The Cambridge Building Society

Pillar 3 Disclosure

31st December 2017

THE CAMBRIDGE
Building Society

cambridgebs.co.uk

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1 Introduction

1.1 Purpose

The purpose of this document is to provide members and other stakeholders with background information on the Society's approach to risk management and the maintenance of its capital strength. As such, it includes details of:

- the Society's approach to risk management, its policies and objectives;
- the governance structure of the Board and Board Committees;
- own funds information (or capital resources);
- regulatory capital requirements; and
- compliance with the EU Capital Requirements Regulation.

1.2 Coverage

This disclosure document applies to the following trading entities:

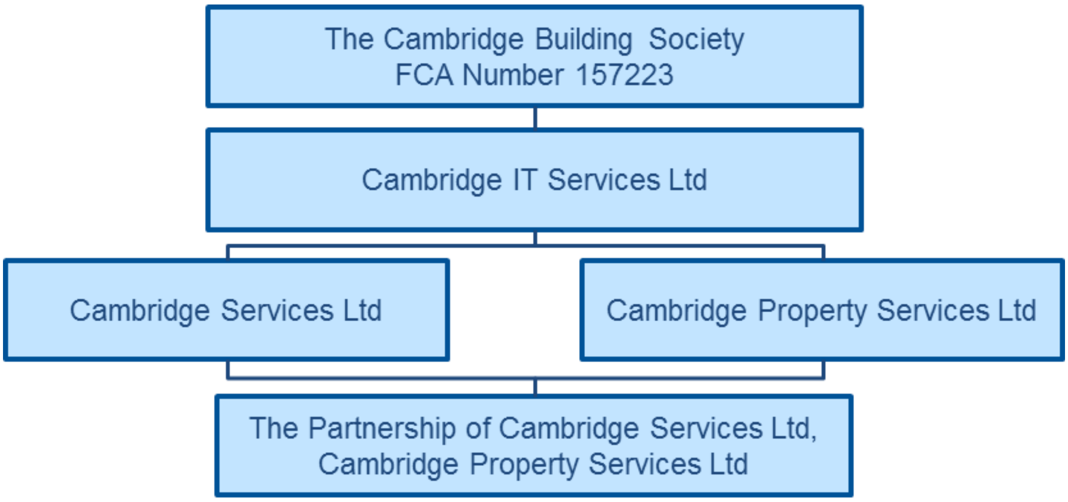

Figure 1: Cambridge Building Society subsidiary structure.

The activities of the subsidiaries are limited to the ownership of the Head Office administration centre and certain IT equipment. There are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources between the Cambridge Building Society and its subsidiaries. The subsidiaries are now dormant and the Society intends to extract their remaining assets and resources in the near future.

The information presented is based on the Society's Annual Report & Accounts as at 31st December 2017, but may differ where regulatory requirements deviate from the requirements underlying the Annual Report and Accounts, for example as a result of including exposures that are not recorded on the balance sheet. Consistent with regulatory reporting for capital adequacy purposes, the "Society" positions from the Annual Report & Accounts have been used, in which the subsidiaries are included in the balance as separate participations.

1.3 Legislative framework

European standards for capital and liquidity requirements for banks, building societies and related institutions are set out in the Capital Requirements Directive IV (CRD IV, 2013/36/EU) and the Capital Requirements Regulation (CRR, 575/2013). This legislation came into force on 1 January 2014, and is the European implementation of Basel III, which sets out global standards for capital and liquidity adequacy.

On a national level, prudential supervision with regards to capital and liquidity adequacy is overseen by the Prudential Regulation Authority (PRA), and CRD IV is implemented in the PRA Rulebook. CRR on the other hand is directly applicable, without implementation in national legislation. CRD IV and CRR are supported by additional guidance and standards defined both on a European and on a national level.

CRR sets out not only capital requirements, but also specifies what the Society must disclose in regard to its risk management policies, procedures, and performance, including the main risks faced by the Society and the governance of those risks. These disclosure requirements are usually referred to as "Pillar 3", being the third pillar of the three-pillar approach which is standard practice for prudential banking regulation.

- Pillar 1 - Minimum capital requirements, on a risk-based approach
- Pillar 2 - Assessment of the adequacy of capital requirements and the risk management system
- Pillar 3 - Disclosure

The information provided is in accordance with the rules laid out in Part 8 of CRR and the Society's Pillar 3 Disclosure Policy, which has been approved by Risk Committee on 6th March 2018.

Under FRS 102, the loan provisions are referred to as Individual Provision and Collective Provision. CRR, however refers to these provisions as General Credit Risk Adjustment and Specific Credit Risk Adjustment. For reasons of consistency, CRR terminology is used for referring to the loan provisions throughout this document, except where specific reference is made to financial accounting policies and processes.

1.4 Introduction to capital adequacy

The purpose of this section is to provide the reader with background information to capital adequacy assessments and regulatory capital requirements for banks and building societies, and to aid interpretation of the information provided in this disclosure.

1.4.1 Capital requirements

Regulatory capital requirements are defined in CRR, and are risk sensitive, which means that if an asset or risk exposure is deemed to be more risky, more capital is required to cover potential losses. Each asset exposure is given a "risk weight", which is a percentage that depends on the risk inherent in the exposure. The Society is required to hold at least 8% of the sum of its risk weighted exposure amount in own funds.

For example, for the same loan amount, the Society would be required to hold more capital for a mortgage if it is secured on commercial property than if it is secured on residential property. This is due to the higher volatility in commercial property values as well as higher default rates that are typically observed for commercial mortgage portfolios. The corresponding Risk Weights are 35% for a residential mortgage (up to 80% Loan To Value), and 100% for a commercial mortgage. This means that for each £100,000 that the Society lends, it is required to maintain a balance of own funds of at least £2,800 if it is a residential mortgage (35% risk weight multiplied by 8% capital requirement), and £8,000 if it is a commercial mortgage (100% risk weight multiplied by 8%).

On top of the minimum capital requirements (Pillar 1, see Section 1.3), the Society holds additional capital for risks that are not captured adequately by Pillar 1 (referred to as Pillar 2A) or risk that may materialise in the future (referred as Pillar 2B). These risks and corresponding capital requirements are captured through stress testing and scenario analysis as part of the Internal Capital Adequacy Assessment Process (ICAAP).

CRD IV introduced additional capital buffers on top of the minimum 8% requirement. A capital conservation buffer is being phased in between 2016 and 2019, and will amount to 2.5% once fully phased in (during 2017, a capital conservation buffer of 1.25% applied). The Bank of England has the authority to set a counter-cyclical buffer where it observes the risk of excessive build-up of systemic risk in the markets (so-called “bubble formation”). As at 31/12/2017 the Counter-cyclical buffer requirement is 0% for exposures in the United Kingdom. However, the Bank of England has announced increases to the counter-cyclical buffer of 0.5% (effective June 2018) and by a further 0.5% (effective November 2018) to a total level of 1.0%. Additional buffers are applicable to institutions that are deemed to be of global or domestic systemic significance. The Society is not classified as of systemic significance, and as such, not subject to these buffers.

1.4.2 Capital resources

To evaluate the overall quality of capital resources, also referred to as own funds items, these are classified into tiers, based on their availability and ability to absorb losses. The highest quality items are Common Equity Tier 1 (CET 1), followed by Additional Tier 1 and finally Tier 2. CRR defines eligibility limits for each own funds tier.

At least 56% of the minimum regulatory capital requirement (Pillar 1 + Pillar 2A) must be covered by CET 1 capital, and at most 25% may be covered by Tier 2 items. The additional capital buffers are required to be covered entirely by CET 1 capital.

For the Society, by far the largest component (91% of the total) of its own funds is its general reserves, which classifies as CET 1 capital.

1.4.3 Capital adequacy assessment

Each bank and building society is required to regularly undertake an ICAAP, which ensures that its capital resources are sufficient to deliver its medium-term planned objectives, and meet capital requirements both in normal and stressed conditions.

The starting point of this process is for the Board to set the risk appetite in the form of a number of risk-appetite statements. Based on the corporate strategy and plan, the risk appetite sets out at a high level in which areas the Society is willing to take certain risks, and in which areas there is no tolerance for risk. The high level statements are then translated into detailed limits.

The next step involves reviewing all risks and making an assessment of capital required to mitigate any material financial impact of those risks. This includes a detailed assessment of the results of stress testing models based on a number of economic scenarios. These scenarios should cover a wide range of severe, but plausible, stress events, both market-wide and company specific, to ensure that a wide variety of adverse situations are tested.

The information that can be extracted from the scenario analysis should be compared against the internal risk limits as well as regulatory limits. In this way, the overall capital adequacy and the corporate plan can be adequately challenged by the Board of the Society. This challenge also takes into account any areas where it is felt that the models and internal assessments do not adequately capture the full risk exposure.

1.5 Risk management summary

The Society is primarily a producer and retailer of financial products, mainly in the form of mortgages and savings. It also invests in liquid assets and raises some funds from the wholesale markets to diversify funding sources. The Society manages interest rate risk arising from its operations using derivative instruments. Building Societies operate in a highly competitive market, with uncertainties arising from the general economic environment and market competition. Therefore, the management of risk is vital for the success of the business.

The Board is responsible for determining an appropriate framework for risk management and control. It has in place a formal risk management structure which includes policy statements, risk exposure limits, reporting lines, mandates and a regular risk review process. The Society maintains a Risk Management Framework, which identifies and categorises all risks the Society is exposed to, and includes an assessment of their likelihood and impact (see Section 2.2). This framework forms the basis for the definition of risk appetite and risk limits, as well as the capital adequacy assessments, and is reviewed regularly by Management and at least annually by the Board.

A set of key figures and ratios is provided in Table 1, which give an overview of the Society's asset and capital levels, as well as the composition of the mortgage book, with regards to both risk characteristics and geographical distribution. Capital ratios (CET 1, Tier 1, and Total Capital are ratios of eligible own funds to risk-weighted exposure amounts (see also Sections 3 and 4). The leverage ratio is the ratio of eligible own funds to total assets (without risk weights) including off-balance sheet exposures (see Section 4.6). The Total Capital and Buffer Requirement is the total of capital requirements and buffers explained in Section 1.4.1 as they apply to the Society (see Section 4.2.2)

In 2017, The Society continued to build on the investments made in recent years to ensure the business is well placed to deliver the evolving customer service requirements. Furthermore, a partnership with the Cambridgeshire County Council Pension Fund was announced in September 2017, in which they will invest £15m through the issuance of Core Capital Deferred Shares (CCDS). Of this total amount, £5m has been issued in 2017.

During 2017 the Society lent over £240m, leading to a total mortgage book growth of 7%. In combination with the CCDS issuance and other changes to reserves, a profit of over £4m saw the total regulatory capital levels increase by £14m, and capital ratios increase by over 2%.

Table 1: Overview of key ratios and figures on risk management.

	31/12/2017	31/12/2016
Key figures (£000)		
Total asset exposure	1,244,321	1,122,095
Total risk-weighted exposure amount	448,958	419,593
Total own funds	70,829	57,209
Key ratios		
Common Equity Tier 1 Ratio	15.7%	13.5%
Tier 1 Ratio	15.7%	13.5%
Total Capital Ratio	15.8%	13.6%
Total Capital and Buffer Requirement	11.0%	10.9%
Leverage Ratio	5.7%	5.0%
Liquidity Coverage Ratio	306%	324%

Composition of mortgage book		
Owner-occupied Residential	78.0%	78.0%
Buy To Let	20.1%	19.7%
Commercial	1.9%	2.2%
Geographical distribution of mortgage book		
Mortgages secured in East of England	86.8%	87.9%
Mortgages secured in South East England	4.9%	4.5%
Mortgages secured in London	4.1%	3.7%
Mortgages secured in East Midlands	3.4%	3.2%
Mortgages secured in other areas	4.2%	4.0%

2 Risk management policies and objectives

2.1 Risk management

The Society's approach to risk management, governance, process and methodologies follows the three lines of defence model. Treasury, Finance and the Commercial teams are responsible for the identification and assessment of risk and controls.

The Risk Management Function, is led by the Chief Risk Officer, and its responsibility is to oversee and challenge the first line, provide guidance and direction and develop the risk management framework. The Risk Management Function is involved in areas such as stress testing; credit, treasury and operational risk analysis; development and monitoring of the risk appetite; as well as compliance monitoring and fraud control.

Internal audit, outsourced to Deloitte, provide independent and objective assurance on the appropriateness and effectiveness of internal controls.

2.2 Risk management framework

The risk management framework has been developed to allow the Society to capture all risks across the Society and provides a framework for them to be aggregated in a meaningful way. This allows all stakeholders within the Society from the Board to the individual risk owners to review risk on a level of detail that is relevant to their role.

The risk management framework operates on three levels: Risk Summaries, Risk Categories, and the Risk Register.

- The Risk Summaries aggregate risks across the Society to the highest level. These are owned by members of the Executive and reviewed quarterly.
- Risk Categories give a more detailed view into the Risk Summaries and allow the Risk Committee to see where the risks in the Society lie. Risk Categories are owned by Managers or members of the Executive.
- The Risk Register contains all the key risks in the Society. These can either be inherent to the nature of the business, or relate to a specific time period. The key controls associated with each risk are also listed on the register and are tested through Internal Audit reviews and Compliance Monitoring.

The Risk Register is updated as necessary, with a review of scoring on a quarterly basis ahead of the Risk Committee and an in-depth review every six months. The Board reviews an updated dashboard on a monthly basis.

As at 31st December 2017, five Risk Summaries have been identified, for which descriptions are given in Table 2.

Table 2: Description of the most significant risks faced by the Society, aggregated into Risk Summaries.

Risk Summary	Description
Business and strategic risk	The risk that the business does not meet its strategic objectives and continue to generate adequate profit to support the business in the medium term
Financial and capital risk	The risk that the Society does not have enough capital to meet its obligations, including the impact of pension obligations
Treasury risk management	The risk that the Society fails to manage its treasury financial risks and fails to meet its obligations as they fall due
Mortgage credit risk	The risk that the Society is exposed to mortgage lending losses due to inadequate lending controls and/ or credit risk management
Operational and conduct risk	The risk that the operation and conduct of the Society exposes it to an unacceptable level of risk and the risk that the correct customer outcomes are not achieved

The Society’s view on risk management is founded on its business strategy, and covers all risks identified in the risk management framework. This has been translated into a high-level risk appetite statement as follows.

- The Society will conduct its business to optimise positive outcomes for its customers.
- The Society will focus primarily on residential lending supported by clearly defined underwriting policies and procedures.
- The Society will not enter into any business activity that could result in a loss of trust with its members and stakeholders or which does not reflect its core values, or which could result in a regulatory or legislative breach.
- The Society aims to hold sufficient liquidity resources, supported by a sustainable net interest-rate margin, diverse sources of funding and closely managed exposure to market risks.
- The Society will minimise losses resulting from operational failures by ensuring that there is a robust system of internal controls.

The Society has adopted a five-step risk management lifecycle (Identify, Assess, Control, Monitor, and Report), supported by a defined risk assessment methodology, which assigns a score to a risk such that adequate controls can be implemented to manage that risk.

The risk management framework is supported by a number of high-level policy statements, approved at the relevant level. The policy management framework is owned and operated by the Risk Department. All policies must be reviewed and approved annually at the appropriate level.

Existing risk scores are formally reviewed by the risk owner on a minimum six-monthly basis, and usually on a quarterly basis.

The purpose of reviewing risk scores is to:

- assess whether a risk is still relevant to the Society's business;
- assess whether any new risks have emerged;
- assess whether the risk assessment score accurately reflects of the level of risk to the business; and
- identify any new or improved controls that have been implemented to mitigate the risk.

‘Risk Events’ are events that cause the Society to experience a direct or indirect realisable risk impact as a result of a control weakness or failure. ‘Near Miss Events’ are events that could have caused the Society to experience a direct or indirect realisable risk impact, but which did not because they were prevented or detected by existing controls. Both are recorded on the Society's Risk Register and reported to the Operational and Conduct Risk Committee and Risk Committee. Further, event data is analysed for trends in controls' failures that can be addressed through improving the design or operation of the controls. Risk events are graded for materiality. All outstanding actions as a result of risk events are monitored through the quarterly action tracking process.

2.3 Risk management policy

The most significant risks faced by the Society are consolidated in the Risk Summaries of the risk management framework (see Table 2). A more detailed description of these risks, along with mitigating actions is set out below.

2.3.1 Business and strategic risk

Margin risk

Margin risk is the risk that competition erodes the margin between rates charged to borrowers and rates paid to savers, thereby threatening the financial strength of the Society. This risk is heightened in the current period of historically low interest rates. However, one of the Society's key aims is to offer both its savers and borrowers competitive rates and only earn sufficient margin to maintain the Society's financial strength in the future and meet the product and service needs of its members.

The Board manages this risk by setting financial objectives and closely monitoring performance against them. Re-forecasts are regularly carried out, enabling the Society to react promptly to challenges to these financial objectives.

Economic uncertainty

The Society is exposed to the movements of economic activity in its lending area and the wider United Kingdom, for example in relation to uncertainties in demand for mortgage lending, and uncertainty in the ability of borrowers to repay their mortgages due to adverse economic conditions.

The Society's strong capital position, retail funding base and flexible approach to doing business mean that it is well placed to continue to meet the needs of its members, whatever future economic conditions prevail.

2.3.2 Financial and capital risk

Capital risk

The Society's financial risks accumulate into capital risk, which is the risk that the Society's own funds are insufficient to comply with capital requirements set by the Board and the regulator.

An overview of the Society's own funds is provided in Section 3. A summary of the regulatory capital requirements that the Society is subject to as well as internal processes to monitor and manage capital risk are provided in Section 4.

Finally, to avert the risk of overly relying on models to determine capital requirements, the Society monitors its leverage ratio, which is a simple ratio of own funds over total assets, without consideration of the riskiness of assets. More details around the leverage ratio are provided in Section 4.6.

Pension funding risk

The Society has an ongoing commitment to fund its defined benefit pension scheme, which is closed to new entrants and future accrual. Pension funding risk is the risk that the value of the scheme's assets will be insufficient to cover its obligations to members over time.

To mitigate this risk, management, together with the trustees of the scheme, regularly review reports prepared by independent actuaries to assess the risks and consider appropriate actions. These actions may include, for example, the trustees adjusting the investment strategy, or the Society changing its contribution to the pension scheme.

2.3.3 Treasury risk management

Funding and liquidity risk

Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can do so only at excessive cost. These obligations include, for example, savers' withdrawals and mortgage advances. Funding risk is the risk that the Society is not able to source the right type of funding to support its asset commitments. The Society manages this risk by sourcing the majority of its funding through stable retail savings deposits, and by enforcing strict limits for the amount and term of funding that is sourced from money markets.

The Society has policies in place to help ensure that it always holds prudent levels of liquid assets such that it can meet these obligations in normal and stressed conditions. The Society also has funding contingency plans in place to ameliorate the effects if a stress should occur, and carries out regular tests to ensure the robustness of these plans.

The Society expresses its liquidity requirement as an internal liquidity requirement, which is based on estimated requirements for liquid assets in a severe but plausible stress scenario. Additionally, the regulatory Liquidity Coverage Ratio (LCR) expresses the Society's liquidity holdings and requirements using a short-term 30-day stress scenario. The LCR is the ratio of the liquidity buffer and the net liquidity outflow. These amounts are expressed as an average of 12 monthly figures over 2017 in Table 3.

Table 3: Key figures for liquidity risk.

Liquidity risk	(£000 / %)
Liquidity buffer	181,877
Net liquidity outflow	60,450
Liquidity Coverage Ratio (%)	306%

Interest rate and Basis risk

Interest rate risk is the risk that the economic value of, or net income arising from, the Society's assets and liabilities are adversely impacted as a result of a change in interest rates. For example, if the Society is funded by variable rate savings but lends at fixed rates, it would expose itself to the risk that if rates rose, its cost of funding would rise without any corresponding increase in interest income on loans.

The Society is on the Matched Treasury approach under PRA guidelines. This means that it has to match the interest rate profile of both its assets and liabilities, and can only take limited interest rate risk subject to tight limits set by ALCO, and only then to the extent that the PRA is satisfied that the Society has the requisite risk management capability.

In order to keep its interest rate risk exposure within limits, the Society enters into interest rate swaps with major banks. For example, the Society swaps the fixed rate of income into a variable rate, usually by reference to the three-month London Inter-Bank Offer Rate (LIBOR). In this case, the Society would pay the bank a fixed rate of interest and in turn receive three-month LIBOR-based income from the bank.

The Society manages its interest rate risk exposure on several different bases, such as the Bank of England Base Rate and LIBOR. Basis risk is the risk of divergent movements of these bases. The Society manages this risk by performing scenario analysis to assess the impact of unexpected relative movements of different interest rates.

Comprehensive interest rate and basis risk limits are set by the ALCO and reviewed against actuals at both Board and ALCO meetings. The interest rate sensitivity of the Society at 31st December 2017 is set out in Section 4.5.

Treasury counterparty risk

Broadly credit risk within Treasury arises from either the Society making direct investments, or from counterparty risk due to entering interest rate swaps as described above. The Society is exposed to credit risk in the event that counterparties are unable to repay funds on maturity.

Treasury counterparty risk is kept to a minimum by only investing in counterparties with high credit ratings and in selected building societies.. In addition, the Society limits exposures to particular counterparties, types of investment or countries, and limits the period it is prepared to invest for. These limits, together with a range of other mitigating processes and controls, are documented in the Society's Treasury Credit Policy. The Board delegates oversight of counterparty credit risk to ALCO, through the Risk Committee.

The selection of counterparties and the approval of limits involve consideration of the background rating information as well as detailed up to date credit reports, including credit default swaps prices, and other market intelligence, for which the Society uses Fitch Ratings. The minimum short-term rating required under Fitch is F1. The long-term credit ratings from Fitch are translated to credit quality steps as shown in Table 4, in line with regulatory guidance.

Table 4: Mapping of the long term Fitch credit ratings to Credit Quality Steps as defined in the Final Draft Implementing Technical Standards by the joint European Supervisory Authorities (JC 2015 067).

Credit Quality Step	Fitch Rating
1	AAA to AA-
2	A+ to A-
3	BBB+ to BBB-
4	BB+ to BB-
5	B+ to B-
6	CCC+ or lower

ALCO reviews counterparty limits on a regular basis and recommends changes to the Board for approval. Limits may be temporarily suspended by the Treasury function in the event of adverse market intelligence. No dealing can be undertaken with counterparties which do not have a pre-approved limit. Where appropriate, exposure to counterparties is monitored on a consolidated basis.

The Society benefits from bilateral credit support agreements (CSAs) in place with all swap counterparties. It posts margin (collateral) when marked to market (MTM) values move against the Society and calls margin should MTM values move in the Society's favour. Exposure is monitored using the swap valuation reports sent to the Society by the counterparty, which are reviewed to ensure valuations are reasonable. Where an overall exposure of the Society to the counterparty exists, this value will be included within the total treasury credit exposure limits.

2.3.4 Mortgage credit risk

Borrowers may be unable to make timely payments on their mortgages and may ultimately default on their loans. This risk is managed through a combination of strict underwriting policies and lending predominantly in the East of England, a region that the Society knows well. Lending can only be approved, according to strict affordability criteria, by a small central team of experienced underwriters. Underwriting is operationally independent of sales activity, ensuring that that the borrower will be able to meet their repayments and that the Society has adequate security for the loan.

No matter how prudent lending is, some members inevitably get into financial difficulties and struggle to keep up their mortgage payments. In addition to rigorous, risk-based underwriting, the Society also prides itself on being highly proactive in supporting its members through any financial difficulties, thereby being true to its mutual values and helping mitigate its mortgage credit risk. As a result, the Society has very low levels of concessions, arrears and repossessions relative to the market as a whole.

As a mutual, the Society is committed to helping members that are in financial difficulty meet their mortgage commitments. This is achieved by:

- having people with relevant expertise empathetically handling approaches from borrowers experiencing repayment difficulties;
- gaining a thorough understanding of their circumstances
- through interviews establishing a repayment plan that considers the interest of both the borrower and the Society;
- ensuring that any repayment plan, be it a temporary reduction in monthly repayment or some other form of concession, is affordable and practical in terms of the borrower's circumstances, but without placing the loan in an unsustainable position; and

Where appropriate for members' needs, the Society applies a policy of forbearance under which a payment concession may be granted. A concession may involve a reduction in the monthly payment, the ability to repay any payment shortfall over a period of time relevant to the borrower's financial circumstances or a mortgage term extension. These strategies are undertaken in order to achieve reduced long-term arrears and allow the best outcome for the customer and the Society by dealing with borrowers' financial difficulties at an early stage. These accounts are subject to ongoing monitoring to ensure that the forbearance measures remain appropriate.

A key control for mortgage lending is the security provided by the property on which the mortgage is lent. The Society requires a written valuer's report for all properties offered as security for a mortgage, and a re-valuation is required for further advances where the total amount advanced will exceed 80% of the last valuation held. On intermediate financial valuation points, valuations are adjusted according to a regional property value index.

A mortgage loan is considered past-due if one or more of the agreed contractual payments has been missed. Contractually deferred interest does not constitute arrears. Loans in arrears on which an agreed payment is now being made should continue to be reported as arrears until full repayment of the outstanding amount or where the arrears balance has been fully capitalised. A financial asset is impaired if there is objective evidence that an impairment event has occurred and that the impairment event has an impact on the estimated future cash flows of the asset or group of assets which are reliably estimated. Impairment may be caused by a single event, or a combination of events.

The Society's overall lending policy is reviewed on a regular basis, and formally approved at least annually by its Mortgage Credit Committee. The Committee receives regular, detailed reports on the quality and risk profile of the mortgage book and provides oversight of all aspects of the book's performance over time. It ultimately reports into the Board and reports through the Risk Committee on specific risk matters.

2.3.5 Operational and conduct risk

Operational risk

Operational risk losses may arise from inadequate or failed internal processes or systems, human error or external events. All such risks are identified, assessed and closely monitored as part of the formal risk management structure, which includes reporting into the Board

Audit Committee and Board Risk Committee. It is the responsibility of each business area, supported by the Chief Risk Officer, to understand how operational risk impacts them and to put in place appropriate controls or take other mitigating actions.

Where the Society has outsourced a particular activity, such as the provision of IT services, it has a robust set of procedures in place to closely monitor the provision and quality of these services against pre-determined service level agreements and key performance indicators. The Society also receives an independent assurance report in respect of its core outsourced IT services.

The Society manages and monitors Operational Risk through maintaining databases of risk events and operational risk losses, regularly carrying out risk control assessments with risk owners, and operational risk scenario analysis. Operational Risk is overseen by the Operational and Conduct Risk Committee, the Risk Committee, and the Board.

Conduct risk

Conduct risk is the risk that the Society does not put customer needs at the heart of what it does and, as such, risks not achieving the best outcomes for members. This has been a significant issue across the financial services sector which has seen large customer redress programmes for issues such as Payment Protection Insurance and swap mis-selling for small firms.

Conduct risk is overseen by the Operational and Conduct Risk Committee, the Risk Committee, and the Board, who consider regular conduct risk management information, approve the conduct risk policy and ensure that conduct risk is at the heart of the product development process. The conduct risk framework is regularly reviewed by Internal Audit.

Internal Audit and Compliance both consider whether the Society is achieving the best outcome for members as part of their reviews. The Society also carries out root cause analysis of complaints to understand if process changes need to be made or wider reviews need to be carried out.

Regulatory risk

The volume, prescription and complexity of regulation, and changes thereto, may impair the Society's ability to compete effectively and profitably grow. The Board and Management Team closely monitor the Society's compliance with all regulatory requirements and keep up to date with relevant changes.

Key areas of regulatory change include:

- Strengthening Accountability in Banking rules implementation by the Financial Conduct Authority and the Prudential Regulation Authority
- Regulation of capital, including ongoing updates of the Capital Requirements Directive (CRD) IV
- Implementation of the European Data Protection Directive

2.4 Risk governance

2.4.1 Board and Board Committees

The Committee structure as at 31st December 2017 is shown in Figure 2.

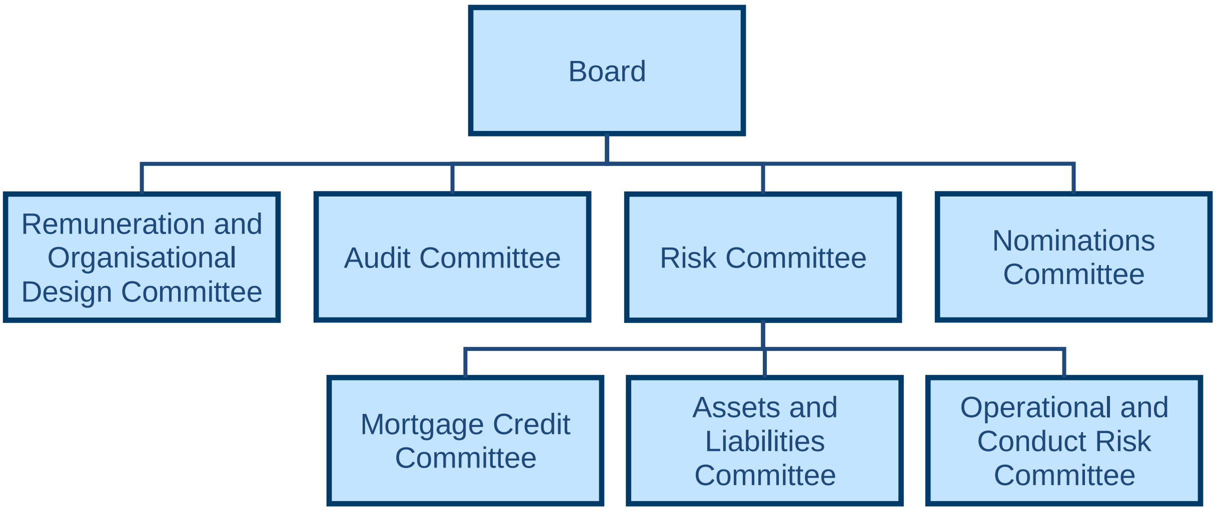

Figure 2: Schematic overview of the Committee structure.

Remuneration and Organisational Design Committee

Composition:

The Committee is made up of at least three Non-executive Directors. Meetings are attended by the Finance Director and the Chief Executive.

Main functions:

The Committee is responsible for reviewing and recommending to the Board policies for remuneration and organisational design; setting the policy for employee benefits structures and scope; approving any performance related pay schemes and payments under these and reviewing on an annual basis the performance objectives of the Executive Directors and Executive set by the Chairman and Chief Executive.

Frequency: meets twice a year or more frequently if required.

Audit Committee

Composition: The Committee is made up of at least three Non-executive Directors. Meetings are attended by the Chief Executive, the Finance Director, the Chief Risk Officer, the Society's outsourced internal audit provider, and the Society's external auditors.

Main functions:

The role of the Audit committee is to review the integrity of financial statements, to review the effectiveness of internal controls and compliance, to monitor and review the effectiveness of the internal audit function and to consider and recommend to the Board (for approval by the members) the appointment or reappointment of the external auditors.

It also, inter alia:

- approves senior management appointments with overall responsibility for arrangements in relation to adherence to internal systems and controls;
- approve the remit of the internal audit and compliance functions and ensure they have adequate resources;
- receives a report on the results of internal audit's work and monitors management's responsiveness to internal audit's findings and recommendations;

- oversees the Society's relationship with the external auditor and monitors the content of the external auditor's annual management letter and management's response;
- reviews arrangements established by management for compliance with regulatory requirements;
- reviews the compliance monitoring programme and ensures that the compliance function is adequately resourced and has appropriate standing in the Society;
- receives a report on the results of the compliance monitoring programme and monitors management's responsiveness to compliance findings and recommendations; and
- approves and monitors the Society's integrated assurance plan.

Frequency: meets four times a year, or more frequently if required.

Risk Committee

Composition:

The Committee is made up of at least three Non-executive Directors. Meetings are also attended by the Chief Executive, the Finance Director, the Chief Operating Officer, and the Chief Risk Officer.

Main functions:

The role of the Risk committee is to oversee risk management strategy, systems and controls and to review the effectiveness of internal controls and compliance.

It also, inter alia:

- approves the remit of the risk management function and ensures that it is appropriately resourced and has sufficient independence to effectively meet its responsibilities;
- monitors how the Society's business strategy impacts its overall risk profile and appetite;
- advises the Board on the Society's overall risk appetite and the metrics to be used to monitor performance against this risk appetite; and
- receives risk reports from operational committees and provide oversight of, and challenge to, those committees on risk matters.

Frequency: meets four times a year, or more frequently if required.

Nominations Committee

Composition:

The Committee is made up of at least two Non-executive Directors together with the Chief Executive. Meetings are attended by the Company Secretary.

Main functions:

- regularly review the structure, size and composition (including the skills, knowledge and experience) required of the Board, compared to its current position and make recommendations to the Board with regard to any changes;
- give full consideration to succession planning for members of the Board and the Chief Executive, taking into account the challenges and opportunities facing the Society, and what skills and expertise are therefore needed on the Board in the future;

- evaluate the balance of skills, knowledge and experience on the Board, and in light of this evaluation, prepare a description of the role and capabilities required for a particular appointment;
- keep under review the leadership needs of the Society, both Executive and Non-executive, to ensure that the Society can continue to compete successfully in the market place; and
- to review and determine the fees for the Society's Non-executive Directors.

Frequency: meets twice a year, or more frequently if required.

Mortgage Credit Committee

Composition:

The Committee is made up of the Chief Risk Officer, the Finance Director, the Head of Lending, the Underwriting Manager, the Business Intelligence Manager, and the Prudential Risk Manager.

Main functions:

- approve the credit quality of the mortgage book involving trend analysis based on risk profile;
- assess the quality of underwriting decisions, and have oversight of the Underwriting Committee;
- approve changes to the lending policy as recommended by the Mortgage Underwriting Committee including underwriting mandates;
- recommend to the Board the Society's high level policy on lending (residential and commercial);
- provide guidance and instruction on any policy change required as a result of a change in the risk profile of the Society's mortgage book;
- receive and approve a report on the credit quality, risk profile and performance of the Society's mortgage book; and
- review relevant internal audit and compliance monitoring reports.

Frequency: meets 4 times a year, or more frequently if required.

Assets & Liabilities Committee

Composition:

The Committee is made up of the Finance Director, Chief Risk Officer, Prudential Risk Manager, Asset & Liability Manager, Treasurer and Product Manager.

Main functions:

The Committee formulates and recommends the Treasury Policies to the Board Risk Committee. The policy sets out risk appetites relating to balance sheet structure, liquidity, interest rate risk and basis risk. The policy also sets out counterparty, sector, country, instrument and funding limits. The Committee is responsible for monitoring the Society's position against these risk appetites and limits.

The Committee also assesses the effect on the Society's capital of the competitive squeeze on margins, the mismatch between interest characteristics of assets and liabilities, capital and solvency directives issued by regulatory bodies, and the performance and risk profile of the pension deficit obligation.

Frequency: meets 10 times a year, or more frequently if required.

Operational and Conduct Risk Committee

Composition:

The Committee is made up of the Chief Operating Officer, the Chief Risk Officer, the Head of Marketing, the Head of Lending, the Head of Direct Distribution, and the Head of Compliance.

Main functions:

- approve the operational risk management framework;
- assess the impact of risk events and monitor actions arising from risk events;
- review relevant internal audit and compliance monitoring reports, including reviews of conduct risk, complaints handling and product governance;
- approve the financial crime policy, the conduct risk policy, and the gifts and hospitality policy;
- review operational Management Information;
- approve the conduct risk management framework;
- review the conduct risk dashboard; and
- review new products and product changes escalated by the Product Development Committee for conduct risk.

Frequency: meets 4 times a year, or more frequently if required

2.4.2 Other directorships held by members of the management body

Information on the number of directorships held by members of the management body can be found in the Annual Report & Accounts.

2.4.3 Recruitment policy for members of the management body

The Nomination Committee conducts a regular review of the structure, size and composition required of the Board and its Committees, compared to its current position and makes recommendations to the Board with regard to any changes. The review encompasses an assessment of the skills, knowledge and expertise of the Board and whether these are aligned to the requirements of the Society's Corporate Plan. Changes identified from the review are recommended to the Board for implementation through a targeted approach to recruitment.

A succession planning review is conducted on an annual basis, unless action is required at an earlier stage, for members of the Board and the Chief Executive. This review takes into account the challenges and opportunities identified by the Corporate Plan, and what skills and expertise are therefore needed for the Board in the future. The findings of the review are used by the Committee to prepare a description of the role to be recruited for and any particular capabilities required of the individual. The Committee utilises external support to ensure that the right potential candidates are identified.

The recruitment of Non-executive Directors is based on the Society's policy of ensuring diversity of its Board members including but not limited to gender, geographical location, and sector.

The Committee is responsible for the review and determination of fees for Non-executive Directors and ensures that they are aligned to the skills and knowledge required for the Board. The Committee recognises the need to attract the right candidates, balancing risk and reward whilst maintaining fees which are in line with the market.

2.4.4 Governance and reporting on risk management

During 2017 the Risk Committee met a total of four times.

The Society operates a structured system of management information reporting to Board, Senior Management and Committees. The main component is the information pack that is reviewed by the Board on a monthly basis. This pack is fully aligned with the risk appetite and key risk indicators that form part of the risk management framework, and also contains several relevant forward-looking indicators intended to keep the Board informed on emerging risks and market developments.

2.4.5 Risk assurance

The Society has a strong and prudent approach to risk management and compliance and is satisfied that the systems and controls are effective and appropriate to the scale and complexity of the business and protect the interests of the members.

3 Own funds

The own funds (or capital resources) of the Society are determined in accordance with Part 2 of CRR, and shown in Table 5.

Table 5: Overview of the Society's Own Funds.

	£000
Common Equity Tier 1	
Instruments and reserves	
Capital instruments and the related share premium accounts	5,000
Retained earnings	63,965
Accumulated other comprehensive income (and other reserves)	3,585
Regulatory adjustments	
Intangible assets	(2,349)
Deferred tax liabilities associated to other intangible assets	101
Total CET 1	**70,302**
Additional Tier 1	
Additional Tier 1	-
Total Tier 1	**70,302**
Tier 2	
Credit risk adjustments	527
Total Tier 2	**527**
Total Capital	**70,829**
Amounts below thresholds for regulatory adjustments	
Deferred tax assets arising from temporary differences	1,029

The majority of the Society's own funds are in the form of Common Equity Tier 1 (CET 1), and consist of retained earnings (see Section 1.4.2 for an explanation of the own funds classifications) and capital instruments in the form of Core Capital Deferred Shares. Both the specific and general credit risk adjustments (see Section 4.2.6) are subtracted from CET 1 capital, but the general credit risk adjustments is included as part of Tier 2.

In 2017, The Society issued CCDS for a total amount of £5m, as part of a partnership with the Cambridgeshire County Council Pension Fund, which encompasses a total investment of £15m over the coming years. The CCDS are included as part of The Society's capital resources as CET 1 capital. The main features of the CCDS are listed in detail in Appendix B, and more information can be found in Note 31 of the Annual Report and Accounts.

Intangible assets recognised on The Society's balance sheet are required to be deducted from CET 1 capital, and the corresponding deferred tax liability may be added back. Deferred tax assets that rely on future profit and arise from temporary differences are also required to be deducted from CET 1 capital, but an exemption is applicable as long as the amount is below 10% of total CET 1 capital.

4 Capital requirements

4.1 Internal Capital Adequacy Assessment Process

Underpinning the Society's Corporate Plan is the need to maintain its capital strength above the Board-agreed requirement, which is in turn higher than the regulatory required minimum capital. In order to do this, the Society needs to generate, and retain, profits that will add to the general reserves, the main source of capital.

Complementing the Corporate Plan, the Society annually undertakes an ICAAP (see Section 1.4.3), to ensure that the Society's capital resources are sufficient to deliver the Corporate Plan objectives in normal as well as stressed conditions.

This process involves reviewing all risks relevant to the Society, and assessing the required capital to mitigate those risks, through analysing the impact of a range of stress scenarios. The key risks that are evaluated as part of the ICAAP are described in Section 2.3.

The Board assesses relevant financial information on each of these areas against a clearly defined risk appetite and approves the capital requirements arising from this detailed review. In its challenge of the capital assessments, the Board also takes into account any areas where they feel the models and internal assessments do not adequately capture the full risk exposure by holding extra capital where appropriate.

The Society translates its overall risk appetite for credit and treasury risk into a range of lending and liquidity limits controlling the exposures taken. These exposures, and other risks, are carefully monitored by the Board and Board committees on a regular basis.

4.2 Risk weighted exposure amounts and capital requirements

The assets of the Society are analysed by risk category and given weightings according to the level of risk entailed. The following sections provide an overview of the risk exposures that contribute to the Society's capital requirements. An explanation of how capital requirements are calculated is provided in Section 1.4.1.

4.2.1 Credit Risk

Credit risk weightings for the calculation of Pillar 1 capital requirements are determined by the Standardised Approach following the methodology set out in Part 3, Title 2, Chapter 2 of CRR. An overview of the total assets, risk-weighted exposure and minimum capital requirements per exposure class is given in Table 6.

Table 6: Overview of the total asset exposure, risk-weighted exposure, and minimum capital requirements (defined as 8% of the risk-weighted exposure) specified into major exposure classes.

Exposure Class	Assets (£000)	Risk-Weighted Exposure (£000)	Minimum Capital Required (£000)
Credit Risk			
Central governments or central banks	138,354	-	-
Regional governments or local authorities	-	-	-
Public sector entities	-	-	-
Multilateral Development Banks	-	-	-
International Organisations	-	-	-
Institutions	20,744	5,201	416
Corporates	2,901	2,901	232
Retail	8,723	6,542	523
Secured by mortgages on immovable property	1,050,730	376,739	30,140

Exposures in default	8,571	8,675	694
Items associated with particular high risk	-	-	-
Covered bonds	-	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-	-
Collective investments undertakings (CIU)	-	-	-
Equity exposures	4,473	6,017	481
Other items	9,825	8,752	700
Securitisation positions SA	-	-	-
Total Credit Risk	*1,244,321*	*414,827*	*33,186*
Operational Risk			
Basic Indicator Approach (BIA)		33,229	2,658
Credit Valuation Adjustment (CVA) Risk			
Standardised Method		903	73
TOTAL		**448,958**	**35,917**

4.2.2 Internal Capital Guidance and buffer requirements

The Society is provided with Individual Capital Guidance (ICG) by the PRA, taking into account the Society's ICAAP, which is the sum of Pillar 1 and Pillar 2A requirements. The ICG and buffer requirement as it applies specifically to The Society are detailed in Table 7.

Table 7: Capital and buffer requirements expressed in £-amounts and as percentage of the risk-weighted exposure.

	% of RWA	£000
Risk Weighted Exposure Amount		448,958
Capital requirements		
Internal Capital Guidance (including Pillar 1)	9.70%	43,553
Capital Conservation Buffer	1.25%	5,612
Counter Cyclical Buffer	0.00%	-
Total	**10.95%**	**49,165**

4.2.3 Residual maturity

The maturity of exposures on a contractual basis is shown in Table 8. Note that this table does not take into account any instalments receivable over the life of the exposure. The retail exposure category consists only of mortgage balances in excess of 80% LTV, and has been combined with the category for exposures secured by mortgages on immovable property for the purpose of this section only. The mortgage exposure is reported gross of specific credit risk adjustments.

Table 8: Residual maturity breakdown by exposure class.

Exposure Class As per 31/12/2017	< 3 mo	3 mo - 6 mo	6 mo - 1 yr	1 yr - 5 yr	> 5 yr	Total
Central governments or central banks	134,534	523	-	3,297	-	138,345
Institutions	13,919	3	1,058	2,615	3,149	20,744

Secured by mortgages on immovable property and Retail	1,222	872	5,096	61,315	993,857	1,062,362
Exposures in default	-	57	36	1,148	7,330	8,571
Equity exposures	4,473	-	-	-	-	4,473
Other items	9,825	-	-	-	-	9,825
Total Credit Risk	163,973	1,455	6,190	68,375	1,004,327	1,244,320

4.2.4 Exposure of wholesale credit investments by credit quality step

The exposure of wholesale credit investments (essentially the exposure to central governments or central banks and institutions) by credit quality step is shown in Table 9. The assignment of a credit quality to an exposure is based on the long-term Fitch rating according to Table 4 on page 12.

Table 9: Exposure of wholesale credit investments by credit quality step.

Credit Quality Step	Fitch rating	Exposure Value
1	AAA to AA-	144,291
2	A+ to A-	13,177
3	BBB+ to BBB-	1,631
4	BB+ to BB-	-
5	B+ to B-	-
6	CCC+ to CCC-	-
Unrated		-
Total		159,098

4.2.5 Operational Risk

Operational Risk is calculated under the Basic Indicator Approach as 15% of the sum of the average net interest, fees and commissions receivable, fees and commissions payable, other operating income, other operating charges, and net profit or loss on financial operations over the previous three years, in accordance with Part 3, Title 3, Chapter 2 of CRR. A breakdown of the calculation of capital requirements for Operational Risk is provided in Table 10.

Table 10: Basic Indicator Approach calculation for Operational Risk.

Operational Risk (£000)	2015	2016	2017
Net interest	17,280	16,180	17,962
Fees & commissions receivable	596	613	409
Fees & commissions payable	89	(36)	(2)
Other operating income	126	107	103
Other operating charges	28	(201)	44
Net profit or loss on financial operations	(84)	27	(75)
Total	18,035	16,690	18,441
Basic Indicator (3 year average)			17,722
Own Funds Requirement (15% of the Basic Indicator)			2,658

4.2.6 Credit risk adjustments

Provisions (under CRR referred to as credit risk adjustments) on commercial and residential accounts are made to reduce the value of loans and advances to the amount that is considered likely to be recoverable in the event of the property held as security for the loan being sold in possession by the Society.

Throughout the year, and at the year-end, individual assessments are made of all loans and advances which are in possession or are significantly in arrears and a specific credit risk adjustment is made against those cases which are considered to be impaired (see also Section 2.3.4). In considering the individual provisions for impaired loans, account is taken of any discount which may be needed against the value of the property at the balance sheet date to agree a sale within three months of that date. Where a property in possession is subject to an acceptable offer from a potential purchaser and the Directors are satisfied that commitment to completion of the transaction exists, the individual provision has been made on the basis of the agreed selling price. On the basis of the Society's previous experience it is recognised that not all serious arrears cases will ultimately result in possession, and the amounts provided on individual cases not in possession reflect the estimated propensity for a loss to be realised. The Society also looks to mitigate losses through the use of Mortgage Indemnity Guarantee insurance, which is taken out on residential lending over 80% loan to value.

An individual provision is also made in the case of accounts, which may not currently be in arrears, where the Society has exercised forbearance in the conduct of the account. The provision is based on the propensity of the account to realise a loss, had forbearance not been shown. In all cases account is taken of any amounts recoverable under contracts of indemnity insurance, where this is virtually certain to be received, and of anticipated disposal costs. No provision is made against the future carrying costs of impaired loans.

A collective provision is made against those advances for which the Society's experience and the general economic climate would indicate that impairment events have occurred but have yet to be notified and as such could ultimately result in a loss.

The amount charged in the income and expenditure account represents losses written off in the year together with the net change in credit risk adjustments. Interest in respect of all loans is credited to the income and expenditure account as it becomes receivable.

Table 11: Reconciliation of specific and general credit risk adjustments.

(£000)	Specific Credit Risk Adjustment	General Credit Risk Adjustment
As at 31 December 2016	697	603
Amounts written off	-	(22)
Charge in Year	(18)	(54)
As at 31 December 2017	679	527

The balance sheet shows loans and advances to customers net of both collective and individual provisions. The effect on the income and expenditure account comprises the movement in the provisions including losses written off or recovered in the year.

Under CRR, the individual and collective provisions are referred to as specific and general credit risk adjustments. A reconciliation of the specific and general credit risk adjustments is shown in Table 11. The specific credit risk adjustment and general credit risk adjustment per significant geographical region are provided in Table 19, Table 20, and Table 21 in Appendix C.

4.2.7 Mortgage portfolio distribution

Table 12 shows an overview of the mortgage portfolio separated by risk characteristics (i.e. owner-occupied residential, buy to let residential, or commercial mortgages), as well as geographical regions. A detailed distribution of performing and non-performing loans as well as general and specific credit risk adjustments with regards to risk characteristics and geographical area is provided in Appendix C.

Table 12: Mortgage portfolio distribution.

Mortgage Portfolio	Owner-occupied Residential	Buy To Let Residential	Commercial	Total
Total exposure	827,800	213,277	19,977	1,061,054
Performing	819,990	212,819	19,684	1,052,483
Non-performing	7,820	458	293	8,571
General credit risk adjustment	249	8	293	550
Specific credit risk adjustment	615	-	65	679
Exposure by region				
Scotland	-	-	-	-
Northern Ireland	-	-	-	-
Wales	-	0.1%	-	-
North East England	0.1%	-	-	0.1%
North West England	0.1%	-	-	0.1%
Yorkshire and the Humber	0.2%	-	-	0.2%
East Midlands	3.8%	2.3%	-	3.4%
West Midlands	0.1%	0.1%	-	0.1%
East of England	87.3%	84.1%	97.9%	86.8%
London	3.1%	8.0%	2.1%	4.1%
South East England	5.0%	5.1%	-	4.9%
South West England	0.3%	0.3%	-	0.3%
	-	-	-	-
Total	100.0%	100.0%	100.0%	100.0%

4.3 Counterparty credit risk and CVA risk

For derivative instruments, risk weightings are determined according to the Mark-To-Market Approach for Counterparty Credit Risk according to Part 3, Title 2, Chapter 6 of CRR, and the Standardised Method for Credit Valuation Adjustment Risk following the approach described in Part 3, Title 6 of CRR for derivatives that are traded Over The Counter (OTC). The exposure values related to counterparty credit risk are shown in Table 13.

Table 13: Overview of exposures to counterparty credit risk

Counterparty Credit Risk	Exposure Value £000
Gross positive fair value of contracts	1,702
Netting benefits	-
Netted current credit exposure	1,702

Potential future exposure	1,842
Collateral held	-
Net derivatives credit exposure	3,544
Risk weighted derivatives credit exposure	1,761
Capital requirement	141

4.4 Encumbered assets

The Society has pledged part of its loan book as collateral with the Bank of England, in order to participate in the Bank's Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS). Participation in these schemes provide the Society with a source of funding that diversifies the funding portfolio and reduces the overall funding cost, and allows the Society to optimise mortgage rates for its members. Although the loans remain fully owned and operated by the Society, they are reported as encumbered.

Other encumbered assets are collateral posted for the derivative portfolio that supports the management of interest rate risk. Details of the encumbered assets, and sources of encumbrance can be found in Table 14 and

	Encumbered assets		Unencumbered assets	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets of the reporting institution	101,454		1,099,949	
Loans on demand	5,251		133,658	
Equity instruments	-	-	-	-
Debt securities	-	-	8,324	8,324
Loans and advances other than loans on demand	96,203		940,897	
Other assets	-		17,070	

Table 15. Note that this information is required to be disclosed as median values over quarterly positions during the 12 months preceding 31st December 2017, and as a result may differ from other information provided in this disclosure.

As can be seen in the tables, the Society has encumbered more assets than it receives in collateral, since its counterparty requires a buffer against potential non-performance of assets in its pool. The Society does not consider making its Other Assets in Table 14 available for encumbrance.

Table 14: Overview of encumbered and unencumbered assets

	Encumbered assets		Unencumbered assets	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets of the reporting institution	101,454		1,099,949	
Loans on demand	5,251		133,658	
Equity instruments	-	-	-	-
Debt securities	-	-	8,324	8,324
Loans and advances other than loans on demand	96,203		940,897	

Other assets	-	17,070

Table 15: Sources of encumbrance

	Matching liabilities, contingent liabilities or securities lent	Assets and collateral received encumbered
Carrying amount of selected financial liabilities	16,667	22,295

4.5 Interest rate risk in the banking book

Interest rate risk is the risk of loss arising from adverse movements in interest rates, reflecting the mismatch between the dates or bases on which interest receivable on assets and interest payable on liabilities resets..

The Society aims to match all fixed rate exposures on either side of the balance sheet using both on-balance sheet and off-balance sheet hedging (subject to ALCO approved mismatch limits). The Society has Board approved limits that ensure that the impact of a change in a range of interest rate scenarios has a limited effect of the present value of its re-pricing gaps, which is shown in Table 16.

Table 16: Impact of parallel and non-parallel shock to interest rates on the present value of assets and liabilities.

Interest Rate sensitivity	Change to central rate (£000)
Impact of interest rate shift of +2%	581
Impact of interest rate shift of -2%	(546)
Impact of interest rate shift short rates up	423
Impact of interest rate shift of short rates down	(406)
Impact of interest rate shift flattener	(260)
Impact of interest rate shift of steepener	166

4.6 Leverage Ratio

The leverage ratio is defined as ratio between the Tier 1 capital and the total on and off balance sheet asset exposure, without taking into account any risk weighting. Its objective is to reduce the risk of excessive leverage (i.e. an excessively low amount of own funds compared to total assets), as well as acting as a back stop against the model complexities involved in calibrating risk weights.

The Society calculates its Tier 1 Capital on the basis that will apply once CRD IV has been fully phased in. In addition to the on-balance sheet assets, the leverage ratio also takes off-balance sheet exposure into account.

The total exposure measure and leverage ratio are shown in Table 17 based on the on-balance and off-balance sheet exposures as per 31st December 2017. The accounting value of assets as it appears in the Annual Report and Accounts is reconciled to the leverage ratio exposure. Differences arise due to:

- Different requirements for the valuation of derivatives
- Inclusion of undrawn credit facilities in the capital exposure
- Deduction of intangible assets from capital resources and capital exposure
- The credit risk exposure is reported gross of the general credit risk adjustment

There is a small difference between the leverage ratio exposure and the credit risk exposure as reported in Table 6 due to the different weighting of undrawn credit facilities.

Table 17: Overview of components for the calculation of the leverage ratio and reconciliation of leverage ratio exposure and accounting value of balance sheet assets.

Leverage ratio	£000
Capital	
Tier 1 Capital (fully phased in definition)	70,302
Accounting value of assets	1,234,384
Accounting value of derivatives	(1,678)
Derivatives gross positive fair value of contracts	1,702
Derivatives potential future exposure	1,842
Undrawn credit facilities	4,170
Deduction of intangible assets	(2,349)
General credit risk adjustment	527
Total leverage ratio exposure	1,238,598
Leverage Ratio	5.7%

5 Remuneration policy

The Directors Remuneration Report, in the Society's Annual Report & Accounts, sets out the policies and process for determining the Remuneration Policy of the Society.

5.1 Remuneration and Organisational Design Committee

The Remuneration and Organisational Design Committee is responsible for the remuneration policy of all Executive Directors, Management and staff and it makes recommendations to the Board regarding remuneration and contractual arrangements. The Committee meets at least twice a year and reviews supporting evidence, including external professional advice if appropriate, on comparative remuneration packages. During 2017, the Committee met a total of three times.

No Director or Executive is involved in any decision as to their own remuneration.

5.2 Nominations Committee

The Society's Nominations Committee determines the fees paid to Non-executive Directors based on comparable data from similar financial services organisations. Members of the Committee do not agree their own fees.

The Committee meets at least twice a year to determine fees paid to Non-executive Directors and to consider the balance and diversity of skills, knowledge and experience of the Board and the requirements of the organisation.

5.3 Material risk takers

The PRA's Remuneration Code contains the principle of proportionality which means that firms are expected to comply with the remuneration requirements of the Code in relation to their size, internal organisation and the nature, scope and complexity of their activities. Accordingly, the Society is grouped in Tier 3 with banks and building societies with total assets averaging less than £15bn over the last three financial years.

In accordance with CRD IV, criteria apply for the identification of 'Code staff', now referred to as staff identified as material risk takers. The Society has conducted a review to ascertain which employees are governed by these requirements.

5.4 Remuneration of Non-executive Directors

The remuneration of Non-executive Directors is based on fees which are reviewed annually. Non-executive Directors do not receive any pension or reward from variable pay schemes.

The Society's policy is designed to ensure that remuneration reflects performance and enables the Society to attract, retain and motivate the Non-executive team to lead and direct the Society in an increasingly regulated and competitive market.

5.5 Main components of remuneration

An overview of aggregated remuneration to material risk takers is provided in Table 18. The table includes remuneration to staff members and Directors that have left or joined during the year.

Table 18: Aggregate quantitative information on remuneration of material risk takers.

Type of staff	Number	Fixed £	Pension £	Variable £	Total £
Non- Executive Directors	8	203,418	-	-	203,418
Executive Directors	4	669,718	53,915	32,016	755,649
Other Material Risk Takers	9	637,693	76,524	50,872	765,089
Total	21	1,510,829	130,439	82,888	1,724,156

5.5.1 Basic salary

The basic salary of Executive Directors is set according to the scope of the role and responsibilities, individual performance (assessed twice a year), salary levels of similar positions in comparable organisations and internal benchmarks.

Salaries are reviewed annually and individual increases are awarded based on the individual's performance against personal objectives measured in accordance with the performance management framework in each business.

5.5.2 Variable pay scheme

The Executive Directors and Executive are part of the Society's overall 'Sharing in Success' variable pay scheme. The scheme's principles are weighted towards customer and financial outcomes to ensure that the scheme balances long term sustainable benefits for both the customers and the Society.

5.6 Contracts

No Executive Director holds a contract with a notice period of more than 6 months. No individuals were remunerated £850,000 or more.

Settlement agreements were structured in line with contractual and legal requirements.

Appendix A: EBA own funds disclosure template

Common Equity Tier 1 (CET1) capital: instruments and reserves		
1	Capital instruments and the related share premium accounts	5,000
2	Retained earnings	63,965
3	Accumulated other comprehensive income (and other reserves)	3,585
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	72,550
Common Equity Tier 1 (CET1) capital: regulatory adjustments		
8	Intangible assets (net of related tax liability) (negative amount)	(2,248)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	(2,248)
29	Common Equity Tier 1 (CET1) capital	70,302
Additional Tier 1 (AT1) capital: instruments		
36	Additional Tier 1 (AT1) capital before regulatory adjustments	0
Additional Tier 1 (AT1) capital: regulatory adjustments		
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital	0
44	Additional Tier 1 (AT1) capital	0
45	Tier 1 capital (T1 = CET1 + AT1)	70,302
Tier 2 (T2) capital: instruments and provisions		
50	Credit risk adjustments	527
51	Tier 2 (T2) capital before regulatory adjustments	527
Tier 2 (T2) capital: regulatory adjustments		
57	Total regulatory adjustments to Tier 2 (T2) capital	0
58	Tier 2 (T2) capital	527
59	Total capital (TC = T1 + T2)	70,829
60	Total risk weighted assets	448,958
Capital ratios and buffers		
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	15.7%
62	Tier 1 (as a percentage of total risk exposure amount)	15.7%
63	Total capital (as a percentage of total risk exposure amount)	15.8%
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)	6.7%
65	of which: capital conservation buffer requirement	1.3%
66	of which: countercyclical buffer requirement	0.0%
67	of which: systemic risk buffer requirement	0.0%
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	0.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	6.1%
Amounts below the thresholds for deduction (before risk weighting)		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	1,029
Applicable caps on the inclusion of provisions in Tier 2		

76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	527
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	5,185

Appendix B: Capital instruments main features

Capital instruments main features template		
1	Issuer	The Cambridge Building Society
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)	N/A
3	Governing law(s) of the instrument	English
Regulatory treatment		
4	Transitional CRR rules	CET1
5	Post-transitional CRR rules	CET1
6	Eligible at solo/(sub-)consolidated/ solo&(sub-)consolidated	S
7	Instrument type (types to be specified by each jurisdiction)	CCDS
8	Amount recognised in regulatory capital (Currency in million, as of most recent reporting date)	£5,000,000
9	Nominal amount of instrument	£5,000,000
9a	Issue price	£100
9b	Redemption price	£100
10	Accounting classification	Shareholder's Equity
11	Original date of issuance	04/09/2017
12	Perpetual or dated	Perpetual
13	Original maturity date	No
14	Issuer call subject to prior supervisory approval	No
15	Optional call date, contingent call dates and redemption amount	N/a
16	Subsequent call dates, if applicable	N/a
Coupons / dividends		
17	Fixed or floating dividend/coupon	Variable
18	Coupon rate and any related index	Bank of England Base Rate + 5%

Capital instruments main features template		
19	Existence of a dividend stopper	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully Discretionary
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully Discretionary
21	Existence of step up or other incentive to redeem	No
22	Noncumulative or cumulative	Noncumulative
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	Non contractual statutory via bail in
31	If write-down, write-down trigger(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)	AT1
36	Non-compliant transitioned features	No
37	If yes, specify non-compliant features	

Appendix C: Geographical breakdown of loans and credit risk adjustments

Table 19, Table 20, and Table 21 below detail performing loan exposure, non-performing loan exposure (defined as more than 3 months past-due), and general and specific credit risk adjustments by geographic region for the main exposure classes in the mortgage book (core residential, buy to let, and commercial). Past due amounts shown relate to the overall mortgage balances, not the amount in arrears.

Table 19: Geographical breakdown of assets classified as core residential.

Owner-occupied Residential	Performing	Non-performing	General credit risk adjustment	Specific credit risk adjustment
East of England	715,090	7,233	228	600
South East England	41,149	-	9	-
London	25,605	209	3	-
East Midlands	31,498	-	8	15
Other areas in UK	6,636	379	-	-
Total	819,980	7,820	249	615

Table 20: Geographical breakdown of assets secured on immovable property classified as buy to let.

Buy To Let Residential	Performing	Non-performing	General credit risk adjustment	Specific credit risk adjustment
East of England	178,990	379	8	-
South East England	10,980	-	-	-
London	17,036	-	-	-
East Midlands	4,880	79	-	-
Other areas in UK	933	-	-	-
Total	212,819	458	8	-

Table 21: Geographical breakdown of assets secured on immovable property classified as commercial.

Commercial	Performing	Non-performing	General credit risk adjustment	Specific credit risk adjustment
East of England	19,260	293	261	64
South East England	-	-	-	-
London	424	-	32	-
East Midlands	-	-	-	-
Other areas in UK	-	-	-	-
Total	19,684	-	293	64

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