Pillar 3 Disclosure Document

31 December 2010

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1. Introduction

The Capital Requirements Directive (CRD), commonly known as Basel 2, was introduced by the European Union in 2007 to govern the amount of capital that all banks and building societies must hold to protect their members and depositors. In the UK the directive has been implemented by our regulator, the Financial Services Authority (FSA).

City of Derry Building Society seeks to ensure that it holds sufficient capital even in an economic downturn to provide security for members' savings.

The CRD is made up of three "Pillars":

Pillar 1 Minimum capital requirements using a risk based capital calculation based primarily on credit risk and operational risk to determine the Capital Resources Requirement (CRR);

Pillar 2 An assessment by the Society to determine appropriate levels of capital to be held by the Society, comprising minimum level Pillar 1 capital and additional risk-based Pillar 2 capital. The Society has undertaken an Internal Capital Adequacy Assessment Process (ICAAP) to both assess and stress test the risks it faces and the ICAAP is reviewed by the FSA as part of its Supervisory Review and Evaluation Process (SREP).

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

This document will be updated annually using the Society's results as contained in the most recent Annual Report and Accounts. Figures used here are correct at 31st December 2010.

2. Risk Management Policies and Objectives

The Board is responsible for ensuring that an effective framework is in place to identify and manage the risks that the Society faces in the course of delivering its business objectives.

Credit Risk

Credit risk is the risk that a financial loss arises from the failure of a customer or counterparty to meet their contractual obligations. The Society is exposed to credit risk through its mortgage lending operations and liquidity management.

The Society has prudent lending policies that are consistent with the Board's risk appetite. All mortgage loan applications are approved by the Chief Executive and details of all approvals are reported to the Board. Day to day management of liquidity credit risk is carried out by the Chief Executive in accordance with the Board's Liquidity Policy and he reports to the Board on a monthly basis.

Liquidity Risk

Liquidity risk is the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due. The Board approved Liquidity Policy ensures day-to-day treasury activities are conducted within a prudent framework.

The Chief Executive reports monthly to the Board and provides sufficient management information that allows the Directors to assess that liquidity is being managed both prudently and in accordance with Board policies.

Liquidity stress tests are carried out each month to assess the extent to which the Society can cope with both sudden large outflows and sustained withdrawals over a 12 month time period. During 2010 the Society successfully implemented the FSA's new liquidity regime whereby a minimum amount of liquid funds must be held in a buffer of highly liquid qualifying securities.

Market Risk

Market risk is the risk of changes to the Society's financial position caused by market fluctuations in interest rates and prices. The potential effects of these risks are mitigated by the adoption of the Administered Approach to treasury management, which helps to negate the effects of interest rate mismatches. Nevertheless, various stress and scenario tests are examined in the ICAAP. The Chief Executive is responsible for the day-to-day management of interest rates and any changes to administered rates are subject to approval by the Board. Monthly reports provided to the Board allow the Directors to gauge the pricing of the Society's products and the effects on business objectives.

Business Risk

Business Risk is the risk arising from changes in the Society's business, including the risk that the firm may not be able to carry out its business plan and its desired strategy. In a narrow sense this is the risk of loss because a firm's income falls or is volatile relative to its fixed cost base. However, in a broader sense, it is exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks that might deflect a firm from its desired strategy and business plan.

Concentration Risk

Concentration Risk is the risk arising from over-exposures to individual mortgage borrowers, liquid asset counterparties or by geographical region. The Society manages exposures to borrowers and counterparties via Board-approved policies and sets limits that are regularly monitored. As a small building society that lends only in its local area, the Society's core mortgage lending activity is exposed to the Northern Ireland housing market.

To mitigate this risk lending policies are prudent and exposures are monitored over time by use of appropriate house price indices.

Operational Risk
Operational risk is the risk of loss arising from inadequate or failed internal processes and systems.

The Board and Chief Executive identify, assess, monitor and control operational risks, via a risk management framework including risk register and ICAAP, and the Chief Executive reports to the Board on a monthly basis.

Regulatory Risk
Regulatory risk is the risk of loss from failure to comply with statutory and regulatory requirements. The Society, as a provider of mortgage and savings products, is regulated by the Financial Services Authority (FSA). The FSA requires the Society to comply with various external laws, regulations and codes, including areas such as, documentation, systems and processes. Failure to comply with relevant regulations could lead to sanctions, fines or other actions from the FSA.

The Chief Executive reports to the Board each month a series of management information that allows the Board to assess the Society's compliance with regulatory and statutory requirements.

3. Capital Resources & Capital Adequacy Assessment

The Society's capital resources at 31st December 2010 amounted to £2,714,328, comprising Tier 1 general reserves (the Society's accumulated profits) of £2,615,420 and Tier 2 capital (general provisions) of £98,908.

City of Derry Building Society aims to hold adequate capital resources to safeguard the business and to allow it to achieve the business objectives set out in its Corporate Plan and, to do this, sufficient profit must be generated and retained to add to general reserves.

A rolling 5 Year Plan is maintained and updated each year to take account of changing market conditions, current and potential risks and the Board's risk appetite. The Society's capital position is set and monitored by the Board approved ICAAP with regard to the Society's risk assessment framework.

4. Measurement of Credit and Operational Risk Capital

Credit Risk
The Society has adopted the Standardised Approach to assess its credit risk capital weightings, under which the level of Pillar 1 capital required is calculated as follows:

Credit Risk Capital Requirement = Exposure Value x Risk Weighting x 8%

Operational Risk
For the calculation of Operational risk, the Society has adopted the Basic Indicator Approach, which is expressed as 15% of the Society's average net income over the last 3 years.

Minimum Capital Requirement – Pillar 1

Exposure Class	**Assets (£000s)**	**Risk Weighted Assets (£000s)**	**Pillar 1 Capital (£000s)**
Residential Mortgages	29,942	14,610	1,169
Commercial Mortgages	497	497	40
Liquid Assets	10,130	1,526	122
Fixed & Other Assets	454	399	32
Credit Risk	41,023	17,032	**1,363**
Operational Risk		608	**91**
Minimum Capital Requirement			**1,454**
City of Derry BS Capital Resources			**2,714**
Excess of Capital Resources over Minimum Capital Requirement			**1,260**

Counterparty Credit Risk
The Society adopts the FSA's Administered Approach to Treasury Management and almost all liquid assets are held at maturities not exceeding 3 months, thus minimizing interest rate mismatches. The Board's Liquidity Policy sets limits for holdings per counterparty and minimum credit ratings with a recognized credit agency.

5. Provisions

Mortgage provisioning is carried out on a case by case basis on all the Society's mortgage accounts, with particular emphasis on those accounts in arrears and on those that, according to the latest quarterly house price index, have balances that are either in excess of the calculated valuation or close to it.

To calculate the provision required for each impaired loan the Board will:

(a) Import mortgage account information such as name, address and balance outstanding for the entire mortgage book into the model;
(b) Update calculated valuations in accordance with the Nationwide Building Society's quarterly regional house price index for Northern Ireland;
(c) Select a sample of loans for an up to date assessment by the Society's valuers;
(d) If the valuation under step (c) is significantly lower than step (b), then any provisioning will take account of the lower figure;
(e) Apply an agreed provisioning framework that takes account of loan performance and loan to value ratio together with a Probability of Repossession factor, based on the Chief Executive's subjective assessment of the borrower's relationship with the Society, his commitment to keeping the property, the reasons for arrears and any mitigating factors.

6. Conclusion

This document is not intended to be a financial statement, but is given to provide background information on capital requirements and the Society's approach to risk management. It also provides asset information and capital calculations under Pillar 1.

Any queries regarding this document should be addressed to Colin Jeffrey (Chief Executive) at the Society's principal office, 43 Carlisle Road, Londonderry, BT48 6JJ.