Basel II Pillar 3 Disclosures

for the year ended 31 March 2013

the West Brom

Contents

Section 1 – Overview	**3**
Background	3
Basis and frequency of disclosure	3
Location and verification	3
Scope	3
Section 2 – Risk Management Objectives and Policies	**4**
Overview	4
Categorisation	4
Risk management framework	4
Governance structure	4
Section 3 – Capital Resources	**5**
Total available capital	5
Tier 1 capital	5
Tier 2 capital	5
Reconciliation of regulatory capital	6
Section 4 – Capital Adequacy	**7**
Capital risk	7
Capital management and reporting	7
Summary of approach to capital adequacy planning	7
Minimum capital requirement (Pillar 1)	7
Section 5 – Credit Risk	**8**
Credit risk overview	8
Analysis of treasury credit risk exposures	8
Residual maturity breakdown of treasury exposures by asset class	9
Treasury credit risk mitigation	10
Analysis of residential property and commercial real estate property exposures	11
Impairment of mortgage loans and advances	13
Impairment losses on debt instruments	13
Past due and impaired loans	14
Impairment losses	15
Counterparty credit risk	16
Section 6 – Market Risk	**17**
Market risk	17
Interest rate risk	17
Interest rate monitoring	17
Interest rate risk summary	17
Section 7 – Operational Risk	**18**
Operational risk overview	18
Operational risk framework	18
Operational risk oversight and governance	18
Section 8 – Securitisation	**19**
Originated securitisations	19
Treatment of securitisations for capital purposes	19
Non-consolidated SPEs for regulatory capital purposes	19
Consolidated SPEs for regulatory capital purposes	20
Purchased securitisation positions	21
Section 9 – Other Risks	**22**
Liquidity risk	22
Pension liability risk	22
Business risk	22
Retail conduct risk	22
Section 10 – Remuneration	**23**
Remuneration Committee	23
Remuneration design characteristics	23
The link between pay and performance	23
Code staff	24
Section 11 – Contacts	**25**
Section 12 – Glossary of Terms	**26**

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.

On 1 April 2013 the responsibility for the regulation of the Society was transferred from the FSA and split between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). In this document the FSA and its successor bodies the PRA and FCA are described as 'the Regulator'.

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 Regulator under the Supervisory Review and Evaluation Process (SREP). Under this process, the Regulator 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 2013, 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 two 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
West Bromwich Homes Limited
Insignia Finance Limited.
Kenrick No. 1 Plc. (a quasi-subsidiary).

Full details of the principal subsidiary undertakings are included in Note 16 to the Annual Report and Accounts for the year ended 31 March 2013.

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 Society 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

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

Categorisation

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

The main risks we manage are:

• Capital risk;	Section 4
• Credit risk;	Section 5
• Market risk, including Interest Rate risk and Residential Property Holding risk;	Section 6
• Operational risk;	Section 7
• Liquidity risk;	Section 9
• Pension liability risk;	Section 9
• Business risk;	Section 9
• Retail conduct risk.	Section 9

Risk management framework

The Society's activities are governed by its constitution, principles and values. The Directors have also agreed a set of statements which describe the Board's risk appetite for each of the above key risk categories (the Society's Risk Appetite Statements).

These Risk Appetite Statements drive corporate planning activity, including capital and liquidity planning, as well as providing the basis for key risk measures.

The final element of the framework is the formal structure for managing risk across the Group. This is based on the '3 lines of defence' model which is illustrated below.

	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 Committee

Table 1: Group's risk management framework

Governance structure

Risk governance is provided by a structure consisting of seven key risk management committees:

- **Group Risk Committee (GRC)** – This committee is chaired by a Non-Executive Director and is responsible for the oversight and management of the key strategic risks identified by the Board.
- **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 Mortgage Committee (RMC)** – This committee is chaired by the Group Risk Director and is responsible for monitoring the Society's residential lending activity and its 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 the Group's exposure to credit risks in the 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.
- **Group Capital Committee (GCC)** – This committee is chaired by the Group Finance Director and is responsible for reviewing the Group's capital resources and capital requirements.
- **Retail Conduct Risk Committee (RCRC)** – This committee is chaired by the Chief Executive and is responsible for reviewing and monitoring all retail conduct related matters.

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

Section 3 – **Capital Resources**

Total available capital

The table below summarises the composition of regulatory capital for the Group as at 31 March 2013, together with the prior year comparatives. During the year ended 31 March 2013, 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	2013 £m	2012 £m
Tier 1		
General reserves	**236.1**	241.1
Profit participating deferred shares (PPDS)	**173.7**	175.0
Permanent interest bearing shares (PIBS)	**74.9**	74.9
Deduct: Intangible assets	**(7.9)**	(7.5)
Deduct: Investments in non-consolidated SPEs and other deductions	**(3.7)**	(3.5)
Total Tier 1 capital	**473.1**	480.0
Tier 2		
Revaluation reserve	**3.7**	3.7
Add back: Collective impairment allowance	**15.1**	24.1
Deduct: Contingency against collective provision add back	**(8.3)**	(10.2)
Deduct: Investments in non-consolidated SPEs	**(0.1)**	(3.5)
Total Tier 2 capital	**10.4**	14.1
Total capital available (own funds)	**483.5**	494.1

Table 2: Total available capital

Tier 1 capital

- PPDS are a form of Tier 1 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 29 to the Annual Report and Accounts;
- 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 28 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. Other deductions are tier specific.

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 3 – **Capital Resources** (continued)

Reconciliation of regulatory capital

A reconciliation of total capital to regulatory capital is presented below:

At 31 March	**2013 £m**	2012 £m
Total equity attributable to members per the Statement of Financial Position	**497.8**	495.9
Adjusted for:		
Available for sale reserves not eligible for inclusion in regulatory capital	**(9.4)**	(1.2)
Intangibles	**(7.9)**	(7.5)
Add back: Collective impairment allowance	**15.1**	24.1
Deduct: Contingency against collective provision add back	**(8.3)**	(10.2)
Deduct: Investments in non-consolidated SPEs and other deductions	**(3.8)**	(7.0)
Regulatory capital	**483.5**	494.1

Table 3: Reconciliation of accounting capital to regulatory capital

Section 4 – **Capital Adequacy**

Capital risk

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

Capital management and reporting

Capital is held to provide a cushion to absorb losses that may occur during the economic cycle. In assessing the adequacy of its capital, the 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 Regulator quarterly and half yearly respectively. In addition, Group capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the Group Capital Committee, Group Risk Committee and the Board.

Summary of approach to capital adequacy planning

The Group regularly conducts an Internal Capital Adequacy Assessment Process (ICAAP) covering all risks. This is used to assess the Group's capital adequacy and determine the levels of capital required going forward to support the current and future risks in the business. This analysis is collated into an Internal Capital Assessment (ICA) that is approved by the Board. The ICA incorporates expected future capital requirements from changes in business volumes, mix of assets and activities within the context of current and anticipated future risks and multiple stressed scenarios. The ICA is used by the Regulator to set the Group's capital requirements as Individual Capital Guidance (ICG).

Minimum capital requirement (Pillar 1)

Under the Regulator's rules, a minimum level of capital (Pillar 1) must be held for credit risk, operational risk and market risk. The 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 2013. Details of the Standardised Approach to the calculation of regulatory requirements are contained in the PRA Handbook.

At 31 March	**2013 Average risk weights %**	**2013 £m**	2012 Average risk weights %	2012 £m
Credit risk				
Residential mortgage loans (performing)	**38.5**	**119.2**	38.3	126.8
Commercial mortgage loans (performing)	**98.9**	**55.4**	97.9	59.9
Residential mortgage loans (past due)	**98.7**	**7.0**	98.5	7.3
Commercial mortgage loans (past due)	**145.6**	**15.6**	140.4	16.7
Liquidity (Treasury instruments and cash)	**11.1**	**9.2**	8.4	12.1
Other items	**100.0**	**12.6**	100.0	12.6
Total capital requirements – credit risk		**219.0**		235.4
Operational risk - Standardised Approach		**5.6**		7.6
Market risk (primarily the counterparty risk capital component)		**0.8**		1.0
Total Pillar 1 capital requirement		**225.4**		244.0
Total capital available		**483.5**		494.1
Excess of capital over minimum capital requirement under Pillar 1		**258.1**		250.1

Table 4: the Group's overall minimum Pillar 1 capital requirements 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.

During the year the Group engaged in only limited lending activity. All such lending was in accordance with the approved credit policy, which is consistent with the risk appetite established by the Board and has been restricted to prime residential owner occupied lending. Currently, no new non-conforming property 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 managed by a specialist Credit Risk department with a reporting line into the Group Risk Director. The Credit Risk department is responsible for setting the credit risk management framework 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 Finance Director, Group Risk Director and three other Non-Executive Directors as members.

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

Throughout the last financial year, a conservative approach to liquidity management has been maintained, investing for short periods with selected financial institutions. The Society has also moved towards a position of holding a significant proportion of liquidity in UK Government guaranteed and supranational financial institution assets, which are considered to be both highly liquid and secure. Treasury operates a strict control framework and exposures are monitored on 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 2013. These encompass both on and off balance sheet exposures (after accounting offsets). They are therefore not directly comparable with the figures reported in Note 34 to the Annual Report and Accounts. The prior year balances have been restated to reflect the inclusion of accounting offsets. The Group has no exposure in its liquidity portfolio to Cyprus, Greece, Ireland, Italy, Portugal or Spain, the emerging markets or to any mortgage market other than the UK and no exposure to non-UK sovereign debt.

At 31 March	Notes	2013 £m	2012 £m	Average over year £m
Concentration by credit grading				
AAA to AA-		**794.6**	1,459.8	**1,075.0**
A+ to A-		**200.9**	282.8	**254.8**
Building societies		**31.7**	82.8	**51.8**
BBB+ to BBB-	1	**2.4**	-	**3.8**
BB+ to BB-	1	**8.3**	-	**2.8**
		1,037.9	1,825.4	**1,388.2**
Concentration by sector				
UK Government & Bank of England		**392.3**	790.0	**500.2**
Supranational financial institutions		**197.4**	349.8	**309.5**
Financial institutions		**324.4**	535.5	**444.2**
Mortgage backed securities		**123.8**	150.1	**134.3**
		1,037.9	1,825.4	**1,388.2**

Table 5: Analysis of the Group's regulatory credit risk exposures to Treasury counterparties

Notes:

1. During the year the Group invested in mortgage backed securities issued by Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc. Further details can be found in Section 8.

At 31 March	2013 £m	2012 £m	Average over year £m
Concentration by region			
UK	**771.3**	1,278.8	**923.2**
Europe (excluding UK)	**64.0**	140.6	**118.7**
North America	**-**	0.3	**0.6**
Australasia	**5.2**	55.9	**36.2**
Supranational financial institutions	**197.4**	349.8	**309.5**
	1,037.9	1,825.4	**1,388.2**

Table 5 (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 encompass both on and off balance sheet exposures (after credit risk mitigation) and include the potential future exposure of derivatives.

An analysis of the maturity of the exposures for liquidity purposes can be found in Note 36 to the Annual Report and Accounts.

Residual breakdown of exposures by asset class

At 31 March 2013

	Notes	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £m	Total £m
UK Government & Bank of England		386.8	-	-	5.5	**392.3**
Supranational financial institutions		66.1	131.3	-	-	**197.4**
Financial institutions		142.1	111.6	83.3	-	**337.0**
Mortgage backed securities	1	28.7	64.6	30.5	-	**123.8**
		623.7	**307.5**	**113.8**	**5.5**	**1,050.5**

At 31 March 2012

	Notes	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £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	84.6	5.5	1,832.5

Table 6: 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.

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 Regulator 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	2013 Exposure values £m	2012 Exposure values £m
UK Government & Bank of England						
Credit quality step						
1	1	**0**	**AAA**	**Aaa**	**384.5**	781.7
Total					**384.5**	781.7
Supranational financial institutions						
Credit quality step						
1		**0**	**AAA**	**Aaa**	**197.4**	349.8
Total					**197.4**	349.8
Financial institutions						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**92.8**	175.0
2	2	**20/50**	**A+ to A-**	**A1 to A3**	**223.6**	339.6
Total					**316.4**	514.6
Securitisation positions						
Credit quality step						
1		**20**	**AAA to AA-**	**Aaa to Aa3**	**112.0**	144.9
2		**50**	**A+ to A-**	**A1 to A3**	**1.0**	5.2
3		**100**	**BBB+ to BBB-**	**Baa1 to Baa3**	**8.3**	-
4		**350**	**BB+ to BB-**	**Ba1 to Ba3**	**2.4**	-
Total					**123.7**	150.1

Table 7: Analysis of the liquidity exposures into credit quality steps based on the ratings as at 31 March 2013

Notes:

1. On 19 April 2013 Fitch downgraded their UK Government rating from AAA to AA+.
2. Includes rated building societies

Capital required under Pillar 1 for liquidity was £9.2m (2011/12: £12.1m)

Treasury credit risk mitigation

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

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	2013 £m	2012 £m
Housing association	**0.1**	0.1
Residential	**30.2**	63.4
Healthcare & leisure	**205.2**	202.0
Industrial & warehouse	**37.1**	26.0
Office	**117.6**	129.5
Retail	**392.9**	462.6
Other	**22.5**	6.4
	805.6	890.0

Table 8: Analysis of the commercial loan portfolio by industry type

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

At 31 March	2013 £m	2012 £m
East Anglia	**20.5**	20.9
East Midlands	**52.4**	55.0
Greater London	**167.1**	206.6
North	**45.7**	44.8
North West	**222.1**	223.8
Scotland	**22.2**	20.9
South East	**119.5**	145.8
South West	**34.5**	39.2
Wales	**9.4**	13.1
West Midlands	**60.2**	65.5
Yorkshire	**52.0**	54.4
	805.6	890.0

Table 9: 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	2013 £m	2012 £m
East Anglia	**95.4**	101.0
East Midlands	**341.3**	363.1
Greater London	**675.9**	719.2
Northern Ireland	**7.0**	7.5
North	**116.4**	123.9
North West	**403.0**	426.2
Scotland	**161.3**	169.1
South East	**691.2**	736.7
South West	**304.2**	326.4
Wales	**201.4**	216.8
West Midlands	**720.1**	787.9
Yorkshire	**242.1**	255.9
	3,959.3	4,233.7

Table 10: 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 2013.

At 31 March	2013 £m	2012 £m
Up to 3 months	**130.5**	30.0
3-12 months	**264.2**	329.7
1-5 years	**506.9**	527.4
More than 5 years	**3,868.4**	4,237.2
	4,770.0	5,124.3

Table 11: 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 financial assets using the following criteria:

- deterioration in payment status;
- tenant failure;
- expected future increase in arrears due to change in loan status;
- breach of loan covenants; and
- any other information discovered during annual review suggesting that a loss is likely in the short to medium term.

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.

A collective provision is made against a group of loans and advances where there is objective evidence that credit losses have been incurred but not identified at the reporting date. The collective impairment calculation takes into account a number of factors, including forbearance measures applied to the loans, such as term extensions and short-term interest only conversions.

If there is objective evidence of an impairment of loans and receivables, 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. This calculation takes into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based upon a recognised index and adjustments to allow for ultimate forced sales values and realisation costs. 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 or not 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 reserves 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.

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

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 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 that are considered off balance sheet for regulatory purposes (see Section 8 – Securitisation). The Group does not consider the geographical spread of impaired exposures to be significant.

Residential lending – Payment due status

At 31 March

	2013 £m	2012 £m
Loans neither past due nor impaired	**3,769.3**	4,039.1
Past due but not impaired		
Past due 1 to 3 months	**60.8**	58.0
Past due 3 to 6 months	**13.0**	23.1
Past due 6 to 12 months	**8.9**	8.7
Past due over 12 months	**3.4**	2.7
Impaired		
Past due 1 to 3 months	**32.0**	35.0
Past due 3 to 6 months	**21.8**	18.3
Past due 6 to 12 months	**17.8**	15.3
Past due over 12 months	**18.7**	21.2
Possessions	**13.6**	12.3
	3,959.3	4,233.7

Table 12: Analysis of impaired and past due loans for residential lending

Commercial lending – Payment due status

At 31 March

	2013 £m	2012 £m
Loans neither past due nor impaired	**477.5**	602.5
Not past due but impaired	**133.9**	117.1
Past due but not impaired		
Past due up to 3 months	**52.1**	4.2
Past due 3 to 6 months	**0.9**	2.0
Past due 6 to 12 months	**1.5**	0.9
Past due over 12 months	**24.6**	18.3
Impaired		
Past due up to 3 months	**6.4**	13.9
Past due 3 to 6 months	**9.8**	16.2
Past due 6 to 12 months	**9.4**	6.0
Past due over 12 months	**89.5**	108.9
	805.6	890.0

Table 13: 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 15 to the Annual Report and Accounts:

At 31 March 2013

	Residential lending		**Commercial**		**Total**		
	Individual £m	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Total £m**
At 1 April 2012	31.0	9.5	32.5	12.2	63.5	21.7	**85.2**
Amounts written off	(5.4)	-	(11.6)	-	(17.0)	-	**(17.0)**
Charge/(Credit) for the year comprises:							
Provision/(Release) for loan impairment	8.2	(1.2)	11.3	(5.5)	19.5	(6.7)	**12.8**
Adjustments to provisions resulting from recoveries	(1.8)	-	(0.2)	-	(2.0)	-	**(2.0)**
Charge/(Credit) for the year	6.4	(1.2)	11.1	(5.5)	17.5	(6.7)	**10.8**
At 31 March 2013	**32.0**	**8.3**	**32.0**	**6.7**	**64.0**	**15.0**	**79.0**

Table 14: Analysis of movement during the year ended 31 March 2013 in impairment provisions

At 31 March 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 15: Analysis of movement during the year ended 31 March 2012 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 £197.2m (2011/12: £210.7m).

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	**2013 £m**	2012 £m
Interest rate contracts	**6.5**	19.1
Other contracts	**23.0**	45.4
Gross positive fair value of contracts	**29.5**	64.5
Cash collateral and netting benefits	**(29.5)**	(64.5)
Net derivatives credit exposure	**-**	-

Table 16: CCR for derivative contracts

Capital required under Pillar 1 for CCR risk totals £0.8m (2011/12: £1.0m). 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 2013 was £20.7m (2011/12: £28.0m) 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**

Market risk

The risk of changes in the value of, or increase arising from, the Society's assets and liabilities as a result of unexpected changes in financial prices, primarily interest rates, property prices, bond yields and inflation. Market risk exposures are managed through the Treasury department which is responsible for managing exposure to all aspects of market risk within parameters set by the Board.

ALCo reviews the Treasury 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 Society's main exposure to equities is through the defined benefit pension scheme. While the Society does attract funds through index-linked savings products, all exposures to equity indices are fully hedged. There is no exposure to foreign exchange rate risk.

The Society has invested in property through its subsidiary West Bromwich Homes Limited and offers residential property for rent. This non-core business exposes the Society to movements in house prices. The Board's strategy is to exit from this business when market conditions are opportune.

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

At 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.

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 35 to the Annual Report and Accounts for the year ended 31 March 2013.

Interest rate risk

The principal market risk is interest rate risk, which arises as a result of differences in the timing of interest rate re-pricing of assets and liabilities. To mitigate this, Group Treasury uses natural balance sheet hedging (e.g. matching 2 year fixed rate mortgages with 2 year fixed rate saving bonds) and derivative instruments. The use of derivatives is only permitted in accordance with the provisions of the Building Societies Act 1986, which place restrictions on their use.

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

Interest rate monitoring

The Group monitors risk using a risk management system and operates within limits set 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 regulatory requirements and best practice, the impact of a parallel shift in interest rates in both directions, subject to a floor at 0%, is monitored. In addition, the impact of alternative non-parallel scenarios upon income and market value is also considered.

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, e.g. Bank Rate mortgages are funded by administered rate liabilities. The impact of these mismatches (basis risks) is monitored by Treasury 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 quarterly to the Regulator.

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 2013 £m	Average 2013 £m	High 2013 £m	Low 2013 £m
Market value	**0.7**	(0.4)	(3.5)	1.8
Net interest income	**(1.7)**	(0.7)	(1.7)	0.3

Table 17: 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 applied a commonly used definition of operational risk - the risk of loss and/or negative impact to the Group resulting from inadequate or failed internal processes or systems, inability to attract, retain and motivate people or from external events.

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.

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, the Operational Risk Committee 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 GRC.

Capital required under Pillar 1 for operational risk was £5.6m (2011/12: £7.6m)

Section 8 – **Securitisation**

Securitisation risk is the residual credit risk arising from retaining an interest in the Group's securitisation companies through the provision of subordinated debt and/or start up expense loans and liquidity facilities where applicable.

Originated securitisations

Securitisation is the process by which a ring fenced group of assets, usually loans, are aggregated into a pool, and sold to 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 dependent 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, Hawthorn Finance Limited and Kenrick No 1 Plc 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) to Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc.

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. The outstanding start-up loans and other balances net of consolidated losses is as follows.

At 31 March

	2013 £m	Write offs £m	Other adjustments* £m	2012 £m
Start up loans and other balances (net of consolidated losses):				
Sandwell Commercial Finance No. 1 Plc	**-**	(1.8)	1.8	-
Sandwell Commercial Finance No. 2 Plc	**0.3**	(4.1)	(2.6)	7.0
Total	**0.3**	(5.9)	(0.8)	7.0

Table 18: 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 gross assets subject to securitisation, notes in issue and underlying balances impaired and past due as at 31 March 2013 are included in the table below. Gross assets includes the gross value of the underlying mortgage loans together with cash, cash equivalents and other assets.

Securitisation Company	**Type**	**Date of Securitisation**	**2013 Gross assets securitised £m**	**2013 External notes in issue £m**	**2013 Underlying assets past due and impaired £m**	2012 Gross assets securitised* £m	2012 External notes in issue £m	2012 Underlying assets past due and impaired* £m
Sandwell Commercial Finance No. 1 Plc	Commercial mortgage securitisation	19 May 2004	**73.9**	**72.1**	**9.7**	87.0	83.6	11.3
Sandwell Commercial Finance No. 2 Plc	Commercial mortgage securitisation	23 September 2005	**150.1**	**134.0**	**6.8**	181.8	161.7	6.2
Total			**224.0**	**206.1**	**16.5**	268.8	245.3	17.5

Table 19: Assets subject to off balance sheet securitisation, notes in issue and impaired and past due assets as at 31 March 2013

* These comparatives have been restated.

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. On 31 December 2012 the outstanding notes issued by Sandwell Commercial Finance No. 3 Limited were redeemed in full.

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.

Kenrick No. 1 Plc
In April 2012, an Originator Trust was created over a £343m portfolio of prime residential mortgages, at book value. Kenrick No. 1 Plc acquired a 99% share in the Originator Trust and issued notes to finance the purchase. The Society retained a 1% share in the Originator Trust.

The balances of assets subject to securitisation, notes in issue and underlying balances past due and impaired as at 31 March 2013 are included in the table below. Underlying assets past due and impaired are part of the totals reported within Table 12 for residential and Table 13 for commercial balances.

Securitisation Company and date of securitisation	**Type**	**2013 Gross assets securitised £m**	**2013 Total notes in issue £m**	**2013 Retained notes in issue £m**	**2013 Underlying assets past due and impaired £m**	2012 Gross assets securitised £m	2012 Total notes in issue £m	2012 Retained notes in issue* £m	2012 Underlying assets past due and impaired £m
Sandwell Commercial Finance No. 3 Plc 18 April 2008	Commercial mortgage securitisation	**-**	**-**	**-**	**-**	152.0	149.6	149.6	11.2
Hawthorn Finance Limited 22 July 2008	Residential mortgage securitisation	**980.4**	**946.3**	**946.3**	**2.4**	1,021.7	992.7	992.7	2.4
Kenrick No. 1 Plc 30 April 2012	Residential mortgage securitisation	**316.0**	**298.2**	**146.1**	**0.1**	-	-	-	-
Total		**1,296.4**	**1,244.5**	**1,092.4**	**2.5**	1,173.7	1,142.3	1,142.3	13.6

Table 20: Assets subject to on balance sheet securitisation and notes in issue as at 31 March 2013

* These comparatives have been restated.

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

Section 8 – **Securitisation** (continued)

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. As at 31 March 2013 these notes had a book value of £13.0m (2011/12: £5.2 m) and of these, £11.8m (2011/12: £5.2m) was risk weighted and £1.2m (2011/12: £nil) was deducted from available Tier 1 capital. The capital requirement for the risk weighted element was £1.4m (2011/12: £0.2m).

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 2012/13.

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 4 to 8.

Liquidity risk

The Society's principal purpose is to make loans secured by way of mortgage on residential property. It funds these loans substantially from short term deposits provided by its saving members. The contractual maturity of the mortgages is typically up to 25 years although loans are often repaid early due to borrowers moving house or remortgaging. On average, loans made by the Society last for seven years.

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

This difference in the nature of borrowers' and savers' relationships causes a structural mismatch between the speed at which the Group can generate cash from its business assets and the demand for funds to meet its liabilities. To mitigate this risk, the Group holds sufficient liquid resources to meet the normal day-to-day operations of the business and, in addition, maintains a buffer of high quality assets which can be converted quickly into cash to cover outflows in severely stressed conditions. Processes are in place to ensure that the quantity, quality and availability of these liquid resources is adequate at all times.

The Board undertakes a detailed annual review of its liquidity adequacy assessment processes (Individual Liquidity Adequacy Assessment or ILAA) and submits this to the Regulator for supervisory review. The ILAA specifies the daily processes that the Group will use to determine the amount of liquidity required to cover its potential cash flow needs under a range of stresses including three standard scenarios 'name-specific', 'market-wide' and 'combined' set by the Regulator.

The supervisory review also informs the Regulator's view of the amount of 'buffer' or highest quality liquid assets that the Group should hold to meet the three standard regulatory stress scenarios and the maximum allowable gap between maturing wholesale assets and wholesale liabilities (wholesale refinancing gap). It issues Individual Liquidity Guidance (ILG) on these and other liquidity risk matters which the Group must meet. Treasury maintains liquid resources at the greater of the ILG measures or the internal assessment of liquidity adequacy.

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

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

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

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

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

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

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

Retail conduct risk

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

The regulatory focus on retail conduct risk has increased with the separation of the Financial Services Authority into the Prudential Regulation Authority and Financial Conduct Authority. The Society has formally mirrored this separation by recognising a specific risk category – retail conduct risk. During the last financial year, a strong governance framework was implemented which included the establishment of a Retail Conduct Risk Committee chaired by the Society's Chief Executive. During 2013/14, further activities are planned to embed a strong conduct culture throughout the organization and to enhance the Society's conduct related management information.

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 30 of the 2013 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 aspects 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 Conduct Authority's (FCA's) Remuneration Code (the Code).

During the 2012/13 financial year, the Committee comprised of the following Non-Executive Directors (NEDs): John Ainley (Chair), Mark Nicholls, Martin Ritchley and Claire Hafner. The Committee was supported by the Chief Executive, Group Finance Director, Group Risk Director and Head of Human Resources who may be invited to attend Committee meetings as and when appropriate, to provide further background information and 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 five 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 performance–related pay scheme. The maximum which could be awarded to Executive Directors and Divisional Directors is up to 50% of basic salary; other Executive Code Staff could be awarded up to 30% of basic salary.
- **Pensions** – as outlined in the 2013 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 related pay cannot be based upon Share Option Schemes or Share Incentives Plans. During the year the Remuneration Code was amended resulting in the Society being categorised as a 'Proportionality level 3' firm, meaning that the Society is not subject to all the requirements of the Code, specifically, the requirement to defer an element of performance related pay. Despite this, the Board has decided to continue with deferral as a requirement of the Scheme.

Section 10 – **Remuneration** (continued)

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 Directors 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 2013 and 2012.

Year End	Number of beneficiaries	Fixed remuneration £000	Variable remuneration £000	**Total remuneration £000**
31 March 2013	23	2,842	625	**3,467**
31 March 2012	26	2,892	548	**3,440**

Table 21: 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 and approved by the Board at the appropriate time before any payment is made.

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	Divisional Director, Credit Risk
Peter Jones	Head of Assets & Liabilities
Jacqui Randle	Head of Human Resources

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

Register Number 104877

Section 12 – **Glossary of Terms**

ARROW
This stands for Advanced Risk Response Operating Framework. It is the Regulator's 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 by the FSA (now PRA/FCA) Handbook.

BIPRU
The Prudential Sourcebook for banks, building societies and investment firms which forms part of the PRA/FCA 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.

FCA
Financial Conduct Authority. On 1 April 2013 the FCA replaced the FSA as the financial services industry regulator for conduct related matters.

FSA
Financial Services Authority. The financial services industry regulator in the UK up to 31 March 2013 when its responsibilities were transferred to the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

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 Regulator 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.

PRA
Prudential Regulation Authority. From 1st April 2013, the PRA replaced the FSA as the financial services industry regulator in the UK for prudential matters.

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 tradeable notes or commercial paper to wholesale investors who receive an income from the underlying assets. Some risk is retained on the balance sheet while the remaining risk is transferred to investors.

SREP
Supervisory Review and Evaluation Process. The Regulator's 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.

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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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