Pillar 3 Disclosures

31 December 2017

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These Pillar 3 disclosures have been prepared purely for explaining 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. They 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 these disclosures to be externally audited.

1. INTRODUCTION

Background

The Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRDIV) came into force on 1st January 2014 and is enforced in the UK, together with local implementing rules and guidance, by the Prudential Regulatory 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.

This document sets out the 2017 Pillar 3 Disclosures for Tipton & Coseley Building Society. The sole purpose of these disclosures is to give information on the basis of calculating Basel III capital requirements and on the management of risks faced by the Group. This is in accordance with the rules laid out in the Capital Requirements Regulation (Part Eight). Unless otherwise stated, all figures are as at 31 December 2017, the Society's financial year-end, with comparative figures for 31 December 2016 where relevant. Pillar 3 Disclosures are published annually with the Annual Report and Accounts in accordance with regulatory guidelines.

The CRD consists of 3 'Pillars' which encompass the key principles of the new regime, these can be summarised as follows:

Pillar 1 — Minimum capital requirements under Basel III. This covers the calculation of a basic minimum capital figure and is carried out by the Society.

Pillar 2 — Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP). The Society has made an assessment of all of the key risks facing the business for which capital has not been provided under Pillar 1. The results of this assessment are subject to review by the Regulator under their SREP arrangements.

Pillar 3 — Sets out the disclosure requirements for firms to publish key information about their underlying risks, capital and risk management. These are aimed at promoting market discipline and designed to raise standards through greater transparency complementing Pillar 1 and Pillar 2. The disclosure in this document meet the Society's obligation under Pillar 3 and are based on the new CRD IV rules.

Location & Verification

The Society's Board reviews and approves the Society's ICAAP on an annual basis. The main pillar 3 disclosures are not subject to audit, however, some of the information within the disclosures also appears in the Society's Annual Report & Accounts.
This document is published on the Society website (www.thetipton.co.uk).

Basis & Frequency

The figures in this disclosure document relate to the Tipton & Coseley Building Society, in previous years the Society prepared Group numbers which included its wholly owned subsidiary Tipton & Coseley Financial Services Ltd, this entity was closed in 2017. The figures have been drawn from the Society's Annual Report and Accounts as at 31 December 2017 unless otherwise stated.

These disclosures will be updated on an annual basis, following publication of the Annual Report & Accounts.

2. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Society has a risk averse culture which, together with the Board's objective of minimising risk, ensures that it maintains a low exposure to the principal risks and uncertainties arising from its activities.

The Board has put in place a formal risk management structure which includes risk policy statements, exposure limits, mandates and reporting lines, along with an active risk review process. The Board has delegated responsibility for risk management to the Risk Committee. The Board has delegated responsibility for the systems of internal control to the Audit & Compliance Committee and on a day to day basis authority is delegated to the Executive Management team to establish, operate and monitor the systems. An Internal Audit function is in place to carry out checks in order to provide assurance about the adequacy and effectiveness of internal controls.

The principal business and financial risks that the Society is exposed to are credit, interest rate, liquidity, operational and conduct risk. The ways in which the Society manages these risks include using forecasting and stress testing models to help guide business strategies; producing key risk information and indicators to measure and monitor performance; and using management and Board committees to monitor and control specific risks.

Principal Risks

Credit Risk

This is the risk that unexpected losses may arise as a result of the Society's borrowers or market counterparties failing to meet their obligations to repay as they fall due. Credit risk arises primarily from mortgage loans to customers and from investments in liquid assets as part of the Society's treasury operations.

Concentration risk adds a further element to credit risk and can arise as a result of the concentration of exposures within the same risk category, whether through geographical location, product type, industry sector or counterparty type.

These risks are managed through Board approved lending and liquidity policies which provide a range of limits that are regularly monitored and reviewed in light of changing economic conditions.

As the Society is predominantly a residential mortgage lender, it is exposed to the UK housing market. As a local building society, this results in a geographical concentration risk as the majority of the Society's lending is within the West Midlands area. The Board has ensured that the Society's ICAAP reflects this concentration.

Interest Rate Risk (including Basis Risk)

This is the risk of a loss of income arising from changes in interest rates and mismatches in interest rate basis. This is primarily managed through a combination of natural hedges that exist in the Society's balance sheet together with appropriate hedging contracts with external counterparties, as permitted by the Board approved financial risk management policy.

Liquidity Risk

Liquidity risk is the risk that the Society, whilst solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost. The Society's Internal Liquidity Adequacy Assessment Policy (ILAAP) assesses whether the Society has sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to maintain full public confidence in the solvency of the Society and to meet its

financial obligations. This is achieved through maintaining a prudent level of liquid assets and wholesale funding facilities, and through management control of the growth of the business. The Society has a Bank of England Reserve account which is an essential element of the management of the Society's High Quality Liquid Assets (HQLAs) as part of the regulatory requirements.

The Society maintains assets in liquid form in such proportion and composition as will at all times enable it to meet its liabilities as they arise, including any unexpected adverse cash flow.

Operational Risk

This is the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events, including legal risk. The Society operates a robust control environment which includes the management of this risk by individual business areas that have responsibility for putting in place appropriate controls for their business and who co-ordinate control and risk assessments on a regular basis.

In order to ensure that the Society has sufficient capital to cover some of these operational risks the Society also maintains a range of insurance policies to cover eventualities such as business interruption, loss of computer systems, crime etc.

To monitor its operational risks the Society uses risk assessment software to put a value on the likelihood and impact (together with the reduction in impact from application of the control) against each risk. This allows the Society to establish the residual risk remaining after operation of controls for each business area.

Conduct Risk

This risk concerns the way in which the Society conducts business with its customers, and includes such matters as treating customers fairly, the way in which it deals with borrowers in default and complaint handling. The Society has a Conduct risk policy and monitors these matters on a regular basis.

Other Material Risks

Business Risk & Reputation Risk

Business risk is the risk that the Society may not be able to carry out its corporate plans due to changes in the operating environment or uncertainty in the economy and could therefore suffer a reduction in income levels; this is a risk that every business faces. Reputation risk can materialise from business risk as well as other operational events, and is the risk of damage to the Society's business as a result of a loss of confidence in the Society following poor performance and/or adverse publicity. The Society manages these risks with a long term focus which encompasses carefully developed and detailed business plans and policies including a detailed short term plan covering a one year time horizon, a medium term plan covering a three year time horizon, and detailed financial forecast scenarios.

Residual Risk

The Board recognises that there are residual risks inherent in any business which may not be identified separately. Adequate provision has been made for general residual risks in the ICAAP by applying a buffer to the minimum capital requirement.

Claims on the Financial Services Compensation Scheme (FSCS)

Along with other deposit takers, the Society is liable to claims on the FSCS. Further details, including the provision held for this, are provided in Note 24 of the Society's Annual Report & Accounts 2017.

Insurance Risk

This is the risk that there may be gaps in the risks covered by the Society's own insurance policies, that there is insufficient cover in place, or that the covenant of the insurers is defective. The Society reviews its insurance cover on an annual basis, including reviewing policy wording and conditions, to ensure the Society's insurance arrangements are robust.

Remuneration Risk

This is principally concerned with the risks created by the way remuneration arrangements are structured. Details of the Society's remuneration policies and practices are set out in section 7 of this document.

3. CAPITAL RESOURCES

As at 31 December 2017 the Society had total capital resources of £39.8m; this is predominantly made up of Tier 1 capital which consists of the Society's general reserves. Tier 2 capital is limited to collective provisions for bad and doubtful debts less the Society's investment in its subsidiary undertaking.

Tier 1 and 2 capital resources

	£'000
Tier 1	
Gross: General reserves (accumulated profit)	38,409
Less: Intangible assets	(98)
Net Tier 1 capital resources	38,311
Tier 2	
Gross: Collective provisions for bad and doubtful debts	1,520
Net Tier 2 capital resources	1,520

Total capital resources

Gross:	39,929
Deductions:	(98)
Net total capital resources (own funds)	**39,831**

4. CAPITAL ADEQUACY ASSESSMENT & RESOURCES REQUIREMENT

The Society maintains a 3 year strategic planning framework which is reviewed by the Board on an annual basis and takes into account current and changing economic conditions. This review results in the production of a 3 year corporate plan including detailed budgets for the forthcoming year. The corporate plan is linked to the ICAAP document and in particular the Board's risk appetite for different business activities and the Society's capital plan.

The capital plan is produced through calculations made within the ICAAP which set-out the Pillar 1 minimum capital requirements for the Society. The Society has adopted the standardised approach to credit risk and the basic indicator approach to operational risk. The Society applies a risk weighting of 8% to the risk weighted asset values to determine the minimum capital requirement for credit risk. The Society calculates its average net income over the previous 3 years and provides 15% of this average as the minimum capital requirement for operational risk.

The table below sets out the Society's Pillar 1 capital requirement as at 31 December 2017 by asset class.

Capital requirement	**£'000**
Institutions	367
Secured on real estate property	8,796
Past due items	33
Other items	256
Total credit risk capital requirement	9,452
Operational risk capital requirement	957
Total Pillar 1 capital requirement	**10,409**
Capital Surplus (resource-requirement)	**29,422**

The Society is provided with Individual Capital Guidance (ICG) by the PRA, with its latest issued ICG set at 9.72% of risk weighted assets or £12,647k.

Capital Ratios	
Total Capital Ratio	**30.6%**
CET 1 Capital Ratio	**29.4%**
Tier 1 Capital Ratio	**29.4%**
Leverage Ratio	**10.2%**

Note: The leverage ratio is calculated by dividing Tier 1 capital by the sum of total assets and off-balance sheet mortgage commitments.

5. CREDIT RISK

Counterparty and Treasury Credit Risk

The Society's Treasury Policy statements (which contain the liquidity policy and financial risk management policy) are used to manage the credit risk arising from the Society's treasury counterparties. One aspect of this risk management is through the setting of exposure limits. In setting these limits consideration is given to the background rating information, balance sheet data and general market intelligence relevant to the counterparty.

The Society has nominated Fitch Ratings (Fitch) as its External Credit Assessment Institution (ECAI) for the 'Institutions' exposure class, and in particular, for the assessment of rated counterparty credit ratings. The minimum ratings required for non-building society and non-UK Clearing Bank counterparties as measured against the Fitch ratings agency are:

- For short-term investments of up to 12 months, rated counterparties must have at least an F1+ rating, with the exception of UK Clearing Banks which the Society considers as acceptable counterparties; and
- For investments over 12 months and up to a maximum of 3 years, rated counterparties must have a long-term rating of at least A-.

Exposure values for off-balance sheet instruments, hedges, are calculated using the CCR mark to market method; counterparty limits are inclusive of any such exposures. Note 28 in the Society's Annual Report & Accounts 2017 provides full details on the Society's use of off-balance sheet instruments including the fair value of financial instruments.

The Executive Management may delete counterparties from the approved list without reference to the Assets & Liabilities Committee or the Board; new counterparties cannot be added to the list without Board approval. Where appropriate, exposure to counterparties is monitored on a group basis.

The risk-weighted asset values under the standardised approach for the Society's non-cash liquidity exposures as at 31 December 2017 are detailed below, none of these exposures are impaired or past due and all are with UK institutions. Exposures rated as Credit Quality Step 2 are restricted to UK building societies and UK Clearing Banks.

Credit Quality Step	Fitch Rating	Risk Weight	Non-cash Exposure £m	Risk Weighted Exposure £m
1	AAA	0%	0.0	0.0
1	AA (BoE Reserve Account and UK Treasury Bills)	0%	63.6	0.0
1	AAA to AA-	20%	0.0	0.0
2	A+ to A-	20%	3.93	0.79
2	A+ to A-	50%	5.02	2.51
Unrated building societies	-	20%	1.0	0.2
Unrated building societies	-	50%	2.0	1.0
			75.55	4.5

An analysis of the residual maturity of these exposures can be found in Notes 9 to 11 of the Society's Annual Report & Accounts 2017.

Past due and impaired mortgages

The Society regards as 'past due' any mortgage where 3 or more monthly repayments have not been made at the accounting date. Arrears of mortgages are monitored very closely and provisions are made for specific and general purposes.

The following table provides an analysis, for capital adequacy purposes, of the Society's mortgage assets as at 31 December 2017.

	Residential			Non-residential		
Geographic region	**Performing**	**Past Due**	**Total**	**Performing**	**Past Due**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
West Midlands	194.6	0.4	195.0	2.89	-	2.89
East Midlands	23.2	-	23.2	-	-	-
South West	11.8	-	11.8	-	-	-
Outer Metropolitan	7.5	-	7.5	-	-	-
North West	9.8	-	9.8	-	-	-
Outer South East	9.7	-	9.7	-	-	-
Greater London	11.7	-	11.7	-	-	-
Yorkshire & Humberside	9.1	-	9.1	-	-	-
East Anglia	3.2	-	3.2	-	-	-
Wales	1.9	-	1.9	-	-	-
North	1.5	-	1.5	-	-	-
Scotland	0.0	-	0.0	-	-	-
	284.0	**0.4**	**284.4**	**2.89**	**-**	**2.89**

The residual maturity analysis for loans and advances to customers is provided in Note 13 of the Society's Annual Report & Accounts 2017 and is on the basis that loans and advances run for their full contractual term and does not take into account any instalments receivable over the life of the exposure. The Annual Report & Accounts 2017 also provide full details of the provisioning methodology in Note 1 along with the movement on provisions for bad and doubtful debts in Note 14.

6. INTEREST RATE RISK

Interest rate risk is referred to in section 2 and arises from the different types of assets and liabilities that the Society has, in particular fixed rate mortgages and fixed rate savings accounts which restrict the Society's ability to change interest rates on these accounts compared to accounts with variable interest rates.

In addition, basis risk, which is a type of interest rate risk, arises where assets and liabilities are subject to rates with different basis and there is a mismatch between the assets and liabilities on a particular basis. These include fixed rates, Bank of England base rate, LIBOR rates and rates administered by the Society, such as variable mortgage and savings rates.

The Society manages these exposures within limits set by the Board, using a combination of on and off balance sheet instruments, and reviews its exposures on a continuous basis. The impact of a movement in interest rates is stress tested on a monthly basis and the results of this gap analysis are reported to the Board. The stress test measures the effect of a parallel shift in interest rates of 2% against the Board limit. In addition, the Society reports its Basis risk position to the Board on a monthly basis.

7. REMUNERATION POLICIES AND PRACTICES

The Board of Tipton & Coseley Building Society is committed to ensuring that it follows as best practice the Regulators Remuneration Code. The Remuneration Code is principally concerned with the risks created by the way remuneration arrangements are structured, not with the absolute amount of remuneration, which is generally a matter for firms' remuneration committees.

The Society will take all necessary steps to ensure that it establishes, implements and maintains remuneration policies, procedures and practices that are consistent with and promote effective risk management whilst also aiming to provide individuals with a level of income that:

- recognises the market value of each position in a competitive market;
- rewards the individual's capabilities and experience;
- recognises the performance of individuals; and
- assists in Executive and staff retention.

The Society's Remuneration Committee's main responsibilities include:

- advising on remuneration policies and practices generally;
- providing specific recommendations on remuneration packages and other terms of employment for Executive Directors and Non-Executive Directors;
- assessing the reasonableness of the remuneration proposals put forward by the Chief Executive for the Executive, including the definition of performance objectives;
- taking into account its statutory duties in relation to equal pay and non-discrimination; and
- ensuring the Society's Remuneration Policy complies with the Regulator's Remuneration Code on an annual basis or more frequently if there are Code changes.

During 2017 the Remuneration Committee comprised wholly of Non-Executive Directors. Executive Directors and other Executives take part in annual, non-pensionable, non-contractual performance related pay schemes which target the Society's key objectives of asset growth, control of management expenses ratio, profitability, service conduct and quality of operations. The performance related pay schemes are formulated by the Remuneration Committee and approved by the Board consistent with the corporate objectives set by the Board in pursuit of sustainable, profitable performance over the long term taking into account known and potential risks to the business. Non-Executive Directors do not have service contracts and do not take part in any performance related pay schemes.

The members of staff whose professional activities have a material impact on the firm's risk profile are the Non-Executive Directors, Executive Directors and other Executives. Aggregate information relating to these categories is set out below:

	Number of Beneficiaries	**Fixed Remuneration (£'000)**	**Variable Remuneration (£'000)**	**Total (£'000)**
Non-Executive Directors:	7	205	-	205
Executive Directors:	2	282	10	292
Other Executives:	4	452	16	468

8. CONCLUSION

This disclosure document has been prepared in accordance with the requirements of CRD IV as interpreted by the Society based on its size and complexity. In the event that a user of this disclosure document requires further explanation on the disclosures given then they should write to the Finance Director at Tipton & Coseley Building Society, 70 Owen Street, Tipton, West Midlands, DY4 8HG.