Pillar 3 Capital Disclosures

(under CRD IV)

Year ended 31 March 2020

the West Brom

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Section 1 – **Executive summary**

Introduction

This document presents the consolidated Pillar 3 disclosures of the West Bromwich Building Society Group ('the Group' or 'the Society') as at 31 March 2020, providing details regarding our capital and risk management. As a building society there are a number of risks which the Society is inherently exposed to. Holding capital is one way in which the Society protects members from the impact of a risk event and this report summarises the Society's capital position.

These Pillar 3 disclosures are made at a time of global uncertainty with the full economic repercussions of the COVID-19 pandemic yet to unfold. In response, the Bank of England and HM Treasury have introduced unprecedented support measures for individuals and businesses. From the Society's perspective, a robust capital position, together with the dedication of our colleagues, has enabled us to continue delivering the critical services on which our members depend and those which are integral to support the foundations of the UK economy. This will remain our focus as we enter into the new financial year.

Summary of the Society's strategy and key metrics

Our strategy is focused on the simple premise of delivering our purpose – supporting the financial wellbeing of our members by providing a safe and good return on the savings they entrust with us and promoting home ownership through responsible lending. Our purpose guides the development of our business model, primary activities and strategic priorities. The historic provision of finance for commercial real estate investment is deemed strategically as non-core which is reflected in the ongoing reduction in the Group's exposure.

Capital and leverage ratios have remained well in excess of regulatory requirements. Under the CRD IV transitional rules effective at the reporting date, the CET 1 ratio has remained stable at 15.9% (2019 restated: 15.9%) and the total capital ratio was maintained at 17.2% (2019: 17.2%). On the CRD IV full implementation basis, which also includes full recognition of the capital impact of IFRS 9 adoption, the CET 1 ratio decreased from 15.1% (as restated) to 15.0% and the total capital ratio was down slightly from 16.0% (as restated) to 15.9%.

CRD IV requires firms to calculate a non-risk-based leverage ratio, to supplement risk-based capital requirements. The Society manages the leverage ratio through regular monitoring and reporting, which forms part of its risk appetite. The leverage ratio reduced marginally to 6.9% (2019: 7.0%) due in part to increased IFRS 9 provision requirements, based on a weakening economic outlook, and the unwind of IFRS 9 transitional relief whereby the increased credit losses arising on adoption of the IFRS 9 accounting standard are, for capital purposes, being recognised over the five year period to 31 March 2023.

At 31 March 2020, the Society's Liquidity Coverage Ratio (LCR) was 188% (2019: 195%). The LCR exceeds the current regulatory minimum requirement of 100%.

Full details of the Society's overall financial position as at 31 March 2020, can be found in the 2020 Annual Report and Accounts. A summary of our key capital ratios, under CRD IV transitional and fully implemented rules, are shown below:

At 31 March

	Transitional CRD IV rules 2020 £m	**Full implementation of CRD IV 2020 £m**	Transitional CRD IV rules 2019* £m	Full implementation of CRD IV 2019* £m
Available capital				
Common Equity Tier 1	**373.3**	**345.2**	382.1	350.7
Additional Tier 1	**8.9**	**-**	8.9	-
Tier 2	**21.6**	**21.6**	21.6	21.6
Total regulatory capital	**403.8**	**366.8**	412.6	372.3
Total risk-weighted assets	**2,347.5**	**2,308.5**	2,400.2	2,321.3
Risk-based capital ratios as a percentage of RWA	**%**	**%**	%	%
Common Equity Tier 1 ratio	**15.9**	**15.0**	15.9	15.1
Tier 1 ratio	**16.3**	**15.0**	16.3	15.1
Total regulatory capital ratio	**17.2**	**15.9**	17.2	16.0
CRR leverage ratio	**£m**	**£m**	£m	£m
Leverage ratio exposure measure	**5,569.6**	**5,569.6**	5,588.7	5,588.7
	%	**%**	%	%
CRR leverage ratio	**6.9**	**6.2**	7.0	6.3
Liquidity coverage ratio	**188**	**188**	195	195

Table 1: Key metrics
*2019 key metrics have been restated as explained in section 2.

Section 2 – **Overview**

Background

The European Parliament and Council approved capital reforms which implemented Basel III into Europe from 1 January 2014. The rules brought in by the EU regulations, the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) applied through the Prudential Regulation Authority (PRA), are referred to collectively as CRD IV.

The objective of the CRD IV package is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the risk of spill-over from the financial sector into the wider economy.

CRD IV also sets out disclosure requirements relevant to banks and building societies under CRR Part Eight (Articles 431 to 455) of Regulation (EU) No 575/2013. These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review and evaluation process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

The Society has adopted the Pillar 1 Standardised Approach to credit risk, counterparty credit risk and operational risk.

The Financial Conduct Authority (FCA) and the PRA are responsible for the regulation of the Society. In this document the PRA and FCA are collectively described as 'the regulator'.

Basis and frequency of disclosure

This document sets out the 2020 Pillar 3 disclosures for the Society. These disclosures have been prepared solely to give information on the basis of calculating Basel III requirements and on the management of risks faced by the Society in accordance with the rules laid out in CRR Part Eight.

The CRR requires the Society to adopt a formal policy to comply with Pillar 3 disclosure requirements and the European Banking Authority (EBA) has issued guidelines on materiality, proprietary and confidential information and disclosure frequency. The Board has put in place such a policy.

All disclosures will be issued on an annual basis, as a minimum, and more frequently if appropriate. The disclosures have been published in conjunction with the publication date of the Society's 2020 Annual Report and Accounts and the information presented is based on those accounts unless otherwise stated. The Pillar 3 disclosures do, in some instances, vary from those reflected in the Annual Report and Accounts due to differences between capital and accounting reporting requirements. This is explained further in the 'Scope' section.

Non-material, proprietary or confidential information

CRR Part Eight allows institutions to omit one or more of the required disclosures (disclosure waivers) if information provided by such disclosures is not regarded as material or if it would be regarded as proprietary or confidential.

There is a requirement to calculate and maintain regulatory capital ratios on both a Group and an Individual Consolidated ('Solo') basis. However, for West Bromwich Building Society, there are no material differences between the Group and Solo consolidation figures. Therefore, the disclosures in this document are presented on a Group basis only.

The Society does not disclose key ratios and figures relating to its risk appetites, as they are considered to be proprietary information as per CRR article 432.

Scope

The principal subsidiaries included in the accounting and regulatory capital group are:

- West Bromwich Mortgage Company Limited (including subsidiary CL Mortgages Limited and quasi-subsidiaries Hawthorn Finance Limited and Hawthorn Asset Co. Limited);
- West Bromwich Commercial Limited;
- West Bromwich Homes Limited;
- Insignia Finance Limited (including subsidiary White Label Lending Limited);
- Kenrick No. 2 Plc (a quasi-subsidiary);
- Kenrick No. 3 Plc (a quasi-subsidiary); and
- West Bromwich Funding Limited (a quasi-subsidiary).

Full details of the Society's subsidiary undertakings are included in Note 15, 'Investments', to the 2020 Annual Report and Accounts.

There are no material current or foreseen practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities between the parent undertaking and its subsidiary undertakings.

The basis of consolidation for accounting (under International Financial Reporting Standards) differs to that for regulatory capital purposes (under CRD IV) as described below.

During the year, management reassessed the accounting for certain securitisation arrangements, specifically those relating to Sandwell Commercial Finance No. 1 plc and Sandwell Commercial Finance No. 2 plc ('the entities'). The principal activities of the entities is that of holding non-core commercial mortgage portfolios. Previously, the entities were fully consolidated into the Group accounts. In these entities the Society has limited exposure to credit losses, with risk transferred in part to third party investors who have purchased loan note securities issued by the entities. The Society's first loss exposure has been fully written down such that the Group is not exposed to further credit losses in these entities. This resulted in a re-evaluation of IFRS 10 'Consolidated Financial Statements' criteria for consolidation of these entities. Management deemed that the Society is no longer exposed to variable returns from these entities as the credit enhancement features have been fully utilised and there is no realistic prospect of this reversing, or of any deferred consideration becoming receivable from the entities. As a result, the entities were deconsolidated with effect from 31 December 2019.

Section 2 – **Overview** (continued)

Scope (continued)

Post-deconsolidation the securitised commercial mortgages continue to be recognised in the Group financial statements reflecting the fact that the derecognition criteria of IFRS 9, 'Financial Instruments', and its predecessor IAS 39, were not met at the time of the securitisation transaction.

There has been no change to the capital treatment of these structured entities, whereby a deduction is made against capital available for the residual risk to the Group pertaining to Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc. This treatment is adopted because, as described above and in Section 11 – Structured entities and securitisation, the significant credit risk associated with the securitised exposures is considered to have been transferred to third parties.

Within this document references to the Society are to the regulatory Group unless otherwise indicated.

Location and verification

These disclosures have been reviewed by the Audit Committee (AC) on behalf of the Society's Board and are published on the West Bromwich Building Society website (www.westbrom.co.uk). These disclosures have not been, and are not required to be, subject to independent external audit, and do not constitute any part of the Society's financial statements; however, some of the information within the disclosures also appears in the Society's audited 2020 Annual Report and Accounts.

European Banking Authority Guidelines on Pillar 3 disclosures

The Society is not a Globally or Other Systemically Important Institution and, taking account of its simple business model and size, has chosen not to reflect the 2016 and 2017 EBA Guidelines for such institutions in its 2020 disclosures other than abbreviated disclosures of the Liquidity Coverage Ratio (LCR) in Section 9 – Liquidity risk.

Regulatory developments

The Basel Committee on Banking Supervision released 'Basel III: Finalising post-crisis reforms to the Basel III framework' in December 2017, with these revised standards initially due to take effect from 1 January 2022, and phased in over five years. The reforms include the following elements; revisions to the Standardised and Internal Ratings Based approach for credit risk, revisions to the Credit Valuation Adjustment (CVA) framework, a revised Standardised Approach for operational risk, revisions to the leverage ratio and new output floor requirements. Revisions to the market risk framework and Pillar 3 disclosure requirements, finalised in January 2019 and December 2018 respectively, had a concurrent original implementation date of 1 January 2022. On 27 March 2020, in response to the development of the COVID-19 pandemic, the Basel Committee's oversight body announced the deferral, by one year to 1 January 2023, of the implementation timelines for the revised Basel III standards, market risk framework and Pillar 3 disclosure requirements. Although initial implementation is now over two years away, the changes are expected to be material for the Society and are therefore being taken into account for internal planning purposes.

In June 2019, the EU published the final Capital Requirements Regulation II or CRR II (EU Regulation 2019/876) in the Official Journal of the European Union. These rules refine and continue to implement Basel III in the EU and amend a number of areas including the leverage ratio, the net stable funding ratio, counterparty credit risk, market risk and exposures to central counterparties, as well as introducing changes to reporting and disclosure requirements.

As part of the EU's Bank Recovery and Resolution Directive, the framework and policies for setting Minimum Requirements for Own Funds and Eligible Liabilities (MREL) are being phased in, on a transitional basis, from 2020. The Society has been classified as a 'modified insolvency' firm for the purposes of MREL which means that the MREL regime does not introduce any additional capital requirements for the Society.

The UK countercyclical capital buffer (CCyB) is set by the Financial Policy Committee (FPC) and creates an additional cushion for banks and building societies to absorb potential losses and continue lending in the event of a stress. In March 2020, the FPC responded to the emerging economic impact of the COVID-19 outbreak by reducing the UK CCyB rate to 0% and cancelling future planned increases. The rate had previously been 1% and had been due to increase to 2% in December 2020. In accordance with Regulation (EU) 2015/1555, disclosures on the CCyB at 31 March 2020 are presented in Appendix 2.

Prior year restatement

It was identified during the year that certain mortgages within the portfolio interest rate risk hedge had been valued, at 31 March 2019, with reference to SONIA. Although this was relevant to hedging instruments (SONIA linked interest rate swaps) within the portfolio, this did not correspond to the documented hedged risk for that portfolio (being fair value movements attributed to movements in LIBOR). The hedged items (mortgages) have been revalued in accordance with the documented hedged risk, resulting in adjustments to the prior year financial statements as outlined in Note 43 to the 2020 Annual Report and Accounts. The cumulative fair value hedge adjustment will tend to nil over the remaining fixed term of the mortgages currently in the hedge, and it is anticipated that the charge recorded as a result of this adjustment will unwind over the remaining fixed term of the mortgages currently designated as hedged items, resulting in a corresponding credit to the Group (and Society) Income Statement.

The 2019 comparative information in these Pillar 3 disclosures has been restated to reflect the change described above which resulted in reductions in CET 1 capital and risk weighted assets at 31 March 2019 of £1.1m and £0.4m respectively. There was no change to reported capital requirements as the impact of the restatement was less than £0.1m. Under CRD IV transitional rules, the 2019 CET 1 ratio decreased from 16.0% to 15.9%, as a result of the prior year restatement, but the Tier 1 and total capital ratios were unchanged. Under full implementation rules (including full recognition of IFRS 9 adoption), the CET 1, Tier 1 and total capital ratios each fell by 0.1% to 15.1%, 15.1% and 16.0% respectively. The prior year adjustment had no impact on the CRR leverage ratio on either a transitional or full implementation basis.

Section 3 – **Risk management objectives and policies**

Overview

Effective management of risks and opportunities is essential to achieving the Society's objectives. The Board aims to manage effectively all the risks that arise from its activities and believes that its approach to risk management reflects an understanding of actual and potential risk exposures, the quantification of the impact of such exposures and the development and implementation of controls that manage exposures within the Board's agreed risk appetite.

Categorisation

In order to identify the key risk categories most relevant to the Society, the Board considered an overall risk universe relating to firms in the financial services sector. This has been distilled into eleven Principal Risk categories as shown below.

The main risks we manage are:

- Capital risk; Section 5
- Credit risk; Section 6
- Market risk, including interest rate risk; Section 7
- Basis risk; Section 7
- Operational risk; Section 8
- Liquidity risk; Section 9
- Information risk; Section 10
- Pension liability risk; Section 10
- Business risk; Section 10
- Retail conduct risk; and Section 10
- Model risk. Section 10

Risk management framework

The Society's activities are governed by its constitution, principles and values. The Board have also agreed a set of Risk Appetite Statements which describe the Board's risk appetite in terms of the principal risk categories indicated above. Further information can be found in the Risk Management Report of the 2020 Annual Report and Accounts on pages 33 to 39.

These Risk Appetite Statements drive corporate planning activity, including capital and liquidity planning, as well as providing the basis for key risk measures which set out the level of risk that the Society is willing to accept or tolerate. The Board reviews and approves risk appetite on an annual basis, or more frequently in the event of changes to the risk environment, with the aim of ensuring that it is consistent with the Society's strategy, business and regulatory environment.

The Society does not disclose key ratios and figures relating to its risk appetite, as they are considered to be proprietary information as per CRR article 432.

The final element of the framework is the formal structure for managing risk. This is based on the 'Three Lines of Defence' model which is illustrated below.

	Activity	Responsibility	Governance
First	Business Operations	Line Management	Line Management Oversight
Second	Policy, Controls, Measure, Monitor	Control Functions	Management and Board Committees
Third	Assurance	Internal Audit	Audit Committee

Governance structure

During the year risk governance was provided by a structure consisting of nine key risk management committees. Each principal risk has a committee with overall responsibility for managing the risk category and making recommendations to the Executive Risk Committee (ERC):

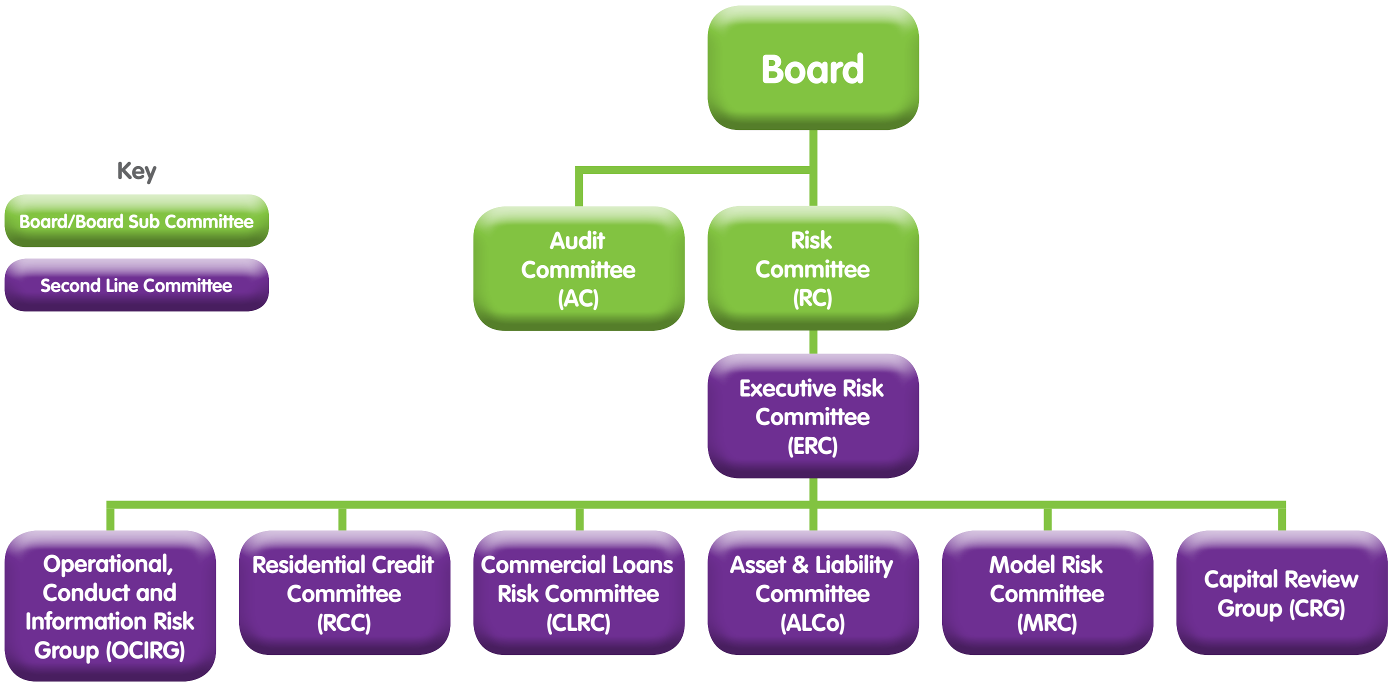
- **Risk Committee (RC)** – This committee, chaired by a Non-Executive Director and comprising of all Non-Executive Directors except the Chairman, is responsible for the oversight and management of the principal and key strategic risks identified by the Board.
- **Executive Risk Committee (ERC)** – This Committee is chaired by the Chief Risk Officer and is responsible for providing the Executive and the RC with an enterprise wide view of the risk profile of the Society, including current and potential risks. The ERC is also accountable for driving the detailed implementation of the Society's Risk Management Framework.
- **Assets & Liabilities Committee (ALCo)** – This Committee is chaired by the Group Finance & Operations Director and is responsible for overseeing the assets and liabilities risk including the assessment of exposure to counterparty credit, market, liquidity, pension liability, basis and interest rate risk.
- **Residential Credit Committee (RCC)** – This Committee is chaired by the Chief Credit Officer and is responsible for monitoring the Society's residential lending activity and its exposure to credit risks in the retail loan books.
- **Commercial Loans Risk Committee (CLRC)** – This Committee is chaired by the Chief Risk Officer and is responsible for monitoring the Society's exposure to credit risks in the commercial loan book.

Section 3 – **Risk management objectives and policies** (continued)

Governance structure (continued)

- **Operational, Conduct & Information Risk Group (OCIRG)** – This Group is chaired by the Chief Risk Officer and is responsible for the oversight of the management of operational and retail conduct risks arising from the Society's business activities. It also maintains oversight and governance of Information Risk across the Society and challenges the effectiveness of the controls in place to mitigate Information Risk (including cyber security). One of its purposes is to support and drive the information risk governance agenda and provide oversight that effective information governance best practice mechanisms are in place within the Society. The Group also reviews activities relating to the development and delivery of the Society's Operational Resilience Plan and Business Continuity and Disaster Recovery Risk Management Framework, important components against which to manage operational resiliency.
- **Capital Review Group (CRG)** – This Group is chaired by the Group Finance & Operations Director and is responsible for reviewing the Society's capital requirements.
- **Model Risk Committee (MRC)** - This Committee is chaired by the Chief Risk Officer and is responsible for overseeing the Society's exposure to model risk across the business.
- **Audit Committee (AC)** – Comprising four Non-Executive Directors, the Committee provides the Board with assurance regarding the integrity of the financial statements and the adequacy and effectiveness of the Society's risk management frameworks.

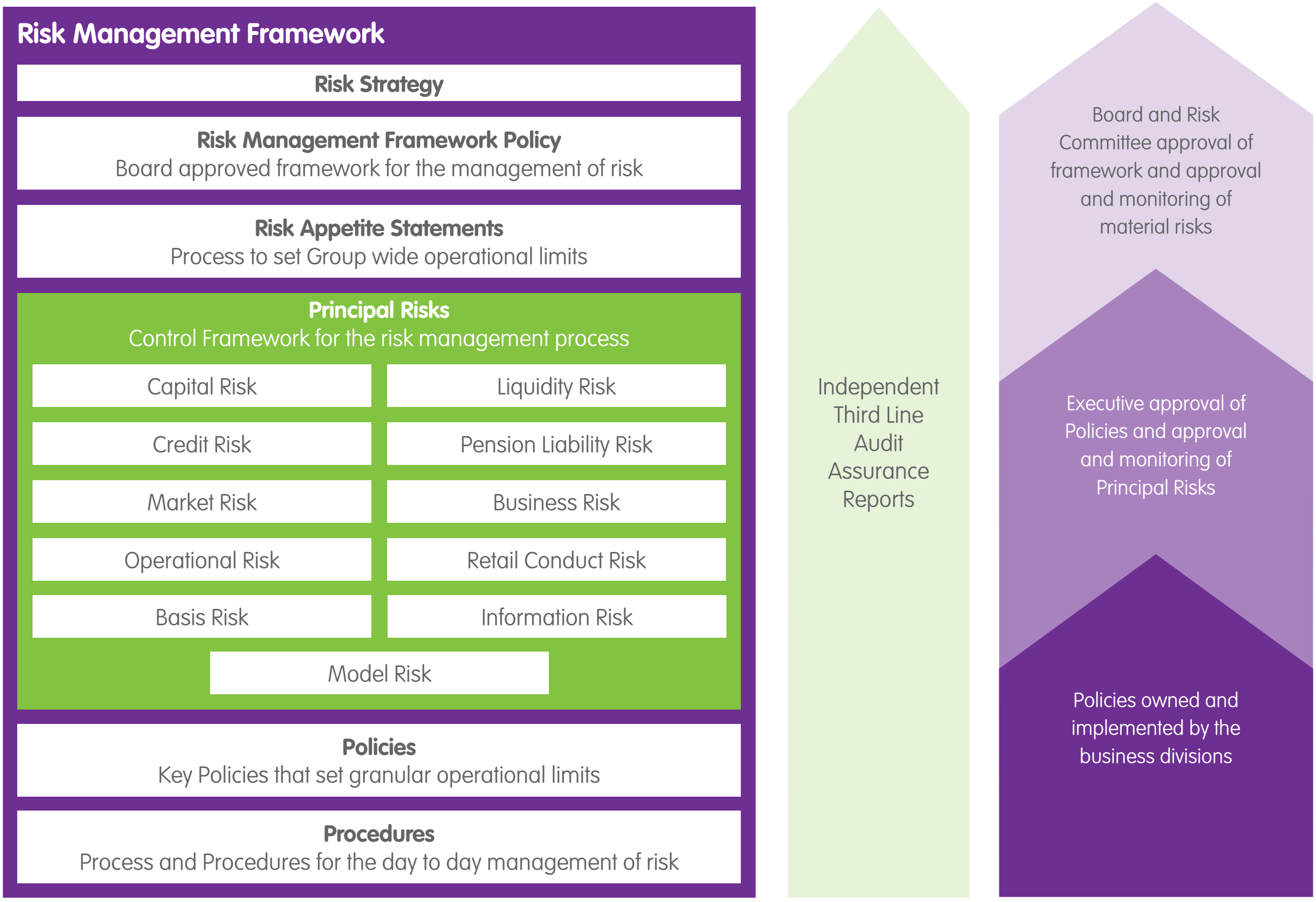
Independent assurance is provided by the Internal Audit function which has a direct reporting line into the Audit Committee (AC).



Section 3 – **Risk management objectives and policies** (continued)

Reporting on key risk measures

Reporting of key risk measures and escalation of issues across the 'Three Lines of Defence' is critical in demonstrating that a risk management framework is designed and operating effectively. The risk management process consists of five key stages: Identify; Measure; Manage; Report; and Monitor. These stages are used to set clear standards for the consistent management of risk in each of the Principal Risk categories on page 7. Reporting on the key risk measures occurs through the distribution of reports on the Principal Risks to RC as shown in the chart below.



Risk strategy

The Society continues to focus on the needs of savers and borrowers and a key part of the risk culture is to put the interests of current and future members, as a whole, first. The Society has defined quantitative and qualitative risk parameters within which it is prepared to operate. This is captured within the Board approved risk appetite statements for each of the Principal Risks and reflected in frameworks and policies that either limit, or where appropriate prohibit, activities that could be detrimental.

These parameters are designed to ensure the Society delivers acceptable returns, generates capital to support delivery of the business plan and support the exit of non-core business, balancing speed with economic cost. The Society's strategy and new lending activity focuses on residential properties to good quality borrowers who can demonstrate their ability to meet their ongoing mortgage payments.

Performance against risk appetite measures and operational limits is reviewed regularly by the ERC and the RC.

ERC ensures that a co-ordinated management approach is taken by the first line across all risk categories. RC and AC continue to provide oversight and advice on risk management controls to the Board. The RC met 10 times and the AC met 5 times within the financial year ending 31 March 2020. Further information about the Society's governance structure, including the Board and AC, is provided within the 2020 Annual Report and Accounts.

The Society uses stress testing as a key management tool to gain a better understanding of the resilience of the Society to external and internal shocks. These tests form a key part of the Society's capital and liquidity assessment and are designed to confirm that it has sufficient capital and liquid resources to support effective forward-looking strategic plans and to ensure it stays within its risk appetites. The Society's approach to stress testing has been self-assessed as fully compliant with the requirements of the PRA's SS3/18, Model risk management principles for stress testing.

The Society undertakes scenario tests to understand and manage the impact of the occurrence of these events and for more severe scenarios has developed a Recovery Plan that details the options available to the Society and any potential obstacles to resolution.

Risk culture

Everyone in the Society has a responsibility for managing risk. Individual ownership of risk and the importance of a strong culture that is supported by the Society's Vision and Values are key to successfully embedding the Risk Management Framework within the Society. In particular:

- The Board assesses whether the Society's purpose, values and their expectations around risk culture have been clearly defined and communicated throughout the organisation, and that they are properly understood by executive management;
- The Society's 'Target Culture Framework' translates the cultural expectations in to a behavioural framework. Measurement towards the framework is by way of the 'Culture Dashboard' reported quarterly to senior management; and
- When conducting reviews, Internal Audit provide an opinion on the risk culture which is compared across divisions to provide a Society-wide heatmap, which is presented at ERC and AC.

Section 4 – **Capital resources**

Total available capital

Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses.

The strength of the Society's capital position meant that the Society comfortably met all externally imposed capital requirements and the minimum leverage ratio throughout the financial year ended 31 March 2020, based on both the CRD IV transitional rules and the full implementation basis. Certain Additional Tier 1 instruments, previously eligible as capital, do not qualify under CRR with transitional rules reducing the element included in the capital computations over a 10 year period. This applies to the Society's permanent interest bearing shares (PIBS).

The table below summarises the composition of regulatory capital for the Society, under both the transitional and full implementation basis of CRD IV. During the years ended 31 March 2020 and 31 March 2019, the Society complied with all externally imposed capital requirements.

At 31 March

	Transitional CRD IV rules 2020 £m	**Full implementation of CRD IV 2020 £m**	Transitional CRD IV rules 2019* £m	Full implementation of CRD IV 2019* £m
Common Equity Tier 1 capital				
General reserves	**246.5**	**246.5**	246.0	246.0
Revaluation reserve	**3.3**	**3.3**	3.3	3.3
Fair value reserve	**(1.9)**	**(1.9)**	(0.1)	(0.1)
Core capital deferred shares (CCDS)	**127.0**	**127.0**	127.0	127.0
IFRS 9 transitional relief	**28.1**	**-**	31.4	-
Intangible assets and goodwill	**(16.3)**	**(16.3)**	(16.5)	(16.5)
Deferred tax assets that rely on future profitability and do not arise from temporary differences	**(11.7)**	**(11.7)**	(13.1)	(13.1)
Foreseeable distributions	**(0.6)**	**(0.6)**	-	-
Other adjustments	**(1.1)**	**(1.1)**	4.1	4.1
Common Equity Tier 1 capital	**373.3**	**345.2**	382.1	350.7
Additional Tier 1 capital				
Permanent interest bearing shares (PIBS)	**8.9**	**8.9**	8.9	8.9
Regulatory adjustments:				
Amortisation of PIBS under transitional rules	**-**	**(8.9)**	-	(8.9)
Total Tier 1 capital	**382.2**	**345.2**	391.0	350.7
Tier 2 capital				
Subordinated liabilities	**21.6**	**21.6**	21.6	21.6
Total Tier 2 capital	**21.6**	**21.6**	21.6	21.6
Total capital	**403.8**	**366.8**	412.6	372.3

Table 2: CRD IV capital position on a transitional and full implementation basis
*2019 general reserves have been restated as explained in section 2.

Section 4 – **Capital resources** (continued)

Tier 1 capital

Tier 1 capital is the primary funding source of the Society. It comprises Common Equity Tier 1 (CET 1) and Additional Tier 1 (AT 1) capital.

Common Equity Tier 1 capital

Common Equity Tier 1 (CET 1) capital comprises general reserves, the revaluation reserve, the fair value reserve and core capital deferred shares (CCDS).

The CCDS, which are a form of CET 1 capital for building societies, are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society. The CCDS were issued on 12 April 2018 as part of a liability management exercise (LME), details of which were included in the 2019 Annual Report and Accounts and 2019 Pillar 3 disclosures. The key features of the CCDS are set out in Appendix 1.

The CCDS holders are entitled to receive a distribution at the discretion of the Society. The total distribution paid on each CCDS in respect of any given financial year of the Society is subject to a cap provided for in the Rules of the Society and adjusted annually for inflation. The Directors declared an interim distribution of £0.50 per CCDS in respect of the period to 30 September 2019 and this was paid in February 2020. These distributions have been recognised in the Group Statement of Changes in Members' Interests and Equity. Subsequent to the balance sheet date, the Directors have declared a final distribution of £0.50 per CCDS in respect of the year to 31 March 2020 which will be paid in August 2020. The final distribution has been deducted from capital but not reflected in the Group financial statements as, for accounting purposes, distributions to the CCDS holders are recognised with reference to the date they are declared.

At 31 March 2020 there were CET 1 regulatory deductions for intangible assets, deferred tax assets reliant on future profitability and not arising on temporary differences and foreseeable distributions to holders of CCDS. The deduction for intangible assets was £16.3m (2019: £16.5m), for deferred tax assets £11.7m (2019: £13.1m) and, in relation to foreseeable distributions, £0.6m (2019: £nil). An additional deduction of £1.1m (2019: add back of £4.1m) was applied comprising deductions for additional valuation adjustments of £0.3m (2019: £0.3m) and for mortgage backed securities of £0.8m (2019: £0.2m) with an adjustment to add back the accumulated loss within risk remote securitisations that was deducted from the Society's accounting reserves of £nil (2019: £4.6m).

Transitional relief is available to phase in the CET 1 impact, primarily in relation to increased commercial loss provisions, of IFRS 9 implementation over a 5 year period. For 2020 the transitional relief offsets 85% (2019: 95%) of the impact and, as at 31 March 2020, amounts to £28.1m (2019: £31.4m). The impact of IFRS 9 transitional arrangements is disclosed, in the format prescribed by EBA guidelines, in Appendix 6.

Additional Tier 1 capital

Additional Tier 1 (AT 1) capital comprises permanent interest bearing shares (PIBS). PIBS are unsecured deferred shares and in a winding up or dissolution of the Society, the claims of PIBS holders would rank behind the claims of all other creditors of the Society with the exception of the CCDS holders. The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society. The key features of the PIBS are set out in Appendix 1.

Under the transitional rules applicable to the current year the value of PIBS is capped at the lower of the value of the PIBS in issue at the year end and the value of the PIBS in issue at 31 December 2012 amortised by 80% (2019: 70%). For the current year there was no amortisation applied as the value of the remaining PIBS is below the amortised value of the PIBS in issue at 31 December 2012.

The amortisation applied is increased by 10% per annum every 1 January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS. The Society has no other qualifying AT 1 instruments.

Whilst noting that any interest payments on the PIBS are at the sole discretion of the Society, the Society announced during its capital restructuring in 2018 that any future payments on PIBS will be made only if and to the extent that they would have been permitted had the LME had not taken place, and in the context of determining the equivalent annual yield that would have been paid to holders of the Society's Profit Participating Deferred Shares (PPDS) had they remained in issue on their original terms. Under the terms and conditions of the PPDS (which are available for viewing on the Society's website), the Society's ability to pay PPDS distributions was constrained by reference to a percentage of profits generated in the relevant financial year, and to the extent of any positive balance on a special PPDS reserve account (to which a percentage of profits or losses of the Society was allocated each year).

Whilst PPDS instruments no longer exist (having been exchanged during the LME), the Society continues to monitor a notional PPDS reserve. At 31 March 2018 (the last accounting date before the completion of the LME) the deficit on the PPDS reserve stood at £9.1m. At 31 March 2019 £2.5m (equivalent to 25% of retained profits (as restated as explained in Section 2) after adding back costs of Tier 2 instruments, net of tax) was added to the notional PPDS reserve reducing the balance to £6.6m. For the year ended 31 March 2020, the Society generated a reported net profit of £1.5m, including the impact of £2.5m Tier 2 interest payable. The net profit disregarding Tier 2 interest (after tax) would therefore have been £3.5m. Accordingly, during the year the notional PPDS reserve deficit reduced by £0.9m (25% of £3.5m) leaving a deficit of £5.7m at 31 March 2020.

Section 4 – **Capital resources** (continued)

Tier 2 capital

Tier 2 capital comprises the Society's qualifying Tier 2 Notes, which are subordinated liabilities issued in April 2018 as part of the LME referred to above. The key features of the Tier 2 Notes are set out in Appendix 1.

The expected credit loss methodology prescribed by IFRS 9 means that a provision requirement is calculated for all credit risk exposures held at amortised cost or fair value through other comprehensive income. On this basis no element of the impairment provisions held at 31 March 2019 or 31 March 2020 has been treated as a general credit risk adjustment for the purposes of calculating Tier 2 capital.

Total Capital Requirement

Under regulatory rules for the Total Capital Requirement (TCR), at least 56% of capital must be CET 1, no more than 44% of capital should be AT 1 and no more than 25% Tier 2. Given the mix of the Society's CET 1, AT 1 and Tier 2 capital, the Society was, at all times during the year, comfortably within these limits.

Reconciliation of regulatory capital

A reconciliation of the accounting balance sheet capital to regulatory capital is presented below.

At 31 March

	Transitional CRD IV rules 2020 £m	**Full implementation of CRD IV 2020 £m**	Transitional CRD IV rules 2019* £m	Full implementation of CRD IV 2019* £m
Total members' interests and equity per the Statement of Financial Position	**383.8**	**383.8**	385.1	385.1
Adjustments to Common Equity Tier 1 capital:				
IFRS 9 transitional relief	**28.1**	**-**	31.4	-
Intangible fixed assets and goodwill	**(16.3)**	**(16.3)**	(16.5)	(16.5)
Deferred tax assets that rely on future profitability and do not arise from temporary differences	**(11.7)**	**(11.7)**	(13.1)	(13.1)
Foreseeable distributions	**(0.6)**	**(0.6)**	-	-
Other adjustments	**(1.1)**	**(1.1)**	4.1	4.1
Total adjustments to Common Equity Tier 1 capital	**(1.6)**	**(29.7)**	5.9	(25.5)
Adjustments to Additional Tier 1 capital:				
Amortisation of PIBS under transitional rules	**-**	**(8.9)**	-	(8.9)
Adjustments for Tier 2 capital:				
Subordinated liabilities	**21.6**	**21.6**	21.6	21.6
Regulatory capital	**403.8**	**366.8**	412.6	372.3

Table 3: Capital reconciliation statement
*2019 members' interests and equity have been restated as explained in section 2.

Section 4 – **Capital resources** (continued)

Regulatory capital flow statement

The table below shows the flow of regulatory capital during the year ended 31 March 2020.

The statement is presented on the basis of the transitional CRD IV rules applicable at the end of the year.

	2020 £m
Common Equity Tier 1 capital at 1 April 2019 (restated)*	382.1
Profit for the period	1.5
Other comprehensive income recognised directly in general reserves	(0.4)
Change in intangible fixed assets and goodwill	0.2
Change in derecognition of deferred tax assets	1.4
Movement in fair value reserve	(1.8)
IFRS 9 transitional adjustments	(3.3)
Distribution to the holders of CCDS	(0.6)
Change in foreseeable distributions to the holders of CCDS	(0.6)
Other movements	(5.2)
Common Equity Tier 1 capital at 31 March 2020	373.3
Additional Tier 1 capital at 1 April 2019 and 31 March 2020	8.9
Tier 2 capital at 1 April 2019 and 31 March 2020	21.6
Regulatory capital at 31 March 2020	**403.8**

Table 4: Regulatory capital flow statement
*Common Equity Tier 1 capital at 1 April 2019 has been restated as explained in Section 2.

Of the profit for the period, £4.5m is deducted within 'Other movements' because it relates to structured entities which were deconsolidated from the accounting group during the year but were never included in the regulatory capital group (as explained in Section 2 – Overview, Scope). The residual loss for the year, largely driven by increased provision requirements due to the deteriorating economic outlook emerging from the COVID-19 pandemic, together with losses recognised directly in reserves and the unwind of IFRS 9 transitional relief (see Appendix 6) contributed to an overall decrease in regulatory capital.

Section 5 – **Capital adequacy**

Capital risk

The risk that the Society has insufficient capital to cover stressed losses or to meet regulatory requirements.

Capital management and reporting

Capital is held to provide a cushion to absorb losses that may occur during the economic cycle. In assessing the adequacy of its capital, the Society considers its risk appetite, the material risks to which it is exposed and the appropriate management strategies for each of the material risks, including whether or not capital provides an appropriate mitigant.

The Society considers its overall capital requirement as part of its Internal Capital Adequacy Assessment Process (ICAAP).

The regulatory capital adequacy of the Society (on a Solo consolidated and a regulatory Group basis, being materially the same) is reported to the regulator quarterly. The Society's capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the CRG, ERC, RC and the Board.

Pillar 2

Pillar 2 encapsulates Pillar 2A and Pillar 2B requirements. Risks not fully covered by, or those risks outside the scope of, Pillar 1 are covered by Pillar 2A whilst risks to which the Society may become exposed over a planning horizon (e.g. due to changes in the economic environment) are covered by Pillar 2B.

The Pillar 2A requirement is a 'point in time' assessment whereas the Pillar 2B requirement is forward-looking.

Internal Capital Adequacy Assessment Process (ICAAP)

On an annual basis the Society conducts an ICAAP which is used to assess the Society's capital adequacy and determine the levels of capital required going forward to support the current and future risks of the business. The ICAAP incorporates expected future capital requirements, within the context of current and anticipated future risks under multiple stressed scenarios. An allocation of capital is made for each of the following risks facing the Society:

- Credit risk from mortgages;
- Credit risk from Treasury assets and derivatives;
- Concentration risk (which can exacerbate credit exposures);
- Market risk;
- Residential property holding risk;
- Interest rate risk;
- Basis risk;
- Operational risk; and
- Pension liability risk.

The capital allocation is based on regulatory requirements for credit risk and operational risk (Pillar 1) with additional (Pillar 2A) allocations to reflect the degree of residual risk that remains after allowing for the effect of the risk controls operated by the Society. The Pillar 2A allocation of capital is a point in time assessment which reflects risks that are not captured or not adequately captured in Pillar 1.

A further capital allocation is made for Pillar 2B. This is a forward-looking assessment, which examines the Society's business plans and subjects them to economic and operational stresses over a five year planning horizon. The severity and duration of the stress scenarios is determined by reference to a severe stress scenario published by the PRA. In addition, the Society incorporates further second order stresses to make the capital stress even more severe than that prescribed by the regulator. This includes allowance for significant increases in retail funding costs.

The output from the assessment of Pillar 1, 2A and 2B capital requirements is reviewed by the CRG, ERC and RC prior to the finalisation of the ICAAP and submission to the Board for formal approval as part of the corporate planning process. The Society continues to be strongly capitalised and maintains its capital substantially above current regulatory requirements.

The ICAAP is used by the PRA in its Capital Supervisory Review and Evaluation Process (SREP) through which it sets the Society's Total Capital Requirement (TCR). The TCR covers the Society's Pillar 1 and Pillar 2A requirements. The PRA also considers whether a PRA Buffer is required. The PRA Buffer is an amount of capital that firms should hold, in addition to their TCR, to cover losses that may arise under a severe stress scenario (Pillar 2B) after allowance for the CRD IV buffers (see below).

Pillar 2A capital and Total Capital Requirement

As at 31 March 2020, the Society's TCR (Pillar 1 and Pillar 2A) of £230.5m is equivalent to 9.8% of risk weighted assets. The Society continues to comfortably meet this requirement using CET 1 capital alone.

Section 5 – **Capital adequacy** (continued)

Pillar 2B – CRD IV capital buffers

To promote the conservation of capital and the build-up of adequate buffers, calculated as a percentage of Risk Weighted Assets (RWA) that can be drawn down in periods of stress, CRD IV requires the holding of supplementary CET 1 capital buffers known as Pillar 2B. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB). To the extent that the PRA considers these CRD IV buffers to be insufficient a PRA Buffer will be added to the Society's capital requirement although the PRA has indicated that, for most firms, most of the time, the CRD IV buffers are likely to be sufficient.

The following table shows the constituent elements of the CRD IV capital requirement that could impact the Society, the phasing in of these requirements, and the quality of capital that can be used to meet the minimum requirement. Capital used to meet the firm-specific Pillar 1, Pillar 2A and Pillar 2B capital requirements, which may include a firm-specific buffer, may not be used to meet the CRD IV supplementary buffers.

CRD IV risk adjusted capital requirements

PRA Buffer (Firm-specific)	Firm-specific buffer assigned by the PRA if CCoB and CCyB buffers are considered to be insufficient.
Capital Conservation Buffer (CCoB)	Used to absorb losses in periods of economic and financial stress. Set at 2.5%
Systemic Risk Buffer (SRB)	Set at 0% for institutions, including the Society, with total assets less than £175 billion. Set at 3% for applicable institutions.
Macro-prudential Countercyclical Buffer (CCyB)	Set by the Bank of England's Financial Policy Committee (FPC) within a range of 0% to 2.5%. Used to ensure financial institutions build up capital in favourable conditions which can be utilised in economic downturns. Set at 0% at 31 March 2020 (2019: 1%).
Pillar 2A	Firm-specific calculation for risks not fully captured under Pillar 1.
Pillar 1	Firm-specific calculation based upon individual firms' risk weighted assets but a minimum of 8%.

- (purple) 100% of this requirement to be met by Common Equity Tier 1.
- (green) A minimum of 56% of this requirement to be met by Common Equity Tier 1. A maximum of 25% may be met by Tier 2 capital.

Minimum capital requirement - Pillar 1

Under the regulator's rules, a minimum level of capital (Pillar 1) must be held for credit risk, operational risk and market risk. The Society has adopted the Standardised Approach to calculate the minimum regulatory capital requirement for credit risk and operational risk.

Table 5 shows the Society's overall minimum capital requirement for credit, operational and market risk.

The credit risk requirement has been calculated under the Standardised Approach (expressed as 8% of the Risk Weighted Assets (RWA) for each of the applicable standardised credit risk exposure classes) at 31 March 2020. Details of the Standardised Approach to the calculation of regulatory requirements are contained in CRD IV.

Section 5 – **Capital adequacy** (continued)

Minimum capital requirement – Pillar 1 (continued)

At 31 March

	Capital requirement 2020 £m	Capital requirement 2019* £m
Loans and advances to customers		
Secured by mortgages on immovable property	**129.5**	131.5
Exposures in default	**26.4**	27.8
Retail	**4.2**	4.3
Corporates	**1.2**	2.1
Treasury assets (excluding counterparty credit risk)		
Central governments or central banks	**-**	-
Multilateral development banks	**-**	-
Institutions	**1.1**	1.1
Covered bonds	**1.2**	1.2
Securitisation positions	**0.7**	1.4
Other items	**15.4**	14.1
Total Pillar 1 credit risk capital requirement	**179.7**	183.5
Operational risk	**7.7**	7.7
Counterparty credit risk **	**0.4**	0.9
Total Pillar 1 capital requirement	**187.8**	192.1
Total capital available	**403.8**	412.6
Excess of capital over minimum Pillar 1 capital requirement	**216.0**	220.5

Table 5: Pillar 1 capital requirements under the Standardised Approach
*2019 total capital available has been restated as explained in section 2.
**Counterparty credit risk requirements relate to derivatives and sale and repurchase agreements (repos) and include credit valuation adjustments (CVAs), which adjust the fair values of derivative financial instruments to reflect the creditworthiness of the counterparties.

Section 5 – **Capital adequacy** (continued)

Quality of capital

CRD IV brings more stringent requirements for the eligibility of capital instruments with a focus on Common Equity as the principal component of regulatory Tier 1 capital, and changes to the regulatory deductions from Common Equity. The regulations set a minimum Tier 1 and Tier 2 capital of 8% of RWA, of which Tier 1 capital (CET 1 and AT 1 capital) must cover 6% of RWA and CET 1 capital alone must cover 4.5% of RWA.

At 31 March

	Minimum	**Transitional CRD IV rules**	**Full implementation of CRD IV rules**	Transitional CRD IV rules	Full implementation of CRD IV rules
		2020	**2020**	2019*	2019*
	%	**%**	**%**	%	%
Common Equity Tier 1 ratio	4.5	**15.9**	**15.0**	15.9	15.1
Tier 1 ratio	6.0	**16.3**	**15.0**	16.3	15.1
Total capital ratio	8.0	**17.2**	**15.9**	17.2	16.0

Table 6: Capital ratios
*2019 capital ratios have been restated as explained in section 2.

CRD IV applies the principle that Tier 1 capital is available to absorb losses of the business on a 'going concern' basis. The Society's PIBS are not able to do this, and therefore will not be eligible as CET 1 capital under full implementation of CRD IV. These PIBS are 'grandfathered' and recognised as AT 1 capital on an amortising basis (see Section 4).

At 31 March 2020, the Society's CET 1 capital resources comprised general and other reserves and CCDS, after applying a number of regulatory adjustments as detailed in Table 2.

Transitional arrangements have been applied to phase in the capital impact of adopting IFRS 9 'Financial Instruments'. The transitional period is five years long and, over that time, the additional impairment provisions recognised as a result of IFRS 9 adoption are added back to CET 1 capital in accordance with formulae set by the regulator. The impact of the IFRS 9 transitional arrangements is disclosed in Appendix 6.

The combined effect of the unwind of IFRS 9 transitional arrangements (which reduced CET 1 capital but also risk weighted assets), the results for the year, losses recognised directly through the Statement of Comprehensive Income and changes in regulatory capital requirements for Treasury assets, resulted in the CET 1 ratio being maintained at 15.9% at 31 March 2020 (2019 restated: 15.9%).

Section 5 – **Capital adequacy** (continued)

Leverage

The leverage ratio is non risk-based measure that is supplementary to the risk-based capital requirements and intended to represent a 'backstop' measure. The calculation determines a ratio based on the relationship between Tier 1 capital and total exposures (including on and off-balance sheet items) without any consideration of underlying risk.

The EU is expected to formalise a binding leverage ratio for all institutions as part of its amendments to CRR.

At 31 March

	Transitional CRD IV rules 2020 £m	**Full implementation of CRD IV rules 2020 £m**	Transitional CRD IV rules 2019* £m	Full implementation of CRD IV rules 2019* £m
Total Tier 1 capital	**382.2**	**345.2**	391.0	350.7
Total assets per the Statement of Financial Position	**5,576.8**	**5,576.8**	5,552.6	5,552.6
Structured entities outside of the scope of regulatory consolidation	**(14.4)**	**(14.4)**	(27.7)	(27.7)
Mortgage pipeline and committed facilities	**38.2**	**38.2**	14.8	14.8
Common Equity adjustments	**(1.0)**	**(1.0)**	5.9	5.9
Exposure to repurchase agreements	**4.8**	**4.8**	49.9	49.9
Derivative swap netting and other adjustments	**(34.8)**	**(34.8)**	(6.8)	(6.8)
Leverage ratio exposure (CRR)	**5,569.6**	**5,569.6**	5,588.7	5,588.7
Leverage ratio (CRR)	**6.9**	**6.2**	7.0	6.3
Leverage ratio (UK)	**7.2**	**6.5**	7.3	6.5

Table 7: Summarised leverage ratio

*2019 total Tier 1 capital and total assets per the Statement of Financial Position have been restated as explained in section 2. The CRR leverage ratio exposure reconciliation has also been updated to exclude assets held within structured entities outside of the regulatory group and include Common Equity adjustments in relation to IFRS 9 transitional arrangements.

At 31 March 2020 the CRR leverage ratio of the Society was significantly above the regulatory minimum. Under the transitional CRD IV provisions it was at 6.9% (2019: 7.0%) which reduces to 6.2% (2019: 6.3%) on a full implementation basis.

The UK leverage ratio presented, for reference, in the above table is calculated in the same way as the CRR leverage ratio except for the exclusion of certain central bank exposures. The Society is not, however, captured by the UK leverage ratio framework as it is currently only applicable to financial institutions with retail deposits of £50bn or more.

The Society recognises the importance of continuing to originate high quality assets, even though this will have the effect of diluting the current leverage ratio. However, the Society expects to continue to operate at a leverage ratio that is considerably in excess of the regulatory requirements including a buffer appropriate to the nature of its business model.

Risk Weighted Assets (RWA) flow statement

The following table shows the movement in credit RWA (excluding operational and counterparty credit risk) over the year to 31 March 2020 arising from changes in the size, quality and measurement of its asset portfolios.

	Mortgages £m	**Treasury £m**	**Other £m**	**Total £m**
Risk weighted assets at 1 April 2019 (restated)	2,070.4	46.2	175.8	**2,292.4**
Change in portfolio size	(10.3)	0.5	6.4	**(3.4)**
IFRS 9 transitional adjustments	(39.9)	-	-	**(39.9)**
Change in portfolio quality and measurement	(4.0)	(9.7)	10.8	**(2.9)**
Risk weighted assets at 31 March 2020	2,016.2	37.0	193.0	**2,246.2**

Table 8: Risk weighted assets flow statement

*Risk weighted assets at 1 April 2019 have been restated due as explained in section 2.

Credit risk weighted assets have reduced year on year driven by a reduction in portfolio size, improvements in portfolio quality, regulatory changes in measurement and the annual unwind of IFRS 9 transitional adjustments.

Section 6 – **Credit risk**

Credit risk overview

Credit risk refers to the risk that a customer or counterparty to a contract will not be able to meet their obligations as they fall due. For the purposes of the Society, this normally means the risk that a borrower will not repay their mortgage loan, or that a financial institution will not repay funds invested by the Society in that institution.

The Society's exposure to residential and commercial credit risk is managed by a specialist Credit Risk team which is responsible for setting the Credit Risk Management Framework and associated limits. It also provides regular reports to the RC, which is chaired by a Non-Executive Director and includes all other Non-Executive Directors, except the Chairman, as members.

The primary source of collateral for mitigating credit risk within the Society's mortgage portfolios is the underlying residential or commercial property. In line with its risk appetite, the Society also uses Mortgage Indemnity Guarantee (MIG) Insurance to insure against losses on residential loan advances where the Loan to Value (LTV) exceeds 80%. For commercial lending, supplementary collateral may be provided in the form of cash or (personal or cross-collateralisation) guarantees. No credit risk mitigation benefits in relation to MIG or commercial guarantees have been assumed when assessing Pillar 1 capital requirements.

Additionally, credit risk can arise within Treasury transactions (used to meet liquidity requirements and those hedging instruments used for interest rate risk purposes). This type of credit risk is managed by the Treasury Middle Office team. This team monitors exposures to counterparties and countries on a daily basis, and ensures operations remain within Board approved limits. ALCo and the Board review the Treasury Policy and limits, with reports presented to ALCo on a monthly basis confirming compliance with such policy limits.

Throughout the last financial year, a conservative approach to liquidity management has been maintained, investing for short periods with selected financial institutions, as well as holding a significant cash balance with the Bank of England. The Society has also maintained a position of holding a significant proportion of liquidity in UK government guaranteed and supranational financial institution assets, which are considered to be both highly liquid and secure. Treasury operates a strict control framework and exposures are monitored on an intra-daily basis.

Analysis of credit risk exposures

The Society calculates credit risk for exposures secured by mortgages on residential properties and commercial real estate and Treasury exposures using the Standardised Approach.

Table 9 below shows the Society's on and off-balance sheet credit risk exposures by standardised exposure class after credit risk mitigation, loss provisions and, in the case of equity release mortgages, fair value adjustments for credit risk.

	31 March 2020 £m	**Average 2020 £m**	31 March 2019* £m	Average 2019* £m
Loans and advances to customers				
Secured by mortgages on immovable property	**4,390.3**	**4,396.2**	4,402.0	4,416.3
Exposures in default	**264.3**	**263.8**	263.2	297.8
Retail	**70.0**	**71.2**	72.3	61.2
Corporates	**15.2**	**20.6**	26.0	25.2
Treasury assets				
Central governments or central banks	**263.5**	**233.0**	202.5	263.6
Multilateral development banks	**55.5**	**63.4**	71.2	68.3
Institutions	**90.2**	**115.7**	141.1	171.6
Covered bonds	**149.5**	**146.7**	143.9	141.9
Securitisation positions	**79.6**	**75.9**	72.1	81.9
Other items	**180.3**	**177.2**	174.0	175.5
	5,558.4	**5,563.7**	5,568.3	5,703.3

Table 9: Credit risk exposures by standardised exposure class
*Exposures to loans secured by mortgages on immovable property at 31 March 2019 have been restated as explained in section 2.

Section 6 – **Credit risk** (continued)

The geographical distribution of credit risk exposures is presented below. Loans and advances to customers are analysed according to the location of the underlying asset. Exposures to multilateral development banks comprise bonds issued by supranational institutions which have been categorised as 'Rest of the World' for the purposes of this disclosure.

At 31 March 2020

	UK £m	Rest of Europe £m	North America £m	Rest of the World £m	Total £m
Loans and advances to customers					
Secured by mortgages on immovable property	**4,390.3**	**-**	**-**	**-**	**4,390.3**
Exposures in default	**264.3**	**-**	**-**	**-**	**264.3**
Retail	**70.0**	**-**	**-**	**-**	**70.0**
Corporates	**15.2**	**-**	**-**	**-**	**15.2**
Treasury assets					
Central governments or central banks	**263.5**	**-**	**-**	**-**	**263.5**
Multilateral development banks	**-**	**-**	**-**	**55.5**	**55.5**
Institutions	**65.7**	**6.7**	**17.8**	**-**	**90.2**
Covered bonds	**149.5**	**-**	**-**	**-**	**149.5**
Securitisation positions	**79.6**	**-**	**-**	**-**	**79.6**
Other items	**180.3**	**-**	**-**	**-**	**180.3**
	5,478.4	**6.7**	**17.8**	**55.5**	**5,558.4**

At 31 March 2019

	UK £m	Rest of Europe £m	North America £m	Rest of the World £m	Total £m
Loans and advances to customers					
Secured by mortgages on immovable property (restated)*	4,402.0	-	-	-	4,402.0
Exposures in default	263.2	-	-	-	263.2
Retail	72.3	-	-	-	72.3
Corporates	26.0	-	-	-	26.0
Treasury assets					
Central governments or central banks	202.5	-	-	-	202.5
Multilateral development banks	-	-	-	71.2	71.2
Institutions	100.0	24.1	17.0	-	141.1
Covered bonds	143.9	-	-	-	143.9
Securitisation positions	72.1	-	-	-	72.1
Other items	174.0	-	-	-	174.0
	5,456.0	24.1	17.0	71.2	5,568.3

Table 10: Geographical distribution of credit risk exposures

*Exposures to loans secured by mortgages on immovable property in the UK at 31 March 2019 have been restated as explained in section 2.

The following table shows the residual maturity of credit risk exposures. The maturity breakdown is stated on a contractual, rather than an expected basis, and does not take into account the cash flows payable or receivable over the life of the instrument. For the purposes of this disclosure, impairment provisions (on an IFRS 9 transitional basis), residential fair value macro hedge and effective interest rate adjustments are classified as 'no specific maturity'. Although not directly comparable, a maturity analysis of the exposures, for liquidity purposes, is provided in Note 35, Liquidity risk, to the 2020 Annual Report and Accounts.

Section 6 – **Credit risk** (continued)

At 31 March 2020

	Up to 12 months £m	1 to 5 years £m	More than 5 years £m	No specific maturity £m	Total £m
Loans and advances to customers					
Secured by mortgages on immovable property	**71.0**	**301.5**	**3,993.1**	**24.7**	**4,390.3**
Exposures in default	**190.3**	**8.3**	**120.4**	**(54.7)**	**264.3**
Retail	**0.1**	**0.7**	**69.3**	**(0.1)**	**70.0**
Corporates	**10.0**	**0.1**	**10.2**	**(5.1)**	**15.2**
Treasury assets					
Central governments or central banks	**252.2**	**-**	**-**	**11.3**	**263.5**
Multilateral development banks	**-**	**55.5**	**-**	**-**	**55.5**
Institutions	**60.8**	**27.8**	**1.6**	**-**	**90.2**
Covered bonds	**35.1**	**114.4**	**-**	**-**	**149.5**
Securitisation positions	**-**	**-**	**79.6**	**-**	**79.6**
Other items	**-**	**-**	**-**	**180.3**	**180.3**
	619.5	**508.3**	**4,274.2**	**156.4**	**5,558.4**

At 31 March 2019

	Up to 12 months £m	1 to 5 years £m	More than 5 years £m	No specific maturity £m	Total £m
Loans and advances to customers					
Secured by mortgages on immovable property (restated)	61.0	327.2	4,003.8	10.0	4,402.0
Exposures in default	189.1	6.7	109.1	(41.7)	263.2
Retail	0.1	1.1	71.4	(0.3)	72.3
Corporates	12.6	2.0	15.2	(3.8)	26.0
Treasury assets					
Central governments or central banks	192.0	-	-	10.5	202.5
Multilateral development banks	30.1	41.1	-	-	71.2
Institutions	110.5	29.8	0.8	-	141.1
Covered bonds	31.7	112.2	-	-	143.9
Securitisation positions	-	-	72.1	-	72.1
Other items	-	-	-	174.0	174.0
	627.1	520.1	4,272.4	148.7	5,568.3

Table 11: Residual maturity of credit risk exposures
*Exposures to loans secured by mortgages on immovable property with no specific maturity at 31 March 2019 have been restated as explained in section 2.

Section 6 – **Credit risk** (continued)

Concentration risk

Residential mortgages

The concentration risk tables which follow show on-balance sheet gross residential mortgage balances before expected credit loss provisions and, in the case of the equity release portfolio, fair value adjustments for credit risk. Fair value macro hedge adjustments are excluded. The figures differ from the equivalent disclosures in Note 33, Credit risk, to the 2020 Annual Report and Accounts due to the inclusion of equity release mortgages which are separately analysed in the Annual Report and Accounts due to being held at fair value through profit or loss, rather than at amortised cost, for accounting purposes.

The following tables analyse the residential loan portfolio by lending type, UK region and indexed loan to value.

At 31 March

Lending type	**2020 £m**	2019 £m
Prime owner occupied	**2,859.1**	2,797.3
Buy to let	**1,422.9**	1,503.2
Equity release	**21.1**	23.1
Other	**56.0**	63.3
	4,359.1	4,386.9

Table 12: Residential loan exposures by lending type

While the Society's branch network is based predominantly in the West Midlands, the online and intermediary distribution channels provide access to the rest of the UK which serves to mitigate geographical concentration risk as illustrated in the table below.

At 31 March

Region	**2020 £m**	**2020 %**	2019 £m	2019 %
East Anglia	**117.8**	**2.7**	126.0	2.9
East Midlands	**456.4**	**10.5**	461.3	10.5
Greater London	**479.5**	**11.0**	498.9	11.4
Northern Ireland	**3.7**	**0.1**	4.1	0.1
North	**188.1**	**4.3**	191.5	4.4
North West	**534.5**	**12.3**	540.5	12.3
Scotland	**89.7**	**2.0**	96.6	2.2
South East	**725.2**	**16.6**	718.6	16.3
South West	**365.9**	**8.4**	364.6	8.3
Wales	**221.0**	**5.1**	217.6	5.0
West Midlands	**728.6**	**16.7**	734.2	16.7
Yorkshire	**448.7**	**10.3**	433.0	9.9
	4,359.1	**100.0**	4,386.9	100.0

Table 13: Residential loan exposures by UK region

Concentration risk (continued)

At 31 March

Indexed loan to value	2020 £m	2020 %	2019 £m	2019 %
>95%	**56.8**	**1.3**	74.6	1.7
91% - 95%	**177.1**	**4.1**	170.8	3.9
86% - 90%	**252.2**	**5.8**	345.3	7.9
76% - 85%	**656.7**	**15.1**	713.3	16.3
51% - 75%	**2,025.4**	**46.4**	2,005.6	45.7
<51%	**1,190.9**	**27.3**	1,077.3	24.5
	4,359.1	**100.0**	4,386.9	100.0

Table 14: Residential loan exposures by loan to value

Commercial mortgages

The concentration risk tables which follow show gross commercial mortgage balances before expected credit loss provisions including, where applicable, fair value adjustments for hedged interest rate risk. The figures differ from the equivalent disclosures in Note 33, Credit risk, to the 2020 Annual Report and Accounts due to the exclusion of amounts relating to securitised commercial exposures where the associated credit risk is considered to have been transferred to third parties.

The following tables analyse the commercial loan portfolio by industry type and UK region.

At 31 March

Industry Type	2020 £m	2020 %	2019 £m	2019 %
Healthcare and leisure	**119.5**	**30.3**	122.8	29.8
Industrial and warehouse	**4.9**	**1.3**	7.0	1.7
Office	**19.1**	**4.8**	18.5	4.5
Retail	**232.8**	**59.0**	241.7	58.7
Residential	**18.1**	**4.6**	21.7	5.3
Other	**0.1**	**0.0**	0.2	0.0
	394.5	**100.0**	411.9	100.0

Table 15: Commercial loan exposures by industry type

Concentration risk (continued)

At 31 March

Region	**2020 £m**	**2020 %**	2019 £m	2019 %
East Anglia	**19.5**	**4.9**	17.0	4.1
East Midlands	**27.1**	**6.9**	27.9	6.8
Greater London	**37.6**	**9.5**	40.9	9.9
North	**38.2**	**9.7**	40.5	9.8
North West	**134.4**	**34.1**	143.1	34.8
Scotland	**0.9**	**0.2**	1.1	0.3
South East	**53.2**	**13.5**	55.0	13.4
South West	**8.5**	**2.2**	8.8	2.1
Wales	**0.9**	**0.2**	1.2	0.3
West Midlands	**34.6**	**8.8**	36.0	8.7
Yorkshire	**39.6**	**10.0**	40.4	9.8
	394.5	**100.0**	411.9	100.0

Table 16: Commercial loan exposures by UK region

Section 6 – **Credit risk** (continued)

Impairment of financial assets

Impairment provisions
Expected credit losses (ECLs) are recognised for all financial assets carried at amortised cost or fair value through other comprehensive income (FVOCI) under IFRS 9, and also for undrawn loan commitments where a mortgage offer has been made but the loan is yet to be advanced and recognised in the Statement of Financial Position.

Staging
At each reporting date, financial assets subject to the impairment requirements of IFRS 9 are categorised into one of three stages:

Stage 1
On initial recognition, financial assets which are not credit impaired are categorised as stage 1 and provision is made for 12 month ECLs, being the losses from default events expected to occur within the next 12 months. Assets remain in stage 1 until such time as they meet the criteria for another stage or are derecognised.

Stage 2 (significant increase in credit risk)
Financial assets which are not in default, but have experienced a significant increase in credit risk (SICR) since initial recognition, are categorised as stage 2. The loss allowance recognised is equivalent to lifetime ECL, being the loss arising from default events expected to occur over the lifetime of the financial asset.

Determining whether a SICR has occurred is a critical aspect of the IFRS 9 methodology and one which involves judgement, based on a combination of quantitative and qualitative measures. As described in the ECL calculation sections which follow, the criteria applied vary across portfolios depending on the nature of the portfolio and availability of relevant credit risk information but all include the IFRS 9 'backstop' of 30 days past due as a stage 2 trigger. The UK government's fiscal and monetary policies created in the response to the COVID-19 pandemic include the requirement for lenders to offer payment holidays to assist borrowers who may struggle to meet their regular payments.

Stage 3 (default)
Defaulted or credit-impaired financial assets are categorised as stage 3, requiring recognition of lifetime ECLs.

Transfers to lower stages (curing)
Financial assets in stages 2 or 3 can transfer back to stages 1 or 2, respectively, once the criteria for SICR or default cease to be met for a period of time defined within the ECL methodology for that portfolio, sometimes known as the 'cure' period. In practice, this means that a stage 2 or 3 loan which ceases to breach the threshold(s)/criteria for that stage will remain in the higher stage for a pre-determined number of months. The use of cure periods gives assurance that accounts have rehabilitated before re-entering lower stages and reduces the level of volatility that might otherwise arise from accounts regularly migrating between stages.

Forward-looking ECL approach
ECL is measured as the present value of the difference between the cash flows contractually due on a financial asset or undrawn commitment and the cash flows expected to be received. In the Statement of Financial Position, the loss allowance is presented as a reduction in the carrying value of the financial asset. In the case of an undrawn loan commitment, the impairment provision is instead presented within provisions for liabilities.

For each of the Group and Society's financial asset portfolios in the scope of IFRS 9 impairment, the estimate of ECL is unbiased and weighted to take into account a range of possible outcomes.

In accordance with IFRS 9, forecasts of future economic conditions are integral to the ECL calculations for each portfolio. The Group currently models four forward-looking macroeconomic scenarios: a central forecast with economic assumptions aligned to the Society's Medium Term Plan (and therefore assigned the highest weighting), together with upside, downside and stress scenarios. The scenarios have been updated with due regard to the latest market data available following the emergence of the COVID-19 pandemic. A more pessimistic view has been taken when developing the forecasts this year, combined with reduced weightings assigned to the central scenario, offset by a higher weighting assigned to the severe low rate scenario.

ECL calculation – core residential mortgages
For the core residential mortgage books, the impairment model employs industry-accepted statistical techniques to address the complex requirements of IFRS 9, with model assumptions and parameters initially determined by regression analysis of historical default data. The assumptions are validated using 'out of time' samples, across a range of economic scenarios, enabling the predictive capabilities of the models to be confirmed.

The model incorporates quantitative factors for identifying SICR by comparing reporting date lifetime probability of default (PD) with residual origination lifetime PD. For the purposes of this quantitative staging assessment, mortgages are segmented by lending type (owner occupied or buy to let). Residual origination PD curves and (relative and absolute) threshold levels are established via an iterative process involving statistical analysis of the Group's default data. In addition, a range of internally monitored potential impairment indicators has been selected as qualitative criteria for classifying an individual loan as stage 2. Examples of qualitative indicators include cancelled direct debit instructions, certain forbearance measures and evidence of impaired credit history obtained from external agencies.

The default criteria for core residential loans are entirely aligned with those used for capital and credit risk management purposes. Loans are considered to be in default or credit-impaired if they are in arrears by three or more months, in litigation, possession or LPA receivership or meet one of a range of internal 'unlikely to pay' indicators.

Within the core residential model ECL is calculated by multiplying the forward-looking PD, exposure at default (EAD) and loss given default (LGD). The model outputs monthly ECLs, which are aggregated over the first 12 months to obtain 12-month ECL and over the life of the loan to calculate lifetime ECL.

The model combines a number of account-specific variables and forecasts of future economic conditions within the calculation of PD.

Section 6 – **Credit risk** (continued)

Impairment of financial assets (continued)

Macroeconomic variable inputs to the model are reviewed quarterly and include house price index (HPI), interest rates, unemployment and GDP. The variables were selected based on statistical tests and other analysis which evidenced their correlation with credit risk.

The core residential impairment model aligns the Group's capital and accounting approaches to the estimation of credit losses as closely as possible.

ECL calculation – undrawn commitments
The loss allowance for undrawn commitments is inferred from the core residential mortgage impairment model outputs for existing loans with similar risk characteristics.

All undrawn commitments are currently allocated to stage 1 such that a 12-month ECL calculation is appropriate.

The Group's IFRS 9 provision requirements for undrawn commitments at 31 March 2019 and 31 March 2020 were negligible.

ECL calculation – second charge residential mortgages
For the closed second charge loan book, a SICR is assessed using external credit agency PD indicators. Absolute thresholds have been set based on analysis of monthly PD scores from origination (or earliest available date) to point of default.

Second charge mortgages are considered to be in default if they are in arrears by three or more months or in bankruptcy, litigation or possession.

Impairment provisions for the closed second charge mortgage book are determined using a simple discounted cash flow model which segregates accounts by payment status. Estimated future cash flows, which consider the forced sale property valuation and level of first charge debt remaining, are discounted to their present value using the effective interest rate of the loan and compared with the account balance at the reporting date. This estimated loss on possession is multiplied by the probability of possession occurring to calculate the ECL requirement.

The key macroeconomic variable affecting the level of second charge impairment losses is HPI, as forecast within the Group's central, upside, downside and stress scenarios.

ECL calculation – commercial mortgages
The key indicator of a SICR for a commercial loan is a downward migration in internal credit rating, determined via an established internal credit risk assessment process. The internal grade is determined at an individual account level, combining expert judgement with prescriptive measures including, but not limited to, loan to value and income/debt service coverage ratios.

Commercial loans are categorised as default if an LPA Receiver (or equivalent) has been appointed, if they are in arrears by greater than or equal to three months, and/or are past scheduled maturity (unless past maturity by no more than 3 months and active negotiations to extend are in progress with the customer). Loans not meeting these criteria may be classified as stage 3 based on expert management judgment of the perceived risk of non-payment.

The ECL requirements for commercial mortgages are assessed on an individual loan basis, with the right to off-setting ECL requirements where cross-collateralisation exists between connected commercial mortgages, using cash flow scenario modelling. This involves estimating the timing and amount of future cash flows, in the event of default, for one or more probability weighted account-specific scenarios based on the Group's central forecast of economic conditions. Applying the Group's macroeconomic scenarios effectively creates a range of alternative outcomes in addition to the central forecast.

Estimated future cash flows, comprising rental receipts and final sales proceeds (each net of costs), are discounted at the effective interest rate of the loan and compared with its carrying value to determine the ECL under each combination of account-specific and macroeconomic scenarios. The relevant macroeconomic weightings are then applied to calculate the overall provision requirement at the reporting date.

ECL calculation – liquid assets
For liquid assets, comprising cash and balances with the Bank of England, loans and advances to credit institutions and investment securities, a SICR is determined by counterparty type and adverse movements in counterparty credit rating beyond specified thresholds. None of the Group's liquid assets are categorised as stage 2 at the reporting date.

Liquid assets are in default if categorised as such by external credit rating agencies. The Group has never experienced a default on its Treasury investment portfolio.

The ECL calculation for liquid assets multiplies the carrying value of the asset by a PD applicable to its credit rating at the reporting date. The PD is obtained from publically available external credit rating agency data tables. The macroeconomic weighted scenarios are translated to shifts in counterparty credit ratings thereby changing the PDs applied in the calculation.

The Group's liquid asset provision requirements at 31 March 2019 and 31 March 2020 were negligible.

Write off of financial assets
Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

Impact of COVID-19 on ECL recognition
COVID-19 was declared a pandemic and UK government support measures only came into play towards the end of the Group's financial year. Nevertheless this required an update of certain assumptions used in the Group's ECL calculation as follows:

- The Group has revised its macroeconomic scenarios and revisited the probability weightings assigned to each scenario to reflect a more pessimistic outlook.

Impairment of financial assets (continued)

- Certain assumptions relating to expected cash flows and exit yields on the commercial loan portfolio have been revisited, with particular focus on those sectors considered most at risk.
- Overlays have been created in respect of residential lending to reflect the impact of support measures that have since been made available to borrowers, including payment holidays

This resulted in an impairment charge of £14.7m in Q4, largely as a result of the unfolding pandemic. The economic outlook remains uncertain and the revisions to assumptions reflect management's best estimates with the information available at the time.

Impairment provisions on performing and non-performing loans, analysed by IFRS 9 stage, are disclosed in Template 4 of Appendix 7.

The following table shows the movement during the year in ECLs under IFRS 9. This analysis differs from that shown in Note 14, Allowance for losses on loans and advances, to the 2020 Annual Report and Accounts as it excludes amounts relating to securitised commercial mortgages which are not part of the regulatory group because the associated credit risk is considered to have been transferred to third parties.

	Loans fully secured on residential property 2020 £m	**Loans fully secured on land 2020 £m**	**Total 2020 £m**	Loans fully secured on residential property 2019 £m	Loans fully secured on land 2019 £m	Total 2019 £m
At beginning of year	**6.0**	**64.6**	**70.6**	7.8	65.0	72.8
Amounts written off	**(1.9)**	**(5.1)**	**(7.0)**	(3.0)	(1.7)	(4.7)
Charge for the year comprising:						
Provision for loan impairment	**3.5**	**14.7**	**18.2**	2.0	1.4	3.4
Adjustments to provisions resulting from recoveries	**(0.6)**	**(0.4)**	**(1.0)**	(0.8)	(0.1)	(0.9)
Charge for the year	**2.9**	**14.3**	**17.2**	1.2	1.3	2.5
At end of year	**7.0**	**73.8**	**80.8**	6.0	64.6	70.6

Table 17: Analysis of movement in impairment provisions

A detailed analysis of the movement in gross exposures and expected credit loss provisions by IFRS 9 stage is presented in Note 33, Credit risk, to the 2020 Annual Report and Accounts.

Residential mortgages

The Society assesses credit risk on owner occupied and buy to let residential mortgages using behavioural scorecard and other analysis to determine probabilities of default across a number of rating grades. The IFRS 9 impairment models make use of this data, incorporating forecasts of future economic conditions and account-specific factors to produce forward-looking probabilities of default by account and allocating loans to one of three stages (as explained in the 'Impairment provisions' section above).

The table below analyses gross exposures to residential assets by 12 month probability of default and IFRS 9 stage at the reporting date, with the exception of the closed second charge lending portfolio for which probability of possession is used as a credit risk measure, rather than probability of default. The equity release portfolio is held at fair value through profit or loss (FVTPL) under IFRS 9 and is therefore not subject to the impairment requirements of IFRS 9 and is excluded from the table. It should also be noted that the figures below show the accounting balances used for provisioning as opposed to capital exposure values (which include off-balance sheet exposures and IFRS 9 transitional adjustments) and therefore do not match the totals in the capital exposure tables in previous sections.

At 31 March 2020

Probability of default range (%)	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
0.00 to < 0.25	2,934.6	100.7	-	**3,035.3**
0.25 to < 0.50	605.5	49.4	-	**654.9**
0.50 to < 0.75	129.3	42.7	-	**172.0**
0.75 to < 1.00	34.1	5.3	-	**39.4**
1.00 to < 5.00	133.6	161.6	-	**295.2**
5.00 to < 10.00	11.1	1.0	-	**12.1**
10.00 to < 100.00	32.8	30.7	-	**63.5**
100.00 (default)	-	-	55.2	**55.2**
Second charge	7.0	2.1	1.3	**10.4**
	3,888.0	**393.5**	**56.5**	**4,338.0**

Section 6 – **Credit risk** (continued)

Impairment of financial assets (continued)

At 31 March 2019

Probability of default range (%)	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
0.00 to < 0.25	3,070.7	109.0	-	3,179.7
0.25 to < 0.50	495.0	39.2	-	534.2
0.50 to < 0.75	182.7	44.7	-	227.4
0.75 to < 1.00	15.3	3.8	-	19.1
1.00 to < 5.00	90.5	186.4	-	276.9
5.00 to < 10.00	4.4	0.2	-	4.6
10.00 to < 100.00	20.5	28.7	-	49.2
100.00 (default)	-	-	60.3	60.3
Second charge	8.1	2.9	1.4	12.4
	3,887.2	414.9	61.7	4,363.8

Table 18: Residential loan exposures by probability of default and IFRS 9 stage

Commercial mortgages

The internal credit risk grading approach for the closed commercial loan book does not use scorecards or probability of default calculations. Instead loans are individually assessed against a series of prescriptive and judgmental criteria, by subject matter experts following a clearly defined methodology, to arrive at a risk grade. The distribution of the portfolio by grade and IFRS 9 stage at 31 March 2020 and 31 March 2019 is set out in the table below. This analysis differs from that shown in Note 33, Credit risk, to the 2020 Annual Report and Accounts as it excludes amounts relating to Sandwell Commercial Finance No.1 Plc and Sandwell Commercial Finance No. 2 Plc where the credit risk associated with the securitised exposures is considered to have been transferred to third parties.

At 31 March 2020

Slotting grade	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Strong	38.3	-	-	**38.3**
Good	11.8	-	-	**11.8**
Satisfactory	0.1	22.6	-	**22.7**
Weak	-	79.5	-	**79.5**
Default:				
In LPA receivership	-	-	242.2	**242.2**
	50.2	**102.1**	**242.2**	**394.5**

At 31 March 2019

Slotting grade	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Strong	36.5	-	-	36.5
Good	23.5	-	-	23.5
Satisfactory	0.2	131.3	-	131.5
Default:				
In LPA receivership	-	-	219.7	219.7
Other default	-	-	0.7	0.7
	60.2	131.3	220.4	411.9

Table 19: Commercial loan exposures by slotting grade and IFRS 9 stage

Section 6 – **Credit risk** (continued)

Forbearance strategies and renegotiated loans

A range of forbearance strategies is employed in order to work with borrowers to manage arrears and, wherever possible, avoid repossession. These are set out in the Society's policies. The agreed strategies reflect the customer's individual circumstances and are used in line with industry guidance.

The principal forbearance measures provided by the Society on arrears cases are as follows:

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time;
- Concessions, where it is agreed to accept the normal monthly payment with no contribution towards paying off the outstanding arrears, reduced payments or, in exceptional circumstances, no repayments for a short period;
- Capitalisation of arrears can be considered but only when the customer has made six consecutive monthly payments, arrears have not been capitalised within the prior five years and express customer consent has been received; and
- Mortgage term extensions to reduce the amount of the monthly payment may be considered as part of a longer-term solution.

Some of these forbearance activities are applied on a small number of commercial mortgages, principally this may be arrangements and capitalisations on a similar basis to residential mortgages. Term extensions may also be used for commercial loans where the loan term has or is due to expire. Such extensions will usually be on similar terms to the original loan.

In response to the COVID-19 outbreak, the Society offered borrowers who were suffering a detrimental impact on their income as a direct consequence of the situation, the opportunity to request a three month payment holiday. The first tranche of such requests was received in the last couple of weeks of the financial year. As at 31 March 2020, payment holidays had been applied to over 2,600 residential mortgages equivalent to circa 7% of residential balances. These arrangements did not result in the loans being categorised as forborne for reporting purposes. An ECL overlay of £1.0m was recorded in respect of these accounts.

An analysis of loan exposures subject to forbearance measures, and the associated impairment provision requirements, is presented in Template 1 of Appendix 7.

Treasury credit risk exposures

The Society's Treasury portfolio comprises liquid assets held to ensure it can meet its financial obligations as they fall due. The Society adopts a conservative approach to liquidity management, investing only in good quality assets or those held with Globally Systemically Important counterparties. Liquid assets do not include any exposures to the emerging markets or to any mortgage markets outside of the UK.

The Society uses external credit ratings from External Credit Assessment Institutions (ECAIs), which are recognised as eligible by the regulator, as part of its assessment of credit risk arising on the Treasury portfolio. For the purpose of calculating credit risk requirements under the Standardised Approach, particular reference is made to the ratings published by Moody's and Fitch. There has been no change in the Society's use of ECAIs during the year.

CRD IV sets out a 'credit quality step' assessment scale. The table below shows the exposure values associated with each credit quality step, mapped to ECAI rating, for on-balance sheet Treasury exposures under the Standardised Approach before and after applicable credit risk mitigation and netting (as described under 'Treasury risk mitigation' and 'Counterparty credit risk' below).

Section 6 – **Credit risk** (continued)

Treasury credit risk exposures (continued)

At 31 March

	Notes	Risk Weight %	Fitch and S&P ratings	Moody's ratings	Exposures 2020 £m	Exposures after mitigation 2020 £m	Exposures 2019 £m	Exposures after mitigation 2019 £m
Central governments or central banks								
Credit quality step								
1	1	0	AAA to AA-	Aaa to Aa3	**263.5**	**263.5**	202.5	202.5
Total					**263.5**	**263.5**	202.5	202.5
Multilateral development banks								
Credit quality step								
1		0	AAA to AA	Aaa to Aa1	**55.5**	**55.5**	71.2	71.2
Total					**55.5**	**55.5**	71.2	71.2
Institutions								
Credit quality step								
1		4/20	AAA to AA-	Aaa to Aa3	**68.6**	**29.4**	67.1	46.6
2		20/50	A+ to A-	A1 to A3	**55.0**	**46.2**	34.7	30.6
3		50	BBB+ to BBB-	Baa1 to Baa3	**-**	**-**	6.8	3.2
Total					**123.6**	**75.6**	108.6	80.4
Covered bonds								
Credit quality step								
1	2	10	AAA to AA-	Aaa to Aa3	**149.5**	**149.5**	143.9	143.9
Total					**149.5**	**149.5**	143.9	143.9
Securitisation positions								
Credit quality step								
1	2,4	10/20	AAA to AA-	Aaa to Aa3	**79.3**	**79.3**	71.1	71.1
4	3,4	350	BB+ to BB-	Ba1 to Ba3	**-**	**-**	1.0	1.0
12	3,4	180	BB+ to BB-	Ba1 to Ba3	**0.3**	**0.3**	-	-
Total					**79.6**	**79.6**	72.1	72.1

Table 20: Treasury exposures by external credit rating and credit quality step

Notes:

1. Includes cash in hand and Cash Ratio Deposit with the Bank of England.
2. The AAA to AA- covered bonds and securitisation positions (mortgage backed securities) all relate to prime loans secured on residential property located in the United Kingdom.
3. The securitisation positions with ratings below AAA to AA- represent mortgage backed securities secured on commercial property located in the United Kingdom and were issued by Sandwell Commercial Finance No. 2 Plc, a structured entity holding a beneficial interest in mortgages originated by the Group. Further details of securitisation exposures can be found in Section 11.
4. The credit quality steps and associated risk weightings for securitisation exposures changed during the year in accordance with Regulation (EU) 2017/2401.

Capital required under Pillar 1 for the Treasury liquidity exposures shown above (excluding counterparty credit risk for derivatives and securities financing transactions) was £3.0m (2019: £3.7m).

Treasury credit risk mitigation

The Society mitigates risk of loss arising from default by its derivative counterparties through legally enforceable Credit Support Annex (CSA) agreements. The CSAs require collateral to be posted against changes in the net mark to market value of derivative exposures with a particular counterparty. In the event of default, this collateral is transferred to the disadvantaged counterparty. These CSAs are taken into consideration when setting the internal credit risk limits for derivative counterparties and the Pillar 1 capital calculations. Market valuations used to determine the amount of cash collateral are performed daily or weekly depending upon the counterparty. No collateral is posted if the net change in market value for the period is less than a specified threshold amount.

The Society may from time to time enter into sale and repurchase agreements (repos) with counterparties with whom the Society has both a Global Master Repurchase Agreement (GMRA) and an active credit line in place. An exposure arises where the cash received in a repo transaction is less than the market value of the asset to be repurchased. This form of counterparty credit risk is managed under the terms of the GMRA through the monitoring and appropriate transfer of collateral.

'Wrong-way' risk may occur when an exposure to a counterparty is adversely correlated with the credit quality of the counterparty. The Society has no 'wrong-way' risk exposure and no appetite for such exposures. The Society mitigates 'wrong-way' risk by ensuring that exposures to derivatives are managed via CSA agreements, which are regularly re-margined and are collateralised with cash.

At the end of the financial year, £69.6m (2019: £48.1m) and £1.9m (2019: £nil) were pledged as collateral under CSA and GMRA arrangements respectively.

Counterparty credit risk

Counterparty Credit Risk (CCR) is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. This uncertainty is factored into the valuation of the Society's credit exposure using the mark to market method plus an add-on for potential future exposure.

This approach applies to contracts for financial derivative instruments, securities financing transactions and long settlement transactions. The Society uses derivative instruments to hedge its exposure to market risk, for example, interest rate risk.

The following table shows the exposures to CCR for derivative contracts.

At 31 March

	2020 £m	2019 £m
Interest rate contracts	**4.5**	6.5
Other contracts	**69.6**	48.1
Gross positive fair value of contracts	**74.1**	54.6
Netting benefits	**(51.4)**	(34.7)
Netted current credit exposure	**22.7**	19.9
Collateral held	**(1.0)**	-
Netted derivative credit exposure	**21.7**	19.9
Add on for potential future credit exposure	**9.8**	10.8
Total derivative exposures	**31.5**	30.7

Table 21: Counterparty credit risk for derivative contracts

The net exposure to derivative transactions is after taking account of legally enforceable collateral arrangements and netting benefits. Within the table above, 'Other contracts' represents amounts pledged as collateral with derivative counterparties including central clearing houses in respect of fair values of derivatives.' Netting benefits' reflect the risk mitigation achieved by offsetting amounts due to the same derivative counterparties and 'Collateral held' reflects cash deposited by those counterparties under collateral arrangements.

The Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event. CSAs are executed in conjunction with these ISDA master agreements which typically provide for the exchange of collateral on a daily or weekly basis to mitigate net mark to market credit exposure.

Whilst exchange traded derivatives have been cleared through central counterparties (CCPs) for many years, recent regulatory initiatives designed to reduce systemic risk in the banking system are directing increasing volumes of Over the Counter derivatives to be cleared through CCPs. Wherever possible, the Society now clears qualifying derivatives through CCPs although the Society enters into a number of amortising swaps that are not currently cleared by any CCPs.

Capital required under Pillar 1 for market and counterparty credit risk, including credit valuation adjustments and exposures to secured financing transactions totals £0.4m (2019: £0.9m). The exposure to derivatives is calculated using the CCR mark to market method.

Section 7 – **Market risk**

Market risk

Market risk refers to the possible changes in the value of, or income arising from, the Society's assets and liabilities as a result of changes in interest/exchange rates, property prices or equities. Market risk exposures are managed through the Treasury department which is responsible for managing exposure to all aspects of market risk within parameters set by the Board. ALCo reviews the Treasury and Financial Risk Management Policy, recommending changes to the Board as appropriate, and ensures that regular reports on all aspects of market risk are assessed and reported to the Board.

Interest rate risk

The key market risk is interest rate risk, which arises as a result of differences in the timing of interest rate re-pricing of assets and liabilities. To mitigate this, Treasury uses natural balance sheet hedging (e.g. matching 2 year fixed rate mortgages with 2 year fixed rate saving bonds) and derivative instruments. The use of derivatives is only permitted in accordance with the provisions of the Building Societies Act 1986, which focus on their use to reduce risk. The maximum level of interest rate risk is governed by the Board approved Treasury and Financial Risk Management Policy in line with the Board's risk appetite.

In line with regulatory requirements and best practice, the impact of a parallel shift in interest rates in both directions, is considered. In addition, the impact of alternative non-parallel scenarios upon income and market value is also considered.

Basis risk

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, e.g. Bank Rate mortgages are funded by LIBOR-linked liabilities. The impact of these mismatches (basis risk) is monitored by Treasury and reported to ALCo. The regulatory authorities have continued to encourage firms to transition away from using LIBOR as a benchmark in all their operations before the end of 2021; SONIA has been chosen as the preferred benchmark rate in the UK. The Society has made good progress in transitioning its exposures to this benchmark ahead of the deadline.

Interest rate risk summary

The levels of pre-tax interest rate risk exposures, to a +/-2% parallel shift, subject to floors as recorded in the Treasury and Financial Risk Management Policy, through the reporting period were as follows:

	As at 31 March 2020 £m	**Average 2020 £m**	**High 2020 £m**	**Low 2020 £m**
Market value	**(0.8)**	(2.0)	(3.7)	(0.8)
Net interest income	**(2.8)**	(2.1)	(2.8)	(1.5)

Table 22: Interest rate risk exposures

Interest rate risk calculations are performed monthly and intra-month as required.

The Group's gap and basis mismatch positions are reported quarterly to the Prudential Regulation Authority (PRA). The Society also employs Economic Value of Equity measures in line with European Banking Authority (EBA) requirements. The Society's internal limits framework ensures that Interest Rate Risk in the Banking Book is controlled at much lower exposures than would trigger a notification to the PRA under the established EBA reporting triggers.

No capital is required under Pillar 1 for this element of market risk.

Derivative activity

The Group has an integrated approach to interest rate risk management, taking advantage of natural hedges which exist within the Group Statement of Financial Position and using derivatives where no such natural hedges exist.

The following table describes the significant activities undertaken by the Group, the associated risks and, where applicable, the type of derivatives typically used in managing such risks.

Activity	Risk	Managed by
Management of the investment of reserves and other non-interest bearing liabilities	Sensitivity to changes in interest rates	Matching against fixed rate assets
Fixed rate mortgage lending and other assets	Sensitivity to changes in interest rates	Pay fixed receive floating interest rate swaps, matching against fixed rate liabilities
Fixed rate savings products and funding	Sensitivity to changes in interest rates	Receive fixed pay floating interest rate swaps, matching against fixed rate receipts
Variable rate funding	Sensitivity to fluctuations in interest rates between quarterly reset dates	Pay floating receive floating interest rate swaps
Commercial mortgage loss provisioning	Sensitivity to changes in interest rates	Pay fixed receive floating interest rate swaps

Section 7 – **Market risk** (continued)

Other market risk

The Society's only exposure to equities is through the investments held in its defined benefit pension scheme. There is no exposure to foreign exchange rates.

The Society has invested in property through its subsidiary West Bromwich Homes Limited and offers residential property for rent. This business exposes the Society to movements in house prices.

Although it is recognised that controls cannot eliminate the risk of holding the properties, the controls which were in place both when acquiring the property and in the ongoing management of the property help to reduce the risk. The key controls include:

At acquisition

- Properties required to have appeal for both owner occupation and buy to let; and
- Properties located in areas with consistent demand for both owner occupation and buy to let properties.

Ongoing management

- Use of a specialist property management agency to ensure the properties remain in a marketable condition whilst optimising rental yields; and
- Property values monitored on a monthly basis with a formal revaluation at least annually.

Section 8 – **Operational risk**

Operational risk overview

The Society has applied a commonly used definition of operational risk - the risk of loss and/or negative impact to the Society resulting from inadequate or failed internal processes, systems or people or from external events.

The Society has adopted The Standardised Approach for the calculation of its Operational Risk Capital Requirement (ORCR), which establishes the Society's minimum Pillar 1 capital requirement for operational risk. This is calculated from the average of the last three years' income, with the income allocated to defined business lines being subject to a prescribed regulatory multiplier. As a mutual lender, the Society's ORCR is primarily derived from retail banking activities.

In order to ensure that the Society's ORCR is suitable for extreme events, management assesses its suitability through the development of a series of stress test scenarios used to estimate the impacts of extreme but plausible low frequency, high impact loss events. These are considered in isolation and in combination to develop a range of potential impacts. The outputs of the scenarios are then used to inform management whether further capital requirements are required for operational risk, in addition to the ORCR.

Operational risk framework

Each business function has a clearly articulated responsibility for identifying, monitoring and controlling its operational risks. The business function receives support and guidance from the Operational and Conduct Risk team, which co-ordinates regular reviews with the function managers and collates the output for review by executive management, the OCIRG, ERC and the RC.

The Operational and Conduct Risk team also provides independent input and challenge to the business functions, both through the regular review of operational risks and day-to-day business initiatives.

Operational risk management and mitigation

Operational Risk is further classified into sub-categories (level 2 risks), each of which is overseen by a Divisional Director. Each level 2 risk has a documented strategy, updated annually, which sets out the approach to managing the risk. Each strategy is based on the following principles: there is a Board approved risk definition; there is a Three Lines of Defence Model, with clearly articulated responsibilities for the management of each risk; there are appropriate policies, processes, systems and controls throughout the Society; and finally, a defined governance structure. Second line control testing is conducted in accordance with the annual controls testing plan agreed by the RC.

Key operational risks and their mitigants are detailed below:

Risk	Brief description	Operational risk management and mitigation
Business Continuity and Disaster Recovery Risk	The risk of failure to adequately assess, document, test and invoke business continuity procedures to safeguard Group assets and personnel, and to adequately maintain or re-commence all essential business operations following a business continuity event.	Each business area has a Business Continuity Plan, reviewed every 6 months. There is a Crisis Management Plan in place with a defined Crisis Management Team. A new role within the First Line has been established to co-ordinate efforts across the business in the development and delivery of the Society's Operational Resilience Plan and Business Continuity and Disaster Recovery Risk Management Framework, important components against which to manage operational resiliency. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Customer Operations Risk	The risk of financial and non-financial impacts resulting from inadequate or failures in customer facing/support processes.	Customer Operations Risks are most concentrated within the Operations function and the branch network, where activity is focussed on customer transactions, occurring by any means, primarily by post and email (Operations), telephone (Operations and branches) or in person (branches). The management and control of these risks is integral to the provision of service. First Line control activities are carried out locally (or by a specialist area outside the team). Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Product risk	The risk of financial and non-financial impacts resulting from the inadequate design and launch of new products and services and monitoring of Conduct Risk associated with the management of existing business.	Product Consideration Group is the First Line committee in the Product Governance Framework, which ensures that risks are mitigated and the Society delivers its obligation for the fair treatment of customers at the following stages: design and governance; identifying target markets; marketing and promotion; sales and advice processes; after-sales information and service; and complaints handling. Other controls include Product Design Risk Assessments and on-going monitoring of third parties and monitoring of Conduct Risk associated with the management of existing business. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.

Section 8 – **Operational risk** (continued)

Risk	Brief description	Operational risk management and mitigation
Financial Reporting Risk	Failure to interpret and comply with financial reporting and taxation requirements, including the misrepresentation of financial statements.	There is dedicated resource within the Finance department, which has systems and controls, governed by an overarching framework, in place for regulatory reporting. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Spreadsheet Risk	The risk of adverse consequences resulting from decisions based on errors in the design, implementation or operation of spreadsheets.	The Spreadsheet Risk Management Framework sets out the requirements with which all spreadsheets must comply, subject to categorisation on the basis of materiality and complexity. The level of, and area responsible for, required control testing and validation is determined from the spreadsheet categorisation. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Technology Risk	The risk of financial and non-financial impacts resulting from failures in the development, delivery, maintenance and continuity of effective IT systems.	There is dedicated IT resource to implement the development, delivery, maintenance and continuity of effective IT systems. Frameworks and policies are in place, against which compliance is assessed in the First Line. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
People Risk	The risk associated with the ability to recruit, develop, motivate and retain the required number and quality of people. People risk includes failure to comply with employment related requirements and inappropriate or unauthorised employee activity.	The management of people-related risks is the responsibility of all managers, whilst the Human Resources department maintains oversight. On a day-to-day level, Human Resources provides advice and support to the business in relation to Recruitment and Selection, Employee Relations, Reward, Learning and Development approaches and Payroll and Administration in adherence to employment legislation and Society policies. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Legal & Regulatory Risk	The risk of regulatory censure, fines or legal action as a result of incorrect or inappropriate business conduct, e.g. failure to comply with legislative / regulatory requirements or Codes of Conduct.	Legal and Regulatory risk is managed by the Group Secretary. The Group has a small internal Legal team and selectively uses external firms where specific legal support is required. Legal and regulatory developments are monitored and scrutinised by Legal & Regulatory Services. In addition, the Society's contractual relations with consumers and businesses alike are reviewed, drafted and validated for the protection of the Society and its members. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Physical Assets, Safety and Security Risk	The risk that appropriate premises and other physical assets are not available to support business operational needs or do not conform to all relevant regulations, including Health and Safety requirements. It includes theft of/ damage to the Society's assets and threats or actual harm to the Society's employees.	Central to managing this risk is the Health & Safety Policy, Information Security Policy and the Physical Security Policy. A dedicated Corporate Facilities department, managed within the Group Secretariat, provides specialist support to First Line areas. As well as the standard risk governance arrangements, additional oversight is provided by the Health & Safety Committee. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Supplier & Outsourcing Risk	The risk of adverse impacts arising from services with outsourced partners or third party suppliers. It includes inappropriate supplier selection and management processes and failure on the part of the supplier to deliver the agreed services and/or comply with relevant laws, codes and ethical behaviours.	All business areas are required to implement procedures and processes to ensure compliance with both the risk management strategy and the Supplier Selection and Management Policy. Controls are in place throughout all stages of procurement, including ongoing contract and supplier management. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Financial Crime Risk	Risk of financial and non-financial impacts arising from internal and external fraud, or from a failure to comply with financial crime legislation.	The Group Secretary retains overall responsibility and oversight of Financial Crime Risk as part of his Money Laundering Reporting Officer responsibilities. The Head of Legal and Regulatory Services is responsible for the day to day running of the Financial Crime Team. The Group pays close attention to the source, likelihood and impact of Financial Crime. All staff are required to complete training to ensure an appropriate level of understanding, with particular regard to identifying and managing financial crime and its associated risks. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.
Change Risk	The risk of financial and non-financial impacts resulting from the inadequate design, management or implementation of change.	Controls are in place to ensure that change is delivered in a controlled manner, whether it be Business As Usual change (such as a process change without systems development); small process or organisational change, where operational and customer impact is low; or project change, where the risk and complexity demands a formal approach to change. For the latter, specific controls include an agreed project methodology and governance arrangements. Control Testing activities are led by the Second Line, in accordance with the plan agreed by Risk Committee.

Section 8 – **Operational risk** (continued)

Operational resilience overview

Operational Resilience has visibility at Board level with regular quarterly reporting to the Board on our overall Operational Resilience capabilities. There is a risk framework for overall governance of Operational Resilience which applies to the Society as a whole. The focus of the quarterly Board update is the resilience of our critical Business Services and the underpinning enablers of those Services (people, premises, technology and third parties) to respond to any risk event that might materialise.

There have been three core themes guiding our Operational Resilience capability development within the last reporting period: firstly regulatory expectations of firms' capabilities; secondly our normal Operational Resilience development plan; and thirdly our response to COVID-19.

On the first point, in December 2019 both the FCA and the PRA issued their consultation papers (CP19/32 and CP29/19 respectively), with the consultation period originally closing on 3 April 2020. This consultation period has now been extended to 1 October 2020 due to the operational impact that the current COVID-19 response is placing on all organisations as they respond to the COVID-19 pandemic. As an organisation we have already adopted the principles and approach outlined by the regulatory authorities and are well placed to respond to further guidance following the end of the consultation period.

On the second point the Society has continued to invest in Operational Resilience capabilities, further strengthening its recovery capabilities within its IT systems should a risk event occur, continuing to review and refine processes, and overall continuing to strengthen the Society's capabilities to mitigate a potential risk event without the need to adopt formal recovery processes.

Finally, in the last quarter of the financial year the Society has focused heavily on our response to COVID-19. All member and business services have been successfully maintained throughout the COVID-19 pandemic. The COVID-19 pandemic has enabled the Society to demonstrate its Operational Resilience capabilities in the 'real world', and the response has proven to be effective. Our operational, technology, premises and people processes have proven to be highly flexible enabling us to respond quickly to the unique circumstances of the COVID-19 crisis.

Operational risk oversight and governance

Oversight and governance arrangements for the setting and management of a robust operational risk management policy and framework are the responsibility of the Board and supported by the OCIRG.

Capital required under Pillar 1 for operational risk was £7.7m (2019: £7.7m).

Section 9 – **Liquidity risk**

Liquidity risk

The risk that the Society either does not have sufficient financial resources to enable it to meet its obligations as they fall due or can secure such resources only at excessive cost.

The Society's primary purpose is to make loans secured by way of mortgage on residential property. It funds these loans substantially from short-term deposits provided by its saving members. The contractual maturity of the mortgages is typically up to 30 years although loans are often repaid early due to borrowers moving house or remortgaging.

Savers' deposits, whilst predominantly accessible on demand, at short notice or for fixed periods, nevertheless tend to remain with the Society for longer periods. A substantial proportion of savers have long established relationships with the Society.

This difference in the nature of borrowers' and savers' relationships with long-term assets funded by short-term, mostly instant access accounts, results in a structural mismatch which can put pressure on resources. To mitigate this risk, the Society holds sufficient liquid resources to meet the normal day-to-day operations of the business and, in addition, maintains a buffer of high quality liquid assets which can be converted quickly into cash to cover outflows in severely stressed conditions. Processes are in place to ensure that the quantity, quality and availability of these liquid resources are adequate at all times.

The Board undertakes a detailed annual review of its liquidity adequacy under the Internal Liquidity Adequacy Assessment Process (ILAAP) and submits this to the PRA for supervisory review. The ILAAP specifies the daily processes that the Society will use to determine the amount of liquidity required to cover its potential cash flow needs under a range of stresses including three PRA standard scenarios 'idiosyncratic', 'market-wide' and 'combined'.

The supervisory review also informs the PRA's view of the amount of 'buffer' or highest quality liquid assets that the Society should hold to meet the three standard regulatory stress scenarios and the maximum allowable gap between maturing wholesale assets and wholesale liabilities (wholesale refinancing gap). Treasury maintains liquid resources at the greater of the LCR requirement or that indicated by the ILAAP.

As prescribed by EBA Guidelines:

- The liquidity buffer represents the amount of the Society's liquidity resources for regulatory purposes. Substantially all of the Society's liquidity buffer is made up of balances with the Bank of England and UK Government securities;
- The total net cash outflow represents the total expected cash outflow on a stressed basis minus total expected contractual cash inflows for the subsequent 30 days; and
- The values at each quarter end date are a simple average of month-end observations over the 12 months preceding the end of each quarter.

		12 month average			
Quarter end		**30 June 2019 £m**	**30 September 2019 £m**	**31 December 2019 £m**	**31 March 2020 £m**
21	**Liquidity Buffer**	**484.5**	**488.2**	**498.4**	**478.2**
22	**Total Net Cash Outflows**	**320.5**	**316.6**	**317.2**	**311.3**
23	**Liquidity Coverage Ratio (%)**	**153%**	**156%**	**159%**	**155%**

Table 23: EBA abbreviated liquidity coverage ratio (LCR) disclosures

The row references in the above table are as set out in the EBA template for abbreviated LCR disclosures.

During the year, the Society maintained the LCR above the regulatory minimum at all times.

The Board has established a Liquidity Risk Policy which lays down a rigorous framework of limits to control the Society's liquidity risk. The governance process surrounding liquidity risk management activities is as follows:

- The RC has delegated authority for the governance of Liquidity Risk Management to the ALCo which meets monthly;
- Operational management of liquidity risk is further delegated to the Liquidity Management Committee (LMC) which meets weekly. LMC looks at liquidity stresses and plans cash flows over a rolling 12 month planning period;
- Treasury is responsible for day-to-day management and maintenance of adequate liquid resources under delegated authority from ALCo; and
- The RC monitors independently the overall liquidity adequacy process, including the activities of ALCo, LMC and Treasury.

The Society is responsible for the liquidity and cash flow requirements of wholly owned subsidiaries.

Net Stable Funding Ratio

The Net Stable Funding Ratio (NSFR) is a long-term stable funding metric, which measures the stability of our funding sources relative to the assets (mortgage balances) we are required to fund.

At 31 March 2020, the NSFR was 131% (31 March 2019: 132%). Based on our interpretation of the available guidance, the Society's NSFR comfortably exceeds the 100% regulatory requirement.

Section 10 – **Other risks**

This section sets out the other risks faced by the business above and beyond the Pillar 1 risks set out in Sections 4 to 9.

Information risk

The risk that customer or Society information assets are managed or processed incorrectly or are not adequately protected. It includes inadequate data quality and failure to comply with data protection and data privacy requirements.

Understanding and managing information risk is imperative to the successful achievement of the Society's business objectives.

Effective policies, procedures and processes complemented by technological defences and detection tools, provide for successful information risk management.

To this end the Society has determined a risk management strategy based on the following principles:

- A clearly articulated and Board approved Information Risk Appetite Statement;
- A clearly articulated and Board approved information risk definition;
- An embedded and compliant Information Risk Management Framework, underpinned by robust processes and tools;
- A Board approved Cyber Resilience Strategy Plan;
- A Three Lines of Defence model with clearly articulated responsibilities for the management of information risk;
- Appropriate processes, systems and controls that support the effective management of information risks across the Society;
- Committee oversight within an appropriate governance structure; and
- An appropriate member of the senior management team with overall accountability for information risk management.

The Society's Operational, Conduct & Information Risk Group (OCIRG) is in place to maintain oversight and governance of information risk across the Society and challenge the effectiveness of the controls in place to mitigate information risk (including cyber security) across the Society. Its purpose is to support and drive the information risk governance agenda and provide the Society with the assurance that effective information governance best practice mechanisms are in place within the Society.

Pension liability risk

The risk that there will be a shortfall in the value of the Society's pension fund assets over and above the guaranteed liability to its employees under the defined benefit pension scheme. This may result from a number of sources including investment strategy, investment performance, market factors and mortality rates. The Staff Retirement Scheme ('the Scheme') is also exposed to possible changes in pension legislation.

The Society has funding obligations for a defined benefit scheme, the Scheme, which is closed to new members and no longer accruing service benefits.

To mitigate these risks, management, together with the Trustees of the Scheme, regularly reviews reports prepared by the Scheme's independent actuaries to assess these risks and take appropriate actions which may, for example, include adjusting the investment strategy or contribution levels to address any funding deficit.

Due to the ownership of pension liability risk lying with the independent Trustee Board, the Society's Internal Audit function's scope with respect to this risk is limited to a periodic review of the Trustee Board's management and governance of the pension fund.

Business risk

The risk of the Society failing to meet its business objectives through the inappropriate selection or implementation of strategic plans.

This is the risk to the Society arising from changes in its business, including the risk that it may not be able to carry out its business plan and its desired strategy or both. This may be due to changes in the competitive environment or events which damage the operating economies of the Society (e.g. competitor activity, changes in regulation or taxation).

The Society regularly models the impact of a range of scenarios on the business plans, with a view to identifying mitigating actions.

Retail conduct risk

The risk that inappropriate behaviours by the Society result in adverse outcomes for retail consumers.

Retail conduct risk (conduct risk) is deemed so important that the FCA was created to increase the regulatory focus on it. This is intended to go beyond the previous focus on compliance with rules, on process and on treating customers fairly, to embrace a holistic approach of how a firm organises itself and does business in order to ensure good customer outcomes.

The management of conduct risk is a key component in the successful delivery of the Society's strategy, objectives and protection of its members and customers.

To this end, the Society has determined a risk management strategy based on the following principles:

- A clearly articulated and Board approved Conduct Risk Appetite Statement;
- An embedded and compliant Conduct Risk Management Framework;
- A Three Lines of Defence model with clearly articulated responsibilities for the management of conduct risk;
- Appropriate business processes, a centralised risk management system used by business areas to manage their risks and controls to support the effective management of conduct risk across the Society; and
- Committee oversight within an appropriate governance structure, in particular the OCIRG. This Committee is chaired by the Chief Risk Officer and is responsible for the oversight of the management of operational and retail conduct risks arising from the Society's business activities.

Section 10 – **Other risks** (continued)

Model risk

The risk of adverse consequences resulting from decisions based on models that are inaccurate, sub-optimal, incorrectly implemented, or misused.

Increasingly, across the sector, models are developed to assess, control and monitor risk more effectively, consistently and accurately. As businesses place more reliance upon the outputs of such models, particularly in reporting and decision-making processes, it becomes increasingly important that an effective framework is in place to manage the model risk.

A process of governance, overseen through the Model Risk Committee, chaired by the Chief Risk Officer, is in place and is applicable throughout the model life cycle, from initiation, through development, approval, implementation to ongoing monitoring and validation. The Society's approach to model risk management is self-assessed as fully compliant with applicable regulation.

Climate change risk

The Society is at risk of future financial losses due to the potential impact of physical and transition risks on its exposure due to climate change. It has therefore been designated a strategic risk for the Society.

The Society has provided the PRA with a high level action plan and timeline of how it intends to identify and manage these risks. The plan covers the four areas identified by the PRA in Supervisory Statement 3/19 Enhancing banks' and insurers' approaches to managing the financial risks from climate change:

Governance: Climate change has Board Risk Committee level visibility and oversight, including associated impacts, following its designation as a strategic risk. The Society plans to escalate all significant proposals and updates regarding climate change risk management, scenario analysis and disclosure to Board-level.

Risk management: The Society is currently in the process of identifying and quantifying its exposures to the financial risks from climate change. This will initially concentrate on current and future exposure to flood risk (physical), and exposure to changing government regulations on EPC ratings (transitional). Once risks have been identified potential actions will be considered.

Scenario analysis: The Society will work with its partners and external climate modelling consultants in order to model the impact of climate change on flood risk. We aim to perform similar analysis with subsidence risk. With regard to transition risk, we aim to match each of our mortgaged properties to its publicly available EPC rating and project forward potential scenarios.

Disclosure: The Society treats risks from climate change like other financial risks, rather than a corporate social responsibility issue and are aware of increasing demands for climate change disclosures from governments, investors, regulators and the wider public. The Society is aware of the Task Force on Climate-related Financial Disclosures recommendations on the reporting of climate change risks. Some disclosures are included within the Risk Management Report on pages 33 to 39 and the Strategic Report on pages 9 to 32 of the 2020 Annual Report and Accounts and we will endeavour to disclose further information in a proportional manner in the future.

Section 11 – **Structured entities and securitisation**

Securitisation is the process by which ring fenced groups of assets, usually loans, are aggregated into a pool, and sold to structured entities with no gains being recognised. The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the originating entity.

As part of a diversified funding strategy the Group transfers pools of mortgage loans to structured entities, including securitisation vehicles, thereby enabling the Society to obtain secured funding or create collateral which can be used in wholesale funding initiatives. Residual credit risk exists where the Group retains an interest in the structured entities through the provision of subordinated debt and/or start up loans and liquidity facilities where applicable.

The Society has neither issued nor invested in re-securitisation assets.

Originated securitisations and funding arrangements

The Group has established structured entities, as part of its funding activities, using residential and commercial mortgage loans as the underlying asset pools.

The equity of the structured entities created for these funding activities is not owned by the Group. However, to comply with the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 and IFRS 10, the structured entities are, in certain circumstances, treated as subsidiaries in the consolidated financial statements. Where the structured entities are not consolidated, the securitised mortgage assets may still be recognised in the Group financial statements under the rules and guidance of IFRS 9. This is despite the fact that some securitisation entities may be structured in such a way that the Group's exposure to losses is capped at levels whereby consolidation is not considered appropriate for regulatory capital purposes.

The Group has experience of issuing securitisations under various programmes and has built up a depth of knowledge, processes and management information to deal effectively with these funding vehicles. The Group undertakes securitisation activities to raise wholesale funding. Securitisation is used to increase the diversification of funding sources, manage maturity mismatch risk and assist overall credit risk management.

Treatment of structured entities for capital purposes

There are two distinct capital treatments for the structured entities that the Group has established. The capital treatment is dependent upon whether or not significant credit risk associated with the ring fenced exposures is considered to have been transferred to third parties. The mortgage originator usually retains an element of risk by holding a tranche of subordinated liabilities. Where the risk is limited to a relatively small tranche of subordinated loans it is usually possible to demonstrate that a significant risk transfer has taken place. Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc are not consolidated for capital purposes. While these entities are not consolidated in the Group financial statements at 31 March 2020, the underlying mortgage pools are included in the accounting group whereas, for capital purposes, no risk weighted exposures are included in the capital calculation for the assets that have been securitised. Instead the subordinated loans, net of any provisions for losses, are deducted from Tier 1 capital.

Alternatively, where the structures do not achieve significant risk transfer, the underlying mortgage pools and other assets of the structured entities remain within the Group and are consolidated for capital purposes. This means the assets are risk weighted along with the Group's own assets using the Standardised Approach as reported in Section 5 – Capital adequacy. Hawthorn Finance Limited, Hawthorn Asset Co Limited, Kenrick No. 2 Plc, Kenrick No. 3 Plc and West Bromwich Funding Limited are treated in this manner.

The accounting treatment for the Group's structured entities is explained in Note 1, Accounting policies, to the 2020 Annual Report and Accounts.

Non-consolidated structured entities for regulatory capital purposes

The Society, through its subsidiary company, West Bromwich Commercial Limited (WBCL), provides subordinated loans (including funding for start-up costs) to Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc.

The notes in these securitisations are serviceable from cash flows generated by the mortgage assets. The Society receives the excess spread on the transactions as deferred consideration, after the structured entities have met their liabilities. The Society does not provide any liquidity facilities to the structured entities. WBCL provides administration and cash management services to the structured entities, for which it receives a fee. The subordinated and start-up loan balances have been written down to £nil (2019: £nil) by the application of cumulative losses on the securitised loans within Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc.

The structured entities were originally set up as follows:

Sandwell Commercial Finance No. 1 Plc
In May 2004, WBCL sold £250m of commercial mortgage assets, at book value, to Sandwell Commercial Finance No. 1 Plc. Sandwell Commercial Finance No. 1 Plc issued notes to finance the purchase of the commercial mortgage assets.

Sandwell Commercial Finance No. 2 Plc
In September 2005, WBCL sold £350m of commercial mortgage assets, at book value, to Sandwell Commercial Finance No. 2 Plc. Sandwell Commercial Finance No. 2 Plc issued notes to finance the purchase of the commercial mortgage assets.

Section 11 – **Securitisation** (continued)

Non-consolidated structured entities for regulatory capital purposes (continued)

The balances of gross assets subject to securitisation, notes in issue and underlying balances past due are included in the table below. Gross assets include the gross value of the underlying mortgage loans together with cash, cash equivalents and other assets.

At 31 March

Securitisation Company	**Date of Securitisation**	**Gross assets securitised 2020 £m**	**External notes in issue 2020 £m**	**Underlying assets more than one month past due 2020 £m**	Gross assets securitised 2019 £m	External notes in Issue 2019* £m	Underlying assets more than one month past due 2019 £m
Sandwell Commercial Finance No. 1 Plc	19 May 2004	**3.0**	**9.6**	**-**	4.5	10.6	-
Sandwell Commercial Finance No. 2 Plc	23 September 2005	**21.5**	**46.9**	**3.3**	29.4	50.0	3.3
		24.5	**56.5**	**3.3**	33.9	60.6	3.3

Table 24: Off-balance sheet originated commercial mortgage securitisations

*The carrying values of the external loan notes in issue at 31 March 2019 have been restated following a review, by each of the securitisation companies, of certain accounting adjustments previously made under the Application Guidance of IAS 39 which resulted in a revised approach to calculating those accounting adjustments.

The gross assets securitised in the above table are subject to impairment provisions of £8.0m (2019: £6.1m) and there were £11.9m (2019: £16.7m) of loans which were categorised as stage 3 (default) under IFRS 9.

Consolidated structured entities for regulatory capital purposes

The structured entities, which are fully consolidated for capital purposes, were originally set up as follows:

Hawthorn Finance Limited and Hawthorn Asset Co Limited
In July 2008, West Bromwich Mortgage Company sold £1,000m of residential buy to let mortgage assets, at book value, to Hawthorn Asset Co Limited, which in turn, borrowed funds from Hawthorn Finance Limited to fund the purchase of the mortgage assets.

Kenrick No. 2 Plc
In May 2013, an Originator Trust was created over a £426.3m portfolio of prime residential mortgages, at book value. Kenrick No. 2 Plc acquired a 99% share in the Originator Trust and issued notes to finance the purchase. The Society retained a 1% share in the Originator Trust. On 18 July 2018, the Society triggered its call option and the loans were bought back by the Society.

Kenrick No. 3 Plc
In January 2018, an Originator Trust was created over a £383.5m portfolio of prime residential mortgages, at book value. Kenrick No. 3 Plc acquired a 99% share in the Originator Trust and issued notes to finance the purchase. The Society retained a 1% share in the Originator Trust. The call option date for all notes is 11 January 2023.

West Bromwich Funding Limited
In July 2019, a Trust was created over a £104.0m portfolio of prime residential mortgages, at book value. West Bromwich Funding Limited acquired a 99% share in the Trust - the purchase of this share in the relevant mortgage loans was financed in part by way of a bilateral loan arrangement. The Society retained a 1% share in the Trust.

Loan notes created under a retained securitisation may be used to raise funding. However, the loan assets within the securitisations do not change and we continue to manage the interest rate risk of the underlying mortgage assets.

To manage interest rate risk, the structured entities enter into derivative transactions with external derivative counterparties, paying a rate of interest based on the mortgage pools and receiving a rate inherent in the debt issuances. Cash flows arising from these derivatives are accounted for on an accruals basis. The derivatives relating to the securitisations are treated as explained in Note 1, Accounting policies, to the 2020 Annual Report and Accounts. The Society is both originator and servicer for each of the issuances, directly for Kenrick No. 2 Plc, Kenrick No. 3 Plc and West Bromwich Funding Limited and via subsidiary West Bromwich Mortgage Company Limited in the case of the Hawthorn entities.

The Society's obligations in respect of these funding vehicles are limited to transferring cash flows from the underlying assets. The Society and its subsidiaries are under no obligation to support any losses that may be incurred by the funding programmes or external lenders/noteholders which are only entitled to obtain payment to the extent of the resources available within the funding vehicles.

Of the structured entities referred to above Hawthorn Finance Limited, Hawthorn Asset Co. Limited, Kenrick No. 2 Plc (now dissolved) and Kenrick No. 3 Plc are securitisation companies. The securitisation vehicles are subject to legal covenants which need to be fulfilled in the event of a downgrade of the contracted liquidity provider. The cash flows resulting from these legal covenants are in respect of amounts held in the transaction bank accounts and the Guaranteed Investment Contract accounts, representing the net cash position arising from the management of the structured entities at any point in time. Funds may need to be either deposited with another institution with the requisite rating or a guarantee obtained from a suitable guarantor (in the event of the liquidity or derivative provider losing its short-term rating unless the rating agencies confirm that the current ratings of the notes will not be affected). There is no additional liquidity risk to the Society, as the cash flows affected solely relate to cash held within the structured entities and no further flows from the Society would be required.

Consolidated structured entities for regulatory capital purposes (continued)

The balances of assets subject to securitisation, notes in issue and underlying balances past due are presented in the table below.

At 31 March

Securitisation company	**Date of securitisation**	**Gross assets securitised 2020 £m**	**Total notes in issue 2020 £m**	**Retained notes in issue 2020 £m**	**Underlying assets more than one month past due 2020 £m**	Gross assets securitised 2019 £m	Total notes in issue 2019 £m	Retained notes in issue 2019 £m	Underlying assets more than one month past due 2019 £m
Hawthorn Finance Limited/ Hawthorn Asset Co. Limited	22 July 2008	**568.1**	**546.2**	**546.2**	**2.2**	614.2	590.5	590.5	3.5
Kenrick No. 3 Plc	25 January 2018	**307.2**	**298.4**	**33.2**	**0.2**	362.4	351.3	33.1	-
		875.3	**844.6**	**579.4**	**2.4**	976.6	941.8	623.6	3.5

Table 25: On-balance sheet originated residential mortgage securitisations

The gross assets securitised in the above table are subject to impairment provisions of £1.0m (2019: £1.1m) and there were £5.7m (2019: £6.8m) of loans which were categorised as stage 3 under IFRS 9.

The issued securitisation notes are rated by Moody's and Fitch.

Purchased securitisation positions

The Society also invests in mortgage backed securities. The treatment of the investment in mortgage backed securities is covered under Section 6 – Credit risk.

Purchases and retention of residential mortgage backed securities (RMBS) are undertaken within a clearly defined credit risk policy. All residential mortgage backed securities holdings are monitored on a daily basis and if the credit rating deteriorates below AAA level the position is reviewed. The liquidity of residential mortgage backed securities assets held, either through sale or sale and repurchase, is regularly tested by Treasury and reported accordingly. The Society holds no re-securitisation positions.

The EU Securitisation Regulation, applicable from January 2019, sets out the framework and criteria for 'simple, transparent and standardised' (STS) securitisation transactions. Investments in RMBS, which have fulfilled the necessary requirements and been designated as STS, receive preferential capital treatment in terms of risk weighting. At 31 March 2020, 89% of the Group's RMBS holdings were STS-compliant.

The Society has invested in commercial mortgage backed securities issued by Sandwell Commercial Finance No. 2 Plc. As at 31 March 2020 these notes had a fair value of £1.1m (2019: £1.2m) and of these, £0.3m (2019: £1.0m) was risk weighted and £0.8m (2019: £0.2m) was deducted, for capital purposes, from reserves. The minimum capital requirement for the risk weighted element was less than £0.1m (2019: £0.3m).

The valuation process of our investments in securitisation exposures primarily focuses on quotations from third parties and observed trade levels. This process did not change for the year ended 31 March 2020. In the table below, the 2020 credit quality steps and associated risk weightings for securitisation exposures reflect the guidance (applicable to the Society's securitisation exposures from 31 December 2019) set out in Regulation (EU) 2017/2401.

RWA %	**CQS**	**Exposure 2020 £m**	**Capital requirement 2020 £m**	Exposure 2019 £m	Capital requirement 2019 £m
10%	1	**70.8**	**0.6**	-	-
15%	1	**8.5**	**0.1**	-	-
20%	1	**-**	**-**	71.1	1.1
180%	12	**0.3**	**-**	-	-
350%	4	**-**	**-**	1.0	0.3
Total		**79.6**	**0.7**	72.1	1.4

Table 26: Purchased securitisation exposures and associated capital requirements by risk weighting and credit quality step

Section 12 – **Remuneration and other corporate governance**

Governance arrangements

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435 are included in Section 3 of this report but are also supplemented by the disclosures included in the Directors' Report on Corporate Governance on pages 46 to 49 and Annual Business Statement on pages 151 to 153 within the 2020 Annual Report and Accounts. The 2020 Annual Report and Accounts are published on the Society's website (www.westbrom.co.uk).

Given the change to the Remuneration Policy this year (specifying the reduction in pension contribution or cash alternative) the Policy will form part of a binding vote at the 2020 AGM. The Policy will thereafter remain in place and be subject to a further binding vote in 2023 (in line with the 3 year agreement) unless any further changes to policy are proposed in the interim period, in which case a vote would be required before the changes were implemented.

Remuneration and recruitment

The responsibilities and decision-making process for determining remuneration policy and membership of the management body, the link between pay and performance and the design and structure of remuneration, including the performance-related pay plans, have been disclosed in the Directors' Remuneration Report within the 2020 Annual Report and Accounts on pages 53 to 61. This report also describes the recruitment policy for Executive and Non-Executive Directors.

These disclosures meet the requirements of CRD IV and the PRA's Remuneration Code ('the Code') for the Society's Directors and are not repeated here. The 2020 Annual Report and Accounts does not include details of the remuneration of Code Staff required under CRD IV and this information is set out below.

Directors

The Board of Directors profiles, set out on pages 40 to 41 of the 2020 Annual Report and Accounts, give information on the relevant skills, knowledge and expertise of the Society's Executive and Non-Executive Directors. Details of their other directorships and interests at 31 March 2020 are disclosed in the Annual Business Statement on pages 151 to 153 of the 2020 Annual Report and Accounts.

The principles of diversity and inclusion are integral to the Society at all levels of the organisation. Information on employee diversity, including progress against targets for Board and senior management, is provided in the Strategic Report on pages 9 to 32 of the 2020 Annual Report and Accounts.

Code Staff

Under the Code, the Society is required to identify those staff that are considered to have a material impact on the Society's risk profile. This includes all Executive Directors, Divisional Directors and Non-Executive Directors. These individuals are defined as 'Code Staff'.

The table below sets out the aggregate quantitative remuneration for Code Staff in relation to their services for the Group for the years ended 31 March 2020 and 31 March 2019. The number of beneficiaries includes Code Staff with full and part year service. In the latter case, only remuneration earned in the Code Staff role is included in the table. The variable remuneration in the table below represents amounts authorised for payment and includes elements relating to performance in this year (non-deferred) and elements deferred from previous years (deferred). The table also includes remuneration awarded but deferred for payment in future years. Outstanding deferred remuneration only relates to those Code Staff who served during the year. The remuneration figures in the table do not include severance pay which is disclosed separately below.

Year to 31 March 2020

	Number of beneficiaries	**Fixed remuneration* £000**	**Variable remuneration (non-deferred) £000**	**Deferred variable pay from previous years £000**	**Total remuneration £000**	***Outstanding deferred remuneration £000***
Non-Executive Director	7	450	-	-	**450**	-
Executive Director	2	961	160	97	**1,218**	222
Other Code staff	9	1,434	245	128	**1,807**	309
	18	**2,845**	**405**	**225**	**3,475**	**531**

Year to 31 March 2019

	Number of beneficiaries	Fixed remuneration* £000	Variable remuneration (non-deferred) £000	Deferred variable pay from previous years £000	Total remuneration £000	*Outstanding deferred remuneration £000*
Non-Executive Director	9	494	-	-	494	-
Executive Director	2	928	176	78	1,182	214
Other Code staff	10	1,418	234	141	1,793	313
	21	2,840	410	219	3,469	527

Table 27: Aggregate quantitative remuneration for Code Staff

* Includes fees, basic salary, pension and other benefits. In the year to 31 March 2020 this also included compensation of £42,000 (2019: £31,568) which was determined with reference to the amount of performance-related pay award that one Executive Director would have received from his previous employer if he had stayed in post.

Section 12 – **Remuneration and other corporate governance** (continued)

Code staff (continued)

Remuneration for Code Staff

Component	Purpose	Operation	Performance metrics
Basic salary/Fees	Fixed remuneration set to attract and retain individuals of sufficient calibre.	Reviewed annually (or more frequently if required). Executive Directors and Divisional Directors receive a basic salary whereas Non-Executive Directors receive fees plus expenses for travel and accommodation in relation to their attendance at meetings.	Influencing factors include: • Role and experience; • Personal performance; • Salary increases awarded across the Society; and • Benchmarking comparisons
Performance-related pay	Variable remuneration linked to the delivery of Society and personal objectives. Used to reward within the context of achieving the Society's goals and objectives.	Maximum annual opportunity for Executive Directors and Divisional Directors is 50% of basic salary. For Executive Directors only, the Remuneration Committee has the discretion to allow a maximum annual opportunity of 75% of basic salary (as approved by voting members at the 2018 AGM). 40% of the performance-related pay earned is deferred over a three year period. Deferred payments are made in equal instalments over the following three years, are subject to annual review and recommendation by the Remuneration Committee and require approval by the Non-Executive members of the Board. The Remuneration Committee has discretion to make a reduction in the level of award (down to zero) or recover awards if necessary including withholding vested awards (malus arrangements) and recovering payments (clawback arrangements) for a period of 3 years after the award is paid.. The annual review prior to payment of a deferred element will take into account a number of factors, making sure the individual has operated within the risk appetite of the Society, not exposed the Society to regulatory or control failings, or taken other such actions that would represent a poor outcome for members. Non-Executive Directors do not receive variable remuneration.	Based on a number of measures, including: • Financial; • Customer; • People; • Risk; and • New and enhanced operational capabilities Reviewed by the Committee annually to ensure that the measures are appropriate.
Pension or pension allowance	A part of fixed remuneration intended to attract and retain individuals of sufficient calibre.	Executive Directors and Divisional Directors are invited to join the Society's stakeholder pension plan or, as an alternative, be provided with a cash allowance (for example, where they have exceeded the annual or lifetime allowance). The opportunity for new Executive Directors and Divisional Directors is a pension contribution or cash allowance equal to the maximum pension contribution available to all other employees (for 2020/21 10.6%). For the current Executive Directors, the opportunity is a cash allowance reducing to the maximum contribution available to all employees (currently 10.6%), over three years: • From April 2020 reducing from 25% to 20%; • From April 2021 reducing to 15%; • From April 2022 reducing to 10.6% (or any such amount equal to the maximum for all employees should this change). Existing Divisional Directors are in the process of aligning to the maximum Society contribution available to all other employees as follows: • For those who contribute to a stakeholder pension scheme: o From April 2020 reducing from 15% to 13.5%; o From April 2021 reducing to 12%; o From April 2022 reducing to 10.6% (or any such amount equal to the maximum for all employees should this change). • For those currently taking a cash alternative o From April 2020 reducing from 12.5% to 11.5% o From April 2021 reducing to 10.6% (or any such amount equal to the maximum for all employees should this change). Non-Executive Directors do not receive a pension or pension allowance.	Not applicable.

Section 12 – **Remuneration and other corporate governance** (continued)

Code staff (continued)

Remuneration for Code Staff (continued)

Component	Purpose	Operation	Performance metrics
Benefits	A part of fixed remuneration intended to attract and retain individuals of sufficient calibre.	Benefits are provided in line with market practice for Executive Directors and Divisional Directors, which include a fully expensed car or cash allowance, private medical care and life assurance. Other benefits may be provided in individual circumstances. Non-Executive Directors do not receive any such benefits.	Not applicable.

There were no sign-on payments or variable remuneration in the form of share or share-like instruments and no individual received remuneration in excess of EUR 1 million.

Severance payments

There were no severance costs recorded for Code Staff in the year to 31 March 2020. For the year ended 31 March 2019, severance costs of £176,000 were recorded with £118,000 paid in the year and £58,000 deferred to and paid in the year ended 31 March 2020. These costs, which related to one member of other Code Staff, are not included in table 27.

Section 13 – **Adequacy of risk management controls**

The Board confirms that the Risk Management Report contained in the 2020 Annual Report and Accounts and the Pillar 3 disclosures above are a fair description of the principal risks and uncertainties that the Society faces. The Board aims to manage effectively all the risks that arise from its activities and believes that the risk management arrangements and controls put in place are adequate with regards to the Society's profile and strategy. The principal external threats facing the Society are outlined in the Risk Management Report within the 2020 Annual Report and Accounts on pages 33 to 39.

By order of the Board.

Section 14 – **Contacts**

Should you have any queries please contact:

Manjit Hayre Chief Risk Officer

Alex Pawley Divisional Director - Treasury and Finance

Neil Noakes Group Secretary

West Bromwich Building Society. Head Office: 2 Providence Place, West Bromwich B70 8AF. Register Number 104877

Appendices – **EBA disclosure templates**

The appendices include information in fixed tabular formats prescribed by the European Banking Authority (EBA), with the stated row and column references corresponding to the EBA templates where applicable. As permitted, templates and/or individual rows and columns within templates have been omitted where they are either not relevant to the Society or would contain nil/immaterial values.

Appendix 1 – **Capital instruments key features**

The table below shows the Society's issued capital instruments as at 31 March 2020. The full terms and conditions of these capital instruments are available on the Society's website as detailed below.

		PIBS	**CCDS**	**Tier 2 Notes**
1	Issuer	West Bromwich Building Society	West Bromwich Building Society	West Bromwich Building Society
2	ISIN	GB00B0CX2M20	GB00BYWR8Q80	XS1775405795
3	Gov. law (sub)	English	English	English
Regulatory treatment				
4	Trans. CRR rules	Additional Tier 1	CET 1	Tier 2
5	Post-transitional CRR rules	Ineligible	CET 1	Tier 2
6	Eligible at Group (G), Individual Consolidated (IC) or Society (S)	G, IC, S	G, IC, S	G, IC, S
7	Instrument type (types to be specified)	Permanent Interest Bearing Shares	Core Capital Deferred Shares	Tier 2 Subordinated Notes
8	Regulatory capital value (£m, as of most recent reporting date)	£8.9m	£127.0m [i]	£21.6m [ii]
9	Nominal amount of instrument	£8.9m	£128.9m [iii]	£22.5m
9a	Issue px	99.8	100.0	100.0
9b	Redemption px	100.0	n/a	100.0
10	Accounting classification	Shareholders' equity	Shareholders' equity	Liability - amortised cost
11	Original date of issuance	29/07/2005	12/04/2018	12/04/2018
12	Perpetual or dated	Perpetual	Perpetual	Dated
13	Original maturity date	No maturity	No maturity	12/04/2038
14	Issuer call	Yes 05/04/2021	No	Yes 12/04/2033
15	Optional call date, contingent call dates and redemption amount	05/04/2021	n/a	12/04/2033; par regulatory/tax call
16	Subsequent call dates, if applicable	Half yearly	n/a	Half yearly
Coupons/dividends				
17	Fixed or floating dividend/coupon	See 18 below	Variable, cap[iv]	
18	Coupon rate and any related index	Discretionary up to 6.15% until 2021 (reset in 2021 and every five years thereafter)	£1 per CCDS for financial year ended 31 March 2020. The distribution cap is currently £16.35 per share.[iv]	11%
19	Existence of a dividend stopper	No	No	No
20a/b	Fully discretionary, partially discretionary or mandatory	Fully discretionary	Fully discretionary	Mandatory
21	Existence of step up or other incentive to redeem	Yes	No	No
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	n/a
23	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	n/a	n/a	n/a
25	If convertible, fully or partially	n/a	n/a	n/a
26	If convertible, conversion rate	n/a	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	n/a	n/a
28	If convertible, specify instrument type convertible into	n/a	n/a	n/a
29	If convertible, specify issuer of instrument it converts to	n/a	n/a	n/a
30	Write-down features	None contractual, statutory via bail in or capital write-down	None contractual, statutory via bail in or capital write-down	None contractual, statutory via bail in or capital write-down
31-34	If write-down, trigger(s), full or partial, permanent or temporary	n/a	n/a	n/a

Appendix 1 – **Capital instruments key features** (continued)

The table below shows the Society's issued capital instruments as at 31 March 2020. The full terms and conditions of these capital instruments are available on the Society's website as detailed below:

		PIBS	CCDS	Tier 2 Notes
35	Instrument type immediately senior	Tier 2	Additional Tier 1	Senior Unsecured
36	Non-compliant transitioned features	Yes	No	No
37	If yes, specify non-compliant features	Step-up	n/a	n/a
	Full terms and conditions of the instruments can be found at :	PIBS prospectus PIBS variation of conditions PIBS updated terms and conditions	CCDS full terms and conditions	Tier 2 Notes full terms and conditions

Notes:

(i) The regulatory capital value reflects the nominal value upon initial recognition less any associated issue costs.
(ii) The regulatory capital value reflects estimates of the fair value adjustment to the nominal value upon initial recognition.
(iii) Issue price of £100 per CCDS (representing £1 of nominal amount and £99 of premium per CCDS).
(iv) As indicated in the Society's Distribution Policy and subject to a cap per CCDS, adjusted annually for inflation by reference to the UK CPI published by the ONS.

Appendix 2 – **Countercyclical capital buffers**

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates based on the geographical distribution of relevant exposures to the overall capital requirements of the Society. The following templates disclose information relevant for the calculation of the countercyclical buffer on a consolidated basis as at 31 March 2020 and 31 March 2019 in accordance with Regulation (EU) 2015/1555.

Template A:
(1) Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Society's aggregate risk weighted exposures, all exposures have been allocated to the UK. Exposures are as defined in Regulation (EU) 2015/1555 and in particular exclude exposures to sovereigns.

At 31 March 2020

		General credit exposures	Securitisation exposures	Own funds requirements			Own fund requirement weights	Countercyclical capital buffer rate
Row	Breakdown by country	Exposure value for SA £m	Exposure value for SA £m	Of which: General credit exposures £m	Of which: Securitisation exposures £m	Total £m	Weighting	%
		010	050	060	090	100	110	120
010	UK	**5,069.6**	**79.6**	**177.9**	**0.7**	**178.6**	**1.00**	**0.00%**
020	Total	**5,069.6**	**79.6**	**177.9**	**0.7**	**178.6**	**1.00**	**0.00%**

At 31 March 2019

		General credit exposure	Securitisation exposures	Own funds requirements			Own fund requirement weights	Countercyclical capital buffer rate
Row	Breakdown by country	Exposure value for SA* £m	Exposure value for SA £m	Of which: General credit exposures £m	Of which: Securitisation exposures £m	Total £m	Weighting	%
		010	050	060	090	100	110	120
010	UK	5,084.3	72.1	180.6	1.4	182.0	1.00	1.00%
020	Total	5,084.3	72.1	180.6	1.4	182.0	1.00	1.00%

Table 28: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

*2019 exposure values for SA have been restated as explained in section 2. Own funds requirements have not been restated as the impact was less than £0.1m.

(2) Amount of institution-specific countercyclical capital buffer

At 31 March

Row		2020	2019*
		010	010
010	Total risk exposure amount	**£2,347.5m**	£2,400.2m
020	Institution specific countercyclical buffer rate	**0.00%**	1.00%
030	Institution specific countercyclical buffer requirement	**£0.0m**	£24.0m

Table 29: Amount of institution-specific countercyclical capital buffer

*2019 total risk exposure amount has been restated as explained in section 2.

Appendix 3 – **Own funds**

The table below has been prepared in accordance with Regulation (EU) No 1423/2013 and discloses the Society's own funds on both a CRD IV transitional and full implementation basis.

		Transitional 2020 £m	Full Implementation 2020 £m	Transitional 2019* £m	Full Implementation 2019* £m
Common Equity Tier 1 (CET1) capital: instruments and reserves					
1	Capital instruments and the related share premium accounts	**127.0**	**127.0**	127.0	127.0
2	Retained earnings	**246.0**	**246.0**	215.8	215.8
3	Accumulated other comprehensive income (and other reserves)[1]	**0.4**	**0.4**	30.0	30.0
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**0.9**	**0.9**	8.0	8.0
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	**374.3**	**374.3**	380.8	380.8
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	**(0.3)**	**(0.3)**	(0.3)	(0.3)
8	Intangible assets (net of related deferred tax liability) (negative amount)	**(16.3)**	**(16.3)**	(16.5)	(16.5)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	**(11.7)**	**(11.7)**	(13.1)	(13.1)
12a	IFRS 9 transitional arrangements	**28.1**	-	31.4	-
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	**(0.8)**	**(0.8)**	(0.2)	(0.2)
20c	of which: securitisation positions (negative amount)	**(0.8)**	**(0.8)**	(0.2)	(0.2)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(1.0)**	**(29.1)**	1.3	(30.1)
29	Common Equity Tier 1 (CET1) capital	**373.3**	**345.2**	382.1	350.7
Additional Tier 1 (AT1) capital: instruments					
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**8.9**	**-**	8.9	-
36	Additional Tier 1 (AT1) capital before regulatory adjustments	**8.9**	**-**	8.9	-
44	Additional Tier 1 (AT1) capital	**8.9**	**-**	8.9	-
45	Tier 1 capital (T1 = CET1 + AT1)	**382.2**	**345.2**	391.0	350.7
Tier 2 (T2) capital: instruments and provisions					
46	Capital instruments and the related share premium accounts	**21.6**	**21.6**	21.6	21.6
51	Tier 2 (T2) capital before regulatory adjustments	**21.6**	**21.6**	21.6	21.6
58	Tier 2 (T2) capital	**21.6**	**21.6**	21.6	21.6
59	Total capital (TC = T1 + T2)	**403.8**	**366.8**	412.6	372.3
60	Total risk weighted assets	**2,347.5**	**2,308.5**	2,400.2	2,321.3

Appendix 3 – **Own funds** (continued)

		Transitional 2020	Full Implementation 2020	Transitional 2019*	Full Implementation 2019*
		%	%	%	%
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**15.9**	**15.0**	15.9	15.1
62	Tier 1 (as a percentage of total risk exposure amount)	**16.3**	**15.0**	16.3	15.1
63	Total capital (as a percentage of total risk exposure amount)	**17.2**	**15.9**	17.2	16.0
64	Institution specific buffer requirement (CET1 requirement in accordance with Article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)[2]	**7.0**	**7.0**	8.0	8.0
65	of which: capital conservation buffer requirement	**2.5**	**2.5**	2.5	2.5
66	of which: countercyclical buffer requirement	**0.0**	**0.0**	1.0	1.0
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)[3]	**7.4**	**6.1**	7.4	6.3
Applicable caps on the inclusion of provisions in Tier 2		**£m**	**£m**	**£m**	**£m**
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	**29.3**	**28.9**	30.0	29.0
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)					
82	Current cap on AT1 instruments subject to phase-out arrangements	**15.0**	**-**	22.5	-

Table 30: EBA own funds disclosure template

*2019 own funds disclosures have been restated, where applicable, as explained in section 2. The 2019 comparative CET1 capital: instruments and reserves figures have also been reanalysed between line items 2, 3 and 5a based on a review of the EBA guidelines for own funds disclosures.

1 In the template above, other comprehensive income for 2019 includes an adjustment to add back accumulated losses, included in accounting reserves, which relate to risk remote securitisations. No such adjustment is required for 2020 as the risk remote securitisation entities are no longer consolidated for accounting purposes.

2 The institution specific buffer requirement comprises a 4.5% (2019: 4.5%) CET 1 requirement as per Article 92(1)(a) of the CRR, together with the capital conservation and countercyclical buffer requirements set out on rows 65 and 66 of the table.

3 The CET 1 available to meet buffers is after allowing for a TCR of 9.8% (2019: 9.8%).

Appendix 4 – **Leverage ratio**

The CRR leverage ratio disclosures below have been prepared in accordance with Commission Implementing Regulation (EU) 2016/200 under CRD IV transitional and end-point (full implementation) rules.

Reference Date	**31 March 2020 (31 March 2019 for comparatives)**
Entity Name	**West Bromwich Building Society**
Level of application	**Consolidated**

Template A: Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

		Transitional 2020 £m	**Full Implementation 2020 £m**	Transitional 2019* £m	Full Implementation 2019* £m
1	Total assets as per published financial statements	**5,576.8**	**5,576.8**	5,552.6	5,552.6
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(14.4)**	**(14.4)**	(27.7)	(27.7)
4	Adjustments for derivative financial instruments	**(34.8)**	**(34.8)**	(6.8)	(6.8)
5	Adjustments for securities financing transactions "SFTs"	**4.8**	**4.8**	49.9	49.9
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	**38.2**	**38.2**	14.8	14.8
7	Other adjustments	**(1.0)**	**(1.0)**	5.9	5.9
8	**Total leverage ratio exposure**	**5,569.6**	**5,569.6**	5,588.7	5,588.7

Template B: Table LRCom: Leverage ratio common disclosure

		Transitional 2020 £m	**Full Implementation 2020 £m**	Transitional 2019* £m	Full Implementation 2019* £m
	On balance sheet exposures (excluding derivatives and SFTs)				
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**5,557.9**	**5,557.9**	5,518.4	5,518.4
2	(Asset amounts deducted in determining Tier 1 capital)	**(1.0)**	**(1.0)**	5.9	5.9
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**5,556.9**	**5,556.9**	5,524.3	5,524.3
	Derivative exposures				
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**1.3**	**1.3**	0.7	0.7
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**17.1**	**17.1**	16.1	16.1
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(48.7)**	**(48.7)**	(17.1)	(17.1)
11	**Total derivative exposures (sum of lines 4 to 10)**	**(30.3)**	**(30.3)**	(0.3)	(0.3)
	Securities financing transaction exposures				
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	**4.8**	**4.8**	49.9	49.9
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**4.8**	**4.8**	49.9	49.9
	Other off-balance sheet exposures				
17	Off-balance sheet exposures at gross notional amount	**191.0**	**191.0**	74.0	74.0
18	(Adjustments for conversion to credit equivalent amounts)	**(152.8)**	**(152.8)**	(59.2)	(59.2)
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	**38.2**	**38.2**	14.8	14.8
	Capital and total exposures				
20	**Tier 1 capital**	**382.2**	**345.2**	391.0	350.7
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**5,569.6**	**5,569.6**	5,588.7	5,588.7
22	**Leverage ratio (%)**	**6.9%**	**6.2%**	7.0%	6.3%
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Transitional**	**Full implementation**	Transitional	Full implementation

Appendix 4 – **Leverage ratio** (continued)

Template C: Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

		Transitional 2020 £m	Full Implementation 2020 £m	Transitional 2019* £m	Full Implementation 2019* £m
EU-1	**Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:**	**5,557.9**	**5,557.9**	5,518.4	5,518.4
EU-3	**Banking book exposures, of which:**	**5,557.9**	**5,557.9**	5,518.4	5,518.4
EU-4	Covered bonds	**149.5**	**149.5**	143.9	143.9
EU-5	Exposures treated as sovereigns	**319.0**	**319.0**	273.5	273.5
EU-7	Institutions	**76.2**	**76.2**	93.4	93.4
EU-8	Secured by mortgages of immovable properties	**4,355.4**	**4,355.4**	4,355.1	4,355.1
EU-9	Retail exposures	**66.7**	**66.7**	71.5	71.5
EU-10	Corporate	**15.2**	**15.2**	26.0	26.0
EU-11	Exposures in default	**264.3**	**264.3**	263.2	263.2
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	**311.6**	**311.6**	291.8	291.8

Template D: Table LRQA– Qualitative information on risk of excessive leverage and factors impacting the leverage ratio

1. Description of the processes used to manage the risk of excessive leverage

The leverage ratio is a key financial indicator monitored by the Board each month. The leverage ratio is projected for the next five years as part of the corporate planning process. The Corporate Plan is subject to stress tests to ensure the Society is able to operate safely and with sufficient capital and leverage during a severe downturn in the general economy and idiosyncratic Society-only stress events. It is recognised that such forward planning is essential to the successful management of the leverage and capital ratios. The Board is satisfied that the risk appetite, controls and planning framework will ensure that an excessive leverage position is not taken.

2. Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers

The Society's leverage ratio has reduced slightly to 6.9% (2019: 7.0%) due to a decrease in Tier 1 capital, driven mainly by additional IFRS 9 provision requirements (as a result of the deteriorating economic outlook) and the unwind of IFRS 9 transitional arrangements.

Table 31: EBA leverage ratio disclosure templates

*2019 leverage ratio disclosures have been restated, where applicable, as explained in section 2. The leverage ratio exposure has also been updated to exclude assets held within structured entities outside of the regulatory group and to incorporate the impact of IFRS 9 transitional arrangements (added back for both the transitional and full implementation basis). The impact of IFRS 9 transitional arrangements on the leverage ratio exposure is disclosed in Appendix 6.

Appendix 5 – **Asset encumbrance**

The following disclosures are presented in accordance with the EBA requirements as set out in EBA/RTS/2017/03.

Template A - Encumbered and unencumbered assets

At 31 March 2020

		Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
		010	**040**	**060**	**090**
010	**Assets of the reporting institution**	**1,386.4**		**4,117.7**	
040	Debt securities	-	-	306.0	306.0
050	of which: covered bonds	-	-	160.8	160.8
060	of which: asset-backed securities	-	-	78.5	78.5
080	of which: issued by financial corporations	-	-	292.6	292.6
120	Other assets	**1,386.4**		**3,787.5**	
121	of which: mortgage loans	1,285.1		3,350.0	

At 31 March 2019

		Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
		010	040	060	090
010	Assets of the reporting institution	1,643.2		3,827.9	
040	Debt securities	-	-	275.2	275.2
050	of which: covered bonds	-	-	127.8	127.8
060	of which: asset-backed securities	-	-	80.7	80.7
080	of which: issued by financial corporations	-	-	271.7	271.7
120	Other assets	1,643.2		3,552.8	
121	of which: mortgage loans	1,596.1		3,181.1	

Appendix 5 – **Asset encumbrance** (continued)

Template B - Collateral received

		Unencumbered		Unencumbered	
		Fair value of encumbered collateral received or own debt securities issued 2020 £m	Fair value of collateral received or own debt securities issued available for encumbrance 2020 £m	Fair value of encumbered collateral received or own debt securities issued 2019 £m	Fair value of collateral received or own debt securities issued available for encumbrance 2019 £m
		010	040	010	040
130	**Collateral received by the reporting institution**	-	-	-	100.1
160	Debt securities	-	-	-	100.1
190	of which: issued by general governments	-	-	-	100.1
241	Own covered bonds and asset-backed securities issued and not yet pledged		216.3		132.5
250	**Total assets, collateral received and own debt securities issued**	1,386.4		1,643.2	

The Society is not required to provide quantitative disclosures on the asset quality indicator within templates A and B, as its total assets fall below the reporting threshold set by EBA.

Template C - Sources of encumbrance

		Matching liabilities, contingent liabilities or securities lent 2020 £m	Assets, collateral received and own debt securities issued other than covered bonds and asset backed securities encumbered 2020 £m	Matching liabilities, contingent liabilities or securities lent 2019 £m	Assets, collateral received and own debt securities issued other than covered bonds and asset backed securities encumbered 2019 £m
		010	030	010	030
10	**Carrying amount of selected financial liabilities**	636.7	887.9	691.7	969.7

Template D - Accompanying narrative information

a) General narrative information on asset encumbrance
Asset encumbrance occurs where assets are pledged to provide security, collateralisation or credit enhancement to a financial transaction and are therefore no longer available for general use.

The asset encumbrance disclosures in templates A to C above are presented in accordance with EBA requirements showing median values of quarterly data over the previous 12 months. The figures are therefore not directly comparable to the asset encumbrance disclosures in the 2020 Annual Report and Accounts which reflect balances at the end of the financial year and also include securitised commercial loans outside of the scope of regulatory consolidation.

b) Information on the importance of encumbrance
The Society's encumbrance levels, in the context of a robust liquidity management framework and funding strategy, are considered appropriate for the size and nature of operations and are monitored in accordance with the Board's risk appetite. The most material sources of encumbrance for the Society are the pledging of mortgage assets and retained mortgage backed securities, issued by Group structured entities, as collateral for wholesale funding initiatives, including Bank of England funding schemes and sale and repurchase (repo) transactions. Asset encumbrance follows the contractual requirements of these funding programmes and a degree of over-collateralisation may be deemed appropriate for reasons of operational efficiency. All of the Society's encumbrance is denominated in its reporting currency of pounds sterling.

Asset encumbrance also arises due to the collateralisation of derivatives liabilities and investment securities under the CSA and GMRA arrangements described in Section 6 under Treasury credit risk mitigation. The Society also treats certain assets as encumbered even though there are no associated liabilities. An example of this would be loans and advances to credit institutions held within the Society's securitisation programmes as these are not available for use in the Society's day-to-day operations.

Within template A, unencumbered assets include items on the Group balance sheet which are not considered available for encumbrance such as intangible fixed assets, property, plant and equipment, derivatives and deferred tax.

Table 32: EBA asset encumbrance disclosure templates

Appendix 6 – **IFRS 9 transitional arrangements**

The Society has elected to adopt the transitional arrangements laid out in Article 473a of Regulation (EU) No 275/2013 which are intended to mitigate the impact of the introduction of IFRS 9 on own funds.

The table below shows the impact of IFRS 9 transitional arrangements as at 31 March in the format prescribed by EBA guidelines.

Comparison of institutions' own funds and capital and leverage ratios with and without the application of transitional arrangements for IFRS 9 or analogous ECLs

At 31 March

		Note	2020	2019*
	Available capital (£m)	**1**		
1	Common Equity Tier 1 (CET1)		**373.3**	382.1
2	CET1 capital as if IFRS 9 transitional arrangements had not been applied		**345.2**	350.7
3	Tier 1		**382.2**	391.0
4	Tier 1 capital as if IFRS 9 transitional arrangements had not been applied		**354.1**	359.6
5	Total regulatory capital		**403.8**	412.6
6	Total capital as if IFRS 9 transitional arrangements had not been applied		**375.7**	381.2
	Total risk-weighted assets (RWAs) (£m)			
7	Total RWAs		**2,347.5**	2,400.2
8	Total RWAs as if IFRS 9 transitional arrangements had not been applied		**2,308.5**	2,321.3
	Capital ratios (%)	**1**		
9	Common Equity Tier 1 ratio		**15.9**	15.9
10	Common Equity Tier 1 ratio as if IFRS 9 transitional arrangements had not been applied		**15.0**	15.1
11	Tier 1 ratio		**16.3**	16.3
12	Tier 1 ratio as if IFRS 9 transitional arrangements had not been applied		**15.3**	15.5
13	Total regulatory capital ratio		**17.2**	17.2
14	Total regulatory capital ratio as if IFRS 9 transitional arrangements had not been applied		**16.3**	16.4
	CRR leverage ratio			
15a	Total leverage ratio exposure measure (£m)		**5,569.6**	5,588.7
15b	Total leverage ratio exposure measure as if IFRS 9 transitional arrangements had not been applied (£m)		**5,541.5**	5,557.3
16	CRR leverage ratio (%)		**6.9**	7.0
17	Leverage ratio as if IFRS 9 transitional arrangements had not been applied (%)		**6.4**	6.5

Table 33: EBA disclosure template for IFRS 9 transitional arrangements

* 2019 own funds, capital and leverage ratios disclosures have been restated, where applicable, as explained in section 2. The CRR leverage ratio exposure has also been updated to exclude assets held within structured entities outside of the regulatory group and to present the measure with and without IFRS 9 transitional arrangements.

1 Capital figures and ratios are reported on the CRD IV transitional basis for Additional Tier 1 and Tier 2 capital in accordance with articles 484-92 of the Capital Requirements Regulation.

Appendix 7 – **Non-performing and forborne exposures**

The following tables present information on the credit quality of forborne, performing and non-performing exposures in the regulatory format set out by EBA/GL/2018/10. The Society has assessed the threshold criteria within the EBA guidelines and concluded that six of the ten templates set out therein are not reportable. Of the remaining templates (Templates 1, 3, 4 and 9), Template 9 'Collateral obtained by taking possession and execution processes' is not applicable as no collateral taken into possession is recognised on the Group balance sheet.

The templates include certain exposures which are held mandatorily at fair value through profit or loss and are therefore not subject to the staging or provisioning requirements of IFRS 9. Exposures are considered to be 'impaired' if they meet the Society's definition of default. Defaulted/impaired exposures are non-performing and, where applicable, categorised as stage 3 under IFRS 9.

To enable calculation of the gross non-performing loan (NPL) ratio in accordance with the EBA guidelines, the disclosures exclude cash balances at central banks and other demand deposits. Fair value macro hedge adjustments are also excluded.

Template 1: Credit quality of forborne exposures

		Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
			Non-performing forborne						Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
2020		**Performing forborne**		**Of which defaulted**	**Of which impaired**	**On performing forborne exposures**	**On non-performing forborne exposures**		
1	Loans and advances	**8.9**	**38.2**	**38.2**	**38.2**	**-**	**(3.8)**	**35.9**	**27.2**
6	*Non-financial corporations*	4.3	31.4	31.4	31.4	-	(3.6)	24.8	20.6
7	*Households*	4.6	6.8	6.8	6.8	-	(0.2)	11.1	6.6
10	**Total**	**8.9**	**38.2**	**38.2**	**38.2**	**-**	**(3.8)**	**35.9**	**27.2**

		Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
			Non-performing forborne						Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
2019		Performing forborne		Of which defaulted	Of which impaired	On performing forborne exposures	On non-performing forborne exposures		
1	Loans and advances	33.7	17.7	17.7	17.7	(2.1)	(1.8)	40.6	13.1
6	*Non-financial corporations*	28.1	8.9	8.9	8.9	(2.0)	(1.6)	26.5	4.5
7	*Households*	5.6	8.8	8.8	8.8	(0.1)	(0.2)	14.1	8.6
10	Total	33.7	17.7	17.7	17.7	(2.1)	(1.8)	40.6	13.1

The overall level of forbearance did not change significantly during the year. Payment holidays granted to borrowers adversely impacted by the COVID-19 pandemic, which represented circa 7% of the residential loan book at 31 March 2020, are not classified as forborne for the purposes of this disclosure.

Appendix 7 – **Non-performing and forborne exposures** (continued)

Template 3: Credit quality of performing and non-performing exposures by past due days

		Gross carrying amount/nominal amount											
		Performing exposures			Non-performing exposures								
2020			Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
1	Loans and advances	4,551.8	4,538.9	12.9	316.7	208.5	6.3	19.1	28.5	0.2	-	54.1	316.7
4	*Credit institutions*	114.8	114.8	-	-	-	-	-	-	-	-	-	-
5	*Other financial corporations*	1.1	1.1	-	-	-	-	-	-	-	-	-	-
6	*Non-financial corporations*	186.0	186.0	-	242.3	146.8	-	15.2	26.4	-	-	53.9	242.3
7	*Of which SMEs*	186.0	186.0	-	242.3	146.8	-	15.2	26.4	-	-	53.9	242.3
8	*Households*	4,249.9	4,237.0	12.9	74.4	61.7	6.3	3.9	2.1	0.2	-	0.2	74.4
9	Debt securities	285.3	285.3	-	-	-	-	-	-	-	-	-	-
12	*Credit institutions*	204.9	204.9	-	-	-	-	-	-	-	-	-	-
13	*Other financial corporations*	80.4	80.4	-	-	-	-	-	-	-	-	-	-
15	Off-balance-sheet exposures	191.1			-								-
20	*Non-financial corporations*	15.2			-								-
21	*Households*	175.9			-								-
22	**Total**	**5,028.2**	**4,824.2**	**12.9**	**316.7**	**208.5**	**6.3**	**19.1**	**28.5**	**0.2**	**-**	**54.1**	**316.7**

Appendix 7 – **Non-performing and forborne exposures** (continued)

Template 3: Credit quality of performing and non-performing exposures by past due days (continued)

		Gross carrying amount/nominal amount											
		Performing exposures			Non-performing exposures								
2019			Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
1	Loans and advances	4,589.0	4,559.6	29.4	303.6	189.2	7.5	40.2	6.2	5.6	-	54.9	303.6
4	*Credit institutions*	93.8	93.8	-	-	-	-	-	-	-	-	-	-
5	*Other financial corporations*	1.3	1.3	-	-	-	-	-	-	-	-	-	-
6	*Non-financial corporations*	196.7	185.2	11.5	220.5	118.8	-	37.5	3.9	5.4	-	54.9	220.5
7	*Of which SMEs*	196.7	185.2	11.5	220.5	118.8	-	37.5	3.9	5.4	-	54.9	220.5
8	*Households*	4,297.2	4,279.3	17.9	83.1	70.4	7.5	2.7	2.3	0.2	-	-	83.1
9	Debt securities	309.3	309.3	-	-	-	-	-	-	-	-	-	-
10	*Central banks*	20.0	20.0	-	-	-	-	-	-	-	-	-	-
12	*Credit institutions*	218.2	218.2	-	-	-	-	-	-	-	-	-	-
13	*Other financial corporations*	71.1	71.1	-	-	-	-	-	-	-	-	-	-
15	Off-balance-sheet exposures	75.7			-								-
20	*Non-financial corporations*	9.4			-								-
21	*Households*	66.3			-								-
22	Total	4,974.0	4,868.9	29.4	303.6	189.2	7.5	40.2	6.2	5.6	-	54.9	303.6

There was a small increase in the level of non-performing exposures mainly within the non-core commercial portfolio. Performing exposures increased due to a higher level of mortgage loan commitments at the year end date. The gross NPL ratio at 31 March 2020 was 6.51% (2019: 6.21%).

Appendix 7 – **Non-performing and forborne exposures** (continued)

Template 4: Performing and non-performing exposures and related provisions

		Gross carrying amount/nominal amount					Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures		Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		On performing exposures	On non-performing exposures
2020			Of which stage 1	Of which stage 2		Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 3		
1	Loans and advances	4,551.8	4,053.4	495.7	316.7	298.4	(13.2)	(1.1)	(12.0)	(75.6)	(67.9)	4,387.3	194.8
4	*Credit institutions*	114.8	114.8	-	-	-	-	-	-	-	-	-	-
5	*Other financial corporations*	1.1	1.1	-	-	-	-	-	-	-	-	1.1	-
6	*Non-financial corporations*	186.0	82.5	103.5	242.3	242.3	(9.4)	(0.1)	(9.3)	(64.6)	(64.6)	155.0	131.4
7	*Of which SMEs*	186.0	82.5	103.5	242.3	242.3	(9.4)	(0.1)	(9.3)	(64.6)	(64.6)	155.0	131.4
8	*Households*	4,249.9	3,855.0	392.2	74.4	56.1	(3.8)	(1.0)	(2.7)	(11.0)	(3.3)	4,231.2	63.4
9	Debt securities	285.3	284.2	-	-	-	-	-	-	-	-	-	-
12	*Credit institutions*	204.9	204.9	-	-	-	-	-	-	-	-	-	-
13	*Other financial corporations*	80.4	79.3	-	-	-	-	-	-	-	-	-	-
15	Off-balance-sheet exposures	191.1	191.1	-	-	-	-	-	-	-	-	-	-
20	*Non-financial corporations*	15.2	15.2	-	-	-	-	-	-	-	-	-	-
21	*Households*	175.9	175.9	-	-	-	-	-	-	-	-	-	-
22	**Total**	**5,028.2**	**4,528.7**	**495.7**	**316.7**	**298.4**	**(13.2)**	**(1.1)**	**(12.0)**	**(75.6)**	**(67.9)**	**4,387.3**	**194.8**

Appendix 7 – **Non-performing and forborne exposures** (continued)

Template 4: Performing and non-performing exposures and related provisions (continued)

2019		Gross carrying amount/nominal amount					Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures		Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		On performing exposures	On non-performing exposures
			Of which stage 1	Of which stage 2		Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 3		
1	Loans and advances	4,589.0	4,041.3	546.2	303.6	282.1	(10.8)	(0.9)	(9.9)	(68.3)	(59.9)	4,448.6	192.2
4	*Credit institutions*	93.8	93.8	-	-	-	-	-	-	-	-	-	-
5	*Other financial corporations*	1.3	1.2	0.1	-	-	-	-	-	-	-	1.3	-
6	*Non-financial corporations*	196.8	64.6	132.2	220.5	220.5	(9.1)	(0.3)	(8.8)	(55.6)	(55.6)	165.1	121.9
7	*Of which SMEs*	196.8	64.6	132.2	220.5	220.5	(9.1)	(0.3)	(8.8)	(55.6)	(55.6)	165.1	121.9
8	*Households*	4,297.1	3,881.7	413.9	83.1	61.6	(1.7)	(0.6)	(1.1)	(12.7)	(4.3)	4,282.2	70.3
9	Debt securities	309.3	309.3	-	-	-	-	-	-	-	-	-	-
10	*Central banks*	20.0	20.0	-	-	-	-	-	-	-	-	-	-
12	*Credit institutions*	218.2	218.2	-	-	-	-	-	-	-	-	-	-
13	*Other financial corporations*	71.1	71.1	-	-	-	-	-	-	-	-	-	-
15	Off-balance-sheet exposures	75.7	75.7	-	-	-	-	-	-	-	-	-	-
20	*Non-financial corporations*	9.4	9.4	-	-	-	-	-	-	-	-	-	-
21	*Households*	66.3	66.3	-	-	-	-	-	-	-	-	-	-
22	Total	4,974.0	4,426.3	546.2	303.6	282.1	(10.8)	(0.9)	(9.9)	(68.3)	(59.9)	4,448.6	192.2

While there was a modest increase in the level of non-performing exposures during the year, impairment provisions rose more significantly due to the worsening economic outlook emerging from the COVID-19 global pandemic.

Table 34: EBA disclosure templates for non-performing and forborne exposures

Glossary

Additional Tier 1 (AT 1) capital
Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to CET 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as PIBS.

Arrears
The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.

Basel III framework
The Basel Committee on Banking Supervision's strengthened global regulatory standards on bank capital adequacy and liquidity, defining the methods by which firms should calculate their regulatory capital requirements in order to protect the financial system against unexpected losses. The requirements, embedded using CRD IV, became effective from 1 January 2014.

Capital conservation buffer (CCoB)
A CRD IV risk adjusted capital requirement for all banks that can be used to absorb losses whilst avoiding breaching minimum capital requirements. This is set at 2.5% of risk weighted assets.

Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)
CRD IV is the legislative package made up of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive to implement the Basel III agreement.

CCR mark to market method
One of the methods allowed under the Standardised Approach to calculate counterparty credit risk exposures for financial derivatives, securities financing transactions and long settlement transactions.

Collateral
Collateral is an asset that a lender accepts as security for a loan. If the borrower defaults on the loan payments, the lender can seize the collateral and resell it to recoup the losses.

Common Equity Tier 1 (CET 1) capital
Common Equity Tier 1 capital comprises general reserves, the fair value reserve and CCDS less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.

Common Equity Tier 1 ratio
Common Equity Tier 1 capital as a percentage of risk weighted assets.

Core capital deferred shares (CCDS)
CCDS are a form of CET 1 capital issued by building societies. They rank behind depositors and creditors.

Countercyclical buffer (CCyB)
A CRD IV risk adjusted capital requirement for all banks that is varied over the financial cycle. It is built up in favourable conditions helping to damp down further credit growth and released in economic downturns.

Counterparty credit risk (CCR)
Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

CRD IV buffers
These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB).

Credit quality steps (CQS)
A credit quality assessment scale as set out in CRD IV.

Credit risk
The potential to incur losses from the failure of a borrower or counterparty to meet its obligation to pay interest or repay capital on an outstanding loan.

Credit risk mitigation
Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set off or netting.

Derivative financial instrument
A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The Society uses derivatives, in the form of interest rate swaps, to mitigate against interest rate risk.

Encumbered assets
Assets used to secure liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Society's securitisation programmes.

Expected credit loss (ECL)
The present value of all cash shortfalls over the expected life of a financial instrument. The term is used in the accounting for impairment provisions under IFRS 9 Financial Instruments.

ECL - 12 month
12-month ECL denotes the portion of lifetime ECLs that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

ECL – lifetime
Lifetime ECLs are the expected credit losses that result from all possible default events over the expected life of a financial instrument.

External credit assessment institution (ECAI)
An ECAI (e.g. Moody's, Standard and Poor's and Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.

European Banking Authority (EBA)
The EBA is an independent European Union Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector.

Fair value reserve
The fair value reserve contains unrealised gains and losses arising from changes in the fair value of non-derivative financial assets that are categorised as fair value through other comprehensive income.

Financial Conduct Authority (FCA)
The financial services industry regulator for conduct related matters.

Forbearance
Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.

Guarantee
An agreement by a third party to cover the potential loss to a credit institution should a specified counterparty default on their obligations.

Impairment provision
An allowance for expected credit losses on a financial asset calculated in accordance with the accounting standard IFRS 9. Where applicable for disclosure purposes, a loan is considered to be impaired if it is categorised as stage 3 under IFRS 9.

Internal Capital Adequacy Assessment (ICAA)
ICAA is the document produced by the Society as a result of the ICAAP.

Internal Capital Adequacy Assessment Process (ICAAP)
The process the Society follows to determine capital requirements under Basel III Pillar 2.

Glossary (continued)

Internal Liquidity Adequacy Assessment Process (ILAAP)
The Society's detailed annual review of its liquidity adequacy which is submitted to the PRA for supervisory review.

Interest rate risk
Interest rate risk is the exposure of a firm's financial condition to movements in interest rates.

International Swaps and Derivatives Association (ISDA) master agreement
A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.

Leverage ratio
Tier 1 capital as a percentage of total exposures which include on- and off-balance sheet assets after netting derivatives.

London Inter-Bank Offered Rate (LIBOR)
The interest rate at which banks offer to lend funds to one another in the international interbank market.

Liquidity coverage ratio (LCR)
A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions.

Liquidity risk
The risk that the Society does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash inflows and outflows.

Loan-to-value (LTV)
The ratio of current exposure value as a proportion of the value of the asset held as security (usually property) expressed as a percentage.

Market risk
The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will reduce income or portfolio values.

Market value (MV) sensitivity
The sensitivity of the whole-life economic value (in today's value) of Society assets and liabilities to, for example, an immediate parallel shift in the yield curve.

Minimum capital requirement
The minimum amount of regulatory capital that a financial institution must hold to meet the Basel III Pillar 1 requirements for credit and operational risk.

Minimum requirements for own funds and eligible liabilities (MREL)
The final framework and policies for setting minimum requirements for own funds and eligible liabilities published as part of the EU's Bank Recovery and Resolution Directive. The Society will be classified as a 'modified insolvency' firm for the purposes of MREL which means that the MREL regime does not introduce any additional capital requirements for the Society.

Net stable funding ratio (NSFR)
The NSFR is a long-term stable funding metric, measured as the ratio of available stable funding to the amount of required stable funding.

Netting
The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.

Operational risk
Operational risk is the risk of loss and/or negative impact to the Society resulting from inadequate or failed internal processes, systems or people, or from external events.

Past due
The status of a financial asset, such as a mortgage loan, when the borrower or counterparty has failed to make a payment when contractually due.

Potential future exposure (PFE)
The PFE is an estimate of the exposure relating to the future cash flows of derivatives. It is based upon the remaining duration and the type of the derivative.

Permanent interest bearing shares (PIBS)
Unsecured, deferred shares that, under transitional rules, are a form of Additional Tier 1 capital. PIBS rank behind the claims of all depositors and creditors of the Society other than the Society's CCDS.

Pillar 1
The part of the Basel III Framework which sets out the regulatory minimum capital requirements for credit and operational risk.

Pillar 2
The part of the Basel III Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks). The TCR is an outcome from Pillar 2.

Probability of default (PD)
An estimate of the probability that a borrower will default on their credit obligations over a fixed time period. With respect to impairment provisions under IFRS 9, 12 month ECLs use 12 month PDs, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan.

Prudential Regulation Authority (PRA)
The financial services industry regulator in the UK for prudential matters.

PRA buffer
An amount of capital that firms should hold, in addition to their TCR, to cover losses that may arise under a severe stress scenario, but avoiding duplication with the CRD IV buffers.

Residual maturity
The remaining time in years that a borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement.

Risk appetite
The articulation of the level of risk that the Society is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.

Risk weighted asset (RWA)
The value of an on- or off-balance sheet exposure adjusted under Pillar 1 rules to reflect the degree of risk it presents.

Sale and repurchase agreement (repo)
An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.

Securitisation
A transaction or scheme where assets are sold to a structured entity in return for immediate cash payment. That entity raises the immediate cash payment by issuing debt securities in the form of tradeable notes or commercial paper to wholesale investors who receive an income from the underlying assets. Some risk is retained on the balance sheet while the remaining risk is transferred to investors.

Stage 1 (IFRS 9)
Stage 1 assets are financial assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the Statement of Financial Position. For the purposes of impairment provisioning under IFRS 9, 12 month ECLs are recognised on stage 1 assets.

Stage 2 (IFRS 9)
Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision.

Stage 3 (IFRS 9)
Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is recognised as an impairment provision.

Stress testing
Various techniques that are used to gauge the potential vulnerability to exceptional but plausible events.

Supervisory review and evaluation process (SREP)
The regulator's assessment of a firm's own capital adequacy assessment (ICAAP) under Basel III Pillar 2.

Supranational financial institution
A supranational financial institution or multilateral development bank is formed and capitalised by two or more central governments to promote economic development for specified member countries. Supranational financial institutions finance their activities by issuing bond debt and are usually considered part of the high quality, sub-sovereign debt market. Some well-known examples of supranational financial institutions are the World Bank, European Bank for Reconstruction and Development, European Investment Bank, Asian Development Bank and Inter-American Development Bank.

Total capital requirement (TCR)
The amount and quality of capital a firm must maintain to comply with the minimum capital requirements under the Capital Requirements Regulation.

Standardised approach (to credit risk)
A methodology used to calculate capital requirements for credit risk. Under the standardised approach, the risk weightings within the calculation are specified by the regulator.

Standardised approach (to operational risk)
A methodology used to calculate capital requirements for operational risk which involves using three year historical net income multiplied by a factor of 12-18%, depending on the underlying business being considered.

Tier 2 capital
A component of regulatory capital comprising qualifying subordinated liabilities.

Subordinated Tier 2 notes (Tier 2 Notes)
A form of Tier 2 capital issued by the Society.

Unencumbered assets
Assets not used as collateral to secure funding. This includes loans and advances to customers that, although transferred to funding vehicles, are held in respect of undrawn self-issued notes under the securitisation programmes and are therefore readily available as collateral to secure funding.

Wrong-way risk
An adverse correlation between the counterparty's probability of default and the mark to market value of the underlying transaction.

Head Office: 2 Providence Place, West Bromwich B70 8AF
www.westbrom.co.uk

Registered Number: 651B

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