



SAFFRON BUILDING SOCIETY

**Pillar 3 Disclosure Document 2011
(as at 31st December 2010)**

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1. Introduction

The legislative framework, the Capital Requirements Directive (CRD), commonly referred to as Basel 2, governing how much capital all banks and building societies must hold to protect their members, depositors and shareholders, was introduced by the European Union from the beginning of 2007. In the UK this is implemented by our regulator, the Financial Services Authority (FSA).

Saffron Building Society's aim is to ensure that we protect our members' savings by having sufficient capital even during a significant economic downturn.

The framework is not just about capital requirements, it also requires disclosure of key pieces of information, such as risk exposures and risk assessment processes.

Below are the 3 main "Pillars" which make up the Capital Requirements Directive.

Pillar 1	Minimum capital requirements
Pillar 2	Assessment of capital requirements by the Firm and FSA
Pillar 3	Disclosure

Pillar 1 assessment is based on a formulaic risk based capital calculation focussing particularly on credit and operational risks to determine the Capital Resources Requirement. The Board of Saffron Building Society has then undertaken a bottom up assessment of all of the risks facing the Society and has established extra capital to be held under Pillar 2. As part of this the Society has undertaken stress tests to determine whether it could maintain capital adequacy in a severe economic downturn.

This policy document deals with the requirements laid down for Pillar 3 (disclosure) and the information provided here is in accordance to the rules laid out in the FSA handbook BIPRU Chapter 11.

This disclosure document applies to the following trading entities on a fully consolidated basis:

Saffron Building Society	FSA Number 100015
Crocus Homeloans Ltd	FSA Number 305200
Saffron IFA Ltd	FSA Number 2455573

Crocus Home Loans Limited (CHL) and Saffron IFA Ltd are wholly owned subsidiaries of Saffron Building Society and all funding comes from the Society.

CHL holds residential mortgage books bought to compliment Society origination. Saffron IFA provides independent financial planning advice.

Using a subsidiary company allows improved balance sheet management, as mortgages within CHL do not convey membership rights to the borrower.

All figures within this document are correct **as at 31 December 2010** unless stated otherwise.

2. Risk management policies and objectives

Saffron Building Society is primarily a producer and retailer of financial products, mainly in the form of mortgages and savings. These products give rise to a financial asset or liability and are termed financial instruments. As well as mortgages and savings the Society also uses wholesale financial instruments to invest liquid asset balances and raise wholesale funding and to manage the interest rate risks arising from its operations.

The Society looks to manage all the risks that arise from its operations, the main risks within its business being credit risk, market risk (including interest rate risk), liquidity risk and operational risk.

The ways in which we manage these risks include using forecasting and stress test models to help guide our business strategies; producing key risk information and indicators to measure and monitor performance; and using management and board committees to monitor and control specific risks.

The Society regards the employees who have the greatest material impact on the risk profile are the CEO and the FD. This due to their position where all material risk based decisions are filtered ahead of formal policy being approved by the board and implemented by employees. As per the disclosure requirements their remuneration is disclosed in the annual report and accounts.

Credit Risk

Credit risk refers to the potential risk that arises from customers (or counterparties) failing to meet their obligations as they fall due. Credit risk arises primarily from loans to our retail customers, loans to our commercial mortgage customers and from liquid assets held by the Treasury department. The Credit Committee is responsible for reviewing the Group's lending policy and monitoring the exposures in accordance with this policy, including exposures to individual counterparties and sector concentration. The Credit Committee recommends lending policy for approval by the full Society board. The Assets & Liabilities Committee is responsible for recommending limits on Treasury counterparties, country exposures and types of financial instruments for approval by the Society board.

Market Risk

Market risk is the risk that the value of, or income arising from, the Society's assets and liabilities varies as a result of changes in interest rates or exchange rates. This incorporates a range of risks but the principal element is interest rate risk.

Interest rate risk arises from imperfect matching of different interest rate features, re-pricing dates and maturities of mortgages, savings and wholesale products. The Society manages this exposure on a continuing basis, within limits set by the Assets & Liabilities Committee using a combination of on and off-balance sheet instruments.

The sensitivity to changes in interest rates impacts the following activities:

1. Management of the investment of reserves and other net non-interest bearing liabilities.
2. Fixed rate savings products and fixed rate funding
3. Fixed and capped rate mortgage lending and fixed rate treasury lending

Interest rate swaps and caps are used to manage the above risks. In addition swaps are used to manage a risk arising from a net exposure to an interest rate basis type e.g. base rate or LIBOR. The Society also monitors prepayment levels on fixed rate mortgages and ensures that the Early Repayment Charge is consistent with the interest rate risk exposure.

The Society uses a parallel shift in interest rates of 2% to assess interest rate shock and to establish risk appetite. In addition internal scenario and stress tests are run for non parallel interest rate movements and limits used based upon Society forecast profitability.

Liquidity Risk

The Society's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets, through wholesale funding and through management control of the growth of the business. The Society fully funds its mortgage lending through its retail deposits.

The Society maintains assets in liquid form in such proportion and composition as will at all times enable it to meet its liabilities as they arise (including any unexpected adverse cash flow).

Operational Risk

Operational risk is the risk of loss arising from failed or inadequate internal processes or systems, human error or other external factors. The risk is managed by individual business areas that have responsibility for putting in place appropriate controls for their business. Each business area has appointed a "risk leader" who co-ordinates control and risk assessments on a regular basis. This is led by the Society risk manager. Regular reporting of risks then takes place through to the Executive, Risk Committee, Audit Committee and Board.

In order to ensure we have sufficient capital to cover some of these operational risks the Society also maintains a range of insurance policies to cover eventualities such as business interruption, loss of computer systems, crime etc.

To monitor its operational risks the society uses a piece of software, which allows a value, a likelihood and an impact (together with a reduction in impact from application of the control) to be assigned to each risk. This allows us to establish a residual risk remaining after operation of controls for each business area of the Group.

Business Risk

Business risk is the risk that the Society may not be able to carry out its business plan or its desired strategy and could therefore suffer losses if its income falls.

This is a risk that every business faces, however the Society looks to mitigate this risk by having a diverse range of products so that its income source is not reliant on one product or one area of its business.

Concentration Risk

Where a firm's exposure to a single borrower or several borrowers within the same group of companies is large, it risks large losses should the borrower default. Concentration risk is concerned mainly with the fact that in some cases these losses may be sufficient to threaten the solvency of a firm.

However, concentration risk need not just be in the form of large loans to single borrowers, it could include a concentration of "high risk" or high LTV loans, niche lending such as buy-to-lets or industry/sector concentrations.

The Society monitors all of these areas carefully to ensure that we do not lend more than appropriate for our position and size. In addition we have limits on specific areas, such as where payments are linked to rental income on the property securing the loan.

The Society, as a regional building society has a geographic concentration in our core lending area. We manage this risk carefully by having business strategies that aim to maintain a good balance of lending across England and Wales and regularly monitoring our exposure by region.

We also take account of concentration risk within our models by having higher economic stresses where geographic concentration risk has been identified. In our case this means that for residential exposures in East Anglia, Greater London and South East we hold slightly more capital and measure greater reductions in asset values in this region than would otherwise be the case.

Pension Obligation Risk

The Society has a closed defined benefit scheme. The scheme is closed to new members and has been closed to future accrual of service cost.

The possibility exists of further impact on Society profitability from increased longevity increasing scheme liabilities, from failure of an insurance company providing an annuity for the fund or from changes in accounting policy leading to the requirement for extra contributions.

We allocate a specific amount of capital under Pillar 2 to cater for a stress reduction in asset values or an increase in pension liabilities.

Remuneration Risk

Remuneration risk could arise if reward schemes were in place which encouraged inappropriate action by risk takers in the business.

It is the responsibility of the Remuneration Committee to approve Remuneration Policies and the reward packages offered to Directors, Executive and staff who are considered to have a material impact on the Society's risk profile (known as "code staff") and to demonstrate that the decisions made are consistent with an assessment of the Group's financial situation and future prospects.

There would also be a risk were the Society not be able to retain and attract the quality of individuals needed to deliver strategic plans so The Remuneration Committee will have regard to the relative position of other firms but will use comparisons with caution in view of

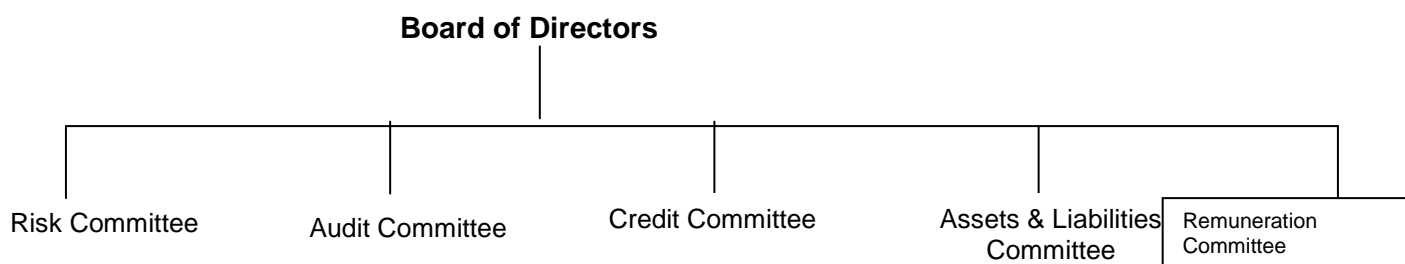
the risk that can result in an upward ratchet of remuneration levels with no corresponding improvement in performance.

The Terms of Reference of the Remuneration Committee are to be found on the Society website.

Residual Risk

We include a capital allocation for risks that are not currently foreseen or measured by our models within our holdings. We also maintain a level of capital in excess of the minimum required by the FSA.

3. Main Board and Committee Structure



Audit Committee

Composition : 3 non-executive directors selected from a pool of 5

Main Functions: The Audit Committee supervises the Society's internal audit programme and oversees compliance with the established systems of control, taking account of the relevant internal and external audit recommendations. Audit Committee receives a report quarterly from Internal Audit on the risk management processes within particular business areas. It also receives a quarterly Risk Report containing Key Risk Indicators and a six monthly Risk and Control assessment.

The Committee will review, and challenge where necessary, the actions and judgements of management, in relation to the society's annual accounts. The Committee liaises with the Society's external auditors concerning the nature and scope of their work and reviews any changes in accounting policy and practice.

Frequency: The Committee meets on a quarterly basis with an additional meeting to deal with the Report and Accounts.

Credit Committee

Composition: 2 non-executive directors and 4 executive directors.

Main Functions: The Credit Committee considers areas of significant risk and the overall credit risk management infrastructure.

It approves the methods for managing and reporting of credit risks. This includes recommending lending risk limits to the Board and monitoring risk exposures.

Frequency: the Committee meets on a monthly basis.

Assets & Liabilities Committee

Composition: 2 non-executive directors and 4 executive directors.

Main Functions: This Committee is responsible for asset and liability management which includes:

- Ensuring the Board's policies are carried out in relation to Treasury and Balance Sheet Management policy (including limits and approved market instruments).

- Reviewing the risk profile of the Group in relation to market and interest rate risk.
- Considering the funding requirements of the Group.
- Considering and recommending treasury counterparty credit and other equivalent exposure limits to the Credit Committee.

Frequency: the Committee meets on a monthly basis.

Risk Committee

Composition: 2 non-executive directors and 4 executive directors.

Main Functions: This Committee is responsible for assisting the Board through the review of information obtained both externally and internally, formulating views about the impact and likelihood of risks crystallizing and recommending measures to control and mitigate these risks.

Frequency: the Committee meets on a quarterly basis.

Remuneration Committee

Composition: All non-executive directors.

Main Functions: The Committee is responsible for reviewing the Group remuneration policy statement prior to board presentation and ensuring levels of remuneration are sufficient to attract and retain high quality staff and directors who are able to add member value.

The Committee adopts strong corporate governance practices, exercises independent judgement and ensures that remuneration policy and practices reflect the FSA requirement that: *“A firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management”*

The committee is also responsible for identifying Remuneration Code Staff and as at 31st July 2011 had determined that the 4 Executive Directors were subject to the provisions of the FSA Remuneration Code.

Frequency: the Committee meets at least twice a year

Key Reports

There are a variety of reports produced to help senior management and delegated Committees monitor the society’s risks, however the main reports are:

- Credit reporting of the overall mortgage portfolio, stress tests and focussed reporting on key credit risk areas.
- Assets & Liabilities reports covering commercial and economic, structural risk management of the balance sheet, liquidity and capital and back office treasury operations.
- Finance Director’s report covering the Balance Business Scorecard; financial, customer, quality and staff performance.
- Risk Report, covering risk and control performance and key risk indicator levels.
- Consolidated Risk Register; integrates the risk position across the Society.

4. Capital Resources

The Capital Resources of the Group are calculated under Pillar 1 of the Capital Requirements Directive. The scope of these resources at 31st December 2010 relate to Saffron Building Society, Crocus Homeloans Limited and Saffron IFA Limited.

There are no current or foreseen material, practical or legal impediment to the prompt transfer of capital resource between Saffron Building Society and Crocus Home Loans Limited.

Total Group assets at the above date are £931.2m of which Crocus Home Loans Limited makes up £52.5m.

The Capital Resources are comprised of:

- General Reserves accumulated by the Group, representing Tier 1 Capital
- Issued Capital in the form of subordinated debt, included in Tier 2 Capital

The Society subordinated debt can be analysed as follows:

Amount	Maturity	Type
£10 million	29/01/2028	6.32% Fixed

The rights of repayment of the holders of subordinated loans are subordinated to the claims of depositors, all creditors and members holding shares in the Society, as regards the principal of their shares and interest due on them.

Tier 1 and 2 capital resources are broken down below

	Tier 1 Capital Resources
Gross	£40.9 million
Deductions	£Nil
Net	£40.9 million
	Tier 2 Capital Resources
Gross	£12.5 million
Deductions	£Nil
Net	£12.5 million
	Total Capital Resources
Gross	£53.4 million
Deductions	£Nil
Net	£53.4 million

5. Capital Resources integrated into Business Strategy

Saffron Building Society aims to maintain sufficient capital resources to allow it to make advances and provide other financial services. In order to maintain this capital the Society needs to generate and retain profits that will add to the general reserves, the main source of capital.

Strategy and Planning

The 5 year Strategic Plan and Annual Operating Plan process establishes risk appetites for business lines being developed by the Society and for each of the risk categories.

The Society ensures it has sufficient financial and non-financial resource to meet the Strategic Plan objectives.

Capital Adequacy Assessment Process

In addition to the Strategic Plan and Operating Plan we have an Internal Capital Adequacy Assessment Process (ICAAP), which focuses on ensuring capital resources of the Society are sufficient to support its plan both in normal and stressed conditions.

This process involves reviewing all business areas with estimates for capital allocation across the Strategic Plan period. The Board then agree (with input from the results of the Society stress models) the economic scenarios to be used in calculating capital requirements.

Finally the Board approves the capital assessment taking into account any areas where they may feel the models and internal assessments do not adequately capture the full risk exposure and holding extra capital where appropriate.

Lending & Business Decisions

The Society translates its overall risk appetite for credit risk into individual lending limits controlling the exposures to be taken on by the Society and Crocus Homeloans Limited. The performance against these limits is monitored monthly and reviewed at least annually.

In addition the Group credit risk is stress tested by type of business and the results reflected in business decisions.

Pricing

Our pricing models also include capital assessment by products. Pricing models are in use for all mortgages launched.

The pricing models provide guidance as to what rate needs to be charged to meet return targets.

6. Risk Weighted Exposure Amounts & Operational Risk Capital

The assets of the Group are allocated risk based exposure amounts in line with the “Standardised Approach” under the Capital Requirements Directive. In addition an evaluation of capital required to cover Operational Risk is calculated under the “Basic Indicator Approach” and determined by reference to the net income of the Group averaged over the previous 3 years.

	Asset	Risk Weighted Asset	Capital
Treasury Assets			
Claims or contingent claims on central governments or central banks	£29.5 million	£Nil	£Nil
Claims or contingent claims on regional governments or local authorities	£1.4 million	£0.3 million	£0.02 million
Claims or contingent claims on institutions	£204.1 million	£40.6 million	£3.25 million
Total Treasury Assets	£235.0 million	£40.9 million	£3.27 million
Loans & Advances to Customers			
Claims or contingent claims on corporates	£4.6 million	£4.6 million	£0.37 million
Claims or contingent claims secured on real estate property	£677.4 million	£265.2 million	£21.21 million
Past due items	£7.7 million	£8.5 million	£0.68 million
Total Loans & Advances to Customers	£689.7 million	£278.3 million	£22.26 million
Total Credit Risk Exposures	£924.7 million	£319.2 million	£25.53 million
Operational Risk Capital Requirement			£1.54 million

In addition the Society holds capital of £1.18 million against mortgage assets offered not completed, off balance sheet financial instruments and other assets.

Counterparty Credit Risk

The purpose of the Society’s counterparty treasury credit risk management policy is to ensure that the Society can obtain the best possible return whilst operating within prudent limits in respect of counterparties.

The methodology for establishing counterparty limits involves consideration of the background rating information and balance sheet data relevant to the counterparty. The minimum rating required under Fitch ratings are:

- Short term facilities up to and including one year in maturity: lending bank to have a short term credit rating of at least F1;
- Facilities over one year and up to and including 5 years in maturity: lending bank to have a long term credit rating of at least A+

Replacement values of outstanding hedging instruments are calculated and counterparty limits are adjusted to reflect any off-balance sheet exposure.

New limits are approved and existing limits removed only on the recommendation of the Assets & Liabilities Committee to the Board. All limits are reviewed regularly, at least annually typically quarterly during 2010, by the Assets & Liabilities Committee, any changes being recommended to the Board as appropriate. The Head of Finance prepares a submission for the approval of new, or the removal of existing counterparties. Limits may be suspended by Treasury Department pending removal in the event of adverse market

intelligence. No dealing will take place with counterparties which do not have a pre-approved limit. Where appropriate, exposure to counterparties is monitored on a consolidated basis.

7. "Past Due" (Loans > 3 months in arrears) Exposures by Geographical Region

Geographic Region	Residential Mortgages (£ million)		
	Past Due	Performing	Total
South East	0.71	167.12	167.83
Greater London	0.07	92.58	92.65
East Anglia	0.12	35.52	35.64
South West	0.11	30.85	30.96
West Midlands	0.34	23.21	23.55
East Midlands	0.24	22.54	22.78
North West	0.00	21.99	22.00
Yorkshire & Humberside	0.06	17.71	17.77
Wales	0.10	8.78	8.88
North	0.06	7.54	7.60
Total	1.81	427.84	429.66
	Saffron Building Society		
Geographic Region	Residential Buy to Let Mortgages (£ million)		
	Past Due	Performing	Total
Greater London	2.17	78.54	80.71
South East	0.17	40.20	40.37
East Anglia	0.00	21.21	21.21
South West	0.00	13.32	13.32
Yorkshire & Humberside	0.00	10.62	10.62
North West	0.00	10.43	10.43
West Midlands	0.66	8.06	8.72
East Midlands	1.13	7.53	8.66
North	0.00	4.64	4.64
Wales	0.00	4.30	4.30
Total	4.13	198.85	202.98
	Saffron Building Society		
Geographic Region	Commercial (£ million)		
	Past Due	Performing	Total
South East	0.00	1.53	1.53
East Anglia	0.00	1.31	1.31
Greater London	0.00	0.87	0.87
West Midlands	0.00	0.36	0.36
East Midlands	0.00	0.22	0.22
North West	0.00	0.21	0.21
South West	0.00	0.03	0.03
Yorkshire & Humberside	0.00	0.00	0.00
North	0.00	0.00	0.00
Wales	0.00	0.00	0.00
Total	0.00	4.53	4.53
	Crocus Homeloans Limited		
Geographic Region	Residential Mortgages (£ million)		
	Past Due	Performing	Total
South East	0.69	14.54	15.23
Greater London	0.16	5.98	6.14
South West	0.00	6.03	6.03
West Midlands	0.27	5.52	5.79
North West	0.17	5.34	5.51
Yorkshire & Humberside	0.03	3.55	3.58
East Midlands	0.17	3.25	3.42
North	0.00	2.82	2.82
Wales	0.00	2.05	2.05
East Anglia	0.24	1.67	1.91
Total	1.73	50.75	52.48
Total Loans & Advances to Customers	7.67	681.97	689.65

* Past Due amounts relate to the overall mortgage balances not the amount in arrears

8. Provisions

Provisions for losses are based upon an appraisal of loans, advances and other assets. Specific provisions are made in respect of properties in possession and in respect of mortgage accounts 2.5% of balance in arrears at that date and against other assets where book value exceeds the estimated realisable value.

The provision on each account represents the amount required to reduce the outstanding balance of the asset to its expected realisable value, by using industry recognised house price indices reduced for anticipated forced sale discounts, and adjusted for costs of realisation, other recoveries and the probability of possession.

General provisions are made where it is considered that there is impairment in the value of assets at the year-end that is not already covered by specific provisions. This is calculated by applying factors that reflect probability of default and loss given default. The mortgage assets are segmented to allow different levels of risk factors to be applied to each part of the portfolio.

The amount shown in our income and expenditure account represents the actual losses incurred and the net change in provisions. Interest that is considered to be irrecoverable on advances secured on repossessed properties is excluded from income from the date of repossession.

The general provisions made at the year-end represent the Directors' assessment of the potential losses which, although not yet specifically identified as relating to payment arrears, are known from experience to exist in the Group's loan portfolio.

These provisions have been deducted from the appropriate asset values shown in the balance sheet with the exception of customer claims which are shown within other creditors.

Both the balance sheet and the provisions for liabilities can be found in the 2010 Annual Report and Accounts.

9. Breakdown of Treasury Assets under the Standardised Approach

Fitch Ratings Services	Maturity of Treasury Investment			
	< 3 months	3 months to 1 year	> 1 year	Total
AAA TO AA-	108.45	24.90	38.97	172.32
A+ to A-	28.17	5.01	1.01	34.19
BBB+ to BBB-	9.01	0.00	0.00	9.01
BB+ to BB-	0.00	0.00	0.00	0.00
B+ to B-	0.00	0.00	0.00	0.00
CCC+ and below	0.00	0.00	0.00	0.00
Unrated Building Societies/Local Government	17.46	1.01	1.01	19.48
Total	163.09	30.92	40.99	235.00

10. Remuneration paid to Remuneration Code staff 2010

Remuneration Code staff have been determined as being the Executive directors of the business.

Analysis of Directors' emoluments:

Executive	Salary/ fees £000	Annual bonus paid £000	Medium term bonus paid £000	Other non-cash benefits £000	Pension contributions £000	2010 Total £000	2009 Total £000
A J Golding	148	25	28	16	20	237	226
J E Hall	125	19	22	15	17	198	176
A Rushworth	88	13	16	11	11	139	131
J P Eastgate	88	13	-	12	12	125	122
	449	70	66	54	60	699	655

11. Conclusion

This disclosure document is intended to provide background information on the Society's approach to risk management as related to maintaining and preserving the capital position of the Group. It also provides asset information and capital calculations under Pillar 1.

In summary the Capital required to be held by the Society has increased in 2010 over 2009 by £1.6m. This reflects an improvement in capital required against past due items offset by a higher capital requirement from increased mortgage and liquidity portfolios. Capital Resources increased by £0.8m

The Society has plans to recover the £0.8m by which the capital required increase exceeded new capital generated in the year through medium term earnings. The Society retains a significant surplus capital against its Pillar 1 requirement of £26.3m.

In the event that a user of this document has comments or requires further information then they are requested to contact Jon Hall, Finance Director at jon.hall@saffronbs.co.uk.

