2018

Teachers Building Society

Pillar 3 Disclosure

For the year ended 31 December 2018

Contents

1. Overview

1.1 Background

This document sets out the Pillar 3 Disclosures for Teachers Building Society ('the Society') for the year ended 31 December 2018. The purpose of these disclosures is to give information on the basis of calculating capital requirements and on the management of risks faced by the Society.

The European Union Capital Requirements Directive came into effect on 1 January 2007. This introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II Accord. This was replaced by Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV) which came into force on 1 January 2014 and is enforced in the UK, together with local implementing rules and guidance, by the Prudential Regulation Authority (PRA). The rules include disclosure requirements known as 'Pillar 3' which apply to banks and building societies. These are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes.

1.2 Basis and frequency of disclosure

The Society has adopted the standardised approach for all exposures and risk areas, and uses the capital risk weighting percentages set by the PRA. The Society uses the Basic Indicator Approach (BIA) for the calculation of its operational risk capital requirement.

These disclosures may differ from but are consistent with the Annual Report and Accounts prepared in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" and with the requirements of the Building Societies Act 1986.

Unless otherwise stated, all figures are as at 31 December 2018, the Society's financial year end. Pillar 3 disclosures are published annually.

1.3 Location and verification

These disclosures have been reviewed and approved by the Executive Committee and Audit and Risk Committee and the Board, and are published on the Society's website (www.teachersbs.co.uk).

All figures disclosed within this document have been subject to internal verification. These disclosures have not been externally audited and do not constitute any part of the Society's financial statements.

The Capital Requirements Directive (CRD) governs the amount and quality of capital to be held by financial institutions in order to protect their members, depositors and shareholders. In the UK the PRA is responsible for ensuring that the banks and building societies that it regulates have implemented the CRD.

2. Risk Management Framework

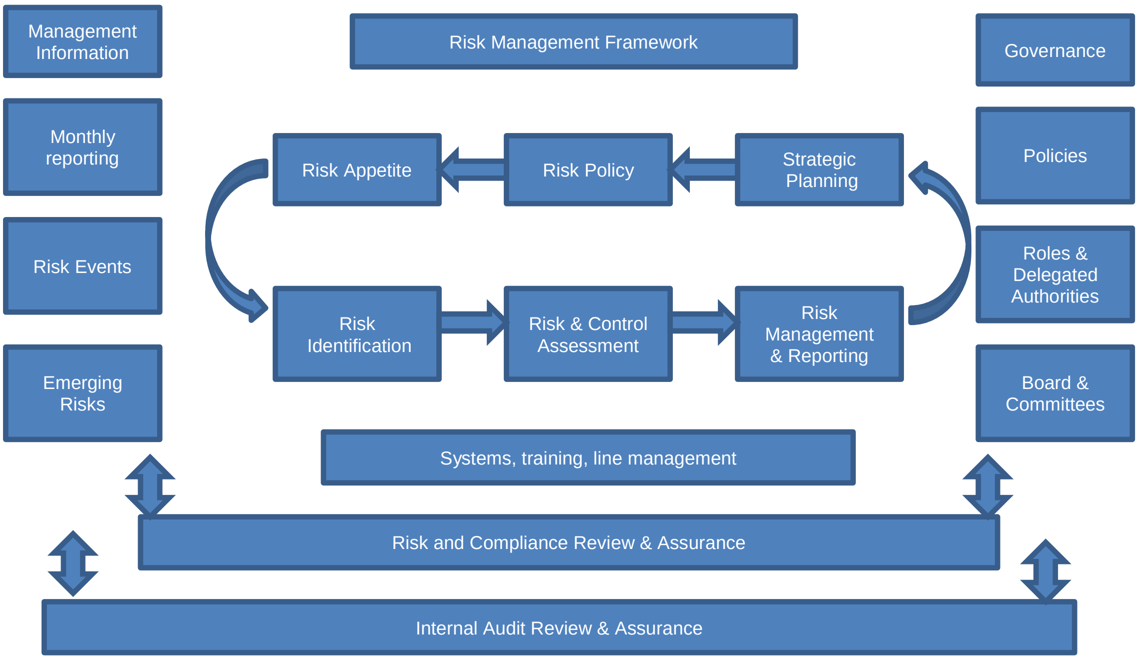
2.1 Managing risk

Teachers Building Society is primarily a producer and retailer of financial products, mainly in the form of residential mortgages and customer deposits or savings. These products give rise to a financial asset or liability and are termed financial instruments. As well as mortgages and savings, the Society also uses the financial markets to invest its reserves and surplus funds, to raise wholesale funding, and to manage the interest rate risks arising from its operations. The management of risk arising out of these activities is central to the culture and continuing success of the Society.

To ensure that the Society's risks are effectively managed and controlled, the Board has established a Risk Management Framework (RMF). Key features of the Society's RMF include the following:

- The Board defines, articulates and documents its risk appetite and mandates management to operate within that risk appetite. The Board risk appetite is supported by a suite of metrics, limits and triggers designed to cover the principal risks.
- The Society regularly carries out robust assessments of the principal risks facing it, including those that would threaten its business model, future performance, solvency or liquidity.
- The Society manages those risks, within the Board's risk appetite, by means of policies, procedures, plans and systems. The key policies relate to various operational risks, retail and wholesale lending, treasury, funding and financial risk management. Financial risks are also managed by the use of forecasting and stress testing models to help guide business strategies.
- Key risk information and indicators are produced to manage and monitor performance.
- Management and Board committees monitor and control specific risks using the information provided.
- The "three lines of defence" model is utilised to provide assurance that risks are being effectively managed.
- The above components form part of an iterative process whereby monitoring and assessment inform planning, policy and risk appetite development which, in turn, determines subsequent monitoring and assessment.

The following diagram summarises the Society's RMF:



2.2 Risk governance

The Board is responsible for determining the Society's risk management framework and for ensuring the Society operates a robust system of internal control to support its strategy and objectives. The Board sets high-level risk appetites to define the level and type of risk the Society is willing to accept and key risk metrics. It monitors the risk profile of the Society by receiving reports, either directly or indirectly, from the following committees engaged in the management or monitoring of risk.

2.3 Risk committees structure

The **Audit & Risk Committee** is a sub-committee of the Board, and comprises only Non-Executive Directors. It reviews the Society's system of internal controls, monitors the Society's risk appetite measures and receives regular reports from the Society's Risk Manager, Compliance Function and Internal Auditors. It reports its findings and makes recommendations to the Board. The committee met 8 times during 2018.

The **Assets and Liabilities Committee** comprises the executive management team. It determines treasury and statement of financial position risk management strategies, capital and funding requirements, and proposes changes to the content of the Society's Financial Risk Policy. The principal objective of the Committee is to identify, control and manage the operational, structural, funding and settlement risks inherent in the Society's statement of financial position with particular regard to the impact on the Society's capital position. The Committee is responsible for reviewing the Society's treasury activity and the current and proposed strategy and limits for liquidity, wholesale funding and hedging activities. It is also responsible for product pricing models and for setting the Society's interest rates. In addition the Committee is responsible for ensuring that the Society complies with its financial risk management, treasury and funding policies and associated risk limits. It provides reports and makes recommendations to the Audit & Risk Committee. The committee met monthly during 2018.

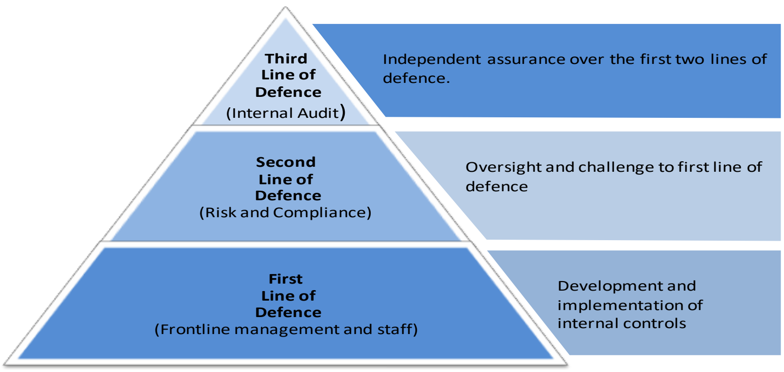
The **Conduct & Operational Risk Committee** comprises the executive management team and is responsible for overseeing the management of the principal operational and conduct risks of the Society. It receives and considers detailed management information and other reports on matters affecting operational risk and customer outcomes and reports its conclusions to the Board and Audit & Risk Committee. It provides reports to the Audit & Risk Committee and the Board. The committee met monthly during 2018.

The **Credit Committee** is a committee comprising the executive management team and is responsible for overseeing credit risk management. Its responsibilities include ensuring compliance with, and proposing amendments to, the Society's Lending Policy and Arrears Management Policy. It also monitors external risks to the Society's lending and considers mortgage applications which fall outside the limits of the normal mortgage underwriting function. It provides reports to the Audit & Risk Committee. The committee met monthly during 2018.

The **Product Governance Committee** comprises the executive management team and is responsible for approval of new products and changes to existing products. In so doing, it considers conduct and other risks that might be relevant to the product in question and ensures that such risks are appropriately managed and controlled. The committee met 59 times during 2018.

2.4 Three Lines of Defence

In order to maintain a strong risk culture, the Society has adopted and continues to develop a 'Three Lines of Defence' approach to its operational implementation of the RMF:



The Three Lines of Defence approach simplifies and clarifies the varying roles and responsibilities of staff on the following basis:

❶ First line of defence	❷ Second line of defence	❸ Third line of defence
Operational Management	**Risk and Compliance**	**Internal Audit**
Operational Management is in the best position to assess risk exposures and is fully responsible for the risks its operations create. Ongoing oversight is provided through management review and oversight. Management run the business and own the risks that arise through these operations.	The second line of defence, which is independent of operations, is responsible for the quantification, analysis and reporting of all risks. These functions create and uphold principles, policies and frameworks for risk management and facilitate risk assessment. The second line's role is the "four-eyes" oversight of the first line of defence to confirm adherence to Policies and the Board's risk appetite.	The Internal Audit function is performed by an independent firm of accountants (not the Society's Auditors) on behalf of the Society who report directly to the Chief Executive and are accountable to the Chairman of the Audit and Risk Committee ("ARC"). The role of Internal Audit is to provide independent assurance to the Board and Senior Management that the organisation's risk management, governance and systems of internal control are operating effectively. The ARC provides oversight of the third line of defence.

2.5 Other governance disclosures

The recruitment policy for the Board is set by the Nomination Committee. Board composition is reviewed at least annually and new Board appointments are made both to reflect the Society's close association with the teaching profession and to ensure that the Society's affairs are directed and overseen with the necessary range of professional skills and business experience. Actual knowledge, skills and expertise of Board members include financial services experience, teaching profession experience, finance and treasury expertise, regulatory and legal knowledge, and marketing expertise.

The Board has a policy of encouraging diversity and has the objective that each gender should represent at least a third of any short-list for any appointment as Non-executive Director.

Members of the Board held, during 2018, fourteen other directorships in aggregate.

3. Risk management policies and objectives

3.1 Strategies and processes to manage risks

The Society seeks to manage all risks that arise from its business operations with the goal of protecting members' and depositors' funds, safeguarding the assets of the Society while delivering long-term sustainable growth for its members. The principal risks and the policies and other mitigation put in place to manage them are summarised in the following table:

Risk	Description (and sub categories)	Key mitigating actions
Credit	The risk that mortgage customers or treasury counterparties are unable to meet their obligations, as they become due. Concentration risk is an aspect of credit risk (as well as of funding risk – see below) and arises from exposure to groups of connected counterparties, or from counterparties in the same economic sector, geographic region or from the same activity or commodity. The Society, as a specialist mortgage lender in the education sector, is exposed to concentration risk in relation to UK property lending and to lending to education professionals.	• Lending Policy: sets limits on categories of lending, the amount and quality of collateral required, and defines clear underwriting criteria. • Bespoke individual underwriting on a case-by-case basis. • Mortgage Indemnity Guarantee (MIG) insurance where the LTV (loan to property value ratio) exceeds 80%. • Financial Risk Policy sets treasury limits on credit exposures to countries, groups and individual counterparties. • Lending Policy and Financial Risk Policy sets limits to mitigate concentration risk.
Financial	**Market and interest rate risk** The risk that the net value of, or net income arising from, the Society's assets and liabilities is impacted as a result of market price or rate changes. The market risk to which the Society is exposed is interest rate risk (re-pricing risk). The use of swaps to hedge interest rate risk may create basis risk which, for the Society, is the risk that changes in interest rates will re-price interest earning assets differently from interest earning liabilities, thus creating an asset/ liability mismatch and a potential monetary loss.	• Close oversight by the Assets and Liabilities Committee. • Financial Risk Policy (sets requirements for use of financial instruments, mainly interest rate swaps, to hedge interest rate risk). • Basis risk exposure managed within risk limits set in Financial Risk Policy. • Stress testing.
	Capital or Solvency risk The risk that the Society maintains insufficient capital resources to protect its depositors, support business growth, meet regulatory requirements and ensure that its liabilities can be met as they fall due.	• Capital planning as part of the Society's Internal Capital Adequacy Assessment Process ('ICAAP') and corporate plan. • Stress testing and monitoring of key ratios by the Assets and Liabilities Committee.
	Liquidity and Funding risk Liquidity risk is the risk that the Society is unable to settle obligations with immediacy and maintain public and stakeholder confidence. Funding risk is the risk that the Society is unable to realise assets or otherwise raise funds on economic terms, and/or within reasonable timescales. Concentration risk is an aspect of funding risk (as well as of credit risk – see above). Teachers Building Society, in common with all traditional building societies, have an inherent funding concentration risk arising from reliance on the UK retail savings market.	• Financial Risk Policy sets risk limits. • Maintaining appropriate levels of High Quality Liquid Assets. • The Society's Individual Liquidity Adequacy Assessment Process ('ILAAP') and Contingency Funding Plan. • Stress testing. • Assets and Liability Committee oversight.

Risk	Description (and sub categories)	Key mitigating actions
Operational	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, but excluding strategic risk.	• Investment in people, systems and processes. • Effective policies and procedures. • Training and competency scheme for key staff detailing proficiency and supervision requirements in line with the senior management function certification regime. • Insurance. • Conduct and Operational Risk Committee oversight. • Cyber risk management framework.
Strategic	The risk that the Society's business model and corporate plan fail to adapt, or respond quickly enough; to external developments or that the adaptation or response is flawed.	• Annual Corporate Planning process including sensitivity testing. • Ongoing Board monitoring of Key Performance and Risk Indicators.
Reputational	The risk that arises from a negative perception by members, regulators, counterparties, potential customers or other stakeholders which damages the Society's brand and reputation and adversely affects its business, earnings, capital or access to funding.	• Board expectation that the Society's business be conducted in a fair and ethical way consistent with the Society's values and beliefs embedded in Society policies. • Robust culture of compliance with legal and regulatory requirements.
Conduct	The risk arising from the Society's conduct in its direct relationship with retail customers, or where the Society has a direct duty to retail customers.	• Oversight and monitoring by Conduct and Operational Risk Committee. • Culture of putting members first.

3.2 Risk management function

The risk management function forms part of the second line of defence and is led by the Legal Director, supported by a Risk Manager. Both attend all executive committee meetings as well as meetings of the Audit & Risk Committee. The Legal Director is also a Board member.

3.3 Risk measurement and reporting

The objective of risk measurement and reporting is to escalate relevant risk information that enables the Board, risk committees and management to monitor and manage the Society's risks. Risk measurement is focused on a suite of risk metrics set against the Board's risk appetite. Metrics relevant to a particular committee are reported to that committee each month. In the case of the Board and the Audit & Risk Committee, all metrics are reported to both at each of their respective meetings.

In addition, significant current and emerging risks are reported to the relevant committee or the Board (as may be appropriate) as and when they arise.

3.4 Adequacy of risk management arrangements

In the Board's opinion, the risk management arrangements in place with regard to the Society's profile and strategy are adequate.

4. Capital adequacy

4.1 Internal Capital Adequacy Assessment Process (ICAAP)

The Society maintains sufficient capital to support its ongoing activities, and this requirement is an integral part of the Society's corporate planning process. The Society's corporate plan covers a rolling four year future period, and takes into account the need to have and maintain adequate capital and non-financial resources to support both existing activities and new ventures that the Society may be contemplating. Closely linked to the corporate plan is the Internal Capital Adequacy Assessment Process (ICAAP), which is a formal process which considers the Society's capital requirement in normal and stressed conditions.

The ICAAP includes a review of the Society's business activities and an assessment of the amount of capital required to support them. The credit risk related capital requirement for various types of mortgage lending and treasury related investments has a major influence on the Society's appetite for such exposures, with limits being established and monitored on a regular basis for each type of credit exposure. The Society undertakes regular stress testing of each major credit risk component with the results of this testing influencing business decisions on an ongoing basis. The Society's mortgage pricing process takes into account the amount of capital required to support different types of mortgage lending.

The ICAAP considers the effects on capital of a severe economic stress and identifies any mitigating actions available to the Society to support its capital position. For Teachers Building Society, the economic stress is considered most likely to affect the level of mortgage losses and the recoverability of liquid asset exposures.

The results of the ICAAP are reviewed by, and discussed with, the regulatory authorities during the Supervisory Review and Evaluation Process (SREP). During the SREP the Society and the regulators agree on the amount and quality of capital to be held by the Society, and this is documented by means of Individual Capital Guidance (ICG) issued to the Society by the regulators.

4.2 Capital resources and ratios

The table below shows the composition of the Society's capital resources under Pillar 3 as at 31 December 2018.

Regulatory Capital As at 31 December	2018 £000s	2017 £000s
Total equity attributable to members	21,219	20,298
Regulatory adjustments and deductions	(140)	(140)
Common Equity Tier 1 (CET1) capital	21,079	20,158
Tier 1 capital	21,079	20,158
Tier 2 capital	225	399
Total regulatory capital	21,304	20,557
Risk weighted assets (RWAs)	95,098	93,571
Capital ratios:		
CET1 capital	22.2%	21.5%
Tier1 capital	22.2%	21.5%
Total regulatory capital	22.4%	22.0%

Note: Under CRD IV the revaluation reserve can be counted as CET1 capital, and is included in Tier 1 capital in the table above.

Minimum capital requirement (Pillar 1)

The table, below, shows the Society's overall minimum capital requirement for Credit Risk under the standardised approach (expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised Credit Risk exposure classes) at 31 December 2018.

Capital Requirements As at 31 December	**2018** **£000s**	**2017** **£000s**
Standardised exposures:		
Mortgages (secured against residential property and land)	83,794	82,577
Central government and central banks	-	-
Financial institutions	1,323	1,074
Counter-party credit risk (derivatives)	358	186
Non-credit obligations (fixed assets)	1,091	1,079
Other	327	324
Operational risk	8,205	8,332
Total risk weighted assets	**95,098**	**93,571**
Minimum Pillar 1 capital requirement @ 8%	7,608	7,486
Regulatory capital in excess of Pillar 1 requirement	**13,696**	**13,974**

4.3 Leverage ratio

The CRD IV requires firms to calculate a non-risk based Leverage Ratio which supplements the risk based capital requirements. The ratio compares the tier 1 capital resources of the firm against a measure of total assets of the Society. The table below shows the Society's Leverage Ratio based on the rules published by the PRA, against a regulatory minimum of 3%.

Leverage ratio As at 31 December	**2018** **£000s**	**2017** **£000s**
Tier 1 capital	21,079	20,158
Leverage ratio	**7.1%**	**7.3%**
Total on-balance sheet assets	294,701	275,140
Deduct derivatives reported on balance sheet	(204)	(121)
Less: asset amounts deducted in determining tier 1 capital:		
Intangible fixed assets	(140)	(140)
Deferred taxation	-	-
Total on-balance sheet exposures	**294,357**	**274,879**
Off-balance sheet exposures and derivatives	716	371
Total leverage ratio exposures	**295,073**	**275,250**

4.4 Encumbered assets

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn.

The Society's policy is to permit the encumbrance of assets where this is required to obtain central bank funding facilities. As a precondition of the Bank of England's Funding for Lending Scheme and Term Funding Scheme, the Society positioned a portfolio of residential mortgage loans in 2013, adding additional collateral in 2017 and 2018, as security with the Bank of England.

CRD IV requires firms to disclose the level of encumbered and unencumbered assets and these are disclosed in the table below.

Encumbrance	2018		2017	
As at 31 December	£000s	% Split	£000s	% Split
Carrying amount:				
Encumbered assets - mortgages secured on residential property	65,270	22%	51,144	19%
Unencumbered assets	229,431	78%	223,996	81%
Total	**294,701**	**100%**	**275,140**	**100%**

4.5 Liquidity

The Society's management of liquidity and funding risks aims to ensure that at all times there are sufficient liquid resources, both as to amount and quality, to cover cash flow mismatches and fluctuations in funding, to retain public confidence and to enable it to meet financial obligations as they fall due, even during episodes of stress. This is achieved through management and stress testing of business cash flows and the setting of appropriate risk limits, to maintain a prudent funding mix, maturity profile and a substantial buffer of high quality liquid assets.

Liquidity Coverage Ratio As at 31 December	2018	2017
	£000s	£000s
Liquidity buffer	55,541	43,580
Total net cash outflows	16,580	20,132
	%	%
Liquidity coverage ratio	335%	216%

5. Operational risk

The Society has adopted the Basic Indicator Approach ("BIA"). Under the BIA, the own funds requirement for operational risk is equal to 15% of the Society's gross income averaged over the previous three years. This generates an own funds requirement as at 31 December 2018 as follows:

	£000s
3-year average gross income	4,376
Own funds requirement at 15%	656

The Board considers the BIA approach appropriate for the Society given the simple and straightforward nature of the operations and the fact that there are no international operations. It has further considered whether the BIA provision is sufficient given the status of the Society's risk management framework. Given the low risk nature of the Society and its risk appetite, it is felt unlikely that any operational issues would exceed the Pillar 1 requirement.

The Society makes use of insurance to mitigate the effect of accepted risks such as material damage, business interruption, professional indemnity, cyber threats, third party liability etc. The insurance policies are reviewed annually by the Executive in order to agree the scope and level of cover.

The Society has in place an extensive Business Continuity Plan, which is reviewed and tested annually. The Board is satisfied that the plan, when enacted, will allow the Society to continue to function after suffering a number of severe events.

6. Credit and operational risk exposures

The Society applies the 'standardised approach' to Credit Risk as specified by the CRD, which entails the application of standardised credit risk weightings to each asset class to produce risk weighted assets for which the capital requirement is then calculated. Additionally, the Society uses the 'basic indicator approach' to calculate the capital required to cover the operational risk associated with the Society's business activities. The resulting capital requirements as at 31 December 2018 are detailed in the table below:

Category	Description	Asset Value £k	Weighted Exposure Value £k	Capital Required £K
Exposure to Central Governments	UK government Treasury bills, gilts, and central bank deposits	55,541	-	-
Exposure to Multilateral Development Banks	Bonds issued by Supranational Banks	-	-	-
Exposure to Institutions	Liquid asset exposures to Credit Institutions	6,615	1,323	106
Secured by Mortgages on Residential Property	Residential Mortgages - performing loans with loan-to-value of less than 80%	224,731	78,656	6,292
	Residential performing mortgages with loan-to-value of more than 80%	4,514	3,386	271
Secured by Mortgages on Commercial Real Estate	Non-residential mortgage exposures	1,752	1,752	140
Past Due Items	Non-performing mortgages	-	-	-
Other Items	Fixed and other assets (including off-statement of financial position exposures and fair value adjustments)	2,134	1,776	142
Total Credit Risk Requirement		**295,287**	**86,893**	**6,951**
Operational Risk Requirement			**8,205**	**656**
Total Pillar 1 Capital Requirement			**95,098**	**7,608**

Accounting Value of Total Assets	294,701
Collective loan loss provisions	225
Unamortised loan origination fees	(201)
Off-statement of financial position exposures	716
Accrued interest	(15)
Intangible fixed assets	(139)
Tax asset	-
Total Assets per Credit Risk Requirement	**295,287**

7. Counter-party credit exposure

7.1 Treasury assets

The Society is exposed to Treasury credit risk in respect of loans and advances to credit institutions, debt securities and financial derivatives. The credit risk exposure to Treasury Instruments equates to their carrying amount recognised in the statement of financial position.

The following table shows the Society's maximum credit risk.

	2018 £000	2017 £000
UK government securities and amounts held with central banks	55,555	36,592
UK financial securities	6,617	5,369
	62,172	41,961

The following table shows exposure broken down by Fitch ratings.

	2018 £000	2017 £000
AAA to AA-	55,555	36,592
A+ to A-	2,012	2,000
BBB+ to BBB-	4,605	3,369
	62,172	41,961

The geographical distribution of these exposures is as follows:

	2018 £000	2017 £000
UK	62,172	41,961
	62,172	41,961

7.2 Derivative instruments

Derivatives are only used by the Society in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity, or for speculative purposes, and are only used to reduce the risk of loss on fluctuations in interest rates. Interest rate swaps are used to hedge the Society's exposures arising from fixed rate mortgage lending and savings products. The Society's primary goal is to manage risk within its risk tolerance, irrespective of the accounting treatment.

Counterparty credit risk arises where a counterparty to a derivative instrument to which the Society has an exposure could default. The Society uses standardised ISDA agreements to enter into bilateral interest rate swap contracts with other financial institutions in order to hedge interest rate risk. The ISDA contracts grant legal rights of set off for derivative transactions with the same counterparty. This can reduce the potential credit risk where the derivative contracts may be for offsetting values.

	2018 £000	2017 £000
Positive fair value of interest rate contracts	204	121

7.3 Analysis of mortgage assets

The following analysis provides information on the distribution of the Society's mortgage book by Loan to Value (LTV), payment due status and geographic distribution.

	2018		2017	
	Residential	Non-Residential	Residential	Non-Residential
Less than 70%	57.6%	100.0%	62.2%	100.0%
More than 70% but less than 80%	17.8%	-	16.4%	-
More than 80% but less than 90%	17.2%	-	15.8%	-
More than 90% but less than 100%	7.4%	-	5.6%	-
More than 100%	0.0%	-	0.0%	-
	100.0%	100.0%	100.0%	100.0%

The table below provides a break-down of secured lending by payment due status:

	2018		2017	
	Residential	Non-Residential	Residential	Non-Residential
Current	99.5%	100.0%	99.6%	100.0%
Past due up to 3 months	0.4%	-	0.3%	-
Past due 3 months up to 6 months	0.1%	-	0.1%	-
Past due 6 months up to 12 months	0.0%	-	-	-
Past due over 12 months	0.0%	-	-	-
Possessions	-	-	-	-
	100.0%	100.0%	100.0%	100.0%

The Society provides secured loans to retail and commercial customers across England and Wales. The Society has a geographical concentration in the South West region around its office in Dorset.

	2018		2017	
	£000		£000	
Region				
South West	51,784	22%	54,828	24%
Greater London	31,599	14%	30,517	13%
Outer Metropolitan	28,915	12%	25,866	11%
South East/East of England	31,323	14%	34,051	15%
Midlands	32,251	14%	30,312	13%
North West/North of England	46,273	20%	46,754	20%
Wales and Scotland	8,852	4%	9,831	4%
	230,997	100%	232,159	100%

Collateral values are updated at the date of each statement of financial position by reference to the Nationwide house price index (HPI). Based on these indexed valuations, the total collateral held against lending secured against land and residential property is estimated to be £563m (2017 : £597m). Any collateral surplus on the sale of repossessed properties, after the deduction for cost incurred in relation to the sale would be returned to the borrower.

8. Impairment provision for losses on loans and advances

The Society reviews its loan portfolios to assess whether an impairment loss should be recorded in the income statement where objective evidence exists that a loss has been incurred. The loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The amount charged in the income statement represents the net change in the ongoing provision, after allowing for losses written off in the year and bad debt recoveries. Provisions for bad and doubtful debts are deducted from loans and advances to customers in the Statement of Financial Position. Suspended interest is credited to an interest suspense account, the balance of which is deducted from loans and advances to customers in the statement of financial position.

The Society uses forbearance techniques to help some borrowers through periods where their finances have become stretched and where servicing of the normal mortgage repayment has become difficult. The Society uses forbearance concessions where they are deemed appropriate for an individual borrower's circumstances and may include interest-only facilities, arrears arrangements, term extensions and capitalisation. The Society ensures that the level of provisioning set reflects the higher probability of default in forbearance cases. Individual provisions are considered for all mortgage accounts in arrears by three months, or more, and for accounts where the property is in possession and there is objective evidence that all cash flows will not be received.

Provisions are made to the extent that the proceeds of sale of the property would be insufficient to meet the outstanding debt and related costs of sale.

Accounts in default are individually assessed and the amount of loss is determined using historical default and loss experience and applying judgement requiring the estimation of forced sale discounts, likelihood of repossession, and the impact of macro-economic factors such as house price volatility, interest rate expectations and unemployment rates. Losses on accounts where the property has been repossessed are provided for after consideration of the likely sale price and the costs of sale.

A collective provision is made against loans and advances which have not been specifically identified as impaired, but where the Society's experience would indicate that losses may ultimately be realised. The impairment value is calculated by applying various factors to each loan. These factors take into account the ratio of the loan to the value of the security, the probability of eventual repossession, the value of the property in the event of a forced sale and the costs of sale together with the general economic climate, which may ultimately result in a loss being realised. The probability of eventual repossession is a judgement made by management based on the proportion of the mortgage book to historically experience either arrears or forbearance.

The following table summarises the movement in provisions during the year:

Movement in impairment provisions

	2018	2017
At 1 January	**£000**	**£000**
Collective provision	399	359
Individual provision	0	5
	399	**364**
Income and expenditure charge/(credit) for the year		
Collective provision	(174)	40
Individual provision	4	(5)
	(170)	**35**
At 31 December		
Collective provision	225	399
Individual provision	4	0
	229	**399**

9. Other financial risks

9.1 Financial risks

The Society manages financial risk by means of Board approved policies which include risk limits, reporting lines, mandates and control procedures. The policies and other risk control procedures are reviewed by the Society's Executive Assets and Liabilities Committee, the Executive Committee, the Audit and Risk Committee and the Board.

9.2 Funding and liquidity risk

Liquidity risk is the risk of being unable to meet demands and commitments to provide funds to customers and other third parties and maintain public and member confidence. Funding risk is the risk that the Society is unable to realise assets or otherwise raise funds on economic terms and/or within reasonable timescales. The primary regulatory measure of liquidity adequacy is the Liquidity Coverage Ratio (LCR) which measures the amount of high-quality liquid assets relative to estimated net stressed cash outflows within a 30 calendar day period. The Society maintains an LCR significantly in excess of the minimum regulatory requirement. At 31 December 2018, the ratio was 335%.

The Society's Financial Risk Policy established controls that ensure sufficient funds are maintained in liquid form at all times so that the Society can meet its liabilities as they fall due. The Society has established policies and procedures and undertakes regular stress tests to ensure that it can withstand normal and abnormal cash outflows. The policy is reviewed by the Executive Assets and Liabilities Committee, with any amendments reviewed and approved by the Board of Directors as part of the Individual Liquidity Adequacy Assessment Process (ILAAP).

9.3 Market risk

The principal Market risk the Society is exposed to is interest rate risk which primarily arises from market changes in interest rates which affect the interest rate margin generated from lending and borrowing activities. One aspect of interest rate risk to which the Society is also exposed is basis risk. This arises where assets and liabilities re-price with reference to differing interest rate bases, principally Bank of England base rate and three month LIBOR.

To reduce the impact of an adverse change in interest rates on the Society's net interest income the net exposure (i.e. after offsetting assets and liabilities internally) is hedged using interest rate swaps within parameters set by the ALCO in accordance with the Society's risk appetite. Basis risk is mitigated by managing the exposure within risk limits set by the ALCO.

The table below illustrates the sensitivity of the Society's Net Interest Income (NII) to a change in interest rates, based on a static statement of financial position, over a one year time period:

Sensitivity of net interest income

As at 31 December

	2018	2017
Illustrative impact on NII of a change in interest rates:	**£000**	**£000**
+ 200 basis point rate change	634	588
+ 100 basis point rate change	317	294
- 25 basis point rate change	(79)	(74)
- 50 basis point rate change	(159)	(147)

The sensitivity to interest rates will change over time depending on the structure of the statement of financial position, prevailing market conditions, product mix and the maturity distribution of assets and liabilities and cannot, therefore, be used to predict future performance.

10. Remuneration policies and practice

Approach to remuneration decision-making

Remuneration policy is determined by the Remuneration Committee on behalf of the Board. The committee is comprised of four Non-Executive Directors and met five times during 2018.

The Society seeks to ensure that its remuneration decisions are in line with its business strategy and long term objectives, and consistent with its current financial condition and future prospects. It also seeks to establish an appropriate balance between the fixed and variable elements of remuneration, although this balance will vary depending on the seniority and nature of an individual's employment.

Performance measures used to calculate variable remuneration are therefore adjusted to take into account, current or potential risks to the business and are consistent with the need to retain a strong capital base. Variable remuneration is not paid unless it is sustainable within the Society's situation as a whole.

Setting executive remuneration

Remuneration of executive directors, other senior executive management and others having a material impact on risk is reviewed annually by the Remuneration Committee. Remuneration is assessed by reference to roles carrying similar responsibilities in comparable organisations, and other criteria such as expertise, experience and contribution to the Society's performance. All comparative data is used with caution by the Committee in order to ensure that the level of remuneration is appropriate. In addition to salary, benefits may comprise a contributory pension scheme, death-in-service benefits and, for new appointees, relocation allowance.

Members of the executive team, including Executive Directors, are eligible to participate in a short and medium-term performance bonus. This bonus is earned as agreed core objectives are achieved and is capped at 24% of an individual's salary. Objectives comprise a broad range of financial and non-financial measures including objectives measured over a three-year period. No bonus is payable unless the Remuneration Committee is satisfied that the Society has been managed within risk appetite, that regulatory and customer outcomes expectations have been met and that the size of bonus is commensurate with the level of profitability achieved. The Remuneration Committee also has the facility to provide discretionary payments in exceptional circumstances.

Guaranteed incentive payments do not form part of any remuneration package and all incentive schemes are non-contractual. Whilst the Remuneration Committee has the absolute discretion under the scheme rules to withhold any payment under it where it feels it is appropriate in all the circumstances to do so, the rules do not include the ability to recover sums already paid. Under the Remuneration Code issued by the Prudential Regulation Authority and the Financial Conduct Authority and the related guidance on proportionality, the Society's regulators have stated that it will normally be appropriate for firms of the size of the Society not to follow such guidance. The Board has adopted this position.

Setting non-executive remuneration

The remuneration of Non-executive Directors (other than the Chair of the Board) is reviewed each year by the Executive Directors and the Chair of the Board, and a recommendation is made to the Board. The Chair's remuneration is reviewed each year by the Remuneration Committee without the Chair being present. The Committee compares the level of fees to those paid in similar financial services organisations, and considers the responsibilities of each Director and the amount available to be paid, as determined by the Society's rules. There are no bonus schemes or other benefits for Non-executive Directors, and they are not entitled to any pension from the Society. Non-executive Directors do not have service contracts.

A similar approach is followed for setting the Chair of the Board's remuneration, although this is determined by the Remuneration Committee, but without the Chair of the Board's participation.

Remuneration for material risk takers

Aggregate remuneration for staff whose professional activities had a material impact on the Society's risk profile during the year ended 31 December 2018 was as follows:

	Number	Fixed £000s	Variable £000s	Total £000s
Senior management	12	636	71	707
Other staff having a material impact on risk	1	55	3	58

A detailed breakdown of the remuneration of executive and non-executive directors (10 individuals) can be found in the Remuneration Report included in the Annual report and Accounts for the year ended 31 December 2018. No individuals were remunerated £1 million or more.

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