



PILLAR 3 DISCLOSURES 2018

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Introduction

1. The Capital Requirements Directive (known as CRD IV) defines how the capital required to be held by banks and building societies in order to provide security for shareholders, members and depositors is calculated. The Directive also determines the rules around corporate governance and regulation and defines the disclosure requirements related to these requirements which are reflected in this Pillar 3 disclosure document.
2. The CRD comprises 3 main elements, or 'Pillars', as follows:
 - **Pillar 1:** Minimum capital requirements;
 - **Pillar 2:** Internal capital adequacy assessment process ('ICAAP') and supervisory review and evaluation process ('SREP');
 - **Pillar 3:** Disclosure.
3. The Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation ('CRR') component of CRD IV which is directly effective, meaning there is no UK rule required for implementation.
4. The Family Building Society (**'FBS'**) is a trading name of National Counties Building Society (**'The Society'**). The Society and the National Counties Group (**'The Group'**) are regulated by the Prudential Regulatory Authority ('PRA') and the Financial Conduct Authority ('FCA').
5. The latest full Group Internal Capital Adequacy Assessment Process ('ICAAP') was approved by the Society Board and submitted to the PRA in June 2017. The Group's Individual Capital Guidance ('ICG') was set by the PRA in November 2017.

The Society Board monitors and updates the Group capital adequacy requirements quarterly.

The Society Board reviewed and approved the Group Pillar 3 Disclosure Policy, which embodies the interpretation of CRR Part Eight, in March 2019. The policy complies with the relevant section of the CRR for an undertaking of the size and complexity of the Group. The disclosures made reflect considerations of frequency of disclosure, materiality and confidentiality as permitted by the CRR.

6. The figures quoted in this disclosure have been drawn from the Group's Annual Report and Accounts as at 31 December 2018, unless otherwise stated. The Report and Accounts were prepared under United Kingdom Accounting Standards - Financial Reporting Standard 102 ('FRS102'), with the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement.

Scope of Application of Directive Requirements

7. These disclosures are made at Group level unless otherwise stated. For disclosure purposes the Group comprises the following entities:
 - **National Counties Building Society** a regulated building society;
 - **Counties Home Loan Management Limited** ('CHLM') a regulated firm;
8. For capital adequacy purposes, CHLM's figures are solo-consolidated with those of the Society with the regulator's approval.
9. For Group accounting purposes NCBS and CHLM are consolidated together with the following entities:
 - **Family & Arden Homes LLP** ('F&A'), an unregulated property investment partnership. As at 31 December 2018 the Society has advanced £5m to F&A for residential property purchases.
 - **National Counties Financial Services Limited** ('NCFS'), an unregulated firm. NCFS has ceased trading and its figures are not material to Group results.
10. CHLM and NCFS are wholly-owned subsidiaries of the Society whilst the Society has a controlling 50.01% interest in F&A.
11. There were no current or foreseen material practical or legal impediments to the prompt transfer of capital or repayment of liabilities between Group entities at the reporting date.
12. The Society is fully committed to supporting its subsidiaries, as stated in the **Annual Report and Accounts 2018, Note 28(b), Financial Commitments**.
13. **Table 1** summarises the capital adequacy monitoring arrangements for the Group and its subsidiaries at 31 December 2018:

TABLE 1	
Monitoring Level	Component entities
Solo-consolidated	Society, CHLM

Risk Management Objectives and Policies

14. The Society's Board is responsible for determining a framework for risk management and control and approves policies and Board sub-committee terms of reference. Senior management is responsible for designing and monitoring risk exposure and operating internal control processes, under the guidance of the Group Risk Committees.
15. In order to maintain a strong risk culture, the Society has adopted the three lines of defence model. The system of internal control is designed to enable the Group to achieve its corporate objectives within a managed risk profile, not to eliminate risk.
16. The risk functions are responsible for oversight of all the Group's risks. In addition the Group has a formal structure for managing **financial risk**, which includes the establishment of risk limits monitoring and reporting, mandates and other control procedures. This structure is reviewed regularly by the Board, with a major review being conducted annually.
17. First line risk control is provided by all relevant business functions. Managers are responsible for identifying and maintaining effective management of risk in accordance with Group risk appetite. Where appropriate, these business functions are supported by specialist risk teams (e.g. Compliance) under the control of executive managers and directors.
18. Second line independent oversight staff report into the Chief Risk Officer or Director of Legal and Compliance as appropriate. They review risk management policies, standards and limits to establish consistency with risk appetite, monitor and report to the Chairman of the Board Group Risk Committee on compliance with those limits, and oversee the first line management of risk. These functions thereby ensure that the first line of defense is properly designed, implemented and operating.
19. Third line assurance is provided by Group Internal Audit, which reports to the Group Audit Committee. Group Internal Audit provides independent assurance regarding the activities of both first line risk control and second line risk oversight. The internal audit function is carried out by Deloitte LLP in order to ensure that the appropriate level of expertise is devoted to the audit work.
20. The Board receives risk management support and insight from the Board Risk Committee and the Group Audit Committee.
21. The **Board Risk Committee** ('BRC') is a Board committee comprising Non-executive Directors responsible for reviewing the Group's risks and the adequacy and effective operation of internal processes. The BRC met four times during 2018.
22. The **Executive Risk Committee** ('ERC'), formerly the Executive Group Risk Committee ('EGRC'), is an executive committee reporting to and supporting the Board Group Risk Committee which carries out a similar role but with operational responsibilities. The EGRC met nine times during 2018.
23. The **Assets and Liabilities Committee** ('ALCO') is an executive committee which considers developments in financial markets and regulatory requirements as they affect the Society's operations and group risk appetite. ALCO recommends and approves appropriate actions, agrees product pricing, and reviews the Society's short and medium term investment and funding strategies, whilst monitoring the various forms of exposure. ALCO meets at least monthly and reported to the EGRC. From 2019 onwards ALCO will report to the Societies Executive Committee.

24. The **Retail Conduct Risk Committee** ('RCRC') focuses on the business model and strategy, culture and governance arrangements with respect to ensuring satisfactory outcomes for customers. The RCRC reported into the EGRC and met four times during 2018. In 2019 RCRC will be incorporated into the ERC as will Data Security Committee referenced below
25. The **Data Security Committee** reported into the EGRC and reviews and monitors all matters related to data security. The committee met on four occasions during 2018.
26. The **Group Audit Committee** ('GAC') is a Board committee comprising Non-executive Directors which reviews the integrity of the financial statements and the effectiveness of internal controls and risk management systems. The GAC also monitors and reviews the effectiveness of the internal and external audit function and met four times during 2018.
27. The **Remuneration Committee** is a Board committee comprising Non-executive Directors which is responsible for determining the remuneration of all Executive Directors.
28. The **Nomination Committee** is responsible for making recommendations on the appointment, election and re-election of Board Directors and on succession planning.
29. The principal business and financial risks to which the Group is exposed are business, credit, market, liquidity, operational, model, conduct and regulatory risk. The Board has also identified pension obligations as a significant risk requiring separate consideration within the Group ICAAP.
30. **Business Risk** reflects competition and variability in the market for financial services (such as mortgages and savings) and the balance of product volume and pricing necessary to cover the costs incurred in management and regulatory compliance.
31. **Credit risk** is the risk that a financial loss will arise from a customer or counterparty failing to meet their obligations. This arises primarily from the Group's lending activities but also as a result of the Group's investments and transactions as part of its treasury operations. **Concentration risk**, which adds a further dimension to credit risk, arises as a result of the concentration of exposures within the same category, whether it is geographical location, product type, industry sector or counterparty type. These risks are managed through adherence to Board-approved lending and arrears policies, which set the Group's risk appetite for credit risk and provide for a range of limits that are regularly monitored and reviewed in the light of changing economic conditions and Group objectives.
32. The Society is predominantly a residential mortgage lender, which means that it is exposed to the U.K. housing market by virtue of its statutory nature limits.
33. Within the residential mortgage business, the Society's main concentration risk is geographical, in that the majority of its lending is in the London and South East regions.
34. Product type concentrations are also present in the Society, in relation to lifetime (equity release) mortgages, interest only mortgages and buy-to-let mortgages. These are monitored on a monthly basis to ensure that Board-approved limits are not exceeded.
35. All concentrations are managed within limits which the Board believes are appropriate to current economic conditions and Group objectives.

36. **Market risk** incorporates the changes in income or reserves as a result of changes to market rates, mainly movements in interest rates, which affect the balance sheet valuation of financial instruments, particularly derivatives, and consequently increases the risk of volatility in profits. Exposure to this risk is primarily managed through a combination of natural hedges that exist in the Group balance sheet together with appropriate hedging contracts with external counterparties, as permitted under the Board-approved financial risk management policy. The Group is also subject to basis risk where the interest rates on offsetting assets and liabilities do not move in exactly the same way. This is monitored and managed by hedging contracts or by reducing the underlying basis risk.
37. **Liquidity risk** concerns the Group's ability to meet its financial obligations as they fall due as a result of imbalances in the cash flow of its activities. This risk is subject to an Individual Liquidity Adequacy Assessment Process ('ILAAP'). The ILAAP is analogous with the ICAAP and is designed to identify and manage all aspects of liquidity risk faced by the Group as well as regulatory liquidity requirements and the Individual Liquidity Guidance ('ILG') received from the PRA following their risk assessment and liquidity review. The ILAAP assesses the minimum amount of liquidity the Group should hold and was updated in July 2018.
38. The ILAAP informs the Board and proposes the liquidity risk appetite and policies and appropriate controls to enable compliance with this appetite. This is documented in, and managed through adherence to, the Board-approved liquidity and financial risk management policies. Liquidity risk is managed on an ongoing basis by ALCO which oversees day to day liquidity risk management by the Group Treasury function. Treasury use a number of daily, weekly and monthly reports and liquidity forecasts to monitor risk against appetite and the effectiveness of liquidity risk mitigants which are in place.
39. **Operational risk** is associated with the Group's internal processes and systems and the potential for these not to function properly. It also covers human error and external events. Risk registers are maintained that document key risks, likelihood of occurrence and an assessment of impact. A range of insurance policies are in place to provide protection against such eventualities as business interruption, public and employer liability and certain losses through criminal activity.
40. **Model risk** is the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports. The Group has incorporated model risk into the risk management framework.
41. **Conduct risk** is linked with regulations affecting our customers, ensuring that the correct culture in terms of 'treating customers fairly' is adhered to and embedded in the Society together with Board expectations of the service levels that we provide to our customers.
42. **Regulatory risk** is the risk of loss arising from failure to comply with statutory and regulatory requirements and the risk that the volume, complexity and cumulative effect of regulatory issues may impact the Society's ability to compete and function effectively.
43. Full details regarding the financial risks and instruments used by the Group are given in the **Annual Report and Accounts 2018, Note 29, Financial Instruments**.
44. **Pension obligation risk** arises as a result of the Group defined benefits pension scheme and derives mainly from changes in the discount rate used and improving life expectancy and the resultant increase in the cost of servicing pension obligations, particularly in respect of those members with a pension commitment linked to final salary. This risk has been reduced going forward through the closure to future accruals of the final salary part of the scheme, closure to new entrants of the cash benefit part of the scheme, and replacing this with a revised benefit structure which eradicates the post retirement

longevity risk with its associated impact on pension annuities. For new employees a defined contribution scheme is in place which does not present any future actuarial risk to the Society. The Board has made adequate provision in the Group ICAAP for residual pension obligation risks.

- 45. **National Counties Building Society continues to have a strong capital base**, as a result of which the Group is able to maintain overall capital at a level comfortably in excess of the ICG.
- 46. The risk management and control framework, as set out above, is encapsulated in the Enterprise Risk Management Framework ('ERMF') which was approved by the Board during April 2018.
- 47. The Group risk appetite, expressed in the ERMF, is set out in **Table 2**.

TABLE 2	
Risk category	Risk appetite
Business	We ensure that the business model, strategy and capital resources are focused on securing the long-term needs of the membership. This entails stable earnings and a moderately risk averse position.
Liquidity and funding	We hold sufficient liquidity resources, and sustain this with diverse sources of funding and minimal exposure to market and off-balance sheet risks
Interest rates	Product interest rates and Group net interest rate exposure will be managed to provide stability in the net interest margin and market valuation of the balance sheet.
Credit	We build high quality lending portfolios that earn an adequate return.
Concentration	Concentration of exposures will be managed to avoid exposures to operational capacity constraints.
Operational	We ensure controls are effective to minimise serious customer or business disruption, or associated financial losses.
Compliance	We maintain legal and regulatory compliance.
Conduct	We deliver fair customer outcomes, and avoid regulatory fine and censure.
Pension	We remain alert to existing and emerging risks to the Society.

48. Exposure is also monitored against the Group risk appetite as measured quantitatively through key ratios and risk indicators which includes the Liquidity Coverage Ratio ('LCR') as well other figures within this disclosure.
49. Details of the Groups LCR, presented as rolling 12-monthly averages as at each quarter-end, are given in **Table 3** below. The liquidity buffer includes High Quality Liquid Assets ('HQLA') held to cover Pillar 2 risks.

TABLE 3				
LCR adjusted values	Mar 2018	Jun 2018	Sep 2018	Dec 2018
Liquidity buffer £m	246.8	253.0	260.4	269.5
Net cash outflows £m	161.0	161.3	162.5	159.9
LCR %	150.0%	160.0%	160.0%	170.0%

50. The Group remains confident that the liquidity risk management arrangements described earlier are adequate given the Group's risk profile and strategy, and that the Group's liquidity profile, as measured by the LCR and other metrics referred to above, remains within its liquidity risk appetite
51. The Group's overall risk profile continues to remain within its risk appetite.
52. Further details of corporate governance arrangements including the Group's policies on Board diversity and appointments, can be found in the **Annual Report and Accounts, Report on Corporate Governance. Details of directorships held by Board members can be found in the Annual Report and Accounts, Annual Business Statement.**

Own Funds

53. Group own funds at 31 December 2018, amount to £105.7m. This is made up predominantly of Common Equity Tier 1 ('CET1') capital comprising accumulated profits of the Group.
54. Tier 2 capital is limited to collective provisions for bad and doubtful debts, which amounted to £0.5m in the Group at 31 December 2018.
55. A reconciliation of own funds per the Statement of Financial Position, Annual Report and Accounts and regulatory own funds as at 31 December 2018 is shown below in **Table 4**:

TABLE 4	
Own funds	£m
Group general reserves	108.0
Non-controlling interests	(0.1)
Retained earnings	107.9
Available for sale reserve	0.6
Accumulated other comprehensive income	0.6
Provision for impairment losses on loans and advances – Collectively identified	0.5
Credit risk adjustments	0.5

56. Details of own funds in the format as required to be published under CRR, and as relevant to the Group, are detailed below in **Table 5**:

TABLE 5	
Own funds disclosure	£m
CET1 capital: instruments and reserves	
Retained earnings	107.9
Accumulated other comprehensive income	0.6
CET1 capital before regulatory adjustments	108.5
CET1 capital: regulatory adjustments	
Additional value adjustments	(0.3)
Intangible assets (net of related tax liability)	(1.1)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences	(1.9)
Regulatory adjustments to CET1 capital	(3.3)
CET1 capital	105.2
Tier 2 capital: instruments and provisions	
Credit risk adjustments	0.5
Tier 2 capital	0.5
Total Capital	105.7
Total risk weighted assets	644.7
Capital ratios and buffers ⁽ⁱ⁾	
CET1	16.3%
Tier 1	16.3%
Total capital	16.4%
Institution specific buffer requirement	7.3%
Of which: capital conservation buffer requirement	1.9%
Of which: countercyclical buffer requirement	0.9%
CET1 available to meet buffers	8.3%
Amounts below thresholds for deduction ⁽ⁱⁱ⁾	
Holdings of CET1 instruments of financial sector entities ⁽ⁱⁱⁱ⁾	-
Deferred tax assets arising from temporary differences	0.6
Amounts below thresholds for deduction	
Credit risk adjustments included in Tier 2 in respect of exposures subject to standardised approach	0.5
Cap on inclusion of credit risk adjustments in Tier 2 under standardised approach	7.7

(i) As a percentage of risk exposure amount

(ii) 10% of adjusted CET1 capital

(iii) The Society has a significant £25K interest in NCFS

57. The Group has no capital instruments in issue and therefore a disclosure of their main features as required by CRR is not applicable.
58. The Group has not had any need for remunerated capital e.g. subordinated debt or permanent interest bearing shares. The Group does have the additional ability to issue core capital deferred shares ('CCDS') which would count as CET1 capital, should this be required in future.
59. Capital buffers are being gradually introduced under CRR to ensure that firms have sufficient capital to protect against losses in times of stress. The capital conservation buffer is therefore increasing to 2.5% from 2019.
60. Under CRD the Group's countercyclical capital buffer ('CCyB') requirement is determined by the geographical location of the borrower rather the location of the secured property. The Group has a number of buy-to-let borrowers who are resident overseas. Therefore further details of the CCyB in the format as required by CRR, as relevant to the Group, are given in **Table 6** below.

TABLE 6

Geographical distribution of credit exposures for the calculation of the CCyB - General credit exposures

Country	Exposure value for standardised approach £m	Own funds requirement £m	Own funds requirement weight	CCyB rate %
UK	1,544.0	45.1	90.95	1.00
Australia	51.1	1.4	2.82	0.00
USA	33.3	0.9	1.81	0.00
Switzerland	8.4	0.2	0.40	0.00
Singapore	7.6	0.2	0.40	0.00
France	7.5	0.2	0.40	0.00
Spain	6.3	0.2	0.40	0.00
UAE	5.1	0.1	0.20	0.00
South Africa	4.9	0.1	0.20	0.00
Hong Kong	4.9	0.1	0.20	1.88
Others	40.4	1.1	2.22	0.09
Total	1,713.5	49.6	100.0	0.91
Total risk exposure amount (£m)				644.7
Institution specific CCyB rate %				0.91
Institution specific CCyB (£m)				5.9

Leverage Ratio

61. The Group leverage ratio is 5.0%, and is calculated on a regulatory basis as at 31 December 2018 at solo-consolidated level for the Group.
62. Details of the components of the leverage ratio calculation as required to be disclosed by CRR and which are applicable for the Group are given in the following tables.

TABLE 7	
Reconciliation of accounting assets and leverage ratio exposures	£m
Total assets as per published financial statements	2,166.5
Adjustment for entities which are consolidated for accounting purposes but outside the scope of regulatory consolidation	(0.2)
Adjustment for derivative financial instruments	(95.8)
Adjustment for securities financing transactions	52.7
Adjustment for off-balance sheet items (conversion to credit equivalent amounts)	21.3
Other adjustments	(29.5)
Total leverage ratio exposure	2,115.0

TABLE 8	
Leverage ratio common disclosure	£m
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	2044.3
Asset amounts deducted in determining Tier 1 capital	(3.3)
Total on-balance sheet exposures (excluding derivatives and SFTs)	2,041.0
Derivative exposures	
Replacement cost associated with all derivative transactions	0.4
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	8.0
Total derivative exposures	8.4
Securities financing transaction exposures	
Counterparty credit risk exposure for SFT Assets	52.7
Total securities financing transactions	52.7
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	64.6
Adjustments for conversion to credit equivalent amounts	(51.7)
Other off-balance sheet exposures	12.9
Capital and total exposure measure	
Tier 1 Capital	105.2
Leverage ratio total exposure measure	2,115.0
Leverage ratio	
Leverage ratio	5.0%

TABLE 9	
Split-up of on balance sheet exposures (excluding derivatives and SFTs)	£m
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), comprised of banking book exposures of which:	2,044.3
Exposures treated as sovereigns	347.6
Institutions	0.1
Secured by mortgages of immovable properties	1,675.8
Retail exposures	3.3
Corporates	0.4
Exposures in default	5.5
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	11.6

63. A number of factors will impact the leverage ratio in any particular period. Profit or losses for the year increase or decrease the capital measure and impact the ratio accordingly. Balance sheet size is the main factor underpinning the exposure measure. Off balance sheet items including the lending pipeline also contribute.
64. The Group ratio of 5.0% represents a reduction in the leverage ratio from the previous year and is driven by the growth in assets and the loss incurred in 2018, which is detailed in the **Annual Report and Accounts, Strategic Report**.
65. The leverage ratio is monitored by ALCO. The Society is strongly capitalised and therefore is not excessively leveraged. The risk posed by excessive leverage is managed as part of the Group's strategic planning framework.

Capital Adequacy Assessment

66. The Group maintains a five-year strategic planning framework, the detail of which is reviewed by the Society's Board annually to take account of current and changing economic conditions and any other factors that may affect the Society's future performance, such as regulatory or technological change. The process culminates in the annual production of a five-year Corporate Plan including financial projections, with detailed budgets covering the following year's activities.
67. The projections are driven by reference to the Group ICAAP submission and in particular the Board's risk appetite for different business activities and risks, which is an important component within the submission.
68. The Group ICAAP contains the capital plan for the next five years and the Board ensures that there are adequate capital resources to support the corporate goals contained within the projections.
69. In order to produce a detailed capital plan, the Group ICAAP contains calculations of the capital resources requirement (effectively the minimum capital required) each year using the standardised approach for credit risk and the basic indicator approach for operational risk.
70. Under the standardised approach for credit risk, the Group applies a risk weighted asset value to each of its exposure classes and provides 8% of that risk weighted asset value as the minimum capital requirement for credit risk.
71. The Group has historically held capital well in excess of its regulatory requirements, although the significant growth in recent years and the loss incurred in 2018 has reduced this surplus. Nevertheless its regulatory capital position remains strong with a high CET1 ratio of 16.3%. The ICG at 31 December 2018 was to hold a minimum amount of capital of 11.03% of risk weighted assets plus a static add-on of £6.3m. Again the Group's capital was comfortably in excess of this requirement.

72. Under the basic indicator approach for operational risk, the Group calculates its average net income over the previous three years and provides 15% of that average net income as the minimum capital requirement for operational risk.
73. Capital is also required in relation to the credit valuation adjustment. This is to account for counterparty credit risk in relation to derivative transactions.
74. **Table 10** provides details of average exposures during 2018 and total exposures and the calculation of own funds requirements within the Group as at 31 December 2018. Details of credit risk for retail lending are given in the section below. Further details of other risk exposures can be found in **Note 29** to the **Annual Report and Accounts 2018**.

TABLE 10	Average exposure 2018 £m	Total exposure £m	Risk weighted exposure £m	Own funds required £m
Own funds requirement				
Central governments or central banks	320.6	338.5	1.6	0.1
Multilateral development banks	13.1	9.1	-	-
Institutions	3.0	5.9	2.4	0.2
Corporates	3.1	3.0	0.5	-
Retail	2.2	3.3	2.5	0.2
Secured by mortgages on immovable property	1,678.3	1,740.4	598.1	47.9
In default	5.4	5.5	5.5	0.4
Equity & High risk *	0.3	0.5	0.8	0.1
Institutions & corporates with a short term credit assessment	2.2	-	-	-
Other	7.6	7.0	7.0	0.6
Credit risk	2,035.8	2,113.2	618.4	49.5
Operational risk			22.2	1.8
Credit valuation adjustment			4.1	0.3
Total own funds required				51.6

* The Society's minority shareholding in Smart Money People Limited is a private equity investment, which under CRR are treated as exposures with a particularly high risk.

Credit Risk- Retail Lending

75. Assessment of the borrower's ability and propensity to make payments and the level of security provided are paramount considerations for the Group.
76. The Group uses an affordability model to assess residential property owner occupier applicants' ongoing ability to service the requested mortgage advance. This includes expenditure data from the Office of National Statistics ('ONS') which takes into account the size of the household unit and the spending patterns of households with similar incomes. In addition to ONS data the Group also collects specific information on ongoing financial commitments in order to assess the ability of the applicant to meet mortgage repayments at appropriate interest rates.
77. Regular reviews are undertaken to assess the performance of loans and the suitability of the affordability model with a view to ensuring that the parameters set within the model are consistent with Group risk appetite.
78. The Group requires a report, prepared by a suitably qualified person, as to the value of the security for mortgage purposes in all cases, except for further advances on loans fully secured on residential property where the new total borrowing does not exceed 60% of the existing valuation.
79. For residential buy-to-let lending, affordability is assessed with reference to the rental value of the property which will secure the mortgage. For loans to non-individual Limited companies personal guarantees are also obtained from the Directors for higher - LTV loans and, for larger portfolios of buy-to-let loans to a single borrower, each individual property is available to cross-collateralise other loans within the same portfolio. For certain specialist FBS mortgages monies placed on deposit with the Society also act as further security on a mortgage.
80. The Group regards as 'past due' any mortgage or loan account which, at the accounting date, is more than three months in arrears. Arrears of mortgage repayments are monitored very closely and the Group has performed favourably in comparison with national arrears statistics. Past due assets are reported under the "In default" exposure class. The only material exposures in this class relate to loans secured on property.
81. Arrears are evidence of loan impairment. Impaired loans will be reviewed, with provisions made against any potential losses in the loan book.
82. A loan is considered "impaired" where there is objective evidence of one or more impairment events after the initial recognition of the loan. Impairment events can be on an individual loan-by-loan basis, for example where the mortgaged property is taken into possession, or on a collective basis for groups of loans with similar characteristics.
83. The Group's accounting policy in relation to impairment provisions for loans and advances is recited in full **at Note 1.10 to the Annual Report and Accounts 2018**.
84. Full details of the movements on impairment provisions for loans and advances are provided **at Note 10(a) to the Annual Report and Accounts 2018**.

85. **Table 11** analyses Group loan exposures at 31 December 2018:

TABLE 11						
	Residential			Other		
	Performing £m	Past due £m	Total £m	Performing £m	Past due £m	Total £m
Loans and advances to customers	1,537.9	5.6	1,543.5	10.9	-	10.9

86. A reconciliation of the above table to the **Annual Report and Accounts 2018** is provided in **Table 12**.

TABLE 12	
Reconciliation of Group Total Loans and Advances to Customers	£m
Group loans and advances to customers per Report & Accounts	1,703.3
Add back: Collective provisions	0.5
Deduct: loan embedded derivatives	(24.0)
Add: loan to subsidiary for investment properties	5.0
Group accounting value of loans and advances to customers	1,684.8
Residential loan exposures for capital adequacy purposes	1,543.5
Other loan exposures for capital adequacy purposes	10.9
Add back: valuation adjustments for hedged risks and effective interest rate	130.4
Group capital adequacy value of loans and advances to customers	1,684.8

87. A residual maturity analysis of gross loans and advances is provided at **Table 13**:

TABLE 13	
Residual maturity – Gross loans	£m
On call or short notice	0.5
0 – 3 months	1.1
3 months – 1 year	7.6
1 – 5 years	141.3
> 5 years	1,423.6
Total	1,574.1

The maturity analysis in **Table 13** assumes that loans and advances run for their full, contractual term or, in the case of equity release loans, for the actuarial life expectancy of the borrower. In practice, mortgage loans seldom continue to the maturity date and, therefore, the actual repayment profile of loans is likely to be significantly different from that disclosed above.

88. Individual impairment provisions are utilised to adjust downwards the value of residential exposures in the capital adequacy calculations. For capital adequacy purposes, collective impairment provisions are regarded as Tier 2 capital (see **Tables 4-5** above).

89. The Group's residential mortgage loan portfolio includes a pool of lifetime mortgages. If the amount received on the sale of the property on redemption of the loan is, in certain circumstances, less than the value of the contractual loan balance due the Group cannot pursue the borrower or the estate for the shortfall. This No Negative Equity Guarantee ('NNEG') represents an exposure that the balance of lifetime loans may not be fully recovered and is presented as an embedded derivative liability on the Group's statement of financial position. The NNEG derivative liability is also applied to adjust downwards the value of residential risk-weighted assets in the capital adequacy calculations.
90. Summarised movements in individual impairment provisions and embedded derivative liability during 2018 are given below.

TABLE 14	Brought forward	(Utilised) / Recovered	Movement	Carried forward
Valuation adjustments	£m	£m	£m	£m
Residential	0.6	-	(0.1)	0.5
Other	0.4	-	(0.2)	0.2
Total Individual provisions	1.0	-	(0.3)	0.7
LM embedded derivative	5.6		18.4	24.0
Total valuation adjustments for capital adequacy purposes	6.6	-	18.1	24.7

91. The key determinants of the value of the NNEG are assumed House Price Inflation ('HPI') and HPI volatility. A lower HPI assumption increases the projected shortfall of property sales against outstanding loans and therefore the NNEG valuation. The Group HPI assumption is determined with reference to historical 20-year HPI growth. Volatility refers to the probability that any one house price will be above or below the average HPI assumption at any one moment in time, with a higher volatility assumption leading to an increased risk and therefore cost which is reflected in a higher NNEG valuation. During 2018 the Group increased the volatility assumption to 13% in line with industry guidance issued by the PRA.
92. The PRA have since indicated that they will review and publish their expectations for the volatility assumption % to be applied by lifetime mortgage lenders annually in September. The Group will monitor this and update the assumption used in the NNEG valuation accordingly.

93. A geographical analysis of the security for Group loans and advances is given in **Table 15**:

TABLE 15						
Geographical region	Residential			Other		
	Performing £m	Past due £m	Total £m	Performing £m	Past due £m	Total £m
North	32.9	-	32.9	-	-	-
Yorkshire & Humberside	66.8	-	66.8	1.9	-	1.9
North West	75.4	0.6	76.0	0.7	-	0.7
East Midlands	48.5	-	48.5	2.5	-	2.5
West Midlands	69.5	0.2	69.7	0.9	-	0.9
East Anglia	50.4	0.2	50.6	0.1	-	0.1
Outer South East	398.8	1.5	400.3	1.5	-	1.5
Outer Metropolitan	176.1	0.2	176.3	-	-	-
London	425.4	2.3	427.7	0.7	-	0.7
South West	154.3	0.5	154.8	0.2	-	0.2
Wales	37.4	0.1	37.5	2.4	-	2.4
Guernsey	2.4	-	2.4	-	-	-
Total loans and advances	1,537.9	5.6	1,543.5	10.9	-	10.9
Total exposures net of individual provisions & embedded derivatives						1,554.4
Effective interest rate adjustments						1.0
Fair value adjustments for hedged interest rate risk						129.4
Net loan exposures for capital adequacy purposes						1,684.8

94. Included within loans and advances are exposures Small to Medium Enterprises of £89.8m.

Credit Risk – Wholesale Lending

95. Counterparty risks relate to the potential for loss as a result of the actions or performance of a counterparty, in particular the failure of a counterparty to repay deposits or investments due and the failure of a counterparty to perform under the terms of derivative transactions.
96. Investments other than those in UK gilts or Treasury bills are spread to the extent practical so as to prevent undue concentration in particular market sectors, geographical areas, maturity profile or institutions. The spread is managed through the setting of exposure limits expressed as absolute limits with reference to the NCBS Group's and the counterparty's free capital.
97. Counterparty credit limits are formally reviewed and agreed by the Board annually. ALCO formally reviews the limits on a quarterly basis, but can address any required changes on an on-going basis.
98. All derivative contracts are with a central counterparty clearing house or covered by bilateral credit support agreements, as a result of which collateral is pledged or held in the form of listed debt securities (usually UK gilts) or cash deposits to provide protection to both the Group and its counterparties against default.
99. Details of the Groups exposure values on derivatives are given in **Table 8**. Further details on the value and type of derivatives held can be found in the **Annual Report and Accounts 2018, Note 29, Financial Instruments**.

Equity Exposures

100. The Group has equity exposures to Smart Money People Limited ('SMP') and F&A, which are held at cost of £0.5m and £50 respectively on the Society's Statement of Financial Position. There have been no disposals or unrealised gains or losses on these investments during 2018.
101. The investment in F&A allows the Group to control a strategic investment in residential property purchases. The minority stake in SMP is held for both strategic reasons and potential capital gain. Neither of these instruments are publically traded.
102. In addition the Society has a Corporate loan exposure to SMP of £0.2m and a mortgage exposure secured on residential property of £5.0m to F&A.

External Credit Assessment Institutions

103. The Group has nominated Moody's Investors Services as its external credit assessment institution.
104. Moody's ratings are applied to non-cash liquidity exposures to central governments / banks, multilateral development banks and institutions, in order to establish the risk-weighted value of those exposures for capital adequacy purposes.
105. Risk-weighted asset values under the standardised approach are calculated by reference to six credit quality steps set out in Article 120 CRR; dependent upon whether they are exposures for up to 3-months, or longer. **Table 16** maps the Group's application of Moody's ratings to CRR credit quality steps, together with the risk weightings applicable according to counterparty type.

TABLE 16							
Matrix of risk weightings by credit quality step and Moody's ratings							
Credit quality step	1	2	3	4	5	6	Un-rated
Moody's short-term ratings	P-1	P-2	P-3	NP			
Risk weighting	20%	50%	100%	150%			
Moody's long-term ratings	Aaa - Aa3	A1 - A3	Baa1 - Baa3	Ba1 - Ba3	B1 - B3	<= Caa1	-
Central Govt & Banks	0%	20%	50%	100%	100%	150%	100%
Institutions: <= 3 months	20%	20%	20%	50%	50%	150%	20%
Institutions: > 3 months	20%	50%	50%	100%	100%	150%	20%
Corporates	20%	50%	100%	100%	150%	150%	100%

106. As is clearly demonstrated from the Moody's ratings attached to each credit quality step, step 1 represents the highest credit quality and step 6, the lowest.
107. The Group does not invest with counterparties within credit quality steps 4 to 6.
108. Unrated institutions have the same credit quality step as the central government of the jurisdiction in which it is incorporated and, in the case of U.K. institutions attract a 20% risk weighting.
109. Application of the matrix (shown in **Table 16**) to Group non-cash liquidity exposures at 31 December 2018 produced risk-weighted asset values as shown in **Table 17**:

TABLE 17						
Risk-weighted asset values of Group non-cash liquidity exposures	Total	Credit Quality	Credit Quality	Credit Quality	Credit Quality	Unrated
		step 1	step 2	step 3	steps 4 - 6	
		£m	£m	£m	£m	
0% risk-weighting	345.5	345.5	-	-	-	-
20% risk-weighting	-	-	-	-	-	-
50% risk-weighting	0.1	-	0.1	-	-	-
100% risk-weighting	-	-	-	-	-	-
150% risk-weighting	-	-	-	-	-	-
Total non-cash exposures	345.6	345.5	0.1	-	-	-
Risk-weighted asset value	0.0	-	0.1	-	-	-

Market Risk

110. Interest rate risk and basis risk are referred to under the heading of Market Risk, in paragraph 36 of this disclosure document.
111. The main activities undertaken by the Group that give rise to interest rate risk are as follows:
- Management of the investment of capital and other non-interest bearing liabilities;
 - Issue of fixed rate savings products;
 - Fixed rate wholesale funding taken by the Treasury department;
 - Fixed and capped rate mortgage and other lending; and,
 - Fixed rate investments held by the Treasury department.
112. Interest rate risk is managed by utilising natural hedges on the balance sheet and by effecting interest rate swaps with external counterparties.
113. The interest rate risk on savings and mortgage products is reviewed on a weekly basis and hedging action taken as appropriate. The Group balance sheet is tested against Board limits on a monthly basis for the effects of a 2% parallel shift in interest rates, after the appropriate adjustment for interest rate floors.
114. Interest rate risk limits are an expression of the Board's risk appetite and are reviewed annually as an integral part of updating the Group financial risk management policy and ICAAP.
115. Basis risk is managed within limits and is monitored monthly with the results being reported to ALCO.
116. The valuation of pension fund liabilities is subject to changes in interest rates. The Board takes account of this liability when considering an appropriate interest rate risk appetite.

Material Credit Risk Mitigation Techniques

117. As indicated earlier in this disclosure document, credit risks are managed through adherence to Board-approved policies, which provide for a range of limits that are regularly monitored.
118. The Treasury department maintains a regular review of active counterparties and recommends action to ALCO to restrict exposures in those cases where the risk of default is considered to have increased beyond the Group risk appetite.
119. Counterparty risk may become significant in relation to the market value of interest rate swaps transacted with major banks as interest rates fluctuate. The Group mitigates this risk through collateral agreements with all interest rate swap counterparties, which protect against counterparty default by means of collateral requirements based on movements in the market values of the instruments involved. The collateral is pledged or received in the form of cash or securities. Some swaps are transacted through a central counterparty clearing house which guarantees performance of the collateral requirements, whilst the remainder are covered by industry-standard bilateral credit support agreements.
120. The Group also uses repos and reverse repos, which are effectively secured borrowing and lending, in its liquidity management operations. The Group's repos and reverse repos are covered by Global Master Repurchase Agreements.

Asset Encumbrance

121. A breakdown of the encumbered and unencumbered assets during the year ended 31 December 2018 as applicable to the Group in the format required by CRR is given in **Tables 18 and 19**.

TABLE 18								
Encumbered and unencumbered assets								
	Carrying amount of encumbered assets £m		Fair value of unencumbered assets £m		Carrying amount of unencumbered assets £m		Fair value of unencumbered assets £m	
		of which notionally eligible EHQLA and HQLA £m		of which notionally eligible EHQLA and HQLA £m		of which eligible EHQLA and HQLA £m		of which eligible EHQLA and HQLA £m
Assets of the reporting institution	444.3	66.9			1,628.6	100.8		
Equity instruments	-	-			0.5	-		
Debt securities	66.9	66.9	66.9	-	100.8	100.8	100.8	100.8
Of which: issued by general governments	66.9	66.9	66.9	-	87.9	87.9	87.9	87.9
Of which: issued by financial corporations	-	-	-	-	14.2	14.2	14.2	14.2
Other assets	381.9	-			1,526.7	-		

TABLE 19 Sources of encumbrance		
	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	316.5	440.8

122. Whilst these disclosures are at Group level, for liquidity purposes it is only the Society which is monitored by the regulator on a solo basis. The exposure values in the above tables are the median of the totals as at the end of each calendar quarter during 2018.
123. An asset is treated as encumbered if it is subject to any form of arrangement to secure, collateralise or credit-enhance a financial transaction from which it cannot freely be withdrawn. The Society also routinely pre-positions assets with counterparties, without entering into any collateral transactions, as part of its liquidity risk management framework. As these assets can be recalled at any time without restriction they are treated as unencumbered.
124. Encumbrance of the Groups assets arises from the use of derivatives for hedging purposes and repo transactions undertaken in accordance with industry standard contractual arrangements. Over-collateralisation increases the level of encumbrance and can arise in the ordinary course of business from repo transactions when the particular asset pledged, after the application of collateral “haircuts,” exceeds the amount borrowed.
125. A small proportion of unencumbered assets would not be deemed by the Society as available for encumbrance in the normal course of business being, for example, intangible assets, other fixed assets and tax/deferred tax assets.

Remuneration Policy

POLICY OBJECTIVES

126. The aim of the Group's Remuneration Policy is to achieve a fair level of financial reward for the Society's staff whilst ensuring primacy of members' interests and avoiding incentives to take inappropriate levels of risk. An objective of the Society is to attract and retain staff with the requisite skills, attitude and motivation to perform its operations to the highest standards in line with its business strategy, risk appetite and long term objectives.
127. In keeping with its values, the Society also seeks to provide its staff with fair financial reward for their contributions commensurate with the level, nature and demands of their roles and their individual achievements.

POLICY OVERSIGHT AND IMPLEMENTATION

128. Responsibility for policy oversight and implementation resides with the Remuneration Committee in respect of the remuneration of the Executive Directors and their immediate subordinates. The Remuneration Policy was reviewed by the Committee in May 2018.
129. During 2018 the Remuneration Committee met four times. The terms of reference of the Committee can be found on the Society's website, www.ncbs.co.uk. In setting remuneration, the Committee takes account of salaries, benefits and fees payable to executives and senior managers within similarly sized building societies and other relevant organisations. Feedback on the deliberations of the Remuneration Committee is provided to the Society's Board by way of its meeting minutes, and its recommendations are considered and endorsed or rejected as appropriate. For additional independent oversight, a review of the Executive Directors' remuneration is commissioned periodically from external consultants to ensure that the Society's rewards remain fair, competitive and in line with industry norms.
130. Further information on the mandate of the Remuneration Committee and its decision making process in determining the remuneration policy for the Executive Directors is contained in the Annual Report on Directors' Remuneration within the Group's Annual Report and Accounts, which is published each year on the Society's website.
131. Responsibility for policy oversight and implementation in respect of the remuneration of all other staff resides with the Executive Directors, with Board approval being required for the budgets for the annual review of staff salaries and for performance linked awards. Any significant changes in staff benefits are also reviewed and agreed by the Board, as is the introduction and construction of any staff and executive performance related pay schemes that may be deemed appropriate from time to time.
132. The provision of performance related pay schemes for Executive Directors and staff relating to financial and business performance is generally considered an appropriate part of a balanced remuneration package. Where such schemes are felt to be justified, the potential rewards are geared to the attainment of corporate targets of key and tangible benefit to the organisation and are set at modest levels, being mindful of the context of the organisation's operating environment, its status as a mutual organisation and the need for robust risk management in order to ensure that the outcomes achieved are beneficial to the organisation over the immediate and the long term. The Society has a variable pay scheme based on both the performance of the Society and the individual. All staff except the Mortgage Adviser team, the Business Development Managers and the Executive Directors are eligible for bonuses under this scheme.

133. The Mortgage Adviser team has a separate bonus structure based on their performance in a number of categories including the quality of calls made, customer feedback and compliance.
134. The Business Development Managers receive commission based on the number of mortgage applications received from brokers and executed.
135. Executive Directors are eligible to participate in an incentive scheme based on their own and the Society's performance. Awards are limited to a maximum of 25% of base pay. In addition there is a medium term incentive plan based on performance over a three year period measured by five performance indicators: customer satisfaction, capital growth, maintaining profit, loan growth and culture. The maximum award under this scheme is between 45% and 75% of base salary over three years. No payment is made until the end of the three year period, with 50% of the payment deferred for a further year. The incentive scheme is subject to detailed rules which permit clawback in the event of unforeseen circumstances or evidence of inappropriate conduct in full compliance with the Remuneration Rules set by the PRA. The incentive plan lapses if the Director leaves in the scheme period otherwise than through redundancy or other similar circumstances that make the Director a good leaver and is subject to an overriding discretion of the Remuneration Committee.
136. All Group employees are employed by the Society. The aggregate quantitative remuneration was £9,179K.
137. No individuals were remunerated €1 million or more in the financial year.
138. As set out in the Remuneration Policy the Society has determined those members of staff whose professional activities have a material impact on the Society's risk profile in accordance with CRD. **Table 20** sets out the aggregate quantitative remuneration for these staff in respect of the period 1 January – 31 December 2018.

TABLE 20	No. of recipients	Fixed remuneration £000	Variable remuneration £000	Total remuneration £000
Executive Directors	4	802	201	1,003
Non-Executive Directors	5	222	-	222
Other Senior Management	7	656	126	782

139. In the case of the Executive Directors and the Senior Managers, fixed remuneration includes pension contributions made by the Society on behalf of the employees, and the value of taxable benefits.

140. **Tables 21 and 22** give details of the variable remuneration for to 'material risk' staff in 2018. All variable remuneration is in the form of cash.

TABLE 21	Variable remuneration awarded in prior years			
	Paid in 2018 £000	Vested and Payable 2019 £000	Vested and Payable 2020 £000	Awarded but not yet vested- payable in 2020 and 2021 £000
Executive Directors	408	15	15	76
Non-Executive Directors	-	-	-	-
Other Senior Management	166	-	-	-

TABLE 22	Variable remuneration awarded in 2018		
	Awarded in 2018 £000	Vested in 2018 £000	Not yet vested – payable in 2020 and 2021 £000
Executive Directors	201	141	60
Non-Executive Directors	-	-	-
Other Senior Management	126	126	-

141. In addition to the remuneration detailed above, no severance or sign-on payments were made or awarded to a 'material risk' employee.

Conclusion

142. In the Board's opinion the risk management arrangements in place are adequate and the Group's risk profile continues to remain within its risk appetite.
143. This disclosure document has been prepared in accordance with the requirements of CRR Part Eight, as interpreted for a group of firms of the size and complexity of the Group.
144. In the event that a user of this disclosure document should require further explanation on the disclosures given, application should be made, in writing, to the **Group Finance Director at National Counties Building Society, Ebbisham House, 30 Church Street, Epsom, Surrey, KT17 4NL**.