Pillar 3 Disclosures

31 December 2019

Contents

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 2019 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 Society. 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 2019, the Society’s financial year-end, with comparative figures for 31 December 2018 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:

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

<u>Pillar 2</u> 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.

<u>Pillar 3</u> 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 (FRN: 159601). The figures have been drawn from the Society’s Annual Report and Accounts as at 31 December 2019 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

Introduction

The Society operates in an environment where financial risks arise as a natural consequence of its business activities. Current and future risks are closely monitored and assessed to ensure they do not pose a threat to financial or operational sustainability of the Society or its members interests.

Risk Management Framework

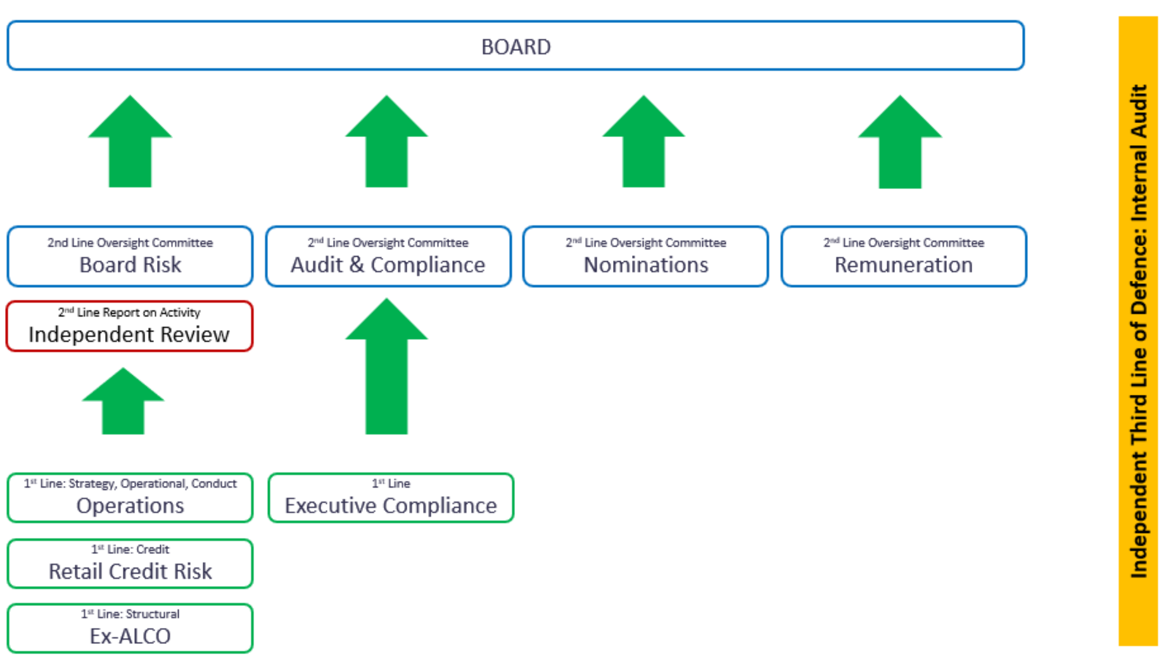
The Board has overall accountability for risk management process and for ensuring that the approach is aligned to business strategy and objectives. The Board has put in place a formal risk management framework, which includes a Risk Committee comprising four Non-Executive Directors, risk policy and risk appetite statements, exposure limits, mandates and reporting lines, and an active risk review process. Risks are monitored, assessed and are the subject of strategic policies approved by the Board.

The Society operates a 'three lines of defence' approach to the allocation of responsibilities for risk identification and management. This is illustrated below:

Line of Defence	Responsibility
First Line	Day to day ownership of risk, including identification, monitoring and management of risks.
Second Line	Oversees the implementation of the Risk Management Framework
Third Line – Internal Audit	Assurance and Validation

Risk Management Structure

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 Senior Leadership Team (SLT) 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.



Detailed below are the Board and management level committees along with a summary of their respective responsibilities:

Board	
Membership	All Board members
Responsibilities	Primary responsibility is to determine the Society's strategy, set risk appetite and to oversee implementation by the Senior Leadership Team. In particular it is responsible for: • Approval of the corporate plan, strategy and long term objectives • Approve the ICAAP, ILAAP, Recovery Plan and Treasury Policy • Approve extension of activities into new business or geographic areas • Approve lending policy • Approve new product proposals.
Frequency	At least 10 times a year

Risk Committee	
Membership	4 Non-Executive Directors
Responsibilities	Primary responsibility is oversight of risk management across the Society In particular it is responsible for: • Development of the Risk Management Framework • Review of risk status and risk metrics against the corporate plan and Board risk appetite. • Review and assessment of new and emerging risks • Detailed review of risks and assessment included within the ICAAP, ILAAP and Recovery Plan. • Review the results of mortgage book stress testing
Frequency	Quarterly

Audit & Compliance Committee	
Membership	4 Non-Executive Directors
Responsibilities	Primary responsibility is oversight to ensure the interest of members and other key stakeholders are adequately protected in relation to financial reporting, internal controls and regulatory compliance and conduct. In particular it is responsible for: • Review Annual Report and Accounts and Summary Financial Statement • Monitoring the adequacy of the Society's accounting records and controls • Monitoring the adequacy of the Society's systems of business and financial control • Monitor and review the overall effectiveness of Internal Audit • Ensuring the Society runs compliantly in accordance with the requirements and standards of the regulatory system
Frequency	Quarterly

Remuneration Committee	
Membership	3 Non-Executive Directors
Responsibilities	Primary responsibility is ensuring remuneration arrangements support the corporate plan and enable the recruitment and retention of Executive Directors and members of the Senior Leadership Team. In particular it is responsible for: • Making recommendations on levels of remuneration of the Executive Directors • Approval of Executive and staff incentive schemes
Frequency	At least three times a year

Nominations Committee	
Membership	Chairman, Vice-Chairman and Chief Executive
Responsibilities	Primary responsibility is the oversight of Director governance and succession. In particular it is responsible for: • Review and make recommendations to the Board at least annually on the Governance of the Board • Evaluate the balance of skills, knowledge, diversity, time commitment and current experience on the Board • Review and make recommendations to the Board on the suitability of new directors
Frequency	At least twice a year

Executive Compliance Committee	
Membership	Head of Compliance, Chief Executive, Finance Director, Operations Director, Director of Risk and Compliance, Director of Sales & Marketing and Director of IT.
Responsibilities	Primary responsibility is for the implementation and oversight of the Compliance Framework ensuring there is a comprehensive understanding of the compliance requirements facing the Society, the promotion of an effective compliance culture and reviewing the outcome from quality assurance and compliance monitoring reports.
Frequency	Quarterly

Executive Operations Committee	
Membership	Chief Executive, Finance Director, Operations Director, Director of Risk and Compliance, Director of Sales & Marketing and Director of IT.
Responsibilities	Primary responsibility is for the implementation of the Risk Management Framework ensuring there is a comprehensive understanding of the strategic, operational and conduct risks facing the Society, the assessment of the probability and the impact of risks materialising, and ensuring appropriate mitigating controls are in place,
Frequency	Quarterly

Executive Assets and Liabilities Committee (ALCO)	
Membership	Finance Director, Chief Executive, Director of Risk & Compliance and Finance Manager
Responsibilities	Primary responsibility is for the implementation and oversight of the Prudential risk framework for the Society's entire balance sheet including liquidity and funding risk, interest rate risk and basis risk.
Frequency	Monthly

Executive Retail Credit Risk Committee (RCRC)	
Membership	Operations Director, Finance Director, Chief Executive, Director of Sales & Marketing and Director of Risk & Compliance
Responsibilities	Primary responsibility is the monitoring and oversight of the Society's exposures to and control of retail credit risk in line with Credit Risk Appetite, and challenging lending strategy.
Frequency	Quarterly

Principal Risks

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.

Credit Risk

Credit risk is the risk that customers or counterparties will not meet their financial obligations to the Society as they fall due. This risk is most likely to arise in the potential inability of customers to make repayments on their mortgage, and of treasury counterparties to repay loan commitments.

The Board has established a treasury policy framework which limits treasury exposures to only those institutions considered highly credit worthy along with limits in place to restrict the amount of exposure that can be taken in relation to any one counterparty, industry sector and geographic region. Monitoring and oversight of treasury positions is performed by ALCO with further oversight provided by the Risk Committee.

Mortgage Credit risk is managed through the Society's underwriting process which seeks to ensure that customers only assume a debt that they can afford to repay. All mortgage applications are rigorously assessed with reference to the Society's lending policy; changes to policy are approved by the Board and the approval of mortgage applications is mandated. No matter how prudent lending policy is, a change in circumstances may lead to some customers getting into financial difficulties. The Society is highly proactive in providing support which can include working with customers to clear arrears, making arrangements, or forbearance. Exposure to mortgage credit risk is monitored by the RCRC with further oversight provided by the Risk Committee.

Interest Rate Risk (including Basis Risk)

Interest rate risk is the risk that the income and expenditure, arising from the Society's assets and liabilities, may change adversely as a result of changes in interest rates. One particular type of interest risk is basis risk, this is the risk that assets and liabilities that are linked to different variable indices (such as Base Rate or LIBOR) may not move in accordance with each other. The Society is exposed to movements in interest rates and manages this exposure on a continuous basis, within limits set by the Board. Monitoring and oversight of interest rate risk is performed by ALCO with further oversight provided by the Risk Committee.

Liquidity and Cash Flow Risk

Liquidity and Cash Flow risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only do so at excessive cost. The Board approved liquidity policy is to maintain sufficient liquid resources both as to amount and quality 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 as they fall due. In addition, regular stress testing is performed to confirm the level of liquid resources is adequate under adverse scenarios.

The Society maintains a level of liquid assets in line with the Board approved treasury policy. Adherence to these limits are monitored by the Finance Director on a day to day basis with further oversight provided by ALCO and the Risk Committee.

Operational Risk (including cyber risk)

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. The Society mitigates this risk through having a strong and effective internal control environment in which risks are monitored on a regular and timely basis by the Risk & Compliance team. Controls have been established and are maintained which appropriately address the risks identified and ensure conduct of the business in accordance with Society policies and risk appetite, and compliance with relevant laws, regulations and rules. In addition, insurance is used to transfer some risks.

The threat of cyber risk continues to increase. Protecting systems and data against potential cyber attacks remains an ongoing focus of risk management activity with further investment made during 2019 on additional safeguarding measures to increase resilience.

Exposure to operational risk is monitored by the Executive Operations Committee with further oversight provided by the Risk Committee.

Conduct Risk

Conduct risk is the risk that the Society's behaviour leads to poor customer outcomes. The Conduct Risk Policy sets out in detail the manner in which the Society should conduct business with its customers to ensure this does not lead to poor outcomes for them. On a day-to-day basis the Compliance team are responsible for monitoring conduct risk and assessing the controls in place to manage this risk. Further monitoring of conduct risk is carried out by the Executive Compliance Committee with oversight provided by the Audit & Compliance Committee.

Other Material Risks

Business Risk & Reputation Risk

Business risk is the risk of loss or reduction in profitability which arises from changes in business or economic conditions, including the failure to deliver business objectives within the corporate plan or implement the required strategy. The Society manages this with a long-term focus on ensuring a sustainable business model, encompassing carefully developed and detailed business plans and policies, which include maintaining a diverse product portfolio.

Included within Business risk is the risk of change. Investment in processes and technology is important for the growth of the Society and for enhancing the ways in which customers do business with us. As the strategic investment programme evolves it is important that risks are managed and resources prioritised to ensure maximum benefit whilst protecting members' interests.

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.

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 10 of this document.

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.

Brexit Risk

The Society is unlikely to be directly affected by the UK leaving the EU as it operates entirely in the UK. However, there is significant uncertainty around the indirect impact and potential risks for the wider UK economy, including the impact to bank base rate, mortgage rates, house price inflation, unemployment and inflation, all of which can have an impact on the financial performance of the Society.

The Board, as part of its corporate planning process, have considered the results of various scenario and sensitivity analysis, including that of a no trade deal scenario, to help inform and quantify the possible risks to the Society arising from Brexit. Economic conditions will be monitored closely and mitigating actions have been identified to adjust the corporate plan should the need arise.

LIBOR (London Interbank Offered Rate) Replacement

The Society is exposed to LIBOR through its hedging of fixed rate mortgages and savings. LIBOR is due to be phased out by the end of 2021.

It is currently expected that SONIA (Sterling Overnight Index Average) will replace LIBOR, however, there are key differences between LIBOR and SONIA. LIBOR is a 'term rate' and is forward looking, whereas SONIA is currently a backward looking rate. To transition existing contracts that reference LIBOR to SONIA, adjustments for term and credit differences might need to be applied to SONIA, to enable the two benchmark rates to be economically equivalent on transition.

The Society has a significant number of legacy contracts which reference LIBOR that extend beyond 2021. The Society anticipates that the areas of greatest change are updating systems and processes which capture LIBOR referenced contracts, amendments to those contracts and updating hedge designations. The Society continues to monitor industry developments to ensure an orderly transition to SONIA and to minimise the risks arising from transition. Furthermore, all new hedging transactions reference SONIA as the benchmark interest rate.

3. Capital Resources

As at 31 December 2019 the Society had total regulatory capital of £41.9m; this is predominantly made up of Core Equity Tier 1 (CET1) capital which consists of the Society's general reserves. Tier 2 capital is limited to the collective impairment provision.

Tier 1 and 2 Capital Resources

	2019	2018
Common Equity Tier 1 (CET 1) Capital	£000	£000
General Reserves	40,864	39,757
CET 1 capital before regulatory adjustments	**40,864**	**39,757**
CET 1 Regulatory Adjustments		
Intangible assets	(122)	(165)
Total Regulatory Adjustments	**(122)**	**(165)**
CET 1 Capital	**40,742**	**39,592**
Total Tier 1 Capital	**40,742**	**39,592**
Tier 2 Capital		
Credit Risk Adjustments - Collective impairment provision	1,134	1,395
Total Tier 2 Capital	**1,134**	**1,395**
Total Regulatory Capital	**41,876**	**40,987**
Total Risk Weighted Assets (RWA)	**138,833**	**129,709**
Capital Ratios and buffers		
CET 1 Ratio (as a % of RWA)	**29.3%**	**30.5%**
Tier 1 Ratio (as a % of RWA)	**29.3%**	**30.5%**
Total Capital (as a % of RWA)	**30.2%**	**31.6%**

The Society does not hold any Additional Tier 1 instruments and no transitional provisions apply in the current or prior periods.

Reconciliation of Regulatory Capital

The table shows the reconciliation between Total Reserves in the balance sheet and regulatory capital in the table above.

	2019	2018
	£000	£000
General reserves	40,864	39,757
Intangible assets	(122)	(165)
Collective impairment provision	1,134	1,395
Total Regulatory Capital	**41,876**	**40,987**

4. Capital Adequacy Assessment & Resources Requirement

4.1 Capital Management

The Society has a policy to hold sufficient capital to safeguard the assets of membership, maintain the confidence of the regulator and to achieve the targets set out in the corporate plan. The Society maintains a 4 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 4 year corporate plan including detailed budgets for the forthcoming year. The corporate plan is supported by the ICAAP document which assesses the level of capital required to meet current and future business activities whilst remaining within Board risk appetite. The ICAAP ensures that the Society meets regulatory capital requirements under business as usual and stressed environments.

The ICAAP sets-out the minimum Pillar 1 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.

4.2 Capital Requirement

The Society is provided with a Total Capital Requirement (TCR) by the PRA, with its latest issued TCR set at 9.72% of risk weighted assets. The table below sets out a summary of the Society's minimum capital requirements and TCR.

	2019	2018
	£000	£000
Credit Risk	10,102	9,422
Operational Risk	1,004	956
Pillar 1 Minimum Capital Requirement	**11,106**	**10,378**
Pillar 2A Capital Requirement	2,388	2,231
Total Capital Requirement (TCR)	**13,494**	**12,609**
Total Regulatory Capital	41,876	40,987
Excess over TCR	**28,382**	**28,378**

The table below sets out the Society's Pillar 1 capital requirement for credit risk as at 31 December 2019 by asset class.

Standardised Exposure Class	Exposure	Risk Weighted Assets	Minimum Capital Required
	£000	£000	£000
Central government and Bank of England	64,801	-	-
Credit institutions	7,794	2,071	165
Total Treasury exposures	**72,595**	**2,071**	**165**
Residential performing loans	318,441	115,412	9,233
Residential past due loans	2,384	2,232	179
Non-residential performing loans	2,221	1,692	135
Non-residential past due loans	44	42	3
Total loans and advances to customers	**323,090**	**119,378**	**9,550**
Fixed and other assets	3,481	3,032	243
Total on balance sheet exposures	**399,166**	**124,481**	**9,958**
Mortgage pipeline	21,321	1,621	130
Derivative credit valuation adjustment	463	181	14
Total off-balance sheet exposures	**21,784**	**1,802**	**144**
Total Credit risk exposure	**420,950**	**126,283**	**10,102**

The difference between the total credit risk exposure measure above and the total assets as per the Society's Statement of Financial Position in the Annual Report and Accounts is as follows:

Reconciliation	2019
Total gross credit risk exposure (as per table above)	**420,950**
Less: allowance for impairment	1,302
Less: Off-balance sheet commitments	21,321
Less: Off-balance sheet derivatives	463
Total assets per the Society's Statement of Financial Position	**397,864**

4.3 Capital Buffers

Countercyclical Buffer

The Society is required to hold a Countercyclical buffer (CCYB) depending on the geographical breakdown of its assets. The CCYB is set by individual country and is designed to limit excessive credit growth. The requirement is calculated by multiplying the total credit risk exposure by the buffer rate for that country and totalling the result.

The Society's assets are wholly located in the UK. The UK element of the CCYB is set by the Financial Policy Committee (FPC) and can range from 0% to 2.5%, and as at 31 December 2019 was 1.0%.

A further increase to the UK's CCYB was announced in December 2019, with the buffer rate increasing to 2% with effect from December 2020.

Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

			Own funds requirements				
	General credit exposures	Trading book exposures	Of which: General credit exposures	Of which: Trading book exposures	Total	Own funds requirement weights	Counter-cyclical capital buffer rate
	£000	£000	£000	£000	£000	%	%
Breakdown by country							
United Kingdom	420,950	-	10,102	-	10,102	100%	1.0%
Total	**420,950**	**-**	**10,102**	**-**	**10,102**	**100%**	**1.0%**

The table below shows the amount of institution specific CCYB as at 31 December 2019:

	2019
Total risk exposure amount (£000)	**138,833**
Institution specific countercyclical buffer rate (%)	1.0%
Institution specific countercyclical capital buffer requirement (£000)	1,388

Capital Conservation Buffer

Along with all other UK financial institutions the Society is required to hold a Capital Conservation Buffer (CCOB). The CCOB can be used to absorb losses during periods of economic and financial stress to avoid breaching minimum capital requirements. The CCOB is set as a percentage of RWA's and as at 31 December 2019 was 2.5%.

4.4 Leverage Ratio

The leverage ratio is a simple, transparent, non-risk based measure that allows a comparison between firms. It is calculated as Tier 1 Capital divided by the adjusted balance sheet exposures.

CRD IV requires a minimum leverage ratio of 3% and at the 31 December 2019 the Society had a leverage ratio of 10.1% (2018: 10.6%).

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures	2019	2018
	£000	£000
Total assets as per published financial statements	397,864	370,714
Adjustments for derivative financial instruments	463	321
Adjustments for off-balance sheet items	4,264	3,443
Other adjustments	(122)	(165)
Leverage ratio total exposure measure	**402,469**	**374,313**

Table LRCom: Leverage ratio common disclosure	2019	2018
	£000	£000
On-balance sheet items (excluding derivatives and SFT's but including collateral)	397,804	370,658
Asset amounts deducted in determining Tier 1 Capital	(122)	(165)
Total on-balance sheet exposures (excluding derivatives and SFT's)	**397,682**	**370,493**
Replacement cost associated with derivatives transactions	60	56
Add-on amounts for PFE associated with derivatives transactions	463	321
Total derivative exposures	**523**	**377**
Off-balance sheet exposures at gross notional amount	21,321	17,215
Adjustments for conversion to credit equivalent amounts	(17,057)	(13,772)
Total off-balance sheet exposures	**4,264**	**3,443**
Tier 1 capital	40,742	39,592
Total exposures	402,469	374,313
Leverage ratio	**10.1%**	**10.6%**

Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives)		2019	2018
		£000	£000
Total on-balance sheet exposures (excluding derivatives)		**397,804**	**370,658**
Total Trading book exposures		-	-
Total Banking book exposures		**397,804**	**370,658**
Of which:			
	Exposures treated as sovereigns	64,801	58,565
	Institutions	7,734	9,750
	Secured by mortgages of immovable properties	320,662	300,638
	Exposures in default	2,428	710
	Other exposures	2,179	995

5. Credit Risk

5.1 Counterparty and Treasury Credit Risk

The Society's Treasury Policy statements (which contain the liquidity policy, funding 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 counterparty exposure limits which limit the risk that can be taken in relation to one counterparty or group of counterparties. The Society's Liquidity policy only permits lending to banks and building societies.

In setting the counterparty limits consideration is given to the background rating information, balance sheet data and general market intelligence relevant to the counterparty. In addition, every bank must have a minimum rating of 'A-' from an External Credit Assessment Institution (ECAI).

The Society has nominated Fitch Ratings (Fitch) as its ECAI for the 'Institutions' exposure class, and in particular, for the assessment of rated counterparty credit ratings.

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

The table below details the Society's liquidity exposures as at 31 December 2019 by maturity and rating. None of these exposures are impaired or past due and all are with UK institutions. Unrated exposures are restricted to unrated building societies.

Credit Quality Step	Credit Rating	Less than 3 months (£000)	3 months to 1 year (£000)	1 to 5 years (£000)	Total (£000)	Risk weighted asset value (£000)
1	AAA to AA-	64,801	-	-	64,801	-
2	A+ to A-	4,905	887	-	5,792	1,671
-	Unrated	2,002	-	-	2,002	400
Total		**71,708**	**887**	**-**	**72,595**	**2,071**

In addition to the exposures above, Treasury credit risk exposures also arise from counterparties in respect of derivative financial instruments. Derivative financial instruments are used to hedge exposure to interest rate risk. Note 26 in the Society's Annual Report & Accounts 2019 provides full details on the Society's use of off-balance sheet instruments including the fair value of financial instruments. All the Society's derivative financial instruments are bilateral in nature and transacted Over-the-Counter (OTC).

All the Society's derivative transactions are governed by agreements based on the International Swaps and Derivatives Association (ISDA) documentation which are supported by a Credit Support Annex (CSA). The CSA governs the process of mitigating credit risk by detailing the frequency and movement of collateral between the Society and the swap counterparty.

Derivative exposures are calculated using the mark to market method as described in the CRR; counterparty limits are inclusive of any such exposures.

Table: CCR1	Replacement cost (£000)	Potential Future Exposure (£000)	Exposure at default (£000)	Risk weighted assets (£000)
Mark to market	60	463	523	262

The Society does not currently centrally clear its derivatives and therefore the risk weighting includes a credit valuation adjustment to reflect this.

Table CCR2: CVA capital charge	**2019**	**2018**
	£000	£000
All portfolios subject to the standardised method	523	377
Total subject to the CVA capital charge	**523**	**377**

5.2 Loans and Advances to Customers

The Society is a lender of primarily residential mortgages throughout England and Wales. Lending is controlled through the Board Risk appetite and the Society's lending policy which requires all applications to be individually underwritten.

Credit risk arises primarily from the failure of borrowers to meet their ongoing financial obligations to repay their mortgage to the Society. Allowance for impairment is reviewed at least annually or where the SLT become aware of a loss event to suggest that a loan is impaired. An individual impairment provision is made against those loans and advances where there is objective evidence of impairment. This may include:

- Significant financial difficulty of the borrower;
- Default by a borrower;
- Restructuring of a loan by the Society on terms that it would not consider otherwise;
- Indications that a borrower has or will enter bankruptcy;
- Observable data relating to a group of assets such as the adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

A further collective provision is held to cover losses, which although not yet incurred, are likely to exist within the Society's loan book. The Annual Report & Accounts 2019 provide full details of the provisioning methodology in Note 1 along with the movement on provisions for bad and doubtful debts in Note 13.

The residual maturity analysis for loans and advances to customers is also provided in Note 12 of the Society's Annual Report & Accounts 2019 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.

A summary of the residual maturity as at 31 December 2019 is shown below:

Residual maturity	**Within 1 year (£000)**	**More than 1 year but less than 5 years (£000)**	**More than 5 years (£000)**	**Total (£000)**
Loans and advances to customers	10,428	51,295	261,367	323,090

The following table provides an analysis, for capital adequacy purposes, of the Society's mortgage assets as at 31 December 2019:

Geographic region	Residential			Non-residential		
	Performing (£000)	Past Due (£000)	Total (£000)	Performing (£000)	Past Due (£000)	Total (£000)
West Midlands	165,039	1,182	166,221	2,200	44	2,244
East Midlands	22,996	599	23,595	21	-	21
South West	25,328	-	25,328	-	-	-
London	42,596	383	42,979	-	-	-
South East	17,934	-	17,934	-	-	-
North West	14,743	109	14,852	-	-	-
Yorkshire & Humberside	12,240	-	12,240	-	-	-
East Anglia	8,588	-	8,588	-	-	-
Wales	5,139	111	5,250	-	-	-
North East	3,838	-	3,838	-	-	-
Total	**318,441**	**2,384**	**320,825**	**2,221**	**44**	**2,265**
Provision	1,132	152	1,284	2	16	18
Charge for the year	(218)	78	(140)	(43)	16	(27)

The Society also insures its residential mortgage book against losses using Mortgage Indemnity (MIG) insurance. MIG insurance is taken out on all lending where the loan to value (LTV) exceeds 80% at origination.

Further details of the Society's non-performing and forborne exposures can be found in Appendix B.

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 instruments used for risk management purposes are derivative financial instruments. The objective of the Society using derivatives is in accordance with the Building Societies Act 1986 and is to limit the extent to which the Society will be affected by changes in interest 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 ALCO and the Board. The stress test measures the effect of a parallel shift in interest rates of 2% against the Board limit.

The table below shows the Society's sensitivity to this measurement (in terms of economic value):

	2% shift in interest rates (£000)
31 December 2019	740

In addition, to monitor basis risk, the Society runs an Earnings at Risk (EAR) model to monitor the impact of changes to different interest bases. This is managed against a set of limits to restrict the maximum negative impact that the scenarios can have to net interest income. The EAR exposures are reported to ALCO and the Board on a monthly basis.

7. Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. The Society mitigates this risk through having a strong and effective internal control environment in which risks are monitored and controlled on a regular and timely basis. In addition, insurance is used to transfer some risks.

Exposure to operational risk is monitored by the Executive Operations Committee with additional oversight provided by the Risk Committee.

7.1 Minimum Capital requirements for operational risk

The Society calculates its operational risk capital requirement using the Basic Indicator Approach (BIA). This is calculated as 15% of the Society's net income averaged over the previous 3 years.

	2019	2018
	£000	£000
Three years prior	6,393	6,026
Two years prior	6,702	6,393
Prior year	6,994	6,702
Basic Indicator (3 year average)	6,696	6,374
Own funds requirement (15% Basic Indicator)	**1,004**	**956**

8. Liquidity Risk

Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only do so at excessive cost, under either normal operating conditions or a stressed environment. The Board approved liquidity policy is to maintain sufficient liquid resources both as to amount and quality 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 as they fall due. This is supported by monthly stress testing to confirm the level of liquid resources is adequate under adverse scenarios. Adherence to these limits is monitored by the Finance Director on a day to day basis with oversight provided by ALCO and Board Risk Committee.

The key regulatory metric to monitor short term liquidity risk is the liquidity coverage ratio (LCR) which measures the potential net cash outflow within a 30 day period under a prescribed set of assumptions as a proportion of high quality liquid assets that are held as a liquidity buffer. The regulatory requirement is that the LCR should be greater than 100%.

The table below summarises the average LCR position by quarter:

	Quarter ending 31 March 2019	Quarter ending 30 June 2019	Quarter ending 30 September 2019	Quarter ending 31 December 2019
Liquidity buffer (£000)	61,085	60,760	70,571	73,013
Total Net cash outflows (£000)	19,082	22,745	23,275	25,988
Liquidity coverage ratio (%)	320%	267%	303%	281%

3 data points are used in the calculation of the averages for each period of reporting.

The LCR at 31 December 2019 was 272% (31 December 2018: 345%).

9. Asset Encumbrance

The Society has pledged part of its loan book as collateral with the Bank of England, in order to participate in the Banks Sterling Monetary Framework (SMF) and Term Funding Scheme (TFS). Participation in these schemes provides the Society with a source of funding that diversifies the funding portfolio. Although the loans remain fully owned and administered by the Society, they are classified as encumbered.

Details of encumbered assets, unencumbered assets and sources of encumbrance are set out in the tables below. The tables have been produced in accordance with regulatory guidelines using median values of quarterly data during the 12 months preceding 31 December 2019, and as a result may differ from other information provided in this document.

Encumbered and unencumbered assets (Template A)				
	Encumbered assets		Unencumbered assets	
	Carrying amount (£000)	Fair Value (£000)	Carrying amount (£000)	Fair Value (£000)
Assets of the reporting institution	**54,347**	**-**	**333,570**	**-**
Loans and advances other than on demand	53,461	-	260,053	-
Other assets	886	-	73,517	-

Sources of encumbrance (Template C)		
	Matching liabilities, contingent liabilities or securities lent (£000)	Assets and collateral received encumbered (£000)
Carrying amount of selected financial liabilities	18,235	54,229

10. Remuneration Policies and Practices

The Board 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 2019 the Remuneration Committee comprised wholly of Non-Executive Directors and met on three occasions.

Full details of the Remuneration Policy and the individual components of remuneration can be found in the Annual Report and Accounts.

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 mortgage book 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	6	189	-	189
Executive Directors	3	489	38	527
Other Executives	3	287	16	303

11. 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.

Appendix A: Exposure by Asset Classes and Risk Weights

Template CR5: Standardised approach											
£000	**0%**	**20%**	**35%**	**50%**	**75%**	**100%**	**150%**	**250%**	**Others**	**Total**	**Unrated**
Central governments or central banks	64,801	-	-	-	-	-	-	-	-	64,801	-
Institutions	-	6,908	-	886	-	-	-	-	-	7,794	2,002
Retail	-	-	-	-	9,495	-	-	-	-	9,495	9,495
Secured by mortgages on immovable property	-	-	308,701	-	-	2,467	-	-	-	311,168	311,168
Exposures in default	-	-	-	-	-	2,394	34	-	-	2,428	2,428
Other items	449	21,320	-	463	-	3,032	-	-	-	25,264	25,264
Total	**65,250**	**28,228**	**308,701**	**1,349**	**9,495**	**7,893**	**34**	**-**	**-**	**420,950**	**350,357**

Appendix B: Non-performing and forborne exposures

Table 1: Credit quality of forborne disclosures

£000	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment		Collateral received and financial guarantees received on forborne exposures	
	Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures	Total	Of which: received on non-performing exposures
		Total	Of which: defaulted	Of which: impaired				
Loans and advances	**1,083**	**317**	**-**	**317**	**100**	**68**	**-**	**-**
Households	1,083	317	-	317	100	68	-	-
Loan commitments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**1,083**	**317**	**-**	**317**	**100**	**68**	**-**	**-**

Table 2: Credit quality of performing and non-performing exposures

£000	Gross carrying amount/nominal amount											
	Performing exposures			Non-performing exposures								
	Total	Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days	Total	Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
Loans and advances	**393,257**	**391,977**	**1,280**	**2,428**	**1,181**	**1,136**	**111**	**-**	**-**	**-**	**-**	**-**
Central banks	64,801	64,801	-	-	-	-	-	-	-	-	-	-
Credit institutions	7,794	7,794	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	2,221	2,192	29	44	-	44	-	-	-	-	-	-
Of which: SME's	*2,221*	*2,192*	*29*	*44*	-	*44*	-	-	-	-	-	-
Households	318,441	317,190	1,251	2,384	1,181	1,092	111	-	-	-	-	-
Off-balance sheet exposures	**21,321**			**-**								**-**
Non-financial corporations	-			-								-
Households	21,321			-								-
Total	**414,578**	**393,377**	**1,280**	**2,428**	**1,181**	**1,136**	**111**	**-**	**-**	**-**	**-**	**-**

Table 3: Performing and non-performing exposures and related provisions

£000	Gross carrying amount/nominal value		Accumulated impairment and provisions		Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures	Non-performing exposures	Performing exposures – accumulated impairment and provisions	Non-performing exposures – accumulated impairment and provisions		On performing exposures	On non-performing exposures
Loans and advances	**393,257**	**2,428**			**-**	**-**	**-**
Central banks	64,801	-	-	-	-	-	-
Credit institutions	7,794	-	-	-	-	-	-
Non-financial corporations	2,221	44	2	16	-	-	-
Of which: SME's	*2,221*	*44*	*2*	*16*	-	-	-
Households	318,441	2,384	1,132	152	-	-	-
Off balance sheet exposures	**21,321**	**-**	**-**	**-**	**-**	**-**	**-**
Non-financial corporations	-	-	-	-	-	-	-
Households	21,321	-	-	-	-	-	-
Total	**414,578**	**2,428**	**1,134**	**168**	**-**	**-**	**-**

Table 4: Collateral obtained by taking possession and execution processes

£000	Collateral obtained by taking possession	
	Value at initial recognition	Accumulated negative changes
Property, plant and equipment (PP&E)	-	-
Other than PP&E	-	-
Residential immoveable property	-	-
Commercial immovable property	-	-
Total	**-**	**-**