

Models & Ratings System Committee – Terms of Reference

1. Constitution

The Board has established a sub-committee, to be known as the Models & Ratings System Committee (MRSC) to support it in achieving its objectives and responsibilities. The Committee reports directly to the Board.

2. Membership

Members of the Committee shall be appointed by the Board.

Only members of the Committee have the right to attend Committee meetings. However, other individuals may be invited to attend all or part of any meeting as and when appropriate and necessary.

The Nominations Committee shall appoint the Committee Chairman.

The Committee shall comprise the following members:

- NED (Chair)
- NED
- Chief Financial Officer
- Director of Finance Operations
- Deputy Finance Director
- Chief Risk Officer (Deputy Chair)
- Deputy CRO & Director of Credit Risk
- Head of Modelling & Measurement
- Head of Credit Risk
- Director of Operations

Other internal and external Subject Matter Experts to attend as required for specialised (e.g. IT, data) papers annotated in the Key Matters Schedule. Attendance is inclusive of Internal & External Audit.

Secretarial duties will be undertaken by a member of the Credit Risk team.

3. Quorum

The quorum necessary for the transaction of business shall be at least four members including:

- Representatives from both the Finance Division and the Credit Risk Control Unit (CRCU), as defined under CRR Article 190;
- The Chair or the Deputy Chair; and
- One Non-Executive Director, inclusive of the Committee Chair.

A duly convened meeting of the Committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers, and discretions vested in or exercisable by the Committee.

4. Frequency of Meetings

The Committee shall convene no less than 5 occasions per annum at appropriate times and otherwise as required.

5. Notice of Meetings

Meetings of the Committee shall be scheduled annually in advance. Ad hoc meetings shall be convened by the Secretary of the Committee at the request of any of its members.

An agenda of items to be discussed and supporting papers, shall be forwarded to each member of the Committee and any other person required to attend, no later than 5 working days before the date of the meeting.

6. Minutes of Meetings

The secretary shall minute the proceedings of all meetings of the Committee, including recording the names of those present and in attendance.

Draft minutes of Committee meetings shall be circulated to the Chairman promptly. Once approved, the secretary shall include the minutes in the papers for the next MRSC, with a summary of the key items for noting.

7. Duties

The MRSC is the designated committee, as defined in CRR article 189, in supporting the Board in fulfilling its oversight responsibilities for the ratings system and modelling activity within the Society:

- I. Seek assurance that the Society implements an effective and compliant rating system for the purpose of calculating Pillar 1 credit risk regulatory capital requirements under the Internal Ratings Based (IRB) approach.
- II. Seek assurance that the Society develops an effective and compliant suite of Expected Credit Loss models, for the purposes of calculating expected losses under IFRS9 Accounting Standards.

- III. Consider and approve, on an annual basis, the Society's Model Risk Policy, taking account of the requirements for an effective control environment for the development and maintenance of model based solutions across the Society.
- IV. Oversee the activities of the Credit Models Working Group (CMWG) and receive and consider recommendations from the working group .
- V. Receive and review monitoring reports on an ongoing basis detailing the performance of credit risk models, understanding areas which require improvement, and tracking the status of remedial actions to improve previously identified weaknesses and limitations.
- VI. Receive and review reporting on the performance and control environment of credit risk models and wider Society models, challenging the prevailing performance, control environment and any proposed management actions.
- VII. Receive and review responses to regulatory papers, considering the appropriateness of proposals alongside the impacts on the rating system and wider credit risk modelling.
- VIII. Receive terms of reference for the development of models ensuring development improves performance, regulatory compliance and/or internal risk measurement.
- IX. Oversee the methodologies and effectiveness of the development process of models, and consider proposals on final model designs and impact assessments alongside reporting from independent model reviewers.
- X. Provide oversight to regulatory notification requirements for changes to the rating system in accordance with provisions detailed in the Model Risk Policy.
- XI. Oversee the data integrity and control environment of data processed through the rating system and data used in the development, validation, monitoring and processing of credit models, challenging the adequacy of the data and actions taken to mitigate vulnerabilities in data utilised.
- XII. Oversee the IT infrastructure and control environment supporting the processing of the rating system and that used to support the development, validation, monitoring and processing of underlying models, challenging the adequacy of the IT infrastructure and actions taken to mitigate vulnerabilities.
- XIII. Understand circumstances where weaknesses in the rating system and/or credit models which could lead to inappropriate/untimely production of credit risk measurements and/or capital requirements which would impact the use of the rating system or use of risk measurements for operational or financial adequacy purposes.
- XIV. To review and consider, on an annual basis, the adequacy of the proposed work plan for the CRCU and provide ongoing monitoring.
- XV. Consider the skill sets and resourcing within the Society for the purposes of maintaining and evolving the rating system and modelling, and challenge where deficiencies are identified.

- XVI. Obtain such professional external advice as the Committee deems appropriate as a means of taking full account of relevant experience across the industry and in challenging its analysis and assessment.
- XVII. Receive and consider Internal Audit reports pertaining to annual review of the rating system as defined in CRR article 191. Furthermore, consider Internal Audit reports pertaining to ongoing progress of key developments, such as IFRS9 Expected Credit Loss modelling.

8. Authority

The Committee is authorised to:

- Annual approval of Model Risk Policy (Level 1).
- Approve the deployment of new credit risk models or adjustments/decommissioning of existing credit risk models in accordance with regulatory notification requirements defined within the Model Risk Policy.
- Approve terms of reference for annual model reviews in accordance with the Model Risk Policy mandates.
- Approve expenditure, in line with Board approved budgets, on any outside legal or other professional advice on any matter within its terms of reference.

9. Reporting Responsibilities

The Committee shall make whatever recommendations to the Board or other Board sub-committees as deemed appropriate on any area within its remit where action or improvement is needed.

10. Other Matters

The Committee shall:

- I. Have access to sufficient resources in order to carry out its duties:
- II. Be provided with appropriate and timely training, both in terms of an induction programme for new members, and on an ongoing basis for all members;
- III. Arrange for a periodic review of its own performance and, at least annually, review its terms of reference to ensure that it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.

Version: 1.4

Date Approved: August 2017

Approved by: Board Nominations Committee