Capital Requirements Directive
Pillar 3 Disclosures
For the year ended 31 August 2017

Contents

INTRODUCTION

The European Union Capital Requirements Directive ('CRD') and Capital Requirements Regulations ('CRR') came into force on 1 January 2014. The CRD and CRR (known collectively as 'CRDIV') seek to ensure that, according to consistent standards, all banks and building societies hold adequate capital to protect their depositors and shareholders.

The Prudential Regulation Authority ('PRA') is the prudential regulator of The Hanley Economic Building Society and its subsidiaries ('the Society') and is responsible for implementing the CRDIV in the UK.

CRDIV comprises 3 main elements, or 'Pillars', namely:

- Pillar 1: Minimum capital requirement for credit market and operational risk, assessed according to a formulaic risk based calculation.

- Pillar 2: Assessment of additional capital requirements following review under the Internal Capital Adequacy Assessment Process ('ICAAP') and the PRA's Supervisory Review and Evaluation Process ('SREP').

- Pillar 3: Disclosure requirements designed to promote market discipline through disclosure of key information about risk exposures and risk management processes.

The Society has adopted the Standardised Approach for Credit risk and the Basic Indicator Approach for Operational risk and seeks to ensure that it protects its Members by holding sufficient capital at all times.

The Society's Board has undertaken an assessment of all of the key risks facing the Society and has assessed the amount of additional capital under Pillar 2 that it considers necessary to cover these risks. This assessment takes into account the capital requirement under stressed scenarios to ensure the Society is well placed to maintain sufficient capital even during a severe downturn in the markets in which it operates.

This disclosure document, prepared as at 31 August 2017, covers the entire business across the three legal entities in the group:

- Hanley Economic Building Society ('the Hanley') [FCA number 206024];
- Hanley Mortgages Services Ltd [FCA Number 301487]; and
- Hanley Financial Services Ltd [FCA number 211538]).

The figures quoted in this disclosure have been drawn from the Society's Annual Report & Accounts as at 31 August 2017, unless stated otherwise.

The Board approved the Society's Pillar 3 Disclosure Document at their meeting dated 23rd January 2018.

RISK MANAGEMENT POLICIES AND OBJECTIVES

The Hanley is a mutual organisation with no equity shareholders. Its mission statement is “to be the chosen provider of mortgages and savings in our heartland built on trusted values and exceptional customer service”.

Risks arise naturally in the course of doing business and especially within the financial services industry. Risk management and governance arrangements provide processes for identifying and managing the most significant risks to the Society’s objectives. These processes allow the Society to be aware of these risks at an early stage and as far as possible to mitigate them.

As a part of its day to day operations the Society will raise funds in the retail and wholesale markets. These funds are then invested in other institutions to manage its overall liquidity position and to support the provision of mortgages to retail customers.

The Society’s prudent nature ensures that it maintains a low exposure to risk, thereby maintaining public confidence and allowing for the achievement of its corporate objectives. The ability to properly identify, measure, monitor and report risk is vital in ensuring financial strength, appropriate customer outcomes and the ongoing security of Members’ funds.

BOARD & SUB-COMMITTEES

The Board has overall responsibility for the identification, assessment, management and mitigation of the risks to which the Society is exposed. To that end it has put in place a formal risk management framework including Board risk appetite statements, individual key risk policies and a defined risk reporting structure.

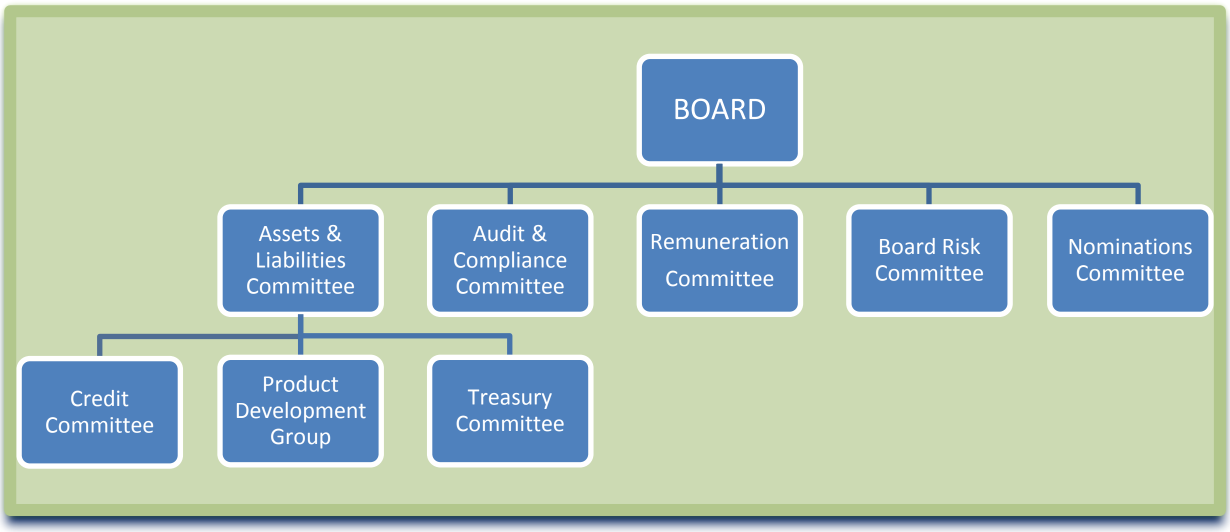

Figure 1: Board and Sub-Committees

The Executive Directors are responsible for designing, operating and monitoring risk management and internal control processes. The Society’s Risk Register records the key risks to which it is exposed and includes an assessment of their likelihood and impact. This is formally reviewed at least annually by the Board and it forms the base for the identification of risks for inclusion in the ICAAP under Pillar 2. In addition all significant risks are considered at each Board meeting.

The Assets and Liabilities Committee ('ALCO'), comprising Non-Executive and Executive Directors, is responsible for the management of structural risk in the balance sheet alongside the maintenance of margin in line with the Society's three year Corporate Plan. Specifically ALCO is responsible for approving the Society's lending policy and monitoring the exposures and arrears performance in accordance with this. This includes exposures to individual counterparties and sector concentration. Furthermore, ALCO is responsible for recommending limits on treasury counterparties, country exposures and types of financial instruments for approval by the Board.

The Audit and Compliance Committee ('A&CC'), consists solely of Non-Executive Directors, and considers all matters of an audit nature, including internal controls, compliance, scope and content of internal and external audit work, financial reporting and other relevant regulatory requirements. Representatives from the Society Executive, Internal Audit and Compliance function, together with External Audit, also attend Committee meetings by invitation. In addition, both Internal and External Auditors are specifically empowered to meet with the Chairman and other members of the Committee in private sessions.

The Board Risk Committee reviews and monitors risk tolerance in accordance with the Board's stated risk appetite and Risk Management Framework and consists of all Directors of the Society, with members of the Leadership Team attending by invitation.

THREE LINES OF DEFENCE

The Society operates a three lines of defence model as outlined below:

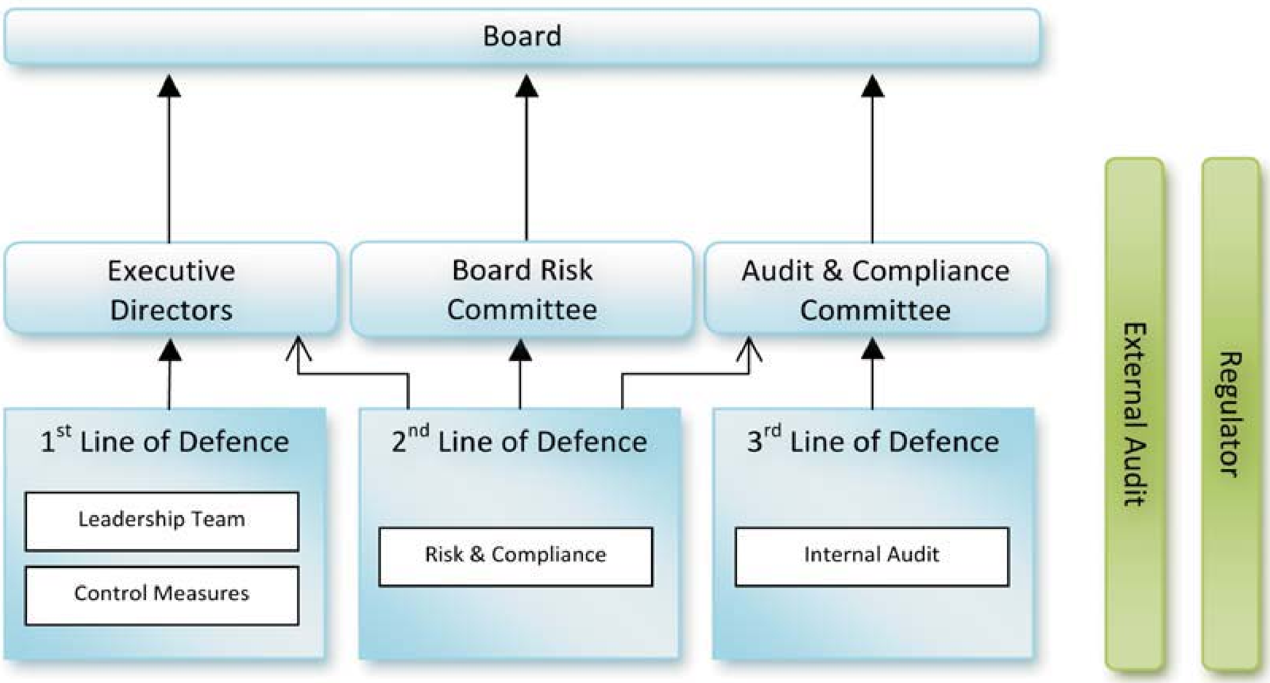

Figure 2: Three lines of defence

First Line of Defence

As the first line of defence the Leadership Team own and manage risks. This includes ensuring that the Society complies with policies, risk appetite and limits, stress testing, self-assessment and development of risk registers. The Leadership team are responsible for identifying, assessing, controlling and mitigating risks by implementing corrective actions to address process and control deficiencies.

Second Line of Defence

The Society's Risk & Compliance function comprise the second line of defence, developing the risk framework and undertaking risk monitoring, challenge and oversight, ensuring reporting is completed to the relevant Committee.

Third Line of Defence

Internal audit (outsourced to RSM UK) act as the third line of defence providing an independent challenge to the overall management of the risk framework. Providing assurance to both the Audit & Compliance Committee and Board on the adequacy of both the first and second line of defence, Internal Audit ensures that risks are appropriately managed in accordance with policy and limits stated within the Board's stated risk appetite. Adherence to regulatory risk requirements is also assured through the monitoring of actions taken to resolve any risk control weaknesses or failings in the Society's strategy, operations and performance.

PRINCIPAL RISKS

The Society is primarily a producer and retailer of financial products, mainly in the form of mortgages and savings. These products give rise to a financial asset or liability and are termed financial instruments.

Building societies operate within a highly competitive financial services market; consequently many of the risks arise simply from competing within such an environment. The Society, like all businesses, faces a number of risks and uncertainties and seeks to actively manage these risks and has an overall cautious approach to risk, which helps to maintain Member confidence particularly in difficult market conditions. The identification and management of risk is a high priority and is integral to strategy and operations.

The principal business and financial risks to which the Society is exposed to are credit, liquidity, market and interest rate, conduct, operational, regulatory & legal and business risk. Additional risks considered to be of importance include concentration risk and insurance risk. The Society has a formal structure for managing these risks including established risk limits, reporting lines, mandates and other control procedures.

CREDIT RISK

Credit risk is the risk of a customer or counterparty not meeting their obligations as they fall due. This risk is most likely to arise in the potential inability of a customer to make repayments on their mortgage, and of treasury counterparties to repay loan commitments.

The risk of treasury counterparty default is managed through Board approved Liquidity, Funding and Structural Risk policies. Counterparty credit quality and exposure limits are monitored by the Assets & Liabilities Committee who make recommendations to the Board on changes in any of its related policies.

Mortgage credit risk is managed through the Society's underwriting process which seeks to ensure that customers can afford to repay their debt. 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. All applications are supported by an independent valuation sourced from the Society's authorised panel of valuers. In the unfortunate event of customers experiencing financial difficulties, the Society is highly proactive in providing support.

In respect of residential development loans, the Society additionally has potential exposure in the value of new build properties and development land. This is mitigated by taking a longer term approach to the management of loans to this sector, which enables the Society to take advantage of any positive cyclical movements in underlying property values.

LIQUIDITY RISK

Liquidity risk is the risk that the Society is not able to meet its financial obligations as they fall due. The Society's Liquidity policy is to maintain sufficient liquid resources to cover cashflow imbalances and fluctuations in funding, to maintain full public confidence in the solvency of the Society and to meet its financial obligations.

The Society manages this risk through continuous forecasting of cashflow requirements and assessment of retail and wholesale funding risk. The required amount, quality and type of liquid assets required to ensure obligations can be met at all times is maintained in accordance with the Liquidity policy. Regular stress tests are performed to ensure the Society can meet its obligations in both normal and stressed circumstances. The management of the Society's liquidity risk is overseen by the Assets & Liabilities Committee.

MARKET AND INTEREST RATE RISK

Interest rate risk represents the Society's exposure to movements in interest rates and is managed on a continuous basis, within limits set by the Board, using interest rate swap derivatives. All transactions in such instruments are undertaken to manage the risks arising from underlying business activities. No transactions of a speculative nature are undertaken.

CONDUCT RISK

Conduct risk is the risk that the Society does not treat its customers fairly and delivers inappropriate consumer outcomes. The Board acknowledges the requirement to fully embrace the Financial Conduct Authority's Principle 6, namely to ensure that the Society pays due regard to the interests of its customers and to treat them fairly at all times. These principles are firmly embedded within the Society's culture and working practices.

OPERATIONAL RISK

Operational risk is the risk of loss through failed or inadequate systems, human error or other external factors. It includes errors, omissions, natural disasters and deliberate acts such as fraud. The Society mitigates this risk through having a robust and effective internal control framework, including internal audit and the Society's risk and compliance function, which are overseen by the Board and the Audit & Compliance Committee.

The Society has adopted the Basic Indicator Approach ('BIA') for operational risk which is expressed as a percentage (15%) of the average of the latest three years of the sum of net interest income and net non-interest income.

REGULATORY AND LEGAL RISK

Regulatory and legal risk is the risk of fines, public censure, limitation on business, or restitution costs arising from failing to understand, interpret, implement and comply with UK and EU regulatory requirements. The Board monitors these risks and their potential impact through the Board Risk Committee and the Audit & Compliance Committee.

BUSINESS RISK

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

CONCENTRATION RISK

The Society is a regional building society whose principal business objective is the provision of secured lending on residential property funded by retail savings. Accordingly its activities are highly concentrated in residential lending, bringing with it exposure to the UK housing market. Although the Society lends throughout England and Wales, it does have particular regional concentrations, specifically the West Midlands (29.60%), London & South East (22.77%) and North West (19.16%). Geographic concentration is monitored when undertaking stress testing, where the results of house price movements are modelled using regional indices.

Product concentration arises through a focus on residential lending. The Society's products are 96% residential based. The risk is monitored through adherence to the Lending Policy and limits.

INSURANCE RISK

This is the risk that there may be gaps in the risks covered by the Society's insurances, that there is insufficient cover in place or that the covenant of the insurer is defective. Processes are in place which provides the Board with the assurance that the Society's insurance arrangements are robust.

CAPITAL ADEQUACY ASSESSMENT, CAPITAL RESOURCES & LEVERAGE

As at 31 August 2017 the Society complied with its capital requirement as defined by the PRA. The capital resources of the Society are calculated under Pillar I CRD IV and were £25.3m 31st August 2017. This comprised of Tier 1 capital (general reserves) and Tier 2 capital (collective impairment provisions for bad and doubtful debts) and is outlined in Table 1 below:

Capital Resources	£'000
Tier 1 Capital	
Gross (Accumulated General Reserves)	26,158
Deductions: Deferred Taxation & NBV Intangible Assets	(1,009)
Net Tier 1 Capital	**25,149**
CET1 Ratio	**17.78%**
Tier 2 Capital	
Collective impairment provision for bad and doubtful debts	150
Deductions	-
Net Tier 2 Capital	**150**
Total Capital	
Gross	25,299
Deductions	-
Net Total Capital	**25,299**

Table 1: Capital Resources 31 August 2017

The Society has no need for remunerated capital and therefore has no subordinated debt or permanent interest bearing shares.

The Society operates a three year Corporate Plan which is contemporised annually as a part of the Board's dedicated strategy meeting. The plan is subject to ongoing review by the Board, considering the current and changing economic conditions and the impact and opportunities available to the Society. The Corporate Plan is driven by reference to the Society's ICAAP and in particular the Board's risk appetite for different business activities and risks.

The ICAAP contains the capital plan for the Society for the next three years and the Board ensures that there are adequate capital resources to support the corporate goals contained within the plan.

In order to produce a detailed capital plan, the Society's ICAAP contains calculations of the capital resources requirement (effectively, the minimum capital required) each year using the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk.

Under the Standardised Approach for credit risk, the Society applies a risk weighted asset value to each of its exposure classes and provides 8% of that risk weighted asset value as the minimum capital requirement for credit risk.

Table 2 details the Society's Pillar 1 capital requirement as at 31 August 2017 by asset class:

EXPOSURE CLASS	Asset £'000	Risk Weighted Asset £'000	Capital £'000
On Balance Sheet:			
Treasury Assets			
Central government	62,353	0	0
Regional & local government	0	0	0
Credit institutions	34,116	8,925	714
Total Treasury Assets	**96,469**	**8,925**	**714**
Loans & Advances to Customers			
Residential – performing loans	289,329	103,284	8,263
Residential – past due items	13,894	10,210	817
Non-residential – performing loans	3,873	3,874	310
Non-residential – past due items	4,955	1,017	81
Total Loans & Advances to Customers	**312,051**	**118,385**	**9,471**
Other Assets			
Fixed & other assets	4,362	3,346	268
Total Other assets	**4,362**	**3,346**	**268**
Total On Balance Sheet	**412,882**	**130,656**	**10,453**
Off-Balance Sheet			
Interest rate derivatives	152	74	6
Mortgage Pipeline Commitments	12,751	951	76
Total Off Balance Sheet	**12,903**	**1,025**	**82**
Credit Risk – Capital Requirement	**425,785**	**131,681**	**10,535**
Operational Risk – Capital Requirement			798
Total Pillar 1 Capital Requirement			11,333
Tier 1 Capital			25,149
Excess over Pillar 1 Minimum			13,816

Table 2: Capital Resource Requirements 31 August 2017

Basel III introduces a non-risk based leverage ratio to supplement the risk based capital requirements. This ratio shows Tier 1 capital as a proportion of on and off balance sheet assets. The ratio does not distinguish between credit quality of loans and acts as a primary constraint to excessive lending in proportion to the capital base. The minimum ratio must be 3% (increasing to 3.25% with effect from 1 October 2017) but the leverage ratio will not become binding until 1 January 2018.

Leverage Ratio	**£'000**
Tier 1 Capital	25,149
Balance Sheet Exposures	405,396
Leverage Ratio	**6.20%**

Table 3: Capital Resources 31 August 2017

CREDIT RISK - MORTGAGES

Mortgage credit risk is managed through the Society's underwriting process which seeks to ensure that customers can afford to repay their debt. The Society is highly proactive in providing support in the unfortunate event of customers experiencing financial difficulties which can include working with them to make arrangements of forbearance or clear arrears. The Society regards any mortgage where 3 or more monthly repayments have not been made at the accounting date as 'past due'.

Table 4 provides an analysis, for capital adequacy purposes, of loans and advances exposures as at 31 August 2017:

Region	Residential		Non - Residential		Total
	Performing £'000	Past Due £'000	Performing £'000	Past Due £'000	£'000
East Anglia	9,542	0	0	0	9,542
East Midlands	19,123	200	0	0	19,323
London & South East	67,542	480	3,030	0	71,052
North	6,424	0	0	0	6,424
North West	42,942	11,879	31	4,675	59,527
South West	21,445	0	103	0	21,548
Wales	12,925	0	0	0	12,925
West Midlands	90,379	1,209	709	280	92,577
Yorkshire & Humberside	19,007	126	0	0	19,133
Total	289,329	13,894	3,873	4,955	312,051

Table 4: Mortgage Loans Exposure 31 August 2017

Table 5 provides a reconciliation of the above table to 'Loans and advances to customers' in the Annual Report & Accounts 2017:

	£'000
Loans and advances to customers per Annual Report & Accounts	302,760
Add back: General and specific loss provisions	9,291
Society accounting value of loans and advances to customers	312,051
Total residential exposures for capital adequacy purposes (as per Table 4)	303,223
Total non-residential exposures for capital adequacy purposes (as per Table 4)	8,828
Society capital adequacy value of loans and advances to customers	312,051
Adjustments to reflect different reporting requirements and timing differences	-
Reconciled value of loans and advances to customers	312,051

Table 5: Reconciliation of Loans and Advances to Customers 31 August 2017

The residual maturity analysis for loans and advances to customers is provided in Note 15 of the Society's Report & Accounts 2017 and is on the basis that loans and advances run for their full contractual term, and in addition, does not take into account any instalments receivable over the life of the exposure.

The Annual Report & Accounts also provides full details of the Society's impairment provisioning methodology in Note 1 together with the movement on provisions for bad and doubtful debts in Note 9.

Residential and non-residential mortgages are classed as 'past due' if the loan is in possession or subject to a Law of Property Act Receivership, has outstanding arrears of more than 3 months or has interest suspended. The total balance outstanding on cases classified as past due is £18.85m. In a number of cases it is the Society's strategy to either appoint an LPA Receiver or take possession of these individual properties with a view to generating a rental income stream to cover interest. As at 31 August 2017 the Society had a total of £13.18m under such an arrangement.

CREDIT RISK - TREASURY

The Society's Liquidity Policy statement is used to manage the credit risk arising from its treasury counterparties. The Policy ensures that the Society operates to obtain the best possible return, within prudent limits in respect of counterparties in terms of both the amount invested and counterparty rating.

Exposure to counterparty credit risk is derived from the investments in banks and building societies the Society makes for liquidity purposes. The minimum policy ratings, as measured against the Fitch ratings agency, are short term F1 and long term AA-. The Board has agreed to include selective UK clearing banks with a long term rating of A-/BBB+ within the Society's eligible counterparties. Treasury deposits are also made with unrated building societies and other mutuals.

Policy limits and counterparties are reviewed regularly by ALCO, with formal approval made at Board level. The Society receives counterparty grading updates from its treasury advisors and limits may be suspended following adverse downgrades.

Table 6 shows the breakdown of liquid assets by maturity and rating at 31 August 2017 under the Standardised Approach:

Ratings	Maturity of Treasury Investments			
	< 3 Months £'000	3 Months to 1 Year £'000	>1 Year £'000	Total £'000
AAA to AA-	64,032	7,022	0	71,054
A+ to A-	14,123	7,002	0	21,125
BBB+ to BBB-	2,283	0	0	2,283
Unrated Building Societies	2,007	0	0	2,007
Total	82,445	14,024	0	96,469

Table 6: Investment Maturity Analysis 31 August 2017

INTEREST RATE RISK

The main activities undertaken by the Society that give rise to interest rate risk are as follows:-

- Management of the investment of capital and other non-interest bearing liabilities;
- Issue of fixed rate savings products;
- Fixed rate wholesale funding;
- Fixed rate mortgage lending; and
- Fixed rate treasury instruments.

Interest rate risk is managed by utilising internal hedges on the Society's balance sheet and by utilising interest rate swaps with external counterparties and, as measured by a 2% parallel shift in interest rates, is reviewed on a regular basis and hedging action taken as appropriate.

Interest rate risk limits are an expression of the Board's risk appetite and are reviewed annually as an integral part of updating the Society's ICAAP.

CRDIV DISCLOSURES

From 1 January 2014 the PRA has adopted the Capital Requirements Directive ('CRDIV') or otherwise known as Basel II. This directive will have future impacts on the capital requirements for banks and building societies and the Society has adopted the new principles when assessing capital adequacy.

A requirement under CRDIV is the introduction of the leverage ratio which measures levels of Tier 1 capital against both on and off balance sheet exposures. CRDIV requires a minimum ratio of 3% (increasing to 3.25% with effect from 1 October 2017) and as at 31 August 2017 the Society had a leverage ratio of 6.20%.

The capital ratio is the level of total capital resources as a percentage of total risk weighted assets. The ratio must be a minimum of 8% and as at 31 August 2017 the Society had a ratio of 17.78%.

CRDIV also introduced a requirement for country by country reporting. The objective of this is to provide increased transparency regarding the source of the Financial Institution's income and the locations of its operations.

The Hanley Economic Building Society and its Subsidiaries are all UK registered entities, the activities of which are disclosed in Note 16 of the Annual Report & Accounts 2017.

The Hanley's total operating income for the year ended 31 August 2017 was £5,878k and profit before taxation was £1,477k. All arose from UK activities.

Corporation tax of £126k was paid in the year and was all within the UK tax jurisdiction.

No public subsidies were received in the year.

The number of full-time equivalent employees was 60.

REMUNERATION POLICIES AND PRACTICES

A risk arises if the Society's remuneration policies and practices could result in staff being rewarded for decisions inconsistent with the Board's risk appetite. It is therefore the Society's policy on remuneration to seek and ensure that its remuneration decisions are in line with effective risk management.

The Society seeks to ensure that its remuneration decisions are in line with its business strategy and long term objectives, and consistent with the Society's current financial condition and future prospects. It also seeks to establish an appropriate balance between the fixed and variable elements of remuneration, although this balance will vary depending on the seniority and nature of an individual's employment. Performance measurements used to calculate variable remuneration are therefore adjusted to take into account current or potential risks to the business and are consistent with the need to retain a strong capital base. Variable remuneration is not paid unless it is sustainable within the Society's situation as a whole. Guaranteed incentive payments do not form part of any remuneration package and all incentive schemes are non-contractual.

The Board has identified that those staff whose professional activities have a material impact on the Society's risk profile are the members of the Leadership team, two of whom, the Chief Executive and Deputy Chief Executive, Finance Director & Group Secretary are Executive Directors.

Information concerning the mandate of the Remuneration Committee and the decision-making process it uses in determining the remuneration policy for the executive directors, and information on the link between pay and performance, is contained in the Directors' Remuneration Report in the Society's Annual Report & Accounts 2017.

The total remuneration of the two Executive Directors in respect of the year ended 31 August 2017 was £305k. The Society does not operate any form of bonus or incentive scheme for Executive Directors.

The total remuneration of these members of the Executive team was £253k. No variable bonus was paid during the year ended 31 August 2017.

CONCLUSION

This disclosure document has been prepared in accordance with regulatory requirements as interpreted by the Society based on its size and complexity, and is updated on an annual basis following the publication of the Annual Report & Accounts.

In the event that a user of this disclosure document requires further explanation on the disclosures given they should write to the Deputy Chief Executive, Finance Director & Group Secretary at Hanley Economic Building Society, Granville House, Festival Park, Hanley, Stoke-on-Trent. ST1 5TB.