Leek United Building Society

Pillar 3 Disclosure

31 December 2013

Contents

1. Introduction

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.

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 (CRR).

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 figures quoted in this disclosure have been drawn from the Group's Annual Report and Accounts as at 31 December 2013, unless otherwise stated.

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

2. Structure and Organisation of the Risk Management Function

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:

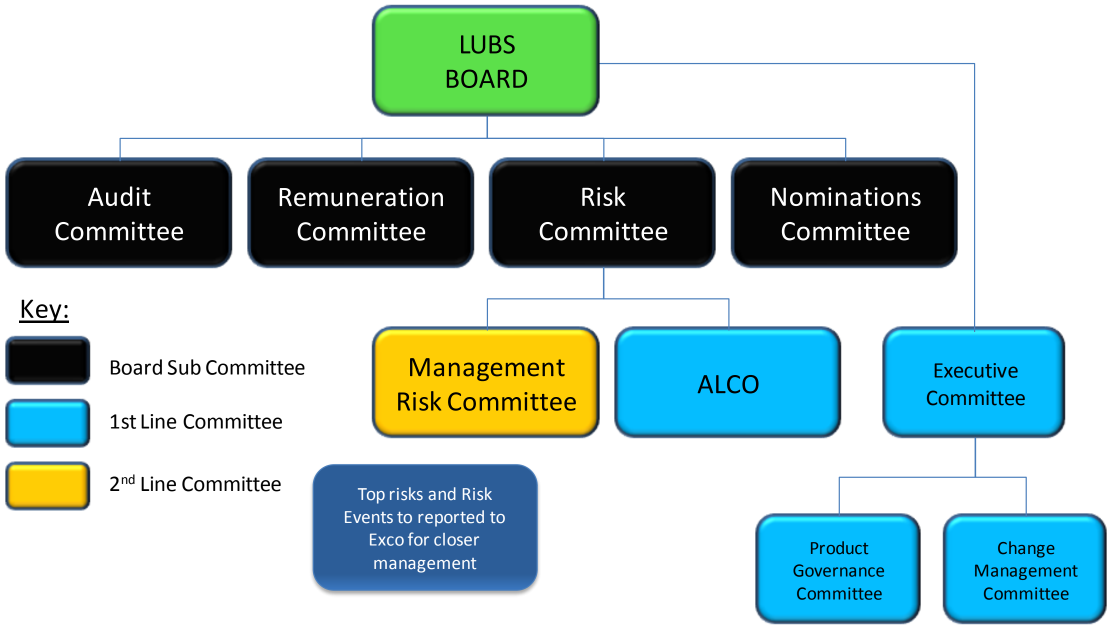
a) Determining the Society's appetite for risk;
b) Determining which types of risk are acceptable and which are not;
c) Providing guidance to management on conduct and probity.
d) Review and approval of the Society Internal Capital Adequacy Assessment Process (ICAAP), ILSA (Individual Liquidity Systems 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 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 Board Risk Appetite is documented within individual risk management policy statements. 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.



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

The Board

The responsibilities of the LUBS Board include:

- 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.

Board Risk Committee

The **Board Risk Committee:**

- Advises the Board on the Risk Management Framework.
- Oversees the design, quality and effectiveness of the Framework.
- Is responsible for risk culture and independence, the risk appetite statement, risk policies and reports of positions against limits, the ICAAP, the Recovery and Resolution Plan and the Pillar 3 disclosure.

In co-operation with the Audit Committee, the BRC monitors identified risk control failings and weaknesses and actions taken to resolve them.

Audit Committee

The **Audit Committee** is responsible for:

- The effective operation of the Society’s internal controls and risk management systems.
- Reviewing the Society’s procedures for detecting fraud and for whistle blowing
- 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.

Management Risk Committee

The **MRC** responsibilities include:

- Overseeing the establishment and maintenance of appropriate risk management systems and controls in line with the Board agreed Risk Management Framework;
- Ensuring the implementation of the risk strategy set by the Board so as to deliver an effective risk management environment
- Monitoring the business's risk profile against the agreed limits and tolerances and reporting on these and any breaches, to the Board Risk Committee.
- Ensure that any regulatory actions are dealt with appropriately and in a timely manner.

Assets and Liability Committee

The Asset and Liability Committee advises and supports the Executive team in carrying out their responsibilities which include:

- Identifying, managing and controlling balance sheet risks in executing its chosen business strategy;
- Overseeing and monitoring relevant strategic, market and liquidity risk appetite limit and risk control frameworks; and
- Ensuring that there are appropriate Key Risk Indicators in place across all core metrics.

3. Risk Management Policies and Objectives

Key Risks

Credit risk

Credit risk is the risk that the Society will incur unexpected losses arising from the failure of customers and counterparties to meet obligations to repay. 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 Assets & Liabilities Committee reviews counterparty limits on a regular basis and recommends changes to the Board for approval.

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 Assets and Liabilities 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 cashflow by either a reduction in interest income or an increase in interest expense.

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

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 by implementing strong controls as defined within the FS Handbook – Senior Management Arrangements, Systems and Controls (SYSC) and the Prudential Sourcebook for Building Societies (BIPRU). 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 Board has ensured that suitable capital provisions are made where appropriate.

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.

Pension scheme liability risk

The pension scheme liability 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.

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

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.

Regulatory and Legal risk

Regulatory and legal 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 as note.

4. Capital Resources

The capital resources of the Society are calculated in accordance with the requirements of GENPRU 2 of the FS Handbook.

The capital resources consist of:

- General Reserves accumulated and Revaluation Reserves, representing Tier 1 Capital
- General Mortgage Provision, representing Tier 2 Capital

December 2013	**£m**
Tier 1 Capital	54.7
Tier 2 Capital	0.9
Total Capital	**55.6**

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 regulatory capital. 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 risk weightings.

5. Pillar 1 Summary

	Asset amount £m	Risk weighted amount (RWA) £m	Allocated capital at 8% of RWA £m
On Balance Sheet:			
Real Estate, Retail and Past Due Assets			
Residential Real Estate - Performing	671.0	234.9	18.8
Retail (Secured by Real Estate Collateral)	2.3	1.7	0.1
Residential Real Estate – Past Due	1.4	1.4	0.1
Commercial Real Estate - Performing	0.5	0.4	0.0
Total Real Estate, Retail and Past Due Assets	**675.2**	**238.4**	**19.0**
Treasury Assets			
Central Government/Central Banks	69.2	0.0	0.0
Institutions	106.1	37.1	3.0
Total Treasury Assets	**175.3**	**37.1**	**3.0**
Other assets	**3.8**	**5.1**	**0.4**
Total On Balance Sheet	**854.3**	**280.6**	**22.4**
Off Balance Sheet:			
Institutions (Derivatives)	-	0.5	0.0
Secured on Real Estate (Pipeline)	-	2.7	0.2
Total Off Balance Sheet		**3.2**	**0.2**
Operational Risk			**1.5**
Total Exposure Value			**24.1**

Further analysis of credit risk - mortgages

<u>Analysis of loan book by geographic area as at 31 December 2013</u>

	Non-residential			Residential		
Geographical region	**Performing £m**	**Past due £m**	**Total £m**	**Performing £m**	**Past due £m**	**Total £m**
East Anglia	0.0	0.0	0.0	19.1	0.0	19.1
East Midlands	0.0	0.0	0.0	71.5	0.1	71.6
Greater London	0.0	0.0	0.0	134.8	0.0	134.8
North West	0.0	0.0	0.0	108.5	0.7	109.2
South East	0.0	0.0	0.0	24.3	0.0	24.3
South West	0.0	0.0	0.0	47.3	0.2	47.5
Wales	0.0	0.0	0.0	16.4	0.0	16.4
West Midlands	0.5	0.0	0.5	188.3	0.5	188.8
Yorks & Humberside	0.0	0.0	0.0	45.3	0.1	45.4
Northern England	0.0	0.0	0.0	17.6	0.0	17.6
Total	**0.5**	**0.0**	**0.5**	**673.1**	**1.6**	**674.7**

A loan is considered to be past due where 3 or more monthly repayments have not been made at the reporting date.

Maturity Analysis

A residual maturity of combined exposures to loans secured on real estate and past due loans as at 31 December 2013 is detailed below:

	£m
In not more than 3 months	6.0
In more than 3 months but not more than one year	18.4
In more than one year but not more than 5 years	114.6
In more than 5 years	<u>536.2</u>
	675.2
Less: provisions	(0.9)
Total	**674.3**

Mortgage Provisioning Approach

Provision is made for all incurred losses on loans and advances based upon an appraisal. 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 and the outstanding loan balance, after making appropriate allowance for costs of repossession and 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.

Further analysis of credit risk - treasury

Breakdown of liquid assets by maturity and rating at 31 December 2013

Ratings	< 3 Months	3 Months to 1 year	>1 year	Total
	Maturity of Liquid Assets			
	£m	£m	£m	£m
AAA to AA-	74.3	0.0	10.2	84.5
A+ to A-	37.5	53.3	0.0	90.8
	111.8	**53.3**	**10.2**	**175.3**

Geographic Distribution of Exposures

Geographical Area	Central Government/ Central Banks £m	Regional Government/ Local Authorities £m	Institutions £m	Total £m
United Kingdom	69.2	0.0	106.1	175.3
European Union (excl. UK)	0.00	0.0	0.0	0.0
Non European Union	0.00	0.0	0.0	0.0
Total	**69.2**	**0.0**	**106.1**	**175.3**

Derivatives

Derivatives are only used by the group 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 or other factors specified in the legislation. The group does not trade in derivatives or use them for speculative purposes.

	Nominal principal amount 2013 £m	Credit risk weighted amount 2013 £m	Replacement Cost 2013 £m
Interest rate contracts maturing:			
In less than 1 year	30	-	-
Between 1 year and 5 years	61	0.1	0.4

The Society uses a combination of on and off-balance sheet hedging instruments rather than just hedging individual transactions. The Board operates a risk-averse approach to, in particular, interest rate risk and ensures, as far as possible, such exposures are acceptable which, where appropriate, will usually involve the arrangement of suitable hedging instruments, such as fixed pay swaps, to hedge fixed rate mortgages, to neutralise or reduce risk.

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, comprising solely Non-Executive Directors, 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 main components of remuneration for code staff 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, pension and medical insurance.

The table below sets out the aggregate remuneration for staff whose professional activities have a material impact on the Society's risk profile i.e. Approved persons, in relation to their services for the Group for the year ended 31 December 2013.

	Number of staff	Fixed Remuneration £'000	Total Remuneration £'000
Executives and Senior Management (Approved Person status)	6	577	577
Non Executive Directors	7	143	143