Hanley
ECONOMIC
Building Society

2019

Capital Requirements Directive
Pillar 3 Disclosures
For the year ended 31 August 2019

Contents

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 Regulation ('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. The Society meets the minimum capital requirement by applying the Standardised Approach to Credit Risk and Basic Indicator Approach ('BIA') to Operational Risk.
- **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 disclosure requirements for Pillar 3 as contained in the CRR and covers the entire business across all 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 subsidiaries Hanley Mortgages Services Ltd and Hanley Financial Services Ltd are wholly owned and funded by the Society. The group financial statements comprise the results of the Society and its subsidiaries, and therefore form part of the consolidation in determining the regulatory capital requirement.

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 2019, 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 17th December 2019.

2. RISK MANAGEMENT POLICIES AND OBJECTIVES

The Hanley is a mutual organisation with no equity shareholders. Its mission statement[1] 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 Risk Committee ('RC') periodically, but at least annually, considers the embeddedness of the Risk Management Framework across the Society. This assessment includes consideration of reports from the first, second and third lines of defence.

[1] The Society's mission statement is to be updated in the financial year ending 31 August 2020.

The Society's internal audit function (the third line) specifically reviews elements of the Group's Risk Management Framework and its embeddedness over a 3 year planning cycle. The results of these reviews, initially reported to Audit and Compliance Committee ('ACC'), also inform the RC assessment.

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.

Risk policy statements, which articulate policy and risk limits in more detail for specific risk categories, have been implemented to manage the risks faced by the Society within the defined risk appetites. These policies are managed by the Leadership Team and reported to various committees on an annual basis.

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

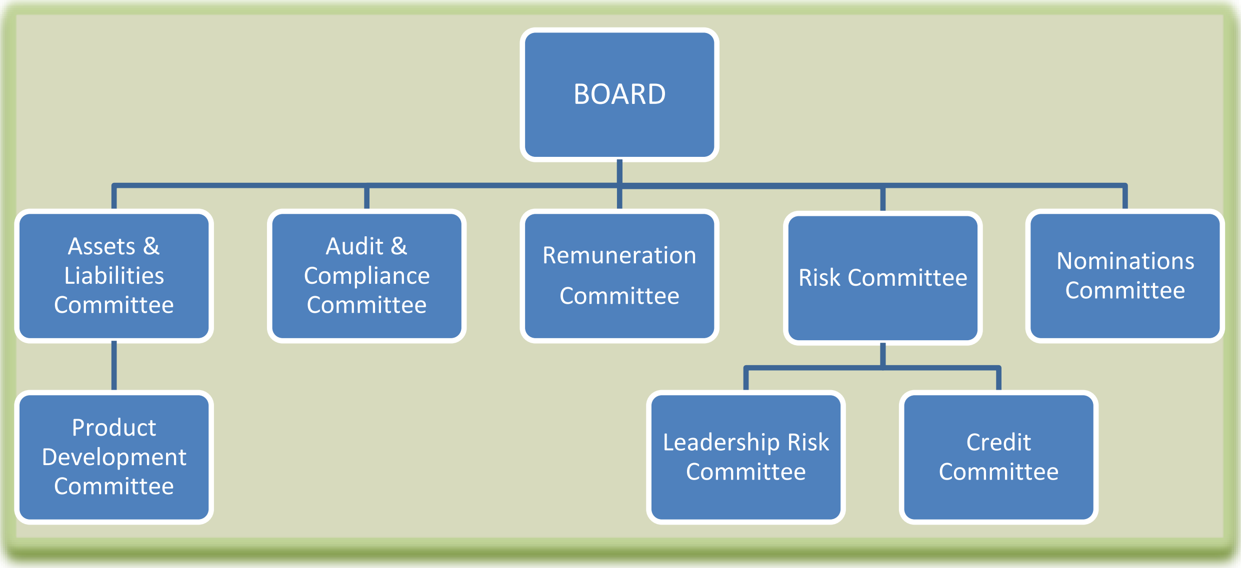

FIGURE 1: BOARD AND SUB-COMMITTEES

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-Executives and the Executive Directors, 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 of Non-Executive and Executive Directors, ACC considers all matters of an audit nature, including internal controls, compliance with the requirements of both the 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.

Risk Committee ('RC')

The RC, considers all risk matters, both current and emerging, relating to the ongoing safety and soundness of the Society. Comprising of three Non-Executive Directors of the Society, with members of the Executive Team attending by invitation, the RC 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 RC 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.

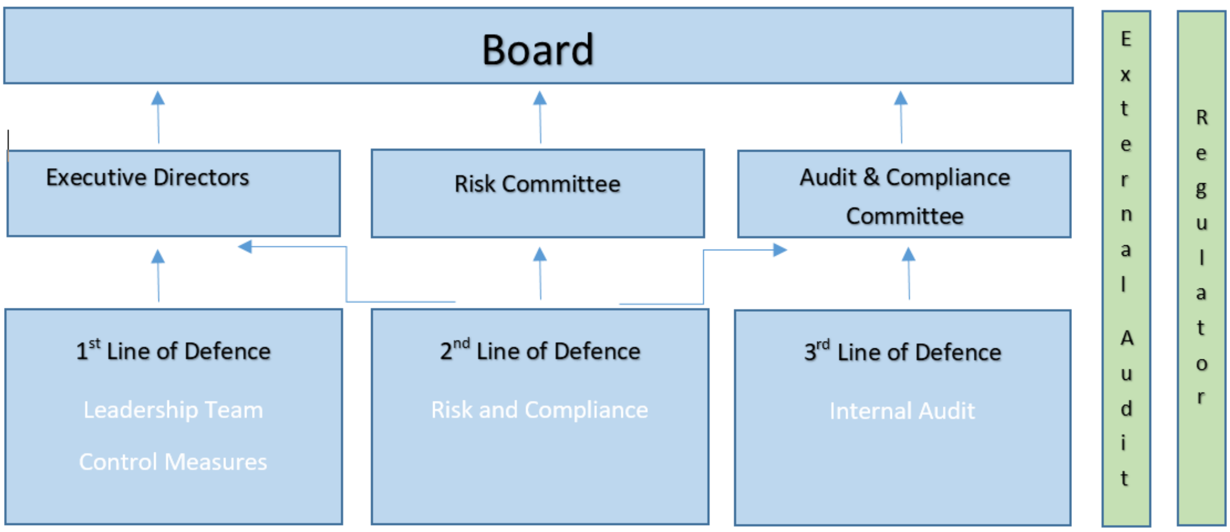

FIGURE 2: THREE LINES OF DEFENCE

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.

Management Information relating to prudential risks (credit, liquidity and interest rate) is reported to ALCO. Management Information relating to Operational risks (operational, conduct and certain business risks) is reported to RC.

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 and reported to both ACC and RC. 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 and financial risks to which the Society is exposed to are:

- Credit Risk;
- Liquidity Risk;
- Interest rate Risk;
- Conduct Risk;
- Operational Risk;
- Regulatory & Legal Risk;
- Capital Risk;
- Business Risk;
- 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.

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, or 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. 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 either under normal business conditions or stressed conditions.

Management of the Society's Liquidity Risk is overseen by ALCO with the Finance Director having responsibility for the daily management of wholesale and retail funding. The Liquidity Risk appetite is as follows:

"In line with its OLAR the Society will maintain sufficient liquid resources, in respect of both amount and quality, to cover cash flow imbalances and fluctuations in funding, to enable it to retain full public confidence in its solvency and to meet its liabilities as they arise."

"The Board have an appetite to demonstrate survival in a number of different scenarios with a minimum survival period of 60 days. Quantitatively for the year ending 31 August 2019 this gives rise to an EWI trigger of £68m which is to be held in its counterbalancing capacity[2], of which £51m will be held in High Quality Liquid Assets ('HQLA') aligned to a survival period of 30 days."

Monthly 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 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

[2] Counterbalancing capacity comprises of marketable instruments in addition to exposures with the Bank of England (HQLA).

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 harm 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 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 RC and the ACC.

2.10 CAPITAL RISK

Capital Risk is the risk of the Society not holding adequate capital, of a pre-requisite quality, to satisfy both the regulatory Total Capital Requirement ('TCR'), including buffer requirements, and the Overall Financial Adequacy Rule ('OFAR')

The Society manages this risk by maintaining a strong capital position relative to its Basel capital requirement ('capital cover' ratio). The Society should have sufficient capital over the period of the Corporate Plan and of a pre-requisite quality, to cover, as an absolute minimum, regulatory capital requirements. The Board has a Capital Risk Appetite of 13.80% of Risk Weighted Assets (RWA), thereby satisfying the OFAR.

2.11 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.

2.12 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 London & South East (29.68%)[3], the West Midlands (24.76%) and North West (16.07%). 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 96.14% residential based. The risk is monitored through adherence to the Lending Policy and limits.

2.13 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.

2.14 BREXIT RISK

[3] Expressed as regional lending exposure as a percentage of the Society's total mortgage book as at 31 August 2019 (£361.31m)

Is the risk of negative implications arising from the uncertainty concerning the future relationship between the United Kingdom and the European Union. While it is difficult to make economic predictions for 2020 and beyond, the Society has no exposure to the EU.

Given the current political and economic uncertainty regarding Brexit and its subsequent impact, ACC concluded that risk faced by the Society would be as a result of the wider impact on the UK economy. ACC and the Board are mindful of the potential impact of Brexit, particularly a hard Brexit, and are committed to monitoring relevant developments to the UK economy.

3. CAPITAL ADEQUACY ASSESSMENT

3.1 OVERVIEW

The Society is required to hold sufficient capital resources to ensure it can continue to operate and protect the solvency of the business. The purpose of holding capital is primarily to meet the Society's business requirements but also to cover unexpected and possible losses that may be incurred. The fundamental element of the Society's capital base is the general reserve and through the generation of adequate profits each year, the Society is able to add to the general reserve to increase its capital base.

The Society utilises a three-year Corporate Plan which is reviewed annually by the Board taking into account any changes in the economic and business environments. Together, with regular forecasting and internal processes for reporting financial information, the Society is able to determine both existing and future needs of both financial and non-financial resources.

3.2 ICAAP

The Society complies with the Basel CRDIV which requires the Society to assess the adequacy of its capital strength through an ICAAP. The ICAAP ensures that capital resources are sufficient to support the Society's Corporate Plan under both normal and stressed conditions.

Through the ICAAP the Board ensure that it is satisfied that the Society holds a level of capital more than sufficient to satisfy the CRDIV requirements to mitigate the principal risks to which the Society is exposed. In consideration of the principal risks, the ICAAP assesses the minimum capital requirements under Pillar 1 and Pillar 2. The Board approve the ICAAP on an annual basis and it is reviewed by the PRA in setting the Society's capital requirements as TCR.

3.3 CAPITAL RESOURCES

As at 31 August 2019 the Society complied with its capital requirements as defined by the PRA. The capital resources of the Society are calculated under Pillar I CRDIV and were £27.47m as at 31st August 2019. This comprised of Tier 1 capital (general reserves less deductions for deferred taxation, intangibles and prudent valuation adjustment) and Tier 2 capital (collective impairment provisions for bad and doubtful debts), all of which is outlined in Table 1 below:

Capital Resources	**2019 £'000**	**2018 £'000**
Tier 1 Capital		
Gross (accumulated general reserves)	28,056	27,341
Less: deferred taxation	(627)	(763)
Less: intangible assets	(65)	(83)
Less: prudent valuation adjustment[4]	(19)	-
Net Tier 1 Capital (CET1)	**27,345**	**26,495**
Tier 2 Capital		
Collective impairment provision for bad and doubtful debts	125	150
Net Tier 2 Capital	**125**	**150**
Total Capital Resources	**27,470**	**26,645**
Total Risk Exposures	**163,444**	**151,653**
Capital Ratios		
CET1 ratio – regulatory minimum 4.5%	16.74%	17.48%
Tier 1 ratio - regulatory minimum 6%	16.74%	17.48%
Total capital ratio - regulatory minimum 8%	16.82%	17.57%
Capital Buffers		
CET1 requirement	4.50%	4.50%
Capital Conservation buffer requirement	2.50%	1.88%
Countercyclical capital buffer requirement	1.00%	0.50%
CET1 requirement plus capital conservation and countercyclical buffer requirements	**8.00%**	**6.88%**

TABLE 1: CAPITAL RESOURCES 31 AUGUST 2019

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.

[4] Prudent Valuation Adjustment is calculated as 0.1% of the Society's marketable instruments fair value.

3.4 CAPITAL ADEQUACY

Table 2 details the Society's Pillar 1 capital requirement as at 31 August 2019 by asset class under the standardised approach:

Exposure Class	Exposure £'000	RWA £'000	Capital £'000
On Balance Sheet:			
Liquidity Exposures			
Central government	62,401	-	-
Regional & local government	-	-	-
Credit institutions	24,627	8,682	695
Interest rate derivatives	316	138	11
Total Liquidity Exposures	**87,344**	**8,820**	**706**
Loans & Advances to Customers			
Residential – non-arrears	342,933	124,905	9,992
Residential – past due	3,330	3,330	266
Non-residential – non-arrears	2,947	2,947	236
Non-residential – past due	6,236	6,236	499
Forward Commitments - off balance sheet	5,756	2,122	170
Total Loans & Advances to Customers	**361,202**	**139,540**	**11,163**
Credit Risk – Pillar 1 Capital Requirement	**448,546**	**148,360**	**11,869**
Fixed & other assets	3,933	3,933	314
Operational Risk		11,065	885
Credit Valuation Adjustment		86	7
Total Pillar 1 Capital Requirement	**452,479**	**163,444**	**13,075**
Total capital resources as per Table 1			27,470
Surplus capital over Pillar 1 capital requirement			**14,395**

TABLE 2: PILLAR 1 CAPITAL RESOURCE REQUIREMENTS 31 AUGUST 2019

Pillar 1 capital is the minimum capital that the Society is required to hold in relation to Credit Risk, Operational Risk and Market Risk, as defined below:

Credit Risk - the risk that unexpected losses arise as a result of the Society's borrowers or market counterparties failing to meet their financial obligations to repay.

Operational Risk - the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Market Risk - the risk of any impact on the Society's financial condition due to adverse market movements caused by market variables such as interest rates, prices etc.

Pillar 1 is a formulaic, risk based calculation that follows rules set out in the Basel III framework, implemented in Europe by the CRDIV framework, and the new CRR. Pillar 1 capital requirement is based on a risk assessment for each type of asset, with the amount held varying depending on the approach adopted, and the relevant CRR treatment. The Society adopts the Standardised Approach for Credit Risk and seeks to ensure that it protects its Members by holding sufficient capital at all times. The minimum amount of capital to be held for Pillar 1 under the standardised approach is calculated as 8% of RWA.

RWAs are calculated by multiplying the exposure value of the asset by its relevant risk weighting in accordance with the CRR.

As stated above, a further component of Pillar 1 capital is Operational Risk for which the Society adopts a BIA, using a percentage of 3 year average net income as a proxy.

Furthermore, because the Society uses derivatives to hedge its exposure to Interest Rate Risk, under the CRR, additional capital is required to cover the Society's exposure to credit valuation adjustments risk.

In respect of Market Risk, the Society has no trading book and therefore no Pillar 1 capital is required.

As at 31 August 2019 the Group's individual capital guidance set by the PRA was did not Pillar 2A is the amount of capital that the Board considers to be required over and above Pillar 1 requirements in order to cover Society specific risks.

Additional notes:

- Loans and advances 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.
- Forward commitments are loans and advances offered to customers that have yet to be accepted.

The difference between the Society's total Credit Risk exposure detailed above of £452.48m and the total assets recognised in the Statement of Financial Position of £446.97m in the Annual Report & Accounts for the year ended 31 August 2019 is as follows:

Reconciliation of Total Credit Risk Exposure & Society's Statement of Financial Position	**£'000**
Total credit risk exposure	452,479
Less: forward commitments	(5,756)
Less: interest rate derivatives	(316)
Less: collective provision	(125)
Add back: deferred tax	627
Add back: intangible fixed assets	65
Total assets recognised in the Statement of Financial Position	**446,974**

TABLE 3: PILLAR 1 CAPITAL RESOURCE REQUIREMENTS 31 AUGUST 2019

3.5 CAPITAL BUFFERS

The Society is required under the CRR to hold additional capital for the following capital buffers:

Capital Conservation Buffer - The capital Conservation buffer is intended to ensure that firms build up buffers of capital outside any periods of stress and is designed to avoid breaches of minimum capital requirements. This capital buffer can then be drawn upon in times when losses are incurred. The buffer requirement as at 31 August 2019 was 2.50% of RWA.

Countercyclical Capital Buffer - The Countercyclical capital buffer also aims to ensure firms avoid breaching minimum capital requirements and various depending on jurisdiction. As at 31 August 2019 the United Kingdom's buffer requirement was 1.00% of RWA.

Table 4 details the capital requirement for both buffers.

Capital Buffers	RWA £'000	Capital £'000
Capital Conservation buffer	163,444	4,086
Countercyclical capital buffer		1,634
Total buffer requirement		**5,720**

TABLE 4: CAPITAL BUFFER REQUIREMENT 31 AUGUST 2019

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 5 provides an analysis, for capital adequacy purposes, of loans and advances exposures as at 31 August 2019:

Region	Residential		Non - Residential		Total
	Performing £'000	Past Due £'000	Performing £'000	Past Due £'000	£'000
East Anglia	10,372	-	-	-	10,372
East Midlands	20,331	-	-	-	20,331
London & South East	104,318	235	2,436	-	106,989
North	7,974	-	-	-	7,974
North West	44,718	2,337	18	5,594	52,667
South West	26,864	151	57	-	27,072
Wales	13,228	-	-	-	13,228
West Midlands	87,554	608	435	641	89,238
Yorkshire & Humberside	22,795	-	-	-	22,795
Scotland	4,780	-	-	-	4,780
Total	**342,934**	**3,331**	**2,946**	**6,235**	**355,446**
Grand Total		**346,265**		**9,181**	**355,446**

TABLE 5: MORTGAGE LOANS EXPOSURE 31 AUGUST 2019

Table 6 provides a reconciliation of Table 5 to 'Loans and advances to customers' in the Annual Report & Accounts 2019:

Reconciliation of loans and advances to customers	**£'000**
Loans and advances to customers per Annual Report & Accounts	355,974
Less: Fair value adjustment for hedged risk and effective interest rate	(653)
Add back: Collective mortgage provision	125
Society accounting value of loans and advances to customers	**355,446**
Total residential exposures for capital adequacy purposes (as per Table 5)	346,265
Total non-residential exposures for capital adequacy purposes (as per Table 5)	9,181
Society capital adequacy value of loans and advances to customers (as per Table 5)	**355,446**
Adjustments to reflect different reporting requirements and timing differences	-
Reconciled value of loans and advances to customers	**355,446**

TABLE 6: RECONCILIATION OF LOANS AND ADVANCES TO CUSTOMERS 31 AUGUST 2019

The residual maturity analysis for loans and advances to customers is detailed in Table 7 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.

Ratings	**Maturity of Loans and Advances**					**RWA £'000**
	< 3 Months £'000	**3 Months to 1 Year £'000**	**1 Year to 5 years £'000**	**> 5 years £'000**	**Total £'000**	
Secured by mortgages on immovable property	1,098	3,579	19,439	321,763	345,879	127,852
Exposures in default	92	3,307	4,069	2,099	9,567	9,566
Total	**1,190**	**6,886**	**23,508**	**323,862**	**355,446**	**137,418**

TABLE 7: LOANS AND ADVANCES MATURITY ANALYSIS 31 AUGUST 2019

4.1 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.

IAS 39 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	Other loans fully secured on land	Total
	£'000	£'000	£'000
Individual Provision			
At 01 September 2018	5,544	-	5,544
Amounts utilised	(610)	-	(610)
Released in the year	-	-	-
Impairment losses on loans and advances	179	-	179
At 31 August 2019	5,113	-	5,113
Collective Provision			
At 01 September 2018	138	12	150
At 31 August 2019	113	12	125
Total at 31 August 2019	**5,226**	**12**	**5,238**

TABLE 8: IMPAIRMENT PROVISIONS 31 AUGUST 2019

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.

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') (Fitch) 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 9: 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 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 10 shows the breakdown of liquid assets by maturity and rating at 31 August 2019 under the Standardised Approach:

Ratings	Maturity of Treasury Investments				RWA £'000
	< 3 Months £'000	3 Months to 1 Year £'000	>1 Year £'000	Total £'000	
AAA to AA-	62,400	-	-	62,400	-
A+ to A-	11,104	12,521	-	23,625	8,481
Unrated Building Societies	1,003	-	-	1,003	201
Total	**74,507**	**12,521**	**-**	**87,028**	**8,682**

TABLE 10: INVESTMENT MATURITY ANALYSIS 31 AUGUST 2019

The Society has no exposure to equities and no assets subject to securitisation. At 31 August 2019 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.

Table 11 below shows an overview of the Society's total CVA capital requirement:

Exposure Class	RWA £'000	Capital Required £'000
CVA risk	**86**	**7**

TABLE 11: CREDIT VALUATION ADJUSTMENT 31 AUGUST 2019

7. OPERATIONAL RISK - CAPITAL REQUIREMENT

The Society has adopted the BIA for Operational Risk which 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	2017 £'000	2018 £'000	2019 £'000	Average £'000
Net interest income[5]	5,698	5,482	5,987	5,722
Net fees[6]	180	180	179	180
Relevant indicator	5,878	5,662	6,166	5,902
ORCR (15%)				**885**
RWA equivalent				**11,065**

TABLE 12: OPERATIONAL RISK PILLAR ONE 31 AUGUST 2019

8. INTEREST RATE RISK IN THE BANKING BOOK ('IRRBB')

IRRBB is the risk to capital or earnings arising from movement of interest rates and commonly derives from the following:

Repricing risk – arises from timing differences in the maturity of fixed and variable rate assets, liabilities and off balance sheet positions.

Basis risk – results from imperfect hedging across each interest rate basis. The Society's banking book basis consists of administered, fixed, LIBOR, SONIA, Bank Base Rate and non-interest bearing assets or liabilities.

The repricing risk is measured systematically on the gaps that exist in the banking book by which the net present value ('NPV') of the Society's mark-to-market value may change in the event of a 2% parallel shift in interest rates; It is prepared and reported to ALCO monthly. The risk is controlled through gap and NPV limits, with the Society's policy to hedge all material positions. Risk management limits are set out in the Policy Statement on Structural and Financial Risk Management which is reviewed annually by ALCO. The Society's exposure to interest rate risk based on a 2% parallel shift was £440k, against its limit £842k which is calculated as 3% of reserves.

Basis risk is mitigated by employing limits on both the overall basis risk mismatch and the exposure to each type of basis risk. The position is reported to ALCO monthly for review with the respective limits reviewed annually as part of the Structural and Financial Risk Management Policy. The Society's overall basis risk mismatch was 58.53% against its limit of 70%.

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

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

9. 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 13. 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 2019 the Society held £46.59m of encumbered assets supporting drawings of £15.00m.

	Encumbered Assets		Unencumbered Assets	
	Carrying Amount £'000	Fair Value £'000	Carrying Amount £'000	Fair Value £'000
Assets of the reporting institution	**46,591**	**-**	**406,147**	**-**
Loans on demand	-	-	66,507	-
Debt securities	-	-	25,327	25,322
Loans & advances other than loans on demand	46,591	-	311,071	-
Other Assets	-	-	3,242	-

TABLE 13: ASSET ENCUMBRANCE QUARTERLY MEDIAN VALUES TO 31 AUGUST 2019

10. 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 Tier 1 capital divided by the Exposure Measure, with the ratio expressed as a percentage.

Table 14 below details the Society's leverage ratio as at 31 August 2019.

Table LRSum: Reconciliation of leverage ratio exposures to the financial statements	**2019 £'000**
Total assets as per the financial statements	446,974
Adjustments:	
Add back: forward commitments	5,756
Add back: interest rate derivatives	316
Add back: collective provision	125
Less: deferred tax	(627)
Less: intangible fixed assets	(65)
Leverage ratio exposure	**452,479**

TABLE 14: LEVERAGE RATIO 31 AUGUST 2019: LRSUM

Table LRCom: Leverage ratio common disclosure	**2019 £'000**
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	446,974
(Asset amounts deducted in determining Tier 1 capital)	(692)
Collective Provision	125
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**446,407**
Replacement cost associated with all derivatives transactions	3
Add-on amounts for PFE associated with all derivatives transactions	313
Total derivative exposures	**316**
Off-balance sheet exposures at gross notional amount	28,782
Adjustments for conversion to credit equivalent amounts	(23,026)
Total off-balance sheet exposures	**5,756**
Tier 1 capital	**27,345**
Leverage ratio total exposure measure	**452,479**
Leverage ratio	**6.04%**

TABLE 15: LEVERAGE RATIO 31 AUGUST 2019: LRCOM

Table LRSpl: Split-up of on-balance sheet exposures (excluding derivatives and SFTs)	**£'000**
Secured by mortgages on immovable property	345,880
Exposures in default	9,566
Sovereign	62,401
Institution	24,627
Other exposures	3,933
Total on-balance sheet exposures	**446,407**

TABLE 16: LEVERAGE RATIO 31 AUGUST 2019: LRSPL

The Society's leverage ratio as at the 31 August 2019 was 6.04%, which is above the regulatory minimum of 3%.

11. 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 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.

Table 17 details the Society's quarterly LCR for the 12 month period ending 31 August 2019.

LCR	30-Nov-18 £'000	28-Feb-19 £'000	31-May-19 £'000	31-Aug-19 £'000
Liquidity buffer	58,284	65,599	64,353	62,359
Total net cash outflows	19,850	20,940	20,148	19,924
LCR %	**293.63%**	**313.27%**	**319.40%**	**312.98%**

TABLE 17: LCR AS AT 31 AUGUST 2019

The average LCR for the financial year ending 31 August 2019 was 333.32%.

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 Finance Director 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 2019.

The Society has a performance based Medium-Term Bonus Scheme 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.

Table 18 sets out the aggregate quantitative remuneration for code staff to year ending 31st August 2019:

Staff Type	Number	Fixed Remuneration £	Variable Remuneration £	Total Remuneration £
Non-Executive Directors	5	147	-	147
Executive Directors	2[7]	270	17	287
Leadership Team	6	403	21	424
Total	**13**	**820**	**38**	**858**

TABLE 18: REMUNERATION ANALYSIS 31 AUGUST 2019

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.

[7] Larne Payne was appointed as Finance Directors on 18th June 2019 and consequently remuneration is split pro rata.