Leeds Building Society

Pillar 3 disclosures

31 December 2020

Contents

1 Executive Summary

This document presents the Pillar 3 disclosures of Leeds Building Society as at 31 December 2020. The Pillar 3 disclosure requirements apply to banks and building societies and require firms to publish key details regarding their capital position and management of risk.

1.1 Summary of Key Metrics

This section summarises the key disclosures reported in this document.

The tables below set out the capital adequacy as at 31 December 2020 under CRD V applying both the transitional and end-point rules for the Prudential Consolidation Group (PG). The capital ratios are calculated as the relevant capital divided by risk weighted assets at 31 December of the relevant year.

TABLE 1: Capital Adequacy	Transitional **2020** **£m**	End Point **2020** **£m**	Transitional 2019 £m	End Point 2019 £m
Prudential Consolidation Group				
Total Common Equity Tier 1	**1,115.7**	**1,112.8**	1,044.1	1,042.0
Additional Tier 1 capital	**5.0**	**-**	7.5	-
Total Tier 2 capital	**227.3**	**232.3**	219.7	227.2
Total regulatory capital	**1,348.0**	**1,345.1**	1,271.3	1,269.2
Total risk weighted assets (RWAs)	**3,070.0**	**3,070.9**	3,103.7	3,104.5
Capital ratios (as a percentage of RWAs)				
Common Equity Tier 1 ratio	**36.34%**	**36.24%**	33.64%	33.56%
Tier 1 ratio	**36.51%**	**36.24%**	33.88%	33.56%
Total capital ratio	**43.91%**	**43.80%**	40.96%	40.88%

Key drivers in movement of Capital Resources and Risk Weighted Assets (RWAs) are set out in section 4 and section 5 respectively.

Leverage Ratio

The leverage ratio calculation, specific to CRD V, is calculated as Tier 1 capital divided by total exposures. The table below sets out the leverage ratio under the transitional and the end-point rules for the PG group, see section 5.4 for further details.

TABLE 2: Leverage Ratio	Transitional **2020** **£m**	End Point **2020** **£m**	Transitional 2019 £m	End Point 2019 £m
Total Tier 1 capital	**1,120.7**	**1,112.8**	1,051.6	1,042.0
Total exposure	**20,889.9**	**20,889.9**	20,964.4	20,964.4
Leverage ratio	**5.4%**	**5.3%**	5.0%	5.0%

Overview

UK Leverage Ratio

The UK leverage ratio is specific to the UK regulatory regime which currently only applies to financial institutions with deposits of £50bn or more, but is set out below and throughout the document for information. The calculation excludes deposits with central banks from the leverage exposure measure.

TABLE 3: UK Leverage Ratio	Transitional **2020** **£m**	End Point **2020** **£m**	Transitional 2019 £m	End Point 2019 £m
Total Tier 1 capital	**1,120.7**	**1,112.8**	1,051.6	1,042.0
Total exposure exc. central bank exposure	**19,066.7**	**19,066.7**	19,512.7	19,512.7
UK Leverage ratio	**5.9%**	**5.8%**	5.4%	5.3%

Asset Encumbrance

An asset becomes encumbered when part or all of its value is pledged to another party to secure, collateralise or credit enhance a financial transaction from which it cannot be freely withdrawn. This may be done to attain funding and/or to collateralise derivative exposures. The Table below is based on the median position of balances throughout the year in line with regulatory guidance. See Appendix A3 for further details.

TABLE 4: Asset Encumbrance	Carrying Amount Encumbered Assets **2020** **£m**	Carrying Amount Unencumbered Assets **2020** **£m**	Carrying Amount Encumbered assets 2019 £m	Carrying Amount Unencumbered assets 2019 £m
Assets	**6,337.4**	**14,375.8**	6,314.4	14,048.7

Liquidity Coverage Ratio (LCR)

The LCR is a measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario. As at 31 December 2020 the LCR was 195% (235% in 2019) and was above both the regulatory and internal limits set by the Board throughout the period. See section 7.6 for further details.

Overview

2 Introduction

2.1 Basis and frequency of disclosures

This document has been prepared in accordance with the Capital Requirements Regulation (Part Eight, Articles 431 to 455) and Capital Requirements Directive (‘CRR’ and ‘CRD IV’, also known as the ‘CRD IV legislative package’) as amended by CRR II and CRD V as at the applicable reporting date. This includes the revisions to CRR on 24 June 2020 as part of a package of accelerated CRR II measures (commonly referred to as the ‘CRR Quick Fix’ package), which were implemented in response to the Covid-19 pandemic. Under the terms of European Union (Withdrawal) Act 2018 and the temporary transitional powers (TTP) available to UK regulators, further changes to Pillar 3 disclosure rules are expected to be implemented in the UK during 2021 to fully align the UK regulatory framework with final Basel III requirements and remaining elements of CRR II.

The disclosures have also been prepared in accordance with relevant technical standards and guidelines issued by the European Banking Authority (EBA), including “Guidelines on materiality, proprietary and confidentiality and on disclosure frequency under Articles 432(1), 432(2) and 433 of CRR”.

The Society uses the Internal Ratings Based (IRB) approach for over 97% of its retail credit risk exposures and a Standardised approach for other exposures and risks in order to calculate capital requirements.

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

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 2020 and the information presented is based on those Accounts unless otherwise stated.

2.2 Verification

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

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

2.3 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.

Overview

The revised Pillar 3 guidelines published by the EBA do not apply for the Society. However, the Society has complied with additional guidance requiring disclosure of the Liquidity Coverage Ratio, shown in section 7.6 and asset encumbrance shown in Appendix A3.

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

The Society holds the following interests in subsidiary undertakings at 31 December 2020, all of which are incorporated in the United Kingdom and registered in England.

Subsidiary names	
Leeds Financial Services Limited	Albion No. 3 plc (in liquidation)
Leeds Mortgage Funding Limited	Albion No. 3 Holdings Limited
Leeds Building Society Covered Bonds LLP	Albion No. 4 plc
Leeds Covered Bonds Designated Member (No. 1) Limited	Albion No. 4 Holdings Limited
Leeds Covered Bonds Designated Member (No. 2) Limited	Guildford No. 1 plc (in liquidation)
Leeds Covered Bonds Holdings Limited	Guildford No. 1 Holdings Limited (in liquidation)

On 17 January 2020 the debt securities issued by Guildford No. 1 plc were repaid in full and the loans assigned to the company were returned.

Further information on the Society's subsidiaries can be found in note 15 to the Annual Report and Accounts for the year ended 31 December 2020.

Table 5, over the page, provides a reconciliation of regulatory adjustments between the Groups accounting balance sheet assets and total credit risk exposures as at 31 December 2020.

Overview

TABLE 5: Year End Balance Sheet Assets reconciled to Regulatory Exposures	Group Balance Sheet Assets	Assets Deducted from own Funds 1	Regulatory Capital Adjustments 2	Regulatory off-balance sheet exposure items 3	IRB Provisions 4	Exposure to counterparty credit risk for derivatives 5	Prudential Group Credit Risk Exposure
Assets	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Cash in hand and balances with the Bank of England	**1,823**						**1,823**
Loans and advances to credit institutions	**202**						**202**
Investment Securities	**950**						**950**
Collateral	**256**		(256)				**-**
Derivative Financial Instruments	**193**					160	**353**
Loans and advances to customers	**16,913**			132	(6)		**17,039**
Other Loans	**16**						**16**
Fair value for hedged risk on loans and advances to customers	**156**						**156**
Other Assets	**14**						**14**
Deferred Tax Asset	**6**		(6)				**-**
Intangible Assets	**29**	(29)					**-**
Property Plant and Equipment	**81**						**81**
Retirement Benefit Surplus	**1**	(1)					**-**
Total	**20,640**						**20,635**

The Group balance sheet is adjusted for the following regulatory adjustments as set out above:

1. Under PRA rules intangible assets (including goodwill) must be deducted from regulatory capital.
2. Specific regulatory capital adjustments relate to the alignment of balance sheet exposures to the prudential credit risk exposure.
3. Regulatory exposure of off-balance sheet items post credit conversion factor (CCF) relates to undrawn credit commitments for mortgages not yet drawn down.
4. Exposures for residential mortgages measured under the IRB Approach are not adjusted for accounting loan impairment in accordance with Article 166 of the CRR. Instead, this is replaced by deducting the regulatory expected loss in excess of accounting impairment provisions from CET 1 capital in accordance with Article 36 of the CRR. There are also adjustments for IFRS transitional arrangements and an additional valuation adjustment related to prudent valuation.
5. Counterparty credit risk relates to derivative contracts and its associated credit valuation adjustments.

Overview

Non material, proprietary or confidential information

Part Eight of Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876 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 £90.8m per Table 11. This is on the basis of the amounts being immaterial.

No geographical split, sector split or residual maturity profile has been included for the commercial loan portfolio due to the low materiality of the remaining exposure £16m in 2020 (£18m: 2019).

IFRS 9

IFRS 9 – Financial Instruments was adopted by the Society from 1 January 2018. The standard replaces IAS 39 – Financial Instruments:

Hedge accounting – IFRS 9 altered the rules for the application of hedge accounting, although the rules in relation to portfolio fair value hedges are still under development. Consequently the standard allows entities to continue to apply IAS 39 for all hedge accounting and the Group has chosen to do this.

For further information please see Note 35 within the ARA.

Minimum Requirements for Own Funds and Eligible Liabilities

MREL was announced in 2016 as part of the EU's Bank Recovery and Resolution Directive with the aim of increasing resilience within the financial sector and reducing the risk to taxpayers if a firm was to fail. All banks and building societies are assigned a preferred resolution strategy by the Bank of England (BoE) dependent on their balance sheet size and quantum of transactional accounts. Due to the Society having a balance sheet in excess of £15bn the BoE have stated a preferred resolution strategy for the Society of 'bail-in' requiring the Society to hold both recovery and resolution capital requirements.

MREL is being phased in for the Society over a transitional period to 31 Dec 2022. The transitional MREL requirement set for the Society, by the BoE, is equal to 18% of risk weighted assets for the period July 2020 to 31 December 2022. End state MREL requirements active from 1 Jan 2023 are two times minimum regulatory requirements plus any regulatory buffers. The table below sets out the Society's interim and end state capital requirement as disclosed on the BOE website:

Binding Minimum Capital Requirement [1]	Interims		End-state	
	MREL	Loss-absorbing capacity (MREL + Buffer)	MREL	Loss-absorbing capacity (MREL + Buffer)
10.9% RWAs	18.0% RWAs	20.5% RWAs	21.8% RWAs	24.3% RWAs

Current Total Capital ratios reported in Table 1 show a significant excess over the end state MREL requirement.

In 2018 the Society issued £200m of MREL eligible subordinated debt which is included in Tier 2 capital.

[1] Binding minimum capital requirements in the table above are as at September 2020.

3 Risk Management Objectives and Policies

3.1 Introduction

The Society's mission is to help people save and have the home they want, continually adapting to anticipate our members' changing needs, to help our members get on with life. This is delivered through our corporate strategy and simple business model – providing a safe place for savings and providing mortgages to our members. Further information regarding our strategy and business model can be found in the Strategic Report, within the 2020 Annual Report and Accounts.

The Society's mission and strategy can only be achieved if risks are identified, understood and managed effectively. By understanding the nature of our risks, management is in a position to make informed decisions that support our longer-term viability and protect members' interests.

The Board aims to manage these risks through a formal structure for monitoring and managing risk. This includes a range of Strategic Risk Appetite statements approved by the Board, detailed supporting frameworks and independent governance and oversight.

Inherent within our strategy are eight principal risk categories. These include: credit; funding and liquidity; capital; market; operational; conduct; model; and strategic / business risks. The Society operates appropriate systems of control to manage its principal risks, as described in throughout the section. Further information regarding our principal risks can be found on pages 40 to 49 of the 2020 Annual Report and Accounts.

3.2 Approach to Risk Management

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

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

Risk Management Objectives and Policies

The main components of the ERMF are discussed below.

Risk Governance and Culture

Risk governance is the process followed to support risk based decision making and oversight across all of our operations, whereas risk culture relates to the behaviours and attitudes of colleagues in making these decisions. Appropriate structures, facets and our values support the Board in discharging their accountability for risk oversight, with management responsible for day to day decision making.

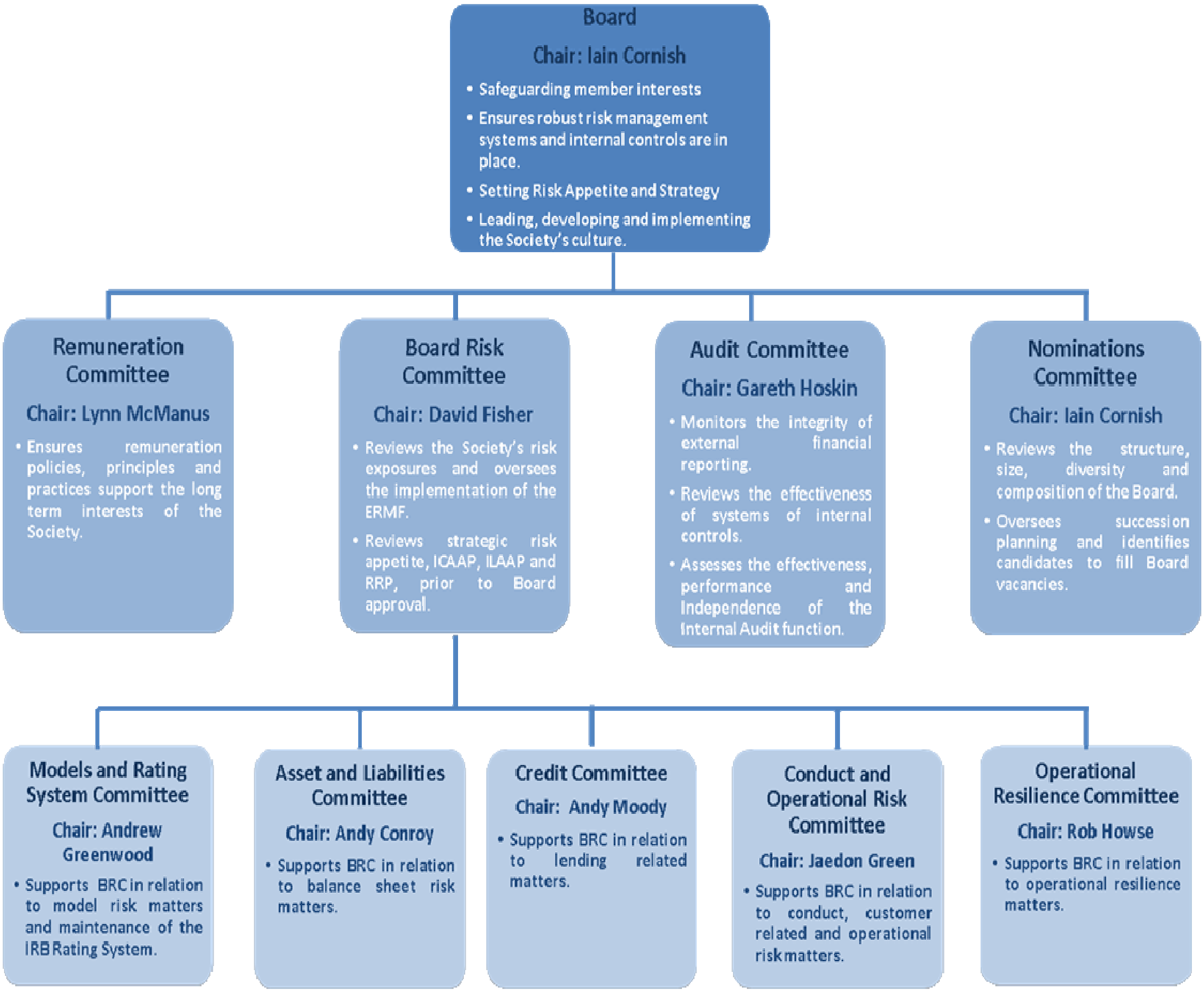
Committee Structure

The Board is our governing body, responsible for overseeing the implementation of our strategy and holding management to account. To support the Board in the delivery of its responsibilities, we operate four board sub-committees, each with distinct mandates in their Terms of Reference (ToR).

BRC provides independent oversight of the effective management of our risk universe. BRC is supported by five executive risk committees, each focusing on a particular discipline(s) of risk. These committees are decision making in nature and operate within delegated mandates and limits provided by the Board/BRC. Refer to page 78 of the Annual Report and Accounts for the year ended 31 December 2020 for the number of BRC meetings held over the previous 12 months.

Our committee structure as at the year-end is set out overleaf:

Risk Management Objectives and Policies



Policies and Delegated Authorities

Mandates are provided by the Board to management via the following routes to manage our day to day activities:

Delegation route	Summary
1. Corporate plan	The Board approves a corporate plan annually, setting the risk appetite alongside, which provides the parameters within which management should operate.
2. Policy framework	We operate a tiered policy framework, through which mandates and limits are delegated to management. Our policies are reviewed on an annual basis (or as appropriate), by relevant committees.
3. Delegated Authorities Manual	The Delegated Authorities Manual is designed to facilitate the effective discharge of responsibilities and continuity of operations within a sound system of financial, operational and budgetary control. It is reviewed by the Board annually.

Risk Management Objectives and Policies

Three Lines of Defence Model and the Risk Function

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

1st Line (Business Lines)	2nd Line (Risk Function)	3rd Line (Internal Audit)
• Executing strategy. • Identifying and managing risks. • Adhering to appetite, policies and standards. • Implementing and maintaining regulatory compliance. • Identifying emerging risks.	• Oversight of day to day activities of the first line. • Maintenance of the ERMF. • Coordination and oversight of the setting of risk appetite. • Policy co-ordination/refresh. • Identifying emerging risks. • Enterprise risk reporting. • Independent risk based assurance plans.	• Independent risk based assurance of the adequacy and effectiveness of first and second line risk management.

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

Risk Culture

Risk culture is an essential element of effective risk management, underpinning how our ERMF is embedded across the business and into decision making. In order to maintain an appropriate risk culture, the ERMF includes a risk culture framework, designed around four components:

Tone from the top and desired behaviours – we expect our values to be demonstrated by the Board and the Senior Leadership Team.

Accountability - we hold individuals at all levels accountable for risk management, to support the delivery of our strategy and business objectives.

Effective communication – we encourage an environment of open and transparent communication around all risk management expectations.

Incentives and performance management - we operate an appropriate incentive scheme and other HR frameworks to promote the desired risk culture. As part of these frameworks, the Society provides appropriate training for colleagues to support a risk aware culture.

3.3 Risk Appetite and Stress Testing

Risk Appetite Framework

A key element of the ERMF is Strategic Risk Appetite (SRA). This comprises qualitative statements and quantitative metrics to set the parameters within which we should operate to deliver our strategy. Our SRA is reinforced through policies and standards, to ensure consistency and alignment to the Board defined parameters.

Risk Management Objectives and Policies

The Board defines SRA across our principal risk categories set out in section 3.1. The metrics are reviewed annually and are used in stress testing to measure and validate our long term viability, under both plausible and more severe scenarios. They are also assessed on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures in relation to appetite and we have developed appropriate early warning indicators and escalation procedures to anticipate and respond to risk profile changes.

Stress Testing

Stress testing is a risk management tool that we use to support an understanding of the vulnerabilities within our business model. Our approach to stress testing is defined within the stress testing framework (part of the ERMF) and supports:

- a sound understanding of internal and external influences on the Society and the principal risks;
- assistance to the Board in strategic business planning and the setting of SRA; and
- management of capital and liquidity resources against SRA and regulatory expectations.

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

Increasing Severity

Activity	Description
Corporate planning	Sensitivity analysis and a suite of alternative scenarios are used to assess the corporate plan under a range of plausible stresses.
Prudential risk assessments	ICAAP - an internal assessment of whether we have sufficient capital, given current risks, as well as future risks from our strategy, under conditions as set out by the PRA. ILAAP - an internal assessment of whether we have sufficient liquidity and stable funding to withstand a range of severe liquidity stresses.
Recovery plan	Scenario analysis is used to inform the development of a suite of recovery actions (primarily capital and liquidity) to be used under extreme stress and to set and validate operational protocols.
Reverse stress testing	An assessment of the stress scenarios under which we would potentially become unviable. This examines potential weaknesess in our business model under extreme events so that mitigating actions can be identified (where possible).

3.4 Risk Assessment and Management

We operate defined risk assessment and management processes to facilitate the consistent identification, analysis, evaluation, treatment and monitoring of risks across the organisation. The framework can be applied to both strategic and operational risk assessments and is set within our business environment, strategy and objectives. A summary of the five stages of this process is set out below:

Risk identification – we operate Board level and operational level risk identification processes to capture new or emerging risks, which could impact corporate objectives and the delivery of our strategy.

Risk analysis –a range of methodologies are used to assess risks identified, in order to understand their severity and likelihood on the delivery of our strategy and to inform risk evaluation and treatment.

Risk evaluation - we evaluate and prioritise risks to inform decision making and to optimise the allocation of resources.

Risk Management Objectives and Policies

Risk treatment – management select and deploy appropriate risk responses, balancing the potential benefit derived versus economic cost, effort and implications for key stakeholders. The principal mechanism for risk treatment is the deployment of a suitable control environment, which reduces the Society's residual risk profile to acceptable levels.

Risk monitoring – we monitor risk assessment and management processes to proactively identify and adjust to changes in risk profile and to understand the effectiveness of implementing risk treatment strategies.

Risk Reporting

The Society operates an appropriate risk reporting hierarchy to provide the right information, to the right people, at the right time. This informs and supports timely decision making using a combination of strategic and business process reporting to understand the current or potential risk profile of the business, which may impact the delivery of our strategy and corporate objectives. These reporting processes are conducted at an appropriate frequency and are co-ordinated by the Risk function.

4 Capital Resources

4.1 Total available Capital

Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses. The requirements of the CRD V package will be implemented up to 1 January 2022 as there are a number of transitional rules which apply.

The strength of the Society's capital position - primarily based on retained profits, supported by the issuance of subordinated debt in 2018 and its conservative lending policy, meant that the Society comfortably met all capital requirements and leverage ratio throughout 2020, based on both the transitional rules (applied from 1 January 2014) and end state rules.

CRD V requires the Society to hold a countercyclical buffer (CCyB) as determined by the BoE's Financial Policy Committee (FPC).

The FPC set a CCyB of 0% from March 2020 for all UK exposures. Any non-UK exposures are assessed per the relevant countries CCyB. The full CCyB details can be found in Appendix A4.

The requirement to maintain a capital conservation buffer was phased in from 1 January 2016. The capital conservation buffer represents 2.5% of risk weighted assets throughout the year ended 31 December 2020 (2019: 2.5%).

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 2.3) and Leeds Building Society Covered Bonds LLP with assets being ring fenced within these entities.

Capital Resources

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

TABLE 6: Total Capital	Transitional 2020 £m	End Point 2020 £m	Transitional 2019 £m	End point 2019 £m
Common Equity Tier 1 (CET 1)				
General reserve	**1,125.1**	**1,125.1**	1,064.6	1,064.6
Revaluation reserve	**9.9**	**9.9**	8.1	8.1
Fair value reserve	**5.4**	**5.4**	(0.9)	(0.9)
Other reserve	**14.3**	**14.3**	14.3	14.3
CET 1 prior to regulatory adjustments	**1,154.7**	**1,154.7**	1,086.1	1,086.1
Regulatory adjustments:				
Deferred Tax	**(5.6)**	**(5.6)**	(6.1)	(6.1)
IFRS 9 transitional add back	**2.9**	**-**	2.1	-
Additional valuation adjustment	**(1.8)**	**(1.8)**	(2.4)	(2.4)
Pension scheme surplus	**(1.0)**	**(1.0)**	(3.0)	(3.0)
Intangible assets	**(28.8)**	**(28.8)**	(19.6)	(19.6)
Excess of expected loss over impairment provision	**(4.7)**	**(4.7)**	(13.0)	(13.0)
CET 1 capital	**1,115.7**	**1,112.8**	1,044.1	1,042.0
Additional Tier 1 capital (AT1):				
Permanent Interest Bearing Shares (PIBS)	**25.0**	**25.0**	25.0	25.0
Regulatory adjustments:				
Grandfathering of PIBS under transitional rules	**(20.0)**	**(25.0)**	(17.5)	(25.0)
Total Tier 1 capital	**1,120.7**	**1,112.8**	1,051.6	1,042.0
Tier 2 capital				
Issuance of subordinated debt	**200.0**	**200.0**	200.0	200.0
Permanent Interest Bearing Shares	**20.0**	**25.0**	17.5	25.0
Provision over expected loss	**7.3**	**7.3**	2.2	2.2
Total Tier 2 capital	**227.3**	**232.3**	219.7	227.2
Total regulatory capital	**1,348.0**	**1,345.1**	1,271.3	1,269.2

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 5) 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 4.2 and 4.3.

4.2 Tier 1 capital

4.2.1 Common Equity Tier 1

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

At 31 December 2020 there was a CET1 regulatory deduction relating to intangible assets and pension surplus, neither of which are eligible capital under either the transitional or fully implemented CRD V rules. A deduction of £28.8m has been made (2019: £19.6m) relating to intangible assets and £1.0m (2019: £3.0m) relating to pension surplus. An additional valuation adjustment of £1.8m was also deducted in 2020 (2019: £2.4m).

The Society has chosen to adopt the IFRS 9 transitional arrangements associated with the move from IAS 39 to IFRS 9. This has led to an add-back adjustment to CET1 of £2.9m (2019: £2.1m) and has been prepared in line with the latest regulations published in June 2020 extended to take account of Covid-19. This value is relatively low due to the Society being granted IRB permission by the PRA in 2018 and the majority of the book being assessed under this approach.

As the Society is regulated under the IRB approach an adjustment to CET1 was required to account for the shortfall in provision that relates to the difference between regulatory expected losses and IFRS 9 provisions. The calculation is separated for accounts in and out of default. For accounts not in default the assessment at the end of 2020 resulted in a deduction of £4.7 (2019: £13.0m).

4.2.2 Additional Tier 1

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

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

The full terms and conditions of the PIBS are set out in the Offering Circular dated 31 March 1992, available on request from the Society (see section 11 for contact information). The key features of the PIBS are set out in Appendix A2.

4.3 Tier 2 capital

At 31 December 2020, Tier 2 capital comprises the Society's qualifying subordinated notes and the proportion of PIBS phased from AT1 to Tier 2. The derecognised proportion of PIBS in AT1 capital is being recognised as Tier 2 capital. On a fully implemented basis, PIBS qualify as and form part of Tier 2 capital.

Under regulatory rules for Individual Capital Guidance, at least 56.25% of capital must be CET1, no more than 43.75% should be AT1 and no more than 25% Tier 2 capital. Given the magnitude of the components of CET1, AT1 and Tier 2 capital, the Society was at all times comfortably within these limits.

Capital Resources

The Society issued £200m of subordinated debt in 2018, which qualifies as Tier 2 capital. The full terms and conditions of this issuance are available on request from the Society; see section 11 for contact information. The key features of the subordinated debt are included in Appendix A2.

As the Society is regulated under the IRB approach an additional adjustment of £7.3m (2019: £2.2m) is required in Tier 2 capital to reflect the level of IFRS 9 provision over regulatory expected losses for cases in default.

4.4 Capital reconciliation statement

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

TABLE 7: Capital reconciliation	**Transitional 2020 £m**	**End Point 2020 £m**	Transitional 2019 £m	End point 2019 £m
Total CET 1 attributable to members per the Statement of Financial Position	**1,154.7**	**1,154.7**	1086.1	1086.1
Adjustments to CET 1 capital:				
Deferred Tax	**(5.6)**	**(5.6)**	(6.1)	(6.1)
IFRS 9 transitional add back	**2.9**	**-**	2.1	-
Additional valuation adjustment	**(1.8)**	**(1.8)**	(2.4)	(2.4)
Defined benefit pension surplus	**(1.0)**	**(1.0)**	(3.0)	(3.0)
Intangible assets net of tax	**(28.8)**	**(28.8)**	(19.6)	(19.6)
Excess of expected loss over impairment provision	**(4.7)**	**(4.7)**	(13.0)	(13.0)
Total adjustments to CET1 capital	**(39.0)**	**(41.9)**	(42.0)	(44.1)
Adjustments to AT 1 capital:				
Permanent Interest Bearing Shares (PIBS)	**25.0**	**25.0**	25.0	25.0
Grandfathering of PIBS	**(20.0)**	**(25.0)**	(17.5)	(25.0)
AT 1 capital	**5.0**	**-**	7.5	-
Adjustments to Tier 2 capital:				
Collective impairment allowance	**-**	**-**	-	-
Issuance of subordinated debt	**200.0**	**200.0**	200.0	200.0
Permanent Interest Bearing Shares	**20.0**	**25.0**	17.5	25.0
Provision over expected loss	**7.3**	**7.3**	2.2	2.2
Tier 2 capital	**227.3**	**232.3**	219.7	227.2
Total regulatory capital	**1,348.0**	**1,345.1**	1,271.3	1,269.2

Capital Resources

4.5 Capital flow statement

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

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

TABLE 8: Capital flow	Transitional 2020 £m	Transitional 2019 £m
Total regulatory capital at 1 January	**1,271.3**	1,225.3
Adjustments to CET 1 capital:		
Profit after tax for the financial year	**62.0**	66.2
Additional valuation adjustment	**0.6**	(0.5)
Pension actuarial movement	**(1.4)**	(7.9)
Revaluation reserve movement	**1.8**	(0.1)
Fair value reserve	**6.3**	1.4
Movement in defined benefit surplus	**2.0**	7.1
Intangible assets	**(9.2)**	(11.1)
Change in excess expected loss over impairment provision	**8.3**	(3.1)
Deferred Tax	**0.5**	(6.1)
IFRS 9 transitional add back	**0.8**	0.8
Total movement in CET1 capital	**71.7**	46.7
Adjustments to AT1 capital:		
Phasing of PIBS from AT1 to Tier 2 (see section 4.2.2)	**(2.5)**	(2.5)
Total movement in AT1 capital	**(2.5)**	(2.5)
Adjustments to Tier 2 capital:		
Phasing of PIBS	**2.5**	2.5
Provision over expected loss	**5.1**	(0.7)
Total movement in Tier 2 capital	**7.6**	1.8
Total regulatory capital at 31 December	**1,348.0**	1,271.3

5 Capital Adequacy

5.1 Capital Management Policy

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

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

Specific capital management reports are presented to the appropriate executive risk and management committees. The key regulatory capital ratios are set out in section 1 of this document. Summarised regulatory capital positions and forecasts (including forecasts under stress scenarios) are reported to the Board and to the Asset and Liability Committee (ALCO).

The Society considers both risk based capital requirements and non-risk based leverage requirements when determining the Society's strategy and has adopted a range of performance metrics over and above the regulatory minimum as the Society's risk appetite.

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

- Common Equity Tier 1 capital (CET 1) ratio (see section 5.3)
- Total capital ratio (total capital/total risk weighted assets) on both a transitional and fully loaded basis; and
- Leverage ratio (see section 5.4).

5.2 Internal Capital Adequacy Assessment Process and Pillar 2

The Society assesses its capital adequacy through an Internal Capital Adequacy Assessment Process (ICAAP), at least annually. This process is used to determine the level of capital required to support the Society's current and future business activities. The ICAAP ensures that the Society meets regulatory capital requirements under business as usual and stressed environments, over a five year time horizon. The Board Risk Committee reviews internal refreshes of the ICAAP at least annually and more frequently when required. During 2020, the Society remained strongly capitalised with capital resources significantly above the PRA prescribed TCR and buffer requirements and transitional MREL requirements.

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

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

As of 31 December 2020 this updated TCR would equate to a Pillar 2A of 2.6% risk weighted assets of which 1.5% has to be covered by CET 1 capital (2019: 3.7% and 2.1% respectively). The Society is not permitted by the PRA to provide any further details regarding the quantum of the individual components.

5.3 Minimum capital requirement – Pillar 1

The Society's minimum capital requirement under Pillar 1 is calculated by adding the credit risk requirement (section 6) to the requirements for operational risk and other commitments.

Credit Risk

The Society has adopted the following approaches to calculate the minimum regulatory capital requirement for credit risk:

IRB Approach for:

- Residential mortgage exposures: prime, but-to-let and shared ownership; and
- Non-credit obligation assets.

Standardised Approach for:

- Commercial mortgage exposures;
- Legacy retail mortgages (secured against residential property); and
- Wholesale credit exposures.

Section 6 sets out further information on credit risk.

Operational Risk

See section 8.

Other Commitments - Credit Valuation Adjustment

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

Environmental Risks

The Society faces financial risk from climate change through two primary channels: physical (weather events / long term shifts in the climate) and transitional (adjustments towards a low carbon economy). Capital requirements for such risks would be captured under the Pillar 2 assessment.

In response to the PRA supervisory statement SS3/19: Enhancing banks' and insurers' approaches to managing the financial risks from Climate Change, the Society has proposed a target state of maturity and initial strategic aims, reflective of LBS size and scale.

Summary of risk weighted assets and Pillar 1 Capital Requirements

The following table shows the Pillar 1 capital requirement, regulatory capital resources and the excess of resources over Pillar 1 capital requirement as at 31 December 2020.

Credit Risk

TABLE 9a: Pillar 1 RWA's and Capital Required by Exposure Class	Avg Risk Weighted Assets 2020 £m	Avg Minimum Capital Requirement 2020 £m	**Risk Weighted Assets 2020 £m**	**Minimum Capital Requirement 2020 £m**	Risk Weighted Assets 2019 £m	Minimum Capital Requirement 2019 £m
Credit risk - IRB Approach						
Secured by mortgages on immovable property	2,020.5	161.6	**2,011.0**	**160.9**	2,030.0	162.4
Exposures in Default	189.3	15.1	**205.8**	**16.5**	172.8	13.8
Non-credit obligation assets	196.9	15.8	**238.1**	**19.0**	155.7	12.5
					-	-
Credit risk - Standardised Approach					-	-
Secured by mortgages on immovable property	194.1	15.5	**187.6**	**15.0**	200.5	16.0
Exposures in Default	7.8	0.6	**8.6**	**0.7**	7.0	0.6
Corporates	-	-	**-**	**-**	-	-
Retail	3.9	0.3	**-**	**-**	7.9	0.6
Central governments or central bank	-	-	**-**	**-**	-	-
Multilateral development banks	-	-	**-**	**-**	-	-
Institutions	86.9	6.9	**53.4**	**4.3**	120.3	9.6
Covered bonds	36.5	2.9	**32.2**	**2.6**	40.7	3.3
Claims on institutions and corporates with a short term credit assessment	-	-	**-**	**-**	-	-
Securitisations	15.3	1.2	**12.4**	**1.0**	18.3	1.5
Other items	-	-	**-**	**-**	-	-
Counterparty risk (CVA)	26.4	2.1	**17.1**	**1.4**	35.7	2.9
Total	2,777.7	222.2	**2,766.4**	**221.3**	2,788.9	223.1
Operational risk			**303.5**	**24.3**	314.8	25.2
Pillar 1 Total Capital Requirement			**3,070.0**	**245.6**	3,103.7	248.3
Total Regulatory Capital Resources				**1,348.0**		1,271.3
Excess capital over minimum Pillar 1 requirement				**1,102.4**		1,023.0

The average data above is derived from a simple average of the year end positions. The same principle has been applied throughout the Pillar 3.

Credit Risk

Impact of IFRS 9

The Society has chosen to adopt the transitional arrangements as laid out in the CRR Quick fix package, adopted by the PRA in June 2020, for mitigating the impact of the introduction of IFRS 9 on own funds.

TABLE 9b: IFRS 9 Transitional Arrangement

	2020 £m IRB	2019 £m IRB
Available capital (amounts)		
1 Common Equity Tier 1 (CET1) capital	**1,115.7**	1,044.1
2. Common Equity Tier 1 (CET1) capital as if IFRS 9 or analogous ECLs transitional arrangement had not been applied	**1,112.8**	1,042.0
3 Tier 1 capital	**1,120.7**	1,051.6
4 Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,117.8**	1,049.5
5 Total capital	**1,348.0**	1,271.3
6 Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,345.1**	1,269.2
Risk weighted assets (amounts)		-
7 Total risk-weighted assets	**3,070.0**	3,103.7
8 Total risk weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**3,070.9**	3,104.5
Capital ratios		
9 Common Equity Tier 1 (as a percentage of risk exposure amount)	**36.34%**	33.64%
10 Common Equity Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**36.24%**	33.56%
11 Tier 1 (as a percentage of risk exposure amount)	**36.51%**	33.88%
12 Tier 1 (as a percentage of risk exposure amount as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**36.40%**	33.81%
13 Total capital (as a percentage of risk exposure amount)	**43.91%**	40.96%
14 Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**43.80%**	40.88%
Leverage Ratio		
15 Leverage ratio total exposure measure	**20,889.9**	20,964.2
16 Leverage ratio	**5.4%**	5.0%
17 Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**5.4%**	5.0%

Risk weighted asset movement

The table below contains certain key capital ratios which have been calculated using totals from Table 1 (CET1 capital, total Tier 1 capital and total capital respectively) in conjunction with total risk weighted assets (RWA) of £3,070.0m under IRB (2019: £3,103.7m).

Credit Risk

TABLE 10: Capital ratios	Regulatory requirement 2020 minimum %	End Point 2020 actual % IRB	Regulatory requirement 2019 minimum %	End Point 2019 actual % IRB
Capital ratios				
Common Equity Tier 1 ratio	**4.50%**	**36.24%**	4.50%	33.56%
Tier 1 ratio	**6.00%**	**36.24%**	6.00%	33.56%
Total regulatory capital ratio	**8.00%**	**43.80%**	8.00%	40.88%

The tables below show the movements in credit risk weighted assets between 1 January 2020 and 31 December 2020 (together with prior year comparatives) in line with EDTF recommendation 16 and reconciles to total RWA on which the ratios above are based.

The RWA movement for residential mortgages reflects minimal growth in residential mortgage balances and a small increase to risk weight percentages across the portfolio.

TABLE 11: Risk weighted assets flow IRB	Residential mortgages £m	Other Loans £m	Liquidity £m	Other items £m	Counterparty risk £m	Total £m
Credit RWA at 1 January 2020	**2,360.7**	**93.3**	**123.3**	**75.9**	**115.2**	**2,768.5**
Change in RWA %	**64.0**	**(1.0)**	**(24.2)**	**-**	**(62.2)**	**(23.4)**
Change in portfolio size	**10.4**	**(1.6)**	**(12.8)**	**18.8**	**(14.7)**	**0.2**
Credit RWA at 31 December 2020	**2,435.1**	**90.8**	**86.2**	**94.8**	**38.3**	**2,745.3**
Operational risk						**303.5**
Other commitments						**21.2**
Total risk weighted assets at 31 December 2020						**3,070.0**

Credit Risk

TABLE 11: Risk weighted assets flow IRB	Residential mortgages £m	Other Loans £m	Liquidity £m	Other items £m	Counterparty risk £m	Total £m
Credit RWA at 1 January 2019	2,202.1	105.6	109.5	85.1	329.1	2,831.4
Change in RWA %	(37.3)	(5.8)	75.9	-	3.4	36.2
Change in portfolio size	195.9	(6.5)	(62.1)	(9.2)	(217.2)	(99.1)
Credit RWA at 31 December 2019	2,360.7	93.3	123.3	75.9	115.2	2,768.5
Operational risk						314.8
Other commitments						20.4
Total risk weighted assets at 31 December 2019						3,103.7

5.4 Leverage ratio

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

TABLE 12a: Summary reconciliation of accounting assets and leverage ratio exposures	End Point **2020 IRB £m**	2019 IRB £m
Total assets as per published financial statements [1]	**20,639.7**	20,807.8
Tier 1 capital reductions	**(41.9)**	(44.1)
Less: positive market value of derivatives	**(192.8)**	(182.9)
Total assets excluding derivatives	**20,405.0**	20,580.8
Adjustments for derivative financial instruments	**352.9**	288.6
Adjustments for repurchase agreements	**-**	0.2
Mortgage pipeline [2]	**132.0**	94.8
Other committed facilities	**-**	-
Total leverage ratio exposures	**20,889.9**	20,964.4

[1] £20,639.7m per financial statements, see table 5 - Tier 1 capital deductions of £41.9m (2019: £20,807.8m - £42.0m).

[2] 2020 calculated as 20% of quoted pipeline (2019: 20%).

The leverage ratio common disclosure is set over the page.

Credit Risk

TABLE 12b: Leverage ratio common disclosure	End Point 2020 IRB £m	2019 IRB £m
On-balance sheet exposures (excluding derivatives and repurchase transactions)		
On-balance sheet items (excluding derivatives, repurchase transactions and fiduciary assets, but including collateral)	**20,446.9**	20,624.9
Asset amounts deducted in determining Tier 1 capital	**(41.9)**	(44.1)
Total on-balance sheet exposures (excluding derivatives, repurchase agreements and fiduciary assets)	**20,405.0**	20,580.8
Derivative exposures		
Replacement cost associated with all derivative transactions	**249.4**	179.3
Add on amounts for Potential Future Exposure (PFE) associated with all derivatives transactions	**103.5**	109.3
Total derivative exposures	**352.9**	288.6
Repurchase transaction exposures		
Gross repurchase transaction assets (with no recognition of netting) after adjusting for sales accounting transactions	**-**	0.2
Total repurchase transaction exposures	**-**	0.2
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	**659.9**	473.9
Adjustments for conversion to credit equivalent amounts	**(527.9)**	(379.1)
Other off-balance sheet exposures	**132.0**	94.8
Capital and total exposures		
Tier 1 capital	**1,112.8**	1,042.0
Total leverage ratio exposures	**20,889.9**	20,964.4
Leverage ratio		
Leverage ratio	**5.3%**	5.0%

The ratios above have been derived from Tier 1 capital figures calculated on a full implementation basis. The improvement in the ratio over the course of 2020 is driven by higher levels of Tier 1 capital generated through earnings retained after tax in the year.

Credit Risk

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

TABLE 12c: Split of on-balance sheet Leverage exposures	End Point	
	2020	2019
	IRB	IRB
	£m	£m
Total on-balance sheet exposures (excluding derivatives, repurchase transactions and exempted exposures) are fully represented by banking book exposures, of which:	**20,446.9**	20,624.9
Covered bonds	**322.2**	405.8
Exposures treated as sovereigns	**1,934.1**	2,003.8
Exposures to regional governments, multilateral development banks, international organisations and public sector entities not treated as sovereigns	**463.7**	468.5
Exposures to institutions	**148.1**	251.0
Secured by mortgages on immovable property using IRB	**16,561.8**	16,519.1
IRB exposures in default	**114.3**	105.3
Secured by mortgages on immovable property using Standardised Approach	**411.7**	407.0
Standardised exposures in default	**8.6**	12.4
Other exposures (for example equity, securitisations and other non-credit obligation assets)	**482.3**	451.9

6 Credit Risk

6.1 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 mortgage customers and wholesale counterparties.

Credit risk is divided into retail and wholesale (section 6.5). Descriptions of retail and wholesale credit risk and their mitigation are included in the Principal Risks section of the Annual Report and Accounts for the year ended 31 December 2020 on pages 40 to 49.

6.2 Approach to Credit Risk

Credit Risk under the IRB Approach

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

- Retail mortgages: UK Prime Residential Real Estate, UK Residential Buy to Let and UK Prime Shared Ownership; and
- Other Non-Credit Obligation Assets.

Credit Risk under the Standardised Approach

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

- Exposures to Central Governments and Central Banks:
- Exposures to Institutions:
- Exposures to Corporates:
- Exposures to Retail:
- Exposures to Multilateral Development Banks:
- Other / legacy retail mortgages (secured against residential property); and
- Items Representing Securitisation Positions

6.3 Credit Risk Exposures

The Society's total credit risk exposure split by exposure class:

TABLE 13: Total Credit Risk Exposure	Average £m	**2020 £m**	2019 £m
Credit risk - IRB Approach			
Secured by mortgages on immovable property	16,540.5	16,561.8	16,519.2
Exposures in Default	109.8	114.3	105.3
Non-credit obligation assets	186.5	216.4	156.5
Credit risk - Standardised Approach			
Secured by mortgages on immovable property	409.4	411.7	407.0
Exposures in Default	10.5	8.6	12.4
Corporates	-	-	-
Retail	264.9	245.5	284.3
Central governments or central bank	1,982.8	1,930.3	2,035.2
Multilateral development banks	222.2	219.2	225.2
Institutions (inc derivatives)	434.4	461.8	407.1
Covered bonds	364.0	322.2	405.8
Claims on institutions and corporates with a short term credit assessment	-	-	-
Securitisations	123.4	106.7	140.1
Counterparty risk (CVA)	52.7	36.5	68.9
Total credit risk exposure	20,701.0	**20,635.0**	20,767.1

Residential credit risk

This risk is overseen by a specialist retail Credit Risk Function, reporting to the Chief Risk Officer, with oversight from BRC. The Society's Lending Policy is approved annually by the Board and is reviewed on an ongoing basis by the BRC. The policy includes a broad range of stock and flow limit structures to support the ongoing risk management of the book in line with the agreed credit risk appetite. The BRC also receives management information, highlighting the performance of the Society's mortgage portfolio.

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

- Credit scorecard assessment;
- Residential affordability assessment based on income and expenditure using stressed interest rates:
- BTL affordability assessment based on interest cover ratio requirements using stressed interest rates:
- Access to credit data, including the credit history of an individual;
- Independent expert appraisal of the suitability and value of a property; and
- Underwriting processes, which are a hybrid of computer systems and suitably qualified underwriters.

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

Credit Risk

The Society has a dedicated Collections function, which seeks to engage with customers, at an early stage, to discuss potential financial difficulties. Forbearance options are determined on a case by case basis, with the aim of working with borrowers to clear arrears. The Society is able to offer customers an appropriate range of options, including an extension of the mortgage term, a temporary change to interest only, capitalisation of arrears, reduced monthly repayments, transfer to an alternative product (subject to meeting criteria). Mortgage Payment Deferrals (MPDs) have also been available from March 2020, in accordance with the FCA guidance, MPDs offered to customers as a result of the COVID-19 pandemic are not considered to be standard forbearance. After all other options have been exhausted, the Society may take possession of the mortgaged property. Analysis of the Society's residential portfolio and forbearance activity is used to inform the provisioning policy. This ensures that the Society properly recognises losses, in accordance with its accounting policies.

Note 8 in the ARA details out the provisions that are held against residential mortgages

Exposures by geographic region

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

TABLE 14: Retail mortgages by region	**2020 £m**	**2020 %**	2019 £m	2019 %
Retail regional analysis				
South East	**3,168.7**	**18.9%**	3,179.5	19.0%
Greater London	**2,733.6**	**16.3%**	2,711.2	16.2%
Midlands	**2,522.0**	**15.1%**	2,543.8	15.2%
Yorkshire and Humberside	**1,493.6**	**8.9%**	1,506.2	9.0%
South West	**1,540.4**	**9.2%**	1,522.9	9.1%
North West	**1,401.9**	**8.4%**	1,389.1	8.3%
Scotland	**1,366.8**	**8.2%**	1,372.3	8.2%
East of England	**818.3**	**4.9%**	820.0	4.9%
North East	**655.6**	**3.9%**	652.7	3.9%
Wales	**517.1**	**3.1%**	518.8	3.1%
Northern Ireland	**448.8**	**2.7%**	435.1	2.6%
Spain	**70.3**	**0.4%**	69.3	0.4%
Other	**15.4**	**0.1%**	18.9	0.1%
Total	**16,752.5**	**100.0%**	16,739.8	100.0%

Table 14 above and Table 15 below agree to the residential mortgages balance in Note 33(b) in the ARA, both tables exclude the equity release portfolio.

Retail maturity profile

TABLE 15: Retail maturity	**2020**			
	Up to 12 months £m	**1 - 5 years £m**	**> 5 years £m**	**Total £m**
Asset classes				
Secured by mortgages on immovable property	**62.5**	**590.9**	**16,099.1**	**16,752.5**

TABLE 15: Retail maturity	2019			
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	Total £m
Asset classes				
Secured by mortgages on immovable property	51.9	550.9	16,137.0	16,739.8

6.4 IRB Models

Overview

As part of its calculation of capital requirements for credit risk, Leeds Building Society uses a suite of IRB models developed for, and applied to, its retail UK exposures defined in section 6.2. The Society was granted its IRB permissions by the PRA with effect from 1st July 2018 with no pre- or post- conditions of use specified. The current suite of models are described in this section.

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

Model Risk Management of the IRB Ratings System

The discriminatory performance and accuracy of the Society's IRB model suite is regarded as critical, in terms of the calculation of credit risk capital requirements, and wider use of model estimates in risk management practices. As part of its Enterprise Risk Management Framework (ERMF) the Society operates a structured and proportionate approach to model risk management and has operated industry good practice and well-defined disciplines to its credit risk related models for a number of years. For more detail on the ERMF please see the Board Risk Committee Report on pages 98 to 103 of the Annual Report and Accounts.

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

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

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

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

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

Credit Risk

Key Features of IRB Models

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

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

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

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

IRB Model Performance

This section provides an overview of the performance of the IRB models over the course of 2018-20.

TABLE 16a: **IRB Model Performance**	**Predicted PD***	**Observed PD***	**Predicted LGD**	**Observed LGD**
2020	**%**	**%**	**%**	**%**
Prime	**0.27**	**0.17**	**1.58**	**1.18**
Buy to let	**0.08**	**0.11**	**4.93**	**2.9**
Shared ownership	**0.45**	**0.26**	**3.81**	**1.84**
Total	**0.24**	**0.16**	**2.43**	**1.53**
2019	%	%	%	%
Prime	0.22	0.24	2.09	2.39
Buy to let	0.08	0.05	5.87	3.98
Shared ownership	0.3	0.46	3.08	1.83
Total	0.19	0.22	2.82	2.51
2018	%	%	%	%
Prime	0.35	0.33	2.93	2.68
Buy to let	0.15	0.15	7.72	5.81
Shared ownership	0.50	0.53	3.10	1.83
Total	0.32	0.31	3.78	3.17

Credit Risk

Predicted PDs[2] generally show a moderate increase on 2019, Observed PD is broadly in line with predicted PD though the impacts of the global pandemic and macro-prudential measures have impacted model performance. Refer to page 46 of the Annual Report and accounts for the year ended 31 December 2020 for further detail regarding the impact of Covid-19 pandemic on model performance.

Loss Given Default estimates continue to be broadly consistent over time with some variation occurring due to house price movements. Observed LGD shows some variance to the predicted values. The LGD model is designed to consider the broad range of potential debt management actions in the possession and recovery process. As a result, estimates include elements of conservatism in order to recognise the potential costs of recovery actions and time taken to manage individual cases through to conclusion. It should be noted that litigation and possession activity has been temporarily paused in light of the global pandemic. The models reflect prevailing market prices, forced sale discounts in the event of forced sale and projected costs involved in litigation / possession activity up to the point of suspension, but actual 2020 activity is very low and therefore model estimates are primarily driven by pre-Covid experience.

Credit Risk Mitigation

The Society's main source of collateral, and therefore means of mitigating credit risk, held against the IRB portfolios is residential property. The recognition of eligible collateral requires a number of factors to be considered such as legal certainty of charge and an appropriate form of valuation. The Society require the collateral valuation to be conducted by an independent firm of appropriately qualified valuer's that are independent of the credit decision process and customer at the time of borrowing. The use of automated valuation models based on market data is also permitted, subject to criteria around the accuracy of the estimate and the LTV of the property. Post origination, collateral is revalued on a quarterly basis using an appropriate industry indexation approach.

The table over the page shows residential lending exposure by PD scale.

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[2] The Predicted and Actual PD columns in the table have been based upon the Application and Behavioural segments only; the PD models applied to accounts in arrears do not form part of the IRB Rating System solution (accounts in arrears are placed directly into their own MIA LRA PD bands) and it therefore not considered appropriate to include them in Pillar Three Disclosures, when measuring PD model predictions vs actuals.

TABLE 16b: Residential lending exposures	2020									
	Original on-balance sheet gross exposure	Off-balance sheet exposures post-CCF	EAD post CRM and post-CCF	Average PD	Number of obligors	Average LGD	RWA	RWA Density	EL	Provision
	£m	£m	£m	%		%	£m	%	£m	£m
PD scale										
0.00 to < 0.15	**1,546.2**	**0.1**	**1,546.2**	**0.11**	**16,815**	**12.57**	**54.0**	**3.49**	**0.2**	
0.15 to < 0.50	**4,852.1**	**8.9**	**4,861.0**	**0.36**	**36,044**	**10.97**	**292.4**	**6.01**	**1.6**	
0.50 to < 0.75	**4,439.8**	**61.6**	**4,501.4**	**0.58**	**48,635**	**9.03**	**439.3**	**9.76**	**2.9**	
0.75 to < 2.50	**3,932.0**	**55.6**	**3,985.9**	**1.39**	**39,733**	**9.34**	**633.4**	**15.89**	**5.9**	
2.50 to < 10.00	**1,426.8**	**5.8**	**1,432.6**	**4.57**	**15,679**	**9.26**	**502.8**	**35.10**	**7.8**	
10.00 to < 100.00	**234.6**	**0.0**	**234.6**	**29.70**	**1,364**	**14.73**	**89.1**	**37.99**	**9.0**	
100.00 (default)	**114.3**	**0.0**	**114.3**	**100.00**	**1,776**	**2.58**	**205.8**	**180.05**	**2.9**	
Total	**16,545.8**	**132.0**	**16,676.1**	**2.10**	**160,046**	**10.05**	**2,216.9**	**13.29**	**30.3**	**33.0**

TABLE 16b: Residential lending exposures	2019									
	Original on-balance sheet gross exposure	Off-balance sheet exposures post-CCF	EAD post CRM and post-CCF	Average PD	Number of obligors	Average LGD	RWA	RWA Density	EL	Provision
	£m	£m	£m	%		%	£m	%	£m	£m
PD scale										
0.00 to < 0.15	1,699.0	0.0	1,699.0	0.11	17,692	13.30	62.8	3.69	0.3	
0.15 to < 0.50	4,618.7	10.3	4,629.0	0.36	32,948	10.68	248.5	5.37	1.4	
0.50 to < 0.75	4,582.9	27.7	4,610.6	0.57	50,251	9.10	420.0	9.11	2.9	
0.75 to < 2.50	4,073.1	48.9	4,120.8	1.39	40,086	10.19	754.9	18.32	6.6	
2.50 to < 10.00	1,272.8	7.8	1,280.7	4.31	13,972	10.04	459.7	35.90	6.9	
10.00 to < 100.00	179.1	0.0	179.1	32.63	1,283	14.97	84.1	46.97	8.2	
100.00 (default)	105.3	0.0	105.3	100.00	1,732	3.22	172.8	164.07	3.4	
Total	16,531.0	94.8	16,624.5	1.93	157,964	10.34	2,202.9	13.25	29.7	18.9

6.5 Wholesale credit risk

A description of wholesale credit risk and its mitigation are included in the Principal Risks section of the Annual Report and accounts for the year ended 31 December 2020 on pages 40 to 49.

Short-term investments

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

Credit Risk

TABLE 17: Credit quality steps for short term investments			**2020** Exposure £m	**2020** Risk weight %	2019 Exposure £m	2019 Risk weight %
Credit quality step	**Fitch rating**	**Moody's rating**				
1	AAA to AA-	Aaa to Aa3	**1,930.5**	**0.4%**	1,655.0	0.6%
2	A+ to A-	A1 to A3	**106.7**	**20.0%**	165.9	20.0%
3	BBB+ to BBB-	Baa1 to Baa3	**-**	**-**	-	-
4	BB+ to BB-	Ba1 to Ba3	**-**	**-**	-	-
5	B+ to B-	B1 to B3	**-**	**-**	-	-
6	CCC+ and below	Caa1 and below	**-**	**-**	-	-
Unrated	Unrated	Unrated	**0.1**	**100.0%**	-	-
Total short term investments			**2,037.3**		1,820.9	

Long-term investments

TABLE 18: Credit quality steps for long term investments			**2020** Exposure £m	**2020** Risk weight %	2019 Exposure £m	2019 Risk weight %
Credit quality step	**Fitch rating**	**Moody's rating**				
1	AAA to AA-	Aaa to Aa3	**937.5**	**4.7%**	1,502.6	4.4%
2	A+ to A-	A1 to A3	**-**	**-**	-	-
3	BBB+ to BBB-	Baa1 to Baa3	**-**	**-**	-	-
4	BB+ to BB-	Ba1 to Ba3	**-**	**-**	-	-
5	B+ to B-	B1 to B3	**-**	**-**	-	-
6	CCC+ and below	Caa1 and below	**-**	**-**	-	-
Unrated	Unrated	Unrated	**-**	**-**	-	-
Total long term investments			**937.5**		1,502.6	

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

Exposures by asset class

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

TABLE 19: Wholesale exposures by asset class	**2020** Average Exposure £m	**2020** Average RWA %	**2020** Year end £m	**2020** RWA £m	**2020** Weighted average RWA %
Asset class					
Central governments or central banks	**1,969.0**	**-**	**1,934.1**	**-**	**-**
Public sector entities	**244.7**	**-**	**245.2**	**-**	**-**
Multilateral development banks	**221.4**	**-**	**218.5**	**-**	**-**
Institutions	**199.6**	**20.0%**	**148.1**	**29.6**	**20.0%**
Covered bonds	**364.0**	**10.0%**	**322.2**	**32.2**	**10.0%**
Covered bonds repurchased	**12.2**	**0.0%**	**-**	**-**	**0.0%**
Securitisation positions	**123.4**	**14.6%**	**106.7**	**12.4**	**13.4%**
Non-UK Government Securities	**14.9**	**-**	**-**	**-**	**-**
Total	**3,149.2**		**2,974.8**	**74.2**	

Credit Risk

	2019 Average Exposure £m	2019 Average RWA %	2019 Year end £m	2019 RWA £m	2019 Weighted average RWA %
Asset class					
Central governments or central banks	1,964.5	-	2,003.8	-	-
Public sector entities	184.8	-	244.2	-	-
Multilateral development banks	168.2	-	224.3	-	-
Institutions	199.3	20.0%	251.0	50.2	20.0%
Covered bonds	367.4	10.0%	405.8	40.6	10.0%
Covered bonds repurchased	12.2	0.0%	24.5	-	0.0%
Securitisation positions	163.8	18.0%	140.1	18.3	15.8%
Non-UK Government Securities	14.9	-	29.7	-	-
Total	3,075.1		3,323.4	109.1	

Exposures by geographic region

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

TABLE 20: Wholesale exposures by geographical region	**2020 UK £m**	**Europe £m**	**Europe supra national £m**	**North America £m**	**Global supra national £m**	**Asia-Supra £m**	**Canada £m**	**Total £m**
Asset class								
Central governments or central banks	**1,934.1**	**-**	**-**	**-**	**-**	**-**	**-**	**1,934.1**
Public sector entities	**-**	**195.2**	**-**	**-**	**-**	**-**	**50.0**	**245.2**
Multilateral development banks	**-**	**-**	**44.1**	**-**	**136.9**	**37.5**	**-**	**218.5**
Institutions	**115.1**	**-**	**-**	**33.0**	**-**	**-**	**-**	**148.1**
Covered bonds	**322.2**	**-**	**-**	**-**	**-**	**-**	**-**	**322.2**
Covered bonds Repurchased	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Securitisation positions	**106.7**	**-**	**-**	**-**	**-**	**-**	**-**	**106.7**
Non-UK Government Securities	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**2,478.0**	**195.2**	**44.1**	**33.0**	**136.9**	**37.5**	**50.0**	**2,974.8**

	2019 UK £m	Europe £m	Europe supra-national £m	North America £m	Global supra-national £m	Asia-Supra £m	Canada £m	Total £m
Asset class								
Central governments or central banks	2,003.8	-	-	-	-	-	-	2,003.8
Public sector entities	-	198.3	-	-	-	-	45.9	244.2
Multilateral development banks	-	-	43.7	-	135.7	44.9	-	224.3
Institutions	165.9	56.4	-	3.8	-	-	25.0	251.0
Covered bonds	405.8	-	-	-	-	-	-	405.8
Covered bonds Repurchased	24.5	-	-	-	-	-	-	24.5
Securitisation positions	140.1	-	-	-	-	-	-	140.1
Non-UK Government Securities	-	29.7	-	-	-	-	-	29.7
Total	2,740.1	284.4	43.7	3.8	135.7	44.9	70.9	3,323.4

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 21: Wholesale exposures by residual maturity	**2020**			
	Up to 12 months £m	**1 - 5 years £m**	**> 5 years £m**	**Total £m**
Asset class				
Central governments or central banks	**1,934.1**	**-**	**-**	**1,934.1**
Public sector entities	**63.2**	**182.0**	**-**	**245.2**
Multilateral development banks	**29.1**	**189.5**	**-**	**218.5**
Institutions	**148.1**	**-**	**-**	**148.1**
Covered bonds	**5.0**	**307.1**	**10.1**	**322.2**
Covered bonds repurchased	**-**	**-**	**-**	**-**
Securitisation positions	**-**	**-**	**106.7**	**106.7**
Non-UK Government Securities	**-**	**-**	**-**	**-**
Total	**2,179.5**	**678.5**	**116.8**	**2,974.8**

	2019			
	Up to 12 months £m	1 - 5 years £m	> 5 years £m	Total £m
Asset class				
Central governments or central banks	2,003.8	-	-	2,003.8
Public sector entities	5.7	238.5	-	244.2
Multilateral development banks	-	219.5	4.9	224.3
Institutions	211.7	39.4	-	251.0
Covered bonds	-	389.9	15.9	405.8
Covered bonds repurchased	24.5	-	-	24.5
Securitisation positions	-	-	140.1	140.1
Non-UK Government Securities	29.7	-	-	29.7
Total	2,275.4	887.2	160.9	3,323.4

Credit Risk

Counterparty credit risk in relation to derivatives and repurchase transactions

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

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

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

Through 2020, the Society monitored its collateral positions on a daily basis, with all collateral being transacted in line with the agreed terms of its CSAs, and taking the form of cash in most cases (although some collateral received is now in the form of securities).

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

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

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

At 31 December 2020 the Society had no counterparty credit risk exposure to repos of £0m (2019: £0.2m).

'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 2020.

TABLE 22: Counterparty Credit Risk for derivative contracts	2020 Notional £m	2020 Exposure £m	2019 Notional £m	2019 Exposure £m
Centrally cleared derivative contracts				
Interest rate contracts	**14,854.6**	**67.4**	17,986.9	51.0
Floating swaps	**881.0**	**0.3**	1,339.0	1.0
Bilateral contracts				
Interest rate contracts	**1,352.5**	**19.3**	2,508.1	28.4
Equity release and equity swaps	**73.5**	**-**	76.6	-
Cross currency swaps	**1,246.6**	**105.8**	1,799.2	102.5
Gross positive fair value of contracts	**18,408.2**	**192.8**	23,709.8	182.9
Netting benefits and collateral		**56.6**		(3.6)
Replacement cost of derivatives		**249.4**		179.3
Potential future credit exposure		**103.5**		109.3
Derivative exposure including potential future credit exposure		**352.9**		288.6

6.6 Impairment of financial assets

Impairment of financial Assets

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

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

- Stage 1 – assets are allocated to this stage on initial recognition and remain in this stage if there has not been a significant increase in credit risk since initial recognition. Impairment losses are recognised to cover 12 month ECL, being the proportion of lifetime ECL arising from default events expected within 12 months of the reporting date.

- Stage 2 – assets where it is determined that there has been a significant increase in credit risk since initial recognition, but where there is no objective evidence of impairment. Impairment losses are recognised to cover lifetime ECL.

- Stage 3 – assets where there is objective evidence of impairment, i.e. they are considered to be in default. Impairment losses are recognised to cover lifetime ECL.

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

Impairment of loans and advances to customers

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

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

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

ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). Each element of the calculation is modelled at individual account level on a monthly basis over the remaining contractual term of the loan, with the first 12 months totalled to obtain the 12 month ECL and the lifetime ECL obtained by totalling the above over the full contractual life of the loan. Modelling assumptions are based on historical data analysis of the impact of economic variables on loan behaviour. These assumptions are then applied to the forecast economic scenarios to predict future loan behaviour.

The overall ECL recorded in the financial statements is calculated as the probability weighted ECL over a range of possible forecasted macroeconomic scenarios.

Forbearance strategies exercised by the Group include mortgage term extensions, transfer of mortgages (in full or in part) to an interest only product and capitalisation of arrears once the customer has demonstrated six months of consecutive contractual payments. These strategies are only adopted where they will not give rise to customer detriment. The implementation of a forbearance strategy does not give rise to the de-recognition of the loan.

Impairment of liquid assets

The Group reviews the external credit ratings of its liquid assets (cash in hand and balances with the BoE, loans and advances to credit institutions and investment securities) at each reporting date. Those assets which are of investment grade (external credit rating of Aaa to Baa3 or equivalent) are considered to have low credit risk and therefore are assumed to have not had a significant increase in credit risk since initial recognition, as allowed by IFRS 9. Liquid assets which are not of investment grade are not expected to be material, but would be assessed on an individual basis.

ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). LGD is calculated based on publicly available data on historic recovery rates by product and PDs are similarly based on public information and analysis performed by third parties to derive PDs for similar products.

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

TABLE 23: Movement in impairment provisions **2020**	**Loans fully secured on residential property**	**Loans fully secured on land**	**Other loans**	**Total**
	£m	**£m**	**£m**	**£m**
At 1 January 2020 (*)	**28.7**	**2.0**	**2.5**	**33.2**
Charge / (release) for the year	**15.0**	**(0.1)**	**-**	**14.9**
Amount written off during the year	**(1.3)**	**-**	**-**	**(1.3)**
Release of provision held against loans sold during the year	**0.4**	**-**	**-**	**0.4**
At 31 December 2020	**42.8**	**1.9**	**2.5**	**47.2**
Income Statement				
Charge / (released) for the year	**15.0**	**(0.1)**	**-**	**14.9**
Recoveries of amounts previously written off	**(0.3)**	**-**	**-**	**(0.3)**
Total income statement losses / (gains)	**14.7**	**(0.1)**	**-**	**14.6**

TABLE 23: Movement in impairment provisions 2019	Loans fully secured on residential property	Loans fully secured on land	Other loans	Total
	£m	£m	£m	£m
At 1 January 2019 (*)	27.7	4.0	2.5	34.2
Charge / (release) for the year	5.5	(2.0)	-	3.5
Amount written off during the year	(4.0)	-	-	(4.0)
Release of provision held against loans sold during the year	(0.5)	-	-	(0.5)
At 31 December 2019	28.7	2.0	2.5	33.2
	-	-	-	-
Income Statement	-	-	-	-
Charge / (released) for the year	5.5	(2.0)	-	3.5
Recoveries of amounts previously written off	(0.5)	(0.2)	-	(0.7)
Total income statement losses / (gains)	5.0	(2.2)	-	2.8

The impairment provisions for the Society's Spanish portfolio included in the above tables in the 2020 data are £7.4m (2019: £7.8m). The remainder of the provision balance relates to UK loans £39.8m (2019: £25.4m).

The Society does not have any impaired wholesale counterparty exposures (2019: £nil).

Credit Risk

Further Credit Quality analysis

Table 24a: Credit quality of forborne exposures	2020							
	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
	Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures		Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
			Of which defaulted	Of which impaired				
Loans and advances	**100**	**94**	**66**	**81**	**- 0**	**- 4**	**189**	**-**
Households	100	94	66	81	- 0	- 4	189	
Total	**100**	**94**	**66**	**81**	**- 0**	**- 4**	**189**	**-**
	2019							
Loans and advances	113	85	71	85	- 1	- 4	193	-
Households	113	85	71	85	- 1	- 4	193	-
Total	113	85	71	85	- 1	- 4	193	-

There have been no significant movements in forborne exposures during the year.

Credit Risk

Table 24b: Credit quality of performing and non-performing exposures by past due days	2020											
	Gross carrying amount/nominal amount											
	Performing exposures			Non-performing exposures								
		Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
Loans and advances	**18,674**	**18,595**	**80**	**202**	**93**	**49**	**34**	**17**	**3**	**1**	**5**	**130**
Central banks	1,908	1,908	-	-	-	-	-	-	-	-	-	-
Credit institutions	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	3	-	-	-	-	-	-	3	3
Non-financial corporations	24	24	-	5	5	-	-	-	-	-	-	-
Of which SMEs	12	12	-	5	5	-	-	-	-	-	-	-
Households	16,743	16,663	80	195	88	49	34	17	3	1	2	128
Debt securities	**950**	**950**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
General governments	302	302	-	-	-	-	-	-	-	-	-	-
Credit institutions	540	540	-	-	-	-	-	-	-	-	-	-
Other financial corporations	108	108	-	-	-	-	-	-	-	-	-	-
Off-balance-sheet exposures	**655**	**655**		**-**								**-**
Households	655	655		-								-
Total	**20,279**	**20,199**	**80**	**202**	**93**	**49**	**34**	**17**	**3**	**1**	**5**	**130**

Performing exposures increased in line with business growth. Non-performing exposures experienced no significant movements during the year. The gross non performing loans ratio at the 31 December 2020 was 1.08% (2019: 0.98%).

Credit Risk

Table 24b: Credit quality of performing and non-performing exposures by past due days	2019											
	Gross carrying amount/nominal amount											
	Performing exposures			Non-performing exposures								
		Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
Loans and advances	**18,324**	**18,235**	**89**	**181**	**90**	**46**	**25**	**13**	**2**	**3**	**2**	**120**
Central banks	1,496	1,496	-	-	-	-	-	-	-	-	-	-
Credit institutions	36	36	-	-	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	3	-	-	-	-	-	3	-	3
Non-financial corporations	24	24	-	7	7	-	-	-	-	-	-	-
Of which SMEs	11	11	-	7	7	-	-	-	-	-	-	-
Households	16,767	16,678	89	172	84	46	25	13	2	1	2	118
Debt securities	**1,708**	**1,708**	**-**	-	-	-	-	-	-	-	-	-
General governments	823	823	-	-	-	-	-	-	-	-	-	-
Credit institutions	745	745	-	-	-	-	-	-	-	-	-	-
Other financial corporations	141	141	-	-	-	-	-	-	-	-	-	-
Off-balance-sheet exposures	**467**	-	-	-	-	-	-	-	-	-	-	-
Households	467	-	-	-	-	-	-	-	-	-	-	-
Total	**20,499**	**19,943**	**89**	**181**	**90**	**46**	**25**	**13**	**2**	**3**	**2**	**120**

Credit Risk

Table 24c: Performing and non-performing exposures and related provisions.	2020														
	Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3			
Loans and advances	**18,674**	**16,345**	**2,330**	**202**	**15**	**188**	**26**	**8**	**19**	**21**	**0**	**21**	**283**	**16,517**	**181**
Central banks	1,908	1,908	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	24	-	*24*	5		5	2		2	0		0	176	22	5
Of which SMEs	12	-	*12*	5		5	1		1	0		0	135	11	5
Households	16,743	14,437	2,306	195	15	180	24	8	17	18	0	18	107	16,495	177
Debt securities	**950**	**950**	**-**	**-**	**-**	**-**	**-**	**0**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
General governments	302	302	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	540	540	-	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	108	108	-	-	-	-	-	*0*	-	-	-	-	-	-	-
Off-balance-sheet exposures	***655***	***655***	***0***	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**		**-**	**-**
Households	655	655	*0*	-	-	-	-	-	-	-	-	-	-	-	-
Total	**20,279**	**17,949**	**2,330**	**202**	**15**	**188**	**26**	**8**	**19**	**21**	**0**	**21**	**283**	**16,517**	**181**

There have been no significant movements in forborne exposures during the year.

Credit Risk

Table 24c: Performing and non-performing exposures and related provisions.	2019														
	Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3			
Loans and advances	**18,324**	**16,776**	**1,547**	**181**	**-**	**181**	**16**	**4**	**12**	**18**	**-**	**18**	**284**	**16,546**	**163**
Central banks	1,496	1,496	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	36	36	-	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	3	-	3	-	-	-	3	-	3	-	-	-
Non-financial corporations	24	24	-	7	-	7	2	-	2	0	-	0	178	-	7
Of which SMEs	11	11	-	7	-	7	1	-	1	0	-	0	-	-	7
Households	16,767	15,220	1,547	172	-	172	14	4	10	15	-	15	107	16,546	157
Debt securities	**1,708**	**1,708**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
General governments	823	823	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	745	745	-	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	141	141	-	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance-sheet exposures	**467**	*467*	-	-	-	-	-	-	-	-	-	-	-	-	-
Households	467	467	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	**20,499**	**18,952**	**1,547**	**181**	**-**	**181**	**16**	**4**	**12**	**18**	**-**	**18**	**284**	**16,546**	**163**

Credit Risk

Table 24d: Collateral obtained by taking possession and execution processes	**2020**		2019	
	Collateral obtained by taking possession			
	Value at initial recognition	Accumulated negative changes	Value at initial recognition	Accumulated negative changes
Other than PP&E	4.5	1.7	7.1	1.6
Residential immovable property	4.5	1.7	7.1	1.6
Total	**4.5**	**1.7**	7.1	1.6

There have been no significant movements during the year.

7 Market Risk

7.1 Market risk overview

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

Daily operational management

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

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

7.2 Interest rate risk

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

Interest rate risk is addressed in the Principal Risks section of the Annual Report and Accounts for the year ended 31 December 2020 on pages 40 to 49.

The table below details the Society's sensitivity to a 200bps change in interest rates, at 31 December 2020, with all other variables held constant. A positive number indicates an increase in earnings or economic value.

TABLE 25: Interest rate sensitivity	2020 +200 bps £m	2020 -200 bps Floor -1% £m	2019 +200 bps £m	2019 -200 bps Floor 0% £m
Annual earnings sensitivity	**74.4**	**(48.5)**	31.4	(14.9)

	2020 +200 bps £m	2020 -200 bps Floor 0% £m	2019 +200 bps £m	2019 -200 bps Floor 0% £m
Economic value sensitivity	**18.1**	**(0.4)**	(30.8)	6.9

Market Risk

The Society also run a stochastic Earnings at Risk (EaR) model to measure interest rate risk. The 12 month EaR exposure at 31 December 2020 is £1.1m (2019: £3.9m). The EaR exposure is monitored on a monthly basis.

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

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

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

7.3 Foreign currency risk

Currency risk is addressed in the Principal Risks section of the Strategic Report of the Annual Report and Accounts for the year ended 31 December 2020 on pages 40 to 49.

7.4 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.

7.5 Derivatives

The main derivatives used by the Society (as set out in Table 22) are interest rate contracts.

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

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

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

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

Historically, the Society has used Libor as the risk free rate that derivatives are traded against. This rate is set to discontinue at the end of 2021 and replaced with the preferred risk free rate, Sonia.

7.6 Liquidity risk

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

Market Risk

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

For further details of the management of liquidity and funding risk see the Principal Risk section of the Annual Report and Accounts for the year ended 2020 on pages 40 to 49.

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

Based on the final LCR rules, the Society's LCR is 195% at the end of the year (2019: 235%), compared to the regulatory minimum of 100%. The 12-month average LCR position over 2020 is presented below:

TABLE 26: Liquidity Coverage Ratio	Total weighted value (average)			
	31 March 2020	30 June 2020	30 September 2020	31 December 2020
	£m	£m	£m	£m
Liquidity buffer	2,892.7	2,802.0	2,802.8	2,815.5
Total net cash outflows	1,212.6	1,199.0	1,216.5	1,277.5
Liquidity Coverage Ratio	241.5%	236.7%	233.7%	224.5%

	Total weighted value (average)			
	31 March 2019	30 June 2019	30 September 2019	31 December 2019
	£m	£m	£m	£m
Liquidity buffer	2,781.1	2,768.8	2,723.2	2,741.4
Total net cash outflows	1,255.2	1,262.8	1,262.6	1,232.0
Liquidity Coverage Ratio	222.2%	219.8%	216.0%	223.0%

With regards the NSFR, a final UK NSFR standard has not yet been published. However, based on the Society's current interpretations, the NSFR is 141.5% (2019: 141.6%).

8 Operational Risk

8.1 Overview

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

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

8.2 Operational risk management framework

The Operational Risk Management Framework ("ORMF") forms part of the broader ERMF, detailed in section 3 and sets out the Society's approach to managing risks, through various processes, across the business at an operational level. The ORMF promotes a common understanding of operational risks across the Society, through standardised protocols and taxonomies to determine minimum internal standards. The framework is reviewed annually to reflect changes within either the Society's strategy or operating environment.

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

The ORMF also outlines the Society's approach to managing incidents, including those which incur a loss. This process ensures that incidents are investigated and resolved in a consistent and timely manner and are escalated where necessary. Incident reporting is received at either the Conduct and Operational Risk Committee ("CORC") or Operational Resilience Committee ("ORC"), along with any root cause analysis and recommended action.

8.3 Operational risk oversight and governance

The Society applies a three lines of defence model to the management of operational risk, as outlined in section 3. This ensures that there is a clear delineation between ownership of risks and controls, oversight and independent assurance. Key accountabilities for the management of operational risk are as follows:

- The first line of defence responsibilities include using operational risk management tools to identify and manage risks, maintaining an appropriate control environment, monitoring and reporting the operational risk profile, ensuring that the operational risk profile adheres to established risk appetite and tolerances, complying with policies, standards and guidelines and promoting a strong risk culture.
- The second line of defence responsibilities include designing operational risk management tools used by the business to identify and manage risks, applying "independent challenge" to the use and output of the operational risk

management tools by the first line, developing and maintaining policies, standards and guidelines, monitoring and reporting of the operational risk profile, designing and providing operational risk training and promoting a strong risk culture.

- Third line of defence responsibilities include independently verifying that the ORMF has been sufficiently well designed and implemented by both the first and second lines of defence, reviewing the "independent challenge" applied by the second line, reviewing monitoring, reporting and governance processes and promoting a strong risk culture.

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

The Society also operates a number of working groups, which are aligned into CORC or ORC, focusing on the risk and control environment for discreet elements of the risk universe. These working groups consist of SMEs from both the first and second line and provide an activity update to their respective parent committee on a periodic basis.

8.4 Operational risk capital requirements

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

As at 31 December 2020 the Society's Pillar 1 minimum risk weighted assets and capital requirements for operational risk were as follows:

TABLE 27: Operational Risk	**2020** **£m**	2019 £m
Operational risk weighted asset (RWA)	**303.5**	314.8
Operational risk capital requirements (RWA x 8%)	**24.3**	25.2

The Society also utilises scenario analysis, based on both internal and external loss data, to understand its operational risk profile under extreme, but plausible events. The outputs of these scenarios are then used to inform management whether further capital requirements are required for operational risk, in addition to minimum capital holdings outlined above. As a result of its 2020 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.

9 Securitisation

9.1 Overview

The Society has securitised a number of mortgage loans by pooling them together and transferring the loans to a Special Purpose Vehicle (SPV), Albion No.4 plc (Albion 4) being 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 create a diversified investor base. Albion 4 is a publicly issued RMBS, with £400m of notes issued £150m being retained by the Society for contingency purposes.

The Society also purchases securitisations originated by other parties (please refer to section 9.4).

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 if required.

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

The Society takes the role of servicer, originator (where the Society originates the assets being securitised), cash manager, bank account provider, swap provider and variable funding note registrar as defined in the relevant prospectus for Albion 4.

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 8.4); the Society does not currently act as a sponsor to any securitisations.

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

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

The Albion 4 securitisation has issued senior tranche instruments with the Society retaining the first loss element.

To manage interest rate risk, the Society enters into derivative transactions with the SPV, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. For Albion 4, the Society acts as swap provider. 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 2020 on pages 142 to 143.

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 the Society retains the risks and rewards associated with the pledged mortgages. Due to the Society's position with respect to the SPV; holds legal power, has exposure or rights to variable returns and has the ability to use its power over the SPV to affect the amount of its returns the SPV is fully consolidated in the Group accounts.

These assets are held at amortised cost. Albion 4 is 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 2020 there were no assets awaiting securitisation.

Securitisations

Albion 4 was incorporated in September 2019 and issued £400m of debt securities of which £250m were issued to external investors in September 2019 and £150m was retained by LBS, amortised to £121m at the current year end. The notes issued are rated by both Fitch and Moody's as AAA. At 31 December 2020, £347m of mortgages were pledged to Albion 4 and outstanding debt securities in issue were £323m. The Society retained £44m of class Z notes.

On 17 January 2020 the debt securities issued by Guildford No. 1 plc were repaid in full and the loans assigned to the company were returned.

TABLE 28: Originated securitisations

		2020			
		Gross assets securitised	**Notes issued**	**Retained notes**	**Underlying assets past due and impaired**
Securitisation company	**Type of securitisation**	**£m**	**£m**	**£m**	**£m**
Albion 4	Residential mortgage securitisation	**346.7**	**323.4**	**165.0**	**0.1**
		346.7	**323.4**	**165.0**	**0.1**

		2019			
		Gross assets securitised	Notes issued	Retained notes	Underlying assets past due and
Securitisation company	**Type of securitisation**	£m	£m	£m	£m
Albion 4	Residential mortgage securitisation	417.4	400.0	193.8	-
Guildford 1	Residential mortgage securitisation	323.6	-	335.9	1.2
		741.0	400.0	529.7	1.2

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 19 and 20 in section 6.

Prior to investing in a new RMBS transaction, the Society conducts the appropriate due diligence credit analysis on securities in accordance with Article 406 of the CRR 2. The Society also operates both issuer and individual securitisation limits to guard against concentration risk.

The Society monitors RMBS investments daily and 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 £106.6m at 31 December 2020 (2019: £140.1m) and comprises senior tranches of RMBS.

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

As at 31 December 2020, no purchased securitisation positions were past due or impaired. The Society uses the standardised approach to calculate RWA, defined under CRR 2 for its purchased securitised positions.

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

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

TABLE 29: Purchased securitisations	2020 Long term investment £m	2020 Risk weight %	2020 RWA £m	2019 Long term investment £m	2019 Risk weight %	2019 RWA £m
RMBS						
Aaa	104.1	13.1%	11.9	137.4	15.8%	17.7
Aa-1	-	20.0%	-	-	20.0%	-
Aa-2	-	20.0%	-	-	20.0%	-
Aa-3	2.5	20.0%	0.5	2.7	20.0%	0.5
A1	-	50.0%	-	-	50.0%	-
A2	-	50.0%	-	-	50.0%	-
A3	-	50.0%	-	-	50.0%	-
Baa-1	-	100.0%	-	-	100.0%	-
Total RMBS	**106.7**		**12.4**	**140.1**		**18.3**

10 Remuneration

10.1 Remuneration Policy

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

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 key priorities;
- ensuring that fixed salary is the main component of total remuneration, to create an acceptable relationship between risk and reward;
- ensuring that monetary and/or non-monetary forms of remuneration does not introduce incentives whereby Relevant Persons favour their own interests, or the institution's interests, to the detriment of consumers;
- ensuring remuneration and recognition practices promote a healthy culture that is consistent with our purpose, values and strategy;
- ensuring remuneration and recognition practices promote diversity and inclusion and avoid unconscious bias;
- ensuring that variable pay elements are transparent, avoid unnecessary complexity and 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.

Revised Remuneration Policy for 2021

The Committee conducted its formal, triennial review of the remuneration schemes during the year, based on key principles, guided by:

- ensuring compensation is structured to attract, motivate and retain high performing colleagues;
- remuneration should promote a healthy, diverse and inclusive culture;
- remuneration should support the business strategy; and
- promoting alignment of approach across the organisation, with an aim of simplifying, wherever possible.

We also considered, and accounted, for the impact of CRD V regulations. Based on these principles, and considering our business model and mutual status, the Committee decided to reduce the maximum bonus potential from 50% to 20%, thereby aligning the bonus scheme potential for the entire senior leadership team. The change reduces 'on target' performance to 15% of base salary (formerly 36%).

An appropriate level of variable pay is retained to promote team alignment and enable the Committee to consider longer term outcomes and sustainable performance for the executive directors. Variable pay for executive directors will be deferred for up to seven years and will remain subject to risk and conduct considerations ahead of any payment.

To ensure total compensation remains competitive, fixed pay has been varied to reflect a proportion of the lost variable pay opportunity. From 1 January 2020, base pay will be adjusted by between 17.8% and 18.2% for the executive directors. Full details are provided on page 110 in the ARA. The adjustment factors in the value of the certainty of fixed pay and an average level of historic bonus achievement. Overall, based on this average, the maximum remuneration for executive directors has been reduced.

Further details on the Remuneration Policy are set out in the Directors' Remuneration Report on pages 104 to 121 of the Annual Report and Accounts for the year ended 31 December 2020.

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 met four times in 2020. The Remuneration Committee reviews the compliance of the Remuneration Policy against the requirements of the FCA dual-regulated firms Remuneration Code. The Directors' Remuneration Report is shown in the Annual Report and Accounts for the year ended 31 December 2020 on pages 104 to 121. 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 on the following page sets out the aggregate quantitative remuneration for MRTs in relation to their services for the year ended 31 December 2020:

TABLE 30: Remuneration 2020	Number of beneficiaries	Fixed remuneration £'000	Variable remuneration £'000	Total remuneration £'000	Deferred remuneration £'000
Type of colleague					
Non executive director	9	490	5	495	-
Executive director	3	1,161	206	1,367	871
Other MRTs	14	2,775	746	3,521	718
Total	**26**	**4,426**	**957**	**5,383**	**1,589**

Remuneration 2019	Number of beneficiaries	Fixed remuneration £'000	Variable remuneration £'000	Total remuneration £'000	Deferred remuneration £'000
Type of colleague					
Non executive director	9	561	21	582	-
Executive director	5	2103	650	2753	669
Other MRTs	17	3055	862	3917	158
Total	**31**	**5,719**	**1,533**	**7,252**	**827**

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

Remuneration

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 2020 review.

There were no sign on payments or severance payments in 2020 (2019: £499,214).

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 104 to 121 of the Annual Report and Accounts for the year ended 31 December 2020.

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 67 to 83 of the Annual Report and Accounts for the year ended 31 December 2020.

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 67 to 83 of the Annual Report and Accounts for the year ended 31 December 2020.

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	Linked to the delivery of the annual business plan targets, including the achievement of strategic objectives and personal objectives	Executive directors have a maximum of 50% of basic pay. Executive directors designated as 'Senior Managers' under the Senior Managers Regime and over the de-minimis, 60% of the bonus will be deferred over a period of seven years with no vesting until three years after the award is made. 50% of variable will be delivered in a share-like instrument. Executive directors designated as 'Senior Managers' under the Senior Managers Regime and below the de-minimis, 40% of the bonus will be deferred over three years. Executive directors in a control function have a maximum of 50% of basic pay, with 40% of the award	Challenging performance objectives are aligned with our Corporate Plan, recognising short, medium and long term goals. Control function schemes are based solely on personal objectives.

		deferred over three years. Chief Officers and Directors have a maximum of 50% of basic pay, with 20% deferred over one year. The Chief Internal Auditor has a maximum of 15%, with 20% deferred over one year. Non-executive directors do not receive performance related pay.	
Operation of malus and clawback	The deferral ensures annual performance creates value sustained over the longer term.	Independent assessment takes place prior to the payment of each deferred award.	Not applicable
Pension	Provides fair market remuneration.	Based on the membership of the Society's defined contribution scheme. In appropriate circumstances, for example where contributions exceed the annual or lifetime allowance, there is an option to receive a monthly cash allowance in lieu of pension contributions.	Not applicable
Benefits	To align total remuneration broadly with the market.	The principal benefits are life assurance, private medical insurance, long-term health insurance and cash health plan. Other benefits may be provided based on individual circumstances, for example, relocation.	Not applicable

10.5 Other directorships

A list of directorships held by members of the senior management team is included on page 204 of the Annual Report and Accounts for the year ended 31 December 2020.

11 Contact Information

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

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Approved by the Board on 25 February 2021

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 capital adequacy framework issued by the Basel Committee on Banking Supervision, which defines the capital and liquidity rules for banks and building societies. The framework has been embedded into UK law through the European Capital Requirements Directive V (CRD V).
Capital Requirements Directive (CRD)	Directives enacted by PS29/20 introduced by the PRA on the 28th December regarding access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.
Capital Requirements Regulation (CRR)	Regulation (EU) No 575/2013 of the European Parliament on-shored in the UK post-Brexit by the Withdrawal act regarding prudential requirements for credit institutions and investment firms.
Common Equity Tier 1 (CET1) capital	CET1 capital is the highest quality form of capital and comprises general reserves from retained profits, less the book values of any pension surplus, goodwill and intangible assets and other regulatory adjustments as defined under CRD V.
Common Equity Tier 1 (CET1) capital ratio	This is a regulatory ratio, calculated as the total of CET1 capital divided by Risk Weighted Assets (RWAs).
Counterparty Credit Risk	This is the risk that a customer or counterparty is unable to pay the interest or to repay the capital on a loan when required.
Covered bonds	Debt securities which are backed by a portfolio of mortgages which is segregated from the issuers 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 V (risk weights under the Standardised Approach to credit risk).
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 BoE 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.
Group	The Society and its subsidiaries including entities under its control.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of CRD V requirements, of the levels of capital that it needs to hold in respect of regulatory capital requirements for risks it faces under a business-as-usual scenario and a variety of stressed scenarios
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.
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)	The Group's own internal assessment of the level of liquidity that it needs to hold in respect of regulatory liquidity requirements in relation to a number of stressed scenarios.
Internal Ratings Based (IRB) Approach	An approach for measuring exposure to credit risk which is more sophisticated than the Standardised Approach, where an entity can calculate its own risk weights for certain assets. The IRB approach may be Foundation or Advanced. IRB approaches can only be used with the permission of the Prudential Regulation Authority.
Loan to Value (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property on which the mortgage is secured. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).
London Clearing House (LCH)	An independent rates and multi-asset clearing house. LCH are a central counterparty which facilitates the exchange of multiple types of transactions.
London Interbank Offered Rate (Libor)	The average interest rate estimated by lending banks in London that the average lending 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 EAD and the net amount recovered, expressed as a percentage of the EAD.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates and customer-driven factors will create

Glossary and Abbreviations

	losses or decrease portfolio values.
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.
Minimum Requirements for Own Funds and Eligible Liabilities (MREL)	MREL is the total loss absorbing capital a financial institution must hold to facilitate the recapitalisation of the institution in resolution
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).
Loans Past Due	Loans past due occur when a borrower has failed to make a payment when it is contractually due.
Pillar 1	The parts of CRD V which set out the minimum capital requirements for credit, market and operational risk
Pillar 2	Those aspects of CRD V 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 V 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.
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.

Glossary and Abbreviations

Repurchase agreement (Repo)	A repurchase agreement allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a commitment to repurchase the asset at a specified price on a given future date. For the party selling the security and agreeing to repurchase the asset in the future, it is a reverse repo.
Residential mortgage backed securities (RMBS)	A category of asset backed security that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Risk Weighted Assets (RWAs)	A regulatory measure which adjusts the value of assets as recorded in the Statement of Financial Position to reflect the relative level of risk. This measure is used in calculating regulatory capital requirements.
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.
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 internally and is less risk sensitive than IRB approaches. This will generally result in a higher capital requirement.
Tier 1 capital	A measure of financial strength as defined by the PRA. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital is defined above.
Tier 2 capital	A further component of regulatory and financial capital as defined by CRD V.

Appendices

A1 EBA Own Funds disclosure template

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

TABLE 31: EBA Own Funds Disclosure Template		End Point 2020 £m	2019 £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves			
2	Retained earnings	1,125.1	1,064.6
3	Accumulated other comprehensive income (and other reserves)	29.6	21.5
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	1,154.7	1,086.1
Common Equity Tier 1 (CET1) capital: regulatory adjustments			
7	Additional value adjustments (negative amount)	(1.8)	(2.4)
8	Intangible assets (net of related deferred tax liability (negative amount)	(28.8)	(19.6)
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)	(5.6)	(6.1)
12	Negative amounts resulting from the calculation of expected loss amounts	(4.7)	(13.0)
15	Defined-benefit pension fund assets (negative amount)	(1.0)	(3.0)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	(41.9)	(44.1)
29	Common Equity Tier 1 (CET1) capital	1,112.8	1,042.0
Additional Tier 1 (AT1) capital: instruments			
36	Additional Tier 1 (AT1) capital before regulatory adjustments	-	-
Additional Tier 1 (AT1) capital: regulatory adjustments			
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital	-	-
44	Additional Tier 1 (AT1) capital	-	-
45	Tier 1 capital (T1 = CET1 + AT1)	1,112.8	1,042.0
Tier 2 (T2) capital: instruments and provisions			
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	225.0	225.0
50	Credit risk adjustments	7.3	2.2
51	Tier 2 (T2) capital before regulatory adjustments	232.3	227.2
Tier 2 (T2) capital: regulatory adjustments			
57	Total regulatory adjustments to Tier 2 (T2) capital	-	-
58	Tier 2 (T2) capital	232.3	227.2
59	Total capital (TC = T1 + T2)	1,345.1	1,269.2
60	Total risk weighted assets	3,070.9	3,104.5
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	36.24%	33.56%
62	Tier 1 (as a percentage of total risk exposure amount)	36.24%	33.56%
63	Total capital (as a percentage of total risk exposure amount)	43.80%	40.88%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	2.50%	3.49%
65	of which: capital conservation buffer requirement	2.50%	2.50%
66	of which: countercyclical buffer requirement	0.00%	0.99%
67	of which: systemic risk buffer requirement	0.00%	0.00%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	28.34%	24.79%
Applicable caps on the inclusion of provisions in Tier 2			
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	7.3	2.2

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	7 April 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

Appendices

Details related to the Society's subordinated debt are provided below:

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

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

Appendices

A3 Asset encumbrance disclosure template

The following disclosures are presented in line with PRA and EBA regulatory reporting requirements. Asset encumbrance occurs through the pledging of assets to secured creditors. The Society may encumber assets for a number of reasons, including 1) to attain short / long term funding through repo/securities lending arrangements; 2) attain long term funding through secured funding transactions, such as securitisations and covered bond issuances; and 3) to collateralise derivative exposures through credit support annexes (CSAs) with counterparts and through centralised derivative clearing. The asset encumbrance disclosure templates below are prepared in accordance with the EBA regulatory reporting technical standards set out in EBA/RTS/2017/03.The table below details, as a median calculation rather than point in time, for different classes of assets, the level of encumbrance and both the carrying and fair value of those assets on a prudential consolidation group basis in the year ended 2020.

Table 32a: Template A - Assets **2020**	**Carrying amounts of encumbered assets £m**	**of which: notionally eligible EHQLA and HQLA £m**	**Fair value of encumbered assets £m**	**of which: notionally eligible EHQLA and HQLA £m**	**Carrying amounts of unencumbered assets £m**	**of which: notionally eligible EHQLA and HQLA £m**	**Fair value of unencumbered assets £m**	**of which: notionally eligible EHQLA and HQLA £m**
Assets of the reporting institution	**6,337**	**-**	**NA**	**-**	**14,376**	**-**	**NA**	**-**
Equity instruments	-	-	-	-	-	-	-	-
Debt securities	50	-	50	-	1,395	1,290	1,395	1,290
of which:								
Covered Bonds					422	367	422	367
Asset Backed Securities					133	109	133	109
Issued by general governments	50	-	50		590	440	590	440
Other assets	328	-	NA	-	505	-	NA	-
of which: mortgage loans								

2019	Carrying amounts of encumbered assets £m	of which: notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which: notionally eligible EHQLA and HQLA £m	Carrying amounts of unencumbered assets £m	of which: notionally eligible EHQLA and HQLA £m	Fair value of unencumbered assets £m	of which: notionally eligible EHQLA and HQLA £m
Assets of the reporting institution	**6,314**	**-**	**NA**	**-**	**14,049**	**-**	**NA**	**-**
Equity instruments	-	-	-	-	-	-	-	-
Debt securities	44	-	98	-	1,264	1,218	1,264	1,218
of which:								
Covered Bonds					360	360	359	360
Asset Backed Securities					161	151	161	151
Issued by general governments	44		98		600	413	600	413
Other assets	263	-	NA		398	-	NA	-
of which: mortgage loans								

Appendices

Table 32b: Template B - Collateral received	Fair value of encumbered collateral received or own debt securities issued	of which: notionally eligible EHQLA and HQLA	collateral received or own debt securities issued available for encumbrance	of which: notionally eligible EHQLA and HQLA
	£m	£m	£m	£m
2020				
Collateral received by the reporting institution				
Loans on demand	146.8	-	-	-
Equity instruments	-	-	-	-
Debt securities	-	-	-	-
of which: covered bonds	-	-	-	-
of which: asset back securities	-	-	-	-
of which: issued by central governments	-	-	-	-
of which: issued by financial corporations	-	-	-	-
of which: issued by non-financial corporations	-	-	-	-
Loans and advances other than loans on demand	-	-	-	-
Other collateral received	-	-	-	-
Own debt securities issued other than own covered bonds or asset back securities	-	-	-	-
Own covered bonds and asset back securities issued and not yet pledged	-	-	-	-
Total assets, collateral received and own debt securities issued	-	-	-	-

2019	Fair value of encumbered collateral received or own debt securities issued £m	of which: notionally eligible EHQLA and HQLA £m	Fair value of collateral received or own debt securities issued available for encumbrance £m	of which: notionally eligible EHQLA and HQLA £m
Collateral received by the reporting institution				
Loans on demand	78.4	-	-	-
Equity instruments	-	-	-	-
Debt securities	34.2	34.2	-	-
of which: covered bonds	-	-	-	-
of which: asset back securities	-	-	-	-
of which: issued by central governments	34.2	34.2	-	-
of which: issued by financial corporations	-	-	-	-
of which: issued by non-financial corporations	-	-	-	-
Loans and advances other than loans on demand	-	-	-	-
Other collateral received	-	-	-	-
Own debt securities issued other than own covered bonds or asset back securities	-	-	-	-
Own covered bonds and asset back securities issued and not yet pledged	-	-	-	-
Total assets, collateral received and own debt securities issued	-	-	-	-

Table 32c: Template C - Encumbered assets/collateral received and associated liabilities	Matching liabilities, contingent liabilities or securities lent		Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered	
	2020 £m	2019 £m	2020 £m	2019 £m
Carrying amount of selected financial liabilities	3,514	2,065	6,123	4,071

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 4). 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 2020 is included in the total exposure to institutions in Tables 17 – 19. Collateralisation agreements are discussed in section 6.5 of this document.

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

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

Appendices

A4 Countercyclical capital buffer analysis

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

Table 33a below shows that based on the country specific rates in place at 31 December 2020 and the geographical distribution of exposures, the Society had an institution specific countercyclical capital buffer requirement of £0.0m (2019 £30.8m).

The requirement results from multiplying the total risk exposure amount (the total credit risk weighted assets from table 9) by the buffer rate for that country and summing the result.

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

TABLE 33a: Amount of institution specific countercyclical capital buffer

	2020	2020	2019	2019
	£m	%	£m	%
Total risk exposure amount	3,070		3,104	
Institution specific countercyclical buffer rate		0.0002%		0.9887%
Institution specific countercyclical capital buffer requireme	0.0		30.7	

At 31 December 2020 the Society had exposures to the following countries with a countercyclical buffer rate greater than zero; Slovakia (1.0%), Norway (1.0%), Luxembourg (0.25%), Bulgaria (0.5%) and Hong Kong (1.0%).

TABLE 33b: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

2020	General credit exposures		Trading book exposures		Securitisation		Own funds requirements					
	Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book exposures for SA	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	of which: General credit exposures	of which: Trading book exposures	of which: Securitisation exposures	**Total**	Own funds requirement weights	Countercyclical capital buffer rate
	£m	£m	£m	£m	£m	£m	£m	£m	£m	**£m**		%
Breakdown by country												
United Kingdom	743.5	16,729.2	-	-	106.7	-	182.3	-	12.4	**194.7**	0.989	0.000%
Hong Kong	1.0	-	-	-	-	-	-	-	-	**-**	-	1.000%
Luxembourg	0.4	-	-	-	-	-	0.0	-	-	**0.0**	-	0.250%
Norway	0.0	-	-	-	-	-	-	-	-	**-**	-	1.000%
Bulgaria	0.1	-	-	-	-	-	-	-	-	**-**	-	0.500%
Slovakia	0.0	-	-	-	-	-	0.0	-	-	**0.0**	-	1.000%
Other Countries	52.0	-	-	-	-	-	1.9	-	-	**1.9**	0.010	0.000%
Total	797.1	16,729.2	-	-	106.7	-	184.2	-	12.4	**196.7**	0.999	

Please note:

The weighting is calculated as each country's own funds requirement as a proportion of the total own funds requirements.

Exposures to sovereigns, multilateral development banks and institutions' senior unsecured debt are exempt from the countercyclical buffer analysis. Those exposures are excluded from this table. This is why the total own funds requirement does not reconcile to the IRB displayed elsewhere in the disclosures.

The table above captures the country of residence of the customer rather than the location of the exposure, as aligned to the CCyB regulations. This will mean there are differences to the geographical exposures in table 14 of this document and the Annual Report and Accounts which record the location of the property rather than the customer.

Appendices

A5 Tables

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