STAFFORD RAILWAY
BUILDING SOCIETY

Pillar 3 Disclosure Document

For the year ended 31 October 2016

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1. Introduction

The Stafford Railway Building Society ("the Society") has an obligation to ensure that its members' are protected by setting aside an adequate amount of capital for the prevailing economic conditions. Internal systems and controls have been designed to predict potential losses which may arise from mortgage lending and operational risks under stressed conditions.

2. Basel III framework

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

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

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

Pillar 1 – this is a risk-based calculation with an emphasis credit risk and operational risk and sets out the minimum capital requirements the Society needs to adhere to. The Society uses the standardised approach to calculate credit risk, which is expressed as 8% of the risk-weighted amounts for each applicable exposure class and calculated by reference to the net income of the Society averaged over the previous three years.

Pillar 2 – this requires the Society to undertake an Internal Capital Adequacy Assessment Process (ICAAP). This involves the assessment of capital that the Board of Directors (the Board) considers adequate to mitigate the various risks to which the Society is exposed, based on the Society's Risk Appetite Statement and its Corporate Plan.

The Pillar 1 capital calculation for credit and operational risk is taken as the starting point and the Society considers whether the calculated amount sufficiently covers the respective risks. Where the capital under this formula is insufficient, additional Pillar 2A capital add-ons are provided, as well as additional capital for specific risks not covered by the credit and operational risk analysis. The Society uses a range of stress tests to model possible adverse future events and calculates the appropriate risk capital.

Pillar 3 – this builds on work undertaken as part of the ICAAP and discloses key elements to the industry and to our members on the Society's capital resources, risk exposures and risk management processes. This document contains the requirements for Pillar 3 (disclosure), and the information provided here is in accordance with the rulers and guidance contained in CRD IV.

In addition to the assessment of capital requirements under Pillar 1 and 2 above, the Society's overall capital requirement is reviewed periodically by the PRA. The PRA set the Individual Capital Guidance (ICG) for the Society, which is the minimum amount of capital they consider that the Society should hold.

3. Scope of application

The Society has no subsidiaries.

The Society operates a simple traditional building society approach to treasury operations with no complex transaction and minimal wholesale funding and standardised approach for credit risk.

The Society has adopted traditional lending approach with regards to its lending.

4. Verification, location and frequency of risk disclosure

This document is reviewed annually by both the Society's Risk Committee and Board and published on the Society's website (www.srbs.co.uk) within six months of the financial year-end, that is, 30 April 2017.

The Society's Annual Report and Accounts are published on the Society's website (www.srbs.co.uk) and can be accessed there in order to act as a reference point.

5. Basis of preparation

The Pillar 3 disclosures have been prepared in order to explain the basis on which the Society has prepared and disclosed certain capital requirements and information about the management of certain risks and for no other purpose. The disclosures do not constitute any form of financial statement and must not be relied upon in making any judgement on the Society. There is no requirement for the disclosures to be externally audited.

The information presented is based on the Society's Annual Report and Accounts as at 31 October 2016, but may differ where regulatory requirements differ from the requirements underlying the Annual Report and Accounts. Consistent with regulatory reporting for capital adequacy purposes, the Society information from the Annual Report and Accounts has been used.

The Society has adopted FRS 102 for the first time for its 2016 Annual Report and Accounts. This had an impact on the capital adequacy assessments disclosed in this report. Under FRS 102, the loan provisions that under the previous accounting standard were referred to as General Provision and Specific Provision are now referred to as Collective and Individual Provision.

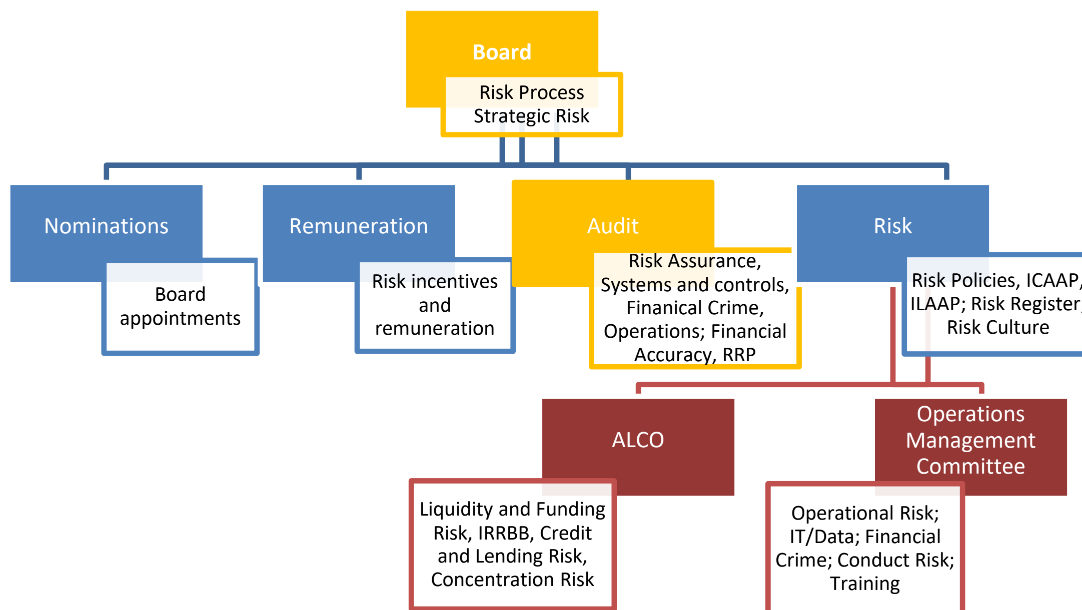
In the event that a user of this document requires further explanation on the disclosures given, application should be made in writing to the Chief Executive or the Finance Director at Stafford Railway Building Society, 4 Market Square, Stafford ST16 2JH.

6. Risk Management Approach and Governance

The Society's Board has ultimate responsibility for developing an appropriate risk and control framework. The Board comprises two Executive Directors and six Non-Executive Directors and meets eleven times a year. The Board of Directors comprises professional and business people from a variety of backgrounds. It is recognised that an appropriate mix of skills and diversity is required on the Board, but that this must be balanced with increasing pressure to have sector and risk management experience to satisfy Regulatory requirements. It is also recognised that to obtain this mix, the Society has to look beyond its local area, although maintaining links with the local community is very important.

The Board is responsible for setting the overall risk strategy and approving the design and implementation of risk management approaches, including the risk management framework policy, the risk appetite statements and metrics that underpin them. It delegates authority for cascading the setting and approval of the more granular limits and tolerances to the Chief Executive.

The Board and Committee structure is set out below:



Where:
1st line - ALCO and OMC
2nd line – Nominations, Remuneration and Risk Committees
3rd line – Board and Audit Committee

IRRBB	Interest rate risk in the banking book
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
RRP	Recovery and Resolution Plan

In principle, each of the Board committees fulfil a similar role, in that, operating under a Board delegated mandate, they provide a forum for the direction and challenge of Management whilst monitoring business performance and risk exposures. Each of the Board committees comprises Non-Executive Directors with other attendees being drawn from the Executive and Senior Management. The current terms of reference

for the ALCO, Audit and Risk Committees are published on the Society's website (https://srbs.co.uk/ about-us/the-board). The key committees are:

6.1 Audit Committee

This Committee is chaired by Colin Lloyd (following the retirement of Brett Philips). Other members of the Committee are Karen McCormick and Nicholas Sandy and meets at least four times a year. Representatives from the Society Executive and Risk and Compliance functions together with the Society's internal and external auditor also attend Committee meetings by invitation. The Committee has overarching responsibility for the Society's systems and controls and considers all matters of an audit nature applying to the Society, including internal controls, compliance, scope and content of internal and external audit work, financial reporting and other relevant prudential requirements. It validates the financial statements of the Society.

A dotted line reporting exists directly between the Chairman of the Audit Committee and the Risk and Compliance Manager.

6.2 Risk Committee

This Committee is chaired by David Gage (Vice Chairman). It meets at least quarterly during the year and advises the Board on the overall risk appetite, tolerance and strategy and reviews the risk management framework and policies. The other members of the Committee are James Dean (Chairman) and Gary Crowe. Representatives from the Society Executive and Compliance functions also attend Committee meetings by invitation.

In particular, the Committee monitors and reviews the consolidated risk picture across the Society. It is responsible for the on-going development and maintenance of the ILAAP and the ICAAP as well as the risk management framework. It also provides support and challenge for the development of the strategic plan and adequate stress testing strategy. The Committee receives standing reports on the risk register along with detailed risk management information that enables it to track performance against the risk appetite.

A dotted line reporting exists directly between the Chairman of the Risk Committee and the Risk and Compliance Manager.

6.3 Assets and Liabilities Committee (ALCO)

The Committee comprises both Executive Directors and members of the management team. The Committee is chaired by Jeremy Hodgkiss (Finance Director and Deputy Chief Executive). Other members of staff and Non-Executive Directors attend as required. The Committee is responsible for ensuring that the Society's treasury risks (liquidity, treasury counterparty risk, interest rate risk in the banking book) are managed and mitigated in line with the Board's risk appetite and related policies. The Committee also ensures that all (non-treasury) lending undertaken by the Society is in line with the Board's risk appetite. The Committee reviews on-going management information and is responsible for recommending changes to the credit policy for Board approval.

The Committee reports and escalates breaches to the Risk Committee.

6.4 Operations Management Committee (OMC)

This Committee comprises both Executive Directors and members of the management team, and chaired by Susan Whiting (Chief Executive). The Committee meets monthly and is responsible for organising and co-ordinating the day-to-day management of the Society, including financial crime, operational risk, conduct risk and information technology, in line with the Board's risk appetite, Corporate Plan and overall strategic direction. Other members of staff and Non-Executive Directors attend as required. The Committee reports and escalates breaches to the Risk Committee.

6.5 Remuneration Committee

This Committee comprises all the Non-Executive Directors under the chairmanship of Karen McCormick and is responsible for compliance with relevant elements of the Financial Conduct Authority (FCA) Remuneration Code. The basis of remuneration is consistent with sound and effective risk management and does not encourage excessive risk-taking. The Committee meets at least once per year to consider the remuneration and other terms of service of the Executive Directors.

The overarching purpose of the Committee is to set remuneration policies to ensure that they are in line with the Society's business strategy, risk appetite and long-term objectives. This includes designing and implementing the reward structure of the Society and ensures that effective risk management is a key component of remuneration and incentive structures.

6.6 Nominations Committee

The Nominations Committee is chaired by the Chairman of the Board, James Dean. It also comprises Nicholas Sandy (Senior Independent Director), David Gage (Vice Chairman) and Susan Whiting (Chief Executive). It identifies and recommends to the Board candidates for nomination as Non-Executive Directors and considers Board succession planning. It meets when there is an appropriate vacancy to fill but in any case at least once a year to review the skills mix of the Board and succession planning.

6.7 Three Lines of Defence approach:

The Society has adopted a "Three Lines of Defence" approach to the operational management of the firm. This approach ensures that staff are aware of their responsibilities and that an effective segregation of duties is in place across the Society.

The Society's risk management framework is based on the best practice "Three lines of defence" model, which is illustrated below.

1. First line of defence – Operational Management

The Society's managers are in the best position to assess and manage the risk exposures within their teams. The management identify, assess, and manage risk through normal business operation. Any breaches are reported to Executive and through the governance structure as appropriate.

2. Second line of defence – Risk and Compliance function

The second line of defence is responsible for challenging of risks, policies and controls in place. This function is operationally independent from the business managers, and can therefore uphold the principles and policies of the Society. They provide oversight of the first line functions and independently report to Risk and/or Audit Committees any policy breaches or control issues.

3. Third line of defence – internal audit and external audit

Internal audit is entirely independent of the operational functions of the Society, and reports directly to the Audit Committee. The function is outsourced to Deloitte LLP to ensure further independence. Their role is to independently confirm that all activities are within policy, legal or regulatory requirements.

External audit is independent and provided by KPMG LLP with a reporting line direct to the Audit Committee.

Line of defence	Responsibility	Oversight
1st	Management	CE/DCE and Finance Director
2nd	Risk and Compliance Manager, MLRO	Risk Committee, Remuneration and Nomination Committee
3rd	Internal Audit (outsourced) External Audit	Audit Committee

Where:

- CE: Chief Executive
- DCE: Deputy Chief Executive
- MLRO: Money Laundering Reporting Officer

7. Risk Management Policies and Objectives

The principal purpose of the Society is to make loans for the purchase and improvement of residential property and to encourage savings by offering our members competitive savings rates and a truly personal service.

The Society views risk management as an integral part of good internal control and corporate governance and puts the safety and security of members' deposits above everything else. Appropriate management and minimisation of the risks arising from business activities achieve this.

The Society's Board of Directors, which comprises two Executive Directors and six Non-Executive Directors, has ultimate responsibility for developing an appropriate risk and control framework. The Society has developed a Board risk appetite statement, risk management framework that is designed to identify, assess, manage and mitigate risks that may influence the delivery of the Society's strategic objectives and has delegated powers to the Risk Committee to advise the Board on the overall risk appetite, tolerance, and strategy. It also oversees and advises the Board on the current risk exposures and future risk strategy.

The risk management framework policy is reviewed annually by the Risk Committee and then approved by the Board.

Risk management information includes a Risk Dashboard which reflects the Board's Risk Appetite Statement and is monitored by ALCO, the Risk Committee and the Board at all of their meetings. In addition, the higher risk items from the Risks and Controls Register are reviewed at each Board meeting. The risks in the Risks and Controls Register are an intrinsic part of the ICAAP process, which requires an assessment of key risks and a quantification of how much capital must be held to mitigate those risks.

Any changes to risks, or new and emerging risks, are identified and communicated to the Executive at management meetings. The Risk and Compliance Manager is responsible for updating risk documentation for presentation to the Risk Committee and Board. Decisions by the Board in respect of policies, risk appetite, management information required, limits and triggers on key risk indicators or risks and controls are communicated to the management team who amend the risk documentation, policies and operational procedures and train appropriate staff.

The Risk Management Framework identified principal risks as being most material to the Society. The Society appoints a Risk Framework Owner (RFO) for each risk, the risk framework must be defined and documented; this comprises a principal risk policy, second level policy (if applicable), procedures and standards and risk appetite tolerance metrics. Principal risks are set out below.

7.1 Stress testing

Stress tests are an integral part of the annual business planning process and annual review of risk appetite. Tests are designed to ensure that the Society's financial position and risk profile provide sufficient resilience to withstand the impact of severe economic stress on the market (systemic stress) or society's specific stress events. Stress testing also informs early-warning triggers, management actions and contingency and recovery plans to mitigate or avoid potential stresses and vulnerabilities and as such is integral to the risk management framework. The stress-testing framework also includes reverse stress testing techniques that aim to identify circumstances under which the Society's business model could be rendered unviable, leading to a significant change in business strategy. Examples include extreme macroeconomic downturn scenarios (for example, an unemployment or credit default) and targeted attacks on the Society (for example cyber threats). Stress testing is used to identify, assess and quantify the potential effectiveness of management actions that could be taken to mitigate the impact of a stress.

7.2 Credit Risk

Credit risk is the risk that a borrower or counterparty to a contract will be unable or unwilling to meet their obligations as they fall due. For the Society, this normally means the risk that a borrower will not repay their mortgage loan, or that a financial institution will not repay funds invested by the Society in that institution. The ALCO is responsible for monitoring the arrears profile through arrears, forbearance and possession reports and treasury counterparty risk through reviews against policy and reviews provided by the Society's treasury brokers. The Board approves changes to counterparties, treasury or lending policy.

Mortgage credit risk is outlined in the Society's Board approved lending risk policy and managed through the Society's underwriting process that seeks to ensure that borrowers only assume a debt that they can afford to repay. All mortgage applications are rigorously assessed with reference to the Society's lending policy. No matter how prudent lending is, however, some members can get into financial difficulties. In such circumstances, the Society is highly proactive in providing support that can include working with them to clear arrears, making arrangements, or forbearance.

The Society's lending policy details the limits set on the Society's lending operations. The Society's lending book is predominantly secured on residential property. The criteria applied to individual mortgages, and the limits set on different types of mortgages, are designed to reduce to a minimum the probability of any loss from lending.

Counterparty and country limits mean that there is little concentration of treasury assets. The institutions that the Society invests in are highly rated (at least A-) or, in the case of Building Societies, are subject to a financial review and the asset types and limits have been agreed with the Regulator as compatible with their guidance to the Society under the Supervisory Statement (SS) 20/15 Supervising building societies' treasury and lending activities. The limits are monitored through the weekly liquidity report.

7.1.1 Concentration risk

The types of concentration risks facing the Society are concentration in one product type, geographical concentration and over-exposure to single borrowers, investors, or counterparties. Counterparty credit risk is considered in section 13.

Although the Society has only one mortgage product, which is predominantly secured on residential property wholly within the UK, this concentration is of low risk because of the inherent nature of the assets and the controls in place as detailed in the lending policy.

The limit on exposure to an individual borrower or a group of connected counterparties is 10% of capital (£1.95million). The Society has no "large exposure" defined by the Building Societies Regulatory Rule Book (BSOCS) as exceeding 10% of capital.

The Society has no dependency on any one form of introduction for mortgages and there is no concentration risk in the type of property held as security.

The Pillar 1 credit risk calculation assumes a diversified firm; therefore, additional capital is required where the Society is exposed to concentration risk.

As part of the ICAAP process, we quantified and provided capital for a severe economic downturn that for whatever reason affected only our core operating area. The Society accepts that Stafford and Staffordshire are its core areas and have stress tested the impact of this as part of its Pillar 2A assessment.

7.3 Strategic Risk

Strategic risk is the risk that the Society fails to execute its strategic plan or fails to effectively execute elements of its strategic plan due to poor planning or changes in the strategic environment.
Strategic risk is managed through regular review and development of key performance indicators, management oversight and an embedded corporate governance framework. This includes recover and resolution plans and specific The Stress Testing (see section 7.1) is undertaken on annual bases to assess impact on the Society corporate plan and desired outcomes.

7.3.1 Business risk

Business risk means any risk to the Society arising from changes in the business or economic conditions, including the risk that the Society may not be able to carry out its business plan or implement required strategy. Business risk is managed through regular review and development of the business plan, management oversight and an embedded corporate governance framework.

7.3.2 Pension obligation risk

Pension obligation risk is the risk to the Society caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related company or otherwise) or the risk that the Society will make payments or other contributions to or with respect to a pension scheme because of a moral obligation or because the Society considers that it needs to do so for some other reason.

The Society has only a defined contribution pension scheme, which is open to all employees, and so it has no exposure to pension obligation risk.

7.4 Liquidity Risk

Liquidity risk is the risk that the Society is not able to meet its financial obligations as they fall due or can only do so at excessive cost. The Society's Board approved liquidity policy is to maintain sufficient liquid resources to cover cash flow requirements and fluctuations in funding, to maintain full public confidence in the solvency of the Society and to meet its financial obligations. This is achieved by maintaining a prudent level of liquid assets and through management control of the growth of the business. The Society holds a buffer of high quality liquid assets such as UK Treasury Bills and government securities as part of regulatory requirements. The Society’s approach to liquidity risk is documented in the Society’s Internal Liquidity Adequacy Assessment Process (ILAAP).

The Society had no wholesale funded liabilities at any point during the year.

Liquidity is monitored daily by the Executive and senior management, reviewed at ALCO meetings, and included in the Management Information for Board meetings.

7.5 Interest Rate Risk

The Society’s Interest rate risk arises from the impact changes in interest rates have on the Society’s cash flows. The Society does not have any fixed rate savings or mortgage products, only variable, and therefore

the Interest Rate Risk for the Society is significantly less than for other similar institutions. The Society's main exposure to interest rates arises from its investment in Government Gilts and Certificates of Deposit with other financial institutions. The Society uses specialist external treasury advisers for investing surplus funds and has a good spread of maturity of its invested monies to manage this risk effectively.

For further details, see Section 16 Interest Rate Risk in the Banking Book (IRRBB) on page 18.

7.6 Basis and Market Risk

Basis and market risk is the risk of an impact on economic value due to pricing assets and liabilities according to different interest rate bases. The Society's basis risk arises from assets and liabilities being linked to different interest rate types including:

- Fixed rates – treasury bills, wholesale funding and term deposits (with other banks and other building societies);
- LIBOR – reinvestment risk on wholesale funding and term deposits;
- Managed rates – the majority of shares and deposits; and
- Zero rates – the Society's capital and fixed assets

A basis risk analysis is prepared monthly and reviewed by ALCO. New products and treasury activities are assessed by ALCO taking into account their impact on the Society's basis risk exposure.

The Society's exposure to basis risk manifests itself as funding risk – the risk that the Society cannot attract appropriate funding, or that funding can only be obtained at high cost.

7.7 Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes financial crime, fraud, data protection and technology and cyber risk amongst others. The Society manages this risk by having a strong and effective internal control environment in which risks are monitored and controlled on a timely basis. Controls have been established and are maintained for all business areas. These controls appropriately address identified risks and ensure good conduct of the business in accordance with the Society's policies and risk appetite and compliance with relevant laws, regulations and rules.

The Society primarily provides a single variable rate flexible mortgage product and a range of variable rate investment products. The Society does not provide any other financial products and it has appropriate controls in place with respect to mortgage advice.

The Society considers that its simple product range, robust systems, policies and internal control framework are the major factors in the achievement of strong control of Operational risk. The main operations and controls are summarised in the Risks and Controls Register which is reviewed by the Risk Committee, both Internal and External Auditors and the Board.

7.8 Regulatory Risk

Regulatory risk is the risk that the volume and complexity of regulatory issues may impact the Society's ability to compete and grow, or result in fines, public censure or restitution costs because of a failure to understand, interpret and comply with UK and EU regulatory requirements. The Society has an internal compliance function to monitor compliance with existing legislation, the implementation of controls and the impact of new requirements. The Audit Committee oversees this.

7.9 Conduct Risk

Conduct risk is the risk that the Society does not treat its members (customers) fairly and of inappropriate or unsatisfactory consumer outcomes. The Board acknowledges the requirement to fully embrace the Financial Conduct Authority (FCA)'s Principle 6, namely to ensure that the Society pays due regard to the interests of its customers and to treat them fairly at all times. These principles are firmly embedded within the Society's culture. This ethos has manifested itself into working practices throughout the Society.

The Audit Committee and the Board monitor the risk. In addition, the Risk Committee reviews and challenges the conduct risk management information. The Board reviews the conduct risk policy annually and receives conduct risk monitoring information monthly.

7.10 People Risk

People risk refers to the costs that may arise because of matters such as discrimination, employee compensation, health and safety, training and competency and key man risk. This risk area also address remuneration, recruitment as well as nomination of directors. The Society's employees are vital to delivering and managing the risk framework. The Society manages this risk through the operational management structure, specific policies and standards as well as management information reported to the Operations Management Committee (OMC) and Risk Committee.

For specific remuneration disclosure see section 17 below.

7.10.1 Remuneration risk

This is the risk that the Society's remuneration policy does not provide effective risk management and is vulnerable to ignoring concentration risks and liquidity risks.

No member of staff is sales-incentivised and no individual sales targets are set. Further information on remuneration risk is considered in section 17.

8. Capital Adequacy

On an annual basis, the Society updates its five-year Corporate Plan, incorporating forecast strategic business growth and capital positions and requirements. This planning cycle is driven by current market and economic conditions and is underpinned by the Society's risk appetite.

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal Internal Capital Adequacy Assessment Process (ICAAP) assists the Society with its management of capital. The Board monitors the Society's capital position monthly to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Society's actual and expected capital position is reviewed against stated risk appetite that aims to maintain capital at a level that equates to or exceeds its Internal Capital Guidance (ICG).
The Board manages the Society's capital and risk exposures to maintain capital in line with regulatory requirements that includes monitoring of:

- Lending decisions – The Society maintains a comprehensive set of sectoral limits in its lending policy in order to manage credit risk appetite. Individual property valuations are monitored against House Price Index (HPI) data.

- Concentration risk – The design of lending products takes into account the overall mix of the loan portfolio to manage exposure to risks arising from the property market and other markets the Society is active in.
- Counterparty risk – Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits that reflect the risk appetite of the Society.

Stress tests are used as part of the process of managing capital requirements.

9. Capital Resources (at 31 October 2016)

During the year ended 31 October 2016, the Society complied with all of the externally imposed capital requirements as laid down by the PRA. During 2016, the Society has continued to comply with the EU Capital Requirements Regulation and Directive (Basel III) as amended by the PRA. Under the current PRA definitions, the Society's capital is structured as follows:

Capital resources	As at 31 October 2016 £000	As at 31 October 2015 £000
Core Tier 1 capital		
General reserves	19,501	18,414
Other reserves	24	79
Total Core Tier 1 capital	19,525	18,493
Tier 2 capital		
Collective provision	273	275
Total Regulatory Capital Resources	19,798	18,768

Tier 1 capital

These are the general reserves of the Society and represent an accumulation of after-tax profits of the Society and the available-for-sale reserve. Tier 1 capital as a percentage of risk-weighted assets is 21.48%.

Tier 2 capital

This is the collective provision of the Society and therefore represents part of the Society's free capital.

10. Risk Weighted Assets and Capital Requirements under Pillar 1

The assets of the Society are analysed by risk category and given risk weightings according to the level of risk attached. The risk weightings are determined by the "standardised approach" to credit risk and "basic indicator approach" to operational risk determined by reference to the net income of the Society. The Society's Pillar 1 capital requirement based on 8% of its risk-weighted assets is derived as follows:

	Balance sheet exposure £000	Risk weighted exposure £000	Capital required £000
Liquidity:			
Cash	54	-	-
Gilt edged securities	41,728	-	-

Institutions	57,183	19,848	1,588
Total liquidity	98,965	19,848	1,588
Loans and advances to customers:			
FSRP < 80% LTV	166,856	58,400	4,672
FSRP > 80% LTV	187	140	11
FSRP in arrears	502	502	40
Other mortgage assets	4,326	4,326	346
Total Loans and advances to customers	171,871	63,368	5,069
Other exposures:			
Fixed and other assets	656	602	49
Total credit risk exposures	271,492	83,818	6,706
Mortgage commitments	7,887	0	0
Market risk			0
Operational Risk		7,083	567
Total Pillar 1 capital requirement		90,901	7,273
Total Capital Available			19,798
Excess of Capital over Minimum Capital Requirement under Pillar 1			12,525

Where:
FSRP – fully secured on residential property

11. Operational risk:

A breakdown of the calculation of capital requirements for operational risk is provided below:

Basic Indicator Approach to Operational Risk	2014 £000	2015 £000	2016 £000
Net interest income	3,567	3,958	3,800
Other income / charges	9	(1)	-
Total	3,576	3,957	3,800
Basic indicator (three year average)			3,778
Own Funds Requirement (15% of the Basic Indicator)			567

12. Leverage Ratio

Basel III introduced a non-risk based leverage ratio to supplement the risk based capital requirements. The ratio shows Tier 1 capital as a proportion of on and off balance sheet assets. The ratio does not distinguish between the credit quality of loans and acts as a primary constraint to excessive lending in proportion to the capital base. The UK leverage ratio framework requires a minimum ratio of 3%.

Currently the Society is not within scope of the UK leverage framework as retail deposits do not exceed £50bn, however the Society's ratio is well above the minimum required.

13. Counterparty Credit Risk

Credit risk is the risk of loss or delay if a customer or counterparty fails to perform their obligations, such as the timely repayment of a loan or other credit arrangement. The Society has no appetite for material credit losses. This is controlled through credit quality standards, underwriting rules, as well as limits by exposure to counterparty, sector, country and instrument.

13.1 Mortgages:

All mortgage loan applications are assessed with reference to the Society's risk appetite and Board approved lending policy.

The Board's risk appetite is based on:

- The maximum proportion of the total mortgage portfolio that certain loans types can represent;
- Loan-to-value (LTV) ratios; and
- The arrears level.

LTV and arrears levels are key drivers of the Pillar 1 credit risk capital calculation. All mortgage products should be priced to ensure that the margin appropriately reflects the credit risk involved and the carrying cost of the incremental risk capital.

The Board believes in a stepwise approach to product development. New products should typically be introduced via a limited number of channels, such as well-established and highly reputable specialist brokers. Capital will be committed in a staged manner, with regular product performance reviews being performed.

For the Society as a whole, mortgages on prime owner occupied residential properties will be a minimum of 80% of mortgage assets and arrears rates will be kept below the national average reported by the Council of Mortgage Lenders.

The lending portfolio is monitored by the OMC to ensure that it remains in line with the stated risk appetite of the Society. All mortgage applications are manually underwritten individually on a case-by-case basis using experienced staff ensuring that they meet the lending policy rules through a full affordability assessment so supporting the risk appetite of the Society. All mortgage applications will be overseen by the Mortgage Manager who ensures that all lending criteria have been applied and that all information submitted within the application is validated. As at 31 October 2016, the mortgage department consisted of the Mortgage Manager, Business Development Manager, four staff and a secretary. All staff involved in underwriting or advising are accredited through a formal training and competence scheme. Both the Mortgage Manager and the Business Development Manager report to the Chief Executive.

The Society's second line Risk and Compliance function undertakes periodic reviews of the Society's lending process and the results of the reviews are reported to the Audit Committee.

The Society operates throughout England and Wales. It has no exposure to properties internationally.
An analysis of the Society's indexed LTV profile is shown in the table below:

	2016	
LTV ratio	£000	%
Less than 50%		
51 – 70%	76,808	44.59
71 – 90%	58,239	33.81

91 – 100%	35,345	20.52
More than 100%	1,422	0.83
Total Gross Mortgages	431	0.25
	172,245	100.00

A geographical analysis of the Society's loans and advances to members is shown below:

	2016	
	£000	%
Region:		
Stafford ST16-ST18	48,897	28.39
Rest of Staffordshire	19,816	11.50
Rest of UK	103,532	60.11
Total Gross Mortgages	172,245	100.00

During the year to 31 October 2016, the Society experienced £nil losses on mortgages (2015: £nil).

An individual FSRP provision of £3k was held at 31 October 2016 covering three residential properties as well as a collective provision on FSRP mortgages totalling £273k.

13.2Treasury

The purpose of the Society's Internal Liquidity Adequacy Assessment Process (ILAAP) is to ensure that the Society has sufficient liquidity to meet its obligation as they fall due.

The Society's treasury risk policy is to ensure that the Society can obtain the best possible return whilst operating within prudent limits in respect of counterparties.

In accordance with its treasury counterparty risk policy, the Society only invests funds in British Government Securities, banking institutions and building societies rated at least A- as assigned by the credit rating agency, Fitch. Once a counterparty attains a rating of A, with a negative outlook, management action is taken to reduce the exposure in that counterparty. The assets are managed with advice from external fund managers.

New limits and counterparties are considered by the ALCO before presenting recommendations to the Risk Committee for challenge and the Board for approval. The credit risk appetite for liquid assets is defined by: the minimum counterparty credit rating; the permissible instruments; the maximum percentage of total liquid assets held at each credit risk level; and the investment term. ALCO monitors exposures to counterparties and countries and ensures the Society is operating within its Board approved limits at its monthly meetings. The Board reviews the Society's exposure by sector on a monthly basis.

The maturity and credit profile of Treasury assets at 31 October 2016 is shown below.

	Maturity of Treasury Investment			
Fitch Ratings	< 3 months £000m	3 months to 1 year £000m	>1 year £000m	Total £000m
Banks: AAA to AA-	13,044	8,054	2,127	23,225
Banks: A+ to A-	7,096	15,058	2,824	24,978
Building Societies	1,009	8,025	-	9,034

Treasury Bills	16,996	17,976	-	34,972
British Government Securities	2,219	4,537	-	6,756
Total	40,364	53,650	4,951	98,965

No provisions for loss relating to counterparty risk are held by the Society as at 31 October 2016.

14. Analysis of Past Dues

The Society's current lending policy is in accordance with its risk appetite, which has been established by the Board, and has produced an inherently low risk mortgage book. The Society has strong Management controls over arrears with no losses arising from default leading to possession in the year to 31 October 2016. The average loan to value of the residential mortgage book was 36.0% as at 31 October 2016.

The table below provides information on mortgage loans by payment due status:

	2016	
	£000	%
Not impaired:		
Neither past due nor impaired	166,467	96.8
Past due up to three months but not impaired	4,954	2.9
Past due over three months but not impaired	532	0.3
Possessions	-	
Impaired:		
Past due up to three months	292	0.2
Past due over three months	-	
Possessions	-	
Sub-total	172,245	
Allowance for impairment	(276)	(0.2)
Total	171,969	100.0

A table of the Society's "past due" loans by geographical area, which are loans more than 3 months in arrears, as at 31 October 2016 are set out below:

	Residential loans		Commercial loans		
Region	Past due	Performing	Past due	Performing	Total
	£m	£m	£m	£m	£m
Stafford ST16 – ST18	0.1	47.0	-	1.8	48.9
Rest of Staffordshire	0.2	18.9	-	0.7	19.8
Rest of England	0.2	102.9	-	0.3	103.4
Scotland	-	0.1	-	-	0.1
Total	0.5	168.9	-	2.8	172.2

15. Provisions

The Society's allowance for impairment is set out below:

	Loans fully secured on Residential Property		Loans fully secured on Land		
	Individual	Collective	Individual	Collective	Total
	£000	£000	£000	£000	£000
Balance at 1 November 2015	4	275	-	-	279
Charge/(credit) for the year	(1)	(2)	-	-	(3)
Balance at 31 October 2016	3	273	-	-	276

Provisions on commercial and residential accounts are made to reduce the value of loans and advances to the amount that is considered likely to be ultimately recoverable in the event of the relevant property held as security being sold in possession by the Society.

The Society considers evidence of impairment for loans and advances at both a specific asset and a collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

In assessing collective impairment, the Society uses statistical modelling of historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by historical trends. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Where certain emerging impairment characteristics are considered significant but not assessed as part of the impairment calculation, the Board may elect to apply an overlay to the impairment provision.

The amount of impairment loss is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised using provisions.

- In determining whether an impairment loss should be recorded, the Society is required to exercise a degree of judgement. Impairments are calculated as the difference between expected future cash flows and the current outstanding balance, using management's best estimate of propensity to default using all available data. Estimates and assumptions are around the probability of any account going into default, the probability of defaulting accounts progressing to possession, the time taken to complete the sale of properties in possession and the eventual loss incurred in the event of forced sale or write-off. These assumptions are based on observable historical data and updated as management considers appropriate to reflect current circumstances. A 5% increase in the outcome of probability of default or eventual loss incurred would result in an increase in the impairments of £14,000.

16. Market Risk and Interest Rate Risk in the Banking Book (IRRBB)

Market risk is the risk that the value of, or income arising from, the Society's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk, foreign currency risk and equity risk.

The Society only deals with products in sterling so is not directly affected by currency risk. The Society's products are also only interest orientated products so are not exposed to other pricing risks.

IRRBB is the impact on economic value due to movements in interest rates and arises from mismatches of the re-pricing or maturity of assets and liabilities as interest rate change. The Society has a relatively simple treasury structure, with the majority of mortgages and all savings products currently on administered rates, while liquidity is typically short duration. As a result, interest rate risk for the Society is significantly less than for other institutions.

The Society's main exposure to interest rates arises from its investment in Government Gilts and Certificates of Deposit with other financial institutions.

Static gap analysis is performed monthly against a 2% parallel shift in interest rates (given the current base rate of 0.25%, the Society has stress tested downwards against a fall of 0.25% in interest rates). ALCO monitors gap reports monthly and the effect of a shift in interest rates as a percentage of capital and reports to the Risk Committee.

The results of the stress test at 31 October 2016 are as follows:

	Net Gap £000	Impact on net interest income £000
At 31 October 2016	660	-
Impact of interest rate shift of +2%	636	(24)
Impact of interest rate shift of 0.25%	714	54

17. Remuneration and Material Risk Takers

The Society has followed Consultation Paper (CP) 33/16 "The PRA's expectations on remuneration" for proportionality of the disclosure.

Full details of the Society's remuneration policy and details of Executive Directors' emoluments for 2016 and comparatives for 2015 are set out in the Directors' Remuneration Report to the Annual Report and Accounts, available on the Society's website, which should be read in conjunction with this report.

The Society's objective in setting remuneration policies is to ensure that they are in line with its business strategy, risk appetite and long-term objectives, and that remuneration is set at a level that retains and attracts staff of the appropriate calibre.

Remuneration of Executive Directors and the Risk and Compliance Officer is determined by the Remuneration Committee, which consists of all the Non-Executive Directors chaired by Mrs Karen McCormick. In setting remuneration, the Committee takes account of fees, salaries and other benefits provided to Directors and to other senior management of comparable institutions. Non-Executive Directors are paid fixed fees only. The remuneration of the MLRO, in common with all other staff, is set by the Chief Executive, subject to overall budgetary controls set by the Board during producing the Society's Corporate Plan.

A bonus is paid to the Executive Directors. The bonus is assessed by the Remuneration Committee and is based on a range of financial and non-financial corporate performance targets. Bonus payments are payable annually, are not guaranteed and are reviewed each year.

No Executive Director holds a contract with a notice period of more than twelve months.

17.1 Remuneration Code Staff

Code staff are defined by the Financial Conduct Authority (FCA) as "staff that have a material impact on the firm's risk profile; this includes staff that perform significant influence functions, senior managers and risk takers".

The Board has determined that Non-Executive Directors, the Chief Executive, the Deputy Chief Executive and Finance Director, the Risk and Compliance Manager and the MLRO fall within the definition of Remuneration Code staff under SYSC 19D of the PRA Handbook. These staff are now identified as "Material Risk Takers" under CRD IV.

Information concerning the mandate of the Remuneration Committee and the decision-making process it uses in determining remuneration policy is contained within the terms of reference which are available on the Society's website.

Aggregate information on Remuneration Code Staff during the year ending 31 October 2016 is given below:

	Total Remuneration £000
Non-Executive Directors	116
Executive Directors	247
Other Remuneration Code staff	102

Fixed Remuneration for Other Remuneration Code Staff includes pension contributions paid by the Society. No other benefits are paid and Directors do not receive pension contributions from the Society.