Pillar 3

Disclosure Document

for the year ended 31 March 2020

Board – June 2020

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EXECUTIVE SUMMARY

This document presents the Pillar 3 disclosures of Dudley Building Society as at 31 March 2020.

The table below provides an overview of the key metrics on capital adequacy.

Key metrics	31 March 2020	31 March 2019
Available capital	**£m**	**£m**
Total Common Equity Tier 1	**23.6**	22.9
Total Tier 2 capital	**1.0**	0.8
Total capital	**24.6**	23.7
Total risk weighted assets (RWAs)	**179.3**	150.9
Capital ratios	**%**	**%**
Common Equity Tier 1 ratio	**13.1**	15.2
Total capital ratio	**13.7**	15.7
Total capital and buffer requirement	**11.3**	12.7
Leverage ratio		
Leverage ratio exposure measure	**£545.2M**	£445.2m
Leverage ratio	**4.3%**	4.9%
Liquidity ratios		
Liquidity coverage ratio	**297%**	197%
Net Stable Funding Ratio	**170%**	168%

dudley building society

1. Introduction

On 1 January 2014, the Capital Requirements Regulation (CRR) and the Capital Requirements Directive came into force and are together referred to as CRDIV or Basel 3. The Capital Requirements Directive governs how much capital all banks and building societies must hold to protect their Members, depositors and shareholders. The revisions introduced by CRD IV seek to strengthen the capital position of the sector and make it more resilient to financial and economic shocks. In the UK this is implemented by the Prudential Regulation Authority (PRA).

Dudley Building Society's primary aim is to ensure the protection of Members' savings by having sufficient capital even during a significant economic downturn.

1.1. Framework

The CRD determines a framework which in addition to capital requirements also requires disclosure of key pieces of information, such as risk exposures and risk assessment processes. Below are the three main "Pillars" which make up the CRD.

Pillar 1: Minimum regulatory capital requirements relating to credit, market and operational risks. The Society meets the minimum capital requirements by applying the standardised approach to credit risk and the Basic Indicator Approach to operational risk.

Pillar 2: Assessment of capital requirements by the Society through the Internal Capital Adequacy Assessment Process (ICAAP) and the PRA through the Supervisory Review and Evaluation Process (SREP) to determine whether additional capital should be held for specific risks not covered under Pillar 1;

Pillar 3: Disclosure of key information about risk exposures, the management of those risks and capital adequacy.

The Pillar 3 Disclosures are designed to promote market discipline through external disclosure of a firm's risk management framework and risk exposures.

For small societies such as the Dudley, the Pillar 1 assessment is based on a formulaic risk-based capital calculation focusing particularly on credit and operational risks to determine the Capital Resources Requirement.

1.2. Scope of application

This document contains the Pillar 3 disclosures for the Dudley Building Society (PRA Number 161294). The principal office of the Society is 7 Harbour Buildings, The Waterfront, Brierley Hill, West Midlands, DY5 1LN.

1.3. Basis and frequency of disclosures

This document sets out the Pillar 3 disclosure requirements of the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) Pillar 3, as relevant to the size and complexity of the Society.

The Pillar 3 disclosures have been prepared purely to comply with the Capital Requirements Directive, in seeking to explain the basis on which the Society has prepared and disclosed certain capital requirements and information about the management of certain risks. It also provides asset information and capital calculations under Pillar 1.

Unless otherwise stated all information relates to the Society's assets as at 31 March 2020.

This document is updated at least annually to ensure that the disclosures, verification and frequency remain appropriate and will be based on the Society's most recent audited financial statements.

Confidential information and materiality
Information is considered material if its omission or misstatement could change or influence the assessment of decision of a user relying on that information for the purpose of making economic decisions. No disclosures have been omitted on the basis of materiality or confidentiality.

1.4. External audit and verification

Verification
This document has been reviewed by the Society's Assets & Liability Committee and approved by its Board in June 2020.

External audit
The disclosures provided in this document have not been subject to external audit except where they are equivalent to those prepared under accounting standards for inclusion in the Society's audited financial statements for the year ended 31 March 2020.

The disclosures do <u>not</u> constitute any form of Financial Statement and must not be relied upon in making any judgement on the Society. All figures within this document are correct as of 31 March 2020 unless stated otherwise.

1.5. Publication media and location

The Pillar 3 disclosure document will be prepared and published on an annual basis and is available on the Society's website (www.dudleybuildingsociety.co.uk). Should you require further information on this document please contact the Society Secretary at the principle office address.

2. Risk Management Policies and Objectives

This section sets out the Society's approach to managing risk.

2.1. Introduction

Dudley Building Society is a traditional Building Society, developing and retailing financial products, principally in the form of mortgages and savings. In executing the Society's strategy and in carrying out its routine business and activities, the Society is exposed to a number of risks. The primary goal of risk management is to ensure that the outcome of risk-taking activity is consistent with the Society's strategy and risk appetite and appropriate for the level and types of risks it takes paying regard to regulatory guidance. Good risk management ensures there is an appropriate balance between risk and regard in order to optimise Member returns and, when issues arise they are managed for the best outcome for Members and the Society.

The Society has a Risk Management Framework that documents the Society's formal structure for managing risks and Board risk appetite. The Board delegates oversight of this area to a Risk Committee, which reviews risk limits, reporting lines, mandates and other control procedures. In addition, the Society's Assets & Liabilities Committee (ALCO) is charged with the responsibility for managing and controlling the balance sheet exposures and the use of financial instruments for risk management purposes.

2.2. Society's Risk Management framework

The Society's Risk management framework ("RMF") provides the foundation for achieving risk management objectives through:

- Articulating the Society's risk management strategy, risk appetite, practices and procedures
- Documenting a consistent framework
- Establishing minimum standards around key risk management issues
- Directing the approach to risk governance throughout the Society

The RMF documents the Society's approach to managing risk through:

- Defining risk appetite
- Detailing the three lines of defence model
- Determining committee roles and responsibilities
- Identifying roles responsible for key risks and oversight of risk decisions
- Documenting the main risk management processes
- Describing the key risks faced by the Society and how they are managed and mitigated
- Listing out the key risk policies in use by the Society

The three lines of defence model

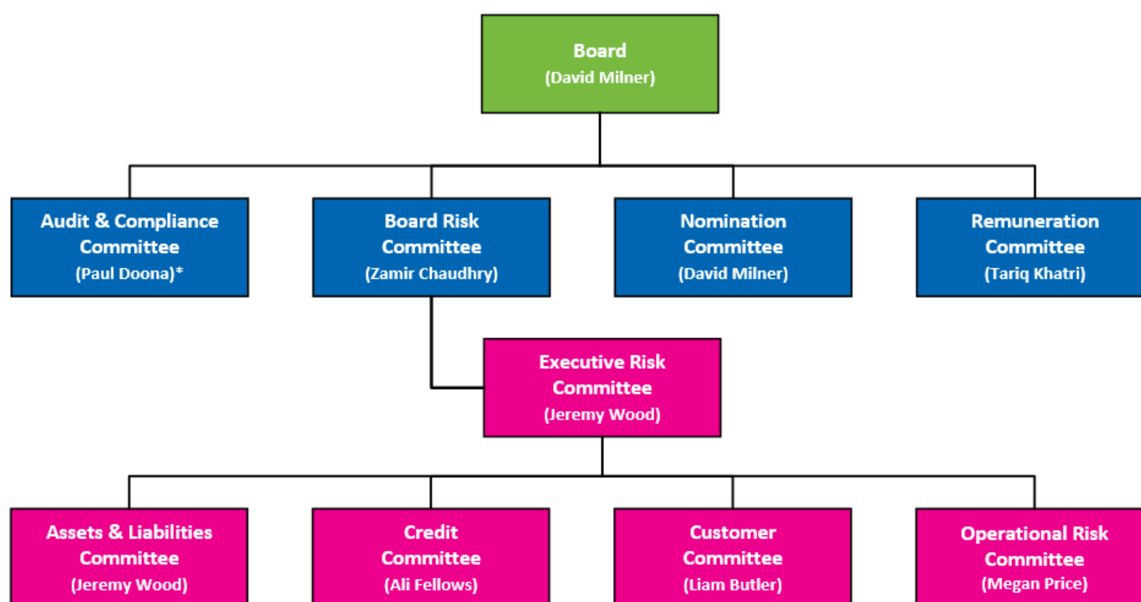
The Society adopts a three lines of defence model to separate risk management activities between:

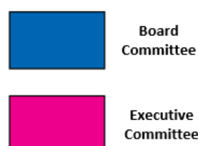
1st line	Those that own and take risks and implement controls;
2nd line	Those that oversee, monitor and challenge the first line; and
3rd line	Audit functions which provide fully independent assurance

In addition, the risk management framework incorporates the requirements of the PRA's Supervisory Statement SS20/15 "Supervising building societies' treasury and lending activities". Specifically, the Society has adopted the Limited Lending Approach and the Matched Treasury Approach to risk management from SS20/15.

2.3. Risk Governance: Board and Committee structure

The Society's Management structure is set by the Society's Board of Directors, including via the establishment of a number of Committees which may include both Executive and Non-Executive Directors to oversee the various sections of the Society's business. The principal Committees from a Risk Management viewpoint are set out below.





** Paul Doona is interim Chair of the Audit & Compliance Committee*

Society Board

The role of the Board is to set strategic direction for the Society, ensure that the necessary financial and human resources are in place to meet them and review the performance of the Executive team. The Board also maintains a risk framework to enable risks to be assessed and managed in accordance with the Board's appetite to risk, including through review and approval of the Society's ILAAP and ICAAP documents.

At 31 March 2020 the Board consisted of three executive directors, including the Chief Executive and six Non-Executive directors, including the Chairman. The Nominations committee maintain a succession plan for Directors.

The Board met 13 times in the financial year ended 31 March 2020. The Board retains certain powers to Committees shown in the chart above.

Society Chairman: The Chairman sets the culture and direction of the Board, facilitating and encouraging effective contribution and challenge from Directors, and maintaining constructive relations between Non-Executive and Executive Directors.

Non-Executive Directors: Non-executive directors constructively challenge and help develop proposals on strategy and oversee executive performance.

The board delegates the implementation of the strategy and the day-to-day management of the Society to the Executive team, which is led by the Chief Executive.

The Board has established Committees to consider certain specialist areas in more detail than would be appropriate at a Board meeting. Each Committee operates within defined terms of reference. Minutes of meetings, evidencing the level and quality of challenge, are formally recorded and proceedings are reported to the Board by the respective committee chairman.

Further details of the Committees and their summary terms of reference are set out below. Full Committee terms of reference are available on the Society's website www.dudleybuildingsociety.co.uk or on request from the Society Secretary.

Audit & Compliance Committee

The Audit & Compliance Committee is a committee of the Board and comprises four Non-Executive Directors and is chaired by Paul Doona. On 16th July 2020 Nicolle Coll (Non-Executive Director) will take over as Chairman. Members of the Executive and Senior management are invited to attend as appropriate. All Non-Executive Directors on this Committee have experience that is relevant to the role and at least one member present has recent financial experience.

The Executive Directors are not members of the Committee but, together with representatives from internal and external auditors, the Society Chairman, other non-executive directors, the Society's Head of Risk, Compliance and Financial Crime and the Society's Head of People, Culture and Governance, attend by invitation.

The Audit and Compliance Committee acts under authority delegated to it by the Board. It is responsible for assessing systems and controls, the provision of accurate financial information and establishing effective whistleblowing practices. The Committee reviews the annual accounts prior to approval by the Board and monitors the effectiveness and independence of both Internal and External Auditors. It also approves the instruction of the Internal and External Auditors to carry out any non-audit assignments.

Main Functions: The purpose of the Committee is to ensure that the interests of the members are protected in relation to financial reporting and internal controls. It considers the adequacy of internal controls and the Society's risk management framework, internal and external audit arrangements, financial reporting and maintains oversight of the Society's second line of defence. In addition, the Committee is responsible for the Society's policies on Whistleblowing and Anti-Bribery and Corruption, Gifts and Hospitality, Data Protection, Procurement and Fitness and Propriety.

The Committee will review, and challenge where necessary, the actions and judgements of management, in relation to the Society's Annual Accounts. The Committee liaises with the Society's external auditors concerning the nature and scope of their work and reviews any changes in accounting policy and practice.

The Committee approves and oversees the delivery of the annual integrated assurance plan comprising the internal audit and risk management and compliance plans. Internal audit services are currently provided to the Society by RSM under the terms of a specific engagement. The Committee's terms of reference provide responsibility to approve the appointment, terms of engagement, reappointment or dismissal of the internal auditors.

The Committee meets at least four times a year. During 2019/20, the Committee met seven times to fulfil its responsibilities and considered the following matters:

- Compliance monitoring
- Effectiveness of the systems of internal control, reviewing updates to key Society policies
- Plans and activities of internal audit
- External audit tender, resulting in the appointment of PwC as statutory auditors
- Integrity of the Society's Financial statements

In considering the integrity of the Society's financial statements the Committee reviews the accounting policies and significant financial judgements. The external auditor, PwC is also used to ensure policies and judgements are reasonable and appropriate.

Board Risk Committee

This Committee monitors and reviews the Society's risk management framework covering Prudential, Operational, Regulatory and Systemic Risk in order to ensure there is a comprehensive understanding of the risks confronting the Society, both in terms of its strategic thinking for the future and its daily operational management. Its review covers the potential likelihood and impact of occurrence of risks, and how they are mitigated. The Society's risk reporting includes its ICAAP and ILAAP.

The principle function of the Board Risk Committee is to provide oversight of the Society's risk management framework, systems and controls, risk strategy and risk appetite. Its main responsibilities are as follows:

- to provide oversight of the Society's risk profile and its operation within risk appetite, considering risk matters escalated from other Committees and escalating, where necessary, to the Board;
- to ensure that an effective risk management approach is operating which allows the Committee to provide effective oversight and fulfil its responsibilities to the Board; and
- to oversee emerging risks in respect of short, medium and long-term impact.

This Committee meets at least ten times each year and monitors and reviews the Society's risk management framework covering Prudential, Operational, Regulatory, Systemic and Strategic Risk in order to ensure there is a comprehensive understanding of the risks confronting the Society, both in terms of its strategic thinking for the future and its daily operational management. Its review covers the potential likelihood and impact of occurrence of risks, and how they are mitigated. The Society's risk reporting includes its ICAAP and ILAAP.

The Committee membership comprises four Non-Executive Directors: Zamir Chaudhry (Chair), Nicole Coll, Paul Doona and Tariq Khatri. The Society Chairman may attend by invitation.

The Committee is supported by the activities of the Executive Risk Committee.

Board Nomination Committee

This Committee meets at least twice a year and reviews succession planning for both Non-Executive and Executive positions. It considers the balance and range of skills, knowledge and experience when dealing with Board appointments. When making recommendations for appointment to the Board, the Committee has due regard for the benefits of diversity.

The Committee oversees the structure, skills, composition and effectiveness of the Board and its Committees.

Oversight of appraisals of all Directors is the responsibility of the Committee, as is the review of the Board's performance collectively.

The Committee membership comprises all Board Members, with the Society Chairman acting as Committee Chair. The Society Chairman does not take part in confirming his re-appointment.

Board Remuneration committee

This Committee meets at least twice a year and recommends for approval by the Board the appropriate remuneration, benefits and contracts of the Directors and Senior Managers of the Society.

The Committee membership comprises all Non-Executive Directors. Tariq Khatri is Chair of the Committee.

Executive Risk Committee

This Committee meets at least ten times each year and is primary responsible for reviewing and managing key risks to ensure that they are within the Board's Risk Appetite. The Committee reports to the Board Risk Committee.

The Committee comprises Executive Directors and relevant Senior Managers. The Chief Executive acts as Chairman.

Assets & Liabilities Committee (ALCO)

This Committee is responsible for managing the structure of the Society's assets and liabilities including policies relating to liquidity, wholesale funding, interest rate risk management and Balance Sheet structure. Oversight of Treasury matters is the responsibility of the Society's Board although matters raised in the Assets & Liabilities Committee are also reported to the Executive and Board Risk Committees.

The Committee membership comprises the Executive Directors – with the CEO (Jeremy Wood) acting as Chair - the Head of Finance, the Head of Risk, Compliance and Financial Crime, the Regulatory, Reporting and Treasury Accountant and the Product and Mortgage Systems Manager.

Main Functions: To recommend treasury and balance sheet risk management strategies, capital requirements in the context of the Society's policies and risk appetite statements for interest rate risk, liquidity and funding and capital and to ensure compliance with regulatory requirements.

The Committee meets at least 10 times a year.

Credit Committee

This Committee meets at least ten times each year and monitors the quality and profile of the mortgage portfolio in line with the Society's Credit Risk and Lending Policy and in accordance with the regulatory limits and guidelines. It reviews policy, lending mandates and arrears performance.

The Executive Directors are members of the Committee, together with the Head of Finance, the Head of Risk, Compliance and Financial Crime, the Head of Operations and the Head of Mortgage Operations. The Head of Risk, Compliance and Financial Crime (Alison Fellows) acts as Chair.

Customer Committee

This Committee meets at least ten times each year and oversees the Society's approach, policies, processes and actions to ensure that there is a focus on the delivery of fair customer outcomes. The Committee comprises Executive Directors and relevant Senior Managers. The Head of Finance acts as Chair.

Operational Risk Committee

This Committee meets at least ten time each year and oversees the Society's operational risk profile. Operational risk – by definition – is the risk of loss resulting from inadequate or failed internal processes, people and systems. The Committee focuses on these areas and extends them to cover financial crime, information security and projects.

Managers of all operational teams form Committee membership. The Head of People, Culture and Governance (Megan Price) is Chair.

2.4. Risk appetite

The Board defines risk appetite as "the level of risk the Society is prepared to accept whilst pursuing its business strategy as a mutual organisation set up for the benefit of its members, recognising a range of possible outcomes as the business plan is implemented". Risk appetite is reflected in qualitative measures set out in the Society's ERMF and in a series of quantitative measures reported to Board Risk Committee and the Board. Risk appetite is formally reviewed at least annually but may be revised more frequently to reflect emerging risks, changes to the economic and market environment or for any other reasons considered appropriate.

2.5. Risk culture

As a Building Society, the Dudley is governed by its strong risk culture, and aims to maintain a low exposure to risk in order to protect members' interests. The Board places significant emphasis on every level of the organisation having an awareness of risk and the importance of effective risk management. Exemplary conduct is also expected from everyone in the organisation.

2.6. Stress testing

Stress testing is a risk management tool used by the Society to understand the impact of severe but plausible scenarios on its business model. The Society uses a prescribed Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) to identify capital and liquidity risks and stress testing is undertaken as part of these processes. Other stress tests are also undertaken with the output from all processes used to inform Board risk appetite, policies, management actions and contingency plans.

Liquidity stress tests are performed on a regular basis with results reported to ALCO. These stress tests help identify any shortfalls in the Society's levels of liquidity in a range of scenarios.

The Society has a Board-agreed risk appetite for interest rate risk whereby the impact on earnings of a 2% shift in interest rates cannot exceed £600k and the outcome of stress tests is measured against this risk appetite.

The PRA carry out an assessment of the Society and may issue specific minimum capital and liquidity levels based on their assessment of the risks faced by the Society, including under stressed conditions.

2.7. Principal risks of the Society

The table below summarises the key risks faced by the Society:

Risk summary	Description	Reference
Capital risk	Risk that the Society is unable to maintain its capital levels at sufficient level to meet operational plan and regulatory requirements	Section 3
Retail credit risks	Risk that a customer is unable or unwilling to honour its obligations to the Society as they fall due, resulting in an actual or potential loss exposure for the Society	Page 18
Wholesale credit risk	Risk that a treasury counterparty is unwilling or unable to honour its obligations to the Society as they fall due, resulting in an actual or potential loss exposure for the Society	Page 22
Operational risk	Risk of incurring losses resulting from inadequate or failed internal processes, people systems or from external events	Page 26
Liquidity risk	Risk that the Society is unable to make available sufficient resources to meet its current and future financial obligations as they fall due or is only able to do so at a premium cost	Page 27
Interest rate risk / Market risk	Risk that arises from changes in interest rates when holding assets and liabilities that possess differing interest rate characteristics	Page 29
Strategic and business risk	Risk that the Society may not be able to achieve its Corporate Plan or its desired strategy due to adverse circumstances outside of the Society's control.	Page 29
IT Security / Cyber risk	Risk that the Society's systems might be infiltrated allowing the intruder to take control of customer accounts or download sensitive data for personal gain	Page 30
Conduct risk	Risk of financial loss, reputational damage and or regulatory censure arising from failure to comply with regulatory or legislative requirements. The risk the Society acts in a way which delivers adverse outcomes for customers and therefore not in accordance with the requirements or principles of Treating Customers Fairly	Page 30

3. Capital Resources

The Society's capital resources are calculated under Pillar 1 of the CRD. The scope of these resources as at 31 March 2020 relate to the Society only.

3.1. Tier 1 Capital

Common Equity Tier 1 capital comprises the Society's general and other reserves, net of regulatory adjustments.

3.2. Tier 2 Capital

Tier 2 capital comprises amounts held as collective provision balances.

3.3. Capital composition (own funds)

The Capital Resources of the Society principally relate to the reserves of the organisation, which are classified as Tier 1. The Society has a small amount of Tier 2 capital, being the level of collective impairment provisions maintained in the Society's Balance Sheet. At 31 March 2020, the Society's capital comprised:

		Capital Resources
Table 1: Regulatory Capital	**Note**	**31 March 2020**
Common Equity Tier 1 Capital (CET1)		**£m**
General Reserves		25.0
Available for Sale Reserve		(0.0)
Less: Regulatory adjustments		
Intangible Assets	1	(1.3)
Prudent Valuation Adjustment	2	(0.1)
Total Tier 1 Capital		**23.6**
Tier 2 Capital		
Collective Impairment Provisions		1.0
Total Tier 2 Capital		**1.0**
Total Capital		**24.6**
Total risk weighted assets		**179.3**

Notes:

1) Intangible fixed assets are computer software and system development costs after amortisation. CRD IV requires intangible fixed assets, net of any deferred tax liabilities, to be deducted from CET1 capital.
2) Capital Requirements Regulation (CRR) requires financial institutions to apply prudent valuation to all fair value positions. The Prudent valuation adjustment is directly deducted from CET1 capital and reflects 0.1% of the value of assets held at market value.

The Society's capital resources are the same under the CRDIV transition arrangements as on the full end point definitions.

3.4. Reconciliation of regulatory capital

A reconciliation of equity attributable to members per the Statement of Financial Position to regulatory capital is shown in Table 2 below.

Table 2: Reconciliation of Regulatory Capital	31 March 2020 £m
Equity attributable to members per the Statement of Financial Position	**24.9**
Adjustments for items not eligible for inclusion in CET1 capital	
Intangible Assets	(1.3)
Prudent valuation adjustment	(0.0)
Total adjustments to Common Equity Tier 1 Capital	**(1.3)**
Adjustments to Tier 2 capital	
Collective impairment Provisions	1.0
Total adjustments to Tier 2 Capital	**1.0**
Regulatory Capital	**24.6**

3.5. Regulatory buffers

Under CRD IV, institutions are required to meet the following own funds requirements:

CET1 ratio 4.5%

Tier 1 capital ratio 6.0%

Total capital ratio 8.0%

There is also a cap on the amount of provisions that can count as Tier 2 capital being 1.25% of credit risk weighted assets.

These form an institution's Pillar 1 requirements. Pillar 2A covers risks not considered to be fully addressed through Pillar 1. In addition to the minimum capital requirements, CRD IV requires institutions to hold capital buffers that can be utilised to absorb losses in stressed conditions. All buffers must be met with CET1 resources.

Capital conservation buffer (CCB)

The CCB is designed to ensure that institutions build up capital buffers outside of times of stress that can be drawn upon if required. As at 31 March 2020 the CCB was 2.5% of risk-weighted assets.

Countercyclical buffer (CCyB)

The CCyB requires financial institutions to hold additional capital to reduce the build-up of systemic risk in a credit boom by providing additional loss-absorbing capacity and acting as an incentive to limit further credit growth. Each institution's specific countercyclical buffer rate is weighted average of the CCyB's that apply in the jurisdictions where the relevant credit exposures are located. All of the Society's credit exposures are in the UK.

The Financial Policy Committee (FPC) is responsible for setting the UK CCyB rate. At 31 March 2020 the UK CCyB was set to 0%.

4. CAPITAL ADEQUACY

4.1. **Pillar 1 capital**

Under PRA rules a minimum level of Pillar 1 capital must be held to cover credit risk, operational risk and for the credit valuation adjustment. The Society calculates credit risk under the standardised approach, operational risk under the basic indicator approach and CVA under the standardised method.

Under this approach the level of capital required against a given level of exposure to credit risk is calculated as: Credit risk capital requirement = Exposure value x Risk weighting x 8%

Under the Basic Indicator Approach for operational risk the Society calculates its average net income over the previous three years and provides 15% of the average net income as the minimum capital requirement for operational risk. See section 6.

4.2. **Pillar 2 capital**

Pillar 2 capital is provided to cover specific risks faced by the Society or risks that are not considered to be covered by Pillar 1. As at 31 March 2020 the capital requirement for Pillar 2A was 0.84% of RWAs.

4.3. **Internal Capital Adequacy Assessment Process (ICAAP)**

The Strategic Plan and Annual Corporate Plan process establishes risk appetites for the various areas of business which the Society conducts. Through this process the Society ensures it has sufficient financial and non-financial resource to meet the Strategic Plan objectives.

In addition to the Strategic Plan and Corporate Plan the Society prepares an ICAAP. The ICAAP sets out the framework for the Society's internal governance and oversight of its risk and capital management policies and involves a review of all risks of relevance to the Society and an assessment of the capital required to ensure the Group's capital resources are sufficient to support its plans – in normal and stressed conditions.

The ICAAP production involves reviewing all business areas with estimates for capital allocation across the Strategic Plan period. The Board sets the economic scenarios to be used in calculating capital requirements, with input from the results of the Society stress models.

Finally, the Board approves the capital assessment taking into account any areas where they may feel the models and internal assessments do not adequately capture the full risk exposure and holding extra capital, where appropriate.

4.4. **Total capital Requirement and buffers**

In addition to the ICAAP process the PRA issues the Society with specific requirements as to the minimum capital the Society must hold. Table 3 below set out the total capital requirement and buffer requirements as they apply to the Society at 31 March 2020.

Table 3	% of RWA	£m
RWAs		**179.3**
Capital requirements		
Total capital requirement (including Pillar 1)	8.84%	15.8
Capital Conservation Buffer	2.50%	4.5
Countercyclical Buffer	0%	-
Total	**11.34%**	**20.3**

The Society is not deemed a Globally Systemically Important firm as defined by Article 131 of EU Directive 2013/36.

4.5. Risk weightings

The Society determines credit risk weightings according to the Standardised approach as set out in the CRR. Risk weightings vary depending on the nature of the asset and carriable factors such as loan to value, security, or for wholesale assets, counterparty, credit ratings and duration. In addition, an evaluation of capital required to cover Operational risk is calculated under the "Basic Indicator Approach" and determined by reference to the net income of the Group averages over the previous three years.

4.6. Capital requirement summary

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement. Table 4 shows the position at 31 March 2020 by asset class.

Table 4: Risk Weighted Exposures & Operational Risk Capital	Asset £m	Risk Weighted Asset £m	Capital Requirement £m
Cash balances	0.7	-	-
Treasury Assets:			
Central Government and Central Banks	89.8	-	-
Regional Governments and Local Authorities	-		
Institutions	10.6	1.8	0.1
Total Treasury Assets	**101.1**	**1.8**	**0.1**
Loans and Advances to Customers:			
Secured on land - performing	0.8	0.6	0.1
Secured on residential property - performing	435.0	153.8	12.3
Past due items	1.8	1.6	0.1
Total Loans & Advances to Customers	**437.6**	**156.0**	**12.5**
Other Assets	**2.2**	**2.2**	**0.2**
Credit Risk Exposure excluding off-balance sheet			
Off Balance Sheet:			
Institutions – Derivatives	0.7	0.3	-
Secured on Real Estate - Commitments	3.6	1.3	0.1
Total Off-Balance Sheet	**4.3**	**1.6**	**0.1**
Total Credit Risk	**545.2**	**161.5**	**12.9**
Operational Risk		**17.5**	**1.4**
Credit Valuation Adjustment (CVA)		**0.3**	**-**
Total Pillar 1 Capital Resource Requirement		**179.3**	**14.3**
Pillar 2A requirement			**1.5**
Total capital requirement			**15.8**
Capital Resources (Table 1)			**24.6**
Excess of Pillar 1 and Pillar 2A requirements			**8.8**

Other assets include tangible fixed assets and exclude intangible fixed assets. Loans and advances to customers are net of individual impairment provisions of £0.6m.

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4.7. Leverage ratio

CRD IV introduces a non-risk-based leverage ratio to supplement the risk-based capital requirements. The leverage ratio is defined as the ratio between Tier 1 capital and the total on- and off-balance sheet exposures. The objective is to reduce the risk of excessive leverage i.e. an excessively low amount of own funds compared to total assets as well as acting as a back-stop against the model complexities involved in calibrating risk weights. The CRD IV requirement is for the minimum leverage ratio to be 3.0%. The Society's leverage ratio is the same under both transitional and full implementation of CRD IV.

The measure of total exposure and calculation of leverage ratio are shown below, together with a reconciliation between total exposure and total asset values as reported in the Society's Annual Report and Accounts.

Table 5: Summary reconciliation of accounting assets and Leverage Ratio exposures	Notes	31 March 2020 £m
Total balance sheet assets as reported in the Annual Report and Accounts		541.3
Adjustments for derivative financial instruments	1	0.6
Adjustments for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	2	3.6
Other adjustments		
- Intangible assets		(1.3)
- Collective provisions		1.0
Total leverage rate exposure measure		**545.2**
Leverage ratio		**4.3%**

Notes

1. The accounting value of derivatives has been converted into an exposure measure
2. Commitments in the form of offered mortgage business are stated after applying a 20% risk weighting in accordance with the amended CRD IV.

The greater asset exposure growth compared with the increase in Tier 1 Capital caused the leverage ratio to reduce from 4.9% to 4.3% as at 31 March 2020. The leverage ratio of the Society is well above the 3% regulatory minimum and it is forecast to remain so within the Corporate Plan. The risk of excessive leverage is managed through the corporate planning process using the leverage ratio and is monitored by ALCO.

Leverage ratio common disclosure

Table 6: Leverage Ratio common disclosure	31 March 2020 £m
On Balance Sheet Exposures (excluding derivatives and Securities Financing Transactions (SFTs)	
On Balance Sheet Exposures (excluding derivatives and SFTs, but including collateral)	542.2
Asset amounts deducted in determining Tier 1 capital	(1.3)
Total on-balance sheet exposure	**540.9**
Derivative exposures	
Replacement cost associated with all derivative transactions	0.1
Add-on amounts for potential future exposures associated with all derivatives (MtM method)	0.6
Total derivative exposures	**0.7**
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	18.0
Adjustments for conversion to credit equivalent amount	(14.4)
Total other off-balance sheet exposures	**3.6**
Capital and Total exposure measures	
Tier 1 Capital (from Table 1)	**23.6**
Leverage ratio total exposure measure	**545.2**
Leverage ratio	**4.3%**

Table 7: Leverage Ratio – Split-up of on-balance sheet exposures (excluding derivatives and SFTs)	31 March 2020 £m
Total On Balance Sheet Exposures (excluding derivatives and SFTs)	**540.9**
Of which:	
Exposures treated as Sovereigns	89.8
Multi-lateral Development Banks	-
Institutions	11.3
Secured by mortgages on immovable properties	436.0
Exposures in default	1.6
Other exposures	2.2

4.8. Capital reporting

Capital adequacy is reported to the PRA quarterly in the Common Reporting (CoREP) returns. It is also monitored monthly through ALCO and reported at each Board meeting.

5. CREDIT RISK

Credit risk refers to the potential risk that arises from customers (or counterparties) failing to meet their obligations as they fall due, resulting in an actual or potential loss exposure for the Society. Credit risk arises primarily from two categories: Retail lending, comprising of loans to our retail mortgage customers and historic loans to our commercial mortgage customers; and Treasury activities, arising from our liquid asset investments. As a primary lender, the Society faces credit risk as an inherent component of its lending activities. Adverse changes in the credit quality of the Society's borrowers, deterioration in U.K. economic conditions or adverse changes in U.K. or even global systemic risks could reduce the recoverability of the Society's assets.

Mitigation

Credit risk is mitigated through Board-approved Lending and Treasury Policies which reflect our low risk tolerance and which include clear guidelines in respect of processes and exposures.

ALCO is responsible for managing Treasury activity and recommends limits on Treasury counterparties, country exposures and types of financial instruments for approval by the Society Board within regulatory guidelines.

Lending and business decisions

The Society translates its overall risk appetite for credit risk into individual lending limits controlling the exposures to be taken on by the Society. The performance against these limits is monitored monthly and reviewed at least annually.

Pricing

Pricing models are used for all mortgage products and provide guidance as to the appropriate rate required to meet target level of return on all mortgages offered.

The Society does not use credit risk mitigation techniques other than taking a first legal charge on property offered as security for a mortgage.

Credit risk weightings are determined by the "Standardised Approach" following the approach set out in the CRR. The minimum capital requirements by standardised credit exposure class at 31 March 2020 is set out in Table 4 above.

The total credit risk exposure of £545.2m reconciles to the Annual Report and Accounts as follows:

Table 8: Reconciliation of Credit Risk Exposure to the Annual Report & Accounts	£m
Total Credit Risk	**545.2**
Less Total Off-Balance Sheet	(4.3)
Less Individual Impairment Provision	(1.0)
Add Intangible Fixed Assets	1.3
Add: Other non-credit exposures	2.1
Total Assets per the Statement of Financial Position as at 31 March 2020	**541.3**

The residual maturity on a contractual basis of credit risk exposures is shown as at 31 March 2020 as follows:

Table 9: Residual maturity of credit risk	Up to 3 months £m	4 - 12 months £m	1 -5 years £m	Over 5 years £m	Individual Impairment £m	Total £m
Residential mortgages	2.3	2.2	30.9	402.0	(0.6)	436.8
Other secured lending	0.1	-	0.7	-	-	0.8
Total retail credit risk exposures	**2.4**	**2.2**	**31.6**	**402.0**	**(0.6)**	**437.6**
Central banks and sovereigns	64.9	12.1	10.8	-	-	87.8
Financial institutions	12.6	-	-	-	-	12.6
Total treasury risk credit exposures	**77.5**	**12.1**	**10.8**	**-**	**-**	**100.4**
Total credit risk exposures	**79.9**	**14.3**	**42.4**	**402.0**	**(0.6)**	**538.0**
Off-balance sheet items						**4.3**
Items with no specific maturity						**2.9**
Total credit risk (per table 5)						**545.2**

Credit concentration risk

Where a firm's exposure to a single borrower or several borrowers is large, it risks large loses should the borrower default. Concentration risk is concerned mainly with the fact that in some cases these losses may be sufficient to threaten a firm's solvency.

Credit concentration risk need not be in the form of large loans to borrowers and could a concentration of exposure within the same category, which may include geographic location, product type, sector or counterparty type as well as a concentration of high risk / high LTV lending.

For Dudley, as a regional building society, this particularly includes a geographic concentration of mortgage lending in its core lending area of the West Midlands. This exposure has been a reducing one over the last 5 years due to the Society changing to an intermediary based model which has resulted in more balanced exposures across regions.

Concentration risk is mitigated where possible by limits set on areas of business, and individual counterparty limits.

5.1. Retail credit risk – Loans and advances to customers

Retail credit risk exposures are limited to and arise from the provision of loans secured on properties within the UK. All mortgage loan applications are reviewed by an individual underwriter an are assesses against credit risk appetite as set out in the Society's Board-approved credit risk policy. Retail credit risk exposure are monitored each month by Credit Committee, with additional reporting of risk appetite to the Board

The Society's total portfolio of loans and advances mostly comprise of owner-occupied and buy-to-let mortgages. The Society also has a small portfolio of equity release mortgages but is not looking to expand this category of lending.

Table 10a: Loans and advances to customers by occupation type	31 March 2020 £m
Owner occupied	376.5
Buy-to-let	49.6
Equity release	9.8
Other	1.7
Total	**437.6**

The table below provides analysis of loans and advances to customers by loan repayment type.

Table 10b: Loans and advances to customers by occupation type	31 March 2020 £m
Repayment	240.2
Interest only	197.4
Total	**437.6**

The Society's ERMF sets out limits for concentration of loans and advances by occupation type and repayment type.

Exposure by geographic region

The geographical distribution of mortgage asset exposures at 31 March 2020 is shown in the table below.

Table 10c: Geographical Region	Performing £m	Past Due* £m	Impairment losses	Total £m	%
East Anglia	8.6	-	-	8.6	2%
East Midlands	26.6	0.4	(0.1)	26.9	6%
Greater London	88.9	0.3	(0.1)	89.1	20%
North	11.1	-	-	11.1	3%
North West	28.4	0.3	-	28.7	7%
South East	126.6	-	(0.2)	126.4	29%
South West	35.9	0.1	(0.1)	35.9	8%
Wales	14.3	0.2	-	14.5	3%
West Midlands	75.4	0.5	(0.1)	75.8	17%
Yorkshire & Humberside	20.6	-	-	20.6	5%
Total	**436.3**	**1.8**	**(0.6)**	**437.6**	**100%**

* A loan is past due when it is 3 months or more in arrears or in possession. Past due amounts relate to the overall mortgage balances, not the amount in arrears and include properties in possession.

NB. In evaluating the above table, no breakdown of the mortgage assets into type is considered appropriate in view of the Society's mortgage assets being principally residential.

Credit risk adjustments – Impairment provisions

A financial asset or group of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

- significant financial difficulty of the borrower or issuer;
- default or delinquency by a borrower;
- the restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise;
- indications that a borrower or issuer will enter bankruptcy;
- the disappearance of an active market for a security; or
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The provision made on each mortgage account represents the amount required to reduce the outstanding balance of the asset to its expected realisable value, by using industry recognised house price indices, and adjusting for costs of realisation, other recoveries and the probability of possession.

Collective impairment provisions are made where it is considered that there is impairment in the value of assets at the year-end that is not already covered by individual impairment provisions.

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 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.

The collective impairment provisions made at the year-end represent the Directors' assessment of the potential losses which, although not yet specifically identified as relating to payment arrears, are known from experience to exist in the Society's loan portfolio. These provisions have been deducted from the appropriate asset values shown in the balance sheet.

Forbearance

A range of forbearance options is available to support customers who are in financial difficulty. The purpose of forbearance is to support customers who have temporary financial difficulties and help them get back on track.

The options offered by the Society are:

- Temporary transfer to an Interest Only arrangement;
- Temporary reduced monthly payment;
- Product review;
- Capitalisation of arrears;
- Extension of mortgage term.

Before being granted a forbearance option, customers will need to provide information to support the request which is likely to include a budget planner, statement of assets and liabilities, bank / credit card statements, payslips etc., in order that the request can be properly assessed. If the forbearance request is granted the account is monitored in accordance with our policy and procedures. At the appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is restored.

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and / or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward.

Impairment losses are recognised in the Income Statement and reflected in an allowance account against loans and receivables. Interest on the impaired assets continues to be recognised through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through the Income Statement.

Table 11 shows the movement on individual and collective impairment allowances as at 31 March 2020.

Table 11: Impairment allowances	Loans fully secured on residential property £m	Other loans fully secured on land £m	Total £m
Individual impairment			
At 1 April 2019	0.5	-	0.5
Amounts recovered	-	-	-
Charge for the year	0.1	-	0.1
At 31 March 2020	**0.6**	**-**	**0.6**
Collective impairment			
At 1 April 2019	0.8	-	0.8
Charge for the year	0.2	-	0.2
At 31 March 2020	**1.0**	**-**	**1.0**

Further details of the level of mortgage provisions can be found in the 2020 Annual Report and Accounts of the Society.

5.2. Wholesale credit risk

Wholesale credit risk is the risk of losses due to a wholesale Treasury counterparty being unable to meet their financial obligations. The Society's exposure to wholesale credit risk results from investments in financial instruments held within the liquidity portfolio and from transactions to hedge interest rate risk.

Counterparty Credit Risk

The purpose of the Society's Treasury Credit Risk Management Policy is to ensure that the Society can obtain the best possible return whilst operating within prudent limits in respect of counterparties. The methodology for establishing counterparty limits involves consideration of the background rating information. Counterparty limits are set based on the Fitch rating. New counterparties can only be added provided the appropriate Fitch ratings are in place and are subject to Board approval.

The minimum rating required (for Banks) under Fitch ratings are:

- Short term facilities up to and including one year in maturity: bank to whom lending is made to have a short-term credit rating of at least F2;

- Facilities over one year and up to and including 5 years in maturity: bank to whom lending is made to have a long-term credit rating of at least BBB-.

The Society's Treasury Policy only permit lending to central government, UK local authorities and banks and building societies with a high credit rating. Counterparty exposures are monitored at least weekly and considered at ALCO every month. Replacement values of outstanding hedging instruments are calculated, and counterparty limits are adjusted to reflect any off-balance sheet exposure.

Interest rate swap derivative instruments are covered under collateralised agreements. Depending on the market value of the instruments this results in either the Society or the swap counterparty depositing collateral funds with the corresponding counterparty. This mitigates the credit risk to either counterparty from any exposure created by movement in the market value of derivatives.

Impairment of wholesale assets

At each balance sheet date, the Society assesses the portfolio of wholesale assets for objective evidence of impairment. Wholesale assets classified as available for sale are considered impaired if an event has occurred after initial recognition of the asset that has an adverse impact on the estimate future cash flows of those assets. Any charges for impairment are recognised in the income statement. The Society reported no such charges on its wholesale assets during the year ended 31 March 2020.

The Society's treasury management process uses Fitch ratings in the assessment of exposures to counterparties, or a Moody's rating in the absence of a Fitch rating. The table below is a summary by standardised credit risk exposure class and credit quality step of the Society's Treasury Assets at 31 March 2020. The External Credit Assessment Institution (ECAI) ratings used in the table are based on Fitch Ratings. The highest credit quality step is step 1.

Table 12

Credit Quality Step	ECAI Long-Term Rating	Banks £000	Building Societies £000	Central Government £000	Local Authorities £000	Total £000
1	AAA to AA-	-	-	89.8	-	89.8
2	A+ to A-	8.3	-	-	-	8.3
3	BBB+ to BBB-	-	2.0	-	-	2.0
4	BB+ to BB-	-	-	-	-	-
5	B+ to B-	0.3	-	-	-	0.3
6	CCC+ & below	-	-	-	-	-
Unrated	-		-		-	-
Total		**8.6**	**2.0**	**89.8**	**-**	**100.4**

The geographical distribution of the above exposures is the United Kingdom. Central government exposure includes central bank exposure. There are no exposures to any unrated counterparties.

The residual maturity of the Society's Treasury Assets at 31 March 2020 is analysed below: -

Table 13

Credit Quality Step	Repayable on demand £m	In not more than three months £m	In more than three months, but not more than one year £m	In more than one year but not more than five years £m	Total £m
1	64.9	2.0	12.1	10.8	89.8
2	6.5	1.8	-	-	8.3
3	-	2.0	-	-	2.0
4	-	-	-	-	-
5	0.3	-	-	-	0.3
6	-	-	-	-	-
Unrated	-	-	-	-	-
Total	**71.7**	**5.8**	**12.1**	**10.8**	**100.4**

5.3. **CVA risk**

Risk weightings for derivative financial instruments are determined according to the mark-to-market approach for counterparty credit risk under the CRR and the standardised method for credit valuation adjustment (CVA) risk. The Society's exposure values related to counterparty credit risk are shown below:

Table 14	Exposure value £000
Gross positive fair value of contracts	709.4
Potential future exposure	670.8
Total net derivatives credit exposure	26.5
RWA requirement	**330.9**

5.4. **Asset encumbrance**

The Society has mortgage assets encumbered with the Bank of England Asset Purchase Facility Fund Limited to secure amounts drawn down under the Term Funding Scheme (TFS) and other central bank facilities. At 31 March 2020, £51.1m (31 March 2019: £60.3m) of mortgage assets held by the Society were pledged to the Bank of England as collateral. The loans remain fully owned and managed by the Society but are reported as encumbered assets. The Society has also pledged £11.8m of debt securities to the Bank of England as collateral against other central bank facilities (2019: £11.0m).

The Society enters into derivative financial contracts as part of its management of interest rate risk, for which collateral is also posted.

The tables below detail the levels of asset encumbrance. The Pillar 3 asset encumbrance disclosure templates have been compiled in accordance with the Threshold criteria under Regulatory Technical Standard (RTS) for disclosure of encumbered and unencumbered assets (EU) 2017/2295, replacing PRA supervisory statement SS11/14 (CRD IV: Compliance with the European Banking Authority's Guidelines on the disclosure of encumbered and unencumbered assets).

Note that this information required to be disclosed as median values over quarterly positions during the 12 months preceding 31 March 2020 and as a result may differ from other information provided in this disclosure.

Table 15: Assets of the reporting institution

Assets of the reporting institution	Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
		Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA		Of which EHQLA and HQLA		Of which EHQLA and HQLA
	£m		£m		£m		£m	
Loans on Demand	-		-		79.1	79.1		
Debt securities	11.9	11.9	11.9	11.9	14.6	14.6	14.6	14.6
Loans & Advances (Mortgage Loans)	54.0				364.6			
Other assets	-				4.6			

Table 15 includes on and off-balance sheet encumbered assets.

Table 15: Encumbered assets/collateral received and associated liabilities	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	43.5	54.0

6. OPERATIONAL RISK

Operational risk is the risk of loss arising from failed or inadequate internal processes or systems, human error or other external factors. The risk is managed by the departmental Managers of the Society – the 'Risk Owners' - who have responsibility for putting in place appropriate controls for their business area. A monthly report to the Board sets out key risk metrics.

In order to ensure we have sufficient capital to cover 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.

Mitigation

To monitor its operational risks, the Society records all its risks and quantifies these through risk likelihood and impact, together with a reduction in impact from application of the controls assigned to each risk. This allows us to establish a residual risk remaining after operation of controls for each business area within the Society.

The Society has a Business Continuity Plan which is kept under regular review and is designed to ensure that any breakdown in systems would not cause significant business disruption.

The calculation for the Pillar 1 capital requirement for Operational Risk as at 31st March 2020 was £1.4m, calculated as follows:

TABLE 16	2017/18	2018/19	2019/20
BASIC INDICATOR APPOACH (BIA) Operational Risk	**£m**	**£m**	**£m**
Net interest income	8.8	9.3	10.0
Fees and commissions receivable	0.2	0.2	0.2
Fees and commissions payable	(0.1)	(0.1)	(0.2)
Net other operating income and charges	0.1	-	-
Net fair value movements	0.1	(0.2)	(0.1)
TOTAL	**9.1**	**9.2**	**9.9**
Basic indicator (three-year average)			**9.4**
Own funds requirement (15% of Basic Indicator)			**£1.4m**

In addition the Society conducts stress testing to determine whether additional capital should be held in Pillar 2A. Given the low risk nature of the Society and its risk appetite, it is considered unlikely that any operational issues would exceed the Pillar 1 requirement.

7. LIQUIDITY and FUNDING RISK

7.1. **Liquidity Risk**

Liquidity risk is the risk that the Society is unable to make available sufficient resources to meet is current or future financial obligations as they fall due or is only able to at a premium cost. This risk also includes the risk the Society attracts excessive liquidity through poor product management, acting as a drag on financial performance.

The Society's Liquidity Policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Society and to enable the Society to meet its financial obligations. This is achieved through maintaining an adequate level and quality of liquid assets, through wholesale funding and through management control of the growth of the business.

The Society relies on its access to sources of funding to finance the origination of new business and working capital. If access to funding became restricted, either through market movements or regulatory or government action, this might result in the scaling back or cessation of new lending.

Mitigation

The Society, through its Treasury team (overseen by ALCO), seeks to mitigate this risk by managing the Society's portfolio of liquid assets to maintain assets in liquid form in such proportion and composition (as determined by ALCO) as will at all times enable it to meet its liabilities as they arise (including any unexpected adverse cash flow).

This results in the Society holding a significant amount of highly-liquid assets, mostly in the form of deposits with the Bank of England and Treasury bills, both eligible to satisfy liquidity buffers required by the Regulator. The Society also holds further assets for use as collateral with derivative counterparties and maintains adequate deposits on call or overnight with the Bank of England or other major banking organisations to meet operational cash flow needs without drawing on buffer-qualifying liquid assets.

It is a requirement for all Banks and Building Societies to construct plans that detect possible failure and minimise the consequences of failure should it occur. The Society has a Board-approved Recovery Plan that outlines a menu of options the Society could credibly take to recover from a stress – whether Society specific or market-wide. The Society also has a Board-approved Resolution Plan containing prescribed information necessary for the Bank of England to establish an orderly resolution of the Society in the event that recovery cannot be achieved. Both documents are updated at least annually.

The Society calculates and expresses its liquidity requirement in terms of survival days in a prescribed stress. The Society also reports liquidity using the regulatory measures of Liquidity Coverage Ratio ("LCR") and Net Stable Funding Requirement ("NSFR").

7.2. LCR

The Society's LCR at 31 March 2020 was 297% (2019: 197%), highlighting a strong liquidity position. The Society's average LCR for the rolling 12 months to each quarter end date for the financial year ended 31 March 2020 is as follows:

TABLE 17	Total adjusted value £m			
Quarter ending on	30 June 2019	30 September 2019	31 December 2019	31 March 2020
Number of data points used in the calculation of the average	12	12	12	12
Liquidity buffer £m	70.9	72.4	75.8	81.2
Total net cash outflows £m	24.6	25.7	26.4	25.9
LCR %	288%	282%	287%	313%

7.3. NSFR

The Society's NSFR at 31 March 2020 was 170% (2019: 168%), exceeding the expected 100% minimum future requirement for NSFR.

8. OTHER RISKS

8.1. Market Risk

Market risk is the risk of changes to the Society's financial condition caused by market interest rates or early redemption of assets. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk). The Society is not directly exposed to equity, foreign currency or commodity risk.

The Society's Pillar 1 capital requirement for market risk is currently set to zero as the Society does not have a trading book.

8.2. Interest rate risk in the Banking Book (IRRBB)

Interest Rate risk is the risk that the value of, or income arising from, the Society's assets and liabilities varies as a result of changes in interest rates.

The Society has adopted the "Matched" approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position.

Interest rate risk arises from imperfect matching of different interest rate features, repricing dates and maturities of mortgages, savings and wholesale products. The Society manages this exposure on a continuing basis, within limits set by ALCO using a combination of financial instruments. The sensitivity to changes in interest rates impacts the following activities:

1. Management of the investment of reserves and other net non-interest-bearing liabilities;
2. Fixed rate funding;
3. Fixed rate mortgage and treasury lending.

Interest rate swaps are used, where appropriate, to manage the above risks. In addition, swaps are used to manage risks arising from a net exposure to an interest rate basis type e.g. SONIA or LIBOR. The Society also monitors prepayment levels on fixed rate mortgages and aims to set the Early Repayment Charge consistent with the interest rate risk exposure.

To quantify the risk across the entire balance sheet the interest rate gap is stressed for parallel interest rate stress. The Society uses a parallel shift in interest rates of 2% and sets a risk appetite for the outcome not to result in a loss of economic value not to exceed £600k. The results are reported to Board Risk Committee and Board.

8.3. Strategic and Business risk

The Society faces competition in all the markets in which it operates. There is risk that the Society may not be able to achieve its Corporate Plan or pursue its desired strategy due to adverse circumstances outside of the Society's control, including the actions of its competitors.

Mitigation

This is a risk that every business faces however, the Society looks to mitigate this risk by having a diverse range of products, so that its income source is not reliant on one product or one area of its business. The Society also maintains close relationships with stakeholders and participants in the markets in which it operates and is involved with sector-wide initiatives through the Building Societies Association. Through these activities the Society can identify market trends, opportunities and challenges to be addressed as part of the Society's strategy.

8.4. **IT security / Cyber**

Cyber-crime and the security of information held by the Society are a constant. The Society acknowledges the risk of a disruption caused by a successful cyber-attack on core IT systems, which may result in the loss or inappropriate use of data or sensitive information. The Society's core systems are dependent upon the continuing availability and resilience of the managed service that is provided by Unisys Ltd.

Mitigation

The Society works closely with Unisys Ltd and regular assurance activities are undertaken on third-party IT Governance and Controls. The Society has already invested heavily and continues to invest in new technologies to ensure the confidentiality, availability and integrity of Society Data.

8.5. **Conduct risk**

This risk can arise when a firm's actions or behaviours result in inappropriate or poor outcomes for customers. The Society has a customer-focused culture that is in line with the principle of an organisation which is owned by its members.

Mitigation

Conduct Risk is assessed and monitored through the Society's Risk Committee structure, including via its Customer Committee which considers all the Society's customer interactions and metrics. The Society has a simple product range that aims to reduce potential exposure to conduct risk. All staff who engage with customers receive relevant training in accordance with the relevant Training and Competency Scheme to ensure customers are treated fairly.

dudley building society

9. Remuneration paid to code staff

The Society has a remuneration policy that aligns to the FCA Regulations Remuneration Code. The detail required for the purposes of this Pillar 3 document is disclosed in our Annual Report and Accounts which is also published on the Society's website. The details are located in the Annual Report and Accounts within the Directors' Remuneration Report and Note 7. Note 7 of the Annual Report and Accounts gives a breakdown of the Directors' remuneration in the financial year; it should be noted that all Director Remuneration is fixed.

The Society has two Board Committees dealing with the appointment and remuneration of code staff: Remuneration committee; and Nominations committee, both of which are described earlier in this document.

9.1. Components of remuneration

The components of remuneration are basic salaries, pension and other benefits.

Basic Salaries: Basic salaries are reviewed annually by undertaking an external benchmarking exercise which compares salaries in similar organisations.

Pension: Samantha Ward is the only Director enrolled into the Society's pension scheme and receives 11% employer contribution.

Benefits: Jeremy Wood and Samantha Ward receive access to a healthcare cash plan and have access to an online portal offering a range of retail discounts. Jeremy Wood and Samantha Ward receive private healthcare cover. Peter Beddows received access to a healthcare cash plan up to the date of his retirement (14 February 2020).

9.2. Code staff

The Society has considered which of its staff fall under the scope of "material risk taker" and are deemed Code staff. The activities of a material risk taker may have material impact on the Society's risk profile although not all affect the Society's risk profile in the same way. The Society deems material risk takes to be Non-Executive Directors, Executive Directors and certain management roles.

Aggregate information on remuneration for the year ended 31 March 2020 is provided in Table 18 below:

Table 18

£000s	Number of staff	Fixed remuneration	Variable remuneration	TOTAL
Executive directors	4	437	-	437
Non-Executive Directors	7	168	-	168
Other material risk takers	10	722	-	722
TOTAL	**21**	**1,327**	**-**	**1,327**

No individuals were remunerated £850,000 or more.

9.3. Non-Executive Directors' remuneration

Non-Executive Director fees are based on comparable data from similar financial service organisations and are recommended by the Remuneration Committee. Remuneration comprises a basic fee with supplementary payments for Committee Chair.

Non-Executive Directors fees are not pensionable, nor do the individuals participate in any incentive schemes or receive any other benefits. Non-Executive Directors have formal contracts of service.

9.4. Contracts of employment

Jeremy Wood, Darren Garner and Samantha Ward have service contracts dated 17 May 2012, 3 February 2020 and 1 February 2020 respectively. Twelve months' notice is required to be given by the Society to Jeremy Wood and six months' notice by the individual. Six months' notice is required to be given by the Society to Samantha Ward and six month's noticed by the individual. Darren Garner is subject to a one-year fixed term contract and requires three months' notice by the Society and three months' notice by the individual.

There are no contractual arrangements in respect of bonuses, deferred consideration or amended arrangements in the event of a transfer of engagement.

APPENDIX: EBA Own Funds Disclosure Template

Common Equity Tier 1 (CET1) Capital: Instruments and reserves		£m
2	General Reserve	24.9
3	Accumulated other comprehensive income and other reserves	-
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	24.9
Common Equity Tier 1 (CET1) Capital: Regulatory adjustments		
8	Intangible asset	(1.3)
28	Total regulatory adjustments to CET1	(1.3)
29	Common Equity Tier 1 (CET1) Capital	23.6
Tier 2 Capital: Instruments and provisions		
50	Credit risk adjustment: Collective provision	1.0
51	Tier 2 capital before regulatory adjustments	1.0
59	Total capital	24.6
60	Total risk weighted assets (RWA)	179.3
Capital ratios and Buffers		
61	Common Equity Tier 1 ratio (as % of RWA)	13.1%
62	Tier 1 ratio (as % of RWA)	13.1%
62	Total Capital (as % of RWA)	13.7%
64	Institution specific buffer requirement (CET1 requirement plus CCB and CCyB)	8.0%
65	Of which: Capital Conservation Buffer Requirement (CCB)	2.5%
66	Of which: Countercyclical Buffer Requirement (CCyB)	0%
68	Common Equity Tier 1 available to meet buffers (as percentage of RWA)	5.8%