Basel II Pillar 3 Disclosures

for the year ended 31 March 2011

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Section 1 – **Overview**

Background

The Capital Requirements Directive (Basel II), which was introduced on 1 January 2007, sets out the rules regarding capital adequacy for banks and building societies.

The rules within Basel II are categorised under three pillars:

Pillar 1 sets out the minimum regulatory capital resources requirement, predominately comprising credit risk and operational risk.

Pillar 2 covers Management's assessment of the additional capital resources required to cover specific risks faced by the institution that are not covered by the minimum regulatory capital resources requirements set out under Pillar 1.

Pillar 3 requires building societies and banks operating under the Basel II framework to disclose qualitative and quantitative information regarding their risk assessment process and capital resources, and hence their capital adequacy.

In addition to the assessment of capital requirement under Pillar 1 and 2 above, the Group's overall capital requirement is also reviewed and agreed by the FSA under the Supervisory Review and Evaluation Process ('SREP'). Under this process, the FSA set the Individual Capital Guidance ('ICG') for the Group, which is the minimum amount of capital that the Group should hold.

Basis and frequency of disclosure

This document has been prepared to meet the Pillar 3 disclosure requirements of Basel II and is 1ssued on an annual basis as soon as practicable after the publication of the Group's Annual Report and Accounts. The document is based upon the Group's Annual Report and Accounts for the year ended 31 March 2011, unless otherwise stated.

Location and verification

These disclosures have been reviewed by the Group Risk Committee ('GRC') on behalf of the Group's Board and are published on the West Bromwich Building Society website (www.westbrom.co.uk). There is no requirement for the disclosures to be audited, however, some of the information within the disclosures also appears in the Group's audited Annual Report and Accounts.

Scope

For accounting purposes, the West Bromwich Building Society's consolidation group comprises the Society itself and a number of subsidiary and quasi-subsidiary entities ('The Group'). The main subsidiaries, which are all solo consolidated, are:

West Bromwich Mortgage Company Limited
West Bromwich Commercial Limited
West Bromwich Homes Limited
Insignia Finance Limited

Full details of the principal subsidiary undertakings are included in Note 15 to the Annual Report and Accounts for the year ended 31 March 2011.

There is a requirement to calculate and maintain regulatory capital ratios on both a Group and "Society solo consolidated basis". However, for West Bromwich Building Society, there are no significant differences between the Group and solo consolidation figures. Therefore, this document includes only the Group analysis.

The Group's Annual Report and Accounts consolidate the investment in two Special Purpose Vehicles ('SPVs'), Sandwell Commercial Finance No. 1 plc and Sandwell Commercial Finance No. 2 plc. These entities are not consolidated within the Group for regulatory capital purposes as they are bankruptcy remote. Instead, the Group's limited exposure to these SPVs is deducted from capital resources.

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.

Section 2 – **Risk Management Objectives and Policies**

Overview

The Society's primary aim is to put the safety and security of members' deposits above everything else. We achieve this by appropriate management of all the risks arising from business activities.

The main risks we manage are:

• Credit risk;	Section 5
• Market risk, including Interest Rate risk;	Section 6
• Operational risk;	Section 7
• Securitisation risk;	Section 8
• Liquidity risk;	Section 9
• Concentration risk;	Section 9
• Property Holding risk;	Section 9
• Pension risk; and	Section 9
• Business risk.	Section 9

Risk oversight

The Society's Board has ultimate responsibility for developing an appropriate risk and control framework. Risk governance is provided through two Board sub-committees: Audit and Compliance Committee and Group Risk Committee.

Each of these Board sub-committees operates under a Board delegated mandate providing a forum for the direction and challenge to Management whilst monitoring business performance and risk exposures.

The Board sub-committees include Non-Executive Directors with other committee members being drawn from the Executive and attended by appropriate members of Senior Management and risk specialists:

- Group Risk Committee ('GRC') has been established by the Board to oversee the Group's risk governance framework and to provide an entity wide perspective on all risk matters. The GRC is responsible for the management of the level of credit risk that has been established by the Board and for approving lending policy and setting limits on credit exposures, which are monitored and reviewed on a monthly basis. It is also responsible for the Internal Capital Adequacy Assessment Process ('ICAAP'); and
- Audit and Compliance Committee ('ACC'), which has overall responsibility for reviewing the Society's internal controls and risk management systems, validating the integrity of the Group's financial statements and reviewing and approving the significant financial reporting issues and accounting policies/issues.

Risk management framework

The risk framework identifies the operational roles and responsibilities, both individual and collective, in the risk management process to ensure that exposed risks are aligned to the Group's risk appetite. The risk appetite, which was first agreed by the Board in May 2009, reflects the Back to Basics Strategy outlined within the Annual Report and Accounts.

The Group's risk management framework is based on the best practice "3 lines of defence" model which is illustrated below.

Line of Defence	Risk Management Activity	Responsibility	Governance
1st	Business Operation	Line Management	Line Management Oversight
2nd	Policy, Controls, Measure , Monitor	Control Functions	Management and Board Committees
3rd	Assurance	Internal Audit	Audit and Compliance Committee

Table 1: Group's risk management framework

Section 3 – **Capital Resources**

Total available capital

The table below summarises the composition of regulatory capital for the Group as at 31 March 2011, together with the prior year comparatives. During the year ended 31 March 2011, the individual entities within the Group and the Group itself complied with all of the externally imposed capital requirements to which they are subject.

At 31 March	**2011 £m**	2010 £m
Tier 1		
General reserves	**251.3**	258.5
Permanent interest bearing shares ('PIBS')	**74.9**	74.9
Profit participating deferred shares ('PPDS')	**177.3**	179.9
Deduct: Intangible assets	**(9.0)**	(7.2)
Deduct: Investments in non consolidated SPVs	**(4.3)**	(4.9)
Total Tier 1 capital	**490.2**	501.2
Tier 2		
Revaluation reserve	**3.7**	3.8
Add back: collective impairment allowance	**18.9**	18.4
Contingency against collective provision add back	**(4.4)**	–
Deduct: Investments in non consolidated SPVs	**(4.3)**	(4.9)
Total Tier 2 capital	**13.9**	17.3
Total capital available (own funds)	**504.1**	518.5

Table 2: Total available capital

Tier 1 capital

- PIBS are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society but rank pari-passu with PPDS. Further details about PIBS are provided in Note 26 to the Annual Report and Accounts;
- PPDS are a form of capital for building societies which are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society but rank pari-passu with PIBS. Further details about PPDS are provided in Note 27 to the Annual Report and Accounts;
- Intangible assets include capitalised software, goodwill and brand names. These are deducted from capital for regulatory purposes; and
- Investments in non-consolidated SPVs consist of the subordinated and start-up loans to securitisation vehicles, which are deducted equally from Tier 1 and Tier 2 capital.

Tier 2 capital

- Revaluation reserve relates to the increase in value of the land and buildings owned by the Group and held for use by the business;
- Collective provisions can be added back to Tier 2 capital; and
- The contingency against collective provision add back is an allowance for part of the collective provision which is of a more specific nature and is therefore disallowable for capital purposes.

Section 4 – **Capital Adequacy**

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 Group considers its risk appetite, the material risks to which the Group is exposed and the appropriate management strategies for each of the Group's material risks, including whether or not capital provides an appropriate mitigant.

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

The Pillar 1 regulatory capital adequacy of the Solo consolidation and the Consolidation Group are reported to the FSA quarterly and half yearly respectively. In addition, summarised regulatory capital positions and forecasts are reported monthly to the Board and to each Group Risk Committee (including forecasts under stress scenarios). The Group Capital Committee, a sub-committee of the Group Risk Committee monitors the capital position on a monthly basis.

Summary of approach to capital adequacy planning

The Group undertakes an ICAAP on a broadly annual basis. The ICAAP may be performed more frequently should a significant shift in the Group's risk profile arise. The ICAAP is the means by which the Group ensures that:

- it has sufficient levels of capital resources to pursue the corporate objectives as set out in the Group's Medium Term Plan in light of the risks it faces; and
- it has sufficient capital resources to trade through a severe recession, if necessary by applying appropriate management actions.

In formulating the Group's Medium Term Plan, the Group considers its overall objectives and evaluates these in light of its risk appetite.

During the year to 31 March 2010, the FSA formally issued the Society's Individual Capital Guidance ('ICG'). The ICG was updated in the year to 31 March 2011. It provides the Group with a specific regulatory minimum and replaced the 'Interim ICG', which was a transitional amount that became effective on 1 January 2008 when the capital requirements framework changed from Basel I to Basel II.

Minimum capital requirement (Pillar 1)

Under FSA rules a minimum level of capital (Pillar 1) must be held for credit risk, operational risk and market risk. The Group has adopted the Standardised Approach to calculate the minimum regulatory capital resource requirement for credit risk and operational risk, and market risk has been calculated in accordance with BIPRU 7.

The following table shows the Group's overall minimum capital requirement for credit risk under the Standardised Approach (expressed as 8% of the risk weighted exposure amounts for each of the applicable Standardised credit risk exposure classes) at 31 March 2011. Details of the Standardised Approach to the calculation of regulatory requirements are contained in the FSA handbook.

At 31 March	**2011 £m**	2010 £m
Credit risk		
Mortgage loans (performing)	**210.1**	233.4
Mortgage loans (past due)	**18.2**	16.0
Liquidity (treasury instruments and cash)	**8.5**	14.6
Other items	**12.5**	12.8
	249.3	276.8
Operational risk – Standardised Approach	**9.6**	9.7
Market risk *	**0.3**	2.9
Total Pillar 1 capital requirement	**259.2**	289.4
Total Capital available	**504.1**	518.5
Excess of capital over minimum capital requirement under Pillar 1	**244.9**	229.1

Table 3: the Group's overall minimum capital requirement for credit risk under the Standardised Approach

*Market risk for Pillar 1 capital adequacy assessment predominately relates to counterparty credit risk under the Standardised Approach and foreign exchange exposures.

Section 5 – **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 Group, 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.

In the Group's current constrained operating environment, the Society is engaged in only minimal lending activity, principally to existing borrowers. All such lending is in accordance with the Group's credit policy, which is consistent with the risk appetite established by the Board. Currently, no new non-conforming lending (i.e. commercial, buy-to-let, sub-prime or self-certified) is being undertaken.

In 2009 the Society established a dedicated Credit Management Division to increase the skills and resource available to manage mortgage arrears. This has entailed a considerable investment to manage the legacy commercial mortgage book.

The Group's exposure to residential and commercial credit risk is monitored by a specialist Credit Risk department with a reporting line into the Group Risk Director. The Credit Risk department is responsible for setting the risk management policy and associated limits. It also provides regular reports to the Group Risk Committee, which is chaired by a Non-executive director and includes the Chief Executive, Group Risk Director, Group Finance Director and now includes three Non-Executive Directors as members.

Additionally, credit risk can occur 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 Assets and Liabilities Management Team ('ALM'). On a daily basis, ALM monitors exposures to counterparties and countries, and ensures the Group is operating within its Board approved limits. The Assets and Liabilities Committee ('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, the Group has maintained a conservative approach to its liquidity management, investing for shortened periods with highly regarded financial institutions. The Group has also moved towards a position of holding a significant proportion of liquidity in the form of Government guaranteed stock, which is considered to be both highly liquid and secure. Treasury operates a strict control framework and exposures are monitored on a daily basis.

Analysis of Treasury credit risk exposures

The tables below analyse the Group's regulatory credit risk exposures to treasury counterparties as at 31 March 2011. These encompass both on and off balance sheet exposures, including the potential future exposures ('PFE') of derivatives. They are therefore not directly comparable with the figures reported in Note 31 to the Annual Report and Accounts. The Group has no exposure in its liquidity portfolio to Sovereign or bank debt relating to the emerging markets, Greece, Ireland, Italy, Portugal or Spain, or to any mortgage market other than the UK.

At 31 March

	2011 £m	2010 £m	**Average over year £m**
Concentration by credit grading			
AAA to AA-	**1,388.8**	1,530.8	1,390.0
A+ to A-	**46.2**	105.4	90.4
Building societies	**59.5**	119.1	101.4
Other	**–**	7.0	4.7
Total	**1,494.5**	1,762.3	1,586.5
Concentration by sector			
Central governments & central banks	**877.1**	780.2	708.4
Financial institutions	**426.5**	729.9	662.2
Local authorities	**–**	7.0	4.7
Asset backed securities	**190.9**	245.2	211.2
Total	**1,494.5**	1,762.3	1,586.5

Table 4: Analysis of the Group's regulatory credit risk exposures to treasury counterparties

Section 5 – **Credit Risk (continued)**

At 31 March	2011 £m	2010 £m	Average over year £m
Concentration by region			
UK	**1,356.5**	1,620.1	**1,455.6**
Europe (excluding UK)	**77.6**	58.2	**56.8**
North America	**3.3**	16.9	**12.3**
Australasia	**57.1**	67.1	**61.8**
	1,494.5	1,762.3	**1,586.5**

Table 4 (continued): Analysis of the Group's regulatory credit risk exposures to treasury counterparties

Residual maturity breakdown of treasury exposures by asset class

The following table shows the residual maturity of exposures 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 exposure. These include on-balance sheet exposures and off-balance sheet exposures after credit conversion factors have been applied.

An analysis of the maturity of the exposures for liquidity purposes can be found in Note 31 in the Annual Report and Accounts.

At 31 March 2011	Notes	< 1 year £m	1 - 5 years £m	> 5 years £m	Total £m
Central governments & central banks		704.4	138.7	34.0	**877.1**
Financial institutions		221.9	190.2	14.4	**426.5**
Local authorities		–	–	–	**–**
Mortgage backed securities	1	38.4	104.8	47.7	**190.9**
		964.7	**433.7**	**96.1**	**1,494.5**

At 31 March 2010	Notes	< 1 year £m	1 - 5 years £m	> 5 years £m	Total £m
Central governments & central banks		417.6	92.1	220.2	729.9
Financial institutions		518.2	73.3	188.7	780.2
Local authorities		–	7.0	–	7.0
Mortgage backed securities	1	65.7	34.0	145.5	245.2
		1,001.5	206.4	554.4	1,762.3

Table 5: Residual maturity analysis of liquidity exposures

Notes:

1. The mortgage backed securities are all rated AAA and relate to prime loans on property located in the United Kingdom.

Section 5 – **Credit Risk (continued)**

The Group uses external credit assessments provided by Moody's, Standard & Poor's and Fitch. These are all recognised by the FSA as eligible external credit assessment institutions ('ECAI') for the purpose of calculating credit risk requirements under the Standardised Approach.

The table below shows the exposure values associated with each credit quality step for treasury exposures under the Standardised Approach.

At 31 March 2011

	Notes	Risk Weight %	Fitch and S&P ratings	Moody's ratings	2011 Exposure values £m	2010 Exposure values £m
Financial institutions						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**331.8**	565.8
2		**20/50**	**A+ to A-**	**A1 to A3**	**13.4**	47.4
Unrated (building societies)		**20/50**			**9.0**	44.2
Total					**354.2**	657.4
Securitisation positions						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**190.9**	245.2
Total					**190.9**	245.2
Regional governments or local authorities						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**–**	7.0
Total					**–**	7.0
Central governments or central banks						
Credit quality step						
1	1	**0**	**AAA to AA-**	**Aaa to Aa3**	**869.3**	739.5
Total					**869.3**	739.5

Table 6: Analysis of the liquidity exposures into credit quality steps

Notes:

1. Includes instruments guaranteed by the UK Government

Capital required under Pillar 1 for liquidity was £8.5m (2009/10 – £14.6m)

Treasury credit risk mitigation

The Group mitigates risk of loss arising from default by its derivative counterparties through legally enforceable Credit Swap 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, weekly and monthly 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.

Section 5 – **Credit Risk (continued)**

A downgrade in the Group's credit rating below BBB+ would have the effect of reducing the market value triggers for margin calls on some of the CSAs, resulting in a potential increase in the amount of collateral the Group would have to provide against the derivatives within the CSAs. However, due to the small number of CSAs with downgrade triggers, this is not deemed a significant risk for the Group.

In compliance with BIPRU 11.5.7 the Group has considered its exposure to wrong-way risk. It does not consider that it has any specific exposures and its policies and procedures effectively remove this possibility. It is acknowledged that it is possible that it may become exposed to general risk where an exposure may, for non-specific reasons, be held to be correlated with a macroeconomic factor, which also affects the creditworthiness of the counterparty.

Analysis of real estate property exposures

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

The following table shows the Group's exposure to Commercial loans by industry type.

At 31 March	**2011 £m**	2010 £m
Housing Association	**0.1**	0.1
Residential	**94.3**	96.7
Healthcare & Leisure	**218.2**	214.7
Industrial & Warehouse	**34.7**	44.8
Office	**134.6**	150.4
Retail	**551.5**	620.8
Other	**9.7**	12.8
Total	**1,043.1**	1,140.3

Table 7: Analysis of exposures to commercial loans by industry type

The following table shows the residual maturity of the Group's on-balance exposures secured by mortgages on residential real estate and commercial real estate as at 31 March 2011.

At 31 March	**2011 £m**	2010 £m
Up to 3 months	**173.2**	37.5
3-12 months	**214.3**	245.3
1-5 years	**1,185.2**	1,081.2
More than 5 years	**4,019.4**	4,705.1
Total	**5,592.1**	6,069.1

Table 8: Analysis of on-balance sheet loan exposures by residual maturity

Section 5 – **Credit Risk (continued)**

Impairment of mortgage loans and advances

A financial asset or a group of financial assets is impaired and impairment losses are incurred if there is objective evidence of impairment.

The Group assesses at each year end date whether there is objective evidence that a financial asset is impaired. Objective evidence of impairment can be defined as one or more events occurring after the initial recognition of the asset that have an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists for individual financial assets. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment, and for which an impairment loss is or continues to be recognised, are not included in a collective assessment of impairment.

If there is objective evidence of an impairment of loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Income Statement.

Impairment losses on debt instruments

At each year end date, the Group assesses whether there is objective evidence that individual debt instruments are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

- Significant financial difficulties of the issuer or obligor;
- Any breach of contract or covenants;
- The granting of any concession or rearrangement of terms;
- The disappearance of an active market;
- Any significant downgrade of ratings; and
- Any significant reduction in market value.

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist at the year end date, then, in the case of available-for-sale instruments, the cumulative loss that had been recognised directly in reserves is removed from equity and recognised in the Income Statement. In the case of held to maturity instruments an appropriate charge is made to the Income Statement.

If in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss shall be reversed, with the amount of the reversal recognised through the Income Statement.

Financial assets are written off when it is reasonably certain that receivables are irrecoverable.

Past due and impaired loans

Past due is defined as loans where the borrower's contracted payments have not been received by the due date.

The Group is managed in segments determined according to similar economic characteristics and customer base. The key segments are:

- Retail lending – incorporating residential lending, savings, investment and protection; and
- Commercial – primarily representing loans for commercial property investment.

Section 5 – **Credit Risk (continued)**

The following tables provide an analysis of impaired and past due loans for Residential and Commercial lending. The figures in the tables include all Group companies but exclude the assets of the securitisation entities as these are considered-off balance sheet for regulatory purposes. The Group does not consider the geographical spread of impaired exposures to be significant.

At 31 March	2011 £m	2010 £m
Loans neither past due nor impaired	**4,353.6**	4,685.2
Past due but not impaired		
Past due 1 to 3 months	**74.1**	83.8
Past due 3 to 6 months	**11.2**	13.2
Past due 6 to 12 months	**5.1**	6.5
Past due over 12 months	**1.3**	1.9
Impaired		
Past due 1 to 3 months	**34.5**	43.6
Past due 3 to 6 months	**25.3**	27.5
Past due 6 to 12 months	**18.5**	16.3
Past due over 12 months	**27.1**	31.5
Possessions	**14.9**	13.6
Total	**4,565.6**	4,923.1

Table 9: Analysis of impaired and past due loans for residential lending

£40.1m (2009/10: £30.1m) of loans that would be past due or impaired have had their terms renegotiated.

At 31 March	2011 £m	2010 £m
Loans neither past due nor impaired	**735.2**	852.6
Not Past Due but Impaired	**64.4**	57.7
Past due but not impaired		
Past due up to 3 months	**35.6**	52.7
Past due 3 to 6 months	**–**	0.1
Past due 6 to 12 months	**2.6**	2.9
Past due over 12 months	**–**	3.3
Impaired		
Past due up to 3 months	**68.6**	77.1
Past due 3 to 6 months	**–**	40.5
Past due 6 to 12 months	**44.1**	2.0
Past due over 12 months	**92.5**	46.4
Possessions	**0.1**	5.0
Total	**1,043.1**	1,140.3

Table 10: Analysis of impaired and past due loans for commercial lending

Section 5 – **Credit Risk (continued)**

Impairment losses

The following table shows the movement during the year in impairment provisions. Further information on the charge to the income statement for provisions is included in Note 13 to the Annual Report and Accounts:

2011

	Retail lending		**Commercial**		**Total**		
	Individual £m	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Total £m**
At 1 April 2010	33.4	5.2	31.8	13.6	65.2	18.8	**84.0**
Amounts written off	(4.9)	–	(4.7)	–	(9.6)	–	**(9.6)**
Charge/(Release) for the year comprises							
Provision/(Release) for loan impairment	2.2	4.6	16.1	(4.5)	18.3	0.1	**18.4**
Adjustments to provisions resulting from recoveries	(1.6)	–	–	–	(1.6)	–	**(1.6)**
Charge/(Credit) for the year	0.6	4.6	16.1	(4.5)	16.7	0.1	**16.8**
As at 31 March 2011	**29.1**	**9.8**	**43.2**	**9.1**	**72.3**	**18.9**	**91.2**

Table 11: Analysis of movement during the year ended 31 March 2011 in impairment provisions

2010

	Retail lending		Commercial		Total		
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Total £m
At 1 April 2009	29.4	3.1	31.8	17.9	61.2	21.0	82.2
Amounts written off	(11.2)	–	(7.6)	–	(18.8)	–	(18.8)
Charge/(Release) for the year comprises							
Provision/(Release) for loan impairment	15.9	2.1	7.6	(4.3)	23.5	(2.2)	21.3
Adjustments to provisions resulting from recoveries	(0.7)	–	–	–	(0.7)	–	(0.7)
Charge/(Credit) for the year	15.2	2.1	7.6	(4.3)	22.8	(2.2)	20.6
As at 31 March 2010	33.4	5.2	31.8	13.6	65.2	18.8	84.0

Table 12: Analysis of movement during the year ended 31 March 2010 in impairment provisions

All impairments were against UK assets. All residential and commercial mortgage loans were against UK assets.

Capital required under Pillar 1 for mortgage loans (both performing and non performing) was £228.3m (2009/10 - £249.4m).

Section 5 – **Credit Risk (continued)**

Counterparty credit risk

The Group uses derivative instruments to hedge its exposure to market risk, for example, interest rate and foreign exchange risk. Counterparty credit risk is the risk that a counterparty to a derivative instrument could default. Risk is mitigated by offsetting the amounts due to the same counterparties ('netting benefits') and by cash deposited with certain of the counterparties ('collateral held').

The following table shows the exposures to counterparty credit risk for derivative contracts:

At 31 March	**2011 £m**	2010 £m
Interest rate contracts	**27.4**	34.3
Foreign exchange contracts	**2.9**	13.1
Other contracts	**43.1**	31.0
Gross positive fair value of contracts	**73.4**	78.4
Exclude intra-group exposures	**(12.3)**	–
Cash collateral and netting benefits	**(61.1)**	(22.5)
Net derivatives credit exposure	–	55.9

Table 13: Counterparty credit risk for derivative contracts

Capital required under Pillar 1 for counterparty credit risk totals £0.3m (2009/10 – £2.9m). It is calculated using the CCR Mark to Market Method.

The net derivatives credit exposure represents the credit exposure to derivative transactions after taking account of legally enforceable collateral arrangements.

The net exposure value of derivatives at 31 March 2011 was £11m (2009/10: £100m) which includes an amount for potential future exposure.

International Swaps and Derivatives Association ('ISDA') documentation confers the ability to use designated cash collateral to set against derivative credit exposures in the event of counterparty default.

Section 6 – **Market Risk**

Types of derivatives

The principal derivatives used by the Group are interest rate swaps, cross currency interest rate swaps and index linked swaps that are used to hedge Group Financial Position exposures. Further information concerning the types of derivatives can be seen in Note 31 to the Annual Report and Accounts for the year ended 31 March 2011.

Market risk

Market risk relates to the possible changes in value of, or income arising from, the Group's assets and liabilities as a result of changes in interest/exchange rates or equities. Market risk exposures are managed through the Group Treasury department, which is responsible for managing the Group's exposure to all aspects of market risk within parameters set by the Board. ALCo reviews the Treasury Policy, recommending changes to the Board as appropriate, and ensures that regular reports on all aspects of market risk (including interest rate risk and foreign exchange risk) are assessed and reported to the Board. The principal market risk within the Group relates to interest rate risk, which arises within the balance sheet as a result of the timing differences of the interest rate re-pricing between the Group's assets and liabilities. To mitigate this, the Treasury department uses natural hedging (for example, 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 places restrictions on their use.

The Group's main exposure to equities is through its defined benefit pension scheme. While the Group does attract funds through index-linked savings products, all exposures to equity indices are fully hedged. The Group has a negligible net exposure to exchange rates.

Interest rate risk

Interest rate risk arises from the varying interest rate features and maturities of mortgage and savings products, and from the liquidity and wholesale funding held by the Group. These primarily arise from the imperfect matching of interest rates between different financial instruments and the timing differences on the re-pricing of assets and liabilities. This risk is managed on a continuous basis, within limits set by the Board, through the use of appropriate financial instruments, including derivatives.

The maximum level of interest rate risk is governed by the Board approved Treasury Policy in line with the Group's risk appetite.

Interest rate monitoring

The Group monitors risk using a Risk Management System and operates within limits set down by the Board following recommendations from ALCo. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

In line with best practice and Basel guidelines, the Group considers the impact of a +/- 2% parallel shift in the yield curve. However, in the day-to-day management of the Group the impact of alternate scenarios are also considered.

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, for example, base rate mortgages funded by LIBOR-linked liabilities. The impact of these mismatches ('basis risk') is monitored by the Assets and Liabilities Management team and reported to ALCo. Action is taken to keep any mismatch within its desired range, which could include changing our product mix or the use of derivatives. The Group also operates a gap limit, and the Group's gap positions are reported monthly to the FSA.

Interest rate risk summary

The levels of Group interest rate risk exposures, to a 2% parallel shift, through the reporting period were as follows:

	As at 31 March 2011 £m	**Average 2011 £m**	**High 2011 £m**	**Low 2011 £m**
Market value	**12.8**	5.5	12.8	(0.9)
Net interest income	**4.6**	1.1	4.6	(2.0)

Table 14: Group Interest Rate risk exposures

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

Section 7 – **Operational Risk**

Operational risk overview

The Group has adopted the Standardised Approach to operational risk. Under this approach, the capital charge for operational risk is calculated by averaging the annual income from prescribed business lines over the past three years and applying a set regulatory multiplier to the different business lines.

The Group has applied a commonly used definition of operational risk – the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.

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 Risk team, which co-ordinates regular reviews with the function managers and collates the output for review by executive management and the Group Risk Committee.

The Risk Division 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 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 the Group Risk Committee.

Capital required under Pillar 1 for Operational risk was £9.6m (2009/10 – £9.7m)

Section 8 – **Securitisation**

West Bromwich Building Society has established a number of securitisation structures to raise funding for the West Bromwich Building Society Group. Special Purpose Vehicles ('SPVs') have purchased beneficial interests in portfolios of commercial and residential mortgages that are funded by floating rate mortgage backed securities ('Notes'). The equity of the SPVs created for these securitisations 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 Standing Interpretations Committee ('SIC') 12, the SPVs are included as subsidiaries in the consolidated financial statements.

West Bromwich Building Society Group, via its subsidiary company, West Bromwich Commercial Limited ('WBCL'), provides subordinated and start-up loans to its securitisation structures as follows:

At 31 March	**2011 £m**	2010 £m
Subordinated loans, start up loans and other balances:		
Sandwell Commercial Finance No. 1 Plc	**3.1**	3.1
Sandwell Commercial Finance No. 2 Plc	**5.5**	6.7
Total	**8.6**	9.8

Table 15: Start up loans and other balances with off-balance sheet securitisations

The Notes are serviceable firstly from cash flows generated by the mortgage assets and thereafter from the proceeds of the subordinated loans. The Group receives the excess spread on the transactions as deferred consideration, after the SPVs have met their liabilities.

The SPVs were originally set up as follows:

Sandwell Commercial Finance No. 1 Plc
In May 2004, WBCL sold £250m of commercial mortgage assets 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 to Sandwell Commercial Finance No. 2 Plc. Sandwell Commercial Finance No. 2 Plc issued notes to finance the purchase of a portfolio of the commercial mortgage assets.

The balances of assets subject to securitisation and notes in issue as at 31 March 2011 are as follows:

Securitisation Company	**Type**	**Date of Securitisation**	**2011 Gross Assets securitised £m**	**2011 External Notes in Issue £m**	2010 Gross Assets securitised £m	2010 External Notes in Issue £m
Sandwell Commercial Finance No. 1 Plc	Commercial mortgage securitisation	19 May 2004	**99.7**	**99.7**	117.3	117.3
Sandwell Commercial Finance No. 2 Plc	Commercial mortgage securitisation	23 September 2005	**185.6**	**185.6**	234.1	234.1
Total			**285.3**	**285.3**	351.4	351.4

Table 16: Assets subject to off-balance sheet securitisation and notes in issue as at 31 March 2011

Treatment of securitisations in capital calculations

The risk has been transferred to the investors, and hence, there are no risk weighted exposures included in the capital calculation for the exposures that have been securitised. However, the subordinated loans and start-up loans to the securitisation structures are deducted from the Group's capital (50% from Tier 1 and 50% from Tier 2 capital).

Purchased securitisation positions

The Group also invests in Mortgage Backed Securities. The treatment of the Group's investment in Mortgage Backed Securities is covered under Section 5 – Risk Measurement and Reporting.

Section 9 – **Other Risks**

This section sets out the other risks faced by the business above and beyond the Pillar 1 risks set out in sections 5 to 7 above.

Liquidity risk

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

Liquidity risk refers to the risk that the Group may not be able to meet its financial obligations as they fall due, or is only able to do so by taking measures which involve an excessive cost. Mortgage lending is usually for terms of up to 25 years while savings accounts have a shorter duration, generally no more than 5 years. This leads to a mismatch between assets and liabilities, known as 'maturity transformation'.

The Group has a low risk appetite in respect of liquidity risk and has a liquidity policy to maintain sufficient high quality liquid resources to:

- cover cash flow imbalances;
- cover fluctuations in funding;
- retain full public confidence in the solvency of the Group; and
- be in a position to meet its financial obligations.

This is achieved through maintaining a prudent level of liquid assets, using a broad range of funding facilities and through controlled management of the growth of the business.

The Society has a very low exposure to wholesale funding and a secure retail funding base, both of which serve to minimise risks relating to funding volatility. The Group has a prudent approach to liquidity management.

The Group has a contingency funding plan, agreed at Board level and reviewed at least annually. ALCo monitors liquidity risk and also receives regular updates on the liquidity position, including the outputs from a wide range of stress tests.

In June 2010, the FSA introduced new requirements for liquidity management and reporting and, following significant investment in infrastructure, the scope and nature of the liquid assets held by the Group complies with this new regulatory requirement.

Concentration risk

This is the risk of losses arising due to the concentration of exposures which have a significant positive correlation (e.g. in terms of geography, industry sector, major counterparty etc), or are influenced by common external factors.

Concentration risk in the liquidity portfolio is subject to limits set by the Board and monitored monthly by ALCo. Concentrations within the loan books are overviewed by the Group Risk Committee. There is a known exposure to commercial mortgages and this is the subject of continuing intensive attention. A further concentration to buy-to-let mortgages is also acknowledged but, currently these mortgages are performing well. If this were to change, the Society would increase the resource available to handle any increased activity.

Property holding risk

Property holding risk refers to the risk of losses in the collective value of the residential investment portfolio following a general decrease in property values. The Group has a portfolio of investment properties which is held by its subsidiary West Bromwich Homes Ltd. The West Bromwich Homes Ltd Board has responsibility for monitoring and controlling the property holding risk. It reports the risk position to the Group Risk Committee on a regular basis.

Although it is recognised that controls cannot eliminate the risk, the controls in place both when acquiring the property and in the on-going management of the property help to reduce the risk. The key controls include:

At acquisition

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

Ongoing management

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

Pension risk

The Group has funding obligations for a defined benefit scheme, the Staff Retirement Scheme ('the Scheme'), which is closed to new entrants and no longer accruing service benefits. Pension risk is the risk that the value of a scheme's assets will be insufficient to cover the projected pension obligations over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. The projection of the Scheme's obligations includes estimates of mortality and inflation, the actual out-turn of which, may differ from the estimates. The Scheme is also exposed to possible changes in pension legislation.

To mitigate these risks, management, together with the Trustees of the Scheme, regularly review 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.

Business risk

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/or its desired strategy. This may be due to changes in the competitive environment or events which damage the operating economies of the Society (e.g. competitor activity or changes in regulation and/or taxation).

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

Section 10 – **Remuneration**

The disclosure of the Group's remuneration policy and practices is provided on pages 26 to 28 of the Annual Report and Accounts. Later in the year, further disclosures will be made in line with the remuneration disclosure requirements of BIPRU 11.5.18 to 21.

Section 11 – **Contacts**

Should you have any queries please contact:

Tom Lynch	Divisional Director Treasury and Capital Management
Andrew Conroy	Divisional Director, Finance
Manjit Hayre	Head of Credit Risk
Peter Jones	Head of Assets & Liabilities

West Bromwich Building Society. Principal Office: 374 High Street, West Bromwich, West Midlands, B70 8LR.

FSA Registration Number 104877

Section 12 – **Glossary of terms**

Basel II Framework
The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. The Accord is structured around Pillars 1, 2 & 3, became law in the EU Capital Requirements Directive, and was implemented in the UK in the FSA Handbook.

BIPRU
The Prudential Sourcebook for banks, building societies and investment firms which forms part of the FSA Handbook for Basel II.

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

CQS (Credit Quality Steps)
A credit quality assessment scale as set out in BIPRU 3.4 (Risk weights under the Standardised Approach to credit risk) and BIPRU 9 (Securitisation).

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.

ECAI
External Credit Assessment Institution. 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.

FSA
Financial Services Authority. The financial services industry regulator in the UK.

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

ICA
Internal Capital Assessment - the document produced as a result of the ICAAP.

ICAAP
Internal Capital Adequacy Assessment Process. The process the Group follows to determine capital requirements under Basel II Pillar 2.

ICG
Individual Capital Guidance. The minimum amount of capital the Group should hold as set by the FSA under Basel II Pillar 2.

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

LIBOR
London Inter Bank Offered Rate.

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

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.

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

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 arising from inadequate or failed internal processes, people and systems or from external events.

PFE
The potential future exposure 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.

PIBS
Permanent Interest Bearing Shares. Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors and creditors of the Society and pari-passu with the Society's PPDS.

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

Pillar 2
The part of the Basel II 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) - ICG is an outcome from Pillar 2.

Pillar 3
The part of the Basel II Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.

PPDS
Profit Participating Deferred Shares are unsecured deferred shares that are a form of Core Tier 1 capital. PPDS rank behind depositors and creditors of the Society and rank pari-passu with the Society's PIBS.

Provisions
Amounts set aside to cover losses associated with credit risks.

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

Securitisation
A transaction or scheme where assets are sold to a Special Purpose Vehicle (SPV) in return for immediate cash payment. That vehicle raises the immediate cash payment by issuing debt securities in the form of tradable 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. Securitisations may be purchased or retained.

SREP
Supervisory Review and Evaluation Process, the FSA assessment of a firm's own capital assessment ('ICA') under Basel II Pillar 2.

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

The Standardised Approach (credit risks)
The Standardised Approach to credit risk, calculated by applying varying RWA percentages to credit exposures, depending on the underlying risk.

The Standardised Approach (operational risks)
The Standardised Approach to operational risk, calculated using three year historical net income multiplied by a factor of 12-18%, depending on the underlying business being considered.

Braille, audio and large print versions of this leaflet are available upon request. Please contact us on 0845 33 00 622.

To find out more, visit your local branch, call us on the number above or visit our website at www.westbrom.co.uk

Head Office: 374 High Street, West Bromwich, West Midlands B70 8LR.
www.westbrom.co.uk

Registered Number: 651B

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