk Exposure	**1,083.0**	**340.1**	**27.2**

5.1.1. Retail Credit Risk

Exposure to retail credit risk is primarily limited to the provision of loans secured on property within the UK. All mortgage loan applications are reviewed by an individual underwriter supported by the use of application scorecards and are assessed with reference to the Society's retail credit risk appetite statement which is approved by the Board Risk Committee. Exposure to retail credit risk is carefully monitored by the Risk Oversight Committee which reports to the Board Risk Committee.

The following tables provide further information on the key drivers of risk of security, maturity and geography.

Minimum credit risk capital requirement by standardised exposure class:

	31 December 2019		**31 December 2018**	
Standardised Exposure class	**Exposure Value £m**	**Capital Requirement £m**	**Exposure Value £m**	**Capital Requirement £m**
Secured Residential Mortgages balance <= 80% of indexed valuation	835.1	23.5	818.8	22.9
Secured Residential Mortgages balance > 80% of indexed valuation	10.3	0.6	6.7	0.4
Secured by Mortgages on Commercial Property	0.2	-	0.2	-
In Default	1.8	0.1	0.6	0.1
Total Loans and Advances to customers	**847.4**	**24.2**	**826.3**	**23.4**

The above table is stated after individual impairment allowances of £22k (2018: £15k), but before a collective impairment allowance of £393k (2018: £390k). The collective allowance is included as Tier 2 capital. The effective interest rate adjustment of £837k (2018: £574k) and fair value adjustment for hedged risk of £888k (2018: -£1,418k) are not included in the above analysis as they are treated as "other assets" for credit risk purposes.

Residual maturity analysis of loans and advances to customers:

31 December 2019	<3 months £m	>3 months but <1 year £m	>1 year but <5 years £m	>5 years £m	Total £m
Secured Residential Mortgages balance < = 80% of indexed valuation	7.0	20.5	134.8	672.8	**835.1**
Secured Residential Mortgages balance > 80% of indexed valuation	-	-	-	10.3	**10.3**
Secured by Mortgages on Commercial Property	-	-	0.1	0.1	**0.2**
In Default	-	-	0.7	1.1	**1.8**
Total Loans and Advances to customers	**7.0**	**20.5**	**135.6**	**684.3**	**847.4**

31 December 2018	<3 months £m	>3 months but <1 year £m	>1 year but <5 years £m	>5 years £m	Total £m
Secured Residential Mortgages balance < = 80% of indexed valuation	6.8	20.2	130.3	661.5	**818.8**
Secured Residential Mortgages balance > 80% of indexed valuation	0.1	0.2	1.1	5.3	**6.7**
Secured by Mortgages on Commercial Property	-	-	-	0.2	**0.2**
In Default	-	-	0.1	0.5	**0.6**
Total Loans and Advances to customers	**6.9**	**20.4**	**131.5**	**667.5**	**826.3**

Analysis of loans and advances to customers by geographic area:

31 December 2019	Performing £m	In default £m	Total £m
West Midlands	192.6	0.4	193.0
North	140.0	0.5	140.5
London	133.7	0.5	134.2
East Midlands	90.6	0.1	90.7
South West	82.8	-	82.8
Outer South East	81.8	0.1	81.9
Yorks & Humberside	54.6	0.1	54.7
Wales & N Ireland	36.6	0.1	36.7
East Anglia	32.7	-	32.7
Total	**845.4**	**1.8**	**847.2**
Other loans	0.2	-	0.2
Total	**845.6**	**1.8**	**847.4**

31 December 2018	Performing £m	In default £m	Total £m
West Midlands	190.7	0.1	190.8
North	143.2	0.1	143.3
London	122.0	-	122.0
East Midlands	94.0	0.1	94.1
South West	80.5	-	80.5
Outer South East	77.4	-	77.4
Yorks & Humberside	53.5	0.3	53.8
Wales & N Ireland	33.3	-	33.3
East Anglia	30.9	-	30.9
Total	**825.5**	**0.6**	**826.1**
Other loans	0.2	-	0.2
Total	**825.7**	**0.6**	**826.3**

Other loans represent mortgages secured on commercial property.

A loan is considered to be in default where payments are more than three months overdue at the reporting date.

Analysis of loans and advances to customers by occupation type:

	31 December 2019 £m	31 December 2018 £m
Owner occupied	589.3	579.6
Buy to Let	257.9	246.5
Commercial	0.2	0.2
Total	**847.4**	**826.3**

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

	31 December 2019 %	31 December 2018 %
Repayment	63%	64%
Interest only	37%	36%
Total	**100%**	**100%**

Policies and limits are set within the RMF with regard to levels of buy to let and interest only lending.

Retail Impairment Allowance

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

Loans and advances are classified as impaired if they are three months or greater in arrears, or where there is specific concern about the realisation of the underlying collateral and where there is objective evidence that all cash flows will not be received. Individual assessments are made of all mortgage loans that are impaired. Based upon these assessments an individual impairment reduction of these assets is made.

In addition, a collective impairment reduction is made against those loans and advances to customers where objective evidence, including forbearance measures, indicates that it is likely that losses may ultimately be realised. The impairment value is calculated by applying various factors to each loan. These factors take into account the Group's expectation of default and delinquency rate, loss emergence periods, regional house price movements, any discount which may be needed against the value of the property thought necessary to achieve a sale, selling costs and any potential recovery of Mortgage Indemnity Guarantee (MIG).

Of the total loans and advances to customers of £847.4m (before individual allowance) at 31 December 2019 (2018: £826.3m) only £0.2m (2018: £0.2m) required an individual allowance. Balances in arrears were £6.2m at 31 December 2019 (2018: £5.8m), of these £1.8m (2018: £0.6m) were more than three months in arrears.

The tables below detail the loans and advances which are in arrears (past due) and/or impaired by occupancy type and repayment type:

	Past Due Exposures 2019 £k	Impaired Exposures 2019 £k	Past Due Exposures 2018 £k	Impaired Exposures 2018 £k
By Occupancy Type				
Owner Occupied	5,060	1,426	5,049	538
Buy to Let	1,151	358	755	104
Total	**6,211**	**1,784**	**5,804**	**642**
By Repayment Type				
Repayment	3,472	352	3,436	454
Interest Only	2,739	1,432	2,368	188
Total	**6,211**	**1,784**	**5,804**	**642**

The tables below detail the individual and collective impairment allowances by occupancy type and repayment type:

	Individual Impairment Allowance 2019 £k	Collective Impairment Allowance 2019 £k	Individual Impairment Allowance 2018 £k	Collective Impairment Allowance 2018 £k
By Occupancy Type				
Owner Occupied	22	328	9	315
Buy to Let	-	65	6	75
Total	**22**	**393**	**15**	**390**
By Repayment Type				
Repayment	-	309	9	275
Interest Only	22	84	6	115
Total	**22**	**393**	**15**	**390**

The tables below detail the movement on individual and collective impairment allowances by occupancy type and repayment type:

	Owner Occupied 2019 £k	Buy to Let 2019 £k	Total 2019 £k	Total 2018 £k
Individual Allowance				
At 1 January	9	6	15	102
Increase/(release)	13	(6)	7	(87)
Utilised	-	-	-	-
At 31 December	**22**	**-**	**22**	**15**
Collective Allowance				
At 1 January	315	75	390	376
Increase/(release)	13	(10)	3	14
At 31 December	**328**	**65**	**393**	**390**

	Repayment 2019 £k	Interest Only 2019 £k	Total 2019 £k	Total 2018 £k
Individual Allowance				
At 1 January	9	6	15	102
Increase/(release)	(9)	16	7	(87)
Utilised	-	-	-	-
At 31 December	**-**	**22**	**22**	**15**
Collective Allowance				
At 1 January	275	115	390	376
Increase/(release)	34	(31)	3	14
At 31 December	**309**	**84**	**393**	**390**

Forbearance Strategy

A range of forbearance options are available to support customers who are in financial difficulty, the purpose of which is to support customers with temporary difficulties. The main options offered are:

- Reduced monthly payment including interest only concession
- An arrangement to clear outstanding arrears
- Payment holiday
- Extension of mortgage term
- Transfer to a new product which could help to reduce monthly payments and, as a last resort
- Capitalisation of arrears

Customers requesting forbearance options will need to provide information to support the request which is likely to include the completion of an Income and Expenditure Questionnaire, bank statements and payslips in order that the request can be properly assessed. If the forbearance request is granted, the account is monitored in accordance with our policy and procedures.

At the end of the period of forbearance (with the exception of capitalisation of arrears), the customer's repayment reverts to the contractual repayment due, allowing the loan to be repaid over its remaining term.

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and/or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward. Typically the receipt of six months qualifying payments is required. Different percentages of probability of default values are applied to these customer accounts reflecting the potentially higher risk of default to the Society.

The table below details the movement of impairment allowance during the year.

Individual Allowance	**2019** **£k**	**2018** **£k**
At 1 January	15	102
Change in loan impairment allowance	7	(87)
Amounts utilised	-	-
At 31 December	**22**	**15**

Collective Allowance	**2019** **£k**	**2018** **£k**
At 1 January	390	376
Change in loan impairment allowance	3	14
At 31 December	**393**	**390**

5.1.2. Wholesale Credit Risk

A Board approved policy statement restricts the level of risk by placing limits on the amount of exposure that can be taken in relation to one counterparty or group of counterparties, and to industry sectors. This is reported by the ALCO to the BRC.

The primary source for obtaining information on wholesale asset counterparties' creditworthiness is External Credit Assessment Institutions (ECAIs). The Society uses ratings provided by Fitch, with a process that sources Fitch ratings from their proprietary website monthly, supplemented by alerts of material rating changes from our external Treasury advisor.

Credit ratings are reviewed regularly and are reported to the ALCO. The Society reviews the capital adequacy and assesses the financial performance and any risks associated with financial institutions.

ALCO is responsible for approving Treasury counterparties for both derivatives and investment purposes. Limits are placed on the amount of risk accepted in relation to one counterparty, or group of counterparties and to industry sectors. This is monitored daily and reviewed regularly by ALCO.

The Society policy only permits lending to central government, UK local authorities, and banks and building societies with a high credit rating. The Society performs regular analysis of counterparty credit risk and monitoring of publicly available information to highlight possible indirect exposures.

Minimum credit risk capital requirement by standardised exposure class:

Standardised Exposure Class	**31 December 2019 (£m)**		**31 December 2018 (£m)**	
	Exposure Value	**Capital Requirement**	**Exposure Value**	**Capital Requirement**
Central Government or Central Banks	116.9	-	119.5	-
Multilateral Development Banks	17.2	-	17.2	-
Institutions	104.8	44.3	104.5	38.6
Total Wholesale Lending	**238.9**	**44.3**	**241.2**	**38.6**

Residual maturity analysis of wholesale credit exposures:

31 December 2019	**<3 Months**	**>3 Months but <1 Year**	**>1 Year but <5 Years**	**>5 Years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Central Government or Central Banks	101.4	15.0	-	0.5[1]	**116.9**
Multilateral Development Banks	-	-	17.2	-	**17.2**
Institutions	27.1	76.5	1.2	-	**104.8**
Total Wholesale Lending	**128.5**	**91.5**	**18.4**	**0.5**	**238.9**

31 December 2018	<3 Months £m	>3 Months but <1 Year £m	>1 Year but <5 Years £m	>5 Years £m	Total £m
Central Government or Central Banks	103.2	15	-	0.6[1]	**118.8**
Multilateral Development Banks	-	-	17.2	-	**17.2**
Institutions	25.6	79.1	0.5	-	**105.2**
Total Wholesale Lending	**128.8**	**94.1**	**17.7**	**0.6**	**241.2**

Note 1: The exposure greater than 5 years relates to the Cash Ratio Deposit account with the Bank of England, which has an undefined maturity

Residual maturity and credit rating analysis of wholesale credit exposures:

31 December 2019 Fitch Rating	Credit Quality Step	< 3 Months £m	>3 Months but <1 Year £m	>1 year £m	Total £m
AAA to AA-	1	101.4	15.0	17.7	134.1
A+ to A-	2	27.1	76.5	1.2	104.8
Total		**128.5**	**91.5**	**18.9**	**238.9**

31 December 2018 Fitch Rating	Credit Quality Step	< 3 Months £m	>3 Months but <1 Year £m	>1 year £m	Total £m
AAA to AA-	1	118.8	34.9	18.2	171.9
A+ to A-	2	10.0	59.2	0.1	69.3
Total		**128.8**	**94.1**	**18.3**	**241.2**

The ECAI (Fitch) rating is aligned with the relevant credit quality step as defined in the CRR. The Society does not make use of any credit risk mitigation techniques.

Analysis of wholesale credit exposures by geographic area:

31 December 2019	Central Government/ Central Banks £m	Multilateral Development Banks £m	Institutions £m	Total £m
United Kingdom	116.9	-	104.4	221.3
Europe	-	5.0	0.4	5.4
Non Europe	-	12.2	-	12.2
Total	**116.9**	**17.2**	**104.8**	**238.9**

31 December 2018	Central Government/ Central Banks £m	Multilateral Development Banks £m	Institutions £m	Total £m
United Kingdom	118.8	-	77.1	195.9
Europe	-	5.0	15.1	20.1
Non Europe	-	12.2	13.0	25.2
Total	**118.8**	**17.2**	**105.2**	**241.2**

Wholesale Impairment Losses

A regular assessment of investment quality is reported monthly to the ALCO. In assessing whether an asset has been impaired, the Society considers the credit rating of the counterparty, the current market valuation and the extent to which coupon payments have been made on a timely basis.

The amount of the impairment loss is recognised in the income statement. Any loss previously recognised through other comprehensive income is reversed out and charged to the income statement as part of the impairment cost.

As at 31 December 2019, no wholesale assets were either past due or impaired and no allowance has therefore been made.

5.1.3. Non-Performing and Forborne Exposures

The tables attached at Appendix 1 analyse the exposures of the Society based on whether the exposure is performing or non-performing, and also draw out exposures which are subject to forbearance measures.

The Society has extremely low exposures to loans which are either subject to forbearance or are non-performing. Exposures subject to forbearance total £1.3m, of which only £0.2m are non-performing. Non-performing balances total £1.8m, which comprise mortgage loans which are up to 1 year past due. There are no properties in possession at 31 December 2019.

5.1.4. Financial Instruments

A financial instrument is a contract which gives rise to a financial asset of one entity and a financial liability of another entity. The Society is a retailer of financial instruments in the form of mortgage and savings products and also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and manage the risks arising from its operations.

The Society has a formal structure for managing risk, including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Board, which is charged with the responsibility for managing and controlling the balance sheet exposures and the use of financial instruments for risk management purposes.

Instruments used for risk management purposes include derivative financial instruments 'derivatives', which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates. Derivatives are only used by the Society in accordance with the Building Societies Act 1986 (as amended by the Building Societies Acts 1997 and 2005), to reduce the risk of loss arising from changes in interest rates of other factors specified in the legislation. The Society does not trade in derivatives or use them for speculative purposes.

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

The following table describes the significant activities undertaken by the Society, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks.

Activity	**Risk**	**Fair Value Interest Rate Hedge**
Fixed rate mortgage products	Sensitivity to increases in interest rates	Pay fixed interest rate swaps
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest rate swaps

Nominal principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the balance sheet date reflecting the Society's maximum exposure should the counterparties default. The credit risk weighted amount, which is calculated according to rules specified by the Prudential Regulatory Authority, is based on the replacement costs, but also takes into account measures of the extent of potential future exposure and the nature of the counterparty.

The table below shows the nominal principal amounts, credit risk weighted amounts and replacement costs of derivatives:

31 December 2019 **Interest rate contracts maturing:**	**Nominal principal amount** **£m**	**Fair Value** **£m**	**Replacement Cost** **£m**	**Credit risk weighted amount** **£m**
In less than 1 year	88.6	(0.2)	-	-
Between 1 year and 5 years	290.6	(0.8)	0.3	0.9
Greater than 5 years[1]	15.0	-	-	0.1
Total	**394.2**	**(1.0)**	**0.3**	**1.0**

[1] The greater than 5 year exposure relates to interest rate swaps maturing in February 2025, which have been taken out to hedge 5 year mortgages with an initial term ending in February 2025.

31 December 2018 **Interest rate contracts maturing:**	**Nominal principal amount** **£m**	**Fair Value** **£m**	**Replacement Cost** **£m**	**Credit risk weighted amount** **£m**
In less than 1 year	51.2	-	-	-
Between 1 year and 5 years	325.2	1.5	2.0	1.8
Total	**376.4**	**1.5**	**2.0**	**1.8**

The net exposure value of derivatives at 31 December 2019, which includes uplifts for Potential Future Credit Exposure (PFCE) under the mark to market method for assessing counterparty credit risk, totalled £2.0m (2018: £3.7m).

5.1.5. Encumbered assets

Asset encumbrance is the process by which assets are pledged in order to secure or collateralise a financial transaction from which they cannot be freely withdrawn.

The Society maintains a level of encumbrance commensurate with the size and scope of its business operation with the majority of encumbrance arising from its participation in the Bank of England's Term Funding Scheme. Additionally, a small amount of asset encumbrance arises from transactions and associated margin requirements conducted under the terms of Credit Support Annex agreements.

The level of encumbrance is regularly monitored and, where appropriate, a prudent buffer of over-collateralisation is voluntarily maintained for operational efficiency.

Unencumbered other assets include cash in hand, derivative assets, property and other fixed assets, intangible assets and deferred tax assets.

The Pillar 3 asset encumbrance disclosure templates have been compiled in accordance with PRA/EBA regulatory reporting requirements. In accordance with the threshold criteria under PRA supervisory statement SS11/14 (CRD IV: Compliance with the European Banking Authority's Guidelines on the disclosure of encumbered and unencumbered assets. In addition, the data is presented as a median calculation based on the four quarter end positions during the year, rather than at a specific point in time (in line with EBA guidance).

The table below shows the balance sheet assets, split between encumbered and non-encumbered assets (based on EBA methodology):

Encumbered and Unencumbered Assets	**Carrying Amount of Encumbered Assets**		**Fair Value of Encumbered Assets**		**Carrying Amount of Non-Encumbered Assets**		**Fair Value of Non-Encumbered Assets**	
2019	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which notionally eligible EHQLA and HQLA**
Assets of the Reporting Institution	198.9	196.6			875.7	68.7		
Debt Securities	-	-	-	-	127.1	32.2	127.1	32.2
Other Assets	-	-			5.8	-		

Encumbered and Unencumbered Assets	**Carrying Amount of Encumbered Assets**	**Fair Value of Encumbered Assets**	**Carrying Amount of Non-Encumbered Assets**	**Fair Value of Non-Encumbered Assets**

2018	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which notionally eligible EHQLA and HQLA**
Assets of the Reporting Institution	196.0	194.4			880.1	46.3		
Debt Securities	-	-	-	-	108.3	11.8	108.3	11.8
Other Assets	-	-			5.3	-		

Collateral Received	**Fair value of encumbered collateral received or own debt securities issued**		**Unencumbered – Fair value of collateral received or own debt securities issued available for encumbrance**	
2019	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which EHQLA and HQLA**
Collateral received by the reporting institution	**-**	**-**	**-**	**-**
Loans on demand	-	-	-	-
Loans and advances other than loans on demand	-	-	-	-
Total Assets, Collateral Received and Own Debt Securities Issued	**199.2**	**196.6**	**-**	**-**

Collateral Received	**Fair value of encumbered collateral received or own debt securities issued**		**Unencumbered – Fair value of collateral received or own debt securities issued available for encumbrance**	
2018	**£m**	**of which notionally eligible EHQLA and HQLA**	**£m**	**of which EHQLA and HQLA**
Collateral received by the reporting institution	**2.1**	**-**	**-**	**-**
Loans on demand	-	-	-	-
Loans and advances other than loans on demand	2.1	-	-	-
Total Assets, Collateral Received and Own Debt Securities Issued	**198.1**	**194.4**	**-**	**-**

The table below shows the liabilities against which collateral has been pledged, alongside the values of the corresponding encumbered assets:

Sources of Encumbrance	Matching Liabilities, Contingent Liabilities or Securities Lent		Assets, Collateral Received and Own Debt Securities issued other than Covered Bonds and ABSs Encumbered	
	2019 £m	2018 £m	2019 £m	2018 £m
Carrying Amount of Selected Financial Liabilities	133.3	135.0	198.6	197.6

5.2 Operational Risk

The Society has adopted the Basic Indicator Approach (BIA) under Pillar I, which is based upon a 15% charge of the average of the last three years' net income, in accordance with Part 3, Title 3 in Chapter 2 of CRR.

The Society's minimum (Pillar 1) capital requirement for Operational Risk is:

Operational Risk	2019 £m	2018 £m
Annual gross income (2016)	-	12.4
Annual gross income (2017)	13.7	13.7
Annual gross income (2018)	13.8	13.8
Annual gross income (2019)	12.9	-
Average annual gross income	**13.5**	**13.3**
Requirement at 15% Risk Weighting	**2.0**	**2.0**

The Board considers the BIA approach appropriate for the Society, given the simple and straightforward nature of the operations and the fact that there are no international operations. It has further considered whether the BIA provision is sufficient given the status of the Society's RMF. Given the low risk nature of the Society and its risk appetite, it is felt unlikely that any operational issues would exceed the Pillar 1 requirement.

The Society makes use of insurance to mitigate the effect of accepted risks such as material damage, business interruption, professional indemnity, third party liability etc. The insurance policies are reviewed annually by the Executive in order to agree the scope and level of cover.

The Society has in place an extensive Business Continuity Plan, which is reviewed and tested annually. The Board is satisfied that the plan, when enacted, will allow the Society to continue to function after suffering a number of severe events.

6. Liquidity and Funding Risk

Liquidity and Funding risk is managed principally by holding appropriate levels of cash and other easily realisable liquid assets (High Quality Liquid Assets) and managing funding maturities to avoid bunching as well as ensuring availability to wholesale funding if required.

Stress tests are undertaken to measure the Society's ability to meet adverse cash flows on a regular basis. This activity is overseen by the ALCO. Liquidity and Funding risk is monitored through a series of metrics including the Liquidity Coverage Ratio and Net Stable Funding Ratio.

6.1 Liquidity Coverage Ratio (LCR)

The Society complies with the rules issued by the Prudential Regulation Authority concerning the quality of liquid assets held by banks and building societies. As a consequence, the Society's LCR at 31 December 2019 was 313% (2018: 251%), highlighting the Society's strong liquidity. The Society's average LCR ratio for the rolling 12 months to each quarter end date in 2019 is as follows:

	Total Adjusted Value £m			
Quarter ending on	**31 March 2019**	**30 June 2019**	**30 September 2019**	**31 December 2019**
No of data points used in the calculation of averages	12	12	12	12
Liquidity Buffer	150.9	135.3	120.5	117.1
Outflows	62.9	63.8	63.3	61.6
Inflows	(12.1)	(12.0)	(12.5)	(13.2)
Total Net Cash Outflows	50.8	51.8	50.8	48.4
Liquidity Coverage Ratio (%)	351%	270%	245%	250%

	Total Adjusted Value £m			
Quarter ending on	**31 March 2018**	**30 June 2018**	**30 September 2018**	**31 December 2018**
No of data points used in the calculation of averages	12	12	12	12
Liquidity Buffer	116.7	134.7	150.9	157.7
Outflows	63.4	62.2	60.6	62.1
Inflows	(9.4)	(11.1)	(12.1)	(12.5)
Total Net Cash Outflows	54.0	51.1	48.5	49.6
Liquidity Coverage Ratio (%)	219%	318%	362%	368%

6.2 Net Stable Funding Ratio (NSFR)

The Society's NSFR at 31 December 2019 was 158% (2018: 158%), exceeding the expected 100% minimum future requirement for NSFR. These figures are based on current interpretations of European NSFR requirements.

7. Market Risk

Market risk is the risk of losses arising from changes in market rates or prices. The main exposure for the Society is interest rate risk. The Society has limited appetite for market risk but acknowledges that, as a mortgage lender, it is not possible or practical to eliminate all risk. To restrict market risk as much as possible the Society has set clearly defined limits within which risk must be managed. These are closely monitored, and reported to senior management and the Board on a monthly basis.

The Society's strategy and approach to the management of market risk is set out in the Treasury Policy Statement. By delegated authority of the Board, the ALCO controls and supervises the Society's treasury and related risk management activities.

The Society's Pillar 1 capital requirement for market risk is currently set to zero, as the Society does not have a trading book.

The Society is not directly exposed to equity, foreign currency or commodity risk, other than through the pension fund which is covered explicitly in Section 2.4.7. The investment policy of the pension fund is the responsibility of the pension fund trustees and may be subject to equity and foreign currency risk.

7.1 Interest Rate Risk

The Society's main exposure to market risk is interest rate risk, resulting from funding fixed rate mortgages with variable rate savings products. Additionally, the Society is exposed to basis risk whereby the interest rate on assets and liabilities with similar repricing periods move by varying degrees, eg assets linked to industry benchmarks funded by variable savings products.

Interest rate risk is managed by utilising natural hedging opportunities that occur within the balance sheet, eg fixed rate mortgages are offset against fixed rate savings products. The remaining net exposure is managed by entering into derivatives with external counterparties.

Exposure to interest rate risk is monitored against limits by measuring the impact on the Society's assets and liabilities of a parallel shift in interest rates (both 0.01% and 2%). It also monitors the impact against the prescribed series of standardised interest rate shocks published by the European Banking Authority (EBA), in their final guidelines on Interest Rate Risk in the Banking Book (IRRBB), in July 2018. In addition, the Society monitors the sensitivity of net interest income to a 2% parallel shift in interest rates.

The Society monitors the impact of a number of stress scenarios against interest rate risk (including basis risk) and these are reported monthly to the ALCO.

The Society's exposure to a 2% change in interest rates was 3.0% of capital (£2.0m) at 31 December 2019 (2018: 1.9%, £1.3m).

8. Remuneration Policy and Practice

The Society seeks to ensure that its remuneration decisions are in line with its business strategy and long term objectives, and consistent with the Society's current financial condition and future prospects. It also seeks to establish an appropriate balance between the fixed and variable elements of remuneration.

The principal responsibilities of the Remuneration Committee are set out in Section 2.3 on pages 11 and 12.

In determining remuneration, the Committee applies the FCA Remuneration Code and considers the guidance in the UK Corporate Governance Code. The Remuneration Committee, is composed solely of Non Executive Directors (three as at 31 December 2019) and met on seven occasions during 2019.

Further details regarding the remuneration policy are set out in the Directors' Remuneration report in the 2019 Annual Report and Accounts, which are published on the Society's website.

The main components of remuneration are as follows:

- Basic salary – this takes into account job content and responsibilities, individual performance (assessed annually against personal objectives) and salary levels of similar positions in comparable organisations.
- Bonus – a performance related pay scheme is in operation for all staff in the Society, excluding Executive Directors. The scheme has quantifiable performance measures based on the Society's performance. The scheme results in a maximum payment of £1,000 per annum regardless of salary.
- Benefits – where appropriate these include the provision of a car or car allowance, pension and medical insurance.

The table below sets out the aggregate remuneration for staff who are Material Risk Takers, as per the relevant EBA regulatory technical standards, in relation to their services for the Society for the year ended 31 December 2019:

	2019			**2018**		
	No of Staff	**Total Remuneration £k**	**Of which Variable £k**	**No of Staff**	**Total Remuneration £k**	**Of which Variable £k**
Executive Directors	4	587	-	4	615	1
Non-Executive Directors	6	200	-	6	191	-
Material Risk Takers	18	1,019	11	21	987	11
Total	**28**	**1,806**	**11**	**31**	**1,793**	**12**

No one individual has received remuneration of EUR 1 million or more in 2019 or 2018.

All remuneration was fixed, with the exception of the Society-wide performance related bonus scheme in 2019 and 2018 which resulted in payments of £750 and £1,000 respectively. The Executive Directors waived their bonus entitlement in 2019 (2018: £1,000 each).

9. Conclusion

This Pillar 3 disclosure report has been prepared in accordance with the requirements of CRD IV, as appropriate to the size and complexity of Leek United Building Society.

In the event that a user of this disclosures document requires further information, application should be made in writing to the Finance Director, Leek United Building Society, 50 St Edward Street, Leek, Staffordshire ST13 5DL.

8. Glossary

Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that the outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed
Basel II	Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the PRA/FCA Handbook
Basel III	Basel III entered into force on 1 January 2014 and introduces more onerous capital requirements for credit institutions and amends the existing standards for Basel I and Basel II
Capital Requirements Regulation (CRR) and Capital Requirements Directive IV (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It has revised the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms. The Capital Requirements Regulation forms part of CRD IV
Common Equity Tier 1 Capital (CET1)	CET1 capital consists of general reserves and other reserves less intangible assets, prudent valuation adjustment and other regulatory deductions
Counterparty Credit Risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows
Credit Risk	This is the risk of losses arising from a debtor's failure to meet their legal and contractual obligations
European Banking Authority (EBA)	An independent EU authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's, Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013
Impairment Allowance	Amounts set aside to cover losses associated with credit risk
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel III requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events
Institutions	Financial institutions such as banks and building societies

Leverage Ratio	Leverage Ratio is defined as Tier 1 Capital divided by the total exposures which includes on and off balance sheet items, with this ratio expressed as a percentage
Minimum Capital Requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Basel III Pillar 1 requirements
Operational Risk	The risk of a loss arising from inadequate or failed internal processes or systems, human error, key supplier failure or external events
Past Due Items	Loans which are overdue for payment (in arrears)
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK from the 1 April 2013. The PRA replaced the FSA (Financial Services Authority)
Retail lending	Residential mortgages including buy to let and secured lending to small businesses
Risk Appetite	The level of risk that the society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst achieving business objective.
Registered Social Landlords (RSL)	Registered social landlords (also known as housing associations) are independent, non-profit-making organisations, which provide homes for people to rent, buy or both
Secured Residential Mortgages > 80% of indexed valuation	Residential mortgages where outstanding balance is greater than 80% of indexed valuation
Secured Residential Mortgages <= 80% of indexed valuation	Residential mortgages where outstanding balance is less than or equal to 80% of indexed valuation
Secured by Mortgages on Commercial Property	Secured business lending
Tier 1 Capital	A component of regulatory capital, it comprises CET1 and Additional Tier 1 capital
Tier 2 Capital	Comprises the collective mortgage allowance (for exposures treated on a Basel II standardised basis)
Wholesale	Lending to financial institutions

Appendix 1

Credit Quality of Forborne Exposures

2019	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
	Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures		Of which collateral and financial guarantees received on non-performing
			Of which defaulted	Of which impaired				
Loans and advances	1.1	0.2	0.2	-	-	-	-	-
Central banks	-	-	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-	-
Credit institutions	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	-	-	-	-	-
Households	*1.1*	*0.2*	*0.2*	-	-	-	-	-
Debt securities	-	-	-	-	-	-	-	-
Loan commitments given	-	-	-	-	-	-	-	-
Total	**1.1**	**0.2**	**0.2**	**-**	**-**	**-**	**-**	**-**

Credit Quality of Performing and Non-Performing Exposures by Past Due Days

2019	Gross carrying amount/nominal amount											
	Performing exposures			Non-performing exposures								
		Not past due or past due <= 30 days	Past due > 30 days <= 90 days		Unlikely to pay that are not past due or are past due <= 90 days	Past due > 90 days <= 180 days	Past due > 180 days <= 1 year	Past due > 1 year <= 2 years	Past due > 2 years <= 5 years	Past due > 5 years <= 7 years	Past due > 7 years	Of which defaulted
Loans and advances	961.2	956.8	4.4	1.8	-	1.6	0.2	-	-	-	-	1.8
Central banks	*102.6*	*102.6*	-	-	-	-	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	*11.3*	*11.3*	-	-	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	-	-	-	-	-	-	-	-	-	-	-	-
Of which SMEs	-	-	-	-	-	-	-	-	-	-	-	-
Households	*847.3*	*842.9*	*4.4*	*1.8*	-	*1.6*	*0.2*	-	-	-	-	*1.8*
Debt securities	125.7	125.7	-	-	-	-	-	-	-	-	-	-
Central banks	-	-	-	-	-	-	-	-	-	-	-	-
General governments	*15.0*	*15.0*	-	-	-	-	-	-	-	-	-	-
Credit institutions	*110.7*	*110.7*	-	-	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	-	-	-	-	-	-	-	-	-	-	-	-
Off balance sheet exposures	35.5			-								-
Central banks	-			-								-
General governments	-			-								-
Credit institutions	-			-								-
Other financial corporations	-			-								-
Non-financial corporations	-			-								-
Households	*35.5*			-								-
Total	**1,122.4**	**1,082.5**	**4.4**	**1.8**	**-**	**1.6**	**0.2**	**-**	**-**	**-**	**-**	**1.8**

Performing and Non-Performing Exposures and Related Provisions

	Gross carrying amount/nominal amount		Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures	Non-performing exposures	Performing exposures – accumulated impairment and provisions	Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		On performing exposures	On non-performing exposures
Loans and advances	961.2	1.8	0.4	-	-	-	-
Central banks	*102.6*	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-
Credit institutions	*11.3*	-	-	-	-	-	-
Other financial corporations	-	-	-	-	-	-	-
Non-financial corporations	-	-	-	-	-	-	-
Of which SMEs	-	-	-	-	-	-	-
Households	*847.3*	*1.8*	*0.4*	-	-	-	-
Debt securities	125.7	-	-	-	-	-	-
Central banks	-	-	-	-	-	-	-
General governments	*15.0*	-	-	-	-	-	-
Credit institutions	*110.7*	-	-	-	-	-	-
Other financial corporations	-	-	-	-	-	-	-
Non-financial corporations	-	-	-	-	-	-	-
Off balance sheet exposures	35.5	-	-	-		-	-
Central banks	-	-	-	-		-	-
General governments	-	-	-	-		-	-
Credit institutions	-	-	-	-		-	-
Other financial corporations	-	-	-	-		-	-
Non-financial corporations	-	-	-	-		-	-
Households	*35.5*	-	-	-		-	-
Total	**1,122.4**	**1.8**	**0.4**	-	-	-	-

Collateral obtained by taking Possession and Execution Process

	Collateral obtained by taking possession	
	Value at initial recognition	**Accumulated negative changes**
Property, plant and equipment (PP&E)	-	-
Other than PP&E	-	-
Residential immovable property	-	-
Commercial immovable property	-	-
Movable property (auto, shipping, etc)	-	-
Equity and debt instruments	-	-
Other	**-**	**-**
Total	**-**	**-**