Pillar 3 disclosures

31 December 2015

Leeds Building Society

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1 Overview

1.1 Background

The introduction of consistent capital adequacy standards and an associated supervisory framework in the European Union originally came into effect on 1 January 2007 in the form of the Basel II Accord. With effect from 1 January 2014 it was replaced by both the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), which are referred to as the CRD IV package. Together with local implementation rules and guidance, the updated regulation is enforced by the Prudential Regulation Authority (PRA).

The objectives of the reform package are to:

- strengthen the regulation, supervision and risk management of the banking sector;
- improve the banking sector's ability to absorb shocks arising from financial and economic stress;
- improve governance; and
- strengthen banks' transparency and disclosures.

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 Leeds Building Society (the Society) regulatory measures, 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. The Society has adopted the Standardised approach for all exposures and risk areas including operational risk, and uses the capital risk weighting percentages set by the CRR. The Society is progressing an application with the PRA to migrate onto the Internal Ratings Based (IRB) approach for credit risk capital requirement assessment for its residential mortgage portfolio.

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 our interpretation of the guidance.

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 2015 and the information presented is based on those Accounts unless otherwise stated.

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1.3 Location and verification

These disclosures have been subject to internal verification and approved by the Audit Committee before approval by the Board. The disclosures are published in the 'Press' section of Leeds Building Society's website under 'Financial results' (leedsbuildingsociety.co.uk/press/financial-results/). The review 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.

There is no formal external audit requirement in relation to these disclosures; however, some of the information also appears in the Society's audited 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) and the information in the Pillar 3 disclosures may not be directly comparable with that information.

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.

For capital purposes the Society is required to calculate and maintain regulatory capital ratios on a consolidated basis. The disclosures contained in this document are provided on the same basis.

The principal subsidiaries are:

Subsidiary name
Leeds Financial Services Limited
Leeds Mortgage Funding Limited
Headrow Commercial Property Services Limited
Leeds Building Society Covered Bonds LLP
Albion No.2 Plc
Albion No.3 Plc
Guildford No.1 Plc

Further information on the Society's subsidiaries can be found in note 13 to the Annual Report and Accounts for the year ended 31 December 2015.

Overview

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 £183.5m (primarily a collateral loan to a third party) per Table 8 on page 24. This is on the basis of the amounts being immaterial.

2 Risk Management Objectives and Policies

2.1 Overview

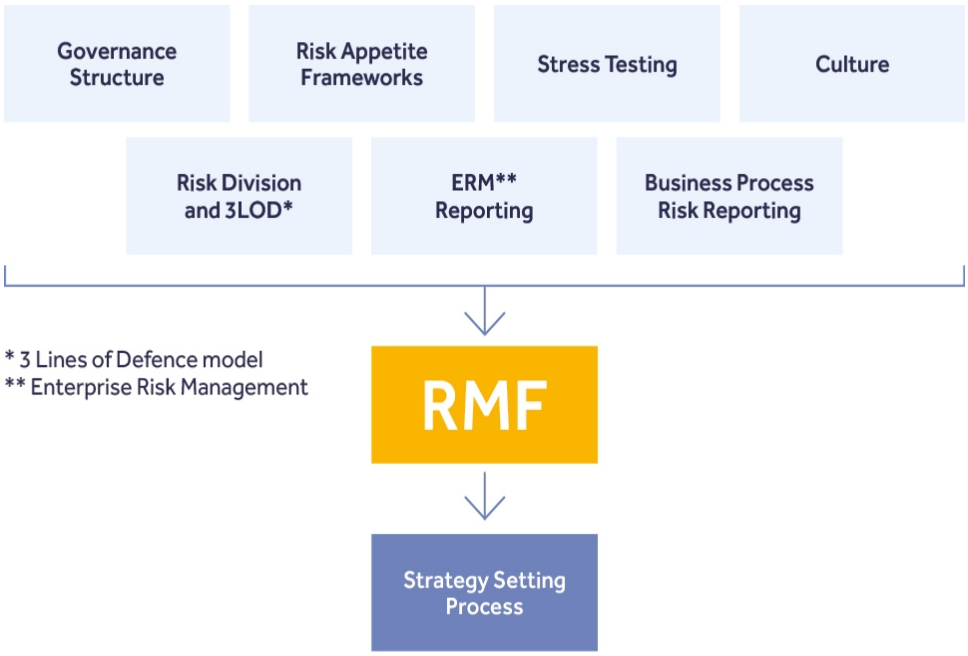
The Society recognises that effective management of the risks arising from its activities is fundamental to the long term success of the business. The Board aims to manage these risks through a formal structure for monitoring and managing risk. This comprises a range of Strategic Risk Appetite statements approved by the Board, detailed supporting frameworks and independent governance and oversight.

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

The CRR requires a concise risk statement approved by the management body succinctly describing the Society's overall risk profile associated with the business strategy. As set out below, the Board has a clearly defined risk appetite which assists the Society with the pursuit of its strategic objectives, in maintaining a quality capital base and achieving capital ratios which exceed both regulatory and internal minima. 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.

2.2 Risk Management Framework

The Risk Management Framework (RMF) explains how the Society deploys a structured approach to risk management and an integrated and holistic view of risks across the Society. This ensures an aligned and consistent approach to the aggregation and management of all risks, which are integrated into business management and decision making, at both strategic and operational levels.



Risk Management

The RMF is an integral part of the Society's strategy, providing a framework for the long term viability of the Society. The Board Risk Committee conducts an annual review of the Framework, on behalf of the Board, and the Chief Risk Officer (CRO) has responsibility for the effectiveness of its implementation.

The scope of the framework

The scope of the RMF extends to all risk types faced by the Society, which are captured within the Society's risk register. Although, the Society identifies, manages and reports against all risk register categories of risk, the Society has identified certain principal risks as summarised below:

Principal risk	Description of risk	Section
Credit risk	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.	5
Market risk	The risk that the value of, or income coming from, the Society's assets and liabilities changes adversely due to movements in interest rates or foreign currency rates.	6
Operational risk	The risk of financial or reputational loss as a result of inadequate or failed processes, people and systems or from external events.	7
Conduct risk	A form of operational risk, the risk that actual or potential customer detriment arises, or may arise, from the way the Society conducts its business.	
Liquidity risk	The risk that the Society is unable to meet its financial obligations as they fall due or can only do so at excessive cost.	8
Business risk	The risk of changes in the external environment that have the potential to affect negatively the Society's business model, such as major regulatory changes, increased levels of competition or macroeconomic conditions.	
Pension obligation risk	The risk that the value of the Society's defined benefit pension scheme assets will be insufficient to cover obligations over the remaining life of the scheme.	

The strategies and processes used to manage the risks identified above are described in the sections identified in the table above.

Hedging and mitigation of risk

Arrangements in place relating to credit risk on loans and advances to customers are covered in detail in note 36 to the Annual Report and Accounts for the year ended 31 December 2015. Information from this note which is required to be disclosed in accordance with Article 442 of the CRR is replicated in the credit risk section of this document. Data not replicated relates to loan to value distributions, fair value of collateral held and forbearance strategies.

Hedging arrangements in place in relation to market risk are discussed in sections 6.2 – 6.5. Counterparty credit risk in relation to derivatives and its mitigation are considered in section 5.3 of this document.

2.3 Risk governance

The Society maintains a robust governance framework which:

- allows the Board to maintain oversight of the risk universe;
- promotes independent challenge from non executive directors;
- delegates appropriate powers and mandates to committees and individuals;
- clearly cascades and articulates Board risk appetite through tiered policies and standards;
- promotes personal accountability; and
- ensures that corporate objectives are delivered within the agreed risk appetite.

2.4 Risk infrastructure

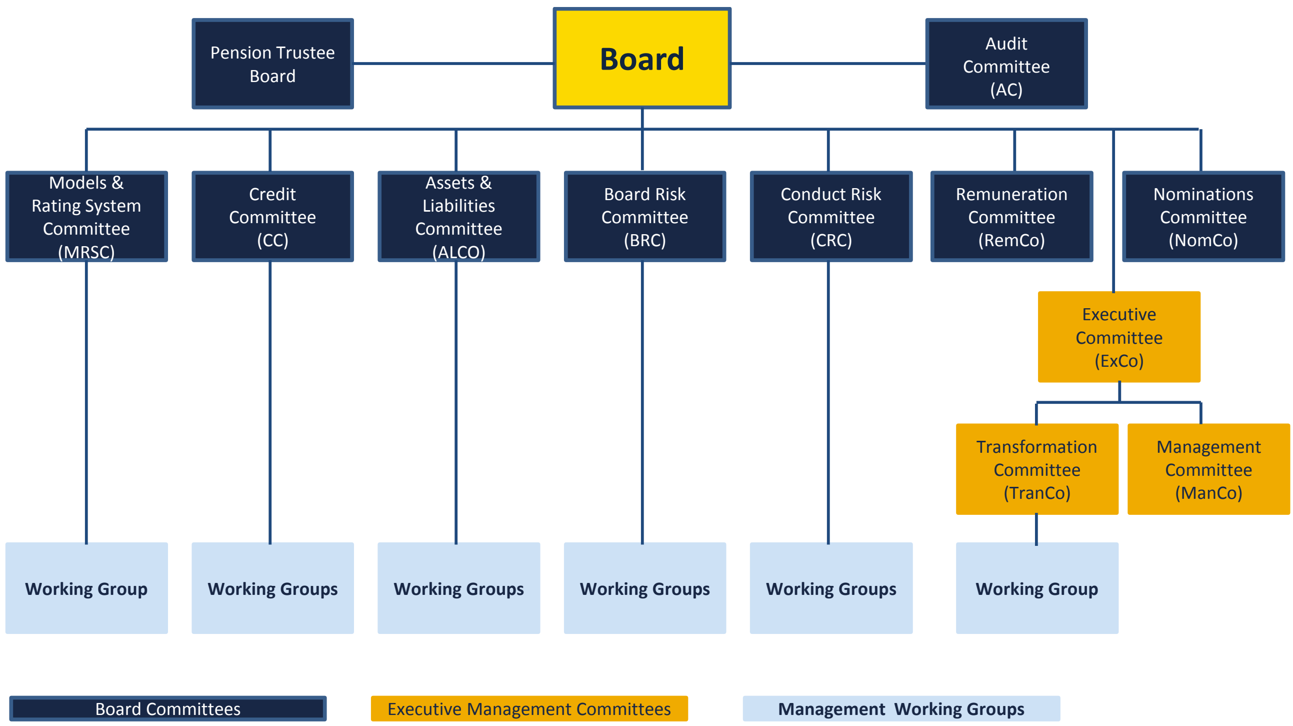
The risk governance infrastructure of the Society is supported by three tiers:

Tier	Infrastructure
Tier 1: Board Governance Infrastructure	• Board Terms of Reference (ToR) and Directors' Information Manual • Board level committee ToR for: ○ Board Risk Committee (BRC); ○ Assets and Liabilities Committee (ALCO); ○ Credit Committee (CC); ○ Conduct Risk Committee (CRC); ○ Remuneration Committee (RemCo); ○ Audit Committee (AC) ○ Nominations Committee (NomCo); and ○ Models and Rating Systems Committee (MRSC).
Tier 2: Executive management governance infrastructure	• List of Board delegated authorities • Executive management level committee ToR for: ○ Executive Committee; ○ Management Committee; and ○ Transformation Committee.
Tier 3: Supporting Risk Management Infrastructure Documentation	• Management level working groups' ToR; • Risk Management Framework; • Standardised committee reporting/management information; • Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), Liquidity Contingency Plan (LCP) and Recovery Plan and Resolution Information Pack; and • Society policies

2.5 Committee structure

During 2015, the Society successfully completed the initial phase of its committee structure migration. This has resulted in a ‘transitional’ structure where board committees are supported by management working groups, rather than executive management committees. The final phase of the migration will be implemented in early 2016 making the BRC the Society’s primary risk based board level committee.

The current committee structure is as follows:



The Corporate Governance Report on pages 44 to 52 of the Annual Report and Accounts for the year ended 31 December 2015 outlines the activities of the committees detailed above.

The Directors’ Remuneration Report is set out on pages 60 to 73 of the Annual Report and Accounts.

The number of times the committees met during 2015 and summaries of the committee constitutions can be found in the Corporate Governance Report referred to above.

2.6 Risk Function and three lines of defence model

Risk Function

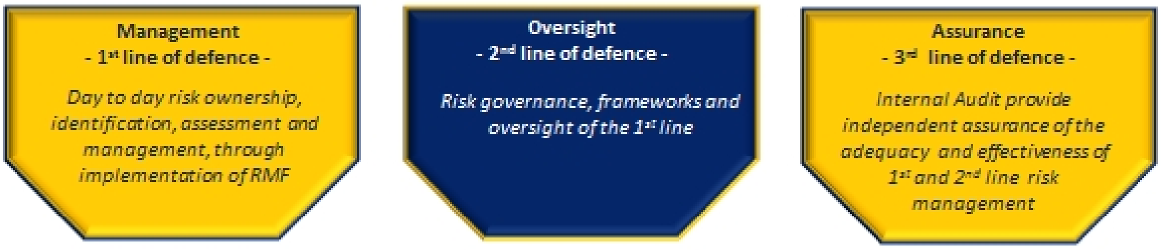
The Risk Function is independent from the operational business divisions. It ensures the Society follows an integrated approach to risk management and is led by the CRO, who reports directly to the Chief Executive Officer and is accountable to the Chairman of the BRC. There are specialist teams aligned with each of the key risk categories to drive good practice throughout the Society.

Three lines of defence model

In order for the RMF to operate effectively:

- Risk is owned by first line management and integrated with business processes; and
- Appropriate supporting arrangements exist to ensure independent risk expertise and assurance are available.

Risk management is a partnership between the operational business areas, the Risk Function and Internal Audit Function. The Society follows a 'three lines of defence' model for risk management:



2.7 Strategic Risk Appetite

A key element of the RMF is Strategic Risk Appetite (SRA). This comprises qualitative statements and quantitative metrics to provide the boundaries the Society must operate within. The Society's SRA is cascaded via policies and standards to ensure consistency and alignment to Board defined parameters.

The Board has defined SRA across six key areas, ensuring a broad suite of metrics is in place to cater for all Society stakeholders (including members, regulators, rating agencies and colleagues). The metrics are reviewed by the Board annually and are stress tested to ensure the long term viability of the Society under severe, but plausible scenarios. They are reported on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures and the Society has developed appropriate early warning indicators and escalation procedures, to address any deterioration in risk profile.

2.8 Risk culture

A sound risk culture is a key element of effective risk management. The Society's risk culture is built on the following pillars:

- Tone from the top – The Board and senior management are responsible for articulating the Society's values, demonstrating through action desired behaviours, holding staff accountable for their behaviour and monitoring behaviour throughout the Society.
- Accountability – All colleagues understand the core values of the Society and its approach to risk management, are capable of performing their prescribed roles and are aware they are held accountable for their actions.
- Effective communication and challenge – An environment of open communication and effective challenge exists in which decision making processes encourage a range of views.
- Incentives – Performance and talent management encourages and reinforces maintenance of the Society's desired risk management behaviour.

2.9 Stress Testing Framework

The Society's Stress Testing Framework (STF) is a risk management process that supports decision making at strategic and operational levels. Stress and scenario testing is an intrinsic component of risk governance and the Society's Board has ultimate responsibility for its application and ensuring it is embedded throughout the Society.

The STF provides the following:

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

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

Activity	Description
Corporate planning	Sensitivity analysis and 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 to withstand a severe stress.
Recovery plan	Scenario analysis is used to inform the development of a suite of capital and liquidity recovery actions, to be used under extreme stresses.
Reverse Stress Testing	An assessment of the stress scenarios under which the Society would potentially become unviable. This identifies weaknesses in the Society's business model under extreme events so that mitigating actions can be implemented.

3 Capital Resources

3.1 Total available capital

The requirements of the CRD IV package (described in more detail in section 1.1) will be implemented over a further six years; there are a number of transitional rules which apply.

The strength of the Society's capital position (primarily based on retained profits) and the conservative nature of the Society's lending, meant that the Society comfortably met the required capital resources and minimum leverage ratio throughout 2015, based on both the transitional rules (applied from 1 January 2014) and when considering the additional provisions which are being phased in between 2014 and 2021.

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 is currently set at zero by the FPC and is industry wide.

The requirement to maintain a capital conservation buffer will be phased in from 1 January 2016.

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.

As set out in section 3.2.2, the Society has amended its treatment of PIBS for regulatory capital purposes. This has had the impact of amending the total regulatory capital at 31 December 2014 on a transitional and full implementation basis.

On a transitional basis, the total regulatory capital at 31 December 2014 has been restated to £745.3m from £740.3m. The difference of £5.0m reflects the amount of PIBS derecognised from Additional Tier 1 which was not previously recognised as Tier 2 capital. On a full implementation basis, the total regulatory capital has been restated from £720.3m to £745.3m. The difference of £25.0m represents the total value of PIBS recorded as Tier 2 capital.

The change in treatment has had the overall impact of aligning total regulatory capital at £829.5m (2014: £745.3m) calculated on both a full implementation and transitional basis albeit the component parts still exhibit differences. These changes impact tables 1 – 3 in section 3, tables 4 and 5 in section 4 and table 27 in appendix A1.

Capital Resources

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

TABLE 1: Total Capital	Ref	Transitional CRD IV rules 2015 £m	Full implementation CRD IV rules 2015 £m	Transitional CRD IV rules 2014 £m	Full implementation CRD IV rules 2014 £m
Common Equity Tier 1 (CET 1)					
General reserve	3.2.1	765.1	765.1	674.7	674.7
Revaluation reserve	3.2.1	12.4	12.4	12.4	12.4
Available for sale reserve	3.2.1	(1.2)	(1.2)	3.9	3.9
Other reserve	3.2.1	14.3	14.3	14.3	14.3
CET 1 prior to regulatory adjustments		790.6	790.6	705.3	705.3
Regulatory adjustments:					
Pension scheme surplus	3.2.1	(5.1)	(5.1)	(1.3)	(1.3)
Intangible assets net of tax	3.2.1	(2.5)	(2.5)	-	-
CET 1 capital		783.0	783.0	704.0	704.0
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	3.2.2	(7.5)	(25.0)	(5.0)	(25.0)
Total Tier 1 capital		800.5	783.0	724.0	704.0
Tier 2 capital					
Collective provisions	3.3	21.5	21.5	16.3	16.3
Subordinated debt	3.3	-	-	0.9	0.9
Permanent interest bearing shares	3.2.2	7.5	25.0	5.0	25.0
Regulatory adjustments:					
Amortisation of subordinated debt under transitional rules	3.3	-	-	(0.9)	(0.9)
Total Tier 2 capital		29.0	46.5	21.3	41.3
Total regulatory capital		829.5	829.5	745.3	745.3

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 below.

Capital Resources

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 available for sale reserve. The general and other reserves represent the Society's accumulated profits, as well as adjustments for pension obligations.

At 31 December 2015 there was one CET1 regulatory deduction relating to a defined benefit pension surplus, which is not eligible capital under either the transitional or fully implemented CRD IV rules. The full excess of pension fund assets at fair value over pension scheme liabilities at present value of £5.1m (2014: £1.3m) has been deducted.

In addition to this amount a deduction of £2.5m (2014: £nil) has been made in respect of intangible assets (net of deferred tax) from eligible capital.

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 Tier 1 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 has derecognised 20% of the instrument in 2014, a further 10% in 2015 and intends to derecognise a further 10% each year thereafter. 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 is being recognised as Tier 2 capital. This represents a change in accounting compared with the treatment adopted and presented in the 2014 Pillar 3 disclosures.

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 11 for contact information).

3.3 Tier 2 capital

At 31 December 2015, Tier 2 capital comprises the Society's collective impairment provisions 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 loaded basis, PIBS qualify as and form part of Tier 2 capital.

The subordinated notes (which formed part of Tier 2 capital at 31 December 2014) were unsecured and ranked behind the claims of all depositors, creditors and investing members, but before holders of PIBS issued by the Society. The subordinated debt matured and was repaid on 9 March 2015. It had a fixed interest rate of 4.34% (2014: 4.34%).

Under regulatory rules, qualifying subordinated notes could not exceed 50% of the total of Tier 1 capital. Furthermore, Tier 2 capital cannot exceed Tier 1 capital. Given the magnitude of the subordinated debt balance and other components of Tier 2 capital, the Society was at all times comfortably within these ratios.

3.4 Capital reconciliation statement

A reconciliation of the accounting balance sheet to the regulatory balance sheet is disclosed below in accordance with EDTF recommendation 10.

TABLE 2: Capital reconciliation	Transitional CRD IV rules 2015 £m	Full implementation CRD IV rules 2015 £m	Transitional CRD IV rules 2014 £m	Full implementation CRD IV rules 2014 £m
Total CET 1 attributable to members per the Statement of Financial Position	**790.6**	**790.6**	705.3	705.3
Adjustments to CET 1 capital:				
Defined benefit pension surplus	**(5.1)**	**(5.1)**	(1.3)	(1.3)
Intangible assets net of tax	**(2.5)**	**(2.5)**	-	-
Total adjustments to CET1 capital	**(7.6)**	**(7.6)**	(1.3)	(1.3)
Adjustments to AT 1 capital:				
Permanent Interest Bearing Shares (PIBS)	**25.0**	**25.0**	25.0	25.0
Grandfathering of PIBS	**(7.5)**	**(25.0)**	(5.0)	(25.0)
AT 1 capital	**17.5**	**-**	20.0	-
Adjustments to Tier 2 capital:				
Collective impairment allow ance	**21.5**	**21.5**	16.3	16.3
Permanent Interest Bearing Shares	**7.5**	**25.0**	5.0	25.0
Tier 2 capital	**29.0**	**46.5**	21.3	41.3
Total regulatory capital	**829.5**	**829.5**	745.3	745.3

Capital Resources

3.5 Capital flow

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

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

TABLE 3: Capital flow	Transitional CRD IV rules 2015 £m	Transitional CRD IV rules 2014 £m
Total regulatory capital at 1 January	**745.3**	680.9
Adjustments to CET 1 capital:		
Profit for the period	**88.9**	69.4
Pension actuarial movement	**1.5**	(6.8)
Available for sale reserve	**(5.1)**	8.0
Movement in defined benefit surplus	**(3.8)**	(0.2)
Intangible assets	**(2.5)**	-
Total adjustments to CET1 capital	**79.0**	70.4
Adjustments to AT1 capital:		
Phasing of PIBS from AT1 to Tier 2 (see section 3.1)	**(2.5)**	(5.0)
Total adjustments to AT1 capital	**(2.5)**	(5.0)
Adjustments to Tier 2 capital:		
Add back: Collective impairment allowance charge/(credit)	**5.2**	(5.8)
Phasing of PIBS	**2.5**	5.0
Other deductions	**-**	(0.2)
Total adjustments to Tier 2 capital	**7.7**	(1.0)
Total regulatory capital at 31 December	**829.5**	745.3

4 Capital Adequacy

4.1 Capital Management Framework and Policy

The Society manages capital in accordance with the principles, approach and accountability documented within the Capital Management Framework (CMF) and Capital Management Policy. The capital management principles of the Society have been designed to meet the capital and leverage expectations of our key stakeholders.

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 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 ratio (see section 4.3)
- solvency (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

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 Risk Committee reviews internal refreshes of the ICAAP on a quarterly basis.

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 an Individual Capital Guidance (ICG) requirement plus the capital planning buffer (now referred to as the PRA buffer) for the Society. During 2015, the Society remained strongly capitalised with capital resources significantly above the PRA prescribed ICG and buffer requirements.

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, CVA and other commitments. The following table shows the capital requirement and resources surplus under Pillar 1 as at 31 December 2015 against the fully implemented total available capital CRD IV position.

TABLE 4: Pillar 1 capital requirement	Average risk weight 2015 %	Average capital requirement 2015 £m	**Risk weight 31.12.2015 %**	**Capital requirement 31.12.2015 £m**	Risk weight 31.12.2014 %	Capital requirement 31.12.2014 £m
Credit risk						
Residential mortgage loans	37.1%	309.8	**37.1%**	**330.1**	37.1%	289.4
Equity release	35.0%	5.1	**35.0%**	**5.1**	35.0%	5.1
Commercial mortgage loans	100.0%	17.6	**100.0%**	**13.6**	100.0%	21.5
Other loans	75.0%	0.2	**75.0%**	**0.1**	75.0%	0.2
Liquidity	5.0%	6.5	**4.7%**	**6.4**	5.2%	6.6
Other items	100.0%	5.0	**100.0%**	**4.1**	100.0%	5.8
Counterparty risk (derivatives including CVA)		8.4		**11.4**		5.4
Total credit risk requirement		352.6		**370.8**		334.0
Operational risk		22.0		**24.2**		19.7
Other commitments		7.8		**8.7**		6.9
Pillar 1 capital requirement		382.4		**403.7**		360.6
Total regulatory capital		787.4		**829.5**		745.3
Excess capital over minimum Pillar 1 requirement		405.0		**425.8**		384.7

CRD IV requires the inclusion of an additional Pillar 1 capital charge for potential market value losses on Over The Counter (OTC) derivatives, 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.

As the Society does not experience large variations in its risk weighted assets month on month, 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.

Capital Adequacy

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 £5,045.9m (2014: £4,507.5m).

TABLE 5: Capital ratios	Regulatory requirement 2015 minimum %	Full implementation CRD IV rules 2015 actual %	Regulatory requirement 2014 minimum %	Full implementation CRD IV rules 2014 actual %
Capital ratios				
Common Equity Tier 1 ratio	**4.5%**	**15.5%**	4.5%	15.6%
Tier 1 ratio	**6.0%**	**15.5%**	6.0%	15.6%
Total regulatory capital ratio	**8.0%**	**16.4%**	8.0%	16.5%

The tables below shows the movements in credit risk weighted assets between 1 January 2014 and 31 December 2015 in line with EDTF recommendation 16 and reconciles to total risk weighted assets on which the ratios above are based.

TABLE 6: Risk weighted assets flow	Residential mortgages £m	Equity release mortgages £m	Commercial mortgages £m	Liquidity £m	Other items £m	Counterparty risk £m	Total £m
Credit RWA at 1 January 2015	**3,617.5**	**63.8**	**268.8**	**82.5**	**75.0**	**67.5**	**4,175.1**
Change in RWA %	0.7	-	-	(0.4)	0.2	-	**0.5**
Change in portfolio size	508.1	-	(98.8)	(2.4)	(22.6)	75.0	**459.3**
Credit RWA at 31 December 2015	**4,126.3**	**63.8**	**170.0**	**79.7**	**52.6**	**142.5**	**4,634.9**
Operational risk							**302.3**
Other commitments							**108.7**
Total risk weighted assets at 31 December 2015							**5,045.9**

	Residential mortgages £m	Equity release mortgages £m	Commercial mortgages £m	Liquidity £m	Other items £m	Counterparty risk £m	Total £m
Credit RWA at 1 January 2014	**3,422.5**	**63.8**	**359.9**	**113.8**	**76.3**	**78.8**	**4,115.1**
Change in RWA %	(88.3)	-	-	(1.2)	-	-	**(89.5)**
Change in portfolio size	283.3	-	(91.1)	(30.1)	(1.3)	(11.3)	**149.5**
Credit RWA at 31 December 2014	**3,617.5**	**63.8**	**268.8**	**82.5**	**75.0**	**67.5**	**4,175.1**
Operational risk							**246.2**
Other commitments							**86.2**
Total risk weighted assets at 31 December 2014							**4,507.5**

The RWA movement for residential mortgages reflects the growth in mortgage balances of £1.3bn.

The reduction in the commercial mortgage RWA has been driven by the overall reduction in the portfolio as the Society continues to implement actions to reduce the portfolio.

4.4 Leverage ratio

The table below shows 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	2015 £m	2014 £m
Total assets as per published financial statements **	13,499.0	12,129.9
Positive market value of derivatives	(104.9)	(120.4)
Total assets excluding derivatives	13,394.1	12,009.5
Adjustments for derivative financial instruments	165.2	88.0
Adjustments for repurchase agreements	25.0	70.0
Mortgage pipeline	292.3	90.2
Other committed facilities	349.4	270.0
Total leverage ratio exposures	**14,226.0**	**12,527.7**

** £13,506.6m per financial statements - Tier 1 capital deductions of £7.6m (2014: £12,131.2m - £1.3m)

Capital Adequacy

The leverage ratio common disclosure is as follows.

TABLE 7b: Leverage ratio common disclosure	2015 £m	2014 £m
On-balance sheet exposures (excluding derivatives and repurchase transactions)		
On-balance sheet items (excluding derivatives, repurchase transactions and fiduciary assets, but including collateral)	13,401.7	12,010.8
Asset amounts deducted in determining Tier 1 capital	(7.6)	(1.3)
Total on-balance sheet exposures (excluding derivatives, repurchase agreements and fiduciary assets)	**13,394.1**	**12,009.5**
Derivative exposures		
Replacement cost associated with all derivative transactions	71.6	24.1
Add on amounts for Potential Future Exposure (PFE) associated with all derivatives transactions	93.6	63.9
Total derivative exposures	**165.2**	**88.0**
Repurchase transaction exposures		
Gross repurchase transaction assets (with no recognition of netting) after adjusting for sales accounting transactions	25.0	70.0
Total repurchase transaction exposures	**25.0**	**70.0**
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	934.0	721.0
Adjustments for conversion to credit equivalent amounts	(292.3)	(360.8)
Other off-balance sheet exposures	**641.7**	**360.2**
Capital and total exposures		
Tier 1 capital	783.0	704.0
Total leverage ratio exposures	14,226.0	12,527.7
Leverage ratio		
Leverage ratio	5.5%	5.6%

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.

TABLE 7c: Split of on-balance sheet exposures	2015 £m	2014 £m
Total on-balance sheet exposures (excluding derivatives, repurchase transactions and exempted exposures) are fully represented by banking book exposures of which:	13,401.7	12,010.8
Covered bonds	59.3	17.0
Exposures treated as sovereigns	1,052.0	1,064.4
Exposures to regional governments, multilateral development banks, international organisations and public sector entities not treated as sovereigns	218.2	178.8
Institutions	175.3	281.5
Secured by mortgages on immovable property	11,357.5	10,043.4
Exposures in default	165.1	199.2
Other exposures (for example equity, securitisations and other non-credit obligation assets)	374.3	226.5

With a leverage ratio of 5.5% at 31 December 2015, the Society's risk to excessive leverage is regarded as low. This is based on regulatory guidance currently expected to come into force from 2018 and our position relative to our peers.

In 2015 the Bank of England 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, the wholesale markets may expect firms to meet minimum requirements even if not captured by the regulations. Firms in scope will be required to meet a minimum ratio requirement of 3.0% 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 ratio is considerably in excess of the potential 3.9% (minimum plus countercyclical buffer element). The ratio is internally monitored on a monthly basis against risk appetite and proposed regulatory changes. The current ratio of 5.5% is broadly in line with the equivalent figure of 5.6% at 31 December 2014.

Factors which have had an impact on the ratio in 2015 include:

- increase in Tier 1 capital through retained earnings;
- increase in on-balance sheet assets via growth in mortgage balances of £1.3bn; and
- annual review of the application of credit conversion factors in accordance with regulation (resulting in use of 50% against 20% in 2014).

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.

Background and outlook

Retail

The key driver of retail credit risk within the Society is the performance of the UK economy. Deterioration in the UK economic environment could result in increased levels of unemployment, an erosion of real household income and reductions in the value of residential property. The combination of these factors may lead to increased levels of mortgage arrears and, in some cases, losses.

During 2015, the UK economy performed steadily. As a result, unemployment declined and real wage inflation started to gain momentum. These economic conditions, coupled with low interest rates, have continued to be supportive of housing market activity.

The current outlook for the UK economy in 2016 remains positive, with economic growth forecast to be broadly in line with 2015. However, uncertainties remain that could impact UK economic performance, such as increasing levels of household debt, the timing and speed of interest rate increases, the outcome of the promised EU referendum, and the implementation of initiatives to reduce the UK's budget deficit. As a consequence, the Society retains a prudent stance to new retail mortgage lending.

Retail credit risk within the Society is also influenced by the performance of the Irish and Spanish economies, through legacy residential lending portfolios (less than 2% of total loan balances). During 2015, both the Irish and Spanish economies experienced improvements in economic performance. Whilst the economic outlook for each country is positive, recoveries within both remain fragile.

Commercial

The UK economic environment also affects the performance of the Society's legacy commercial loan portfolio. Following the financial crisis, reduced demand for UK goods and services led to lower levels of rental demand and, as a consequence, lower commercial property prices. The economic recovery has partly reversed these reductions, although the extent of reversal depends on sector and geography.

The Society stopped advancing new commercial loans in 2008 and has successfully deployed a strategy to reduce its exposure to this area. In 2015, the portfolio reduced by a further £75m to £194m, exclusive of provisions. The Society is seeking to further reduce its commercial asset exposure in 2016, supported by current economic forecasts.

5.2 Retail and commercial credit risk

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

TABLE 8: Retail and commercial credit risk	Average £m	2015 £m	2014 £m
Retail mortgages	10,453.6	11,150.6	9,756.6
Commercial lending	231.4	194.0	268.8
Other loans	184.2	183.5	184.8
Total gross exposure (contractual amounts)	10,869.2	11,528.1	10,210.2
Impairment, fair value, EIR and hedging adjustments	33.5	16.2	50.7
Total net exposures	10,902.7	11,544.3	10,260.9

Retail credit risk mitigation

Exposure to this risk is managed by the Operations Function and overseen by a specialist Retail Credit Risk Function, reporting to the CRO. Further oversight is provided by dedicated working groups, the CC and BRC.

The Society's Credit Policy is formally approved annually by the CC and reviewed on an ongoing basis. This Policy details current limit structures for mortgage lending and reflects the Society's current credit risk appetite. The CC receives management information highlighting the performance of the Society's mortgage portfolio.

Retail credit risk for new lending is managed using the following tools:

- credit scorecard assessment;
- affordability assessment based on income and expenditure under current and stressed interest rates;
- credit data (reviewing the credit history of an individual);
- independent expert appraisal of the suitability and value of a property; and
- underwriting systems, which are a combination of quantitative scoring systems and suitably qualified underwriters.

The Society's Credit Risk Function monitors the performance of the portfolio, including stress testing, on an ongoing basis. This identifies trends which help to build an understanding of the portfolio, to assess whether the current risk appetite remains appropriate, or, if not, what changes may be required.

If a borrower's financial situation starts to deteriorate, the Society has established procedures to respond appropriately. A dedicated Collections Function engages with customers at an early stage to discuss financial difficulties. The Society is able to offer customers an appropriate range of forbearance options including: an extension 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). Forbearance options are determined on a case by case basis, with the aim of working with borrowers to clear arrears. After all other options have been exhausted, the Society may take possession of the mortgaged property.

Credit Risk

Oversight of the Society's arrears management activity is provided by a dedicated working group and the CC. In addition, the Risk Function also conducts regular assessments to ensure that customers are treated appropriately.

An analysis of the Society's residential portfolio and forbearance activity is used to inform the provisioning policy to ensure losses are properly recognised in accordance with accounting policies.

Exposures by geographic region

As shown in the table below, the largest regional concentrations are in the South East, Greater London, Midlands and Yorkshire and Humberside.

TABLE 9: Retail mortgages by region	2015 £m	2015 %	2014 £m	2014 %
Retail regional analysis				
East of England	**433.0**	**3.9%**	353.8	3.6%
Greater London	**1,268.9**	**11.4%**	1,106.9	11.3%
Midlands	**1,431.2**	**12.8%**	1,209.8	12.4%
North East	**478.9**	**4.3%**	447.7	4.6%
North West	**847.3**	**7.6%**	748.2	7.7%
Northern Ireland	**347.0**	**3.1%**	346.4	3.6%
Other	**27.1**	**0.2%**	39.0	0.4%
Scotland	**724.8**	**6.5%**	639.1	6.6%
South East	**2,742.9**	**24.6%**	2,263.7	23.2%
South West	**1,019.1**	**9.1%**	849.8	8.7%
Southern Ireland	**146.3**	**1.3%**	159.8	1.6%
Spain	**76.2**	**0.7%**	85.7	0.9%
Wales	**375.7**	**3.4%**	335.9	3.4%
Yorkshire and Humberside	**1,232.2**	**11.1%**	1,170.8	12.0%
Total	**11,150.6**	**100.0%**	9,756.6	100.0%

Credit Risk

Residential maturity profile

TABLE 10: Retail maturity	2015 Up to 12 months £m	 1 - 5 years £m	 > 5 years £m	 Total £m
Asset classes				
Secured by mortagages on immovable property	**53.3**	**355.8**	**10,736.9**	**11,146.0**

The table above is net of impairment, fair value, EIR and hedging adjustments of £4.6m.

	2014 Up to 12 months £m	 1 - 5 years £m	 > 5 years £m	 Total £m
Asset classes				
Secured by mortagages on immovable property	56.3	328.6	9,371.7	9,756.6

Commercial credit risk mitigation

Following the closure of commercial lending operations to new customers in 2008, the Society has retained a team of appropriately skilled colleagues to implement its exit strategy. This team is supported by the Risk Function, which provides second line oversight of the performance and management of the portfolio.

Portfolio performance is monitored closely and overseen by a working group and the CC, with monthly reporting to the Board. All loans are assessed on a case by case basis, using a broad range of potential impairment indicators. If a loan is deemed impaired then the Society uses a combination of formal recovery actions and appropriate forbearance, including loan extensions, restructures or property sales, to reduce the size of the loan book and minimise losses.

The performance of the commercial portfolio and forbearance measures inform the Society's provisioning judgements.

Credit Risk

Exposures by sector

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

TABLE 11: Exposures by sector	2015 £m	2015 %	2014 £m	2014 %
Sector				
Retail	**60.7**	**31.3%**	95.2	35.4%
Offices	**74.9**	**38.6%**	99.2	36.9%
Commercial investment and industrial units	**39.6**	**20.4%**	55.2	20.5%
Leisure and hotel	**2.9**	**1.5%**	3.0	1.1%
Other, including mixed use	**15.9**	**8.2%**	16.2	6.1%
Total	**194.0**	**100.0%**	268.8	100.0%

Exposures by geographic region

The table below shows a regionally diverse commercial loan portfolio with the largest concentration being in the South East and Greater London.

TABLE 12: Commercial exposures by region	2015 £m	2015 %	2014 £m	2014 %
Commercial regional analysis				
East of England	**15.7**	**8.1%**	22.0	8.2%
Gibraltar	**0.4**	**0.2%**	1.3	0.5%
Greater London	**29.4**	**15.2%**	41.4	15.4%
Midlands	**5.7**	**2.9%**	14.5	5.4%
North East	**13.4**	**6.9%**	25.0	9.3%
North West	**20.3**	**10.5%**	23.7	8.8%
Scotland	**11.5**	**5.9%**	14.2	5.3%
South East	**66.1**	**34.0%**	83.3	31.0%
South West	**3.4**	**1.8%**	8.9	3.3%
Wales	**4.5**	**2.3%**	4.7	1.7%
Yorkshire and Humberside	**23.6**	**12.2%**	29.8	11.1%
Total	**194.0**	**100.0%**	268.8	100.0%

Credit Risk

Commercial maturity profile

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

TABLE 13: Commercial maturity	**2015** **Up to 12 months** **£m**	**1 - 5 years** **£m**	**> 5 years** **£m**	**Total** **£m**
Asset classes				
Secured by mortagages on immovable property	**72.4**	**98.6**	**23.0**	**194.0**

	2014 Up to 12 months £m	1 - 5 years £m	> 5 years £m	Total £m
Asset classes				
Secured by mortagages on immovable property	78.7	144.2	45.9	268.8

5.3 Wholesale credit risk

Background and outlook

Since the onset of the financial crisis, global financial markets and economies across the world have experienced significant levels of volatility and stress. Although economic data suggests that the UK recovery is becoming established, recoveries in many other countries have been prolonged with legacy issues, such as high unemployment, high levels of government debt and depressed property values, acting as a barrier to sustainable economic growth. In order to stimulate growth, a number of central banks have continued to loosen monetary policy, though the unwinding of this support could be a source of potential stress in the future.

The Society has no direct wholesale credit exposure to sovereign or financial institutions in Cyprus, Greece, Ireland, Italy, Portugal, Spain, or Russia.

Wholesale credit risk mitigation

Wholesale credit risk emanates from the Society's assets held within the liquidity portfolio and derivative exposures.

Liquidity portfolio

Following the financial crisis, the Society significantly tightened its wholesale counterparty credit criteria. This resulted in limits and exposures being mainly UK centric, with limits extended to only a small number of highly rated counterparties based outside the UK. The Society's UK exposure is diversified, through holdings of UK Government securities, holdings in highly rated financial institutions, and asset backed securities, along with deposits at the Bank of England.

Every wholesale counterparty is subject to a full review on at least an annual basis. This ensures that counterparty exposures remain compliant with Board approved wholesale credit limits and policy. Established credit lines are based on a combination of internal assessment, credit default swap spreads, the jurisdiction in which the counterparty is domiciled and other market intelligence.

Operationally, a dedicated resource within the first line Treasury Function monitors the Society's exposures on a daily basis, reporting market developments as appropriate. Oversight is provided by the Risk Function and a dedicated working group, which reviews wholesale credit exposures. ALCO also receives management information about wholesale credit exposures at each meeting.

Derivative exposures

The Society only enters into derivative contracts for hedging market risk, not for trading or speculative purposes. The same credit assessment and limit structure as operated for the liquidity portfolio is applied to assess the creditworthiness of a derivative counterparty.

In recent years the Society has sought to reduce its derivative counterparty exposures through the centralised clearing of interest rate swaps. Derivative exposures arising from swaps that are not currently eligible for clearing are mitigated through a netting arrangement, allowing the Society to net off individual transactions in the event of a default. Credit Support Annexes (CSA) limit potential exposures, through the exchange of collateral between the Society and its swap counterparties.

Credit Risk

Short term investments

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

TABLE 14: Credit quality steps for short term investments			2015 Exposure £m	2015 Risk weight %	2014 Exposure £m	2014 Risk weight %
Credit quality step	**Fitch rating**	**Moody's rating**				
1	AAA to AA-	Aaa to Aa3	**820.3**	**0.5%**	650.3	1.5%
2	A+ to A-	A1 to A3	**68.2**	**20.0%**	129.2	20.0%
3	BBB+ to BBB-	Baa1 to Baa3	**0.2**	**20.0%**	72.2	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	**-**	**-**	-	-
Total short term investments			**888.7**		851.7	

Long term investments

TABLE 15: Credit quality steps for long term investments			2015 Exposure £m	2015 Risk weight %	2014 Exposure £m	2014 Risk weight %
Credit quality step	**Fitch rating**	**Moody's rating**				
1	AAA to AA-	Aaa to Aa3	**964.0**	**2.3%**	981.5	1.2%
2	A+ to A-	A1 to A3	**74.9**	**50.0%**	30.5	50.0%
3	BBB+ to BBB-	Baa1 to Baa3	**-**	**-**	-	-
4	BB+ to BB-	Ba1 to Ba3	**1.7**	**100.0%**	1.7	100.0%
5	B+ to B-	B1 to B3	**-**	**-**	-	-
6	CCC+ and below	Caa1 and below	**-**	**-**	-	-
Unrated	Unrated	Unrated	**-**	**-**	6.7	50.0%
Total long term investments			**1,040.6**		1,020.4	

The Society has nominated two External Credit Assessment Institutions (ECAIs) to assign to credit quality steps for short and long terms 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 16: Exposures by asset class	2015 Average Exposure £m	2015 Average RWA %	2015 Year end £m	2015 RWA £m	2015 Weighted average RWA %
Asset class					
Central goverments or central banks	1,368.2	-	1,402.0	-	-
Public sector entities	38.4	-	53.9	-	-
Multilateral development banks	160.2	-	164.3	-	-
Institutions	228.4	28.6%	175.3	58.9	33.6%
Covered bonds	38.2	10.0%	59.3	5.9	9.9%
Securitisation positions	64.1	20.3%	74.5	14.9	20.0%
Other items	3.4	25.4%	-	-	-
Total	1,900.9		1,929.3	79.7	

	2014 Average Exposure £m	2014 Average RWA %	2014 Year end £m	2014 RWA £m	2014 Weighted average RWA %
Asset class					
Central goverments or central banks	1,390.3	-	1,334.4	-	-
Public sector entities	35.4	-	22.8	-	-
Multilateral development banks	148.7	-	156.0	-	-
Institutions	239.7	28.0%	281.5	66.3	23.6%
Covered bonds	48.8	10.0%	17.0	1.7	10.0%
Securitisation positions	94.3	20.0%	53.7	11.1	20.7%
Other items	4.4	50.0%	6.7	3.4	50.7%
Total	1,961.6		1,872.1	82.5	

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 17: Geographic region	2015 UK £m	Europe £m	Europe supra-national £m	North America £m	Global supra-national £m	Far East £m	Total £m
Asset class							
Central goverments or central banks	1,402.0	-	-	-	-	-	1,402.0
Public sector entities	-	53.9	-	-	-	-	53.9
Multilateral development banks	-	-	65.1	1.8	52.2	45.2	164.3
Institutions	102.1	73.1	-	0.1	-	-	175.3
Covered bonds	59.3	-	-	-	-	-	59.3
Securitisation positions	74.5						74.5
Total	1,637.9	127.0	65.1	1.9	52.2	45.2	1,929.3

	2014 UK £m	Europe £m	Europe supra-national £m	North america £m	Global supra-national £m	Far east £m	Total £m
Asset class							
Central goverments or central banks	1,334.4	-	-	-	-	-	1,334.4
Public sector entities	-	22.8	-	-	-	-	22.8
Multilateral development banks	-	-	58.5	10.0	52.5	35.0	156.0
Institutions	163.8	81.2	-	36.5	-	-	281.5
Covered bonds	17.0	-	-	-	-	-	17.0
Securitisation positions	53.7						53.7
Other items	6.7	-	-	-	-	-	6.7
Total	1,575.6	104.0	58.5	46.5	52.5	35.0	1,872.1

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 18: Residual maturity	2015 Up to 12 months £m	1 - 5 years £m	5 > years £m	Total £m
Asset class				
Central goverments or central banks	1,099.1	302.9	-	1,402.0
Public sector entities	8.1	45.8	-	53.9
Multilateral development banks	65.1	97.4	1.8	164.3
Institutions	173.6	1.7	-	175.3
Covered bonds	2.0	57.3	-	59.3
Securitisation positions	-	-	74.5	74.5
Total	**1,347.9**	**505.1**	**76.3**	**1,929.3**

	2014 Up to 12 months £m	1 - 5 years £m	5 > years £m	Total £m
Asset class				
Central goverments or central banks	877.3	457.1	-	1,334.4
Public sector entities	7.9	14.9	-	22.8
Multilateral development banks	42.5	113.5	-	156.0
Institutions	279.8	1.7	-	281.5
Covered bonds	5.0	12.0	-	17.0
Securitisation positions			53.7	53.7
Other items	6.7	-	-	6.7
Total	**1,219.2**	**599.2**	**53.7**	**1,872.1**

Credit Risk

Counterparty credit risk in relation to derivatives

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 deposited by some counterparties (collateral held) under a 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 2015, the Society monitored its collateral positions on a daily basis, with all collateral being transacted in line with the agreed terms of our CSAs, and taking the form of cash. If the Society were to be downgraded, additional collateral (of up to 50% of the initial margin) would potentially be required by the counterparty under one CSA. ‘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 2015:

TABLE 19: Counterparty Credit Risk for derivative contracts	2015 Notional £m	2015 Exposure £m	2014 Notional £m	2014 Exposure £m
Centrally cleared derivative contracts				
Interest rate contracts	**9,704.7**	**28.0**	4,135.6	18.8
Bilateral contracts				
Interest rate contracts	**3,607.5**	**47.7**	4,806.5	67.4
Quanto sw aps	**-**	**-**	14.5	-
Equity sw aps	**198.9**	**12.6**	262.8	25.6
Cross currency sw aps	**1,255.4**	**16.0**	376.5	7.7
Floating sw aps	**750.0**	**0.5**	791.7	0.9
Bank base rate sw aps	**528.8**	**0.1**	1,025.9	-
Gross positive fair value of contracts	**16,045.3**	**104.9**	11,413.5	120.4
Netting benefits and collateral		**(33.3)**		(96.3)
Replacement cost of derivatives		**71.6**		24.1
Potential future credit exposure		**93.6**		63.9
Derivative exposure including potential future credit exposure		**165.2**		88.0

Whilst exchange traded derivatives have been cleared through Central Counterparties (CCPs) for many years, recent regulatory initiatives designed to reduce systemic risk in the financial system are directing increasing volumes of OTC derivatives to be cleared through CCPs. The Society now transacts all new qualifying swaps through CCPs.

5.4 Impairment of financial assets

Impairment provision

Individual assessments are made of all mortgage loans in arrears or possession and investment securities where there is objective evidence that all cashflows will not be received. Based on these assessments, an individual impairment provision of these assets is made. In addition, a collective impairment provision is made against those loans and advances to customers where objective evidence, including forbearance measures, indicates that it is likely that losses may ultimately be realised and a loss event has occurred. The impairment value is calculated by applying various factors to each loan. These factors take into account the Society's experience of default and delinquency rates, loss emergence periods, regional house price movements and adjustments to allow for forced sale values.

Past due and impaired loans

Impaired loans are those loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or does not expect to collect them when they are contractually due.

Loans past due occur when a borrower has failed to make a payment when it is contractually due.

The following table shows the movement in the year in impairment provisions.

Credit Risk

TABLE 20: Movement in impairment provisions	2015 Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2015				
Collective impairment	9.8	6.5	-	16.3
Individual impairment	19.8	18.5	2.5	40.8
Opening impairment	**29.6**	**25.0**	**2.5**	**57.1**
Income and expenditure account				
Charge for the year:				
Collective impairment	1.0	4.2	-	5.2
Individual impairment	5.8	8.1	-	13.9
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.6)	-	-	(0.6)
Total income and expenditure	**6.2**	**12.3**	**-**	**18.5**
Amount written off during the year:				
Individual impairment	(9.9)	(1.6)	-	(11.5)
At 31 December 2015				
Collective impairment	10.8	10.7	-	21.5
Individual impairment	15.1	25.0	2.5	42.6
Closing impairment	**25.9**	**35.7**	**2.5**	**64.1**

The proportion of the impairment provisions relating to Spain and Ireland is disclosed below table 21 on page 39. The remainder of the provision balances relates to UK loans.

TABLE 20: Movement in impairment provisions	2014 Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2014				
Collective impairment	12.3	9.8	-	22.1
Individual impairment	25.8	26.6	-	52.4
Opening impairment	**38.1**	**36.4**	**-**	**74.5**
Income and expenditure account				
Charge/(release) for the year:				
Collective impairment	(2.5)	(3.3)	-	(5.8)
Individual impairment	9.1	34.4	2.5	46.0
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.7)	-	-	(0.7)
Total income and expenditure	**5.9**	**31.1**	**2.5**	**39.5**
Amount w ritten off during the year:				
Individual impairment	(14.4)	(42.5)	-	(56.9)
At 31 December 2014				
Collective impairment	9.8	6.5	-	16.3
Individual impairment	19.8	18.5	2.5	40.8
Closing impairment	**29.6**	**25.0**	**2.5**	**57.1**

The table on the following pages shows the payment status of loans.

Credit Risk

TABLE 21: Retail lending impairment	Group and Society Residential 2015 £m	Group and Society Residential 2015 %	Group and Society Other 2015 £m	Group and Society Other 2015 %
Not impaired:				
Neither past due nor impaired	10,707.6	96.0%	181.0	98.6%
Past due up to 3 months not impaired	297.1	2.7%	-	-
Impaired:				
Not past due impaired	-	-	2.5	1.4%
Past due 3 to 6 months	58.7	0.5%	-	-
Past due 6 to 12 months	41.1	0.4%	-	-
Past due over 12 months	32.7	0.3%	-	-
Possessions	13.4	0.1%	-	-
Total	11,150.6	100.0%	183.5	100.0%

	Group and Society Residential 2014 £m	Group and Society Residential 2014 %	Group and Society Other 2014 £m	Group and Society Other 2014 %
Not impaired:				
Neither past due nor impaired	9,256.4	94.9%	182.3	98.6%
Past due up to 3 months not impaired	330.4	3.4%	-	-
Impaired:				
Not past due impaired	-	-	2.5	1.4%
Past due 3 to 6 months	72.5	0.7%	-	-
Past due 6 to 12 months	40.4	0.4%	-	-
Past due over 12 months	39.9	0.4%	-	-
Possessions	17.0	0.2%	-	-
Total	9,756.6	100.0%	184.8	100.0%

The impairment provisions for the Society's Spanish and Irish portfolio included in the above tables in the 2015 data are £2.9m and £10.1m respectively (2014: £3.0m and £13.3m).

The 2015 value of impaired loans in Spain and Ireland shown in the above tables are £4.2m and £24.3m respectively (2014: £6.4m and £31.8m).

The Society does not have any impaired wholesale counterparty exposures (2014: £nil).

TABLE 22: Commercial lending impairment	Group & Society Commercial 2015 £m	2015 %	Group & Society Commercial 2014 £m	2014 %
Not impaired:				
Neither past due nor impaired	**137.8**	**71.0%**	197.7	73.6%
Past due up to 3 months not impaired	**-**	**-**	-	-
Impaired:				
Not past due impaired	**42.8**	**22.1%**	43.5	16.2%
Past due up to 3 months	**0.1**	**-**	3.5	1.3%
Past due 3 to 6 months	**-**	**-**	-	-
Past due 6 to 12 months	**-**	**-**	-	-
Past due over 12 months	**-**	**-**	-	-
Possessions	**13.3**	**6.9%**	24.1	8.9%
Total	**194.0**	**100.0%**	268.8	100.0%

6 Market Risk

6.1 Market risk overview

Market risk is the risk that the value of, or income coming from, the Society's assets and liabilities changes adversely due to movements in interest rates or foreign currency rates.

Background and outlook

In recent years, the UK has experienced a low interest rate environment. During 2015, the ongoing uncertainty about the timing of Bank Base Rate increases resulted in fluctuations in swap rates. It is expected that markets will continue to fluctuate throughout 2016, due to the ongoing uncertainty in the global economy.

Daily operational management

On a daily basis, the Society's exposure to market risk is managed by the Treasury Function, in line with the 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

The Society is exposed to interest rate risk, due to the differing interest rate characteristics and maturity profile of its mortgage and savings products. From an earnings perspective, in the event of an upward or downward movement in interest rates, the Society is exposed to net interest income variances, the extent of which depends on the interest rate characteristics of the balance sheet at the time of any rate change.

The Society converts fixed cash flows to a variable rate basis, where appropriate, through interest rate derivatives so that cash flows follow the general movements in interest rates and reduce the risk exposure.

The Society is also exposed to other variations of interest rate risk such as basis risk (as a consequence of changes in the relationship between different interest rates, which have similar but not identical characteristics for example Libor and the Bank of England Base Rate) and product option risk (as a consequence of customer behaviour, arising from certain product features).

All interest rate exposures are managed through the use of Board approved limits, offsetting assets and liabilities, as well as the use of financial derivative instruments, such as interest rate and basis swaps. Board limits are reviewed annually and ALCO receives management information on interest rate risk exposures. Operationally, the Treasury Function is responsible for managing the Society's interest rate and basis risk exposures. This is overseen by the Risk Function.

Market Risk

Under the PRA's 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.

The table below details the Society's sensitivity to a 200bps change in interest rates, at 31 December 2015, with all other variables held constant. A positive number indicates an increase in earnings or market value.

TABLE 23: Interest rate sensitivity	Annual earnings sensitivity			
	2015		2014	
	+200 bps £m	-200 bps £m	+200 bps £m	-200 bps £m
Annual earnings sensitivity	43.1	(6.6)	27.6	(7.7)

	Market value sensitivity			
	2015		2014	
	+200 bps £m	-200 bps £m	+200 bps £m	-200 bps £m
Market value sensitivity	(5.2)	0.9	(5.1)	(1.2)

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 2015 is £1.2m down on its prior year equivalent of £1.9m. The interest rate risk position of the Society is reviewed three times a week and the key IRR 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
- no assumption is included for prepayments within the gap and market value risk reporting that is run on a thrice weekly basis.

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 the risk of loss emanating from movements in foreign exchange rates. The Society is exposed to appreciation in the value of foreign currency denominated liabilities or depreciation in foreign currency denominated assets. While the Society's assets and liabilities are mainly denominated in sterling, these exposures arise from the Society's wholesale funding operations and legacy Irish and Spanish residential portfolios.

Foreign currency risk is managed through Board approved limits, offsetting assets and liabilities and the use of financial derivative instruments, such as foreign currency derivatives. The Treasury Function is responsible for managing the Society's foreign currency risk exposures, with oversight provided by the Risk Function.

A subset of foreign currency risk is redenomination risk. This is the risk of loss as a result of a reduction in the value of foreign currency denominated assets, which is not matched by a reduction in the value of foreign currency liabilities, for instance if a jurisdiction were to leave the Euro and change its currency. The Society is exposed to this risk through its legacy lending operations in Ireland and Spain. During 2015, the Society reduced its exposure to redenomination risk by completing a retained securitisation, which can be used to provide funding from the European Central Bank (ECB) in the event of such a scenario. ALCO is primarily responsible for managing this risk, which is also subject to oversight from BRC.

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.

6.5 Derivative activities

The main derivatives used by the Society (as set out in Table 19 on page 35) are interest rate swaps, interest rate options and cross currency swaps.

The table below describes the significant activities undertaken by the Society, the related risks associated with such activities 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.

Activity	Risk	Type of derivative
Fixed rate savings products rate	Sensitivity to falls in interest rates	Receive fixed interest (fair value hedge)
Fixed rate mortgage lending	Sensitivity to increases in interest rates	Pay fixed interest rate (fair value hedge)
Fixed rate funding rate	Sensitivity to falls in interest rates	Receive fixed interest (fair value hedge)
Fixed rate asset investments	Sensitivity to increases in interest rates	Pay fixed interest rate (fair value hedge)
Equity linked savings products	Sensitivity to changes in equity indices	Equity linked 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 (fair value hedge)
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 hedging relationships are entered into only when the underlying position being hedged contains the same risk features. The derivatives used will match the risks 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 purposes, however, not all are designated as such. Some derivatives are held as economic hedges to which IAS 39 does not need to be applied. 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.

7 Operational Risk

7.1 Overview

The Society defines operational risk as 'the risk of financial or reputational loss as a result of inadequate or failed processes, people and systems or from external events.'

Operational risks are inherent to, or arise in, Society business activities, with the Board setting an overarching operational risk appetite that establishes the limits within which management is expected to operate. The management of operational risk is designed to allow the Society to minimise losses and reputational damage by establishing secure, resilient systems and processes that allow the Society to deliver the products and services required by its members.

The Society categorises operational risk into the sub categories detailed in the table below.

Risk driver	Overview of risk
Legal and regulatory	Failures arising out of internal regulatory, statutory or legal non-compliance, including codes of conduct and associated risks from engagement with third-parties.
Business continuity	Failure to establish resilient processes or adequate business continuity, and recovery arrangements.
People	An inability to attract, retain and develop people resources appropriately for the delivery of customer expectations and Society objectives.
IT and information security	Failure to establish, develop and maintain an IT environment that secures customer data and Society information.
Financial crime	Internal or external financial crime events relating to money, financial services or markets including: offences involving fraud or dishonesty (including bribery), handling the proceeds of crime, and/or the financing of terrorism.
Process	Financial or opportunity loss arising out of the failure to develop and maintain an effective infrastructure and processes to support the delivery of Society objectives, as well as adequately identifying and implementing business change programmes.

7.2 Oversight and governance

The management of operational risk at the Society is facilitated by the three lines of defence model, as outlined in section 2. The first line has primary responsibility for the identification, mitigation and management of operational risks. Second line oversight is provided by the Risk Function, with dedicated resources focusing on business continuity, information security, financial crime, compliance, conduct and operational risk.

The first line is mandated to deliver the operating plan within the limits of Board defined risk appetite. Key directive controls are established within Society's approved policies, with business areas responsible for developing and maintaining a range of preventative and detective controls that ensure compliance with these policies.

Specialist management working groups provide oversight in respect of operational risk exposures, in areas such as regulatory change, information security, business change, conduct risk and business continuity. In addition, senior management and board committees receive risk reports and management information (MI) that track operational risk exposures in the operating environment, with the Board receiving minutes or updates from each of its committees.

Operational Risk

The three lines of defence model also provides bottom up escalation of actual events or situations which almost crystallised as events to the Risk Function and senior management. This is balanced with the top down strategic oversight of the overall risk profile of operations considered by the Board and its committees, which measures exposures against the approved risk appetite.

Assurance on the management of operational risk is provided by a programme of risk based audits performed by the Society's third line Internal Audit Function and reported through to the Audit Committee.

7.3 Risk Management Framework: operational risk

Operational risk is embedded into all elements of the Society's RMF, however, the key operational risk components are as follows.

Enterprise Risk Management

The diagram below summarises the Enterprise Risk Management (ERM) Framework and how operational risk reporting supports the Society's ERM approach. The ERM Framework is designed to integrate top down and bottom up reporting, providing a holistic view of risk exposure and profile reporting against the Society's strategy and agreed corporate objectives.

Business process reporting

To complement top down strategic reporting under the ERM Framework, the Society deploys a variety of business process reporting requirements. These processes ensure that the control environment remains appropriate, with remedial action undertaken if necessary, and that the reporting of operational risk is consistent across the business. Business process reporting is facilitated by the Risk Function. The main reporting requirements are outlined below.

Operational Risk

Risk registers

The Risk Function engages with each area of the business to maintain departmental risk registers, which include an assessment of the effectiveness of key controls as well as relevant mitigation actions to enhance and maintain the control environment. On a quarterly basis, each department assesses the effectiveness of its controls.

Risk and Control Self Assessment (RCSA)

To support an accurate and up to date understanding of the Society's risk profile, all departments are subject to a RCSA twice a year. The focus of the RCSA is the validation of the risk profile of the business area and the accuracy of key risks and controls against existing or emerging themes, compared to the focus on controls completion under a quarterly submission process.

In addition, senior management is subject to an annual attestation, which supports the Board in assessing and reporting on the Society's control environment.

Operational risk events

The Society identifies operational risk events as incident or events causing a direct financial loss, reputational damage or legal and regulatory implications. These are generally associated with the failure of a process, a system or a human error. In addition, situations which almost crystallised as event are also recorded. These are events that do not lead to a loss or reputational damage, but where a control failure has occurred.

The impacts of operational risk events and incidents that result in a financial loss or unplanned cost are captured and recorded by the Risk Function following reporting by the first line. This data is used to inform internal loss reports and provides a process for ensuring that risk incidents and events potentially material to the Society are identified, managed, reported and escalated to appropriate levels of senior management and relevant governance fora. In addition to loss data, the Risk Function captures any loss recoveries and considers the extent of any potential losses that could have been generated by near miss events. Current year loss data is assessed against risk appetite with historic trends, near miss information and external events utilised to inform Society risk assessments.

In order to fulfil its quarterly and annual regulatory operational risk loss reporting obligations, the Society collects and retains its loss data by the number of events and the value of events, which are also recorded by event type and the underlying business line. While this structure supports external reporting, it also enables management to understand better those areas and exposures that require continuing management attention.

7.4 Operational risk appetite

As outlined in section 2, the Society's risk appetite articulates the level and type of risk that the Society is willing to assume in pursuit of its strategic goals.

The operational risk appetite is defined in line with the overarching SRA Framework, designed to ensure that appetite is appropriately cascaded across the various frameworks and that it is consistent and linked directly to Board appetite.

The Board proactively monitors a full suite of quantitative and qualitative metrics designed to measure and monitor operational performance against the approved appetite positions. The Society has developed MI, dashboards and management reports that ensure performance is reported, in a timely manner, to a range of management working groups, Board committees and the Board.

Operational risk appetite metrics are reviewed and refreshed once a year to reflect the changing profile of risk exposures. In 2015, the Society continued to operate within its operational risk appetite.

7.5 Capital requirements and stress testing

The Society has adopted The Standardised Approach (TSA) for the calculation of its Operational Risk Capital Requirement (ORCR), which establishes the Society's minimum Pillar 1 capital requirement for operational risk. The ORCR is derived from the average of the last three years income, with the income allocated to defined business lines being subject to a prescribed multiplier to determine the ORCR. The Society's strategy is to concentrate on its core business activities limits and its income exposure to two business lines: retail banking and commercial banking.

In order to ensure that the Society's ORCR is suitable for extreme events, management assesses its suitability through the development of a series of stress test scenarios used to estimate the impacts of extreme but plausible low frequency, high impact loss events.

The Risk Function combines internal and external data to develop scenarios that could emerge in isolation, or combine to develop a range of potential impacts. The outputs of the scenarios are then used to inform management whether further capital requirements are required for operational risk, in addition to the ORCR.

As a result of its 2015 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.

7.6 Conduct risk

Conduct risk, a form of operational risk, is the risk that actual or potential customer detriment arises, or may arise, from the way the Society conducts its business. The Society has an extremely limited tolerance for conduct risk events, although it is recognised that operational risk failures may create isolated incidents.

Background and outlook

Financial institutions continue to bear the cost of poor customer conduct and unfair customer outcomes. Given the longevity of many financial products, it is likely that issues will continue to arise in the market.

From a conduct perspective the FCA and European Banking Authority (EBA) continue to shape the industry. The main regulatory changes in the coming year are:

- The introduction of the European Mortgage Credit Directive in March 2016. This aims to enhance existing consumer protection already provided through the current mortgage regulatory framework. The Society is well prepared and will meet the regulatory timeframes.
- The Senior Managers Regime (SMR) comes into force in March 2016. This outlines requirements for senior managers, introduces certified roles (for example mortgage advisers) and establishes new conduct requirements. Businesses have a further year, until March 2017, to issue certificates under the certification regime, and prepare for the wider application of the 'junior' conduct rules for example to colleagues outside the senior management and the certification regimes. The Society is well prepared to meet the SMR timeframes.
- In July 2015, the FCA released new rules on complaint handling. The majority of the new rules apply from June 2016 and focus on complaint reporting to the FCA and the timeframes for handling complaints. The Society is updating its systems and processes to accommodate the new requirements.

Conduct risk mitigation

In line with its stated appetite, the Society restricts its activities to areas where appropriate expertise is in place.

Customer facing and operational departments provide first line management of conduct risk. All colleagues complete mandatory conduct risk training and there is a Board approved Conduct Risk Policy in place. Dedicated teams undertake first line quality assurance activity, along with independent second line compliance monitoring, with both areas overseeing and reporting on compliance and conduct risk. Detailed conduct risk management information is submitted for review and discussion to the CRC, with actions and outcomes being appropriately monitored and subsequently incorporated into BRC and Board reporting.

It has been widely reported by the FCA that sales incentive schemes were a contributing cause of customer detriment. Colleagues employed by the Society do not operate to sales targets, but, instead, are measured against a number of competencies and quality metrics.

The Society maintains a Product Governance Framework. This Framework delivers an ongoing research and review process for new and existing products, ensuring the Society offers products that meet the needs of members.

8 Other Risks

8.1 Liquidity risk

Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only do so at excessive cost.

Background and outlook

During 2015, the UK savings market remained competitive following the launch of pensioner bonds and an increased appetite for retail savings from challenger banks. Wholesale funding markets continued to perform strongly in 2015, although spreads were wider than those seen in 2014.

As a mutual, the Society is predominantly funded through retail deposits. During 2015, the Society's savings portfolio continued to grow, accounting for 80% of total funding by the year end. The Society also accesses funding via the UK and international wholesale markets.

During 2015, the Society issued €500m of senior unsecured debt, a £300m covered bond, and a £325m residential mortgage backed securitisation (Albion No. 3). It is anticipated that markets will remain open to the Society in 2016, although they remain susceptible to volatility and uncertainty.

The introduction of CRD IV requires the Society to be compliant with new liquidity standards. These include a requirement to maintain a Liquidity Coverage Ratio (LCR) and a Net Stable Funding Ratio (NSFR), to underpin the quality and quantity of liquidity under stressed conditions and the stability of the Society's funding profile. Implementation of these measures will be phased in between October 2015 and 2018. At 31 December 2015, the Society's LCR stood at 194% (2014: 196%) and NSFR 133% (2014:136%), both significantly above the regulatory minimum.

Liquidity risk mitigation

The risk is managed through Board approved limits and policy, to determine the overall level, composition and maturity of liquidity and funding balances. The Treasury Function is responsible for the day-to-day management of liquidity and wholesale funding with policy compliance being monitored daily by the Finance and Risk Functions. This is reported at each meeting of ALCO and the Board.

The Society also manages liquidity risk through the use of sale and repurchase agreements (repo). This is where treasury assets are lent in return for cash, to ensure they can provide readily realisable liquidity. The Society has pre-positioned collateral with the Bank of England and European Central Bank, to provide additional contingent liquidity. This can be drawn upon if required.

The adequacy of the Society's liquidity is determined through its annual ILAAP. This determines the minimum level of liquid assets is required under multiple stressed environments. These liquid assets, known as 'buffer assets', are of very high credit quality (for example, UK Government securities and deposits held with the Bank of England). This ensures they can be readily and easily converted to cash as liabilities fall due. The Board approved the most recent ILAAP in September 2015 and concluded that the amount and composition of the Society's liquid resources was adequate and covered the assumed effects of a prolonged severe stress. At the end of 2015, the Society's liquid buffer eligible assets totalled £1.6bn (2014: £1.4bn) and accounted for 93% of total liquidity (2014: 90%).

Other Risks

8.2 Business risk

Business risk represents the risk of changes in the external environment that have the potential to affect negatively the Society's business model. These include major regulatory changes, increased levels of competition, or macroeconomic conditions.

Background and outlook

During 2015, the competitive environment heightened as a consequence of supportive macroeconomic conditions and an increased number of providers in the UK savings and mortgage market, following the emergence of challenger banks. It is expected that increased competition will continue into 2016.

The potential for an EU referendum during 2016 will provide further uncertainty in the external environment. In this regard, the directors are currently assessing the potential consequences for the Society.

Business risk mitigation

The Society addresses business risks within its Corporate Plan which is reviewed annually by the Board and is considered in the context of the Society's SRA. This includes stress testing of the Society's business across a range of severe but plausible scenarios. The Board is provided with regular updates on the Society's key strategies to ensure these are consistent and remain within risk appetite.

8.3 Pension obligation risk

The Society has funding obligations for a defined benefit pension scheme, which is closed to future accrual. Pension risk is the risk that the value of the scheme's assets will be insufficient to cover obligations over the remaining life of the scheme. The return on the scheme's assets will vary, depending on the movement in the value of its investments, whilst the projection of the scheme's liabilities is based on estimates of mortality and inflation. In practice, the actual outcome may differ to the estimates and any shortfall will be borne by the Society.

Background and outlook

During 2015 and in line with legal requirements, the Society completed its triennial review of assets and liabilities, to determine the pension scheme's funding position. Based on this valuation, the scheme remains well funded, with a plan agreed to recover the deficit by 2019. This funding plan is an extension of existing arrangements and, as such, does not represent a commercial stress to the Society. Given the inherent volatility of valuation assumptions, the Society is aware that future liabilities may change positively or negatively and a range of alternative funding strategies is being considered to limit future volatility.

Pension obligation risk mitigation

This risk is managed through regular meetings of the Pension Trustee Board. The Pension Trustee Board receives quarterly investment monitoring updates, prepared by the scheme's independent advisers and annual actuarial updates, which may lead to a course of appropriate action, such as altering asset allocations. The Society conducts annual stress testing of the scheme's assets and liabilities under various severe but plausible scenarios, as part of the ICAAP.

9 Securitisation

9.1 Overview

The Society has securitised a number of mortgage loans by pooling them together and transferring the loans to three Special Purpose Entities (SPE). These are Albion No.2 Plc (Albion 2), 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 2 and Albion 3 are 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.

9.2 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 obtain both secured funding and created additional collateral, which can be used to source additional funding.

As there has not been a transfer of significant 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, seller (or originator – where the Society originates the assets being securitised), cash manager, bank account provider and variable funding note registrar as defined in the relevant prospectus in relation to Albion 3 and Guilford 1. The Society takes the role of servicer, seller, cash manager and variable funding note registrar in relation to Albion 2.

In addition to the above roles, the Society also acts as investor where it purchases a position in a third-party originated securitisation transaction: see section 9.4); 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 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

The Albion 2 and Albion 3 securitisations have 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 2015.

9.3 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 it has retained substantially all the risks and rewards of ownership. These assets are held at amortised cost. Albion 2, Albion 3 and Guildford 1 are fully consolidated into the Group accounts. 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 2015 there were no assets awaiting securitisation.

Securitisations

Albion 2 was incorporated in May 2013 and issued £300m of debt securities to external investors in July 2013. The notes issued are rated by both Fitch and Moody's as AAA. At 31 December 2015, £130m of mortgages were pledged to Albion 2 (2014: £202m) and outstanding debt securities in issue were £106m (2014: £185m). The Society retained £36m of class Z notes (2014: £36m).

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 2015, £353m of mortgages were pledged to Albion 3 (2014: £nil) and outstanding debt securities in issue were £325m (2014: £nil). The Society retained £45m of class Z notes (2014: £nil).

Guildford 1 was incorporated in August 2014 with debt securities issued in February 2015. €400millon 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 2015, £738m of mortgages were pledged to Guildford 1 (2014: £nil) and outstanding debt securities issued and acquired by the Society were £621m (2014: £nil). In addition, the Society retained £111m of class Z notes (2014: £nil).

Securitisation

TABLE 24: Originated securitisations

Securitisation company	Type of securitisation	2015 Gross assets securitised £m	2015 Notes issued £m	2015 Retained notes £m	2015 Underlying assets past due and impaired £m
Albion 2	Residential mortgage securitisation	**130.0**	**106.4**	**35.9**	**0.6**
Albion 3	Residential mortgage securitisation	**353.4**	**325.0**	**45.4**	**0.2**
Guildford 1	Residential mortgage securitisation	**737.7**	**-**	**731.8**	**1.9**
		1,221.1	**431.4**	**813.1**	**2.7**

Securitisation company	Type of securitisation	2014 Gross assets securitised £m	2014 Notes issued £m	2014 Retained notes £m	2014 Underlying assets past due and impaired £m
Albion 2	Residential mortgage securitisation	**202.2**	**185.4**	**35.9**	**3.9**

9.4 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 £74.5m at 31 December 2015 (2014: £53.7m) and comprises senior tranches of RMBS.

Purchases and retention of RMBS are undertaken within a clearly defined credit risk policy. RMBS are held as 'Available for sale' at fair value in the Society's Statement of Financial Position (with the exception of those reclassified in 2008 – see note 12 of the Annual Report and Accounts for the year ended 31 December 2015). If the assets are sold before maturity, a gain or loss is recognised in the Income Statement.

As at 31 December 2015, 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 25: Purchased securitisations	2015 >3months investment £m	2015 Risk weight %	2015 Long term RWA £m	2014 >3months investment £m	2014 Risk weight %	2014 Long term RWA £m
RMBS						
Aaa	58.8	20.0%	11.8	37.7	20.0%	7.5
Aa-1	-	20.0%	-	-	20.0%	-
Aa-2	11.5	20.0%	2.3	10.0	20.0%	2.0
Aa-3	4.2	20.0%	0.8	4.5	20.0%	0.9
A1	-	50.0%	-	-	50.0%	-
A2	-	50.0%	-	1.5	50.0%	0.8
A3	-	50.0%	-	-	50.0%	-
Baa-1	-	100.0%	-	-	100.0%	-
Total RMBS	**74.5**		**14.9**	**53.7**		**11.2**

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

10 Remuneration

10.1 Remuneration Policy

The Remuneration Policy reflects the Society's objectives for corporate governance, as well as the sustained long-term success of the organisation. It ensures that:

- colleagues feel motivated to create sustainable results, which are in the interest of our members;
- the Society is able to attract, develop and retain high-performing, talented and engaged colleagues of the required calibre in a competitive market; and
- colleagues are offered a competitive and market aligned remuneration package.

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 60 to 73 of the Annual Report and Accounts for the year ended 31 December 2015.

10.2 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 2015 on pages 60 to 73. This report sets out the work and composition of the Remuneration Committee.

10.3 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.

The table below sets out the aggregate quantitative remuneration for MRTs in relation to their services for the year ended 31 December 2015:

TABLE 26: Remuneration	Number of beneficiaries	Fixed remuneration £'000	Variable remuneration £'000	Total remuneration £'000	Deferred remuneration £'000
Type of colleague					
Non-executive director	10	507	-	507	-
Executive director	5	1,383	674	2,057	270
Other MRTs	42	4,286	904	5,190	115
Total	**57**	**6,176**	**1,578**	**7,754**	**385**

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 2015 review.

There were no sign on payments or severance payments made within the year (2014: none).

Mrs K L Rebecchi left the business on 30 June 2015. A loss of office payment was made, consisting of £136,407 paid in respect of the balance of contractual entitlement and £87,500 was paid which was reflective of an assessment of the director’s statutory rights and in accordance with the Remuneration Policy. The director will remain eligible to receive a bonus award for 2015, prorated to reflect the period of employment during the financial year.

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 60 to 73 of the Annual Report and Accounts for the year ended 31 December 2015.

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 44 to 52 of the Annual Report and Accounts for the year ended 31 December 2015.

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 44 to 52 of the Annual Report and Accounts for the year ended 31 December 2015.

10.4 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	Rewards performance against a range of financial and business objectives	Maximum of 75% of basic pay, with 40% of the award deferred over three years for executive directors. Maximum of 50% with 20% deferred over one year for directors. Non executive directors do not receive variable remuneration.	Delivery of corporate, personal and peer group performance objectives
Operation of malus and clawback	Deferral element has been introduced to ensure annual performance creates value sustained over the longer term.	Independent assessment takes place prior to the payment of each deferred award.	Not applicable
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 of lifetime allowance, there is an option to receive a 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 and long term health insurance. Other benefits may be provided based on individual circumstances for example relocation	Not applicable

10.5 Other directorships

A list of directorships held by members of the senior management team is included on pages 132 and 133 of the Annual Report and Accounts for the year ended 31 December 2015.

11 Contact Information

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

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At the Society's Registered Office:

Leeds Building Society

105 Albion Street

Leeds

LS1 5AS

Approved by the Board on 23 February 2016

12 Glossary and Abbreviations

Assets and Liabilities Committee (ALCO)	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.
Basel III Framework	Basel III is the third framework issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements in order to retain enough capital to protect the financial system against unexpected losses. The Basel III framework replaced Basel II from 1 January 2013. The regulatory framework was implemented in Europe through the Capital Requirements Directive IV (CRD IV) package of regulation and was effective from 1 January 2014. CRD IV comprises the CRD and CRR.
Capital Requirements Directive (CRD)	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 forming the Basel III Framework.
Capital Requirements Regulation (CRR)	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 forming the Basel III Framework.
Common Equity Tier 1 (CET1) capital	The highest form of regulatory capital under CRD IV represented by accumulated reserves and qualifying financial instruments less any specific regulatory adjustments.
Counterparty Credit Risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Covered bonds	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.
Credit quality steps	A credit quality assessment scale as set out in CRD IV (risk weights under the Standardised Approach to credit risk).

Glossary and Abbreviations

Credit risk	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 loan.
Credit risk mitigation	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meets 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.
Credit Support Annex (CSA)	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.
Default	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.
Exposure At Default (EAD)	An estimate of the maximum loss that an entity might suffer if a borrower or other counterparty fails to meet their obligations at default.
External Credit Assessment Institution (ECAI)	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.
Expected loss (EL)	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.
Financial Conduct Authority (FCA)	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.
Financial Policy Committee (FPC)	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.
Global Master Repurchase Agreement (GMRA)	A model legal agreement designed for parties transacting repos. It is published by the International Capital Market Association, which is the body representing the bond and repo markets in Europe.

Glossary and Abbreviations

Group	The Society and its subsidiaries
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of Basel III 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 stress scenarios.
Institution	An institution is defined in Article 1 of the Capital Requirements Directive (CRD) as a credit institution or investment firm. 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. 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.
Interest rate risk	Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates.
Internal Liquidity Adequacy Assessment Process (ILAAP)	A firm must carry out an ILAAP in accordance with the Internal Liquidity Adequacy Assessment rules, and the ILAAP should be proportionate to the nature, scale and complexity of the firm's activities. An ILAAP should be updated annually, or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of liquid resources or the firm's funding profile is no longer adequate.
Internal Ratings Based (IRB) Approach	An approach for measuring exposure to credit risk which is more sophisticated than the Standardised Approach. The IRB approach may be Foundation or Advanced. IRB approaches can only be used with the permission of the Prudential Regulation Authority.
International Swaps and Derivatives Association (ISDA)	A trade organisation of participants in the market for over the counter (OTC) derivatives. It has created a standardised contract (the ISDA Master Agreement) to enter into derivative transactions.
London Interbank Offered Rate (Libor)	The average interest rate estimated by leading banks in London that the average leading bank would be charged if borrowing from other banks.
Loss Given Default (LGD)	A parameter used in relation to credit risk exposures modelled under the IRB approach; an estimate of the difference between the exposure at default (EAD) and the net amount recovered, expressed as a percentage of the EAD.

Glossary and Abbreviations

Loan To Value (LTV)	The ratio of current exposure value as a proportion of the value of the asset held as security (usually residential property) expressed as a percentage.
Market risk	The risk that the value of, or income from, assets and liabilities changes as a result of movements in market prices, interest rates or exchange rates.
Maturity	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.
Minimum capital requirement	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.
Operational risk	The risk of loss arising from inadequate, inefficient or failed internal processes, human resources, systems or external events (for example fraud).
Permanent Interest Bearing Shares (PIBS)	Unsecured, deferred shares that are a form of Additional Tier 1 capital (subject to phasing to Tier 2).
Pillar 1	The parts of CRD IV which set out the minimum capital requirements for credit, market and operational risk
Pillar 2	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.
Pillar 3	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.
Potential future credit exposure (PFCE)	A measure defined as the maximum expected credit exposure over a specified period of time calculated at some level of confidence.
Probability of default (PD)	A measure of how likely a customer is to reach default over a defined period of time.
Provisions	Amounts set aside to cover incurred losses associated with credit risks.

Glossary and Abbreviations

Prudential Regulation Authority (PRA)	The UK regulatory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms.
Repurchase agreement (Repo)	The sale of securities together with an agreement for the seller to buy back the securities at a later date. The original buyer effectively acts as a lender with the seller effectively acting as a borrower (using their security as collateral for a secured cash loan at a fixed rate of interest).
Residential Mortgage Backed Securities (RMBS)	A type of mortgage backed debt obligation whose cash flows come from residential debt, such as mortgages. A RMBS is comprised of a pool of mortgage loans created by banks and other financial institutions. The cash flows from each of the pooled mortgages is packaged by a special purpose entity into classes and tranches. The SPE then issues securities which can be purchased by investors.
Risk Weighted Assets (RWA)	The value of assets after adjustments under the prudential rules to reflect their inherent risks
Securitisation	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. The Society has established securitisation structures (using residential mortgages as assets) as part of its funding activities.
Society	Leeds Building Society
Special Purpose Entity (SPE)	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.

Glossary and Abbreviations

Standardised approach	The approach used to calculate credit risk exposures and the related capital requirements. The method uses parameters determined by the regulator rather than internal and is less risk sensitive than IRB approaches. This will generally result in a higher capital requirement.
Tier 1 capital	A measure of the Society's financial strength comprising CET1 capital plus any other Tier 1 financial instruments net of regulatory adjustments.
Tier 2 capital	A further component of regulatory and financial capital as defined by CRD IV which for the Society is represented by certain impairment provisions.

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 transitional and full implementation rules is presented below.

TABLE 27: EBA Own Funds Disclosure Template		Transitional CRD IV rules		Full implementation CRD IV rules	
		2015 £m	2014 £m	**2015 £m**	2014 £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves					
1	Capital instruments and the related share premium accounts				
2	Retained earnings	765.1	674.7	765.1	674.7
3	Accumulated other comprehensive income (and other reserves)	25.5	30.6	25.5	30.6
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	Common Equity Tier 1 (CET1) capital before regulatory adjustments	790.6	705.3	790.6	705.3
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)				
8	Intangible assets (net of related deferred tax liability (negative amount)	(2.5)	-	(2.5)	-
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				
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)	(5.1)	(1.3)	(5.1)	(1.3)
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)				

A1 EBA Own Funds disclosure template (continued)

TABLE 27: EBA Own Funds Disclosure Template *(continued)*		Transitional CRD IV rules		Full implementation CRD IV rules	
		2015 £m	2014 £m	**2015 £m**	2014 £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)	(7.6)	(1.3)	(7.6)	(1.3)
29	Common Equity Tier 1 (CET1) capital	783.0	704.0	783.0	704.0
Additional Tier 1 (AT1) capital: instruments					
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	17.5	20.0	-	-
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	17.5	20.0	-	-
Additional Tier 1 (AT1) capital: regulatory adjustments					
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	-	-	-	-

A1 EBA Own Funds disclosure template (continued)

TABLE 27: EBA Own Funds Disclosure Template *(continued)*		Transitional CRD IV rules		Full implementation CRD IV rules	
		2015 £m	2014 £m	**2015 £m**	2014 £m
44	Additional Tier 1 (AT1) capital	17.5	20.0	-	-
45	Tier 1 capital (T1 = CET1 + AT1)	800.5	724.0	783.0	704.0
Tier 2 (T2) capital: instruments and provisions					
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	7.5	5.0	25.0	25.0
49	of which: instruments issued by subsidiaries subject to phase out				
50	Credit risk adjustments	21.5	16.3	21.5	16.3
51	Tier 2 (T2) capital before regulatory adjustments	29.0	21.3	46.5	41.3
Tier 2 (T2) capital: regulatory adjustments					
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	29.0	21.3	46.5	41.3
59	Total capital (TC = T1 + T2)	829.5	745.3	829.5	745.3

A1 EBA Own Funds disclosure template (continued)

TABLE 27: EBA Own Funds Disclosure Template *(continued)*		Transitional CRD IV rules		Full implementation CRD IV rules	
		2015 £m	2014 £m	**2015 £m**	2014 £m
60	Total risk weighted assets	5,045.9	4,507.5	5,045.9	4,507.5
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	15.5%	15.6%	15.5%	15.6%
62	Tier 1 (as a percentage of total risk exposure amount)	15.9%	16.1%	15.5%	15.6%
63	Total capital (as a percentage of total risk exposure amount)	16.4%	16.5%	16.4%	16.5%
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)				
65	of which: capital conservation buffer requirement				
66	of which: countercyclical buffer requirement				
67	of which: systemic risk buffer requirement				
67a	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)				
Amounts below the thresholds for deduction (before risk weighting)					
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)				
Applicable caps on the inclusion of provisions in Tier 2					
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	21.5	16.3	21.5	16.3
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)				
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings- based approach				
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)					
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	17.5	20.0	-	-
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	7.5	5.0	-	-
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)	-	0.9	-	-

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
	Regulatory treatment	
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
	Coupons/dividends	
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
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

A3 Asset encumbrance disclosure template

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

Table 28a: Template A - Assets	Carrying amounts of encumbered assets £m	Fair value of encumbered assets £m	Carrying amounts of unencumbered assets £m	Fair value of unencumbered assets £m
Assets of the reporting institution	**4,503**		**8,928**	
Equity instruments	-	-	-	-
Debt securities	-	-	849	849
Other assets	129		59	

Template B – Collateral received

Based on the threshold criteria contained in PRA supervisory statement SS11/14 (‘CRD IV: Compliance with the European Banking Authority’s Guidelines on the disclosure of encumbered and unencumbered assets’), the Society has utilised the waiver to not disclose the content of Template B of the EBA Guidelines.

Table 28b: Template C - Encumbered assets/collateral received and associated liabilities	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	**1,965**	**2,893**

Appendices

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 2, Albion 3 and Guildford 1). Please refer to section 9 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 2015 is included in the total exposure to institutions in Tables 16 – 18 on pages 31 to 33. Collateralisation agreements are discussed in section 5.3 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.