Newcastle
Building Society

Pillar 3 Disclosures
31 December 2015

Approved by the Board: 28 April 2016

Index

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1. Overview

1.1 Background

Basel III is a comprehensive set of reform measures in banking prudential regulation developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector.

In 2013, the European Union adopted a legislative package, the Capital Requirements Directive IV (CRD IV) to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework. CRD IV is made up of the Capital Requirements Directive (2013/36/EU) (CRD) which must be implemented through national law and the Capital Requirements Regulation (575/2013) (CRR), which is directly applicable to firms across the EU.

Basel III, in the form of the new CRD IV came into force on 1 January 2014 and updates the three “pillars” of the Basel Framework which first came into force from 1 January 2008. Pillar 1 of the standards sets out the minimum capital requirements firms are required to meet for credit, market and operational risk. Under Pillar 2, firms and supervisors have to take a view on whether a firm should hold additional capital against risks not covered in Pillar 1, assess the suitability of Pillar 1 capital requirements and demonstrate their ability to manage their capital position through a severe stressed scenario. Pillar 3 aims to improve market discipline by requiring firms to publish key details of their risks, capital and risk management.

Details of the impact the Basel III requirements have had on the Society and Group are shown in section 12.2 on page 37, including in relation to transitional provisions.

1.2 Future Developments

The Basel Committee on Banking Supervision issued Revised Pillar 3 disclosure requirements in January 2015 to promote more standardised, comparable and frequent Pillar 3 reporting. These revised disclosure requirements will be first applicable to the Newcastle Building Society Group (the Group) from the end of 2016, with the first reporting under the revised framework to be published concurrently with the Group’s year-end 2016 Annual Report and Accounts.

1.3 Policy

This document has been prepared in accordance with the requirements of Part Eight (Articles 431 to 455) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council.

The Society adopts the standardised approach to credit and operational risk.

These disclosures are on a standardised basis and unless otherwise stated, all figures are as at 31 December 2015 and based on the most recently published Annual Report and Accounts.

This report will be prepared on an annual basis and will be published on the Newcastle Building Society website (www.newcastle.co.uk), as soon as is practicable after publication of the Annual Report and Accounts.

These disclosures are not subject to external audit, although where they are equivalent to those prepared under accounting requirements for inclusion in the Group’s audited Annual Report and Accounts, those disclosures in the Annual Report and Accounts have been subject to external audit. These disclosures do not constitute any form of financial statement and must not be relied upon in making any judgement on Newcastle Building Society or the Group (as defined in section 2).

These disclosures were reviewed and approved by the Society’s Board on 28 April 2016.

2. Scope

The Pillar 3 reporting framework applies to Newcastle Building Society (the Society) and its subsidiary undertakings (the Group).

The Society's consolidation group for accounting purposes comprises the Society itself and the following principal subsidiaries:

- Newcastle Financial Services Limited
- Newcastle Strategic Solutions Limited
- Newcastle Systems Management Limited
- Newcastle Portland House Limited
- Newcastle Mortgage Loans (Jersey) Limited

All of the above subsidiary undertakings, except for Newcastle Mortgage Loans (Jersey) Limited, which is incorporated and in Jersey, are incorporated in England and Wales and operate in the United Kingdom.

For prudential and Pillar 3 reporting purposes, the Group presents its consolidated position as above. There are no current or foreseen legal impediments to the prompt transfer of capital resources or the repayment of liabilities within the Group.

Further details of Group consolidation policies and the Group structure are given in Notes 1 and 14 of the Group's audited Annual Report and Accounts.

3. Executive summary

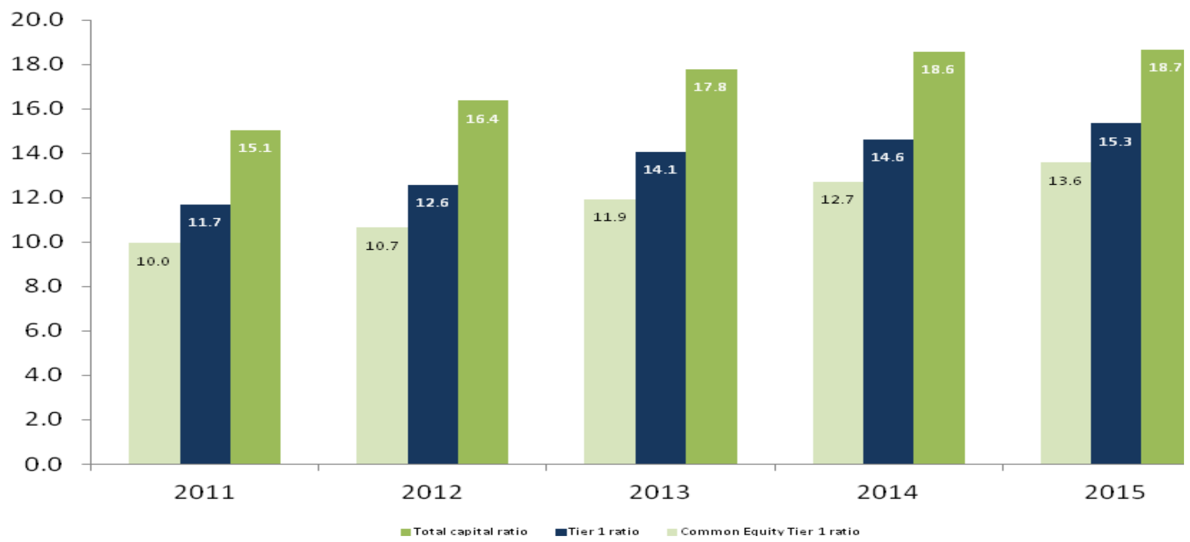
The Society is pleased to report that 2015 has been another year of good progress with all capital ratios strengthening over the 12 month period.

The Society has increased its capital generating capacity through improved profitability whilst at the same time the higher risk commercial real estate book now represents only 5% of mortgage assets at 31 December 2015. Subsequent to the year-end there have been further redemptions in the Commercial Real Estate book reducing the exposure to 4% of mortgage assets.

In 2015 risk weighted assets reduced by 5% from £1,257m to £1,191m reflecting the successful wind down of legacy portfolios (£197m reduction in legacy books in 2015) which is now starting to be offset by the growth in the prime residential book.

Total capital reduced from £233m to £222m reflecting the repayment of £9.6m of subordinated debt in August 2015 (which had been amortising from capital over a 5 year period), a reduction in qualifying capital for the remaining tranches of subordinated debt which are repayable in 2017 and 2019 (both £25m and amortising from capital over a 5 year period), offset by retained profits for the year of £3.3m.

The five year trend for the Group's capital ratios is shown in the table below and further details are included on page 13 of the Annual Report and Accounts and in section 5 of this document.



The Group complied with capital guidance provided by the PRA throughout 2015 and capital plans show the Group continuing to comply, with significant headroom, over the 5 year planning horizon.

The Society's risk management framework is designed to enable the Society to proactively identify and manage risks to support the achievement of the Society's objectives. It includes monitoring and controlling the significant risks to which the Society is exposed to ensure the security and resilience of the Society. The Society's ability to identify, measure, monitor, report and control risks is key to delivering sustainable and resilient business performance, including fair outcomes for Members and customers.

4. Risk Management

4.1 Background

The Board is ultimately responsible for ensuring that adequate systems of risk management are in place, and that the Society's strategy, risk appetite, and risk management are consistent. To assist the Board, the Society's Group Risk Committee oversees the management of risk across the Group and is supported by the Group Risk department and various sub-committees. The Group Risk department is responsible for ensuring that appropriate risk management is used. This includes the provision of reports on risks, and risk management for the GRC and its sub-committees. The Strategy Planning and Risk Director provides formal updates on risk management to the Board, in relation to the Group, at least quarterly.

The Society and Group risk management framework operates under the 'three lines of defence' principle.

- The first line of defence is within departments, business units and subsidiaries where Executives, Managers and staff have responsibility for risk management and ensuring adequate controls are in place to mitigate risk.

- The second line of defence is provided by the Group Risk Committee and supporting sub-committees together with oversight of the first line by the Group Risk department.

- The third line of defence is provided by Internal Audit and the Audit Committee, which are responsible for reviewing the effectiveness of the first and second lines of defence.

The Group has detailed risk management policies setting out how risk is managed across the Group, including specific risk appetite statements. The risk appetite statement outlines for each risk area the basis on which risks are accepted or declined. This forms the basis for the various limits and key criteria, set out in policies, which must be followed in order to mitigate risk exposures. These limits are embedded into daily, weekly and monthly management and Board reporting in order to monitor compliance with the Society's risk profile.

Further details on risk appetite and risk management are given in the Risk Management Report on pages 30 to 33 of the Annual Report and Accounts.

4.2 Principal Types of Risk

Credit Risk

Credit risk is the risk that a treasury counterparty, debtor or borrower will not be able to meet their obligations as they fall due. Credit risk arises primarily on retail and commercial loans, and on treasury assets held for liquidity purposes. The Group has comprehensive policies in place covering credit risk management that set out criteria that must be followed before funds are advanced and also incorporate limits for concentration risk arising from, inter alia, large exposures, geographical areas and lending types. Return on Capital Employed benchmarks are set to ensure reward is commensurate with the risk taken, once the risk is considered acceptable to the Society.

For retail lending the Group operates underwriting procedures to prudent policy criteria.

Loans are underwritten individually based on affordability, credit score and credit history, acceptable collateral (including loan to value), and the Society's lending criteria. The Society does not undertake subprime or self-certification lending.

The Society's lending policy is subject to review at least annually and the residential mortgage book is subject to monthly reporting in relation to its credit risk characteristics (including loan to value, loan to income, arrears, early delinquencies, external credit account information and arrears arising from cohorts of lending). The Society has a Credit Risk department that monitors and reports credit risk within the residential mortgage portfolios, including stress testing. This team also monitors the performance of the commercial and residential investment portfolios through annual reviews and key risk management information, including tenant and borrower watchlists, arrears trends, breach reports and general market and sector specific information.

The Society has two committees established to oversee risk within the commercial portfolio including Commercial Credit Committee and the Provisioning Committee (a committee with a remit to consider recommendations in relation to provisions for commercial loans). A targeted approach to collections and recovery for commercial and Buy to Let (BTL) portfolio borrowers is taken by the Society featuring a rapid response where difficulties are identified such as late payments, tenant failure, ratings downgrades and general negative market news.

Credit risk on liquid assets is controlled via the operation of counterparty, sector, instrument, and country limits for treasury assets. Counterparty limits are set with regard to external ratings agency assessments with the Society investing only in highly rated financial institutions or other building societies with strong capital ratios. The Society supplements ratings agency information with more extensive credit assessment procedures for counterparty limits including market information and movement on credit default swap (CDS) spreads for countries and individual counterparties. Treasury counterparty risk is monitored within Treasury Risk in accordance with the treasury policy. All treasury counterparty ratings, CDS spreads and market information are monitored in real time and prompt action is taken where volatile market conditions require a tightening of criteria. Throughout 2015 the Society has continued to make use of the London Clearing House (LCH) with the LCH acting as a central counterparty to treasury swaps originally undertaken with institutional counterparties. Derivatives are only used by the Group in accordance with the Building Societies Act 1986. These instruments are not used for trading or speculative purposes and their sole purpose is to mitigate risks arising from movement in interest rates or indices. The Society has a Credit Support Annex in place for all derivative counterparties.

Liquidity Risk

Liquidity risk is the risk of loss or failure caused by the Group being unable to meet its liabilities or commitments as they fall due, or to be able to do so only at excessive cost. The nature of the business of a building society is to lend longer-term (typically up to 25 years) and fund with short term savings accounts. This leads to a maturity mismatch between assets and liabilities. The Group’s liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, and enable the Group to meet its financial obligations when they fall due. This is achieved by maintaining a prudent level of liquid assets and ensuring that funding and lending plans are balanced.

The Group's liquidity risk is managed by the Asset and Liability Committee (ALCO). ALCO reviews and approves the results of liquidity stress testing scenarios and cash-flow forecasts under base case and stressed scenarios. ALCO appraises long term funding plans and scenarios to ensure adequate liquid assets are in place to meet both regulatory and operational requirements following input by the Group Balance Sheet Management and Product Development departments.

In October 2015 new liquidity regulations came into force, which replaced the Liquidity Standards Regime with new Europe wide regulations for liquidity. Under the new liquidity regulations the Liquidity Coverage Ratio (“LCR”) has been introduced for banks and building societies with an initial target ratio of 80%. LCR shows high quality liquid assets as a percentage of net cash outflows over a 30 day stress period. For further information see section 7.7 of this document.

The Society has continued to maintain a significant level of high quality liquid assets throughout 2015, as detailed in the Strategic Report on page 11 of the Annual Report and Accounts. The Society has complied with its Individual Liquidity Guidance throughout 2015.

Conduct Risk

Conduct risk is the risk of poor consumer outcomes, resulting from poorly designed or targeted products, mis-selling of products, inadequate controls relating to fraud prevention and detection or to prevent money laundering. The Group has established a conduct risk framework including a Retail Conduct Risk Appetite statement supported by detailed policies relating to compliance, treating customers fairly, fraud, and anti-money laundering. Compliance with the Retail Conduct Risk Appetite statement is monitored by the Conduct and Operational Risk Committee (CORC) with oversight from the Group Risk Committee (GRC). The Group has a Product Approval Committee which approves all products. Included in the terms of reference for the Product Approval Committee is consideration of risks to consumer outcomes arising from products or services.

The Society maintains a Treating Customer Fairly dashboard, which looks at evidence supporting good customer outcomes (or suggesting poor outcomes) and this is reviewed quarterly and reported to the Board.

Operational Risk

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events. For the Group this definition includes legal risk, strategic risk and reputational risk.

CORC oversees operational and conduct risk. GRC also monitors operational and conduct risk on a quarterly basis.

The Group has an established operational risk framework with an operational risk policy that sets out the framework for operational risk, including the measurement and management of risk, operational risk appetite, use of scenario testing for operational risk, tracking of risk events and operational losses, timescales for implementation of action plans and escalation procedures for more serious risk events that require immediate action to mitigate loss.

A key feature of the Group's operational risk framework is that key risks and controls are identified for all areas of the business ranging from the high level risks, discussed at Board level, down to the risks within individual departments. Risk assessments remain the responsibility of the relevant departmental managers and Executives, and are updated regularly for new risks, the results of risk events and following internal audit reviews.

Risks are scored in terms of the impact and probability of the risk arising and are scored before and after considering the impact of controls. The operational risk system is also utilised by Internal Audit with the audit inspection plan based on high scoring risk areas or where there is significant reliance on key controls to mitigate the impact of otherwise significant risks. Group corporate insurance policies are also negotiated with full regard to the key risks within the Group requiring greater mitigation.

Market Risk

The principal market risk to which the Group is exposed is interest rate risk. Interest rate risk in the banking (or non-trading book) is covered further in section 9. The Group has no exposure to foreign currency and a very small direct net exposure to equities through a small shareholding in Standard Life arising from the de-mutualisation of the insurance company in 2006. At 31 December 2015 these holdings were held on the balance sheet at £0.4m, a value that fairly reflects their market price. The Group has an indirect exposure to the performance of equities through its defined benefit pension scheme.

Concentration Risk

Concentration risk is the risk arising from a single large exposure or a group of exposures where the potential for loss is connected. Concentration risk arises from operating in a particular geographical location, a particular industry sector or from large exposures in the form of large loans to single borrowers or treasury counterparties. The Society, whilst being a regional building society, has a geographic concentration within the North East of England of less than a fifth of its residential mortgage book, reflecting the largest geographic concentration of mortgages held within a single region.

The Group has a comprehensive range of limits and controls in place which enable the Board and related sub-committees to measure and monitor concentration risk across the Society's business and at a Group consolidated level. The Group Risk Committee has oversight of all relevant management information and is able to provide assurance and recommendations to the Board in relation to the management of any significant emerging risks.

Commercial borrower activity is similarly monitored with large exposure to individual borrowers considered as a source of potential concentration risk. The Group Risk Committee is satisfied at 31 December 2015 that no exposure in any one risk concentration exceeds the Society's risk appetite.

Pension Obligation Risk

The Group has funding obligations for a defined benefit scheme which is closed to new entrants. It was closed to future benefit accrual with effect from 30 November 2010. Pension risk is the risk that the value of the Scheme's assets, together with any agreed employer contributions, will be insufficient to cover the projected obligations of the Scheme over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates.

The projection of the Scheme's obligations includes estimates of mortality and inflation, the actual out-turn of which may differ from estimates. The Scheme is also exposed to changes in pension legislation. To mitigate these risks the Trustees of the Scheme, in consultation with management, regularly review reports prepared by the Scheme's independent actuary and take appropriate actions including adjusting the investment strategy. The Group also performs stress testing on the pension scheme liabilities and assets as part of capital planning as set out in the ICAAP. The Society undertook a Pension Increase Exchange exercise in 2014 which reduced the risk associated with the pension scheme. Through 2015, the pension scheme has rebalanced its investment strategy in favour of Diversified Growth Funds and increased the level of Liability Driven Investments.

The Society accounts for its defined benefits pension scheme in line with International Accounting Standard 19R with key assumptions made in calculating the year end obligation include assumed future discount, RPI, CPI and mortality rates. For further detail see Note 28 to the 2015 Annual Report and Accounts.

Solutions Business Risk

The Society's business model includes diversification via the Newcastle Strategic Solutions business. This increases the exposure to operational risk, particularly in relation to IT systems capability and human error.

The Society established the Newcastle Strategic Solutions business in 1997, whereby the Society provides outsourced services, such as internet banking, IT services, and account administration, to other financial institutions. There are various operational and strategic risks arising from the Solutions business including, inter alia:

- Systems failures (mainframe, internet and telephony);
- Breach of information security/Data Protection Act;
- Failure of Society's employees to follow third party procedures/basic human error;
- Failure of a business partner; and
- Poor service – resulting in failure to meet Service Level Agreements.

The Society has systems and controls in place to address the risks in the Solutions area including dedicated teams in IT, Finance, Compliance, Financial Crime Unit, technical departments and dedicated relationship and service managers. The Society implemented several projects and recruited additional specialist risk staff in 2015 to further enhance its resilience and combat risks from Cyber-crime. A separate Newcastle Strategic Solutions Board exists to oversee third party contract risks, financial performance and operational matters that arise from the Group's subsidiary entity, Newcastle Strategic Solutions Limited.

Deferred taxation

The Group's calculation of Tier 1 Capital as a result of the implementation of Basel III capital calculation requirements contains deductions for certain deferred taxation components. Under Basel III, the Group's deferred tax assets that rely on future profitability, excluding those arising from temporary differences, must be deducted from Common Equity Tier 1 Capital, reducing both Tier 1 and Total Capital Available.

The Group's deferred tax asset recovery is conditional on future profits of the Group. The Society Audit Committee has assessed the deferred taxation position as at 31 December 2015 and is satisfied that the amount will be recovered through forecast future Group profits which will flow back to the Society.

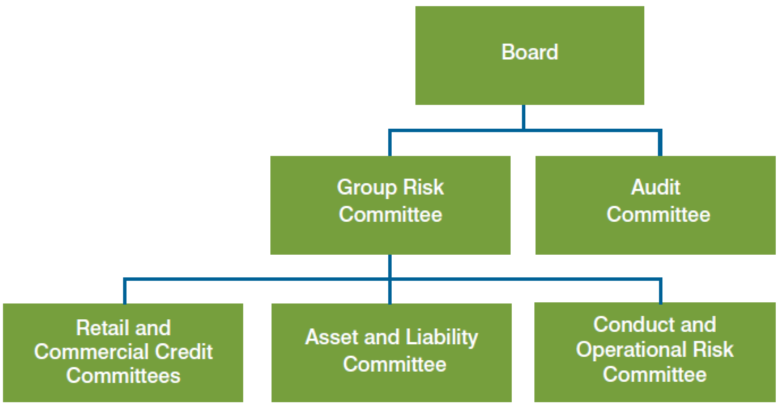
See section 12 for details of the impact of transition to the final Basel III position on the Group capital position.

4.3 Risk Governance

The Society has a well developed risk and compliance structure with the Credit Risk, Treasury Risk and Operational Risk functions supported by separate Compliance, Business Assurance (Internal Audit) and Financial Crime Units. The Society has extensive policies and procedures covering financial risk, credit risk and operational risk which are approved by the Board via sub-committees as appropriate.

The risk governance structure is set out below.

Risk Governance Structure



Group Risk Committee (GRC)

GRC oversees the Society's risk management and governance framework, and oversees the Society's overall risk profile. Terms of reference for GRC are included on the Society's website under governance (http://www.company-newcastle.co.uk/governance/).

The duties of GRC include:

- Oversight of overall risk appetite, risk management strategy and framework, including oversight of both prudential and conduct risk appetites;
- Oversight of compliance with risk policy;
- Oversight of the risk sub-committees (see below);
- Review and assessment of the adequacy of risk management information to monitor and control risks;
- Approval of new initiatives and projects, including the risks those initiatives and projects expose the Group to;
- Consideration and approval of the top risks for the Society and Group including low likelihood, high impact risks;
- Approval and recommendation to the Board of both the Internal Capital Adequacy Assessment Process (ICAAP) and the Individual Liquidity Adequacy Assessment (ILAA); and
- Approval of stress testing and scenario testing.

The Committee normally meets at least six times a year and more frequently where required (During 2015 the Committee met eight times). It is supported by four Executive committees that meet on a monthly basis, as follows:

The Retail Credit Committee is responsible for credit risk across the Group arising from the retail mortgage portfolio as follows:

- Review of lending policy statements and compliance therewith;
- Review of risk metrics and management information for the retail mortgage portfolio;
- Review and approval of arrears and possessions policy and compliance therewith;
- Sanction of larger loans in accordance with the lending policy statement;
- Review and approval of new types of mortgage products including ensuring return on capital employed meets internal benchmarks and that risks have been effectively considered and mitigated;
- Review of performance for underwriters, panel managers and brokers;
- Review of credit risk profile of retail mortgage book including trends on arrears (both historical and against the market), losses and capital requirements;
- Review of key economic data impacting credit risk including trends on unemployment, house prices, arrears rates, affordability and inflation;
- Review of credit control activity levels including customer contact volumes, forbearance measures granted, disturbed payment patterns and changes in behavioural and credit scoring. This includes reviewing the effectiveness of forbearance measures granted to customers;
- Review and approval of stress testing assumptions and outputs including monitoring of trends;
- Review of arrears and possessions reports including causal factors and lessons learned; and
- Review of Mortgage Indemnity Guarantee (MIG) policy arrangements.

The Commercial Credit Committee is responsible for credit risk across the Group's non-retail mortgage portfolio as follows:

- Review of non-retail policies and compliance therewith;
- Review of risk metrics and management information for the non-retail mortgage portfolio;
- Monitor compliance with controls and limits set out in the policies;
- Review of credit risk profile of existing mortgage book including trends on arrears, losses and capital requirements;
- Review of key performance indicators in relation to the delivery of the commercial strategy;
- Review of risk indicators and risk factors. This includes review of tenant and borrower watch-lists and sector specific reports;
- Approval of annual reviews, breach reports and mitigation activity in accordance with the delegation of authorities;
- Review and approval of stress testing assumptions and outputs including monitoring of trends; and
- Review of key trends in commercial property markets including values, yields and levels of activity.

Operational Risk is overseen by the Conduct and Operational Risk Committee (CORC). Its remit includes:

- Review of operational risk policy and other related risk and compliance policy statements;
- Monitoring compliance with policies;
- Review of risk indicators in risk dashboards including risk event trends across the business, actions being taken on significant risk events, and status of project risks;
- Review of conduct risk indicators, via monthly dashboards, including in relation to Compliance monitoring, Mortgage Conduct of Business (MCOB), Treating Customers Fairly, Complaints, Information Security and Fraud monitoring;
- Approval of corporate insurance policy statement, status of claims and effectiveness of policies at mitigating operational risk; and
- Review of business continuity policy, disaster scenarios and results of annual disaster recovery test.

The Asset and Liability Committee (ALCO) is responsible for all aspects of treasury risk management including liquidity and funding risk, interest rate risk and hedging activity, treasury counterparty credit risk and balance sheet management. Terms of reference for ALCO are included on the Society's website under governance (http://www.company-newcastle.co.uk/governance/). Key responsibilities of ALCO include:

- Review of treasury policy and compliance therewith;
- Review of treasury dealing strategy and compliance with risk appetite statement;
- Management of balance sheet assets and liabilities, including structural changes and achievement of strategic objectives in relation to growth or shrinkage;
- Review of risk dashboards covering all aspects of treasury, liquidity, funding and interest rate risk, including basis risk;
- Setting of interest rate view and changes thereto based on changes to the economic outlook and interest rate environment;
- Review of wider treasury markets and economic backdrop to assess the impact on the Society's funding and liquidity requirements;
- Detailed review and agreement of cash-flow requirements across the business;
- Monitoring of interest rate risk and hedging activity, including impact on profitability;
- Review of treasury counterparty limits and country limits including assessing the impact of ratings changes;
- Review of funding including sources, mix and compliance with limits;
- Review of contingency funding plans;
- Review of liquidity requirements and compliance with limits;
- Review and approval of results of liquidity stress testing scenarios; and
- Review and approval of changes to interest rates, mix of new business and maturity defence strategy.

4.4 Other Governance

Further details of the Society's corporate governance arrangements are given on pages 20 to 24 of the Annual Report and Accounts.

The Board

The Board is responsible for agreeing the overall strategy for the Group including approval of the corporate strategy, with the responsibility for implementing it being delegated to the Executive team. The Board is responsible for monitoring operational and financial performance in pursuit of the strategy.

The Board is responsible for risk management, for governance, and for ensuring adequate internal controls. The Board delegates oversight of risk management to the Group Risk Committee, and oversight of internal controls to the Audit Committee.

The Board is responsible for approving the budgets and forecasts, the adequacy of capital and liquidity plans, the adequacy of the systems of internal control and major capital expenditure. In addition, the Board is responsible for final approval of the interim results and Annual Report and Accounts on a going concern basis. Further details are given on pages 20 to 24 of the Annual Report and Accounts.

The Board consider the Group's governance structure, control environment, risk mitigation activities and risk monitoring sufficient to meet the Group's ongoing profile and strategy.

In addition to the Group Risk Committee and sub-committees detailed above, the Board has six other committees which are noted below.

Remuneration Committee

This Committee considers and makes recommendations on Executive Director and Executive emoluments and contracts of employment. The Committee considers proposals from the Chief Executive for changes to the level of fees for Non-Executive Directors including the fees for the Chairman. The Committee's report is included on pages 27 to 29 of the Annual Report and Accounts. In addition, section 10 of this report sets out the remuneration disclosures as required under Article 450 of the CRR which have been approved by the Remuneration Committee.

Nominations Committee

This Committee advises on the structure of the Board including succession planning, on nominations to it and the re-election of Board members retiring by rotation. The committee also ensures that the Board has the appropriate balance of skills, diversity and experience.

Newcastle Strategic Solutions (NSSL) Board

NSSL's Board oversee all aspects of the savings management business including risks, financial performance and operational matters. In addition it sanctions new third party contracts, in line with its delegated authority, after considering the relevant financial model, contract obligations and full project risk assessment. The NSSL Board establish and review a risk appetite statement for NSSL, evaluate and monitor NSSL risk and compliance matters and consider and act upon the findings of any external/ internal audits or reviews. Further details are given on page 22 of the Annual Report and Accounts.

Newcastle Systems Management (NSML) Board

NSML's Board oversee the strategic direction of Information Technology and associated services, ensuring this is consistent with the Society's agreed corporate strategy for ongoing development and improvement in the IT proposition. The NSML Board establish and review a risk appetite statement for NSML, monitor developments in the area of cyber and other technological risk mitigation, ensure that NSML complies with all relevant legislation and act upon the findings of any external/ internal audits or reviews. Further details are given on pages 22 and 23 of the Annual Report and Accounts.

Newcastle Financial Services (NFSL) Board

NFSL's Board oversee the strategic direction of the Group's financial advice subsidiary, ensure compliance with all relevant legislation and act upon the findings of any external/ internal audits or reviews. Further details are given on page 23 of the Annual Report and Accounts.

Audit Committee

This Committee considers all audit matters relating to the Group, the system of internal control, financial reporting and evaluation of first and second lines of defence for risk management.

Reports from the Strategy, Planning and Risk Director, internal audit and the external auditors provide input on key risks and uncertainties direct to the Audit Committee.

The main responsibilities of the Committee as delegated by the Board are:

- Financial reporting: monitoring of the integrity of the financial statements of the Group including the interim and annual reports, and any other formal announcements relating to the Group's financial performance. This includes review of significant financial reporting judgements and offering advice to the Board on whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, providing the information necessary for Members to assess the performance, strategy and business model of the Group.

- Effectiveness of internal control and risk management systems, including internal financial control: The Audit Committee works closely with the Group Risk Committee to ensure that management and staff take appropriate responsibility for departmental, business unit and subsidiary risk mitigation and internal control. This includes review of the scope and effectiveness of the Group's internal controls and risk management systems, including those for ensuring compliance with the regulatory environment in which the Group operates. The Committee also reviews the Group's procedures for detecting fraud and irregularities ensuring arrangements are in place by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting control or other matters and to ensure independent investigation and appropriate follow up of such matters is undertaken.

- Internal audit: The Society's internal audit function is carried out by the Business Assurance department and reflects the Audit Committee's primary available resource. The Committee retains the authority to obtain outside legal or independent professional advice as it sees fit.

- The Committee approves and reviews the internal audit work programme and results and ensures the internal audit department maintains sufficient access to the Board, management and the books and records of the Society. This oversight allows the Audit Committee to monitor and assess the role and effectiveness of the internal audit function in the overall context of the Group's internal control framework and ensure appropriate management responsiveness to audit findings and recommendations given.

- External audit: The Audit Committee oversees the Group's relationship with the external auditors, including appointment, reappointment, removal and assessment of independence, objectivity, effectiveness and remuneration. The Society has established a policy on the use of the external auditors for non-audit work which is considered and approved annually by the Audit Committee. The principal purpose of this policy is to ensure the continued independence and objectivity of the external auditors.

Further details on the work of the Audit Committee are given in the Audit Committee Report included on pages 25 and 26 of the Annual Report and Accounts.

4.5 Risk Appetite

The Board approved risk appetite statements consider profitability in a stressed scenario, capital, liquidity, operational risk, credit risk, interest rate risk, the fair treatment of customers and conduct risk, and IT risk. They set out key limits and escalation triggers.

The risk appetite statements, together with the risk position, are reported to the Board quarterly and formally approved annually.

5. Capital Resources

The Society and Group has operated within the Individual Capital Guidance (ICG) issued by the PRA throughout 2015.

5.1 Total Capital Available

An analysis of Total Capital Available (TCA) as at 31 December is set out in the following table:

	Basel III Transitional **Group £m** **31-Dec-15**	End Point Basel III **Group £m** **31-Dec-15**	Basel III Transitional **Group £m** **31-Dec-14**	End Point Basel III **Group £m** **31-Dec-14**
Common Equity Tier 1 capital				
Profit and loss reserves	169.7	169.7	166.6	166.6
Deferred tax assets that rely on future profitability excluding those arising from temporary differences~	(6.0)	(6.0)	(6.9)	(6.9)
AFS reserve*	(0.5)	(0.5)	-	(0.4)
Intangible assets	(1.4)	(1.4)	-	-
	161.8	**161.8**	**159.7**	**159.3**
Additional Tier 1 capital	30.0	30.0	29.9	29.9
PIBS Grandfathering to Tier 2 capital	(9.0)	(30.0)	(5.9)	(29.9)
	21.0	**-**	**24.0**	**-**
Total Tier 1 capital	**182.8**	**161.8**	**183.7**	**159.3**
Tier 2 capital				
Collective Impairment allowance	2.3	2.3	4.2	4.2
PIBS Grandfathering to T2 capital	9.0	30.0	5.9	29.9
Subordinated debt	28.3	-	39.5	-
	39.6	**32.3**	**49.6**	**34.1**
Total Capital Available	**222.4**	**194.1**	**233.3**	**193.4**

~ Deferred tax assets relating to temporary timing differences of £1.8m are held on balance sheet at 31 December 2015 and are not deducted from Common Equity Tier 1, in line with article 48 of the CRR.
*Net market values below book value on the Society's Available For Sale debt security portfolio are included in Common Equity Tier 1 capital as part of other reserves, net of taxation.

The above includes full amortisation of the subordinated debt over the Basel III transitional period and transitional grandfathering of the Society's PIBS to Tier 2 Capital from Tier 1 but does not factor in accumulated Group profits over a similar period or other capital transactions that could be undertaken. It presents an end point Basel III position using the 31 December 2015 Group balance sheet only, assuming no other movement in reserves or other capital tier 1 and 2 items.

The following table details the Group's capital flows through 2015. Figures are presented under a Basel III transitional basis.

Basel III Transitional	£m
Common Equity Tier 1 capital at 31 December 2014	**159.7**
Group profit after taxation for the financial year 2015	3.3
Other comprehensive (expense)/income:	
Actuarial re-measurement on retirement benefit obligations	(0.4)
Income tax on items that will not be reclassified to the income statement	0.1
Other movements:	
Reduction in deferred tax asset	0.9
Intangible assets	(1.4)
AFS reserve movement	(0.5)
Other	0.1
Common Equity Tier 1 capital at 31 December 2015	**161.8**
Additional Tier 1 capital at 31 December 2014	**24.0**
PIBS Grandfathering to Tier 2 capital	(3.1)
Amortisation of PIBS issue costs	0.1
Additional Tier 1 capital at 31 December 2015	**21.0**
Tier 2 capital at 31 December 2014	**49.6**
Reduction in collective provision	(1.9)
Amortisation of capital value of Subordinated debt	(11.2)
Amortisation of subordinated debt issue costs	-
PIBS Grandfathering to T2 capital	3.1
Tier 2 capital at 31 December 2015	**39.6**

The below table reconciles the Group balance sheet capital, reserves and subordinated liabilities to their regulatory capital values.

	31-Dec-15 £m
Balance sheet reserves	**169.2**
Deferred Tax asset (capital impact)	(6.0)
Intangible assets	(1.4)
Regulatory Common Equity Tier 1 capital	**161.8**
Balance sheet Subscribed capital	**30.0**
Grandfathering of PIBS under Basel III	(9.0)
Additional Tier 1 capital	**21.0**
Balance sheet subordinated liabilities	**50.0**
Amortisation of capital value of subordinated liabilities	(21.7)
Collective impairment allowance	2.3
Grandfathering of PIBS under Basel III	9.0
Total Tier 2 capital	**39.6**
Total Regulatory capital	**222.4**

5.2 Common Equity Tier 1 Capital

Common Equity Tier 1 Capital comprises profit and loss reserves being the accumulation of retained profits. Common Equity Tier 1 Capital is a key measure of focus under the capital regulations (see section 12). Under Basel III, deferred tax assets that rely on future profitability to be realised are to be excluded from Total Capital Available. The Group does not capitalise internally generated intangible assets but deducts from Tier 1 capital externally purchased computer software meeting the IFRS definition of intangible assets. For further detail of the transitional provisions of Basel III and their impact to the Group's capital position see section 12.

5.3 Additional Tier 1 Capital

Additional Tier 1 Capital consists of permanent interest bearing shares (PIBS). PIBS are unsecured deferred shares and rank behind the claims of all subordinated note holders, depositors, creditors and investing Members of Newcastle Building Society. Further details on PIBS are given in Note 25 of the Annual Report and Accounts. Under Basel III, the capital value of the Group's PIBS move from tier 1 capital to tier 2 capital over a transitional period.

5.4 Tier 2 Capital

Tier 2 capital comprises subordinated debt, collective impairment provisions against the mortgage book and PIBS that have been moved from Tier 1 capital under Basel II to Tier 2 capital under Basel III.

Fixed term subordinated debt is unsecured and ranks behind the claims of all note holders, depositors, creditors and investing Members of Newcastle Building Society. Further details on subordinated debt are given in Note 24 of the Annual Report and Accounts.

Fixed term subordinated debt is amortised over the remaining 4 year life of the issue for capital reporting purposes and held at carrying value in the financial report and accounts. Amortisation deductions of £20m have been made in the above TCA calculations.

The Society repaid its £9.6m issue of 6.375% fixed rate subordinated notes during 2015. For capital purposes, the issue had already been fully amortised at the date of sale (with £1.2m amortisation through January 2015 to June 2015 to bring the amortised capital base of the 6.375% issue to £nil). The repayment therefore had no net impact to the Group's additional tier 1 capital position at 31 December 2015.

6. Capital Adequacy

The Group adopts the standardised approach to credit and operational risk for the purposes of calculating the Pillar 1 minimum capital requirements. Pillar 1 capital is reported to the Board each month and to the PRA on a quarterly basis.

6.1 Internal Capital Adequacy Assessment Process (ICAAP)

The Group assesses the overall capital requirement for current and future activities via the ICAAP. The ICAAP is updated on an annual basis, or more frequently where there is a significant change to the business strategy or a major change to the economic environment. The capital plan is updated in conjunction with the update to the Society's five year strategic plan so that strategy and capital are always in alignment and that the risks arising in pursuit of the Society's strategy are always fully incorporated into capital requirements.

The ICAAP process is presented to and approved by the Board via the Group Risk Committee. The last ICAAP was prepared as at 31 December 2014 and was approved by the Board in April 2015. The ICAAP at 31 December 2015 is in the process of being finalised and will be approved by the Board in April 2016. These disclosures include extracts from ICAAP and are based on the final financial results of the Group contained in the 2015 Annual Report and Accounts.

The ICAAP covers all material risks to determine the capital requirement over a five-year horizon and includes stressed scenarios to satisfy regulatory requirements. Where Pillar 1 capital is deemed insufficient to cover stressed losses a supplementary Pillar 2 add-on is applied.

The Group ICAAP is subject to regular review by internal audit and external advisors in order to confirm that the Society's approach to the ICAAP is robust, compliant and up to date with the requirements of the PRA Handbook. The Group's ICAAP is subject to the Supervisory Review and Evaluation Process by the PRA.

6.2 Minimum Capital Regulatory Requirement: Pillar I

The table below shows the Group's Pillar 1 Capital Resources Requirement (CRR) for each key risk area under the standardised approach (expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised credit risk exposure classes) at 31 December:

Group Pillar 1	2015 On Balance sheet	2015 Risk Weighted Assets*	2015 Capital @ 8%	2014 On Balance sheet	2014 Risk Weighted Assets	2014 Capital @ 8%
	£m	£m	£m	£m	£m	£m
Mortgage Loans Credit Risk	2,478.6	998.2	79.8	2,660.1	1,079.3	86.4
Liquidity Credit Risk	726.0	59.3	4.7	816.6	56.6	4.5
Other Assets	42.8	33.2	2.7	41.3	33.0	2.7
Hedging Instruments~**	-	18.3	1.5	-	9.2	0.7
Mortgage commitments**	-	8.9	0.7	-	6.6	0.5
Total Credit Risk (standardised)	-	1,117.8	89.4	-	1,184.7	94.8
Operational Risk (standardised)	-	73.4	5.9	-	72.2	5.8
Total Pillar 1 CRR		**1,191.3**	**95.3**		**1,256.9**	**100.6**

*Risk weighted assets are broadly derived from the following balance sheet categories:

- Mortgage loans credit risk: Loans and advances to customers.
- Liquidity credit risk: Cash and balances with the Bank of England, Loans and advances to banks, Debt securities and Assets pledged as collateral.
- Other assets: Property, plant and equipment, deferred tax assets and other assets.

~Being Credit Valuation Adjustments of £10.2m and EADi adjustments of £8.1m.

** Mortgage commitments are not held on balance sheet. Hedging instrument credit risk is derived in line with the standardised method for own funds requirements for credit valuation adjustment risk - not balance sheet derived.

Risk weighted assets and capital are analysed at 31 December by exposure class in line with Article 112 of the CRR as follows:

Exposure Class	Capital @ 8% 2015 £m	2014 £m
Retail Exposures		
Residential Lending	66.7	68.5
Other Secured Lending	1.1	1.4
Past Due Items	0.6	0.6
Commercial Exposures		
Commercial Lending	11.5	16.0
Other Exposure Classes		
Covered Bonds	2.0	0.9
Residential Mortgage Backed Securities (RMBS)	2.6	3.4
Other	0.1	0.2
Other		
Fixed and other assets	4.8	3.9
Operational Risk (standardised)	5.9	5.8
Total Pillar 1 CRR	**95.3**	**100.6**

There is no Pillar I requirement in respect of market risk as the Society and Group does not have a trading book. Interest Rate Risk in the Banking Book is dealt with as a capital add-on at Pillar 2, based on the risk appetite set by the Board for a 200bp parallel shift in interest rates. Due to the sustained low 2015 interest rate environment, the rate shocks for interest rate reductions communicated to ALCO have remained at -10bp and -20bp throughout 2015 with the Committee also stressing the impact of longer term interest rate changes on collateral balances.

At 31 December 2015 the Group held excess capital over and above the Pillar 1 minimum regulatory requirement of £127.1m (2013: £132.7m). The movement reflects improved CET 1 strength against a lower risk balance sheet offset by further amortisation of the capital value of the Society's subordinated debt.

7. Credit Risk Measurement, Mitigation and Reporting

For the purposes of Pillar 3 disclosures, credit risk is sub-divided into residential mortgages, other secured lending, commercial lending, and treasury credit risks. Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent across most of the Group's activities. Adverse changes in the credit quality of borrowers or a general deterioration in UK economic conditions could affect the recoverability and value of the Group's assets and therefore its financial performance. Comprehensive risk management policies and processes have been established as part of the Society's overall governance framework to measure, mitigate and manage credit risk within the Group's risk appetite.

7.1 Exposures

The gross credit risk exposures (based on the definitions for regulatory capital purposes, before credit risk mitigation) and the averages for the year are summarised below:

Mortgage Assets	Average to Dec-15 £m	As at Dec-15 £m	As at Dec-14 £m
Residential Mortgages	1,769.2	1,760.4	1,778.0
Housing Associations	625.0	570.4	679.5
Other secured lending	8.4	7.0	9.8
Commercial Real Estate Loans	164.5	136.1	192.9
Serviced Apartments	23.4	23.1	23.7
	2,590.5	**2,497.0**	**2,683.9**
Treasury:			
Deposits with central governments or central banks	268.2	231.6	304.7
Cash collateral pledged to derivative counterparties	195.7	192.2	199.2
Deposits with multilateral development banks	20.0	10.0	30.0
Covered bonds	88.7	122.8	54.7
RMBS	191.2	165.2	217.3
Other	1.3	1.1	1.5
Cash in hand and equivalent cash items	6.6	4.2	9.0
	771.8	**727.1**	**816.4**
Total	**3,362.2**	**3,224.1**	**3,500.3**

7.2 Retail Credit Risk

The Group has comprehensive policies in place covering all aspects of credit risk management that set out strict criteria that must be followed before funds are advanced. Prospective customer eligibility for loans is controlled by underwriting using core credit score and affordability criteria. The Group risk appetite incorporates limits for concentration risk arising from, inter alia, larger loans, higher LTV and geographical exposures.

These various limits combined with formal governance and policies reflect the Group's view and appetite for risk in the retail mortgage portfolio.

All limits and policies are reviewed annually by the Board and the Group Risk Committee and, in between reviews, the profile and profitability of mortgage completions and mortgage pipeline is reviewed in the context of underlying credit risk profile. An investigation is carried out in the event a loan defaults within the first 12 months of completion to identify causal factors and inform policy generally.

The key areas covered in lending policy are:

- Formal approval process;
- Use of scorecard including cut-offs;
- Types of property acceptable as security;
- Valuation requirements including use of approved valuers;
- Limits on minimum and maximum advances;

- LTV limits by exposure and type;
- Exposure limits;
- Underwriting criteria;
- Restricted criteria for existing interest only mortgages (NB the Society ceased new interest only lending in 2012);
- Separate limits for buy to let lending (NB the Society re-entered the BTL market in 2015 with focus on lending to individuals looking to borrow on up to 3 properties, with a maximum loan size of £1m and a maximum LTV of 75%);
- Mandates and delegation of authorities;
- Affordability assessment including loan to income monitoring;
- Monthly credit risk dashboard with key indicators including arrears, possessions and dynamic delinquency;
- Ongoing monitoring including credit control and complaints;
- Monitoring of effectiveness of forbearance measures; and
- Robust and fair arrears management processes.

In addition, all mortgage products are strictly controlled through ALCO approval and subject to minimum benchmarks for Return on Capital Employed.

The Group does not offer and has never offered sub-prime or self-certified mortgages.

Credit risk under Pillar 1 is calculated using the standardised methodology in line the CRR and CRD regulations. Non-defaulted retail mortgage assets up to 80% LTV attract a 35% risk weighting, whilst the proportion above 80% LTV attracts a 75% risk weighting. Mortgages in default attract a risk weighting of 100% if no provisions are held and LTV is less than or equal to 80%, and 150% where the LTV is greater than 80% and no provisions are held. While the Society has Mortgage Indemnity Guarantee insurance in place for lending greater than 80% LTV this is not included as mitigation within capital calculations.

7.3 Loans to Housing Associations

The Society has a large portfolio of loans to Housing Associations which is reducing over time. The Society has not undertaken any new lending of this type with balances falling by £109m in 2015, due to redemptions. There has been no loss experience on the portfolio since this area of business commenced and no Housing Association loans are past due or impaired.

7.4 Commercial Credit Risk

Commercial lending is split between lending to low risk housing associations detailed above, residential investment lending (commercial Buy to Let) and commercial investment lending (secured on commercial real estate). An analysis of loans within the commercial lending book is given on pages 73 to 75 of the Annual Report and Accounts.

The Group has not undertaken commercial lending since 2008 but the Credit Risk department continues to monitor the performance of the portfolios through annual reviews, and key risk management information, including tenant and borrower watchlists, arrears trends and breach reports.

The Society grants forbearance to commercial borrowers, in exceptional circumstances, in the form of extending the loan term on maturity on terms as good as or better than at the inception of the loan. Generally the Society expects commercial investment loans to be repaid on maturity given the strategy of winding down the portfolio but will grant forbearance when this is also in the best interests of the Society e.g. providing the borrower with a little more time to sell the security property following a tenant renewal. Further details are given in Note 30 on page 74 of the Annual Report and Accounts. The Society extended the loan term on two commercial loans during 2015, for relatively short periods.

Credit risk capital for the Society's commercial lending under Pillar 1 is determined by reference to the Standardised methodology. Risk weights of 100% are applied to lending secured on commercial real estate and risk weights of 35% or 100%, depending on LTV, are applied to residential lending. Exposures to housing associations are risk weighted at 35% or 100% depending on LTV.

The following table provides an analysis of commercial lending exposure by industry sector at 31 December for the Group:

Commercial lending	2015 £m	2014 £m
Housing Associations	570.4	679.5
Serviced apartments (retail investors)	23.1	23.7
Loans secured on commercial real estate:		
Retail	88.7	119.1
Office	14.9	27.3
Industrial	21.4	29.0
Hotel/leisure	10.6	17.3
Other	0.5	0.2
	729.6	**896.1**

7.5 Geographical Distribution

The geographical distribution of all mortgage assets at 31 December 2015 is as follows:

Mortgages	Residential Mortgages £m	Housing Associations £m	Other Secured Lending £m	Commercial Real Estate £m	Serviced Apartments £m	Total Balances £m
UK	1,719.5	570.4	7.0	136.1	23.1	**2,456.1**
Jersey	8.5	-	-	-	-	**8.5**
Gibraltar	32.4	-	-	-	-	**32.4**
	1,760.4	**570.4**	**7.0**	**136.1**	**23.1**	**2,497.0**

The Group's Jersey and Gibraltar books are not material in size and considered to be of high credit quality.

The Group's geographic concentration across its residential lending and BTL lending is detailed below.

Geographical Book	Exposure
Cumbria	2.0%
North East	18.2%
East Anglia	1.8%
East Midlands	6.6%
Gibraltar	2.2%
Greater London	9.6%
Jersey	0.6%
North West	9.5%
Northern Ireland	0.4%
Scotland	8.6%
South East	16.0%
South West	6.4%
Wales	2.8%
West Midlands	6.2%
Yorkshire	9.1%

7.6 Residual Maturity of Exposures by Asset Class

The following table shows residual maturity of exposures on a contractual basis as opposed to an expected basis. Where a loan is repayable by instalment, each instalment has been treated as a separate repayment in the maturity analysis set out below. The Group's experience is that in many cases mortgages are redeemed before their scheduled maturity date. As a consequence, the maturity analysis illustrated below may not reflect actual experience.

Residual maturity of mortgage assets at 31 December 2015:

	On demand £m	< 12 months £m	1-5 years £m	> 5 years £m	Total £m
Mortgage Assets	6.2	121.1	280.3	2,089.4	**2,497.0**

7.7 Treasury Credit Risk

The Group has exposures to banks, building societies, sovereigns and asset backed securities in its non-trading book treasury portfolio. The Group does not operate a trading book. Exposures in the treasury portfolio are held for liquidity purposes or in the case of fair value exposures on derivatives, for hedging purposes. The Group's policy is to maintain overall high quality liquid assets in excess of regulatory requirements.

The Board's policy on managing credit risk relating to treasury exposures is set out in detail within the treasury policy. Credit limits are set for individual counterparties using external credit ratings which feed into the Society's assessment of the credit risk. Institutions, including building societies which do not have external ratings, are individually assessed based mainly on the strength of their capital ratios. Counterparties are approved by ALCO and Group Risk Committee. The Society also uses market information and Credit Default Swap spreads to inform treasury dealing decisions and keep up to date on treasury counterparty credit risk. Limits are also in place for instrument types and countries to mitigate against concentration risk arising in the treasury portfolio.

Where a counterparty is downgraded to a level below the acceptable rating then the counterparty and related limit is removed from the treasury dealing approved counterparty list. Where there are existing investments, the Treasurer will recommend to the Chief Executive and Finance Director whether they should be sold, if possible, or allowed to run to maturity with ALCO and GRC to be notified of the decision.

All limits are monitored against the sum of on and off-balance sheet exposures. The risk of a default from a derivative counterparty is minimised as all derivative exposures are covered by a Credit Support Annex (CSA) whereby, in the event of a positive mark-to-market valuation, the counterparty must post cash collateral to the Group. The Group similarly places cash collateral with its derivative counterparties in the event on a negative mark-to-market valuation. In the unlikely event of a downgrade to the Society credit rating there would be no impact to the cash collateral postings required at 31 December 2015 as the Group's exposures to and with counterparties are already primarily cash collateralised. Use of the LCH to facilitate the Group's derivative transactions through 2015 has continued to mitigate the credit risk associated with derivative transactions. Note 30 of the 2015 Annual Report and Accounts (pages 70 to 71) gives further details on fair value measurement and valuation of derivatives.

The Group uses external credit assessments provided by Standards & Poor's, Fitch, and Moody's. These are recognised by the PRA as eligible external credit assessment institutions (ECAI's) for the purpose of calculating credit risk requirements under the standardised approach. For all credit exposures that are assessed, the risk weight is dependent on the level of the assessment (i.e. the credit rating). An 8% capital requirement is then applied as per the standardised approach.

The PRA's mapping of ECAIs' credit assessments to credit quality steps for the purposes of the standardised approach to credit risk, as adopted by the Group, is as below.

Long-term mapping

						Institution (includes banks)			
							Credit assessment method		
Credit quality step	Fitch's s assessment	Moody's assessments	S&P's assessments	DBRS assessments	Corporate	Sovereign method	Maturity> three months	Maturity three months or less	Sovereign
1	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA to AAL	20%	20%	20%	20%	0%
2	A+ to A-	A1 to A3	A+ to A-	AH to AL	50%	50%	50%	20%	20%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBBH to BBBL	100%	100%	50%	20%	50%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BBH to BBL	100%	100%	100%	50%	100%
5	B+ to B-	B1 to B3	B+ to B-	BH to BL	150%	100%	100%	50%	100%
6	CCC+ and below	Caa1 and below	CCC+ and below	CCCH and below	150%	150%	150%	150%	150%

The Group's Treasury Risk department monitors forthcoming regulatory standards pertaining to CRD IV: Liquidity closely. The Group monitors actual and forecasts anticipated liquidity holdings over the planning horizon with cash-flow forecasts considered each month by ALCO. The CRD's liquidity coverage requirements, designed to ensure that financial institutions hold sufficient highly liquid assets on hand to weather short term liquidity disruptions, are monitored routinely by Treasury Risk. The Group holds sufficient liquid assets throughout its forecast horizon to remain compliant with the Basel Committee on Banking Supervision's Liquidity Coverage Ratio. At 31 December 2015 the Group held a Liquidity Coverage Ratio of 230%.This is in excess of the current minimum requirement of 80% set by regulators.

The Basel Committee on Banking Supervision published the final standard on the calculation of the Net Stable Funding Ratio in October 2014. The Net Stable Funding Ratio is defined as the amount of available stable funding relative to the amount of required stable funding. Expected to be implemented at a minimum of 100% from January 2018. The Group's Net Stable Funding Ratio at 31 December 2015 was 138%.

The table below shows the Group's credit risk exposures to Treasury counterparties at 31 December 2015.

Risk Weighting (credit quality step)	**S&P rating and Fitch IBCA**	**Moody's Rating**	**2015**	**2014**
			£m	**£m**
Central banks and Central Governments				
0%	AAA to AA-	Aaa to Aa3	231.6	304.7
			231.6	304.7
Cash collateral pledged to derivative counterparties				
0%	Cash collateral pledged to derivative counterparties only		192.2	199.2
			192.2	199.2
Multilateral Development Banks				
0%	AAA to AA-	Aaa	10.0	30.0
			10.0	30.0
Financial Institutions				
20%	AAA to AA-	Aaa to Aa3	-	-
50%	A+ to A-	A1 to A3	-	-
50%	BBB+ or lower	Baa1 or lower	-	-
50%	Unrated		-	-
			-	-
Asset Backed Securities				
20%	AAA to AA-	Aaa to Aa3	165.2	217.3
50%	A+ to A-	A1 to A3	-	-
50%	BBB+ or lower	Baa1 or lower	-	-
			165.2	217.3
Covered Bonds				
20%	AAA to AA-	Aaa to Aa3	122.8	54.7
50%	A+ to A-	A1 to A3	-	-
50%	BBB+ or lower	Baa1 or lower	-	-
			122.8	54.7
Other				
150%			1.1	1.5
			1.1	1.5
Cash in hand and equivalent cash items				
Cash in hand and equivalent cash items (0%)			4.2	9.0
			4.2	9.0

The Group calculates an 8% capital requirement based on the risk weighted assets for the above treasury assets. There is no material difference between the Group's exposures stated above and the Group's exposure prior to credit mitigation.

The geographical distribution of treasury exposures as at 31 December 2015 is set out in the table below. At 31 December 2015 the Society had no direct exposures to counterparties based in the Eurozone.

Treasury Exposures	2015 £m	2014 £m
UK	695.8	762.9
Multilateral development banks	10.0	30.0
Europe (excluding UK)	15.6	15.0
North America	5.7	6.4
Rest of the World	0.0	2.2
	727.1	816.4

The residual maturity of these treasury exposures at 31 December 2015 is as follows:

Treasury assets	< 12 months £m	1-5 years £m	5-10 years £m	Total £m
Central banks and Central Government*	181.2	-	50.4	**231.6**
Cash collateral pledged to derivative counterparties	192.2	-	-	**192.2**
Multilateral Development Banks	10.0	-	-	**10.0**
Other	1.1	-	-	**1.1**
Financial institutions	-	-	-	**-**
Residential Mortgage Backed Securities	24.6	140.6	-	**165.2**
Covered Bonds	21.0	90.1	11.7	**122.8**
Cash in hand and equivalent cash items	4.2	-	-	**4.2**
	434.3	**230.7**	**62.1**	**727.1**

*Includes UK Government Gilts at a fair value of £50.4m.

7.8 Impairment Provisions

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of assets is impaired. An asset is impaired where an event has occurred which indicates the Group does not expect to collect all the contractual cash flows due, or expects to collect them later than they are contractually due. Impairment loss is calculated as the difference between the assets' carrying value and the present value of the estimated cash flows from those assets.

Objective evidence can be defined as one or more events occurring after initial recognition of the asset, that have a bearing on estimated future cash flows of the financial asset or group of assets. Objective evidence may include indications that the borrower or group of borrowers are experiencing significant financial difficulty, default or delinquency in interest or principal repayments, failure of the tenant, and other indicators of potential breach or future default.

The Group first assesses whether objective evidence of impairment exists for financial assets. Assets that are separately significant are considered individually, and if there is no objective evidence of impairment, are grouped together with assets of similar credit risk characteristics and collectively assessed. Assets that are individually assessed for impairment, and for which an impairment loss is recognised, are not included in a collective assessment of impairment.

Residential and commercial loans are assessed individually for impairment and those not individually impaired are assessed collectively in the light of information available. Note 1 of The Annual Report and Accounts shows the accounting policy adopted for impaired assets.

The Group considers several factors when deciding if a commercial exposure is impaired including any missed payments, tenant failure, tenant voids and likelihood of re-letting and any other potential loan servicing issues arising from assessments or professional advice particularly where this provides evidence that a loan is or is unlikely to be fully serviced.

The credit quality of the Society's residential lending assets is excellent and they continue to perform, with 3 month arrears remaining well below Council of Mortgage Lenders reported averages. Impairment of the residential book is considered collectively for loans with 3 months or more arrears based on an estimation of loss given default and probability of default based on individual loan circumstances. All properties entering possession are provided specifically based on loan to value and anticipated disposal costs. A small collective provision arises from the Society's roll-rate to possession modelling for loans with low arrears, previous arrears or where forbearance has previously been granted.

7.9 Past Due and Impaired Loans

Past due is defined as loans where the borrowers' contracted payments have not been received by the due date. The amounts shown as past due represent the full amount of the loan outstanding, and not just the amount that is past due.

An analysis of loan portfolios, by past due and impaired status, is given below:

Prime residential mortgage book

The prime residential mortgage book consists of traditional residential loans to homeowners. No sub-prime or self-certification lending has ever been undertaken.

	2015	**2015**
	£m	**%**
Neither past due not impaired	1,648.5	99.0
Past due up to 3 months but not impaired	10.4	0.6
Impaired and past due 3 to 6 months	3.8	0.2
Impaired and past due over 6 months	2.3	0.1
In possession	0.3	0.1
	1,665.3	**100.0**

Retail BTL mortgage book

The Retail BTL mortgage book consists of buy-to-let individuals with balances < £1m (including legacy business – no new BTL lending is in arrears or possession).

	2015	**2015**
	£m	**%**
Neither past due nor impaired	21.1	97.4
Past due up to 3 months but not impaired	0.2	1.0
Impaired and past due over 6 months	0.3	1.1
In possession	0.1	0.5
	21.7	**100.0**

Specialist residential book

The Specialist residential mortgage book consists of portfolio investor buy-to-let (including loans > £1m) and residential investment loans.

	2015	**2015**
	£m	**%**
Neither past due nor impaired	61.9	86.1
Past due up to 3 months but not impaired	8.3	11.5
LPA receivership	1.7	2.4
	71.9	**100.0**

Commercial lending book

The commercial lending book comprises loans secured on commercial property and loans to Housing Associations. Loans secured on serviced apartments totalling £23.1m have been excluded from the table below as they reflect only small individual loans of a retail nature. Loans to Housing Associations totalling £570.4m have been excluded from the table below as no loans to Housing Association were past due or impaired at 31 December 2015.

	2015 £m	2015 %
Neither past due nor impaired	100.8	74.1
Not past due but impaired	24.5	18.0
Impaired and past due up to 3 months	3.3	2.4
Impaired LPA receivership	7.5	5.5
	136.1	**100.0**

Allowance for losses on loans and advances to customers

	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m
Balance at 1 January 2015	0.9	0.5	18.5	3.6	0.3	-	**19.7**	**4.1**
Charge / (credit) for the year	0.4	(0.3)	5.6	(1.1)	-	-	**6.0**	**(1.4)**
Utilised during the year	(0.6)	-	(9.4)	-	-	-	**(10.0)**	**-**
Interest suspended	-	-	0.5	(0.5)	-	-	**0.5**	**(0.5)**
At 31 December 2015	0.7	0.2	15.2	2.0	0.3	-	**16.2**	**2.2**

7.10 Credit Risk Mitigation

The Group's core credit risk mitigation is to perform a full assessment of the borrower's ability to service the mortgage and obtaining adequate security for the funds advanced.

Residential Mortgages

Residential property is the Group's main source of collateral and means of mitigating credit risk inherent in its residential mortgage portfolio. All mortgage lending activities are supported by an appropriate form of valuation from the Society's approved panel of valuers. All residential property must be insured to cover property risks and this may be done via a third party. Additional protection is also afforded to borrowers through optional income protection insurance. The Society has mortgage indemnity insurance in place for all new lending higher than 80% LTV.

Commercial Mortgages

Commercial property is the Group's main source of collateral and means of mitigating credit risk inherent in its commercial mortgage portfolio. Collateral for the majority of commercial loans comprises first legal charges over freehold and long leasehold property but guarantees and debentures may also be taken as security as well as cash on deposit. The Society will also seek assignment of rents from tenant covenants. Guarantees and other off-balance sheet security are not used in the calculation of Pillar 1 capital requirements therefore the exposure values before and after credit risk mitigation are identical. For property-based lending, supporting information such as professional valuations are an important tool to help determine the suitability of the security property and, in the case of investment lending, generating the cash to cover interest and repay the advance. All valuations are undertaken by Members of an approved panel of external valuers with specialist experience where required. The Society has an in-house team working on the wind down of the commercial portfolio and this team is supplemented by the comprehensive use of external valuers and property experts that provide options analysis. The Society will pursue recovery of all shortfalls incurred where this is identified as being feasible and appropriate. The Society also ensures that appropriate insurance is taken out to protect security properties.

8. Operational Risk

Operational risk is defined on page 7.

The Society calculates the Operational Risk Capital Requirement (ORCR), for Pillar I capital, under the standardised approach, as defined by the CRR. The ORCR is calculated by taking the Group's three year average net interest and other income, split across discrete business lines, and applying percentages representing the regulators' assumed risk inherent in these business lines.

The Basel Committee on Banking Supervision is currently reviewing the adequacy of the capital requirements framework, with draft proposals to replace the previous Basic Indicator and Standardised Approach to calculating operational risk capital requirements with a new 'revised standardised approach'. The Basel committee issued a second consultative document in December 2015 and the Society continues to monitor the proposals closely.

8.1 Capital Requirement

At 31 December 2015, the Group's ORCR equated to 12.2% of net income (12.2% in 2014). The Group's income has been split into 3 separate material business lines and the operational risk percentages as set out in Article 317 of the CRR applied to calculate the base ORCR.

The ORCR provides the base for assessing the capital required for operational risk. A full assessment of the risks facing the Society and Group has been completed for the purposes of Pillar 2 and add-ons identified where it is felt that the Pillar 1 capital requirement is insufficient. The Group seeks to mitigate operational risk by implementing a strong control environment and ensuring adequate insurance cover is in place across all known high risk areas. For further detail see section 4 of this document, 'Risk Management'.

9. Market Risk

9.1 Market Risk Overview

The principal market risk to which the Group is exposed is interest rate risk.

9.2 Interest Rate Risk in the Non-trading Book

Interest Rate Risk arises on mortgages, savings and treasury instruments due to timing differences on re-pricing of assets and liabilities and the imperfect matching on interest rates between different asset and liability types. This risk is managed using financial instruments including derivatives. Natural hedging strategies are also utilised e.g. matching two year fixed rate mortgages with two-year fixed rate bonds.

The Group's risk appetite for interest rate risk is documented in the treasury policy and includes limits for the maximum adverse impact on net interest margin, maximum value at risk, basis risk, as well as limits to minimise gaps in specific time buckets.

9.3 Use of Derivatives

Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate exchange contracts, commonly known as interest rate swaps, basis risk swaps, interest rate options and interest rate caps. The Group uses derivatives in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and, accordingly, they are used exclusively to reduce the risk of loss arising from changes in interest rates. Note 30 on pages 67 to 75 of the Annual Report and Accounts gives details of the derivative financial instruments held at 31 December 2015.

The Group's treasury policy sets out processes and controls in place to manage interest rate risk, including:

- Monthly discussion and agreement at ALCO of the Group's interest rate view;
- Day to day review of exposures and market outlook by both the Treasury and Balance Sheet Management team and fine-tuning of ALCO's view as appropriate;
- All new mortgage and savings ranges are reviewed by the Balance Sheet Management team to assess the impact on interest margin and determine appropriate hedging activity;
- Regular treasury strategy meetings to review hedging activity and assess the impact on sensitivity (both in terms of 200bp shock and margin impact for current year);
- Review of results of stress testing and resultant impact on annual profitability and overall value sensitivity;
- Review of basis risk under static and dynamic modelling scenarios; and
- Monthly review of interest rate risk exposures and hedging by the Balance Sheet Management team, to review actual outcomes against plans for the month and allow hedging proposals to be formed.

In assessing interest rate risk exposures relating to fixed-rate assets and liabilities it is necessary to make assessments of likely prepayment rates. The risk of prepayment assumptions being inaccurate is mitigated if too low, by additional unexpected early redemption charges, and if too high through additional interest income or funding. The Group uses interest rate gap sensitivity analysis to assess exposure to interest rate risk. This analysis shows the Group's exposure to interest rate risk in terms of the net risk after taking account of management action to hedge inherent exposures. The Group's Balance Sheet Management Department is responsible for reporting monthly the Group's interest rate risk exposure to ALCO.

The Group has established a risk appetite for sensitivity to a 200bp parallel shift in interest rates both in terms of impact on reserves and annual net interest income. These are as follows:

	Limit £m	Actual £m
+200bp shock – impact on net interest margin (annual guideline)	(5.0)	2.2
+200bp shock to gap sensitivity	(14.3)	(5.6)

Due to the low interest rate environment experienced over the last year, the rate shocks for interest rate reductions reported to ALCO are -10bp and -20bp. A hypothetical -200bp shock would decrease the Society margin by £2.2m over the next 12 months.

Details of the derivatives used to manage associated risks are given in the Risk Management Report in the Annual Report and Accounts and further details on the derivative financial instruments held at 31 December 2015 are given in Note 30 on pages 67 to 75 of the Annual Report and Accounts.

The Group has no material direct exposure to equity risk holding only a small portfolio of shares with a value of £0.4m at 31 December 2015. The Group has a small number of structured products which have an embedded derivative attached to them i.e. the return payable is derived from the performance of an underlying index. Under IAS 39 both the underlying product and the derivative are fair value accounted through the Income Statements. The fair value amounts are approximately equal and offsetting so there is no material charge or credit in the accounts. The Society is contractually required to pay only the par value of these shares on maturity, plus the relative performance of the index with the fair value of the Group’s equity exposure at 31 December 2015 being £1.9m.

10. Remuneration

10.1 Remuneration Committee

The Remuneration Committee has responsibility for ensuring compliance with the Regulators' Remuneration Code and for approving disclosures included in this report in relation to remuneration. Further details are available within the Remuneration Committee Report on pages 27 to 29 of the Annual Report and Accounts.

The Committee does not consult with the Society's Members on its Executive remuneration policy but takes into account feedback given by Members. The Committee has for a number of years invited Members to vote on the annual remuneration report and Members have always voted in favour. In 2014, the Society voluntarily elected to adopt some of the changes to remuneration reporting that apply to UK listed companies and one of the factors that the Committee took into consideration was the opportunity to give Members a chance to vote on the Society's remuneration policy. Members voted and gave their support (89.35% voted to approve the policy with 18,145 votes for, 2,163 against and 539 withheld) to the policy in April 2015 which took immediate effect. Similar approval was given to the Directors' Remuneration Report (89.85% approval with 18,297 votes for, 2066 against and 485 withheld). In accordance with the Code, the policy will be put forward for vote again in 2018.

10.2 Code Staff

Code Staff are currently defined as categories of staff including senior management, control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management, or whose professional activities have a material impact on the Group's risk profile. The table below shows the aggregate remuneration for Code Staff in relation to their services to the Society and Group:

	Typical Functions	Number of code staff	Fixed Remuneration £'000	Variable Remuneration £'000 (Note 1)	**Total 2015 £'000**	Total 2014 £'000
Executive Directors	CEO, Deputy CEO & Finance Director, Chief Operating Officer (see note 2), Strategy Planning & Risk Director	4	917	18	**935**	862
Other Executives	Sales & Marketing, Treasury, Information Technology, Operations, Human Resources, Commercial Services, Business Assurance	8	787	21	**808**	774
Control Functions	Compliance, Underwriting	2	117	3	**120**	116
Total		14	1,821	42	**1,863**	1,752

Note 1: Variable remuneration reflects participation in the Group's annual Corporate Bonus Scheme.

Note 2: The Society's Chief Operating Officer was appointed to the role of Chief Executive Officer on 1st May 2015. The Society's previous Chief Executive Officer received £181,000 in lieu of notice during 2015.

There were no amounts of deferred remuneration awarded, paid out or reduced through performance adjustments during the financial year. No sign on payments were made during the financial year.

10.3 Decision Making Process for Determining the Remuneration Policy

The Remuneration Committee considers and makes recommendations to the Board on Executive remuneration and conditions of employment, and also on the general framework of staff bonus schemes. The Committee met 3 times during 2015 and consists solely of Non-Executive directors; John Morris (Chairman), David Buffham and Karen Ingham (appointed 25 January 2016). Catherine Vine-Lott, the Committee's previous Chair retired 31 December 2015 and Richard Mayland retired 22 April 2015. The Committee is responsible for the Society's remuneration policy although, with the exception of Executive Directors, Executives and those designated as Code Staff, on a day to day basis the responsibility has been delegated to the Chief Executive for practical reasons.

The committee's terms of reference are available online at www.company-newcastle.co.uk/governance/

The Society's remuneration policy is designed to provide competitive remuneration packages that attract, retain and reward our senior team, to deliver business objectives in support of the Society's strategy whilst providing value for Members.

10.4 Design Structure of the Remuneration System

Basic Salaries

Remuneration packages are normally set at a level to attract, motivate and retain Executives, Officers and staff of the Society of the calibre necessary to oversee the operations of the Society. Basic salaries are normally set by taking into account salary levels within similar sized financial services organisations and the market as a whole, so as to attract and retain the skills levels that are appropriate to operate an organisation of the Society's complexity.

A 2.0% across the board pay increase was received by all staff in April 2015.

Executive Directors, Executives and other Code Staff receive salaries. Non-Executive directors are paid fees set at a level appropriate to reflect the skills and time required to oversee the Society's operations and progress. They receive a base fee and additional fees depending upon the Board Committees on which they sit or chair.

Benefits

All staff, including Executive Directors and Executives are eligible for membership of the Newcastle Building Society Group Personal Pension Scheme, which is a defined contribution scheme. All Code Staff receive a range of taxable benefits, which include a motor vehicle or cash equivalent, private health care and the ability to participate in a concessionary mortgage scheme. No Executive participated in the concessionary mortgage scheme during the year. Life cover for a lump sum on death in service is also provided of four times basic salary.

10.5 Link Between Pay and Performance

Performance Related Bonuses

In recognition of the continued progress and achievements of the Society's 2015 corporate key performance indicators (KPI's), the Remuneration Committee approved a modest payment of a maximum 3.0% under the Society's Corporate Bonus Scheme at the end of 2015. The payment was made to all staff. Determined against achievement of the current year's KPIs, there is no consequent deferral of the bonus payment or vested element. Variable remuneration is limited to discretionary participation in the Society's Corporate Bonus Scheme and none of the Society's staff or Non-Executive Directors hold any interest in Shares or Options relating to the Society or the Group's subsidiary companies. No formal approved ratio between fixed and variable remuneration is currently applicable to the Society's Code staff.

The KPI's underpinning the Corporate Bonus Scheme are based on the following:

- Financial performance covering profitability, capital, liquidity and credit risk;
- Focus on Members including achievement of service levels, customer satisfaction, and dealing with complaints;
- Achievement of staff engagement strategies and minimum employee satisfaction levels;
- Success of the Solutions business, including profitability; and
- Delivery of key projects and targets.

Progress against the corporate KPI's is formally reviewed by the Remuneration Committee at the end of the financial year with progress being monitored by the Board on a monthly basis.

Sales related incentive and bonus schemes were removed from the Society's business in January 2013, with the exception of those staff employed by the Society's subsidiary company Newcastle Financial Services Limited (NFSL). The bonus schemes which operate within NFSL are set in such a way as to ensure that they promote both good customer outcomes and the financial strength of the Group, do not reward failure and they do not encourage any employee to take risks out with the Society's agreed risk appetite. The Remuneration Committee has monitored the operation of these bonus schemes throughout 2015 to ensure compliance with the Code and the Society's remuneration policy statement.

For further information around the Group's management body including qualifications and experience, directorships held, recruitment and diversity policies, and committee representation, please refer to the 2015 Annual Report and Accounts available at http://www.company-newcastle.co.uk/.

11. Encumbrance

The European Banking Authority defines encumbrance to mean “pledging an asset or entering into any form of transaction to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.”

The Group makes use of interest rate swaps to mitigate its exposure to interest rate risk as detailed in section 9 of this Pillar 3 report. Against the Group’s derivative liabilities cash collateral is pledged to the underlying counterparties to reduce their exposure to the Group. Similarly, cash collateral is received by the Group against its derivative assets to reduce the Group’s exposure to counterparties. Offsetting collateral is pledged in line with underlying Credit Support Annexes with the Group’s financial counterparties. Cash collateral pledged is considered to be encumbered as it is no longer under the legal ownership or control of the Group. Collateral posted is measured against counterparty mark-to-market values and may not reflect the Society's internal valuation of its financial instruments.

The Group also makes use of repurchase agreements with banks in order to access funding. Non cash financial asset collateral, typically debt securities, is pledged to secure the funding with the assets pledged encumbered throughout the duration of the repurchase agreement in place.

There were no debt securities pledged as collateral under repurchase agreements with banks that were considered to be encumbered at 31 December 2015 (2014: £48.5m at fair value).

In the ordinary course of business, the Group may from time to time access market-wide facilities provided by central banks secured against non-cash collateral, including mortgage assets. Use of the facilities encumbers the assets pledged as collateral throughout the duration of the facility use.

To secure funding, the Group enters into legal agreements where cash and other financial assets are pledged as collateral to reduce counterparty exposure to the Group. Counterparties are assigned primary legal charge over the agreed collateral assets in the unlikely event of a default.

Note, with total assets of less than €30bn and an asset encumbrance level of less than 15%, the Group is not required to report the information in parts B, C or E of Annex XVI to the ‘implementing technical standards on asset encumbrance reporting under Article 100 of the Capital Requirements Regulation’.

The Group’s encumbrance position at 31 December 2015 is detailed as follows. All figures are presented in £millions and are as at 31 December 2015.

The following table is an extract of table F 32.01 – Assets of the reporting institution (AE-ASS):

		Carrying amount of encumbered assets		Carrying amount of non-encumbered assets		Fair value of non-encumbered assets	
			of which: central bank's eligible		of which: central bank's eligible		of which: central bank's eligible
		10	30	60	80	90	100
10	**Assets of the reporting institution**	341.2	145.9	3,104.30	475.2		
20	Loans on demand	3.1	-	176.4	-		
30	Equity instruments	-	-	-	-	-	-
40	Debt securities	-	-	347.2	320.9	347.2	320.9
50	of which: covered bonds	-	-	122.3	122.3	122.3	122.3
60	of which: asset-backed securities	-	-	164.3	148	164.3	148
70	of which: issued by general government	-	-	50.5	50.5	50.5	50.5
80	of which: issued by financial corps	-	-	10	-	10	-
90	of which: issued by non-financial corps	-	-	-	-	-	-
100	Loans and advances other than loans on demand	145.9	145.9	2,332.70	154.4		
110	of which: mortgage loans	145.9	145.9	2,332.70	154.4		
120	Other assets*	192.2	-	248	-		

Encumbrance % at 31 December 2015: 10%

*Derivative financial liabilities are a source of encumbrance with cash collateral pledged against these liabilities included as 'other assets' for the purpose of Pillar 3 reporting.

The other assets category includes deferred tax assets of £7.8m, plant, property and equipment of £23.4m, and prepayments and accrued income of £9.4m. None of these are deemed available for encumbrance in the normal course of business.

The following is an extract of table F 32.04- Sources of Encumbrance (AE-SOU):

		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		10	30
10	**Carrying amount of selected financial liabilities**	**75**	**338.1**
20	Derivatives		192.3
30	of which: Over-The-Counter		
40	Deposits	75	145.9
50	Repurchase agreements	75	145.9
60	of which: central banks	75	145.9
70	Collateralised deposits other than repurchase agreements		
80	of which: central banks		
90	Debt securities issued		
100	of which: covered bonds issued		
110	of which: asset-backed securities issued		
120	**Other sources of encumbrance**		**3.1**
130	Nominal of loan commitments received		
140	Nominal of financial guarantees received		
150	Fair value of securities borrowed with non-cash-collateral		
160	Other		3.1
170	**TOTAL SOURCES OF ENCUMBRANCE**	**75**	**341.2**

12. Basel III: leverage ratio and transition

12.1 Leverage ratio

An underlying feature of the financial crisis was the build-up of excessive on and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while maintaining strong risk-based capital ratios. At the height of the crisis, the market forced the banking sector to reduce its leverage in a manner that amplified downward pressure on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital, and shrinking credit availability.

The Basel III reforms introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk-based backstop measure.

The Basel Committee is of the view that:

- a simple leverage ratio framework is critical and complementary to the risk-based capital framework; and
- a credible leverage ratio is one that ensures broad and adequate capture of both on and off balance sheet leverage of banks.

12.2 Transition

Basel III came into force on 1 January 2014 alongside a number of transitional provisions.

The table below shows the 31 December 2015 capital position under Basel III reporting including the existing transitional position and the end point position. The impact of Basel III on the Society is mainly in relation to Permanent Interest Bearing Shares (PIBS) which move from tier 1 to tier 2 capital over a transitional period. The un-wind of the Society's subordinated debt under Basel III is similar to the position under Basel II. Other changes that have impacted the Society from 1 January 2014 include the deduction from Common Equity Tier 1 capital of deferred tax assets relating to trading losses, deductions in respect of intangible assets held on balance sheet, a different calculation of risk weights on equity release mortgage assets and inclusion of the available for sale reserve in capital.

The impact of Basel III has been reflected in the Group capital plans and the ICAAP.

Leverage ratio – Group (Point in time at 31 December)	2015 Transitional Basel III £m	2015 End point Basel III £m	2014 Transitional Basel III £m	2014 End point Basel III £m
Common Equity Tier 1 capital*	161.8	161.8	159.7	159.3
Additional Tier 1 capital	21.0	-	24.0	-
Total Tier 1 capital	182.8	161.8	183.7	159.3
Additional Tier 2 capital	39.6	32.3	49.6	34.1
Total capital	222.4	194.1	233.3	193.4
Total assets	3,247.4	3,247.4	3,518.0	3,518.0
Off balance sheet commitments	23.3	23.3	18.9	18.9
Potential future exposure (current exposure method, applying netting rules) – Derivatives	8.1	8.1	8.4	8.4
Derivatives - Market value adjustment	-	-	-	-
Total exposures	3,278.8	3,278.8	3,545.3	3,545.3
Leverage ratio (Tier 1/total exposures)	**5.6%**	**4.9%**	**5.2%**	**4.5%**
Capital ratios at 31 December				
Total RWAs	1,191.2	1,191.2	1,256.9	1,256.9
CET1 ratio	13.6%	13.6%	12.7%	12.7%
Tier 1 ratio	15.3%	13.6%	14.6%	12.7%
Solvency ratio	18.7%	16.3%	18.6%	15.4%

*Deferred tax assets in respect of trading losses are expected to be zero at the Basel III end point. Also profits in respect of future periods are not included in this figure – therefore the end point Basel III leverage ratio is expected to be higher than the figure disclosed above.

The above includes full amortisation of the subordinated debt over the Basel III transitional period but does not factor in accumulated Group profits over a similar period or other capital transactions that could be undertaken. It presents an end point Basel III position using the 31 December 2015 Group balance sheet only assuming no movement in reserves or other capital tier 1 and 2 items.

Total assets above reflect the group's total assets per the 2015 report and accounts excluding fair value adjustments for hedged risk and the fair value of derivative assets held on the balance sheet.

The Group's leverage ratio, calculated as the simple arithmetic mean of the monthly leverage ratio over a quarter, sits at 5.5% for the quarter to December 2015 under the Basel III transitional basis and at 4.9% under the fully loaded Basel III end point. The December 2015 leverage position is higher than the quarter to December average due to increasing tier 1 capital through the quarter as verified profits become eligible for capital inclusion against a broadly stable risk weighted assets base.

13. Capital instruments key features

	Disclosure template for main features of regulatory capital instruments	Permanent Interest Bearing Shares (PIBS)			Subordinated Debt	
1	Issuer	Newcastle Building Society	Newcastle Building Society	Newcastle Building Society	Newcastle Building Society	Newcastle Building Society
2	Unique identifier (e.g. CUSIP, ISIN, or Bloomberg identifier for private placement)	Private issue	GB0006361371	GB0006371529	Private issue	XS0178286901
3	Governing law(s) of the instrument	English	English	English	English	English
	Regulatory treatment					
4	Transitional Basel III rules (1)	Additional Tier 1 / Tier 2	Additional Tier 1 / Tier 2	Additional Tier 1 / Tier 2	Tier 2	Tier 2
5	Post-transitional Basel III rules (2)	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2
6	Eligible at solo/group/group & solo (3)	Group	Group	Group	Group	Group
7	Instrument type (types to be specified by each jurisdiction)	PIBS	PIBS	PIBS	Subordinated Debt	Subordinated Debt
8	Amount recognised in regulatory capital (Currency in mil, as of most recent reporting date)	10.0	10.0	10.0	8.8	19.6
9	Par value of instrument	10.0	10.0	10.0	25.0	25.0
9a	Issue price		100.317%	100.446%		99.873%
10	Accounting classification	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
11	Original date of issuance	18-Dec-08	22-Jun-93	15-Sep-92	02-Oct-02	31-Oct-03
12	Perpetual or dated	Perpetual	Perpetual	Perpetual	Dated	Dated
13	Original maturity date (4)	No maturity	No maturity	No maturity	02-Oct-17	23-Dec-19
14	Issuer call subject to prior supervisory approval	Yes	No	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	Issuer call date 18 December 2018 (par)	No issuer call	No issuer call	Issuer call date 02 October 2012 (par)	Issuer call date 23 December 2014 (par)
16	Subsequent call dates, if applicable	On each subsequent interest payment date (30 June or 31 December)	n/a	n/a	On each subsequent interest payment date (2nd April or 2nd October)	n/a
	Coupons/dividends					
17	Fixed or floating dividend/coupon	Fixed	Fixed	Fixed	Fixed	Fixed
18	Coupon rate and any related index	12.000%	10.750%	12.625%	7.190%	3.849%
19	Existence of a dividend stopper	Yes (5)	Yes (6)	Yes (6)	No	No
20	Fully discretionary, partially discretionary or mandatory	Partially discretionary	Partially discretionary	Partially discretionary	Mandatory	Mandatory
21	Existence of a step up or other incentive to redeem	Yes (7)	No	No	Yes (8)	Yes (8)
22	Noncumulative or cumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative
23	Convertible or non-convertible	Nonconvertible (9)	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible
24	If convertible, conversion trigger(s)	n/a	n/a	n/a	n/a	n/a
25	If convertible, fully or partially	n/a	n/a	n/a	n/a	n/a
26	If convertible, conversion rate	n/a	n/a	n/a	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	n/a	n/a	n/a	n/a

28	If convertible, specify instrument type convertible into	n/a	n/a	n/a	n/a	n/a
29	If convertible, specify issuer of instrument it converts into	n/a	n/a	n/a	n/a	n/a
30	Write-down feature	None contractual, statutory via bail-in	None contractual, statutory via bail-in	None contractual, statutory via bail-in	None contractual, statutory via bail-in	None contractual, statutory via bail-in
31	If write-down, write-down trigger(s)	n/a	n/a	n/a	n/a	n/a
32	If write-down, full or partial	n/a	n/a	n/a	n/a	n/a
33	If write-down, permanent or temporary	n/a	n/a	n/a	n/a	n/a
34	If temporary write-down, description of write-up mechanism	n/a	n/a	n/a	n/a	n/a
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Subordinated debt	Subordinated debt	Subordinated debt	Senior unsecured (10)	Senior unsecured (10)
36	Non-compliant transitioned features	Yes	No	No	Yes	Yes
37	If yes, specify non-compliant features	Step-up reset rate	n/a	n/a	Step-up reset rate	Step-up reset rate

(1)PIBS transition out of AT1 capital into T2 capital in line with the CRR's 'grandfathering' rules, falling fully to T2 capital instruments under fully implemented Basel III.

(2) The capital values of the Society's subordinated debt issues are amortising straight line to nil over their remaining 5 years to maturity/call date.

(3) The Newcastle Building Society accounting and regulatory groups are the same.

(4) The 2010 PIBS issue can be called by the Society on 18 December 2018 by giving 30 to 60 days' notice to the PIBS holders, subject to having gained regulatory consent in advance of sending the notices.

(5) Should the Board pass a resolution delaying or requiring a reduction in the interest payment on an interest payment date and the Society is unable to issue Payment PIBS or Payment Successor securities, the Society shall not pay interest or dividend on any other class of Deferred Shares of the Society, other than any Mandatory PIBS, for a period of 12 months following the passing of such resolution.

(6) Interest in respect of the PIBS shall not be paid or credited in respect of any interest period if the Society has at any time before the date for payment of the interest cancelled the payment of any interest or dividend upon any other shares of any class other than deferred shares, or any deposit (including subordinated debt) with the Society.

(7) Step up 18 December 2018.

(8) The Society's 2017 subordinated debt reached its step-up date in 2012 and the Society's 2019 subordinated debt reached its optional reset date in 2014.

(9) On 10 May 2010 the Society announced that a Capital Agreement (the Agreement) had been approved by holders of certain classes of the Society's existing subordinated debt and permanent interest bearing shares. The Agreement involved adding a conversion feature such that the relevant instruments would convert into profit participating deferred shares (PPDS) should the Society's core tier 1 capital ratio fall below 5%. In return for this feature an increase in coupon was agreed for each instrument. The Agreement further contained an upper trigger point for core tier I ratio whereby relevant instruments would cease to be convertible and the coupon uplift would fall away if the Society's ratio exceeded 12%. In August 2014 the Society announced that it had exceeded the 12% Ceiling Trigger set out in the Capital Agreement. In accordance with the Agreement the instruments are no longer convertible and the coupon uplift has been removed, in addition the remaining unamortised capital exchange costs totalling £0.5m have been written off.

(10) On a winding up, the subordinated notes rank behind the claims against the Society of all depositors, creditors and investing Members (other than holders of deferred shares i.e. PIBS) of the Society**.**

Glossary of Terms

Basel III – The third of the Basel Accords, issued by the Basel Committee on Banking Supervision, which are a long term package of changes that will strengthen regulatory standards for capital and liquidity. The standards started to be phased in from 1 January 2014. Basel III became law in the EU Capital Requirements Directive, and was implemented in the UK via the PRA / FCA Handbooks.

Common Equity Tier 1 Capital – Defined by the PRA as general reserves or qualifying capital instruments which for the Society is the accumulation of retained profits at 31 December 2015. Deferred taxation is deducted from the retained profits to calculate the final Common Equity Tier 1 Capital position.

Counterparty Credit Risk – this is the risk that a counterparty to a transaction could default before final settlement of the transaction.

Credit Risk - The risk that a customer or counterparty is unable to honour their repayment obligations as they fall due.

CRR – Capital Resources Requirement, this is the minimum amount of capital resources that a financial institution must hold as set out in Basel III Pillar 1 rules.

ICAAP – Internal Capital Adequacy Assessment Process. The Group's own assessment of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.

ICG – Individual Capital Guidance, guidance from the PRA on the minimum level of capital that must be held.

Impaired loans – Loans where an event has occurred which indicates the Group does not expect to collect all the contractual cash flows due, or expects to collect them later than they are contractually due.

Interest Rate Risk – this is the exposure to adverse movements in interest rates.

Material – The CRR considers information in disclosures shall be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

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

Past due – Loans on which payments are overdue including those on which partial payments are being made.

PIBS – Permanent Interest Bearing Shares, these are unsecured, deferred shares that are a form of Tier 1 and Tier 2 capital at 31 December 2015. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing Members of the Newcastle Building Society.

Pillar 1 – Pillar 1 of the Basel III framework addresses the total minimum capital requirements for Credit, Market and Operational Risks.

Pillar 2 – This is the part of the Basel III framework which sets out the process by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks, including Pillar 1 risks. The ICG is an outcome from Pillar 2.

Pillar 3 – This is the part of the Basel III framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. This report is the outcome of the Pillar 3 process.

Risk Weighted Assets (RWA) – The value of assets, after adjustment, under Basel III rules to reflect the degree of risk they represent. The Society measures RWA using the standardised approach.

Standardised Approach – the basic method used to calculate credit risk capital requirements under Basel III. For Credit risk, the risk weights used in the calculation are based on the underlying risk and are determined by supervisory parameters. For operational risk, an average of three year historical net income is multiplied by a factor of 12-18%, depending on the underlying business being considered.

Stress Testing – various techniques used to gauge the potential vulnerability to exceptional but plausible events.

Subordinated debt – A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing Members (other than holders of PIBS).

Supranational financial institution – a supranational financial institution is formed and capitalised by two or more central governments to promote economic development for specified member countries.

Tier 1 Capital – Tier 1 capital is divided into Common Equity Tier 1 and Additional Tier 1 capital. Common Equity Tier 1 capital is defined above. Additional Tier 1 capital includes qualifying instruments such as PIBS.

Tier 2 Capital – comprises the Group's qualifying subordinated debt and collective impairment allowance (for exposures treated on a Basel III standardised basis).

Wrong way risk - Defined by the PRA as a situation where there is an adverse correlation between the counterparty's probability of default and the mark-to-market value of an underlying transaction. The Society has no material exposure to wrong way risk as at 31 December 2015.