Leek United Building Society

Pillar 3 Disclosure

31 December 2012

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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.
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> **Pillar 3**: This policy document deals with the requirements under Pillar 3 (disclosure) and the information provided is in accordance with the Rules laid down in the FSA handbook.

The Board approved the ICAAP on 22 May 2013.

The figures quoted in this disclosure have been drawn from the Group's Annual Report and Accounts as at 31 December 2012, 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

The Board is responsible for determining a framework for risk management and control and approves all policies and Committee terms of reference. It deploys the Audit and Risk Committee and the Risk Management Committee to administer a risk management process which identifies the key risks facing the business and monitors the activities of those Committees and how risks are being managed.

Audit and Risk Committee

The Committee's role with respect to risk management is to assure the Board that risks are being managed in accordance with the Operational Risk Policy, and the relevant sections of the Lending Policy and treasury policy statements (Liquidity and Market Risk) with respect to Credit, Market and Liquidity Risk, and that the system of internal control is also functioning effectively.
The Committee also reviews the ICAAP on a half yearly basis and recommends its approval to the Board.

Risk Management Committee

The Risk Management Committee's main responsibility is to assess and monitor the management of risk across the Group.

Internal Audit

Though not part of the structure for the management of risk, the internal audit function provides independent and objective assurance that these processes are appropriate and are effectively applied.

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. The Society is exposed to credit risk through the mortgage book and liquid assets. 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.

Some mild geographical concentration does exist within the mortgage book but this is continuing to diminish.

Stress testing of the mortgage book has revealed that the Society's book is extremely resilient even when subject to a 40% drop in values.

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

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. The Society has adopted the Extended Approach to Risk Management and manages all risks across the Balance Sheet in a structured approach, the objectives being to confine the level of interest rate and maturity risk to a level which is acceptable and to minimise risks affecting the Society's future business objectives. By delegated authority of the Board, the Assets and Liabilities Committee (ALCO) controls and supervises the Society's treasury and related risk management activities.

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 FSA Manual – 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.

Interest rate risk

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 Society has adopted the Extended Approach to interest rate risk, which allows greater flexibility over the matching of fixed rate exposures on either side of the balance sheet, using a combination of 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 to neutralise or reduce risk.

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.

4. Capital Resources

December 2012	**£'000**
Tier 1 Capital	52,379
Tier 2 Capital	2,313
Total Capital	**54,692**

5. Pillar 1 Summary

	Asset amount	**Risk weighted amount (RWA)**	**Allocated capital at 8% of RWA**
	£'m	**£'m**	**£'m**
Loans and advances to customers			
Commercial Loans secured on property	0.70	0.70	0.06
Residential loans secured on property	620.50	219.31	17.54
	621.20	**220.01**	**17.60**
Treasury and other assets			
Liquid assets placed with financial institutions	184.35	43.92	3.52
Other assets	4.00	4.00	0.32
	188.35	**47.92**	**3.84**
Total credit risk exposures and RWA	**809.55**	**267.93**	**21.44**
Operational risk capital allocation			**1.53**
Pillar 1 capital allocation			**22.97**

Further analysis of credit risk - mortgages

Analysis of residential loan book by geographic area as at 31 December 2012.

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

	Non-residential			Residential		
Geographical region	Performing £m	Past due £m	**Total £m**	Performing £m	Past due £m	**Total £m**
East Midlands				83.7	0.0	83.7
Greater London				122.8	0.0	122.8
North East				10.8	0.0	10.8
North West		0.1	0.1	106.8	0.0	106.8
South East				20.8	0.0	20.8
South West				39.9	0.0	39.9
Wales				13.7	0.0	13.7
West Midlands	0.6		0.6	183.9	0.5	184.4
Yorks & Humberside				37.1	0.1	37.2
Total	**0.6**	**0.1**	**0.7**	**619.5**	**0.6**	**620.1**

Further analysis of credit risk - treasury

Breakdown of liquid assets by maturity and rating at 31 December 2012.

	Maturity of Liquid Assets			
Ratings	**< 3 Months**	**3 Months to 1 year**	**>1 year**	**Total**
	£'m	**£'m**	**£'m**	**£'m**
AAA to AA-	67.66	0	15.01	82.67
A+ to A-	27.69	54.27	19.72	101.68
	95.35	**54.27**	**34.73**	**184.35**

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 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.

- Variable pay – relevant senior managers are eligible to participate in a discretionary non-pensionable annual bonus scheme. This is calculated by reference to business performance measured together with individual performance against personal objectives, both of which are linked to the achievement of the Group's strategic objectives (which include effective risk management).

- Benefits – include the provision of a car, pension and medical insurance for code staff.

The table below sets out the aggregate remuneration for code staff in relation to their services for the Group for the year ended 31 December 2012.

	Number of staff	Fixed Remuneration £'000	Variable Remuneration £'000	Total Remuneration £'000
Senior management	8	663	25	688
Other code staff	8	128	-	128