the West Brom

Pillar 3 Capital Disclosures (under CRD IV)

for the year ended 31 March 2015

the West Brom

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Section 1 – **Overview**

Background

The European Parliament and Council approved new capital reforms which implemented Basel III into Europe from 1 January 2014. Some of the changes have been implemented in the EU via a regulation which applies directly to the UK, whilst some of the provisions of Basel III have been implemented via a directive which required approval by national regulators, the Prudential Regulation Authority (PRA) in the UK. The new rules brought in by the EU regulations, the Capital Requirements Regulations (CRR) and the capital requirements directive (CRD) applied through the PRA, are referred to collectively as CRD IV.

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

The reforms implemented under CRD IV, bring in more stringent requirements for the eligibility of capital instruments. The focus is on having 'fully loss absorbing' capital referred to as Common Equity Tier 1. Tier 1 capital that is not deemed to be fully loss absorbing can be included within capital as Additional Tier 1 capital under CRD IV, but only under transitional arrangements. In addition to changes affecting the eligibility of capital instruments, CRD IV has brought in a number of deductions which are applied to capital. These deductions, including identification as to whether they are permanent or temporary, have been included in this report.

To promote the conservation of capital and the build-up of adequate buffers that can be drawn down in periods of stress, CRD IV implements the use of common equity capital buffers; a capital conservation buffer of 2.5% of RWAs to be built up from 2016 to 2019; a systemic risk buffer applied to institutions judged to be systemically important; Sectoral Capital Requirements (SCR); and a Countercyclical Capital Buffer (CCB) of up to an additional 2.5% of RWAs, the CCB is currently set at zero. The Financial Policy Committee published a Policy Statement in January 2014 explaining the circumstances in which the SCR and CCB may be applied. A PRA buffer will also be set, and will replace the current Pillar 2b requirement.

This report has been prepared under CRD IV in line with the current disclosure requirements as presented in Part Eight (Articles 431 to 455) of Regulation (EU) No 575/2013 of the European Parliament and of the Council. Future reports will be expanded to include further disclosures in compliance with the timeline disclosed within the regulation.

For all exposures and risk areas the Standardised Approach is adopted, which uses capital risk weighting percentages set by the PRA.

The tables within this report show the Society regulatory measures on both a transitional basis per the PRA policy statement PS7/13 and an end point basis to reflect current expectations of where CRD IV will become binding.

The responsibility for the regulation of the Society is split between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). In this document the PRA and FCA are described as 'the Regulator'. In addition to the assessment of capital requirement under CRD IV, 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 disclosure requirements of CRD IV and is issued on an annual basis in conjunction with 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 2015, unless otherwise stated.

Location and verification

These disclosures have been reviewed by the Risk Committee (RC) 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 Structured Entities 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); and
Kenrick No. 2 Plc. (a quasi-subsidiary).

Full details of the principal subsidiary undertakings are included in Note 15 to the Annual Report and Accounts for the year ended 31 March 2015. 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, Measure, Monitor	Control Functions	Management and Board Committees
3rd	Assurance	Internal Audit	Audit Committee

Table 1: Group's risk management framework

Governance structure

During the year risk governance was provided by a structure consisting of seven key risk management committees:

- **Risk Committee (RC)** – 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.
- **Executive Risk Committee (ERC)** – This Committee is chaired by the Chief Risk Officer and is responsible for providing the Executive and Risk Committee with an enterprise wide view of the risk profile of the Society including current and potential risks. The ERC is also accountable for driving the detailed implementation of the Society's Risk Management Framework.
- **Assets & Liabilities Committee (ALCo)** – This Committee is chaired by the Group Finance Director and is responsible for overseeing the assets and liabilities risk including the assessment of exposure to Treasury counterparty credit, market, liquidity and interest rate risk.
- **Residential Credit Committee (RCC)** – This Committee is chaired by the Chief Risk Officer and is responsible for monitoring the Society's residential lending activity and its exposure to credit risks in the retail loan books.
- **Commercial Loans Risk Committee (CLRC)** – This Committee is chaired by the Chief Risk Officer and is responsible for monitoring the Society's exposure to credit risks in the commercial loan book.
- **Operational and Conduct Risk Committee (OCRC)** – This Committee is chaired by the Chief Risk Officer and is responsible for the oversight of the management of operational and conduct risks arising from the Society'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 and capital requirements.

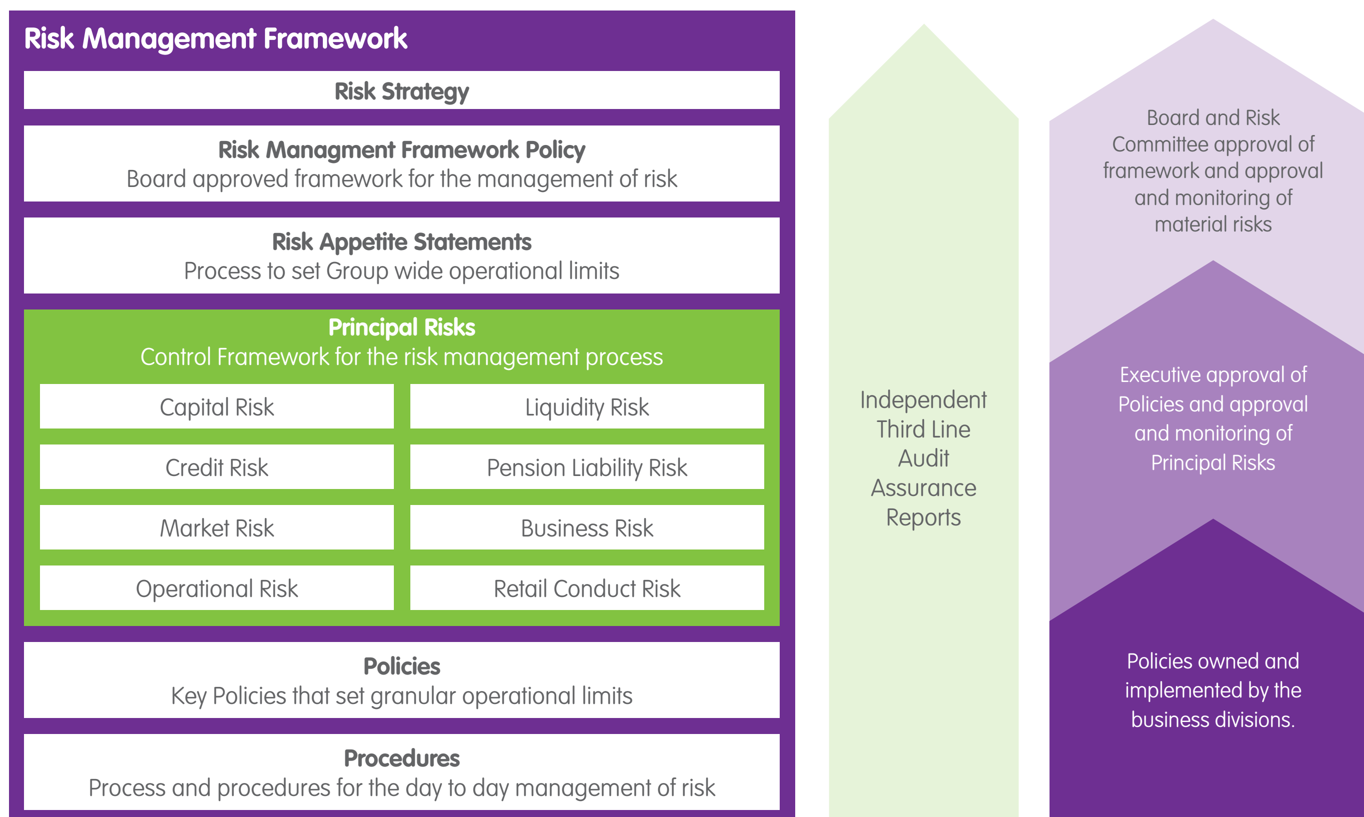
Since the year end the Chief Risk Officer's role and responsibilities have been replaced by a Chief Financial Risk Officer and the Group Secretary. In April, the Group Finance Director's job title was changed to Group Finance & Operations Director to more accurately reflect the breadth of his role.

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

Section 2 – **Risk Management Objectives and Policies** (continued)

Reporting on key risk measures

Reporting and escalation of key risk measures across the three lines of defence is critical in demonstrating that a risk management framework is designed and operating effectively. The risk management process consists of five key stages: Identify; Measure; Manage; Report; and Monitor. These stages are used to set clear standards for the consistent management of risk in each of the Principal Risk categories above. Reporting on the key risk measures occurs through the distribution of reports on the Principal Risks to Risk Committee and is shown in the chart below.



Risk strategy

The Group continues to focus on the needs of savers and borrowers as embodied in the Back to Basics strategy. As the Group now enters a period of growth a key part of the risk culture is to continue to put the interests of current and future members as a whole first. The Society has defined quantitative and qualitative risk parameters within which it is prepared to operate. These statements are designed to ensure the Group delivers acceptable returns, generates capital to support delivery of the business plan and support the exit of non-core business balancing speed with economic cost. Mortgages form a key part of the Group's strategy and new lending activity will focus on owner occupied properties to good quality borrowers who can demonstrate their ability to meet their mortgage payments.

The Group's performance against these limits is reviewed regularly by the Executive Risk Committee and the Risk Committee.

The Society uses stress testing as a key management tool to gain a better understanding of the resilience of the Group to external and internal shocks. These tests form a key part of the Group's capital and liquidity assessment and are designed to confirm that the Group has sufficient capital and liquid resources, support effective forward looking strategic plans and to ensure the Group stays within its risk appetite.

Section 3 – **Capital Resources**

Total available capital

The table below summarises the composition of regulatory capital for the Group as at 31 March 2015 and 31 March 2014, under both the transitional and full implementation basis of CRD IV. During the years ended 31 March 2015 and 31 March 2014, 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

	Notes	Transitional CRD IV rules 2015 £m	Full implementation of CRD IV 2015 £m	Transitional CRD IV rules 2014 £m	Full implementation of CRD IV 2014 £m
Common Equity Tier 1 capital					
General reserves		**233.1**	**233.1**	234.9	234.9
Revaluation reserve	1	**3.4**	**3.4**	3.4	3.4
Available for sale reserve (AFS)		**3.5**	**3.5**	4.4	4.4
Cash flow hedging reserve		**(0.1)**	**(0.1)**	0.2	0.2
Profit participating deferred shares (PPDS)	2	**177.1**	**177.1**	174.7	174.7
Common Equity Tier 1 prior to regulatory adjustments		**417.0**	**417.0**	417.6	417.6
Regulatory adjustments:					
Unrealised reserves on available for sale assets	3	**-**	**-**	(4.4)	-
Unrealised reserves on investment properties	3	**-**	**-**	(22.4)	-
Cash flow hedging reserve	4	**0.1**	**0.1**	(0.2)	(0.2)
Intangible assets and goodwill	5	**(7.0)**	**(7.0)**	(8.7)	(8.7)
Deferred tax asset relating to operating losses	6	**(15.7)**	**(15.7)**	(17.5)	(17.5)
Other deductions		**(4.1)**	**(4.1)**	(1.2)	(1.2)
Common Equity Tier 1 (CET 1) capital		**390.3**	**390.3**	363.2	390.0
Additional Tier 1 capital					
Permanent interest bearing shares (PIBS)	7	**74.9**	**74.9**	**74.9**	**74.9**
Regulatory adjustments:					
Amortisation of PIBS under transitional rules		**(22.5)**	**(74.9)**	**(15.0)**	**(74.9)**
Total Tier 1 capital		**442.7**	**390.3**	**423.1**	**390.0**
Tier 2 capital					
Collective provision		**16.6**	**16.6**	**15.7**	**15.7**
Other deductions		**(0.5)**	**(0.5)**	**(0.6)**	**(0.6)**
Total Tier 2 capital		**16.1**	**16.1**	**15.1**	**15.1**
Total capital		**458.8**	**406.4**	**438.2**	**405.1**

Table 2: Total available capital showing the Group position under both the transitional and full implementation basis of CRD IV

Tier 1 capital

Notes:

1. Revaluation reserve relates to the increase in value of the land and buildings owned by the Group and held for use by the business.
2. PPDS are a form of Common Equity 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. The PPDS are entitled to receive a distribution, at the discretion of the Society, of up to 25% of the Group's post-tax profits in the future (calculated prior to payment of the PPDS dividend). No such distribution may be made if the cumulative reserves are in deficit. Further details about PPDS are provided in Note 27 to the Annual Report and Accounts.

Section 3 – **Capital Resources** (continued)

Tier 1 capital (continued)

3. Under the transitional rules of CRD IV the available for sale reserve and reserves generated by the revaluation of investment properties could be included in capital from 1 January 2015.
4. The cash flow hedging reserve is not included in capital.
5. Intangible assets include capitalised software and goodwill. A full deduction is made from CET1 for intangible assets and goodwill.
6. Under the rules of CRD IV (transitional and on full implementation) deferred tax assets relating to previous operating losses are deducted from capital.
7. PIBS are unsecured deferred shares and in a winding up or dissolution of the Society, rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society but rank pari-passu with PPDS. The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society.

   With respect to future interest payments, as a condition of the PPDS, the Society has undertaken to pay an amount which, when annualised, represents the lower of: 6.15% of the outstanding principal amount of the PIBS and the dividend yield attributable to the PPDS with respect to the prior financial year ending 31 March whose payment is at the discretion of the Society. Further details about PIBS are provided in Note 26 to the Annual Report and Accounts.

   Under the transitional rules applicable to the current year, 30% (2013/14: 20%) of the value of PIBS is deducted from Tier 1 capital. Under the transitional rules the amortisation deduction is increased by 10% per annum every 1 January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS.

Tier 2 capital

- The Tier 2 capital comprises the Society's collective impairment provisions.

Reconciliation of regulatory capital

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

At 31 March

	Transitional CRD IV rules 2015 £m	**Full implementation of CRD IV 2015 £m**	Transitional CRD IV rules 2014 £m	Full implementation of CRD IV 2014 £m
Total equity attributable to members per the Statement of Financial Position	**491.9**	**491.9**	492.5	492.5
Adjustments for items not eligible for inclusion in Common Equity Tier 1 capital:				
Available for sale reserves	**-**	**-**	(4.4)	-
Unrealised reserves on investment properties	**-**	**-**	(22.4)	-
Cash flow hedging reserve	**0.1**	**0.1**	(0.2)	(0.2)
Intangible fixed assets and goodwill	**(7.0)**	**(7.0)**	(8.7)	(8.7)
Deferred tax asset relating to operating losses	**(15.7)**	**(15.7)**	(17.5)	(17.5)
Other deductions	**(4.1)**	**(4.1)**	(1.2)	(1.2)
Total adjustments to Common Equity Tier 1 capital	**(26.7)**	**(26.7)**	(54.4)	(27.6)
Adjustments to Additional Tier 1 capital: Amortisation of PIBS under transitional rules	**(22.5)**	**(74.9)**	(15.0)	(74.9)
Adjustments to Tier 2 capital:				
Add back: Collective impairment allowance	**16.6**	**16.6**	15.7	15.7
Other deductions	**(0.5)**	**(0.5)**	(0.6)	(0.6)
Total adjustments to Tier 2 capital	**16.1**	**16.1**	15.1	15.1
Regulatory capital	**458.8**	**406.4**	438.2	405.1

Table 3: Reconciliation of accounting capital to regulatory capital

Section 3 – **Capital Resources** (continued)

Regulatory capital flow statement

The table below shows the flow of regulatory capital and associated deductions in 2015.

At 31 March

	£m
Common Equity Tier 1 capital at 1 April 2014	**363.2**
Profit for the period	**9.2**
Other comprehensive income recognised directly in general reserves	**(9.8)**
Reductions in intangible fixed assets and goodwill	**1.7**
Recognition of reserves generated by the revaluation on investment properties	**22.4**
Reduction in the derecognition of the deferred tax asset relating to operating losses	**1.8**
Movement in available sale and cashflow reserves in the year	**1.2**
Inclusion of year-end available for sale reserve (not included in the prior year under transitional CRD IV rules)	**3.5**
Other movements	**(2.9)**
Common Equity Tier 1 capital at 31 March 2015	**390.3**
Additional Tier 1 capital at 1 April 2014	**59.9**
Amortisation of PIBS under transitional rules	**(7.5)**
Additional Tier 1 capital at 31 March 2015	**52.4**
Tier 2 capital at 1 April 2014	**15.1**
Movement in collective impairment allowance	**0.9**
Other movements	**0.1**
Tier 2 capital at 31 March 2015	**16.1**
Regulatory capital at 31 March 2015	**458.8**

Table 4: Regulatory capital flow statement under transitional CRD IV rules

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 regulatory capital adequacy of the Solo consolidation and the Consolidation Group are reported to the Regulator quarterly. In addition, Group capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the Group Capital Committee (GCC), Risk Committee (RC) 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 Individual 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. An allocation of capital is made for each of the following risks facing the Society:

- Credit risk from mortgages and other retail lending;
- Credit risk from treasury assets and derivatives;
- Concentration risk;
- Interest rate risk;
- Liquidity risk;
- Operational risk; and
- Pension obligation risk.

The output from the ICAAP financial model, including stress results, is reviewed in detail by the GCC prior to finalisation. The ICAAP is then reviewed by RC before submission to the Board for formal approval as part of the corporate planning process. The Society's Internal Audit function reviews the accuracy and consistency of the financial information included within the ICAAP document. The Society continues to be strongly capitalised and maintains its capital substantially above current regulatory requirements.

The ICAAP and ICA are used by the PRA in its Supervisory Review and Evaluation Process (SREP) through which it sets the Society's capital requirements, expressed as Individual Capital Guidance (ICG) which includes a capital planning buffer to ensure that the requirements may be met throughout the planning horizon.

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 table overleaf 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 2015. Details of the Standardised Approach to the calculation of regulatory requirements are contained in the PRA Handbook.

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

Minimum capital requirement – Pillar 1 (continued)

At 31 March

	2015 Average risk weights %	2015 £m	2014 Average risk weights %	2014 £m
Credit risk				
Residential mortgage loans (performing)	35.8	110.1	36.9	109.2
Commercial mortgage loans (performing)	97.2	24.1	98.6	30.4
Residential mortgage loans (past due)	102.1	11.6	100.3	11.7
Commercial mortgage loans (past due)	145.9	43.0	143.9	38.6
Liquidity (Treasury instruments and cash)	12.8	7.3	14.8	9.0
Other items	101.2	13.1	100.0	9.3
Total capital requirements – credit risk		209.2		208.2
Operational risk - Standardised Approach		6.7		6.4
Market risk		1.6		1.5
Total Pillar 1 capital requirement		217.5		216.1
Total capital available under transitional CRD IV rules		458.8		438.2
Excess of capital over minimum capital requirement under Pillar 1		241.3		222.1

Table 5: the Group's overall minimum Pillar 1 capital requirements under the Standardised Approach

Market risk above includes potential market value losses on OTC derivatives, known as Credit Valuation Adjustment (CVA). The CVA charge has been calculated based on the net contractual collateral derivative position of the Society.

Quality of capital

CRD IV brings more stringent requirements for the eligibility of capital instruments with a focus on Common Equity as the principal component of regulatory Tier 1 capital, and changes to the regulatory deductions from Common Equity. The regulations set a minimum of Tier 1 capital at 6% of Risk Weighted Assets (RWAs), of which Common Equity Tier 1 (CET1) is required to be a minimum of 4.5% of RWAs. The total of Tier 1 and Tier 2 capital must be a minimum of 8% of RWAs.

At 31 March

	Minimum %	Transitional CRD IV rules 2015 %	Full implementation of CRD IV rules 2015 %	Transitional CRD IV rules 2014 %	Full implementation of CRD IV rules 2014 %
Common Equity Tier 1 ratio	4.5	14.4	14.4	13.4	14.3
Tier 1 ratio	6.0	16.3	14.4	15.7	14.3
Total capital ratio	8.0	16.9	14.9	16.2	14.9

Table 6: Group capital ratios

CRD IV applies the principle that Tier 1 capital is available to absorb losses of the business on a 'going concern' basis. The Society's PIBS are not able to do this, and therefore will not be eligible as Tier 1 capital. These PIBS are 'grandfathered' and recognised as additional Tier 1 capital on an amortising basis over a further 7 years from 1 January 2015.

The Directors consider that the Society will continue to remain adequately capitalised.

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

Leverage

CRD IV introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and is intended as a 'backstop' measure. The calculation determines a ratio based on the relationship between Tier 1 capital and total balance sheet exposures. The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to collateral value of secured lending. The CRD IV requirement is for the minimum level of this ratio to be 3%. For the Society this measure does not come into effect until 2018.

At 31 March

	Transitional CRD IV rules 2015 £m	**Full implementation of CRD IV 2015 £m**	Transitional CRD IV rules 2014 £m	Full implementation of CRD IV 2014 £m
Total Tier 1 capital (per table 2)	**442.7**	**390.3**	423.1	390.0
Total assets per the Statement of Financial Position	**5,600.4**	**5,600.4**	5,650.5	5,650.5
Mortgage pipeline and committed facilities	**49.3**	**49.3**	30.8	30.8
Common Equity adjustments relating to assets	**(26.8)**	**(26.8)**	(54.5)	(27.6)
Netted derivative adjustment	**(22.3)**	**(22.3)**	(21.5)	(21.5)
Adjusted assets – based on Accounting Group	**5,600.6**	**5,600.6**	5,605.3	5,632.2
Structured entities with significant risk transfer (per Section 8)	**(125.5)**	**(125.5)**	(166.1)	(166.1)
Adjusted assets – based on regulatory group	**5,475.1**	**5,475.1**	5,439.2	5,466.1
Leverage ratio – based on Regulatory Group (%)	**8.1**	**7.1**	7.8	7.1

Table 7: Group leverage ratio

At 31 March 2015 the leverage ratio of the Society was significantly above the 3% regulatory minimum. Under the transitional CRD IV provisions it was at 8.1% (2013/14: 7.8%) based on the regulatory group. Upon full implementation this will reduce to 7.1% (2013/14: 7.1%). A modest reduction is expected during 2015/16 as the Society returns to net balance sheet growth by increasing the level of high quality prime new lending assets. The PIBS amortisation also has an adverse impact on the ratio. In considering a target for this ratio the Society recognises the importance of continuing to originate high quality assets even though this will have the effect of diluting the current Leverage ratio. The Society expects to continue to operate at a leverage ratio that is considerably in excess of the regulatory requirements including a buffer appropriate to the nature of its business model.

The Board's preferred measure is a Risk Weighted Asset measure and this shows a Common Equity Tier 1 ratio of 14.4%. Whilst no absolute target has been set for this measure, based on current methodology this ratio is expected to be maintained at, or close to current levels.

Risk Weighted Assets (RWA) flow statement

The following table shows the movement in credit risk RWAs over the year to 31 March 2015. Movements reflect changes in book size, book quality and model updates.

	Residential Mortgages £m	**Commercial Mortgages £m**	**Treasury £m**	**Other £m**	**Total £m**
Risk Weighted Assets at 1 April 2014	1,511.3	862.9	113.5	115.3	**2,603.0**
Measurement change	-	-	0.6	22.4	**23.0**
Portfolio quality (increase)/decrease	(42.0)	2.9	(16.1)	4.2	**(51.0)**
Portfolio size increase/(decrease)	52.2	(27.0)	(7.1)	22.1	**40.2**
Risk Weighted Assets at 31 March 2015	1,521.5	838.8	90.9	164.0	**2,615.2**

Table 8: Risk Weighted Assets flow statement

The reduction in commercial mortgages is a direct result of the Society's Back to Basics strategy. The Society capital position has been enhanced through a measured balance sheet contraction programme particularly focused on higher risk non-core assets. This is reflected in the overall book quality improvement which also includes the positive benefit of decreasing loan to value ratios due to house price increases and general improving performance of the underlying residential mortgages. Other assets have increased as a consequence of the re-recognition within Common Equity Tier 1 capital of the unrealised reserves on investment properties and available for sale treasury assets in line with CRD IV transition requirements.

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 increased 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. No new commercial, buy-to-let, sub-prime or self-certified lending 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 Chief Financial Risk Officer. The Credit Risk department is responsible for setting the credit risk management framework and associated limits. It also provides regular reports through the Executive Risk Committee to the Risk Committee, which is chaired by a Non-Executive Director and includes the Chief Executive, Group Finance & Operations Director, Chief Financial Risk Officer 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 monitored by the Treasury Middle Office team. On a daily basis, this team reviews 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 Group holds 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 2015. These include exposures to derivatives (after accounting offsets). They are therefore not directly comparable with the figures reported in Note 32 to the Annual Report and Accounts. 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	**2015 £m**	2014 £m	Average over year £m
Concentration by credit grading				
AAA to AA-		**549.7**	508.8	529.2
A+ to A-		**170.8**	224.7	197.7
Building societies		**8.6**	44.6	26.6
BBB+ to BBB-	1	**-**	17.5	8.8
BB+ to CCC	1	**5.0**	2.4	3.7
		734.1	798.0	766.0
Concentration by sector				
UK Government & Bank of England		**260.8**	136.3	198.6
Supranational financial institutions		**45.3**	127.4	86.3
Financial institutions		**338.5**	437.4	387.9
Mortgage backed securities		**89.5**	96.9	93.2
		734.1	798.0	766.0

Table 9: Analysis of the Group's regulatory credit risk exposures to Treasury counterparties

Notes:

1. These credit grading bands include investments 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.

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

Analysis of treasury credit risk exposures (continued)

At 31 March

	2015 £m	2014 £m	Average over year £m
Concentration by region			
UK	**552.0**	543.9	548.0
Europe (excluding UK)	**94.1**	96.3	95.2
North America	**13.1**	9.8	11.4
Australasia	**29.6**	20.6	25.1
Supranational financial institutions	**45.3**	127.4	86.3
	734.1	798.0	766.0

Table 9 (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.

Although not always directly comparable, an analysis of the maturity of the exposures for liquidity purposes can be found in Note 34 to the Annual Report and Accounts.

Residual breakdown of exposures by asset class

At 31 March 2015

	Notes	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £m	**Total £m**
UK Government & Bank of England		253.6	-	-	7.2	**260.8**
Supranational financial institutions		38.6	6.7	-	-	**45.3**
Financial institutions		191.6	146.9	-	-	**338.5**
Mortgage backed securities	1	-	-	89.5	-	**89.5**
		483.8	153.6	89.5	7.2	**734.1**

At 31 March 2014

	Notes	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £m	Total £m
UK Government & Bank of England		128.1	-	-	8.2	136.3
Supranational financial institutions		63.9	63.5	-	-	127.4
Financial institutions		305.2	126.7	5.5	-	437.4
Mortgage backed securities	1	12.0	60.2	24.7	-	96.9
		509.2	250.4	30.2	8.2	798.0

Table 10: 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)

Residual maturity breakdown of treasury exposures by asset class (continued)

The Group uses external credit ratings as part of its assessment of credit risk which are recognised by the Regulator as eligible External Credit Assessment Institutions (ECAI) for the purpose of calculating credit risk requirements under the Standardised Approach. Particular reference is made to the ratings published by Moody's and Fitch.

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 ratings	Moody's ratings	**2015 Exposure values £m**	2014 Exposure values £m
UK Government & Bank of England						
Credit quality step						
1	1	0	AA+	Aa1	**260.8**	136.3
Total					**260.8**	136.3
Supranational financial institutions						
Credit quality step						
1		0	AAA to AA	Aaa to Aa1	**45.3**	127.4
Total					**45.3**	127.4
Financial institutions						
Credit quality step						
1		20	AAA to AA-	Aaa to Aa3	**154.5**	154.3
2	2	50	A+ to A-	A1 to A3	**168.0**	249.6
3		50	BBB+ to BBB-	Ba1 to Ba3	**-**	0.3
Total					**322.5**	404.2
Securitisation positions						
Credit quality step						
1		20	AAA to AA-	Aaa to Aa3	**84.5**	86.4
2		50	A+ to A-	A1 to A3	**-**	0.5
3		100	BBB+ to BBB-	Baa1 to Baa3	**-**	7.6
4		350	BB+ to BB-	Ba1 to Ba3	**5.0**	2.4
Total					**89.5**	96.9

Table 11: Analysis of the liquidity exposures into credit quality steps based on the ratings as at 31 March 2015

Notes:

1. Includes cash in hand and Cash Ratio Deposit with the Bank of England
2. Includes rated building societies

Capital required under Pillar 1 for liquidity was £7.3m (2013/14: £9.0m)

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.

'Wrong-way' risk may occur when an exposure to a counterparty is adversely correlated with the credit quality of the counterparty. The Society has no 'wrong-way' risk exposure and no appetite for such exposures.

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

Concentration risk

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

	2015 £m	2014 £m
Residential	**22.9**	22.9
Healthcare & leisure	**177.8**	184.4
Industrial & warehouse	**14.2**	16.8
Office	**86.2**	103.3
Retail	**336.9**	361.8
Other	**19.8**	20.5
	657.8	709.7

Table 12: 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

	2015 £m	2014 £m
East Anglia	**14.2**	18.1
East Midlands	**39.4**	43.4
Greater London	**125.9**	142.6
North	**42.9**	41.3
North West	**202.4**	211.9
Scotland	**20.3**	18.3
South East	**87.9**	97.4
South West	**26.6**	27.7
Wales	**6.1**	8.4
West Midlands	**47.4**	51.6
Yorkshire	**44.7**	49.0
	657.8	709.7

Table 13: Analysis of the commercial loan portfolio by geographic spread

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

Concentration risk (continued)

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

At 31 March

	2015 £m	2014 £m
East Anglia	**99.9**	93.8
East Midlands	**344.6**	330.4
Greater London	**616.5**	648.8
Northern Ireland	**6.2**	6.6
North	**127.3**	115.6
North West	**419.7**	395.0
Scotland	**140.2**	150.1
South East	**707.4**	681.1
South West	**301.6**	293.8
Wales	**188.2**	190.0
West Midlands	**687.5**	681.0
Yorkshire	**259.5**	239.3
	3,898.6	3,825.5

Table 14: 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 2015.

At 31 March

	2015 £m	2014 £m
Up to 3 months	**312.0**	239.1
3-12 months	**79.9**	73.9
1-5 years	**604.6**	571.8
More than 5 years	**3,556.4**	3,629.6
	4,552.9	4,514.4

Table 15: Analysis of on-balance sheet loan exposures by residual maturity

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

Impairment of mortgage loans and advances

For a financial asset or a group of financial assets to be impaired or impairment losses incurred there needs to be objective evidence.

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 investment securities

At each year end date the Group assesses whether or not there is objective evidence that individual investment securities 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

	2015 £m	2014 £m
Loans neither past due nor impaired	**3,766.5**	3,645.3
Past due but not impaired		
Past due 1 to 3 months	**41.5**	64.2
Past due 3 to 6 months	**10.1**	13.9
Past due 6 to 12 months	**10.5**	8.3
Past due over 12 months	**3.9**	4.3
Impaired		
Past due 1 to 3 months	**35.1**	38.9
Past due 3 to 6 months	**13.2**	16.3
Past due 6 to 12 months	**9.5**	10.2
Past due over 12 months	**5.4**	12.0
Possessions	**2.9**	12.1
	3,898.6	3,825.5

Table 16: Analysis of impaired and past due loans for residential lending

Commercial lending – Payment due status

At 31 March

	2015 £m	2014 £m
Loans neither past due nor impaired	**448.9**	408.7
Not past due but impaired	**101.8**	164.0
Past due but not impaired		
Past due up to 3 months	**1.4**	-
Past due 3 to 6 months	**3.1**	-
Past due 6 to 12 months	**-**	9.2
Past due over 12 months	**30.5**	68.3
Impaired		
Past due up to 3 months	**4.0**	18.2
Past due 3 to 6 months	**-**	-
Past due 6 to 12 months	**-**	5.4
Past due over 12 months	**68.1**	35.9
	657.8	709.7

Table 17: 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. This analysis differs from that shown in Note 14 to the Annual Report and Accounts as it excludes amounts relating to Sandwell Commercial Finance No.1 Plc and Sandwell Commercial Finance No. 2 Plc where the credit risk associated with the securitised exposures is considered to have been transferred to third parties.

At 31 March 2015

	Retail residential lending		Commercial		Total		
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	**Total £m**
At 1 April 2014	20.3	7.2	38.0	8.0	58.3	15.2	**73.5**
Amounts written off	(4.3)	-	(5.7)	-	(10.0)	-	**(10.0)**
Charge/(Credit) for the year comprises:							
Provision/(Release) for loan impairment	1.2	1.5	(0.4)	(0.5)	0.8	1.0	**1.8**
Adjustments to provisions resulting from recoveries	(1.4)	-	(0.2)	-	(1.6)	-	**(1.6)**
Charge/(Credit) for the year	(0.2)	1.5	(0.6)	(0.5)	(0.8)	1.0	**0.2**
At 31 March 2015	15.8	8.7	31.7	7.5	47.5	16.2	**63.7**

Table 18: Analysis of movement during the year ended 31 March 2015 in impairment provisions

At 31 March 2014

	Retail residential lending		Commercial		Total		
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Total £m
At 1 April 2013	32.0	8.3	32.0	6.7	64.0	15.0	79.0
Amounts written off	(15.7)	-	(3.4)	-	(19.1)	-	(19.1)
Charge/(Credit) for the year comprises:							
Provision/(Release) for loan impairment	6.3	(1.1)	11.6	1.3	17.9	0.2	18.1
Adjustments to provisions resulting from recoveries	(2.3)	-	(2.2)	-	(4.5)	-	(4.5)
Charge/(Credit) for the year	4.0	(1.1)	9.4	1.3	13.4	0.2	13.6
At 31 March 2014	20.3	7.2	38.0	8.0	58.3	15.2	73.5

Table 19: Analysis of movement during the year ended 31 March 2014 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 £188.8m (2013/14: £189.9m).

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

Counterparty credit risk

Counterparty credit risk (CCR) is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. CCR differs from credit risk in that exposure at default is calculated. It arises where a counterparty default may lead to losses of an uncertain nature and this uncertainty is factored into the valuation of the Group's credit exposure using the mark to market method plus an add-on for potential future exposure.

Such transactions relate to contracts for financial derivative instruments, securities financing transactions and long settlement transactions. The Group uses derivative instruments to hedge its exposure to market risk, for example, interest rate. 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

	2015 £m	2014 £m
Interest rate contracts	**2.5**	5.8
Other contracts	**16.5**	27.9
Gross positive fair value of contracts	**19.0**	33.7
Cash collateral and netting benefits	**(19.0)**	(19.5)
Net derivatives credit exposure	**-**	14.2

Table 20: CCR for derivative contracts

Capital required under Pillar 1 for Market risk, including CVA totals £1.6m (2013/14: £1.5m). 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 Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements which typically provide for the exchange of collateral on a weekly basis to mitigate net mark to market credit exposure.

Whilst exchange traded derivatives have been cleared through central counterparties (CCPs) for many years, recent regulatory initiatives designed to reduce systemic risk in the banking system are directing increasing volumes of OTC derivatives to be cleared through CCPs. The Society now transacts all new qualifying swaps through Central Counterparties.

The net exposure value of derivatives at 31 March 2015 was £9.8m (2013/14: £27.9m) which includes an amount for potential future exposure.

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.

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, Treasury uses natural balance sheet hedging (e.g. matching 2 year fixed rate mortgages with 2 year fixed rate saving bonds) and derivative instruments. The use of derivatives is only permitted in accordance with the provisions of the Building Societies Act 1986, which focus on their use to reduce risk.

The maximum level of interest rate risk is governed by the Board approved Treasury 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 pre-tax interest rate risk exposures, to a +2% parallel shift, through the reporting period were as follows:

	As at 31 March 2015 £m	Average 2015 £m	High 2015 £m	Low 2015 £m
Market value	**(1.0)**	(1.7)	(2.6)	(0.8)
Net interest income	**(1.4)**	(2.6)	(2.5)	(1.4)

Table 21: Group Interest Rate risk exposures

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

Other market risk

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 33 to the Annual Report and Accounts for the year ended 31 March 2015.

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 Society resulting from inadequate or failed internal processes, systems or 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 Risk Committee.

The Risk Function 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 categorisation

Key operational risks are detailed below.

Risk category	Brief description
Business Continuity and Disaster Recovery Risk	The risk of failure to adequately assess, document, test and invoke business continuity procedures to safeguard Group assets and personnel, and to adequately maintain or re-commence all essential business operations following a business continuity event.
Customer Operations Risk	The risk of financial and non-financial impacts resulting from inadequate or failures in customer facing/support processes.
Change Risk	The risk of financial and non-financial impacts resulting from the inadequate design, management or implementation of change.
Product Risk	The risk of financial and non-financial impacts resulting from the inadequate design and launch of new products and services.
Financial Reporting Risk	Failure to interpret and comply with financial reporting and taxation requirements, including the misrepresentation of financial statements.
Model Risk	Risk of errors in the design, implementation or operation of models.
Technology Risk	The risk of financial and non-financial impacts resulting from failures in the development, delivery, maintenance and continuity of effective IT systems.
People Risk	The risk associated with the ability to recruit, develop, motivate and retain the required number and quality of people. People risk includes failure to comply with employment related requirements and inappropriate or unauthorised employee activity.
Information Risk	The risk that customer or Society information assets are managed or processed incorrectly or are not adequately protected. It includes inadequate data quality and failure to comply with Data Protection and Data Privacy requirements.
Legal & Regulatory Risk	The risk of regulatory censure, fines or legal action as a result of incorrect or inappropriate business conduct, e.g. failure to comply with legislative / regulatory requirements or Codes of Conduct.
Physical Assets, Safety and Security Risk	The risk that appropriate premises and other physical assets are not available to support business operational needs or do not conform to all relevant regulations, including Health and Safety requirements. It includes theft of/damage to the Society's assets and threats or actual harm to the Society's employees.
Supplier & Outsourcing Risk	The risk of adverse impacts arising from services with outsourced partners or third-party suppliers. It includes inappropriate supplier selection and management processes and failure on the part of the supplier to deliver the agreed services and/or comply with relevant laws, codes and ethical behaviours.
Financial Crime Risk	Risk of financial and non-financial impacts arising from internal and external fraud, or from a failure to comply with financial crime legislation.

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

Section 7 – **Operational Risk** (continued)

Operational risk management and mitigation

Business continuity & disaster recovery risk
The Group has developed business continuity plans to manage situations where there has been a denial of service for example. In addition the Group is testing further scenarios to ensure readiness for the migration to the new Head Office in 2015. Business Continuity is reported to the OCRC.

Customer operations risk
The Group puts the needs of members first. Retention is a key part of the development and execution of the product strategy and its performance is overseen through the Product Consideration Group.

Change risk
Change Programs are carefully managed to ensure that they meet requirements, can be delivered to agreed timetables and within budget with targeted reliance on external support. The Group has established a strong track record of successful delivery and targeted use of investment. All key projects have a dedicated steering committee and report up to the Executive Committee.

Product risk
Product development and distribution is managed in a number of first line committees including the Product Consideration Group and the Conduct Risk Group to ensure that products and advice meet new and existing members' needs. Oversight takes place at the Risk Committee (RC).

Financial reporting risk
The Group has dedicated, qualified resource for the management of financial reporting but also uses external specialists where this may provide additional added value, for instance in taxation matters. Financial reporting is externally audited with all output reviewed by the Audit Committee prior to release.

Model risk
The Group has policies, procedures and controls for the creation and control of models. Oversight is provided by the Model Validation Committee.

Technology risk
The Group has dedicated IT resource to implement the development, delivery, maintenance and continuity of effective IT systems. Oversight is provided by the Operational & Conduct Risk Committee (OCRC) and ultimately the Risk Committee.

People risk
The Group manages its people risk by operating a rigorous recruitment and selection process. All new colleagues are formally inducted into the organisation. To ensure that the vision and values are embedded from day one a member of the Executive, usually the Chief Executive attends each induction event.

The Group benchmarks its reward strategy with the market and complies with the regulatory standards in this respect. Policies and procedures are used by the Group to attract and retain high performing staff. The Group runs a regular survey to test employee engagement.

Information risk
The Group recognises the importance of information management and the need to protect its members. The Group is determined to ensure that its defences are robust and undertakes tests to ensure that internal controls are strong. Oversight of this risk takes place at the OCRC.

Legal and regulatory risk
Legal and Regulatory risk is managed by the Group Secretary under a separate reporting line to the Chief Executive. The Group has a small internal Legal team and selectively uses external firms where specific legal support is required.

Physical assets, safety and security risk
The Group undertakes a regular review of its insurance arrangements in the market place. To do this it uses the services of a broker to ensure good value for the Group's members and to ensure quality of cover. Oversight of the insurance arrangements is provided by the OCRC and RC.

Supplier and outsourcing risk
The Group manages this risk through a specialist procurement area with additional oversight provided by the Executive Committee for more material projects.

Financial crime risk
Financial Crime is managed by the Group Secretary who is the Group's approved Money Laundering and Compliance Officer and has an independent reporting line in to the Chief Executive. Financial Crime is a dedicated expertise to reflect the evolving threats to the Group and the rapid growth in technology. The Group has re-entered the mortgage market and the Group pays close attention to the source, likelihood and impact of Financial Crime. Oversight is provided by the OCRC.

Operational risk oversight and governance

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

Capital required under Pillar 1 for operational risk was £6.7m (2013/14: £6.4m)

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 Structured Entities. 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 Structured Entities 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 Structured Entities are included as subsidiaries in the consolidated financial statements. This is despite the fact that some Structured Entities 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 Structured Entity 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 Tier 1 capital (at 31 March 2015 this figure was £nil). Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc are not consolidated for capital purposes.

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. Hawthorn Finance Limited, Kenrick No 1 Plc and Kenrick No 2 Plc are treated in this manner.

Non-consolidated Structured Entities 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 Structured Entities have met their liabilities. The Group does not provide any liquidity facilities to the Structured Entities. WBCL provides administration and cash management services to the Structured Entities, for which it receives a fee. The start-up loan balances have been written down to £nil (2014: £nil) by the application of cumulative losses on the securitised loans within Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc.

Section 8 – **Securitisation** (continued)

The Structured Entities were originally set up as follows:

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

Sandwell Commercial Finance No. 2 Plc
In September 2005, WBCL sold £350m of commercial mortgage assets, at book value, to Sandwell Commercial Finance No. 2 Plc. Sandwell Commercial Finance No. 2 Plc issued notes to finance the purchase of 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 2015 are included in the table below. Gross assets include the gross value of the underlying mortgage loans together with cash, cash equivalents and other assets.

Securitisation Company	Type	Date of Securitisation	Gross assets securitised 2015 £m	External notes in issue 2015 £m	Underlying assets past due and impaired 2015 £m	Gross assets securitised 2014 £m	External notes in issue 2014 £m	Underlying assets past due and impaired 2014 £m
Sandwell Commercial No 1. Plc	Commercial mortgage securitisation	19 May 2004	**45.4**	**44.3**	**4.5**	62.7	60.9	4.4
Sandwell Commercial No 2. Plc	Commercial mortgage securitisation	23 September 2005	**92.4**	**77.5**	**-**	122.3	115.9	5.9
Total			**137.8**	**121.8**	**4.5**	185.0	176.8	10.3

Table 22: Assets subject to off balance sheet securitisation, notes in issue and impaired and past due assets as at 31 March 2015 and 31 March 2014.

The gross assets securitised in Table 22 are subject to impairment provisions of £6.1m (2013/14: £11.8m)

Consolidated Structured Entities for regulatory capital purposes

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

Hawthorn Finance Limited
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.

Kenrick No. 2 Plc
In May 2013, an Originator Trust was created over a £426.3m portfolio of prime residential mortgages, at book value. Kenrick No. 2 Plc acquired a 99% share in the Originator Trust and issued notes to finance the purchase. The Society retained a 1% share in the Originator Trust.

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

The balances of assets subject to securitisation, notes in issue and underlying balances past due and impaired as at 31 March 2015 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.

Section 8 – **Securitisation** (continued)

Consolidated Structured Entities for regulatory capital purposes (continued)

Securitisation Company and date of securitisation	Type	Gross assets securitised 2015 £m	Total notes in issue 2015 £m	Retained notes in issue 2015 £m	Underlying assets past due and impaired 2015 £m	Gross assets securitised 2014 £m	Total notes in issue 2014 £m	Retained notes in issue 2014 £m	Underlying assets past due and impaired 2014 £m
Hawthorn Finance Limited 22 July 2008	Residential mortgage securitisation	**882.5**	**848.1**	**848.1**	**1.7**	945.5	906.9	906.9	4.5
Kenrick No. 1 Plc 30 April 2012	Residential mortgage securitisation	**210.5**	**191.5**	**99.3**	**-**	260.7	242.1	121.5	-
Kenrick No. 2 Plc 28 May 2013	Residential mortgage securitisation	**333.1**	**305.5**	**40.6**	**0.6**	395.6	372.4	40.6	-
Total		**1,426.1**	**1,345.1**	**988.0**	**2.3**	1,601.8	1,521.4	1,069.0	4.5

Table 23: Assets subject to on balance sheet securitisation and notes in issue as at 31 March 2015

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.

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

The Group has invested in commercial mortgage backed securities issued by Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc. As at 31 March 2015 these notes had a book value of £7.4m (2013/14: £11.8m) and of these, £5.0m (2013/14: £10.6m) was risk weighted and £2.4m (2013/14: £1.2m) was deducted from available Tier 1 capital. The capital requirement for the risk weighted element was £1.4m (2013/14: £1.3m).

The valuation process of our investments in securitisation exposures primarily focuses on quotations from third parties and observed trade levels. This process did not change in 2014/15.

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 on demand, at short notice or after 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;
- Treasury is responsible for day-to-day management and maintenance of adequate liquid resources under delegated authority from ALCo; and
- The 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 members 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 and has an Operational and Conduct Risk Committee (OCRC) chaired by the Society's Chief Financial Risk Officer. During 2015/16, further activities are planned to strengthen the conduct culture throughout the organisation and further enhance the Society's conduct related management information.

Section 10 – **Asset encumbrance**

Templates A and C are as prescribed in EBA Guideline EBA/GL/2014/03 on disclosure of encumbered and unencumbered assets. The values disclosed are those as at 31 March 2015.

The carrying amount of encumbered assets in Template A row 010 column 010 is in respect of on balance sheet assets only and therefore excludes off balance sheet Funding for Lending Scheme (FLS) treasury bills. The amount shown in Template C row 010 column 030 includes both encumbered on and off balance sheet asstes and therefore includes off balance sheet FLS treasury bills.

Template A – Assets		**Carrying amount of encumbered assets £m**	**Fair value of encumbered assets £m**	**Carrying amount of unencumbered assets £m**	**Fair value of unencumbered assets £m**
		010	040	060	090
010	**Assets of the reporting institution**	1,039.4		4,435.5	
030	Equity instruments	-	-	-	-
040	Debt securities	1,039.4	1,040.6	177.9	180.4
120	Other assets	-		4,257.6	

Table 24: Assets

Template B – Collateral received

The EBA Guideline allows competent authorities to waive the requirement to disclose Template B – Collateral received, and in Supervisory Statement SS11/14 (CRD IV11; compliance with the European Banking Authority's Guidelines on the disclosure of encumbered and unencumbered assets) the PRA waived the Template B requirements subject to a firm meeting certain criteria. The Society meets the criteria and therefore Template B is not disclosed.

Template C – Encumbered assets/collateral received and associated liabilities		**Matching liabilities, contingent liabilities or securities lent £m**	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m**
		010	030
010	**Carrying amount of selected financial liabilities**	915.5	1,127.8

Table 25: Encumbered assets/collateral received and associated liabilities

Template D – Information on importance of encumbrance

The most material sources of encumbrance for the Society are secured funding via the Society's securitisation programmes which are supported by pledging mortgage assets. Further detail on these activities is set out in note 13 to the 2015 Annual Report & Accounts. The Society also pledges debt securities as collateral in sale and repurchase transactions - see note 11 to the 2015 Annual Report & Accounts.

An additional source of encumbrance is the collateralisation of derivatives liabilities. The Society also treats some cash and balances with the Bank of England, some loans and advances to credit institutions and some debt securities as encumbered even though there are no associated liabilities.

In common with many other financial institutions, the Society began to make increasing use of secured funding from the start of the financial crisis.

The over collateralisation in Template C predominantly represents over-collateralisation in respect of the externally issued securitisation programmes, of treasury bills drawn down under the FLS scheme and encumbered assets with no corresponding liabilities.

A general description of terms and conditions of the collateralisation agreements entered into for securing liabilities are available in the 2015 Annual Report & Accounts as follows; for sale and repurchase transactions of debt securities in note 11, for the securitisation programmes in note 13 and for derivatives in note 12.

Section 11 – **Remuneration and other corporate governance**

Governance arrangements

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435 are included in Section 2 of this report but are also supplemented by the disclosures included in the Directors' Report on Corporate Governance on pages 27 to 30 and Annual Business Statement on pages 104 and 105 within the 2015 Annual Report & Accounts. The 2015 Annual Report and Accounts are published on the Society's website (www.westbrom.co.uk).

Remuneration

The responsibilities and decision-making process for determining remuneration policy and membership of the management body, the link between pay and performance and the design and structure of remuneration, including the performance pay plans, have been disclosed in the 2015 Annual Report and Accounts on pages 34 to 39.

These disclosures meet the requirements of CRD IV and the PRA's Remuneration Code ('the Code'), for the Society's Directors and are not repeated here. The 2015 Annual Report and Accounts also refers to Code staff but does not include the details of remuneration required under CRD IV. This information is therefore set out below.

Code staff

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

The table below sets out the aggregate quantitative remuneration for Code Staff in relation to their services for the West Brom for the year ended 31 March 2015.

Year to 31 March

	Number of beneficiaries	Fixed remuneration £000	Variable remuneration (non-deferred) £000	Deferred variable pay from previous years £000	Total remuneration £000	*Outstanding deferred remuneration £000*
2015	23	2,448	371	193	3,012	*549*

Table 26: Aggregate quantitative remuneration of Code Staff

Remuneration for Code Staff

Component	Purpose	Operation	Performance Metrics
Basic Pay	Reflects level of responsibility.	Reviewed annually (or more frequently if required) linked to performance or market benchmarking	Influencing factors include: • Role and experience • Personal performance • Benchmarking comparisons • Salary increases awarded across the Society
Performance-Related Pay	Linked to the delivery of Society and personal objectives. Used to reward within the context of achieving the Society's goals and objectives.	Maximum annual opportunity for Executive Directors and Divisional Directors is 50% of basic salary. 40% of the Performance-Related Pay earned (maximum 20% of basic salary) is deferred over a three year period. Non-Executive Directors do not receive variable remuneration.	Based on a number of measures, including: • Financial • Customer • People • Risk • Strategy Reviewed by the Committee annually to ensure that the measures are appropriate.
Pension or Pension Allowance	A part of fixed remuneration intended to attract and retain individuals of sufficient calibre.	Executive Directors and Divisional Directors are invited to join the Society's stakeholder pension plan or, as an alternative, be provided with a cash allowance. Non-Executive Directors do not receive a pension or pension allowance.	Not applicable.
Benefits	To provide market competitive remuneration.	Benefits are provided in line with market practice for Executive Directors and Divisional Directors, which include a fully expensed car, private medical care and life assurance. Other benefits may be provided in individual circumstances. Non-Executive Directors do not receive any benefits.	

A proportion of variable remuneration earned by Code Staff in the current financial year 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.

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

Section 11 – Remuneration and other corporate governance (continued)

Severance payments

Year to 31 March

	Number of beneficiaries	Severance pay £000	Highest individual award £000
2015	5	699	194

Table 27: Aggregate severance pay of Code Staff

At the start of the year a restructuring took place which reduced the number of executive roles, and a number of individuals were made redundant. No Executive or Non-Executive Directors were affected by the redundancies. The severance payments reflect the contractual amounts payable on redundancy. The expenditure is a one-off and not expected to be repeated.

Section 12 – Adequacy of risk management controls

The Board confirms that the Risk Management Report contained in the Annual Report and Accounts for the year ended 31 March 2015 and the Pillar 3 disclosures above are a fair description of the principal risks and uncertainties that the Group faces. The Board aims to manage effectively all the risks that arise from its activities and believes that the risk management arrangements and controls put in place are adequate with regards to the Group's profile and strategy.

By order of the Board

Section 13 – Contacts

Should you have any queries please contact:

Manjit Hayre Chief Financial Risk Officer

Tom Lynch Divisional Director, Treasury and Finance

Jacqui Randle Divisional Director, Human Resources

Neil Noakes Group Secretary

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Section 14 – **Glossary**

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.

Basel III
In December 2010, the Basel Committee on Banking Supervision issued the Basel III rules text, which presents the details of the strengthened global regulatory standards on bank capital adequacy and liquidity. The requirements, embedded using CRD IV, became effective from 1 January 2014.

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

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

Couterparty Credit Risk (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.

Commercial lending
Loans secured on commercial assets. Commercial assets can include office buildings, industrial property, hotels, medical centres, shopping centres, farm land, buy to let and housing association properties.

Common Equity Tier 1 capital (CET1)
CET1 capital comprises internally generated capital from general reserves and other reserves less intangible assets, goodwill and other regulatory adjustments.

Common Equity Tier 1 capital ratio
Common Equity Tier 1 capital as a percentage of Risk Weighted Assets.

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
Individual Capital Assessment - the document produced by the Society 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 following a SREP exercise and a review of the Society ICA.

Individually/collectively assessed
At each Statement of Financial Position date the Group assesses whether or not there is objective evidence that individual financial assets are impaired. If no objective evidence of impairment exists for an individually assessed financial asset, it is included in a group of financial assets with similar credit risk characteristics and collective assessed for impairment. A collective provision is made against a group of financial assets where there is evidence that credit losses have been incurred, but not individually identified, at the reporting date.

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

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

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

LIBOR
London Inter-Bank Offered Rate.

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

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.

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

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 III Pillar 1 requirements for credit and operational risk.

Section 14 – **Glossary** (continued)

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 III Framework which sets out the regulatory minimum capital requirements for credit and operational risk.

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

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 Structured Entity in return for immediate cash payment. That entity raises the immediate cash payment by issuing debt securities in the form of tradeable notes or commercial paper to wholesale investors who receive an income from the underlying assets. Some risk is retained on the balance sheet while the remaining risk is transferred to investors.

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.

Braille, audio and large print versions of this document are available upon request. Please contact us on 0345 241 3784.

To find out more, visit your local branch, call us on the number above or visit our website

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