



## Pillar 3 Disclosure Document

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## 1. Introduction

The legislative framework, the Capital Requirements Directive (CRD), commonly referred to as Basel 2, governing how much capital all banks and building societies must hold to protect their members, depositors and shareholders, was introduced by the European Union from the beginning of 2007. In the UK this is implemented by our regulator, the Financial Services Authority (FSA).

Stafford Railway Building Society's aim is to ensure that we protect our members' savings by having sufficient capital even during a significant economic downturn.

The new framework is not just about capital requirements, it also requires disclosure of key pieces of information, such as risk exposures and risk assessment processes.

Below are the 3 main "Pillars" which make up the Capital Requirements Directive.

Pillar 1 Minimum capital requirements

Pillar 2 Internal capital adequacy assessment process (ICAAP)

Pillar 3 Disclosure

Pillar 1 assessment is based on a formulaic risk based capital calculation focussing particularly on credit and operational risks to determine the Capital Resources Requirement.

The Board of Stafford Railway Building Society has undertaken an assessment of all of the risks facing the Society and has established the capital to be held under Pillar 2. As part of this the Society has carried out stress tests to consider the levels of capital required to cope with a severe economic downturn.

This policy document deals with the requirements laid down for Pillar 3 (disclosure) and the information provided here is in accordance with the rules laid out in the FSA handbook BIPRU Chapter 11.

All figures within this document are correct as at 31 October 2009 unless stated otherwise.

## 2. Risk management policies and objectives

Stafford Railway Building 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.

The Society looks to manage all the risks that arise from its operations, these are detailed below.

We manage these risks include using forecasting and stress test models to help guide our business strategies; producing key risk information and indicators to measure and monitor performance; and using management and board committees to monitor and control specific risks.

### **Credit Risk**

Credit risk is the risk that losses may arise as a result of failure by a borrower or counterparty to meet its obligation to repay. The Assets and Liabilities committee is responsible for reviewing the Lending policy of the Society and monitoring the arrears profile, they are also responsible for maintaining the Society's Treasury Counterparty list and the allowable exposures for each.

### **Market Risk**

Market risk is the risk arising due to adverse market movements. The Society has no trading book and consequently this is not applicable.

### **Liquidity Risk**

Liquidity risk is the risk that the Society will be unable to meet its financial obligations as they fall due. The Society's liquidity policy addresses both the level and quality of liquid assets.

### **Operational Risk**

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

The Society's operations comprise two main areas, namely providing a single variable rate flexible mortgage product, and offering a range of variable rate investment products. The Society does not provide financial advice, only senior management can deal with mortgage applications and the risk of mis-selling by the Society is not applicable.

The Society considers that its robust systems, policies and internal control framework are major factors in this achievement and this continues to be the case. The main operations and controls are summarised in the Risks and Controls Register. This register is reviewed by the Audit Committee and the Board.

### **Concentration Risk**

The types of concentration that can arise are concentration in one product type, geographical concentration, and over exposure to single borrowers, investors, or counterparties.

Although the Society has only one mortgage product, which is predominantly secured on UK residential property, this concentration is considered to be of low risk because of the inherent nature of the assets and the controls in place to ensure that the Society does not incur loss. . Also, the product is flexible, so the profile of borrowers is likely to bear resemblance to that of a building society with a number of mortgage products. If anything, the lack of initial discounts or cash back means that the mortgage tends to appeal to more mature borrowers with more ability to pay and contribute equity at an initial stage. The Society has no dependency on any one form of introduction for mortgages. There is no concentration risk in the type of property held as security.

### **Residual Risk**

We include a capital allocation for those risks that are unforeseen; we maintain a level of capital which is in excess of the minimum amount required by the FSA.

### **Business risk**

This is the risk that the Society is exposed to due to macroeconomic factors, i.e. economic downturn, loss of business to competitors, pricing pressures, changes in costs. These factors are considered as part of our corporate planning process.

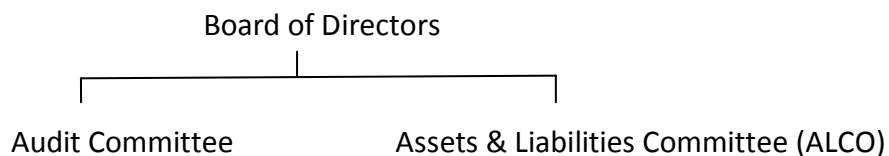
### **Interest rate risk**

Interest rate risk arises from the impact changes in interest rates have on the Society's cash flows. This is particularly relevant where a society has fixed rate products, which this Society does not have. The Society provides no fixed rate mortgages or savings accounts. The only exposure to fixed rates is from its investment in gilts and CD's,

### **Pension obligation risk**

The Society has only a defined contribution pension scheme which is open to all employees and so it has no exposure to pension obligation risk.

### 3. Main Board and Committee Structure



#### **Audit Committee**

The Audit Committee consists entirely of Non-Executive directors and meets four times per year.

The Audit Committee reviews the effectiveness of internal controls, the compliance function and the Society's risk management function. It considers and recommends the appointment of the internal and external auditors and monitors their effectiveness and independence.

#### **Assets & Liabilities Committee (ALCO)**

The Assets and Liabilities Committee consists entirely of Non-Executive directors and meets quarterly throughout the year or more often when circumstances require.

The Assets and Liabilities Committee monitors and controls balance sheet risk in relation to market risk and credit risk.

### 4. Capital Resources

The Capital Resources of the Society are calculated under Pillar 1 of the Capital Requirements Directive.

Total Society assets at the above date are £175.0M.

The Capital Resources are comprised of:

- General Reserves accumulated by the Society, representing Tier 1 Capital

Tier 1 and 2 capital resources are broken down below

### Capital Resources

Tier 1	£11,135
Tier 2 – General Provisions	£261
Total Capital Resources	£11,396

## 5. Capital Resources integrated into Business Strategy

Stafford Railway Building Society aims to maintain sufficient capital resources to allow it to make advances. In order to maintain this capital the Society needs to generate and retain profits that will add to the general reserves, the main source of capital.

### Strategy and Planning

The 5 year Corporate Plan process establishes risk appetites for business lines being developed by the Society and for each of the risk categories.

The Society ensures it has sufficient financial and non-financial resource to meet the Corporate Plan objectives.

### Capital Adequacy Assessment Process

In addition to the Corporate Plan we have an Internal Capital Adequacy Assessment Process (ICAAP), which focuses on ensuring capital resources of the Society are sufficient to support its plan both in normal and stressed conditions.

This process involves reviewing all business areas with estimates for capital allocation across the Corporate Plan period. The Board then agree (with input from the results of the Society stress models) the economic scenarios to be used in calculating capital requirements.

Finally the Board approves the capital assessment taking into account any areas where they may feel the models and internal assessments do not adequately capture the full risk exposure and holding extra capital where appropriate.

### Lending & Business Decisions

The Society translates its overall risk appetite for credit risk into individual lending limits controlling the exposures to be taken on by the Society. The performance against these limits is monitored monthly and reviewed at least annually.

In addition the Society credit risk is stress tested by type of business and the results reflected in business decisions.

### Pricing

The pricing model provides guidance as to what rate needs to be charged to meet return targets.

## 6. Risk Weighted Exposure Amounts & Operational Risk Capital

The assets of the Society are allocated risk based exposure amounts in line with the “Standardised Approach” under the Capital Requirements Directive. In addition an evaluation of capital required to cover Operational Risk is calculated under the “Basic Indicator Approach” and determined by reference to the net income of the Society averaged over the previous 3 years.

### CAPITAL RESOURCE REQUIREMENT

	Exposure £000's	Risk Weighted Exposure £000's	Capital Required £000's
<b>Liquidity</b>			
Cash	22	0	0
Local Government	0	0	0
Credit Institutions	34,218	6,912	669
Gilt Edged securities	7,621		
<b>TOTAL LIQUIDITY</b>	<b>41,861</b>	<b>6,912</b>	<b>669</b>
<b>Loans and advances to customers</b>			
Residential – performing loans	125,036	44,191	3,535
Non – residential – performing loans	6,067	6,067	485
Past Due Items	1,216	1,216	97
<b>TOTAL Loans and advances to customers</b>	<b>132,319</b>	<b>51,474</b>	<b>4,117</b>
<b>Other exposures</b>			
Fixed and other assets	824	824	66
<b>TOTAL other exposures</b>	<b>824</b>	<b>824</b>	<b>66</b>
<b>TOTAL CREDIT RISK EXPOSURES</b>	<b>175,004</b>	<b>60,654</b>	<b>4,852</b>
<b>OPERATIONAL RISK CAPITAL REQUIRMENT</b>			<b>396</b>

## Counterparty Credit Risk

The Society's counterparty treasury credit risk management policy is to ensure that the Society can obtain the best possible return whilst operating within prudent limits in respect of counterparties.

The Society only deposits funds in gilts, with institutions rated F1+, and with larger Building Societies

New limits and counterparties are approved by the Assets and Liabilities Committee (ALCO). All limits are reviewed annually or when circumstances require.

## 7. "Past Due" (Loans > 3 months in arrears) Exposures by Geographical Region

\* Past Due amounts relate to the overall mortgage balances not the amount in arrears

Region	Residential		Commercial		Total
	Past Due	Performing	Past Due	Performing	
	£M	£M	£M	£M	
Stafford ST16 – ST21	0.47	40.44	0	4.35	44.79
Rest of Staffordshire	0.56	29.60	0	0.38	29.98
Rest of England	0.22	56.06	0	1.34	57.40
Scotland	0	0.43	0	0	0.43
<b>Total</b>	<b>1.25</b>	<b>126.53</b>	<b>0</b>	<b>6.07</b>	<b>132.60</b>

## 8. Provisions

Provisions for losses are based upon an appraisal of loans, advances and other assets. Specific provisions are made in respect of properties in possession and in respect of mortgage accounts 2.5% of balance in arrears at that date and against other assets where book value exceeds the estimated realisable value.

The provision on each account represents the amount required to reduce the outstanding balance of the asset to its expected realisable value, by using industry recognised house price indices, and adjusting for costs of realisation, other recoveries and the probability of possession.

General provisions are made where it is considered that there is impairment in the value of assets at the year-end that is not already covered by specific provisions.

These provisions have been deducted from the appropriate asset values shown in the balance sheet with the exception of customer claims which are shown within other creditors.

Both the balance sheet and the provisions for liabilities can be found in the 2008 Annual Report and Accounts.

## 9. Breakdown of Liquid Assets under the Standardised Approach

	Maturity of Treasury Investment			
	< 3 Mths £M	3Mths to 1 year £M	>1 year £M	Total £M
Fitch Ratings Services				
F1+	12.6	11.6	3.0	27.2
Unrated Building Societies	2.0	5.1	0	7.1
British Government Securities	0	0	7.6	7.6
<b>Total</b>	<b>14.6</b>	<b>16.7</b>	<b>10.6</b>	<b>41.9</b>

## 10. Conclusion

This disclosure document is intended to provide background information on the Society's approach to risk management as related to maintaining and preserving the capital position of the Society. It also provides asset information and capital calculations under Pillar 1.

In the event that a user of this document has comments or requires further information then they are requested to contact the Society.