

# **Pillar 3 disclosures**

**31 December 2018**



**Leeds Building Society**

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# Overview

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## 1 Overview

### 1.1 Background

On 1 January 2014, the Basel III regulation was implemented through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) together referred to as CRD IV. Some of the regulations introduced under CRD IV are being phased in over the period to 1 January 2022 under transitional arrangements. These disclosures have been prepared according to the CRD IV regulatory requirements.

### 1.2 Basis and frequency of disclosures

This document has been prepared under CRD IV in line with the current disclosure requirements as presented in Part Eight (Articles 431 to 455) of Regulation (EU) No 575/2013 of the European Parliament and of the Council. The tables within these disclosures show the regulatory measures of Leeds Building Society and its subsidiaries (the Society), on both a transitional basis (per the PRA Policy statement PS7/13) and an end point basis, reflecting current expectations of the PRA requirements at the end of the CRD IV transitional period. During 2018, the Prudential Regulation Authority (PRA) granted the Society permission to use the Internal Ratings Based (IRB) approach to credit risk exposures. The IRB approach has been applied to prime residential, buy to let, shared ownership and completed self-build mortgages. For all other exposures and operational risk the Standardised approach continues to apply.

The comparative information in this document for 2017 is presented entirely on the Standardised approach. A summary of the 2018 position under the Standardised approach is shown in table 4a for comparative purposes.

The IRB Approach allows the Society to calculate capital requirements using internally developed models rather than the standardised percentages set out in the CRR. The IRB models are subject to a robust monitoring process on an ongoing basis to ensure that they reflect regulatory and economic developments and are in line with industry best practice.

This document reflects guidance notes and technical standards issued by the European Banking Authority and (where deemed appropriate and as indicated) the recommendations of the Enhanced Disclosure Task Force contained in the document entitled '*Enhancing the Risk Disclosures of Banks*'. The disclosures in this document represent the Society's interpretation of the guidance.

The document incorporates the revised disclosure requirements presented in the document entitled "Revised Pillar 3 disclosure requirements" issued by the Basel Committee on Banking Supervision dated January 2015 and the additional tables specifically required for entities using the Internal Ratings Based approach to the calculation of certain credit risk exposure requirements.

All disclosures will be issued on an annual basis, as a minimum, and more frequently if appropriate. The disclosures have been published in conjunction with the publication date of the Society's Annual Report and Accounts for the year ended 31 December 2018 and the information presented is based on those Accounts unless otherwise stated.

### 1.3 Verification

These disclosures have been subject to internal verification and reviewed by the Audit Committee before approval by the Board. The production of the document is governed by a formal policy which is owned and approved by the Audit Committee which covers, inter alia, adequacy, verification, frequency and medium of publication of the disclosures.

# Overview

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There is no formal external audit requirement in relation to these disclosures; however, some of the information also appears in the Society's Annual Report and Accounts, which are subject to external audit verification. The Annual Report and Accounts have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted for use in the European Union and the information in the Pillar 3 disclosures may not be directly comparable with that information due to differences in regulatory requirements. The disclosures are published on the "Financial results" section of Leeds Building Society's website ([www.leedsbuildingsociety.co.uk/press/financial-results/](http://www.leedsbuildingsociety.co.uk/press/financial-results/)).

## 1.4 Scope

This document has been prepared in relation to Leeds Building Society. For accounting purposes, the Society's consolidation group comprises the Society and all of its subsidiary entities. The Society is regulated by the Financial Conduct Authority (FCA) and the PRA.

The revised Pillar 3 guidelines published by the EBA do not apply for the Society. However, the Society has complied with additional guidance requiring disclosure of the Liquidity Coverage Ratio, shown on page 46 and asset encumbrance shown on page 72.

For capital purposes the Society is required to calculate and maintain regulatory capital ratios on a consolidated (Group) basis and on a Society only basis. The disclosures contained in this document are provided on the Group basis (except where otherwise stated) in accordance with Article 6(3) of the CRR.

The principal subsidiaries are:

Subsidiary name
Leeds Mortgage Funding Limited
Ravenstone Limited (in liquidation)
Leeds Building Society Covered Bonds LLP
Albion No.2 plc (in liquidation)
Albion No.3 plc
Guildford No.1 plc

Further information on the Society's subsidiaries can be found in note 15 to the Annual Report and Accounts for the year ended 31 December 2018.

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## *Non material, proprietary or confidential information*

Part Eight of Regulation (EU) No 575/2013 allows institutions to omit one or more of the required disclosures (disclosure waivers) if information provided by such disclosures is not regarded as material or if it would be regarded as proprietary or confidential. Some of the required disclosures, such as those on own funds or in relation to remuneration, cannot be omitted due to concerns relating to their materiality, proprietary nature or confidentiality.

No Pillar 3 information has been excluded from the disclosures in this document on the basis of it being proprietary or confidential or on the grounds of materiality other than as described below.

No geographical split, sector split or residual maturity profile (as set out in CRR Article 442 paragraphs (d) – (f)) is presented in relation to the other loans of £170.0m (primarily a collateral loan to a third party) per Table 8. This is on the basis of the amounts being immaterial.

## *IFRS 9*

IFRS 9 – Financial Instruments was adopted by the Society from 1 January 2018. The standard replaces IAS 39 – Financial Instruments: Recognition and Measurement and has three sections:

- Classification and measurement – the standard introduces new categories for the classification and measurement of financial assets. The classification of assets requires an assessment of the Group's business model for managing the assets and of the contractual cash flow characteristics of the assets. This has resulted in some changes to the classification of assets for the Group but has not had a material impact on carrying values in the Statement of Financial Position at 1 January 2018.
- Impairment – under IAS 39, impairment loss provisions were calculated on an incurred loss model, whereby provisions were recognised once an impairment 'trigger' event had been identified. IFRS 9 changes this model to an expected credit loss (ECL) model which incorporates forward looking information such that when a financial asset is first recognised, an impairment loss provision is made for the expected losses from defaults over the following 12 months (12 month ECL). If, at a later time, the Group determines that there has been a significant increase in the credit risk of the asset, this impairment loss is increased to cover the expected losses over the whole life of the asset (lifetime ECL). This change in the calculation of impairment losses results in earlier recognition of credit losses in the financial statements but does not change the amount of the eventual loss suffered. This change has resulted in an increase in the Group's provisions for impairment losses.
- Hedge accounting – IFRS 9 alters the rules for the application of hedge accounting, although the rules in relation to portfolio fair value hedges are still under development. Consequently the standard allows entities to continue to apply IAS 39 for all hedge accounting and the Group has chosen to do this.

The adoption of IFRS 9 resulted in a reduction in equity attributable to members at 1 January 2018 of £19.7 million. More detail on the impact of IFRS 9 on capital is set out in section 4.3 of this document, additional detail of the impact on the Society can be found in the accounting policies of the Annual Report and Accounts on pages 113 to 120 and in note 38 to the Accounts.

## *Minimum Requirements for Own Funds and Eligible Liabilities*

As part of the EU's Bank Recovery and Resolution Directive, the final framework and policies for setting Minimum Requirements for Own Funds and Eligible Liabilities (MREL) have been published. These will be phased in on a transitional basis from 2020. The Society has been notified of its indicative MREL, which has been factored into future

# Overview

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plans, to ensure it is well positioned to meet the requirements. In 2018 the Society issued £200m of MREL eligible subordinated debt which is included in Tier 2 capital.

# Risk Management Objectives and Policies

## 2 Risk Management Objectives and Policies

### 2.1 Introduction

The Society recognises that effective management of the risks arising from its activities is fundamental to the long term success of the business. The Board aims to manage these risks through a formal structure for monitoring and managing risk. This includes a range of Strategic Risk Appetite statements approved by the Board, detailed supporting frameworks and independent governance and oversight. The Society has a separate Board Risk Committee (BRC) that meets 8 times per year.

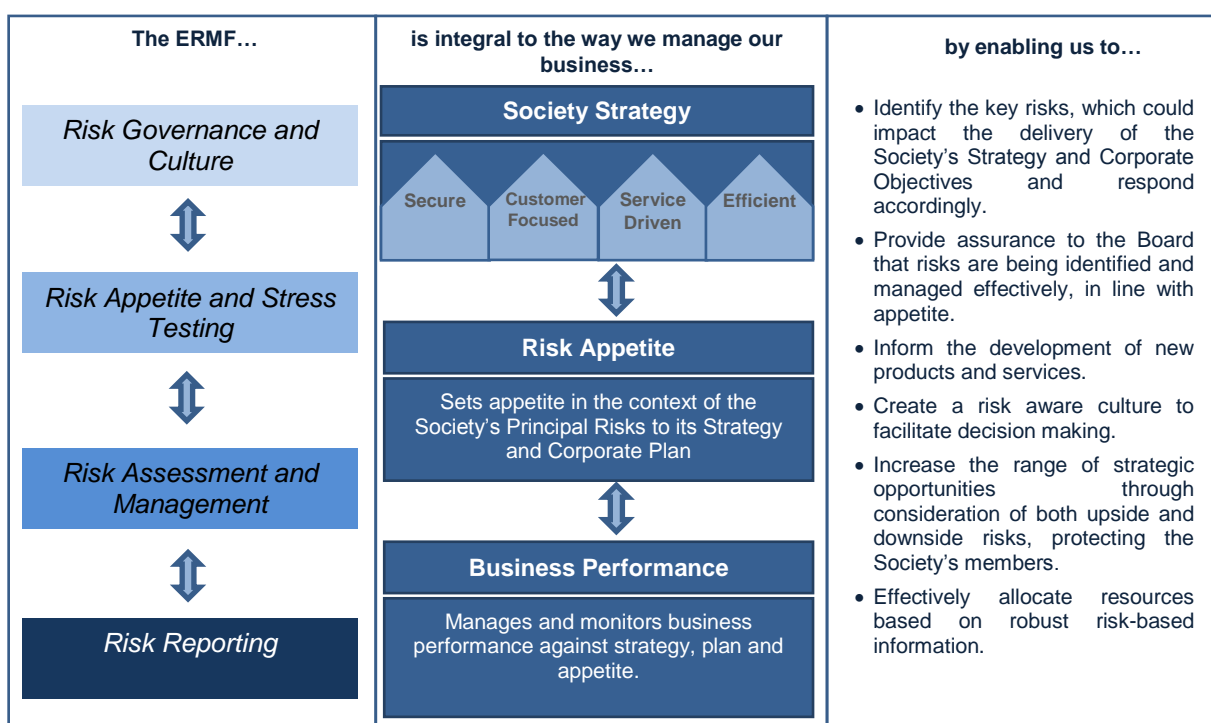
The Board considers that the risk management arrangements and systems are adequate in relation to the strategy, size and complexity of the Society.

Capital quality and composition is actively monitored with regulatory ratios forming an integral part of internal planning and the decision making process. The key regulatory capital ratios are set out in sections 4.3 and 4.4 of this document.

Inherent in the Society's strategy are seven principal risk categories: credit; funding and liquidity; capital; market; operational; conduct; and strategic/business risks. For each of these principal risk categories, the Society operates appropriate systems of control, including - but not limited to - Board defined Strategic Risk Appetite and a suite of Board approved policies. These set the risk parameters within which to deliver the Corporate Plan and also provide appropriate triggers for management response under stressed conditions. Additional detail on the Society's Risk Management Objectives and Policies can be found on pages 66 to 70 of the Annual Report and Accounts.

### 2.2 Approach to Risk Management

The Enterprise Risk Management Framework ("ERMF") integrates various risk management tools to support the effective development and implementation of the Society's strategy. The framework sets out a structured and consistent approach to identifying, assessing, controlling and monitoring risks, which is used to inform decision making at both strategic and operational levels. The ERMF is reviewed annually by the BRC, on behalf of the Board, and the Chief Risk Officer ("CRO") has responsibility for its implementation.





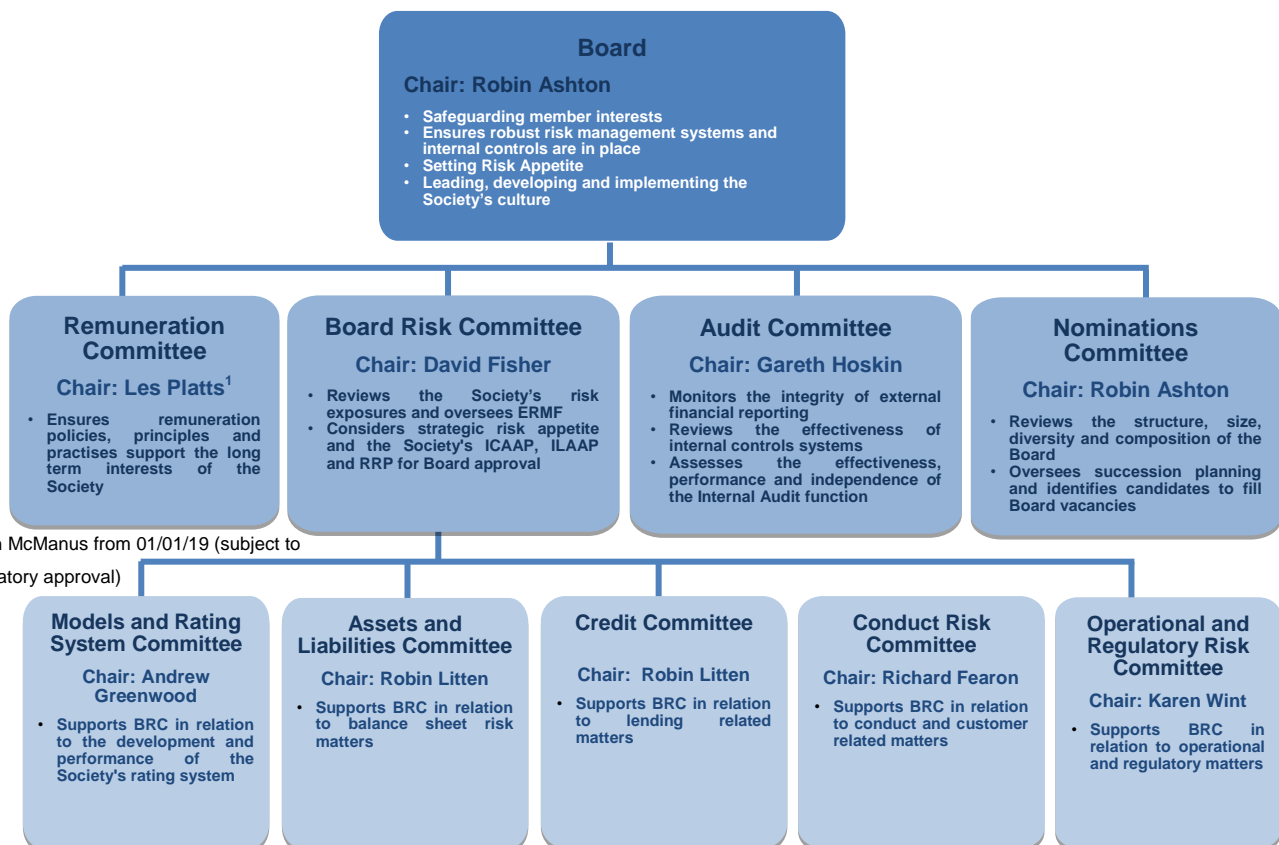
# Risk Management Objectives and Policies

## Risk Governance and Culture

Risk governance is the architecture used to support risk-based decision making and oversight across all operations of the Society, whereas risk culture relates to the behaviours and attitudes of colleagues in making these decisions. These structures, disciplines and values support the Board in its fiduciary responsibility for risk oversight and delegate authority to management for day-to-day decision making.

## Committee Structure

The Board is the governing body of the Society and is responsible for overseeing the implementation of the Society's strategy and holding management to account. To support the Board in the delivery of its responsibilities, the Society operates four Board sub-committees, each with distinct and cascaded mandates in a Terms of Reference ("ToR"). From a risk management perspective, BRC provides independent oversight of the effective management of the Society's risk universe. BRC is supported by five Executive Risk Committees, each focusing on a particular discipline(s) of risk. These committees are decision making in nature and operate within delegated mandates and limits provided by the Board/BRC. The Society's current committee structure is set out below:



<sup>1</sup>Lynn McManus from 01/01/19 (subject to regulatory approval)

# Risk Management Objectives and Policies

## Policies and Delegated Authorities

Mandates are also provided by the Board to Management via the following routes to manage the day-to-day activities of the Society:

Delegation route	Summary
1. Policy Framework	Delegated mandates and limits are approved through the Society's suite of policies, which are reviewed on an annual basis by the Board or relevant Board Sub-Committee.
2. Delegated Authorities Manual	The Delegated Authorities Manual is designed to facilitate the effective discharge of responsibilities and continuity of operations within a sound system of financial, operational and budgetary control. It is reviewed by the Board annually.
3. Corporate Plan	Subsequent to the approval of Strategic Risk Appetite, the Corporate Plan provides the annual Board approved parameters within which management can operate.

## Three Lines of Defence Model and the Risk Function

The Society's approach to risk management aligns to a 'three lines of defence' model, which is standard practice within the financial services sector. This ensures a clear delineation of responsibilities between control over day-to-day operations, risk oversight and independent assurance of activities. The key accountabilities under the three lines of defence model are detailed below:

1 <sup>st</sup> Line (Business Lines)	2 <sup>nd</sup> Line (Risk Function)	3 <sup>rd</sup> Line (Internal Audit)
<ul style="list-style-type: none"> <li>Executes strategy.</li> <li>Identifying and managing own risks.</li> <li>Adhering to appetite, policies and standards.</li> <li>Implementing and maintaining regulatory compliance.</li> <li>Identifying emerging risks.</li> </ul>	<ul style="list-style-type: none"> <li>Oversight of day-to-day activities of the 1st line.</li> <li>Maintenance of the ERMF.</li> <li>Coordination and oversight of the setting of risk appetite.</li> <li>Guardians of policies.</li> <li>Identifying emerging risks.</li> <li>Enterprise risk reporting.</li> <li>Conduct independent risk based assurance.</li> </ul>	<ul style="list-style-type: none"> <li>Independent assurance of the adequacy and effectiveness of 1st and 2nd line risk management, on a risk based approach.</li> </ul>

The Risk function is independent from the operational business divisions. It ensures the Society follows a consistent approach to risk management and is led by the CRO, who reports directly to the Chief Executive Officer and is also accountable to the Chairman of the BRC. The Risk function comprises specialist teams, aligned to key risk disciplines, which provide oversight and independent challenge of first line activities.

## Risk Culture

Risk culture is an essential element of effective risk management, underpinning how the Society's ERMF is embedded across the business and into decision making. The Society operates a risk aware culture, built upon the following four principles:

**Tone from the Top and Desired Behaviours** - Reflects the Society's Values, which are clearly demonstrated by the Board and the Senior Leadership Team.

# Risk Management Objectives and Policies

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**Accountability** - The Society holds individuals at all levels accountable for risk management, to support the delivery of its Strategy and business objectives.

**Effective communication** -The Society cultivates an environment of open and transparent communication about risk and risk taking expectations.

**Incentives and Talent Management** - The Society operates an appropriate incentive scheme and other HR frameworks to promote the desired risk culture.

## 2.3 Risk Appetite and Stress Testing

### *Risk Appetite Framework*

A key element of the ERMF is Strategic Risk Appetite (“SRA”). This comprises qualitative statements and quantitative metrics to provide the boundaries within which the Society must operate to deliver its Strategy. The Society’s SRA is reinforced through policies and standards, to ensure consistency and alignment to Board defined parameters.

The Board defines SRA across the Society’s seven principal risk categories (listed on Pages 14 to 21 of the Annual Report and Accounts). The metrics are reviewed by the Board annually and are used in stress testing to measure and validate the long-term viability of the Society, under both plausible and more severe scenarios. They are also forecast on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures in relation to appetite and the Society has developed appropriate early warning indicators and escalation procedures to highlight and respond to risk profile changes.

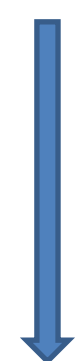
### *Stress Testing*

Stress testing is a risk management tool used throughout the Society to support an understanding of the vulnerabilities within the Society’s business model. The Society’s approach to stress testing is defined within the Stress Testing Framework, which is owned by BRC and requires/provides:

- a sound understanding of internal and external influences on the Society and its principal risks;
- enhanced risk management and complementary stress testing approaches/scenario analyses (including reverse stress testing);
- assistance to the Board in strategic business planning and setting of SRA; and
- management of capital and liquidity resources against SRA and regulatory expectations.

# Risk Management Objectives and Policies

The Society has developed an annual programme of stress testing activity, which informs the planning process and the calibration of SRA. The key components of the programme are as follows:



Activity	Description
Corporate Planning	Sensitivity analysis and a suite of alternative scenarios are used to assess the Corporate Plan under a range of severe, but plausible, stresses.
ICAAP	An internal assessment of whether the Society has sufficient capital to withstand a severe stress.
ILAAP	An internal assessment of whether the Society has sufficient liquidity and stable funding to withstand a severe stress.
Recovery Plan	Scenario analysis is used to inform the development of a suite of recovery actions (primarily capital and liquidity) to be used under extreme stress and to set and validate operational protocols.
Reverse Stress Testing	An assessment of the stress scenarios under which the Society would potentially become unviable. This examines potential weaknesses in the Society's business model under extreme events so that mitigating actions can be identified (as appropriate).

## 2.4 Risk Assessment and Management

The Society operates defined risk assessment and management processes to facilitate the consistent identification, analysis, evaluation and response to risks across the Society. The framework can be applied for both strategic and operational risk assessments and is set within the Society's business environment and its Strategy and Objectives. A summary of the five stages of this process is set out below:

**Risk Identification** – The Society operates enterprise 'top down' and operational 'bottom up' risk identification processes to capture new or emerging risks, which could impact corporate objectives and the delivery of the Society's strategy.

**Risk Analysis** – The Society utilises a range of methodologies to assess risks identified in order to understand their severity and likelihood on the delivery of the Society's strategy and to inform risk evaluation and treatment.

**Risk Evaluation** – The Society evaluates and prioritises risks to inform decision making on risk responses and to optimise the allocation of resources.

**Risk Treatment** – Management selects and deploys appropriate risk responses, including avoidance, limitation, transfer and acceptance, balancing the potential benefit derived versus economic cost, effort and implications for key stakeholders.

**Monitoring and Review** – The Society monitors its risk assessment and management processes to proactively identify and adjust to changes in risk profile and to understand the effectiveness of implementing risk treatment strategies.

### *Risk Reporting*

The Society operates an appropriate risk reporting hierarchy to provide the right information, to the right people, at the right time, to influence decision making. The Society uses a combination of strategic and business process reporting to understand the current or potential risk profile of the Society, which may impact the delivery of its Strategy and Corporate Objectives. These reporting processes are conducted at an appropriate frequency and are coordinated by the Risk Function.

# Capital Resources

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## 3 Capital Resources

### 3.1 Total available Capital

Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses. The requirements of the CRD IV package (described in more detail in section 1.1) will be implemented over a further three years to 1 January 2022; there are a number of transitional rules which apply.

The strength of the Society's capital position (primarily based on retained profits), the issuance of subordinated debt within the year and the conservative lending policy of the Society, meant that the Society comfortably met the required capital requirements and minimum leverage ratio throughout 2018, based on both the transitional rules (applied from 1 January 2014) and end state rules.

CRD IV requires the Society to hold a countercyclical buffer as determined by the Bank of England's Financial Policy Committee (FPC). The Society's buffer was set at 1% from November 2018 and the same rate is industry wide. The Society's institution specific countercyclical capital buffer is immaterial for 2018 (see Appendix A4 for details).

The requirement to maintain a capital conservation buffer was phased in from 1 January 2016. The capital conservation buffer represents 1.875% of risk weighted assets throughout the year ended 31 December 2018 (2017: 1.250%).

The Society does not foresee any practical or legal impediments to the transfer of capital resources or the repayment of liabilities between the parent and its subsidiaries with the exception of the securitisation vehicles (listed in section 1.4) and Leeds Building Society Covered Bonds LLP with assets being ring fenced within these entities.

# Capital Resources

The table below sets out the capital position based on both the transitional and full implementation rules of CRD IV:

<b>TABLE 1: Total Capital</b>	<b>Ref</b>	<b>Transitional CRD IV rules 2018 £m</b>	<b>Full implementation CRD IV rules 2018 £m</b>	<b>Transitional CRD IV rules 2017 £m</b>	<b>Full implementation CRD IV rules 2017 £m</b>
<b>Common Equity Tier 1 (CET 1)</b>					
General reserve		1,006.3	1,006.3	931.3	931.3
Revaluation reserve	3.2.1	8.2	8.2	11.1	11.1
Fair value reserve		(2.3)	(2.3)	2.3	2.3
Other reserve		14.3	14.3	14.3	14.3
<b>CET 1 prior to regulatory adjustments</b>					
		1,026.5	1,026.5	959.0	959.0
Regulatory adjustments:					
IFRS 9 transitional add back		1.3	-		
Additional valuation adjustment		(1.9)	(1.9)	(1.3)	(1.3)
Pension scheme surplus	3.2.1	(10.1)	(10.1)	(1.0)	(1.0)
Intangible assets		(8.5)	(8.5)	(5.2)	(5.2)
Excess of expected loss over impairment provision		(9.9)	(9.9)	-	-
<b>CET 1 capital</b>					
		997.4	996.1	951.5	951.5
Additional Tier 1 capital (AT1)					
Permanent Interest Bearing Shares (PIBS)	3.2.2	25.0	25.0	25.0	25.0
Regulatory adjustments:					
Grandfathering of PIBS under transitional rules		(15.0)	(25.0)	(12.5)	(25.0)
<b>Total Tier 1 capital</b>					
		1,007.4	996.1	964.0	951.5
<b>Tier 2 capital</b>					
Provisions	3.3	-	-	11.6	11.6
Issuance of subordinated debt		200.0	200.0	-	-
Permanent Interest Bearing Shares	3.2.2	15.0	25.0	12.5	25.0
Provision over expected loss		2.9	2.9	-	-
<b>Total Tier 2 capital</b>					
		217.9	227.9	24.1	36.6
<b>Total regulatory capital</b>					
		1,225.3	1,224.0	988.1	988.1

In accordance with Article 437(2) the EBA has developed technical standards which specify uniform disclosure templates (and have been adopted by the EU). These templates are set out in Appendix A1. The table above (together with the ratios in section 4.3) provides a summary of the template information tailored to the Society.

The main components of Common Equity Tier 1, Additional Tier 1 and Tier 2 capital (including financial instruments issued by the Society) are described in sections 3.2 and 3.3.

# Capital Resources

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## 3.2 Tier 1 capital

### 3.2.1 Common Equity Tier 1

Common Equity Tier 1 (CET1) capital comprises the general reserve, other reserve, revaluation reserve and fair value reserve. The general and other reserves represent the Society's accumulated profits, as well as adjustments for pension obligations.

At 31 December 2018 there was a CET1 regulatory deduction relating to intangible assets and pension surplus, neither of which are eligible capital under either the transitional or fully implemented CRD IV rules. A deduction of £8.5m has been made (2017: £5.2m) relating to intangible assets and £10.1m (2017: £1.0) relating to pension surplus. An additional valuation adjustment of £1.9m was also deducted in 2018 (2017: £1.3m).

The Society has chosen to adopt the transitional arrangements associated with the move from IAS 39 to IFRS 9. This has led to an add back adjustment to CET1 of £1.3m. A transitional factor of 95% has been used for 2018 in line with the regulatory requirements. This value is relatively low due to the Society being granted IRB permission in the year.

As the Society received IRB permission in 2018 an adjustment to CET1 was required to account for the shortfall in provision that relates to the difference between regulatory expected losses and IFRS 9 provisions. For 2018 this value is a deduction of £9.9m.

### 3.2.2 Additional Tier 1

Additional Tier 1 (AT1) capital comprises Permanent Interest Bearing Shares (PIBS). PIBS are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Society. The PIBS, which are denominated in sterling, were issued for an indeterminate period and are only repayable in the event of resolution of the Society. The interest rate on PIBS is fixed at 13.375%. The Society has no other qualifying AT1 instruments.

As defined in the CRD IV requirements, the Society's PIBS will cease to qualify as an AT1 capital instrument by 1 January 2022. The Society derecognised 20% of the instrument in 2014 and has derecognised an additional 10% in each subsequent year. This will continue until 2022 when 100% of the instrument will have been derecognised from AT1 capital. However, the PIBS will continue to meet the definition of Tier 2 capital, and qualify as a Tier 2 capital instrument. As a result, the amount of the PIBS which is derecognised from AT1 capital is being recognised as Tier 2 capital.

The full terms and conditions of the PIBS are set out in the Offering Circular dated 31 March 1992, available on request from the Society (see section 10 for contact information). The key features of the PIBS are set out in Appendix A2.

## 3.3 Tier 2 capital

At 31 December 2018, Tier 2 capital comprises the Society's qualifying subordinated notes and the proportion of PIBS phased from AT1 to Tier 2. The derecognised proportion of PIBS in AT1 capital is being recognised as Tier 2 capital. On a fully implemented basis, PIBS qualify as and form part of Tier 2 capital.

Under regulatory rules for Individual Capital Guidance, at least 56% of capital must be CET1, no more than 44% should be AT1 and no more than 25% Tier 2 capital. Given the magnitude of the components of CET1, AT1 and Tier 2 capital, the Society was at all times comfortably within these limits.

# Capital Resources

The Society issued £200m of subordinated debt in 2018, which qualifies as Tier 2 capital. The full terms and conditions of this issuance are available on request from the Society, see section 10 for contact information. The key features of the subordinated debt are included in Appendix A2.

As the Society was granted IRB permission in the year and IFRS 9 came in to force an additional adjustment of £2.9m is required in Tier 2 capital to reflect the level of IFRS 9 provision over expected losses.

## 3.4 Capital reconciliation statement

A reconciliation of the accounting balance sheet to the regulatory balance sheet is disclosed below in accordance with the Enhanced Disclosure Task Force's (EDTF) recommendation 10.

<b>TABLE 2: Capital reconciliation</b>	<b>Transitional CRD IV rules 2018 £m</b>	<b>Full implementation CRD IV rules 2018 £m</b>	<b>Transitional CRD IV rules 2017 £m</b>	<b>Full implementation CRD IV rules 2017 £m</b>
<b>Total CET 1 attributable to members per the Statement of Financial Position</b>	<b>1,026.5</b>	<b>1,026.5</b>	959.0	959.0
Adjustments to CET 1 capital:				
IFRS 9 transitional add back	1.3	-	-	-
Additional valuation adjustment	(1.9)	(1.9)	(1.3)	(1.3)
Defined benefit pension surplus	(10.1)	(10.1)	(1.0)	(1.0)
Intangible assets net of tax	(8.5)	(8.5)	(5.2)	(5.2)
Excess of expected loss over impairment provision	(9.9)	(9.9)	-	-
<b>Total adjustments to CET1 capital</b>	<b>(29.1)</b>	<b>(30.4)</b>	(7.5)	(7.5)
Adjustments to AT 1 capital:				
Permanent Interest Bearing Shares (PIBS)	25.0	25.0	25.0	25.0
Grandfathering of PIBS	(15.0)	(25.0)	(12.5)	(25.0)
<b>AT 1 capital</b>	<b>10.0</b>	<b>-</b>	12.5	-
Adjustments to Tier 2 capital:				
Collective impairment allowance	-	-	11.6	11.6
Issuance of subordinated debt	200.0	200.0	-	-
Permanent Interest Bearing Shares	15.0	25.0	12.5	25.0
Provision over expected loss	2.9	2.9	-	-
<b>Tier 2 capital</b>	<b>217.9</b>	<b>227.9</b>	24.1	36.6
<b>Total regulatory capital</b>	<b>1,225.3</b>	<b>1,224.0</b>	988.1	988.1



# Capital Resources

## 3.5 Capital flow statement

The capital flow statement, presented in accordance with EDTF recommendation 11, is set out below.

The statement presents transitional rules data in relation to capital flow on the basis that it is intended to be based on the applicable regulatory rules in force at the period end.

<b>TABLE 3: Capital flow</b>	<b>Transitional CRD IV rules 2018 £m</b>	Transitional CRD IV rules 2017 £m
<b>Total regulatory capital at 1 January</b>	<b>988.1</b>	913.8
Adjustments to CET 1 capital:		
Profit for the period	<b>89.2</b>	88.0
Additional valuation adjustment	<b>(0.6)</b>	(1.3)
Pension actuarial movement and tax recognised in OCI	<b>4.8</b>	(0.5)
Revaluation reserve movement	<b>(1.9)</b>	-
Fair value reserve	<b>(4.9)</b>	(2.8)
Movement in defined benefit surplus	<b>(9.1)</b>	(1.0)
Intangible assets	<b>(3.3)</b>	(2.2)
Impact of introduction of IFRS 9	<b>(18.4)</b>	-
Change in excess expected loss over impairment provision	<b>(9.9)</b>	-
<b>Total adjustments to CET1 capital</b>	<b>45.9</b>	80.2
Adjustments to AT1 capital:		
Phasing of PIBS from AT1 to Tier 2 (see section 3.1)	<b>(2.5)</b>	(2.5)
<b>Total adjustments to AT1 capital</b>	<b>(2.5)</b>	(2.5)
Adjustments to Tier 2 capital:		
Collective impairment allowance (credit)	<b>(11.6)</b>	(5.9)
Issuance of subordinated debt	<b>200.0</b>	-
Phasing of PIBS	<b>2.5</b>	2.5
Provision over expected loss	<b>2.9</b>	-
<b>Total adjustments to Tier 2 capital</b>	<b>193.8</b>	(3.4)
<b>Total regulatory capital at 31 December</b>	<b>1,225.3</b>	988.1

# Capital Adequacy

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## 4 Capital Adequacy

### 4.1 Capital Management Policy

The Capital Management Policy (CMP) outlines the systems and key controls to ensure capital is measured and managed within the boundaries of risk appetite set by the Board. It also provides a clear articulation of the accountability for capital management across the Society. The CMP is supported by a series of Capital Standards.

Capital adequacy is monitored on a monthly basis against a number of key metrics to ensure that it stays within the Board's risk appetite and above the regulatory minima.

Tier 1, Tier 2 and total capital are tracked on both a transitional and fully loaded basis against prior periods and internal plans. The key ratios calculated and assessed include:

- Common Equity Tier 1 capital (CET 1) ratio (see section 4.3)
- Total capital ratio (total capital/total risk weighted assets) on both a transitional and fully loaded basis; and
- Leverage ratio (see section 4.4).

### 4.2 Internal Capital Adequacy Assessment Process and Pillar 2

The Society assesses its capital adequacy through an Internal Capital Adequacy Assessment Process (ICAAP), at least annually. This process is used to determine the level of capital required to support the Society's current and future business activities. The ICAAP ensures that the Society meets regulatory capital requirements under business as usual and stressed environments, over a five year time horizon. The Board Risk Committee reviews internal refreshes of the ICAAP at least three times a year.

Following Board approval, the ICAAP is considered by the PRA as part of its Supervisory Review and Evaluation Process (SREP). This is used to determine a Total Capital Requirement (TCR) plus the PRA buffer for the Society.

Under Pillar 2A, additional minimum capital requirements are set by the PRA by issuing an entity specific TCR. This represents a point in time estimate of the total amount of capital that is needed by the entity. It includes the assessment of risks that are not fully covered by Pillar 1 such as credit concentration and operational risk, and those risks outside the scope of Pillar 1 such as pensions and interest rate risk.

Post year end the Society has received an updated TCR requirement from the PRA reflecting IRB permission being granted in 2018. As of 31 December 2018 this updated TCR would equate to a Pillar 2A of 3.7% risk weighted assets of which 2.1% has to be covered by CET 1 capital (2017: 1.6% and 0.9% respectively). The Society is not permitted by the PRA to provide any further details regarding the quantum of the individual components.

During 2018, the Society remained strongly capitalised with capital resources significantly above the PRA prescribed TCR and buffer requirements.

# Capital Adequacy

## 4.3 Minimum capital requirement – Pillar 1

The Society's minimum capital requirement under Pillar 1 is calculated by adding the credit risk requirement (section 5) to the requirements for operational risk and other commitments.

The following table shows the Pillar 1 capital requirement, regulatory capital resources and the excess of resources over Pillar 1 capital requirement as at 31 December 2018. There has been a significant reduction in the capital requirement in the year due to the Society being granted IRB permission.

TABLE 4: Pillar 1 capital requirement	Average risk weight	Average capital requirement	Risk weight	Capital requirement	Risk weight	Capital requirement
	2018 %	2018 £m	IRB 2018 %	IRB 2018 £m	Standardised 2017 %	Standardised 2017 £m
<b>Credit risk</b>						
Residential mortgage loans	25.0%	306.1	13.7%	176.2	36.3%	436.0
Equity release	35.1%	5.2	35.1%	5.2	35.1%	5.2
Commercial mortgage loans	100.0%	4.7	100.0%	3.2	100.0%	6.1
Other loans	-	-	-	-	-	-
Liquidity	3.7%	8.3	3.7%	8.8	3.7%	7.8
Other items	100.0%	6.0	100.0%	6.8	100.0%	5.2
Counterparty risk (derivatives including CVA)		27.1		26.3		27.9
<b>Total credit risk requirement</b>		357.4		226.5		488.2
Operational risk		26.3		26.4		26.2
Other commitments		6.8		1.8		11.8
<b>Pillar 1 capital requirement</b>		390.5		254.7		526.2
<b>Total regulatory capital resources</b>		1,106.7		1,225.3		988.1
<b>Excess capital over minimum Pillar 1 requirement</b>		716.2		970.6		461.9

CRD IV requires the inclusion of an additional Pillar 1 capital charge for potential market value losses on Over The Counter (OTC) derivatives which is known as the Credit Valuation Adjustment (CVA). The CVA charge has been calculated based on the netted contractual and collateral derivative position of the Society and is included in the capital requirement for counterparty risk above.

The average data above is derived from a simple average of the year end positions. The same principle has been applied in relation to Tables 8 and 16 in section 5 of this document. The 2018 average therefore reflects the transition to IRB on 1st July 2018.

# Capital Adequacy

The impact on the above table of adopting IRB measurement techniques on a transitional basis is as follows.

<b>TABLE 4a: Impact of IRB on capital requirement</b>	<b>IRB and Standardised approach 2018 £m</b>	<b>Adjustment 2018 £m</b>	<b>Standardised approach 2018 £m</b>	<b>Standardised approach 2017 £m</b>
<b>CET 1 capital (Standardised)</b>	-	-	<b>1,024.9</b>	951.5
Excess of expected loss over impairment provision	-	(27.5)	-	-
<b>CET 1 capital (IRB)</b>	<b>997.4</b>	-	-	-
<b>Total Tier 1 capital</b>	<b>1,007.4</b>	<b>(27.5)</b>	<b>1,034.9</b>	964.0
<b>Total Tier 2 capital</b>	<b>217.9</b>	-	<b>217.9</b>	24.1
<b>Credit Risk</b>				
Residential mortgage loans (IRB)	<b>166.3</b>	<b>166.3</b>	-	-
Residential mortgage loans (Standardised)	<b>9.9</b>	<b>(445.7)</b>	<b>455.6</b>	436.0
Equity release	<b>5.2</b>	-	<b>5.2</b>	5.2
Commercial mortgage loans	<b>3.2</b>	-	<b>3.2</b>	6.1
Liquidity	<b>8.8</b>	-	<b>8.8</b>	7.8
Other items	<b>6.8</b>	-	<b>6.8</b>	5.2
Counterparty risk (derivatives including CVA)	<b>26.3</b>	-	<b>26.3</b>	27.9
<b>Operational risk</b>	<b>26.4</b>	-	<b>26.4</b>	26.2
<b>Other commitments</b>	<b>1.8</b>	-	<b>1.8</b>	11.8
<b>Capital ratios</b>				
Common Equity Tier 1 ratio	<b>31.3%</b>	<b>16.4%</b>	<b>14.9%</b>	14.5%
Tier 1 ratio	<b>31.6%</b>	<b>16.7%</b>	<b>14.9%</b>	14.7%
Total regulatory capital ratio	<b>38.5%</b>	<b>20.3%</b>	<b>18.2%</b>	15.0%

Variances in the above table are detailed below:

- The excess of expected loss over impairment represents an adjustment made for all possible future losses. This is calculated using IRB models less impairment provisions calculated under IFRS 9. This differs from the treatment under the Standardised Approach where only accounting impairments are adjusted for
- For residential mortgage loans the risk weights used to calculate the capital requirement are determined by IRB models. These differ significantly from the risk weights applied using the Standardised Approach (table 6 shows the impact of the change in risk weight percentage on the RWA)

# Capital Adequacy

## Impact of IFRS 9

The Society has chosen to adopt the transitional arrangements as laid out in Article 473a of Regulation (EU) No 275/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds.

**TABLE 4b: IFRS 9 Transitional Arrangement**

	2018	2017
	£m	£m
	IRB	Standardised
<b>Available capital (amounts)</b>		
1 Common Equity Tier 1 (CET1) capital	997.4	951.5
2. Common Equity Tier 1 (CET1) capital as if IFRS 9 or analogous ECLs transitional arrangement had not been applied	996.1	951.5
3 Tier 1 capital	1,007.4	964.0
4 Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	996.1	951.5
5 Total capital	1,225.3	988.1
6 Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	1,224.0	988.1
<b>Risk weighted assets (amounts)</b>		
7 Total risk-weighted assets	3,183.7	6,577.6
8 Total risk weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	3,190.3	6,577.6
<b>Capital ratios</b>		
9 Common Equity Tier 1 (as a percentage of risk exposure amount)	31.3%	14.5%
10 Common Equity Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	31.2%	14.5%
11 Tier 1 (as a percentage of risk exposure amount)	31.6%	14.7%
12 Tier 1 (as a percentage of risk exposure amount as if IFRS 9 or analogous ECLs transitional arrangements had not been applied)	31.2%	14.5%
13 Total capital (as a percentage of risk exposure amount)	38.5%	15.0%
14 Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	38.4%	15.0%
<b>Leverage Ratio</b>		
15 Leverage ratio total exposure measure	19,594.5	18,933.7
16 Leverage ratio	5.1%	5.0%
17 Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	5.1%	5.0%

# Capital Adequacy

## Risk weighted asset movement

The table below contains certain key capital ratios which have been calculated using totals from Table 1 (CET1 capital, total Tier 1 capital and total capital respectively) in conjunction with total risk weighted assets (RWA) of £3,190.3m under IRB (2017: £6,577.6m - Standardised).

TABLE5: Capital ratios	Regulatory requirement	Full implementation CRD IV rules	Regulatory requirement	Full implementation CRD IV rules
	2018 minimum %	2018 actual %	2017 minimum %	2017 actual %
		IRB		Standardised
<b>Capital ratios</b>				
Common Equity Tier 1 ratio	4.5%	31.2%	4.5%	14.5%
Tier 1 ratio	6.0%	31.2%	6.0%	14.5%
Total regulatory capital ratio	8.0%	38.4%	8.0%	15.0%

The tables below show the movements in credit risk weighted assets between 1 January 2018 and 31 December 2018 (together with prior year comparatives) in line with EDTF recommendation 16 and reconciles to total RWA on which the ratios above are based. The increase across all ratios is due to the Society being granted IRB permission.

TABLE 6: Risk weighted assets flow IRB	Residential mortgages £m	Equity release mortgages £m	Commercial mortgages £m	Liquidity £m	Other items £m	Counterparty risk £m	Total £m
<b>Credit RWA at 1 January 2018</b>	5,450.0	65.0	76.3	97.5	65.0	348.8	6,102.6
Change in RWA %	(3,337.7)	0.1	2.4	-	-	-	(3,335.2)
Change in portfolio size	89.8	0.1	(38.2)	12.0	20.1	(19.7)	64.1
<b>Credit RWA at 31 December 2018</b>	2,202.1	65.2	40.5	109.5	85.1	329.1	2,831.5
Operational risk							330.0
Other commitments							22.2
<b>Total risk weighted assets at 31 December 2018</b>							3,183.7

# Capital Adequacy

**TABLE 6: Risk weighted assets flow Standardised**

	Residential mortgages £m	Equity release mortgages £m	Commercial mortgages £m	Liquidity £m	Other items £m	Counterparty risk £m	Total £m
<b>Credit RWA at 1 January 2017</b>	4,811.3	65.0	105.0	68.8	41.3	180.0	5,271.4
Change in RWA %	(8.3)	-	-	0.3	-	-	(8.0)
Change in portfolio size	647.0	-	(28.7)	28.4	23.7	168.8	839.2
<b>Credit RWA at 31 December 2017</b>	5,450.0	65.0	76.3	97.5	65.0	348.8	6,102.6
Operational risk							327.5
Other commitments							147.5
<b>Total risk weighted assets at 31 December 2017</b>							<b>6,577.6</b>

The RWA movement for residential mortgages reflects the growth in residential mortgage balances of £0.9bn and the impact of the move to IRB on the RWA %. The use of the IRB Approach significantly reduces the risk weight used to calculate the RWA, hence the large reduction in RWA in 2018. The fall in the commercial mortgage RWA has been driven by the overall reduction in the portfolio. The above table includes commercial residential RWA's of £14.9m (2017: £15.6m) as well as £25.6m (2017: £60.7m) of commercial RWA's.

## 4.4 Leverage ratio

The tables below and on the following pages show the Society's fully implemented leverage ratio based on the final draft 'Implementing Technical Standards' published by the European Banking Authority in June 2015.

**TABLE 7a: Summary reconciliation of accounting assets and leverage ratio exposures**

	2018 IRB £m	2017 Standardised £m
Total assets as per published financial statements <sup>1</sup>	19,390.1	18,484.0
Tier 1 capital reductions	(29.1)	(7.4)
Less: positive market value of derivatives	(273.4)	(258.6)
Total assets excluding derivatives	19,087.6	18,218.0
Adjustments for derivative financial instruments	372.4	318.2
Adjustments for repurchase agreements	-	-
Mortgage pipeline 2	134.5	397.5
Other committed facilities	-	-
<b>Total leverage ratio exposures</b>	<b>19,594.5</b>	<b>18,933.7</b>

<sup>1</sup> £19,390.1m per financial statements - Tier 1 capital deductions of £29.1m (2017: £18,484.0m - £7.4m)

<sup>2</sup> 2018 calculated as 20% of quoted pipeline (2017: 50%)

# Capital Adequacy

The leverage ratio common disclosure is as follows.

<b>TABLE 7b: Leverage ratio common disclosure</b>	<b>2018 IRB £m</b>	<b>2017 Standardised £m</b>
<b>On-balance sheet exposures (excluding derivatives and repurchase transactions)</b>		
On-balance sheet items (excluding derivatives, repurchase transactions and fiduciary assets, but including collateral)	19,116.7	18,225.4
Asset amounts deducted in determining Tier 1 capital	(29.1)	(7.4)
<b>Total on-balance sheet exposures (excluding derivatives, repurchase agreements and fiduciary assets)</b>	<b>19,087.6</b>	<b>18,218.0</b>
<b>Derivative exposures</b>		
Replacement cost associated with all derivative transactions	160.3	177.7
Add on amounts for Potential Future Exposure (PFE) associated with all derivatives transactions	212.1	140.5
<b>Total derivative exposures</b>	<b>372.4</b>	<b>318.2</b>
<b>Repurchase transaction exposures</b>		
Gross repurchase transaction assets (with no recognition of netting) after adjusting for sales accounting transactions	-	-
<b>Total repurchase transaction exposures</b>	<b>-</b>	<b>-</b>
<b>Other off-balance sheet exposures</b>		
Off-balance sheet exposures at gross notional amount	672.6	794.9
Adjustments for conversion to credit equivalent amounts	(134.5)	(397.4)
<b>Other off-balance sheet exposures</b>	<b>538.1</b>	<b>397.5</b>
<b>Capital and total exposures</b>		
Tier 1 capital	996.1	951.5
Total leverage ratio exposures	19,594.5	18,933.7
<b>Leverage ratio</b>		
Leverage ratio	5.1%	5.0%

The ratios above have been derived from Tier 1 capital figures calculated on a full implementation basis.



# Capital Adequacy

The on-balance sheet exposures can be split as follows.

<b>TABLE 7c: Split of on-balance sheet exposures</b>	<b>2018</b>	2017
	<b>IRB</b>	Standardised
	<b>£m</b>	£m
Total on-balance sheet exposures (excluding derivatives, repurchase transactions and exempted exposures) are fully represented by banking book exposures of which:	<b>19,116.7</b>	18,225.4
Covered bonds	<b>329.3</b>	191.1
Exposures treated as sovereigns	<b>1,880.7</b>	1,967.5
Exposures to regional governments, multilateral development banks, international organisations and public sector entities not treated as sovereigns	<b>237.0</b>	184.0
Exposures to institutions	<b>162.5</b>	261.4
Secured by mortgages on immovable property using IRB	<b>15,430.3</b>	-
IRB exposures in default	<b>116.2</b>	-
Secured by mortgages on immovable property using Standardised Approach	<b>415.0</b>	15,070.0
Standardised exposures in default	<b>11.9</b>	107.2
Other exposures (for example equity, securitisations and other non-credit obligation assets)	<b>533.8</b>	444.2

With a CRR leverage ratio of 5.1% at 31 December 2018 (2017: 5.0%), the Society's risk to excessive leverage continues to be regarded as low.

In 2015 the Bank of England (BoE) issued a Policy Statement on the implementation of a UK leverage ratio. The Society does not have to meet the requirements of this new leverage framework as retail deposits are not in excess of £50bn. However, other stakeholders may expect firms to meet minimum requirements even if not captured by the regulations.

The BoE updated the UK leverage framework in 2017 to increase requirements from 3.0% to 3.25%. At the same time it altered the denominator to exclude assets constituting claims on central banks with a maturity of no longer than three months. The UK leverage ratio is relevant to PRA-regulated banks and building societies with retail deposits equal or greater than £50bn. The Society is therefore not currently captured by the requirements.

Firms in scope will be required to meet a minimum ratio requirement of 3.25% and to confirm that they hold an amount of CET1 capital which is greater than or equal to their countercyclical leverage ratio buffer.

The Society's UK leverage ratio is considerably in excess of the potential 4.15% (minimum plus countercyclical buffer element). The ratio is internally monitored on a monthly basis against risk appetite and proposed regulatory changes.

Factors which have had an impact on the ratio in 2018 include:

- increase in Tier 1 capital through retained earnings;
- issuance of £200m Tier 2 eligible subordinated debt;
- increase in on-balance sheet assets via growth in mortgage balances of £0.9bn

# Credit Risk

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## 5 Credit Risk

### 5.1 Overview

Credit risk is the risk that customers or counterparties will not meet their financial obligations when they are due. The Society faces this risk from its lending operations to retail mortgage customers, commercial mortgage customers, and wholesale counterparties.

Credit risk is divided into retail, commercial (section 5.3) and wholesale (section 5.5). Descriptions of retail, commercial and wholesale credit risk and their mitigation are included in the Principal Risks section of the Annual Report and Accounts for the year ended 31 December 2018 on pages 14 to 21.

### 5.2 Approach to Credit Risk

#### *Credit Risk under the IRB Approach*

The Society uses the IRB Approach for the following credit risk exposure classes:

- Retail mortgages: UK Prime Residential Real Estate, UK Residential Buy to Let and UK Prime Shared Ownership

#### *Credit Risk under the Standardised Approach*

The Society uses the Standardised Approach for the following credit risk exposure classes:

- Exposures to Central Governments and Central Banks
- Exposures to Institutions
- Exposures to Corporates (UK Housing Association Mortgages and UK Commercial Real Estate)
- UK Self Certified Residential Real Estate
- UK Sub-Prime Residential Real Estate
- Gibraltar Prime Residential Real Estate
- Spain Residential Real Estate
- UK Equity Release Mortgages
- Equity Exposures
- Items Representing Securitisation Positions
- Other Non-Credit Obligation Assets

# Credit Risk

## 5.3 Retail and commercial credit risk

The Society's exposure to retail and commercial credit risk is summarised as follows:

<b>TABLE 8: Retail and commercial credit risk</b>	Average £m	<b>2018</b> £m	2017 £m
<b>IRB Approach</b>			
Prime	9,252.8	<b>9,296.2</b>	9,209.5
Buy to let	4,237.7	<b>4,688.1</b>	3,787.3
Shared ownership	1,537.9	<b>1,562.3</b>	1,513.4
<b>Standardised Approach</b>			
Overseas	163.3	<b>79.0</b>	247.6
Other	176.7	<b>179.2</b>	174.2
<b>Retail mortgages</b>	<b>15,368.4</b>	<b>15,804.8</b>	14,932.0
<b>Standardised Approach</b>			
Commercial lending	51.2	<b>30.8</b>	71.6
Other loans	177.7	<b>170.0</b>	185.3
<b>Total gross exposure (contractual amounts)</b>	<b>15,597.3</b>	<b>16,005.6</b>	15,188.9
Impairment & fair value adjustment	24.7	<b>27.8</b>	21.6
<b>Total net exposures</b>	<b>15,622.0</b>	<b>16,033.4</b>	15,210.5

### Residential credit risk

This risk is overseen by a specialist retail Credit Risk Function, reporting to the Chief Risk Officer, with oversight from BRC. The Society's Credit Policy is approved annually by the Board and is reviewed on an ongoing basis by the BRC, and details the current limit structures in respect of mortgage lending and reflects the Society's current risk appetite. The BRC also receives management information, highlighting the performance of the Society's mortgage portfolio.

With regard to new lending, residential credit risk is managed using the following tools:

- Credit scorecard assessment;
- Affordability assessment based on income and expenditure;
- Stressed interest rates;
- Access to credit data, including the credit history of an individual;
- Independent expert appraisal of the suitability and value of a property; and
- Underwriting processes, which are a hybrid of computer systems and suitably qualified underwriters.

The Society's retail credit risk function monitors the performance of the portfolio, including stress testing, on an ongoing basis. This identifies trends and facilitates understanding of the portfolio, which is used to assess whether the current risk appetite remains appropriate. If a borrower's financial situation starts to deteriorate, the Society has established procedures to respond appropriately.

The Society has a dedicated Collections function, which seeks to engage with customers, at an early stage, to discuss potential financial difficulties. Forbearance options are determined on a case by case basis, with the aim of working with borrowers to clear arrears. The Society is able to offer customers an appropriate range of options, including an extension

# Credit Risk

of the mortgage term, a temporary change to interest only, deferral of interest, reduced monthly repayments, transfer to an alternative product or a special interest rate (subject to meeting criteria). After all other options have been exhausted, the Society may take possession of the mortgaged property. Analysis of the Society's residential portfolio and forbearance activity is used to inform the provisioning policy. This ensures that the Society properly recognises losses, in accordance with its accounting policies.

## Exposures by geographic region

The Group's geographical concentration of residential mortgage loans is as follows.

TABLE9: Retail mortgages by region	2018	2018	2017	2017
	£m	%	£m	%
<b>Retail regional analysis</b>				
South East	2,987.2	18.9%	2,807.1	18.8%
Greater London	2,544.6	16.1%	2,448.8	16.4%
Midlands	2,402.3	15.2%	2,224.9	14.9%
Yorkshire and Humberside	1,517.3	9.6%	1,478.3	9.9%
South West	1,375.0	8.7%	1,254.3	8.4%
North West	1,327.6	8.4%	1,209.5	8.1%
Scotland	1,248.6	7.9%	1,090.0	7.3%
East of England	790.2	5.0%	731.7	4.9%
North East	616.4	3.9%	582.3	3.9%
Wales	489.9	3.1%	448.0	3.0%
Northern Ireland	410.9	2.6%	373.3	2.5%
Republic of Ireland	-	-	164.3	1.1%
Spain	79.0	0.5%	89.6	0.6%
Other	15.8	0.1%	29.9	0.2%
<b>Total</b>	<b>15,804.8</b>	<b>100.0%</b>	<b>14,932.0</b>	<b>100.0%</b>

# Credit Risk

## Retail maturity profile

TABLE 10: Retail maturity

	2018			Total £m
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	
<b>Asset classes</b>				
Secured by mortgages on immovable property	38.0	478.5	15,260.6	15,777.1

The table above includes impairment of £27.7m.

TABLE 10: Retail maturity

	2017			Total £m
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	
<b>Asset classes</b>				
Secured by mortgages on immovable property	50.1	422.5	14,435.8	14,908.4

The table above includes impairment, fair value, EIR and hedging adjustments of £23.6m.

## Commercial mortgage risk

Although the Society closed its commercial lending operations to new business in 2008, management has retained a team of appropriately skilled colleagues, to implement the exit strategy from this asset class. This function has also been supported by the Risk Function, which provides second line oversight of the performance and management of the portfolio. All loans continue to be assessed on a case by case basis, using a broad range of potential impairment indicators. If a loan is deemed impaired the Society uses a combination of formal recovery action and appropriate forbearance, through loan extensions, restructures or property sales, to reduce the risk and minimise losses. Similar to residential credit exposures, analysis of the commercial portfolio and forbearance measures informs the Society's provisioning policy. Over recent years, the Society has made significant provisions against its commercial portfolio, which has ensured that impairment and losses have been recognised in accordance with its accounting policies. The following tables include commercial assets only, they do not include the £14.9m (2017: £15.6m) of commercial loans secured on residential property.

# Credit Risk

## Commercial exposures by sector

The table below provides an overview of the sectoral split of the Society's commercial loan portfolio:

<b>TABLE 11: Commercial exposures by sector</b>	<b>2018</b>	<b>2018</b>	2017	2017
	<b>£m</b>	<b>%</b>	£m	%
<b>Sector</b>				
Retail	18.6	60.4%	21.2	29.5%
Offices	1.1	3.6%	24.6	34.4%
Commercial investment and industrial units	8.7	28.2%	20.5	28.7%
Leisure and hotel	0.4	1.2%	2.9	4.0%
Other, including mixed use	2.0	6.6%	2.4	3.4%
<b>Total</b>	<b>30.8</b>	<b>100.0%</b>	71.6	100.0%

## Commercial exposures by geographic region

The table below shows the commercial loan portfolio which remains relatively diverse on a regional basis though the reducing value of the book may increase proportional concentrations.

<b>TABLE 12: Commercial exposures by region</b>	<b>2018</b>	<b>2018</b>	2017	2017
	<b>£m</b>	<b>%</b>	£m	%
<b>Commercial regional analysis</b>				
South East	6.4	20.8%	16.7	23.3%
Yorkshire and Humberside	0.8	2.6%	19.0	26.7%
North West	12.5	40.6%	16.2	22.6%
Greater London	0.1	0.3%	0.1	0.1%
Scotland	0.1	0.3%	6.7	9.4%
Midlands	3.5	11.4%	4.3	5.9%
Wales	4.0	13.0%	4.1	5.7%
North East	0.8	2.6%	0.8	1.1%
East of England	1.5	4.9%	2.5	3.5%
South West	0.9	2.9%	1.0	1.4%
Gibraltar	0.2	0.6%	0.2	0.3%
<b>Total</b>	<b>30.8</b>	<b>100.0%</b>	71.6	100.0%

# Credit Risk

## Commercial maturity profile

The table below provides an overview of the contractual maturity profile of the Society's commercial loan portfolio.

TABLE 13: Commercial exposures by maturity	2018			Total £m
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	
<b>Asset classes</b>				
Secured by mortgages on immovable property	17.1	0.3	13.4	30.8
	2017			Total £m
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	
<b>Asset classes</b>				
Secured by mortgages on immovable property	22.1	37.4	12.1	71.6

## 5.4 IRB Models

### Overview

As part of its calculation of capital requirements for credit risk, Leeds Building Society uses a suite of IRB models developed for, and applied to, its retail UK exposures defined in section 5.2. The Society was granted its IRB permissions by the PRA with effect from 1st July 2018 with no pre- or post- conditions of use specified. The models are described in this section.

In addition to driving the calculation of regulatory capital requirements, the Society's IRB models support the Society's business operations in a number of key areas. Examples include credit decisioning, portfolio management, product pricing, forecasting and stress testing, expected credit losses for impairment, and the development of strategic risk appetite.

### Model Risk Management of the IRB Ratings System

The discriminatory performance and accuracy of the Society's IRB model suite is regarded as critical, in terms of the calculation credit risk capital requirements, and wider use of model estimates in risk management practices. As part of its Enterprise Risk Management Framework (ERMF) the Society operates a structured and proportionate approach to model risk management and has operated industry good practice and well-defined disciplines to its credit risk related models for a number of years, as evidenced through confirmation of its IRB permission and successful delivery of its IFRS9 project during 2018. For more detail on the ERMF please see the Board Risk Committee Report on pages 66 to 70 of the Annual Report and Accounts.

In terms of model governance, all IRB related models are required to have a Model Owner, and a Model Output Owner. The Model Owner resides in the Credit Risk Control Unit as defined in the Capital Requirements Regulation, and the Model Output Owner in the first line of defence.

All models developed for IRB purposes are defined as Very High Materiality under Model Risk Policy. As a result, they must be:

# Credit Risk

- Developed in accordance with Model Risk Policy and associated model standards, and attested against all pertinent prudential regulation and guidance.
- Independently reviewed by an external team of specialists.
- Reviewed and recommended by the Credit Models Working Group, the Society's technical model review forum.
- Approved by the Society's Designated Committee, the Models and Rating System Committee.

Performance of approved models is monitored monthly by the Credit Risk Control Unit, and reported in detail to the Credit Models Working Group bi-monthly. The Models and Rating System Committee meet at least six times per year and review summarised reporting against approved Key Performance Indicators, designed in accordance with the Society's model validation framework.

All IRB models are subject to full annual review, an external independent review, and re-approval by the Models and Rating System Committee, in accordance with prudential regulation. Internal Audit also performs a full program of third line annual IRB assurance activity.

## Key Features of IRB Models

The IRB models and their key features are summarised as follows:

• Probability of Default (PD)	Exposures are placed into long run PD rating grades based upon application / behavioural scores, Loan to Value and Arrears Status. Each rating grade is assigned a regulatory PD. Exposures may subsequently migrate across grades over time.
• Loss Given Default (LGD)	Deterministic models predicting propensity for possession (given default), movements in property values, property value haircuts and costs incurred – in current and downturn conditions.
• Exposures at Default (EAD)	Deterministic model predicting exposure at the point of default taking into account balance and interested accrued – in current and downturn conditions.

These form the base inputs to the regulatory risk weight function, in order to derive Pillar 1 risk weighted assets at account level. Thereafter, minimum capital requirements are calculated as 8% of risk weighted assets, reflecting to credit risk capital required to cover unexpected losses attributed to the portfolio.

Expected losses are also derived by multiplying PD, LGD and EAD together, both on a point in time and downturn basis. These reflect losses which the Society expects to lose as a result of customers default across the course of an economic cycle. Where such expected losses exceed accounting provisions, the excess of expected losses is deducted from CET1 capital.

## IRB Model Performance

This section provides an overview of the performance of the IRB models over the course of 2018.

<b>TABLE 14a: IRB Model Performance</b>	<b>Predicted PD</b>	<b>Observed PD</b>	<b>Predicted LGD</b>	<b>Observed LGD</b>
<b>2018</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
<b>Prime</b>	<b>0.35%</b>	<b>0.33%</b>	<b>2.93%</b>	<b>2.68%</b>
<b>Buy to let</b>	<b>0.15%</b>	<b>0.15%</b>	<b>7.72%</b>	<b>5.81%</b>
<b>Shared ownership</b>	<b>0.50%</b>	<b>0.53%</b>	<b>3.10%</b>	<b>2.46%</b>
<b>Total</b>	<b>0.32%</b>	<b>0.31%</b>	<b>3.78%</b>	<b>3.17%</b>



# Credit Risk

Loss Given Default estimates continue to be consistent over time. There have been no material changes to the operational collections and recoveries processes, and the models fully reflect the forced sales processes and costs involved in litigation / possession activity.

Observed PD is broadly in line with predicted PD. Observed LGD shows some variance to the predicted values. The LGD model is designed to consider the broad range of potential debt management actions in the possession and recovery process. As a result, estimates include elements of conservatism in order to recognise the potential costs of recovery actions and time taken to manage individual cases through to conclusion.

## Credit Risk Mitigation

The Society's main source of collateral, and therefore means of mitigating credit risk, held against the IRB portfolios is residential property. All mortgage lending activity is supported by an appropriate form of valuation conducted by an independent firm of valuers or, for lower LTV lending (criteria), an automated valuation model. The table below shows residential lending exposure by PD scale.

TABLE 14b: Residential lending exposures	Original on- balance sheet gross exposure	Off-balance sheet exposures pre-CCF	EAD post CRM and post-CCF	Average PD	Number of obligors	Average LGD	RWA	RWA density	EL	Provision
	£m	£m	£m				£m			£m
<b>PD scale</b>										
0.00 to < 0.15	1,531.6	-	1,531.6	0.1	15,409	15.4%	54.8	3.58%	0.2	
0.25 to < 0.50	4,227.4	15.1	4,227.4	0.4	28,894	28.9%	217.4	5.14%	1.2	
0.50 to < 0.75	4,459.0	51.7	4,459.0	0.6	50,794	50.8%	449.7	10.09%	2.9	
0.75 to < 2.50	3,934.4	60.6	3,934.4	1.6	40,064	40.1%	689.1	17.51%	6.5	
2.50 to < 10.00	1,109.9	7.1	1,109.9	5.1	12,671	12.7%	394.2	35.52%	6.0	
10.00 to < 100.00	168.0	-	168.0	52.6	1,152	1.2%	68.6	40.83%	5.9	
100.00 (default)	116.2	-	116.2	100.0	2,328	2.3%	167.5	144.16%	2.4	
<b>Total</b>	<b>15,546.5</b>	<b>134.5</b>	<b>15,546.5</b>	<b>2.4</b>	<b>151,312</b>	<b>35.0%</b>	<b>2,041.3</b>	<b>36.7%</b>	<b>25.1</b>	<b>18.1</b>

# Credit Risk

## 5.5 Wholesale credit risk

A description of wholesale credit risk and its mitigation are included in the Principal Risks section of the Annual Report and Accounts for the year ended 31 December 2018 on pages 14 to 21.

### Short-term investments

The split of the Society's wholesale investments into the assigned credit quality steps for short and long term investments is set out in the tables below.

			2018		2017	
			Exposure £m	Risk weight %	Exposure £m	Risk weight %
Credit quality step	Fitch rating	Moody's rating				
1	AAA to AA-	Aaa to Aa3	1,493.8	0.6%	1,822.4	0.7%
2	A+ to A-	A1 to A3	102.3	20.0%	111.4	20.0%
3	BBB+ to BBB-	Baa1 to Baa3	-	-	7.0	20.0%
4	BB+ to BB-	Ba1 to Ba3	-	-	-	-
5	B+ to B-	B1 to B3	-	-	-	-
6	CCC+ and below	Caa1 and below	-	-	-	-
Unrated	Unrated	Unrated	-	-	80.4	20.0%
<b>Total short term investments</b>			<b>1,596.1</b>		<b>2,021.2</b>	

The unrated items above represent London Clearing House (LCH) collateral.

### Long-term investments

			2018		2017	
			Exposure £m	Risk weight %	Exposure £m	Risk weight %
Credit quality step	Fitch rating	Moody's rating				
1	AAA to AA-	Aaa to Aa3	1,202.1	11.6%	737.1	6.8%
2	A+ to A-	A1 to A3	-	-	-	-
3	BBB+ to BBB-	Baa1 to Baa3	-	-	-	-
4	BB+ to BB-	Ba1 to Ba3	-	-	-	-
5	B+ to B-	B1 to B3	-	-	-	-
6	CCC+ and below	Caa1 and below	-	-	-	-
Unrated	Unrated	Unrated	-	-	1.7	20.0%
<b>Total long term investments</b>			<b>1,202.1</b>		<b>738.8</b>	

The Society has nominated two External Credit Assessment Institutions (ECAIs) to assign credit quality steps for short and long term investments: Moody's Investors Service (Moody's) and Fitch Group (Fitch). There have been no changes to the ECAIs during the year.

# Credit Risk

## Exposures by asset class

The split of the Society's total wholesale investments by asset class is set out in the table below.

TABLE 17: Wholesale exposures by asset class	2018		2018		
	Average Exposure £m	Average RWA %	Year end £m	RWA £m	Weighted average RWA %
<b>Asset class</b>					
Central governments or central banks	1,924.1	-	1,880.7	-	-
Public sector entities	89.2	-	125.2	-	-
Multilateral development banks	121.3	-	111.8	-	-
Institutions	212.0	20.0%	162.5	32.5	20.0%
Covered bonds	260.2	10.0%	329.3	32.8	10.0%
Securitisation positions	172.4	20.3%	188.7	37.8	20.5%
<b>Total</b>	<b>2,779.2</b>		<b>2,798.2</b>	<b>103.1</b>	

	2017		2017		
	Average Exposure £m	Average RWA %	Year end £m	RWA £m	Weighted average RWA %
<b>Asset class</b>					
Central governments or central banks	1,748.2	-	1,967.5	-	-
Public sector entities	59.9	5.1%	53.2	-	-
Multilateral development banks	151.9	-	130.8	-	-
Institutions	197.0	20.0%	261.4	52.3	20.0%
Covered bonds	143.3	10.1%	191.1	19.1	10.0%
Securitisation positions	146.4	20.0%	156.0	31.2	20.0%
<b>Total</b>	<b>2,446.7</b>		<b>2,760.0</b>	<b>102.6</b>	

# Credit Risk

## Exposures by geographic region

The split of the Society's total wholesale investments by geographical region is set out in the table below.

TABLE 18: Wholesale exposures by geographical region	2018						Total £m
	UK £m	Europe £m	Europe supra- national £m	North America £m	Global supra- national £m	Far East £m	
<b>Asset class</b>							
Central governments or central banks	1,880.7	-	-	-	-	-	1,880.7
Public sector entities	-	125.2	-	-	-	-	125.2
Multilateral development banks	-	-	44.8	-	67.0	-	111.8
Institutions	119.9	18.1	-	24.5	-	-	162.5
Covered bonds	329.3	-	-	-	-	-	329.3
Securitisation positions	188.7	-	-	-	-	-	188.7
<b>Total</b>	<b>2,518.6</b>	<b>143.3</b>	<b>44.8</b>	<b>24.5</b>	<b>67.0</b>	<b>-</b>	<b>2,798.2</b>
	2017						Total £m
	UK £m	Europe £m	Europe supra- national £m	North America £m	Global supra- national £m	Far East £m	
<b>Asset class</b>							
Central governments or central banks	1,967.5	-	-	-	-	-	1,967.5
Public sector entities	-	53.2	-	-	-	-	53.2
Multilateral development banks	-	-	56.7	-	53.0	21.1	130.8
Institutions	217.9	36.0	-	7.5	-	-	261.4
Covered bonds	191.1	-	-	-	-	-	191.1
Securitisation positions	156.0	-	-	-	-	-	156.0
<b>Total</b>	<b>2,532.5</b>	<b>89.2</b>	<b>56.7</b>	<b>7.5</b>	<b>53.0</b>	<b>21.1</b>	<b>2,760.0</b>

# Credit Risk

## Residual maturity profile

The split of the Society's total wholesale investments by maturity profile is set out in the table below.

TABLE 19: Wholesale exposures by residual maturity	2018			Total £m
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	
<b>Asset class</b>				
Central governments or central banks	1,855.7	25.0	-	1,880.7
Public sector entities	56.6	68.6	-	125.2
Multilateral development banks	17.0	94.8	-	111.8
Institutions	162.5	-	-	162.5
Covered bonds	20.0	309.3	-	329.3
Securitisation positions	-	10.0	178.7	188.7
<b>Total</b>	<b>2,111.8</b>	<b>507.7</b>	<b>178.7</b>	<b>2,798.2</b>

	2017			Total £m
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	
<b>Asset class</b>				
Central governments or central banks	1,795.1	172.4	-	1,967.5
Public sector entities	11.1	42.1	-	53.2
Multilateral development banks	21.0	109.8	-	130.8
Institutions	259.7	-	1.7	261.4
Covered bonds	36.0	150.7	4.4	191.1
Securitisation positions	-	10.0	146.0	156.0
<b>Total</b>	<b>2,122.9</b>	<b>485.0</b>	<b>152.1</b>	<b>2,760.0</b>

# Credit Risk

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## *Counterparty credit risk in relation to derivatives and repurchase transactions*

Counterparty credit risk in relation to derivatives is the risk that a counterparty could default and the Society has to replace positively valued swaps at current market prices. This risk is mitigated by offsetting the amounts due to the same counterparties (netting benefits) and by cash and securities deposited by some counterparties (collateral held) under a Credit Support Annex (CSA).

Derivatives are contracts or arrangements that are valued in accordance with the mark to market method as outlined within CRR Article 274. Valuations are derived from one or more underlying price, rate or index inherent in the contract or arrangement, such as interest rates, exchange rates or stock market indices. As a member of ISDA, the Society benefits from the netting of counterparty credit exposures, including collateral, when calculating its counterparty exposure. Derivatives are only used by the Society in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates, or other factors of a prescribed nature that affect the business. Accordingly, such instruments are not used in trading activity or for speculative purposes.

CSAs exist for collateralising derivative transactions with counterparties to which the Society has derivative exposures in order to mitigate the risk of loss on default. The CSAs allow margin calls to be made on the net mark-to-market value of derivative exposures with a particular counterparty. CSAs are taken into consideration when calculating credit risk exposure for derivative counterparties, and the Society does recognise the risk mitigating effect of these CSAs in its Pillar 1 capital requirement calculations.

Through 2018, the Society monitored its collateral positions on a daily basis, with all collateral being transacted in line with the agreed terms of its CSAs, and taking the form of cash in most cases (although some collateral received is now in the form of securities).

Under the Society's two client clearing agreements, the Society may be required to provide additional collateral of 20% or 50% of initial margin based on the internal risk methodologies of the clearing counterparty.

The Society may from time to time enter into repurchase agreements (repos) with counterparties with whom the Society has both a Global Master Repurchase Agreement (GMRA) and an active credit line in place. The credit risk that arises from such a transaction is managed under the terms of the GMRA through the monitoring and appropriate transfer of collateral.

The exposure to repos is measured by calculating the difference between the value of the asset repurchased and the cash received from the counterparty. Repos are not included as assets on the statutory balance sheet but are relevant for both counterparty credit risk and leverage purposes (see also notes 7a and 7b).

At 31 December 2018 the Society had no exposure to repos (2017: £nil).

'Wrong way' risk may occur when an exposure to a counterparty is adversely correlated with the credit quality of the counterparty. The Society has no 'wrong way' risk exposure and no appetite for such exposures.

# Credit Risk

The following tables show the Society's exposure to counterparty credit risk for derivative contracts as at 31 December 2018

<b>TABLE 20: Counterparty Credit Risk for derivative contracts</b>	<b>2018 Notional £m</b>	<b>2018 Exposure £m</b>	2017 Notional £m	2017 Exposure £m
<b>Centrally cleared derivative contracts</b>				
Interest rate contracts	21,641.7	60.4	13,424.6	47.0
Floating sw aps	1,339.0	1.3	1,589.0	2.3
<b>Bilateral contracts</b>				
Interest rate contracts	1,616.5	17.9	1,923.9	30.6
Equity release and equity sw aps	79.4	-	109.3	4.7
Cross currency sw aps	1,933.3	193.8	1,968.5	173.0
Bank base rate sw aps	-	-	905.5	0.9
<b>Gross positive fair value of contracts</b>	<b>26,609.9</b>	<b>273.4</b>	<b>19,920.8</b>	<b>258.5</b>
Netting benefits and collateral		(113.1)		(80.8)
<b>Replacement cost of derivatives</b>		<b>160.3</b>		<b>177.7</b>
Potential future credit exposure		212.1		140.5
<b>Derivative exposure including potential future credit exposure</b>		<b>372.4</b>		<b>318.2</b>

# Credit Risk

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## 5.6 Impairment of financial assets

### *Impairment provision*

Impairment losses are calculated for all financial assets held at amortised cost or at FVOCI. Loss provisions are also held against undrawn loan commitments, where a loan offer has been issued to a customer and remains unexpired but the loan has not yet completed and so has not yet been recognised in the Statement of Financial Position.

Impairment losses are calculated on an expected credit loss (ECL) basis. Financial assets are classified individually into one of three stages, as follows:

- Stage 1 – assets are allocated to this stage on initial recognition and remain in this stage if there is no significant increase in credit risk since initial recognition. Impairment losses are recognised to cover 12 month ECL, being the proportion of lifetime ECL arising from default events expected within 12 months of the reporting date.
- Stage 2 – assets where it is determined that there has been a significant increase in credit risk since initial recognition, but where there is no objective evidence of impairment. Impairment losses are recognised to cover lifetime ECL.
- Stage 3 – assets where there is objective evidence of impairment, i.e. they are considered to be in default. Impairment losses are recognised to cover lifetime ECL.

If a loss is ultimately realised, it is written off against the provision previously made. Any subsequent recoveries are recognised directly in the Income Statement as they arise.

The primary driver in determining whether an individual loan has had a significant increase in credit risk is a quantitative assessment of the increase in lifetime probability of default (PD). At each reporting date, lifetime PD is recalculated and compared to the lifetime PD calculated on initial recognition. The loan is allocated to Stage 2 if the lifetime PD has increased over a pre-determined threshold which is set using a test based approach and expressed as a percentage increase, segmented by product type and risk banding at the date of initial recognition.

In addition to the above, a number of qualitative criteria have been set such that loans which are considered to have a significantly increased credit risk but would not be captured above are moved to Stage 2. These qualitative criteria include loans which have reached the end of their contractual term and loans where the customer has been identified as bankrupt but is not in arrears. A backstop is also in place such that all loans which are 30 days past due are moved to Stage 2.

Individual loans are considered to be in default and are allocated to Stage 3 if the loan is more than 90 days past due, is subject to certain forbearance activities, is in possession or if the customer has been identified as bankrupt and is in arrears by more than a nominal amount. A cure period is in place such that the loan would move back to Stage 2 if the loan remains not in default for 12 months or for loans subject to forbearance, if 12 consecutive full payments are made after the forbearance activity has completed.

ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). Each element of the calculation is modelled at individual account level on a monthly basis over the remaining life of the loan, with the first 12 months totalled to obtain the 12 month ECL and the lifetime ECL obtained by totalling the above over the



# Credit Risk

full life of the loan. Modelling assumptions are based on historical data analysis of the impact of economic variables on loan behaviour. These assumptions are then applied to the forecast economic scenarios to predict future loan behaviour.

Under IAS 39, impairment loss provisions were calculated on an incurred loss model, whereby provisions were recognised once an impairment 'trigger' event had been identified. IFRS 9 changes this model to an expected credit loss (ECL) model which incorporates forward looking information such that when a financial asset is first recognised, an impairment loss provision is made for the expected losses from defaults over the following 12 months (12 month ECL). If, at a later time, the Group determines that there has been a significant increase in the credit risk of the asset, this impairment loss is increased to cover the expected losses over the whole life of the asset (lifetime ECL). This change in the calculation of impairment losses results in earlier recognition of credit losses in the financial statements but does not change the amount of the eventual loss suffered.

The following table shows impairment provisions on loans and advances to customers.

**TABLE 21: Movement in impairment provisions**

2018	Loans fully secured on residential property	Loans fully secured on land	Other loans	Total
	£m	£m	£m	£m
At 1 January 2018 (*)	50.2	17.2	2.5	69.9
Charge / (release) for the year	3.0	(3.6)	-	(0.6)
Amount written off during the year	(4.2)	(9.6)	-	(13.8)
Release of provision held against loans sold during the year	(21.3)	-	-	(21.3)
<b>At 31 December 2018</b>	<b>27.7</b>	<b>4.0</b>	<b>2.5</b>	<b>34.2</b>
Income Statement				
Charge / (released) for the year	3.0	(3.6)	-	(0.6)
Recoveries of amounts previously written off	(0.6)	-	-	(0.6)
<b>Total income statement losses / (gains)</b>	<b>2.4</b>	<b>(3.6)</b>	<b>-</b>	<b>(1.2)</b>

(\*) The Group adopted IFRS 9 – Financial Instruments with effect from 1 January 2018 and the figures in the above table are presented on this basis. A reconciliation between the closing impairment loss provision under IAS 39 at 31 December 2017 and opening impairment loss provision under IFRS 9 at 1 January 2018 can be found on pages 170 to 175 of the Annual Report and Accounts.

# Credit Risk

<b>TABLE 21: Movement in impairment provisions</b>	Loans fully secured on residential property	Loans fully secured on land	Other loans	Total
2017	£m	£m	£m	£m
At 1 January 2017				
Collective impairment	11.9	5.6	-	17.5
Individual impairment	14.1	20.1	2.5	36.7
<hr/>				
Opening impairment	26.0	25.7	2.5	54.2
Income Statement				
Charge/(release) for the year				
Collective impairment	(3.9)	(2.0)	-	(5.9)
Individual impairment	6.4	(4.9)	-	1.5
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(1.1)	-	-	(1.1)
<hr/>				
Total Income Statement losses / (gains)	1.4	(6.9)	-	(5.5)
Amount written off during the year				
Individual impairment	(3.6)	(1.6)	-	(5.2)
At 31 December 2017				
Collective impairment	8.0	3.6	-	11.6
Individual impairment	15.8	13.6	2.5	31.9
<hr/>				
Closing impairment	23.8	17.2	2.5	43.5

The impairment provisions for the Society's Spanish portfolio included in the above tables in the 2018 data are £7.3m (2017: Spain £4.5m and Ireland £10.1m). The Irish portfolio was sold in 2018. Further detail of the sale can be found on page 132 of the Annual Report and Accounts. The remainder of the provision balance relates to UK loans.

# Credit Risk

In 2017 loans in the analysis below which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears or for which a loss event has occurred.

<b>Group and Society</b>	<b>2018</b>	<b>2018</b>	2017	2017
	<b>£M</b>	<b>%</b>	£M	%
- Not past due	15,552.2	98.4	14,613.0	97.8
- Past due up to 3 months	190.8	1.2	221.6	1.4
- Past due 3 to 6 months	28.5	0.2	38.6	0.3
- Past due 6 to 12 months	18.4	0.1	22.5	0.2
- Past due over 12 months	9.5	0.1	28.1	0.2
- Possessions	5.4	-	8.2	0.1
<b>Total gross exposure</b>	<b>15,804.8</b>	<b>100.0</b>	14,932.0	100.0

Of the loans and advances secured on residential property in Spain £11.7m (2017: £11.2m) are past due and £0.5m (2017: £0.6m) are in possession.

<b>Group and Society</b>	<b>2018</b>	<b>2018</b>
	<b>£M</b>	<b>%</b>
- Not past due	<b>30.8</b>	<b>100.0</b>
	2017	2017
<b>Group and Society</b>	£M	%
<b>Not impaired:</b>		
- Neither past due nor impaired	32.8	45.7
<b>Impaired:</b>		
- Not past due but impaired	34.8	48.6
- Possessions	4.0	5.7
<b>Total gross exposure</b>	71.6	100.0

The Society does not have any impaired wholesale counterparty exposures (2017: £nil).

# Market Risk

## 6 Market Risk

### 6.1 Market risk overview

Market risk is the risk that the value of, or income arising from, the Society's assets and liabilities changes adversely due to movements in market prices, or rate changes. The Society does not currently have a Pillar 1 exposure to market risk.

#### *Daily operational management*

On a daily basis, the Society's exposure to market risk is managed by the Treasury Function, in line with Board approved limits. Market risk is measured and reported using a variety of techniques, including interest rate repricing, gap analysis, duration, market value and earnings sensitivity analysis under a series of different rate scenarios.

Risk Type	Reporting measure
Interest rate risk	Value at risk
Basis risk	Earnings at risk
Foreign exchange risk	Sensitivity
Price risk	N/A
Product option risk	Against limits

### 6.2 Interest rate risk

Under the PRA handbook for CRR firms (interest risk arising from non-trading book activities), the Society carries out evaluations of sudden and unexpected 200 basis points (bps) change in interest rates in both directions and reports to the PRA if the results of the analysis show that the economic value of the Society would decline by more than 20% of Total Regulatory Capital.

Interest rate risk is addressed in the Principal Risks section of the Annual Report and Accounts for the year ended 31 December 2018 on pages 14 to 21.

The table below details the Society's sensitivity to a 200bps change in interest rates, at 31 December 2018, with all other variables held constant. A positive number indicates an increase in earnings or market value.

TABLE 24: Interest rate sensitivity	Annual earnings sensitivity			
	2018		2017	
	+200 bps £m	-200 bps £m	+200 bps £m	-200 bps £m
Annual earnings sensitivity	52.6	(27.5)	52.4	(18.9)
	Market value sensitivity			
	2018		2017	
	+200 bps £m	-200 bps £m	+200 bps £m	-200 bps £m
Market value sensitivity	(12.4)	2.0	(9.9)	6.4

# Market Risk

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The above sensitivities include a zero rate floor assumption.

The Society also runs stochastic Earnings at Risk (EaR) model to measure interest rate risk. The 12 month EaR exposure at 31 December 2018 is £8.0m (2017: £4.2m). The EaR exposure is monitored on a monthly basis.

The Society also undertakes interest rate gap and market value risk analysis. This is performed three times per week and the key interest rate risk assumptions are:

- mortgage pipeline business is assumed as a percentage of applications and percentage of offers based on historical experience. Completion of the pipeline is assumed over the next six months;
- variable rate non-maturity savings balances are assumed to reprice in one month and one day; and
- contractual prepayment assumptions are inherent within the gap and market value risk reporting.

The Society has set optionality limits to minimise the potential impact from fixed rate mortgage and savings balances which have penalty free access. Additional reporting is also undertaken on a quarterly basis to monitor historic utilisation of fixed rate mortgage and savings optionality, as well as the potential future exposure of mortgage optionality.

## 6.3 Foreign currency risk

Currency risk is addressed in the Principal Risks section of the Strategic Report of the Annual Report and Accounts for the year ended 31 December 2018 on pages 14 to 21.

## 6.4 Price risk

The Society's policy is to have no material exposure to equity markets. Any exposures arising from the Society's products are eliminated, as far as it is practicable, by appropriate hedging contracts.

# Market Risk

## 6.5 Derivatives

The main derivatives used by the Society (as set out in Table 20) are interest rate contracts.

The table below describes the significant activities undertaken by the Society, the related risks associated with such activities that are hedged by the Society and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on balance sheet instruments or natural hedges that exist within the Society balance sheet. There are other risks present in the below activities, for example sensitivity to changes in house prices, however these are not hedged by the Society.

Activity	Risk	Type of Derivative
Fixed rate savings products	Sensitivity to changes in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay fixed interest rate swaps (fair value hedge)
Fixed rate wholesale funding	Sensitivity to changes in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate asset investments	Sensitivity to changes in interest rates	Pay fixed interest rate swaps (fair value hedge)
Equity release mortgages	Sensitivity to changes in interest rates	Pay fixed interest rate swaps
Investment and funding in foreign currency	Sensitivity to changes in foreign exchange rates	Cross currency interest rate swaps and foreign exchange contracts
Issuance of debt securities on different interest bases	Sensitivity to divergence between interest rate bases	Pay floating receive floating interest rate swaps

Derivatives for use in hedge relationships are entered into only when the underlying position being hedged contains the same risk features. The derivatives used will match the risks of the underlying asset or liability and therefore hedge the associated market risk. Certain financial instruments (including retail products) contain features that are similar to derivatives and in these cases risk is managed by entering derivative contracts that have matching features.

All derivatives entered in to by the Society are used for hedging economic purposes, however, not all are designated as accounting hedges. In these cases natural offsets can be achieved. These types of hedge are only entered in to where a high degree of effectiveness can be achieved.

## 6.6 Liquidity risk

The Society's management of liquidity and funding risks aims to ensure that at all times there are sufficient liquid assets, both as to amount and quality, to cover cash flow mismatches and fluctuations in funding, to retain stakeholder confidence and to meet financial obligations as they fall due, even during stressed conditions.

This is achieved through management and stress testing of business cash flows, setting appropriate risk limits to maintain a prudent funding mix and maturity profile, and maintaining sufficient levels of high quality liquid assets and appropriate encumbrance levels.

## Market Risk

For further details of the management of liquidity and funding risk see the Principal Risk section of the Annual Report and Accounts for the year ended 2018 on pages 14 to 21.

The Prudential Regulation Authority (PRA) monitors liquidity under the CRD IV framework using two measures. The Liquidity Coverage Ratio (LCR) is a measure of short term liquidity and the Net Stable Funding Ratio (NSFR) is a measure of liquidity over a longer horizon.

Based on the final LCR rules, the Society's LCR is 214% at the end of the year (2017: 198%), compared to the regulatory minimum of 100%. The 12-month average LCR position over 2018 is presented below:

TABLE 25: Liquidity Coverage Ratio	12-month weighted average value			
	31 March 2018	30 June 2018	30 September 2018	31 December 2018
	£m	£m	£m	£m
Liquidity buffer	2,485.8	2,681.7	2,786.8	2,846.8
Total net cash outflows	1,197.7	1,239.3	1,226.6	1,241.0
Liquidity Coverage Ratio	211%	217%	228%	230%

With regards the NSFR, a final European NSFR standard has not yet been published. However, based on the Society's current interpretations, the NSFR is 144.8% (2017: 135%).

# Operational Risk

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## 7 Operational Risk

### 7.1 Overview

Operational risk is “the risk of financial or reputational loss as a result of inadequate or failed processes, people and systems or from external events.” The Society manages operational risk across a range of sub-categories as outlined below:

- Legal & Regulatory
- People Risk
- Information Security Risk
- IT Risk
- Business Continuity Risk
- Data Risk
- Financial Crime Risk
- Process Risk
- Reporting Risk

### 7.2 Operational risk management framework

The Operational Risk Management Framework (“ORMF”) forms part of the broader ERMF, detailed in Section 2 and sets out the Society’s approach to managing risks, through various processes, across the business at an operational level. The ORMF promotes a common understanding of operational risks across the Society, through standardised protocols and taxonomies to determine minimum internal standards. The framework is reviewed annually to reflect changes within either the Society’s strategy or operating environment.

Under the ORMF it is the responsibility of each business area to ensure that risks are identified, assessed, managed and monitored to support the achievement of functional and strategic objectives. These risks and associated controls are captured within departmental risk registers and are reviewed on a periodic basis. A formal Risk and Control Self-Assessment (“RCSA”) is conducted semi-annually to validate the accuracy of the risk and control environment to coincide with the preparation of the annual and interim financial statements. The outputs from each RCSA exercise are reported through to the Audit Committee, along with any actions identified to further improve the control environment. Oversight of risk and control assessments is provided by Subject Matter Experts (“SMEs”) within the Risk Function and also by Internal Audit through a risk based approach.

The ORMF also outlines the Society’s approach to managing incidents, including those which incur a loss. This process ensures that incidents are investigated and resolved in a consistent manner and that incidents are escalated appropriately for timely remediation. Incident and loss reporting is received at each Operational and Regulatory Risk Committee (“ORRC”), along with any root cause analysis and recommended control enhancements.

### 7.3 Operational risk oversight and governance

The Society applies a three lines of defence model to the management of operational risk, as outlined in Section 2. This ensures that there is a clear delineation between ownership of risks and controls, oversight and independent assurance. Key accountabilities for the management of operational risk are as follows:

- The first line of defence responsibilities include using operational risk management tools to identify and manage risks, assessing and enhancing controls, monitoring and reporting the operational risk profile, ensuring that the operational risk profile adheres to the established risk appetite and tolerance, complying with policies, standards and guidelines and promoting a strong risk culture.



# Operational Risk

- The second line of defence responsibilities include designing operational risk management tools used by the business to identify and manage risks, applying “independent challenge” to the use and output of the operational risk management tools by the first line of defence, developing and maintaining policies, standards and guidelines, monitoring and reporting of the operational risk profile, designing and providing operational risk training and promoting a strong risk culture.
- Third line of defence responsibilities include independently verifying that the ORMF has been sufficiently well designed and implemented by both the first and second lines of defence, reviewing the “independent challenge” applied by the second line of defence, reviewing monitoring, reporting and governance processes and promoting a strong risk culture.

From a governance perspective, the Board has delegated responsibility for the oversight of operational risk to BRC, which is also supported by ORRC. At each meeting these committees receive a combination of business reporting and management information in relation to the Society’s operational risk profile.

The Society also operates a number of working groups, which are aligned into ORRC and focus on the risk and control environment for discreet elements of the risk universe. These working groups consist of SMEs from both the first and second line and provide an update to ORRC with regard to their activities on a periodic basis.

## 7.4 Operational risk capital requirements

The Society adopts the Standardised Approach (“TSA”) for the purpose of calculating its Pillar 1 capital requirement for operational risk. This is determined as average total income over the last three years per defined business line multiplied by a prescribed regulatory risk factor. As a mutual lender, the Society’s operational risk capital requirement is primarily derived from retail banking activities.

As at 31 December 2018 the Society’s Pillar 1 minimum risk weighted assets and capital requirements for operational risk were as follows:

	<b>2018</b>	2017
	<b>£m</b>	£m
Operational risk weighted asset (RWA)	<b>330.0</b>	327.5
Operational risk capital requirements (RWA x 8%)	<b>26.4</b>	26.2

The Society also utilises scenario analysis, based on both internal and external loss data, to understand its operational risk profile under extreme, but plausible events. The outputs of these scenarios are then used to inform management whether further capital requirements are required for operational risk, in addition to the minimum capital holdings outlined above. As a result of its 2018 stress testing outputs and in line with regulatory requirements, the Society holds additional Pillar 2 capital for operational risk. Levels of capital held for operational risk remain significantly in excess of the actual loss experience of the Society.

# Securitisation

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## 8 Securitisation

### 8.1 Overview

The Society has securitised a number of mortgage loans by pooling them together and transferring the loans to two Special Purpose Entities (SPE). These are Albion No.3 plc (Albion 3) and Guildford No. 1 plc (Guildford 1), each a standalone Residential Mortgage Backed Security (RMBS).

The Society undertakes securitisation activities to raise wholesale funding. Securitisation funding forms a balanced portion of the Society's wholesale funding which helps ensure that the investor base remains diversified (as it attracts different investors to those who participate in other wholesale funding activities). Albion 3 is a publicly issued RMBS, raising funding externally. Guildford 1 is a retained RMBS, issued to provide notes which can be used by the Society to raise contingent liquidity.

The Society also purchases securitisations originated by other parties (please refer to section 8.4).

### 8.2 Originated securitisations

Securitisation funding is secured against the Society's mortgage assets, as part of the Society's structured funding strategy. This strategy has enabled the Society to both obtain secured funding and create additional collateral, which can be used to source additional funding.

As there has not been a significant transfer of credit risk, the Society does not calculate risk weighted exposure amounts for any positions it holds in the securitisations and these continue to be calculated in line with capital requirements applied to the underlying mortgage assets. The risk relating to the underlying mortgage pool remains with the Society and is included in the residential mortgage tables detailed throughout this document.

The Society takes the role of servicer, originator (where the Society originates the assets being securitised), cash manager, bank account provider and variable funding note registrar as defined in the relevant prospectuses in relation to Albion 3 and Guildford 1.

In addition to the above roles, the Society also acts as investor where it purchases a position in a third-party originated securitisation transactions (see section 8.4); the Society does not currently act as a sponsor to any securitisations.

The SPEs also represent a liquidity risk to the Group due to legal covenants which need to be fulfilled in the event of a downgrade of the Society. The cash flows resulting from these legal covenants are in respect of amounts required to collateralise swaps and are held in the transaction bank accounts and the Guaranteed Investment Contract accounts, representing the net cash position arising from the management of the securitisation programme at any point in time. Funds may need to be either deposited with another institution with the requisite rating or a guarantee obtained from a suitable guarantor (in the event of the Society losing its short term rating unless the rating agencies confirm that the current ratings of the notes will not be affected). The cash flows required in the event of downgrade are considered in the Society's Internal Liquidity Adequacy Assessment Process (ILAAP).

The parties holding the notes in issue are only entitled to obtain payment of the principal and interest to the extent that the resources of the RMBS structures are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form.

# Securitisation

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The Albion 3 securitisation has issued senior tranche instruments to investors with the Society retaining the first loss element. The Society retained all loss elements of the Guildford 1 RMBS as it is a retained securitisation.

To manage interest rate risk, the Society enters into derivative transactions with the SPEs, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives and hedge accounting policy, which can be found in the Annual Report and Accounts for the year ended 31 December 2018 on pages 161 to 165.

## 8.3 Treatment of the securitisations

Residential mortgages have been pledged by the Society in order to raise wholesale funding.

The pledged mortgages remain on the balance sheet of the Society as the Society retains the risks and rewards associated with the pledged mortgages. As the Society has power over the SPEs, has exposure or rights to variable returns from its involvement with the SPEs and has the ability to use its power over the SPEs to affect the amount of its returns from them the SPEs are fully consolidated in the Group accounts.

These assets are held at amortised cost. The transfers of the mortgage loans to the securitisation companies are not treated as sales by the Society (as originator), and therefore no gains are recognised.

The Society uses Moody's and Fitch as the credit rating agencies for the securitisations.

As at 31 December 2018 there were no assets awaiting securitisation.

### *Securitisations*

Albion 3 was incorporated in July 2015 and issued £325m of debt securities to external investors in September 2015. The notes issued are rated by both Fitch and Moody's as AAA. At 31 December 2018, £126m of mortgages were pledged to Albion 3 (2017: £165m) and outstanding debt securities in issue were £91m (2017: £138m). The Society retained £45m of class Z notes (2017: £45m).

Guildford 1 was incorporated in August 2014 with debt securities issued in February 2015. €400million class A1 notes in euros and £480m class A2 were issued and acquired by the Society. These notes are rated by both Fitch and Moody's as AAA. At 31 December 2018, £374m of mortgages were pledged to Guildford 1 (2017: £452m) and outstanding debt securities issued and acquired by the Society were £401m (2017: £482m) which includes £77m of class Z notes (2017: £93m).

# Securitisation

TABLE 27: Originated securitisations

Securitisation company	Type of securitisation	2018			
		Gross assets securitised £m	Notes issued £m	Retained notes £m	Underlying assets past due and impaired £m
Albion 3	Residential mortgage securitisation	126.0	91.4	45.4	0.6
Guildford 1	Residential mortgage securitisation	374.0	-	400.6	0.7
		<b>500.0</b>	<b>91.4</b>	<b>446.0</b>	<b>1.3</b>

Securitisation company	Type of securitisation	2017			
		Gross assets securitised £m	Notes issued £m	Retained notes £m	Underlying assets past due and impaired £m
Albion 3	Residential mortgage securitisation	165.2	137.5	45.4	0.5
Guildford 1	Residential mortgage securitisation	452.4	-	482.0	2.0
		<b>617.6</b>	<b>137.5</b>	<b>527.4</b>	<b>2.5</b>

## 8.4 Purchased securitisation positions

The Society invests in securitised assets as part of its overall investment strategy to maintain a diverse and liquid portfolio. The Society's holdings of RMBS and their associated risk weightings for capital purposes are included in tables 17 and 18 in section 5.

Prior to investing in a new RMBS transaction, the Treasury Function conducts the appropriate due diligence credit analysis on securities in accordance with Article 406 of the CRR. The Society also operates both issuer and individual securitisation limits to guard against concentration risk.

Daily checks are carried out by the Society using the Bloomberg rates for the purchased RMBS. Limits are in place to mitigate the risk of over investing. The Society also carries out quarterly stress testing for RMBS as part of the ongoing due diligence requirements set out in the CRR.

The Society's exposure to purchased securitisation positions amounted to £188.7m at 31 December 2018 (2017: £156.0m) and comprises senior tranches of RMBS.

Purchases and retention of RMBS are undertaken within a clearly defined credit risk policy. RMBS are held as 'at fair value through Other Comprehensive Income' in the Society's Statement of Financial Position. If the assets are sold before maturity, a gain or loss is recognised in the Income Statement.

# Securitisation

As at 31 December 2018, no purchased securitisation positions were past due or impaired. The Society uses the standardised approach to calculate RWA, defined under CRR for its purchased securitised positions.

TABLE 28: Purchased securitisations	Long term investment	2018 Risk weight	Long term RWA	Long term investment	2017 Risk weight	Long term RWA
	£m	%	£m	£m	%	£m
<b>RMBS</b>						
Aaa	185.5	20.0%	37.2	148.5	20.0%	29.7
Aa-1	-	20.0%	-	-	20.0%	-
Aa-2	-	20.0%	-	4.0	20.0%	0.8
Aa-3	3.2	20.0%	0.6	3.5	20.0%	0.7
A1	-	50.0%	-	-	50.0%	-
A2	-	50.0%	-	-	50.0%	-
A3	-	50.0%	-	-	50.0%	-
Baa-1	-	100.0%	-	-	100.0%	-
<b>Total RMBS</b>	<b>188.7</b>		<b>37.8</b>	156.0		31.2

In the table above, long term is defined as where the original effective maturity is greater than three months.

In line with the CRR the Society monitors and stresses both the asset and underlying pool of asset backed securities. These are reported via the Treasury Credit Risk Working Group to ALCO on a quarterly basis.

# Remuneration

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## 9 Remuneration

### 9.1 Remuneration Policy

The Society's Remuneration Policy is designed to provide value for members, provide competitive remuneration packages which support the long-term interests of the Society and which attract, reward and retain talented colleagues, to enable the delivery of business objectives to support the Society's strategy.

The Remuneration Policy focuses on ensuring effective and sound risk management through:

- a robust governance structure for setting goals and considering outcomes in the context of a defined risk assessment process;
- including both financial and non-financial goals in performance objectives and results assessments;
- alignment with the Society's strategy, values, long term goals and priorities;
- ensuring that fixed salary is the main component of total remuneration, to create an acceptable relationship between risk and reward;
- ensuring that variable pay elements do not encourage risk taking outside the level of risk tolerated by the Society; and
- ensuring that variable remuneration does not breach risk, capital and liquidity limits.

The Society commits that an advisory vote on the Remuneration Policy will take place once a year, unless the approved Policy remains unchanged, in which case it commits to propose a similar resolution at least every three years. This vote is in addition to the annual advisory vote on the Directors' Remuneration Report.

Further details on the Remuneration Policy are set out in the Directors' Remuneration Report on pages 80 to 94 of the Annual Report and Accounts for the year ended 31 December 2018.

### 9.2 Remuneration governance

The Remuneration Committee, under delegated authority from the Board, is responsible for setting the Society's Remuneration Policy and ensuring it is implemented and adhered to. The Remuneration Committee reviews the compliance of the Remuneration Policy against the requirements of the dual-regulated firms Remuneration Code. The Directors' Remuneration Report is shown in the Annual Report and Accounts for the year ended 31 December 2018 on pages 80 to 94. This report sets out the work and composition of the Remuneration Committee.

### 9.3 Material Risk Takers

The Remuneration Policy also references management who are considered 'Material Risk Takers' (MRTs), as defined by the Remuneration Code. This includes executive directors and other members of the senior leadership team.

# Remuneration

The table below sets out the aggregate quantitative remuneration for MRTs in relation to their services for the year ended 31 December 2018:

<b>TABLE 29: Remuneration</b>	<b>Number of beneficiaries</b>	<b>Fixed remuneration £'000</b>	<b>Variable remuneration £'000</b>	<b>Total remuneration £'000</b>	<b>Deferred remuneration £'000</b>
<b>Type of colleague</b>					
Non-executive director	8	537	24	561	-
Executive director	5	1,971	824	2,795	764
Other MRTs	15	2,430	794	3,224	166
<b>Total</b>	<b>28</b>	<b>4,938</b>	<b>1,642</b>	<b>6,580</b>	<b>930</b>

Due to the structure of the organisation, all beneficiaries operate in a single business area.

Remuneration takes the form of cash, with deferred remuneration being unvested. This is subject to risk assessment and adjustment prior to the scheduled date of payment. No adjustments were made as a result of the 2018 review.

There were no sign on payments or severance payments made within the year (2017: none).

No individual received remuneration exceeding the value of €1m. Full details of individual remuneration of the directors is provided in the Directors' Remuneration Report on pages 80 to 94 of the Annual Report and Accounts for the year ended 31 December 2018.

## **Recruitment policy**

The Society has a policy in place covering the recruitment of members of the management body. Details of the practical application of this policy are contained in the Corporate Governance Report on pages 48 to 61 of the Annual Report and Accounts for the year ended 31 December 2018.

## **Diversity**

The policy on diversity (regarding selection of members of the Society in general and specifically in relation to members of the management board) is described in the Corporate Governance Report on pages 48 to 61 of the Annual Report and Accounts for the year ended 31 December 2018.

# Remuneration

## 9.4 Remuneration structures for Material Risk Takers

The main components of remuneration for MRTs are:

	Purpose	Operation	Performance metrics
Basic pay	Reflects level of accountability.	Once set, any future increases are linked to personal performance and market benchmarking.	Execution of the role, as defined in the role profile.
Performance related pay	Linked to the delivery of the annual business plan targets, including the achievement of strategic objectives and personal objectives	<p>Executive directors have a maximum of 50% of basic pay.</p> <p>Executive directors designated as 'Senior Managers' under the Senior Managers Regime and over the de-minimis, 60% of the bonus will be deferred over a period of seven years with no vesting until three years after the award is made. 50% of variable will be delivered in a share-like instrument.</p> <p>Executive directors designated as 'Senior Managers' under the Senior Managers Regime and below the de-minimis, 40% of the bonus will be deferred over three years.</p> <p>Executive directors in a control function have a maximum of 50% of basic pay, with 40% of the award deferred over three years.</p> <p>Directors have a maximum of 50% of basic pay, with 20% deferred over one year.</p> <p>The Chief Internal Auditor has a maximum of 15%, with 20% deferred over one year.</p> <p>Non-executive directors do not receive performance related pay.</p>	<p>Challenging performance objectives are aligned with our Corporate Plan, recognising short, medium and long term goals.</p> <p>Control function schemes are based solely on personal objectives.</p>
Operation of malus and clawback	The deferral ensures annual performance creates value sustained over the longer term.	Independent assessment takes place prior to the payment of each deferred award.	Not applicable



# Remuneration

Pension	Provides market competitive remuneration.	Based on the membership of the Society's defined contribution scheme. In appropriate circumstances, for example where contributions exceed the annual or lifetime allowance, there is an option to receive a monthly cash allowance in lieu of pension contributions.	Not applicable
Benefits	To align total remuneration broadly with the market.	The principal benefits are life assurance, private medical insurance, long-term health insurance and cash health plan. Other benefits may be provided based on individual circumstances for example relocation.	Not applicable

## 9.5 Other directorships

A list of directorships held by members of the senior management team is included on page 179 of the Annual Report and Accounts for the year ended 31 December 2018.

# Contact Information

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## 10 Contact Information

If you have any queries regarding this document, please contact:

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LS1 5AS

Approved by the Board on 26 February 2019

# Glossary and Abbreviations

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## 11 Glossary and Abbreviations

<b>Assets and Liabilities Committee (ALCO)</b>	A Society Board level committee which oversees treasury policy, financial risk management, wholesale funding and liquidity. It also recommends the Society's Internal Liquidity Adequacy Assessment Process (ILAAP) for Board approval.
<b>Basel III Framework</b>	Basel III is the third capital adequacy framework issued by the Basel Committee on Banking Supervision, which defines the capital and liquidity rules for banks and building societies. The framework has been embedded into UK law through the European Capital Requirements Directive IV (CRD IV).
<b>Capital Requirements Directive (CRD)</b>	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms  Together with the CRR forms the Basel III Framework.
<b>Capital Requirements Regulation (CRR)</b>	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms  Together with the CRD this forms the Basel III Framework.
<b>Common Equity Tier 1 (CET1) capital</b>	CET1 capital is the highest quality form of capital and comprises general reserves from retained profits, less the book values of any pension surplus, goodwill and intangible assets and other regulatory adjustments as defined under CRD IV.
<b>Common Equity Tier 1 (CET1) capital ratio</b>	This is a regulatory ratio, calculated as the total of CET1 capital divided by Risk Weighted Assets (RWAs).
<b>Counterparty Credit Risk</b>	This is the risk that a customer or counterparty is unable to pay the interest or to repay the capital on a loan when required.
<b>Covered bonds</b>	Debt securities which are backed by a portfolio of mortgages which is segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.
<b>Credit quality steps</b>	A credit quality assessment scale as set out in CRD IV (risk weights under the Standardised Approach to credit risk).
<b>Credit risk</b>	The potential to incur losses from the failure of a borrower or counterparty to meet its obligation to pay interest or repay capital on an outstanding

# Glossary and Abbreviations

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	loan.
<b>Credit risk mitigation</b>	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set off or netting.
<b>Credit Support Annex (CSA)</b>	A Credit Support Annex is a legal document which regulates credit support (collateral) for derivative transactions. It is one of the four parts that make up an ISDA Master Agreement but is not mandatory. It is possible to have an ISDA agreement without a CSA but not normally a CSA without an ISDA agreement.
<b>Default</b>	Default occurs when a borrower is deemed unlikely to repay their loan or other amount due to the Society. This occurs when a borrower reaches a predefined arrears status.
<b>Exposure At Default (EAD)</b>	An estimate of the maximum loss that an entity might suffer if a borrower or other counterparty fails to meet their obligations at default.
<b>External Credit Assessment Institution (ECAI)</b>	An ECAI (for example Moody's, Standard and Poor's, Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
<b>Expected loss (EL)</b>	A calculation to estimate potential losses on current exposures due to potential defaults in the next 12 months; the term is used in relation to exposures modelled under the Internal Ratings Based (IRB) approach and is derived from the multiplication of the PD, LGD and EAD.
<b>Financial Conduct Authority (FCA)</b>	The UK regulatory body responsible for conduct of business regulation and supervision of UK authorised firms. The FCA is also responsible for the prudential regulation of firms which do not fall within the scope of the PRA.
<b>Financial Policy Committee (FPC)</b>	An official committee of the Bank of England the primary role of which is to identify, monitor, and take action to remove or reduce risks that threaten the resilience of the UK financial system as a whole.
<b>Group</b>	The Society and its subsidiaries including entities under its control.
<b>Internal Capital Adequacy Assessment Process (ICAAP)</b>	The Group's own assessment, as part of CRD IV requirements, of the levels of capital that it needs to hold in respect of regulatory capital requirements for risks it faces under a business-as-usual scenario and a variety of stressed scenarios

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<b>Institution</b>	<p>An institution is defined in Article 1 of the Capital Requirements Directive (CRD) as a credit institution or investment firm.</p> <p>A credit institution is defined in Article 4 of the Capital Requirements Regulation (CRR) as an undertaking whose business is to take deposits or other repayable funds from the public and to grant credits for its own account.</p> <p>An investment firm is defined in Article 4 of the Markets in Financial Instruments Directive (Directive 2004/39/EC of the European Parliament and of the Council) as any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.</p>
<b>Interest rate risk</b>	<p>Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates.</p>
<b>Internal Liquidity Adequacy Assessment Process (ILAAP)</b>	<p>The Group's own internal assessment of the level of liquidity that it needs to hold in respect of regulatory liquidity requirements in relation to a number of stressed scenarios.</p>
<b>Internal Ratings Based (IRB) Approach</b>	<p>An approach for measuring exposure to credit risk which is more sophisticated than the Standardised Approach, where an entity can calculate its own risk weights for certain assets. The IRB approach may be Foundation or Advanced.</p> <p>IRB approaches can only be used with the permission of the Prudential Regulation Authority.</p>
<b>Loan to Value (LTV)</b>	<p>A ratio which expresses the amount of a mortgage as a percentage of the value of the property on which the mortgage is secured. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).</p>
<b>London Clearing House (LCH)</b>	<p>An independent rates and multi-asset clearing house. LCH are a central counterparty which facilitates the exchange of multiple types of transactions.</p>
<b>London Interbank Offered Rate (Libor)</b>	<p>The average interest rate estimated by lending banks in London that the average lending bank would be charged if borrowing from other banks.</p>
<b>Loss Given Default (LGD)</b>	<p>A parameter used in relation to credit risk exposures modelled under the IRB approach; an estimate of the difference between the EAD and the net amount recovered, expressed as a percentage of the EAD.</p>

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<b>Market risk</b>	The risk that movements in market risk factors, including foreign exchange rates, interest rates and customer-driven factors will create losses or decrease portfolio values.
<b>Maturity</b>	The remaining time the borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement.
<b>Minimum capital requirement</b>	The minimum amount of regulatory capital that a financial institution must hold to meet the Basel III Pillar 1 requirements for credit, market and operational risk.
<b>Minimum Requirements for Own Funds and Eligible Liabilities (MREL)</b>	MREL is the total loss absorbing capital a financial institution must hold to facilitate the recapitalisation of the institution in resolution
<b>Operational risk</b>	The risk of loss arising from inadequate, inefficient or failed internal processes, human resources, systems or external events (for example fraud).
<b>Permanent Interest Bearing Shares (PIBS)</b>	Unsecured, deferred shares that are a form of Additional Tier 1 capital (subject to phasing to Tier 2).
<b>Pillar 1</b>	The parts of CRD IV which set out the minimum capital requirements for credit, market and operational risk
<b>Pillar 2</b>	Those aspects of CRD IV which set out the process by which the Society should review its overall capital adequacy and the processes under which the regulators/supervisors evaluate how well financial institutions are assessing their risks and take appropriate actions in response the institutions' assessments.
<b>Pillar 3</b>	The part of CRD IV governing the production of this document. It sets out information disclosures relating to risks, the amount of capital required to cover those risks, and the approach to risk management.
<b>Potential future credit exposure (PFCE)</b>	A measure defined as the maximum expected credit exposure over a specified period of time calculated at some level of confidence.
<b>Probability of default (PD)</b>	A measure of how likely a customer is to reach default over a defined period of time.
<b>Provisions</b>	Amounts set aside to cover incurred losses associated with credit risks.
<b>Prudential Regulation Authority (PRA)</b>	The UK regulatory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms.

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<b>Repurchase agreement (Repo)</b>	A repurchase agreement allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a commitment to repurchase the asset at a specified price on a given future date. For the party selling the security and agreeing to repurchase the asset in the future, it is a reverse repo.
<b>Residential mortgage backed securities (RMBS)</b>	A category of asset backed security that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
<b>Risk Weighted Assets (RWAs)</b>	A regulatory measure which adjusts the value of assets as recorded in the Statement of Financial Position to reflect the relative level of risk. This measure is used in calculating regulatory capital requirements.
<b>Securitisation</b>	<p>The process by which a group of assets (usually loans) is aggregated into a pool which is used to back the issuance of new securities. A company transfers assets to a special purpose entity which issues securities backed by those assets.</p> <p>The Society has established securitisation structures (using residential mortgages as assets) as part of its funding activities.</p>
<b>Society</b>	Leeds Building Society.
<b>Special Purpose Entity (SPE)</b>	A legal entity (usually a limited company of some type or, sometimes, a limited partnership) created to fulfil narrow, specific or temporary objectives. In the context of the Society, the SPEs are used in relation to securitisation activities.
<b>Standardised approach</b>	The approach used to calculate credit risk exposures and the related capital requirements. The method uses parameters determined by the regulator rather than internally and is less risk sensitive than IRB approaches. This will generally result in a higher capital requirement.
<b>Tier 1 capital</b>	A measure of financial strength as defined by the PRA. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital is defined above.
<b>Tier 2 capital</b>	A further component of regulatory and financial capital as defined by CRD IV.

# Appendices



# Appendices

## A1 EBA Own Funds disclosure template

In accordance with Commission Implementing Regulation (EU) No 1423 of 2013, the full Society disclosure of its own funds calculated in accordance with the full implementation rules is presented below.

		Full implementation CRD IV rules	
		2018 £m	2017 £m
<b>Common Equity Tier 1 (CET1) Capital: instruments and reserves</b>			
1	Capital instruments and the related share premium accounts		
2	Retained earnings	1,006.3	931.3
3	Accumulated other comprehensive income (and other reserves)	20.2	27.7
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1		
5	Minority interests (amount allowed in consolidated CET1)		
5a	Independently reviewed interim profits net of any foreseeable charge or dividend		
6	<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>1,026.5</b>	<b>959.0</b>
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>			
7	Additional value adjustments (negative amount)	(1.9)	(1.3)
8	Intangible assets (net of related deferred tax liability (negative amount)	(8.5)	(5.2)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)		
11	Fair value reserves related to gains or losses on cash flow hedges		
12	Negative amounts resulting from the calculation of expected loss amounts	(9.9)	-
13	Any increase in equity that results from securitised assets (negative amount)		
14	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing		
15	Defined-benefit pension fund assets (negative amount)	(10.1)	(1.0)
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)		
17	Direct, indirect and synthetic holdings of the CET 1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)		
18	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)		
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)		
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative		
20b	of which: qualifying holdings outside the financial sector (negative amount)		
20c	of which: securitisation positions (negative amount)		
20d	of which: free deliveries (negative amount)		
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)		

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## A1 EBA Own Funds disclosure template (continued)

TABLE 30: EBA Own Funds Disclosure Template ( <i>continued</i> )		Full implementation CRD IV rules	
		2018 £m	2017 £m
22	Amount exceeding the 15% threshold (negative amount)		
23	of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities		
25	of which: deferred tax assets arising from temporary differences		
25a	Losses for the current financial year (negative amount)		
25b	Foreseeable tax charges relating to CET1 items (negative amount)		
27	Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)		
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	(30.4)	(7.5)
29	Common Equity Tier 1 (CET1) capital	996.1	951.5
<b>Additional Tier 1 (AT1) capital: instruments</b>			
30	Capital instruments and the related share premium accounts		
31	of which: classified as equity under applicable accounting standards		
32	of which: classified as liabilities under applicable accounting standards		
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	-
34	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties		
35	of which: instruments issued by subsidiaries subject to phase out		
36	Additional Tier 1 (AT1) capital before regulatory adjustments	-	-
<b>Additional Tier 1 (AT1) capital: regulatory adjustments</b>			
37	Direct and indirect holdings by an institution of own AT1 instruments (negative amount)		
38	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)		
39	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)		
40	Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)		
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)		
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital	-	-

# Appendices

## A1 EBA Own Funds disclosure template (continued)

TABLE 30: EBA Own Funds Disclosure Template (continued)		Full implementation CRD IV rules	
		2018 £m	2017 £m
44	Additional Tier 1 (AT1) capital	-	-
45	Tier 1 capital (T1 = CET1 + AT1)	996.1	951.5
<b>Tier 2 (T2) capital: instruments and provisions</b>			
46	Capital instruments and the related share premium accounts		
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2		
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	225.0	25.0
49	of which: instruments issued by subsidiaries subject to phase out		
50	Credit risk adjustments	2.9	11.6
51	Tier 2 (T2) capital before regulatory adjustments	227.9	36.6
<b>Tier 2 (T2) capital: regulatory adjustments</b>			
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)		
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)		
54	Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)		
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)		
57	Total regulatory adjustments to Tier 2 (T2) capital	-	-
58	Tier 2 (T2) capital	227.9	36.6
59	Total capital (TC = T1 + T2)	1,224.0	988.1

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## A1 EBA Own Funds disclosure template (continued)

		Full implementation CRD IV rules	
		2018 £m	2017 £m
60	Total risk weighted assets	3,190.3	6,577.5
<b>Capital ratios and buffers</b>			
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	31.2%	14.5%
62	Tier 1 (as a percentage of total risk exposure amount)	31.2%	14.5%
63	Total capital (as a percentage of total risk exposure amount)	38.4%	15.0%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	2.82%	1.25%
65	of which: capital conservation buffer requirement	1.88%	1.25%
66	of which: countercyclical buffer requirement	0.94%	-
67	of which: systemic risk buffer requirement		
67	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer		
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	23.87%	5.42%
<b>Amounts below the thresholds for deduction (before risk weighting)</b>			
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)		
<b>Applicable caps on the inclusion of provisions in Tier 2</b>			
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	-	11.6
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	-	-
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings- based approach (prior to the application of the cap)	2.9	-
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	-	-
<b>Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)</b>			
80	Current cap on CET1 instruments subject to phase out arrangements		
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)		
82	Current cap on AT1 instruments subject to phase out arrangements	-	-
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-	-
84	Current cap on T2 instruments subject to phase out arrangements	-	-
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-	-

\*The changes seen in the total RWA's and capital ratios are mostly due to the Society receiving IRB permission in 2018. Further detail on this can be seen in Section 3 of this disclosure.

\*\* In the year the UK was given a countercyclical buffer of 1%

# Appendices

## A2 Capital instruments key features

Details relating to the Permanent Interest Bearing Securities issued by the Society are provided in the table below.

1	Issuer	Leeds Building Society
2	Unique identifier (for example CUSIP, ISIN or Bloomberg identifier for private placement):	ISIN GB0005104913
3	Governing law(s) of the instrument	English
	<b>Regulatory treatment</b>	
4	Transitional CRR rules	AT1
5	Post transitional CRR rules	Tier 2
6	Eligible at solo/(sub) consolidated/solo and (sub) consolidated	Group Solo consolidated Society
7	Instrument type (types to be specified by each jurisdiction)	PIBS
8	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	£25m
9	Nominal amount of instrument	£25m
9a	Issue price	£100.227
9b	Redemption price	£100.000
10	Accounting classification	Liability – amortised cost
11	Original date of issuance	31 July 1992
12	Perpetual or dated	Perpetual
13	Original maturity date	No maturity
14	Issuer call subject to prior supervisory approval	No
15	Option call date, contingent call dates and redemption amount	N/A
16	Subsequent call date, if applicable	N/A
	<b>Coupons/dividends</b>	
17	Fixed or floating dividend/coupon	Fixed
18	Coupon rate and any related index	13.375%
19	Existence of a dividend stopper	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Partially discretionary
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Mandatory
21	Existence of step up or other incentive to redeem	No
22	Noncumulative or cumulative	Cumulative

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23	Convertible or non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	N/A
25	If convertible, fully or partially	N/A
26	If convertible, conversion rate	N/A
27	If convertible, mandatory or optional conversion	N/A
28	If convertible, specify instrument type convertible into	N/A
29	If convertible, specify issuer of instrument it converts into	N/A
30	Write down features	N/A
31	If write down, write down triggers(s)	N/A
32	If write down, full or partial	N/A
33	If write down, permanent or temporary	N/A
34	If temporary write down, description of write up mechanism	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Tier 2
36	Non-compliant transitioned features	Yes
37	If yes, specify non-compliant features	No conversion

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Details related to the issuance of subordinated debt in 2018 are provided below:

1	Issuer	Leeds Building Society
2	Unique identifier (for example CUSIP, ISIN or Bloomberg identifier for private placement):	XS1812121876
3	Governing law(s) of the instrument	English
	<b>Regulatory treatment</b>	
4	Transitional CRR rules	Tier 2
5	Post transitional CRR rules	Tier 2
6	Eligible at solo/(sub) consolidated/solo and (sub) consolidated	Group Solo consolidated Society
7	Instrument type (types to be specified by each jurisdiction)	Subordinated debt
8	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	£200m
9	Nominal amount of instrument	£200m
9a	Issue price	£98.357
9b	Redemption price	£100.000
10	Accounting classification	Liability – amortised cost
11	Original date of issuance	25 April 2018
12	Perpetual or dated	Dated
13	Original maturity date	25 April 2029
14	Issuer call subject to prior supervisory approval	Yes
15	Option call date, contingent call dates and redemption amount	25 Apr 2028 £200m
16	Subsequent call date, if applicable	N/A
	<b>Coupons/dividends</b>	
17	Fixed or floating dividend/coupon	Fixed
18	Coupon rate and any related index	3.75%
19	Existence of a dividend stopper	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Mandatory
21	Existence of step up or other incentive to redeem	Yes
22	Noncumulative or cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible

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24	If convertible, conversion trigger(s)	NA
25	If convertible, fully or partially	NA
26	If convertible, conversion rate	NA
27	If convertible, mandatory or optional conversion	NA
28	If convertible, specify instrument type convertible into	NA
29	If convertible, specify issuer of instrument it converts into	NA



# Appendices

## A3 Asset encumbrance disclosure template

The following disclosures are presented in line with PRA and EBA regulatory reporting requirements.

<b>Table 31a: Template A - Assets</b>	<b>Carrying amounts of encumbered assets £m</b>	<b>of which: notionally eligible EHQLA and HQLA</b>	<b>Fair value of encumbered assets £m</b>	<b>Carrying amounts of unencumbered assets £m</b>	<b>of which: notionally eligible EHQLA and HQLA</b>	<b>Fair value of unencumbered assets £m</b>
<b>Assets of the reporting institution</b>	<b>5,558</b>	<b>-</b>	<b>NA</b>	<b>13,770</b>	<b>-</b>	<b>NA</b>
Equity instruments	-	-	-	-	-	-
Debt securities	-	-	-	1,221	1,028	1,222
Other assets	202	-	NA	398	-	NA

<b>Table 31b: Template B - Collateral received</b>	<b>Fair value of encumbered collateral received or own debt securities issued £m</b>	<b>of which: notionally eligible EHQLA and HQLA £m</b>	<b>Fair value of collateral received or own debt securities issued available for encumbrance £m</b>	<b>of which: notionally eligible EHQLA and HQLA £m</b>
<b>Collateral received by the reporting institution</b>				
Loans on demand	134.2	-	-	-
Equity instruments	-	-	-	-
Debt securities	59.6	59.6	-	-
of which: covered bonds	-	-	-	-
of which: asset back securities	-	-	-	-
of which: issued by central	59.6	59.6	-	-
of which: issued by financial corporations	-	-	-	-
of which: issued by non-financial corporations	-	-	-	-
Loans and advances other than loans on demand	-	-	-	-
Other collateral received	-	-	-	-
Own debt securities issued other than own covered bonds or asset	-	-	-	-
Own covered bonds and asset back securities issued and not yet	-	-	-	-
Total assets, collateral received and own debt securities issued	-	-	-	-

**Table 31c: Template C - Encumbered assets/collateral received and associated liabilities**

	<b>Matching liabilities, contingent liabilities or securities lent £m</b>	<b>Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m</b>
<b>Carrying amount of selected financial liabilities</b>	<b>1,637</b>	<b>3,338</b>

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## **Template D – Information on importance of encumbrance**

The Society maintains a level of asset encumbrance in line with the scale and scope of its operations. The majority of its encumbrance arises from its wholesale funding activities: its covered bonds and residential mortgage backed security programmes (Albion 3 and Guildford 1). Please refer to section 8 for more information in relation to these.

A further source of encumbrance arises in relation to collateral arrangements pertaining to derivative contracts. The Society is over-collateralised in relation to certain LCH Clearnet contracts. This over-collateralisation at 31 December 2018 is included in the total exposure to institutions in Tables 17 – 19. Collateralisation agreements are discussed in section 5.5 of this document.

As previously noted, for capital purposes the Society is required to calculate and maintain regulatory capital ratios on a consolidated basis. As a result encumbrance is considered and reported on a consolidated basis; there is no material difference in the level of encumbrance at Group and Society level.

The disclosures above have been compiled in accordance with EBA and PRA Guidelines and are based on median values on a rolling basis over the last twelve months. As a result, the above disclosures will differ from equivalent data presented in the Annual Report and Accounts.

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## A4 Countercyclical capital buffer analysis

The analysis required by EBA Final Draft Regulatory Technical Standards on disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer under Article 440 of the CRR is set out below.

Table 32a below shows that based on the country specific rates in place at 31 December 2018 and the geographical distribution of exposures, the Society had an institution specific countercyclical capital buffer requirement of £22.9m.

The requirement results from multiplying the total risk exposure amount (the total credit risk weighted assets from table 6) by the buffer rate for that country and summing the result.

The buffer rate is a weighted average including countries with a zero buffer percentage rate and is derived from dividing the total risk exposure amount into the buffer requirement.

**TABLE 32a: Amount of institution specific countercyclical capital buffer**

	2018 £m	2018 %
Total risk exposure amount	2,428	
Institution specific countercyclical buffer rate		0.9443%
Institution specific countercyclical capital buffer requirement	22.9	

At 31 December 2018 the Society's only exposures in countries with a countercyclical buffer rate greater than zero were the United Kingdom, Hong Kong, Norway and Sweden. Per table 32b the rates for these three countries at 31 December 2018 were 1.000%, 1.875%, 2.000% and 2.000% respectively.

The Czech Republic, Iceland and Slovakia introduced non-zero buffer rates during 2017. These are now 1.000%, 1.250% and 1.250% respectively. The Society currently has no exposure in these locations.

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TABLE 32b: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

	General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements			Total	Own funds requirement weights	Countercyclical capital buffer rate
	Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book exposures for SA	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	of which: General credit exposures	of which: Trading book exposures	of which: Securitisation exposures			
	£m	£m	£m	£m	£m	£m	£m	£m	£m			
<b>Breakdown by country</b>												
United Kingdom	771.0	15,681.2	-	-	188.7	-	181.8	-	3.0	<b>184.9</b>	0.944	1.000%
Hong Kong	1.3	-	-	-	-	-	-	-	-	-	-	1.875%
Ireland	205.7	-	-	-	-	-	7.7	-	-	<b>7.7</b>	0.039	0.000%
Norway	-	-	-	-	-	-	-	-	-	-	-	2.000%
Spain	78.1	-	-	-	-	-	2.5	-	-	<b>2.5</b>	0.013	0.000%
Sweden	0.2	-	-	-	-	-	-	-	-	-	-	2.000%
United States Of America	4.3	-	-	-	-	-	0.2	-	-	<b>0.2</b>	0.001	0.000%
France	2.0	-	-	-	-	-	0.1	-	-	<b>0.1</b>	-	0.000%
Denmark	8.7	-	-	-	-	-	0.3	-	-	<b>0.3</b>	0.002	0.000%
Bulgaria	0.1	-	-	-	-	-	-	-	-	-	-	0.000%
Lithuania	0.0	-	-	-	-	-	-	-	-	-	-	0.000%
<b>Total</b>	<b>1,071.4</b>	<b>15,681.2</b>	<b>-</b>	<b>-</b>	<b>188.7</b>	<b>-</b>	<b>192.6</b>	<b>-</b>	<b>3.0</b>	<b>195.7</b>	<b>0.999</b>	

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