Always with your interest at heart

Pillar 3 Disclosure

31 December 2019

Contents

1. Overview

1.1 Background

This document presents the consolidated Pillar 3 disclosures of the Furness Building Society as at 31 December 2019.

The Society is regulated for prudential capital purposes under the Basel 3 regulation which was implemented in the EU via the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), together known as Capital Requirements Directive IV (CRD IV). CRD IV consists of three main ‘Pillars’:

Pillar 1	This covers the minimum capital requirements of Basel 3. The calculation is based on a risk based approach. It focuses on credit, operational and market risk in determining the Society’s Minimum Capital Requirement.
Pillar 2	Assessment of capital adequacy – the Internal Capital Adequacy Assessment Process (ICAAP), undertaken by the Society, and the Supervisory Review and Evaluation Process (SREP), undertaken by the PRA in the UK, assess additional capital requirements not captured by Pillar 1. This is known as the Total Capital Requirement.
Pillar 3	Pillar 3 complements Pillars 1 and 2 and aims to encourage market discipline by setting out disclosure requirements which should allow market participants to assess key pieces of information on a firm’s capital, risk exposures, risk management processes and remuneration. These requirements are set out in Part 8 of the CRR (‘Part 8’). These requirements are updated with additional guidance issued by appropriate bodies such as Basel Committee, European Banking Authority.

The document has been prepared to meet the Pillar 3 disclosure requirements of CRD IV as presented in the Part Eight (Articles 431 to 455) of Regulation (EU) no 575/2013. A BCBS March 2017 review led to a consolidation of all existing BCBS disclosure requirements into the Pillar 3 framework. These guidelines apply only to Globally and Other Systematically Important Institutions.

The Society is not Globally or Other Systemically important institution and taking account of its relatively simple business model and low risk profile has chosen not to reflect in full the BCBS framework. However, the Society has had regard to these guidelines in preparation of this document.

1.2 Basis and Frequency of Disclosures, Scope of Application

These Pillar 3 disclosures are based on the Society’s Annual Report & Accounts for the year ended 31 December 2019. All figures are stated as at 31 December 2019 with comparatives as at 31 December 2018 where applicable, unless otherwise stated.

The disclosures are updated on at least an annual basis and are issued in conjunction with the publication of the Annual Report & Accounts. The content of Pillar 3 reporting will continue to be reviewed on an ongoing basis to ensure that they are appropriate and informative in line with regulatory changes and best practices and remain proportionate (in terms of materiality) to a small to medium building society.

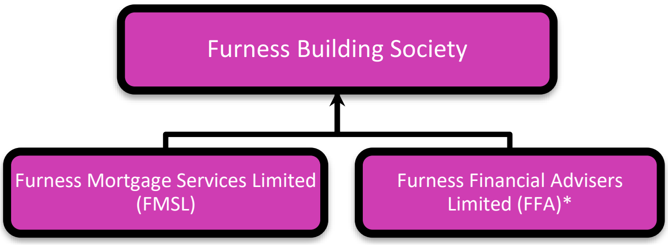
This document is published on Furness Building Society’s website (www.furnessbs.co.uk).

The disclosures are reviewed by the Board. They are not subject to External Audit, however, some of the information within the disclosures also appears in the Group’s audited Annual Report & Accounts for the years ended 31 December 2019 or 31 December 2018, usually rounded to the nearest £0.1m.

The Society’s Annual Report & Accounts have been prepared in accordance with FRS102 and ‘IAS 39 Financial Instruments’ accounting standards, whereas the Pillar 3 disclosures are prepared under CRD IV rules. The main differences between accounting and regulatory reported exposures and capital are set out in sections 3 & 4 of this document.

The Society has adopted the Standardised Approach ('SA') for credit risk and the Basic Indicator Approach ('BIA') for operational risk.

Our Pillar 3 disclosures are based on the Society's consolidated Group position, which is also detailed in our Annual Report & Accounts. The Group consolidation includes the Furness Building Society and its two wholly owned subsidiaries, Furness Mortgage Services Limited (FMSL) and Furness Financial Advisers Limited (FFA).



* Dormant Entity

References hereafter to the "**Group"** within these Pillar 3 disclosures comprise these three entities.

See below a brief overview of the above two subsidiaries.

Furness Mortgage Services Limited (FMSL) manages secondary mortgage portfolios and acquired five mortgages books from 2000 to 2004. FMSL's current mortgage portfolio is in 'run-off' and no longer issues mortgages. As at 31 December 2019 FMSL had £4m of mortgage balances outstanding.

Furness Financial Advisers Limited (FFA) is no longer trading and is operationally dormant, but as at 31 December 2019 still retains capital and intercompany balances with the Society.

1.3 Summary of Key Prudential Metrics

Key Metrics	**Dec-19**	**Dec-18**
Available Capital	**£m**	**£m**
Common Equity Tier1 (CET1)	71.2	68.4
Tier 1	71.2	68.4
Total Capital	74.2	72.6
Risk-weighted assets	**£m**	**£m**
Total risk-weighted assets (RWA)	366.4	346.0
Risk-based capital ratios as a percentage of RWA	**%**	**%**
Common Equity Tier 1 Ratio	19.43%	19.77%
Tier 1 ratio	19.43%	19.77%
Total capital ratio	20.25%	20.98%
Additional CET1 buffer requirements as a percentage of RWA	**%**	**%**
Capital conservation buffer requirement (increasing to 2.5% by 2019)	2.50%	1.88%
Countercyclical buffer requirement	1.00%	1.00%
Total of bank CET1 specific buffer requirements	3.50%	2.88%
CET1 available after meeting the Society's minimum capital requirements*	8.33%	8.88%
Basel III Leverage Ratio		
Total Basel III leverage ratio exposure measure (£m)	1,041.1	1,026.9
Basel III leverage ratio (%)	6.84%	6.66%
Liquidity Coverage Ratio		
Total Liquid Assets (£m)	105.1	156.0
Total net cash outflow (£m)	65.7	60.5
LCR Ratio (%)	159.9%	257.8%
Net Stable Funding Ratio		
Total available stable funding (£m)	920.0	925.7
Total required stable funding (£m)	681.5	619.7
NSFR ratio (%)	135.0%	149.4%

* reflects the amount of CET1 capital available after meeting our pillar 1 and pillar 2A requirements, see section 4.5 for further information regarding Total Capital Requirements ("TCR").

Capital and Leverage Ratios

The Group's CET1 ratio at December 2019 is 19.43%, which is 34bp lower than December 2018 (19.77%). The main drivers behind the change over 2019 are as follows:

- RWAs increased by £20.4m in 2019 driven by a £56m increase in mortgage assets over the year.
- the higher RWA capital requirement from asset growth is partly offset by higher CET1 capital of £2.8m in the year driven by retained earnings (£2.4m).

As at December 2019 the Society holds a CET1 surplus to minimum capital requirements of 8.33%, which is 4.83% above specific buffer requirements of 3.50%.

As at 31 December 2019, the Group's Leverage ratio was 6.84%, (6.66: 2018), which is above the current 3% regulatory minimum level.

Liquidity and Funding Ratios

The Group held liquidity and funding levels above minimum regulatory requirements of 100% for both the Liquidity Coverage Ratio (159.9%) and Net Stable Funding Ratio (135.0%) as at December 2019. There was a reduction in total liquid assets during 2019 due to early repayment of £20m of Term Funding Scheme (TFS) funding and mortgage lending growth during the year.

2. Risk Management

2.1 Risk Management Framework

2.1.1 Overview

The Group is retailer of financial instruments in the form of mortgages and savings. The Group also uses wholesale financial instruments to invest in liquid assets, raise wholesale funding and to manage the interest rate risks arising from its operations.

The Board has overall responsibility for maintaining a system of internal control to ensure that an effective risk management and oversight process operates across the Society. The risk management framework is designed to identify, understand and monitor the risks within the business, including risks to which the Society may become exposed, and manages rather than eliminates risks to meet the Society's business objectives.

The Society uses the industry standard three lines of defence model for the management of risk:

• LINE 1 – BUSINESS OPERATIONS

Business Areas – The first opportunity to identify risks and put in place steps to mitigate them as necessary. Management is delegated responsibility to identify and evaluate the risks within their business areas and ensure controls are operating effectively over those risks, such that the Society meets the aim of its internal control system and operates within the risk appetite agreed by the Board. The delegated management responsibility extends to activities undertaken by outsourced relationships.

• LINE 2 – OVERSIGHT FUNCTIONS

Risk Management Committees and related functions (eg Compliance and Risk) – These areas provide oversight and support the business in identifying and managing risk and generally co-ordinate the risk management activity across the whole business. These areas provide a level of assurance as to the adequacy and operation of the risk and control environment across the Group. Where the Society does not have internal expertise or resource capacity, the Society will engage with third parties to provide second line assurance as necessary.

• LINE 3 – INDEPENDENT ASSURANCE

The Internal function provide independent assurance which is reported to the Audit Committee. This is the 'backstop' line of defence and provides objective assurance that all risks have been identified and are being managed appropriately through the control framework in place, including the adequacy of the internal control system.

The Board has determined a clearly defined Statement of Risk Appetite, containing both quantitative and qualitative measures which are integrated into decision making processes.

The risk framework comprises a number of Committees, including the key committees of Board Risk and Audit. Through the Board Risk and Audit Committees, the Board receives comprehensive and timely reporting on the Society's identification, measurement and management of risk.

The Board's defined Statement of Risk Appetite is reviewed and adjusted at least annually and forms a key part of the corporate planning process. Adherence to the risk appetite is monitored by the Committees in the risk framework and reported to the Board each month against agreed measures.

The risk management framework is proportionate to the scale and complexity of the business and is commensurate with the degree of risk in the business to support decision making. It ensures the Society deploys a consistent approach to risk management in each of the principal risk areas.

2.1.2 Summary of Key Risk Areas

Credit Risk

This is the risk that borrowers or counterparties to whom the Society has lent money may default on their obligation to repay the Society. The Society manages the risk associated with mortgage borrowers by means of a prudent Lending policy that includes both a thorough assessment of the creditworthiness of the borrower and the value of the proposed security. Mortgages are monitored closely and on an ongoing basis, with timely action being taken for those mortgages that fall into arrears.

The Credit Risk Committee meets regularly to consider the risks associated with this lending and reviews large and potential default accounts.

In the case of liquid asset investments, the credit risk associated with lending to financial institutions is addressed by the Society's Assets and Liabilities Committee (ALCO) which ensures that investments are restricted principally to cash held with the Bank of England, UK Government issued debt instruments, liquid regulatory compliant AAA rated debt securities and operational call accounts with large UK based clearing banks with investment grade credit ratings.

The Society keeps abreast of developments affecting financial sector firms and takes appropriate action to safeguard the Society's investments.

The Society has continued improving the analysis and management information to understand and manage its credit risk exposures effectively.

The Society's mortgage book has inherent credit risk associated with fluctuations in the House Price Index (HPI).

The Society utilises manual underwriting procedures which enables individual risk assessment of complex cases.

See section 5.1 for further detail of the Society's approach to credit risk, including further analysis of past due and impaired assets by lending category and a credit analysis of Treasury Assets.

Concentration Risk

As a regional building society, the Society is exposed to concentration risk because its activities are highly concentrated in residential lending and/or associated products and services funded predominantly by retail deposits. Concentration risk is concerned mainly with the risk that in extreme scenarios, the lack of diversification may mean the losses resulting from such concentrations may be sufficient to threaten the solvency of the Group.

The following types of concentration risk are monitored to ensure that lending is not more than is appropriate for the Group in relation to its Position/Size; Geographic, Funding, Large Exposures and Product Type.

The Society heartland is within the North West area where it also has a higher proportion of its mortgage balances. This regional geographic concentration risk is considered when undertaking stress testing and models the impact of falls in regional property prices. The Society's lending concentration in the North West has been steadily decreasing over recent years with the increased use of UK wide intermediary origination channels. The Society regularly monitors its geographic concentration risk and adjusts its lending strategy where appropriate in line with Board limits.

The Society has a low proportion of its total lending in the form of commercial mortgages (£4.7m or 0.5% of loans as at December 2019) and monitors the amount of this type of lending on a regular basis to ensure that the quality and quantity remain within the Board's risk appetite. No new commercial lending is undertaken other than further advances on existing lending.

See section 5.1 for further analysis of the Society's exposures by lending category and geography.

Interest Rate and Basis Risk

The Society is exposed to interest rate and basis risk arising within the banking book, which results from different interest rate features, re-pricing dates and maturities of assets (mortgages and treasury investments), and liabilities (savings).

The Society's ALCO monitors and manages this exposure. The following activities are affected by interest rate risk:

- fixed rate mortgage lending and fixed rate treasury investments
- fixed rate savings products and fixed rate wholesale treasury funding
- management of the investment of reserves and other net non-interest bearing liabilities.

To manage fixed rate risk, the Society uses a combination of natural hedging, matching on balance sheet assets and liabilities with similar maturity dates, and interest rate swaps.

Basis risk is managed within a defined limit structure for each basis category (eg LIBOR or Base Rate).

The Society's interest rate related risk appetite is measured against:

- the economic impact of a parallel shift in interest rates of 2% over the life of the balance sheet with the limit set at £2m.
- the impact on annualised Net Interest Income (NII) of a 100bps interest rate shock on a static balance sheet

See section 5.2.1 for further details on the measurement and control of interest rate risk.

Liquidity Risk

The nature of the Society's business involves 'maturity transformation' whereby the Society borrows for relatively short terms and lends on mortgages for much longer periods. This mismatch creates liquidity risk whereby the Society could be unable to meet its financial obligations as they fall due.

Funding risk is the inability to access funding markets or to do so at excessive cost. In order to minimise funding risk the Society ensures there is no over reliance on a single source of funds.

The purpose of the Society's Internal Liquidity Adequacy Assessment Process (ILAAP) is to ensure that these commitments can be met in a timely manner under both normal and stress conditions and that the Group maintains the confidence of its existing and potential investors and suppliers.

On a day-to-day basis the Group's liquidity position is managed by the Treasury function which is responsible for the liquid asset portfolio and contingency arrangements. Liquidity and funding risk is monitored by the ALCO which meets on a frequent basis and receives a variety of management information reports which enable it to monitor the amount and composition of the liquid asset portfolio and ensure Group compliance with the regulations covering liquidity as well as the Board Statement of Risk Appetite of the Group.

The Society's liquidity policy has been developed to ensure that the Group is able to meet known, and also a reasonable level of possible unforeseen, financial obligations as they fall due under both normal conditions and defined stress scenarios. This is achieved by a combination of:

- undertaking an annual review of Liquidity and Funding via the ILAAP
- maintaining an appropriate level of high quality liquid assets (Liquidity Buffer)
- having access to additional sources of funds through the wholesale market as well as from retail customers
- access to Bank of England liquidity insurance facilities
- regular stress testing to ensure the Society can meet its liquidity adequacy requirements under a number of defined stress scenarios
- maintaining and testing a Liquidity Contingency Plan.

Sufficient liquidity is maintained at a level aimed at ensuring management, regulatory and member confidence in the solvency of the Group. A significant proportion of the Society's liquid assets are held in a Bank of England reserve account, UK Bank call accounts and short term deposits, to provide instant access to funds if and when required. In addition the Society holds a portfolio of treasury investments where there is an active secondary market enabling liquidation if required under a stress scenario. These treasury investments are all eligible for use as collateral in the Discount Window Facility with the Bank of England and inclusion in the Society's Liquid Asset Buffer.

See section 5.2.2 and 5.2.3 for further details on the measurement and control of liquidity risk.

Capital Risk

Capital risk refers to a situation where an events occurs that reduces the Society's capital to an unacceptable or unsustainable level. The Society regularly tests various scenarios to ensure it retains sufficient capital to manage foreseeable and possible events.

The Society's Internal Capital Adequacy Assessment Process (ICAAP) is the Society's evaluation of its capital position and requirements and sets out the approaches to manage capital risk across the planning horizon including the evaluation and monitoring of risk appetite limits.

The Society maintains a sufficient level of regulatory capital in order to absorb losses, deliver the Corporate Plan and support the Society's risk profile in both normal and stressed conditions.

The Board has approved a set of risk appetite measures and operating limits to manage and monitor capital levels on an ongoing basis, including:

- maintaining a conservative capital surplus over and above minimum regulatory Pillar 1, Pillar 2 and regulatory buffer requirements over the corporate planning period
- monitoring risk appetite Early Warning Indicators on a monthly basis for both CET1 and Leverage ratios, ensuring a sufficient surplus to regulatory requirements.

See sections 3 and 4 for further detail on the Group's capital position as at December 2019 and the stress testing undertaken as part of the Internal Capital Adequacy Assessment Process (ICAAP).

Operational Risk

This relates to the risk of financial loss as a direct result of failed systems, people and procedures and includes items such as defective title or money transmission errors. The operational risks faced by the Group are assessed on a regular basis and an appropriate system of control exists to mitigate these risks. In addition, the Society regularly considers succession planning to mitigate the key person risk.

The risk of data or financial loss as a result of cyber security risk is a growing risk which the Society takes extremely seriously. The Board invested in improving the security of the IT infrastructure during 2018 and 2019. These investments included moving the data platforms to secure data centres and encryption of data, which have significantly improved the data security for our customers.

The Society has strengthened its processes and controls and invested in training of staff to reduce the risk of financial crime. The investment has focussed on minimising Authorised Push Payment Fraud as well as potential abuse of third party withdrawals (including the possible misuse of powers of attorney).

The Society has a number of operational risks to manage on an on-going basis and in 2019 we successfully moved our Head Office in Barrow to a new location at Emlyn Hughes House. The Society utilised its own resource in addition to engaging external specialists to support the move, which was delivered with minimal disruption to staff and business or our customers.

The Society's Operational Risk Manager maintains the risk database and works with the Group's staff to embed a clear awareness of risks and how to address them. The Group measures its risks before and after the application of appropriate controls. The Group's Management Risk Committee comprises of the Society's Executive Team, the Operational Risk Manager and the Chief Risk Officer. Ultimately, the Board is responsible for deciding on whether it accepts the residual risk that exists after the application of these controls.

Conduct Risk

Conduct risk is the risk that the Society fails to design and implement operational arrangements, systems and controls which deliver fair outcomes for customers whilst maintaining regulatory and legal compliance.

The Group must ensure that it conducts dealings with its customers in a manner that is fair and is in their interests. The Board is ultimately responsible for the fair treatment of customers.

The Society has a Management Risk Committee which is chaired by the Chief Risk Officer with Executives and senior staff from each area of the Society and a Customer Service Forum with front-line staff from all areas represented.

The Committees meet two-monthly and consider related regulatory developments, the outcomes from customer complaints and receives feedback from staff and customers on customer service, literature and processes.

Conduct risk key performance indicators, which cover culture, marketing, product development, sales processes and post-sale service, are considered by the Board on a quarterly basis.

Although the Society seeks to control its own conduct risk, it also carries a potential liability to the Financial Services Compensation Scheme (FSCS) the size of the liability depends upon the failure of other members of the FSCS.

Pension Liability Risk

The Society operates a Defined Benefit Pension Scheme that provides benefits based upon final pensionable pay. This Scheme was closed to new entrants in September 2000 and closed to future accrual with effect from 1 January 2017.

The Scheme deficit on an accounting basis was £3.6m at 31 December 2019 (£4.3m: 2018). The Scheme liability remains a significant potential risk to the Group. However, the action taken to close the Scheme to future accrual has limited the risk of a further increase to the existing liabilities.

The Society currently makes an annual pension cash contribution of £0.97m, as part of an agreed schedule in order to support the reduction of the pension deficit.

The Society monitors possible future pension risk as part of the ICAAP process and ensures sufficient capital is held against this risk.

Business and Strategic Risk

The Society considers that Business and Strategic risks are inextricably linked

This is the risk that circumstances prevent the Society from achieving its long-term strategic objectives. Inability to deliver a long-term strategy threatens the future of the business. Strategic risk can arise from staff making poor decisions, inadequate capacity or capability to manage change, or from a failure to respond to changes in the business environment.

The main uncertainties affecting the Society relate to the current economic environment which has a direct impact on saving members' sentiment regarding saving and on borrowers' ability to meet their mortgage commitments. During 2019 the housing market has remained slow, in part caused by the uncertainty created by the political negotiations surrounding Brexit and the General Election. The uncertainty has impacted volumes of transactions and reduction of prices in some areas of the country. As noted above the Society has not noticed any increase in arrears over the period. The Society has undertaken stress tests and scenario analyses during the year, including both severe capital stress testing as part of our 2019 ICAAP and negative Brexit scenario modelling, assessing downside risks to profit, capital and liquidity. As a result we are confident that the Group has sufficient resources to withstand the economic and business challenges of a negative Brexit impact.

The Society's strategy is reviewed at least annually by the Board and Management to ensure it remains appropriate, deliverable and sustainable with external assistance sought when required to validate conclusions. The on-going management of strategic risk is supported by the business performance and risk reporting data provided to the Board and Risk Committees.

During 2018, the Society conducted a review of the strategy and we have continued to develop our strategic options and plans during 2019. The current challenging economic environment and competitive low interest rate mortgage market continues to put pressure on the net interest margin and this has been addressed through our strategy development.

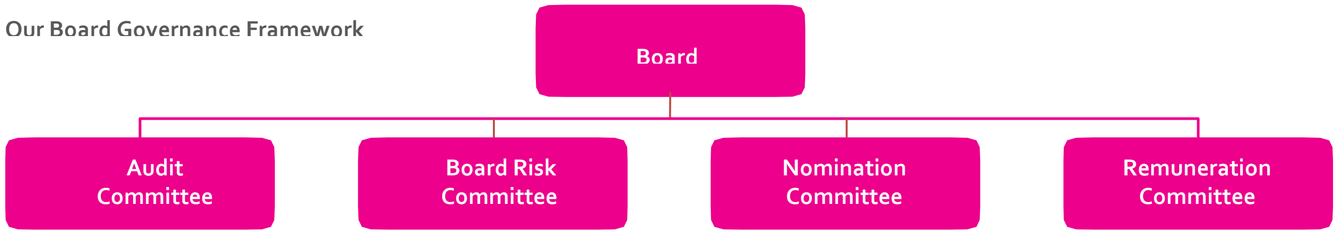
We will build on the strategy in 2020 with further investment in technology, capability and product propositions and distribution to ensure we are in the best position to meet customer expectations and secure a sustainable future for the Society.

2.2 Main Board and Committee Structure

2.2.1 Board of Directors

The Society's Board of Directors comprises three Executive Directors and six Non-Executive Directors.

The Board governance and committee framework is as shown below:



From a risk management perspective there are two Board appointed committees which report directly to the Board; the Board Risk Committee and Audit Committee.

In addition the Group's Assets and Liabilities Committee (ALCO) chaired by the Chief Executive, the Management Risk Committee and Retail Credit Risk Committee, both Chaired by the Chief Risk Officer, provide reports to the Board Risk Committee with all three comprised of executives and members of the senior management team.

2.2.2 Board Audit Committee

Composition: Three Non-Executive Directors

The Audit Committee comprises only Non-Executive Directors in order to maintain independence which is crucial in assessing the work of Management and the assurance provided by the Internal and External Audit functions. The Committee invites Executive Directors together with representatives from Internal and External Auditor to attend the meetings and also regularly meets with the Internal and External Auditor and the Society's Chief Risk and Compliance Officers independently.

Main Functions: The key roles and responsibilities delegated to the Committee by the Board are to:

- monitor the integrity of the Society's external financial reporting, including reviewing significant financial reporting judgements made by Management to ensure that they are appropriate
- providing advice to the Board on whether the Annual Report & Accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for members to assess the Society's position and performance, business model and strategy
- review the effectiveness of the Society's internal controls and risk management systems
- ensure that there are satisfactory whistleblowing arrangements to enable employees to raise any concerns about possible improprieties and that there are effective arrangements for investigation of any such concerns
- monitor and review the activities and performance of both Internal and External Auditor's and the Society's Compliance function.

The Audit Committee meets on a quarterly basis, with additional meetings held as required to approve the Annual Report & Accounts.

2.2.3 Board Risk Committee

Composition: Three Non-Executive Directors, Finance Director and Chief Risk Officer

Main Functions: The Committee's main roles are:

- advise the Board on risk appetite, which is the amount of risk the Society is willing to take in pursuit of its strategic objectives
- regularly assess the principal risks facing the Society
- advise the Board on current risk exposure and future risk strategy
- monitor the risk profile and key limits against the prescribed risk appetite
- monitor and review the effectiveness of the risk framework to ensure that key risks are identified and appropriately managed
- ensure the Risk function is adequately resourced to perform effective
- provide technical reviews of key policies and critical documents.

2.2.4 Assets and Liabilities Committee (ALCO)

Composition: Chief Executive (Chair), Finance Director, Marketing & Sales Director, Chief Risk Officer, Group Treasurer with Non-Executive Directors as observers.

Main Functions: The Committee is an executive decision making committee whose decisions and recommendations are reported to the Board on a monthly basis. The principal objective of the Committee is:

- to ensure that the Society's overall objectives with regard to liquidity, funding and interest rate risk are appropriately managed, controlled and aligned with Corporate Plan objectives
- to review the Society's treasury activity and the current and proposed strategy and limits for liquidity, wholesale funding and hedging activities
- to ensure that the Group complies with Society and Regulatory limits
- to implement and control Board approved liquidity risk appetite and pricing policy across all business lines.

The Committee receives a variety of reports to enable it to discharge the above mentioned responsibilities and meets at a minimum on a monthly basis and more frequently when necessary.

2.2.5 Management Risk Committee

Composition: Chief Risk Officer (Chair), Chief Compliance Officer and Company Secretary, Operations & Change Director, Marketing & Sales Director, Head of HR, Chief Information Officer, Head of Financial Change, Operational Risk Manager, Planning & Control Lead

Main Functions: The Committee is a management committee that provides oversight over the Society's Operational, Conduct and Strategic Risk profile:

- to receive, review and challenge Operational and Conduct Risk MI to ensure that the risks are managed within the Board's Risk Appetite and the Society's risk limits
- to review and consider any proposed changes to the Society's controls and recommend any material changes to the Executive Committee
- to review the Operational Risk and Conduct Risk policies (and any supporting policies) and recommend any changes to the Board Risk Committee.

The Committee receives a variety of reports to enable it to discharge the above mentioned responsibilities and meets at a minimum on a two-monthly basis and more frequently when necessary.

2.2.6 Retail Credit Risk Committee

Composition: Chief Risk Officer (Chair), Operations & Change Director, Credit Risk Manager, Head of Financial Change, Head of Corporate Finance, Broker Hub lead, Head of Mortgage Strategy, Senior Underwriter

Main Functions: The Committee is a management committee that provides oversight over the Society's Credit Risk profile:

- to receive and challenge credit risk MI to ensure that the credit risks are managed within the Board's Risk Appetite and the Society's risk limits
- to monitor the performance of the Society's underwriting controls and the management of arrears
- to review the Credit Risk Policy and any proposed changes to the key underwriting controls and/or new products and where appropriate recommend these to the Board Risk Committee and/or Board for approval.

The Committee receives a variety of reports to enable it to discharge the above mentioned responsibilities and meets at a minimum on a monthly basis and more frequently when necessary.

3. Capital Resources

3.1 Overview of RWAs and Minimum Pillar 1 Capital Requirements

	Risk Weighted Assets		Minimum Pillar 1 Capital Requirements	
	Dec 19	Dec 18	Dec 19	Dec 18
	£m	£m	£m	£m
Credit Risk (excluding counterparty credit risk)	**333.6**	**312.7**	**26.6**	**25.1**
of which standardised approach	333.6	312.7	26.6	25.1
Counterparty credit risk (CCR)	**2.1**	**3.0**	**0.2**	**0.2**
of which standardised approach for credit risk	2.1	3.0	0.2	0.2
Operational Risk	**28.7**	**27.8**	**2.3**	**2.2**
of which basic indicator approach	28.7	27.8	2.3	2.2
Amounts below the thresholds for deduction (250% risk weight)	**2.0**	**2.5**	**0.2**	**0.2**
Total Risk Weighted Assets and Minimum Pillar 1 Capital	**366.4**	**346.0**	**29.3**	**27.7**

Total Risk Weighted Assets (RWAs) increased by £20.4m in 2019 principally driven by a £56m increase in mortgage assets over the year.

The £20.4m RWA increase increased Pillar 1 minimum capital requirements by £1.6m.

3.2 Regulatory Capital

The Group's capital resources as at 31 December 2019, calculated in accordance with CRD IV, are £74.2m (Dec 2018 £72.6m) as set out in the table below:

Composition of Regulatory Capital	**Dec-19**	**Dec-18**
Common Equity Tier 1 Capital: Instruments and Reserves	**£m**	**£m**
Retained Earnings	71.5	69.1
Accumulated other comprehensive income (and other reserves)	0.0	0.0
Common Equity Tier 1 Capital before Regulatory Adjustments	**71.5**	**69.1**
Common Equity Tier 1 Capital: Regulatory Adjustments	**£m**	**£m**
Other intangibles other than mortgage servicing rights (net of related tax liability)	(0.3)	(0.7)
Total regulatory adjustments to Common Equity Tier 1	**(0.3)**	**(0.7)**
Total Common Equity Tier 1	**71.2**	**68.4**
Tier 2 Capital: Instruments and Provisions	**£m**	**£m**
Directly issued qualifying Tier 2 instruments	2.5	3.5
Provisions	0.5	0.7
Total Tier 2 Capital	**3.0**	**4.2**
Total Regulatory Capital	**74.2**	**72.6**
Total Risk Weighted Assets (RWA)	**366.4**	**346.0**

Common Equity Tier 1 (CET1) Capital £71.2m (+£2.8m in 2019)

The Group's main source of CET1 is from its General Reserves, which include the Society's retained profits accumulated since formation, plus any reported Available for Sale Reserves. The Group's Intangible Assets are deducted from its regulatory CET1.

CET1 is £71.2m as at 31 December 2019, with a £2.8m increase in the year from retained earnings (£2.4m) and a reduction in intangible asset deductions (£0.4m). Note that the £2.4m of retained earnings generated in 2019 included a £0.2m net actuarial reserve loss relating to the revaluation of our defined benefit pension scheme liability as at year end.

There are currently no known impediments that would prevent the transfer of capital resources from Furness Building Society to its subsidiaries should the need arise.

Tier 2 Capital £3m (£1.2m in 2019)

Reported Tier 2 capital includes a Subordinated Debt of £2.5m plus a £0.5m regulatory adjustment relating to Collective Impairment Provisions.

Total outstanding Subordinated Debt is £5.0m as at December 2019 but is subject to £2.5m of amortisation deductions as the debt is now within five years of final maturity. The £1.2m reduction in Tier 2 in 2019 principally results from an additional Subordinated Debt deduction of £1.0m in the year as the instrument moves closer to final maturity.

The subordinated loan has a final maturity on 25 June 2022. The interest payment on the loan is currently calculated as the average of the largest four building societies' headline mortgage rates plus a margin of 2.25%.

	Dec-19	Dec-18
Capital Ratios and Buffers	%	%
Common Equity Tier 1 (as a % of RWAs)	**19.43%**	**19.77%**
Tier 1 (as a % of RWAs)	**19.43%**	**19.77%**
Total Capital (as a % of RWAs)	**20.25%**	**20.98%**
Institution-specific buffer requirement (as a % of RWAs)	**3.50%**	**2.88%**
Of which capital conservation buffer requirement (as a % of RWAs)	2.50%	1.88%
Of which society-specific countercyclical buffer requirement (as a % of RWAs)	1.00%	1.00%
Common Equity Tier 1 available after meeting the Society's minimum capital requirements (as a % of RWAs)	**8.33%**	**8.88%**

The Society's CET1 ratio at December 2019 is 19.43%, which is 34bp lower than December 2018 (19.77%). The main drivers behind the change over 2019 are as follows:

- RWAs increased by £20.4m in 2019 driven by a £56m increase in mortgage assets over the year
- the higher RWA capital requirement from asset growth is partly offset by higher CET1 capital of £2.8m in the year driven by retained earnings (£2.4m).

As at December 2019 the Society holds CET1 surplus to minimum capital requirements of 8.33%, which is 4.83% above specific buffer requirements of 3.50%.

3.3 Reconciliation of Regulatory Capital to the Annual Report

	Dec 19 (£m)
General Reserves	71.5
Available for Sale Reserve	0.0
Total Reserves in Statement of Financial Position	**71.5**
Intangible Assets	(0.3)
Subordinated Debt	2.5
Collective Impairment Provisions	0.5
Regulatory Capital	**74.2**

4. Capital Requirements

4.1 Approach to assessment of adequacy of capital

Under Pillar 1 the Group has followed the Standardised Approach permitted by the CRD when calculating the minimum capital requirement for Credit Risk and the Basic Indicator Approach in relation to Operational Risk. This approach involves applying a regulatory defined risk based percentage requirement calculation to produce the Group's minimum Pillar 1 credit and operational risk capital requirements.

As required under Pillar 2, the Society's Board also performs a further assessment of the risks that the Group is exposed to and calculates the additional amount of capital that it considers necessary to cover these risks over and above Pillar 1 minimum requirements.

This is covered in the Society's annual Internal Capital Adequacy Assessment Process (ICAAP), which ensures that its capital resources are sufficient to support its business plan in both normal and stressed economic conditions. The ICAAP serves two key purposes:

1) an annual assessment of the Group's firm specific Pillar 2A risks plus a Pillar 2B forecast stress test scenario, based on its current and future risk profile as per the business plan
2) an assessment of the Group's ability to meet its current Total Capital requirements, provided by the Prudential Regulatory Authority (PRA), on a forecast basis.

Based on the ICAAP assessment, the Board closely monitors and controls the Society's regulatory capital levels to ensure all Pillar 1, 2 and buffer requirements set by the PRA are met. It is important that the Group maintains sufficient capital to support its ongoing activities and this requirement is an integral part of the Group's corporate planning process.

The credit risk related capital requirement for various types of mortgage lending and treasury related investments has a major influence on the Group's appetite for such exposures with limits being established and monitored on a regular basis for each type of credit exposure.

The Group undertakes regular stress testing of each major credit risk component with the results of this testing influencing business decisions on an ongoing basis.

4.2 Pillar 1 Capital Requirement - Credit Risk

The Group applies the 'Standardised Approach' to credit risk under CRD IV. The Pillar 1 credit risk capital requirement under this approach is calculated using the formula below:

- Exposure value x applicable risk weight (driven by asset type, counterparty, LTV and performing/past due status) x 8%.

The Group's minimum Pillar 1 credit risk capital requirement as at December 2019 is £27.0m. The table below breaks down the capital requirement by exposure class, including a reconciliation of assets reported in the Group's annual report to CRD IV reported exposures.

Exposure Class	Asset (£m)	Risk Weighted Assets (£m)	Capital (£m)
Central Government \ Central Bank	93.3	0.0	0.0
Institutions	22.7	2.1	0.2
Total Treasury Assets	**116.0**	**2.1**	**0.2**
Residential Retail Performing	876.4	309.0	24.6
Residential Retail Past Due	1.5	1.5	0.1
Commercial Real Estate Performing	4.6	4.6	0.4
Commercial Real Estate Past Due	0.0	0.0	0.0
Total Retail and Commercial Real Estate Assets	**882.5**	**315.1**	**25.1**
Other Assets	**5.1**	**6.4**	**0.5**
Total Assets as per Statement of Financial Position	**1,003.6**	**323.6**	**25.8**
Regulatory Adjustment Intangible Assets	(0.3)	(0.3)	0.0
Derivatives	1.7	0.8	0.1
Residential Retail - Pipeline Lending	36.1	13.6	1.1
Total Off Balance Sheet	**37.5**	**14.1**	**1.2**
Total Exposure Value	**1,041.1**	**337.7**	**27.0**

Below is a breakdown of credit risk exposures under the standardised approach by asset class and risk weight.

Risk weight / Asset Classes	0%	10%	20%	35%	50%	75%	100%	150%	others	Total credit exposures amount (post ccf post crm)
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Sovereigns and their central banks	93.9									93.9
Multilateral development banks	4.0									4.0
Banks		7.7	6.2						3.4	17.3
Secured by residential property				901.4		9.3				910.7
Secured by commercial real estate							4.7			4.7
Past-due loans							1.5			1.5
Other assets	2.2					1.7	4.3		0.8	9.0
Total	100.1	7.7	6.2	901.4	–	11.0	10.5	–	4.2	1,041.1

4.3 Pillar 1 Capital Requirement - Operational Risk

The Group uses the Basic Indicator Approach (BIA) to calculate additional capital required to cover Operational Risk under Pillar 1. The Basic Indicator Approach requires the calculation of the Relevant Indicator as set out in Article 316 of the CRR.

The Society's Operational Risk Capital Requirement under the relevant indicator equals Net Interest and Net Non –Interest Income over the past three accounting years times 15% times 8%.

As at December 2019, the Society's Pillar 1 capital requirement under the BIA for Operational Risk is £2.3m (2018 £2.2m).

4.4 Total Pillar 1 Minimum Capital Requirement

The Group's total minimum capital requirement including both credit and operational risk is £29.3m as at December 2019 (£27.7m: December 2018). The table below shows the Society's excess capital resources over the minimum Pillar 1 capital requirement at the year-end.

As at Dec 19	**£m**
Credit Risk	27.0
Operational Risk	2.3
Total Pillar 1 Minimum Capital Requirement	**29.3**
Total Capital Resources	74.2
Excess Capital over Pillar 1 Minimum Capital	**44.9**

The exposures in each asset class as at December 2019 and average exposures held in each class during the financial year are detailed below.

Exposure Class	Total Assets (£m)	Average Assets (£m)
Central Government \ Central Bank	93.3	116.4
Institutions	22.7	25.1
Total Treasury Assets	**116.0**	**141.5**
Residential Retail Performing	876.4	846.5
Residential Retail Past Due	1.5	1.8
Commercial Real Estate Performing	4.6	5.1
Commercial Real Estate Past Due	0.0	0.1
Total Retail and Commercial Real Estate Assets	**882.5**	**853.5**
Other Assets	5.1	5.2
Total Assets as per Statement of Financial Position	**1,003.6**	**1,000.2**
Regulatory Adjustment Intangible Assets	(0.3)	(0.5)
Derivatives	1.7	2.0
Residential Retail - Pipeline Lending	36.1	32.4
Total Off Balance Sheet	**37.5**	**33.9**
Total Exposure Value	**1,041.1**	**1,034.1**

4.5 Total Capital Requirement

The Prudential Regulatory Authority published its updated Total Capital Requirement under Pillar 2A in December 2017 which came into force from 1 January 2018. Pillar 2A Capital requirements are for risks not fully captured under the Capital Requirements Regulations.

At December 2019 the Society's Total Capital Requirement for Pillar 1 and Pillar 2A risks were £43.7m (2018 £41.8m).

Total Capital Requirement	£m
Pillar 1	29.3
Pillar 2A	14.4
Total	**43.7**

Note the Group holds sufficient CET 1 Capital to meet all of its Total Capital Requirement and regulatory capital buffers – see section 3.2 for further details on capital ratio surplus to minimum capital and buffer requirements.

4.6 Countercyclical Capital buffer

The Society's Total Exposure Value of £1,041.1m is geographically concentrated as depicted in the table below. The Countercyclical buffer rate remained at 1% as at December 2019 with the Financial Planning Committee announcing a rise to 2% in November 2020. On the 11th March 2020 the Countercyclical Capital Buffer was reduced to 0% with immediate effect in the UK. The announcement was part of a package of financial measures introduced to support the economy though the effects of the Coronavirus outbreak. The Countercyclical buffer requirement equates to £3.7m as at December 2019.

Geographical Breakdown - Dec 19	Countercyclical capital buffer rate	Exposure Value (£m)	Risk weighted assets (£m)	Bank specific countercyclical buffer rate	Countercyclical buffer amount (£m)
U.K.	1.0%	1,037.1	366.4	0.0%	3.7
Luxembourg	1.0%	4.0	-	0.0%	-
Total	**1.0%**	**1,041.1**	**366.4**	**0.0%**	**3.7**

4.7 Leverage Ratio

In addition to the risk based Pillar 1 capital requirements detailed above, CRD IV also requires firms to calculate a simple, non-risk based leverage ratio. The ratio is calculated as Tier 1 capital resources divided by total exposures, expressed as a percentage.

As at 31 December 2019, the Group's Leverage ratio was 6.84%, (6.66%: 2018) above the current 3% regulatory minimum level. The Society's Leverage Ratio increased due to Tier 1 Reserves growing by 4% (£2.8m) whilst growth in asset exposures was lower 1.4% (£14.2m) as Mortgage Asset growth of £56m was offset by reduction in Balances with the Bank of England. The breakdown of leverage exposure values and ratio as at December 2019 are shown below:

	2019	2018
Summary comparison of accounting assets vs leverage ratio exposure	**£m**	**£m**
Total consolidated assets as per published financial statements	1,003.6	996.7
Adjustments for derivative financial instruments	1.7	2.3
Adjustments for off balance sheet items (converted to credit equivalents)	36.1	28.6
Other Adjustments	(0.3)	(0.7)
Leverage Ratio Exposure Measure	**1,041.1**	**1,026.9**

Leverage Ratio common disclosure template	**£m**	**£m**
On Balance Sheet Exposures	1,003.6	996.7
Asset amounts deducted in determining Basel III Tier 1 Capital	(0.3)	(0.7)
Total On Balance Sheet Exposures	**1,003.3**	**996.0**
Derivatives		
Replacement Cost of all derivative transactions	0.4	1.0
Add on amounts for potential future replacement costs of derivative contracts	1.3	1.3
Total derivative exposure	**1.7**	**2.3**
Other Off Balance Sheet Exposures		
Off Balance Sheet exposures at gross equivalent amounts	72.2	57.1
(Adjustments for conversion to credit equivalent amounts)	(36.1)	(28.5)
Off Balance Sheet items	**36.1**	**28.6**
Capital and Total exposure		
Tier 1 Capital	**71.2**	**68.4**
Total Exposures	**1,041.1**	**1,026.9**
Basel III Leverage Ratio	**6.84%**	**6.66%**

5. Credit and Other Financial Risks

5.1 Credit & Concentration Risk

The Group is exposed to the risk that arises from customers or counterparties failing to meet their obligations as they fall due, primarily from mortgage loans to retail and commercial customers and from liquid asset investments held by the Treasury function.

The Society's Retail Credit Risk Committee is responsible for reviewing the Group's retail Lending policy and recommends changes to the Society's Board Risk Committee and Board of Directors.

Risk Appetite and Credit Risk Management

The Society has a detailed Risk Appetite Statement which supports managers to translate the risk appetite into policies, limits and procedures. Credit Risk is controlled through detailed policy limits and Lending policy criteria. This takes into account the different risks associated with the types of lending undertaken by the Society.

Credit Risk management is embedded throughout the business and representatives from the relevant business areas attend monthly Retail Credit Risk Committee meetings. The Retail Credit Risk Committee operates under a Terms of Reference agreed by the Board Risk Committee and:

- monitors and manages the risk profile, quality and performance of new and residual mortgage assets within the Risk Appetite
- monitors and manages the Lending policy and the limits regarding the Society's internal controls and the 'Supervisory Statement'
- reviews such other Credit Risk related management information as considered appropriate.

The Board Risk Committee receives regular reports from the Retail Credit Risk Committee and the Board receives regular reports on the performance of the mortgage portfolio.

The Society operates a 'Three lines of Defence Model':

Primary responsibility for credit risk management and control rests with Line 1 management. Within the Operations department mortgage cases are reviewed, checked, underwritten and approved. Where the policy requires, mortgage cases will be authorised by the Executive Advances Committee. In all cases, Line 1 management is responsible for managing and controlling credit risk in line with the policies, procedures, controls.

As second line, the Risk and Compliance functions provide independent oversight of mortgage credit risk by undertaking structured sampling of a number of cases each month, plus periodic reviews of tranches of mortgage lending or of specific parts of the mortgage book. The Risk and Compliance functions also undertake compliance reviews of mortgage lending, which includes some sampling of cases.

The Risk and Compliance functions liaise on a regular basis with third line Internal Audit in order to ensure that there is adequate oversight and assurance around credit risk activities.

General Approach to Mortgage Lending

The Society's mortgage lending is principally through the intermediary channel through an on line intermediary mortgage application system.

A centralised Underwriting team is based at the Society's Head Office. This Underwriting team is independent of the Mortgage Sales function which ensures segregation between sales and underwriting functions. Authority to approve mortgage applications is delegated by the Board.

The Society's underwriting approach is to make lending decisions which are sound, sustainable and take into account the borrower's willingness and ability to repay the amount borrowed:

- all cases are individually underwritten using credit reference data and a number of sources of evidence regarding the status of the borrower
- the Society does not use an automated application scorecard to determine lending decisions
- a detailed Lending policy sets out the Society's lending criteria for different types of lending along with the necessary evidence requirements and minimum level of approval required if a policy exception is sought
- policy criteria cover items such as income, security type, income and expenditure profile, credit history, acceptable security types, tenure and LTV.

There is monitoring within the business to ensure the loans are affordable and all lending is responsible. This is supported by Risk Management, Compliance and Internal Audit undertaking reviews of adherence to policies and regulation in accordance with the Board approved risk based plans.

The Retail Credit Risk Committee meets regularly to monitor management information and control the risks associated with the mortgage lending portfolio in order to ensure activity remains within policy and approved limits. On a monthly basis, the performance of the mortgage book against lending and risk appetite limits and mortgage arrears are considered by the Retail Credit Risk Committee and reported to the Board Risk Committee and Board.

5.1.1 Mortgage Credit & Concentration Risk

Geographic Concentration

A detailed analysis of the geographic distribution of residential and commercial mortgage lending by UK region as at 31 December 2019 is set out below. A loan is defined as past due when it is three months or more in arrears. Note the numbers below reflect notional value of loans and do not include accounting adjustments so will not fully reconcile to amounts shown in table 4.2.

Loans Secured on Residential Property Excluding Buy to Let

Geographic Area	Performing (£m)	Past Due (£m)	Total (£m)
North West	206.6	0.8	207.4
North & Midlands	167.5	0.4	167.9
London & South	227.4	0.2	227.6
Scotland	47.4	0.0	47.4
Northern Ireland	0.0	0.0	0.0
Total	**648.9**	**1.4**	**650.3**

Loans Secured on Residential Property Buy to Let

Geographic Area	Performing (£m)	Past Due (£m)	Total (£m)
North West	47.5	0.0	47.5
North & Midlands	47.4	0.1	47.5
London & South	119.2	0.0	119.2
Scotland	11.8	0.0	11.8
Northern Ireland	0.0	0.0	0.0
Total	**225.9**	**0.1**	**226.0**

Loans Secured on Commercial Real Estate

Geographic Area	Performing (£m)	Past Due (£m)	Total (£m)
North West	4.7	0.0	4.7
North & Midlands	0.0	0.0	0.0
London & South	0.0	0.0	0.0
Scotland	0.0	0.0	0.0
Northern Ireland	0.0	0.0	0.0
Total	**4.7**	**0.0**	**4.7**

Maturity Analysis

A residual maturity breakdown of combined total residential, buy to let and commercial mortgage loans as at 31 December 2019 is detailed below. Values shown in the table are fair value including adjustments for Effective Interest Rate (EIR) and hedging.

Maturity	£m
In not more than 3 months	0.8
In more than 3 months but not more than 1 year	2.8
In more than 1 year but not more than 5 years	65.8
In more than 5 years	813.9
	883.3
Less: Provisions	(0.8)
Total	**882.5**

Provisions

Management determines the Group's impairment allowances following an appraisal of all outstanding mortgages, liquid asset investments and other assets:

- the Group measures the amount of impairment loss by applying estimated loss factors based on the Group's experience of default, loss emergence periods, the effect of changes in house prices, selling costs and any adjustment for the expected forced sales value
- individual assessments are made of all loans and advances against properties which are in possession, or in arrears by three months or more, or are subject to forbearance activities or other significant causes of concern. Individual impairment allowances are made against those loans and advances where there is objective evidence of impairment.

An analysis of total collective and individual impairment provisions by lending type over 2019 is shown below.

	Loans Secured	Other Loans (£m)	Total (£m)
Individual Impairment	0.18	0.22	0.40
Collective Impairment	0.62	0.05	0.67
Total Impairment at 1 Jan 2019	**0.80**	**0.27**	**1.07**
Written Off			
Individual Impairment	(0.17)	(0.01)	(0.18)
Collective Impairment	0.15	(0.03)	0.12
Total 2019 Written Off	**(0.02)**	**(0.04)**	**(0.06)**
Provision Movement			
Individual Impairment	0.12	(0.11)	0.01
Collective Impairment	(0.29)	0.02	(0.27)
Total 2019 Provision Movement	**(0.17)**	**(0.09)**	**(0.26)**
Individual Impairment	0.13	0.10	0.23
Collective Impairment	0.49	0.04	0.53
Total Impairment at 31 Dec 2019	**0.62**	**0.14**	**0.76**

Mortgage related provisions have been deducted from the associated asset values shown in the statement of financial position. Provisions for potential customer compensation are shown in the statement of financial position under the caption 'Provisions for Liabilities'. At 31 December 2019 the Group did not have any provisions relating to the Group's liquid asset investments.

The statement of financial position and the related provisions for liabilities can be found in the Group's 2019 Annual Report & Accounts.

5.1.2 Market Counterparty Credit & Concentration Risk

The Society is exposed to the risk that market counterparties will fail to meet their obligations as they fall due and subsequently default resulting in a loss. Treasury credit risk primarily arises from the Society investing in liquid assets.

Credit risk generated by entering into interest rate swaps is mitigated as all OTC derivatives entered into by the Society are centrally cleared through London Clearing House (LCH) via its clearing agent Societe Generale Corporate & Investment Banking (SGCIB). Counterparty credit risk is transferred from the swap counterparty to LCH which is considered to be a much higher credit quality being majority owned by the London Stock Exchange.

Prudential regulation requires the Society to hold buffer eligible liquidity to meet the minimum requirements of the Liquidity Coverage Ratio (LCR) plus any Regulatory Pillar 2 liquidity add-on.

Assets eligible to be included in the buffer must be high quality in order to reduce risk exposure. The range of regulatory reforms seen during the last few years has significantly improved the health of the UK Banking sector however the risk of counterparty default remains. The Society mitigates and controls the risk of counterparty default by the following means:

- liquid assets are entirely denominated in sterling
- liquidity is invested in accordance with a Board approved policy and risk appetite
- the majority of the Society's liquid assets are held in a Reserve Account with the Bank of England, or other Central Bank exposure in the form of Treasury Bills or Gilts
- limited short term deposits are held in the form of call account balances with the Society's Clearing Bank. Any exposures to bank institutions are subject to minimum credit rating requirements and limits, which are monitored daily by Treasury and reported to ALCO and Board monthly
- a limited amount of liquidity is invested in bond issues which have a AAA credit rating with all three rating agencies. This AAA status must be maintained throughout the period which the Society holds the asset.

A summary of the Group's Treasury asset credit risk as at December 2019 by exposure class and External Credit Assessment Institution (ECAI) credit rating quality steps is shown below. Note that Fitch ratings are applied in the table below:

Credit Quality	Fitch rating	Central Government (£m)	Banks and Institutions (£m)	Building Societies (£m)	Total (£m)
1	AAA to AA-	93.9	11.7	0.0	**105.6**
2	A+ to A-	0.0	6.2	0.0	**6.2**
3	BBB+ to BB-	0.0	0.0	0.0	**0.0**
4	BB+ to BB-	0.0	0.0	0.0	**0.0**
5	B+ to B-	0.0	0.0	0.0	**0.0**
6	CCC+ and below	0.0	0.0	0.0	**0.0**
Total		**93.9**	**17.9**	**0.0**	**111.8**

A further breakdown of the Group's Treasury assets by geography is shown below, which also includes a £3.4m exposure to the LCH clearing house relating to collateral posted in support of interest rate swaps and £0.8m cash. The £4m European Union exposure relates to a holding in European Investment Bank issued debt denominated in sterling as part of the Society's liquidity holdings.

United Kingdom	112.0
European Union	4.0
Total (£m)	**116.0**

An analysis of exposures to Clearing Banks and Building Societies by residual maturity as at December 2019 is shown below:

Repayable on Demand	6.2
In not more than 3 Months	4.0
In more than 3 Months not more than 1 year	2.0
More than 1 year not more than 5 years	5.7
Total (£m)	**17.9**

5.2 Other Financial Risks

5.2.1 Interest Rate Risk in the Banking Book (IRRBB)

IRRBB is the adverse impact on the Society's future cash flows arising from changes in interest rates including:

- economic Value (NPV) – the risk to the capital value of the Society as a result of changes in interest rates
- earnings Risk (NII) – the risk to the Society's profitability as a result of changes in interest rates
- basis Risk – the risk to the Society's profitability arising from non-parallel movements in net mismatch exposures to different bases
- optionality – the risk to the Society's profit arising from the provision of embedded optionality in products such as early prepayment or access with or without penalty.

The Society is exposed to interest rate risk as a retailer of financial instruments, principally in the form of mortgage and savings products, investment in liquid assets and wholesale borrowing.

Risk control and mitigation is exercised by the following:

- Interest Rate Risk is managed within a Board approved Treasury and Financial Risk Management policy
- the Society's Board has set out clear limits and risk appetite for each aspect of Interest Rate Risk
- Interest Rate Risk is managed by the Society on balance sheet or through interest rate swaps in a manner consistent with the Building Society Act 1986.

The Society ensures compliance with risk appetite and maintains interest rate risk exposure within defined limits through monthly monitoring by the Assets and Liabilities Committee (ALCO) of the following metrics:

- Economic Value +/- 200bps parallel instantaneous yield curve shock
- Earnings +/- 100bps static simulation of earnings at risk over a 12 month period.

Sensitivity of reported reserves to +200bps interest rate movement (economic value)	**£000**
At 31 December 2019	**42**
Average for the period	376
Maximum for the period	801
Minimum for the period	29

Sensitivity of projected net interest income to +100bps interest rate movement (earnings)	**£000**
At 31 December 2019	**732**
Average for the period	816
Maximum for the period	1,044
Minimum for the period	608

The Society models a range of variations in different interest rate bases, including LIBOR and Bank Base Rate. In addition the Society models the impact on the balance sheet of an interest rate view formulated by reference to market counterparties Barclays, Lloyds and Nat West Markets.

The composition of the balance sheet is modelled in line with the 3 year Corporate Plan to determine the extent to which the Society maintains control over the level of interest rates through administered rate mortgage and savings balances.

The Society's balance sheet is denominated solely in sterling and as such is not directly affected by currency risk.

5.2.2 Liquidity Risk

Liquidity risk is the risk that the Society cannot satisfy the Overall Liquidity Adequacy Rule (OLAR) by having insufficient liquidity resources to meets its obligations as they fall due. These obligations include repayment of share and deposit balances and mortgage lending commitments.

Risk control and mitigation is exercised by the following means:

- continuous forecasting of cash flow requirements and assessment of retail/wholesale funding and mortgage pipeline risk
- the required amount, quality and type of liquid assets required to meet OLAR in accordance with Liquidity Risk policy, Funding policy and Board Liquidity Risk Appetite
- the Society performs regular stress testing to ensure that the Society can meet OLAR both under BAU conditions and under a range of regulatory defined liquidity stress scenarios.

5.2.3 Liquidity Coverage Ratio and Net Stable Funding Ratio

The Liquidity Coverage Ratio is a measure designed to ensure a common reporting standard for banks and building societies under the European Capital Requirements Regulation (CRR) and a key component of liquidity regulation under CRD IV.

The measure is designed to ensure that banks and building societies have sufficient high quality unencumbered liquid assets to meet a stressed liabilities outflow over a 30 day time horizon.

High Quality Assets are stocks of liquid assets which can quickly be converted into cash within the market and have an appropriate reduction in value under the measure of liquid assets to recognise realisation. The measure must meet a minimum requirement of at least 100%.

The table below sets out the Society's quarterly Liquidity Coverage Ratio during 2019.

Liquidity Coverage Ratio					
Quarter Ending	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**
	£m	**£m**	**£m**	**£m**	**£m**
Liquid Assets	156.0	139.4	133.6	135.4	105.1
Total Net Cash Outflows	60.5	62.8	59.8	70.0	65.7
Liquidity Coverage Ratio (%)	**257.8%**	**222.0%**	**223.5%**	**193.4%**	**159.9%**

There was a reduction in total liquid assets during 2019 due to early repayment of £20m of Term Funding Scheme (TFS) funding and mortgage lending growth during the year.

The Net Stable Funding Ratio (NSFR) was introduced to reduce funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress. A minimum requirement of at least 100% must be maintained to meet regulatory requirements.

The table below sets out the Society's quarterly Net Stable Funding Ratio during 2019:

Net Stable Funding Ratio					
Quarter Ending	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**
	£m	**£m**	**£m**	**£m**	**£m**
Available Funding	925.7	894.0	895.4	919.5	920.0
Required Funding	619.7	614.5	621.0	672.8	681.5
Net Stable Funding Ratio (%)	**149.4%**	**145.5%**	**144.2%**	**136.7%**	**135.0%**

5.2.4 Asset Encumbrance

CRD IV requires firms to disclose amounts of assets encumbered and unencumbered as part of the Pillar 3 disclosure. The tables below provides a breakdown the Society's encumbered and unencumbered assets as at December 2019 including matching liabilities where relevant.

Disclosure of asset encumbrance	Encumbered assets		Unencumbered Assets	
	Carrying Amount £m	Fair Value Amount £m	Carrying Amount £m	Fair Value Amount £m
Assets of the reporting institution: Of which:	**252.8**	**252.8**	**753.5**	**754.0**
Equity instruments	**0.0**	**0.0**	**0.0**	**0.0**
Debt securities:	**0.0**	**0.0**	**14.4**	**14.4**
of which covered bonds	0.0	0.0	7.7	7.7
of which asset backed securities	0.0	0.0	0.0	0.0
of which issued by general governments	0.0	0.0	2.7	2.7
of which issued by financial corporations	0.0	0.0	4.0	4.0
of which issued by non- financial corporations	0.0	0.0	0.0	0.0
Other Assets including mortgage loans	**252.8**	**252.8**	**739.1**	**739.6**

Sources of Encumbrance	Matching liabilities ,contingent liabilities or securities lent (£m)	Assets , collateral received and own debt securities issued (other than covered bonds and ABS) encumbered (£m)
Carrying amount (£m)	**93.4**	**252.8**

As at December 2019, the Society has £252.8m of assets encumbered and comprises:

- £249.4m of mortgage assets pledged to the Bank of England to support both Term Funding Scheme borrowings and to support contingent liquidity drawdowns if required. Note the Society has £90m of Term Funding Scheme borrowing as at December 2019
- £3.4m of cash collateral posted to LCH clearing house in support of interest rate swaps.

6. Remuneration

The Group's Senior Management remuneration policy is aligned with FCA regulations, to attract and retain suitably qualified and competent individuals who have the motivation and ability to ensure the Group's continuing success.

The Remuneration Committee determines the level of remuneration for Executive Directors and the Senior Management team which is reviewed annually taking into account rates and benefits paid by comparable organisations, together with individual responsibilities, experience, expertise and overall contribution.

The Remuneration Committee is made up of four Non-Executive Directors, including the Chair of the Risk Committee. The Chief Executive and Chief Compliance Officer also attend except when their own terms and conditions are being discussed. The meeting is chaired by the Vice-Chairman. The Committee generally meets five times a year.

Executive Director's remuneration structures comprises fixed and variable components, pension, benefits and other arrangements which are aligned with business strategy, its risk appetite, objectives, values and long term interests of the Society. Individual salary increases are based on the rating given to an individual's performance against their performance, behaviours and role profile at their annual review.

Executive Directors participate in an incentive scheme under which they may receive a non-pensionable bonus depending upon performance in relation to pre-determined objectives. These objectives are approved by the Remuneration Committee in line with the strategic objectives of the Group in order to incentivise them to perform at the highest levels in the interests of members and within the risk appetite of the Group.

The bonus amount varies between 0% and 40% depending on performance against a number of pre-agreed measures, approved by the Remuneration Committee. Payment of 50% of the award is deferred for three years.

The Remuneration Committee determined that, in addition to the four Executive Directors in post during all or part of 2019, four other Executives and one further employee are designated as being Material Risk Takers and subject to the Remuneration Code.

Fixed and variable remuneration for Material Risk Takers in relation to 2019 (including deferred elements) is set out below:

Remuneration - Dec 19	Executive Directors	Other Mateial Risk Takers
Total fixed remuneration (£000)	**637**	**566**
of which cash based - non deferred	587	519
of which other - non deferred	50	47
Number of Employees	**4**	**5**
Total variable remuneration (£000)	**134**	**114**
of which cash based	67	80
of which deferred	67	34
Number of Employees	**4**	**5**
Total Remuneration (£000)	**771**	**680**

Note that the Executive Directors' Remuneration information shown in page 25 of the Annual Report & Accounts includes only details relating to Executive Directors who held positions during the year. As such the Annual Report & Accounts remuneration disclosure differs to the numbers detailed in the table above due to the inclusion of individuals who held Senior Management responsibilities during the year but were not Executive Directors (including the Chief Risk Officer and Chief Compliance Officer/Group Secretary) and other Material Risk Takers.

7. Contacts

In the event of queries around this document please contact one of the following:

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