Pillar 3 Capital Disclosures

(under CRD IV)

for the year ended 31 March 2019

the West Brom

Contents

Contents (continued)

Tables

Tables (continued)

The Society has adopted the EU's regulatory transitional arrangements for International Financial Reporting Standard ('IFRS') 9 Financial instruments. A number of tables in this document report under this arrangement as follows:

a. Some figures for 2019 (indicated with "t") within this table have been prepared on an IFRS 9 transitional basis.

b. All figures within this table have been prepared on an IFRS 9 transitional basis.

All other tables report numbers on the basis of full adoption of IFRS 9.

Section 1 – **Executive summary**

Introduction

This document presents the consolidated Pillar 3 disclosures of the West Bromwich Building Society Group ('the Group' or 'the Society') as at 31 March 2019, providing details regarding our capital and risk management.

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

As a building society there are a number of risks which the Society is inherently exposed to. Holding capital is one way that the Society protects members from the impact of a risk event and this report summarises the Society's capital position.

Summary of key metrics

Capital and leverage ratios have remained well in excess of regulatory requirements with a Common Equity Tier 1 (CET1) ratio of 16.0% (2018: 14.8%) and a Leverage ratio of 7.0% (2018: 6.9%).

The CET1 ratio has increased, reflecting profit after tax for the period of £9.1 million, partially offset by other movements through the Statement of Comprehensive Income. The total capital ratio increased to 17.2% (2018: 16.7%).

CRD IV requires firms to calculate a non-risk-based leverage ratio, to supplement risk-based capital requirements. The Society manages the leverage ratio through regular monitoring and reporting, which forms part of its risk appetite.

The leverage ratio increased slightly to 7.0% (2018: 6.9%) as a result of increased profits and reduced assets more than offsetting the impact of the increase in pension deficit and the reduction in Permanent Interest Bearing Shares (PIBS) following the Liability Management Exercise (LME).

At 31 March 2019, the Society's Liquidity Coverage Ratio (LCR) was 195% (2018: 194%). The LCR exceeds the current UK regulatory minimum requirement of 100%.

Full details of the Society's overall financial position as at 31 March 2019, can be found in the 2019 Annual Report and Accounts. A summary of our key capital ratios, under CRD IV transitional rules, are shown below:

	2019 £m	2018 £m
Available capital		
Common Equity Tier 1 (CET 1)	**383.2**	374.2
Additional Tier 1	**8.9**	30.0
Total Tier 2 Capital	**21.6**	16.3
Total regulatory capital	**413.7**	420.5
	£m	£m
Total risk-weighted assets	**2,400.6**	2,523.1
	%	%
Risk-based capital ratios as a percentage of RWA		
Common Equity Tier 1 ratio	**16.0**	14.8
Tier 1 ratio	**16.3**	16.0
Total regulatory capital ratio	**17.2**	16.7
CRR leverage ratio	**£m**	£m
Total leverage ratio exposure measure	**5,586.3**	5,885.2
	%	%
CRR leverage ratio	**7.0**	6.9
Liquidity coverage ratio	**195**	194

Table 1: Executive summary KPIs

Section 1 – **Executive summary** (continued)

Liability Management Exercise

In April 2018, the Society completed a Liability Management Exercise (LME) to modernise its capital structure, through a market-based exercise in which investors agreed to exchange all of the Society's Profit Participating Deferred Shares (PPDS) and most of its PIBS for a combination of Core Capital Deferred Shares (CCDS), cash and (in the case of PPDS holders) Tier 2 subordinated notes (Tier 2 Notes). CCDS are instruments specifically designed for UK building societies to comply with CET1 capital eligibility criteria under the current prudential rules, whilst respecting their mutual status.

The transaction had the effect of increasing CET1 capital by £3.9m and total regulatory capital by £4.4m. Total remunerated regulatory capital (CCDS, PIBS, PPDS and Tier 2 Notes) reduced by £48m, more than offset by an increase in member reserves of £52m. The reduction in remunerated capital is largely a consequence of the removal of £66m of the Society's PIBS which, whilst part of member's interest, under CRD IV rules contributed reducing amounts to regulatory capital. At the time of restructuring, PIBS contributed only £30m to the Society's total regulatory capital, with this amount set to reduce to £nil in the year ending 31 March 2022. At this point the Society's total regulatory capital will be better off by £26m (before future distributions) as a consequence of the LME.

Further details of the LME are included in Section 5 and a brief summary of key terms of the CCDS and Tier 2 Notes are set out in Appendix 1.

Section 2 – **Overview**

Background

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

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

CRD IV also sets out disclosure requirements relevant to banks and building societies under CRR Part Eight (Articles 431 to 455). These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review and evaluation process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

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

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

Basis and frequency of disclosure

This document sets out the 2019 Pillar 3 disclosures for the Society. These disclosures have been prepared solely to give information on the basis of calculating Basel III requirements and on the management of risks faced by the Society in accordance with the rules laid out in CRR Part Eight.

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

All disclosures will be issued on an annual basis, as a minimum, and more frequently if appropriate. The disclosures have been published in conjunction with the publication date of the Society's 2019 Annual Report and Accounts and the information presented is based on those accounts unless otherwise stated. However, the required capital disclosures do differ in some instances from that reported under International Financial Reporting Standards (IFRS), as reflected in the Society's 2019 Annual Report and Accounts, as there is a difference in scope between the capital reporting and accounting reporting requirements as explained in the Scope section.

Non material, proprietary or confidential information

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

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

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

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 11 - Securitisation). Within this document references to Society are to the regulatory group unless specific reference is made to the contrary.

The principal subsidiaries included for capital purposes 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);
Kenrick No. 2 Plc. (a quasi-subsidiary); and
Kenrick No. 3 Plc. (a quasi-subsidiary).

Full details of the principal subsidiary undertakings are included in Note 15, Investments, to the 2019 Annual Report and Accounts.

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

Section 2 – **Overview** (continued)

Location and verification

These disclosures have been reviewed by the Audit Committee (AC) on behalf of the Society's Board and are published on the West Bromwich Building Society website (www.westbrom.co.uk). These disclosures have not been, and are not required to be, subject to independent external audit, and do not constitute any part of the Society's financial statements; however, some of the information within the disclosures also appears in the Society's audited 2019 Annual Report and Accounts.

European Banking Authority Guidelines on Pillar 3 disclosures

The Society is not a Globally or Other Systemically Important Institution and taking account of its simple business model and size, has chosen not to reflect the 2016 and 2017 EBA Guidelines for such institutions in its 2019 disclosures other than abbreviated disclosures of the Liquidity Coverage Ratio (LCR) in Section 9 – Liquidity risk.

Regulatory developments

The Basel Committee on Banking Supervision released 'Basel III: Finalising post-crisis reforms to the Basel III framework' in December 2017, with these revised standards taking effect from January 2022, and phased in over five years. The reforms include the following elements; revisions to the Standardised and Internal Ratings Based approach for credit risk, revisions to the Credit Valuation Adjustment (CVA) framework, a revised Standardised Approach for operational risk, revisions to the leverage ratio and leverage. These will materially impact the Society, and although initial implementation is over two years away, the Society is taking them into account within its future plans.

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

IFRS 9 'Financial Instruments'
IFRS 9 'Financial Instruments' has been adopted by the Group with effect from 1 April 2018. The new standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces significant changes to the classification and measurement of financial instruments, including a new impairment approach. As permitted under IFRS 9, comparative figures will not be restated. The main changes are summarised below:

- Classification and measurement – the standard introduces new categories for the classification and measurement of financial assets. The classification of assets requires an assessment of the Group's business model for managing the assets and of the contractual cash flow characteristics of the assets. This has resulted in some changes to the classification of assets for the Group but has not had a material impact on carrying values in the Statement of Financial Position at 1 April 2018.
- Impairment – under IAS 39, impairment loss provisions were calculated on an incurred loss model, whereby provisions were recognised once an impairment 'trigger' event had been identified. IFRS 9 changes this model to an expected credit loss (ECL) model which incorporates forward looking estimates such that when a financial asset is first recognised, an impairment loss provision is made for the expected losses from defaults over the following 12 months (12 month ECL). If, at a later time, the Group determines that there has been a significant increase in the credit risk of the asset, this impairment loss is increased to cover the expected losses over the whole life of the asset (lifetime ECL). This change in the calculation of impairment losses results in earlier recognition of credit losses in the financial statements but does not change the amount of the eventual loss suffered. This change has resulted in an increase in the Group's provisions for impairment losses.
- Hedge accounting – IFRS 9 alters the rules for the application of hedge accounting, although the rules in relation to portfolio fair value hedges are still under development. The Group has made the accounting policy choice, allowed under IFRS 9, to continue applying IAS 39 for all hedge relationships until such time as the new macro hedging rules (carved out as a separate IASB project) are finalised.

The Group has elected to apply the IFRS 9 transitional arrangements to capital calculations from 1 April 2018, as permitted by EU Regulation (2017/2395). The transitional arrangements reduce the impact on capital resources of increased ECL provisions, on a scaling basis, over the period to 31 March 2023. In 2019 5% of the increase in expected credit loss provisions is deducted from capital resources rising to 75% in 2023 and 100% in 2024.

The adoption of IFRS 9 and related transitional arrangements resulted in a net reduction in equity attributable to members at 1 April 2019 of £2.1 million and reduced the CET1 capital ratio by 0.09%. More detail on the impact of IFRS 9 on capital is set out in Section 6 of this document, additional detail of the impact on the Society can be found in the 2019 Annual Report and Accounts, Note 1, Accounting policies on pages 68 to 79 and in Note 43, Impact of adopting IFRS 9 'Financial Instruments'.

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

Overview

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

Categorisation

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

The main risks we manage are:

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

Risk management framework

The Society's activities are governed by its constitution, principles and values. The Board have also agreed a set of Risk Appetite Statements which describe the Board's risk appetite in terms of the principal risk categories indicated above. Further information can be found in the Risk Management Report of the 2019 Annual Report and Accounts on pages 25 to 31.

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

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

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

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

Governance structure

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

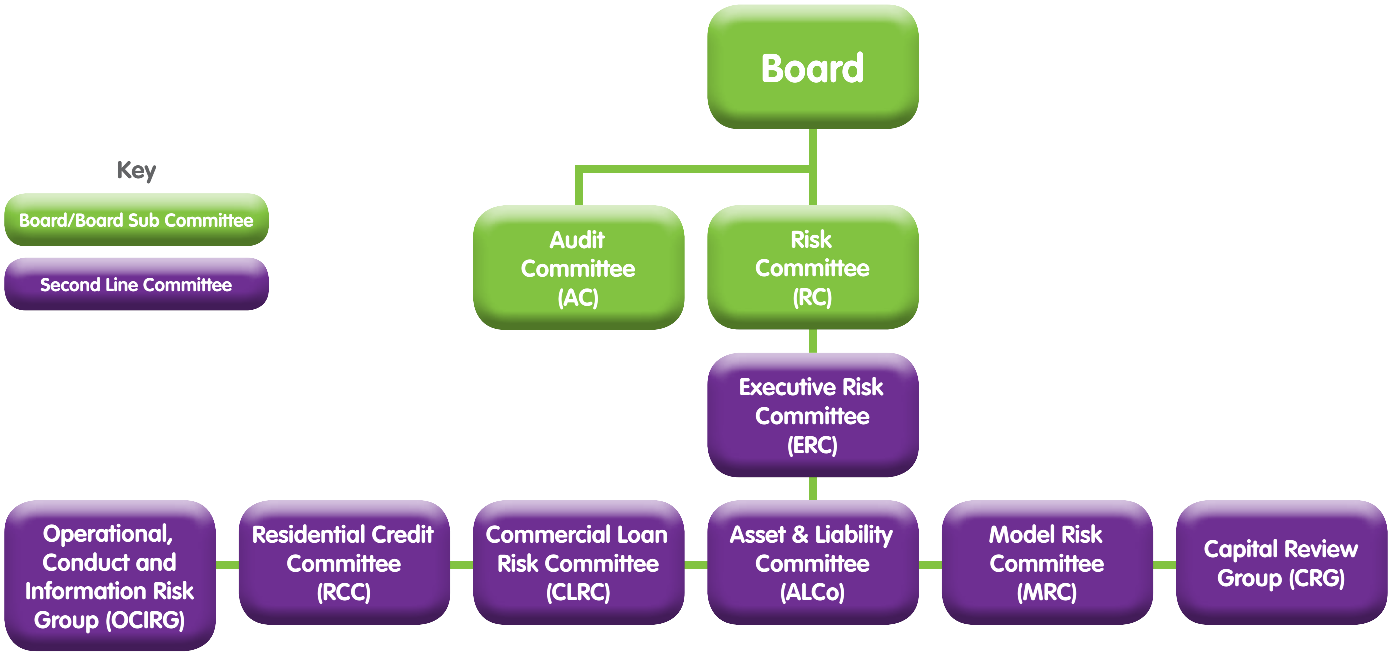
- **Risk Committee (RC)** – This committee, chaired by a Non-Executive Director and comprising of all Non-Executive Directors except the Chairman, is responsible for the oversight and management of the principal and key strategic risks identified by the Board.
- **Executive Risk Committee (ERC)** – This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

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

Governance structure (continued)

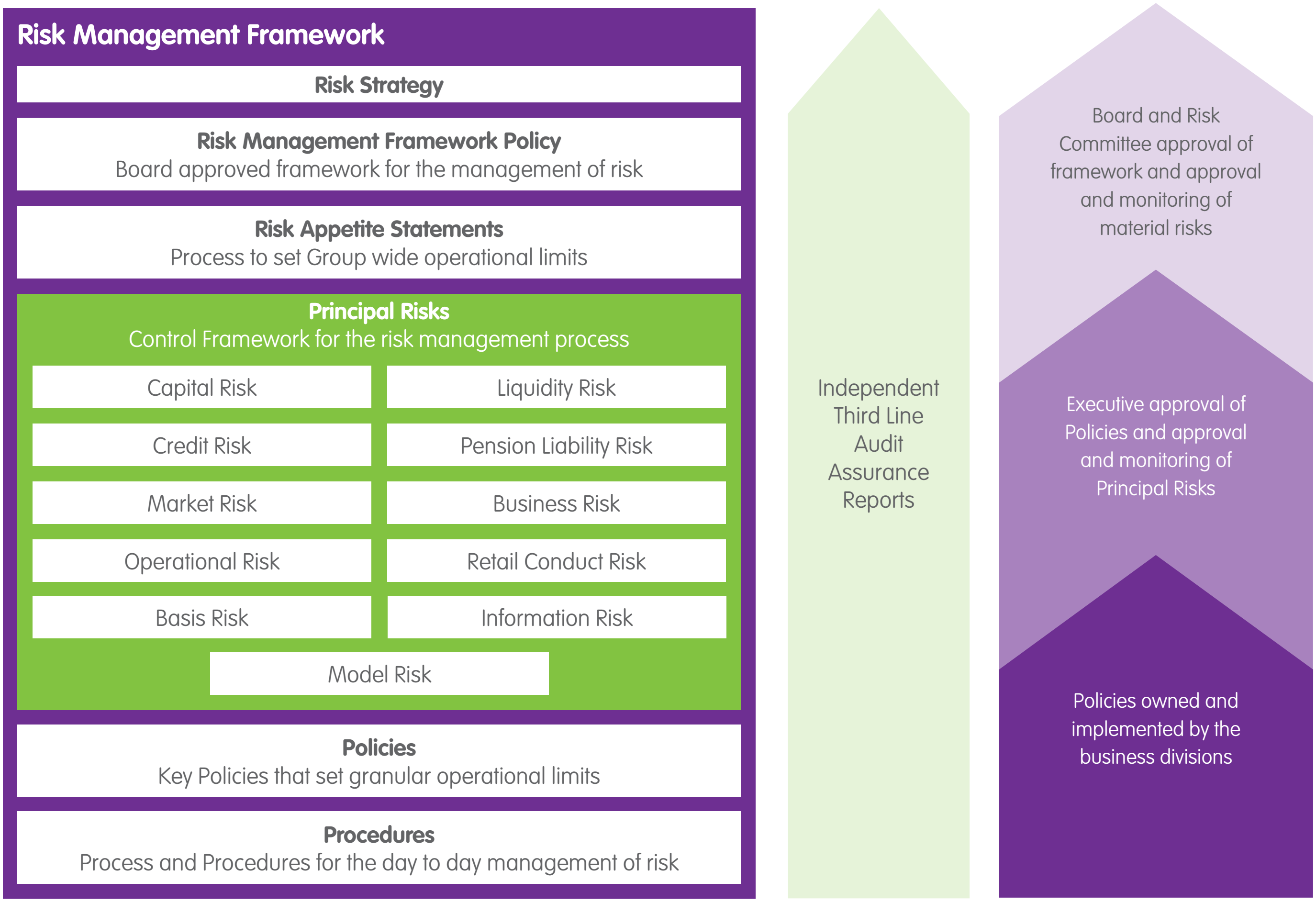
- **Operational, Conduct & Information Risk Group (OCIRG)** – This Group is chaired by the Chief Risk Officer and is responsible for the oversight of the management of operational and retail conduct risks arising from the Society's business activities. It also maintains oversight and governance of Information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

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



Reporting on key risk measures

Reporting of key risk measures and escalation of issues across the 'Three Lines of Defence' is critical in demonstrating that a risk management framework is designed and operating effectively. The risk management process consists of five key stages: Identify; Measure; Manage; Report; and Monitor. These stages are used to set clear standards for the consistent management of risk in each of the Principal Risk categories on page 9. Reporting on the key risk measures occurs through the distribution of reports on the Principal Risks to RC as shown in the chart below.



Risk strategy

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

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

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

ERC ensures that a co-ordinated management approach is taken by the first line across all risk categories. RC and AC continue to provide oversight and advice on risk management controls to the Board. The RC met 7 times and the AC met 5 times within the financial year ending 31 March 2019. Further information about the Society's governance structure, including the Board and AC, is provided within the 2019 Annual Report and Accounts.

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

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

Section 4 – **Capital resources**

Total available capital

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

The strength of the Society's capital position meant that the Society comfortably met all externally imposed capital requirements and the minimum leverage ratio throughout the financial year ended 31 March 2019, based on both the CRD IV transitional rules and the full implementation basis rules. Certain Additional Tier 1 instruments previously eligible as capital do not qualify under CRR and transitional rules, which reduce the element included in the capital computations over a 10 year period. This applies to the Society's PIBS.

The table below summarises the composition of regulatory capital for the Society, under both the transitional and full implementation basis of CRD IV. During the years ended 31 March 2019 and 31 March 2018, the individual entities within the Society's capital group and the Society itself complied with all externally imposed capital requirements.

At 31 March

	Transitional CRD IV rules 2019 £m	**Full implementation of CRD IV 2019 £m**	Transitional CRD IV rules 2018 £m	Full implementation of CRD IV 2018 £m
Common Equity Tier 1 capital				
General reserves	**247.1**	**247.1**	215.8	215.8
Revaluation reserve	**3.3**	**3.3**	3.4	3.4
Available for sale reserve (AFS)	**-**	**-**	0.8	0.8
Fair value reserve	**(0.1)**	**(0.1)**	-	-
Core capital deferred shares (CCDS)	**127.0**	**127.0**	-	-
Profit participating deferred shares (PPDS)	**-**	**-**	175.0	175.0
Common Equity Tier 1 prior to regulatory adjustments	**377.3**	**377.3**	395.0	395.0
Regulatory adjustments:				
IFRS 9 Transitional relief add-back	**31.4**	**-**	-	-
Intangible assets and goodwill	**(16.5)**	**(16.5)**	(15.3)	(15.3)
Deferred tax asset relating to operating losses	**(13.1)**	**(13.1)**	(8.7)	(8.7)
Other adjustments	**4.1**	**4.1**	3.2	3.2
Common Equity Tier 1 (CET 1) capital	**383.2**	**351.8**	374.2	374.2
Additional Tier 1 capital				
Permanent interest bearing shares (PIBS)	**8.9**	**8.9**	75.0	75.0
Regulatory adjustments:				
Amortisation of PIBS under transitional rules	**-**	**(8.9)**	(45.0)	(75.0)
Total Tier 1 capital	**392.1**	**351.8**	404.2	374.2
Tier 2 capital				
Tier 2 Subordinated loan Instruments	**21.6**	**21.6**	-	-
Collective provision	**0.0**	**0.0**	16.3	16.3
Total Tier 2 capital	**21.6**	**21.6**	16.3	16.3
Total capital	**413.7**	**373.4**	420.5	390.5

Table 2: Total available capital position of the Society's regulatory capital group under both the transitional and full implementation basis of CRD IV.

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

Tier 1 Capital

Tier 1 capital is the primary funding source of the Society. It comprises the CET1 and the Additional Tier 1 (AT1) capital.

Common Equity Tier 1 Capital

Common Equity Tier 1 (CET1) capital comprises the general reserve, other reserve, revaluation reserve, fair value reserve and CCDS. Prior to the LME (see Section 5) the PPDS formed part of the Society's CET1 base.

The CCDS, which are a form of CET1 capital for building societies, are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society. The CCDS were acquired on 12 April 2018 as part of the LME; further details are included in Section 5. The key features of the CCDS are set out in Appendix 1.

At 31 March 2019 there were CET1 regulatory deductions for intangible assets and deferred tax assets relating to operating losses. The deduction for intangible assets was £16.5m (2018: £15.3m) and £13.1m (2018: £8.7m) for deferred tax assets relating to operating losses. An additional adjustment of £4.1m (2018: £3.2m) was applied comprising of deductions for additional valuation adjustments of £0.3m (2018: £0.4m) and low quality mortgage backed security notes of £0.2m (2018: £0.7m) together with an adjustment to add back the accumulated loss within the risk remote securitisations that was deducted from the Society's accounting reserves of £4.6m (2018: £4.3m).

Following the implementation of IFRS 9, transitional relief is available to phase in the impact on CET 1 of the additional credit risk provisions over a 5 year period. In the first year of implementation, the transitional relief offsets 95% of the impact and as at 31 March 2019 this amounted to £31.4m.

Further details on IFRS 9 Transitional Arrangements can be found in Section 5.

Additional Tier 1 Capital

Additional Tier 1 (AT1) capital comprises PIBS. PIBS are unsecured deferred shares and in a winding up or dissolution of the Society, rank behind the claims of all depositors, creditors and investing members of the Society.

The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society.

As part of the LME, the majority of the PIBS were exchanged for CCDS and/or cash on 12 April 2018; further details are included in Section 5. The key features of the PIBS are set out in Appendix 1.

Under the transitional rules applicable to the current year the value of PIBS is capped at the lower of the value of the PIBS in issue at the year end and the value of the PIBS in issue at 31 December 2012 amortised by 70% (2018: 60%). For the current year there was no amortisation applied as the value of the remaining PIBS is below the amortised value of the PIBS in issue at 31 December 2012.

The amortisation applied is increased by 10% per annum every 1 January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS. The Society has no other qualifying AT1 instruments.

The key features of the PIBS are set out in Appendix 1.

Tier 2 Capital

At 31 March 2019, Tier 2 capital comprises the Society's qualifying Tier 2 Notes together with any collective impairment provision.

The Tier 2 Notes were acquired as part of the LME; further details are included in Section 5. The key features of the Tier 2 Notes are set out in Appendix 1.

Under regulatory rules for Total Capital Requirements (TCR), at least 56% of capital must be CET1, no more than 44% should be AT1 and no more than 25% Tier 2 capital. Given the magnitude of the components of CET1, AT1 and Tier 2 capital, the Society was at all times comfortably within these limits.

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

Reconciliation of regulatory capital

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

At 31 March

	Transitional CRD IV rules 2019 £m	**Full implementation of CRD IV 2019 £m**	Transitional CRD IV rules 2018 £m	Full implementation of CRD IV 2018 £m
Total equity attributable to members per the Statement of Financial Position	**386.2**	**386.2**	470.0	470.0
Adjustments to Common Equity Tier 1 capital:				
IFRS 9 transitional addback	**31.4**	**-**	-	-
Intangible fixed assets and goodwill	**(16.5)**	**(16.5)**	(15.3)	(15.3)
Deferred tax asset relating to operating losses	**(13.1)**	**(13.1)**	(8.7)	(8.7)
Other adjustments	**4.1**	**4.1**	3.2	3.2
Total adjustments to Common Equity Tier 1 capital	**5.9**	**(25.5)**	(20.8)	(20.8)
Adjustments to Additional Tier 1 capital: Amortisation of PIBS under transitional rules	**-**	**(8.9)**	(45.0)	(75.0)
Adjustments for Tier 2 capital:				
Add: Tier 2 Subordinated instruments issued	**21.6**	**21.6**	-	-
Add back: Collective impairment allowance	**0.0**	**0.0**	16.3	16.3
Total adjustments for Tier 2 capital	**21.6**	**21.6**	16.3	16.3
Regulatory capital	**413.7**	**373.4**	420.5	390.5

Table 3: Reconciliation of accounting capital to regulatory capital.

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

Regulatory capital flow statement

The table below shows the flow of regulatory capital and associated deductions in the year to 31 March 2019.

The statement presents transitional rules data in relation to capital flow on the basis of the applicable regulatory rules in force at the period end.

At 31 March

	2019 £m
Common Equity Tier 1 capital at 1 April 2018	**374.2**
Profit for the period	**9.1**
Other comprehensive income recognised directly in general reserves	**(1.9)**
Increase in general reserves from capital restucturing	**51.9**
Decrease in reserves due to IFRS 9 implementation net of tax	**(27.8)**
Deferred tax related to IFRS9 implentation (ineligible as CET1)	**(5.8)**
Increase in intangible fixed assets and goodwill	**(1.2)**
Reduction to the derecognition of the deferred tax asset relating to operating losses	**1.4**
Movement in available for sale / fair value reserve	**(0.9)**
Movement in revaluation reserve	**(0.1)**
Core capital deferred shares acquired	**127.0**
Profit participating deferred shares disposed	**(175.0)**
Transitional IFRS 9 addback to CET 1	**31.4**
Other movements	**0.9**
Common Equity Tier 1 capital at 31 March 2019	**383.2**
Additional Tier 1 capital at 1 April 2018	**30.0**
Disposal of PIBS	**(66.1)**
Reverse amortisation of PIBS under transitional rules	**45.0**
Additional Tier 1 capital at 31 March 2019	**8.9**
Tier 2 capital at 1 April 2018	**16.3**
Pillar 2 subordinated instruments acquired	**21.6**
Movement in collective impairment allowance	**(16.3)**
Tier 2 capital at 31 March 2019	**21.6**
Regulatory capital at 31 March 2019	**413.7**

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

The reduction in equity attributable to members is due to the application of IFRS 9 (see Section 5) and the LME (see Section 5) and the Statements of Changes in Members' Interests and Equity within the 2019 Annual Report and Accounts.

Section 5 – **Capital adequacy**

Capital risk

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

Capital management and reporting

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

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

The regulatory capital adequacy of the Society Solo consolidation and the Consolidation Group, which are materially the same, are reported to the Regulator quarterly. The Society's capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the CRG, ERC, RC and the Board.

Pillar 2

Pillar 2 covers risks not fully covered or those risks outside the scope of Pillar 1 under Pillar 2A; and risks to which the Society may become exposed over a planning horizon (e.g. due to changes in the economic environment) referred to as Pillar 2B.

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

Internal Capital Adequacy Assessment Process (ICAAP)

On an annual basis the Society conducts an ICAAP. This is used to assess the Society's capital adequacy and determine the levels of capital required going forward to support the current and future risks in the business. This analysis is collated through the ICAAP and is approved by the Board. The ICAAP incorporates expected future capital requirements 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;
- Credit risk from treasury assets and derivatives;
- Concentration risk (which can exacerbate credit exposures);
- Market risk;
- Residential property holding risk;
- Interest rate risk;
- Basis risk;
- Operational risk; and
- Pension liability risk.

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

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

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

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

Pillar 2A capital

The Society received a TCR from the PRA of during the year of 9.8% of risk weighted assets. The equivalent figure at 31 March 2018 was the Pillar 1 and Pillar 2A capital requirement based on the previous ICG of 11.3% of risk weighted assets.

The Society continues to comfortably meet this requirement using CET1 capital alone.

Pillar 2B – CRD IV capital buffers

To promote the conservation of capital and the build-up of adequate buffers, calculated as a percentage of Risk Weighted Assets (RWAs) that can be drawn down in periods of stress, CRD IV requires the holding of supplementary CET1 capital buffers from 1 January 2016, known as Pillar 2B. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB). To the extent that the PRA considers these CRD IV buffers to be insufficient a PRA Buffer will be added to the Society's capital requirement although the PRA has stated that it believes that for most firms, most of the time, the CRD IV buffers are likely to be sufficient once fully phased in.

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

CRD IV risk adjusted capital requirements

PRA Buffer (Firm specific)	Applicable from Jan 2016. Firm specific buffer assigned by the PRA if CCoB and CCyB buffers are considered to be insufficient.
Capital Conservation Buffer (CCoB)	Phased in from 2016 - 2019. Used to absorb losses in periods of economic and financial stress. 2.50% from 1 January 2019 (1 January 2018: 1.875%).
Systemic Risk Buffer (SRB)	Full application from 1 January 2019 to 3%. Set at 0% for institutions including the Society with total assets less than £175 billion.
Macro-prudential Countercyclical Buffer (CCyB)	Set by the Bank of England's Financial Policy Committee (FPC) within a range of 0% and 2.5%. This buffer is to ensure financial institutions build up capital in favourable conditions, which can be utilised in economic downturns. At 31 March 2019 set at 1% (31 March 2018: 0%).
Pillar 2A	Firm specific calculation for risks not fully captured under Pillar 1.
Pillar 1	Firm specific calculation based upon individual firms risk weighted assets, a minimum of 8%.

100% of this requirement to be met by Common Equity Tier 1.

A minimum of 56% of this requirement to be met by Common Equity Tier 1. A maximum of 25% may be met by Tier 2 capital.

Minimum capital requirement - Pillar 1

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

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

The credit risk requirement has been calculated under the Standardised Approach (expressed as 8% of the Risk Weighted Assets (RWAs) for each of the applicable standardised credit risk exposure classes) at 31 March 2019. Details of the Standardised Approach to the calculation of regulatory requirements are contained in CRD IV.

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

Minimum capital requirement – Pillar 1 (continued)

At 31 March

	2019 Average risk weights %	**2019 Capital required £m**	2018 Average risk weights %	2018 Capital required £m
Credit risk				
Residential loans (performing)	**35.7**	**123.0**	35.5	123.4
Commercial loans (performing)	**96.8**	**14.9**	99.4	12.3
Residential loans (past due)	**100.4**	**5.8**	101.8	6.2
Commercial loans (past due)	**143.9**	**22.0**	144.2	29.5
Liquidity (treasury instruments and cash)	**8.1**	**3.7**	8.7	5.1
Other items	**99.7**	**14.1**	99.2	14.3
Total Pillar 1 credit risk capital requirement		**183.5**		190.8
Operational risk - Standardised Approach		**7.7**		8.1
Market and counterparty credit risk *		**0.9**		2.9
Total Pillar 1 capital requirement		**192.1**		201.8
Total Capital available		**413.7**		420.5
Excess of capital over minimum capital requirement under Pillar 1		**221.6**		218.7

Table 5: The Society's overall minimum Pillar 1 capital requirements under the Standardised Approach.

*Market and counterparty credit risk includes potential market value losses on 'over the counter' derivatives, known as Credit Valuation Adjustment (CVA). The CVA charge has been calculated based on the net contractual collateral derivative position of the Society and this includes potential future credit exposures relating to derivatives and haircuts on Secured Financing Transactions (Repos).

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

Impact of IFRS 9 transitional arrangements

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

The table below shows the impact of IFRS 9 transitional arrangements as at 31 March 2019.

Ref*		Footnotes	2019	2018[1]
	Available capital (£m)	2		
1	Common Equity Tier 1 (CET 1)	†	**383.2**	374.2
2	CET1 capital as if IFRS 9 transitional arrangements had not been applied		**351.8**	N/A
3	Tier 1	†	**392.1**	404.2
4	Tier 1 capital as if IFRS 9 transitional arrangements had not been applied		**360.7**	N/A
5	Total regulatory capital	†	**413.7**	420.5
6	Total capital as if IFRS 9 transitional arrangements had not been applied		**382.3**	N/A
	Total risk-weighted assets (RWAs') (£m)			
7	Total RWAs	†	**2,400.6**	2,523.1
8	Total RWAs as if IFRS 9 transitional arrangements had not been applied		**2,321.7**	N/A
	Capital ratios (%)	2		
9	Common Equity Tier 1 ratio	†	**16.0**	14.8
10	Common Equity Tier 1 ratio as if IFRS 9 transitional arrangements had not been applied		**15.2**	N/A
11	Tier 1 ratio	†	**16.3**	16.0
12	Tier 1 ratio as if IFRS 9 transitional arrangements had not been applied		**15.5**	N/A
13	Total regulatory capital ratio	†	**17.2**	16.7
14	Total regulatory capital ratio as if IFRS 9 transitional arrangements had not been applied		**16.5**	N/A
	CRR leverage ratio			
15	Total leverage ratio exposure measure (£m)		**5,586.3**	5,885.2
16	CRR leverage ratio (%)	†	**7.0**	6.9
17	Leverage ratio as if IFRS 9 transitional arrangements had not been applied (%)		**6.5**	N/A

Table 6: Comparison of the Society's own funds and capital and leverage ratios with and without the application of transitional arrangements for IFRS 9

* The references in this, and subsequent tables, identify the lines prescribed in the relevant European Banking Authority ('EBA') template where applicable and where there is a value.

1 Figures presented as reported under IAS 39 'Financial instruments: recognition and measurement' at 31 March 2018.

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

† Prepared on IFRS 9 transitional basis

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 RWAs, of which 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 2019 %	Full implementation of CRD IV rules 2019 %	Transitional CRD IV rules 2018 %	Full implementation of CRD IV rules 2018 %
Common Equity Tier 1 ratio	**4.5**	**16.0**	**15.2**	14.8	14.8
Tier 1 ratio	**6.0**	**16.3**	**15.2**	16.0	14.8
Total capital ratio	**8.0**	**17.2**	**16.1**	16.7	15.5

Table 7: Capital ratios.

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

Quality of capital (continued)

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 CET1 capital. These PIBS are 'grandfathered' and recognised as AT1 capital on an amortising basis (see Section 4).

At 31 March 2019, the Society's CET1 capital resources comprised general and other reserves and CCDS, issued in April 2018 as part of the LME. The LME solidified the Society's capital position and increased members' general reserves by £51.9m. This transaction is further explained in the "Liability Management Exercise" section below.

The combined effects of the LME, annual profits and reduction in higher RWA commercial loans explains the improvement in the CET1 ratio from 14.8% to 16.0% at 31 March 2019. The leverage ratio, a simpler capital measure which is not adjusted for relative risk, was 7.0% (2018: 6.9%) substantially above the expected regulatory minimum of 3%.

Transitional arrangements have been applied to phase in the capital impact of adopting IFRS 9 'Financial Instruments', which resulted in a £27.8m reduction to reserves, mainly due to increased commercial provision requirements. This transitional period is five years long and, over that time, the additional impairment provisions, recognised as a result of IFRS 9 adoption, are added back to CET1 capital in accordance with formulae set by the Regulator. Had the transitional arrangements not been in place, the CET1 ratio at 31 March 2019 would have been 15.2% and the leverage ratio would have been 6.5%.

Liability Management Exercise

The LME was undertaken to modernise the Society's capital structure and secure its capital position via the issue of qualifying CET1 capital instruments, namely CCDS. This negotiated arm's length transaction completed in April 2018 and involved:

- The exchange of 100% the Society's PPDS for a combination of new CCDS, new 11% Tier 2 subordinated notes (Tier 2 Notes) and cash. The exchanged PPDS were cancelled on the settlement date.
- The exchange of 77% of the Society's PIBS for CCDS and cash. The exchanged PIBS were cancelled on the settlement date.
- The buyback of 11% of the Society's PIBS from retail investors in exchange for cash. The settled PIBS were cancelled immediately.

In accordance with IAS 32 'Financial Instruments: Presentation' the cancellation of the exchanged PPDS and exchanged/tendered PIBS, consideration paid and issue of CCDS have been recognised directly in equity within the Society's Annual Report and the Tier 2 Notes are presented as subordinated liabilities in the Statement of Financial Position within the Annual Report and Accounts. They have been initially recognised at fair value, assessed as being the nominal value of the Tier 2 Notes (£22.5m) net of directly attributable issue costs (of £0.9m), and subsequently measured at amortised cost using the effective interest method.

The transaction had the effect of increasing CET1 capital by £3.9m and total regulatory capital by £4.4m. Total remunerated regulatory capital (CCDS, PIBS, PPDS and Tier 2 Notes) reduced by £47.5m, more than offset by an increase in member reserves of £51.9m. The reduction in remunerated capital is largely a consequence of the removal of £66.1m of the Society's £75.0m of PIBS which, whilst part of member's interest, under CRD IV rules contributed reducing amounts to regulatory capital. At the time of restructuring, PIBS contributed only £30.0m to the Society's total regulatory capital, with this amount set to reduce to £nil in the year ending 31 March 2022. At this point the Society's total regulatory capital will be better off by £25.5m (before future distributions) as a consequence of the LME. The impact of the completion of the LME on various capital bases is shown in the table below:

	PPDS £m	PIBS[1] £m	General reserves £m	CCDS £m	Tier 2 Notes £m	Total £m
Total capital: Transitional CRD IV rules	(175.0)	(21.1)	51.9	127.0	21.6	**4.4**
Total capital: Full implementation of CRD IV rules	(175.0)	-	51.9	127.0	21.6	**25.5**
CET1 capital only: Full and transitional CRD IV rules[2]	(175.0)	-	51.9	127.0	-	**3.9**

Table 8: Impact of capital restructuring under the LME on regulatory capital.

1) The regulatory capital value of the PIBS is amortising under CRD IV transitional rules and will reduce to £nil under full implementation on 5 April 2021.

2) PIBS and Tier 2 Notes do not count towards CET1 capital.

The terms of the CCDS, Tier 2 and the terms of the PIBS as varied following the 9 April 2018 vote, are available on the Society's website with links detailed in Appendix 1.

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

Leverage

The leverage ratio is non-risk based measure 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 without any consideration of the underlying assets.

The EU is expected to formalise a binding leverage ratio for all institutions as part of its amendments to CRR expected later in 2019.

At 31 March

	Transitional CRD IV rules 2019 £m	**Full implementation of CRD IV rules 2019 £m**	Transitional CRD IV rules 2018 £m	Full implementation of CRD IV rules 2018 £m
Total Tier 1 capital	**392.1**	**351.8**	404.2	374.2
Total assets per the Statement of Financial Position	**5,553.9**	**5,553.9**	5,781.5	5,781.5
Mortgage pipeline and committed facilities	**14.8**	**14.8**	62.0	62.0
Common Equity adjustments relating to assets	**(25.5)**	**(25.5)**	(20.8)	(20.8)
Exposure to repurchase agreements	**49.9**	**49.9**	70.0	70.0
Derivative swap netting and other adjustments	**(6.8)**	**(6.8)**	(7.5)	(7.5)
Adjusted assets	**5,586.3**	**5,586.3**	5,885.2	5,885.2
Leverage ratio	**7.0**	**6.3**	6.9	6.4

Table 9: Summarised leverage ratio.

At 31 March 2019 the leverage ratio of the Society was significantly above the regulatory minimum. Under the transitional CRD IV provisions it was at 7.0 % (2018: 6.9%). Upon full implementation this will reduce to 6.3% (2018: 6.4%). The Society recognises the importance of continuing to originate high quality assets even though this will have the effect of diluting the current leverage ratio. However, the Society expects to continue to operate at a leverage ratio that is considerably in excess of the regulatory requirements including a buffer appropriate to the nature of its business model.

Risk Weighted Assets (RWA) flow statement

The following table shows the movement in credit risk RWAs over the year to 31 March 2019 arising from changes in the size and quality of on balance sheet assets.

	Residential Mortgages £m	**Commercial Mortgages £m**	**Treasury £m**	**Other £m**	**Total £m**
Risk weighted assets at 1 April 2018	1,620.3	523.2	63.7	178.7	**2,385.9**
Portfolio size increase /(decrease)	(16.5)	(34.1)	(14.6)	(1.4)	**(66.6)**
Impact of IFRS9 Transitional relief	(0.4)	(3.8)	-	-	**(4.2)**
Portfolio quality and measurement decrease/ (increase)	6.3	(24.2)	(2.9)	(1.5)	**(22.3)**
Risk weighted assets at 31 March 2019	1,609.7	461.1	46.2	175.8	**2,292.8**

Table 10: Risk Weighted Assets flow statement.

The capital position has been enhanced through a measured balance sheet contraction programme focused on higher risk non-core assets. This is reflected in the large reduction in the RWA requirement relating to the commercial mortgages.

Section 6 – **Credit risk**

Credit risk overview

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

During the year the Society's lending was in accordance with the approved credit policy, which is consistent with the risk appetite established by the Board.

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

The Society insures its residential mortgage book against losses using Mortgage Indemnity Guarantee (MIG) Insurance. MIG Insurance is taken on advances where the Loan To Value (LTV) exceeds 80% in line with its risk appetite. No credit risk mitigation benefits have been assumed from this purchase when assessing its Pillar 1 capital requirements.

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

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

Analysis of residential and commercial credit risk exposures

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

The following table shows the residual maturity of the Society's on-balance sheet exposures secured by mortgages on residential properties and commercial real estate after allowance for fair value and individual loss provisions. The equity release loan balances are included after applying fair value adjustments.

At 31 March

Residual maturity	**2019 £m**	2018 £m
Up to 3 months	**152.0**	200.8
3-12 months	**59.4**	22.8
1-5 years	**315.2**	360.4
More than 5 years	**4,193.7**	4,176.8
	4,720.3	4,760.8

Table 11: Analysis of on-balance sheet loan exposures by residual maturity.

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

Concentration risk

The following tables show the level of concentrations within the residential and commercial loan books to geographical (UK region), loan type and industry type.

The residential exposures shown below are the gross loan balances before expected credit loss provisions and fair value macro hedge adjustments. The equity release loan balances are included before applying fair value adjustments. The following table shows the Society's exposure to residential loans by region.

At 31 March

	Concentration		Concentration	
Region	**2019 £m**	**2019 %**	2018 £m	2018 %
East Anglia	**126.0**	**2.9**	130.2	3.0
East Midlands	**461.3**	**10.5**	450.9	10.3
Greater London	**498.9**	**11.4**	520.3	11.9
Northern Ireland	**4.1**	**0.1**	4.5	0.1
North	**191.5**	**4.4**	187.8	4.3
North West	**540.5**	**12.3**	546.6	12.5
Scotland	**96.6**	**2.2**	105.3	2.4
South East	**718.6**	**16.3**	725.4	16.4
South West	**364.6**	**8.3**	366.1	8.3
Wales	**217.6**	**5.0**	218.0	5.0
West Midlands	**734.2**	**16.7**	718.6	16.4
Yorkshire	**433.0**	**9.9**	412.3	9.4
	4,386.9	**100.0**	4,386.0	100.0

Table 12: Analysis of the residential loan portfolio by geographic spread.

The table below provides further information on the Society's residential loans and advances to customers by payment due status at 31 March.

At 31 March

	Concentration		Concentration	
Payments due status	**2019 £m**	**2019 %**	2018 £m	2018 %
Not past due	**4,342.5**	**99.0**	4,336.4	98.9
Past due 1 to 3 months	**27.2**	**0.6**	23.3	0.5
Past due 3 to 6 months	**7.3**	**0.2**	8.6	0.2
Past due 6 to 12 months	**1.7**	**0.0**	3.7	0.1
Past due over 12 months	**1.2**	**0.0**	1.1	0.0
Possessions	**7.0**	**0.2**	12.9	0.3
	4,386.9	**100.0**	4,386.0	100.0

Table 13: Analysis of the residential loan portfolio by payments due status.

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

Concentration risk (continued)

The following table shows the Society's exposure to residential loans by indexed loan to value.

At 31 March

Indexed loan to value **LTV**	**Concentration** **2019** **£m**	**2019** **%**	Concentration 2018 £m	2018 %
>96%	**74.6**	**1.7%**	48.1	1.1%
91% - 95%	**170.8**	**3.9%**	97.5	2.2%
86% - 90%	**345.3**	**7.9%**	224.0	5.1%
76% - 85%	**713.3**	**16.3%**	673.4	15.4%
51% - 75%	**2,005.6**	**45.7%**	2,258.6	51.5%
<50%	**1,077.3**	**24.5%**	1,084.4	24.7%
	4,386.9	**100.0%**	4,386.0	100.0%

Table 14: Analysis of the residential loan portfolio by indexed loan to value (LTV).

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

At 31 March

Region	**Concentration** **2019** **£m**	**2019** **%**	Concentration 2018 £m	2018 %
East Anglia	**17.0**	**4.1%**	17.0	3.3%
East Midlands	**27.9**	**6.8%**	30.9	7.4%
Greater London	**40.9**	**9.9%**	40.8	9.2%
North	**40.5**	**9.8%**	41.1	8.2%
North West	**143.1**	**34.8%**	147.5	35.1%
Scotland	**1.1**	**0.3%**	2.8	0.7%
South East	**55.0**	**13.4%**	63.4	14.7%
South West	**8.8**	**2.1%**	9.2	2.1%
Wales	**1.2**	**0.3%**	1.7	0.4%
West Midlands	**36.0**	**8.7%**	39.1	9.6%
Yorkshire	**40.4**	**9.8%**	41.5	9.3%
	411.9	**100.0%**	435.0	100.0%

Table 15: Analysis of the Commercial loan portfolio by geographic spread.

The following table shows the Society's exposure to commercial loans by industry type.

At 31 March

Industry Type	**Concentration** **2019** **£m**	**2019** **%**	Concentration 2018 £m	2018 %
Healthcare & Leisure	**122.8**	**29.8%**	131.1	27.8%
Industrial & Warehouse	**7.0**	**1.7%**	6.7	1.4%
Office	**18.5**	**4.5%**	20.6	4.8%
Retail	**241.7**	**58.7%**	255.9	61.6%
Residential	**21.7**	**5.3%**	20.5	4.4%
Other	**0.2**	**0.0%**	0.2	0.0%
	411.9	**100.0%**	435.0	100.0%

Table 16: Analysis of the commercial loan portfolio by industry type.

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

Concentration risk (continued)

The table below provides further information on the Group's commercial loans and advances to customers by payment due status at 31 March.

At 31 March

	Concentration		Concentration	
Payments due status	**2019 £m**	**2019 %**	2018 £m	2018 %
Not past due	**299.8**	**72.8%**	318.8	73.2%
Past due up to 3 months	**11.5**	**2.8%**	-	0.0%
Past due 3 to 6 months	**-**	**0.0%**	6.8	1.6%
Past due 6 to 12 months	**32.9**	**8.0%**	42.1	9.7%
Past due over 12 months	**67.7**	**16.4%**	67.3	15.5%
	411.9	**100.0%**	435.0	100.0%

Table 17: Analysis of the commercial loan portfolio by payments due status.

Impairment of financial assets

Impairment provision

Under IAS 39, impairment loss provisions were calculated on an incurred loss model, whereby provisions were recognised once an impairment 'trigger' event had been identified. IFRS 9 changes this model to an expected credit loss (ECL) model which incorporates forward looking information such that when a financial asset is first recognised, an impairment loss provision is made for the expected losses from defaults over the following 12 months (12 month ECL). If, at a later time, it is determined that there has been a significant increase in the credit risk of the asset, this impairment loss is increased to cover the expected losses over the whole life of the asset (lifetime ECL). This change in the calculation of impairment losses results in earlier recognition of credit losses in the financial statements but does not change the amount of the eventual loss suffered.

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

Staging

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

Stage 1

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

Stage 2 (significant increase in credit risk)

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

Determining whether a significant increase in credit risk has occurred is a critical aspect of the IFRS 9 methodology and one which involves judgement, based on a combination of quantitative and qualitative measures. As described in the ECL calculation sections which follow, the criteria applied vary across portfolios depending on the nature of the portfolio and availability of relevant credit risk information but all include the IFRS 9 'backstop' of 30 days past due as a stage 2 trigger.

Stage 3 (default)

Defaulted or credit impaired financial assets are categorised as stage 3, requiring recognition of lifetime ECLs.

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

Forward-looking ECL approach

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

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

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

In accordance with IFRS 9, forecasts of future economic conditions are integral to the ECL calculations for each portfolio. The Group currently models four forward-looking macroeconomic scenarios: a central forecast with economic assumptions aligned to the Group's Medium Term Plan (and therefore assigned the highest probability), together with upside, downside and stress scenarios. The stress scenario has been developed with due regard to market data available in relation to the UK's planned exit from the European Union.

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

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

Residential loans are considered to be in default or credit-impaired if they are in arrears by three or more months or in bankruptcy, litigation, possession or LPA receivership.

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

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

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

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

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

The Group's IFRS 9 provision requirements for undrawn commitments at 1 April 2018 and 31 March 2019 were negligible.

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

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

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

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

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

Commercial loans are categorised as default if they are in arrears by greater than or equal to three months or past scheduled maturity with no formal extension having been agreed. Loans not meeting these criteria may be classified as stage 3 based on expert management judgment of the perceived risk of non-payment.

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

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

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

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

Liquid assets are in default if categorised as such by external credit rating agencies or if 90 days past due. The Society has never experienced an impairment loss or default on its Treasury investment portfolio.

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

The Society's liquid asset provision requirements at 1 April 2018 and 31 March 2019 were negligible, considerably less than £0.1m and are therefore not analysed within this document.

ECL calculation – impact of IFRS 9
The table below analyses the movements in impairment loss allowances arising on transition from the IAS 39 incurred loss methodology applied in 2017/18 to the expected credit loss approach prescribed by IFRS 9 and effective from 1 April 2018:

	Notes	Loans fully secured on residential property £m	Loans fully secured on land £m	Total £m
Impairment provision (unaudited)				
At 31 March 2018 (IAS 39 basis)		13.2	33.7	**46.9**
Reclassification	1	(7.0)	-	**(7.0)**
IAS 39 collective provisions on assets not individually impaired	2	(2.5)	(11.4)	**(13.9)**
12 month ECL on assets not individually impaired under IAS 39	3	0.6	0.1	**0.7**
Lifetime ECL on assets not individually impaired under IAS 39	4	3.1	21.0	**24.1**
Changes to calculation methodology for assets individually impaired under IAS 39	5	(1.0)	21.6	**20.6**
Post model adjustments	6	1.4	-	**1.4**
At 1 April 2018 (IFRS 9 basis)		**7.8**	**65.0**	**72.8**

Table 18: Reconciliation of impairment provisions from IAS 39 to IFRS 9 basis.

Notes

1. The Society's closed portfolio of equity release mortgages has been reclassified as FVTPL under IFRS 9. FVTPL assets are not subject to the impairment requirements of IFRS 9 and the equity release loss allowance previously recognised under IAS 39 is no longer required.
2. Assets not individually impaired under IAS 39 were grouped on the basis of similar credit risk characteristics and included in a collective impairment assessment. A collective provision was made where there was objective evidence that credit losses had been incurred but not observed at the reporting date. The expected loss methodology prescribed by IFRS 9 means that a provision requirement is calculated for all loans and advances to customers held at amortised cost.
3. Under IFRS 9, a provision is made for 12 month ECL on up to date loans allocated to stage 1. These loans were previously included in a collective impairment assessment under IAS 39.
4. Under IFRS 9, loans which have experienced a significant increase in credit risk since initial recognition or are in default are allocated to stages 2 or 3, thereby requiring a provision for lifetime ECL. This is a key driver for the increase in loss allowances on IFRS 9 adoption. The Group's closed commercial book is particularly sensitive to uncertainties in the economic outlook, for the retail sector and generally, which are now captured within the impairment calculation. In accordance with IAS 39, these loans were previously included in a collective impairment assessment with provisions made only where there was objective evidence of incurred credit losses.
5. The IFRS 9 provision for commercial loans which were individually impaired under IAS 39 includes an allowance for multiple economic scenarios, reflecting Brexit uncertainty and the weakened outlook for the retail sector, in some cases over long time periods. This increases the range of possible adverse outcomes which must be considered in the forward-looking calculation of ECLs resulting in significantly higher IFRS 9 loss allowances than those previously recognised under IAS 39.
6. Where the IFRS 9 models do not fully capture the credit risk associated with certain portfolios due to, for example, low volumes of historical defaults within the model development data set, the expected loss arising from those risks is estimated and an additional allowance recognised. The main element of the post model adjustment provision is an allowance for the risk that a proportion of interest only mortgages will not redeem at contractual maturity due to the borrower being unable to repay the capital on the loan.

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

The following table, shows the movement during the year in ECLs under IFRS 9. This analysis differs from that shown in Note 14, Allowance for losses on loans and advances, to the 2019 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.

	Loans fully secured on residential property £m	Loans fully secured on land £m	Total £m
At 1 April 2018*	7.8	65.0	**72.8**
Charge for the year comprising:	(3.0)	(1.7)	**(4.7)**
Amounts written off			
Provision for loan impairment	2.0	1.4	**3.4**
Adjustments to provisions resulting from recoveries	(0.8)	(0.1)	**(0.9)**
Charge for the year	1.2	1.3	**2.5**
At 31 March 2019	**6.0**	**64.6**	**70.6**

Table 19: Analysis of movement during the year ended 31 March 2019 in impairment provisions under IFRS 9.
* The Group adopted IFRS 9 – Financial Instruments with effect from 1 April 2018 and the figures in the above table are presented on this basis.

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

The transition to IFRS 9 has not resulted in any changes to the Society's credit risk management strategy. However, IFRS 9 models now provide the Society with additional insights into both the drivers of credit risks and customers who may be more vulnerable to the threat of arrears in the event of changed economic scenarios.

Residential loans

The following tables show the balances of residential loans and related impairment provision as at 31 March 2019. The equity release portfolio was reclassified from an amortised cost to fair value through profit or loss (FVTPL) basis of measurement on IFRS 9 adoption and is therefore excluded from tables 20 and 21 below. It should also be noted that the figures below show the balances used for provisioning as opposed to capital exposure values (which include potential exposure due to undrawn facilities and pipeline business that do not appear on balance sheet) and therefore do not match the totals in the capital exposure tables in previous sections.

The Society assesses credit risk on owner occupied and buy to let residential mortgages using behavioural scorecard and other analysis to determine probabilities of default across a number of rating grades. The IFRS 9 impairment models make use of this data, incorporating forecasts of future economic conditions and account-specific factors to produce forward-looking probabilities of default by account and allocating loans to one of three stages (as explained in The Annual Report and Accounts in Note 1, Accounting policies).

The table below analyses gross exposures to residential assets by 12 month probability of default and IFRS 9 stage at the reporting date, with the exception of the closed second charge lending portfolio for which probability of possession is used as a credit risk measure, rather than probability of default.

At 31 March 2019

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

Table 20: Analysis of gross exposures to residential assets by 12 month probability of default and IFRS 9 stage.

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

The tables below analyse the movement in gross residential exposures and the related ECL provision, by IFRS 9 staging, for the year ended 31 March 2019:

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross exposure (IFRS 9 basis)				
At 1 April 2018	3,907.7	379.5	72.9	**4,360.1**
Transfers due to increased credit risk:				
From stage 1 to stage 2	(231.0)	231.0	-	**-**
From stage 1 to stage 3	(12.8)	-	12.8	**-**
From stage 2 to stage 3	-	(19.2)	19.2	**-**
Transfers due to decreased credit risk:				
From stage 2 to stage 1	151.6	(151.6)	-	**-**
From stage 3 to stage 1	6.7	-	(6.7)	**-**
From stage 3 to stage 2	-	15.2	(15.2)	**-**
Mortgage advances	691.3	-	-	**691.3**
Redemptions and repayments	(626.7)	(40.0)	(17.5)	**(684.2)**
Amounts written off	(0.1)	-	(3.7)	**(3.8)**
Other movements	0.5	-	(0.1)	**0.4**
At 31 March 2019	**3,887.2**	**414.9**	**61.7**	**4,363.8**

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Expected credit loss provision (IFRS 9 basis)				
At 1 April 2018	0.6	2.5	4.7	**7.8**
Transfers due to increased credit risk:				
From stage 1 to stage 2	-	0.4	-	**0.4**
From stage 1 to stage 3	(0.1)	-	0.5	**0.4**
From stage 2 to stage 3	-	(0.3)	1.0	**0.7**
Transfers due to decreased credit risk:				
From stage 2 to stage 1	0.1	(0.7)	-	**(0.6)**
From stage 3 to stage 2	-	0.1	(0.5)	**(0.4)**
Remeasurement of expected credit losses with no stage transfer	0.2	(0.6)	2.6	**2.2**
Redemptions	(0.1)	(0.3)	(0.2)	**(0.6)**
Amounts written off	(0.1)	-	(3.7)	**(3.8)**
Other movements	-	-	(0.1)	**(0.1)**
At 31 March 2019	**0.6**	**1.1**	**4.3**	**6.0**

Table 21: Reconciliation of movements in gross exposures and ECL provision by IFRS 9 stage for residential loans.

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

Commercial loans

The internal credit risk grading approach for the closed commercial loan book does not use scorecards or probability of default calculations. Instead loans are individually assessed against a series of prescriptive and judgmental criteria, by subject matter experts following a clearly defined methodology, to arrive at a risk grade. The distribution of the portfolio by grade and IFRS 9 stage at 31 March 2019 is set out in the table below.

At 31 March 2019

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

Table 22: Analysis of commercial loan balances by IFRS 9 stage and slotting grade

The tables below analyse the movement in gross commercial exposures and the related expected credit loss allowances, by IFRS 9 staging, for the year ended 31 March 2019:

At 31 March 2019

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross exposure (IFRS 9 basis)				
At 1 April 2018	56.3	115.7	263.0	**435.0**
Transfers due to increased credit risk:				
From stage 1 to stage 2	(1.8)	1.8	-	**-**
Transfers due to decreased credit risk:				
From stage 2 to stage 1	8.5	(8.5)	-	**-**
From stage 3 to stage 2	-	26.0	(26.0)	**-**
Net redemptions, repayments and fair value adjustments for hedged risk	(2.8)	(3.2)	(14.1)	**(20.1)**
Amounts written off	-	(0.5)	(1.4)	**(1.9)**
Other movements	-	-	(1.1)	**(1.1)**
At 31 March 2019	60.2	131.3	220.4	**411.9**

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Expected credit loss allowance (IFRS 9 basis)				
At 1 April 2018	0.1	11.8	53.1	**65.0**
Transfers due to increased credit risk:				
From stage 1 to stage 2	(0.1)	0.1	-	**-**
Transfers due to decreased credit risk:				
From stage 2 to stage 1	0.3	(0.2)	-	**0.1**
From stage 3 to stage 2	-	2.3	(2.6)	**(0.3)**
Remeasurement of expected credit losses with no stage transfer	-	(4.7)	6.4	**1.7**
Redemptions	-	-	-	**-**
Amounts written off	-	(0.5)	(1.4)	**(1.9)**
At 31 March 2019	0.3	8.8	55.5	**64.6**

Table 23: Reconciliation of movements in gross exposures and ECL provision by IFRS 9 stage for residential loans.

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

Forbearance strategies and renegotiated loans

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

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

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

The table below analyses residential mortgage balances with renegotiated terms at the year-end date:

At 31 March 2019

Payments due status	**Arrangements £m**	**Concessions £m**	**Capitalisation £m**	**Term extensions £m**	**Total £m**
Not past due	1.2	0.8	0.9	20.7	**23.6**
Past due 1 to 3 months	1.9	0.5	-	0.2	**2.6**
Past due 3 to 6 months	2.9	0.3	-	0.1	**3.3**
Past due 6 to 12 months	0.5	-	-	-	**0.5**
Past due over 12 months	0.7	0.1	-	-	**0.8**
	7.2	**1.7**	**0.9**	**21.0**	**30.8**

At 31 March 2018

Payments due status	Arrangements £m	Concessions £m	Capitalisation £m	Term extensions £m	Total £m
Not past due	0.7	0.6	1.6	7.4	10.3
Past due 1 to 3 months	2.1	0.7	0.3	0.2	3.3
Past due 3 to 6 months	2.5	0.3	0.1	0.1	3.0
Past due 6 to 12 months	2.1	0.1	-	-	2.2
Past due over 12 months	0.8	-	-	0.1	0.9
	8.2	1.7	2.0	7.8	19.7

Table 24: Residential mortgage balances with renegotiated terms at the year-end date.

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

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

Forbearance strategies and renegotiated loans (continued)

The analysis below sets out the commercial mortgage balances with evidence of forbearance and renegotiated terms at the year-end date.

At 31 March 2019

Payments due status	**Arrangements £m**	**Capitalisation £m**	**Term extensions £m**	**Total £m**
Not past due	3.2	11.2	0.9	**15.3**
Past due up to 3 months	8.9	-	-	**8.9**
Past due 6 to 12 months	4.0	-	-	**4.0**
Past due over 12 months	3.0	-	-	**3.0**
	19.1	11.2	0.9	**31.2**

At 31 March 2018

Payments due status	Arrangements £m	Capitalisation £m	Term extensions £m	Total £m
Not past due	3.2	11.2	2.9	17.3
Past due 6 to 12 months	12.9	-	-	12.9
Past due over 12 months	3.0	-	-	3.0
Total	19.1	11.2	2.9	33.2

Table 25: Commercial mortgage balances with evidence of forbearance and renegotiated terms at the year-end date.

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

Analysis of treasury credit risk exposures

The following tables analyse the Society's regulatory credit risk exposures to Treasury counterparties. These include both on and off balance sheet exposures (after credit risk mitigation). They are therefore not directly comparable with the figures reported in Note 34, Credit risk, to the 2019 Annual Report and Accounts. The Society 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.

At 31 March

	Notes	2019 £m	2018 £m	Average over year £m
Concentration by credit grading				
AAA to AA-		**545.6**	713.2	**629.4**
A+ to A-		**34.0**	93.2	**63.6**
BBB+ to BBB-	1	**50.1**	15.2	**32.7**
BB+ to BB-	1	**1.0**	1.9	**1.5**
		630.8	823.5	**727.2**
Concentration by sector				
UK Government & Bank of England		**202.5**	324.7	**263.5**
Supranational institutions		**71.2**	65.3	**68.3**
Financial institutions		**141.1**	202.0	**171.6**
Asset backed securities		**216.0**	231.5	**223.8**
		630.8	823.5	**727.2**
Concentration by region				
UK		**518.5**	669.0	**593.6**
Europe (excluding UK)		**24.1**	47.4	**35.8**
North America		**17.0**	20.5	**18.8**
Australasia		**-**	0.1	**0.1**
East Asia		**-**	21.2	**10.6**
Supranational		**71.2**	65.3	**68.3**
		630.8	823.5	**727.2**

Table 26: Analysis of regulatory credit risk exposures to Treasury counterparties.

Notes:

1. These credit grading bands include investments in asset backed securities issued by Sandwell Commercial Finance No. 2 Plc. a quasi-subsidiary of the Society. Further details of this entity can be found in Section 11.

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

Residual maturity breakdown of treasury exposures by asset class

The following table shows the residual maturity of exposures. The maturity breakdown is stated on a contractual rather than an expected basis, and does not take into account the cash flows payable or receivable over the life of the exposure. These encompass both on and off balance sheet exposures (after credit risk mitigation).

Although not directly comparable, an analysis of the maturity of the exposures for liquidity purposes can be found in Note 34, Credit risk, to the 2019 Annual Report and Accounts.

At 31 March 2019

	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £m	**Total £m**
UK Government & Bank of England	192.0	-	-	10.5	**202.5**
Supranational financial institutions	30.1	41.1	-	-	**71.2**
Financial institutions	110.5	29.8	0.8	-	**141.1**
Asset backed securities	31.7	112.1	72.2	-	**216.0**
	364.3	183.0	73.0	10.5	**630.8**

At 31 March 2018

	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £m	Total £m
UK Government & Bank of England	318.1	-	-	6.6	324.7
Supranational financial institutions	35.1	30.2	-	-	65.3
Financial institutions	198.7	3.3	-	-	202.0
Asset backed securities	48.9	91.0	91.6	-	231.5
	600.8	124.5	91.6	6.6	823.5

Table 27: Residual maturity analysis of treasury exposures by asset class.

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

Analysis of liquidity exposures by credit quality step

The Society 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. There has been no change in the Society's use of ECAIs during the year.

The table below shows the exposure values associated with each credit quality step for on balance sheet Treasury exposures under the Standardised Approach.

At 31 March

	Notes	Risk Weight %	Fitch and S&P ratings	Moody's ratings	**2019 Exposure values £m**	2018 Exposure values £m
UK Government & Bank of England						
Credit quality step						
1	1	0	AA+	Aa1	**202.5**	324.7
Total					**202.5**	324.7
Supranational financial institutions						
Credit quality step						
1		0	AAA to AA	Aaa to Aa1	**71.2**	65.3
Total					**71.2**	65.3
Financial institutions						
Credit quality step						
1		20	AAA to AA-	Aaa to Aa3	**46.6**	51.3
2		50	A+ to A-	A1 to A3	**30.6**	55.0
3		50	BBB+ to BBB-	Baa1 to Baa3	**3.2**	14.0
Total					**80.4**	120.3
Asset backed securities positions						
Credit quality step						
1	2	20	AAA to AA-	Aaa to Aa3	**215.0**	229.5
2	3	50	A+ to A-	A1 to A3	**-**	0.1
3	3	100	BBB+ to BBB-	Baa1 to Baa3	**-**	-
4	3	350	BB+ to BB-	Ba1 to Ba3	**1.0**	1.9
Total					**216.0**	231.5

Table 28: Analysis of the liquidity exposures into credit quality steps based on the ratings

Notes:

1. Includes cash in hand and Cash Ratio Deposit with the Bank of England.
2. The AAA to AA- asset backed securities all relate to prime loans secured on residential property located in the United Kingdom.
3. The asset backed securities with ratings below AAA to AA-, which relate to loans secured on commercial property located in the United Kingdom, were issued by Sandwell Commercial Finance No. 2 Plc. a quasi-subsidiary of the Society. Further details of these entities can be found in Section 11.

Capital required under Pillar 1 for treasury liquidity exposures was £3.7m (2018: £5.1m)

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

Treasury credit risk mitigation

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

The Society may from time to time enter into repurchase agreements (repos) with counterparties with whom the Society has both a Global Master Repurchase Agreement (GMRA) and an active credit line in place. The credit risk that arises from such a transaction is managed under the terms of the GMRA through the monitoring and appropriate transfer of collateral.

The exposure to repos is measured by calculating the difference between the value of the asset repurchased and the cash received from the counterparty. Repos are not included as assets on the statutory balance sheet but are relevant for both counterparty credit risk and leverage purposes.

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

Counterparty credit risk

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

This approach applies to contracts for financial derivative instruments, securities financing transactions and long settlement transactions. The Society uses derivative instruments to hedge its exposure to market risk, for example, interest rate risk. Risk is mitigated by offsetting the amounts due to the same counterparties ('netting benefits') and by cash deposited by certain of the counterparties ('collateral').

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

At 31 March

	2019 £m	2018 £m
Interest rate contracts	**6.5**	19.5
Other contracts	**48.1**	41.0
Gross positive fair value of contracts	**54.6**	60.5
Netting benefits	**(34.7)**	(34.0)
Netted current credit exposure	**19.9**	26.5
Add on for potential future credit exposure	**10.8**	11.6
Total derivative exposures	**30.7**	38.1

Table 29: CCR for derivative contracts.

The net derivatives credit exposure represents the credit exposure to derivative transactions after taking account of legally enforceable collateral arrangements. The collateral arrangements are included within the above table under 'Other contracts'.

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

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

Capital required under Pillar 1 for Market and Counterparty credit risk, including CVA and exposures to Secured Financing Transactions totals £0.9m (2018: £2.9m). The exposure to derivatives is calculated using the CCR Mark to Market method.

Section 7 – **Market risk**

Market risk

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

Interest rate risk

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

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

Basis risk

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, e.g. Bank Rate mortgages are funded by LIBOR-linked liabilities. The impact of these mismatches (basis risk) is monitored by Treasury and reported to ALCo.

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 2019 £m	Average 2019 £m	High 2019 £m	Low 2019 £m
Market value	**(2.6)**	(4.3)	(6.1)	(2.0)
Net interest income	**(2.9)**	(2.4)	(3.5)	(1.6)

Table 30: Interest Rate risk exposures.

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

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

Derivative activity

The principal derivatives used by the Society are interest rate swaps and index linked swaps that are used to hedge Statement of Financial Position exposures.

The following table describes the significant activities undertaken by the Society, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks. Such risks may also be managed using Statement of Financial Position instruments as part of an integrated approach to risk management.

Activity	Risk	Managed by
Management of the investment of reserves and other non-interest bearing liabilities	Sensitivity to changes in interest rates	Matching against fixed rate assets
Fixed rate mortgage lending and other assets	Sensitivity to rises in interest rates	Pay fixed rate interest rate swaps, matching against fixed rate liabilities
Fixed rate savings products and funding	Sensitivity to falls in interest rates	Receive fixed rate interest rate swaps, matching against fixed rate receipts
Capped, collared or floored products	Sensitivity to changes in interest rates	Matching against appropriate cap, collar or floor derivatives or suitable assets or liabilities
Capped, collared or floored products	Sensitivity to changes in interest rates	Matching against appropriate cap, collar or floor derivatives or suitable assets or liabilities

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

Other market risk

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

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

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

At acquisition

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

Ongoing management

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

Section 8 – **Operational risk**

Operational risk overview

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

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

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

Operational risk framework

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

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

Operational risk management and mitigation

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

Key operational risks and their mitigants are detailed below:

Risk	Brief description	Operational risk management and mitigation
Business Continuity and Disaster Recovery Risk	The risk of failure to adequately assess, document, test and invoke business continuity procedures to safeguard Group assets and personnel, and to adequately maintain or re-commence all essential business operations following a business continuity event.	Each business area has a Business Continuity Plan, reviewed every 6 months. There is a Crisis Management Plan with a defined Crisis Management Team. Testing activities are led by the second line according to the plan agreed by Risk Committee. Examples include bi-annual Work Area Recovery tests, call cascades and desktop exercises with the Crisis Management Team.
Customer Operations Risk	The risk of financial and non-financial impacts resulting from inadequate or failures in customer facing/support processes	Customer Operations Risks are most concentrated within the Operations function and the branch network, where activity is focussed on customer transactions, occurring by any means, primarily by post and email (Operations), telephone (Operations and branches) or in person (branches). The management and control of these risks is integral to the provision of service. First line control activities are carried out locally (or by a specialist area outside the team).
Product risk	The risk of financial and non-financial impacts resulting from the inadequate design and launch of new products and services.	Product Consideration Group is the first line Committee in the Product Governance Framework, which ensures that risks are mitigated and the Society delivers its obligation for the fair treatment of customers at the following stages: design and governance; identifying target markets; marketing and promotion; sales and advice processes; after-sales information and service; and complaints handling. Other controls include Product Design Risk Assessments and on-going monitoring of third parties and monitoring of Conduct Risk associated with the management of existing business.
Financial Reporting Risk	Failure to interpret and comply with financial reporting and taxation requirements, including the misrepresentation of financial statements.	There is dedicated resource within the Finance department, which has systems and controls in place for regulatory reporting. This is supported by second line controls testing and utilisation of external advisors where required.
Technology Risk	The risk of financial and non-financial impacts resulting from failures in the development, delivery, maintenance and continuity of effective IT systems	There is dedicated IT resource to implement the development, delivery, maintenance and continuity of effective IT systems. Oversight is provided by the Operational, Conduct & Information Risk Group (OCIRG) and ultimately the Risk Committee.

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

Risk	Brief description	Operational risk management and mitigation
People Risk	The risk associated with the ability to recruit, develop, motivate and retain the required number and quality of people. People risk includes failure to comply with employment related requirements and inappropriate or unauthorised employee activity.	The management of People related risks is the responsibility of all managers, whilst the Human Resources department maintains oversight. On a day-to-day level, Human Resources provides advice and support to the business in relation to Recruitment and Selection, Employee Relations, Reward, Learning and Development approaches and Payroll and Administration in adherence to employment legislation and Society policies.
Legal & Regulatory Risk	The risk of regulatory censure, fines or legal action as a result of incorrect or inappropriate business conduct, e.g. failure to comply with legislative / regulatory requirements or Codes of Conduct.	Legal and Regulatory risk is managed by the Group Secretary 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 risk that appropriate premises and other physical assets are not available to support business operational needs or do not conform to all relevant regulations, including Health and Safety requirements. It includes theft of/ damage to the Society's assets and threats or actual harm to the Society's employees.	Central to managing this risk is the Health & Safety Policy, Information Security Policy and the Physical Security Policy. A dedicated Corporate Facilities department, managed by the Divisional Director HR, provides specialist support to first line areas. As well as the standard risk governance arrangements, additional oversight is provided by the Health & Safety Committee.
Supplier & Outsourcing Risk	The risk of adverse impacts arising from services with outsourced partners or third-party suppliers. It includes inappropriate supplier selection and management processes and failure on the part of the supplier to deliver the agreed services and/or comply with relevant laws, codes and ethical behaviours.	Business areas play a key first line role by setting out procedures and processes to ensure compliance with both the risk management strategy and the Supplier Selection and Management Policy. Controls are in place throughout all stages of procurement, including ongoing contract and supplier management.
Financial Crime Risk	Risk of financial and non-financial impacts arising from internal and external fraud, or from a failure to comply with financial crime legislation.	The Group Secretary retains overall responsibility and oversight of Financial Crime Risk as part of his Money Laundering Reporting Officer responsibilities. The Head of Data Protection and Financial Crime is responsible for the day to day running of the Financial Crime Team. The Group pays close attention to the source, likelihood and impact of Financial Crime.
Change Risk	The risk of financial and non-financial impacts resulting from the inadequate design, management or implementation of change.	Controls exist to ensure change is delivered in a controlled manner, whether it be Business As Usual change (such as a process change without systems development); small process or organisational change where operational and customer impact is low; or project change, where the risk and complexity demands a formal approach to change. For the latter, specific controls include an agreed project methodology and governance arrangements.

Operational risk oversight and governance

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

Capital required under Pillar 1 for operational risk was £7.7m (2018: £8.1m).

Section 9 – **Liquidity risk**

Liquidity risk

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

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

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

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

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

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

As prescribed by EBA Guidelines:

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

		12 month weighted average value			
Quarter end		**30 June 2018 £m**	**30 September 2018 £m**	**31 December 2018 £m**	**31 March 2019 £m**
21	Liquidity Buffer	582.9	555.2	535.9	486.1
22	Total Net Cash Outflows	386.9	362.0	344.2	333.4
23	Liquidity Coverage Ratio (%)	152%	154%	155%	147%

Table 31: Abbreviated disclosure of the LCR in the format prescribed by EBA guidelines.

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

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

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

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

Net Stable Funding Ratio

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

At 31 March 2019, the NSFR was 130.2% (31 March 2018: 139.9%). Based on current interpretations of NSFR requirements, the Society's NSFR exceeds the expected 100% minimum future requirement. A final European NSFR standard which introduces a binding minimum NSFR ratio is expected to be issued later in 2019.

Section 10 – **Other risks**

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

Information risk

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

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

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

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

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

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

Pension liability risk

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

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

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

Business risk

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

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

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

Retail conduct risk

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

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

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

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

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

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

Model risk

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

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

The Society continues to develop its modelling capabilities and has integrated models into key business activities such as loan decisioning, loss assessment, strategic planning, product pricing and the assessment of capital requirements. In recognition of this, model risk was elevated to a principal risk during the year ending 31 March 2019.

A process of governance has been established applicable throughout the model life cycle, from initiation, through development, approval, implementation to ongoing monitoring and validation. In the development of its approach to Model Risk, the Society has ensured full compliance with applicable regulation.

Section 11 – **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.

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

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 with no gains being recognised. The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the originating entity. 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 IFRS 10, 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. The Group undertakes securitisation activities to raise wholesale funding. Securitisation is used to increase the diversification of funding sources, manage maturity mismatch risk and assist overall credit risk management.

Treatment of 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. 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 5 – Capital Adequacy. Hawthorn Finance Limited, Kenrick No. 1 Plc, Kenrick No. 2 Plc and Kenrick No. 3 Plc are treated in this manner.

Non-consolidated structured entities for regulatory capital purposes

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

The notes in these securitisations are serviceable from cash flows generated by the mortgage assets. The Society receives the excess spread on the transactions as deferred consideration, after the structured entities have met their liabilities. The Society does not provide any liquidity facilities to the structured entities. WBCL provides administration and cash management services to the structured entities, for which it receives a fee. The subordinated start-up loan balances have been written down to £nil (2018: £nil) by the application of cumulative losses on the securitised loans within Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc.

The structured entities were originally set up as follows:

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

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

Section 11 – **Securitisation** (continued)

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

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

Securitisation Company	**Type**	**Date of Securitisation**	**Gross assets securitised 2019 £m**	**External notes in issue 2019 £m**	**Underlying assets past due more than one month 2019 £m**	Gross assets securitised 2018 £m	Total notes in issue 2018 £m	Underlying assets past due and impaired 2018 £m
Sandwell Commercial Finance No. 1 Plc	Commercial mortgage securitisation	19 May 2004	**4.5**	**6.5**	**-**	10.7	12.7	-
Sandwell Commercial Finance No. 2 Plc	Commercial mortgage securitisation	23 September 2005	**29.4**	**21.0**	**3.3**	45.4	31.7	9.4
			33.9	**27.5**	**3.3**	56.1	44.4	9.4

Table 32: Assets subject to off balance sheet securitisation, notes in issue and impaired and past due assets.

The gross assets securitised in the above table are subject to impairment provisions of £6.1m (2018: £8.5m) and there were £16.7m of loans which were stage 3 under IFRS 9.

Consolidated structured entities for regulatory capital purposes

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

Hawthorn Finance Limited
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. On 11 April 2017, the Society triggered its call option and the loans were bought back by the Society.

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

Kenrick No. 3 Plc
In January 2018, an Originator Trust was created over a £383.5m portfolio of prime residential mortgages, at book value. Kenrick No. 3 Plc acquired a 99% share in the Originator Trust and issued notes to finance the purchase. The Society retained a 1% share in the Originator Trust. The call option date for all notes is 11 January 2020.

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

To manage interest rate risk, the structured entities enter into derivative transactions with external derivative counterparties, paying a rate of interest based on the securitised mortgages and receiving a rate inherent in the debt issuances. Cash flows arising from these derivatives are accounted for on an accruals basis. The derivatives relating to the securitisations are treated as explained in Note 1, Accounting policies, to the 2019 Annual Report and Accounts. The Society is both originator and servicer for each of the issues.

The Society's obligations in respect of the Hawthorn and Kenrick securitisation vehicles are limited to transferring cash flows from the underlying assets and the Society and its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation programmes or holders of the issued notes. The parties holding the notes in issue are therefore only entitled to obtain payment to the extent of the resources in the Hawthorn and Kenrick securitisation vehicles respectively.

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

Section 11 – **Securitisation** (continued)

Consolidated structured entities for regulatory capital purposes (continued)

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

Securitisation Company and date of securitisation	**Type**	**Gross assets securitised 2019 £m**	**Total notes in issue 2019 £m**	**Retained notes in issue 2019 £m**	**Underlying assets past due more than one month 2019 £m**	Gross assets securitised 2018 £m	Total notes in issue 2018 £m	Retained notes in issue 2018 £m	Underlying assets past due and impaired 2018 £m
Hawthorn Finance Limited - 22 July 2008	Residential mortgage securitisation	**614.2**	**590.5**	**590.5**	**3.5**	667.3	641.0	641.0	3.0
Kenrick 2 - 28 May 2013	Residential mortgage securitisation	**-**	**-**	**-**	**-**	178.8	144.2	40.6	0.9
Kenrick 3 - 25 January 2018	Residential mortgage securitisation	**362.4**	**351.3**	**33.1**	**-**	392.7	382.3	33.1	-
		976.6	**941.8**	**623.6**	**3.5**	1,238.8	1,167.5	714.7	3.9

Table 33: Assets subject to on balance sheet securitisation and notes in issue.

The gross assets securitised in the above table are subject to impairment provisions of £1.1m (2018: £0.9m) and there were £6.8m of loans which were stage 3 under IFRS 9.

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

Purchased securitisation positions

The Society also invests in mortgage backed securities. The treatment of the Group's investment in mortgage backed securities is covered under Section 6 – 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 sale and repurchase, is regularly tested by Treasury and reported accordingly. The Society holds no re-securitisations.

The Society has invested in commercial mortgage backed securities issued by Sandwell Commercial Finance No. 2 Plc. As at 31 March 2019 these notes had a book value of £1.2m (2018: £2.7m) and of these, £1.0m (2018: £1.9m) was risk weighted and £0.2m (2018: £0.7m) was deducted, for capital purposes from reserves. The minimum capital requirement for the risk weighted element was £0.3m (2018: £0.5m).

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 2018/19.

RWA %	**CQS**	**2019 Exposure £m**	**2019 Capital £m**	2018 Exposure £m	2018 Capital £m
20%	1	**71.1**	**1.1**	89.6	1.4
50%	2	**-**	**-**	0.1	-
100%	3	**-**	**-**	-	-
350%	4	**1.0**	**0.3**	1.9	0.5
		72.1	**1.4**	91.6	1.9

Table 34: Purchased securitisation exposures and associated capital requirements by risk weight band.

Section 12 – **Asset encumbrance**

The following disclosures are presented in line with the EBA regulatory requirements. The values disclosed are median values of quarterly data on a rolling basis over the previous 12 months.

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
2019		**010**	**040**	**060**	**090**
010	**Assets of the reporting institution**	1,643.2		3,827.9	
040	Debt securities	-	-	275.2	275.2
120	Other assets*	-		212.9	

		Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
2018		**010**	**040**	**060**	**090**
010	Assets of the reporting institution	1,575.6		4,164.3	
040	Debt securities	-	-	313.9	313.9
120	Other assets*	-		208.1	

- *Other assets include derivative financial assets; property plant and equipment; intangible assets; prepayments; deferred tax assets; pension benefit surplus and investment properties. These assets would not be available for encumbrance in the normal course of business.

Template B – Collateral received

		Fair value of encumbered collateral received or own debt securities issued £m	Unencumbered Fair value of collateral received or own debt securities issued available for encumbrance £m
2019		010	040
130	Collateral received by the reporting institution	-	100.1
160	Debt securities	-	100.1
190	of which: issued by general governments	-	100.1
250	Total Assets, Collateral Received and On Debt Securities Issued.	1,643.2	

		Fair value of encumbered collateral received or own debt securities issued £m	Unencumbered Fair value of collateral received or own debt securities issued available for encumbrance £m
2018		010	040
130	Collateral received by the reporting institution	-	99.9
160	Debt securities	-	99.9
190	of which: issued by general governments	-	99.9
250	Total Assets, Collateral Received and On Debt Securities Issued.	1,575.6	

Section 12 – **Asset encumbrance** (continued)

Template C – Encumbered assets/collateral received and associated liabilities

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

2018		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and asset backed securities encumbered £m
		010	030
010	Carrying amount of selected financial liabilities	606.8	936.0

Table 35: EBA asset encumbrance templates.

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, Loans and advances to customers, within the 2019 Annual Report and Accounts. The Society also pledges debt securities as collateral in sale and repurchase (repo) transactions - see Note 40, Asset encumbrance, within the 2019 Annual Report and Accounts, which includes a general description of terms and conditions of the collateralisation agreements entered into for securing liabilities.

An additional source of encumbrance is the collateralisation of derivatives liabilities. The Society also treats some loans and advances to credit institutions and some debt securities as encumbered even though there are no associated liabilities. An example of this would be liquid assets held within the Society's securitisation programmes as these are not available for use in the Society's day-to-day operations.

Section 13 – **Remuneration and other corporate governance**

Governance arrangements

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435 are included in Section 3 of this report but are also supplemented by the disclosures included in the Directors' Report on Corporate Governance on pages 37 to 40 and Annual Business Statement on pages 138 to 140 within the 2019 Annual Report and Accounts. The 2019 Annual Report and Accounts are published on the Society's website (www.westbrom.co.uk).

The Remuneration Policy is subject to a binding vote of the members in line with that passed at the 2018 AGM. This policy will remain in place for the remainder of the three year term agreed, and will be subject to a further binding vote in 2021, unless any further changes to policy are proposed in the interim period, in which case a vote would be required before the changes were implemented.

Remuneration

The responsibilities and decision-making process for determining remuneration policy and membership of the management body, the link between pay and performance and the design and structure of remuneration, including the performance related pay plans, have been disclosed in the Directors' Remuneration Report within the 2019 Annual Report and Accounts on pages 44 to 51.

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 2019 Annual Report and Accounts does not include details of the remuneration of Code Staff required under CRD IV and this information is set out below.

Code staff

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

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

Year to 31 March 2019

	Number of beneficiaries	Fixed remuneration* £000	Variable remuneration (non-deferred) £000	Deferred variable pay from previous years £000	Total remuneration £000	*Outstanding deferred remuneration £000*
Non-Executive Director	9	494	-	-	494	-
Executive Director	2	928	176	78	1,182	214
Other Code staff	10	1,418	234	141	1,793	293
	21	2,840	410	219	3,469	507

Year to 31 March 2018

	Number of beneficiaries	Fixed remuneration* £000	Variable remuneration (non-deferred) £000	Deferred variable pay from previous years £000	Total remuneration £000	*Outstanding deferred remuneration £000*
Non-Executive Director	8	500	-	-	500	-
Executive Director	2	930	174	59	1,163	175
Other Code staff	10	1,471	240	142	1,853	311
	20	2,901	414	201	3,516	485

Table 36: Aggregate quantitative remuneration of Code Staff.

* Includes fees, basic salary, pension and other benefits. In the year to 31 March 2019 this also included compensation of £31,600 (2018: 56,800) which was determined with reference to the amount of performance-related pay award that one Executive Director would have received from his previous employer if he had stayed in post.

Section 13 – **Remuneration and other corporate governance** (continued)

Code staff (continued)

Remuneration for Code Staff

Component	Purpose	Operation	Performance Metrics
Basic Pay	Reflects level of responsibility.	Reviewed annually (or more frequently if required) linked to market benchmarking	Influencing factors include: • Role and experience; • Personal performance; • Benchmarking comparisons; and • 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. For Executive Directors only, the Remuneration Committee has the authority to increase the maximum to 75% should it be considered appropriate. 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; and • Enhanced operational capabilities. Reviewed by the Committee annually to ensure that the measures are appropriate.
Pension or Pension Allowance	A part of fixed remuneration intended to attract and retain individuals of sufficient calibre.	Executive Directors and Divisional Directors are invited to join the Society's stakeholder pension plan or, as an alternative, be provided with a cash allowance. 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 or cash allowance, private medical care and life assurance. Other benefits may be provided in individual circumstances. Non-Executive Directors do not receive any benefits.	Not applicable.

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.

Severance payments

In the year to 31 March 2019 severance costs of £176,000 (2018: nil) were recorded, with £118,000 (2018: nil) paid in the year and £58,000 (2018: nil) deferred to the following year. These amounts, which related to one member of other code staff, are not included in table 36.

Section 14 – **Adequacy of risk management controls**

The Board confirms that the Risk Management Report contained in the 2019 Annual Report and Accounts and the Pillar 3 disclosures above are a fair description of the principal risks and uncertainties that the Society faces. The Board aims to manage effectively all the risks that arise from its activities and believes that the risk management arrangements and controls put in place are adequate with regards to the Society's profile and strategy. The principal external threats facing the Society are outlined in the Risk Management Report within the 2019 Annual Report and Accounts on pages 25 and 31.

By order of the Board.

Section 15 – **Contacts**

Should you have any queries please contact:

Manjit Hayre	Chief Risk Officer
Tom Lynch	Divisional Director, Treasury and Finance
Neil Noakes	Group Secretary

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

Section 16 – **Glossary**

Additional Tier 1 (AT 1) capital
Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to CET1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as PIBS.

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

Available for sale reserve (AFS)
The AFS contains unrealised gains and losses arising from changes in the fair value of non-derivative financial assets that are categorised as available for sale. This has been replaced by fail value through other comprehensive income (FVOCI) reserve.

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 Handbook (now PRA rulebook).

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.

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

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

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

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

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

Core Capital Deferred Shares (CCDS)
CCDS are a form of CET1 capital issued by building societies. They rank behind depositors and creditors.

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

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

Counterparty Credit Risk (CCR) Mark to Market method
One of the methods allowed under the Standardised Approach for determining exposure values for financial derivative instruments.

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

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

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

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

CRR Mark to Market method
This is a method for calculating counterparty credit risk exposures for financial derivatives, securities financing transactions and long settlement transactions.

Derivative financial instrument
A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.

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

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

ECL - 12 month
12-month ECL denote the portion of Lifetime Expected Credit Losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

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

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

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

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

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

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

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

Section 16 – **Glossary** (continued)

Individual Capital Guidance (ICG)
The minimum amount of capital the Society should hold as set by the regulator under Basel III following a SREP exercise and a review of the Society ICAAP. This terminology is being replaced with the TCR.

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

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

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

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

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

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

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

Liability Management Exercise (LME)
The LME completed by the Society in April 2018 in order to modernise the Society's capital structure. Existing PPDS and PIBS were exchanged for a combination of CCDS, Tier 2 Notes and cash. See Section 5 for fuller details.

Loan-to-Value (LTV)
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.

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

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.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL)
The final framework and policies for setting Minimum Requirements for Own Funds and Eligible Liabilities (MREL) have been published as part of EU's Bank Recovery and Resolution Directive, The Society will be classified as a "modified insolvency" firm for the purposes of MREL. This means that the MREL regime does not introduce any additional capital requirements for the Society.

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

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

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

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

Permanent Interest Bearing Shares (PIBS)
Unsecured, deferred shares that, under transitional rules, are a form of Additional Tier 1 capital. PIBS rank behind the claims of all depositors and creditors of the Society other than the Society's 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 TCR is an outcome from Pillar 2.

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

Profit Participating Deferred Shares (PPDS)
Unsecured deferred shares exchanged and cancelled under the LME in April 2018, which were a form of CET1 capital. PPDS ranked behind depositors and creditors of the Society.

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

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

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

Residual maturity
The remaining period to the contractual maturity date of a financial asset or financial liability.

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

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

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

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

Stage 1 (IFRS 9)
Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the Balance Sheet. 12 month ECLs are recognised as the impairment provision for all financial assets on initial recognition.

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

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

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

Supervisory Review and Evaluation Process (SREP)
The Regulator's assessment of a firm's own capital adequacy assessment (ICAAP) under Basel III Pillar 2.

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

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

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.

Tier 2 capital
A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.

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

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

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

Appendix 1 – EBA Capital instruments key features disclosure template

The table below shows the capital instruments currently issued by the Society as at the year end. As part of the settlement of the LME on 12 April 2018 the PPDS were exchanged and cancelled in full. The full terms and conditions of the PPDS including the Special Conditions of Issue of the PPDS prior to their cancellation can also be found on the Society's website: PPDS Special Conditions. The full terms and conditions of the capital instruments still in issue are available on the Society's website as detailed below:

		PIBS	CCDS[1]	Tier 2 Notes[1]
1.	Issuer	West Bromwich Building Society	West Bromwich Building Society	West Bromwich Building Society
2.	ISIN	GB00B0CX2M20	GB00BYWR8Q80	XS1775405795
3.	Gov. law (sub)	English	English	English
4.	Trans. CRR rules	Additional Tier 1	CET1	Tier 2
5.	Post-transitional CRR rules	Ineligible	CET1	Tier 2
6.	Eligible at Group (G), Individual Consolidated (IC) or Society (S)	G, IC, S	G, IC, S	G, IC, S
7.	Instrument type (types to be specified)	Permanent Interest Bearing Shares	Core Capital Deferred Shares	Tier 2 Subordinated Notes
8.	Regulatory capital value (£)	£8.9m	£127.0m[2]	£21.6m [3]
9.	Nominal amount of instrument	£8.9m	£128.9m[4]	£22.5m
9a.	Issue px	99.8	100.0	100.0
9b.	Redemption px	100.0	n/a	100.0
10.	Accounting classification	Shareholders equity	Shareholders equity	Liability - amortised cost
11.	Original date of issuance	29/07/2005	12/04/2018	12/04/2018
12.	Perpetual or dated	Perpetual	Perpetual	Dated
13.	Original maturity date	No maturity	No maturity	12/04/2038
14.	Issuer call	Yes 05/04/2021	No	Yes 12/04/2033
15.	Optional call date, contingent call dates and redemption	05/04/2021	n/a	12/04/2033; par regulatory/tax call
16.	Subsequent call dates, if applicable	Half yearly	n/a	Half yearly
17.	Fixed or floating dividend/coupon	See 18 below	Variable, cap[5]	Fixed
18.	Coupon rate and any related index	Discretionary up to 6.15% until 2021 (reset in 2021 and every five years thereafter)	0% for financial year ended 31 March 2019. The distribution cap is currently £16.11 per share.[5]	11%
19	Existence of a dividend stopper	No[6]	No	No
20.a/b	Fully discretionary, partially discretionary or mandatory	Fully discretionary	Fully discretionary	Mandatory
21.	Existence of step up or other incentive	Yes	No	No
22.	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	n/a
23.	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
30.	Write-down features	None contractual, statutory via bail in or capital write-down	None contractual, statutory via bail in or capital write-down	None contractual, statutory via bail in or capital write-down
35.	Instrument type immediately senior	Tier 2	Additional Tier 1	Senior Unsecured
36.	Non-compliant transitioned features	Yes	No	No
37.	If yes, specify non-compliant features	Step-up	n/a	n/a
	Full terms and conditions of the instruments can be found at :	PIBS prospectus PIBS variation of conditions PIBS updated terms and conditions	CCDS full terms and conditions	Tier 2 Notes full terms and conditions

Notes:

1. These instruments were only added after the financial year ended 31 March 2018 and have been updated in this Pillar 3 document to reflect the position as stated in the 30 September 2018 Interim Statement and 2019 Annual Report and Accounts.
2. The regulatory capital value reflects the nominal value upon initial recognition less any associated issue costs.
3. The regulatory capital value reflects estimates of the fair value adjustment to the nominal value upon initial recognition.
4. Nominal amount of £1 per CCDS, with the Issue Price of £100 per CCDS (representing £1 of Nominal Amount and £99 of premium per CCDS).
5. As indicated in the Society's Distribution Policy and subject to a cap per CCDS, adjusted annually for inflation by reference to the UK CPI published by the ONS.
6. The PIBS conditions were varied at a meeting on 9 April 2018, removing the dividend stopper prohibiting payments on any other class of deferred shares with effect from the 10 April 2018.

Appendix 2 – EBA Countercyclical Capital Buffers disclosure templates

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

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

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

Row		General Credit Exposure value for SA	Securitisation Exposure value for SA	Own Funds requirements			Own fund requirement weights	Countercyclical capital buffer rate
				Of which: General credit exposures	Of which: Securitisation exposures	Total		
		10	50	70	90	100	110	120
		£m	£m	£m	£m	£m	%	%
10	UK	5,085.6	72.1	180.6	1.4	182.1	100%	1%
20	Total	5,085.6	72.1	180.6	1.4	182.1	100%	1%

Table 37: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer.

Amount of institution-specific countercyclical capital buffer

Row		Column
		10
10	Total risk exposure amount	£2,401m
20	Institution specific countercyclical buffer rate	1%
30	Institution specific countercyclical buffer requirement	£24.0m

Table 38: Amount of institution-specific countercyclical capital buffer.

Appendix 3 – **EBA Own Funds disclosure template**

Common Equity Tier 1 (CET1) Capital: instruments and reserves		Transitional 2019 £m	Full Implementation 2019 £m	Transitional 2018 £m	Full Implementation 2018 £m
1	Capital instruments and the related share premium accounts	**127.0**	**127.0**	175.0	175.0
2	Retained earnings	**247.1**	**247.1**	215.8	215.8
3	Accumulated other comprehensive income (and other reserves)*	**7.8**	**7.8**	8.5	8.5
5	Common Equity Tier 1 (CET1) capital before regulatory adjustments	**381.9**	**381.9**	399.3	399.3
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	**(0.3)**	**(0.3)**	(0.4)	(0.4)
8	Intangible assets (net of related deferred tax liability) (negative amount)	**(16.5)**	**(16.5)**	(15.3)	(15.3)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	**(13.1)**	**(13.1)**	(8.7)	(8.7)
	Other regulatory adjustments (IFRS 9)	**31.4**	-	-	-
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	**(0.2)**	**(0.2)**	(0.7)	(0.7)
20c	of which: securitisation positions (negative amount)	**(0.2)**	**(0.2)**	(0.7)	(0.7)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	**1.3**	**(30.1)**	(25.1)	(25.1)
29	Common Equity Tier 1 (CET1) capital	**383.2**	**351.8**	374.2	374.2
Additional Tier 1 (AT1) capital: instruments					
32	Capital instruments classified as equity under applicable accounting standards	**8.9**	**-**	30.0	-
36,44	Additional Tier 1 (AT1) capital	**8.9**	**-**	30.0	-
45	Total Tier 1 Capital	**392.1**	**351.8**	404.2	374.2
Tier 2 Capital Tier 2 (T2) capital: instruments and provisions					
50	Credit risk adjustments	**21.6**	**21.6**	16.3	16.3
51,58	Total Tier 2 Capital	**21.6**	**21.6**	16.3	16.3
59	Total Capital	**413.7**	**373.4**	420.5	390.5
60	Total risk weighted assets	**2,400.6**	**2,321.7**	2,523.1	2,523.1
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**16.0%**	**15.2%**	14.8%	14.8%
62	Tier 1 (as a percentage of total risk exposure amount)	**16.3%**	**15.2%**	16.0%	14.8%
63	Total capital (as a percentage of total risk exposure amount)	**17.2%**	**16.1%**	16.7%	15.5%
64	Institution specific buffer requirement (CET1 requirement in accordance with Article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	**8.0%**	**8.0%**	6.4%	6.4%
65	of which: capital conservation buffer requirement	**2.5%**	**2.5%**	1.9%	1.9%
66	of which: countercyclical buffer requirement	**1.0%**	**1.0%**	0.0%	0.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)[1]	**7.4%**	**6.3%**	5.4%	4.2%

Table 39: EBA Own Funds disclosure templates.

* In the template above, other comprehensive income includes an adjustment to add back the loss within the risk remote securitisations that was deducted from accounting reserves £4.6m (2018: £4.3m).

(1) The CET 1 available to meet buffers is after allowing for the TCR of 9.8% (2018: 11.3%).

In line with EBA guidelines, specific rows that are not considered to be relevant to the Society's activities or for which the information provided would not be material have been omitted.

Appendix 4 – **EBA Leverage Ratio disclosure templates**

Reference Date	31 March 2019 (31 March 2018 for comparatives)
Entity Name	West Bromwich Building Society
Level of application	Consolidated

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

		2019 Transitional £m	2019 Full Implementation £m	2018 Transitional £m	2018 Full Implementation £m
1	Total assets as per published financial statements	**5,553.9**	**5,553.9**	5,781.5	5,781.5
4	Adjustments for derivative financial instruments	**(6.8)**	**(6.8)**	(7.5)	(7.5)
5	Adjustments for securities financing transactions "SFTs"	**49.9**	**49.9**	70.0	70.0
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**14.8**	**14.8**	62.0	62.0
7	Other adjustments	**(25.5)**	**(25.5)**	(20.8)	(20.8)
8	**Total leverage ratio exposure**	**5,586.3**	**5,586.3**	5,885.2	5,885.2

Template B:Table LRCom: Leverage ratio common disclosure

		2019 Transitional £m	2019 Full Implementation £m	2018 Transitional £m	2018 Full Implementation £m
	On balance sheet exposures (excluding derivatives and SFTs)				
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**5,547.4**	**5,547.4**	5,762.0	5,762.0
2	(Asset amounts deducted in determining Tier 1 capital)	**(25.5)**	**(25.5)**	(20.8)	(20.8)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**5,521.9**	**5,521.9**	5,741.2	5,741.2
	Derivative exposures				
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	**0.7**	**0.7**	4.2	4.2
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**16.1**	**16.1**	14.9	14.9
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(17.1)**	**(17.1)**	(7.1)	(7.1)
11	**Total derivative exposures (sum of lines 4 to 10)**	**(0.3)**	**(0.3)**	12.0	12.0
	Securities financing transaction exposures				
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**49.9**	**49.9**	70.0	70.0
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**49.9**	**49.9**	70.0	70.0
	Other off-balance sheet exposures				
17	Off-balance sheet exposures at gross notional amount	**74.0**	**74.0**	124.0	124.0
18	(Adjustments for conversion to credit equivalent amounts)	**(59.2)**	**(59.2)**	(62.0)	(62.0)
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	**14.8**	**14.8**	62.0	62.0
	Capital and total exposures				
20	**Tier 1 capital**	**392.1**	**351.8**	404.2	374.2
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**5,586.3**	**5,586.3**	5,885.2	5,885.2
22	**Leverage ratio (%)**	**7.0%**	**6.3%**	6.9%	6.4%
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Transitional**	**Full implementation**	Transitional	Full Implementation

Appendix 4 – EBA Leverage Ratio disclosure templates (continued)

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

		2019 Transitional £m	2019 Full Implementation £m	2018 Transitional £m	2018 Full Implementation £m
EU-1	**Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:**	**5,547.4**	**5,547.4**	5,762.0	5,762.0
EU-3	**Banking book exposures, of which:**	**5,547.4**	**5,547.4**	5,762.0	5,762.0
EU-4	Covered bonds	**143.9**	**143.9**	139.8	139.8
EU-5	Exposures treated as sovereigns	**273.5**	**273.5**	389.6	389.6
EU-7	Institutions	**93.4**	**93.4**	130.1	130.1
EU-8	Secured by mortgages of immovable properties	**4,384.1**	**4,384.1**	4,411.0	4,411.0
EU-9	Retail exposures	**71.5**	**71.5**	44.2	44.2
EU-10	Corporate	**26.0**	**26.0**	16.2	16.2
EU-11	Exposures in default	**263.2**	**263.2**	332.3	332.3
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	**291.8**	**291.8**	298.8	298.8

Table 40: EBA Leverage Ratio disclosure templates.

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

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

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

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

The Society's leverage ratio has increased by 0.1% to 7.0% (2018: 6.9%). The net increase is due to the reduction in total assets during the year.

In line with EBA guidelines, specific rows that are not considered to be relevant to the Society's activities or for which the information provided would not be material have been omitted.

Appendix 5 – Supplementary information – analysis of directorships

The following table shows the number of external directorships held by the members of the management body of the Society.

	Number of external group directorships
Julie Hopes	2
Mark Nicholls	1
Mark Preston	1
Martin Ritchley	0
Lynne Shamwana	1
James Turner	1
Ashraf Piranie	3
Jonathan Westhoff	0

Table 41: Analysis of number of external directorships held by the members of the management body of the Society as at 31 March 2019.

In the table above, in line with article 91 of the CRD IV rules, multiple directorships within the same group are treated as a single role and directorships with bodies that do not predominantly pursue commercial objectives are also excluded.

Further details of the Directors and other members of the management body of the Society can be found on pages 32 to 33 of the 2019 Annual Report and Accounts.

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