Furness BUILDING SOCIETY

Always with your interest at heart

Pillar 3 Disclosure

31 December 2017

Contents

1. Overview

1.1 Background

This document presents the consolidated Pillar 3 disclosures of the Furness Building Society as at 31 December 2017. These disclosures have been prepared with reference to CRR Part Eight (Articles 431 to 455) of Regulation (EU) no 575/2013 updated with the Basel Committee on Banking Supervision (BCBS) review of March 2017 and the European Banking Authority Technical Standards for Liquidity Risk Management and Unencumbered Assets.

The BCBS March 2017 review lead to a consolidation of all existing BCBS disclosure requirements into the Pillar 3 framework. These disclosure requirements cover the composition of capital, the leverage ratio, the liquidity coverage ratio (LCR), the countercyclical capital buffer, interest rate risk in the banking book and remuneration.

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 Societies 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 to 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.

1.2 Basis and Frequency of Disclosures, Scope of Application

These Pillar 3 disclosures are based on the Society’s Annual Report and Accounts for the year ended 31 December 2017. All figures are stated as at 31 December 2017 with comparatives as at 31 December 2016 where applicable.

The disclosures are updated on at least an annual basis and are issued in conjunction with the publication of the Annual Report and 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.

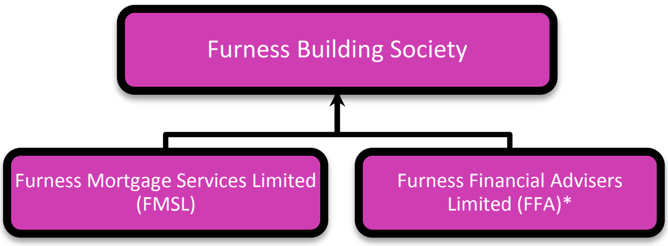
This document is published on Furness Building Society’s website (www.furnessbs.co.uk).

The disclosures are reviewed by the Board but are not subject to external audit; however, some of the information within the disclosures also appears in the Group’s audited Annual Report and Accounts for the year ended 31 December 2017.

The Society's Annual Report and Accounts have been prepared in line with the FRS 102 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 and 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 2017 FMSL had £4.3m of balances outstanding.

Furness Financial Advisers Limited (FFA) is no longer trading and is operationally dormant.

2. Risk Management

2.1 Risk Management Framework

2.1.1 Overview

The Group is primarily a producer and retailer of financial products, mainly in the form of mortgages and savings products. As well as mortgages and savings, the Group uses wholesale financial instruments to invest in liquid assets, to raise wholesale funding and to manage the interest rate risks arising from its operations within its banking book.

The Board has approved a risk management framework for the Group which is proportionate to both the size of the Group and the risks to which it is exposed. This framework enables the Group to identify, monitor, control and report on the key risks faced by the Group.

As a mutual building society which is run for the benefit of its members, Furness Building Society exists to create value to its members over the long term. With no shareholders to satisfy, the Society is able to take a long term view of value creation and therefore, relative to banking peers, is able to adopt a low risk appetite.

The Group faces a broad range of risks reflecting its responsibilities to its members and staff, whilst adhering to all appropriate regulations, rules and guidelines. The Group manages its principal risks, such as financial risk, credit risk, operational risk, conduct and strategic risk through its policies and procedures in all business processes. The Board may consider operating in higher risk areas - but only when it is satisfied that the level of risk is understood, can be monitored and reported against and can be effectively mitigated to a level within the Board's risk appetite. The Board would not expect risks to be taken which go against the Society's values, could result in adverse customer outcomes, significant operational losses and/or serious reputational damage to the Society.

The Groups risks are managed using the Board Statement of Risk Appetite; forecasting and stress test models and risk management policies to help guide business strategies; producing key risk information and indicators to manage and monitor performance; together with reviews by management and the Board committees.

Our risk governance structure includes a dedicated Board Risk Committee, Executive Committee, Assets and Liabilities Committee (ALCO), Retail Credit Risk Committee, Operational Risk Committee and Conduct and Compliance Risk Committee to monitor and control specific risks.

The objective of the risk management policies is to identify risk and reduce these to levels that are in line with the risk appetite of the Group which is set by the Board

2.1.2 Summary of Key Risk Areas

Credit Risk

Retail Credit risk refers to the potential risk that arises from customers or Wholesale Credit risk when financial counterparties fail to meet their obligations as they fall due. Credit risk arises primarily from loans to retail customers, loans to commercial mortgage customers and Wholesale Credit risk from the management of the Groups liquid asset investments held by the Treasury department.

- 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.

- The Board monitors exposures in accordance with this policy including concentration to individual retail counterparties and sector concentration.

- ALCO is responsible for recommending limits and minimum credit ratings on Treasury counterparties, country exposures and types of financial instruments, for approval by the Board of Directors.

- The Society has clear and articulated appetite for retail credit risk, and maintains a risk based approach to lending and a well-balanced overall portfolio managed by applying robust criteria limits as documented in the Society Lending Policy.

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

- See section 5.1 and 5.2 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 considered to face concentration risk because its activities and those of its subsidiaries are highly concentrated in residential lending and/or associated products and services funded predominantly by retail deposits. Concentration risk is concerned mainly with the fact 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 considered to affect the Society and are monitored and managed by the Board 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 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 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 mortgages, savings and treasury investments.

The Society's ALCO monitors and manages this exposure using a combination of on and off-balance sheet instruments. The following activities are affected by changes to interest rates:-

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

Interest rate swaps are used to manage these risks. In addition, the risks arising from a net exposure to interest basis risk such as the base rate or LIBOR are managed by setting product limits and having products with the same basis on the opposite side of the balance sheet. The prepayment risks associated with fixed rate mortgages are managed through the use of early repayment charges.

The Society's interest rate related risk appetite is measured against the impact of a parallel shift in interest rates of 2% - see section 5.2.1 for further details on the measurement and control of interest rate risk.

Liquidity Risk

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. 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 inclusion in the Societies Liquid Asset Buffer.

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

Capital Risk

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
- Setting both a maximum level of losses and capital utilisation which it considers could be sustained during a 12 month period
- Monitoring risk appetite Early Warning Indicators on a monthly basis for both Tier 1 Capital and Leverage ratios, ensuring a sufficient surplus to regulatory requirements

See section 4 for further detail on the Group's capital position as at Dec 17 and the stress testing undertaken as part of the Internal Capital Adequacy Assessment Process (ICAAP).

Operational Risk

The risk of loss arising from failed or inadequate internal processes or systems, human error or other external factors constitute operational risk. There are several categories of risk recognized in the Society's Operational Risk policy, including fraud, data security, succession, management information, project, IT and infrastructure and business continuity.

- Each of the key risk areas within the Group are owned by a manager who reports directly to an Executive. These managers are responsible for devising appropriate controls to mitigate the risks in their area of responsibility.

- These controls are considered by the Executive to whom the manager reports and where appropriate, by the Group's Management Risk Committee which comprises the Society's Executive Team, the Operational Risk Manager and the Chief Risk Officer

- 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 and ultimately, the Board is responsible for deciding on whether it accepts the residual risk that exists after the application of these controls.

The Society recognises the increased risks in relation to cyber security and data loss and is committed to ensuring that its information is accurate, appropriately classified, securely stored and managed in accordance with legislative and the Group's Cyber Security and Data Security policies which outline the Society's approach to safeguarding the Society's operating environment and protecting customer data.

Conduct Risk

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 an Executive Committee which is chaired by the Chief Executive with the Executive Team, the Operational Risk Manager and the Chief Risk Officer, a Conduct Risk Committee which is chaired by an Executive with senior staff from each area of the Society and a Customer Service Forum with front-line staff from all areas represented.

- The Committees meet quarterly 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.

- The Society has a training and competence scheme which reviews the knowledge, ability and compliance levels of the mortgage, savings and insurance sales teams on an ongoing 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

Although the Society closed its final salary pension scheme to new members in 2000 and closed the scheme to future accrual with effect from 1 January 2017 it is still exposed to the pension liabilities of existing and former members of staff who remain members of the pension scheme.

While the scheme retains liabilities, there remains a risk that the scheme's assets may be insufficient to cover the benefits due to them and leading to potential increases in pension benefit obligations recognised in the Society's financial accounts. As per Note 31 in the Annual Report and Accounts, the Society's pension deficit under FRS 102 as at 31 December 17 was valued at £4.3m.

Given the current reported position, the final salary pension scheme will remain a key focus for the Society's Board of Directors, who have negotiated with the trustees of the scheme a schedule of contributions to close the deficit which existed at the date of the last triennial actuarial review of the pension scheme performed as at 6 April 2014. The next triennial review of the schemes is due in June 2018.

Business and Strategic Risk

The Society considers that Business and Strategic risks are inextricably linked and recognises that in an adverse macroeconomic environment it may be unable to achieve its corporate plan objectives and profitability targets due to factors beyond its control.

The Group undertakes a corporate planning process which involves the Board of Directors and senior management team who consider the potential impact of negative scenarios. The corporate planning process involves a review of the business model and assessment of threats and opportunities to ensure the Society's strategy is adaptable to any external developments.

The Society monitors performance against the corporate plan targets on a monthly basis and undertakes plan reforecasts at the end of each quarter.

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.

- 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) and Executive Committee are chaired by the Chief Executive and provide reports to the Board Risk Committee as does the Credit 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

Main Functions: The Committee's main role is:

- To review the effectiveness of the Group's systems of internal control and risk management process
- To review the internal and external audit processes
- To consider external and internal audit reports
- To consider compliance with regulatory and legal requirements
- To consider financial reports including the Group's Annual Report and Accounts
- To approve and monitor the annual internal audit plan

The Audit Committee meets on a quarterly basis, with an additional meeting being held each February to approve the Annual Report and Accounts.

2.2.3 Assets and Liabilities Committee (ALCO)

Composition: Chief Executive, Finance Director, Marketing and Sales Director, Chief Compliance Officer and Group Secretary, Group Treasurer with three 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 identify, control and manage the operational, structural, funding, basis, counterparty and settlement risks inherent in the Group's balance sheet with particular regard to the impact on the Group's capital position.
- 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.

The full 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.

2.2.4 Board Risk Committee

Composition: Three Non-Executive Directors, Finance Director and Chief Risk Officer with the Chief Executive as observer.

Main Functions: The Committee's main purpose is to consider and make recommendations to the Board on the management/mitigation of risks and undertakes:-

- To review the risks and controls identified by the Audit Committee as well as the Group’s Assets and Liabilities Committee (ALCO), the Conduct and Compliance Risk Committee, Executive Committee, Operational Risk Committee and Retail Credit Risk Committee.
- To challenge their assessments where appropriate and determining whether they consider that the main risks have been identified and whether they have been adequately mitigated
- To recommend the risk appetite of the Group to the Board, including what it considers to be the Group’s top priority risks to be and how they will be monitored and controlled under the risk management framework.

3. Capital Resources

3.1 Overview of Risk Management and RWA

	Risk Weighted Assets		Minimum Capital Requirements	
	Dec 17	Dec 16	Dec 17	Dec 16
	£m	£m	£m	£m
Credit Risk (excluding counterparty credit risk)	**288.3**	**281.5**	**23.0**	**22.6**
of which standardised approach	288.3	281.5	23.0	22.6
Counterparty credit risk	**3.4**	**6.9**	**0.3**	**0.5**
of which standardised approach for credit risk	3.4	6.9	0.3	0.5
Equity positions in banking book under market based approach	0	0	0	0
Equity Investments	0	0	0	0
Settlement Risk	0	0	0	0
Securitisation Exposures	0	0	0	0
Market Risk	0	0	0	0
of which Standardised approach	0	0	0	0
Operational Risk	**27.1**	**26.3**	**2.2**	**2.1**
of which basic indicator approach	27.1	26.3	2.2	2.1
Amounts below the thresholds for deduction (subject to 250% risk weight)	**2.3**	**2.8**	**0.2**	**0.2**
Total Risk Weighted Assets and Capital	**321.1**	**317.5**	**25.7**	**25.4**

3.2 Regulatory Capital

The Group's capital resources as at 31 December 2017, calculated in accordance with CRD IV, are £70.8m (Dec 2016 £67.2m) as set out in the table below:-

Group Capital Resources	**Dec 17 (£m)**
General Reserves	66.6
Available for Sale Reserve	0.1
Intangible Assets	(1.0)
Total Common Equity Tier 1 (CET1) capital	**65.7**
Subordinated Debt	4.5
Collective Impairment Provisions	0.6
Total Tier 2 capital	**5.1**
Total Capital Resources (Tier 1 + Tier 2)	**70.8**

Common Equity Tier 1 (CET1) Capital- £65.7m

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.

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 - £5.1m

Reported Tier 2 capital includes a £5.0m subordinated loan plus a £0.6m regulatory adjustment relating to Collective Impairment Provisions.
Subordinated Debt is subject to amortisation once maturity for repayment is within five years of final maturity and £0.5m amortisation has been deducted accordingly

The subordinated loan has a final maturity on 25th 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%

3.3 Reconciliation of Regulatory Capital to the Annual Report

	Dec 17 (£m)
General Reserves	66.6
Available for Sale Reserve	0.1
Total Reserves in Statement of Financial Position	**66.7**
Intangible Assets	(1.0)
Subordinated Debt	4.5
Collective Impairment Provisions	0.6
Regulatory Capital	**70.8**

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 as part 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 and 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 31 December 2017 is £23.5m. 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	Assets (£m)	Risk Weighted Assets (£m)	Capital (£m)
Central Government \ Central Bank	100.8	0.0	0.0
Institutions	29.0	3.4	0.3
Total Treasury Assets	**129.8**	**3.4**	**0.3**
Residential Retail Performing	754.5	267.2	21.3
Residential Retail Past Due	2.7	2.6	0.2
Commercial Real Estate Performing	6.3	6.1	0.5
Commercial Real Estate Past Due	0.2	0.2	0.0
Total Retail and Commercial Real Estate Assets	**763.7**	**275.9**	**22.0**
Other Assets	5.3	6.7	0.5
Total Assets as per Statement of Financial Position	**898.8**	**286.0**	**22.8**
Regulatory Adjustment Intangible Assets	(1.0)	(1.0)	(0.1)
Derivatives	1.6	0.8	0.1
Treasury Bills FLS	30	0.0	0.0
Residential Retail - Pipeline Lending	22.3	8.2	0.7
Total Off Balance Sheet	**52.9**	**8.0**	**0.7**
Total Exposure Value	**951.7**	**294.0**	**23.5**

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 31 December 2017, the Society's Pillar 1 capital requirement under the BIA for Operational Risk is £2.2m (2016 £2.1m).

4.4 Total Pillar 1 Minimum Capital Requirement

The Group's total minimum capital requirement including both credit and operational risk is £25.7m as at 31 December 2017 (Dec 16 £25.4m on a comparable basis). The table below shows the Society's excess capital resources over the minimum Pillar 1 capital requirement at the year end.

As at Dec 17	£m
Credit Risk	23.5
Operational Risk	2.2
Total Pillar 1 Minimum Capital Requirement	**25.7**
Total Capital Resources	70.8
Excess Capital over Pillar 1 Minimum Capital	**45.1**

The exposures in each asset class as at 31 December 2017 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	100.8	93.8
Institutions	29.0	28.0
Total Treasury Assets	**129.8**	**121.8**
Residential Retail Performing	754.5	719.7
Residential Retail Past Due	2.7	3.5
Commercial Real Estate Performing	6.3	6.8
Commercial Real Estate Past Due	0.2	0.1
Total Retail and Commercial Real Estate Assets	**763.7**	**730.1**
Other Assets	5.3	5.7
Total Assets as per Statement of Financial Position	**898.8**	**857.6**
Regulatory Adjustment Intangible Assets	(1.0)	(0.7)
Derivatives	1.6	1.1
Treasury Bills FLS	30.0	30.0
Residential Retail - Pipeline Lending	22.3	18.4
Total Off Balance Sheet	**52.9**	**48.8**
Total Exposure Value	**951.7**	**906.4**

4.5 Total Capital Requirement

The Prudential Regulatory Authority published its updated Capital Requirements under Pillar 2A in December 2017 which comes into force from 1 January 2018. The Society has decided to disclose this requirement in its Pillar 3 disclosure voluntarily for 2017.

Pillar 2A Capital requirements are for risks not fully captured under the Capital Requirements Regulations

At 31 December 2017 the Society's Total Capital Requirement for Pillar 1 and Pillar 2A risks were £39.5M.

Total Capital Requirement	£m
Pillar 1	25.7
Pillar 2A	13.8
Total	**39.5**

Note the Group holds sufficient CET 1 Capital to meet all of its Total Capital Requirements and Board approved Capital Buffers. In addition the Group also have £5.1m of Tier 2 Capital resources available.

4.6 Countercyclical Capital buffer

The Society's Total Exposure Value in the table above of £951.7m is geographically concentrated as depicted in the table below.

The Financial Policy Committee has set a countercyclical buffer rate of zero as at 31 December 2017. Therefore no additional capital is required to be held as at 31 December 2017 in respect of the countercyclical capital buffer. The Bank of England Financial Policy Committee set the countercyclical capital buffer at 0.5 percent of risk-weighted assets for U.K. loans effective in June 2018, and to increase the level again to 1 percent from 1st November 2018.

Geographical Breakdown - Dec 17	Countercyclical capital buffer rate	Exposure Value (£m)	Risk weighted assets (£m)	Bank specific countercyclical buffer rate	Countercyclical buffer amount (£m)
U.K.	0.0%	947.7	294.0	0.0%	0.0
Luxembourg	0.0%	4.0	-	0.0%	0.0
Total	0.0%	**951.7**	**294.0**	**0.0%**	**0.0**

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 2017, the Group’s Leverage ratio was 6.90%, (2016 7.06%) well above the current 3% regulatory minimum level. The Society’s Leverage Ratio declined due to greater asset exposure growth year on year of 9.59% compared to Tier 1 Capital growth of 7.18% year on year.

Leverage Ratio values are reported as at period end (December).

	2017	2016
Summary comparison of accounting assets vs leverage ratio exposure	**£m**	**£m**
Total consolidated assets as per published financial statements	898.8	816.0
Adjustments for derivative financial instruments	1.6	0.6
Adjustments for off balance sheet items (converted to credit equivalents)	52.3	53.4
Other Adjustments	(1.0)	(1.6)
Leverage Ratio Exposure Measure	**951.7**	**868.4**

Leverage Ratio common disclosure template	**£m**	**£m**
On Balance Sheet Exposures	898.8	816.0
Asset amounts deducted in determining Basel III Tier 1 Capital	(1.0)	(1.6)
Total On Balance Sheet Exposures	**897.8**	**814.4**
Derivatives		
Replacement Cost of all derivative transactions	0.7	0.4
Add on amounts for potential future replacement costs of derivative contracts	0.9	**0.2**
Total derivative exposure	**1.6**	**0.6**
Securities financiang transaction exposure		
Other Off Balance Sheet Exposures		
Off Balance Sheet exposures at gross equivalent amounts	74.6	76.8
(Adjustments for conversion to credit equivalent amounts)	(22.3)	(23.4)
Off Balance Sheet items	**52.3**	**53.4**
Capital and Total exposure		
Tier 1 Capital	**65.7**	**61.2**
Total Exposures	**951.7**	**868.4**
Basel III Leverage Ratio	**6.90%**	**7.06%**

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 department.

The Society's 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 business owners 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 Credit Risk Committee meetings. The Credit Risk Committee operates under a Terms of Reference agreed by the Board Risk Committee and:

- Monitors and manages the risk profile and 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 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 Customer Services department mortgage cases are reviewed, checked, underwritten and approved. Where policy requires, mortgage cases will be authorised by an Executive Advances Committee. In all cases, Line 1 management is responsible for managing and controlling credit risk in line with the policies, procedures, controls.

The Risk function provides 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 function also undertakes compliance reviews of mortgage lending, which includes some sampling of cases.

There is also independent Line 1 "back office" oversight of front office Treasury activities and compliance with Treasury policy and the Risk function provides independent Line 2 oversight of what the "back office" does.

The Risk function, which includes compliance, liaises on a regular basis with Internal Audit in order to ensure that there is adequate oversight and assurance around credit risk activities.

General Approach to Mortgage Lending

The Society 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 automated credit scoring systems solely 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 and this is supported by Risk Management and Internal Audit undertaking regular reviews of adherence to policies and regulation in accordance with the Board approved risk based plans.

In order to achieve effective management and control, management information is produced that allows Executives to monitor performance and report to the Credit Risk Committee, Board Risk Committee and Board where risk profile is nearing the risk appetite trigger limits.

On a monthly basis, performance of the mortgage book against lending limits and mortgage arrears are considered by the 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 2017 is set out below. A loan is defined as past due when it three months or more in arrears. (Note due to rounding, numbers below will not full reconcile to section 4.2)

Loans Secured on Residential Property excluding Buy To Let (BTL)

Geographic Area	Performing (£m)	Past Due (£m)	Total (£m)
North West	235.6	1.2	236.8
North & Midlands	169.0	0.7	169.7
London & South	145.1	0.1	145.2
Scotland	30.7	0.2	30.9
Northern Ireland	0.0	0.0	0.0
Total	**580.4**	**2.2**	**582.6**

Loans Secured on Residential Property Buy To Let (BTL)

Geographic Area	Performing (£m)	Past Due (£m)	Total (£m)
North West	49.3	0.2	49.5
North & Midlands	40.5	0.2	40.7
London & South	80.4	0.0	80.4
Scotland	3.7	0.0	3.7
Northern Ireland	0.0	0.0	0.0
Total	**173.9**	**0.4**	**174.3**

Loans secured on Commercial Real Estate

Geographic Area	Performing (£m)	Past Due (£m)	Total (£m)
North West	5.6	0.2	5.8
North & Midlands	0.6	0.0	0.6
London & South	0.0	0.0	0.0
Scotland	0.0	0.0	0.0
Northern Ireland	0.0	0.0	0.0
Total	**6.2**	**0.2**	**6.4**

Maturity Analysis

A residual maturity breakdown of combined residential and commercial mortgages and past due loans as at 31 December 2017 is detailed below.

Maturity	£m
In not more than 3 months	0.9
In more than 3 months but not more than 1 year	2.9
In more than 1 year but not more than 5 years	44.1
In more than 5 years	716.9
	764.8
Less: Provisions	(1.1)
Total	**763.7**

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 cases of concern. Individual impairment allowances are made against those loans and advances where there is objective evidence of impairment.

- In respect of loans which are 3 months or more in arrears but where the property has not been taken into possession, the directors, in accordance with recommended practice, apply a factor to take into account the probability of the cases resulting in repossession when calculating the individual allowance to be made.

An analysis of total collective and individual impairment provisions by lending type over 2017 is shown below.

	Loans Secured on Residential Property (£m)	Other Loans (£m)	Total (£m)
Individual Impairment	0.11	0.43	0.54
Collective Impairment	0.94	0.02	0.96
Total Impairment at 1 Jan 2017	**1.05**	**0.45**	**1.50**
Written Off			
Individual Impairment	(0.02)	0.00	(0.02)
Collective Impairment	(0.06)	0.00	(0.06)
Total 2017 Written Off	**(0.08)**	**0.00**	**(0.08)**
Provision Movement			
Individual Impairment	0.01	(0.02)	(0.08)
Collective Impairment	(0.26)	0.00	(0.08)
Total 2017 Provision Movement	**(0.25)**	**(0.02)**	**(0.16)**
Individual Impairment	0.10	0.41	0.51
Collective Impairment	0.62	0.02	0.64
Total Impairment at 31 Dec 2017	**0.72**	**0.43**	**1.15**

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 2017 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 2017 Annual Report and 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 New Edge. Counterparty credit risk is transferred from the swap counterparty to LCH which is considered to be a much higher credit quality being 57% owned by the London Stock Exchange with the remaining 47% being owned by its users (clearing members).

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

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 2017 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-	100.1	12.5	3.0	115.6
2	A+ to A-	0.0	0.9	0.0	0.9
3	BBB+ to BB-	0.0	10.4	0.0	10.4
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		**100.1**	**23.8**	**3.0**	**126.9**

A further breakdown of the Group's Treasury assets by geography is shown below, which includes a £2.9m exposure in relation to the LCH clearing house in relation to Interest Rate Swaps. The European Union exposure relates to a European Investment Bank Treasury Investment in sterling as part of the liquidity holdings.

United Kingdom	125.8
European Union	4.0
Total (£m)	**129.8**

An analysis of exposures to Clearing Banks and Building Societies by residual maturity is below:

Repayable on Demand	11.3
In not more than 3 Months	0.0
In more than 3 Months not more than 1 year	3.0
More than 1 year not more than 5 years	12.5
Total (£m)	**26.8**

5.2 Other Financial Risks

5.2.1 Interest Rate Risk in the Banking Book

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 of the Society 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 yield curve shifts over a 3 year time horizon and 3 non-parallel shifts in the yield curve
- 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 2017	**(433)**
Average for the period	(751)
Maximum for the period	(1786)
Minimum for the period	(132)

Sensitivity of projected net interest income to +100bps interest rate movement (earnings)	£000
At 31 December 2017	**1,221**
Average for the period	1,238
Maximum for the period	1,325
Minimum for the period	1,130

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 market counterparties Barclays, Lloyds and RBS / National Westminster.
The composition of the balance sheet is modelled over a 3 year time horizon in line with the 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 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

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 assets which can quickly be converted into cash within the market and have an appropriate reduction in value under the measure to recognise realisation and the qualifying stock is known as the Liquidity Buffer.

The measure must meet a minimum phased requirement of at least 100% from 2018 onwards with the current requirement of 90% as at 31 December 2017.

The table below sets out the Society's average quarterly Liquidity Coverage Ratio for the 12 month period ending 31 December 2017.

Liquidity Coverage Ratio				
Quarter Ending	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**
	£m	**£m**	**£m**	**£m**
Liquidity Buffer	113.6	134.7	149.3	142.4
Total Net Cash Outflows	48.5	59.4	57.1	55.4
Liquidity Coverage Ratio (%)	**234.3**	**226.7**	**261.6**	**257.2**

5.2.4 Unencumbered Assets

Article 443 of the CCR requires disclosure of encumbered and unencumbered assets.

The Society has entered both the Funding for Lending Scheme and Term Funding Scheme with the Bank of England.
These schemes offer low cost funding to banks and building societies which allows the Society to offer lending products to customers at competitive rates with the funding secured by a lien over receivables from mortgage loans pledged as collateral security until the Schemes repayment date.

The pledged mortgage loans and other qualifying securities listed within the qualifying pool against the borrowed funding are therefore encumbered.

Additionally the society has Off Balance Sheet Derivative Interest Rate Swap contracts with various counterparties which require both the Society and the Counterparty to place Initial Margins and Mark to Market movements (Variation Margin) in the form of cash with a Central Clearing Provider. Such cash qualifies as an encumbered asset and the Society had £2.9m lodged with a Central Clearing Counterparty London Clearing House at the Balance Sheet date.

The following Tables detail the segmentation of the Society's assets into encumbered and unencumbered Assets. Values are recorded as financial year end values (December 2017).
The Society has departed from the recommended disclosure of median values and non- disclosure of fair value amounts as recommended in guidance as the majority of encumbered assets are within the Bank of England Funding for Lending and Term Funding Schemes.
This information is available on the Bank of England website.

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	**112.0**	**112.0**	**786.8**	**787.4**
Equity instruments	**0.0**	**0.0**	**0.0**	**0.0**
Debt securities	**3.0**	**3.0**	**16.6**	**16.6**
of which covered bonds				
of which asset backed securities				
of which issued by general governments	3.0	3.0	16.6	16.6
of which issued by financial corporations				
of which issued by non finnacial corporations				
Other assets	**109.0**	**109.0**	**770.2**	**770.8**

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 of selected liabilities	**47.9**	**112.0**

The Society's has £6.0m in the form of cash, fixed assets and other assets in its balance sheet which are not eligible for encumbrance at the balance sheet date of 31 December 2017.

In addition to the above, the Society held £30m of Treasury Bills off balance sheet liabilities in relation to its Funding for Lending Scheme (FLS) drawings.

6. Remuneration

The Group implemented a Senior Management Remuneration Policy 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 peer group organisations, together with individual responsibilities, experience, expertise and overall contribution.

The Remuneration Committee is made up of three Non-Executive Directors, including the Chair of the Risk Committee. The Chief Executive and Chief Risk 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 four 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 Board 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.

In 2017 the scheme was amended to reflect the award of deferred bonuses where only 50% was payable on Board ratification of achievement of objectives with the remainder being deferred for three years subject to performance.

The maximum amount of performance pay was set at 20% of basic salary for on target performance and to 40% for over performance.

The Remuneration Committee determined that, in addition to the Executive Directors in post during all or part of 2017, one other Executive and two Interim Executive Directors are designated as being Senior Management staff.

The Committee determined that two other members of staff were Material Risk Takers.

The Society payments made to them during the year ended 31 December 2017 were as follows:

Remuneration - Dec 17	Senior Management	Material Risk Takers
Total fixed remuneration (£000)	**650**	**143**
of which cash based - non deferred	604	134
of which other - non deferred	46	9
Number of Employees	**7**	**2**
Total variable remuneration (£000)	**139**	**10**
of which cash based	70	10
of which deferred	70	0
Number of Employees	**4**	**2**
Total Remuneration (£000)	**789**	**153**

Note there were no guaranteed bonuses, sign on awards or severance payments to report in 2017.

Note that the Executive Directors' Remuneration information shown in Page 30 of the Annual Report and Accounts include only details of the permanent Executive Directors in position as at 31st Dec 2017. As such the Annual Report and 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 Interim Chief Executive, Interim Finance Director and the acting Chief Risk Officer) and other Material Risk Takers.

7. Contacts

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

Gary Mason Head of Regulatory Reporting gary.mason@furness-bs.co.uk
Matt Dobson Finance Director matthew.dobson@furness-bs.co.uk