Basel II Pillar 3 Disclosures

for the year ended 31 March 2012

the West Brom

Contents

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 including those 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 sets 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 issued 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 2012, 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 all of its subsidiary and quasi-subsidiary entities. For capital purposes the Group is ostensibly the same, except that it excludes 2 of its securitisation quasi-subsidiaries; Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc. These Special Purpose Entities (SPEs) are not consolidated for capital purposes, a deduction is instead made against capital available for the residual risk relating to these entities which is retained by the Group. This treatment is adopted as the significant credit risk associated with the securitised exposures is considered to have been transferred to third parties; (see Section 8 - Securitisation).

The principal subsidiaries included for capital purposes in the Group and Society Solo consolidation are:

West Bromwich Mortgage Company Limited (includes quasi-subsidiary - Hawthorn Finance Limited)
West Bromwich Commercial Limited (includes quasi-subsidiary - Sandwell Commercial Finance No. 3 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 2012.

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.

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 Board's primary aim is to put the safety and security of members' deposits above everything else. It achieves 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: Group Risk Committee (GRC) and Audit & Compliance Committee (ACC).

These Board sub-committees operate 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 (NEDs) with other committee members being drawn from the Executive, and attended by appropriate members of Senior Management and risk specialists.

- **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 risk appetite 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).

- **ACC** 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.

These committees are supported by the following executive committees:

- **Assets & Liabilities Committee (ALCo)** – This committee is chaired by the Group Finance Director and is responsible for the assessment of exposure to Treasury counterparty credit, market, liquidity and interest rate risk.

- **Residential Credit Committee (RCC)** – This committee is chaired by the Group Risk Director and is responsible for monitoring exposure to credit risks in the Group's retail loan books.

- **Commercial Lending Risk Committee (CLRC)** – This committee is chaired by the Group Risk Director and is responsible for monitoring exposure to credit risks in the Group's commercial loan book.

- **Operational Risk Committee (ORC)** – This committee is chaired by the Group Risk Director and is responsible for the oversight of the management of operational risks arising from the Group's business activities.

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 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 Operations	Line Management	Line Management Oversight
2nd	Policy, Controls, Measurement, Monitoring	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 2012, together with the prior year comparatives. During the year ended 31 March 2012, 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	**2012 £m**	2011 £m
Tier 1		
General reserves	**241.1**	251.3
Permanent interest bearing shares (PIBS)	**74.9**	74.9
Profit participating deferred shares (PPDS)	**175.0**	177.3
Deduct: Intangible assets	**(7.5)**	(9.0)
Deduct: Investments in non-consolidated SPEs	**(3.5)**	(4.3)
Total Tier 1 capital	**480.0**	490.2
Tier 2		
Revaluation reserve	**3.7**	3.7
Add back: collective impairment allowance	**24.1**	18.9
Contingency against collective provision add back	**(10.2)**	(4.4)
Deduct: Investments in non-consolidated SPEs	**(3.5)**	(4.3)
Total Tier 2 capital	**14.1**	13.9
Total capital available (own funds)	**494.1**	504.1

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 SPEs consist of the subordinated and start-up loans to securitisation entities, 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 has some specific characteristics and which has therefore been disallowed 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 GRC (including forecasts under stress scenarios). The Group Capital Committee, a sub-committee of the GRC monitors the capital position on a monthly basis.

Summary of Approach to Capital Adequacy Planning

The Group completes a full ICAAP review at least bi-annually. 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 2012, the FSA formally updated the Society's Individual Capital Guidance (ICG) following their supervisory review.

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. The capital resource requirement for market risk has been calculated in accordance with BIPRU 7.

The following table shows the Group'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 exposure amounts for each of the applicable standardised credit risk exposure classes) at 31 March 2012. Details of the Standardised Approach to the calculation of regulatory requirements are contained in the FSA Handbook.

At 31 March	Notes	2012 £m	2011 £m
Credit risk			
Mortgage loans (performing)		**186.7**	210.1
Mortgage loans (past due)		**24.0**	18.2
Liquidity (treasury instruments and cash)		**12.1**	8.5
Other items		**12.6**	12.5
Total capital requirements - credit risk		**235.4**	249.3
Operational risk – Standardised Approach		**7.6**	9.6
Market risk	1	**1.0**	0.3
Total Pillar 1 capital requirement		**244.0**	259.2
Total capital available		**494.1**	504.1
Excess of capital over minimum capital requirement under Pillar 1		**250.1**	244.9

Table 3: the Group's overall minimum Pillar 1 capital requirements under the Standardised Approach

Notes:

1. Market risk for Pillar 1 capital adequacy assessment predominately relates to counterparty credit risk under the Standardised Approach.

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, it is engaged in only limited lending activity, almost entirely to owner occupiers. 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.

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 GRC, which is chaired by a NED, has another three NEDs as members and includes the Chief Executive, Group Risk Director and Group Finance Director.

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, countries and asset categories, 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 predominantly for short 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 UK Government, Bank of England and Supranational financial institutional assets, which are 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 following tables analyse the Group's regulatory credit risk exposures to treasury counterparties as at 31 March 2012. These encompass both on and off balance sheet exposures (after credit risk mitigation) and include 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 direct exposure in its liquidity portfolio to Sovereign or bank debt relating to the emerging markets, Greece, Ireland, Italy, Belgium, Portugal or Spain, or to any mortgage market other than the UK.

At 31 March	**2012 £m**	2011 £m	**Average over year £m**
Concentration by credit grading			
AAA to AA-	**1,461.9**	1,359.1	**1,341.6**
A+ to A-	**287.8**	14.9	**121.4**
Building societies	**82.8**	59.5	**65.2**
Total	**1,832.5**	1,433.5	**1,528.2**
Concentration by sector			
UK Government & Bank of England	**790.0**	877.1	**750.9**
Supranational financial institutions	**349.8**	–	**141.1**
Financial institutions	**542.6**	365.5	**470.8**
Mortgage backed securities	**150.1**	190.9	**165.4**
Total	**1,832.5**	1,433.5	**1,528.2**

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

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

At 31 March

	2012 £m	2011 £m	Average over year £m
Concentration by region			
UK	**1,284.2**	1,302.7	**1,202.9**
Europe (excluding UK)	**141.8**	74.6	**122.2**
North America	**0.3**	0.1	**5.2**
Australasia	**56.4**	56.1	**56.8**
Supranational financial institutions	**349.8**	–	**141.1**
	1,832.5	1,433.5	**1,528.2**

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 both on and off balance sheet exposures (after credit risk mitigation) and include the PFE of derivatives.

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

Residual breakdown of exposures by asset class

At 31 March 2012

	Notes	< 1 year £m	1 - 5 years £m	> 5 years £m	Total £m
UK Government & Bank of England		784.5	–	5.5	**790.0**
Supranational financial institutions		26.5	323.3	–	**349.8**
Financial institutions		412.8	114.2	15.6	**542.6**
Mortgage backed securities	1	23.7	57.4	69.0	**150.1**
		1,247.5	**494.9**	**90.1**	**1,832.5**

At 31 March 2011

	Notes	< 1 year £m	1 - 5 years £m	> 5 years £m	Total £m
UK Government & Bank of England		704.4	138.7	34.0	877.1
Supranational financial institutions		–	–	–	–
Financial institutions		202.4	148.9	14.2	365.5
Mortgage backed securities	1	38.4	104.8	47.7	190.9
		945.2	392.4	95.9	1,433.5

Table 5: Residual maturity analysis of liquidity exposures

Notes:

1. The mortgage backed securities all relate to prime loans secured on property located in the United Kingdom. They were all rated AAA at issuance and rank in the senior positions in the capital structure.

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

	Notes	Risk Weight %	Fitch and S&P ratings	Moody's ratings	2012 Exposure values £m	2011 Exposure values £m
UK Government & Bank of England						
Credit quality step						
1	1	**0**	**AAA**	**Aaa**	**781.7**	869.3
Total					**781.7**	869.3
Supranational financial institutions						
Credit quality step						
1		**0**	**AAA**	**Aaa**	**349.8**	–
Total					**349.8**	–
Financial institutions						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**175.0**	331.8
2	2	**20/50**	**A+ to A-**	**A1 to A3**	**339.6**	13.4
Unrated (building societies)		**20/50**			**–**	9.0
Total					**514.6**	354.2
Securitisation positions						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**144.9**	190.9
2		**50**	**A+ to A-**	**A1 to A3**	**5.2**	–
Total					**150.1**	190.9

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

Notes:

1. Includes instruments guaranteed by the UK Government
2. Includes rated building societies

Capital required under Pillar 1 for liquidity was £12.1m (2010/11: £8.5m)

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)**

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 Residential Property and Commercial Real Estate Property Exposures

The Group calculates credit risk for exposures secured by mortgages on residential properties 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	**2012 £m**	2011 £m
Housing Association	**0.1**	0.1
Residential	**63.4**	94.3
Healthcare & Leisure	**202.0**	218.2
Industrial & Warehouse	**26.0**	34.7
Office	**129.5**	134.6
Retail	**462.6**	551.5
Other	**6.4**	9.7
Total	**890.0**	1,043.1

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

The following table shows the Group's exposure to commercial loans by region.

At 31 March	**2012 £m**	2011 £m
East Anglia	**20.9**	21.2
East Midlands	**55.0**	62.2
Greater London	**206.6**	277.7
North	**44.8**	47.2
North West	**223.8**	233.7
Scotland	**20.9**	30.1
South East	**145.8**	155.6
South West	**39.2**	44.6
Wales	**13.1**	14.2
West Midlands	**65.5**	73.5
Yorkshire	**54.4**	83.1
Total	**890.0**	1,043.1

Table 8: Analysis of the commercial loan portfolio by geographic spread

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

The following table shows the Group's exposure to residential loans by region.

At 31 March	**2012 £m**	2011 £m
East Anglia	**101.0**	106.2
East Midlands	**363.1**	385.2
Greater London	**719.2**	773.5
Northern Ireland	**7.5**	8.2
North	**123.9**	132.5
North West	**426.2**	451.3
Scotland	**169.1**	179.2
South East	**736.7**	791.1
South West	**326.4**	351.0
Wales	**216.8**	234.7
West Midlands	**787.9**	880.5
Yorkshire	**255.9**	272.2
Total	**4,233.7**	4,565.6

Table 9: Analysis of the residential loan portfolio by geographic spread

The following table shows the residual maturity of the Group's on balance sheet exposures secured by mortgages on residential properties and commercial real estate as at 31 March 2012.

At 31 March	**2012 £m**	2011 £m
Up to 3 months	**30.0**	173.2
3-12 months	**329.7**	214.3
1-5 years	**527.4**	1,185.2
More than 5 years	**4,237.2**	4,019.4
Total	**5,124.3**	5,592.1

Table 10: Analysis of on balance sheet loan exposures by residual maturity

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.

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

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, investments 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.

Residential lending – Payment due status

At 31 March

	2012 £m	2011 £m
Loans neither past due nor impaired	**4,039.1**	4,353.6
Past due but not impaired		
Past due 1 to 3 months	**58.0**	74.1
Past due 3 to 6 months	**23.1**	11.2
Past due 6 to 12 months	**8.7**	5.1
Past due over 12 months	**2.7**	1.3
Impaired		
Past due 1 to 3 months	**35.0**	34.5
Past due 3 to 6 months	**18.3**	25.3
Past due 6 to 12 months	**15.3**	18.5
Past due over 12 months	**21.2**	27.1
Possessions	**12.3**	14.9
Total	**4,233.7**	4,565.6

Table 11: Analysis of impaired and past due loans for residential lending

Commercial lending – Payment due status

At 31 March

	2012 £m	2011 £m
Loans neither past due nor impaired	**602.5**	735.2
Not past due but impaired	**117.1**	64.4
Past due but not impaired		
Past due 1 to 3 months	**4.2**	35.6
Past due 3 to 6 months	**2.0**	-
Past due 6 to 12 months	**0.9**	2.6
Past due over 12 months	**18.3**	-
Impaired		
Past due 1 to 3 months	**13.9**	68.6
Past due 3 to 6 months	**16.2**	-
Past due 6 to 12 months	**6.0**	44.1
Past due over 12 months	**108.9**	92.5
Possessions	**-**	0.1
Total	**890.0**	1,043.1

Table 12: 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 14 to the Annual Report and Accounts:

2012

	Residential lending		**Commercial**		**Total**		
	Individual £m	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Total £m**
At 1 April 2011	29.1	9.8	43.2	9.1	72.3	18.9	**91.2**
Amounts written off	(6.1)	–	(10.4)	–	(16.5)	–	**(16.5)**
Charge/(Credit) for the year comprises:							
Provision/(Release) for loan impairment	9.9	(0.3)	(0.3)	3.1	9.6	2.8	**12.4**
Adjustments to provisions resulting from recoveries	(1.9)	–	–	–	(1.9)	–	**(1.9)**
Charge/(Credit) for the year	8.0	(0.3)	(0.3)	3.1	7.7	2.8	**10.5**
At 31 March 2012	**31.0**	**9.5**	**32.5**	**12.2**	**63.5**	**21.7**	**85.2**

Table 13: Analysis of movement during the year ended 31 March 2012 in impairment provisions

2011

	Residential 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/(Credit) 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
At 31 March 2011	29.1	9.8	43.2	9.1	72.3	18.9	91.2

Table 14: Analysis of movement during the year ended 31 March 2011 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 £210.7m (2010/11: £228.3m).

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 (CCR) 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 CCR for derivative contracts:

At 31 March	2012 £m	2011 £m
Interest rate contracts	**19.1**	27.4
Foreign exchange contracts	**–**	2.9
Other contracts	**45.4**	43.1
Gross positive fair value of contracts	**64.5**	73.4
Exclude intra-group exposures	**–**	(12.3)
Cash collateral and netting benefits	**(64.5)**	(61.1)
Net derivatives credit exposure	**–**	–

Table 15: CCR for derivative contracts

Capital required under Pillar 1 for CCR risk totals £1.0m (2010/11: £0.3m). 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 2012 was £28.0m (2010/11: £11.3m) 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 and index-linked swaps that are used to hedge Group Financial Position exposures. Further information concerning the types of derivatives can be found in Note 31 to the Annual Report and Accounts for the year ended 31 March 2012.

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 rates, 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 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 foreign exchange rate risk.

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 where applicable).

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 alternative 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 gap limits, 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 2012 £m	**Average 2012 £m**	**High 2012 £m**	**Low 2012 £m**
Market value	**(5.0)**	(4.9)	(12.0)	0.7
Net interest income	**(1.9)**	(1.5)	(3.8)	–

Table 16: 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 functions receive 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, the Operational Risk Committee and the GRC.

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 GRC.

Capital required under Pillar 1 for operational risk was £7.6m (2010/11: £9.6m)

Section 8 – **Securitisation**

Originated Securitisations

Securitisation is the process by which a ring fenced group of assets, usually loans, are aggregated into a pool, and sold to bankruptcy remote Special Purpose Entities (SPEs). 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. The Group has established securitisation structures as part of its funding activities, using residential and commercial mortgage loans as the underlying asset pools.

The equity of the SPEs 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 SPEs are included as subsidiaries in the consolidated financial statements. This is despite the fact that some SPEs may be structured to cap group exposures to losses at levels which mean that consolidation is not considered to be appropriate for 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. Securitisation has historically been used to increase the diversification of funding sources, manage maturity mismatch risk, and assist overall credit risk management.

Treatment of Securitisations for Capital Purposes

There are two distinct capital treatments for the securitisations that the Group has originated. The capital treatment is dependant upon whether or not significant credit risk associated with the securitised 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 loans. 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. Where this is the case, the SPE is not consolidated for capital purposes and no risk weighted exposures are included in the capital calculation for the assets that have been securitised, instead the subordinated loans net of any deductions arising from consolidated losses are deducted from the Group's capital (50% from Tier 1 and 50% from Tier 2 capital). Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc are not consolidated for capital purposes with instead a deduction made from capital available.

Alternatively, where the structures do not achieve significant risk transfer, the underlying mortgage pools and other assets of the securitisations 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 4 – Capital Adequacy. Sandwell Commercial Finance No. 3 Limited, Hawthorn Asset Co Limited and Hawthorn Finance Limited are treated in this manner.

Non-consolidated SPEs for Regulatory Capital Purposes

The Group, through its subsidiary company, West Bromwich Commercial Limited (WBCL), provides subordinated loans (including funding for start-up costs), net of consolidated losses. See the table below.

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 SPEs have met their liabilities. The Group does not provide any liquidity facilities to the SPEs. WBCL provides administration and cash management services to the SPEs, for which it receives a fee.

At 31 March	**2012 £m**	Write offs £m	Other adjustments * £m	2011 £m
Start up loans and other balances (net of consolidated losses):				
Sandwell Commercial Finance No. 1 Plc	**–**	(3.1)	–	3.1
Sandwell Commercial Finance No. 2 Plc	**7.0**	–	1.5	5.5
Total	**7.0**	(3.1)	1.5	8.6

Table 17: Start up loans and other balances (net of consolidated losses) with off balance sheet securitisations

* Other adjustments include the excess spread from cash flows generated by the mortgage assets after the notes have been serviced.

Section 8 – **Securitisation (continued)**

The SPEs 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 a portfolio of the commercial mortgage assets.

The balances of assets subject to securitisation, notes in issue and underlying balances impaired and past due as at 31 March 2012 were as follows:

Securitisation Company	Type	Date of Securitisation	2012 Gross assets* securitised £m	2012 External notes in issue £m	2012 Underlying assets past due and impaired £m	2011 Gross assets* securitised £m	2011 External notes in issue £m	2011 Underlying assets past due and impaired £m
Sandwell Commercial Finance No. 1 Plc	Commercial mortgage securitisation	19 May 2004	**84.0**	**83.6**	**3.3**	100.0	99.7	3.3
Sandwell Commercial Finance No. 2 Plc	Commercial mortgage securitisation	23 September 2005	**178.9**	**161.7**	**1.2**	202.5	185.6	1.2
Total			**262.9**	**245.3**	**4.5**	302.5	285.3	4.5

Table 18: Assets subject to off balance sheet securitisation, notes in issue and impaired and past due assets as at 31 March 2012

*Gross assets includes the gross value of the underlying mortgage loans together with cash and cash equivalents and other assets. Comparatives have been updated to reflect the changes in BIPRU 11.5.17.

Consolidated SPEs for Regulatory Capital Purposes

The SPEs which are fully consolidated for capital purposes were originally set up as follows:

Sandwell Commercial Finance No. 3 Limited
In April 2008 WBCL sold £230m of commercial mortgage assets, at book value, to Sandwell Commercial Finance No. 3 Limited. Sandwell Commercial Finance No. 3 Limited issued notes to finance the purchase of the commercial mortgage assets.

Hawthorn Finance 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.

The balances of assets subject to securitisation and notes in issue as at 31 March 2012 were as follows:

Securitisation Company	Type	Date of Securitisation	2012 Gross assets securitised £m	2012 Retained notes in issue £m	2011 Gross assets securitised £m	2011 Retained notes in issue £m
Sandwell Commercial Finance No. 3 Limited	Commercial mortgage securitisation	18 April 2008	**152.0**	**149.6**	178.0	174.5
Hawthorn Finance Limited	Residential mortgage securitisation	22 July 2008	**1,021.7**	**992.3**	1,024.2	999.4
Total			**1,173.7**	**1,141.9**	1,202.2	1,173.9

Table 19: Assets subject to on balance sheet securitisation and notes in issue as at 31 March 2012

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

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 – Credit Risk.

The Group has invested in mortgage backed securities issued by Sandwell Commercial Finance No. 1 plc and Sandwell Commercial Finance No. 2 plc (Section 8). As at 31 March 2012 these had a book value £5.2m (2010/11: £6.6 m) and a capital requirement of £0.2m (2010/11: £0.1m).

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 in 2011/12.

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.

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.

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.

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 monitored by the GRC. 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 Group 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 Limited. The West Bromwich Homes Board has responsibility for monitoring and controlling the property holding risk. It reports the risk position to the GRC on a regular basis.

Although it is recognised that controls cannot eliminate the risk, the controls which were in place both when acquiring the property and in the ongoing management of the property help to reduce the risk (no additional properties are being acquired). The key controls include:

On acquisition

- Only affordable mid price properties were acquired;
- Properties were 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 9 – **Other Risks (continued)**

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 Group 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 Group (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 principles underlying the Society's Remuneration Policy, and detailed information on the work and composition of the Remuneration Committee, is set out in the Directors' Remuneration Report on pages 28 to 31 of the 2012 Annual Report and Accounts.

Remuneration Committee

The Society's Remuneration Committee meets regularly throughout the year and is responsible for determining, on behalf of the Board, the Group's Remuneration Policy and reviewing its adequacy and effectiveness. The Policy takes account of areas of the UK Corporate Governance Code that are considered appropriate to building societies, the disclosure requirements of the third EU Capital Requirements Directive and the detailed requirements of the Financial Services Authority's (FSA's) Remuneration Code (the Code).

During the 2011/12 financial year, the Committee comprised NEDs: Lesley James (Chair) until her resignation on 27 July 2011, John Ainley (Chair) from 27 July 2011, Mark Nicholls, Martin Ritchley and Richard Sommers (until his resignation from the Committee on 27 July 2011) and Claire Hafner from 25 October 2011. The Committee was supported by the Chief Executive, Group Finance Director, Group Risk Director and Head of Human Resources who may also be invited to attend Committee meetings as and when appropriate, to provide further background information and/or context to assist the Committee in its duties. In no case was any person present when their own remuneration was discussed.

The Committee is responsible for setting, reviewing and approving remuneration for executive Code Staff. The Chairman's remuneration is reviewed and approved by the full Board (without the Chairman's involvement), remuneration for other non-executive Code Staff is reviewed by the Chairman and Executive Directors.

The Committee met seven times during the year.

Remuneration Design Characteristics

Non-executive Code Staff are remunerated solely by fees, do not participate in any variable pay arrangements and do not receive any pension or other benefits from the Society.

Executive Code Staff remuneration is made up of the following components:

- Basic salary – this takes into account job content and responsibilities, individual performance and salary levels of similar positions in comparable organisations.
- Variable remuneration – executive Code Staff are eligible to participate in a discretionary non-pensionable annual bonus scheme. The maximum which could be awarded to Executive Directors and Divisional Directors was up to 50% of basic salary, other executive Code Staff could be awarded up to 30% of basic salary.
- Pensions – as outlined in the 2012 Annual Report and Accounts, Executive Directors receive a cash allowance in lieu of pension contributions. This is set as a percentage of basic salary (Chief Executive 25% and other Executive Directors 20%). Other executive Code Staff are able to join the Society stakeholder pension scheme to which the Society makes contributions of up to 15% of their basic salary, as an alternative, a cash allowance of up to 10% of basic salary can be taken in lieu of pension contributions.
- Benefits – executive Code Staff receive, as appropriate, the provision of a car or car allowance, private medical insurance, health screening, housing allowance or concessionary mortgage and a lump sum of four times basic salary in the event of death in service.

The Link Between Pay and Performance

The reward package for executive Code Staff is designed to align their interests with those of the Society's members, to promote sound and effective risk management and to provide a strong incentive to perform at the highest levels. All such schemes are subject to challenging performance criteria reflecting the Society's objectives.

Executive Code Staff are eligible to receive performance related pay based on the achievement of a number of corporate or corporate and personal performance objectives. The corporate performance objectives were reviewed and approved by the Board, personal performance objectives were reviewed and approved by the Remuneration Committee.

At the year end, the performance of the Executive Directors against their objectives was assessed by the Remuneration Committee and awards recommended for approval to the Board. The performance of other executive Code Staff was assessed by the Executive Directors and awards recommended to the Remuneration Committee for approval.

As a building society, the West Brom does not issue shares on the Stock Exchange. For this reason the annual performance pay cannot be based upon Share Option Schemes or Share Incentive Plans. The 2011/12 scheme incorporates the requirements of the FSA Remuneration Code such as deferral and performance adjustment in the event of poorer than expected results.

Code Staff

Under the Code, the Society is required to identify those staff who are considered to have a material impact on the Society's risk profile. This includes all Executive and NEDs, all members of the Society's Executive Committee (ExCo) and other senior individuals in the Treasury and Risk areas. 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 West Brom for the years ended 31 March 2012 and 2011.

Year End	Number of beneficiaries	Fixed remuneration £000	Variable remuneration £000	**Total remuneration £000**
March 2012	26	2,892	548	**3,440**
March 2011	26	2,938	586	**3,524**

Table 20: Aggregate quantitative remuneration of Code Staff

Variable remuneration included in the above table is the total amount awarded to Code Staff each year. It includes an element that is deferred to subsequent years. Performance–related pay deferred to future years is subject to review by the Remuneration Committee at the appropriate time before any payment is made.

The change in presentation, which was adopted this year, has required the Society to restate the Code Staff table for the year ended March 2011.

Under the two years covered by these disclosures, there were no sign-on payments or variable remuneration in the form of share or share-like instruments.

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
Jacqui Randle	Head of Human Resources

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FSA Register Number 104877

Section 12 – **Glossary of terms**

ARROW
This stands for Advanced Risk Response Operating Framework. It is the FSA process for assessing and dealing with risk.

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 framework 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.

CCR Mark to Market Method
One of the methods allowed under the Standardised Approach for determining exposure values for financial derivative instruments.

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.

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.

NED
Non-Executive Director

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). The 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 Entity (SPE) in return for immediate cash payment. That entity 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.

Subordinated debt
A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing members (other than holders of PIBS and PPDS).

Supranational financial institution
A Supranational Financial Institution 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.

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

The Standardised Approach (operational risk)
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.

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

Braille, audio and large print versions of this document 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

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