Saffron Building Society

and its subsidiary (the Group)

Pillar 3 Disclosure

(as at 31st December 2017)

INDEX

1. Introduction

On 1st January 2014 the legislative framework, the Capital Requirements Directive (CRD), currently referred to as Basel II, was replaced by Basel III which was implemented across the European Union through the Capital Requirements Regulation (CRR) and nationally in the United Kingdom through the Capital Requirements Directive (CRD). Together these are referred to as CRD IV.

This directive continues to govern how much capital all banks and building societies must hold to protect their Members, depositors and shareholders. The revisions introduced by CRD IV seek to strengthen the capital position of the sector and make it more resilient to financial and economic shocks.

In the UK this is implemented by our regulator, the Prudential Regulation Authority (PRA).

Saffron Building Society's (and its subsidiary: the Group) aim is to ensure that it protects its Members' savings by having sufficient capital at all times (including during a significant economic downturn).

1.1. Framework

The CRD determines a framework which in addition to capital requirements also requires disclosure of key pieces of information, such as risk exposures and risk assessment processes.

Below are the three main 'Pillars' which make up the CRD:

Pillar 1	Minimum capital requirements using defined formula;
Pillar 2	Assessment of capital requirements by the Firm (Internal Capital Adequacy Assessment Process, "ICAAP") and PRA (Supervisory Review and Evaluation Process, "SREP") to determine whether additional capital should be held for those risks not covered under Pillar 1;
Pillar 3	Disclosure of key information on capital, risk exposures and risk management processes.

The 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 (CRR).

CRD IV introduced additional capital buffers on top of the minimum requirements:

- *Capital conservation buffer* being phased in and will amount to 2.5% of RWAs from 1 January 2019. For the financial year ended 31 December 2017 the requirement was 1.25%, rising to 1.875% from 1 January 2018 and 2.5% from 1 January 2019.
- *Countercyclical buffer* set by the Bank of England where it observes systemic risks in the market. A requirement of 0% of RWAs applied for the year ended 31 December 2017 however the requirement will increase to 0.5% from June 2018 and 1% from November 2018.

Through the ICAAP, the Group's Board has then undertaken a detailed assessment of all of the risks facing the Group and has established extra capital to be held under Pillar 2. As part of this assessment, the Group has undertaken stress tests to determine whether it could maintain adequate capital under stressed conditions (including in a severe economic downturn). Section 6 of this document contains additional information on the ICAAP.

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

1.2. Pillar 3 Disclosure

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

Saffron Building Society	PRA Number 100015
Crocus Home Loans Ltd	PRA Number 305200

Crocus Home Loans Limited (CHL) is a wholly owned subsidiary of Saffron Building Society and all funding comes from the Group.

CHL holds residential mortgage books bought to compliment Group origination.

1.3. Basis of preparation

This Pillar 3 disclosure document has been prepared in accordance with the requirements of Capital Requirements Regulation and Directive part 8 as interpreted for a group of firms of this size. Through these disclosures the group will demonstrate its assessment of risk and capital as well as its approach to risk management.

This document communicates the strategy the Society has put in place to manage risks, as well as provide details of the structure of the organisation and its risk management functions and is intended to provide background information on the Group's approach to risk management as it relates to maintaining and preserving the capital position of the Group. It also provides asset information and capital calculations under Pillar 1.

Confidential Information and materiality

Information is considered material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. No disclosures have been omitted on the basis of materiality or confidentiality.

Frequency of disclosure, media and location

The Pillar 3 disclosure document will be prepared and published on an annual basis and is available on the Society's website (www.saffronbs.co.uk). Should you require further information on this document please contact The Society Secretary, Saffron Building Society, Saffron House, 1A Market Street, Saffron Walden, Essex CB10 1HX.

Verification

The Pillar 3 disclosure document has been reviewed and approved by the Risk, Audit, Compliance and Conduct Committee. The disclosures are not subject to external audit; however, some of the information within the disclosures also appears in the Society's audited 2017 Annual Report and Accounts. The disclosures do not constitute any form of financial statement and must not be relied upon in making any judgement about the group. All figures within this document are correct **as of 31 December 2017** unless stated otherwise.

2. Risk management policies and objectives

2.1. Introduction

In executing the Group's strategy and in undertaking its routine business and activities, the Group is exposed to a range of risks. The primary goal of risk management is to ensure that the outcome of risk-taking activity is consistent with the Society's strategies and risk appetite and appropriate for the level and type of risks that it takes paying regard to regulatory guidance. It ensures that there is an appropriate balance between risk and reward in order to optimise Member returns and, when issues arise they are managed for the best outcome of the Society and its Members.

2.2. Risk management framework

The Society's Enterprise-wide Risk Management Framework (ERMF) provides the foundation for achieving these goals through:

- articulating the Society's risk management practices and procedures;
- documenting a consistent framework for risk management across the Society;
- establishing minimum standards around key risk management framework issues;
- articulating the Society's risk strategy and enterprise wide risk appetite; and
- directing the approach to risk governance throughout the Society.

The ERMF sets out the Society's method of managing risk via:

- Defining its Risk Appetite, which is the level of risk that Saffron is prepared to accept whilst pursuing its business strategy, recognising a range of possible outcomes as the business plan is implemented;
- Detailing the 3 Lines of Defence (3LoD) model and its operation within the Saffron Risk Management Framework;

- Determining the roles and responsibilities of the committees in place to govern risk;
- Identifying those roles responsible for the key risks and how the oversight operated together with the reporting structure to ensure independent oversight of risk decisions;
- Documenting the main risk management processes under its approach of Identify; Evaluate; Mitigate; Report; Manage and Challenge;
- Describing the key risks facing the Society and how they are managed; and
- Listing and explaining where the policies sit in the Saffron hierarchy and how they operate

The ERMF is supported by policies and procedures to embed the principles into the business.

The "Three lines of defence" model
The Society adopts a "three lines of defence" model to enable it to separate risk management activities between:

- those that own and take risk and implement controls (1st line);
- those that oversee, monitor and challenge the first line (2nd line); and
- the audit functions which provide fully independent assurance (3rd line).

2.3. Risk governance

The oversight and direction of the Board is central to the Society's risk management framework. The Board exercises governance over risk through a series of Board committees and management structures. Each of the Board committees includes at least two Non-Executive Directors (one of which chairs), with other committee members drawn from the Executive and appropriate members of senior management. The Committees forming part of the Risk Management framework comprise of:

Committee	Board / Management	Chaired by
Risk, Audit, Compliance and Conduct Committee	Board	Non-Executive Director
Board Credit Committee	Board	Non-Executive Director
Assets & Liabilities Committee	Management	Chief Financial Officer
Executive Risk Committee	Management	Chief Risk Officer
Credit Committee	Management	Chief Risk Officer

Other committees include:

Committee	Board / Management	Chaired by
Remuneration and Loans Committee	Board	Non-Executive Director
Nominations Committee	Board	Non-Executive Director
Product Management Committee	Management	Chief Customer Officer

Group Board
It is the Board's role to set the strategic direction for the Society, ensure that the necessary financial and human resources are in place to meet them and review the performance of the Executive team. The Board also maintains a framework to enable risk to be assessed and managed in accordance with its risk appetite. At the end of the year the Board consisted of three Executive Directors and six Non-Executive Directors (including a Chairman).

The Board met seven times in 2017 including a session dedicated to strategy and has a formal calendar of items for review. The Board retains certain powers for decision making but also delegates certain responsibilities and powers to Committees which are listed below. The Chairman holds meetings at least twice a year with the Non-Executive Directors without the Executive Directors being present. The Non-Executive Directors meet once a year without the Chairman inter alia to review the Chairman's performance.

The **Chairman** is responsible for the leadership of the Board and its effectiveness. The Chairman sets the governance agenda, standards and expectations for Board Directors and ensures constructive challenge and openness between Non-Executive and Executive Directors.

Non-Executive Directors constructively challenge and help develop proposals on strategy and oversee executive performance.

The **Executive Directors** are expected to manage the Society under the strategic direction of the Board as a whole.

The Board has established Committees to consider certain specialist areas in more detail than would be appropriate at a Board meeting. Each Committee operates within defined terms of reference. Minutes of meetings, evidencing the level and quality of challenge, are formally recorded and proceedings are reported to the full Board by the respective Committee Chairman. The Committees and their summary terms of reference are set out below.

The full terms of reference may be obtained through the Society website or on request from the Society Secretary.

Risk, Audit, Compliance and Conduct Committee

This Committee comprises nominated Non-Executive Directors, excluding the Chairman, and is chaired by Neil Holden (approved Non-Executive Director and Senior Independent Director). Members of the Executive and senior management are invited to attend as appropriate. In 2017 a sub-committee focussing on compliance and conduct risk was established to ensure a balanced and proportionate approach was being taken to the key risks.

The Committee (including the sub-committee) reviews the effectiveness of the relevant Group systems of internal control and monitors compliance with regulatory requirements and relevant codes of practice. It considers and approves the remit of the risk and compliance management functions and provides input, review and challenge to Executive management's identification and assessment of risks.

It provides ongoing monitoring of the overarching and specific risk management frameworks and ensures that either the Society remains within its risk appetite and tolerances in the various aspects of its business or that management takes appropriate mitigating actions where the risk appetite is being, or appears to be at risk of being breached. It approves and oversees the delivery of the annual integrated assurance plan comprising the internal audit and risk management and compliance plans.

Internal audit services are currently provided to the Society by PwC under the terms of a specific engagement. Under the Committee's terms of reference, it has responsibility to approve the terms of engagement, appointment, reappointment or dismissal of the internal auditors.

These activities are based on a thorough risk assessment of the full scope of the Group's business activities and in the context of the Board's strategy and risk appetite. It is also responsible for managing the relationship with the external auditor, including an annual review of auditor effectiveness and their appointment, reappointment and removal.

All Non-Executive Directors on this Committee have experience that is relevant to the role and at least one member present has recent financial experience.

During 2017 the Committee met eight times to fulfil its responsibilities and, in particular, considered reports for the following:

- the effectiveness of the system of internal control;
- the plans and activities of internal and external audit, risk, compliance and financial crime teams;
- the effectiveness and independence of internal and external audit and the effectiveness and resourcing of risk, compliance and financial crimes teams;
- the principal risks faced by the Society, together with evidence that the Society is currently operating within risk appetite and will continue to do so based on the outlook for those risks; and
- the integrity of the Group's financial statements;

In considering the integrity of the Group's financial statements RACCC reviews at least annually the acceptability of accounting policies and significant financial judgements. The external auditor, Deloitte, is also utilised to help ensure that suitable accounting policies have been implemented and appropriate judgements made by management. As a result of discussions with both Management and the external auditor, RACCC determined the key risks of misstatement of the Group's financial statements related to the following judgement areas:

- Revenue recognition using the effective interest rate (EIR) method
- Loan loss provisioning
- Valuation of lifetime mortgages and associated swap

Further details can be found in the Society's Report and Accounts which are available on the Society's website, www.saffronbs.co.uk

Board Credit Committee
The Committee comprises Non-Executive Directors, and is chaired by Nick Treble (Non-Executive Director and Vice Chairman). Members of the Executive are invited to attend as appropriate. The Committee reviews and approves the lending of customer facilities in excess of Credit Committee approval limit on a sole or aggregate basis and counterparty exposure limits in respect of Treasury activities as recommended by the Assets and Liabilities Committee. The Committee also reviews and approves levels of impairment including reviewing approaches used and key assumptions adopted in determining the level of provisions. The Committee meets four times a year and when necessary

Assets & Liabilities Committee
The Committee comprises Executive Directors, the Chief Risk Officer, Head of Commercial Finance and Treasury and the Treasurer. It recommends treasury and balance sheet risk management strategies, capital requirements in the context of the Society's policy statement concerning liquidity, funding and structural risk management policies. The Committee meets at least eleven times a year and is chaired by the Chief Financial Officer.

Executive Risk Committee
The Committee comprises Executive Directors and representatives from Risk and Compliance. Representatives from other departments may also attend by invitation.

The Committee considers information regarding all principal risks faced by the Society as documented in the ERMF to consider, review and challenge how existing risks in the business are being controlled and mitigated in accordance with stated risk appetite and consider new and emerging risks. The Committee provides regular reports and recommendation, where appropriate, to RACCC. The Committee meets at least ten times a year and is chaired by the Chief Risk Officer.

Remuneration and Loans Committee
This Committee comprises all the Non-Executive Directors and is chaired by Nick Treble (Non-Executive Director and Vice Chairman). It sets remuneration policy for Directors and reviews and approves remuneration arrangements and service contracts for Executive Directors.

The Committee takes responsibility for monitoring compliance with the regulatory Remuneration Code as it applies to Material Risk Takers under the Senior Manager Regime. It also considers and approves loans to Directors or connected persons. The Committee meets at least twice a year to review remuneration and as necessary to approve applications for Directors' loans.

Nominations Committee
This Committee consists of the Senior Independent Director, Neil Holden, who chairs the Committee, the Chairman of the Society, Vice Chairman and Chief Executive Officer. The Committee reviews the balance of Board skills, independence, experience and knowledge, its structure and composition, any new appointments and the performance of Directors.

The Committee also ensures that the Society meets its statutory responsibilities, giving due consideration to relevant laws, regulation and codes, in particular to be responsible for adherence to the Building Societies Act and follows good practice in Corporate Governance, including reviewing the UK Corporate Governance Code.

In the appointment of new Directors the Committee focuses on the need for diversity around the Board table and uses a professional search firm or open advertising to encourage applications from a range of candidates. The Committee considers diversity in the context of experience, background and skills as well as gender and ethnicity. The percentage of females on the Society's Board is 33%.

Credit Committee
The Committee comprises Executive Directors, the Chief Risk Officer and Head of Credit Risk. The Committee reviews lending propositions and loan performance as well as benchmark and trend data. It reviews and recommends to the Board changes to lending policy or limits. The Committee meets at least eleven times a year and is chaired by the Chief Risk Officer

Product Management Committee
The Committee comprises Executive Directors and representatives from Risk, Finance, Product and Service departments.

The Committee approves and monitors (in line with the defined principles, strategy and operating plan) all Society products and propositions (new and existing) including mortgage, retail and business savings, third party products and services. The Committee meets at least ten times a year and is chaired by the Chief Customer Officer.

2.4. Risk appetite

The Board defines risk appetite as "the level of risk the Society is prepared to accept whilst pursuing its business strategy as a mutual Society set up for the benefit of its members, recognising a range of possible outcomes as the business plan is implemented". Risk appetite is reflected in qualitative measures set out in the Society's ERMF and in a series of quantitative measures that are reported to the Board at each meeting.

Risk appetite is formally reviewed at least annually but may be revised more frequently to reflect emerging risks, changes to the economic and market environment or for any other reasons considered appropriate.

2.5. Risk culture

The Board places significant emphasis on every level of the organisation having an awareness of risk and the importance of effective management of risk. Each department across the organisation is expected to take ownership for the identification and management of risks specific to their areas, with the Board and Management Committees, together with the three lines of defence model ensuring a strong risk culture is embedded throughout the organisation, set by the "tone from the top". As a Mutual organisation, exemplary conduct is also expected from everyone in the organisation and conduct is taken into consideration when making decisions on remuneration across all levels of the organisation to ensure incentives do not drive poor customer outcomes.

2.6. Stress testing

Stress testing is a risk management tool used by the Group to understand the impact of severe but plausible scenarios on its business model. The Group uses a prescribed Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) to identify and quantify the capital and liquidity risks it faces. Stress testing is undertaken as part of these processes with the combined output used to inform the Board's risk appetite, certain policies together with management actions and contingency plans.

As part of its credit risk management framework, the Society undertakes a number of overarching stress tests of Pillar 2A capital. These cover:

- HPI Fall and Arrears Deterioration
- Conduct Risk events
- Operational near miss experience including mortgage operations processing, savings administration, finance and treasury, legal, reputational and people risks
- Future technological developments risks, information security and third party outsource risk

Liquidity stress tests are performed on a regular basis with the results reported to ALCO. These stress tests are designed to identify any shortfalls in the Society's liquidity holdings against a range of run off rates of retail and wholesale funding.

The Society adopts as an absolute measure of basis risk in its balance sheet the 'PRA's Basis Risk Ratio'. In addition to quantify the actual financial exposure created by movements in different rate types it applies stress tests to its balance sheet. The outcome of the key stresses is measured against the board agreed 'interest rate risk appetite' of 4% of capital.

In addition, the PRA carries out an assessment of the Society and may issue revised capital or liquidity guidance specifying minimum capital and liquidity levels based on their assessment of the risks faced by the Group, including under stress.

3. Capital resources

The Group's capital resources are calculated under Pillar 1 of the CRD. The scope of these resources as of 31 December 2017 relate to Saffron Building Society and Crocus Home Loans Ltd.

There are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources between Saffron Building Society and its subsidiary.

Total Group assets at the above date were £1,020m of which Crocus Home Loans Ltd makes up £48m.

3.1. Total capital

The following table shows Saffron Building Society's capital resources at 31 December 2017.

£m	Note	31 December 2017	31 December 2016
Common Equity Tier 1 Capital			
General reserves		54.7	51.7
Available for sale reserve		0.0	0.3
Revaluation reserve		0.4	0.4
Less: Regulatory adjustments			
Intangible assets	1	(10.0)	(10.7)
Pension Scheme surplus	2	(0.2)	-
Deferred tax assets	3	-	-
Prudent Valuation Adjustment	4	(0.1)	-
Total Common Equity Tier 1 Capital		**44.8**	**41.7**
Tier 2 Capital			
Credit risk adjustments: Collective provision		0.4	0.3
Subordinated liabilities	5	10.0	10.0
Total Tier 2 Capital		**10.4**	**10.3**
Total Capital		**55.2**	**52.0**

Notes:

1) CRD IV requires intangible fixed assets, net of any deferred tax liabilities, to be deducted from CET1 capital
2) CRD IV does not permit a pension fund deficit to be added back to regulatory capital but requires a surplus, net of any deferred tax liabilities, to be deducted from CET1 capital
3) Deferred tax assets that rely on future profit and arise from temporary differences are also required to be deducted from CET1 capital, but an exemption is applicable as long as the amount represents less than 10% of total CET 1 capital. The Society's deferred tax asset at 31 December 2017 falls below the threshold for regulatory adjustment.
4) Capital Requirements Regulation (CRR) requires financial institutions to apply prudent valuation to all fair value positions. The Prudent Valuation Adjustment is directly deducted from the Common Equity Tier 1 (CET1) capital.
5) The Group 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 Group, as regards the principal of their shares and interest due on them.

Under CRD IV rules subordinated liability instruments are required to satisfy prescribed criteria in order to be eligible for regulated capital. The subordinated debt held by Saffron continues to meet these criteria and is therefore recognised as Tier 2 capital.

3.2. Reconciliation of regulatory capital

A reconciliation of equity attributable to members per the Statement of Financial Position to regulatory capital is presented below:

£m	31 December 2017	31 December 2016
Equity attributable to members per the Statement of Financial Position	**55.1**	**52.4**
Adjustments for items not eligible for inclusion in CET1 capital		
Intangible assets	(10.0)	(10.7)
Pension Scheme surplus	(0.2)	-
Prudent Valuation Adjustment	(0.1)	-
Total adjustments to Common Equity Tier 1 Capital	**(10.3)**	**(10.7)**
Adjustments to Tier 2 Capital		
Add back: Collective provision	0.4	0.3
Add back: Subordinated liabilities	10.0	10.0
Total adjustments to Tier 2 Capital	**10.4**	**10.3**
Regulatory capital	**55.2**	**52.0**

4. Capital adequacy

4.1. Internal Capital Adequacy Process (ICAAP)

The five year Strategic plan and Annual Operating plan process establishes risk appetites for each of the Group's business lines and for each risk category. Through this process, the Group ensures it has sufficient financial and non-financial resources to meet its Strategic plan objectives.

In addition to the Strategic plan and Operating plan, the Group operates a formal Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP sets out the framework for the Society's internal governance and oversight of its risk and capital management policies and involves a review of all risks of relevance to the Society and an assessment of the capital required to ensure the Group's capital resources are sufficient to support its plans - in both normal and stressed conditions.

The production of the ICAAP involves reviewing all business areas with estimates for capital allocation across the Strategic plan period and a comparison against Board risk appetite. The Group Board then agrees (with input from the results of the Group stress models including the PRA's 'Annual Cyclical Scenario') the economic scenarios to be used in calculating capital requirements.

The Board reviews the risks and makes an assessment of the capital required to mitigate the financial impact of the risks, including assessment of the results of stress testing modelled output. 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.

In addition to the ICAAP process the PRA issues the Society with Individual Capital Guidance (ICG) which is currently 9.95% of risk weighted assets. This sets the minimum capital the Society must hold under Pillar 1 and 2A requirements.

4.2. Risk weightings

The Group determines credit risk weightings according to the Standardised Approach as set out in the CRR. Under this approach the level of capital required against a given level of exposure to credit risk is calculated as:

Credit risk capital requirement = Exposure value x Risk weighting x 8%

Risk weightings vary depending on the nature of the asset and variable factors such as loan to value, security, or for wholesale assets, counterparty, credit ratings and duration.

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 three years.

4.3. Capital requirements summary

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement. The table below shows the position at 31 December 2017.

	31 December 2017		
Capital requirement	**Exposure**	**RWA**	**Capital @8%**
Credit risk			
Loans and advances to customers	842.3	316.7	25.4
Wholesale assets	154.5	0.5	0.0
Other items	304.5	17.2	1.4
Operational risk		36.1	2.9
Credit Valuation Adjustment (CVA)		2.6	0.2
Minimum capital requirement	**1,301.3**	**373.1**	**29.9**
Capital resources			55.2
Excess of own resources over minimum Pillar 1 requirement			**25.3**

	31 December 2016		
Capital requirement	**Exposure**	**RWA**	**Capital @8%**
Credit risk			
Loans and advances to customers	861.2	331.6	26.6
Wholesale assets	228.2	3.9	0.3
Other items	340.4	20.1	1.6
Operational risk		38.9	3.1
Credit Valuation Adjustment (CVA)		-	-
Minimum capital requirement	**1,429.8**	**394.5**	**31.6**
Capital resources			52.0
Excess of own resources over minimum Pillar 1 requirement			**20.4**

4.4. Leverage ratio

The leverage ratio is defined as the ratio between Tier 1 Capital and total exposures (on and off balance sheet) without taking into account any risk weightings. Its objective is to reduce the risk of excessive leverage i.e. an excessively low amount of own funds compared to total assets as well as acting as a back-stop against the model complexities involved in calibrating risk weights. The leverage ratio also takes off-balance sheet exposures into account.

The measure of total exposure and calculation of leverage ratio are shown below, together with reconciliation between total exposure and total asset values as reported in the Society's Annual Report and Accounts.

£m	31 December 2017	31 December 2016
Total Tier 1 Capital	**44.8**	**41.7**
Total assets as reported in statutory accounts	1,019.9	1,114.5
Accounting value of derivatives	(2.8)	(3.0)
Derivatives gross positive fair value of contracts	1.5	3.9
Derivatives potential future exposure	2.6	2.7
Undrawn credit facilities	11.1	8.1
Deduction of intangible assets	(10.0)	(10.7)
General credit risk adjustments	0.4	0.3
Total leverage ratio exposure	**1,022.7**	**1,115.9**
Leverage ratio	**4.4%**	**3.7%**

5. Credit risk

Credit risk is the risk that a customer is unwilling or unable to honour its obligations to the Society as they fall due, resulting in an actual or potential loss exposure for the Society. The Society segments credit risk into two categories: Retail; and Treasury. As a primary lender the Group faces credit risk as an inherent component of its lending activities. Adverse changes in the credit quality of the Group's borrowers, a general deterioration in UK economic conditions or adverse changes arising from systemic risks in UK and global financial systems could reduce the recoverability and value of the Group's assets.

The Society operates within a credit risk appetite which directs our lending to lower risk / lower return sectors of the mortgage market, both in terms of property location and borrower characteristics and this is monitored carefully and benchmarked against external loss and risk data.

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 Board Credit Committee.

The Assets and Liabilities Committee (ALCO) is responsible for recommending limits on Treasury counterparties, country exposures and types of financial instruments for approval by the Board Credit Committee.

Lending and business decisions

The Group translates its overall risk appetite for credit risk into individual lending limits. The performance against these limits is monitored monthly and the limits 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

Pricing models are in use for all mortgages. Our pricing model includes an assessment of capital requirement by product and provides guidance as to what rate needs to be charged to meet return targets based on capital requirement for the product.

Concentration risk

Where a firm's exposure to a single borrower or several borrowers (for example, 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 geographic concentration of 'high risk' or high LTV loans, specific lending such as buy-to-let or industry/sector concentrations.

The Group monitors all of these areas carefully to ensure that it does not lend more than is appropriate for its position and size. In addition it has limits on specific areas, such as where payments are linked to rental income on the property securing the loan.

The Group, as a regional building society (and associated subsidiary) has a geographical concentration in its core lending area. It manages this risk carefully by having business strategies that aim to maintain a good balance of lending across England and Wales and regularly monitoring its exposure by region.

It also takes account of concentration risk within its models by having higher economic stresses where geographical concentration risk has been identified.

In the Group's case this means that for residential exposures in East Anglia, Greater London and South East England it holds more capital and models greater reductions in asset values in this region than would otherwise be the case.

5.1. Retail credit risk – Loans and advances to customers

Retail credit risk exposures are limited to and arise from the provision of loans secured on properties within the UK. All mortgage loan applications are reviewed by an individual underwriter and are assessed against credit risk appetite as set out in the Society's Board-approved Credit Risk Policy. Retail credit risk exposures are monitored each month by Credit Committee, with additional reporting of risk appetite to the RACCC and Board.

	Asset	Risk Weighted Asset	Capital	RWA Density
Loans & Advances to Customers				
Claims or contingent claims on corporates	£2.7m	£1.6m	£0.1m	57%
Claims or contingent claims on real estate property	£832.6m	£307.1m	£24.6m	37%
Past due items	£7.0m	£8.0m	£0.6m	115%
Total Loans & Advances to Customers	**£842.3m**	**£316.7m**	**£25.4m**	**38%**

The Group's total portfolio of loans and advances mostly comprise of owner-occupied ad buy-to let mortgages. The Group also has a small portfolio of equity release mortgages and non-residential loans but is not looking to expand these portfolios.

	2017	2016
Owner occupied	**59.7%**	59.5%
Buy to let	**30.6%**	30.4%
Equity release	**7.8%**	8.2%
Other	**1.9%**	1.9%

"Past Due" (Loans > 3 months in arrears or in possession) exposures by geographical region

	2017			
Geographical Region	Residential Mortgages (£million)			
	Past Due*	Performing	Total	%
S.East	1.40	255.64	257.04	30.6%
Gr.Lon	0.57	255.67	256.24	30.5%
S.West	0.04	73.95	73.99	8.8%
W.Mids	0.72	50.09	50.80	6.1%
N.West	0.83	49.20	50.03	6.0%
E.Mids	1.02	38.94	39.96	4.8%
E.Ang	0.34	37.83	38.17	4.5%
Yorks&Humb	1.93	34.10	36.03	4.3%
Wales	0.14	19.01	19.14	2.3%
North	0.03	18.13	18.16	2.2%
Total	7.01	832.55	839.56	100.0%
	0.8%	99.2%		

Geographical Region	Commercial (£million)			
	Past Due*	Performing	Total	%
S.East	-	1.19	1.19	43.3%
E.Ang	-	1.00	1.00	36.3%
W.Mids	-	0.36	0.36	13.1%
Gr.Lon	-	0.17	0.17	6.0%
S.West	-	0.03	0.03	1.3%
Total	-	2.75	2.75	100.0%
	0.0%	100.0%		

Total Loans & Advances to Customers	7.01	835.30	842.31	
	0.8%	99.2%		

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

Credit risk adjustments - Impairment provisions

Provisions for losses are based upon an appraisal of loans, advances and other assets. Individual provisions are made where required in respect of properties in possession and where a Receiver of Rents (RoR) has been appointed. Individual provision are also made in respect of mortgage accounts where 3 payments have been missed (90 days past due) 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 re-possession.

Collective 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 the Group's income statement represents the actual losses incurred and the net change in provisions.

The collective provision 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 statement of financial position and the provisions for liabilities can be found in the 2017 Annual Report and Accounts.

	Individual £000	Collective £000	Total £000
Group			
At 1 January 2017	3,668	309	3,977
Charge / (credit) for the year	291	65	356
Amounts utilised in the period	(397)	-	(397)
At 31 December 2017	**3,562**	**374**	**3,936**
Society			
At 1 January 2017	3,602	307	3,909
Charge / (credit) for the year	245	66	311
Amounts utilised in the period	(362)	-	(362)
At 31 December 2017	**3,485**	**373**	**3,858**

5.2. Wholesale credit risk

Counterparty credit risk

The purpose of the Group's counterparty treasury credit risk management policy is to ensure that the Group 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 for counterparties 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 modified and/or removed only on the recommendation of the Assets and Liabilities Committee to the Board Credit committee. All limits (and operational guidelines) are reviewed regularly (and at least annually) by the Assets and Liabilities committee.

The Treasurer prepares a submission for the approval of new, or the removal of existing, counterparties. Limits may be suspended by the 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. Interest rate swap derivative instruments are all covered under 'collateralised' agreements. Depending on the market value of the instruments, this results in either the Group or the swap counterparty depositing collateral funds with the corresponding counterparty. This mitigates the credit risk to either counterparty from any exposure created by movement in the market value of derivatives.

Impairment of Wholesale assets

At each balance sheet date the Society assesses the portfolio of wholesale assets for objective evidence of impairment. Wholesale assets classified as available for sale assets are considered impaired if an event has occurred after initial recognition of the asset that has an adverse impact on the estimated future cash flows of those assets. Any charges for impairment are recognised in the income statement. The Society reported no such charges on its wholesale assets during the year ended 31 December 2017.

	Asset	Risk Weighted Asset	Capital	RWA Density
Treasury Assets				
Claims or contingent claims on central governments or central banks	£86.3m	£Nil	£Nil	0%
Claims or contingent claims on multinational development banks	£38.8m	£Nil	£Nil	0%
Claims or contingent claims on institutions	£29.5m	£0.5m	£0.0m	2%
Total Treasury Assets	**£154.5m**	**£0.5m**	**£0.0m**	**0%**

Analysed by credit quality based on long term Fitch ratings.

Fitch Ratings Services	Maturity of Treasury Investment			
	< 3 months	3 months to 1 year	> 1 year	Total
AAA	£5.0m	£16.8m	£16.9m	£38.8m
AA	£59.1m	£19.4m	£8.9m	£87.3m
A	£28.4m	-	-	£28.4m
Total	**£92.5m**	**£36.2m**	**£25.8m**	**£154.5m**

5.3. CVA risk

Risk weightings for derivative financial instruments are determined according to the Mark-to-Market Approach for Counterparty Credit Risk under the CRR and the Standardised Method for Credit Valuation Adjustment (CVA) Risk. The Society's exposure values related to counterparty credit risk are shown below:

	Exposure value £000s
Gross positive fair value of contracts	1,295
Potential future exposure	2,841
Total net derivatives credit exposure	3,274
RWA requirement	2,613
Group Capital requirement	209

5.4. Asset encumbrance

The Society has pledged a portion of its mortgage assets as collateral with the Bank of England in order to participate in the Bank's Funding for Lending Scheme ("FLS") and Term Funding Scheme ("TFS"), part of the Sterling Monetary Framework. The Society participates in FLS and TFS as they provide the Society with an additional source of funding, helping to diversify funding and lower overall funding costs to the Society. The loans remain fully owned and managed by the Society but are reported as encumbered assets.

The Society enters into derivative financial contracts as part of its management of interest rate risk for which collateral is also posted.

The table below details the levels of asset encumbrance for 2017. Note that this information is required to be disclosed as median values over quarterly positions during the 12 months preceding 31st December 2017, and as a result may differ from other information provided in this disclosure.

The Society is required to encumber more assets than it receives in collateral to allow for the potential non-performance of assets held in the pools.

2017	**Encumbered assets**		**Unencumbered assets**	
£000s	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Assets of the reporting institution	**89,728**		**1,013,168**	
Loans and advances	89,728		863,013	
Debt securities	-	-	126,071	126,071
Other assets	-		24,084	

6. Operational Risk

Operational risk is the risk of incurring losses resulting from inadequate or failed internal processes, people or systems, or from external events. This definition includes legal risk and environmental risk together with events or circumstances where disaster recovery planning does not work.

The activities of the Group expose it to any operational risks relating to its ability to implement and maintain effective systems to process its transactions with Members and customers. A significant breakdown in IT systems of the Group might adversely impact the ability of the Group to operate its business effectively.

To address these risks, the Head of Operational Risk has put in place risk and control self-assessments (RCSA) covering the operations of the entire society. RSCAs are reviewed and tested on a regular basis and the results reported to the Executive and RACCC. Any incidents and near misses are assessed in terms of potential cost to the Society and the causes identified to improve controls. Additionally the Group's internal audit function (provided externally by PwC) carries out targeted reviews of critical systems and processes to ensure that they are properly designed and operate effectively.

The Group has a Business Continuity Plan which is kept under regular review and is designed to ensure that any breakdown in systems would not cause significant disruption to the business.

The Society adopts the Basic Indicator Approach ("BIA") to calculate its Pillar 1 capital requirements for Operational Risk. This uses as a proxy the product of the specified factor of 15% applied to the average net interest income plus net non-interest income over the previous three years to calculate a charge for operational risk.

The calculation for the Pillar 1 capital requirement for Operational Risk as at 31st December 2017 was £2.9m, calculated as follows:

	2015	**2016**	**2017**
Net interest income	20.3	19.3	19.4
Fees and commissions receivable	0.4	0.5	0.7
Fees and commissions payable	(0.6)	(0.7)	(0.8)
Net other operating income and charges	0.2	0.4	0.3
Net fair value movements	(0.1)	(0.5)	(1.0)
TOTAL	**20.2**	**19.0**	**18.6**
Basic indicator (three year average)			19.3
Own funds requirement (15% of Basic Indicator)			2.9

In addition the Society conducts stress testing to determine whether additional capital should be held in Pillar 2A. Further details of stress testing can be found in section two.

7. Other risks

7.1. Interest Rate Risk in the Banking Book (IRRBB)

IRRBB indicates the risk that arises from holding assets and liabilities that possess differing interest rate characteristics. This primarily occurs for the Society where it offers fixed interest rate mortgages and savings products. The risk arises where either fixed rate mortgages are funded by variable rate savings or vice versa.

An example of this risk materialising would be where interest rates rise and this result in a need to increase variable rates. Thus savings costs would increase but fixed rate mortgage income would remain unchanged. Thus reducing the net income generated.

Where possible the risk can be managed by matching against each other mortgages and savings with the same fixed interest duration. Where this is not possible interest rate derivatives are entered into to hedge out the risk.

In order to monitor and evaluate this risk the society produces an interest gap report on a daily, weekly and monthly basis with results being reported to ALCO on a monthly basis.

To quantify the risk across the entire balance sheet the interest rate gap is stressed for parallel interest rate stress. The Society's risk appetite is quantified that a parallel shift of 2% in interest rates in either direction should not result in a loss of economic value in excess of 4% of reserves. This would include the effect of interest rate risk related to the portfolio of lifetime mortgages.

As at 31st December 2017 the effect of a 2% parallel shift in interest rates was £0.45m being well within the 4% of reserves limit which was £2.6m.

7.2. Market Risk

Market risk is the risk of any impact on the Society's financial position due to adverse movements in market rates, such as interest rates, house price indices, equity prices, currency or commodity prices or early redemption of assets. The Society's principal exposure to market risk is interest rate risk and prepayment risk within the Group's portfolio of equity release mortgages recorded at fair value.

The Society's is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk). The Society has adopted the "matched " approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position. The Society manages market risk through on-balance sheet matching of assets and liabilities or derivative financial instruments. Following the adoption of FRS102 movements in interest rates and other indices have a direct impact on the value of certain balance sheet items which, in turn, creates volatility in reported earnings.

The management of interest rate risk is based on a full statement of financial position gap analysis. The statement of financial position is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported to the monthly ALCO meeting. In addition management reviews interest rate basis risk, including under stressed scenarios. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum of 4% of capital. These are in turn reviewed monthly by the ALCO and reported to RACCC.

7.3. Liquidity risk

Liquidity risk is the risk that the Society is unable to make available sufficient resources to meet its current or future financial obligations as they fall due, or is only able to do so at a premium cost. This includes the risk the Society attracts excessive liquidity through poor product management, acting as a drag on financial performance.

The Group relies on its access to sources of funding to finance the origination of new business and working capital. If access to funding became restricted, either through market movements or regulatory or Government action, this might result in the scaling back or cessation of new lending. The Group, through its treasury operation, overseen by the Assets and Liabilities Committee, seeks to mitigate this risk by managing the Group's liquidity portfolio and actively seeking alternative sources of finance.

The Group's liquidity policy is to maintain sufficient assets in liquid form at all times to ensure that the Group can meet all its liabilities as they fall due and also meet all regulatory liquidity requirements.

The Group manages this risk on a continuous basis through ALCO and by ensuring compliance with the Treasury Policy approved by the board. In practice this results in the Group holding a significant amount of highly liquid assets, mainly UK gilts, Treasury bills, multilateral development bank securities and deposits with the Bank of England, which are eligible to meet its required liquidity buffer set by the regulator. The Society also holds a separate pool of such assets for use as collateral with derivative counterparties. In addition the Group maintains deposits placed on call or overnight with the Bank of England and major banks to meet its operational needs without drawing on its buffer requirements.

In accordance with BIPRU12, the Group maintains a significant level of high quality, UK Government Debt and AAA rated debt instruments, which are classed as Eligible Buffer Assets. As at 31 December 2017 the Group held Eligible Buffer Assets amounting to £154.5m.

It is a requirement for all Banks and Building Societies to construct plans that detect possible failure and minimise the consequences of failure should it occur. The Society has a Board-approved Recovery and Resolution Plan that outlines a menu of options the Society could credibly take to recover from a Society-specific or market-wide stress. The resolution plan contains prescribed information necessary for the Bank of England to establish an orderly resolution of the Society in the event that recovery cannot be achieved. The Recovery and Resolution Plan document is updated at least annually.

7.4. Business risk

The Group faces competition in all the core markets in which it operates. There is a danger that its profitability and/or market share may be impacted by the actions of its competitors. To mitigate this risk, the Group maintains close relationships with its Members and customers, business introducers and other significant participants in the markets in which it is active as well as participating in sector-wide organisations (for example, the Building Societies Association) and initiatives. This allows market trends to be identified and addressed within the Group's business strategy.

7.5. Pension obligation risk

The Group has a defined benefit pension scheme. The scheme is closed to new Members and is closed to future accrual of service cost.

Pension obligation risk relates to defined benefit pension schemes and defined contribution schemes offering guaranteed returns that are not fully matched by underlying investments.

The Society will ensure that the Pension Scheme is sufficiently funded to ensure that the Pension Scheme can make its pension commitments as and when required. As such the possibility exists of a further impact to Group 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.

The framework for Pillar 2A pension obligation risk capital includes a set of stresses on the accounting basis which will be used to assess adequacy of a firms' own assessment. The Group allocates a specific amount of capital under Pillar 2 to cater for a stress reduction in asset values and/or an increase in pension liabilities.

7.6. Remuneration risk

Remuneration risk can arise if reward schemes are in place which can encourage inappropriate action by risk takers in the business.

It is the responsibility of the Remuneration and Loans 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 Group's risk profile (known as 'code staff').

A further responsibility is to demonstrate that remuneration decisions made are consistent with an assessment of the Group's financial situation and future prospects. At the same time, there is a risk that the Group is unable to retain and attract the quality of individuals needed to deliver its strategic plans. Accordingly, the Remuneration and loans committee has regard to the relative position of the Group to other societies and financial services businesses and uses market benchmarks when formulating remuneration strategy.

The Terms of Reference of the Remuneration and loans committee are set out on the Group website.

7.7. IT Security / Cyber crime

Cyber-crime and the security of information held by the Society are a present and growing threat that the Society's systems might be infiltrated allowing the intruder to take control of customer accounts or download sensitive data for personal gain.

The Society has followed a programme of significant investment in technology, which includes cyber-risk reduction initiatives and further progress towards attainment of Information Security industry standards. Further investment will continue in 2018.

7.8. Compliance risk

Compliance risk is the risk of financial loss, reputational damage and or regulatory censure arising from failure to comply with regulatory or legislative requirements.

The market sectors in which the Group operates and the markets from which it receives its funding have been subject to extensive intervention by the UK Government, European Union and other regulatory bodies. To the extent that such actions disadvantage the Group, when compared to other market participants, they represent a risk to the Group. In order to mitigate this risk, the Group has been active in explaining its position to the authorities and works with its professional advisors in this process.

Ultimately there are three risks when it comes to ensuring that we comply with regulations:

a) Failing to identify new or developing regulatory requirements / guidance;
b) Failing to comply with all regulatory requirements; and
c) Failing to identify breaches and take appropriate action.

A dedicated compliance team, reporting directly to the CEO, monitor rule compliance through a programme of departmental and thematic reviews and, under the supervision of RACCC, ensures that the Society stays within the various regulatory regimes and provides Executive management and the Board with regular updates on regulatory issues.

7.9. Conduct risk

Conduct risk forms a part of compliance risk and is the risk that the Society acts in a way which delivers adverse outcomes for customers and therefore not in accordance with the requirements or principles of Treating Customers Fairly.

Every department in the Society is aware of and responsible for ensuring Members are put first and the highest standards of conduct upheld, with regular training provided to ensure these principles are embedded in the culture of the Society. The Compliance team acts as second line of defence and reports to RACCC on conduct matters.

8. Remuneration paid to Code staff

The Directors' Remuneration Report, which is set out on pages 24 to 25 of the Society's Annual Report and Accounts, describes the policies and process for determining the remuneration policy of the Society. Further detail on Executive and Non-Executive Directors' remuneration is also provided in Note 7 of the Annual Report and Accounts 2017.

The Society has two Board committees dealing with appointment and remuneration of code staff: Remuneration and Loans Committee; and Nominations committee, both of which are covered in section 2.3. of the document.

8.1. Components of remuneration

Executive directors' remuneration must fairly reflect responsibilities, expertise, experience and performance whilst being competitive enough to attract, motivate, reward and retain high quality executive directors. The Society continues to operate in a competitive environment from a sector as a well as geographic perspective. Performance at a high level is expected, with rewards directly linked to appropriate risk management, financial performance, quality customer service and individual excellence. The remuneration package for executive directors is made up of the following components:

Component	Level	Basis
Basic salary	Salary level decisions are recommended to the Remuneration and Loans Committee	Based on job content, responsibilities and remuneration levels for similar positions in financial services
Pension	Pension contribution is 13.5% of basic salary paid monthly into a group personal pension plan unless otherwise requested to be payable as a cash alternative	None of the executive directors are members of the (closed) final salary scheme
Bonus	Reward in the form of a bonus payment is linked to appropriate risk management, financial performance, capital management, quality customer service, operational fitness and people engagement. Organisational measures are reviewed by the Remuneration and Loans Committee each year. For the 2016 performance year, 50% of bonus earned was deferred until March 2019. For the 2017 performance year, 40% of bonus earned will be deferred over three years, payable in 2019, 2020 and 2021.	Earned on an annual basis and is determined by a combination of organisation and individual performance. For the 2017 performance year, deferral applies to individual amounts in excess of £5,000
Other benefits	Cash allowance (in lieu of a lease vehicle) of 10% of basic salary paid monthly through payroll. Income protection, death in service, private medical insurance and enhanced annual leave	Considered typical for the sector

8.2. Code Staff

In accordance with regulation the Society has considered which of its staff fall under the scope of 'material risk taker' and are deemed Code staff. The activities of a material risk taker may have material impact on the firms risk profile although not all affect the Society's risk profile in the same way. The Society deems material risks takers to be Non-Executive Directors, Directors, Executives and other senior management roles (typically Heads of Functions).

Aggregate information on remuneration for the year ended 31 December 2017 is provided below:

£000s	Number of staff	Fixed remuneration	Variable remuneration	Total
Executive Directors	3	596	64	**660**
Non-Executive Directors	6	214	-	**214**
Other material risk takers	14	1,075	75	**1,150**
TOTAL	**23**	**1,885**	**139**	**2,024**

No individuals received total remuneration exceeding £850,000.

8.3. Non-Executive Directors' remuneration

Non-executive directors' remuneration comprise entirely of fees which are reviewed annually. Non-executive directors are not entitled to any bonus or pension from the Society.

8.4. Contracts of employment

All three executive directors are employed by the Society on a permanent service contract which may be terminated either party giving six months' notice.