

The background of the slide is composed of a grid of green squares of various sizes. Some squares contain photographs of diverse people: an elderly couple, a woman, a man, and a family. The text is centered on the right side of the slide.

Pillar 3 Disclosure

31 December 2016

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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 included additional capital and disclosure requirements. The rules are enforced in the UK by the Prudential Regulation Authority (PRA).

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.

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 2016, with comparative figures for 31 December 2015 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, SD13 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

This document deals with the requirements for Pillar 3 (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 2016 (2015: 31 December 2015). 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 2016 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 2016.

Directors

A summary of the relevant experience of each of the Executive and Non-Executive Directors is given on pages 16 and 17 of the 2016 Annual Report and Accounts.

Confirmation of directorships held is disclosed in the Annual Business Statement, which is available on page 70 of the 2016 Annual Report and Accounts.

The policy regarding recruitment and diversity for selection of Directors is outlined on page 21 of the 2016 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 prepositioned mortgage assets with the Bank of England in July 2016, allowing access, if required, to wholesale funding through the Sterling Monetary Framework.

Up until 30 September 2016 the Society provided a range of services such as life insurance, financial planning and long term investments via a relationship with Legal & General. As from 1 October 2016 the Society has entered into a new arrangement with Wren Sterling, who provide an enhanced proposition via a whole of market Independent Financial Planning Service to our existing and new members. The Society also offers general insurance products, supplied by RSA, to its 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 our 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.

2.2. Risk Management Framework (RMF)

The Society's view on risk management is founded on its business strategy, and covers all risks identified in the RMF. This has been translated into a high-level risk appetite statement 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 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 with the aim to deliver sustainable member value for the Society.'

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: credit, strategic, market, liquidity and funding, conduct, regulatory and legal, pension and operational (the Society's Risk Appetite Statements).

These risk appetite statements enable the Board to formally communicate to the organisation the level of risk that they are willing to accept to achieve Society objectives, both in terms of qualitative and quantitative measures.

A key component of the RMF is the central risk register. This is designed to incorporate all known risks, as well as the controls that manage those risks, and to be reviewed by business units (via the Risk &

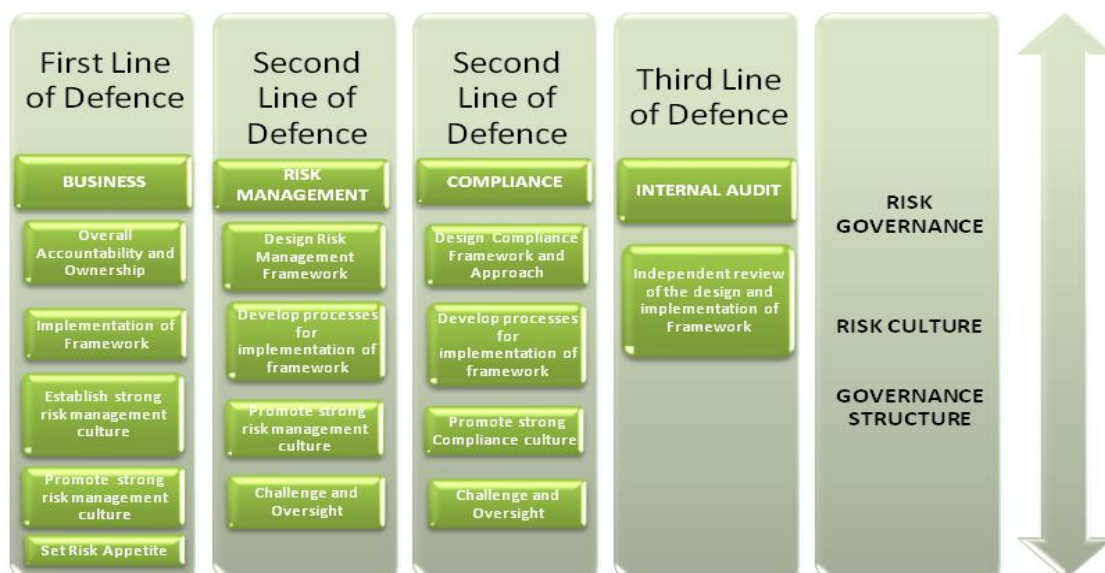
Control Self-Assessment (RCSA) programme), assessed by the second line of defence and challenged by the Management Risk Committee, with management information regularly received by the Board Risk Committee, allowing them to closely monitor these key risks in relation to capital requirements.

The Society has a documented framework for the management of risk. The risk appetite enables the Board to formally communicate to the organisation on the level and type of risks they are willing to accept to achieve Society objectives outlined in the Corporate Plan. The risk appetite is defined both qualitatively and quantitatively in terms of the risk the Board is willing to accept. The formal risk register review and assessment process is defined as a qualitative measure whilst formal key risk indicators have been produced as quantitative measures to assess the risk appetite of the Society.

The final element of the framework is the formal structure for managing risks across the Society. This is based on the three lines of defence model which is made up as follows:

- First Line of Defence – Business
- Second Line of Defence – Risk Management
- Third Line of Defence – Internal Audit

Further information on the three lines of defence model is provided below:



2.3. Principal Risks

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

2.3.1. 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 write-off of Treasury exposures.

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 Management Risk Committee which reports to the Board Risk Committee.

There is also potential risk from the failure of a counterparty, however our Treasury policies also mean that we set tight criteria over where we will, and where we won't place excess funds. The criteria include both long term and short term ratings published by external credit rating agencies, which are an indication of a company's creditworthiness as well as the results of published regulatory stress tests.

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 Management Risk Committee to the Board Risk Committee.

The primary source for obtaining information on wholesale asset counterparties' creditworthiness is External Credit Assessment Institutions (ECAIs). The Society uses ratings provided by Fitch. Credit ratings are reviewed regularly and are reported to the Management Risk Committee. The Society reviews the capital adequacy and assesses the financial performance and any risks associated with financial institutions.

The Assets and Liabilities Committee (ALCO) is responsible for recommending credit limits on Treasury counterparties for approval by the Board, and these are set out in the Wholesale Credit Risk policy statement and reviewed annually or more frequently if appropriate.

Our risk appetite is as follows:

"The Society will adopt a prudent lending approach to our mortgage customers and Treasury counterparties resulting in low default rates and not impacting on earnings or capital."

2.3.2. 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 rates, as there is a risk that changes in interest rates will result in changes to income due to the difference between interest rates charged for mortgages compared to those paid for funding over different re-pricing time periods. In addition, the Society is also exposed to basis risk, this is the risk that interest rates on assets and liabilities can move by varying amounts due to the underlying interest rate characteristic of the asset or liability.

The Society has a cautious approach to market risk and operates with policies and risk appetites. Reports are produced on a monthly basis to ensure the Society remains within these limits. The Society does not operate a trading book and only takes out interest rate swaps with approved counterparties to reduce interest rate risk exposure.

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 2.3.8. 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. 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 Asset and Liability Committee (ALCO) controls and supervises the Society's treasury and related risk management activities.

Interest rate risk is the potential adverse impact on the Society's future cash flows from changes in interest rates and arises due to the differing interest rate risk characteristics of the Society's assets and liabilities. Interest rate risk exists within the Society's banking book largely through the provision of fixed rate mortgages and fixed rate savings products. Changes in the variable rate of interest have the potential to adversely affect future cash flows by either a reduction in interest income or an increase in interest expense. The Society's exposure to a 2% change in interest rates was 0.8% of capital (£0.4m) at 31 December 2016 (2015: 0.8%, £0.4m).

The Board has ensured that suitable capital provisions are made where appropriate.

Our risk appetite is as follows:

"The Society will manage the interest rate and basis risk positions to ensure that losses due to adverse movements in market rates do not have a significant impact."

2.3.3. 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. We continue to hold very strong levels of liquidity. There is potential risk to this from an extreme scenario of depositors withdrawing their funds.

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. The Society also complies with the rules issued by the Prudential Regulatory Authority concerning the quality of liquid assets held by banks and building societies. As a consequence the Society held £100.5m at 31 December 2016 (2015: £46.2m) on deposit with the Bank of England to ensure ready access to liquid funds should the need arise.

The Society aims to provide customer savings rates that are both fair and sustainable and monitor them closely. The Society has appropriate policies in place and monitors the liquidity and funding positions closely on an ongoing and forward looking basis. There are also contingency plans in place should extreme situations arise.

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 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, prudence and return. The policy also lays down strict guidelines on counterparty criteria and sector limits to ensure that liquid capital investments are of a high quality. The Society regularly performs stress tests to ensure that liquidity levels remain at operational levels in exceptional circumstances

Our risk appetite is as follows:

“The Society will maintain sufficient liquid resources, over and above the financial minimum, that gives our members confidence that it has the ability to meet the financial obligations as they fall due. The Society will maintain sufficient retail deposits to fully support and fund all 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.”

2.3.4. Operational risk

This is the risk of a loss arising from inadequate or failed internal processes or systems, human error, key supplier failure or external events. Operational risk is managed through the Management Risk Committee and reported to the Board Risk Committee.

The Society manages these risks as an integral part of its operations, utilising controls, the Risk & Control Self-Assessment tool and the Risk Registers. 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.

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

Our risk appetite is as follows:

“The Society will maintain efficient operational processes and controls to ensure that it can optimise its resources and reduce the impact of operational risks on the Society’s performance.”

2.3.5. Conduct Risk

Conduct risk is the risk that the Society is unable to demonstrate that it is putting the customer interest at the very heart of the business.

The Society has no appetite for unfair customer outcomes arising from any element of the conduct risk lifecycle, which includes product design, sales and after sales processes and culture.

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 strive to deliver positive outcomes to our customers and members at all times, maintaining a high degree of customer and public confidence, to be achieved primarily through focusing on its core mission statement.”

2.3.6. Strategic Risk

Strategic risk is the risk of losses as a result of strategic/management decisions or business choices. Factors such as competition and regulatory change could impact the Society should it fail to keep up with the pace of change. As a result there could be significant loss or insufficient capital to meet operational and regulatory demands.

The Society has an established corporate planning process which is subject to rigorous challenge which sets the overall direction for the Society. The Society recognises that it operates in a competitive market place and keeps a close eye on market trends and is mindful of these in its decision making. The Society operates a Three Lines of Defence model providing oversight, challenge and independent assurance and the Non Executives 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”

2.3.7. Regulatory and Legal Risk

This relates to 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. It is essential for the Society to comply with all applicable regulatory requirements.

Continuous monitoring of regulatory change requirements is ongoing to ensure awareness and compliance by the Society. 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 requirements are met within agreed timeframes.”

2.3.8. Pension Risk

Pension risk is the risk of financial deficit in the Society’s defined benefit scheme and therefore 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.

This most recent actuarial valuation as at 24 April 2015 showed a deficit of £3,814,000. The Society agreed with the trustees that it will aim to eliminate the deficit over a period of 5 years from 24 April 2015 by the payment of £765,000 before 31 March 2016 and thereafter annual contributions of £765,000 to be paid for 4 years until March 2020 in respect of the deficit.

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 we can meet our existing and future liabilities.”

2.4. 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 financial statements. The Board is also responsible for defining and influencing the culture of risk management across the Society including:

- a) Determining the Society’s appetite for risk;
- b) Determining which types of risk are acceptable and which are not;

- c) Providing guidance to management on conduct and probity;
- d) Review and approval of the Society's ICAAP (Internal Capital Adequacy Assessment Process), ILAAP (Individual Liquidity Adequacy Assessment Process), LCP (Liquidity Contingency Plan) and RRP (Recovery and Resolution Plan).

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.

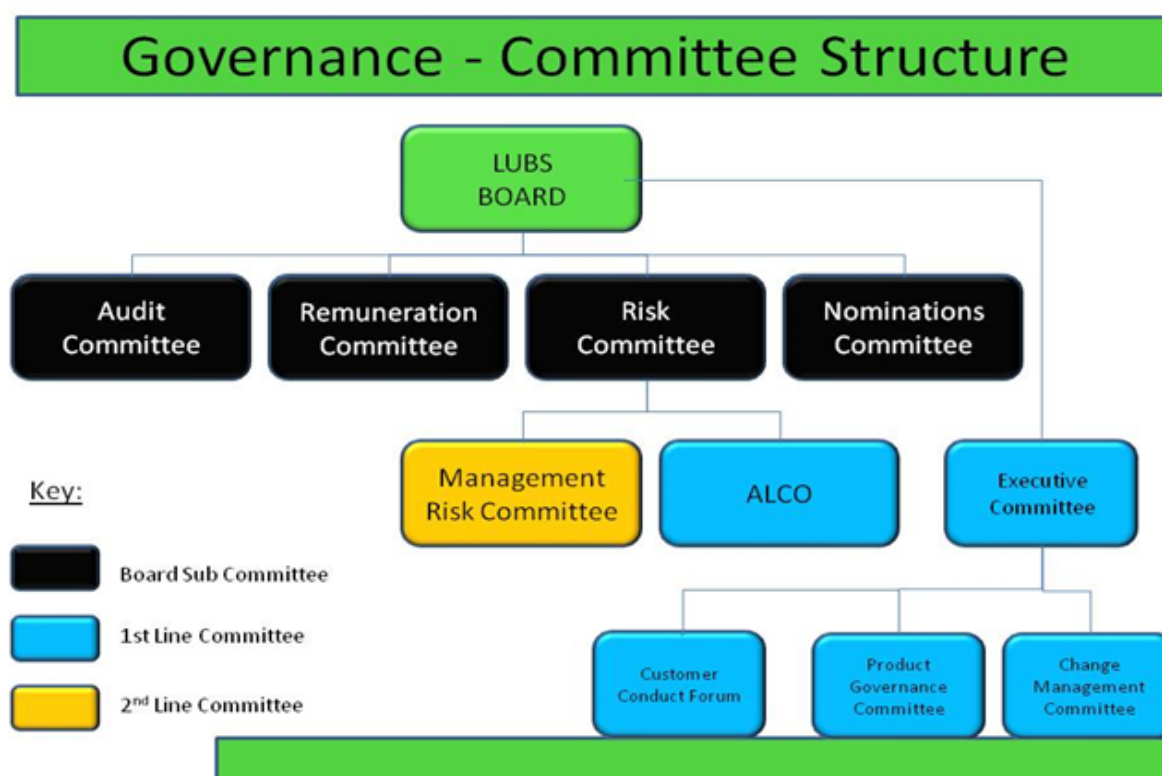
The Board retains ultimate responsibility for ensuring that the Society operates within a framework of prudent and effective controls which enables risk to be assessed and managed.

The Board will review the activities of the Society on an ongoing basis and ensure any risks, risk events, emerging risks, change management activities or key risk indicators are reviewed in accordance with the risk appetite of the Board. Any activities which would breach the appetite must be escalated to the Board for approval. The Board own and approve both the overall and individual elements of the risk appetite for the Society including the RMF.

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 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)	
	Management Risk Committee	Asset & Liability Committee
Pension Risk	Operational Risk	Market Risk
	Conduct Risk	Liquidity and Funding Risk
	Legal and Regulatory Risk	Strategic Risk
	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 meets monthly with the exception of August and met 11 times in 2016.

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:

- To provide assurance to the Board of the independence and quality of the risk and compliance functions.
- To review, challenge and approve the RMF.
- To provide specialist advice to the Board and other Committees in assessing prudential and conduct risks including those arising from the Corporate Planning process and major new business initiatives.
- To ensure the Society has in place an adequate stress testing framework to identify, measure and limit extreme risk (unexpected risk).
- To review, challenge and recommend to the Board for approval the risk appetite statement and supporting risk appetite metrics, ensuring these are linked to stress tests as well as actual and forecast profit, capital and liquidity capacity.
- To provide assurance to the Board that the Society maintains sound risk management and internal control systems.
- To provide assurance to the Board that the Society is up to date with regulatory risk requirements and is adhering to best practice in risk measurement methodologies and risk management practice.

- To review, challenge and recommend to the Board for approval the Internal Capital Adequacy Assessment Process (ICAAP) document.
- To review and approve the terms of reference of the Management Risk Committee (MRC) and the Asset and Liability Committee (ALCO).
- To receive a report summarising any fraudulent activity identified against the Society and on accounts of customers of the Society, ensuring any fraud investigations are performed effectively.
- To review reports from the Money Laundering Reporting Office and review the adequacy and effectiveness of anti-money laundering systems and controls.

The Committee usually meets bi-monthly and met nine times in 2016.

Audit Committee

The Board Audit Committee (BAC), a sub-committee of the Board, assists the Board in carrying out its responsibilities as follows:

- To review the effectiveness of the Society's first and second lines of defence internal controls and risk management systems established by management, to identify, assess, manage and monitor financial and non-financial risks, for ensuring compliance with the regulatory environment in which the Society operates.
- To review management's 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 review the adequacy and security of the Society's arrangements for its employees and contractors to raise concerns in confidence about possible wrong doing in financial reporting or other matters.
- To approve the appointment or removal of the providers of Internal Audit services and to monitor their effectiveness in its operation of the third line of defence.
- To monitor the integrity of the financial statements of the Society, reviewing any significant financial judgements contained therein.
- To review the Pillar 3 disclosure and to recommend to the Board for approval.
- To oversee the appointment, reappointment and removal process of the external auditor; reviewing their performance, objectivity and independence.

The Committee met 5 times in 2016.

Management Risk Committee

The Management Risk Committee (MRC)'s main responsibility is to assess the management of operational, credit and conduct risk together with legal and regulatory risk across the Society. Responsibilities of the MRC also include ensuring the detailed application of the RMF and the development of key risk policies and indicators.

The Committee usually meets monthly.

Asset and Liability Committee

The Asset and Liability Committee (ALCO) supervises the Society'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. Management of market, liquidity and funding, and strategic risk has been delegated to the ALCO.

The Committee usually meets monthly, or more regularly if required for hedging or investment decisions.

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 risk 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 Management Risk 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 those 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 forms an integral part of the corporate planning process, liquidity forecasting and capital planning. These include the following

- Combined: PRA Stress Scenario, UK Variant Scenario, One Year Severe shock
- Credit Risk: Regional HPI Stress, Insufficient Buy to Let Rental Coverage, Counterparty Risk Weighting Deterioration
- Strategic Risk: Margin Stress, Lack of Cost Control
- Market Risk: Basis Risk Stress, Interest Rate Shift
- Liquidity Risk: Liquidity Stress Scenarios
- Conduct Risk: Regulatory Fine
- Regulatory and Legal Risk: Increase in Buy to Let Risk Weighting
- Pension Risk: 1 in 200 Year Scenario
- Operational Risk: Head Office becomes unavailable, IT systems successfully hacked, Significant loss of personnel

The results of these stress tests feed into the ICAAP and the corporate planning process and informs 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. Principle 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 75% 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 10 years, against loss incurred as a consequence of exceeding normal lending limits.

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.

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 MRC monthly and subsequently to BRC. 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 Wholesale Credit Risk policy are reviewed at least annually.

3. Capital Resources

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:

- General Reserves accumulated, Revaluation Reserves and Available for Sale Reserve representing Common Equity Tier 1 Capital (CET1), less net book value of intangible assets
- Collective Mortgage Provision, representing Tier 2 Capital

	31 December 2016 £m	31 December 2015 £m
Tier 1 Capital (all Common Equity Tier 1 Capital)		
General Reserves	56.9	57.8
Revaluation Reserve	1.0	0.9
Available for Sale Reserve	0.1	-
Less intangible assets	(0.2)	-
Total Tier 1 Capital¹	57.8	58.7
Tier 2 Capital		
Collective impairment provisions	0.3	0.4
Total Capital Resources	58.1	59.1

¹Total Tier 1 Capital is the same as CET1 Capital

The net book value of intangible assets is deducted from CET1 and Tier 1 Capital. There are no deductions required from Tier 2 capital. Deferred tax assets 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 £57.8m (2015: £58.7m), comprises general reserves, revaluation reserve, available for sale reserve and intangible assets, as shown in the above table, these in turn agree to the balance sheet in the audited financial statements. The Tier 2 capital of £0.3m (2015: £0.4m) reflects the collective mortgage provision held.

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 Individual Capital Guidance 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:

$$\text{Pillar 1 credit risk capital requirement} = \text{Exposure Value} \times \text{Risk Weighting} \times 8\%$$

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).

In addition to credit ratings, the Society monitors whether the counterparty (where relevant) has passed the Bank of England stress test and, where the counterparty is not subject to the Bank of England stress test, reviews its capital adequacy. Credit ratings are reviewed regularly, with Bank of England stress test results and capital adequacy figures reviewed annually or semi-annually in line with their publication, and all are reported to the monthly ALCO and MRC meetings. Consideration will be given to selling holdings where ratings fall below the minimum criteria for a counterparty.

Capital Requirements Summary

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement.

The following table shows the Society's overall minimum capital requirement as at 31 December 2016.

	31 December 2016 £m	31 December 2015 £m
Total Risk Weighted Assets (Credit & Operational Risk)	322.6	314.0
Credit Risk (Section 5.1)		
Loans and advances to customers	20.9	20.8
Wholesale lending	1.9	1.8
Other	1.1	0.7
Total Credit Risk	23.9	23.3
Operational risk (Section 5.2)	1.8	1.8
Credit valuation adjustment	0.1	-
Capital Requirement under Pillar 1	25.8	25.1
Capital resources (Section 3)	58.1	59.1
Excess of own funds over Pillar 1 Capital requirement	32.3	34.0
Capital Ratios		
Common Equity Tier 1 ratio	17.9%	18.7%
Capital ratio	18.0%	18.8%

Minimum capital requirements relate to RWA multiplied by 8% to give Pillar 1 capital requirements. The capital resources of the Society at 31 December 2016 totalled £58.1m (2015: £59.1m). 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.

CRD IV Disclosure Requirements

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 ratio is defined as the Capital Measure divided by the Exposure Measure, with this expressed as a percentage. The calculation is based on the balance sheet at 31 December.

The capital measure for the leverage ratio is Total Tier 1 Capital (as per Section 3). For the Society, this 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.

	31 December 2016 £m	31 December 2015 £m
Total Tier 1 Capital	57.8	58.7
Exposure:		
Balance Sheet Exposure ¹	928.0	891.0
Derivative Exposure ²	1.7	1.0
Mortgage Pipeline ³	13.0	8.4
Total Leverage Ratio Exposure	942.7	900.4
Leverage Ratio⁴	6.1%	6.5%

Note 1: The balance sheet exposure represents the balance sheet assets in the audited financial statements, adjusted to exclude the collective mortgage provision of £0.3m (2015 £0.4m) and intangible assets deducted from reserves of £0.2m (2015: nil)

Note 2: Represents the positive fair value plus 'potential future exposure' of interest rate swaps

Note 3: Mortgage business offered is converted at a factor of 50% for capital and leverage purposes

Note 4: For the Society, there is no difference between assessing capital and leverage under the transitional rules and the final rules.

The Basel Committee for Banking Supervision (BCBS) will continue to test for a minimum requirement of 3% for the leverage ratio during the parallel run period (i.e. from 1 January 2013 to 1 January 2017).

At 31 December 2016 the leverage ratio of the Society was well above the 3% regulatory minimum at 6.1% based on the final rules.

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 6, the Society has eight principal risks being:

- Credit risk
- Liquidity and Funding risk
- Market risk
- Strategic risk
- Regulatory and Legal risk
- Conduct risk
- Pension risk
- Operational risk

Liquidity and Funding risk, Market risk, Strategic risk, Regulatory and Legal Risk, Conduct risk and Pension risk are discussed in detail in section 2.

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 write-off of Treasury exposures.

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.

Where an advance exceeds 75% 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 10 years, against loss incurred as a consequence of exceeding normal lending limits.

There is potential risk from the failure of a counterparty, however our Treasury policies also mean that we set tight criteria over where we will, and where we won't place excess funds. The criteria include both long term and short term ratings published by external credit rating agencies, which are an indication of a company's creditworthiness as well as the results of published regulatory stress tests.

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 below details the minimum capital requirement by standardised credit exposure class at 31 December 2016:

As at 31 December 2016

Pillar 1 Capital Resource Requirement	Exposure	Risk Weighted Assets	Minimum Capital Requirements
Central Government and Bank of England	111.3	-	-
Credit institutions	69.0	23.5	1.9
Total non-cash liquidity exposures	180.3	23.5	1.9
Non-residential and business - performing loans	2.2	0.8	0.1
Residential use - performing loans	737.8	259.8	20.7
Residential use - past due loans	1.1	1.1	0.1
Gross loans receivables	741.1	261.7	20.9
Fixed and other assets	6.6	8.4	0.7
Total on-balance sheet exposures	928.0	293.6	23.5
Total off-balance sheet exposures	14.7	5.5	0.4
Total Credit Risk Exposure	942.7	299.1	23.9

As at 31 December 2015

Pillar 1 Capital Resource Requirement	Exposure	Risk Weighted Assets	Minimum Capital Requirements
Central Government and Bank of England	87.0	-	-
Credit institutions	84.8	23.1	1.8
Total non-cash liquidity exposures	171.8	23.1	1.8
Non-residential and business - performing loans	12.8	9.7	0.8
Residential use - performing loans	700.6	249.4	19.9
Residential use - past due loans	1.2	1.2	0.1
Gross loans receivables	714.7	260.3	20.8
Fixed and other assets	4.6	5.1	0.4
Total on-balance sheet exposures	891.1	288.5	23.0
Total off-balance sheet exposures	9.3	3.4	0.3
Total Credit Risk Exposure	900.4	291.9	23.3

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 Management Risk 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 2016		31 December 2015	
Standardised Exposure class	Exposure Value £m	Capital Requirement £m	Exposure Value £m	Capital Requirement £m
Secured Residential Mortgages balance <= 80% of indexed valuation	731.7	20.3	695.0	19.5
Secured Residential Mortgages balance > 80% of indexed valuation	8.1	0.5	10.2	0.6
Secured by Mortgages on Commercial Property	0.2	-	0.3	-
Past Due Items	1.1	0.1	1.2	0.1
Unsecured Loan ¹	-	-	8.0	0.6
Total Loans and Advances to customers	741.1	20.9	714.7	20.8

Note 1: The unsecured loan represents a single exposure as part of a syndicated loan provided as part of a registered social landlord arrangement and was repaid during 2016.

The above table is stated after specific provisions of £222k (2015: £133k), but before a collective provision of £281k (2015: £384k). The collection provision is included as Tier 2 capital. The effective interest rate adjustment of £83k (2015: £172k) and fair value adjustment for hedged risk of £1,962k (2015: £754k) 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 2016	<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	8.9	20.0	115.9	586.9	731.7
Secured Residential Mortgages balance > 80% of indexed valuation	-	-	-	8.1	8.1
Secured by Mortgages on Commercial Property	-	-	-	0.2	0.2
Past Due Items	-	-	0.1	1.0	1.1
Unsecured Loan	-	-	-	-	-
Total Loans and Advances to customers	8.9	20.0	116.0	596.2	741.1

31 December 2015	<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	6.9	20.2	113.7	554.2	695.0
Secured Residential Mortgages balance > 80% of indexed valuation	-	-	0.4	9.8	10.2
Secured by Mortgages on Commercial Property	-	-	-	0.3	0.3
Past Due Items	-	-	0.1	1.1	1.2
Unsecured Loan	-	-	8.0	-	8.0
Total Loans and Advances to customers	6.9	20.2	122.2	565.4	714.7

Analysis of loans and advances to customers by geographic area:

31 December 2016	Performing £m	Past due £m	Total £m
West Midlands	185.9	0.9	186.8
North	129.5	-	129.5
East Midlands	90.8	0.1	90.9
London	94.4	-	94.4
Outer South East	70.2	-	70.2
South West	66.0	-	66.0
Yorks & Humberside	49.0	-	49.0
Wales & N Ireland	26.2	-	26.2
East Anglia	27.8	0.1	27.9
Total	739.8	1.1	740.9
Other loans (see below)	0.2	-	0.2
Total	740.0	1.1	741.1

31 December 2015	Performing £m	Past due £m	Total £m
West Midlands	188.9	1.0	189.9
North	125.2	-	125.2
East Midlands	87.0	0.2	87.2
London	87.0	-	87.0
Outer South East	61.2	-	61.2
South West	57.8	-	57.8
Yorks & Humberside	46.9	-	46.9
Wales & N Ireland	25.9	-	25.9
East Anglia	25.3	-	25.3
Total	705.2	1.2	706.4
Other loans	8.3	-	8.3
Total	713.5	1.2	714.7

Other loans include the unsecured loan representing a single exposure as part of a syndicated loan provided as part of a registered social landlord arrangement (which was repaid in 2016), as well as mortgages secured on commercial property.

A loan is considered to be past due where payments are more than 90 days overdue at the reporting date.

Analysis of loans and advances to customers by occupation type:

	31 December 2016	31 December 2015
	£m	£m
Owner occupied	511.3	518.2
Buy to Let	227.6	183.7
RSL	2.0	4.5
Commercial	0.2	0.3
Unsecured loan	-	8.0
Total	741.1	714.7

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

	31 December 2016	31 December 2015
	%	%
Repayment	64%	66%
Interest only	36%	34%
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 Provisions

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

Individual assessments are made of all mortgage loans that are three months or greater in arrears, or in possession, or where there is specific concern about the realisation of the underlying collateral, for example due to structural issues with the property and where there is objective evidence that all cash flows will not be received. 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 and thus a loss event has occurred. The impairment value is calculated by applying various factors to each loan. These factors take into account the Society's expectation of default and delinquency rate, loss emergence periods, regional house price movements and adjustments to allow for forced sale discounts, selling costs and any potential recovery of Mortgage Indemnity Guarantee (MIG). Impairment provisions are made to reduce the value of impaired loans and advances to the amount that is considered to be ultimately received based upon objective evidence.

Of the total loans and advances to customers of £741.3m (before specific provisions) at 31 December 2016 (2015: £714.8m) only £0.9m (2015: £0.6m) required a specific provision. Balances in arrears were £6.1m at 31 December 2016 (2015: £6.3m), of these £1.3m (2015: £1.3m) were more than 90 days in arrears.

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 who have temporary difficulties to get back on their feet. The main options offered are:

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

Customers requesting a forbearance option will need to provide information to support the request which is likely to include the completion of an Income and Expenditure Questionnaire, bank statements, payslips etc. 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 appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is recalculated. 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 provisions during the year.

Individual Provision	2016 £k	2015 £k
At 1 January	133	22
Provision increase/(release)	101	127
Provision utilised	(12)	(16)
At 31 December	222	133

Collective Provision	2016 £k	2015 £k
At 1 January	384	303
Provision increase/(release)	(103)	81
At 31 December	281	384

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 Management Risk Committee to the Board Risk Committee.

The primary source for obtaining information on wholesale asset counterparties' creditworthiness is External Credit Assessment Institutions (ECAIs). The Society uses ratings provided by Fitch. Credit ratings are reviewed regularly and are reported to the Management Risk Committee. The Society reviews the capital adequacy and assesses the financial performance and any risks associated with financial institutions.

BRC 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 MRC and BRC.

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 2016 (£m)		31 December 2015 (£m)	
	Exposure Value	Capital Requirement	Exposure Value	Capital Requirement
Central Government or Central Banks	111.3	-	87.0	-
Institutions	69.0	1.9	84.8	1.8
Total Wholesale Lending	180.3	1.9	171.8	1.8

Residual maturity analysis of wholesale credit exposures:

31 December 2016	<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	111.0	-	-	0.3 ¹	111.3
Institutions	22.5	35.0	11.5	-	69.0
Total Wholesale Lending	133.5	35.0	11.5	0.3	180.3

31 December 2015	<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	76.8	10.0	-	0.2 ¹	87.0
Institutions	37.0	38.1	9.7	-	84.8
Total Wholesale Lending	113.8	48.1	9.7	0.2	171.8

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 2016	Credit Quality Step	< 3 Months £m	>3 Months but <1 Year £m	>1 year £m	Total £m
Fitch Rating					
AAA to AA-	1	118.9	11.9	2.7	133.5
A+ to A-	2	13.7	23.1	0.2	37.0
BBB+ to BBB-	3	0.9	-	8.9	9.8
Total		133.5	35.0	11.8	180.3

31 December 2015	Credit Quality Step	< 3 Months £m	>3 Months but <1 Year £m	>1 year £m	Total £m
Fitch Rating					
AAA to AA-	1	86.5	36.0	1.4	123.9
A+ to A-	2	27.3	8.1	-	35.4
BBB+ to BBB-	3	-	4.0	8.5	12.5
Total		113.8	48.1	9.9	171.8

The ECAI (Fitch) rating is aligned with the relevant credit quality step as defined in the CRR.

Analysis of wholesale credit exposures by geographic area:

31 December 2016	Central Government/ Central Banks £m	Institutions £m	Total £m
United Kingdom	111.3	57.1	168.4
Europe	-	5.0	5.0
Non Europe	-	6.9	6.9
Total	111.3	69.0	180.3

31 December 2015	Central Government/ Central Banks £m	Institutions £m	Total £m
United Kingdom	87.0	73.9	160.9
Europe	-	4.9	4.9
Non Europe	-	6.0	6.0
Total	87.0	84.8	171.8

Wholesale Impairment Provisions

A regular assessment of investment quality is reported monthly to the Management Risk Committee. 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 2016, no wholesale assets were either past due or impaired and no provision has therefore been made.

5.1.3. 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 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 2016	Nominal principal amount £m	Fair Value £m	Replacement Cost £m	Credit risk weighted amount £m
Interest rate contracts maturing:				
In less than 1 year	64.0	(0.4)	-	-
Between 1 year and 5 years	241.8	(2.5)	0.5	0.8
Total	305.8	(2.9)	0.5	0.8

31 December 2015	Nominal principal amount £m	Fair Value £m	Replacement Cost £m	Credit risk weighted amount £m
Interest rate contracts maturing:				
In less than 1 year	43.0	(0.2)	-	-
Between 1 year and 5 years	174.1	(1.2)	0.1	0.3
Total	217.1	(1.4)	0.1	0.3

The net exposure value of derivatives at 31 December 2016, which includes uplifts for Potential Future Credit Exposure (PFCE) under the mark to market method for assessing counterparty credit risk, totalled £1.7m (2015: £1.0m).

5.1.4. Encumbered assets

Encumbered assets consist of the Bank of England Cash Ratio Deposit account and deposits covered by the requirements of Credit Support Annex agreements.

	31 December 2016 £m	31 December 2015 £m
Encumbered assets	4.0	1.9
Non-Encumbered Assets	923.9	888.7
Total	927.9	890.6

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	2016 £m	2015 £m
Annual gross income (2013)		11.7
Annual gross income (2014)	11.3	11.3
Annual gross income (2015)	13.1	13.1
Annual gross income (2016)	12.4	-
Average annual gross income	12.3	12.0
Requirement at 15% Risk Weighting	1.8	1.8

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. 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 Remuneration Committee is responsible for the following:

- To review the overall remuneration policy for the Society.
- To approve appropriate levels of remuneration and conditions for Executive Directors the Head of Risk and Compliance.
- To set the level of fees payable to the Chair of the Board.
- To approve any incentive schemes (excluding those that relate to Executive Directors which are referred to the Board).
- To establish the parameters within which the Executive Directors are to conduct negotiations with employee representatives recognised by the Society for the purpose of setting the general level of remuneration and conditions of employment for all other employees.

In determining remuneration, the Committee considers the guidance in the UK Corporate Governance Code April 2016 (the Code) and applies the FCA Remuneration Code. The Remuneration Committee, is composed solely of Non Executive Directors (three as at 31 December 2016) and met on 7 occasions during 2016.

Further details regarding the remuneration policy are set out in the Directors' Remuneration report in the 2016 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 was introduced for the first time in 2015, for all staff including 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 2016.

	2016			2015		
	No of Staff	Total Remuneration £k	Of which Variable £k	No of Staff	Total Remuneration £k	Of which Variable £k
Executive Directors	3	520	2	3	509	3
Non-Executive Directors	9	154	-	7	154	-
Material Risk Takers ¹	16	718	11	13	620	11
Total	28	1,392	13	23	1,283	14

¹ One individual received £1k holiday pay and £13k as part of a leaving arrangement in 2016

No one individual has received remuneration of EUR1 million or more in 2015 or 2016.

All remuneration was fixed, with the exception of the performance related bonus scheme in 2015 and 2016 which resulted in a maximum payment of £1,000 per annum.

7. 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 Paul Wilson, 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 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
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
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 more than 90 days in arrears
Provisions	Amounts set aside to cover incurred losses associated with credit risks
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK 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 provision (for exposures treated on a Basel II standardised basis)
Wholesale	Lending to financial institutions