Penrith Building Society

Pillar 3 Disclosures

Year ended 31st December 2014

1. Introduction

The European Union introduced the legislative framework known as the Capital Requirements Directive (CRD) from the start of 2007. This framework is commonly known as Basel 2 and governs how much capital all banks and building societies must hold to protect their members, depositors and shareholders. The second part of this legislation is the Capital Resource Requirement (CRR).

In June 2013, the European Union Council formally adopted the CRD and CRR legislation, to replace the existing capital requirement directives. The legislation was implemented on 1 January 2014.

CRR contain Pillar 1 and Pillar 3 requirements and is directly applicable by EU law. The accompanying CRD contains Pillar 2 measures that allow a degree of national discretion by the UK Regulator, being the Prudential Regulation Authority (PRA). The objectives of the new legislation is to improve the financial services industry's ability to absorb shocks arising from financial or other economic stresses, so reducing the potentially destabilising impact on the financial sector in the real economy.

Penrith Building Society's (the Society's) aim is to ensure that members' savings are protected by maintaining sufficient levels of capital even at times of significant economic downturn.

Below are the three main 'Pillars' that make up the CRD:

Pillar 1 – Sets out the minimum capital requirements and uses a risk based capital calculation focusing on credit and operational risk, to determine the CRR.

Pillar 2 – Assesses whether there are further capital requirements beyond Pillar 1. An annual exercise is carried out by the Society, the Internal Capital Adequacy Assessment Process (ICAAP) to consider the key risk factors facing the Society under stressed conditions and determines additional capital requirements to manage these risks. The most recent review was completed in December 2014.

Pillar 3 – This looks at disclosure of the CRD in relation to key information about risk management and capital. This document discloses the information in accordance with regulatory guidance.

The Society's overall capital requirement is reviewed by the PRA under the Supervisory Review and Evaluation Process (SREP), taking into account the ICAAP. From this an Individual Capital Guidance (ICG), being the regulatory minimum capital the Society should hold, is set. The last review by the PRA of the capital requirements was completed in August 2013.

The figures quoted in this disclosure document are drawn from the Society's Annual Report and Accounts as at 31st December 2014.

This document is reviewed annually by the Board and is published on the Society's website to coincide with the release of the Society's results for the financial year end.

In the event that a reader of this document needs additional information, a request should be made in writing to the Finance Director at Penrith Building Society, 7 King Street, Penrith, CA11 7QY.

2. Main Board and Committee Structure

The Society's Board of Directors comprises two executive directors (Chief Executive and Finance Director) and five non-executive directors. The Board members are professional and business people from a variety of backgrounds, bringing a mixture of skills and diversity together with sector knowledge.

The Board has delegated responsibilities to five sub-committees as follows:

Audit, Risk and Compliance Committee (ARCC)
The ARCC comprises 3 non-executive directors. The role of the ARCC includes ensuring that the Society complies with all regulatory and prudential requirements and reviewing the Society's internal controls and management systems. The ARCC is also responsible for the review of the effectiveness of the compliance monitoring and internal audit functions, approval of their respective annual review plans and the monitoring of the External Auditors' independence, objectivity and effectiveness.

Conduct Risk Committee (CRC)
The CRC comprises 2 non-executive directors and both executive directors. The role of the CRC is to review the Society's policies, procedures and collated management information in all areas having impact on the Society's members and makes recommendations thereon to the Board and management.

Nominations Committee
The Nominations Committee comprises of 2 non-executive directors and the chief executive. The Committee is responsible for making recommendations on appointments to the Board, ensuring that the Board has sufficient directors with appropriate skill sets, who are fit and proper and independent. The Committee has an annual responsibility to review the Society's Succession Plan and to ensure this remains appropriate to the on-going needs of the Society.

Remuneration Committee
The Remuneration Committee comprises all the non-executive directors. The committee is responsible for setting the Society's remuneration policy for executive directors. The Committee also settles all other benefits and matters relevant to executive directors including contracts of employment with the Society.

Assets and Liabilities Committee (ALCO)
The ALCO is a management committee comprising both executive directors and members of the senior management team. The role of the ALCO is to monitor liquidity, treasury and basis risk and to review product development for both savings and mortgages against the market. It reviews forward looking economic data and how the Society's cashflow forecasts and budget projections respond to market conditions.

3. Capital Resources

The capital resources of the Society, split between Tier 1 and Tier 2 capital, are summarised below:

£000	**2014**	**2013**
General Reserves	10,231	10,157
Common Equity Tier 1 Capital Resource	**10,231**	**10,157**
General Provisions	70	90
Tier 2 Capital Resource	**70**	**90**
Total Capital Resource	**10,301**	**10,247**

The Society's main source of capital is from retained profits which are added to the general reserves that have accumulated since the Society's formation in 1877. In addition, the Society holds a general provision for bad and doubtful debts, which qualifies as additional capital resource.

4. Capital Requirements

It is essential that the Society maintains sufficient capital to support its ongoing activities and this requirement is an integral part of the Society's corporate planning process. The Society's Corporate Plan projects forward three years and takes into account the need to maintain adequate financial and non-financial resources to support the Corporate Plan objectives.

In addition to the corporate planning process the Society is required to undertake an ICAAP review, a formal process that calculates the Society's capital requirement in normal and stressed conditions, taking into consideration all of the Society's business activities and calculating the capital required to support them.

The ICAAP acts as the Society's capital planning document for the period of the Corporate Plan. It includes a calculation of the Pillar 1 capital resource requirement for each year of the plan using:

- the Standardised Approach for credit risk, applying a risk weighting of 8% of the Society's risk weighted assets values; and
- the Basic Indicator Approach for operational risk, applying a risk weighting of 15% of the Society's average net income over the previous three years.

The table below summarises the Society's Pillar 1 capital requirements:

£000	**2014**	**2013**
Credit Risk	2,694	2,702
Operational Risk	179	179
Pillar 1: Minimum Capital Requirement	**2,873**	**2,881**
Total Capital Resources	10,301	10,247
Excess over Pillar 1	**7,428**	**7,366**

The main areas of impact to the Society from the CRD legislation are capital buffer requirements. These include higher thresholds for all forms of capital with an increased focus on Common Equity Tier 1 (CET1).

The Society has always maintained a strong capital position and as at 31st December 2014, the Society's CET1 ratio was 29.5% (2013: 31.00%). This is significantly above the initial capital requirements of 4.5% outlined in the CRD.

In addition to the capital buffers calculated under Pillar 1, from 2016 the Society will be required to hold a capital conservation buffer equivalent to 2.5% of risk weighted assets. In addition, during periods of excessive credit growth in the market, a countercyclical buffer, also equivalent to 2.5% of risk weighted assets, may be required. Neither of these additional buffer requirements would cause concern for the Society, based on the CET1 capital resource at this time.

The legislation also introduces a leverage ratio measure. The Basel Committee is using the period to 2017 to test a minimum Tier 1 leverage ratio of 3.0%. At 31st December 2014, the Society's Tier 1 leverage ratio is 10.00% (2013: 10.88%).

There is still further work to be completed by the European Banking Authority and the PRA to embed the changes in legislation across the sector and the Society will continue to monitor this area and comply with necessary reporting changes as they arise.

5. Key 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. As well as mortgage and savings, the Society also uses wholesale financial instruments to invest in liquid assets. The Society may also raise funds on the wholesale market if considered necessary, although it has not had the need to raise funds in this way for many years.

The Board has an established risk management framework for the Society that is proportionate to both the size of the Society and the risks to which it is exposed. This framework enables the Board to identify, monitor, control and report on the key risks faced by the Society.

The Society looks to manage the risks that arise from its operations. The ways in which risks are managed include using forecasting and stress test models to help guide business strategies; producing key risk information and indicators to manage and monitor performance; and using management and Board Committees to monitor and control specific risks.

Consideration of the main risks faced by the Society is as follows:

Credit Risk

The main areas of credit risk for the Society are in respect of mortgage lending and treasury investments. The table below sets out the breakdown of credit risk under the Standardised Approach at 31st December 2014:

£000	Exposure	Risk Weighted	Capital Required
Liquidity			
Cash	41	0	0
Credit institutions	16,166	5,041	403
Gilts/ Treasury bills	8,628	0	0
Total liquidity	**24,835**	**5,041**	**403**
Loans and advances			
Residential performing loans	66,960	23,653	1,892
Non-residential performing loans	1,997	1,997	160
Past due items	841	841	67
Total loans and advances*	**61,585**	**26,491**	**2,119**
Other exposures (fixed and other assets)	707	707	57
Off balance sheet items (mortgage commitments)	7,158	1,432	115
Total Credit Risk Exposures	**93,619**	**32,764**	**2,694**

*The Annual Report and Accounts as at 31st December 2014 reports total loans and advances net of all general and specific provisions. The total here is before any provisions are applied.

Credit Risk – mortgages

Credit risk arising from mortgage loans to customers is managed through the Board approved Responsible Lending Policy and the monitoring and proactive management of arrears.

The Responsible Lending Policy reflects the Society's low credit risk appetite in mortgages. Consequently, the arrears profile of the Society is minimal. The Society had four properties in possession at 31st December 2014 and continues to manage these to minimise any loss to the Society from their subsequent disposal. No new arrears cases of concern have arisen during 2014. The average loan to value of the mortgage book at 31st December 2014 was 41.71% (2013: 37.39%).

The table below details the loan book by geographical area. An item is deemed 'past due' where a loan is over 3 months in arrears. The past due amounts relate to overall mortgage balances, not the amount in arrears.

	Residential		**Non-residential**	
	Performing	**Past Due**	**Performing**	**Past Due**
	£000	**£000**	**£000**	**£000**
Postcode areas CA10, CA11	20,550	606	1,667	187
Other CA postcodes	13,730	41	-	-
Other England and Wales	32,462	7	330	-
Scotland	218	-	-	-
Totals	**66,960**	**654**	**1,997**	**187**

Loss provisions are calculated following an appraisal of all outstanding loans and other assets.

Specific provisions are considered for all loans which are 3 months or more in arrears or where a mortgaged property has been taken into possession. A provision is made where the loan balance plus any likely costs to be incurred exceeds the estimated sale value of the property.

General provisions are based on the Society's experience and general economic conditions and are made against the loan book overall, excluding any loans specifically provided for, to cover potential losses which may arise due to unforeseen events.

The Society's general and specific provisions are detailed below:

	Loans fully secured on residential property		**Loans fully secured on land**		
	Specific	**General**	**Specific**	**General**	**Total**
	£	**£**	**£**	**£**	**£**
As at 1st January 2014	44,941	76,893	85,059	13,382	220,275
Amount utilised in year	(11,314)	-	-	-	(11,314)
Charge/ (Credit) for the year	26,676	(20,000)	30,000	-	36,676
As at 31st December 2014	**60,303**	**56,893**	**115,059**	**13,382**	**245,637**

Credit Risk – counterparties

This is the risk that losses may arise due to the failure of a counterparty in a treasury investment, to meet the obligation to repay. It is the responsibility of the ALCO to manage this risk, through the maintenance of a list of approved counterparties and monitoring of activity against the limits set under the Board approved Liquidity Policy and Financial Risk Management Policy.

The Liquidity Policy and Financial Risk Management Policy have been drawn up to ensure that the Society can obtain the best possible return on its investments whilst operating within prudential limits in respect of counterparties.

In selecting counterparties and the limits to be applied to them, the Society makes use of rating information, balance sheet data, and any other background information available. The Society's policies require that funds are only invested in Government backed securities (Gilts or Treasury Bills), financial institutions with a minimum Fitch IBCA short term rating of F1 (unless a counterparty with a lower rating is expressly approved by the Board) and building societies which satisfy the Society's requirements in respect of the level of free capital available.

The limits applied to counterparties and the appointment of new counterparties must be approved by the Board. All counterparties and limits are reviewed as a minimum annually and more often as circumstances dictate.

The table below shows the breakdown of treasury investments by maturity, based on their rating at 31st December 2014. No exposures are impaired or past due:

	Maturity Of Treasury Investments			
	Up to 3 mths	**3-12 mths**	**Over 12 mths**	**Total**
	£000	**£000**	**£000**	**£000**
Fitch rated F1/F1+	8,635	4,523	-	13,158
Building Society - rated	504	501	-	1,005
- unrated	501	1,502	-	2,003
Gilts/ Treasury Bills	5,497	998	2,133	8,628
Cash	41	-	-	41
Totals	**15,178**	**7,524**	**2,133**	**24,835**

Interest Rate Risk

This is the risk of changes to the financial position of the Society caused by changes in market interest rates. The Society has limited exposure to this risk as any fixed rate mortgage lending undertaken is matched by fixed rate retail savings and no derivative financial instruments are used. The exposure may arise in Gilts or T-Bills where these are linked to Libor.

The balance sheet is subject to a stress-test of a 2% rise/ fall in interest rates on a monthly basis. This is monitored by ALCO. Limits have been set at a maximum of 1.5% of capital. At 31st December 2014 the stress test recorded a £120,000 exposure to a movement in interest rates, compared to the limit of £155,000.

Liquidity Risk

This is the risk that the Society will be unable to meet its financial obligations as they fall due. The Liquidity Policy specifies the minimum levels of liquidity which must be held and the financial instruments in which that liquidity may be invested to ensure that there are sufficient funds available at all times to meet all calls, foreseen and unforeseen, on the Society. Monitoring of compliance with the Liquidity Policy is reported through the ALCO to the Board.

Operational Risk

This is the risk of loss arising from failed or inadequate internal processes or systems, human error or other external factors.

The Society manages its operational risks through internal controls and various risk mitigation techniques, such as insurance and business continuity planning.

The Society has adopted the Basic Indicator Approach (BIA) to operational risk which is expressed as a percentage of the average of the latest three years of the sum of net interest income and net non-interest income. The requirement for both 2014 and 2013 was £179,000.

Other Risks

Conduct Risk

This is the risk that the Society does not treat its customers fairly and of inappropriate consumer outcomes. The principles set out by the Financial Conduct Authority (FCA) to ensure the Society has due regard for the interests of its customers and to treat them fairly at all times, are firmly embedded within the Society's culture.

The Society has a separate Conduct Risk Committee, a sub-committee of the Board, which meets on a quarterly basis to review management information, both quantitative and qualitative in respect of conduct related matters.

Regulatory Risk

This is the risk that the volume and complexity of regulatory issues may impact the Society's ability to compete and grow in the future. Since April 2013 the Society has been supervised by two regulators in the UK, the PRA and FCA. The Board monitors changes arising from both these supervisory bodies, together with European changes, to ensure the Society continues to meet all of its regulatory requirements.

Loss of Key Personnel

Certain roles within the Society require specialist skills, which can be difficult to resource at short notice. To mitigate this risk the Society has created a Succession Plan for non-executive directors and the senior management team.

Full detail of the financial risks and instruments used by the Society are given in Note 24 to the Annual Report and Accounts, 31st December 2014, which are available on the Society's website.

6. Directors Remuneration

The Society's remuneration policy is to reward Directors through salary or fees according to their skills, expertise, experience and overall contribution, taking into account salary and fee levels in comparable organisations. The policy is to set remuneration at levels sufficient to attract and retain executives and non-executive directors of sufficient calibre and expertise.

Executive Directors' remuneration comprises basic salary and pension benefits. The Society does not have bonus or share option schemes. Their salaries are considered by the Remuneration Committee which meets at least once a year. Salary levels are set having regard to job content and responsibilities, the performance of the individual and salaries in similar organisations. The Society does not have a defined benefit or final salary pension scheme. The Society makes contributions to the private pension arrangements of the Executive Directors.

The Chief Executive's and Finance Director's contracts of employment require a 12 month and 6 month notice period respectively.

The remuneration of all Non-Executive Directors is fee based and is reviewed annually by the Board. They do not participate in any performance pay scheme, pension arrangements or other benefits and do not have service contracts. The Chairman of the Board, Chairman of the ARCC and the Chairman of the CRC receive higher fees than other Non-Executive Directors in recognition of the additional workload and responsibilities incumbent on those positions.

An advisory vote on the Directors Remuneration Policy is taken at every Annual General Meeting.

Details of remuneration are shown below:

Fees for services as non-executive directors:	**2014**	**2013**
	£	**£**
R J Cairns (Appointed 1st May 2013) (Chairman from 1st September 2014)	11,362	6,532
G Silburn	12,022	11,786
D Driver	12,022	11,786
A G Waterfield	9,994	9,798
J Lincoln (Appointed 1st October 2014)	2,498	-
J S Hollins-Gibson (Retired 30th September 2014)	11,601	15,164
P O'M Campbell (Retired 30th April 2013)	-	7,348
G M Rigg (Retired 30th September 2013)	-	3,266
Total for non-executive directors	**59,499**	**65,680**
Fees for services as executive directors:		
A S Fazal - Salary - Pension contributions	105,000 10,500	100,000 10,000
E L James - Salary - Pension contributions	73,500 7,350	70,000 7,000
Total for executive directors	**196,350**	**187,000**
Grand Total	**255,849**	**252,680**

7. Country by Country Reporting

The CRD brings in new transparency rules for EU Financial Institutions. These include a requirement for financial institutions to disclose, on a country by country basis, information on activities, turnover and employees. For the Society these became mandatory on 1st July 2014.

Penrith Building Society is a UK registered entity only, with the head office and branch in one location in Penrith, Cumbria.

The Society's activities are set out on page 3 of the Annual Report and Accounts (as published on the website). The Society provides long-term residential mortgages to borrowers, financed by personal savings from members, in keeping with traditional building society principles and values.

The following table summarises the Society's turnover, being total operating income, and number of full time equivalent employees:

£000	**2014**	**2013**
Total operating income	1,423	1,279
Profit for the year	74	53
Number		
Full time equivalent employees	17	15