Pillar 3 Disclosure

31 December
2014

www.leekunited.co.uk

Leek United
BUILDING SOCIETY

MORTGAGES SAVINGS INSURANCE FINANCIAL PLANNING

Contents

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 (Group) in accordance with the Capital Requirements Directive (CRD).

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

The 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 policy 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 new CRD IV rules.

This document details Leek United's Pillar 3 disclosures as at 31 December 2014, with comparative figures for 31 December 2013 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 Prudential Regulation Authority (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 Edward Street, Leek, Staffordshire, SD13 5DL.

The Society (Group) consists of the following:

Group member	**Activity**
Leek United Building Society	Provision of mortgage and savings products, and general insurance broking services as Leek United Building Society.
Leek United Home Loans Ltd (Wholly owned subsidiary of Leek United Building Society)	The principal activity of the subsidiary is the purchase and administration of mortgage portfolios.
Leek United Financial Services Ltd (Wholly owned subsidiary of Leek United Building Society)	The principal activity of the subsidiary is the provision of financial services.
The Mortgage Outlet Ltd (Wholly owned subsidiary of Leek United Building Society)	The Mortgage Outlet Ltd 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.

2. Structure and Organisation of the Risk Management Framework

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 Internal Capital Adequacy Assessment Process (ICAAP), ILSA (Individual Liquidity Systems Assessment), CFP (Contingency Funding Plan) and Recovery and Resolution Plan (RRP).

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 Internal Capital Adequacy Assessment Process (ICAAP) and ILSA (Individual Liquidity Systems Assessment).

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 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 Board's Risk Appetite Statement is as follows:

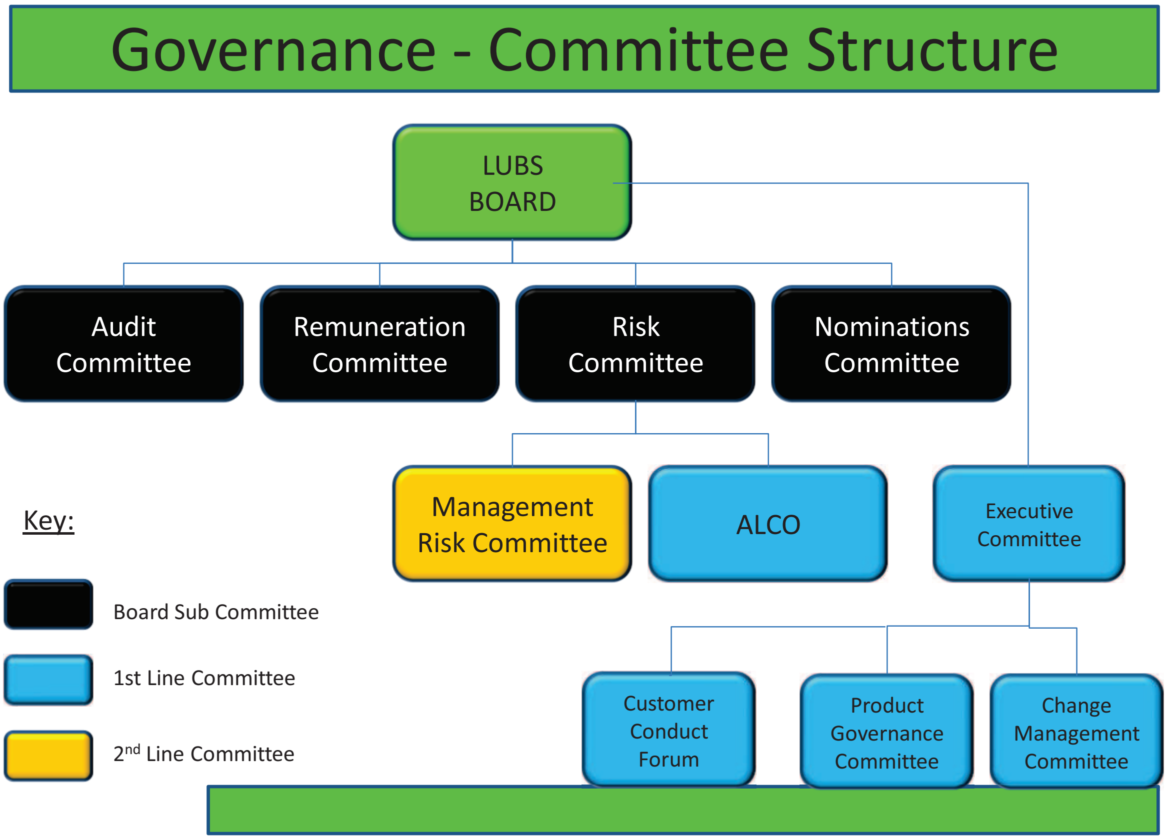
'As a mutual organisation the Board and Management are custodians of the interests of our members. Therefore we seek a position for our risk appetite, which reflects a preference for safe options that have a low degree of risk and may only have a limited potential for reward, whilst sustaining and enhancing Member Value in the Society.'

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 Risk Management Framework (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.

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 Risk and 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.

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
	Reputational & Conduct Risk	Liquidity 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 LUBS Board include:

- Owning and approving the risk appetite for the Society including the Risk Management Framework;
- 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

Board Risk Committee

The role of 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:

- provide assurance to the Board of the independence and quality of the risk and compliance functions;
- to advise the Board on the Risk Management Framework and oversee the design, quality and effectiveness of the Framework;
- to provide specialist advice to the Board and other committees in assessing Prudential and Conduct risks arising;
- to ensure the Society has adequate stress testing in place and to review, challenge and approve this framework;
- to ensure that the risks are being managed in accordance with policy and within the limits of the Board's stated risk appetite;
- to provide assurance to the Board that the Society is adhering to regulatory risk requirements and best practice in risk management methodologies and risk management practice;
- to monitor the identified risk control failings and weaknesses and actions taken to resolve them, in co-operation with the Board Audit Committee.

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The Committee now meets quarterly but met 8 times in 2014.

Audit Committee

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

- the effective operation of the Society's lines of defence, internal controls and risk management systems;

- reviewing the adequacy and effectiveness of the Society's fraud prevention systems and controls;
- the appointment or removal of the Head of Internal Audit, and monitoring of the effectiveness of the Internal Audit function;
- monitoring the integrity of the financial statements of the Society, reviewing any significant financial reporting judgments contained therein;
- the engagement, performance and effectiveness of the external auditor, ensuring that the provision of non-audit services and associated fees do not impair the independence and objectivity of the external audit and that recommendations have been acted upon by the Society.

The Committee meets quarterly.

Management Risk Committee

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

The Committee meets monthly.

Asset and Liability Committee

The 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. Responsibility for market, liquidity and strategic risk has been delegated to the Asset and Liability Committee.

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

Stress Testing and Planning

The Board agrees a number of stress testing scenarios that the business uses to ensure that we consider extreme but plausible events which could impact on the Society. The modelling of those scenarios helps us to understand the impact on our profitability, balance sheet, capital and liquidity positions. We will also undertake reverse stress tests in which scenarios are specifically designed to result in the business model being no longer viable.

Stress testing forms an integral part of our annual business planning process, liquidity forecasting and capital planning.

3. Capital Resources

From the 1st January 2014, the Basel III regulations, more commonly known as CRD IV, have become part of European law. One of the objectives of the new 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 and Revaluation Reserves, representing Common Equity Tier 1 Capital (CET1)
- General Mortgage Provision, representing Tier 2 Capital

	31 December 2014 £m	**31 December 2013 £m**
General Reserves	54.7	53.6
Revaluation Reserve	1.1	1.1
Total Common Equity Tier 1 Capital	**55.8**	**54.7**
Tier 2 Capital	**0.8**	**0.9**
Total Capital	**56.6**	**55.6**

Note that there are no deductions required from Tier 1 or Tier 2 capital. Deferred tax assets are below the 10% CET1 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 £55.8m (2013: £54.7m), comprises general reserves and revaluation reserve, as shown in the above table, these in turn agree to the balance sheet in the audited financial statements. The Tier 2 capital of £0.8m (2013: £0.9m) reflects the general 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 Prudential Regulatory Authority (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 Prudential Regulation Authority, 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 Prudential Regulation Authority 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:

Credit risk capital requirement = Exposure Value x Risk Weighting x 8%.

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

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

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 2014.

	31 December 2014 £m	31 December 2013 £m
Credit Risk (Section 5.1)		
- Loans and advances to customers	19.6	19.1
- Wholesale Lending	3.2	3.0
- Other	0.6	0.5
Operational Risk (Section 5.8)	1.7	1.6
Capital Requirement under Pillar 1	25.1	24.2
Capital resources (Section 3)	56.6	55.6
Excess of own funds over Pillar 1 Capital requirement	**31.5**	**31.4**
Capital Ratios		
Common Equity Tier 1 ratio	17.8%	18.1%
Capital ratio	**18.0%**	**18.3%**

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 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 31st December.

The capital measure for the leverage ratio is Tier 1 Capital (as per Section 3).

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

	31 December 2014 £m	31 December 2013 £m
Total Tier 1 Capital	**55.8**	**54.7**
Exposure:		
Balance Sheet Exposure [1]	906.5	854.3
Derivative Exposure [2]	0.8	1.1
Mortgage Pipeline	6.6	2.9
Total Leverage Ratio Exposure [3]	**913.9**	**858.3**
Leverage Ratio [4]	**6.1%**	**6.4%**

Note 1 The balance sheet exposure represents the balance sheet assets in the audited financial statements, adjusted to exclude the general mortgage provision of £0.8m (2013 £0.9m) and to include the deferred tax asset on the pension scheme liability of £0.5m (2013 nil) which is offset directly against the pension liability in the financial statements
Note 2 Represents the positive fair value plus 'potential future exposure' of interest rate swaps
Note 3 There are no deductions applied to Tier 1 capital so none are applied to the exposure measure
Note 4 For the Society, there is no difference between assessing capital and leverage under the transitional rules and the final rules.

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

At the 31 December 2014 the leverage ratio of the Society was well above the 3% regulatory minimum at 6.1% based on the Final rules.

5. Key Risks

As set out on page 6, the Society has eight principal risks being:

- Credit risk
- Liquidity risk
- Market risk
- Strategic risk
- Regulatory and compliance risk
- Reputational and conduct risk
- Pension scheme obligation risk
- Operational risk

These are explained in more detail in the sections below.

5.1 Credit Risk

Credit risk is the risk of losses arising from a debtor's failure to meet their legal obligations. Concentration risk adds a further dimension to credit risk, arising as a result of the concentration of exposures within the same category, whether geographical, product type or counterparty type. These risks are managed through policies approved by the Board, which provide for a range of limits that are regularly monitored and reviewed in the light of changing economic conditions. The policies reflect the very conservative nature of the Society and its low appetite for risk.

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

In relation to Treasury counterparty credit risk the Society has a low appetite for Treasury credit losses. This is reflected in its assessment of counterparties and in robust internal systems and controls that are in place to prevent credit losses, including segregation of duties and reporting.

The selection of counterparties and the approval of limits involves consideration of the background rating information as well as detailed up to date publicly available credit information, and ongoing monitoring of other market intelligence.

The Asset & Liability Committee reviews counterparty limits on a regular basis and recommends changes to the Board for approval.

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 2014		31 December 2013	
Standardised Exposure class	**Exposure Value £m**	**Capital Require-ment £m**	**Exposure Value £m**	**Capital Require-ment £m**
Secured Residential Mortgages bal <= 80% of indexed valuation	661.2	18.6	663.0	18.7
Secured Residential Mortgages bal > 80% of indexed valuation	5.1	0.3	2.3	0.1
Secured by Mortgages on Commercial Property	0.4	0.0	0.5	0.0
Past Due Items	1.3	0.1	1.4	0.1
Unsecured Loan [1]	8.0	0.7	8.0	0.2
Total Loans and Advances to customers	**676.0**	**19.6**	**675.2**	**19.1**

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 is fully performing.

The above table is net of specific provisions of £18k. A general provision of £800k is held, but is included as Tier 2 capital and therefore not included in the above analysis for credit risk.

Residual maturity analysis of loans and advances to customers:

31 December 2014	**<3 Months £m**	**>3 Months but <1 Year £m**	**>1 Year but <5 Years £m**	**>5 Years £m**	**Total £m**
Secured Residential Mortgages bal < = 80% of indexed valuation	6.3	17.8	112.9	524.2	**661.2**
Secured Residential Mortgages bal > 80% of indexed valuation	-	0.1	0.6	4.4	**5.1**
Secured by Mortgages on Commercial Property	0.1	-	0.1	0.2	**0.4**
Past Due Items	-	-	0.3	0.9	**1.3**
Unsecured Loan	-	-	8.0	-	**8.0**
Total Loans and Advances to customers	**6.4**	**17.9**	**121.9**	**529.7**	**676.0**

31 December 2013	<3 Months £m	>3 Months but <1 Year £m	>1 Year but <5 Years £m	>5 Years £m	Total £m
Secured Residential Mortgages bal < = 80% of indexed valuation	6.0	18.3	113.4	525.3	**663.0**
Secured Residential Mortgages bal > 80% of indexed valuation	-	0.1	0.3	1.9	**2.3**
Secured by Mortgages on Commercial Property	-	-	0.1	0.4	**0.5**
Past Due Items	-	-	0.8	0.6	**1.4**
Unsecured Loan	-	-	-	8.0	**8.0**
Total Loans and Advances to customers	**6.0**	**18.4**	**114.6**	**536.2**	**675.2**

Analysis of loans and advances to customers by geographic area:

31 December 2014	**Non-residential**			**Residential**		
Geographical region	**Performing £m**	**Past due £m**	**Total £m**	**Performing £m**	**Past due £m**	**Total £m**
East Midlands	-	-	-	90.5	-	90.5
Greater London	-	-	-	122.9	-	122.9
North East	-	-	-	14.5	-	14.5
North West	-	-	-	122.4	0.3	122.7
Northern Ireland	-	-	-	0.1	-	0.1
South East	-	-	-	25.7	-	25.7
South West	-	-	-	51.6	0.2	51.8
Wales	-	-	-	19.1	0.1	19.2
West Midlands	0.4	0.1	0.5	180.7	0.6	181.3
Yorks & Humberside	-	-	-	46.8	-	46.8
Total	**0.4**	**0.1**	**0.5**	**674.3**	**1.2**	**675.5**

31 December 2013	Non-residential			Residential		
Geographical region	**Performing £m**	**Past due £m**	**Total £m**	**Performing £m**	**Past due £m**	**Total £m**
East Midlands	-	-	-	86.5	0.1	86.6
Greater London	-	-	-	138.8	-	138.8
North East	-	-	-	13.7	-	13.7
North West	-	-	-	120.6	0.5	121.1
Northern Ireland	-	-	-	0.1	-	0.1
South East	-	-	-	24.3	-	24.3
South West	-	-	-	47.3	0.2	47.5
Wales	-	-	-	16.4	-	16.4
West Midlands	0.5	-	0.5	180.3	0.5	180.8
Yorks & Humberside	-	-	-	45.3	0.1	45.4
Total	**0.5**	**-**	**0.5**	**673.3**	**1.4**	**674.7**

A loan is considered to be past due where three or more monthly repayments have not been made at the reporting date.

Analysis of loans and advances to customers by occupation type:

	31 December 2014 £m	31 December 2013 £m
Owner occupied	500.0	498.9
Buy to Let	163.0	163.3
RSL	12.5	12.5
Commercial	0.5	0.5
Total	**676.0**	**675.2**

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

	31 December 2014 %	31 December 2013 %
Repayment	65%	62%
Interest only	35%	38%
Total	**100%**	**100%**

Policies and limits are set within the Risk Management Framework 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.

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

General provisions are made to reflect the probability that other loans may also be impaired at the balance sheet date, with the result that the amount outstanding may not be recoverable in full. The provision is based upon the Society's experience, current economic trends and consistency with industry levels.

Of the total loans and advances to customers of £676.0m at 31 December 2014 (2013: £675.2m) only £0.8m required a specific provision (2013: £1.1m). Balances one month or more past due were £8.0m at 31 December 2014 (2013: £5.9m), of these £1.3m (2013: £1.4m) were 3 or more months in arrears.

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

	2014 (£k)	**2013 (£k)**
Specific Provision		
At 1st January	18	149
Provision release	-	(124)
Provision utilised	-	(7)
At 31 December	18	18
General Provision		
At 1st January	900	1,000
Provision release	(100)	(100)
Provision utilised	-	-
At 31 December	800	900

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, assesses the financial performance, non-performing loans and any other risks associated with financial institutions.

Minimum credit risk capital requirement by standardised exposure class:

Standardised Exposure Class	31 December 2014 (£m)		31 December 2013 (£m)	
	Exposure Value	Capital Requirement	Exposure Value	Capital Requirement
Central Government or Central Banks	82.8	-	69.2	**-**
Institutions	143.8	3.2	106.1	**3.0**
Total Wholesale Lending	**226.6**	**3.2**	**175.3**	**3.0**

Residual maturity analysis of Wholesale credit exposures:

31 December 2014	<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	82.6	-	-	0.2 [1]	**82.8**
Institutions	64.7	47.7	31.4	-	**143.8**
Total Wholesale Lending	**147.3**	**47.7**	**31.4**	**0.2**	**226.6**

31 December 2013	<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	69.1	-	-	0.1 [1]	**69.2**
Institutions	42.7	52.1	11.3	-	**106.1**
Total Wholesale Lending	**111.8**	**52.1**	**11.3**	**0.1**	**175.3**

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 2014 Fitch Rating	Credit Quality Step	< 3 Months (£m)	>3 Months but <1 Year (£m)	>1 year (£m)	Total (£m)
AAA to AA-	1	93.5	18.6	22.5	134.5
A+ to A-	2	53.8	29.1	9.1	92.1
		147.3	**47.7**	**31.6**	**226.6**

31 December 2013 Fitch Rating	Credit Quality Step	< 3 Months (£m)	>3 Months but <1 Year (£m)	>1 year (£m)	Total (£m)
AAA to AA-	1	74.3	-	10.2	84.5
A+ to A-	2	37.5	52.1	1.2	90.8
		111.8	**52.1**	**11.4**	**175.3**

Analysis of Wholesale credit exposures by geographic area:

31 December 2014	Central Government/ Central Banks (£m)	Institutions (£m)	Total (£m)
United Kingdom	82.8	129.8	212.6
European Union (excl UK)	-	4.9	4.9
Non European Union	-	9.1	9.1
Total	**82.8**	**143.8**	**226.6**

31 December 2013	Central Government/ Central Banks (£m)	Institutions (£m)	Total (£m)
United Kingdom	69.2	106.1	175.3
European Union (excl UK)	-	-	-
Non European Union	-	-	-
Total	**69.2**	**106.1**	**175.3**

Wholesale credit exposures have been diversified in 2014 to include overseas counterparties (within the European Union, Switzerland, USA, Canada and Australia only) who meet strong credit rating criteria as set out in the Society's credit risk policy.

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. As at 31 December 2014, 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.

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 rate	Pay Fixed interest rate Swaps
Fixed Rate Savings products	Sensitivity to falls in interest rate	Receive Fixed interest rate swaps

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

31 December 2014	Nominal principal amount (£m)	Fair Value (£m)	Replacement Cost (£m)	Credit risk weighted amount (£m)
Interest rate contracts maturing:				
In less than 1 year	11.1	(0.1)	-	-
Between 1 year and 5 years	143.1	(1.8)	-	0.2

31 December 2013	Nominal principal amount (£m)	Fair Value (£m)	Replacement Cost (£m)	Credit risk weighted amount (£m)
Interest rate contracts maturing:				
In less than 1 year	30.0	(0.4)	-	-
Between 1 year and 5 years	61.0	0.2	0.9	0.5

The net exposure value of derivatives at 31 December 2014, which includes uplifts for Potential Future Credit Exposure (PFCE) under the mark to market method for assessing counterparty credit risk, totalled £0.8m (2013: £1.2m).

5.2 Liquidity Risk

Liquidity risk is the risk that the Society is unable to meet financial obligations as they fall due. The risk is managed principally by holding cash and other easily realisable liquid assets, and managing funding maturities to avoid bunching. 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.

5.3 Market Risk

Market risk is the risk of any impact on a society's financial condition due to adverse market movements caused by market variables such as interest rates, prices, etc. Market risk in the context of the Society relates primarily to interest rate risk. The Society is not exposed to equity, foreign currency or commodity risk. The Society's strategy and approach to the management of market risk is set out in its Policy Statement on Market Risk. 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 cashflows 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% parallel shift in interest rates, in line with the interest rate gap position disclosed in Note 24 of the audited financial accounts, is less than £0.1m.

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

5.4 Strategic Risk

Strategic risk is the risk of losses as a result of strategic/management decisions or business choices (as distinct from those which occur as the result of breaches of rules or regulations or triggered by legal issues). Strategic risk is managed through the Annual Corporate Planning process and through the application of a comprehensive range of stress tests, designed to evaluate the strength of the Corporate Plan and ensure that this remains within risk appetite.

Strategic risk is further reduced through the independent review and challenge process undertaken by the Board. The Board also receive regular information about market trends and developments, including sectoral benchmarking and peer comparisons.

5.5 Regulatory and Compliance Risk

Regulatory and compliance risk 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 risk is mitigated via ongoing horizon tracking of emerging regulatory issues, themes and legislation as well as the activities of the Compliance team.

5.6 Reputational and Conduct Risk

Reputation and conduct risk is the risk that the perception of the Society is damaged in the eyes of key stakeholders (e.g. members, regulators, colleagues). In the case of customers this is the risk that we are unable to demonstrate that we are putting the customer's interest at the very heart of the business. The risk is mitigated through the review undertaken by the Management Risk Committee in assessing all aspects of product design, together with the activities of the Compliance team in assessing any emerging regulatory changes or requirements, as well as training and competence levels. This is also supported through the Product Governance Committee.

5.7 Pension Scheme Obligation Risk

The pension scheme obligation risk is the risk that there may be a shortfall in the fund arising from improving life expectancy and reduced fund returns, and it is therefore unable to meet its obligations to employees and former employees within the defined benefit scheme. This risk has been reduced by increasing contributions, however, market volatility continues to impact on fund returns. The Board has made adequate provision in the ICAAP for residual pension obligation risks but will continue to monitor progress carefully.

5.8 Operational Risk

Operational risk is the risk of either a loss or negative impact to the Society arising from inadequate or failed internal processes, people and systems or from external events (such as regulation, sector, environment).

The Society seeks to mitigate operational risk through a robust control environment. Operational risk is managed through the Management Risk Committee and reported to the Board Risk Committee.

Minimum Capital Requirements 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.

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

Operational Risk	**2014 £m**	**2013 £m**
Annual gross income (2011)	-	10.2
Annual gross income (2012)	9.9	9.9
Annual gross income (2013)	11.7	11.7
Annual gross income (2014)	12.4	-
Average annual gross income	**11.3**	**10.6**
Requirement at 15% Risk Weighting	**1.7**	**1.6**

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 risk management framework. 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 terms and conditions of employment of Executive Directors and the level of fees payable to Non-Executive Directors. It aims to set remuneration at levels that are sufficient to ensure that the interests of the executives are aligned with those of the Society's members and that the Society is able to attract, retain and motivate high calibre individuals. The Remuneration Committee, comprising solely of Non-Executive Directors (four as at 31 December 2014), met on five occasions during 2014.

Further details regarding the remuneration policy are set out in the Directors' Remuneration report in the 2014 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.
- Benefits – 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 2014.

	Number of Staff	Total Remuneration £'000
Executive Directors*	4	396
Non Executive Directors	6	132
Senior Management	11	512
Total	21	1,040

All remuneration was fixed.

*One individual received £18k holiday pay relating to 2013 and 2014 and an additional £10k as part of an agreed retirement package

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 that a customer or counterparty fails to meet their 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 loss arising from inadequate or failed internal processes, people and systems, or from external events
Past Due Items	Loans which are 90 days or more 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 general mortgage provision (for exposures treated on a Basel II standardised basis)
Wholesale	Lending to financial institutions