Penrith Building Society

Pillar 3 Disclosure Document

31st December 2011

PENRITH BUILDING SOCIETY

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A member of the Building Societies Association
Authorised and regulated by the Financial Services Authority

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1. Introduction

The European Union introduced the legislative framework known as the Capital Requirements Directive (CRD) from the beginning 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. In the UK the Financial Services Authority (FSA) is responsible for ensuring that the banks and building societies that it regulates have implemented the CRD.

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

Below are the 3 main "Pillars" that make up the CRD:

Pillar 1	Minimum capital requirements
Pillar 2	Assessment of capital requirements by the firm and the FSA
Pillar 3	Disclosure

The Society has followed the Standardised Approach in the assessment of the minimum capital requirement under Pillar 1. This involves the application of a defined risk based capital calculation to produce the Society's credit and operational risks.

For the purposes of establishing the capital requirement under Pillar 2, the Society's Board has undertaken a thorough assessment of the risks that the Society is exposed to and has calculated the additional amount of capital that it considers necessary to cover these risks. This process included stress testing to ensure that the Society could maintain adequate capital in the event of 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 down in the FSA handbook BIPRU Chapter 11.

All figures within this document are correct as at **31 December 2011** unless otherwise stated.

2. Risk Management Policies and Objectives

Penrith 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. As well as mortgages and savings, the Society also uses wholesale financial instruments to invest in liquid assets. The Society may also raise funding on the wholesale markets if considered necessary. The Society 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 risks faced by building societies follow.

Credit Risk

This is the risk that losses may arise due to the failure of a borrower or counterparty to meet the obligation to repay. The Board is responsible for reviewing the Society's Lending Policy and the monitoring of arrears. The Board is also responsible for the maintenance of the list of approved counterparties and the limits applicable to each of those counterparties under the Society's Liquidity Policy.

Market Risk

This is the risk arising due to adverse market movements. The Society does not have a trading book and therefore this risk is not applicable.

Liquidity Risk

This is the risk that the Society will be unable to meet its financial obligations as they fall due. The Society's 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.

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 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. There is no intention to move to a more advanced approach in the short to medium term.

The Society does not engage in any complex forms of funding or use off-balance sheet instruments and the Board is therefore content that no risk to the Society arises from these sources.

The Society manages its operational risks through internal controls, and various risk mitigation techniques, such as insurance and business continuity planning. A register of the operational risks applicable and details of how these risks are controlled is maintained by the Society. This register is reviewed at least once annually by the Audit and Compliance Committee and the Board

Interest Rate Risk

The risk of the impact of changes in interest rates on the Society. The Society has no exposure to fixed rate mortgages or savings with the only exposure to fixed rates being Certificates of Deposit and Gilts. The Society's Liquidity Policy includes limits in respect of the maturity profile of investments and the Society obtains specialist advice on the placing of investments. Also the potential effects of interest rate changes are measured by regular stress testing.

Business Risk

This is the risk that the Society may face due to economic downturn, competition and other macroeconomic factors. These factors are considered by the Board in the process of drafting the Society's Corporate Plan.

Concentration Risk

As a local building society, it is considered that the Society faces concentration risk because its activities are highly concentrated in residential lending funded by retail savings. In addition to this the Society faces Geographical Concentration risk, Product Concentration risk, Funding Concentration risk and Large Exposure (to borrowers and liquidity counterparties) Risk.

These risks are monitored by the Board to ensure that they remain manageable for a Society the size of Penrith.

Pension Liability Risk

The Society has a defined contribution pension scheme and a stakeholder scheme and therefore has no exposure to this risk.

Residual Risk

The Society holds capital to cover events that can be anticipated with a reasonable degree of certainty and also to cope with scenarios that result from stressed conditions. The level of capital maintained is in excess of the minimum requirement of the FSA.

Securitisation Risk

This is the risk that capital resources held in respect of assets that are securitised are inadequate. This risk is not applicable to the Society.

Group Risk

The Society is a solo entity and has no exposure to group risk and has no appetite to become a parent or member of a group structure.

3. Main Board and Committee Structure

The Society's Board of Directors comprises two executive Directors and six non-executive Directors.

The Board has established the Audit and Compliance Committee to assist and advise the Board in these areas.

This Committee consists of four non executive Directors.

The Committee's principal purposes include ensuring that the Society complies with all regulatory and prudential requirements and to review the effectiveness of the Society's internal controls and management systems. It also reviews the internal and external audit functions and recommends the appointment/reappointment of the firms fulfilling those functions.

4. Capital Resources

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

Total assets at 31 December 2011 were £87,409,025.

At 31 December 2010 the Society's Capital Resources totaled £10,432,249 and comprised:

- £10,322,791 of Tier 1 Capital in the form of General Reserves;
- £109,458 of Tier 2 Capital in the form of mortgage related general provisions.

5. Capital Resources and Business Strategy

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.

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 Internal Capital Adequacy Assessment Process (ICAAP) which is a formal process that calculates the Society's capital requirement in normal and stressed conditions.

The ICAAP process involves reviewing all of the Society's business activities and calculating the capital required to support them.

The Society undertakes regular stress testing with the results of this testing influencing business decisions on an ongoing basis.

The Society has in place lending limits for both mortgages and the investment of surplus funds which control the level of exposures which the Society may have in those areas of business.

6. Risk Weighted Exposures and Operational Risk Capital

The Society applies the "Standardised Approach" to Credit Risk as specified by the Capital Requirements Directive. Also the Society uses the "Basic Indicator Approach" to evaluate the additional capital required to cover the Operational Risk associated with the Society's activities. The resulting capital requirements at 31 December 2011 are set out below:

Liquidity	**Exposure**	**Risk Weighted**	**Capital Required**
Cash	58,885	0	0
Credit Institutions	28,714,690	11,859,810	948,785
Gilts	6,196,039	0	0
Total liquidity	34,969,614	11,859,810	948,785
Loans and Advances			
Residential Performing Loans	50,013,688	17,588,858	1,407,109
Non residential Performing Loans	1,663,821	1,663,821	133,106
Past Due Items – Residential	428,818	428,818	34,305
Past Due Items – Non Residential	0	0	0
	52,106,327	19,681,497	1,574,520
Other Exposures			
Fixed and Other Assets	444,745	444,745	35,580
Operational Risk			184,453
Off Balance Sheet Items	3,516,152	703,230	56,258
Total Pillar 1 Capital Requirement			2,799,596

7. Loans By Geographical Region

	Residential		Non residential	
	Past Due	Performing	Past Due	Performing
Postcode areas CA10, CA11	298,760	17,237,644		1,249,460
Other CA postcodes	0	9,453,527		37,067
Other England and Wales	130,058	23,042,729		377,294
Scotland		279,788		
	428,818	50,013,688		1,663,821

Past due items relate to loans over 3 months in arrear. Past due amounts relate to overall mortgage balances not the amount in arrears.

8. Provisions

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

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

A general provision based on the Society's experience and general economic conditions is made against mortgages not specifically identified above in order to cover potential losses which may arise due to unforeseen events

The Society's general provision for bad and doubtful debts as at 31st December 2011 is set out below:

	Loans on Residential Property	Loans Fully Secured on Land	Total
As at 1st January 2011	32,692	71,700	104,392
(Credit)/Charge for 2011	32,206	(27,140)	5,066
Balance as at 31st December 2011	64,898	44,560	109,458

At 31st December 2011 there were no specific provisions.

9. Breakdown of Treasury Assets under the Standardised Approach

Counterparty Credit Risk

The Society's Liquidity and Risk Management policies have been drawn up to ensure that the Society can obtain the best possible return on its investments whilst operating within prudent 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 at least once annually and more often as circumstances dictate.

	Maturity of Treasury Investment			
	up to 3 month	3 to 12 months	over 12 months	Total
Fitch rated F1/F1+	4,782,059	13,331,872	2,044,877	20,158,808
Fitch rated F2	1,024,291	1,002,630		2,026,921
Building Societies Rated	2,016,896	500,605		2,517,501
Unrated	1,004,354	3,007,106		4,011,460
Gilts	4,134,187		2,061,852	6,196,039
Cash	58,885			58,885
Totals	13,020,672	17,842,213	4,106,729	34,969,614

10. Directors Remuneration

The Society's remuneration policy is to reward Directors through salary and fees according to their skills, expertise, experience and overall contribution, taking into account fee and salary levels in comparable organizations.

The Society's policy with regard to Executive Directors is to set remuneration at levels sufficient to attract and retain executives of sufficient calibre and expertise.

Executive Directors' remuneration comprises basic salary and pension benefits. The Society does not have bonus or share option schemes.

Executive salaries are considered by the Remuneration Committee which meets at least once yearly. 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/final salary pension scheme. The Society makes contributions to the private pension arrangements of the Executive Directors.

The Chief Executive and Deputy Chief Executive's contracts of employment require a 12 month notice period.

The remuneration of all Non-Executive Directors is reviewed annually by the Board.

The remuneration consists of annual fees assessed by comparison with similar organisations and other external factors.

The Chairman of the Board, Chairman of the Audit and Compliance Committee and the Senior Independent Director receive higher fees than other Non-Executive Directors in recognition of the additional workload and responsibilities incumbent on those positions.

Non-Executive Directors do not participate in any performance pay scheme, pension arrangements or other benefits and do not have service contracts.

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

Details of remuneration are shown overleaf.

Details of Remuneration		**2011**	**2010**
For Services as Non-Executive Directors:			
P O'M Campbell (Chairman)		14,720	14,290
J S Hollins-Gibson (Vice Chairman and Chairman of Audit and Compliance Committee)		11,440	11,110
D Driver		9,510	9,230
G M Rigg		9,510	9,230
G Silburn (Senior Independent Director)		10,300	10,000
A G Waterfield		9,510	4,615
Lord Hothfield (Retired 31st March 2010)		-------	2,230
Total Non Executive Directors		64,990	60,705
For Services as Executive Directors:			
C Hayward	Salary	74,763	72,704
	Pension Contributions	84,000	84,000
		158,763	156,704
A Fazal	Salary	58,334	-----
(Appointed 30th March 2011)	Pension Contributions	5,833	-----
		64,167	-----
P Richardson	Salary	1,278	64,058
(Resigned 7th January 2011)	Pension Contributions	518	6,220
		1,796	70,278
Total Executive Directors		224,726	226,982
Grand Total		289,716	287,687

11. Conclusion

This document provides a description of the Society's risk management approach in so far as the maintenance and preservation of the capital position of the Society and details capital calculations under Pillar 1 of the CRD.

Should any person using this document have any comments or requires further information please contact Mr C Hayward, the Society's Chief Executive or Mr A Fazal, the Society's Deputy Chief Executive.