PILLAR 3 DISCLOSURES

2016

Introduction

1. The Capital Requirements Directive (known as CRD IV) defines how the capital required to be held by banks and building societies in order to provide security for shareholders, members and depositors is calculated. The Directive also determined the rules around corporate governance and regulation and defines the disclosure requirements related to these requirements which are reflected in this Pillar 3 disclosure document.
2. The CRD comprises 3 main elements, or 'Pillars', as follows:
   - **Pillar 1:** Minimum capital requirements;
   - **Pillar 2:** Internal capital adequacy assessment process ('ICAAP') and supervisory review and evaluation process ('SREP');
   - **Pillar 3:** Disclosure.
3. The Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation ('CRR') component of CRD IV which is directly effective, meaning there is no UK rule required for implementation.
4. The Family Building Society **('FBS')** is a trading name of National Counties Building Society **('The Society').** The Society and the National Counties Group **('The Group')** are regulated by the Prudential Regulatory Authority ('PRA') and the Financial Conduct Authority ('FCA').

   The Society Board approved the latest full Group ICAAP in November 2016 but reviews the updated capital requirements and adequacy quarterly. The 2014 Group ICAAP was submitted to the PRA, at their request, in May 2014.
5. The Group was issued its current Individual Capital Guidance ("ICG") from the PRA in October 2015.
6. The Society Board reviewed and approved the Group Pillar 3 Disclosure Policy, which embodies the interpretation of CRR Part Eight, in March 2017. The policy complies with the relevant section of the CRR for an undertaking of the size and complexity of the Group. The disclosures made reflect considerations of frequency of disclosure, materiality and confidentiality as permitted by the CRR.
7. The figures quoted in this disclosure have been drawn from the Group's Annual Report and Accounts as at 31 December 2016, unless otherwise stated. The Report and Accounts were prepared under United Kingdom Accounting Standards including Financial Reporting Standard 102 ('FRS102'), with the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement.

Scope of Application of Directive Requirements

8. These disclosures are made at Group level unless otherwise stated.
9. The Group comprises the following trading entities:
    - **National Counties Building Society** a regulated building society;
    - **Counties Home Loan Management Limited** (‘CHLM’) a regulated firm;
    - **National Counties Financial Services Limited** (‘NCFS’) an unregulated firm. NCFS figures are not material to Group results.
10. National Counties Estate Agents Limited, a subsidiary of the Society, is no longer trading and its figures are not material and not included in these disclosures.
11. CHLM and NCFS are wholly-owned subsidiaries of the Society and are consolidated for Group accounting purposes.
12. For capital adequacy purposes, CHLM’s figures are solo-consolidated with those of the Society with the regulator’s approval.
13. There were no current or foreseen material practical or legal impediments to the prompt transfer of capital or repayment of liabilities between Group entities at the reporting date.
14. The Society is fully committed to supporting its subsidiaries, as stated in the **Annual Report and Accounts 2016, Note 28(b), Financial Commitments**.
15. **Table 1** summarises the capital adequacy monitoring arrangements for the Group and its subsidiaries at 31 December 2016:

TABLE 1

Monitoring level	Component entities
Group	Society, CHLM, NCFS
Solo-consolidated	Society, CHLM

Risk Management Objectives and Policies

16. The Society's Board is responsible for determining a framework for risk management and control and approves policies and Board sub-committee terms of reference. Senior management is responsible for designing, operating and monitoring risk management and internal control processes, under the guidance of the Group Risk Committees.
17. In order to maintain a strong risk culture, the Society has adopted the three lines of defence model. The system of internal control is designed to enable the Group to achieve its corporate objectives within a managed risk profile, not to eliminate risk.
18. The risk function is responsible for oversight of all the Group's risks. In addition the Group has a formal structure for managing **financial risk**, which includes the establishment of risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Board, with a major review being conducted annually.
19. First line risk control is provided by all relevant business functions. Managers are responsible for identifying and maintaining effective management of risk in accordance with group risk appetite. Where appropriate, these business functions are supported by specialist risk teams (e.g. Compliance) under the control of executive managers and directors.
20. Second line independent oversight staff report into the Director of Risk or Director of Legal and Compliance as appropriate. They review risk management policies, standards and limits to establish consistency with risk appetite, monitor and report to the Chairman of the Board Group Risk Committee on compliance with those limits, and oversee the first line management of risk. These functions thereby ensure that the first line of defence is properly designed, implemented and operating.
21. Third line assurance is provided by Group Internal Audit, which reports to the Group Audit Committee. Group Internal Audit provides independent assurance regarding the activities of both first line risk control and second line risk oversight. The internal audit function is carried out by Deloitte LLP in order to ensure that the appropriate level of expertise is devoted to the audit work.
22. The Board receives risk management support and insight from the Board Group Risk Committee and the Group Audit Committee.
23. The **Board Group Risk Committee** ('BGRC') is a Board committee comprising Non-executive Directors responsible for reviewing the Group's risks and the adequacy and effective operation of internal processes. The BGRC met five times during 2016.
24. The **Executive Group Risk Committee** ('EGRC') is an executive committee reporting to and supporting the Board Group Risk Committee which carries out a similar role but with operational responsibilities. The EGRC met ten times during 2016.
25. The **Assets and Liabilities Committee** ('ALCO') is an executive committee which considers developments in financial markets as they affect the Society's operations against group risk appetite and regulatory requirements, recommends and approves resulting outcome, agrees product pricing and reviews the Society's short and medium term investment and funding strategies, whilst monitoring the various forms of exposure. ALCO meets monthly and reports to the EGRC.
26. The **Retail Conduct Risk Committee** ('RCRC') focuses on the business model and strategy, culture and governance arrangements with respect to ensuring satisfactory outcomes for customers. The RCRC also reports into the EGRC.
27. The **Data Security Committee** also reports into the EGRC and reviews and monitors all matters related to data security. The committee met on four occasions during 2016.

28. The **Group Audit Committee** ('GAC') is a Board committee comprising Non-executive Directors which reviews the integrity of the financial statements and the effectiveness of internal controls and risk management systems. The GAC also monitors and reviews the effectiveness of the internal audit function and met four times during 2016.
29. The **Remuneration Committee** is a Board committee comprising Non-executive Directors which is responsible for determining the remuneration of all Executive Directors.
30. The **Nomination Committee** is responsible for making recommendations on the appointment, election and re-election of Board Directors and on succession planning.
31. The principal business and financial risks to which the Group is exposed are credit, market, liquidity, operational, conduct and regulatory risk. The Board has also identified pension obligations as a significant risk requiring separate consideration within the Group ICAAP.
32. **Credit risk** is the risk that a financial loss will arise from a customer or counterparty failing to meet their obligations. This arises primarily from the Group's lending activities but also as a result of the Group's investments and transactions as part of its treasury operations. **Concentration risk**, which adds a further dimension to credit risk, arises as a result of the concentration of exposures within the same category, whether it is geographical location, product type, industry sector or counterparty type. These risks are managed through adherence to Board-approved lending and arrears policies, which set the Group's risk appetite for credit risk and provide for a range of limits that are regularly monitored and reviewed in the light of changing economic conditions and Group objectives.
33. The Society is predominantly a residential mortgage lender, which means that it is exposed to the U.K. housing market by virtue of its statutory nature limits.
34. Within the residential mortgage business, the Society's main concentration risk is geographical, in that the majority of its lending is in the London and South East regions.
35. Product type concentrations are also present in the Society, in relation to lifetime (equity release) mortgages, interest only mortgages and buy-to-let mortgages. These are monitored on a monthly basis to ensure that Board-approved limits are not exceeded.
36. All concentrations are managed within limits which the Board believes are appropriate to current economic conditions and Group objectives.
37. Certain concentrations may become an issue during periods of economic downturn and the Board has ensured that the Group ICAAP makes provision for a significant amount of capital to be available to cover such eventualities.
38. **Market risk** incorporates the loss of income as a result of changes to market rates, mainly movements in interest rates which affect the balance sheet valuation of financial instruments, particularly derivatives, and consequently increases the risk of volatility in profits. Exposure to this risk is primarily managed through a combination of natural hedges that exist in the Group balance sheet together with appropriate hedging contracts with external counterparties, as permitted under the Board-approved financial risk management policy. The Group is also subject to basis risk where the interest rates on offsetting assets and liabilities do not move in exactly the same way. This is monitored and managed by hedging contracts or reducing the underlying basis risk.
39. **Liquidity risk** concerns the Group's ability to meet its financial obligations as they fall due as a result of imbalances in the cash flow of its activities. This risk is subject to an Individual Liquidity Adequacy Assessment Process ('ILAAP'). The ILAAP is analogous with the ICAAP and is designed to identify and manage all aspects of liquidity risk faced by the Group as well as regulatory liquidity requirements introduced since 2015 and the

Individual Liquidity Guidance ('ILG') received from the PRA following their risk assessment and liquidity review. The ILAAP assesses the minimum amount of liquidity the Group should hold and was updated in November 2016.

40. The ILAAP informs the Board and proposes the liquidity risk appetite and policies and appropriate controls to enable compliance with this appetite. This is documented in, and managed through adherence to, the Board-approved liquidity and financial risk management policies.

41. **Operational risk** is associated with the Group's internal processes and systems and the potential for these to not function properly. It also covers human error and external events. Risk registers are maintained that document key risks, likelihood of occurrence and an assessment of impact. A range of insurance policies are in place to provide protection against such eventualities as business interruption, public and employer liability and certain losses through criminal activity.

42. **Conduct risk** is linked with regulations affecting our customers, ensuring that the correct culture in terms of 'treating customers fairly' is adhered to and embedded in the Society and Board expectations of the service levels that we provide to our customers.

43. **Regulatory risk** is the risk of loss arising from failure to comply with statutory and regulatory requirements and the risk that the volume, complexity and cumulative effect of regulatory issues may impact the Society's ability to compete and function effectively.

44. Full details regarding the financial risks and instruments used by the Group are given in the **Annual Report and Accounts 2016, Note 29, Financial Instruments.**

45. **Pension obligation risk** arises as a result of the Group defined benefits pension scheme and derives mainly from improving life expectancy and the resultant increase in the cost of servicing pension obligations, particularly in respect of those members with a pension commitment linked to final salary. This risk has been reduced going forward through the closure to future accruals of the final salary part of the scheme and replacing this with a revised benefit structure which eradicates the post retirement longevity risk with its associated impact on pension annuities. For new employees a defined contribution scheme is in place which does not present any future actuarial risk to the Society. The Board has made adequate provision in the Group ICAAP for residual pension obligation risks.

46. In addition to the capital required in relation to the above risks, the Board has provided a 'PRA Buffer' level of capital in the Group ICAAP. This buffer is specifically designed to be used if necessary during difficult economic times. The PRA buffer is expressed as a percentage of risk weighted assets rather than a fixed amount and is in addition to the regulatory capital conservation buffer.

47. As at 31 December 2016, the Group was not required to hold a countercyclical capital buffer.

48. **National Counties Building Society has one of the strongest capital bases within the U.K. building society industry**, as a result of which the Group is able to maintain overall capital at a level well in excess of the ICG, even after the addition of the buffer referred to above.

49. The risk management and control framework, as set out above, is encapsulated in the Enterprise Risk Management Framework ('ERMF') which was approved by the Board during March 2016.

50. The Group risk appetite, expressed in the ERMF, is set out in **Table 2**:

TABLE 2	
Risk category	**Risk appetite**
Business	We ensure that the business model, strategy and capital resources are focused on securing the long-term needs of the membership. This entails stable earnings and a moderately risk averse position.
Liquidity and funding Interest rates	We hold sufficient liquidity resources, and sustain this with diverse sources of funding and minimal exposure to market and off-balance sheet risks
Credit concentration	We build high quality lending portfolios that earn an adequate return.
Operational	We ensure controls are effective to minimise serious customer or business disruption, or associated financial losses.
Compliance	We maintain legal and regulatory compliance.
Conduct	We deliver fair customer outcomes, and avoid regulatory fine and censure.
Pension residual	We remain alert to existing and emerging risks to the business.

51. Risk is also monitored against the Group risk appetite as measured quantitatively through key ratios and risk indicators. The Group’s risk profile continues to remain within its risk appetite.

52. Further details of corporate governance arrangements including the Group’s policies on Board diversity and appointments, can be found in the **Annual Report and Accounts, Report on Corporate Governance. Details of directorships held by Board members can be found in the Annual Report and Accounts, Annual Business Statement.**

Own Funds

53. Group own funds at 31 December 2016, amount to £116.2m. This is made up predominantly of Common Equity Tier 1 ("CET1") capital comprising accumulated profits of the Group.

54. Tier 2 capital is limited to collective provisions for bad and doubtful debts, which amounted to £0.5m in the Group at 31 December 2016.

55. **Table 3** provides details of the components of Tier 1 capital, Tier 2 capital and total Own funds within the Group:

TABLE 3 Own funds	£m
General Reserves	115.7
Available-for-sale reserve	0.8
Deduction - intangible assets	(0.8)
CET1 capital	**115.7**
Tier 1 capital	**115.7**
Collective provisions	0.5
Deductions	-
Tier 2 capital	**0.5**
Own Funds	**116.2**

56. The Group has not had any need for remunerated capital e.g. subordinated debt or permanent interest bearing shares because of its capital strength. The Group does have the ability to issue core capital deferred shares ('CCDS') which would count as CET1 capital, should this be required in future.

Leverage Ratio

57. The Group leverage ratio at 31 December 2016, applying CRR Article 499 (2) and (3) is 6.5%.

TABLE 4 Leverage ratio	
Capital measure (£m)	115.7
Exposure measure (£m)	1,771.8
Leverage ratio (%)	**6.5**

58. Details of the components of the leverage ratio calculation which are applicable for the Group are given in the following tables:

TABLE 5 Reconciliation of accounting assets and leverage ratio exposures	£m
Total assets as per published financial statements	1,865.4
Adjustment for derivative financial instruments	(127.5)
Adjustment for off balance sheet items	36.6
Other adjustments	(2.7)
Total leverage ratio exposure	**1,771.8**

TABLE 6 Leverage ratio exposure measure	£m
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	1,735.2
Total on-balance sheet exposures (excluding derivatives and SFTs)	**1,735.2**
Derivative exposures	
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	5.3
Total derivative exposures	**5.3**
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	62.6
Adjustments for conversion to credit equivalent amounts	(31.3)
Other off-balance sheet exposures	**31.3**
Leverage ratio total exposure measure	
Leverage ratio exposure measure	**1,771.8**

TABLE 7 On balance sheet exposures (excluding derivatives and SFTs)	£m
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**1,735.2**
Exposures treated as sovereigns	327.2
Secured by mortgages of immovable properties	1,384.9
Retail exposures	1.4
Corporates	0.4
Exposures in default	3.7
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	17.6

59. A number of factors will impact the leverage ratio in any particular period. Profit for the year increases the capital measure and improves the ratio. Balance sheet size is the main factor underpinning the exposure measure. Off balance sheet items, primarily the lending pipeline, also contribute.

60. The Group ratio of 6.5% represents a reduction in the leverage ratio from the previous year and is driven by the growth in assets in 2016, which is detailed in **Annual Report and Accounts, Strategic Report.**

61. The leverage ratio is monitored by ALCO. The Society is one of the strongest capitalised societies and therefore is not excessively leveraged. The risk posed by excessive leverage is managed within the ICAAP.

Capital Adequacy Assessment

62. The Group maintains a five-year strategic planning framework, the detail of which is reviewed by the Society's Board annually to take account of current and changing economic conditions and any other factors that may affect the Society's future performance, such as regulatory or technological change. The process culminates in the annual production of a five-year Corporate Plan including financial projections, with detailed budgets covering the following year's activities.
63. The projections are driven by reference to the Group ICAAP submission and in particular the Board's risk appetite for different business activities/risks, which is an important component within the submission.
64. The Group ICAAP contains the capital plan for the next five years and the Board ensures that there are adequate capital resources to support the corporate goals contained within the projections.
65. In order to produce a detailed capital plan, the Group ICAAP contains calculations of the capital resources requirement (effectively the minimum capital required) each year using the standardised approach for credit risk and the basic indicator approach for operational risk.
66. Under the standardised approach for credit risk, the Group 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.
67. Under the basic indicator approach for operational risk, the Group calculates its average net income over the previous three years and provides 15% of that average net income as the minimum capital requirement for operational risk.
68. Capital is also required in relation to the credit valuation adjustment. This is to account for counterparty credit risk in relation to derivative transactions.
69. **Table 8** provides details of the calculation of own funds requirements within the Group as at 31 December 2016:

TABLE 8 Own funds requirement	Risk weighted exposure £m	Own funds required £m
Central governments or central banks	-	-
Multilateral development banks	-	-
Corporates	0.4	-
Retail	1.0	0.1
Secured by mortgages on immovable property	505.1	40.4
In default	3.7	0.3
Institutions & corporates with a short term credit assessment	1.5	0.1
Other	9.8	0.8
Credit risk	**521.5**	**41.7**
Operational risk	**29.5**	**2.4**
Credit valuation adjustment	**1.9**	**0.2**
Total own funds required		**44.3**

Credit Risk - Retail Lending

70. Assessment of the borrower's ability and propensity to make payments and the level of security provided are paramount considerations for the Group.

71. The Group uses an affordability model to assess residential property owner occupier applicants' ongoing ability to service the requested mortgage advance. This includes expenditure data from the Office of National Statistics ('ONS') which takes into account the size of the household unit and the spending patterns of households with similar incomes. In addition to ONS data the Group also collects specific information on ongoing financial commitments in order to assess the ability of the applicant to meet mortgage repayments at appropriate interest rates.

72. Regular reviews are undertaken to assess the performance of loans and the suitability of the affordability model with a view to ensuring that the parameters set within the model are consistent with Group risk appetite..

73. The Group requires a report, prepared by a suitably qualified person, as to the value of the security for mortgage purposes in all cases, except for further advances on loans fully secured on residential property where the new total borrowing does not exceed 60% of the existing valuation.

74. For residential buy-to-let lending, affordability is assessed with reference to the rental value of the property which will secure the mortgage.

75. The Group regards as ‘past due’ any mortgage or loan account which, at the accounting date, is more than three months in arrears. Arrears of mortgage repayments are monitored very closely and the Group has performed favourably in comparison with national arrears statistics. Past due assets are reported under the “In default” exposure class. The only material exposures in this class relate to loans secured on property.

76. Arrears are evidence of loan impairment. Impaired loans will be reviewed, with provisions made against any potential losses in the loan book.

77. A loan is considered “impaired” where there is objective evidence of one or more impairment events after the initial recognition of the loan. Impairment events can be on an individual loan-by-loan basis, for example where the mortgaged property is taken into possession, or on a collective basis for groups of loans with similar characteristics.

78. The Group’s accounting policy in relation to impairment provisions for loans and advances is recited in full **at Note 1.9 to the Annual Report and Accounts 2016.**

79. Full details of the movements on impairment provisions for loans and advances are provided **at Note 10(a) to the Annual Report and Accounts 2016.**

80. **Table 9** analyses Group loan exposures at 31 December 2016:

TABLE 9

	Residential			Other		
	Performing £m	Past due £m	Total £m	Performing £m	Past due £m	Total £m
Loans and advances to customers	1,220.6	3.4	1,224.0	17.2	0.3	17.5

81. A reconciliation of the above table to **the Annual Report and Accounts 2016** is provided in **Table 10:**

TABLE 10 Reconciliation of Group Total Loans and Advances to Customers	£m
Group loans and advances to customers per Report & Accounts	1,392.2
Add back: Collective provisions	0.5
Deduct: loan embedded derivatives	(2.4)
Group accounting value of loans and advances to customers	**1,390.2**
Residential loan exposures for capital adequacy purposes	1,224.0
Other loan exposures for capital adequacy purposes	17.5
Add back: valuation adjustments for hedged risks and effective interest rate	151.1
Deduct: loan embedded derivatives	(2.4)
Group capital adequacy value of loans and advances to customers	**1,390.2**

82. A residual maturity analysis of gross loans and advances is provided at **Table 11**:

TABLE 11 Residual maturity – Gross loans	£m
On call or short notice	1.1
0 – 3 months	0.6
3 months – 1 year	7.6
1 – 5 years	74.4
> 5 years	1,161.2
Total	**1,244.9**

83. The maturity analysis in **Table 11** assumes that loans and advances run for their full, agreed term or, in the case of equity release loans, for the actuarial life expectancy of the borrower. In practice, mortgage loans seldom continue to the maturity date and, therefore, the actual repayment profile of loans is likely to be significantly different from that disclosed above.

84. Individual impairment provisions are utilised to adjust downwards the value of residential exposures in the capital adequacy calculations. For capital adequacy purposes, collective impairment provisions are regarded as Tier 2 capital (see **Table 3** above).

85. The Group's residential mortgage loan portfolio includes a pool of lifetime mortgages. If the amount received on the sale of the property on redemption of the loan is, in certain circumstances, less than the value of the contractual loan balance due the Group cannot pursue the borrower or the estate for the shortfall. This No Negative Equity Guarantee ('NNEG') represents an exposure that the balance of lifetime loans may not be fully recovered and is presented as an embedded derivative liability on the Group's statement of financial position. The NNEG derivative liability is also applied to adjust downwards the value of residential risk-weighted assets in the capital adequacy calculations.

86. Summarised movements in individual impairment provisions and embedded derivative liability during 2016 are given below.

TABLE 12 Valuation adjustments	Brought forward £m	(Utilised) / Recovered £m	Mvmnt £m	Carried forward £m
Residential	1.2	(0.4)	(0.4)	0.4
Other	2.5	-	0.3	2.8
Total Individual provisions	**3.7**	**(0.4)**	**(0.1)**	**3.2**
LM embedded derivative	1.9	-	0.5	2.4
Total valuation adjustments for capital adequacy purposes	**5.6**	**(0.4)**	**0.4**	**5.6**

87. A geographical analysis of Group loans and advances is given in **Table 13**:

TABLE 13						
	Residential			Other		
Geographical region	Performing £m	Past due £m	Total £m	Performing £m	Past due £m	Total £m
North	26.3	-	26.3	-	-	-
Yorkshire & Humberside	55.5	0.1	55.6	1.9	-	1.9
North West	66.0	0.6	66.6	0.8	-	0.8
East Midlands	42.2	0.2	42.4	2.8	-	2.8
West Midlands	53.5	0.3	53.8	1.5	-	1.5
East Anglia	42.5	0.2	42.7	0.1	0.3	0.4
Outer South East	298.6	0.5	299.1	5.2	-	5.2
Outer Metropolitan	156.0	0.4	156.4	1.3	-	1.3
London	313.2	0.4	313.6	0.7	-	0.7
South West	128.0	0.5	128.5	0.2	-	0.2
Wales	33.6	0.2	33.8	2.7	-	2.7
Scotland	5.2	-	5.2	-	-	-
Total Mortgages	**1,220.6**	**3.4**	**1,224.0**	**17.2**	**0.3**	**17.5**
Loans not secured on property	-	-	-	-	-	-
Total loans and advances	**1,220.6**	**3.4**	**1,224.0**	**17.2**	**0.3**	**17.5**

Total exposures net of individual provisions	**1,241.5**
Effective interest rate adjustments	0.4
Fair value adjustments for hedged interest rate risk	150.7
Loan embedded derivatives	(2.4)
Net loan exposures for capital adequacy purposes	**1,390.2**

Credit Risk – Wholesale Lending

88. Counterparty risks relate to the potential for loss as a result of the actions or performance of a counterparty, in particular the failure of a counterparty to repay deposits or investments due and the failure of a counterparty to perform under the terms of derivative transactions.

89. Investments other than those in UK gilts or Treasury bills are spread to the extent practical so as to prevent undue concentration in particular market sectors, geographical areas, maturity profile or institutions. The spread is managed through the setting of exposure limits expressed as absolute limits with reference to the NCBS Group's and the counterparty's free capital.

90. The Group maintains an approved counterparty list detailing the maximum exposure allowed to individual banks and building societies. The list is reviewed by ALCO quarterly.

91. All derivative contracts are covered by a central counterparty clearing house or by bilateral credit support agreements, as a result of which collateral is pledged or held in the form of listed debt securities (usually UK gilts) or cash deposits to provide protection to both the Group and its counterparties against default.

92. Further details on the value and type of derivatives held can be found in **Annual Report and Accounts 2016, Note 29, Financial Instruments**.

External Credit Assessment Institutions

93. The Group has nominated Moody's Investors Services as its external credit assessment institution.

94. Moody's ratings are applied to non-cash liquidity exposures to central governments / banks, multilateral development banks and institutions, in order to establish the risk-weighted value of those exposures for capital adequacy purposes.

95. Risk-weighted asset values under the standardised approach are calculated by reference to six credit quality steps set out in Article 120 CRR, dependent upon whether they are exposures for up to 3 months, or longer. **Table 14** maps the Group's application of Moody's ratings to CRR credit quality steps, together with the risk weightings applicable according to counterparty type:

TABLE 14

Matrix of risk weightings by credit quality step and Moody's ratings

Credit quality step	1	2	3	4	5	6	Un-rated
Moody's short-term ratings	P-1	P-2	P-3	NP			
Risk weighting	20%	50%	100%	150%			
Moody's long-term ratings	Aaa - Aa3	A1 - A3	Baa1 - Baa3	Ba1 - Ba3	B1 - B3	<= Caa1	-
Central Govt & Banks	0%	20%	50%	100%	100%	150%	100%
Institutions: <= 3 months	20%	20%	20%	50%	50%	150%	20%
Institutions: > 3 months	20%	50%	50%	100%	100%	150%	20%
Corporates	20%	50%	100%	100%	150%	150%	100%

96. As is clearly demonstrated from the Moody's ratings attached to each credit quality step, step 1 represents the highest credit quality and step 6, the lowest.

97. The Group does not invest with counterparties within credit quality steps 4 to 6.

98. Unrated institutions have the same credit quality step as the central government of the jurisdiction in which it is incorporated and, in the case of U.K. institutions attract a 20% risk weighting.

99. Application of the matrix (shown in **Table 14**) to Group non-cash liquidity exposures at 31 December 2016 produced risk-weighted asset values as shown in **Table 15**:

TABLE 15

Risk-weighted asset values of Group non-cash liquidity exposures	Total	Credit Quality step 1	Credit Quality step 2	Credit Quality step 3	Credit Quality steps 4 - 6	Unrated
	£m	£m	£m	£m	£m	£m
0% risk-weighting	327.2	327.2	-	-	-	-
20% risk-weighting	1.9	1.9	-	-	-	-
50% risk-weighting	0.1	-	0.1	-	-	-
100% risk-weighting	-	-	-	-	-	-
150% risk-weighting	-	-	-	-	-	-
Total non-cash exposures	**329.2**	**329.1**	**0.1**	**-**	**-**	**-**
Risk-weighted asset value	**0.4**	**0.4**	**-**	**-**	**-**	**-**

Market Risk

100. Interest rate risk and basis risk are referred to under the heading of Market Risk, in paragraph 37 of this disclosure document.

101. The main activities undertaken by the Group 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 taken by the Treasury department;
    - Fixed and capped rate mortgage and other lending; and,
    - Fixed rate investments by the Treasury department.

102. Interest rate risk is managed by utilising natural hedges on the balance sheet and by effecting interest rate swaps with external counterparties.

103. The interest rate risk on savings and mortgage products is reviewed on a weekly basis and hedging action taken as appropriate. The Group balance sheet is tested against Board limits on a monthly basis for the effects of a 2% parallel shift in interest rates, after the appropriate adjustment for interest rate floors.

104. Interest rate risk limits are an expression of the Board's risk appetite and are reviewed annually as an integral part of updating the Group financial risk management policy and ICAAP.

105. Basis risk is managed within limits and is monitored monthly with the results being reported to ALCO.

106. The valuation of pension fund liabilities is subject to changes in interest rates. The Board takes account of this liability when considering an appropriate interest rate risk appetite.

Material Credit Risk Mitigation Techniques

107. As indicated earlier in this disclosure document, credit risks are managed through adherence to Board-approved policies, which provide for a range of limits that are regularly monitored.

108. The Treasury department maintains a regular review of active counterparties and recommends action to ALCO to restrict exposures in those cases where the risk of default is considered to have increased beyond the Group risk appetite.

109. Counterparty risk may become significant in relation to the market value of interest rate swaps transacted with major banks as interest rates fluctuate. The Group mitigates this risk through collateral agreements with all interest rate swap counterparties, which protect against counterparty default by means of collateral requirements based on movements in the market values of the instruments involved. The collateral is pledged or received in the form of cash or securities. Some swaps are transacted through a central counterparty clearing house which guarantees performance of the collateral requirements, whilst the remainder are covered by industry-standard bilateral credit support agreements.

110. The Group also uses repos and reverse repos, which are effectively secured borrowing and lending, in its liquidity management operations. The Group's repos and reverse repos are covered by Global Master Repurchase Agreements.

Asset Encumbrance

111. An asset is treated as encumbered if it is subject to any form of arrangement to secure, collateralise or credit-enhance a financial transaction from which it cannot be freely withdrawn.

112. Encumbrance of the Group's assets arises from the use of derivatives for hedging purposes and repo transactions undertaken in accordance with industry standard contractual arrangements. The level of encumbrance has varied with operational requirements and interest rates and is managed in line with the Group's liquidity and risk management objectives and policies.

113. A breakdown of the median encumbered and unencumbered assets during the year ended 31 December 2016 is given in **Table 16**:

TABLE 16

Encumbered and unencumbered assets – median value

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Assets of the reporting institution	**355.0**		**1,427.3**	
Equity instruments	-		-	
Debt securities	101.6	101.6	78.7	78.7
Other assets	253.4		1,348.6	

114. A small proportion of unencumbered other assets would not be deemed by the Society as available for encumbrance in the normal course of business being, for example, intangible assets, other fixed assets and tax/deferred tax assets.

115. **Table 17** summarises the median encumbered assets and collateral received against selected financial liabilities.

TABLE 17 **Encumbered assets / collateral received and associated liabilities.**	**Matching liabilities, contingent liabilities or securities lent £m**	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m**
Carrying amount of selected financial liabilities	238.5	300.3

FCA Remuneration Code Disclosures

POLICY OBJECTIVES

116. The aim of the Group's Remuneration Policy is to achieve a fair level of financial reward for the Society's staff whilst ensuring primacy of members' interests and avoiding incentives to take inappropriate levels of risk. An objective of the Society is to attract and retain staff with the requisite skills, attitude and motivation to perform its operations to the highest standards in line with its business strategy, risk appetite and long term objectives.
117. In keeping with its values, the Society also seeks to provide its staff with fair financial reward for their contributions commensurate with the level, nature and demands of their roles and their individual achievements.

POLICY OVERSIGHT AND IMPLEMENTATION

118. Responsibility for policy oversight and implementation resides with the Remuneration Committee in respect of the remuneration of the Executive Directors and their immediate subordinates. The Remuneration Policy was reviewed by the Committee in April 2016.
119. During 2016 the Remuneration Committee was chaired by Patrick Muir (Non-executive Director), and met four times. The terms of reference of the Committee can be found on the Society's website, www.ncbs.co.uk. In setting remuneration, the Committee takes account of salaries, benefits and fees payable to executives and senior managers within similarly sized building societies and other relevant organisations. Feedback on the deliberations of the Remuneration Committee is provided to the Society's Board by way of its meeting minutes, and its recommendations are considered and endorsed or rejected as appropriate. For additional independent oversight, a review of the Executive Directors' remuneration is commissioned periodically from external consultants to ensure that the Society's rewards remain fair, competitive and in line with industry norms.
120. Further information on the mandate of the Remuneration Committee and its decision making process in determining the remuneration policy for the Executive Directors is contained in the Annual Report on Directors' Remuneration within the Group's Annual Report and Accounts, which is published each year on the Society's website.
121. Responsibility for policy oversight and implementation in respect of the remuneration of all other staff resides with the Executive Directors, with Board approval being required for the budgets for the annual review of staff salaries and for performance linked awards. Any significant changes in staff benefits are also reviewed and agreed by the Board, as is the introduction and construction of any staff and executive performance related pay schemes that may be deemed appropriate from time to time.
122. The provision of performance related pay schemes for Executive Directors and staff relating to financial and business performance is generally considered an appropriate part of a balanced remuneration package. Where such schemes are felt to be justified, the potential rewards are geared to the attainment of corporate targets of key and tangible benefit to the organisation and are set at modest levels, being mindful of the context of the organisation's operating environment, its status as a mutual organisation and the need for robust risk management in order to ensure that the outcomes achieved are beneficial to the organisation over the immediate and the long term. The Society has a variable pay scheme based on both the performance of the Society and the individual. All staff except the Mortgage Adviser team, the Business Development Managers and the Executive Directors are eligible for bonuses under this scheme.
123. The Mortgage Adviser team has a separate bonus structure based on their performance in a number of categories including the quality of calls made, customer feedback and compliance.
124. The Business Development Managers receive commission based on the number of mortgage applications received from brokers and executed.

125. Executive Directors are eligible to participate in an incentive scheme based on their own and the Society's performance. Awards are limited to a maximum of 25% of base pay. In addition there is a medium term incentive plan based on performance over a three year period measured by four performance indicators: capital protection and growth, increase in net revenue, customer satisfaction and maintenance of a fair margin between lending and borrowing rates. The maximum award under this scheme is 100% of base salary over three years. No payment is made until the end of the three year period, with 50% of the payment deferred for a further year. The incentive scheme is subject to detailed rules which permit clawback in the event of unforeseen circumstances or evidence of inappropriate conduct and is subject to an overriding discretion of the Remuneration Committee.

126. All Group employees are employed by the Society. The aggregate quantitative remuneration was £6,700k.

127. No individuals were remunerated €1 million or more in the financial year.

128. **Table 18** sets out the aggregate quantitative remuneration for staff whose professional activities have a material impact on the Society's risk profile in respect of the period 1 January – 31 December 2016:

TABLE 18	No. of recipients	Fixed remuneration £000	Variable remuneration £000
Senior management	18	1,851.0	271.0
Other staff	-	-	-

129. In the case of the Executive Directors and the Senior Managers, fixed remuneration includes pension contributions made by the Society on behalf of the employees, and the value of taxable benefits.

130. **Table 19** gives details of the variable remuneration awarded to 'material risk' staff in 2016:

TABLE 19	Variable remuneration paid £000	Variable remuneration deferred £000	Total variable remuneration £000
Senior management	271.0	200.0	471.0
Other staff	-	-	-

131. In addition to the remuneration detailed above, no severance payments were made to a 'material risk' employee.

Conclusion

132. In the Board's opinion the risk management arrangements in place are adequate and the Group's risk profile continues to remain within its risk appetite.

133. This disclosure document has been prepared in accordance with the requirements of CRR Part Eight, as interpreted for a group of firms of the size and complexity of the Group.

134. In the event that a user of this disclosure document should require further explanation on the disclosures given, application should be made, in writing, to the **Finance Director at National Counties Building Society, Ebbisham House, 30 Church Street, Epsom, Surrey, KT17 4NL**.