Hanley
ECONOMIC
Building Society

2018

Capital Requirements Directive
Pillar 3 Disclosures
For the year ended 31 August 2018

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The Pillar 3 disclosures in this document have been prepared solely for the purpose of compliance with the Capital Requirements Directive. The information contained in and disclosed by this statement as to the capital requirements and the management of risk does not constitute a financial statement and shall not be used or relied upon by anyone for any purpose.

1. INTRODUCTION

1.1 BACKGROUND

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 Basel Committee on Banking Supervision (BCBS) released a revised version of the Pillar 3 framework in January 2015.

The European Banking Authority (EBA) issued their own guidelines in December 2016 to ensure the harmonised and timely implementation of the framework in the EU. This guidance is regarded as good practice, although not mandatory at present, and this document seeks to reflect the guidance in line with society peers.

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.

1.2 BASIS, FREQUENCY AND SCOPE OF DISCLOSURE

This disclosure document, is prepared in accordance with the CRR and 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 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.

The figures quoted in this disclosure are as at 31 August 2018, unless stated otherwise. Disclosures are issued on an annual basis and are not subject to external audit, except where they are equivalent to those included within the Annual Report and Accounts.

Copies of this disclosure will be available on the Society's website (www.thehanley.co.uk) alongside the publication of the Annual Report and Accounts.

The Board approved the Society's Pillar 3 Disclosure Document at their meeting dated 18th December 2018.

2. 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".

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. 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.

Risks arise naturally in the course of doing business in the financial services industry. To mitigate these risks to acceptable levels, the Board has put in place a Risk Management Framework which covers all aspects of the Society's operations.

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 and long term success.

2.1 RISK GOVERNANCE STRUCTURE

The Board has overall responsibility for the identification, assessment, management and mitigation of the risks to which the Society is exposed. 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.

Through its governance structure, the Board operates an open and honest culture when identifying and monitoring risks. This culture is underpinned by appropriate risk training for staff, good risk identification & escalation procedures and a robust whistleblowing mechanism.

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.

Identification, monitoring and review of principal risks to which the Society is exposed to is monitored through the following Committee structure:

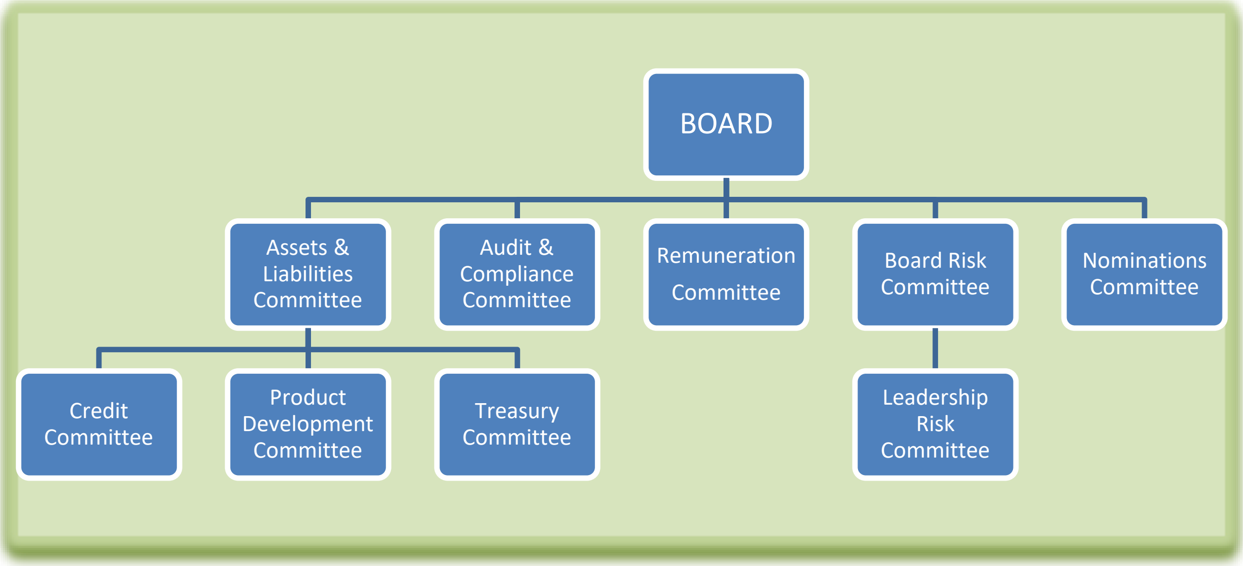

FIGURE 1: BOARD AND SUB-COMMITTEES

The Board accepts overall responsibility for the ensuring that the Society maintains adequate financial resources, both in terms of liquidity and capital. Financial risk is managed through a formal structure and is closely monitored by the Board and supported by the Audit & Compliance Committee and the Assets & Liabilities Committee.

Assets and Liabilities Committee ('ALCO')

Comprising Non-Executive and the Executive Director, ALCO is responsible for the management of structural risk in the statement of financial position 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.

Audit and Compliance Committee ('ACC')

Consisting solely of Non-Executive Directors, ACC considers all matters of an audit nature, including internal controls, compliance with the requirements of both the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA'). The scope and content of internal and external audit work, financial reporting and other relevant regulatory requirements are also reviewed by the committee. Society Executives, and representatives from the 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.

Board Risk Committee ('BRC')

The BRC, considers all risk matters, both current and emerging, relating to the ongoing safety and soundness of the Society. Comprising of all the Directors of the Society, the BRC monitors risk tolerance in accordance with the Board's stated risk appetite and Risk Management Framework and has clear sight of both current and emerging risks. The BRC provides assurance that the Society is adhering to regulatory risk requirements by monitoring actions taken to resolve any risk control weaknesses or failings to the Society's strategy, operations and performance.

2.2 THREE LINES OF DEFENCE

The Society operates an internal governance framework that includes a three lines of defence model which is recognised as an industry standard for risk management.

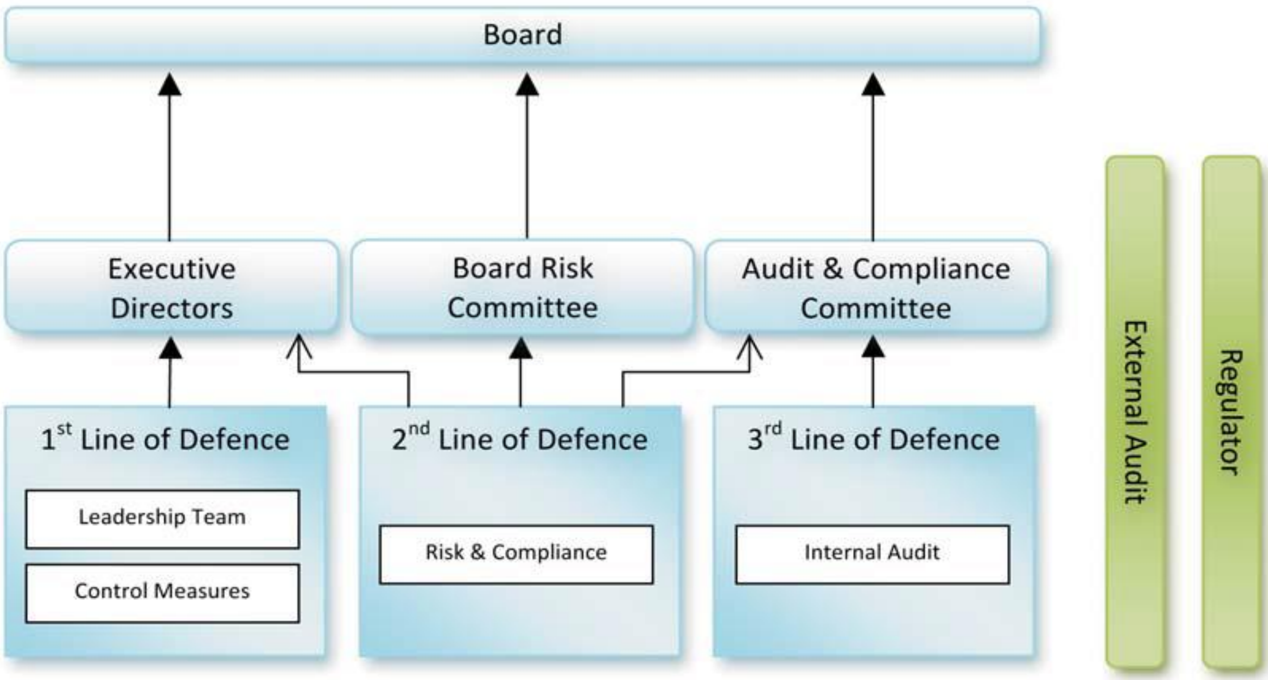

FIGURE 2: THREE LINES OF DEFENCE

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. It helps to ensure the Society complies with applicable laws and regulations and that policies and procedures are contemporary and operating as intended.

Third Line of Defence

Internal audit (outsourced to PricewaterhouseCoopers LLP) 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.

2.3 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. The Society 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. Each of these risks is considered below.

The Society has a formal structure for managing these risks including established risk limits, reporting lines, mandates and other control procedures.

2.4 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 ALCO 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.

2.5 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 adequate liquid resources, both in amount and quality, to cover cash flow imbalances and fluctuations in funding, to maintain full public confidence in the solvency of the Society and to meet its financial obligations.

Liquidity risk is controlled in accordance with the Board's approved Liquidity Policy, which details the approved Liquidity Risk limits set by the Board. 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.

Periodic stress testing is 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 ALCO.

2.6 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.

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 effecting interest rate derivatives with external counterparties. This is measured by a 2% parallel shift in interest rates, is reviewed on a regular basis and action taken as appropriate to hedge the risk.

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

Basis risk is reported to ALCO and the Board and is managed within the limits stated in the Structural Financial Risk Management Policy.

The Society has no direct exposure to foreign currency exchange rates.

2.7 CONDUCT RISK

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

A formal Conduct Risk Policy is in place to ensure that appropriate actions will be taken by the Leadership Team to identify, and manage effectively, the conduct risks to which the Society and its Members may be exposed.

2.8 OPERATIONAL RISK

Operational risk is the risk of loss from inadequate or failed internal processes, people and systems 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 relevant insurance, internal audit and the Society's risk and compliance function, which are overseen by the Board and the ACC.

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 fees.

2.9 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 ACC.

2.10 BUSINESS RISK

Business risk is 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.

2.11 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 (28.21%), London & South East (26.09%) and North West (16.67%). 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 mortgage exposures are 98.91% residential based. The risk is monitored through adherence to the Lending Policy and limits.

2.12 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.

3. CAPITAL ADEQUACY ASSESSMENT, CAPITAL RESOURCES & LEVERAGE

As at 31 August 2018 the Society complied with its capital requirements as defined by the PRA. The capital resources of the Society are calculated under Pillar I CRD IV and were £26.65m as at 31st August 2018. This comprised of Tier 1 capital (general reserves less deductions for deferred taxation and intangibles) and Tier 2 capital (collective impairment provisions for bad and doubtful debts), all of which is outlined in Table 1 below:

Capital Resources	2018 £'000	2017 £'000
Tier 1 Capital		
Gross (Accumulated General Reserves)	27,341	26,158
Deductions: Deferred Taxation	(763)	(913)
Deductions: NBV Intangible Assets	(83)	(96)
Net Tier 1 Capital	**26,495**	**25,149**
CET1 Ratio - Regulatory Minimum 4.5%	**17.48%**	**17.78%**
Tier 2 Capital		
Collective impairment provision for bad and doubtful debts	150	150
Deductions	-	-
Net Tier 2 Capital	**150**	**150**
Total Capital Resources	**26,645**	**25,299**

TABLE 1: CAPITAL RESOURCES 31 AUGUST 2018

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 ('SA') for credit risk and BIA for operational risk.

Under the SA 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 & Pillar 2 capital requirement as at 31 August 2018 by asset class under the standardised approach:

Exposure Class	**Exposure £'000**	**Risk Weighted Asset £'000**	**Capital £'000**
On Balance Sheet:			
Liquidity Exposures			
Central government	58,380	-	-
Regional & local government	-	-	-
Credit institutions	35,938	8,536	683
Interest Rate Derivatives	468	223	18
Total Liquidity Exposures	**94,786**	**8,759**	**701**
Loans & Advances to Customers			
Residential – Non-Arrears	313,875	113,522	9,081
Residential – Past Due	10,231	10,266	822
Non-residential – Non-Arrears	3,350	3,350	268
Non-residential – Past Due	305	318	25
Forward Commitments - Off Balance Sheet	4,394	1,611	129
Total Loans & Advances to Customers	**332,155**	**129,067**	**10,325**
Other Exposures			
Fixed & other assets	3,300	3,300	264
Total Other Exposures	**3,300**	**3,300**	**264**
Credit Risk – Pillar 1 Capital Requirement	**430,241**	**141,126**	**11,290**
Operational Risk – Capital Requirement		10,395	832
Credit Valuation Adjustment - Capital Requirement		132	11
Total Capital Requirement ('TCR') (8% of RWA)		**151,653**	**12,133**
Total Capital Resources as per Table 1			26,495
Excess over TCR			**14,362**

TABLE 2: PILLAR 1 CAPITAL RESOURCE REQUIREMENTS 31 AUGUST 2018

The difference between the Society's total credit risk exposure detailed above of £430.24m and the total assets recognised in the Statement of Financial Position of £426.28m in the Annual Report & Accounts for the year ended 31 August 2018 is as follows:

Reconciliation of Total Credit Risk Exposure & Society's Statement of Financial Position	**£'000**
Total credit risk exposure	430,241
Less: Forward Commitments	(4,394)
Less: Interest Rate Derivatives	(264)
Less: Liquidity Premium	(3)
Less: Collective Provision	(150)
Add back: Deferred Tax	763
Add back: Intangible Fixed Assets	83
Total assets recognised in the Statement of Financial Position	**426,276**

TABLE 3: PILLAR 1 CAPITAL RESOURCE REQUIREMENTS 31 AUGUST 2018

4. CREDIT RISK - LOANS AND ADVANCES

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.

Table 4 provides an analysis, for capital adequacy purposes, of loans and advances exposures as at 31 August 2018:

Region	Residential		Non - Residential		Total
	Performing £'000	Past Due £'000	Performing £'000	Past Due £'000	£'000
East Anglia	8,319	142	-	-	8,461
East Midlands	21,278	-	-	-	21,278
London & South East	83,856	575	2,686	-	87,117
North	7,773	-	-	-	7,773
North West	41,176	8,441	28	90	49,735
South West	25,328	-	89	-	25,417
Wales	12,643	-	-	-	12,643
West Midlands	92,170	1,073	547	215	94,005
Yorkshire & Humberside	21,332	-	-	-	21,332
Total	**313,875**	**10,231**	**3,350**	**305**	**327,761**

TABLE 4: MORTGAGE LOANS EXPOSURE 31 AUGUST 2018

Table 5 provides a reconciliation of the above table to 'Loans and advances to customers' in the Annual Report & Accounts 2018:

Reconciliation of loans and advances to customers	**£'000**
Loans and advances to customers per Annual Report & Accounts	327,442
Add back: Fair value adjustment for hedged risk and effective interest rate	169
Add back: Collective mortgage provision	150
Society accounting value of loans and advances to customers	**327,761**
Total residential exposures for capital adequacy purposes (as per Table 4)	324,106
Total non-residential exposures for capital adequacy purposes (as per Table 4)	3,655
Society capital adequacy value of loans and advances to customers	**327,761**
Adjustments to reflect different reporting requirements and timing differences	-
Reconciled value of loans and advances to customers	**327,761**

TABLE 5: RECONCILIATION OF LOANS AND ADVANCES TO CUSTOMERS 31 AUGUST 2018

The residual maturity analysis for loans and advances to customers is provided in Note 15 of the Society's Report & Accounts 2018 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 impairment losses 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 ('LPA'), has outstanding arrears of more than 3 months or has interest suspended. The total exposure on cases classified as past due is £10.54m as at 31 August 2018. 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 £13.93m under such an arrangement.

5. CREDIT RISK - LIQUIDITY

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. Treasury exposures are assigned risk weightings determined by both residual maturity and Credit Quality Step ('CQS'). External credit assessment institutions ('ECAI') (Moody's, Fitch and Standard & Poor's) credit ratings are mapped to each CQS to determine the risk weighting applied to each exposure.

CQS	Ratings	Central Banks and Governments Risk Weighting	< = 3 Months Residual Maturity		> 3 Months Residual Maturity	
			Rated Institutions Risk Weighting	Unrated Institutions Risk Weighting	Rated Institutions Risk Weighting	Unrated Institutions Risk Weighting
1	AAA to AA-	0%	20%	20%	20%	20%
2	A+ to A-	20%	20%		50%	
3	BBB+ to BBB-	50%	20%		50%	
4	BB+ to BB-	100%	50%		100%	
5	B+ to B-	100%	50%		100%	
6	CCC+ and below	150%	150%		150%	

TABLE 6: LIQUIDITY RISK WEIGHTINGS AS DEFINED IN THE CRR

The Society nominated ECAI is Fitch and all marketable instruments have a minimum Fitch rating of F1 (Short Term) and A- (Long Term). The Board has agreed to include selective unrated Building Societies and UK clearing banks with a long term rating of BBB+ within the Society's eligible counterparties and controls exist as to the maximum exposure limit for each counterparty.

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 7 shows the breakdown of liquid assets by maturity and rating at 31 August 2018 under the Standardised Approach:

Ratings	Maturity of Treasury Investments				Risk weighted asset value £'000
	< 3 Months £'000	3 Months to 1 Year £'000	>1 Year £'000	Total £'000	
AAA to AA-	70,103	-	-	70,103	2,345
A+ to A-	14,928	4,494	-	19,422	5,232
BBB+ to BBB-	2,284	-	-	2,284	457
Unrated Building Societies	2,009	500	-	2,509	502
Total	**89,324**	**4,994**	**-**	**94,318**	**8,536**

TABLE 7: INVESTMENT MATURITY ANALYSIS 31 AUGUST 2018

The Society has no exposure to equities and no assets subject to securitisation. At 31 August 2018 the Society did not make any provisions relating to its portfolio of liquid asset investments.

6. CREDIT RISK - CREDIT VALUATION ADJUSTMENT ('CVA')

The Society uses derivatives (interest rate swaps) to hedge its exposure to interest rate risk and therefore under the CRR, additional capital is required to cover the Society's exposure to CVA risk; this is applicable for all derivatives that are not subject to centralised clearing. All of the Society's derivatives are bilateral and conducted over-the-counter.

The table below shows an overview of the Society's total CVA capital requirement.

Exposure Class	RWA £'000	Capital Required £'000
CVA Risk	**132**	**11**

TABLE 8: CREDIT VALUATION ADJUSTMENT 31 AUGUST 2018

7. OPERATIONAL RISK - CAPITAL REQUIREMENT

The Society has adopted the BIA for Operational Risk (CRR Article 315-316). Under the BIA, a Pillar 1 operational risk capital requirement ('ORCR') is calculated at 15% of the average over three years of the sum of the elements listed below:

1. Interest receivable and similar income; less
2. Interest payable and similar charges;
3. Commissions/fees receivable; less
4. Commissions/fees payable.

Financial Year Ending 31 August	2016 £'000	2017 £'000	2018 £'000	Average £'000
Net interest income[1]	4,921	5,698	5,482	5,367
Net fees[2]	171	180	180	177
Relevant indicator	5,092	5,878	5,662	5,544
ORCR (15%)				**832**
RWA equivalent				**10,395**

TABLE 9: OPERATIONAL RISK PILLAR ONE 31 AUGUST 2018

[1] Net Interest Income comprises of interest receivable and similar income and interest payable and similar income.

[2] Net Fees comprises of commission/fees receivable and commission/fees payable

8. ASSET ENCUMBRANCE

The Society has pledged mortgage assets as collateral with the Bank of England, in order to participate in the Bank's Term Funding Scheme ('TFS'). Participation in this scheme enabled the Society to access an additional source of funding and reduce its overall funding cost benefiting Members.

Encumbered assets remain fully owned and operated by the Society, and are shown in the table above. This information is required to be disclosed as median values over quarterly positions during the financial year, and as such values may differ from other information provided in this disclosure. As at 31 August 2018 the Society held £56.28m of encumbered assets supporting drawings of £25.00m.

	Encumbered Assets		Unencumbered Assets	
	Carrying Amount £'000	Fair Value £'000	Carrying Amount £'000	Fair Value £'000
Assets of the reporting institution	**61,370**	**-**	**354,949**	**-**
Loans on demand	-	-	63,190	-
Debt securities	-	-	31,597	31,562
Loans & advances other than loans on demand	61,370	-	255,631	-
Other Assets	-	-	4,531	-

TABLE 10: ASSET ENCUMBRANCE QUARTERLY MEDIAN VALUES TO 31 AUGUST 2018

9. LEVERAGE

The leverage ratio has two objectives: first to limit the risk of excessive leverage by constraining the building up of leverage in the banking sector during economic upswings and second to act as a simple instrument that offers a safeguard against the risks associated with the risk models underpinning risk-weighted assets. The ratio is defined as the Capital Measure divided by the Exposure Measure, with the ratio expressed as a percentage.

The capital measure for the leverage ratio is Tier 1 capital as defined in Section 3. The Exposure Measure consists of both on and off balance sheet exposures, with the latter being introduced in January 2014 when the Basel Committee on Banking Supervision published a revised methodology for calculating the leverage ratio. The revised paper requires off balance sheet items to be converted into credit exposure equivalents by using credit conversion factors.

The table below details the Society’s leverage ratio as at 31 August 2018.

Table LRSum: Reconciliation of leverage ratio exposures to the financial statements	2018 £'000
Total assets as per the financial statements	426,276
Adjustments:	
Add back: Forward Commitments	4,394
Add back: Interest Rate Derivatives	264
Add back: Liquidity Premium	3
Less: Collective Provision	150
Less: Deferred Tax	(763)
Less: Intangible Fixed Assets	(83)
Leverage ratio exposure	**430,241**

TABLE 11: LEVERAGE RATIO 31 AUGUST 2018: LRSUM

Table LRCom: Leverage ratio common disclosure	2018 £'000
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	425,380
(Asset amounts deducted in determining Tier 1 capital)	(846)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**424,534**
Replacement cost associated with all derivatives transactions (i.e net of eligible cash variation margin)	200
Add-on amounts for PFE associated with all derivatives transactions (mark- to-market method)	268
Total derivatives exposures	**425,002**
Total off-balance sheet exposures	**4,394**
Tier 1 capital	26,495
Total exposures	430,241
Leverage ratio	**6.16%**

TABLE 12: LEVERAGE RATIO 31 AUGUST 2018: LRCOM

Table LRSpl: Split-up of on-balance sheet exposures (excluding derivatives and SFTs)	£'000
Secured by Mortgages on Immovable Property	317,225
Exposures in Default	10,536
Sovereign	58,380
Institution	35,938
Other exposures (e.g. equity, securitisations, and other non-credit obligations assets)	3,300
Total on-balance sheet exposures	**425,379**

TABLE 13: LEVERAGE RATIO 31 AUGUST 2018: LRSPL

The Society's leverage ratio as at the 31 August 2018 was 6.16%, which is above the regulatory minimum of 3%.

10. LIQUIDITY COVERAGE RATIO ('LCR')

The LCR was introduced as part of the CRDIV framework with its aim to improve short-term resilience of the liquidity risk profile of firms by requiring a buffer of High Quality Liquid Assets ('HQLA') to be held. The measure is designed to ensure that all credit institutions have sufficient available HQLA to meet a stressed net cash outflows over a 30 day horizon. The measure must be greater than the 100% threshold as defined in the CRR.

The below table details the Society's quarterly LCR for the 12 month period ending 31 August 2018.

LCR	30-Nov-17 £'000	28-Feb-18 £'000	31-May-18 £'000	31-Aug-18 £'000
Liquidity Buffer	62,824	75,490	65,323	58,338
Total Net Cash Outflows	21,008	18,550	17,731	6,954
LCR %	**299.05%**	**406.95%**	**368.41%**	**838.91%**

TABLE 14: LIQUIDITY COVERAGE RATIO 31 AUGUST 2018

The average LCR for the financial year ending 31 August 2018 was 367.79%.

11. IMPAIRMENT OF LOANS AND ADVANCES

The Society reviews its mortgage portfolio to assess the adequacy of its impairment provision on at least a quarterly basis. In undertaking this review, the Society assesses whether there is objective evidence that financial assets not carried at fair value through the Income Statement are impaired.

Objective evidence that financial assets are impaired includes:

- Significant financial difficulty of the borrower;
- 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 will enter bankruptcy;
- The disappearance of an active market for a security; or
- The observable data relating to a group of assets such as adverse changes in the payment status of borrowers, or economic conditions that correlate with defaults in the group.

A financial asset or a group of financial assets is 'impaired' when the 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 cashflows of the asset(s) that can be estimated reliably.

The Society considers evidence of impairment for loans and advances at an individual and collective level. All individually significant loans and advances are assessed for individual impairment. Those found not to be individually impaired are then collectively assessed for impairment that has been incurred but not yet identified, and are grouped on the basis of similar credit risk characteristics. For capital adequacy purposes, the collective impairment provision is classified as Tier 2 capital.

FRS102 requires for financial assets measured at amortised cost, that the impairment loss to be measured as the difference between the assets carrying amount and the present value of estimated cash flows, discounted at the assets original effective interest rate (that is the effective interest rate computed at initial recognition).

	Loans fully secured on residential property £'000	Other loans fully secured on land £'000	Total £'000
Individual Provision			
At 01 September 2017	9,141	-	9,141
Amounts utilised	(3,461)	-	(3,461)
Released in the year	-	-	-
Impairment losses on loans and advances	(136)	-	(136)
At 31 August 2018	5,544	-	5,544
Collective Provision			
At 01 September 2017	138	12	150
At 31 August 2018	138	12	150
Total at 31 August 2018	**5,682**	**12**	**5,694**

TABLE 15: IMPAIRMENT PROVISIONS 31 AUGUST 2018

Loans and advances detailed within the Society's Statement of Financial Position are net of impairment provisions and the charge or credit to the Income Statement comprises the movement in the impairment provisions, both for the individual and collective impairment provisions, together with any losses incurred or written off by the Society in the year.

12. 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 CEO/FD are Executive Directors. However, the Deputy CEO/FD left our employment on 31st May 2018.

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 2018.

The Society has a performance based Medium-Term Incentive Plan (MTIP) for the Executive Directors and the Leadership Team. The plan is designed to promote appropriate behaviours which contribute to the long-term success of the Society, while being consistent with the Society's values and risk appetite. The payment of any reward will be linked to the delivery of both personal and Society strategic objectives.

In addition to personal objectives, achievement of targets on Society profit, mortgage asset growth and operational success will trigger the payment of a cash bonus. The scheme is designed to ensure an award will be triggered only if the profit target for the year is achieved.

The following table sets out the aggregate quantitative remuneration for code staff to year ending 31st August 2018:

Staff Type	Number	Fixed Remuneration £	Variable Remuneration £	Total Remuneration £
Non-Executive Directors	7	151,321	-	151,321
Executive Directors	2	297,562	41,244	338,807
Leadership Team	6	339,548	54,587	394,135
Total	**13**	**788,431**	**95,831**	**884,263**

TABLE 16: REMUNERATION ANALYSIS 31 AUGUST 2018

In the case of the Executive Directors and members of the Leadership Team, fixed remuneration includes pension contributions made by the Society on behalf of the employees, and the value of taxable benefits.

13. 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 Chief Executive & Group Secretary at Hanley Economic Building Society, Granville House, Festival Park, Hanley, Stoke-on-Trent, ST1 5TB.