Pillar 3 Capital Disclosures (under CRD IV)

for the year ended 31 March 2014

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Section 1 – **Overview**

Background

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

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

The reforms implemented under CRD IV, bring in more stringent requirements for the eligibility of capital instruments. The focus is on having 'fully loss absorbing' capital referred to as Common Equity Tier 1. Tier 1 capital that is not deemed to be fully loss absorbing can be included within capital as Additional Tier 1 capital under CRD IV, but only under transitional arrangements, which cover a nine year period.

In addition to changes affecting the eligibility of capital instruments, CRD IV has brought in a number of deductions which are applied to capital. Some of the deductions are temporary, applying only to the current year whilst others are expected to be a permanent feature of CRD IV. These deductions, including identification as to whether they are permanent or temporary, have been included in this report.

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

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

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

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

On 1 April 2013 the responsibility for the regulation of the Society was transferred from the Financial Services Authority (FSA) and split between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). In this document the PRA and FCA are described as 'the Regulator'. In addition to the assessment of capital requirement under CRD IV, the Group's overall capital requirement is also reviewed and agreed by the Regulator under the Supervisory Review and Evaluation Process (SREP). Under this process, the Regulator sets the Individual Capital Guidance (ICG) for the Group, which is the minimum amount of capital that the Group should hold.

Basis and frequency of disclosure

This document has been prepared to meet the disclosure requirements of CRD IV and is issued on an annual basis in conjunction with the publication of the Group's Annual Report and Accounts. The document is based upon the Group's Annual Report and Accounts for the year ended 31 March 2014, unless otherwise stated.

Location and verification

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

Scope

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

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

West Bromwich Mortgage Company Limited (includes quasi-subsidiary – Hawthorn Finance Limited);
West Bromwich Commercial Limited;
West Bromwich Homes Limited;
Insignia Finance Limited;
Kenrick No. 1 Plc. (a quasi-subsidiary); and
Kenrick No. 2 Plc. (a quasi-subsidiary)

Full details of the principal subsidiary undertakings are included in Note 16 to the Annual Report and Accounts for the year ended 31 March 2014. There is a requirement to calculate and maintain regulatory capital ratios on both a Group and Society Solo consolidated basis. However, for West Bromwich Building Society, there are no significant differences between the Group and Society Solo consolidation figures. Therefore, this document includes only the Group analysis.

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

Section 2 – Risk Management Objectives and Policies

Overview

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

Categorisation

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

The main risks we manage are:

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

Risk management framework

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

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

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

	Activity	Responsibility	Governance
1st	Business Operations	Line Management	Line Management Oversight
2nd	Policy, Controls, Measurement, Monitoring	Control Functions	Management and Board Committees
3rd	Assurance	Internal Audit	Audit Committee

Table 1: Group's risk management framework

Governance structure

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

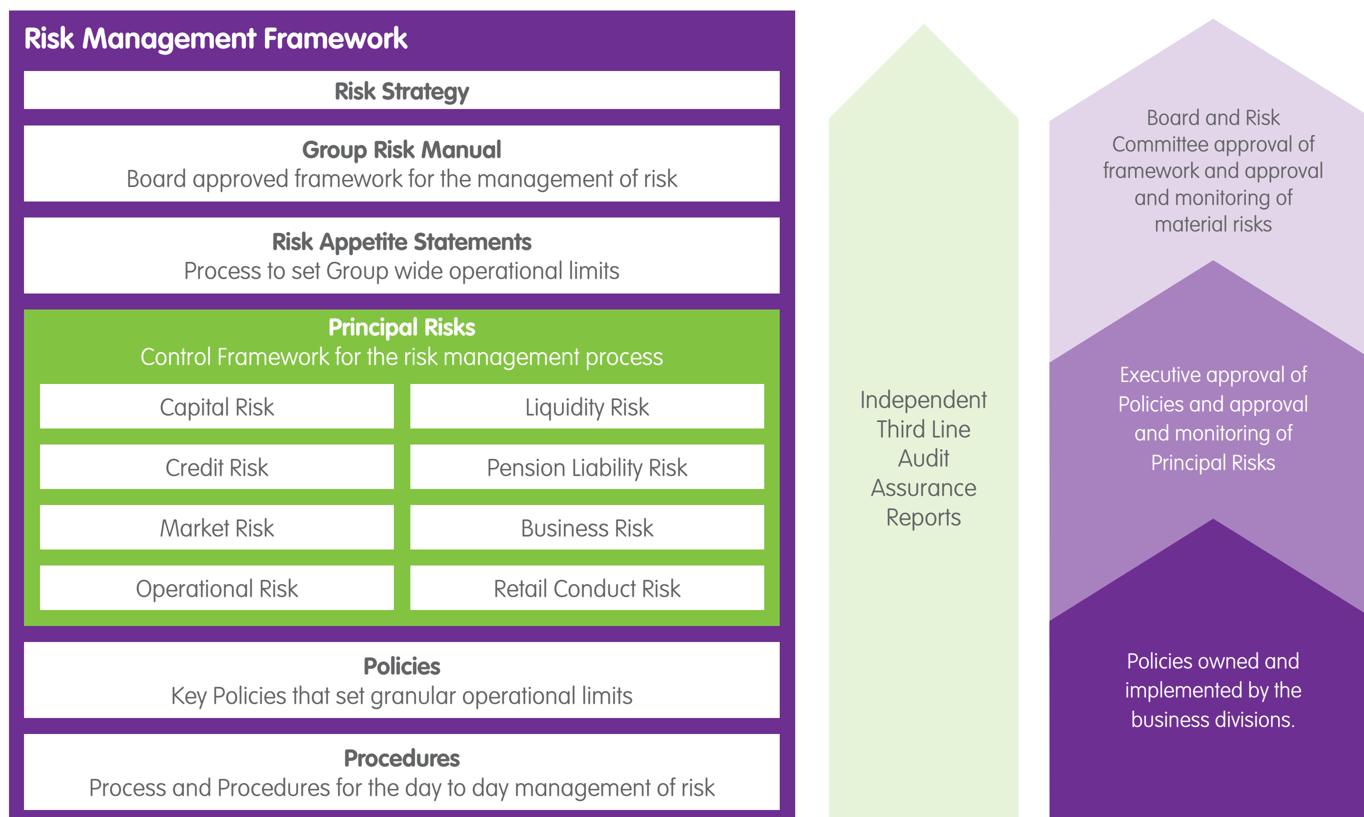
- **Risk Committee (RC)** – This committee is chaired by a Non-Executive Director and is responsible for the oversight and management of the key strategic risks identified by the Board.
- **Assets & Liabilities Committee (ALCo)** – This committee is chaired by the Group Finance Director and is responsible for the assessment of exposure to treasury counterparty credit, market, liquidity and interest rate risk.
- **Residential Credit Committee (RCC)** – This committee is chaired by the Chief Risk Officer and is responsible for monitoring the Group'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 Group's exposure to credit risks in the commercial loan book.
- **Operational Risk Committee (ORC)** – This committee is chaired by the Chief Risk Officer and is responsible for the oversight of the management of operational risks arising from the Group's business activities.
- **Group Capital Committee (GCC)** – This committee is chaired by the Group Finance Director and is responsible for reviewing the Group's capital resources and capital requirements.
- **Retail Conduct Risk Committee (RCRC)** – This committee is chaired by the Chief Executive and is responsible for reviewing and monitoring all retail conduct related matters.
- **Executive Committee (ExCo)** – This committee is chaired by the Chief Executive and is responsible for monitoring, review and management of the key strategic and operational risks identified by the Senior Management team.

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

Section 2 – Risk Management Objectives and Policies (continued)

Reporting on key risk measures

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



Risk strategy

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

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

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

Section 3 – **Capital Resources**

Total available capital

The table below summarises the composition of regulatory capital for the Group as at 31 March 2014, under both the transitional and full implementation basis of CRD IV. During the year ended 31 March 2014, the individual entities within the Group and the Group itself complied with all of the externally imposed capital requirements to which they are subject.

At 31 March

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

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

Tier 1 capital

- Revaluation reserve relates to the increase in value of the land and buildings owned by the Group and held for use by the business.
- PPDS are a form of Common Equity Tier 1 capital for building societies which are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society but rank pari-passu with PIBS. The PPDS are entitled to receive a distribution, at the discretion of the Society, of up to 25% of the Group's post-tax profits in the future (calculated prior to payment of the PPDS dividend). No such distribution may be made if the cumulative reserves are in deficit. Further details about PPDS are provided in Note 29 to the Annual Report and Accounts.
- PIBS are unsecured deferred shares and in a winding up or dissolution of the Society, rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society but rank pari-passu with PPDS. The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society.

  With respect to future interest payments, as a condition of the PPDS, the Society has undertaken to pay an amount which, when annualised, represents the lower of: 6.15% of the outstanding principal amount of the PIBS and the dividend yield attributable to the PPDS with respect to the prior financial year ending 31 March whose payment is at the discretion of the Society. Further details about PIBS are provided in Note 28 to the Annual Report and Accounts.

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

Tier 1 capital (continued)

- The available for sale reserve and reserves generated by the revaluation of investment properties cannot be included in capital for 2014, but are included from 1 January 2015, and are therefore not shown as reconciling items in the full implementation column.
- The cash flow hedging reserve is not included in capital.
- Intangible assets include capitalised software and goodwill. A full deduction is made from CET1 for intangible assets and goodwill.
- Under the rules of CRD IV (transitional and on full implementation) deferred tax assets relating to previous operating losses are deducted from capital.
- Under the transitional rules applicable to the current year, 20% of the value of PIBS is deducted from Tier 1 capital. Under the transitional rules the amortisation deduction is increased by 10% per annum every 1 January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS.
- A 50% weighting is applied to mortgage pipeline and committed facilities as per the Basel III leverage ratio framework.

Tier 2 capital

- Collective provisions can be added back to Tier 2 capital.

Reconciliation of regulatory capital

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

At 31 March

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

Table 3: Reconciliation of accounting capital to regulatory capital

Regulatory capital flow statement

The table below shows the flow of regulatory capital and associated deductions in 2014, including the adjustments relating to the adoption of the new regulatory capital definitions under CRD IV:

At 31 March

	£m
Core Tier 1 capital at 31 Mar 2013	398.2
Prior year adjustment (note 1)	2.8
Core Tier 1 capital at 1 April 2013 (restated)	401.0
Profit for the period	1.0
Other comprehensive income recognised directly in general reserves	(9.1)
Intangible fixed assets and goodwill	(0.8)
Movement in credit exposure to securitisations	3.7
Derecognition of unrealised reserves on investment properties under CRD IV transitional rules	(22.4)
Derecognition of deferred tax asset relating to operating losses under CRD IV transitional rules	(17.5)
Transfer of b/f revaluation reserve from Tier 2 capital under CRD IV	3.7
Exclude other reserves	4.8
Other movements	(1.2)
Common Equity Tier 1 capital at 31 March 2014	363.2
Additional Tier 1 capital at 1 April 2013	74.9
Amortisation of PIBS under transitional rules	(15.0)
Additional Tier 1 capital at 31 March 2014	59.9
Tier 2 capital at 1 April 2013	10.4
Movement in collective impairment allowance	8.9
Transfer of b/f revaluation reserve from Core Tier 1 capital under CRD IV	(3.7)
Other movements	(0.5)
Tier 2 capital at 31 March 2014	15.1
Regulatory capital at 31 March 2014	**438.2**

Table 4: Regulatory capital flow statement

Note 1: Restated due to the implementation of IFRIC 21 'Levies'. The implementation constitutes a change in accounting policy and is therefore retrospectively applied. For further detail, see note 1 to the Annual Report and Accounts.

Section 4 – **Capital Adequacy**

Capital risk

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

Capital management and reporting

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

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

The regulatory capital adequacy of the Solo consolidation and the consolidation Group are reported to the Regulator quarterly and half yearly respectively. In addition, Group capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the Group Capital Committee, Risk Committee and the Board.

Summary of approach to capital adequacy planning

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

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

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

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

Minimum capital requirement – Pillar 1

Under the Regulator's rules, a minimum level of capital (Pillar 1) must be held for credit risk, operational risk and market risk. The Group has adopted the Standardised Approach to calculate the minimum regulatory capital resource requirement for credit risk and operational risk. The capital resource requirement for market risk has been calculated in accordance with the requirements of the Capital Requirements Regulation.

The table overleaf shows the Group's overall minimum capital requirement for credit, operational and market risk.

The credit risk requirement has been calculated under the Standardised Approach (expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised credit risk exposure classes) at 31 March 2014. Details of the Standardised Approach to the calculation of regulatory requirements are contained in the PRA Handbook.

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

Minimum capital requirement – Pillar 1 (continued)

At 31 March

	2014 Average risk weights %	2014 £m	2013* Average risk weights %	2013* £m
Credit risk				
Residential mortgage loans (performing)	**36.9**	**109.2**	38.5	119.2
Commercial mortgage loans (performing)	**98.6**	**30.4**	98.9	55.4
Residential mortgage loans (past due)	**100.3**	**11.7**	98.7	7.0
Commercial mortgage loans (past due)	**143.9**	**38.6**	145.6	15.6
Liquidity (Treasury instruments and cash)	**14.8**	**9.0**	11.1	9.2
Other items	**100.0**	**9.3**	100.0	12.6
Total capital requirements – credit risk		**208.2**		219.0
Operational risk - Standardised Approach		**6.4**		5.6
Market risk (primarily the counterparty risk capital component)		**1.5**		0.8
Total Pillar 1 capital requirement		**216.1**		225.4
Total capital available		**438.2**		483.5
Excess of capital over minimum capital requirement under Pillar 1		**222.1**		258.1

Note *: The comparative risk weighted assets and corresponding risk weights are calculated under the Basel II regime as disclosed in the 2012/13 Pillar III report.

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

Quality of capital

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

At 31 March

	Transitional CRD IV rules		Full implementation of CRD IV	
	Minimum 2014	**Actual 2014**	Minimum 2014	Actual 2014
Common Equity Tier 1 ratio	**4.5**	**13.4**	4.5	14.3
Tier 1 ratio	**6.0**	**15.7**	6.0	14.3
Total capital ratio	**8.0**	**16.2**	8.0	14.9

Table 6: Group capital ratios

CRD IV applies the principle that Tier 1 capital is available to absorb losses of the business on a 'going concern' basis. The Society's PIBS are not able to do this, and therefore will not be eligible as Tier 1 capital. These PIBS are 'grandfathered' and recognised as additional Tier 1 capital on an amortising basis, with 80% of the nominal value of the PIBS included in the above figure. This reduces by 10% per annum each subsequent 1st January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS.

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

Leverage

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

At 31 March

	Transitional CRD IV rules 2014 £m	Full implementation of CRD IV 2014 £m
Total Tier 1 capital (per table 2)	**423.1**	390.0
Total assets per the Statement of Financial Position	**5,650.5**	5,650.5
Mortgage pipeline and committed facilities	**30.8**	30.8
Common Equity adjustments relating to assets	**(54.5)**	(27.6)
Netted derivative adjustment	**(21.5)**	(21.5)
Adjusted assets – based on accounting group	**5,605.3**	5,632.2
Special purpose entities with significant risk transfer (per Section 8)	**(173.2)**	(173.2)
Adjusted assets – based on regulatory group	**5,432.1**	5,459.0
Leverage ratio – based on accounting group (%)	**7.5**	6.9
Leverage ratio – based on regulatory group (%)	**7.8**	7.1

Table 7: Group leverage ratio

At 31 March 2014 the leverage ratio of the Society was significantly above the 3% regulatory minimum. Under the transitional CRD IV provisions it was at 7.5% based on the accounting group and 7.8% based on the regulatory group. Upon full implementation these figures will reduce to 6.9% and 7.1% respectively. A modest reduction is expected during 2014/15 as the Society returns to net balance sheet growth by increasing the level of high quality prime new lending assets. In considering a target for this ratio the Society recognises the importance of continuing to originate high quality assets even though this will have the effect of diluting the current leverage ratio. The Society expects to continue to operate at a leverage ratio that is considerably in excess of the regulatory requirements including a buffer appropriate to the nature of its business model.

The Board's preferred measure is a risk weighted asset measure and this shows a Common Equity Tier 1 ratio of 13.4%. Whilst no absolute target has been set for this measure, based on current methodology this ratio is expected to be maintained at, or close to current levels.

Risk weighted assets (RWA) flow statement

The following table shows the movement in credit risk RWAs over the year to 31 March 2014. Movements reflect changes in book size, book quality and model updates.

At 31 March – Transitional CRD IV rules

	Residential Mortgages 2014 £m	**Commercial mortgages 2014 £m**	**Treasury 2014 £m**	**Other 2014 £m**	**Total 2014 £m**
Risk weighted assets at 1 April 2013	1,577.5	887.5	115.0	157.5	**2,737.5**
Measurement change	55.8	58.0	(0.6)	(41.6)	**71.6**
Portfolio size decrease	(55.2)	(111.1)	(29.9)	(0.6)	**(196.8)**
Portfolio quality (increase)/decrease	(66.8)	28.5	29.0	-	**(9.3)**
Risk weighted assets at 31 March 2014	1,511.3	862.9	113.5	115.3	**2,603.0**

Table 8: Risk weighted assets flow statement for on balance sheet assets

The reduction in both residential and commercial mortgages is a direct result of the Society's Back to Basics strategy. The Society's capital position has been enhanced through a measured balance sheet contraction programme particularly focused on higher risk non-core assets. This is reflected in the book quality improvement which also includes the positive benefit of decreasing loan to value ratios due to house price increases and general improving performance of the underlying residential mortgages.

Section 5 – **Credit Risk**

Credit risk overview

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

During the year, all lending activity was in accordance with the approved credit policy, which is consistent with the risk appetite established by the Board and has been restricted to prime residential owner occupied lending. Currently, no new commercial, buy-to-let, sub-prime or self-certified lending is being undertaken.

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

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

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

Analysis of treasury credit risk exposures

The following tables analyse the Group's regulatory credit risk exposures to Treasury counterparties as at 31 March 2014. These encompass both on and off balance sheet exposures (after accounting offsets). They are therefore not directly comparable with the figures reported in Note 34 to the Annual Report and Accounts. The prior year balances have been restated to reflect the inclusion of accounting offsets. The Group has no exposure in its liquidity portfolio to Cyprus, Greece, Ireland, Italy, Portugal or Spain, the emerging markets or to any mortgage market other than the UK and no exposure to non-UK sovereign debt.

At 31 March

	Notes	**2014 £m**	2013 £m	Average over year £m
Concentration by credit grading				
AAA to AA-		**508.8**	794.6	656.3
A+ to A-		**224.7**	200.9	231.5
Building societies		**44.6**	31.7	37.7
BBB+ to BBB-	1	**17.5**	2.4	7.9
BB+ to BB-	1	**2.4**	8.3	5.9
		798.0	1,037.9	939.3
Concentration by sector				
UK Government & Bank of England		**136.3**	392.3	243.1
Supranational financial institutions		**127.4**	197.4	210.9
Financial institutions		**437.4**	324.4	364.9
Mortgage backed securities		**96.9**	123.8	120.4
		798.0	1,037.9	939.3

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

Notes:

1. These credit grading bands include investments in mortgage backed securities issued by Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc. Further details can be found in Section 8.

Analysis of treasury credit risk exposures (continued)

At 31 March

	2014 £m	2013 £m	Average over year £m
Concentration by region			
UK	**543.9**	771.3	599.2
Europe (excluding UK)	**96.3**	64.0	78.6
North America	**9.8**	-	5.4
Australasia	**20.6**	5.2	10.9
Supranational financial institutions	**127.4**	197.4	245.2
	798.0	1,037.9	939.3

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

Residual maturity breakdown of treasury exposures by asset class

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

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

Residual breakdown of exposures by asset class

At 31 March 2014

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

At 31 March 2013

	Notes	< 1 year £m	1 – 5 years £m	> 5 years £m	No specific maturity £m	Total £m
UK Government & Bank of England		386.8	-	-	5.5	392.3
Supranational financial institutions		66.1	131.3	-	-	197.4
Financial institutions		141.9	104.9	77.6	-	324.4
Mortgage backed securities	1	28.7	64.6	30.5	-	123. 8
		623.5	300.8	108.1	5.5	1,037.9

Table 10: Residual maturity analysis of liquidity exposures

Notes:

1. The mortgage backed securities all relate to prime loans secured on property located in the United Kingdom.

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

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

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

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

At 31 March

	Notes	Risk Weight %	Fitch ratings	Moody's ratings	**2014 Exposure values £m**	2013 Exposure values £m
UK Government & Bank of England						
Credit quality step						
1	1	0	AAA	Aaa	**126.0**	384.5
Total					**126.0**	384.5
Supranational financial institutions						
Credit quality step						
1		0	AAA	Aaa	**127.4**	197.4
Total					**127.4**	197.4
Financial institutions						
Credit quality step						
1		20	AAA to AA-	Aaa to Aa3	**154.3**	92.8
2	2	50	A+ to A-	A1 to A3	**249.6**	223.6
3		50	BBB+ to BBB-	Ba1 to Ba3	**0.3**	-
Total					**404.2**	316.4
Securitisation positions						
Credit quality step						
1		20	AAA to AA-	Aaa to Aa3	**86.4**	112.1
2		50	A+ to A-	A1 to A3	**0.5**	1.0
3		100	BBB+ to BBB-	Baa1 to Baa3	**7.6**	8.3
4		350	BB+ to BB-	Ba1 to Ba3	**2.4**	2.4
Total					**96.9**	123.8

Table 11: Analysis of the liquidity exposures into credit quality steps based on the ratings as at 31 March 2014

Notes:

1. On 19 April 2013 Fitch downgraded their UK Government rating from AAA to AA+.

2. Includes rated building societies.

Capital required under Pillar 1 for liquidity was £9.0m (2012/13: £9.2m).

Treasury credit risk mitigation

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

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

Treasury credit risk mitigation (continued)

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

Concentration risk

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

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

At 31 March

	2014 £m	2013 £m
Housing association	**-**	0.1
Residential	**22.9**	30.2
Healthcare and leisure	**184.4**	205.2
Industrial and warehouse	**16.8**	37.1
Office	**103.3**	117.6
Retail	**361.8**	392.9
Other	**20.5**	22.5
	709.7	805.6

Table 12: Analysis of the commercial loan portfolio by industry type

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

At 31 March

	2014 £m	2013 £m
East Anglia	**18.1**	20.5
East Midlands	**43.4**	52.4
Greater London	**142.6**	167.1
North	**41.3**	45.7
North West	**211.9**	222.1
Scotland	**18.3**	22.2
South East	**97.4**	119.5
South West	**27.7**	34.5
Wales	**8.4**	9.4
West Midlands	**51.6**	60.2
Yorkshire	**49.0**	52.0
	709.7	805.6

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

Concentration risk (continued)

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

At 31 March

	2014 £m	2013 £m
East Anglia	**93.8**	95.4
East Midlands	**330.4**	341.3
Greater London	**648.8**	675.9
Northern Ireland	**6.6**	7.0
North	**115.6**	116.4
North West	**395.0**	403.0
Scotland	**150.1**	161.3
South East	**681.1**	691.2
South West	**293.8**	304.2
Wales	**190.0**	201.4
West Midlands	**681.0**	720.1
Yorkshire	**239.3**	242.1
	3,825.5	3,959.3

Table 14: Analysis of the residential loan portfolio by geographic spread

The following table shows the residual maturity of the Group's on-balance sheet exposures secured by mortgages on residential properties and commercial real estate as at 31 March 2014.

At 31 March

	2014 £m	2013 £m
Up to 3 months	**239.1**	130.5
3-12 months	**73.9**	264.2
1-5 years	**571.8**	506.9
More than 5 years	**3,629.6**	3,868.4
	4,514.4	4,770.0

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

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

Impairment of mortgage loans and advances

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

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

The Group first assesses whether objective evidence of impairment exists for financial assets using the following criteria:

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

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

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

If there is objective evidence of an impairment of loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. This calculation takes into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based upon a recognised index and adjustments to allow for ultimate forced sales values and realisation costs. The amount of the loss is recognised in the Income Statement.

Impairment losses on investment securities

At each year end date the Group assesses whether or not there is objective evidence that individual investment securities are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

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

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

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

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

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

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

Past due and impaired loans

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

The following tables provide an analysis of impaired and past due loans for residential and commercial lending. The figures in the tables include all Group companies but exclude the assets of the securitisation entities that are considered off balance sheet for regulatory purposes (see Section 8 – Securitisation). The Group does not consider the geographical spread of impaired exposures to be significant.

Residential lending – Payment due status

At 31 March

	2014 £m	2013 £m
Loans neither past due nor impaired	**3,645.3**	3,769.3
Past due but not impaired		
Past due 1 to 3 months	**64.2**	60.8
Past due 3 to 6 months	**13.9**	13.0
Past due 6 to 12 months	**8.3**	8.9
Past due over 12 months	**4.3**	3.4
Impaired		
Past due 1 to 3 months	**38.9**	32.0
Past due 3 to 6 months	**16.3**	21.8
Past due 6 to 12 months	**10.2**	17.8
Past due over 12 months	**12.0**	18.7
Possessions	**12.1**	13.6
	3,825.5	3,959.3

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

Commercial lending – Payment due status

At 31 March

	2014 £m	2013 £m
Loans neither past due nor impaired	**408.7**	477.5
Not past due but impaired	**164.0**	133.9
Past due but not impaired		
Past due up to 3 months	**-**	52.1
Past due 3 to 6 months	**-**	0.9
Past due 6 to 12 months	**9.2**	1.5
Past due over 12 months	**68.3**	24.6
Impaired		
Past due up to 3 months	**18.2**	6.4
Past due 3 to 6 months	**-**	9.8
Past due 6 to 12 months	**5.4**	9.4
Past due over 12 months	**35.9**	89.5
	709.7	805.6

Table 17: Analysis of impaired and past due loans for commercial lending

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

Impairment losses

The following table shows the movement during the year in impairment provisions.

At 31 March 2014

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

Table 18: Analysis of movement during the year ended 31 March 2014 in impairment provisions

At 31 March 2013

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

Table 19: Analysis of movement during the year ended 31 March 2013 in impairment provisions

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

Capital required under Pillar 1 for mortgage loans (both performing and non performing) was £189.9m (2012/13: £197.2m).

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

Counterparty credit risk

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

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

At 31 March

	2014 £m	2013 £m
Interest rate contracts	**5.8**	6.5
Other contracts	**27.9**	23.0
Gross positive fair value of contracts	**33.7**	29.5
Cash collateral and netting benefits	**(19.5)**	(29.5)
Net derivatives credit exposure	**14.2**	-

Table 20: CCR for derivative contracts

Capital required under Pillar 1 for CCR risk totals £1.5m (2012/13: £0.8m). It is calculated using the CCR Mark to Market Method.

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

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

The net exposure value of derivatives at 31 March 2014 was £27.9m (2012/13: £20.7m) which includes an amount for potential future exposure.

Section 6 – **Market Risk**

Market risk

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

ALCo reviews the Treasury Policy, recommending changes to the Board as appropriate, and ensures that regular reports on all aspects of market risk are assessed and reported to the Board.

Interest rate risk

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

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

Interest rate monitoring

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

In line with regulatory requirements and best practice, the impact of a parallel shift in interest rates in both directions, subject to a floor at 0%, is monitored. In addition, the impact of alternative non-parallel scenarios upon income and market value is also considered.

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, e.g. Bank Rate mortgages are funded by administered rate liabilities. The impact of these mismatches (basis risks) is monitored by Treasury and reported to ALCo. Action is taken to keep any mismatch within its desired range, which could include changing our product mix or the use of derivatives. The Group also operates gap limits, and the Group's gap positions are reported quarterly to the Regulator.

Interest rate risk summary

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

	As at 31 March 2014 £m	Average 2014 £m	High 2014 £m	Low 2014 £m
Market value	**(1.8)**	-	(5.1)	8.2
Net interest income	**(2.4)**	(2.7)	(3.3)	(2.1)

Table 21: Group Interest Rate risk exposures

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

Other market risk

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

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

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

At acquisition

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

Ongoing management

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

The principal derivatives used by the Group are interest rate swaps and index linked swaps that are used to hedge Group financial position exposures. Further information concerning the types of derivatives can be found in Note 35 to the Annual Report and Accounts for the year ended 31 March 2014.

Section 7 – **Operational Risk**

Operational risk overview

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

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

Operational risk framework

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

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

Operational risk categorisation

Key operational risks are detailed below.

Risk category	Brief description
Business Continuity and Disaster Recovery Risk	The risk of failure to adequately assess, document, test and invoke business continuity procedures to safeguard Group assets and personnel, and to adequately maintain or re-commence all essential business operations following a business continuity event.
Change Risk	The risk to the Group arising from a failure to manage projects, the associated transition to business as usual, and changes to products, processes, systems and structures.
Control Risk	The risk of incurring a loss or suffering the misappropriation of, or damage to, Group assets as a result of financial crime or error due to having inadequate systems, procedures, or internal controls.
Customer Service Risk	The risk of high attrition rates due to poor retention activity, poor customer experience or product service.
Human Resources Risk	The risk associated with the ability to recruit, develop, motivate and retain the required number and quality of people.
Information Confidentiality, Integrity and Availability Risk	The risk of loss or damage to; inappropriate/unauthorised access to data, information and systems; inaccurate, incomplete or invalid data, information or data processing; the inability of authorised users to gain access to data and information systems when required.
Legal and 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.
Marketing, Sales and Distribution Risk	The risks associated with loss of market share and profitability due to inappropriately designed products which are sold through methods and channels which do not suit the customer.
Reputational Risk	The risk that adverse publicity arising from the Group's business or associations could challenge its reputation and damage the confidence of consumers and/or market counterparties.
Safety, Security and Infrastructure Risk	The risk that the Society suffers loss or damage to reputation as a result of poor Health and Safety or Facilities Management procedures and/or inadequate or inappropriate insurance cover.
Other Assets Risk	The risk from exposure to various creditors through their failure to deliver goods and services for which prepayments have been made, or to debtors through their failure to settle their obligations in respect of service provided by the Group.

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

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

Operational risk management and mitigation

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

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

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

Customer service risk
The Group puts the needs of new and existing members first. Retention is a key part of the development and execution of the product strategy and its performance is overseen through the Product Consideration Group and the Liquidity Management Committee.

Human resources risk
The Group manages its people risk by operating a rigorous recruitment and selection process. All new colleagues are formally inducted into the organisation. To ensure that the vision and values are embedded from day 1 a member of the Executive, usually the Chief Executive, attends each induction event.

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

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

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

Marketing, sales and distribution risk
Marketing, sales and distribution risk is managed by number of first line committees including the Product Consideration Group and the Retail Conduct Risk Committee to ensure that products and advice meet new and existing members' needs. Oversight takes place at the RC.

Reputational risk
The Group undertakes a number of activities to manage its reputational risk. These include proactive monitoring of articles in both the news and social media in addition to operating a clear commitment to corporate and social responsibility. Many colleagues invest a significant amount of time in contributing towards community activities.

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

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

Operational risk oversight and governance

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

Capital required under Pillar 1 for operational risk was £6.4m (2012/13: £5.6m).

Section 8 – **Securitisation**

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

Originated securitisations

Securitisation is the process by which a ring fenced group of assets, usually loans, are aggregated into a pool and sold to Special Purpose Entities (SPEs). The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the originating entity. The Group has established securitisation structures as part of its funding activities, using residential and commercial mortgage loans as the underlying asset pools.

The equity of the SPEs created for these securitisations is not owned by the Group. However, to comply with the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 and Standing Interpretations Committee (SIC) 12, the SPEs are included as subsidiaries in the consolidated financial statements. This is despite the fact that some SPEs may be structured to cap Group exposures to losses at levels which mean that consolidation is not considered to be appropriate for capital purposes.

The Group has experience of issuing securitisations under various programmes, and has built up a depth of knowledge, processes and management information to deal effectively with these funding vehicles. Securitisation has historically been used to increase the diversification of funding sources, manage maturity mismatch risk, and assist overall credit risk management.

Treatment of securitisations for capital purposes

There are two distinct capital treatments for the securitisations that the Group has originated. The capital treatment is dependent upon whether or not significant credit risk associated with the securitised exposures is considered to have been transferred to third parties. The mortgage originator usually retains an element of risk by holding a tranche of subordinated loans. Where the risk is limited to a relatively small tranche of subordinated loans it is usually possible to demonstrate that a significant risk transfer has taken place. Where this is the case, the SPE is not consolidated for capital purposes and no risk weighted exposures are included in the capital calculation for the assets that have been securitised, instead the subordinated loans net of any deductions arising from consolidated losses are deducted from Tier 1 capital (at 31 March 2014 this figure was £nil). Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc are not consolidated for capital purposes.

Alternatively, where the structures do not achieve significant risk transfer, the underlying mortgage pools and other assets of the securitisations remain within the Group and are consolidated for capital purposes. This means the assets are risk weighted along with the Group's own assets using the Standardised Approach as reported in Section 4 – Capital Adequacy. Hawthorn Asset Co Limited, Hawthorn Finance Limited, Kenrick No 1 Plc and Kenrick No 2 Plc are treated in this manner.

Non-consolidated SPEs for regulatory capital purposes

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

The Notes are serviceable firstly from cash flows generated by the mortgage assets and thereafter from the proceeds of the subordinated loans. The Group receives the excess spread on the transactions as deferred consideration, after the SPEs have met their liabilities. The Group does not provide any liquidity facilities to the SPEs. WBCL provides administration and cash management services to the SPEs, for which it receives a fee. The outstanding startup loans and other balances net of consolidated losses is as follows.

At 31 March

	2014 £m	Write offs £m	Other adjustments* £m	2013 £m
Start up loans and other balances (net of consolidated losses):				
Sandwell Commercial Finance No. 1 Plc	-	-	-	-
Sandwell Commercial Finance No. 2 Plc	-	(0.8)	0.5	0.3
Total	-	(0.8)	0.5	0.3

Table 22: Start up loans and other balances (net of consolidated losses) with off balance sheet securitisations

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

Section 8 – **Securitisation** (continued)

The SPEs were originally set up as follows:

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

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

The balances of gross assets subject to securitisation, notes in issue and underlying balances impaired and past due as at 31 March 2014 are included in the table below. Gross assets includes the gross value of the underlying mortgage loans together with cash, cash equivalents and other assets.

Securitisation Company	Type	Date of Securitisation	Gross assets securitised 2014 £m	External notes in issue 2014 £m	Underlying assets past due and impaired 2014 £m	Gross assets securitised 2013 £m	External notes in issue 2013 £m	Underlying assets past due and impaired 2013 £m
Sandwell Commercial No 1. Plc	Commercial mortgage securitisation	19 May 2004	**62.7**	**60.9**	**4.4**	73.9	72.1	9.7
Sandwell Commercial No 2. Plc	Commercial mortgage securitisation	23 September 2005	**122.3**	**115.9**	**5.9**	150.1	134.0	6.8
Total			**185.0**	**176.8**	**10.3**	224.0	206.1	16.5

Table 23: Assets subject to off balance sheet securitisation, notes in issue and impaired and past due assets as at 31 March 2014 and 31 March 2013.

The gross assets securitised in table 23 are subject to provisions of £11.8m (2012/13: £15.4m).

Consolidated SPEs for regulatory capital purposes

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

Hawthorn Finance Limited
In July 2008, West Bromwich Mortgage Company sold £1,000m of residential buy-to-let mortgage assets, at book value, to Hawthorn Asset Co Limited, which in turn, borrowed funds from Hawthorn Finance Limited to fund the purchase of the mortgage assets.

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

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

Loan notes created under a retained securitisation may be used to raise funding. The risks associated with the assets which provide the collateral for a retained securitisation do not materially change as a result of being used in a retained securitisation and we continue to manage the risks in the same manner as for assets which have not been securitised.

The balances of assets subject to securitisation, notes in issue and underlying balances past due and impaired as at 31 March 2014 are included in the table below. Underlying assets past due and impaired are part of the totals reported within Table 16 for residential and Table 17 for commercial balances.

Section 8 – **Securitisation** (continued)

Consolidated SPEs for regulatory capital purposes (continued)

Securitisation Company and date of securitisation	Type	Gross assets securitised 2014 £m	Total notes in issue 2014 £m	Retained notes in issue 2014 £m	Underlying assets past due and impaired 2014 £m	Gross assets securitised 2013 £m	Total notes in issue 2013 £m	Retained notes in issue 2013 £m	Underlying assets past due and impaired 2013 £m
Hawthorn Finance Limited 22 July 2008	Residential mortgage securitisation	**945.5**	**906.9**	**906.9**	**4.5**	980.4	946.3	946.3	2.4
Kenrick No. 1 Plc 30 April 2012	Residential mortgage securitisation	**260.7**	**242.1**	**121.5**	**-**	316.0	298.2	146.1	0.1
Kenrick No. 2 Plc 28 May 2013	Residential mortgage securitisation	**395.6**	**372.4**	**40.6**	**-**	-	-	-	-
Total		**1,601.8**	**1,521.4**	**1,069.0**	**4.5**	1,296.4	1,244.5	1,092.4	2.5

Table 24: Assets subject to on balance sheet securitisation and notes in issue as at 31 March 2014 and 31 March 2013

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

Purchased securitisation positions

The Group also invests in mortgage backed securities. The treatment of the Group's investment in mortgage backed securities is covered under Section 5 – Credit Risk.

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

The Group has invested in commercial mortgage backed securities issued by Sandwell Commercial Finance No. 1 Plc and Sandwell Commercial Finance No. 2 Plc. As at 31 March 2014 these notes had a nominal value of £11.8m (2012/13: £13.0m) and of this value, £10.6m (2012/13: £11.8m) was risk weighted and £1.2m (2012/13: £1.2m) was deducted from available Tier 1 capital. The capital requirement for the risk weighted element was £1.3m (2012/13: £1.4m).

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 2013/14.

Section 9 – **Other Risks**

This section sets out the other risks faced by the business above and beyond the Pillar 1 risks set out in sections 4 to 8.

Liquidity risk

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

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

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

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

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

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

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

Pension liability risk

The Group has funding obligations for a defined benefit scheme, the Staff Retirement Scheme (the Scheme), which is closed to new members and no longer accruing service benefits. Pension liability risk is the risk that there will be a shortfall in the value of the Society's pension fund assets over and above the guaranteed liability to its employees under the defined benefit pension scheme. This may result from a number of sources including investment strategy, investment performance, market factors and mortality rates. The Scheme is also exposed to possible changes in pension legislation.

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

Business risk

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

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

Retail conduct risk

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

The regulatory focus on retail conduct risk has increased with the separation of the Financial Services Authority into the Prudential Regulation Authority and Financial Conduct Authority. The Society has formally mirrored this separation by recognising a specific risk category – retail conduct risk. During the 2012/13 financial year, a strong governance framework was implemented which included the establishment of a Retail Conduct Risk Committee chaired by the Society's Chief Executive. During 2013/14, further activities took place to embed a strong conduct culture throughout the organisation and to enhance the Society's conduct related management information.

Section 10 – **Remuneration and Other Corporate Governance**

Remuneration

In order to comply with the disclosure requirements of CRD IV and the PRA's Remuneration Code (the Code), the responsibilities and decision-making process for determining remuneration policy and membership of the management body, the link between pay and performance and the design and structure of remuneration, including the performance pay plans, have been disclosed in the 2014 Annual Report and Accounts on pages 29 to 32 and pages 36 to 41. The 2013/14 Annual Report and Accounts are published on the Society's website (www.westbrom.co.uk).

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 and Non-Executive Directors, all members of the Society's Executive Committee (ExCo) and other senior individuals in the Treasury and Risk areas. These individuals are defined as 'Code Staff'.

The table below sets out the aggregate quantitative remuneration for Code Staff in relation to their services for the West Brom for the year ended 31 March 2014.

Year to 31 March

	Number of beneficiaries	Fixed remuneration £000	Variable remuneration (non-deferred) £000	Deferred variable pay from previous years £000	Total remuneration £000	*Outstanding deferred remuneration £000*
2014	22	2,493	470	146	3,109	*370*

Table 25: Aggregate quantitative remuneration of Code Staff

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.

Section 11 – **Contacts**

Should you have any queries please contact:

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Section 12 – **Glossary**

Basel II framework
The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. The framework is structured around Pillars 1, 2 & 3, became law in the EU Capital Requirements Directive, and was implemented in the UK by the FSA (now PRA/FCA) Handbook. This was superseded by Basel III on 1 January 2014.

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

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

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

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

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

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

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

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

CQS (Credit Quality Steps)
A credit quality assessment scale as set out in the Capital Requirements Regulation (Risk weights under the Standardised Approach to credit risk).

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

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

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

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

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

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

ICA
Individual Capital Assessment - the document produced by the Society as a result of the ICAAP.

ICAAP
Internal Capital Adequacy Assessment Process. The process the Group follows to determine capital requirements.

ICG
Individual Capital Guidance. The minimum amount of capital the Group should hold as set by the Regulator following a SREP exercise and a review of the Society ICA.

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

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

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

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

LIBOR
London Inter-Bank Offered Rate.

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

LTV
Loan-to-Value. The ratio of current exposure value as a proportion of the value of the asset held as security (usually 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.

Section 12 – **Glossary** (continued)

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.

NED
Non-Executive Director.

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

Operational risk
Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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A10530-07/14-01