Basel II Pillar 3 Disclosures
31 December 2011

April 2012

Index

	Page
1. Overview	**3**
2. Scope	**4**
3. Risk Management	**5**
4. Capital Resources	**14**
5. Capital Adequacy	**16**
6. Credit Risk Measurement, Mitigation and Reporting	**18**
7. Securitisation	**24**
8. Operational Risk	**24**
9. Market Risk	**25**
10. Remuneration	**27**

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1. Overview

1.1 Background

The European Union Capital Requirements Directive (CRD), commonly referred to as Basel II (named after the Basel Committee on Banking Supervision), was introduced on 1 January 2007. Implementation of the CRD in the UK was by way of rules introduced by the Financial Services Authority ("the FSA") in the FSA Handbook. Among them are disclosure requirements for banks and building societies operating under the revised capital adequacy framework which are known as Pillar 3 and are designed to promote market discipline by providing market participants with key information on a firm's risk exposures and risk management processes. The disclosure requirements aim to complement the minimum capital requirements described under Pillar 1 as well as the supervisory review process of Pillar 2.

1.2 Basis

This document has been prepared in accordance with the requirements of Basel II Pillar 3 disclosure requirements set out in BIPRU 11: Disclosure (Pillar 3) of the FSA Handbook.

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 2011 and based on the most recently published Annual Report and Accounts.

1.3 Frequency and Location

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.

1.4 Verification

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 are approved by the Society's Board.

2. Scope

The Basel II framework applies to Newcastle Building Society ("the Society") and its subsidiary undertakings (hereby known as the "Group").

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

- Kings Manor Properties Limited
- Newcastle Financial Services Limited
- Newcastle Mortgage Loans (Jersey) Limited
- Newcastle Portland House Limited
- Newcastle Strategic Solutions Limited
- Newton Facilities Management Limited

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

As part of the subsidiary rationalisation programme that commenced in 2010 various subsidiaries have been wound up including dormant companies, companies that no longer trade, Newton Facilities Computer Purchasing Limited and Newton Facilities Computer Leasing Limited (where the assets and liabilities have been transferred to the Society). Newcastle Building Society Covered Bonds LLP was wound up in 2011.

The Special Purpose Vehicle ("SPV") used for securitisation, (comprising the following quasi subsidiaries; Bamburgh Holdings Limited, Bamburgh Finance No. 1 PLC and Bamburgh Mortgage Trustees Limited) is in the process of being wound up following repayment of the commercial mortgage backed securities in Bamburgh Finance No. 1 PLC in February 2011. All assets and liabilities within these companies were transferred back to the Society's balance sheet in 2011.

For prudential and Pillar 3 reporting purposes, the Society solo consolidated Newcastle Mortgage Loans (Jersey) Limited. There are no current or foreseen legal impediments to the 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 16 of the Group's audited Annual Report and Accounts.

3. Risk Management

3.1 Background

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 primary 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 department and Group Risk Committee with supporting executive committees covering credit risk, market and liquidity risk, and operational risk (see further details in paragraph 3.3). The third line of defence is provided by Business Assurance 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 and the Society's risk profile. All new projects and initiatives require a full risk and capital requirements assessment to assess the adequacy of the return for the risk being taken and resultant capital required. The risk appetite statement is subject to annual review and approval by the Board and performance against the risk appetite statement is monitored on a quarterly basis.

3.2 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 sectors. 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 manual underwriting procedures to prudent policy criteria, including restrictions on loan to value and maximum income multiples/rental cover and affordability criteria. The Group does not undertake sub-prime or self-certification lending.

The level of Buy to Let (BTL) lending has been capped via the application of portfolio limits that reflect the risk appetite for this type of lending. The Group no longer undertakes commercial lending. The Commercial Risk Division continues to monitor the performance of the commercial, housing association 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 a Commercial Credit Committee and a Risk and Recovery Committee to oversee risk within the Commercial portfolio.

A specialist collections division operates which has a more targeted approach to collections and recovery for commercial and BTL portfolio borrowers, featuring a rapid response where difficulties are identified such as late payments, tenant failure, ratings downgrades and general negative market news. The Society has a Credit Risk Management Information department that monitors credit risk within the mortgage portfolio including stress testing.

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. 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 Middle Office in accordance with the Treasury Risk Policy. All treasury counterparty ratings, CDS spreads and market information are monitored real time within the treasury risk department and prompt action is taken where volatile market conditions require the tightening of criteria.

Liquidity Risk

Liquidity risk is the risk that the Group is 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 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 as and when they fall due. This is achieved by maintaining a prudent level of liquid assets and ensuring that funding and lending plans are always in balance.

The Society has continued to invest in liquidity of the highest quality and further details are provided on page 9 of the Annual Report and Accounts.

The Society has complied with the Individual Liquidity Guidance set by the FSA throughout 2011.

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.

The Group has a well established operational risk framework with a detailed Operational Risk Policy that sets out the framework for operational risk, including the measurement and management of risk, operational risk appetite, managing project risk, capital adequacy requirements, 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 used 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 regard to the key risks within the Group requiring greater mitigation. The key risks also dovetail in to stress testing and reverse stress testing scenarios, and production of the ICAAP and ILAA.

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 only a very moderate direct net exposure to equities through a small shareholding in Standard Life arising from the de-mutualisation of the insurance company in 2006. The Group has an indirect exposure to the performance of equities through its defined benefit pension scheme (which is now closed to future accrual).

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. The Society, whilst being a regional building society, has a geographic concentration within the North East of England of less than a quarter of its residential mortgage book.

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.

Pension Obligation Risk
Pension liability risk is the risk that the Society has to make good a shortfall between assets and liabilities in its defined benefit pension schemes in order to ensure that the schemes can meet their obligations for pension benefits due to current and former employees. The Group has a defined benefit scheme which is closed to new members and to future accrual. The possibility exists of an impact on Group profitability from increased longevity, increasing scheme liabilities due to higher inflation, a fall in asset values or returns, changes to discount factors used to value future pension liabilities or from changes in accounting rules or policy leading to the requirement for extra contributions. In 2009 the Society took actions to curtail the impact of increasing salary inflation by imposing a salary cap and in 2010 the defined benefit scheme was closed to future accrual.

Solutions Business Risk
The Society established the Strategic Solutions division in 1997, whereby the Society provides outsourced services, such as internet banking 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. A separate Solutions Board exists to oversee third party contract risks, financial performance and operational matters.

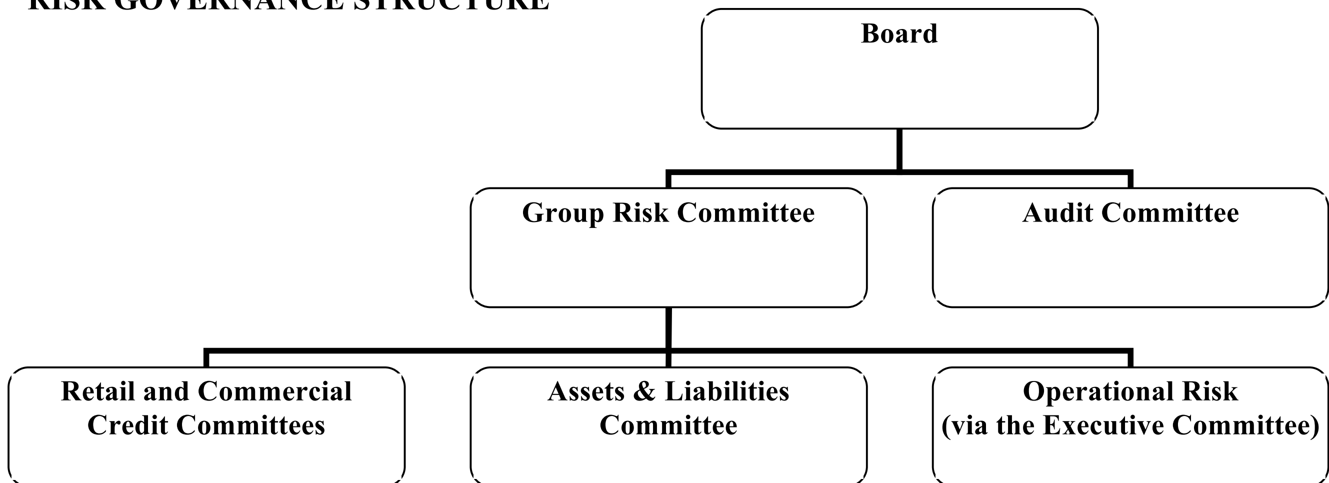
The Prepaid Cards Division of the Solutions business was sold in December 2011. Further details are given in note 10 on page 40 of the Annual Report and Accounts.

3.3 Risk Governance

The Society has a well developed risk and compliance structure with the credit risk, treasury risk and operational risk departments supported by separate compliance, 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



The Group Risk Committee is a Board Committee that has responsibility, under its detailed terms of reference, for considering and co-ordinating the approach to risk management across the group in the following key areas:

- Oversight of the risk appetite, risk management strategy and framework;
- Oversight of compliance with risk policy statements and approval of changes to those policies on an annual basis, or more frequently where market conditions require;
- Oversight of the Retail & Commercial Credit Committees;
- Oversight of Operational Risk and the governance of Operational Risk by the Executive;
- Oversight of the Assets & Liabilities Committee;
- Review and assessment of the adequacy of risk management information to monitor and control risks;
- Approval of new initiatives and projects, including risks to which the Group is exposed and the amount of capital required to cover those risks;
- 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 the Individual Liquidity Adequacy Assessment Process;
- Approval and recommendation to the Board of the Internal Capital Adequacy Assessment Process; and
- Consideration and approval of stress testing scenarios including reverse stress tests.

The Group Risk Committee meets six times a year and 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 mortgage portfolio as follows:

- Review of lending policy statements and compliance therewith;
- Review of risk metrics and management information for all areas of the mortgage portfolio;
- Review and approval of arrears and possessions policy (including breach policies) and monitoring compliance therewith;
- Monitor compliance with controls and limits set out in the lending policy statements;
- Sanction of larger loans in accordance with the lending policy statement and limits set on higher value loans;
- 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;
- Performance review of underwriters, panel managers and brokers;
- Review of credit risk profile of existing 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, inflation and confidence indices;
- Review of credit control activity levels including customer contact volumes, disturbed payment patterns and changes in behavioural 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 the credit risk profile of the 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 issues;
- Approval of annual reviews, breach reports and loan restructures in accordance with the delegation of authorities;
- Review and approval of stress testing assumptions and outputs including monitoring of trends;
- Review of key trends in commercial property markets including values, yields, and levels of activity; and
- Approval of changes to the Risk Grade Scorecard and monitoring of the effectiveness thereof.

The Assets and Liabilities Committee is responsible for all aspects of treasury risk management including liquidity risk, market risk, treasury counterparty credit risk, balance sheet management and product pricing. The ALCO terms of reference covers the following areas:

- Review of Treasury Policy Statement and compliance therewith;
- Review of treasury dealing strategy and compliance with risk appetite statement;
- Management of balance sheet assets and liabilities;

- Review of risk dashboards covering all aspects of treasury, liquidity, funding and interest rate risk;
- Setting of interest rate view;
- 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 cashflow requirements across the business on a rolling 24 month basis;
- Monitoring of interest rate risk and hedging activity, including profit performance;
- Review of treasury counterparty limits and country limits including assessing the impact of ratings downgrades;
- Review of funding including sources, mix and compliance with limits;
- Review of liquidity requirements and compliance with limits;
- Review and approval of results of liquidity stress testing scenarios; and
- Review and approval of product pricing including rate changes, mix of new business and maturity defence strategy.

Operational Risk is overseen by the Executive Committee which comprises the Executive Directors and other officers as listed on page 70 of the Annual Report and Accounts. 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 events trends across the business, actions being taken on significant risk events, and status of project risks;
- Review of compliance risk indicators, via monthly dashboards, including in relation to Mortgage Conduct of Business (MCOB), Treating Customers Fairly (TCF), Complaints, Information Security and Fraud Risk Policy compliance;
- 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 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 excluded. This forms the basis for various limits and key criteria, set out in the 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 and the Society's risk profile.

3.4 Other Governance

Full details of the Society's corporate governance arrangements are given on pages 16 to 19 of the Annual Report and Accounts.

The Board

The Board is responsible for agreeing the overall strategy for the Society, 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 approving 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.

In addition to the Group Risk Committee the Board has four other Committees which are noted below.

Remuneration Committee
This Committee considers and makes recommendations on Executive Director and Executive emoluments and contracts of employment as well as on the level of Non-Executive Directors' fees. The Committee's report is included on pages 20 and 21 of the Annual Report and Accounts. In addition, section 10 of this report sets out the remuneration disclosures as required under BIPRU 11.5.18.

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.

Newcastle Strategic Solutions Committee ("NSSL")
NSSL oversees all aspects of the Solutions business including risks, financial performance and operational matters. In addition it sanctions new third party contracts after considering the relevant financial model, contract obligations and full project risk assessment.

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

Financial Reporting

- to review the accounting policies, to monitor 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, and reviewing significant financial reporting judgements contained therein. This includes ensuring the reports present a balanced and clear assessment of the Society's financial position and outlook.

Internal Control and Risk Management

- to review the 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 fulfils its responsibilities by reviewing reports prepared by the business and Group Risk, Internal Audit and External Audit on a regular basis; and
- to review the Society's procedures for detecting fraud and irregularities and to ensure that arrangements are in place by which staff may in confidence, raise concerns about possible improprieties in matters, and to ensure that arrangements are in place for independent investigation and appropriate follow up action.

Internal Audit

- to monitor the effectiveness of the Group's internal audit function, its independence and objectivity. On a regular basis, the Head of Internal Audit has meetings with members of the Audit Committee only.

External Audit

- to oversee the Group's relations with the external auditors, including appointment, removal, independence and remuneration. On an annual basis the Audit Committee meets with the External Auditors without management present.
- 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.

3.5 Risk Appetite

The Group is committed to remaining a financially strong, dynamic and independent mutual organisation that operates for the long-term benefit of its members. The Group's risk appetite has been developed with this focus.

The Board approved risk appetite statement considers profit and loss in a moderate stress scenario; capital adequacy in a severe stress; and the existence of "tail risks" – low likelihood, high impact risks. It also sets out limits in relation to liquidity, Solutions business, credit risk and operational risk. Policies, including credit risk policies, treasury policies and operational risk policies set more detailed limits to ensure that the Society complies with the Board approved risk appetite statement.

The risk appetite statement is subject to annual review and approval by the Board and performance against the risk appetite statement is monitored on a quarterly basis.

This manifests itself in detailed policies across the business, including;

- Tranche limits for new products;
- Geographic, product and large exposure limits;
- Lending limits for LTV and high income multiples;
- Maturity and gap limits;
- Hedging strategies;
- Limits on instrument use and counterparty exposures;
- Liquidity and funding limits;
- Interest rate risk limits in terms of balance sheet and net income impact;
- Operational risk policy; and
- Tax risk policy.

The Group acknowledges that the risk appetites across the business may change depending on the economic cycle and market conditions. The overall risk appetite in terms of capital and profit put at risk will remain the same but as an adverse cycle approaches the detailed risk appetites will be adapted to achieve the overall risk appetite objectives.

4. Capital Resources

Throughout the year the Society and Group complied with the capital requirements as notified by the FSA in its Individual Capital Guidance.

4.1 Total Capital Available

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

	Group £m 2011	Group £m 2010
Tier 1 capital		
Profit and loss account reserves	170.8	174.5
Permanent Interest Bearing Shares	29.6	29.6
Genpru 1.3.36(2)(b) Waiver	-	0.2
Total Tier 1 capital	**200.4**	**204.3**
Tier 2 capital		
Revaluation reserves	-	-
General/collective provisions	1.6	6.4
Fixed term subordinated debt	56.0	58.6
Total Tier 2 capital	**57.6**	**65.0**
Total Capital Available	**258.0**	**269.3**

The TCA of the Society on a solo consolidation basis is not materially different to that on a Group basis so only Group figures have been disclosed.

4.2 Tier 1 Capital

Tier 1 capital comprises profit and loss reserves being the accumulation of retained profits, and 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 29 of the Annual Report and Accounts.

For capital purposes unrealised gains/losses on available for sale debt securities and cash flow hedges are removed from reserves in accordance with Genpru 1.3.36 (2)(b).

4.3 Tier 2 Capital

Tier 2 capital comprises subordinated debt, reserves created on property revaluations (in this case the reserve is a small deficit of £11k) and collective provisions against the mortgage book.

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 debts are given in note 28 of the Annual Report and Accounts.

Under FSA Rules, qualifying subordinated notes cannot exceed 50% of the total of Tier 1 capital, and Tier 2 capital cannot exceed Tier 1 capital.

In December 2010 the Society purchased £1.4m of the 7.375% 2015 subordinated debts for £0.7m and subsequently cancelled the debt.

4.4 Capital Exchange

In May 2010, the Society announced that it had reached an agreement with holders of certain classes of the Society's existing subordinated debt and permanent interest bearing shares leading to a material strengthening of the Society's capital position (the "Capital Agreement").

As a result of the Capital Agreement, in addition to the £170.8 million of core tier 1 capital disclosed above at 31 December 2011, the Society also has £45 million of contingent core tier 1 capital. The Capital Agreement has therefore strengthened the Society's capital position, providing 2.6% of contingent core tier 1 capital in addition to the existing 10% core tier 1 capital ratio as at 31 December 2011. Further details are given in Note 28 of the Annual Report and Accounts.

4.5 Capital Impact of Basel III

The Basel Committee on Banking Supervision ("BCBS") issued its revised Basel III text in December 2010. This sets out reforms to the quantity and quality of regulatory capital in order to improve the resilience of the banking sector. The Basel III text will be implemented in Europe via the Capital Resources Requirement and Capital Requirements Directive. The latter will then be implemented in the UK by the Financial Services Authority via the issue of policy statements for inclusion in the FSA Handbook.

The likely impact of Basel 3 on the Society is that from 1 January 2013 PIBS and subordinated debt will be phased out from regulatory capital over 10 years. As the Society's subordinated debt is all due for repayment by 2019 the impact is to accelerate the un-wind of the subordinated debt from the Society's capital resources. There are other impacts including in relation to deduction of deferred tax assets from capital, additional capital requirements for counterparty credit risk on derivative instruments and inclusion of Available for Sale Reserves. The impact of these items on capital will be phased in accordance with transitional arrangements and indeed may have no impact at all depending on the rules finally adopted in the UK and the size of the items at the time of implementation.

In addition to the strengthened capital standards, the Basel III text requires firms to calculate a non-risk based leverage ratio and the BCBS is currently testing the ratio at a minimum Tier 1 level of 3% through to 2017.

5. Capital Adequacy

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

5.1 Internal Capital Adequacy Assessment Process ("ICAAP")

The Society and Group 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 three 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 interim ICAAP was approved by the Group Risk Committee in March 2012 in respect of the year ended 31 December 2011. These disclosures include extracts from the last approved ICAAP and are based on the final financial results of the Society and Group contained in the 2011 Annual Report and Accounts.

The ICAAP covers all material risks to determine the capital requirement over a three-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 Society and 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 FSA Handbook. The Society's ICAAP is subject to the Supervisory Review and Evaluation Process by the FSA.

5.2 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:

	2011		2010	
Group Pillar 1	**Risk Weighted Assets**	**Capital @ 8%**	Risk Weighted Assets	Capital @ 8%
	£m	**£m**	£m	£m
Mortgage Credit Risk	1,420.4	**113.6**	1,628.6	**130.3**
Liquidity Credit Risk	127.4	**10.2**	65.4	**5.2**
Other Assets	64.9	**5.2**	86.6	**6.9**
Hedging Instruments	36.3	**2.9**	52.0	**4.2**
Mortgage commitments	3.8	**0.3**	7.2	**0.6**
Total Credit Risk (standardised)	1,652.8	**132.2**	1,839.8	**147.2**
Operational Risk (standardised)	62.5	**5.0**	73.0	**5.8**
Total Pillar 1 CRR	1,715.3	**137.2**	1,912.8	**153.0**

Risk weighted assets and capital are analysed at 31 December by exposure class as defined in chapter 3 BIPRU of the FSA Handbook as follows:

Exposure Class	**Capital @ 8%**	
	2011 £m	2010 £m
Retail Exposures		
Residential Lending	76.0	83.6
Other secured lending	3.0	3.4
Past Due Items	1.9	2.3
Commercial Exposures		
Commercial Lending	32.7	41.0
Other Exposure Classes		
Deposits with central governments or central banks	0.0	0.0
Corporate	3.0	0.6
Financial Institutions	10.4	9.4
Other		
Fixed and other assets	5.2	6.9
Operational Risk (standardised)	5.0	5.8
Total Pillar 1 CRR	**137.2**	**153.0**

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 on the non-trading 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.

At 31 December 2011 the Group held excess capital over and above the Pillar 1 minimum regulatory requirement of £120.8m (2010: £116.3m).

The capital requirements of the Society on a solo consolidation basis are not materially different to that on a Group basis so only Group figures have been disclosed.

6 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.

6.1 Exposures

The gross credit risk exposure (based on the definitions for regulatory capital purposes, before credit risk mitigation) and the average for the year is summarised below:

Mortgage Assets	**Average to December 2011 £m**	**As at December 2011 £m**	**As at December 2010 £m**
Residential Mortgages	2,692.2	2,574.1	2,810.2
Other secured lending	33.9	28.1	39.7
Commercial Loans*	446.6	393.3	499.9
	3,172.7	**2,995.5**	**3,349.8**
Treasury:			
Deposits with central governments or central banks	460.4	362.8	558.1
Corporate	0.0	0.0	0.0
Institutions	674.0	834.6	513.3
	1,134.4	**1,197.4**	**1,071.4**
	4,307.1	**4,192.9**	**4,421.2**

*Commercial Loan balances in 2010 included securitised commercial assets. Further details are given in section 7 of these disclosures.

6.2 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 and also incorporate limits for concentration risk arising from, inter alia, larger loans, higher LTV and higher income multiple lending and geographical limits. These various limits combined with formal governance and policies reflect the Group's view and appetite for risk in the retail mortgage portfolio. The Group currently operates manual underwriting procedures and does not use auto accept rules although a residential scorecard has been developed and is in parallel run for deployment in 2012.

The key areas covered in lending policy are:

- Formal approval process;
- Types of property acceptable as security;
- Valuation requirements including use of approved valuers;
- Limits on minimum and maximum advances, LTV and income multiples;
- Exposure limits;
- Underwriting criteria;
- Restricted criteria for interest only mortgages;

- Separate limits for buy to let lending;
- Mandates and delegation of authorities;
- Consideration of affordability;
- 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 which comply with TCF principles.

In addition, all mortgage products are strictly controlled through ALCO approval and subject to minimum benchmarks for Return on Capital requirements where full account is taken of capital requirements at Pillar 1 and Pillar 2.

All limits and policies are reviewed annually by the Board and 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 Group does not offer and has never offered sub-prime or self certified mortgages. The predecessor Society, Universal, acquired mortgage books containing small amounts of sub-prime and self certification mortgage assets. However, less than £2m of such balances remain and they are currently redeeming at a rate of circa 20% per annum. They comprise only 0.1% of the overall loan portfolio and are therefore not separately analysed.

Credit risk under Pillar 1 is calculated using the Standardised methodology in line with BIPRU 3.4. 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.

6.3 Other Secured Lending

The Society has a small portfolio of loans secured on traded endowment policies which is reducing over time. The Society is not undertaking any new lending of this type and balances are falling by 20% - 25% per annum currently due to maturities and redemptions. Loss experience on the portfolio has been low since this area of business commenced in 2001. A separate lending policy statement covered this lending with the key criteria being lending restricted to 65% to 80% of policy surrender value, depending on the type of policy.

6.4 Commercial Credit Risk

Commercial lending activity is split between lending to private sector landlords, property investors and housing associations. An analysis of loans within the commercial lending book is given on page 66 of the Annual Report and Accounts. Following the securitisation being called at the first option in February 2011, all Group commercial loan exposures are held by the Society.

The Group has limits in place to restrict the maximum amount of commercial, BTL and RSL lending held as a proportion of the overall mortgage portfolio.

All commercial loans were underwritten individually in accordance with criteria set out in a Board approved commercial lending policy statement. A formal Credit Committee existed for the

sanctioning of new loans which comprised senior members of the Executive team and external commercial lending experts. All loans were assessed based on the strength of the borrower, tenant quality and location of the underlying property with a Risk Grade Score allocated based on the degree of risk within the loan. The entire portfolio is risk graded. Return on Capital Employed Benchmarks were utilised which incorporated the need for Pillar 1 and Pillar 2 capital including any additional requirement due to concentration risk.

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

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 property 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.

Commercial lending activity is split between lending to private sector landlords, property investors and housing associations. These loans are further diversified by industry type and the following table provides an analysis of commercial lending exposure by industry sector at 31 December for the Group:

	2011 £m	**2010 £m**
Housing Associations	858.8	869.8
Loans secured on commercial property:		
Retail	193.1	211.1
Office Industrial	58.3	68.3
Industrial	50.2	79.2
Hotel/leisure	74.9	92.2
Other	16.8	38.7
	1,252.1	**1,359.3**

6.5 Geographical Distribution

The geographical distribution of all mortgage assets at 31st December 2011 is as follows:

Mortgages	**Residential Mortgages £m**	**Other Secured Lending £m**	**Commercial Mortgages £m**	**Total Balances £m**
UK	2,505.6	28.1	393.3	2,927.0
Channel Islands (Jersey)	25.6		-	25.6
Other European Countries (Gibraltar)	42.9	-	-	42.9
Rest of the World	-	-	-	-
	2,574.1	**28.1**	**393.3**	**2,995.5**

6.6 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 exposures					
	On demand £m	**< 12 months £m**	**1-5 years £m**	**> 5 years £m**	**Total £m**
Mortgage Assets	17.1	246.2	358.8	2,373.4	**2,995.5**

6.7 Treasury Credit Risk

The Group has exposures to banks, building societies and sovereigns 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 a liquid asset buffer of high quality unencumbered assets in line with the Individual Liquidity Guidance set by the FSA.

The Board's policy on managing credit risk relating to treasury exposures is set out in detail within the Treasury Policy Statement. Credit limits are set for individual counterparties partly based on external credit ratings (Moody's, Fitch and Standard & Poors). Institutions, including building societies which do not have external ratings, are individually assessed and 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 down-rated to a level below the acceptable rating then the counterparty and related limit is removed from the treasury dealing approved counterparty list. If there is an existing investment a proposal must be taken to ALCO as to whether the investment should be sold or allowed to run to maturity. All limits are monitored against the sum of on and off-balance exposures. The risk of a default from a derivative counterparty is minimised as the majority of derivative exposures are covered by Credit Support Agreement's (CSA's) whereby, in the event of a positive mark-to-market valuation, the counterparty must post collateral to the Group.

The exposure value to the Counterparty is derived by adding the net market value of the contract (replacement cost) to the contract's potential credit exposure, which is derived by applying a multiple based on the contract's residual maturity to the notional value of the contract. The total exposure value on counterparty credit risk exposures at 31 December 2011 was:

Derivative Exposures

	£m
Total exposure excluding CSA deposits	63.1
CSA Netting	26.8
Total exposure	36.3

The Group uses external credit assessments provided by Standards & Poors, Fitch, and Moody's. These are recognised by the FSA as eligible external credit assessment institutions (ECAI) 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 table below shows the Group's credit risk exposures to Treasury counterparties.

Exposure by credit grading

Risk Weighting (credit quality step)	S&P rating and Fitch IBCA	Moody's Rating	31/12/11	31/12/10
			£m	£m
0% (1)	AAA	Aaa	551.3	777.7
20% (1)	AA+ to AA-	Aa1 to Aa3	460.3	122.0
50% (2)	A+ to A-	A1 to A3	126.9	117.4
100% (3)	BBB+ or lower	Baa1 or lower	20.1	19.9
50% (2)	unrated		9.1	3.2
Icelandic			29.7	31.2
			1,197.4	**1,071.4**
Concentration by sector				
Financial Institutions			965.7	1.038.1
Asset Backed Securities including Covered Bonds			231.7	33.3
			1,197.4	**1,071.4**

Treasury exposures less than BBB+ relate to short term investments with building societies.

The geographical distribution of treasury exposures set out in the table below. At 31 December the Society had no exposures to Portugal, Italy, Ireland or Greece. Investments with Spanish banks totalled £3m which matured in March 2012 and was repaid.

Treasury Exposures £m	31/12/11	31/12/10
UK	858.3	800.9
Europe (excluding UK)	286.2	232.3
North America	10.2	9.5
Rest of the World	42.7	28.7
	1,197.4	**1,071.4**

The residual maturity of these treasury exposures at 31 December 2011 is as follows:

Residual Maturity of Exposures by Asset Class

	< 12 months £m	1-5 years £m	5-10 years £m	> 10 years £m	Total £m
Treasury Assets					
Financial Institutions	623.0	239.0	103.7	0.0	965.7
Asset Backed Securities	12.6	120.1	99.0	0.0	231.7
	635.6	**359.1**	**202.7**	**0.0**	**1,197.4**

6.8 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. 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.

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 characteristic 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 lending are assessed individually for impairment and those not individually impaired are assessed collectively in the light of national or local economic conditions that correlate with defaults on assets in the group. Note 1 of The Annual Report and Accounts shows the accounting policy adopted for impaired assets.

6.9 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 prime residential, Buy to Let and commercial loans is shown in note 34 of the Annual Report and Accounts. The charge for impairments during the year to 31 December 2011, for the mortgage portfolio, is summarised in note 14 of the Annual Report and Accounts.

6.10 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 effected through a third party. Additional protection is also afforded to borrowers through optional payment protection insurance.

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 may also be taken as security. 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 valuers with specialist experience where required. The Society has in-house experts and a specialist debt recovery team dedicated to commercial loans which are supplemented by the comprehensive use of external valuers and property experts that provide options analysis. The Society ensures that appropriate insurance is taken out to protect security properties.

7. Securitisation

In 2002, the Society securitised a £210m portfolio of commercial mortgage assets via a Special Purpose Vehicle ("SPV") set up for this function. The notes were due for repayment in 2038, although as loans in the Bamburgh mortgage portfolio redeemed, the Class A note balances were reduced.

On 1 February 2011 the commercial mortgage backed securities in Bamburgh Finance No. 1 PLC were repaid on the first optional call date. The commercial mortgage assets held within the SPV structure were transferred back to the Society's balance sheet. This transaction had no impact on the capital requirements of the Group. Further details are given in note 25 on page 51 of the Annual Report and Accounts.

8. Operational Risk

Operational risk is defined on page 6.

8.1 Capital Requirement

The Group has adopted the standardised approach to operational risk under Pillar 1 which produces an overall operational risk capital requirement equating to 12.5% of net income at 31 December 2011 (12.5% in 2010). The Group's income has been split into 4 separate business lines and the operational risk percentage as set out in BIPRU 6.4.15 applied to calculate the base Operational Risk Capital Requirement ("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.

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 Statement 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 34 on pages 60 to 68 of the Annual Report and Accounts gives details of the derivative financial instruments held at 31 December 2011.

The Group's Treasury Policy Statement 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 to act as a basis for liquidity investment and hedging decisions for the coming month;
- Day to day review of exposures and market outlook by both the Treasury and Balance Sheet Risk teams and fine-tuning of ALCO's view as appropriate, with agreement from the Group Finance Director;
- All new mortgage and savings ranges are reviewed by the Balance Sheet Risk team to assess the impact on interest margin and determine appropriate hedging activity;
- Weekly 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; and
- Monthly review of interest rate risk exposures and hedging by the Balance Sheet Risk 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 mortgage assets it is necessary to make assessments of likely prepayment. 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. These effects broadly offset each other; although timing of cash flows differ (early repayment charges not received in year 1 will be offset by additional margin over several years).

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 net interest income. These are as follows:

	Limit	**Actual**
+200bp shock–impact on net interest margin (guideline)	-£5.0m	£0.1m
+200bp shock to gap sensitivity	-£17.3m	£5.7m

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 2011 are given in Note 34 on pages 60 to 68 of the Annual Report and Accounts.

10. Remuneration

10.1 Remuneration Committee

The remuneration committee has responsibility for ensuring compliance with the FSA remuneration code. Further details are available within the Remuneration Committee Report on pages 20 and 21 of the Annual Report and Accounts.

In compliance with the FSA Policy Statement PS10/21 'Implementing CRD3 requirements on the disclosure of remuneration', issued in December 2010, the following table outlines the remuneration paid to Code Staff for the year to 31 December 2011. The subsequent paragraphs provide further information on the Society's remuneration policies and governance.

10.2 Code Staff

Code Staff are currently defined as categories of staff including senior management, risk takers, control functions and any employee receiving total remuneration, that takes them into the same remuneration bracket as senior management and risk takers, 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 companies:

	Typical Functions	Number of code staff	Fixed Remuneration £'000 (note 1)	Variable Remuneration £'000 (note 2)	Total Remuneration £'000	Deferred variable Remuneration £'000 (note 3)
Executive directors	CEO Finance Director Operations Director Business Services Director	4	768	12	780	-
Executives	Sales & Marketing IT Operations Human Resources	7	712	15	727	-
Other Senior Management	Internal Audit Risk Management Compliance Underwriting	4	207	-	207	-

Note 1 – includes base salary and other cash payments in the year
Note 2 – comprises payment of costs as part of relocation agreements
Note 3 – there were no amounts of deferred remuneration awarded, paid out or reduced through performance adjustments during the financial year.

No sign on or severance 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 2011 and consists solely of non-executive directors; Catherine Vine-Lott, David Buffham and Richard Mayland. 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.

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.

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 only 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. Life cover for a lump sum on death in service is also provided.

10.5 Link Between Pay and Performance

Performance Related Bonuses

In the light of continuing difficult trading conditions, the payment of bonuses to Executive Directors, Executives and Code Staff has been suspended since 2007. However, in 2011 a small bonus of £200 was paid to all staff including the four Code Staff but excluding Executive Directors and Executives.

Sales related incentive bonus schemes have continued to be operated for most sales staff. Bonus schemes, when operated, are set in such a way as to ensure that they promote the financial strength of the Society, do not reward failure and that they do not encourage any officer of the Society to take risks outside of the Society's normal risk appetite.