

# 2020

**Teachers Building Society  
Pillar 3 Disclosure**

For the year ended 31 December 2020

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## 1. Executive Summary

Key Metrics	December 2020	December 2019
<b>Available Capital</b>	<b>£000</b>	<b>£000</b>
Total Common Equity Tier 1	21,874	21,357
Total Tier 2 capital	177	229
<b>Total capital</b>	<b>22,051</b>	<b>21,586</b>
Total risk weighted assets (RWA)	108,930	98,808
<b>Capital ratios</b>	<b>%</b>	<b>%</b>
Common Equity Tier 1 ratio	20.1	21.6
Total capital ratio	20.2	21.8
Total capital and buffer requirement	10.5	11.5
<b>Leverage ratio</b>		
Leverage ratio exposure measure	355,996	309,804
Leverage ratio	6.1%	6.9%
<b>Liquidity</b>		
Liquidity Coverage ratio	374%	238%

## 2. Overview

### 2.1 Background

This document sets out the Pillar 3 Disclosures for Teachers Building Society ('the Society') for the year ended 31 December 2020. The purpose of these disclosures is to provide information on the Society's capital adequacy and on the management of risks faced by the Society.

The 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.

The CRD sets out three main areas, known as "Pillars", each deal with a different aspect of the rules. An explanation of the three pillars is set out below:

Pillar 1 - sets out the minimum levels of capital that have to be maintained. The calculation of Pillar 1 is based on the size of an institution and its risk characteristics. Larger firms calculate their Pillar 1 requirements using an internal ratings based (IRB) model which allows an internal assessment of risk weightings to be applied to assets. As a small firm the Society operates under the Standardised approach which uses prescribed risk weightings as set out in the CRD for credit risk. The Society uses the Basic Indicator Approach (BIA) for the calculation of its operational risk capital requirement.

Pillar 2 - is focused on an internal assessment of risks that are not fully covered by Pillar 1 or are not within the scope of Pillar 1. The review of Pillar 2 is documented in the Society's Internal Capital Adequacy Assessment Process (ICAAP) which is approved annually by the Board. Pillar 2 also includes the Capital Conservation Buffer, which is prescribed in the CRD, and the Countercyclical Capital Buffer (CCyB) which is set in the UK by the Financial Policy Committee (FPC). These buffers are required to ensure the Society will meet its capital adequacy requirements even under periods of economic stress.

Pillar 3 - covers the disclosure requirements of the CRD and is satisfied by the publication of this document. This document provides details of the principal business risks faced by the Society, the Society's approach to management of these risks and gives a breakdown of the capital amounts calculated under the Pillar 1 provisions.

This document is also required to provide details concerning the remuneration of certain staff that have been assessed as being subject to the requirements of the Remuneration Code.

## **2.2 Basis and frequency of disclosure**

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 2020, the Society’s financial year end. Pillar 3 disclosures are published annually.

## **2.3 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](http://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.

### 3. Risk Management Framework

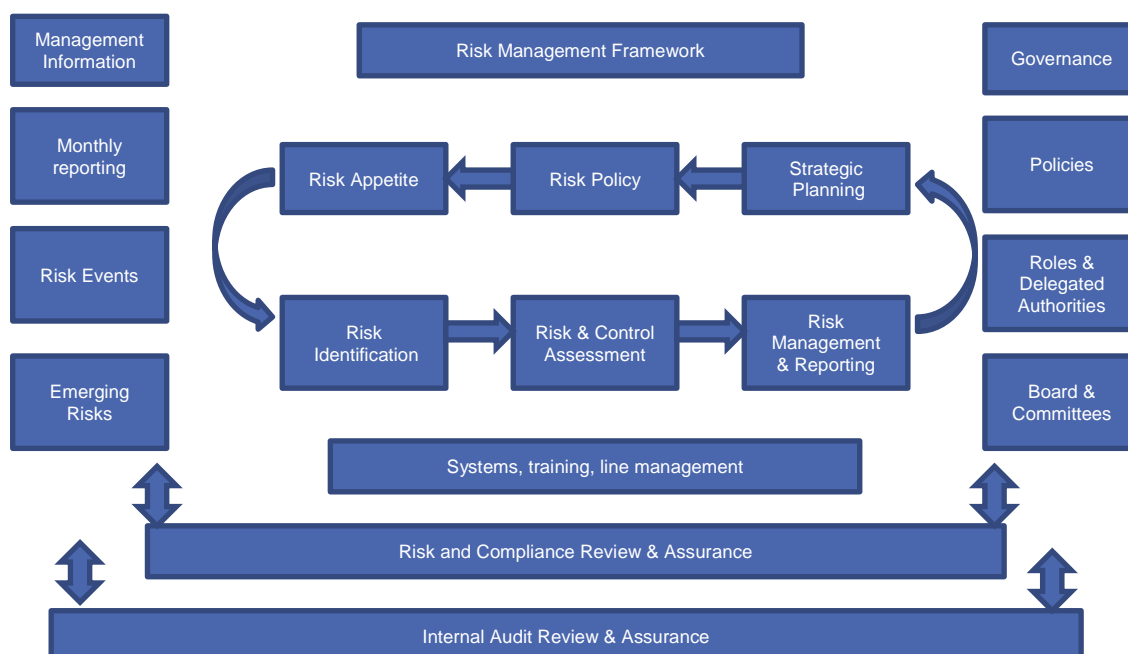
#### 3.1 Managing risk

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:



### 3.2 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.

### 3.3 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 **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.

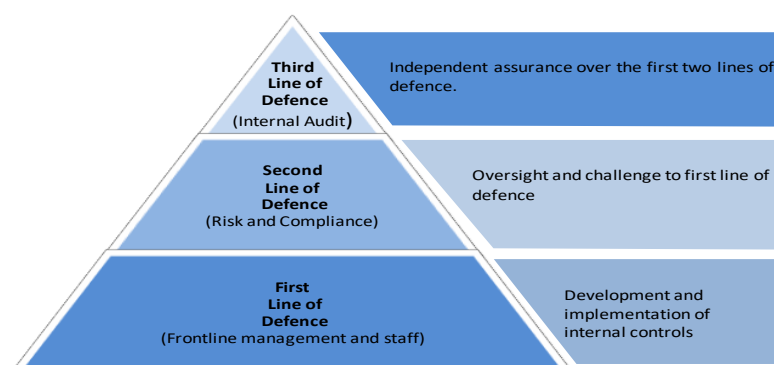
The **Conduct & Operational Risk Committee** comprises the executive management team and is responsible for overseeing the management of the principal operational and conduct risks of the Society. It receives and considers detailed management information and other reports on matters affecting operational 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 **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 **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.

### 3.4 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:

① First line of defence	② Second line of defence	③ Third line of defence
Operational Management	Risk and Compliance	Internal Audit
<p>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.</p>	<p>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.</p>	<p>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.</p>

### 3.5 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 2020, seventeen other directorships in aggregate.

## 4. Risk management policies and objectives

### 4.1 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 table below. Whilst the post Brexit trading arrangements with the European Union will have limited direct impact on the Society, it is likely to add to the economic difficulties caused by the Covid-19 pandemic. This could therefore exacerbate the effect on the economy and the housing market as well as the Society's members' ability to pay their mortgages. The impact of this has been considered in the Society's stress testing framework.

Risk	Description (and sub categories)	Key mitigating actions
<b>Credit</b>	<p>The risk that mortgage customers or treasury counterparties are unable to meet their obligations as they become due.</p> <p>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.</p>	<ul style="list-style-type: none"> <li>• Lending Policy: sets limits on categories of lending, the amount and quality of collateral required, and defines clear underwriting criteria.</li> <li>• Bespoke individual underwriting on a case-by-case basis.</li> <li>• Mortgage Indemnity Guarantee (MIG) insurance where the LTV (loan to property value ratio) exceeds 80%.</li> <li>• Financial Risk Policy sets treasury limits on credit exposures to countries, groups and individual counterparties.</li> <li>• Lending Policy and Financial Risk Policy sets limits to mitigate concentration risk.</li> <li>• Oversight by Executive Credit Committee and Board Audit and Risk Committee.</li> </ul>
<b>Financial</b>	<p><b>Market and Interest Rate risk</b></p> <p>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.</p>	<ul style="list-style-type: none"> <li>• Close oversight by the Executive Assets and Liabilities Committee and Board Audit and Risk Committee.</li> <li>• Financial Risk Policy (sets requirements for use of financial instruments, mainly interest rate swaps, to hedge interest rate risk).</li> <li>• Basis risk exposure managed within risk limits set in Financial Risk Policy.</li> <li>• Stress testing.</li> </ul>
	<p><b>Capital or Solvency risk</b></p> <p>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.</p>	<ul style="list-style-type: none"> <li>• Capital planning as part of the Society's Internal Capital Adequacy Assessment Process ('ICAAP') and corporate plan.</li> <li>• Stress testing and monitoring of key ratios by the Executive Assets and Liabilities Committee and Board Audit and Risk Committee.</li> </ul>
	<p><b>Liquidity and Funding risk</b></p> <p>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.</p> <p>Concentration risk is an aspect of funding risk (as well as of credit risk - see above). Traditional building societies, such as Teachers Building Society, have an inherent funding concentration risk arising from reliance on the UK retail savings market.</p>	<ul style="list-style-type: none"> <li>• Financial Risk Policy sets risk limits.</li> <li>• Maintaining appropriate levels of High Quality Liquid Assets.</li> <li>• The Society's Individual Liquidity Adequacy Assessment Process ('ILAAP') and Contingency Funding Plan.</li> <li>• Stress testing.</li> <li>• Oversight by Executive Asset and Liability Committee and Board Audit and Risk Committee.</li> </ul>



Risk	Description (and sub categories)	Key mitigating actions
<b>Operational</b>	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including cyber security risk and a risk of a failure by third party suppliers but excluding strategic risk. Currently, this includes risks to operational delivery posed by the Covid-19 pandemic.	<ul style="list-style-type: none"> <li>• Investment in people, systems and processes.</li> <li>• Effective policies and procedures including those designed to support operational resilience and Covid Secure and Homeworking policies.</li> <li>• Training and competence scheme for key colleagues detailing proficiency and supervision requirements.</li> <li>• Insurance.</li> <li>• Executive Conduct and Operational Risk Committee and Board Audit and Risk Committee oversight.</li> <li>• Cyber risk management framework.</li> <li>• Contingency plans are in place which have been tested</li> </ul>
<b>Strategic</b>	The risk that the Society's business model and corporate plan fail to adapt, or respond quickly to, external developments or that the adaptation or response is flawed.	<ul style="list-style-type: none"> <li>• Annual Corporate Planning process including sensitivity testing.</li> <li>• Ongoing Executive Committee and Board monitoring of Key Performance and Risk Indicators.</li> </ul>
<b>Reputational</b>	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.	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Robust culture of compliance with legal and regulatory requirements.</li> <li>• Oversight by the Executive Conduct and Operational Risk Committee and the Board.</li> </ul>
<b>Conduct</b>	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.	<ul style="list-style-type: none"> <li>• Oversight and monitoring by Executive Conduct and Operational Risk Committee and the Board.</li> <li>• Training and awareness for key colleagues</li> <li>• Culture of putting members first.</li> </ul>
<b>Climate</b>	The Society is aware of the potential risk resulting from climate change and the impact it could have on the value of its assets.	<ul style="list-style-type: none"> <li>• The Society's assets are insured against flood risk where necessary.</li> <li>• Oversight by Executive Credit Committee and Board Audit and Risk Committee.</li> </ul>

## 4.2 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.

## 4.3 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.

## 4.4 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.

## 5. Capital adequacy

### 5.1 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 a Total Capital Requirement issued to the Society by the regulators.

### 5.2 Capital resources and ratios

The table below shows the composition of the Society's capital resources under Pillar 3 as at 31 December 2020.

Regulatory Capital As at 31 December	2020 £000s	2019 £000s
Total equity attributable to members	21,899	21,420
Regulatory adjustments and deductions	(25)	(63)
<b>Common Equity Tier 1 (CET1) capital</b>	<b>21,874</b>	<b>21,357</b>
Tier 1 capital	21,874	21,357
Tier 2 capital	177	229
<b>Total regulatory capital</b>	<b>22,051</b>	<b>21,586</b>
<b>Risk weighted assets (RWAs)</b>	<b>108,930</b>	<b>98,808</b>
<b>Capital ratios:</b>		
CET1 capital - regulatory minimum 4.5%	20.1%	21.6%
Tier1 capital - regulatory minimum 6.0%	20.1%	21.6%
Total regulatory capital - regulatory minimum 8.0%	20.2%	21.8%

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 2020.

<b>Capital Requirements</b>	<b>2020</b>	<b>2019</b>
As at 31 December	£000s	£000s
<b>Standardised exposures:</b>		
Mortgages (secured against residential property and land)	91,098	84,039
Central government and central banks	-	-
Financial institutions	1,822	1,424
Counter-party credit risk (derivatives)	458	308
Commitment	4,440	2,541
Other	1,825	1,783
Operational risk	9,287	8,713
<b>Total risk weighted assets</b>	<b>108,930</b>	<b>98,808</b>
Minimum Pillar 1 capital requirement @ 8%	8,714	7,905
<b>Regulatory capital in excess of Pillar 1 requirement</b>	<b>13,337</b>	<b>13,681</b>

### 5.3 Total Capital Requirement

The total regulatory capital requirement for the Society is 10.5%. This is made up as follows:

- Pillar 1 Capital Requirement – 8%
- Pillar 2 Capital Conservation Buffer – 2.5%
- Pillar 2 Countercyclical Buffer – 0%

As part of the Society's Internal Capital Adequacy Assessment Process (ICAAP), a capital add-on in excess of the regulatory minimum is considered appropriate. This add-on equates to 4% of risk weighted assets and takes the total internal requirement to 14.5%

#### Capital Buffers:

- Capital conservation buffer – this is an additional amount of capital required above the Pillar 1 capital requirement to be drawn on in times of stress. As at 31 December 2020 institutions in the UK are required to hold 2.5% of risk weighted assets.
- Countercyclical capital buffer (CCyB) – is an additional amount of capital required above the Pillar 1 capital requirement to absorb potential losses, to enhance resilience and contribute to a stable financial system. In the UK the CCyB is set by the Financial Policy Committee which is an official committee of the Bank of England. As at 31 December 2020 the CCyB rate was 0% having been reduced on 11<sup>th</sup> March 2020.

## 5.4 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	2020	2019
As at 31 December	£000s	£000s
Tier 1 capital	21,874	21,357
<b>Leverage ratio</b>	<b>6.1%</b>	<b>6.9%</b>
Total on-balance sheet assets	332,905	296,568
Deduct derivatives reported on balance sheet	-	(22)
Less: asset amounts deducted in determining tier 1 capital:		
Intangible fixed assets	(25)	(63)
Deferred taxation	-	-
<b>Total on-balance sheet exposures</b>	<b>332,880</b>	<b>296,483</b>
Off-balance sheet exposures and derivatives	23,116	13,321
<b>Total leverage ratio exposures</b>	<b>355,996</b>	<b>309,804</b>

### 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 Term Funding Scheme (TFS) and Term Funding Scheme with additional incentives for SMEs (TFSME), 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.

In addition to the above, in 2019 the Society placed funds with RBS as collateral against negative fair value movements from interest rate swap contracts held under the agreed Credit Support Annexes.

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

Encumbrance	2020		2019	
	£000s	% Split	£000s	% Split
As at 31 December				
<b>Carrying amount:</b>				
Encumbered assets - mortgages secured on residential property	45,804	13.8%	53,708	18.1%
Encumbered assets - collateral placed with RBS against derivatives	800	0.2%	540	0.2%
Unencumbered assets	286,301	86.0%	242,320	81.7%
<b>Total</b>	<b>332,905</b>	<b>100.0%</b>	<b>296,568</b>	<b>100.0%</b>

## 5.5 Liquidity and Funding

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 2020, the ratio was 374%.

The Society's Financial Risk Policy establishes 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).

The LCR is calculated by dividing the value of high quality liquid asset, held as a liquidity buffer, by the forecast net cash outflows under stress over 30 calendar days. From January 2018, the minimum requirement for the LCR ratio is 100%. The Society's LCR has been significantly above this level since inception and is expected to continue at this higher level. The table below shows the Society's LCR for the financial year ended 31 December 2020, with the prior year comparison.

<b>Liquidity Coverage Ratio</b>	<b>2020</b>	<b>2019</b>
<b>As at 31 December</b>		
	<b>£000s</b>	<b>£000s</b>
Liquidity buffer	70,118	57,370
Total net cash outflows	18,733	24,061
	<b>%</b>	<b>%</b>
Liquidity coverage ratio	374%	238%

## 6. 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 2020 as follows:

	£000s
3-year average gross income	4,953
Own funds requirement at 15%	743

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 is also developing an operational risk framework to meet the requirements set out by the PRA and FCA.

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.

## 7. 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 2020 are detailed in the table below:

Category	Description	Asset Value £000	Weighted Exposure Value £000	Capital Required £000
Exposure to Central Governments	UK government Treasury bills, gilts, and central bank deposits	70,509	-	-
Exposure to Multilateral Development Banks	Bonds issued by Supranational Banks	-	-	-
Exposure to Institutions	Liquid asset exposures to Credit Institutions	7,909	1,822	146
Secured by Mortgages on Residential Property	Residential Mortgages - performing loans with loan-to-value of less than 80%	247,320	86,562	6,925
	Residential performing mortgages with loan-to-value of more than 80%	3,460	2,595	208
Secured by Mortgages on Commercial Real Estate	Non-residential mortgage exposures	1,713	1,713	137
Past Due Items	Non-performing mortgages	228	228	18
Swap Exposure	Off-statement of financial position derivative exposure	915	458	37
Commitment	Off-statement of financial position pipeline commitment	22,201	4,440	355
Other Items	Fixed and other assets	1,825	1,825	146
<b>Total Credit Risk Requirement</b>		<b>356,080</b>	<b>99,643</b>	<b>7,971</b>
<b>Operational Risk Requirement</b>			<b>9,287</b>	<b>743</b>
<b>Total Pillar 1 Capital Requirement</b>			<b>108,930</b>	<b>8,714</b>

Accounting Value of Total Assets	332,905
Loan loss provisions	218
Unamortised loan origination fees	(131)
Off-statement of financial position exposures	23,116
Accrued interest	(3)
Intangible fixed assets	(25)
Tax asset	-
<b>Total Assets per Credit Risk Requirement</b>	<b>356,080</b>

## 8. Counter-party credit exposure

### 8.1 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.

	<b>2020</b>	<b>2019</b>
	<b>£000</b>	<b>£000</b>
UK government securities and amounts held with central banks	70,509	57,385
UK financial securities	7,912	6,311
	<b>78,421</b>	<b>63,696</b>

The following table shows exposure broken down by Fitch ratings.

	<b>2020</b>	<b>2019</b>
	<b>£000</b>	<b>£000</b>
AAA to AA-	70,509	57,385
A+ to A-	7,411	5,809
BBB+ to BBB-	-	-
Unrated	501	502
	<b>78,421</b>	<b>63,696</b>

The geographical distribution of these exposures is as follows:

	<b>2020</b>	<b>2019</b>
	<b>£000</b>	<b>£000</b>
UK	78,421	63,696
	<b>78,421</b>	<b>63,696</b>

### 8.2 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.

	<b>2020</b>	<b>2019</b>
	<b>£000</b>	<b>£000</b>
Positive fair value of interest rate contracts	0	22



### 8.3 Analysis of mortgage assets

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

	2020		2019	
	Residential	Non-Residential	Residential	Non-Residential
Less than or equal to 50%	29.2%	43.9%		
More than 50% but less than or equal to 60%	13.2%	56.1%		
More than 60% but less than or equal to 70%	16.9%	-	55.9%	100.0%
More than 70% but less than or equal to 80%	19.3%	-	18.5%	-
More than 80% but less than or equal to 90%	19.5%	-	17.5%	-
More than 90% but less than or equal to 100%	1.9%	-	8.1%	-
More than 100%	0.0%	-	0.0%	-
	100.0%	100.0%	100.0%	100.0%

The Society regards as "past due" any mortgage or loan account where three or more monthly repayments have not been made at the accounting date. Arrears of mortgage repayments are monitored closely and the Society has performed well in comparison with national arrears and possession statistics. A detailed geographical analysis including "past due" and "performing" exposures is set out below.

Geographical Regions	Secured on residential property			Secured on land			Total balance	Percentage of book
	Past due balance	Performing balance	Total balance	Past due balance	Performing balance	Total balance	All loans to customers	
	£000	£000	£000	£000	£000	£000	£000	
East Anglia	-	9,493	9,493	-	-	-	9,493	4%
East Midlands	88	16,453	16,541	-	-	-	16,541	7%
Greater London	-	32,633	32,633	-	-	-	32,633	13%
North West	93	22,821	22,915	-	-	-	22,915	9%
Northern	-	9,570	9,570	-	-	-	9,570	4%
Outer Metropolitan	-	36,326	36,326	-	-	-	36,326	14%
Outer South East	-	26,803	26,803	-	-	-	26,803	11%
Scotland	-	1,161	1,161	-	-	-	1,161	0%
South West	47	55,965	56,011	-	1,713	1,713	57,724	23%
Wales	-	8,480	8,480	-	-	-	8,480	3%
West Midlands	-	16,851	16,851	-	-	-	16,851	7%
Yorkshire & Humberside	-	14,224	14,224	-	-	-	14,224	6%
<b>Total</b>	<b>228</b>	<b>250,781</b>	<b>251,008</b>	<b>-</b>	<b>1,713</b>	<b>1,713</b>	<b>252,721</b>	<b>100%</b>

A maturity analysis, based on contractual maturity of loan types is shown in the table below. Loans to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis.

Contractual Maturity Analysis	Memo items						Total arrears	Specific loss
	Total Balance	Not more than 3	More than 3 months	More than 1 year but	More than 5 years	Total		
	£000	£000	£000	£000	£000	£000	£000	
<b>Loans past due</b>								
Residential mortgages - owner occupied	228	-	-	-	228	6	-	
Residential mortgages - buy to let	-	-	-	-	-	-	-	
Commercial	-	-	-	-	-	-	-	
<b>Total past due</b>	<b>228</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>228</b>	<b>6</b>	<b>-</b>	
<b>Performing loans</b>	<b>252,493</b>	<b>13</b>	<b>338</b>	<b>9,367</b>	<b>242,775</b>	<b>-</b>	<b>41</b>	
<b>Total loans</b>	<b>252,721</b>	<b>13</b>	<b>338</b>	<b>9,367</b>	<b>243,003</b>	<b>6</b>	<b>41</b>	

## 9. 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. 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 arrears or 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 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 applied based on externally obtained credit scores for each mortgage account.

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

<b>Movement in impairment provisions</b>		
	<b>2020</b>	<b>2019</b>
	<b>£000</b>	<b>£000</b>
At 1 January		
Collective provision	229	225
Individual provision	0	4
	<b>229</b>	<b>229</b>
Income and expenditure charge/(credit) for the year		
Collective provision	(52)	4
Individual provision	41	(4)
	<b>(11)</b>	<b>0</b>
At 31 December		
Collective provision	177	229
Individual provision	41	0
	<b>218</b>	<b>229</b>

## 10. Other financial risks

### 10.1 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.

### 10.2 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

	2020	2019
Illustrative impact on NII of a change in interest rates:	£000	£000
+ 200 basis point rate change	4.2	19.5
+ 100 basis point rate change	2.1	9.8
+ 50 basis point rate change	1.1	4.9
- 10 basis point rate change	(0.2)	(1.0)

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.

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## 11. 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 four times during 2020.

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.

### 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 2020 was as follows:

	Number	Fixed £000s	Variable £000s	Total £000s
Senior management	11	741	105	846
Other staff having a material impact on risk	1	71	7	78

A detailed breakdown of the remuneration of executive and non-executive directors (9 individuals) can be found in the Remuneration Report included in the Annual report and Accounts for the year ended 31 December 2020. No individuals were remunerated £1 million or more.



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