Market Harborough Building Society

150 Years Strong

Annual Report and Accounts 2019

Contents

Chairman's Statement

2019 was dominated by political deadlock on Brexit which only appears to have been resolved by the result of the General Election in December 2019. Despite the uncertainty which impacted homebuyers and savers your Society had a strong 2019 with a record inflow of retail savings, growth in mortgages and satisfactory profits.

ECONOMY

The economic environment was subdued and base rate remained at 0.75% throughout 2019. Since the year end a base rate cut of 0.65% in response to the Coronavirus pandemic has been made and further stimulus is being considered by the government to reduce the impacts of what is likely to be a significant recessionary factor.

After a long period of slow wage growth there was an acceleration in 2019 which then slowed in Q4. Estimated annual growth in average weekly earnings for employees was 3.2% for total pay. In real terms (after adjusting for inflation), annual growth in total pay was around 1.5%. The UK's employment rate remained high in 2019 (76.2% in October), 0.4 percentage points higher than a year earlier. Despite reaching a new record high, the employment rate has been broadly unchanged over the last few quarters. In the same period, UK unemployment rate was estimated (by ONS) at 3.8%, 0.3 percentage points less than a year earlier but largely flat on the previous quarter.

The weak economy meant companies could not fully pass on higher costs to their customers, squeezing profit margins. For High Street retailers it was a particularly difficult year faced with the continued shift to online shopping, higher business rates and the rise in the National Living Wage. Inflation in 2019 had been running at 1.4% (12 month CPI at December 2019) but is forecast to fall back to 1.25% in the spring.

Growth in the economy was sluggish in 2019 with quarter four recording zero growth in gross domestic product (GDP). This brought GDP growth in the year to just 1.4%.

House prices were generally steady in 2019 and UK average house prices increased by 0.7% over the year to October 2019 (to £233,000), the lowest growth since September 2012. This average disguises some significant country variations and prices moved by only 0.5% in England against 3.3% in Wales. Over the same period the increases were 1.4% in Scotland and 4.0% in Northern Ireland. In England the lowest annual regional growth rate was in London (down 1.6%), followed by the North East (down 1.1%). Locally the East Midlands showed a 1.3% increase to October. More importantly the volume of residential purchase transactions remained at around 1.2m - its level since 2014.

BUSINESS RESULTS

The Society made a profit for the year of £3.3m before tax, which is a return to the level of profits in 2017, after a record year in 2018. Gross lending (mortgage sales) of £101m was the same as that achieved in 2018 (£101m) and mortgage growth was 3.2% compared to 5.5% in 2018. Mortgage redemptions were managed by an active programme of contacting those whose mortgage products matured to understand their current requirements. Most members chose to stay with the Society.

Against a market trend of compression of mortgage margins, the Society improved its mortgage interest rate on new business compared to 2018. This resulted from a continued focus on customers with more complex requirements who value our personal approach - not by sacrificing credit quality. These customers access the Society either directly or via partner mortgage brokers across the UK.

Our mortgage book remains high performing in terms of arrears and forbearance and no repossessions were made in 2019.

We value our saving members and in 2019 attracted record new savings money (£65m, compared to an increase of £15m in 2018). Branches remain an important arm of the business and we were pleased to welcome many new members in face to face account openings. Complementing this, our Online Service offered a quick, convenient way for many to become a saver with the Society. This service was enhanced in 2019 to significantly improve "pass through" rates making the process better for customers.

Long-standing savers will know that we carried out a comprehensive review of our product range during the year. This meant some products were combined into a new simpler range and we were pleased that members appear to like the result – both staying with us and, in many cases, increasing their holdings. Our notice accounts, which give extra returns over easy access, proved especially popular.

This inflow of retail funds was balanced by repaying £25m to the Funding for Lending Scheme (FLS) in December and a further £35m to the Term Funding Scheme (TFS) in January 2020. FLS is an optional Bank of England scheme (along with the later TFS) in which the Society participated. These repayments were part of planned refinancing and removed all scheme maturities in 2020.

Continued profitability has given the Society a strong capital position of 8.2% (Reserves/Total Assets). This strength gives resilience as well as allowing continued investment in service and infrastructure.

Chairman's Statement (continued)

YOUR SOCIETY

There were a number of changes to our Board in the year. Melanie Duke stepped down as a non-executive director after nine years. I want to thank Melanie for her expertise and great service to the Society. Michael Thomas assumed her former responsibilities as Vice Chair and Senior Independent Director. After a comprehensive recruitment campaign we welcomed three new non-executive directors: Lindsay Forster, Mike Bury and Justin Fox. Lindsay has a distinguished career in marketing, Mike is a very experienced financial services Director and Justin has considerable treasury expertise. This strengthening of the Board anticipates my own planned departure in 2020.

MHBS' success rests on a large number of people and I want to thank all our members - savers and borrowers - for their support in 2019. I also want to recognise the Society's loyal staff, business partners and suppliers for their contribution.

2020 will be the Society's 150th year and a challenging one but it is in excellent financial health, with a vigour for continued success in serving our members.

Nicholas Johnston

Chairman

26 March 2020

Chief Executive's Review

I am pleased to report that the Society delivered another strong year in 2019 with a clear focus on its members, communities and staff. It is solid financial results, built on meeting members' needs, which allow MHBS to continue to invest for the future to ensure its relevance as it enters its 150th year.

Despite a year dominated by economic and political uncertainty assets grew by 13% supported by very significant inflows of retail funding. Profits remained very satisfactory at £2.7m and adding to our already robust capital position.

Safety is central to what we do and I am pleased to report that no credit losses were realised in 2019 and made no repossessions as our lending strategy remained cautious and at conservative loan to value ratios.

MORTGAGES

Mortgage advances in 2019 were almost the same as the previous year at £101m (£101m 2018). Despite aggressive competition in the mortgage market the pay rate on new loans was in fact higher than the previous year. Credit quality in the mortgage book was maintained and at 31 December 2019 the number of loans that were more than 12 months of payments behind was 2 (2018: 2). The amount in arrears was £7k on accounts with total capital balances of £32k (2018:£7k, on accounts with capital balances of £35k). Once again no commercial, BTL or holiday let loans are in arrears and no repossessions were made in 2019 (2018:0). This level of credit performance compares well with industry and peer averages. We have realised no credit losses for over ten years now.

New mortgage lending is focused on helping both local first time buyers and making lower loan to value ("LTV") loans for those with more complex needs. This model is true to our roots of helping local buyers and taking a personalised approach to recognise that applicants are individuals. Overall MHBS mortgages have an average LTV of 48% and this conservatism gives protection in the event of a down turn in house prices.

As a building society we focus on the customer and see mortgages as a service where we can add value through identifying solutions. Many members come to us via brokers and in 2019 we added significantly to our reach through growing new relationships with carefully selected mortgage intermediaries. This important channel will be developed further in 2020 as we introduce a broker portal. This electronic interface will mean mortgage applications will become significantly paper free and more efficient whilst keeping the personal service reflected in our motto of "Traditional values in a changing world".

FUNDING

Over the years our savings range had become excessively complex. In 2019 we simplified it by reducing the number of products from over 200 to less than 25. As we also standardised our terms this gave a fairer, clearer choice to savers who continued to support us in 2019. A net inflow of £15m in 2018 was followed by a further £65m in 2019. These substantial receipts came from both long standing and new members of the society.

This inflow was achieved though attractively priced notice products and "member exclusive" bonds. New account openings were either made in branch or via our secure Online Service web page. We welcomed many existing members who chose to come in to discuss their holdings in face to face reviews. However Online Service proved very popular as it gives 24/7 automated account opening in minutes with payment functionality between MHBS accounts as well as your current account. All MHBS accounts are enabled to allow members to register for Online service.

As I have mentioned in previous years' Reviews, the Society chose to participate in the Bank of England's FLS (Funding for Lending Scheme) and the TFS (Term Funding Scheme). In 2019 we repaid £25m of FLS funding and a further £35m of TFS funding in January 2020 and now have no repayments due until 2021. This orderly refinancing is in line with our strategy for the management maturities and liquidity.

FINANCIAL STRENGTH

Our objectives as a mutual are to give value to our members and make profits to sustain this over the long run. Profits are a building society's only means to build the reserves which give resilience in the event of strains. We do not seek to maximise profits and MHBS' level of profits are healthy (£3.3m before tax) and consciously set at levels reflecting our strategy. This profit position has given MHBS a capital ratio of 8.2% (capital/total assets) giving both strength and optionality to develop the business.

OUR COMMUNITIES AND STAFF

The Society aims to take a positive role in our members' lives. In 2019 an initiative to help our vulnerable customers in their financial dealings was launched. This saw a wide-ranging training programme delivered to staff aimed at offering better protection to savers and borrowers who are especially susceptible to detriment, either long term or transiently.

Our branches also took an active role in promoting the "Take Five" campaign aimed at protecting customers from fraud.

Investing in our staff is an important pillar of the Society's values and a wide-ranging suite of leadership development ran throughout 2019. This programme for over twenty of the Society's leaders included technical as well as behavioural content designed to ensure the customer is "front and centre" as decisions are made and our people are developed.

Chief Executive's Review (continued)

OUR COMMUNITIES AND STAFF (Continued)

We are also supporting three members of staff on the Loughborough University Master's degree for Building Societies. This local degree course gives a business education over a three year duration tailored to the particular disciplines of a modern mutual.

We believe financial education is important and staff worked with schools locally through the WizeUp initiative where students receive practical advice on budgeting, savings and other life skills.

Our people again made a very significant contribution to our communities in the year. Staff gave a record 1,000 hours of time fundraising and volunteering for the member nominated Alzheimer's Society as well as LOROS, Cransley, Rainbows and Cancer Research. This work has benefits for all involved.

The Society directly donated £39k to its Charitable Foundation which supported many smaller local good causes and a further £16k to local hospices. It has now given over £200,000 to the local community since its creation twenty years ago.

MEMBERS

As a mutual business we look for ways to recognise our member owners. This focus is in three areas; listening to members, contributing to our communities and giving value through products and service.

As noted above, in 2019 the direction of our charitable giving was set by members and this consultation with the membership will be made again for 2020. Members can also express their views to directors through a dedicated email askthedirectors@mhbs.co.uk as well as in person at our annual general meeting.

The range of local partners offering exclusive discounts to our members was expanded in 2019 and this will continue in 2020. Members can now get discounts on furnishings, bikes, estate agency, spectacles and garden supplies.

Finally turning to products our notable receipts of funds in 2019 was substantially in member exclusive savings products. These provided attractive rates not available on general sale. Mortgage holders also qualify for member exclusive offers in both savings and mortgages.

OUTLOOK

Whilst some of the uncertainty around Brexit has now been removed, the outlook for the economy holds a number of risks, the most significant being COVID-19 (coronavirus). How these risks will impact our members and markets is uncertain. The Bank of England has cut Bank base rate from 0.75% to 0.10% in a response to the coronavirus outbreak and the prospect is for a prolonged period of low interest rates.

Whilst the High Street has had a challenging year in 2019, this is likely to worsen in the current climate. We remain committed to our branch presence which keeps us in the heart of our local communities. We enter 2020, our 150th year, with confidence in our business and people and have adopted the phrase "150 years strong" to reflect the combined strength of MHBS' finances and vision.

Mark Robinson

Chief Executive

26 March 2020

Corporate Governance Report

The Board is responsible for the governance of the Society on behalf of the members. The Board is committed to best practice in corporate governance. A new Corporate Governance Code was issued in 2018 by the Financial Reporting Council (FRC), which came into effect for all reporting periods starting on or after 1 January 2019. Although the Code does not directly apply to mutual organisations, the Group has regard to its principles as they apply to a building society. The full UK Corporate Governance Code can be found on the FRC's website www.frc.org.uk

BOARD LEADERSHIP AND COMPANY PURPOSE

As a mutual financial institution, the Society has maintained the core values of a building society, providing value-based products to enable Members' savings to fund home ownership. The Society's ethos is to place Members at the heart of strategic and tactical decision-making processes. Commitment to our Members is manifested in the culture of the Society which, in turn is underpinned by strong corporate governance. The Board of the Society believes in having a continuous focus on culture and values and ensures that the tone they set is reflected in the actions and behaviours of staff. Culture is monitored by the Board through the review of a culture dashboard which seeks to capture the Society's cultural aspirations, how the Society influences these cultural aspirations, how the Society measures its success in achieving these cultural aspirations and how the behaviours and beliefs of the Society underpin performance. The Society has also developed a behavioural toolkit for staff to embed the values of the Society in all staff behaviour.

The Board's role is to focus on strategic decisions within a framework of prudent and effective controls, which enable risk to be assessed and managed. The Board has a general duty to take decisions objectively in the interests of the Society and to ensure that the Society operates within its Rules and Memorandum, regulations and guidance issued by relevant regulatory authorities and all relevant legislation. In addition, it ensures that appropriate systems of control, human resources and risk management are in place to safeguard Members' interests. The Board normally meets six times a year and holds further meetings as and when required. The Board met on six occasions during 2019. At least once a year, the non-executive Directors meet without the executive Directors present. A schedule of retained powers and those delegated by the Board is maintained. The day to day running of the Society is delegated to members of the senior management team and management committees.

The Board has appointed a Senior Independent Director, Michael Thomas, whose role is to attend to any matters requiring to be dealt with independently from the Chair and Chief Executive.

The Board looks to identify and manage any conflicts of interest which may arise through a declarations of interest schedule which is maintained by the Head of Risk. Directors are required to seek the consent of the Board in advance of accepting any external directorship appointment. Should a conflict of interest arise a director will recuse himself/herself from the matter to be considered by the Board.

BOARD COMMITTEES

There are five Board Committees, covering the areas of Audit and Compliance, Risk, Assets and Liabilities, Nominations and Remuneration. The Terms of Reference for each of the Board Committees can be found on the Society's website; www.mhbs.co.uk.

Audit and Compliance Committee

The Audit and Compliance Committee meets at least four times a year and was chaired by Michael Thomas, its other members being Melanie Duke (until 30 September 2019), Zoe Shapiro, Andrew Merrick, Lindsay Forster (from 1 July 2019), Michael Bury (from 1 May 2019) and Justin Fox (from 1 May 2019). The Chair of the Board would not normally be a member of the Committee, however Nicholas Johnston joined the Committee on 1 June 2019 in order to provide continuity and support new members in a period of transition. Nicholas Johnston will stand down from the Committee at the AGM in April 2020. All members of the Committee have experience that is relevant to the role, with at least one member being required to have recent and relevant financial experience. All are, or were, non-executive directors.

The activities of the Audit and Compliance Committee are set out more fully in the Audit and Compliance Committee Report.

The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities. It deals with matters relating to internal and external audit, accounting policies and procedures, and compliance with regulatory requirements. For further information regarding the work of the Committee and how it discharged its responsibilities refer to the Audit and Compliance Committee Report.

Corporate Governance Report (continued)

BOARD COMMITTEES (Continued)

Risk Committee

The Committee meets at least four times each year. It is responsible for identifying and monitoring risks to the Society's strategy, operations and performance. Its key responsibilities are:

- Development and monitoring of the Risk Framework;
- Monitoring risks to the Society and agreeing the key risks;
- Monitoring Credit Risk in the lending book;
- Monitoring Operational including Cyber Risk and Conduct Risk; and
- Appraising stress tests.

The Committee was chaired by Zoe Shapiro; other members being Michael Thomas, Jonathan Fox, Andrew Merrick, Nicholas Johnston (from 1 June 2019), Lindsay Forster (from 1 July 2019), Michael Bury (from 1 May 2019) and Justin Fox (from 1 May 2019); all of whom are, or were, non-executive directors.

Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) meets at least four times each year and is responsible for the management and composition of the Society's balance sheet, monitoring the Society's exposure to interest rate variations and monitoring compliance with the Society's liquidity and funding, counterparty and IRRBB (interest rate risk in the banking book) management policies. It recommends, as appropriate, changes to these policies. Members are Andrew Merrick (Chair of the Committee from 1 April 2019), Melanie Duke (until 31 March 2019 and Chair until this date) Nicholas Fielden, Nicholas Johnston, Mark Robinson, Michelle Pledger, Michael Thomas, Justin Fox (from 1 May 2019) and Michael Bury (from 1 May 2019). All are directors of the Society, with the exception of Michelle Pledger and four of whom are non-executive directors.

Nominations Committee

The Committee is chaired by Nicholas Johnston, its other members being Michael Thomas and Zoe Shapiro (from 18 October 2019). The Committee meets not less than twice each year to review succession planning, and also, whenever a director vacancy is expected, to make recommendations for appointments to the Board. Board succession planning ensures that the correct mix of skills is represented on the Board and its Committees. The Board is mindful of the Walker Report on diversity, including gender, race and ethnicity. In 2016 the Board agreed a target of at least one third of the Board to be made up of the under-represented gender, whilst recruiting the best candidate for the role.

In sourcing suitable candidates for consideration, the Committee uses one or more of the following methods:

- Open advertising;
- The services of a search and selection agency; and
- Advertising to the Society's membership.

The appointment of directors is based on objective skills based criteria as well as the ability to meet the requirements of the PRA's approved person's regime and the assurance that candidates can commit the time required to fulfil the role effectively.

Further information about the Committee can be found in the Nominations Committee Report.

Remuneration Committee

The Committee meets at least three times each year and is responsible for determining the remuneration of the Chairman, executive directors and other senior managers, and for making recommendations to the Board on remuneration for staff and non-executive directors. It consists of no less than two non-executive directors: Jonathan Fox (Chair), Melanie Duke (until 30 September 2019), Justin Fox (from 28 November 2019) and Lindsay Forster (from 28 November 2019). There were no meetings or scheduled meetings between 30 September 2019 and 28 November 2019. The remuneration policies for executive and non-executive directors are set out in the Directors' Remuneration Report.

Corporate Governance Report (continued)

BOARD COMMITTEES (continued)

Attendance at Board and Committee meetings during the year was as follows:

Director	Board	Audit & Compliance	Risk	Assets & Liabilities	Nominations	Remuneration
Nicholas Johnston	5 (5)	4 (3)	2 (2)	2 (2)	4 (4)	-
Melanie Duke	4 (4)	4 (4)	1*	1 (1)	2 (2)	2 (2)
Nicholas Fielden	5 (5)	5*	4*	4 (4)	-	3*
Jonathan Fox	5 (5)	-	3 (4)	-	-	3 (3)
Andrew Merrick	5 (5)	5 (5)	3 (4)	3 (4)	-	-
Mark Robinson	5 (5)	5*	4*	4 (4)	3*	3*
Zoe Shapiro	4 (5)	5 (5)	4 (4)	2*	1 (1)	-
Michael Thomas	5 (5)	5 (5)	4 (4)	4 (4)	4 (4)	-
Lindsay Forster	3 (4)	1 (2)	1 (1)	1*		1 (1)
Michael Bury	4 (4)	3 (3)	2 (2)	3 (3)		
Justin Fox	4 (4)	3 (3)	2 (2)	3 (3)		1 (1)

( ) = number of meetings eligible to attend.

Attendance by invitation is marked with *

Proceedings of all Committees are formally minuted and minutes are subsequently considered by the full Board.

All of the Committees carried out self-evaluation exercises during the year, which were reviewed by the full Board. The Board also carried out its own self-evaluation.

DIVISION OF RESPONSIBILITIES

The offices of Chair and Chief Executive are distinct with the Chair responsible for leading the Board and the Chief Executive responsible for managing the Society's business within the strategic framework set by the Board. Nicholas Johnston is the Society's Chair and the post of Chief Executive is held by Mark Robinson. The 'Strengthening Accountability in Banking: a new regulatory framework for individuals' regime, effective from 7 March 2016, introduced a responsibilities framework where specific Senior Management Functions and Prescribed Responsibilities are allocated to individuals. The Board is content that the allocation of Senior Management Functions and Prescribed Responsibilities between the Directors and Senior Management is appropriate and meets the requirements of the regime.

The Chair sets the direction of the Board and promotes a culture of openness and debate by facilitating the effective contribution of non-executive Directors and maintaining constructive relations between executive and non-executive Directors. The Chair also ensures that the Directors receive accurate, timely and clear information. This information is provided by executive Directors and senior management, who are available to the Board to provide clarification and amplification where necessary.

The non-executive Directors are responsible for bringing independent judgement to the monitoring of performance and resources and for developing, scrutinising and providing effective challenge to the Board's discussions on strategic proposals, whilst supporting executive management. Their role requires an understanding of the risks in the business and the provision of leadership within a framework of prudent and effective risk management controls.

The Nominations Committee evaluates the ability of Directors to commit the time required for their role prior to appointment. The formal appraisal process carried out by the Chair each year also assesses whether Directors have demonstrated this ability during the year.

Throughout the year the Board determined that all the non-executive Directors remained independent. The Board is content that any conflicts of interest which may arise can be appropriately managed.

The non-executive Directors meet without the executives present on an annual basis.

Corporate Governance Report (continued)

DIVISION OF RESPONSIBILITIES (Continued)

The terms and conditions of appointment of non-executive Directors may be obtained by writing to the Society Secretary at the Society's Head Office.

All Directors have access to the advice of the Society Secretary and, if necessary, are able to take independent professional advice at the expense of the Society.

COMPOSITION, SUCCESSION AND EVALUATION

During the year the Board consisted of nine non-executive Directors and two executive Directors. The size and composition of the Board is kept under review to ensure an appropriate balance of skills and experience for the requirements of the business.

The Chair conducts a thorough review of all non-executive Directors to assess their independence and their contribution to the Board. He confirms that all non-executive Directors continue to be effective and independent in character and collectively bring to the Society a wide range of valuable expertise. In addition, all non-executive Directors are free of any relationships or circumstances that might materially interfere with the exercise of their judgement.

Following an assessment led by the Senior Independent Director, the Chair is also confirmed as being effective and independent in character and judgement. The assessment of independence takes account of the period of time that the Chair has served on the Board.

The Nominations Committee leads the process for Board appointments and makes recommendations to the Board. The Committee comprises the Chair, the Vice-Chair & Senior Independent Director and a further non-executive director. The Committee evaluates the plans for orderly succession aimed at ensuring an appropriate balance of skills, diversity and experience on the Board. In light of this evaluation, a description of the role and capabilities for a particular appointment is prepared. The Nominations Committee has a rigorous procedure for the appointment of new non-executive Directors to the Board. This procedure ensures appointments to the Board are based on merit and normally includes the use of independent recruitment consultants. Currently this role is fulfilled by Warren Partners which has no other connection with the Society.

The Society complies with the PRA and FCA (the Regulators) Strengthening Accountability in Banking Regime and all Directors are required to be either; registered with the Regulators as Approved Persons in order to fulfil their Senior Management Function(s) and Prescribed Responsibilities as Directors, or have been Notified to the Regulators as holding the position of non-executive Director. In addition all Directors must meet the tests of fitness and propriety laid down by the Regulator. They are also subject to election by Members at the Annual General Meeting following their appointment.

The Chair is appointed to the position annually by the Board from among the existing non-executive Directors. This practice is supported by the Regulators.

On appointment, the Society requires non-executive Directors to attend in-house induction training which includes sessions on Liquidity Risk, Capital Risk, Credit and Interest Rate Risk and Conduct Risk. There are also sessions on Finance and Key Resources. Additionally, new Directors are expected to attend relevant training provided by the Building Societies Association, which covers building society business, Directors' responsibilities and the regulatory environment. Presentations to the Board by senior management and external courses provide opportunities for non-executive Directors to update their skills and knowledge base. The Chair ensures that non-executive Directors continually update their skills and knowledge to fulfil their role on the Board and any Committees. Training and development needs are identified and individual Director performance and effectiveness evaluated as part of the annual appraisal of the Board. These needs are usually met by internal briefings and via attendance at industry seminars and conferences.

The Chair conducts assessments of all Directors individually, reviewing their performance, contribution and commitment to the role.

The Chair is able to confirm that the performance of all Board members continues to be effective and all members are committed to providing sufficient time for Board and Committee meetings and any other necessary duties.

Following a formal appraisal of the Chair led by the Senior Independent Director, the Board can confirm that the performance of Nicholas Johnston, as Chair, is effective and that he devotes sufficient time for Board and Committee meetings and any other necessary duties.

One of the independent non-executive directors is appointed as the Senior Independent Director, to provide a sounding board for the Chairman and to serve as an intermediary for the other directors as necessary.

Corporate Governance Report (continued)

COMPOSITION, SUCCESSION AND EVALUATION (continued)

The Board and each Committee reviewed its own effectiveness in 2019 by means of a self-assessment questionnaire. The results of the Board Committee assessments are in turn reviewed by the Board. The Board is mindful of the Code requirement for FTSE 350 companies to conduct an external evaluation every three years and whilst this requirement would not apply to the Society, the Board considers annually whether such an evaluation would be beneficial. As part of the internal audit service provided by Deloitte, their representative attends at least one Board meeting and one of each committee's meetings annually. Deloitte provide feedback on the performance of the Board and committees.

AUDIT, RISK AND INTERNAL CONTROL

The Statement of Directors' Responsibilities sets out the Board's responsibilities in relation to the preparation of the Society's Annual Accounts and a statement that the Society's business is a going concern is included in the Directors' Report. The Directors have evaluated the Society's performance and considered the outlook for the Society which are reported on in the Chief Executive's Review.

The Audit and Compliance Committee has advised the Board that, after due consideration and review, the Annual Report and Accounts are, in the opinion of the Committee, fair, balanced and understandable.

The responsibility for implementing, operating and monitoring systems of risk management and internal control has been delegated by the Board to senior management. The Audit and Compliance Committee and the Risk Committee, on behalf of the Board, are responsible for reviewing the adequacy of these processes. The system of internal control is designed to allow the Society to achieve its strategic objectives within a managed risk profile. However, no system of internal control can completely eradicate risk. As such, the internal control system can only provide reasonable and not absolute assurance against material misstatement or loss.

There is an established risk management framework which identifies, evaluates and manages significant risks faced by the Society. The Board has ultimate responsibility for ensuring the effectiveness of the Society's systems of risk management and internal control and, following robust assessments of the principal risks by the Risk Committee, it is satisfied that the Society's systems are effective and meet the requirements of the Code.

The membership of the Society's Audit and Compliance Committee comprises not less than three non-executive Directors. The Board is satisfied that at least one member of the Committee has recent and relevant financial experience and that the Committee as a whole has competence relevant to the sector within which the Society operates.

The Committee usually meets four times a year. In addition to non-executive Directors, the meetings are also attended by representatives from the Society's internal and external auditors, its two executive Directors and other members of senior management by invitation as appropriate. At least annually, external auditors meet with the Committee Chair and with the Committee in the absence of any executive Directors.

The Committee considers the adequacy of internal controls. It also reviews both internal and external audit reports, assesses the effectiveness of the internal and external auditors and agrees the annual internal audit plan. The Committee also has responsibility for ensuring effective whistleblowing arrangements are in place, which enables any concerns to be raised by employees in confidence.

Minutes of the Committee's meetings are distributed to all Board members and the Chair of the Committee reports to the Board at each regular meeting of the Board following a meeting of the Committee.

The Internal Audit function is outsourced to Deloitte LLP under specific terms of reference and provides independent and objective assurance that these processes are adequate and applied effectively. A copy of the Internal Audit Charter is available to members from the Society's Secretary upon request and from the Society's website www.mhbs.co.uk. The external auditors may provide non-audit services on a consultancy basis to the Society. The extent and cost of the work is reported to the Audit and Compliance Committee for approval in advance of any such engagement. The Revised Ethical Standard 2016 introduced restrictions around the provision of non-audit services, including tax services. The Society has ensured compliance with these regulations. The Society is of the opinion that auditor objectivity and independence is not challenged by provision of services allowable under the Revised Ethical Standard.

REMUNERATION

The remuneration policies for executive and non-executive Directors are set out in the Directors' Remuneration Report. These policies explain the Society's application of the Code Principles.

SUBSIDIARY COMPANY

The Society has one subsidiary company, Market Harborough Mortgages Ltd, which is managed by a separate Board of Directors comprising Nicholas Johnston (Chairman), Mark Robinson and Nicholas Fielden. The Company became dormant on 1 January 2016.

Corporate Governance Report (continued)

RELATIONS WITH MEMBERS

Dialogue with members

The Society's members are all customers of the Society. Engagement with customers is undertaken in various ways including social media, regular communications and mainstream media.

The Society is keen to find out its members' views so that it can continually improve. It provides them with a number of ways and opportunities to give their feedback. A dedicated email address (asktheboard@mhbs.co.uk) is promoted, inviting members to engage with the Board. Each enquiry receives a response and questions and answers are shared on the Society's website. The Society surveys a selection of its members on a regular basis through its customer satisfaction survey to provide input into the services and products it offers. The results of this feedback and other complaints or praise received are shared in Board meetings. Members of the Board visit branches and meet with members as part of their role. The Society also encourages its members to attend its annual general meeting where they are able to ask questions and voice their opinions.

Furthermore, each year as part of the AGM documentation, the Society produces a members' magazine called 'Your Society' which provides news about the Society as well as information on its products and services. In addition the Society also sends a copy of its summary financial statement which provides an abridged version of information contained within the Annual Report and Accounts.

The Board believes that the AGM and other communications with its members provides the opportunity for members to give feedback to the Society on any aspect of its activities.

CONSTRUCTIVE USE OF THE ANNUAL GENERAL MEETING

Each year notice of the annual general meeting is given to all members who are eligible to vote. Members are sent voting forms and are encouraged to vote online, by post, at a local branch or by person or proxy at the annual general meeting.

All postal and proxy votes are counted using independent scrutineers.

All members of the Board are present at the annual general meeting each year (unless, exceptionally, their absence is unavoidable) and the Chair of the Audit and Compliance, Nominations, Risk and Remuneration Committees are therefore available to answer questions.

The Notice of the annual general meeting and related papers are sent at least 21 days before the meeting in accordance with the Building Societies Act 1986.

RELATIONS WITH THE WORKFORCE

The Board engages with the Society's workforce through employee surveys and non-executive Director visits to Branches and Departments. A staff engagement committee has also been established to facilitate staff discussion, in the absence of management, on matters of importance to them and these may be escalated to the Society's Senior Management Committee for consideration. The Society's Senior Independent Director is also available for staff to raise matters that may need to be considered independently from the Chair or Chief Executive and to whom whistleblowing reports may be made in accordance with the Society's whistleblowing policy. The Society's Senior Independent Director formally meets with the staff engagement committee and reports back to the Board, or follows up issued raised in confidence, as appropriate. Further to feedback from these meetings, the Society's pension contributions were enhanced during 2019.

The Board believes that these mechanisms fulfil the spirit of the Code in relation to workforce engagement.

On behalf of the Board of Directors:

Nicholas Johnston

Chairman

26 March 2020

Nominations Committee Report

This report explains how the Society applies the principles of the UK Corporate Governance Code July 2018 (the Code) relating to the operation of the Nominations Committee. The report details how the Committee discharged its responsibilities in line with the provisions of the July 2018 version of the Financial Reporting Council's guidance on 'Composition, Succession and Evaluation'.

NOMINATIONS COMMITTEE

The Nominations Committee is responsible for making recommendations to the Board for the appointment of Directors, ensuring that plans are in place for orderly succession to both the Board and senior management positions, and overseeing the development of a diverse pipeline for succession.

The members of the Committee are: Nicholas Johnston (Chair), Melanie Duke (retired 30 September 2019), Michael Thomas and Zoe Shapiro (from 18 October 2019).

FREQUENCY

The Committee meets not less than twice each year to review succession planning and also, whenever a director vacancy is expected, to make recommendations for appointments to the Board. Board succession planning ensures that the correct mix of skills is represented on the Board and its Committees.

EQUALITY, DIVERSITY AND INCLUSION (DIVERSITY PIPELINE)

The Society continues to pursue a strategy of creating an inclusive environment where all colleagues can contribute and succeed. The Society's diversity and inclusion ambition is to foster an inclusive environment where everyone can contribute to the Society's success. The Board believes investing in this culture is fundamental in ensuring it achieves its objectives.

The Nominations Committee has reviewed the diversity of the Board, senior management and workforce, and has set targets in order to improve or maintain diversity in line with the expanded definition within the Code. The Board is also mindful of the Walker Report on diversity. The Nominations Committee has set targets for gender and ethnicity and monitors diversity of age, gender, disability, ethnicity and education & social background within the whole workforce.

In 2016 the Board agreed an ongoing target of at least one third of the Board to be made up of the under-represented gender, whilst recruiting the best candidate for the role. In order to ensure a gender diverse pipeline for senior management roles, diversity of direct reports to senior management is also monitored.

The Committee has reviewed the gender diversity of the Board, Senior Management and workforce and has implemented targets and or monitoring to improve all types of diversity, not just gender. In 2019 the Board agreed a target for the ethnicity of the whole workforce (including Board and senior management) to be at least representative of the local area; that being the most typical catchment area for recruitment. Should an under-representation be identified, the Nominations Committee considers which policies are to be put in place to increase diversity of that characteristic. These policies can include directions to recruitment agencies to seek certain diversity characteristics or diversity specified shortlisting.

GENDER DIVERSITY

31 December 2019	Male	Female	Total	% Female
Board of Directors	6	2	8	25%
Executive Management	3	3	6	50%
Executive Management Direct Reports	5	13	18	72%

31 December 2018	Male	Female	Total	% Female
Board of Directors	5	3	8	38%
Executive Management	3	3	6	50%
Executive Management Direct Reports	5	15	20	75%

Nominations Committee Report (continued)

ETHNIC DIVERSITY

Workforce	White British	Other Ethnicity	Total	% Other
31 December 2019	115	6	121	5%
31 January 2019	106	6	116	5%

Data collected on 31 January 2019 was the initial ethnicity data capture by the Society. In that survey, four members of the workforce chose not to disclose their ethnicity.

The most recent comparative data from the local community is from the 2011 Population Census. For Market Harborough, the census reported 3.7% of the population were from an ethnic minority.

SUCCESSION PLANNING

The Nominations Committee has reviewed the Board's succession plan, establishing the desired skills and experience for the overall composition of the Board. It regularly reviews the skills matrix for the Board identifying any existing or potential skill gaps. The Committee has ensured that there are plans in place for orderly succession for appointments to the Board and to Senior Management, so as to maintain an appropriate balance of skills and experience within the Society and on the Board, and to ensure progressive refreshing of the Board.

The Committee takes into account:

- Non-Executive Director succession timeline, including anticipated retirement dates
- Continued independence of each Non-Executive Director
- Impact of future changes on Board committee membership
- The Society's Equality and Diversity Policy and the importance of maintaining a diverse Board

All Directors are subject to re-election every two years. The Committee believes this provides members with the opportunity to refresh the Board in a timely manner without leaving the Society at risk of having no directors in place to lead the Society. The Committee keeps this policy under review. The Committee ensures that the Chair and all Non-Executive Directors do not remain in post beyond nine years from the date of their first election to the Board. Nick Johnston and Melanie Duke, both due to stand down at the 2019 AGM, agreed to stay on to provide stability to the Board during a period of recruitment to the Board, with new appointments being made during 2018 and 2019. Melanie Duke subsequently stood down on 30 September 2019 and Nick Johnston will stand down at the forthcoming AGM in 2020 when a new Chair will be elected. The Committee ensures that each Non-Executive Director is independent whilst serving as a Director.

The Committee ensures that there are regular evaluations of the performance of the Board, its Committees, the Chair and individual Directors. The outcomes of these evaluations and the identification of the strengths and weaknesses have supported the desirable attributes of a diverse pipeline of candidates. These are acted upon at each recruitment.

In sourcing suitable candidates for consideration, the Committee uses one or more of the following methods:

- Open advertising;
- The services of a search and selection agency; and
- Advertising to the Society's membership.

The appointment of directors is based on objective skills based criteria as well as the ability to meet the requirements of the PRA's approved person's regime and the assurance that candidates can commit the time required to fulfil the role effectively.

Nominations Committee Report (continued)

BOARD EVALUATION

The Committee ensures that there are regular evaluations of the performance of the Board, its Committees, the Chair and individual Directors. The Chair has acted on the results of the evaluations by recognising the strengths and addressing any weaknesses of the Board.

The Board considers annually whether to undertake an independent effectiveness review by a professional third party. No such review was carried out in 2019.

Each year the performance of the Board and its Committees is observed by Deloitte in its capacity as internal auditor to the Society. Deloitte comment on the performance in its Annual Conclusion provided under the Audit Charter. The Board considers this feedback and acts upon the comments made. In its latest report, received during 2019, Deloitte concluded that the Society's Board had an appropriate mix of skills and experience.

On behalf of the Board of Directors

Nicholas Johnston

Chair of Nominations Committee

26 March 2020

Audit and Compliance Committee Report

This report explains how the Society applies the principles of the UK Corporate Governance Code relating to the operation of the Audit and Compliance Committee and the system of internal control. The report details how the Committee discharged its responsibilities in line with the provisions of the Financial Reporting Council's 'Guidance on Audit and Compliance Committees'. In particular it details the significant issues reviewed and concluded on including the Committee's assessment of those areas on which accounting judgement was exercised. The Audit and Compliance Committee met five times during 2019 and in addition met with the external and internal auditors without the executive Directors present.

FINANCIAL AND BUSINESS REPORTING

The Code prescribes that the Board should present a fair, balanced and understandable assessment of the company's position and prospects.

The Directors are responsible for preparing the Annual Report and Accounts. At the request of the Board, the Committee considered whether the 2019 Report and Accounts are fair, balanced and understandable and whether it provided the necessary information for members and other stakeholders to assess the Society's position and performance, business model and strategy. In order to do this, the Committee considered the accounting policies adopted by the Society, the presentation and disclosure of financial information and, in particular, the key judgements made by management.

In evaluating this year's financial reporting process, the Committee noted that members of the Board are involved at an early stage in agreeing the overall tone and content of the Report and Accounts and that members of the Executive Committee and the Board review, comment on and challenge early drafts as part of a robust verification process.

The Committee also paid particular attention during the year to the following matters which are important by virtue of their potential impact on the Society's results, particularly because they involve a high level of complexity, judgement or estimation by management:

Current economic impacts

The Committee considered the risks to the Society's business and resources from Brexit and COVID-19 (coronavirus). Modelling of various economic downturns has been carried out to predict the potential impact on loan losses and provisioning. Operational impacts have also been considered such as the availability of skilled resource staff and the impact on suppliers with global connections. The Committee noted that the liability arising from the defined benefit retirement benefits would also be impacted due to the economic impact from Brexit and any subsequent fall in security values. It also noted such impact could be driven by the global pandemic caused by COVID-19 (coronavirus). The Society considered that it was well placed to cope with the potential risks arising from Brexit and coronavirus. More details can be found in the Principal risks and uncertainties on page 23.

Provisioning for loan impairment

The Committee monitored loan impairment provisions by considering key assumptions contained in the Society's provisioning model and the relevant disclosure in the Report and Accounts. In particular, the Committee examined and challenged the assumptions adopted and the impact of the low level of impairment data, and has satisfied itself with the level of impairment provisions made for the mortgage portfolio. Further information about these assumptions can be found in note 30 to the accounts.

IFRS 9 became effective from 1 January 2018. During 2019 the Committee continued to monitor the significant judgemental areas in light of best practice developments and the embedding of the new rules on a business as usual basis.

Effective Interest Rate

Interest income on the Society's mortgages is measured under the effective interest method. This method includes an estimation of mortgage product lives which is based on historic customer behaviour and management's judgement. The Committee has examined the approach taken including the revised mortgage product lives, and has satisfied itself that the estimates and accounting treatment are appropriate.

Retirement Benefit Liabilities

The Society operates one defined benefit pension scheme. This was closed to future accrual in 2005, however the Society remains responsible for making good the liabilities under the scheme. The scheme is revalued under the requirements of IAS 19 each year and the movements in the deficit are reflected in the Group's accounts. The current deficit is £0.6m (2018: £1.4m). The Committee has considered the valuation assumptions used by the Actuary and satisfied itself that these assumptions are appropriate.

Audit and Compliance Committee Report (continued)

EXTERNAL AUDIT

The Committee considered matters raised during the statutory external audit, through discussion with senior management of the business and the external auditor, and concluded that there were no adjustments required that were material to the financial statements.

In light of its enquiries above, the Committee is satisfied that, taken as a whole, the 2019 Annual Report and Accounts is fair, balanced and understandable and provides a clear and accurate presentation of the Society's position and prospects.

Audit and Compliance Committee and Auditor

The Code prescribes that the Board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the Society's auditors.

The Audit and Compliance Committee is responsible for providing oversight of the external audit process by monitoring the relationship with the external auditor, agreeing its remuneration and terms of engagement, and making recommendations to the Board on the appointment, re-appointment or removal of the external auditor as appropriate. As part of the external audit process, BDO LLP highlight any material control weaknesses that come to its attention. The Committee considers annually the external auditor's independence and effectiveness in light of the guidance issued by the by The Institute of Chartered Accountants in England & Wales (ICAEW) and the Financial Reporting Council (FRC).

The Committee is also responsible for monitoring the performance, objectivity and independence of the external auditor, ensuring that the policy to provide non-audit services is appropriately applied. No such services were provided during 2019. In order to retain independence and objectivity, the Society's policy is to tender for audit services on a regular basis. External audit was put out to tender in 2019. Presentations from three audit firms were received by a panel consisting of Executive and non-executive Directors. As a result of the tender, BDO LLP were recommended by the Audit and Compliance Committee and appointed by the Board. Further to consideration by the Committee, BDO LLP are recommended as external auditor to the Society at the 2020 annual general meeting. Internal audit was last put out to tender in October 2014, further to which Deloitte LLP was appointed internal auditor. The Committee considers annually whether to retender for internal audit services.

INTERNAL CONTROLS

The Society recognises the importance of good systems of internal control in the achievement of its objectives and the safeguarding of its assets. Good internal controls also facilitate the effectiveness and efficiency of operations, help to ensure the reliability of internal and external reporting and assist in compliance with applicable laws and regulations.

Management is responsible for designing an appropriate internal control framework whereas the Audit and Compliance Committee is responsible for ensuring that the Board receives appropriate assurance over the effective operation as well as design of this framework. Consistent with these responsibilities, the Committee undertook the following activities during 2019 to satisfy itself over the robustness of the internal control framework:

- Compliance

  The Society's Compliance function provides second line assurance on activities across the Society. The outputs of Compliance activities are reported to the Committee, together with progress updates on management's implementation of the findings. During the year the Committee approved the Compliance annual plan of work and it also approved an overarching Compliance Approach document setting out how the Compliance function remains independent of the areas it reviews.

- Internal Audit

  The Society's Internal Audit function provides independent assurance to the Board, via the Audit and Compliance Committee, on the effectiveness of the internal control framework. The information received and considered by the Committee during 2019 provided assurance that there were no material breaches of control and that the Society maintained an adequate internal control framework that met the principles of the UK Corporate Governance Code. The Audit and Compliance Committee is also responsible for agreeing the annual budget of Internal Audit and for approving its annual risk based plan of work. Internal Audit provides the Committee with reports on its findings and recommendations as well as updates on the progress made by management in addressing these findings, including verification that actions have been accurately reported as complete. The Committee is satisfied that, throughout 2019, Internal Audit had an appropriate level of resource to deliver its plan of work and that it discharged its responsibilities effectively.

Michael Thomas

Chair of the Audit and Compliance

Committee 26 March 2020

Remuneration Report

This report explains how the Society has applied the principles of the UK Corporate Governance Code July 2018 (the Code) relating to the operation of the Remuneration Committee in 2019. The report details how the Committee discharged its responsibilities in line with the provision of the July 2018 version of the Financial Reporting Council's 'Remuneration' principles.

This report sets out the Board's policy on the remuneration of Directors. The Society has adopted high standards of corporate governance and this includes the provision to its members of full details of Directors' remuneration. Members will be asked to vote at the Annual General Meeting on an advisory resolution on the Board's policy on the remuneration of Directors.

The Society had a successful year in 2019, delivering post-tax profits of £2.7m. In addition, the Society's strong capital position was preserved and good progress was made against strategic objectives. The Remuneration Committee has taken these factors into account when considering the appropriateness of remuneration at the Society.

REMUNERATION COMMITTEE

The Remuneration Committee is responsible for determining the remuneration of the Chair and the remuneration and other benefits of the Executive Directors and Senior Managers, and makes recommendations to the Board concerning the remuneration of Non-Executive Directors and other staff. The Committee has reviewed workforce remuneration and the alignment of incentives and rewards with culture, taking these into account when setting the policy for Executive Director remuneration.

The Committee's terms of reference were last reviewed and updated in March 2019 and they are available on the Society's website. The Committee meets at least twice each year.

The Committee consists of no less than two independent Non-Executive Directors. In 2019 the members were: Jonathan Fox (Chair), Melanie Duke (until 30 September), Justin Fox (from 28 November 2019) and Lindsay Forster (from 28 November 2019). The Committee is chaired by an independent Non-Executive Director who is not the Chair of the Board. The Committee's Chair had served more than 12 months on the Committee prior to appointment as Chair of the Remuneration Committee.

The Society's Chief Executive and Finance Director comment upon proposals and provide information, as and when required, and attend meetings at the Committee's request.

In making its decisions and recommendations, the Committee takes into account all relevant factors, including a review of comparative benefit packages from similar financial organisations and the internal consistency between roles and recognition. The Committee seeks independent professional advice on Director and Senior Executive pay on a periodic basis. In 2017 it commissioned such advice from Total Reward Solutions. This advice informed its decisions and recommendations for 2018 and 2019. However, the Committee exercises independent judgement when evaluating the advice of external third parties and when receiving views from Executive Directors and senior management. The Society and Directors have no other connection with Total Reward Solutions.

The Committee supports linking reward to performance. In doing so, it pays close attention to the performance of the Society and the risks to which it is exposed, external market conditions, and its overall responsibility to members within a framework of good corporate governance. Levels of remuneration for the Chair and all Non-Executive Directors reflect the time commitment and responsibilities of their roles and do not contain any elements of performance related pay.

WORKFORCE AND STAKEHOLDER ENGAGEMENT

The Senior Independent Director ('SID') has been appointed as the principal contact for workforce engagement. The SID meets with the workforce twice each year and reports back to the Board on each occasion. There is a mechanism to provide for feedback to be made in confidence, as appropriate. During 2019, following discussions with the workforce, employer pension contributions were increased to 10% of base salary, for those members of staff contributing at least 5%. Lower contribution rates were available to those contributing at lower rates. The scheme was aligned for all employees, including Executives.

During the year, the Committee considered the incentive schemes available to Executives, senior leaders and other employees. To improve the internal consistency of the schemes, the incentives available for senior leaders were increased (excluding Executives).

The Society's Remuneration Policy applies to all employees and all incentive schemes are aligned to the Society's strategic objectives. Objectives set as part of the Executive scheme were shared with the workforce during the first quarter of 2019.

The Remuneration Report is provided to the Society's membership for annual consideration and approval at the Annual General Meeting. At the 2019 Annual General Meeting, 89% of votes were cast in favour of the Report. No adverse comments were received from members in regards to the Report or Executive pay.

Remuneration Report (continued)

POLICY AIMS AND OBJECTIVES

The Committee's decision-making processes take into account:

- The need to recruit, retain and motivate staff with appropriate skills and experience to make an effective contribution to the Society's strategy and operations, and so to act in the long-term interests of the Society's members;
- The link between individual awards, the delivery of strategy and the long-term performance of the Society being clearly defined. Outcomes will not reward poor performance;
- The Society's incentive schemes driving behaviours consistent with Society purpose, values and strategy;
- The need for a clear and uncomplicated link between performance and remuneration;
- The Society's remuneration arrangements being transparent and promoting effective engagement with stakeholders and the workforce;
- The range of possible values of rewards to individual Directors and any other limits or discretions being identified and explained;
- The levels of remuneration, as a reference, for similar jobs within the UK financial services sector;
- The need for pay arrangements not to directly or indirectly expose the Society to inappropriate risk;
- The structure of remuneration, avoiding complexity that the rationale and operation are easy to understand;
- The PRA Rulebook;
- The application of provisions of the FCA's Remuneration Code for dual regulated firms (PRA and FCA regulated); and
- The provisions of the UK Corporate Governance Code insofar as they relate to Building Societies.

During 2019 the Committee considered these policy aims and objectives ensuring that Executive remuneration policy and practices reflected: clarity, simplicity, risk, predictability, proportionality and alignment to the Society's culture. For example the Committee ensured that the design of Executive incentive scheme was clearly defined and communicated, rewards were capped and proportionate and Executives were required to demonstrate how they had promoted values aligned with the desired culture of the Society.

No payments under incentive schemes are guaranteed and all schemes are non-contractual. The Society's Remuneration Committee uses its discretion to override formulaic outcomes. The Committee considers the outcome of the incentive schemes on an annual basis, adjusting incentive payments as it sees fit. This review was carried out in 2019 and payments were aligned to anticipated outcome with regard to Society and individual performance.

Policies and incentive schemes are reviewed on an annual basis and revised as appropriate. The remuneration policies in place during 2019 were reviewed by the Committee and were considered to be effective. In 2019 objectives were introduced to support the development of the members of the wider leadership team.

CONFLICTS OF INTEREST

The Society seeks to ensure that its remuneration decisions do not encourage conflicts of interest. The Remuneration Committee is aware of the potential for such conflicts when considering remuneration for Directors, and seeks external professional advice where appropriate.

CONTRACTUAL ARRANGEMENTS

The Society will not enter into an employment contract which would compensate any individual for failing to perform his/her duties satisfactorily. Contractual notice periods do not exceed one year, and any contractual entitlement to a termination payment will not exceed twelve months' salary and benefits. Bonus schemes for Executive Directors and other senior managers make provision for clawback of payments in the event of subsequent determination of wrong doing. Directors' terms of appointment are robust in reducing compensation to reflect departing Directors' obligations to mitigate loss.

STATUTORY CONSIDERATIONS

The Society ensures that its remuneration decisions are in line with statutory requirements, for example, in relation to equal pay and non-discrimination and ensure compliance with regulatory requirements such as the Remuneration Code.

The Society has established provisions that enable the Society to recover and/or withhold sums or awards and specifies the circumstances in which it would be appropriate to do so.

Remuneration Report (continued)

EXECUTIVE DIRECTORS

For Executive Directors the Society seeks to establish an appropriate balance between the fixed and variable elements of remuneration. The Committee has been mandated by the Board to ensure that fixed remuneration is in line with the market rate for Executive Directors in similar positions at comparable organisations. Performance appraisals of the Executive Directors are carried out at least annually to assess their success in meeting individual and corporate objectives.

The Committee has been mandated by the Board to reward exceptional performance through incentive schemes. Awards under the incentive schemes reflect the outcomes of appraisals.

The main components of the Executive Directors' remuneration are:

- Base salary and core benefits
- Variable remuneration incentive scheme

Base salaries take into account the content and responsibilities of the job, salary levels in comparable organisations and individual performance in the role. The Chief Executive is appraised annually by the Chair, and the Chief Executive carries out a performance assessment of the Finance Director and other Executives.

Pension Benefits

The Society contributes to a defined contribution scheme for eligible staff, including Executive Directors, who may elect to receive this contribution as a pension allowance. Only basic salary is pensionable. The pension contribution rates for Executive Directors, or payments in lieu, are aligned with those available to the workforce. Pension consequences and associated costs of basic salary increases, particularly for Directors close to retirement, are carefully considered when compared with workforce arrangements.

Other Benefits

The Society provides other taxable benefits to Executive Directors, namely the provision of a car allowance and private medical insurance.

Neither of the Executive Directors has a contractual notice period which exceeds one year, or a contractual entitlement to a termination payment which would exceed twelve months' salary and benefits.

VARIABLE REMUNERATION

In considering the targets for both the annual and the long term incentive schemes, the Remuneration Committee has regard to the goals set by the Board in the Society's three-year Corporate Plan.

The Society seeks to ensure that its remuneration decisions are in line with its business strategy and long term objectives, and consistent with the Society's current financial condition and future prospects. Incentive schemes take into account the need to retain a strong balance sheet, and variable remuneration amounts will not be paid unless they are sustainable within the Society's situation as a whole. No payments under incentive schemes are guaranteed and all schemes are non-contractual. None of the incentive payments are pensionable.

Annual Incentive Scheme

Annual incentives are paid in cash on the achievement of key targets which will be of benefit to the Society and its members, and which take into account individual performance. The structure of the scheme is approved by the Remuneration Committee at the beginning of each financial year. The rewards for 2019 were based on the Society meeting its business performance targets and the personal performance of the individual (including a component relating to culture). The scheme was subject to a cap of 20% of base salary (excluding allowances).

Long Term Incentive Scheme

Long term incentive schemes are set annually, based on performance over a three year period as measured against pre-determined business objectives. The structure of each new three-year scheme is approved by the Remuneration Committee at the commencement of the period to which it relates.

Currently the schemes includes targets for growth and mix of mortgage assets, profitability and the achievement of strategic objectives (including stakeholder satisfaction). The schemes are capped at 10% of base salary (excluding allowances).

Remuneration Report (continued)

EXECUTIVE DIRECTORS' REMUNERATION

The emoluments below represent audited information.

2019 All figures £	Base Salary	Benefits & Allowances	Performance pay annual incentive scheme	Performance pay long-term incentive scheme	Pension Contribution	Total
Mark Robinson	172,152	33,408	32,775	16,016	10,000	**264,353**
Nicholas Fielden	138,460	13,653	27,750	12,877	16,615	**209,356**
Total	**310,613**	**47,061**	**60,525**	**28,896**	**26,615**	**473,710**

2018 All figures £	Base Salary	Benefits & Allowances	Performance pay annual incentive scheme	Performance pay long-term incentive scheme	Pension Contribution	Total
Mark Robinson	168,051	33,458	30,299	16,341	7,500	**255,649**
Nicholas Fielden	135,055	13,583	24,350	13,133	16,207	**202,328**
Total	**303,106**	**47,041**	**54,649**	**29,474**	**23,707**	**457,977**

The benefits and allowances received by Executive Directors relate to private medical insurance, the provision of a car allowance and pension allowance in lieu of contribution. Only base salaries are pensionable.

NON-EXECUTIVE DIRECTORS

The Board aims to ensure that fees are in line with the amount paid to Non-Executive Directors in similar positions at comparable organisations. The Remuneration Committee makes recommendations to the full Board in respect of any changes to the remuneration of Non-Executive Directors. As is conventional, additional fees are paid to the Chairs of the Assets & Liabilities Committee, Audit & Compliance Committee, Risk Committee and Remuneration Committee, in recognition of the additional workload and responsibility.

Non-Executive Directors' remuneration does not include any bonus payments, pension or other benefits. Non-Executive Directors do not have service contracts providing for notice periods which exceed three months; neither do they have any contractual entitlement to termination payments. Their effectiveness is appraised annually by the Chair, and the Board as a whole, under the leadership of the Vice-Chair, assesses the Chair's performance.

Remuneration Report (continued)

NON-EXECUTIVE DIRECTORS' REMUNERATION

Directors' fees **All figures £**	**2019**	**2018**
Nicholas Johnston – Chair & Chair of Nominations Committee	42,408	41,331
Michael Thomas – Chair of Audit & Compliance Committee *and Vice-Chair and Senior Independent Director from 1 October 2019*	30,087	27,505
Melanie Duke – Chair of Assets & Liabilities Committee (to 31 March 2019) *and as Vice Chairman and Senior Independent Director (from 27 April 2018)* to 30 September 2019	23,638	30,505
Kenneth Piggott – Vice Chair, Senior Independent Director and Chair of Remuneration Committee to 26 April 2018	0	11,530
Brian Brodie from 1 January 2018 to 3 May 2018	0	8,415
Michael Bury from 1 May 2019	17,032	0
Lindsay Forster from 1 July 2019	12,774	0
Jonathan Fox - Chair of Remuneration Committee (from 27 April 2018)	28,237	26,428
Justin Fox from 1 May 2019	16,632	0
Alison Littley from 1 January 2018 to 30 September 2018	0	16,836
Andrew Merrick – Chair of Assets & Liabilities Committee from 1 April 2019	28,008	24,811
Zoe Shapiro - Chair of Risk Committee	28,237	27,505
Total	**227,053**	**214,866**

Fees include amounts paid to the Chairs of the Assets & Liabilities Committee, Audit & Compliance Committee, Risk Committee and Remuneration Committee of £3,350 in 2019 and £3,250 in 2018. A taxable annual travel allowance of £1,850/£2,450 was paid to Non-Executive Directors travelling more than 35/80 miles to meetings at the Society, which is included in the fees above.

Jonathan Fox
Chair of Remuneration Committee
26 March 2020

Directors' Report

Your directors have pleasure in presenting their Annual Report for the year ended 31 December 2019.

BUSINESS OBJECTIVES

Your Society's principal business objectives are the provision of secured lending on residential property, savings products for private individuals and small businesses, and related insurance services. The Society operates solely in the UK and all of its operations are based in the UK. Our products are promoted nationally via mortgage brokers, the internet and by post, and in Leicestershire and Northamptonshire via our branches. We seek to develop by offering the combined advantages of value-for-money and innovation in our products and by delivering a first-class personalised service to members.

BUSINESS REVIEW

A review of the Society's business performance during 2019 is included in the Chairman's Statement and the Chief Executive's Review.

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group operates in a business environment that contains financial risks. To mitigate these risks, the Board has implemented a clearly defined risk management framework that comprises the following features:

- a risk focused governance structure;
- a risk appetite statement, risk policy statements and risk limits;
- risk identification, monitoring and reporting processes; and
- an effective internal control framework.

The financial instruments used by the Group to mitigate certain risks, particularly interest rate risk, are set out in Note 27 of the accounts.

The Board has established Committees to assist in the implementation and monitoring of risk management across the Group, including the Audit & Compliance Committee, the Risk Committee, the Assets and Liabilities Committee (ALCO), the Remuneration Committee and the Nominations Committee. Details of the role and responsibilities of each Committee are set out in the Corporate Governance Report.

The key policies that the Group has implemented to manage the risks that it faces include a Risk Appetite Statement, Lending Policies, a Conduct Risk Policy and Financial Risk Management Policies (Liquidity and Funding Policy, Interest Rate Risk in the Banking Book Policy and Counterparty Policy). These are reviewed, amended and approved by the Board on a regular basis.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks to which the Group is exposed, along with the risk management objectives and policies are set out below:

Business risk and margin compression: the risk of loss or reduction in profitability due to failure to achieve business objectives. The Group's Corporate Plan, approved by the Board, sets out the key objectives and how key risks to achieving those objectives will be managed. The Group manages this risk by ensuring that a diverse range of products and services are in place, the setting of detailed plans and the monitoring of actual performance against these plans by the Board. Key business risks include:

- Competitive mortgage and retail savings markets. The Society's net interest margin remains robust despite the low interest rate environment. There is a risk that increased competition reduces mortgage yields and increases the cost paid for retail savings. The Directors continue to closely monitor the economic environment, the mortgage and savings markets, the balance sheet composition of the Group and product pricing to ensure that the Society's product mix remains appropriate and that net interest margin remains in line with the Corporate Plan;
- Increasing management expenses. Operating costs are likely to increase in the short-term as investment is made in services to improve growth prospects and deliver operating efficiencies. There is a risk that costs continue to increase over and above the growth in interest margin;
- The risks arising from climate change. Climate change will bring financial risks to the Society's business. Whilst the Board considers the strategic issues on an ongoing basis and maintains overall responsibility for monitoring and mitigating against these risks. The Board has delegated the responsibility of monitoring these risks to the Risk Committee in the first instance.

Directors' Report (continued)

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

Operational risk: the risk of loss arising from inadequate or failed internal processes, the actions of people, the Group's IT systems, regulatory compliance, fraud and financial crime. The Group maintains policies and procedures for all key internal processes. The Risk and Compliance function is the Group's principal forum responsible for monitoring operational risk and ensuring that appropriate actions are taken to strengthen internal controls implemented across the business to manage operational risk.

The Society recognises that the risks from cybercrime are of growing concern. The Society recognises this risk to our customers and processes. The Society carried out several cyber related projects and has recruited an additional specialist to significantly enhance its resilience and combat risks from cybercrime. In 2018 and again in 2019 the Society has been awarded the Cyber Essentials Plus standard of assurance, a government backed cyber security certification scheme, endorsing the cyber security standards it employs across all areas of the business. The Society continues to maintain a sustained focus in this area.

Pension obligation risk: the risk of a reduction in profit resulting from the Society, being the funder of last resort, having to make significant contributions to the Society's defined benefit pension scheme. Since 2005, the Group has embarked upon a programme of measures to reduce its pension scheme liabilities for the benefit of pension scheme members and the long-term interests of Society members. Details of the Group's pension scheme including the cost to the Society for the year and the updated scheme valuation (IAS 19) at 31 December 2019 are set out in Note 6 and Note 24 of the accounts.

Credit risk: the risk of loss if a customer or counterparty fails to perform its obligations. The risk arises from the Group's loans and advances to customers and the investment of liquid assets with treasury counterparties. Treasury counterparty and sector exposure limits have been established by the Board within the Counterparty Policy and these are monitored by ALCO.

All mortgage applications are assessed with reference to the credit and underwriting criteria set out in the Group's Lending Policies. Details of the Group's arrears performance are set out in the Chief Executive's Review. The Group recognises that the personal and financial circumstances of our borrowers can be affected by deteriorating economic conditions and unplanned events. When this happens, we apply a formal policy directed towards forbearance and fair treatment of customers. The Group uses a number of forbearance measures to assist those borrowers including agreeing a temporary payment concession or a temporary transfer to interest only payments in order to reduce the borrowers' financial pressures. We expect borrowers to resume normal payments once they are able.

Conduct risk: the risk of loss arising through interaction with the customer throughout the product lifecycle that causes some form of consumer detriment. The Conduct Risk Policy sets out the values that staff are expected to demonstrate in all their dealings with consumers and the detailed metrics that are monitored that may indicate consumer detriment to ensure that appropriate and timely action can be taken. As with Operational risk the Risk and Compliance function is the principal forum responsible for monitoring conduct risk, ensuring there are adequate controls implemented and that these are effective in managing conduct risk and delivering good customer outcomes. The Risk and Compliance functions report directly to the Risk Committee and Board in relation to customer outcomes.

Interest rate risk: the risk of reductions in net interest margin arising from unfavourable movements in interest rates due to mismatches between the dates on which interest receivable on assets and interest payable on liabilities are reset to market rates or from the re-pricing of assets and liabilities according to different interest bases. This risk is managed within approved limits set by the Board within the Financial Risk Management Policies using a combination of on and off balance sheet financial instruments and is monitored by ALCO. Further to the monitoring by ALCO, the Board manages this risk via the corporate plan, budgets and forecasts. Details of the Group's interest rate sensitivity and the use of derivatives for hedging purposes are set out in Note 32 of the accounts.

Directors' Report (continued)

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

Risks associated with the UK leaving the EU: The effects on the UK economy post Brexit remain highly uncertain. The Society is not directly affected by the impacts of Brexit as the business model is based on lending in GBP that is secured on UK properties. The business model is exposed to the secondary impacts on the economy. These would manifest themselves in the same way as any other economic downturn through decreased house prices and higher unemployment and therefore default rates.

The business does lend to ex pats, some of whom are based in Europe. The underwriting process considers the job / profession of the borrower and ex pats tend to be in the professions with transferable skills and roles. Should they have to return to the UK then they are likely to be as employable as anyone else. Should jobs not be available, the low LTV will offer protection, and the number of properties that may have to be sold or repossessed is clearly immaterial to the wider market.

The ultimate protection against any downturn is loan to value (LTV). The Society has a low LTV portfolio, with only 1.1% of balances exceeding 75% LTV. Furthermore, the stress tests it carries out include severe scenarios with low probability. These stress tests are also incorporated into the IFRS 9 provisioning approach. Differing economic scenarios are probability weighted within the approach – the most severe scenario is given a 5% probability weighting, with the most likely economic scenario a 25% probability weighting.

The Society notes not only the risks to its mortgage assets but also operational risks due to impact on resources, availability of skilled staff and suppliers with connections to the EEA. It believes it is well placed to deal with any such impact.

Risks associated with COVID-19 (coronavirus)

COVID-19 (coronavirus) which began to have significant impacts in early 2020 presents a major risk to the global economy. At the time of writing this report, the Department of Health has confirmed that the risk to the UK in general has risen from moderate to high. The Society continues to monitor the impact of the virus and has convened its pandemic planning committee. The Committee continues to assess the needs of the business and has modelled various scenarios for operational resilience. The Society has tested its ability to operate with home based working. Impacts to our markets have been modelled and are within stressed capabilities for the business.

Liquidity risk: the risk that the Group does not have sufficient financial resources to meet its liabilities as they fall due, or can secure them only at an excessive cost. It arises from the maturity mismatch of the Group's assets and liabilities. The Group's policy is to maintain liquid assets at all times which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due both in business-as-usual and stressed scenarios, to smooth out the effect of maturity mismatches between assets and liabilities, and to maintain the highest level of public confidence in the Group. The Financial Risk Management Policies detail liquidity risk limits set by the Board and these are reviewed daily by the Group's Finance department and monitored each time the ALCO meets. Further details of liquidity and funding are set out below.

Concentration risk: the risk of loss due to either a large individual or connected exposure, or significant exposures to groups of counterparties who could be affected by common factors, including geographical location. The Board has set limits for the geographical concentration of mortgage assets and the maximum value of exposures to single or connected mortgage borrowers and treasury counterparties and these are monitored by the Board and ALCO.

Directors' Report (continued)

BOARD RISK FRAMEWORK

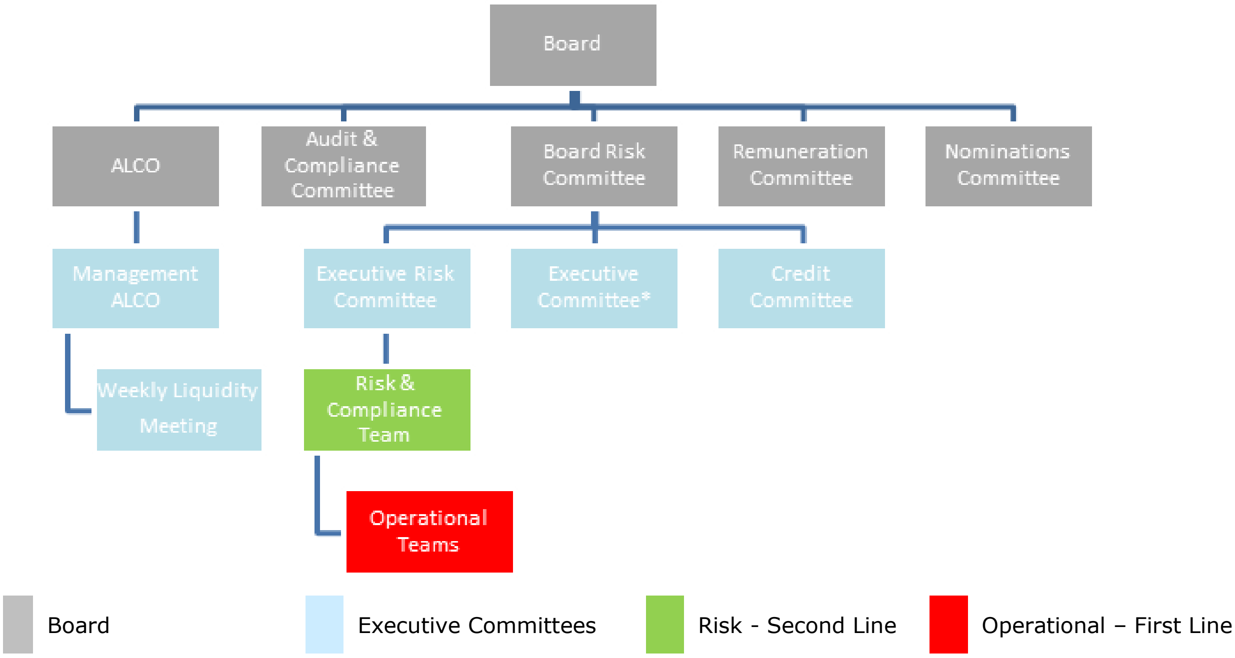
The risk management framework is designed to safely deliver the Corporate Plan in line with the Board's risk appetite. The Board is responsible for ratification of all policies. All of the senior management are involved in the development of risk management policies and their subsequent monitoring as part of their core roles.

The Society operates a 'three lines of defence' model that is appropriate to a business of its scale and complexity.

The approach is applied to all of the key business risks, such that for each of them there is a specific Board committee responsible for setting policies to manage that risk in accordance with the overall risk appetite, financial risk management objectives and policies.

The Group's objective is to minimise the impact of financial and other risks upon its performance. An explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in notes 27 to 32 to the annual accounts.

The Society's risk governance structure is detailed below:



*This Committee can escalate risk matters to any of the Board Committees or Board itself

Directors' Report (continued)

KEY PERFORMANCE INDICATORS

The following "key performance indicators" provide an overview, in tabular form, of the Group's progress.

	2019 Group	2018 Group	2017 Group
Total assets	£531m	£469m	£424m
New mortgage lending	£101m	£101m	£106m
Growth in mortgage assets	3.3%	5.5%	6.2%
Net increase / (decrease) in retail deposits	£65m	£15m	(£26m)
Liquidity to funding ratio*	21.3%	17.8%	17.8%
Management expenses as a percentage of mean total assets	1.6%	1.5%	1.6%
Post-tax profit	£2.7m	£3.2m	£2.7m
Profit as a percentage of mean total assets	0.5%	0.7%	0.6%
Net interest receivable as a percentage of mean total assets	3.2%	3.4%	3.4%
Gross capital as a percentage of shares and borrowings	8.9%	9.4%	9.5%
Free capital as a percentage of shares and borrowings	8.7%	9.2%	9.1%

* Includes 2019:£nil (2018:£26m, 2017:£46m) "off-balance sheet" liquidity drawn under the Funding for Lending Scheme

For a definition of terms see the Annual Business Statement on page 97.

NON-FINANCIAL INDICATORS

Customer surveys in 2019 showed that 90% of new savers and 89% of new mortgage customers would recommend us. In December 2019 91% of employees responded to a satisfaction survey; 88% of respondents agreed that they enjoyed their job. During 2019 the Society continued to support the development of its staff; four employees celebrated examination passes and the achievement of qualifications in four different professional subjects.

PROPERTY PLANT AND EQUIPMENT

Freehold premises owned by the Group are shown in the accounts at cost less depreciation.

Directors' Report (continued)

DIRECTORS

As at 31 December 2019 the Board comprised eight non-executive directors and two executive directors. The Board meets at least six times a year with the addition of two strategy sessions. Board Committees meet at intervening times. Any additional meetings are held as required.

The Society considers all Non-executive directors to be independent. The directors holding office during the year were:

Non-executive directors	Executive directors
Nicholas Johnston : Chairman	Mark Robinson : Chief Executive
Michael Thomas : Vice-Chairman and Senior Independent Director (from 1 October 2019)	Nicholas Fielden : Finance Director
Melanie Duke : Vice-Chairman and Senior Independent Director (retired 30 September 2019)	
Michael Bury (from 1 May 2019)	
Lindsay Forster (from 1 July 2019)	
Jonathan Fox	
Justin Fox (from 1 May 2019)	
Andrew Merrick	
Zoe Shapiro	

The Society maintains liability cover for the directors as permitted by the Building Societies Act 1986.

LONG TERM VIABILITY STATEMENT AND GOING CONCERN

The UK Corporate Governance Code requires a longer term viability statement. The Code requires the directors to explain how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

The directors have assessed the viability of the Group over a three year period taking into account the business strategy and the principal risks as set out above. The directors have a reasonable expectation that the business can continue in operation and meet its liabilities as they fall due over the three year period of their assessment. The directors have determined that a three year period of assessment is an appropriate period over which to provide its viability statement. The three year period is considered to be most appropriate as it is the longest period over which the Board considers that it can form a reasonable view of the likely macroeconomic environment and associated key drivers of business performance. As part of the annual Group Internal Capital and Internal Liquidity Adequacy Assessment Process (ILAAP), the Group stresses its capital and liquidity plans respectively, under "severe but plausible" stress test scenarios, in line with PRA requirements.

The ICAAP ensures that the plan projections for capital requirements and capital generation are resilient to stresses should the environment deteriorate beyond the levels currently envisaged in the Corporate Plan. A capital buffer is held to ensure the Group can deal with any erosion in its capital and meet its capital requirements at all times. The ILAAP test ensures that the Group holds sufficient liquid assets to meet its liquidity needs not only under normal circumstances but if the Group were to enter into a period of stress. Brexit and COVID-19 could also cause significant disruption to the UK economy and the markets within which the Society operates. However, we remain confident that the Society's high quality balance sheet, robust capital ratios and careful approach to managing risk will continue to underpin its financial strength and place it in a strong position to continue to grow. The Society's ICAAP uses the Bank of England's stress testing scenarios and has found its capital position to be robust enough to withstand the suggested stressed scenario.

Directors' Report (continued)

LONG TERM VIABILITY STATEMENT AND GOING CONCERN (CONTINUED)

In making this long-term viability statement the Board has taken into account its current position and performed a robust assessment of the principal risks and uncertainties that would threaten the business model, future performance, solvency or liquidity of the Group. These risks are described in the principal risks and uncertainties section above. The Group's Risk Management Framework and governance structure in place to deal with these risks are described above.

After considering the Group's capital and liquidity positions, the Board has a reasonable expectation that the Group will continue in operation and meet its liabilities as they fall due over the next three years.

OTHER MATTERS

Corporate and Social Responsibility

Your Society seeks to act responsibly in all its activities and has considered its operational impact on the economic, social and physical environment. Its policy on the Modern Slavery Act is available on our website www.mhbs.co.uk as is its commitment to the UK Money Markets Code.

Capital Adequacy

The Society meets the requirements of the Capital Requirements Directive (CRD) which requires the Society to assess the adequacy of its capital through an Internal Capital Adequacy Assessment Process (ICAAP). Through the application of the ICAAP the Board is satisfied that the Society holds a level of capital more than sufficient to satisfy both the CRD's Pillar 1 minimum capital requirements and to cover those risks that the Board has identified under Pillar 2. The Pillar 3 disclosures required under the CRD are available from the Society's Secretary, or on our website www.mhbs.co.uk

Supplier Payment Policy

It is the Society's policy to agree the terms of payment with suppliers in advance and to make payment within the agreed terms of credit once the supplier has performed in accordance with the terms of the contract. The number of creditor days was 2 at 31 December 2019 (31 December 2018: 10).

Post Balance Sheet Events

The Society repaid £35m of funding to the Term Funding Scheme in January 2020.

The Bank of England cut Bank base rate from 0.75% to 0.10% in March 2020 in response to the economic impact of the global pandemic arising from COVID-19 (coronavirus).

Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Society's auditor is unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

The Auditor, BDO LLP, has indicated their willingness to continue as external auditors to the Society and therefore a resolution for their election will be put to the Annual General Meeting in 2020.

On behalf of the Board of Directors:

Nicholas Johnston

Chairman

26 March 2020

Statement of Directors' Responsibilities

DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT, THE ANNUAL BUSINESS STATEMENT, THE DIRECTORS' REPORT AND THE ANNUAL ACCOUNTS

The directors are responsible for preparing the Annual Report, Annual Business Statement, Directors' Report and the annual accounts in accordance with applicable law and regulations.

The Building Societies Act 1986 ("the Act") requires the directors to prepare group and society annual accounts for each financial year. Under that law they have elected to prepare the group and society annual accounts in accordance with IFRSs as adopted by the EU and applicable law.

The Group and Society annual accounts are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the group and the society; the Building Societies Act 1986 provides in relation to such annual accounts that references in the relevant part of that Act to annual accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the group and society annual accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

In addition to the annual accounts the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the group.

DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROLS

The directors are responsible for ensuring that the group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the group and society, in accordance with the Act;
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Conduct Authority and Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The directors are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of annual accounts may differ from legislation in other jurisdictions.

Nicholas Johnston

Chairman

26 March 2020

Independent auditor's report to the members of Market Harborough Building Society

Opinion

We have audited the annual accounts of Market Harborough Building Society (the 'Society') and its subsidiaries (the 'Group') for the year ended 31 December 2019 which comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests, the Group and Society Cash Flow Statements, and notes to the annual accounts, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the annual accounts:

- give a true and fair view of the state of affairs of the Group and of the Society as at 31 December 2019 and of the Group's and Society's profit for the year then ended;
- have been properly prepared in accordance with the IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the annual accounts section of our report. We are independent of the Group and the Society in accordance with the ethical requirements that are relevant to our audit of the annual accounts in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the annual accounts is not appropriate; or
- the directors have not disclosed in the annual accounts any identified material uncertainties that may cast significant doubt about the Group's or the Society's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the annual accounts are authorised for issue.

Independent auditor's report to the members of Market Harborough Building Society (continued)

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the annual accounts of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How we addressed the key audit matter in our audit
Revenue recognition The Group has recognised interest income of £16,208k (2018: £15,085k) under the effective interest rate ("EIR") method. The loans and advances to customers of £424,783k (2018: £411,125k) contain prepaid fees that are integral to the EIR as well as accrued interest income, both are spread over the behavioural life of the loans and advances using the EIR method. The net EIR liability at year end is £386k (2018: £443k). Refer to page 16 (Audit Committee Report), note 1 (accounting policy: pages 43, 45, 46, and 47) and note 3. The Society's interest income on mortgages is recognised on EIR basis in accordance with IFRS 9. The calculation of EIR is complex and relies heavily on the quality of data in the EIR models. Significant management judgement is required to determine the expected cash flows for Society's loans and advances within these models, which are expected to be materially sensitive to these and for that reason we consider this to be a key audit matter.	We performed the following procedures: • We evaluated the design and implementation of controls over the review and approval of EIR assumptions. • We tested the operating effectiveness of business process controls over loan origination including the initial recording of contractual interest rates and associated loan amounts which form key inputs into the effective interest income calculations. We checked the completeness and accuracy of data and key model inputs feeding into the EIR adjustment model through reconciliation to underlying records. • We utilised data analytics to perform a full recalculation of the contractual interest recognised during the financial year on loans advanced. • We assessed the models for their sensitivities to changes in the key assumptions by inflating the time spent on Standard Variable Rate by one month. • We challenged the reasonableness of the loan behavioural life assumptions used by management considering historical experience of loan behavioural lives based on customer behaviour, product type, market factors, recent performance and external data where applicable. • Assessed whether the revenue recognition policies adopted by the Society are in accordance with requirements of relevant accounting standards. This included assessment of the types of fees being spread within the effective interest rate models. • Assessed how the Society's model calculates effective interest rate adjustments by recalculating one loan and have tested the integrity of the model calculations to ensure these are consistent. • Through inspection of contractual terms we challenged those fees and costs included or excluded from the EIR estimates, including early redemption charges. Key observation: We have not identified any indicators that the assumptions included in the EIR model are unreasonable in consideration of the Society's mortgage portfolios, historic behaviours and current economic and market conditions.

Independent auditor's report to the members of Market Harborough Building Society (continued)

Loan loss provisioning Provision for impairment losses on loans and advances to customers is £690,000. Refer to page 16 (Audit Committee Report), page 23 (Director's report), note 1 (accounting policy: pages 43 and 49 to 51) note 13 and 30 (Financial disclosures). Commensurate with the activities of the Society, the total loan loss provision is a material balance. Under IFRS 9, the Society is required to assess the recoverability of the loan portfolio for all items and not just those specifically identified. Therefore the Society is required to assess the Expected Credit Loss ("ECL") provision for all performing loan books, taking into account economic factors (including assessment of Probability of Default (PDs), Loss Given Default (LGDs) and Exposure at Default (EADs) along with the staging, to ensure that credit impaired loans are presented and valued accurately. These are subject to significant management judgement and estimation and for that reason we consider this to be a key audit matter.	We performed the following procedures: • Assessed the completeness and accuracy of the underlying data feeding into ECL model by agreeing on a sample basis to the underlying documentation. • We assessed whether the spreadsheet model performs the impairment calculation as designed, by testing the integrity of the model calculations • On a sample basis we made our own assessment of the valuation and recoverability of loan assets by reviewing the recent sold prices for similar properties. • On a sample basis for Stage 3 loans we understood the default trigger, management strategy and the basis for the collateral valuation. • We challenged the reasonableness of the Society's key assumptions, including the adjustments to implied PDs, haircuts applied to the collateral values, and EADs by discussing these with the management and the Audit and Compliance Committee and performed sensitivity analysis, to identify those to which the provisioning is most sensitive. • We have assessed the staging of loans based on management's definition of significant increase in credit risk • We compared the Society's total impairment provision to those of comparable organisations • We assessed the reasonability of multiple economic scenarios used, including weighting and probability changes. • Assessed the adequacy of the Society's disclosures in respect loan loss provisioning and of the degree of estimation involved in arriving at the provision. Key observation: We have not identified any indicators that the provision for loans and advances is unreasonably estimated in consideration of the key assumptions and judgements made.

Independent auditor’s report to the members of Market Harborough Building Society (continued)

Our application of materiality

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements on the audit and in forming our opinion. Materiality is assessed on both quantitative and qualitative grounds. We applied the following to the annual accounts of the Group and Society:

Materiality	£310,000
Performance materiality	£201,500
Reporting threshold	£6,200

The materiality for the Group and Society was set at the same level, due to the fact that Society accounts for 97% of net assets of the Group and 100% of its revenues and profits. We consider materiality to be the magnitude by which misstatements, individually or taken together, could reasonably be expected to influence the economic decisions of the users of the annual accounts. We determined the materiality for the annual accounts as a whole to be £310,000, which was set at 0.75% of Tier 1 Capital. This provides a basis for determining the nature and extent of our risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature and extent of further audit procedures.

We determined that Tier 1 capital was the most appropriate benchmark as regulatory stability is considered to be a main driver for the Group and the Society as well as the purpose of the group and Society which is to optimise rather than maximise profits.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in the light of other relevant qualitative considerations.

On the basis of our risk assessment together with our assessment of the overall control environment, our judgment was that overall performance materiality should be 65% of materiality.

We agreed with the Audit and Compliance Committee that we would report all individual audit differences in excess of the reporting threshold to the Audit and Compliance Committee and any other differences that, in our view, warranted reporting on qualitative grounds.

An overview of the scope of our audit

Our audit approach was developed by obtaining an understanding of the Group and the Society’s activities and the overall control environment. Based on this understanding, we assessed those aspects of the Group’s and the Society’s transactions and balances which were most likely to give risk to a material misstatement.

The Group is made up of the Society and its wholly owned subsidiary. The significant component is Market Harborough Building Society, with the remaining subsidiary being dormant company. This component was subject to a desktop review performed by the Group audit team. The Society accounts for 97% of the Group’s net assets, 100% of the Group’s revenue and 100% of the Group’s profit before tax.

Capability of the audit to detect irregularities, including fraud

We gained an understanding of the legal and regulatory framework applicable to the Society and the industry in which it operates and considered the risk of acts by the Society which would be contrary to applicable laws and regulations, including fraud. These included but were not limited to compliance with the Building Societies Act 1986, Prudential Regulation Authority (“PRA”) and Financial Conduct Authority (“FCA”) regulations, pension, and tax legislation.

Our audit procedures were designed to respond to risks of material misstatement in the annual accounts, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery, misrepresentations or through collusion.

We considered compliance with this framework through discussions with the Audit and Compliance Committee and performed audit procedures on these areas as considered necessary. Our procedures involved enquiry with the management, Audit and Compliance Committee, Risk Committee, Asset and Liabilities Committee and the board, review of the reporting to the Directors with respect to compliance with laws and regulation, review of board meeting minutes, review of internal audit reports and review of correspondence with the regulators.

There are inherent limitations in an audit of annual accounts and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the annual accounts, the less likely we would become aware of it. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

Independent auditor's report to the members of Market Harborough Building Society (continued)

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual report and Accounts, other than the annual accounts and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the annual accounts does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the annual accounts, our responsibility is to read the other information, and, in doing so, consider whether the other information is materially inconsistent with the annual accounts or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the annual accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Building Societies Act 1986

In our opinion, based on the work undertaken in the course of the audit:

- The annual business statement and the directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- The information given in the directors' report for the financial year for which the annual accounts are prepared is consistent with the annual accounts; and
- The information given in the annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

In the light of the knowledge and understanding of the Society and their environment obtained in the course of the audit, we have not identified any material misstatements in the directors' report.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters in relation to which the Building Societies Act 1986 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society; or
- the Society's annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

Opinion on other matter prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013

In our opinion the information given on page 96 for the financial year ended 31 December 2019 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Responsibilities of directors

As explained more fully in the Statement of directors' responsibilities, the directors are responsible for the preparation of the annual accounts and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the directors are responsible for assessing the Group's and the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the annual accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual accounts.

A further description of our responsibilities for the audit of the annual accounts is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Independent auditor's report to the members of Market Harborough Building Society (continued)

Other matters which we are required to address

Following the recommendation of the audit committee, we were appointed by the Board of Directors on 25th September 2019 to audit the annual accounts for the year ending 31 December 2019 and subsequent financial periods. The period of total uninterrupted engagement is 1 year, covering the year ended 31 December 2019.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting our audit.

Our audit opinion is consistent with the additional report to the audit committee.

Use of our report

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Matthew Hopkins (Senior Statutory Auditor)

For and on behalf of BDO LLP, Statutory Auditor

London, UK

26 March 2020

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Income Statements

For the year ended 31 December 2019 All figures £'000	Note	2019 Group	2018 Group	2019 Society	2018 Society
Interest income calculated using the effective interest method	3	16,208	15,085	16,208	15,085
Interest payable and similar charges	4	(5,090)	(4,193)	(5,090)	(4,193)
Net Interest Income		**11,118**	**10,892**	**11,118**	**10,892**
Fees and commissions receivable		236	297	236	297
Fees and commissions payable		(76)	(100)	(76)	(100)
Other operating income		14	13	14	13
Net (loss)/gain from derivative financial instruments	5	(109)	14	(109)	14
Total Net Income		**11,183**	**11,116**	**11,183**	**11,116**
Administrative expenses	6	(7,548)	(6,529)	(7,548)	(6,529)
Depreciation and amortisation	16,17	(217)	(382)	(217)	(382)
Other operating charges		(13)	(12)	(13)	(12)
Other finance cost		(38)	(207)	(38)	(207)
Operating Profit		**3,367**	**3,986**	**3,367**	**3,986**
Impairment losses on loans and advances		(51)	11	(51)	11
Provision for liabilities – FSCS levy	23	0	11	0	11
Profit Before Tax		**3,316**	**4,008**	**3,316**	**4,008**
Tax on profit on ordinary activities	10	(584)	(811)	(584)	(811)
Profit For The Financial Year		**2,732**	**3,197**	**2,732**	**3,197**

The notes on pages 43 to 96 form part of these Annual Report and Accounts.

All of the above arise from continuing operations.

All of the above arose in the UK.

Statements of Comprehensive Income

For the year ended 31 December 2019 All figures £'000	Note	2019 Group	2018 Group	2019 Society	2018 Society
Profit For The Financial Year		**2,732**	**3,197**	**2,732**	**3,197**
Items that will not be reclassified to the income statement					
Re-measurement of defined benefit obligation	24	727	186	727	186
Tax on items that will not be reclassified to the income statement		(124)	(28)	(124)	(28)
Other comprehensive income for the period net of income tax		**603**	**158**	**603**	**158**
Total Comprehensive Income For The Period		**3,335**	**3,355**	**3,335**	**3,355**

The notes on pages 43 to 96 form part of these Annual Report and Accounts.

Statements of Financial Position

As at 31 December 2019 All figures £'000	Note	2019 Group	2018 Group	2019 Society	2018 Society
Cash in hand and balances at central banks		97,611	48,681	97,611	48,681
Loans and advances to credit institutions	11	6,017	6,379	6,017	6,379
Derivative financial instruments	12	73	230	73	230
Loans and advances to customers	13	424,783	411,125	424,783	411,125
Other assets	15	556	432	556	432
Property, plant and equipment	16	1,658	1,697	1,658	1,697
Intangible assets	17	380	118	380	118
Deferred tax asset	18	172	371	172	371
Total Assets		**531,250**	**469,033**	**531,250**	**469,033**
Shares	19	394,896	340,246	394,896	340,246
Amounts owed to credit institutions	20	45,113	45,130	45,113	45,130
Amounts owed to other customers	21	45,895	40,887	45,895	40,887
Derivative financial instruments	12	356	97	356	97
Other liabilities and accruals	22	792	753	1,977	1,938
Current tax liabilities		193	408	193	408
Provisions for liabilities and charges	23	0	6	0	6
Retirement benefit liabilities	24	593	1,429	593	1,429
Total Liabilities		**487,838**	**428,956**	**489,023**	**430,141**
General reserve	25	43,412	40,077	42,227	38,892
Total Reserves		**43,412**	**40,077**	**42,227**	**38,892**
Total Reserves and Liabilities		**531,250**	**469,033**	**531,250**	**469,033**

The notes on pages 43 to 96 form part of these Annual Report and Accounts.

Approved by the Board of Directors on 26 March 2020, and signed on its behalf by:

Nicholas Johnston	Mark Robinson
Chairman	**Chief Executive**

Statements of Changes in Members' Interests

Group 2019 **All figures £'000**	**General reserve**	**Total**
Balance at 1 January 2019	40,077	40,077
Profit for the year	2,732	2,732
Other comprehensive income for the year (net of tax)		
Re-measurement of defined benefit obligation	603	603
Total Other Comprehensive Income	**603**	**603**
Total comprehensive income	**3,335**	**3,335**
Balance At 31 December 2019	**43,412**	**43,412**

Society 2019 **All figures £'000**	**General reserve**	**Total**
Balance at 1 January 2019	38,892	38,892
Profit for the year	2,732	2,732
Other comprehensive income for the year (net of tax)		
Re-measurement of defined benefit obligation	603	603
Total Other Comprehensive Income	**603**	**603**
Total comprehensive income	**3,335**	**3,335**
Balance At 31 December 2019	**42,227**	**42,227**

Statements of Changes in Members' Interests (continued)

Group 2018 **All figures £'000**	**General reserves**	**Total**
Balance at 31 December 2017	36,512	36,512
Impact of initial recognition of IFRS 9	260	260
Deferred tax element of initial recognition of IFRS 9	(50)	(50)
Balance at 1 January 2018	**36,722**	**36,722**
Profit for the year	3,197	3,197
Other comprehensive income for the year (net of tax)		
Re-measurement of defined benefit obligation	158	158
Total other comprehensive income	**158**	**158**
Total other comprehensive income for the period	**3,355**	**3,355**
Balance At 31 December 2018	**40,077**	**40,077**

Society 2018 **All figures £'000**	**General reserves**	**Total**
Balance at 31 December 2017	35,327	35,327
Impact of initial recognition of IFRS 9	260	260
Deferred tax element of initial recognition of IFRS 9	(50)	(50)
Balance at 1 January 2018	**35,537**	**35,537**
Profit for the year	3,197	3,197
Other comprehensive income for the year (net of tax)		
Re-measurement of defined benefit obligation	158	158
Total other comprehensive income	**158**	**158**
Total other comprehensive income for the period	**3,355**	**3,355**
Balance At 31 December 2018	**38,892**	**38,892**

The notes on pages 43 to 96 form part of these Annual Report and Accounts.

Cash Flow Statements

For the year ended 31 December 2019 All figures £'000	Note	2019 Group	2018 Group	2019 Society	2018 Society
Profit before tax		3,316	4,008	3,316	4,008
Depreciation and amortisation		217	382	217	382
Fair value gain on derivative instruments		109	(14)	109	(14)
Increase/(decrease) in impairment of loans and advances		47	(7)	47	(7)
Total Cash Flows From Operating Activities		**3,689**	**4,369**	**3,689**	**4,369**
(Increase) in other assets		(139)	(2)	(139)	(2)
Increase in other liabilities		235	42	235	42
(Increase) in loans and advances to customers		(13,358)	(21,137)	(13,358)	(21,137)
Increase in shares		54,488	20,822	54,488	20,822
Increase with other credit institutions		0	20,000	0	20,000
Increase with other customers		4,911	866	4,911	866
(Decrease)/increase in retirement benefit obligation		(109)	46	(109)	46
Taxation paid		(725)	(667)	(725)	(667)
Net Cash Generated From Operating Activities		**48,992**	**24,339**	**48,992**	**24,339**
Proceeds from disposal of property, plant and equipment		0	7	0	7
Purchase of property, plant and equipment		(66)	(122)	(66)	(122)
Purchase of intangible assets		(373)	(26)	(373)	(26)
Net Cash Generated From Investing Activities		**(439)**	**(141)**	**(439)**	**(141)**
Net Cash Generated From Financing Activities		**0**	**0**	**0**	**0**
Net Change In Cash Or Cash Equivalents		**48,553**	**24,198**	**48,553**	**24,198**
Cash and cash equivalents at 1 January		**55,050**	**30,852**	**55,050**	**30,852**
Cash And Cash Equivalents At 31 December	26	**103,603**	**55,050**	**103,603**	**55,050**

The notes on pages 43 to 96 form part of these Annual Report and Accounts.

Notes to the Annual Report and Accounts

1. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these Annual Report and Accounts are set out below.

Basis of accounting

Both the Society and Group annual accounts are prepared and approved by the directors in accordance with IFRS as adopted by the EU and those parts of the Building Societies Act 1986 and Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to societies reporting under IFRS. The statements of the Society are presented in GB pounds sterling (GBP), which is the functional and presentation currency of the Society as it represents the primary currency of the underlying transactions, assets, funding and revenues. Amounts are rounded to the nearest thousand unless otherwise stated.

The directors have prepared forecasts of the Society's financial position for the period ending twelve months from the date of approval of these Annual Report and Accounts. They have also considered the effect on the Society's business of operating under stressed but plausible operating conditions. As a result they are satisfied that the Society and the Group have adequate resources to continue in business for the foreseeable future. For this reason, the Annual Report and Accounts continue to be prepared on a going concern basis.

The directors have considered the impacts of the UK leaving the EEA and have concluded that this would not impact the going concern basis under which these accounts have been prepared.

The accounting policies for the Group also include those for the Society unless otherwise stated.

Use of judgements and estimates

In preparing these consolidated financial statements, management has made judgements and estimates that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and judgements are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

Judgements

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the consolidated financial statements are included in:

- Note 13: loans and advances to customers – the assessment of the expected life of mortgages will change the timescale over which interest income is released and thus impact the gross carrying value of the mortgages.
- Note 27: classification of financial assets - the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest (SPPI) on the principal amount outstanding.
- Note 30: establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of expected credit loss (ECL) and selection and approval of models used to measure ECL.

Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year is included in the following note:

- Note 12: determination of the fair value of financial instruments with significant unobservable inputs.
- Note 24: measurement of defined benefit obligations: key actuarial assumptions.
- Note 18: recognition of deferred tax assets: availability of future taxable profit against which carry-forward tax losses can be used.
- Note 30: impairment of financial instruments: key assumptions used in estimating recoverable cash flows.
- Note 30: impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUTING POLICIES (continued)

Changes in accounting policies

IFRS 16 - 'Leases'

This became effective from 1 January 2019. The impact of the change in policy is immaterial.

Lessor accounting

The standard addresses accounting by lessees and lessors, but the provisions for lessor accounting are little changed from those in IAS 17 and so the accounting for the Group's lease receivables will be unaffected.

Lessee accounting

Accounting by lessees has changed significantly, with a right-of-use asset recognised on the balance sheet for all leases, based on discounted future commitments. This normally includes leases previously treated as operating leases and not recognised on the balance sheet. A corresponding liability arises representing the present value of future lease commitments. Additionally, the Group has undertaken an exercise to identify potential lease agreements arising from service contracts it holds.

The Group made use of practical expedients within IFRS 16. These included the right to exclude contracts that had not previously been classified as leases before the implementation date, and the ability to exclude leases of low value and those with a short term. A discount rate based on an incremental borrowing rate (at 1 January 2020: 1.7%) was used when performing the present value calculations.

There is no immediate tax impact from transition and the Group's regulatory capital is unaffected. Under IFRS 16, the amount charged to profit and loss represents depreciation on the right of use asset and a finance charge on the liability instead of rents. While this is a change of classification, the overall effect on profit is insignificant. There is no impact on reported cash flows. Comparative amounts were not restated as the modified retrospective approach was employed.

Interest rate benchmark reform: Amendments to IFRS 9 and IAS 39 'Financial Instruments'

Following the request received by the Financial Stability Board from the G20, a fundamental review and reform of the major interest rate benchmarks is underway across the world's largest financial markets. This reform was not contemplated when IAS 39 was published, and consequently the IASB has published a set of temporary exceptions from applying specific hedge accounting requirements to provide clarification on how the standard should be applied in these circumstances.

Amendments to IFRS 9 and IAS 39 were endorsed in January 2020 and modify specific hedge accounting requirements. Under these temporary exceptions, interbank offered rates ('Ibors') are assumed to continue unaltered for the purposes of hedge accounting until such time as the uncertainty is resolved.

The application of this set of temporary exceptions is mandatory for accounting periods starting on or after 1 January 2020, but early adoption is permitted. Market Harborough Building Society elected to apply these exceptions for the year ended 31 December 2019. Significant judgement will be required in determining when uncertainty is expected to be resolved and therefore when the temporary exceptions will cease to apply.

However, at 31 December 2019, the uncertainty continued to exist and so the temporary exceptions apply to all of the Group's hedge accounting relationships that reference benchmarks subject to reform or replacement.

Basis of consolidation

Subsidiary companies are defined as those in which the Society has the power over relevant activities, has exposure to the rights of variable returns and has the influence to affect those returns. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. The Group accounts consolidate the assets, liabilities and results of the Society and of its subsidiary, eliminating intercompany balances and transactions. All entities have accounting periods ending on 31 December.

The results of subsidiary undertakings acquired or disposed of during the year are included in the income statements from the effective date of acquisition or up to the effective date that ownership ceases. The Society has one subsidiary company which remained dormant throughout the financial period; no acquisitions or disposals were made during 2019.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Interest

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the gross carrying amount of the financial asset.

When calculating the effective interest rate for financial instruments, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not ECL.

The calculation of the effective interest rate includes transaction costs and fees and charges paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost less the expected credit loss of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

Fees and commission

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate.

Other fee and commission income – including account servicing fees, commission relating to the sale of third party products, placement fees and syndication fees – is recognised as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised in the income statement.

A contract with a customer that results in a recognised financial instrument in the Group's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Group first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

Leases

Lessee accounting

A right-of-use asset is recognised on the balance sheet for all leases, based on discounted future commitments. A corresponding liability arises representing the present value of future lease commitments. Contracts not classified as leases prior to 1 January 2019 and leases of low value and those with a short term are excluded from this treatment, in which case rental charges are charged to the income statement on a straight-line basis over the life of the lease.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Taxation

Income Tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income.

Current Tax

Current tax is the expected tax payable on the taxable income and gains arising in the accounting period.

Deferred Tax

Deferred tax is provided using the statement of financial position liability method, providing for temporary differences between the carrying amount of assets and liabilities for accounting purposes and the amounts used for taxation purposes.

Deferred tax assets and liabilities are recognised gross on the statement of financial position and deferred tax assets are only recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Both current and deferred taxes are determined using the rates enacted or substantively enacted at the statement of financial position date.

Tax relating to actuarial gains/(losses) on retirement benefit obligations is recognised in other comprehensive income.

Financial assets and financial liabilities

Recognition and initial measurement

The Group initially recognises loans and advances, deposits and debt securities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Group becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

Note 27 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class. Note 27 discloses the levels of the fair value hierarchy and how it is applied in accordance with IFRS13.

Estimates and judgements

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement.

At regular intervals throughout the year, the expected life of mortgage assets is reassessed for reasonableness. Any variation in the expected life of mortgage assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

A one month increase in average life of a mortgage, allied to the assumption that this additional time would be on SVR would result in an increase in the value of loans on the statement of financial position by approximately £104k.

Classification

On initial recognition, a financial asset is classified as measured at: amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit and loss (FVTPL).

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest(SPPI).

All other financial assets are classified as measured at FVTPL.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Classification – Business model assessment

The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed;
- how managers of the business are compensated (e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected); and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Classification –Assessment of whether contractual cash flows are SPPI

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse loans); and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Society holds a portfolio of long-term fixed-rate loans for which the Group has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Group has determined that the contractual cash flows of these loans are SPPI because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Financial liabilities

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL as classified in 27 Financial Instruments.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Fair Value Measurement

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

The best evidence of the fair value of a financial instrument on initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value on initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique for which any unobservable inputs are judged to be insignificant in relation to the measurement, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value on initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

Derecognition of financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

Impairment

The Group recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments
- loans and advances to customers and
- Loan commitments issued.

The Group measures loss allowances at an amount equal to lifetime ECL except for other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 30).

The Group considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Group does not apply the low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'. These financial instruments have experienced a significant increase in credit risk since inception, further detail is provided in Note 30. As a backstop all financial instrument 30 days past due will be included in 'Stage 2'.

Estimates and judgements

The Group makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are described below:

Impairment losses on loans and advances to customers

The Group reviews its mortgage advances portfolio at least on a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded, the Group is required to exercise a degree of judgement. Impairment provisions are calculated using historical arrears experience, modelled credit risk characteristics and expected cash flows.

Estimates are applied to determine prevailing market conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time expected to complete the sale of properties in possession. The accuracy of the provision would therefore be affected by unexpected changes to these assumptions.

A sensitivity analysis of these assumptions is provided in Note 30 of the Accounts.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows that the Group expects to receive;

See also Note 30.

Credit-impaired financial assets

At each reporting date, the Group assesses financial assets carried at amortised cost and debt financial assets carried at FVOCI (referred to as 'Stage 3 financial assets') for credit impairment. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- or the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered credit-impaired even when the regulatory definition of default is different.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments: generally, as a provision. Where a financial instrument includes both a drawn and an undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component, the Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision;

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and OCI. Financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Estimates and judgements

The Group reviews its mortgage advances portfolio at least on a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded, the Group is required to exercise a degree of judgement. Impairment provisions are calculated using historical arrears experience, modelled credit risk characteristics and expected cash flows.

Estimates are applied to determine prevailing market conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time expected to complete the sale of properties in possession. The accuracy of the provision would therefore be affected by unexpected changes to these assumptions.

Individual assessment

An individual measurement of impairment was based on management's best estimate of the present value of the cash flows that were expected to be received. In estimating these cash flows, management made judgements about a debtor's financial situation and the net realisable value of any underlying collateral. Each impaired asset was assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable were independently approved by the Credit Risk function.

Measurement of impairment

Impairment losses on assets measured at amortised cost were calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses on financial assets were calculated as the difference between the carrying amount and the fair value.

Where certain emerging impairment characteristics are considered significant but not assessed as part of the impairment calculation, management may elect to apply an overlay to the impairment provision.

Reversal of impairment

For assets measured at amortised cost, if an event occurring after the impairment was recognised caused the amount of impairment loss to decrease, then the decrease in impairment loss was reversed through profit or loss.

Presentation

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and. Interest on the impaired assets continued to be recognised through the unwinding of the discount.

Write-off

The Group writes off a loan or an investment debt security, either partially or in full, and any related allowance for impairment losses, when there is no realistic prospect of recovery.

Cash and cash equivalents

'Cash and cash equivalents' include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in its fair value, and are used by the Group in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Derivatives held for risk management purposes and hedge accounting

Derivatives continue to be accounted for under IAS 39.

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position. The Society does not hold derivatives for trading purposes.

The Group designates certain derivatives held for risk management as well as certain non-derivative financial instruments as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both on inception of the hedging relationship and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80–125%. For a cash flow hedge of a forecast transaction, the Group makes an assessment of whether the forecast transaction is highly probable to occur and presents an exposure to variations in cash flows that could ultimately affect profit or loss.

These hedging relationships are discussed below.

Fair value hedges

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss. The change in fair value of the hedged item attributable to the hedged risk is recognised in profit or loss. If the hedged item would otherwise be measured at cost or amortised cost, then its carrying amount is adjusted accordingly.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a Central Clearing Counterparty (CCP) by both parties as a consequence of laws or regulations or contract changes due to commercial reasons without changes in its terms except for those that are necessary for the novation, then the derivative is not considered expired or terminated.

Any adjustment up to the point of discontinuation to a hedged item for which the effective interest method is used is amortised to profit or loss as an adjustment to the recalculated effective interest rate of the item over its remaining life.

On hedge discontinuation, any hedging adjustment made previously to a hedged financial instrument for which the effective interest method is used is amortised to profit or loss by adjusting the effective interest rate of the hedged item from the date on which amortisation begins. If the hedged item is derecognised, then the adjustment is recognised immediately in profit or loss when the item is derecognised.

Estimates and judgements

The Group employs the following techniques in determining the fair value of its derivatives and financial assets:

Derivative financial instruments - calculated by discounted cash flow models using yield curves that are based on observable market data.

A change in the yield curve of 1% would change the total net fair value of derivative financial instruments by £1,352k.

The classification of these fair value techniques is in line with the fair value hierarchy detailed in IFRS 13: 'Fair Value Measurement' which splits the source of input when deriving fair values into three levels, as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly.

Level 3 – inputs for the asset or liability that are not based on observable market data.

Loans and advances

'Loans and advances' captions in the statement of financial position include loans and advances measured at amortised cost are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Property and equipment

Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Any gain or loss on disposal of an item of property and equipment is recognised within other income in profit or loss.

Depreciation

Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term.

The estimated useful lives of significant items of property and equipment are as follows:

- Land is not depreciated
- Buildings - 100 years
- IT equipment - 3–5 years; and
- Fixtures and fittings - 5 years.

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Intangible assets

Software

Software acquired by the Group is measured at cost less accumulated amortisation and any accumulated impairment losses.

Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate: that the product is technically feasible, 'its intention and ability to complete the development and use the software in a manner that will generate future economic benefits', and that it can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and capitalised borrowing costs, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and any accumulated impairment losses.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Software is amortised on a straight-line basis in profit or loss over its estimated useful life, from the date on which it is available for use. The estimated useful life of software for the current and comparative periods is three to five years.

Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Impairment of non-financial assets

At each reporting date, the Group reviews the carrying amounts of its non-financial assets (other than deferred tax assets) to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The 'recoverable amount' of an asset or Cash-generating unit (CGU) is the greater of its value in use and its fair value less costs to sell. 'Value in use' is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

Provisions

Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Loan commitments

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

Liabilities arising from financial guarantees and loan commitments are included within provisions.

Employee benefits

Defined contribution plans

Obligations for contributions to defined contribution plans are expensed as the related service is provided and recognised as personnel expenses in profit or loss. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

Defined benefit plans

The Group's net obligation in respect of its defined benefit plan is calculated by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets.

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Group, the recognised asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Re-measurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in OCI. The Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognised in personnel expenses in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in profit or loss. The Group recognises gains and losses on the settlement of a defined benefit plan when the settlement occurs.

Estimates and judgements

The Group operates a defined benefit pension scheme. Significant judgements (on such areas as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net deficit.

The assumptions are outlined in note 24 to the accounts. Of these assumptions, the main determinant of the liability is the discount rate. A variation of 0.5% in the discount rate will change liabilities by approximately 9%.

Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value. Re-measurements are recognised in profit or loss in the period in which they arise. The long term incentive bonuses are disclosed in the Directors' remuneration report.

Notes to the Annual Report and Accounts (continued)

2. FUTURE ACCOUNTING DEVELOPMENTS

There are no standards and interpretations in issue but not effective which address matters relevant to the Group's accounting and reporting.

3. INTEREST INCOME CALCULATED USING THE EFFECTIVE INTEREST METHOD

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
On loans fully secured on residential property	15,427	14,471	15,427	14,471
On other loans	453	477	453	477
On liquid assets	457	241	457	241
Net interest (income) on derivatives	(129)	(104)	(129)	(104)
Total	**16,208**	**15,085**	**16,208**	**15,085**

Included within interest income is £2k (2018: £4k) in respect of interest income accrued on impaired loans two or more months in arrears.

4. INTEREST PAYABLE AND SIMILAR CHARGES

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
On shares held by individuals	4,242	3,453	4,242	3,453
On deposits and other borrowings	853	757	853	757
Net interest expense on derivatives	(5)	(17)	(5)	(17)
Total	**5,090**	**4,193**	**5,090**	**4,193**

5. NET (LOSS)/GAIN FROM DERIVATIVE FINANCIAL INSTRUMENTS

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Derivatives in designated fair value hedge relationships	(416)	79	(416)	79
Adjustments to hedged items in fair value hedge accounting relationships	307	(69)	307	(69)
Derivatives not in designated fair value hedge relationships	0	4	0	4
Total	**(109)**	**14**	**(109)**	**14**

The net loss from derivative financial instruments of £109k (2018: gain of £14k) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis.

Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering the Group's underlying performance.

Notes to the Annual Report and Accounts (continued)

6. ADMINISTRATIVE EXPENSES

All figures £'000	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Staff costs				
Wages and salaries	3,848	3,557	3,848	3,557
Social security costs	407	339	407	339
Other pension costs	282	167	282	167
Total staff costs	4,537	4,063	4,537	4,063
Operating lease rentals	21	21	21	21
Other administrative costs	2,990	2,445	2,990	2,445
Total	**7,548**	**6,529**	**7,548**	**6,529**

7. AUDITOR'S REMUNERATION

Included in other administrative costs are the fees paid to auditors. These are analysed below:

All figures £'000 and exclude VAT	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Audit of these Annual Report and Accounts	103	77	103	77
Other assurance services	2	20	2	20
Total	**105**	**97**	**105**	**97**

Notes to the Annual Report and Accounts (continued)

8. STAFF NUMBERS

The average Full Time Equivalents of staff for the Group and the Society, including executive directors, all of whom were employed in the UK, was:

Full Time Equivalents	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Full time employees	67	59	67	59
Part time employees	34	33	34	33
Total	**101**	**92**	**101**	**92**

Full Time Equivalents	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Head office	86	78	86	78
Branches	15	14	15	14
Total	**101**	**92**	**101**	**92**

The average number of staff for the Group and the Society, including executive directors, all of whom were employed in the UK, was:

Headcount Numbers	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Branch Full time employees	3	2	3	2
Branch Part time employees	21	20	21	20
Total	**24**	**22**	**24**	**22**

Headcount Numbers	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Head Office Full time employees	63	57	63	57
Head Office Part time employees	34	31	34	31
Total	**97**	**88**	**97**	**88**

Headcount Numbers	**2019 Group**	**2018 Group**	**2019 Society**	**2018 Society**
Total Branch employees	24	22	24	22
Total Head Office employees	97	88	97	88
Total	**101**	**92**	**101**	**92**

Notes to the Annual Report and Accounts (continued)

9. DIRECTORS' EMOLUMENTS AND TRANSACTIONS

Directors' Emoluments

Group and Society All figures £'000	2019	2018
For services as non-executive directors	227	215
For services as executive directors	474	458
Total	**701**	**673**

Directors Transactions

Full details of emoluments for non-executive directors are given in the Directors' Remuneration Report under the heading "Non-Executive Directors' Remuneration". Full details of emoluments for executive directors are given in the Directors' Remuneration Report under the heading "Executive Directors' Remuneration"

There have been no significant contracts during the year in which any director had a material interest.

At the year end, there were no outstanding mortgage loans (2017: nil) granted in the ordinary course of business to directors of the Society.

A register is maintained in accordance with the requirements of Section 68 of the Building Societies Act 1986, and the requisite particulars are available for inspection at the Society's head office during the period of 15 days expiring with the annual general meeting, and at the annual general meeting on 30 April 2020.

Notes to the Annual Report and Accounts (continued)

10. TAX ON PROFIT ON ORDINARY ACTIVITIES

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Current tax	526	822	526	822
Adjustment in respect of prior years	(17)	5	(17)	5
Total current tax	**509**	**827**	**509**	**827**
Origination and reversal of temporary difference	107	(15)	107	(15)
Effect of change in tax rate on deferred tax	(12)	2	(12)	2
Adjustment in respect of prior years	(20)	(3)	(20)	(3)
Total deferred tax	**75**	**(16)**	**75**	**(16)**
Total tax expense	**584**	**811**	**584**	**811**

The total tax charge for the period differs from that calculated using the UK standard rate of corporation tax. The differences are explained below.

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Profit before tax	**3,316**	**4,008**	**3,316**	**4,008**
Expected tax at 19%	628	804	628	804
Expenses not deductible for corporation tax purposes	6	4	6	4
Effect of change in tax rate on deferred tax	(12)	2	(12)	2
Adjustment in respect of prior years	(38)	1	(38)	1
Total tax expense	**584**	**811**	**584**	**811**

At Summer Budget 2015, the government announced legislation setting the Corporation Tax main rate at 19% for the years starting the 1 April 2017, 2018 and 2019 and at 17% for the year starting 1 April 2020. Existing temporary differences may therefore unwind in periods subject to this reduced rate.

11. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Repayable on call and short notice (included within cash and cash equivalents)	5,992	6,369	5,992	6,369
Other loans and advances to credit institutions	25	10	25	10
Total	**6,017**	**6,379**	**6,017**	**6,379**

At 31 December 2019 the Group and Society had £520k (2018:£nil) deposited against derivative contracts.

Notes to the Annual Report and Accounts (continued)

12. DERIVATIVE FINANCIAL INSTRUMENTS

The Group mitigates the credit risk of derivatives by holding collateral in the form of cash where credit risk exceeds an agreed threshold as set out below.

Derivative transactions are entered into under International Swaps and Derivatives Association (ISDA) master agreements. In general, under these agreements, in certain circumstances – e.g. when a credit event such as a default occurs – all outstanding transactions under the agreement with the counterparty are terminated. The termination values are therefore assessed for settlement of all transactions with the counterparty. There is no right of set off. The Group executes a credit support annex in conjunction with each ISDA agreement, which requires the Group and its counterparties to post collateral to mitigate counterparty credit risk, where collateral is only posted should the minimum threshold amount of £250,000 be reached. At 31 December 2019, £520k was placed as cash collateral with swap counterparties.

The Society does not transact derivatives on exchanges or with Central Clearing Parties and therefore no collateral is posted daily.

Before fair value hedge accounting is applied by the Group, the Group determines whether an economic relationship between the hedged item and the hedging instrument exists based on an evaluation of the qualitative characteristics of these items and the hedged risk that is supported by quantitative analysis. The Group considers whether the critical terms of the hedged item and hedging instrument closely align when assessing the presence of an economic relationship. The Group evaluates whether the fair value of the hedged item and the hedging instrument respond similarly to similar risks. The Group further supports this qualitative assessment by using regression analysis to assess whether the hedging instrument is expected to be and has been highly effective.

The Group establishes a hedge ratio by aligning the par amount of the fixed-rate loan or deposit and the notional amount of the interest rate swap designated as a hedging instrument. Under the Group policy, in order to conclude that a hedge relationship is effective, all of the following criteria should be met.

- The regression co-efficient (R squared), which measures the correlation between the variables in the regression, is at least 0.9.
- The slope of the regression line is within a 0.8–1.25 range.
- The confidence level of the slope is at least 95%.

In these hedge relationships, the main sources of ineffectiveness are:

- the effect of the counterparty and the Group's own credit risk on the fair value of the interest rate swap, which is not reflected in the fair value of the hedged item attributable to the change in interest rate; and
- differences in maturities of the interest rate swap and the loans or the deposit products.

There were no other sources of ineffectiveness in these hedge relationships.

The effective portion of fair value gains on derivatives held in qualifying fair value hedging relationships and the hedging gain or loss on the hedged items are included in net gains from derivative financial instruments (Note 5).

At 31 December 2019, the Group held the following interest rate swaps as hedging instruments in fair value hedges of interest risk.

Group and Society As at December 2019 **All figures £'000**	**Maturity**		
	Less than 1 year	**1 – 5 years**	**More than 5 years**
Hedge of loans and advances			
Nominal amount	21,500	63,500	0
Average fixed interest rate	1.19%	0.86%	

Notes to the Annual Report and Accounts (continued)

DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group and Society As at December 2018 All figures £'000	Maturity		
	Less than 1 year	1 – 5 years	More than 5 years
Hedge of retail deposits			
Nominal amount	2,000	0	0
Average fixed interest rate	1.5%		
Hedge of loans and advances			
Nominal amount	12,000	53,000	0
Average fixed interest rate	0.8%	1.1%	

The amounts relating to items designated as hedging instruments and hedge ineffectiveness were as follows.

Group and Society As at December 2019 All figures £'000	Nominal	Fair Value Assets	Fair Value Liabilities	Change in fair value used for calculating hedge ineffectiveness for 2018	Ineffectiveness recognised in profit or loss
Derivatives designated as fair value hedges – interest rate swaps	82,000	73	(355)	(415)	(109)

Group and Society As at December 2018 All figures £'000	Nominal	Fair Value Assets	Fair Value Liabilities	Change in fair value used for calculating hedge ineffectiveness for 2018	Ineffectiveness recognised in profit or loss
Derivatives designated as fair value hedges – interest rate swaps	60,000	228	(94)	79	10

The line item in the statement of financial position where the hedging instrument is included is derivative financial instruments.

The line item in the profit or loss that includes hedge ineffectiveness is Net gains / (losses) from derivative financial instruments.

Notes to the Annual Report and Accounts (continued)

DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The amounts relating to items designated as hedged items were as follows

Group and Society As at December 2019 All figures £'000	Carrying amount		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Change in value used for calculating hedge ineffectiveness
	Assets	Liabilities	Assets	Liabilities	
Retail deposits	-	-		-	(40)
Loans and advances	72,684	0	232		346

Group and Society As at December 2018 All figures £'000	Carrying amount		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Change in value used for calculating hedge ineffectiveness
	Assets	Liabilities	Assets	Liabilities	
Retail deposits	0	1,309		(40)	19
Loans and advances	52,868	0	(115)		(88)

The line item in the statement of financial position in which the hedged item is included is shares for retail deposits and loans and advances to customers for loans and advances. There was no accumulated amount of fair value hedged adjustments remaining in the statement of financial position for any hedged items that have ceased to be adjusted for hedging gains and losses.

Following the request received by the Financial Stability Board from the G20, a fundamental review and reform of the major interest rate benchmarks is underway across the world's largest financial markets. This reform was not contemplated when IAS 39 was published, and consequently the IASB has published a set of temporary exceptions from applying specific hedge accounting requirements to provide clarification on how the standard should be applied in these circumstances.

Amendments to IFRS 9 and IAS 39 were endorsed in January 2020 and modify specific hedge accounting requirements. Under these temporary exceptions, interbank offered rates ('Ibors') are assumed to continue unaltered for the purposes of hedge accounting until such time as the uncertainty is resolved.

The application of this set of temporary exceptions is mandatory for accounting periods starting on or after 1 January 2020, but early adoption is permitted. Market Harborough Building Society elected to apply these exceptions for the year ended 31 December 2019. Significant judgement will be required in determining when uncertainty is expected to be resolved and therefore when the temporary exceptions will cease to apply.

However, at 31 December 2019, the uncertainty continued to exist and so the temporary exceptions apply to all of the Group's hedge accounting relationships that reference benchmarks subject to reform or replacement.

The Group has fair value hedge accounting relationships that are exposed to sterling Libor as well as overnight rates subject to the market-wide benchmarks reform, such as the sterling overnight ('SONIA'). The existing derivatives that are designated in relationships referencing sterling Libor will transition to new risk-free rates ('RFRs'). External progress on the transition to RFRs is being monitored, with the objective of ensuring a smooth transition for the Group's hedge accounting relationships. Some hedges may need to be de-designated and new relationships entered into.

The hedge accounting relationships that are affected by the adoption of the temporary exceptions are the hedge items presented in the Statements of Financial Position as 'Derivative Financials instruments' and 'Loans and advances to customers'.

Notes to the Annual Report and Accounts (continued)

DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The notional amounts of interest rate derivatives designated in hedge accounting relationships represent the extent of the risk exposure managed by the Group that is directly affected by market-wide benchmarks reform and impacted by the temporary exceptions.

Group and Society As at December 2019 All figures £'000	Impacted by IBOR reform	Not impacted by IBOR reform	Notional amount
Fair value hedges	15,000	70,000	**85,000**

13. LOANS AND ADVANCES TO CUSTOMERS

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Loans fully secured on residential property	415,697	401,591	415,697	401,591
Other loans fully secured on land	9,544	10,292	9,544	10,292
Gross loan receivables	**425,241**	**411,883**	**425,241**	**411,883**
Stage 1 (see below)	(484)	(257)	(484)	(257)
Stage 2 (see below)	(206)	(386)	(206)	(386)
Stage 3 (see below)	-	-	-	-
Provision for impairment losses on loans and advances	**(690)**	**(643)**	**(690)**	**(643)**
Net loan receivables	**424,551**	**411,240**	**424,551**	**411,240**
Fair value adjustment for hedged risk	232	(115)	232	(115)
Total	**424,783**	**411,125**	**424,783**	**411,125**

The Group has pledged £120m (2018: £112m) of mortgage loan pools with the Bank of England. Of these mortgage loan pools £64m (2018: £84m) are encumbered mortgage assets through the Term Funding Scheme.

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement.

At regular intervals throughout the year, the expected life of mortgage assets is reassessed for reasonableness. Any variation in the expected life of mortgage assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

A one month increase in average life of a mortgage, allied to the assumption that this additional time would be on SVR would result in a £104k (2018:£119k) increase in the gross carrying value of loans and advances.

Notes to the Annual Report and Accounts (continued)

LOANS ANS ADVANCES TO CUSTOMERS (continued)

The movement in provision for impairment losses on loans and advances for the Group may be analysed as follows:

Group and Society 2019 All figures £'000	Loans fully secured on residential property	Other loans fully secured on land	Total
Stage 1 provision at 1 January	227	30	257
New assets originated	202	0	202
Transfer to Stage 1 due to change in credit risk	57	(1)	56
Assets derecognised	(29)	(2)	(31)
Stage 1 provision at 31 December	**457**	**27**	**484**
Stage 2 provision at 1 January	361	25	386
New assets originated	75	0	75
Transfer to Stage 2 due to change in credit risk	(108)	(25)	(133)
Assets derecognised	(122)	0	(122)
Stage 2 provision At 31 December	**206**	**0**	**206**
Stage 3 provision at 1 January	0	0	0
New assets originated	0	0	0
Transfer to Stage 3 due to change in credit risk	0	0	0
Assets derecognised	0	0	0
Stage 3 provision at 31 December	**0**	**0**	**0**

Group and Society 2018 All figures £'000	Loans fully secured on residential property	Other loans fully secured on land	Total
Stage 1 provision at 1 January	153	44	197
New assets originated	79	2	81
Transfer to Stage 1 due to change in credit risk	8	(2)	6
Assets derecognised	(13)	(14)	(27)
Stage 1 provision at 31 December	**227**	**30**	**257**
Stage 2 provision at 1 January	234	29	263
New assets originated	36	0	36
Transfer to Stage 2 due to change in credit risk	121	(4)	117
Assets derecognised	(30)	0	(30)
Stage 2 provision At 31 December	**361**	**25**	**386**
Stage 3 provision at 1 January	190	0	190
New assets originated	29	0	29
Transfer to Stage 3 due to change in credit risk	(194)	0	(194)
Assets derecognised	(25)	0	(25)
Stage 3 provision at 31 December	**0**	**0**	**(0)**

Notes to the Annual Report and Accounts (continued)

LOANS ANS ADVANCES TO CUSTOMERS (continued)

Group and Society 2019 All figures £'000	Loans fully secured on residential property	Other loans fully secured on land	Total
Stage 1 balance at 1 January	376,089	9,786	385,875
New assets originated	98,190	0	98,190
Transfer to Stage 1 due to change in credit risk	(20,772)	149	(20,623)
Assets derecognised	(58,005)	(391)	(58,396)
Stage 1 balance at 31 December	**395,502**	**9,544**	**405,046**
Stage 2 balance at 1 January	24,836	506	25,342
New assets originated	2,606	0	2,606
Transfer to Stage 2 due to change in credit risk	(1,426)	(506)	(1,932)
Assets derecognised	(6,348)	0	(6,348)
Stage 2 balance At 31 December	**19,668**	**0**	**19,668**
Stage 3 balance at 1 January	666	0	666
New assets originated	4	0	4
Transfer to Stage 3 due to change in credit risk	(56)	0	(56)
Assets derecognised	(87)	0	(87)
Stage 3 balance at 31 December	**527**	**0**	**527**

Group and Society 2018 All figures £'000	Loans fully secured on residential property	Other loans fully secured on land	Total
Stage 1 balance at 1 January	351,789	12,026	363,815
New assets originated	95,712	587	96,299
Transfer to Stage 1 due to change in credit risk	(18,903)	(290)	(19,193)
Assets derecognised	(52,509)	(2,537)	(55,046)
Stage 1 balance at 31 December	**376,089**	**9,786**	**385,875**
Stage 2 balance at 1 January	20,022	522	20,544
New assets originated	2,166	0	2,166
Transfer to Stage 2 due to change in credit risk	5,900	(16)	5,884
Assets derecognised	(3,252)	0	(3,252)
Stage 2 balance At 31 December	**24,836**	**506**	**25,342**
Stage 3 balance at 1 January	6,387	0	6,387
New assets originated	574	0	574
Transfer to Stage 3 due to change in credit risk	(5,721)	0	(5,721)
Assets derecognised	(573)	0	(573)
Stage 3 balance at 31 December	**666**	**0**	**666**

Notes to the Annual Report and Accounts (continued)

14. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

The Society directly holds 100% of the issued ordinary share capital of Market Harborough Mortgages Limited. The principal activity of the company is mortgage related finance. Its share capital is £1 (2018: £1). Its principal place of business is Welland House, The Square, Market Harborough, Leicestershire, LE16 7PD. It is registered in England and Wales. There have been no additions or disposals of investments during the year. Market Harborough Mortgages Limited became dormant from 1 January 2016.

15. OTHER ASSETS

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Prepayments and accrued income	513	427	513	427
Other debtors	43	5	43	5
Total	**556**	**432**	**556**	**432**

16. PROPERTY PLANT AND EQUIPMENT

Group & Society 2019 All figures £'000	Freehold Property	Leasehold Property	Equipment Fixtures & Fittings	Motor Vehicles	Total
At 1 January	1,640	73	3,505	25	5,243
Additions	0	0	66	0	66
Disposals	0	0	(142)	0	(142)
Total cost at 31 December	**1,640**	**73**	**3,429**	**25**	**5,167**
At 1 January	120	73	3335	17	3,545
Charge for the year	3	0	98	5	106
On disposals	0	0	(142)	0	(142)
Total depreciation at 31 December	**123**	**73**	**3,291**	**22**	**3,509**
Net book value at 31 December	**1,517**	**0**	**138**	**3**	**1,658**

Notes to the Annual Report and Accounts (continued)

PROPERTY PLANT AND EQUIPMENT (continued)

Group & Society 2018 All figures £'000	Freehold Property	Leasehold Property	Equipment Fixtures & Fittings	Motor Vehicles	Total
At 1 January	1,640	73	3,396	25	5,134
Additions	0	0	122	0	122
Disposals	0	0	(12)	0	(12)
Total cost at 31 December	**1,640**	**73**	**3,506**	**25**	**5,244**
At 1 January	0	73	3,222	12	3,307
Charge for the year	120	0	120	5	245
On disposals	0	0	(5)	0	(5)
Total depreciation at 31 December	**120**	**73**	**3,337**	**17**	**3,547**
Net book value at 31 December	**1,520**	**0**	**169**	**8**	**1,697**

All of the freehold property and leasehold property included above was occupied by the Society.

17. INTANGIBLE ASSETS

Group & Society 2019 All figures £'000	Purchased Software
At 1 January	3,504
Additions	373
Written off in the year	(381)
Total cost at 31 December	**3,496**
At 1 January	3,386
Charge for the year	111
Written off in the year	(381)
Total amortisation at 31 December	**3,116**
Net book value at 31 December	**380**

Notes to the Annual Report and Accounts (continued)

INTANGIBLE ASSETS (continued)

Group & Society 2018 All figures £'000	Purchased Software
At 1 January	3,478
Additions	26
Total cost at 31 December	**3,504**
At 1 January	3,249
Charge for the year	137
Total amortisation at 31 December	**3,386**
Net book value at 31 December	**118**

18. DEFERRED TAX

Deferred tax movement All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
At 1 January	371	470	371	470
Adjustment for prior years	0	(3)	0	(3)
IFRS 9 transitional adjustment	0	(50)	0	(50)
Income statement credit	(75)	16	(75)	16
Recognised directly in other comprehensive income	(124)	(62)	(124)	(62)
At 31 December	**172**	**371**	**172**	**371**

The deferred tax charge in the income statement comprises the following temporary differences:

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Property, plant and equipment and intangibles	(58)	5	(58)	5
IFRS 9 transitional adjustment	5	3	5	3
Pensions and other post tax retirement benefits	(21)	7	(21)	7
Effect of change in tax rate	12	(2)	12	(2)
Adjustment for prior years	20	3	20	3
Other provisions	(33)	0	(33)	0
Total	**(75)**	**16**	**(75)**	**16**

Notes to the Annual Report and Accounts (continued)

DEFERRED TAX (continued)

Deferred income tax assets are attributable to the following items:

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Pensions and other post-retirement benefits	101	243	101	243
Property, plant and equipment	29	10	29	10
Other provisions	42	118	42	118
Total	**172**	**371**	**172**	**371**

In 2016, a reduction in the corporation tax rate to 19% from 1 April 2017 and to 17% from 1 April 2020 was substantively enacted into legislation. All deferred tax balances have been recognised at 17%, being the rate enacted at the balance sheet date at which the balances are expected to reverse.

19. SHARES

Group and Society All figures £'000	2019	2018
Held by individuals	393,559	339,026
Other shares	1,337	1,260
Fair value adjustment for hedged risk	0	(40)
Total	**394,896**	**340,246**

20. AMOUNTS OWED TO CREDIT INSTITUTIONS

Group and Society All figures £'000	2019	2018
Amounts owed to credit institutions	45,113	45,130
Total	**45,113**	**45,130**

At 31 December 2019 the Society has drawn £45m under the Term Funding Scheme, included above. The drawings are repayable to the Bank of England by 2022.

Notes to the Annual Report and Accounts (continued)

21. AMOUNTS OWED TO OTHER CUSTOMERS

Group and Society All figures £'000	2019	2018
Retail customers:		
On demand	6,486	7,219
Notice	36,859	26,657
Term	426	0
Local authorities		
Term	2,124	7,011
Total	**45,895**	**40,887**

22. OTHER LIABILITIES AND ACCRUALS

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Accruals and deferred income	578	549	578	549
Other taxes and social security	175	156	175	156
Amounts due to subsidiary	0	0	1,185	1,185
Other creditors	39	48	39	48
Total	**792**	**753**	**1,977**	**1,938**

23. PROVISIONS FOR LIABILITIES AND CHARGES

Group and Society All figures £'000	2019	2018
FSCS levy		
At 1 January	6	30
Charge for the year	0	(11)
Provision utilised	(6)	(13)
Total at 31 December	**0**	**6**

Notes to the Annual Report and Accounts (continued)

24. RETIREMENT BENEFIT LIABILITIES

Defined benefit scheme

The Society operates a pension scheme providing benefits based on final pensionable pay that was closed for the accrual of future benefits on 6 April 2005 and replaced with a defined contribution group personal pension scheme. The assets of the former are held separately from those of the Society being invested with an insurance company in managed funds.

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme was at 6 April 2018 and takes into account the closure of the scheme for future service accrual. This review showed that the market value of the scheme assets at 6 April 2018 was £9.2 million and that the actuarial value of those assets represented 93% of the benefits that had accrued to members after allowing for expected future increase in salaries. The Actuarial Report at 6 April 2019 estimated an updated valuation of assets would be £9.5m and that the scheme remained 93% funded.

Following the High Court ruling in October 2018, the liability reported includes an increase of £172k relating to an additional provision for GMP equalisation. This additional charge has been accounted for through the Income Statement for 2018.

An updated actuarial valuation at 31 December 2019 was carried out on a market value basis by a qualified independent actuary, as follows:

Group and Society **Growth and rates of return**	**2019**	**2018**
Discount rate	2.0	2.8
Rate of increase in salaries	3.4	3.5
Rate of increase in pensions	2.9	3.4
Inflation	2.9	3.4

Group and Society **Expected life at 31 December (normal retirement age of 65)**	**2019**	**2018**
Expected life at retirement for a new pensioner (yrs) - Male	21.8	22.7
Expected life at retirement for a new pensioner (yrs) - Female	24.0	24.9
Expected life at retirement in 20 years’ time (yrs) – Male	23.1	24.1
Expected life at retirement in 20 years’ time (yrs) - Female	25.5	26.3

Notes to the Annual Report and Accounts (continued)

RETIREMENT BENEFIT LIABILITIES (continued)

Approximate sensitivities of the principal assumptions are set out in the table below which shows the increase or reduction in the pension obligations that would result. Each sensitivity considers one change in isolation.

Group and Society **All figures £'000**	**Change in assumption**	**2019**	**2018**
Discount rate	Decrease by 0.5%	Increase by 9%	Increase by 11%
Rate of inflation	Increase by 0.5%	Increase by 5%	Increase by 6%
Rate of increase in salaries	Increase by 0.5%	Increase by less than 1%	Increase by 1%
Life expectancy	Increase by 1 year	Increase by 4%	Increase by 3%

Fair Value of scheme assets **Group and Society** **All figures £'000**	**2019**	**2018**
As at 1 January	8,861	9,460
Interest on pension scheme assets	247	225
Contributions by employer	200	179
Benefits paid	(269)	(380)
Administration costs	(36)	0
Gain on asset returns	1,227	(623)
At 31 December	**10,230**	**8,861**

Present value of defined benefit obligations **Group and Society** **All figures £'000**	**2019**	**2018**
As at 1 January	(10,290)	(11,029)
Interest on pension scheme liabilities	(302)	(450)
Benefits paid	269	380
Experience gain/loss on liabilities	119	7
Loss on changes in assumptions	(619)	802
At 31 December	**(10,823)**	**(10,290)**

Notes to the Annual Report and Accounts (continued)

RETIREMENT BENEFIT LIABILITIES (continued)

The amounts recognised in the statement of financial position are determined as follows:

Group and Society All figures £'000	**2019**	**2018**
Present value of funded obligations	(10,823)	(10,290)
Fair value of plan assets	10,230	8,861
Liability in the statement of financial position	**(593)**	**(1,429)**

The actual return on plan assets was a gain of £1,474k (2018: £398k loss). The amounts recognised in the statement of comprehensive income are as follows:

Group and Society All figures £'000	**2019**	**2018**
Amounts recognised in finance income		
Interest cost	(302)	(450)
Administration costs	(36)	0
Interest on pension scheme assets	247	225
Total	**(91)**	**(225)**

Movement in the liability recognised in the statement of financial position:

Group and Society All figures £'000	**2019**	**2018**
Opening defined benefit obligation	(1,429)	(1,569)
Total as above	(91)	(225)
Employer contributions	200	179
Re-measurement gains/(losses)	727	186
Closing defined benefit obligation	**(593)**	**(1,429)**

The amounts recognised in the statement of other comprehensive income are as follows:

Group and Society All figures £'000	**2019**	**2018**
Actual return less interest on pension scheme assets	1,227	(623)
Experience gain/(loss) arising on scheme liabilities	119	7
Changes in assumptions underlying the present value of the scheme liabilities	(619)	802
Re-measurement of defined benefit obligation	**727**	**186**

Notes to the Annual Report and Accounts (continued)

RETIREMENT BENEFIT LIABILITIES (continued)

The major categories of plan assets are:

Group and Society **All figures £'000**	**2019**	**2018**
Equities	2,147	1,800
Bonds	7,327	6,256
Cash	51	104
Property	705	701
Total	**10,230**	**8,861**

The average duration of the defined benefit obligation at 31 December 2019 is 20 years (2018: 18 years). The table below shows an analysis by term to retirement of Scheme membership and past service liability as at the date of the last full actuarial valuation, 6 April 2018:

		Term to Retirement					
	Pensioners	0-5 years	6 – 10 years	11-15 years	16-20 years	21-25 years	26-30 years
Proportion of total liabilities (funding basis)	54.1%	17.1%	16.8%	5.2%	4.1%	2.6%	0.1%
Number of members	52	14	13	7	10	8	1

During 2019 the Group made additional contributions of £200k (2018: £184k) as part of its funding plan. The Group and Society expect to contribute £200k to the fund during 2020. History of experience gains and losses for the current and previous four years is as follows:

Group & Society **All figures £'000**	**2019**	**2018**	**2017**	**2016**	**2015**
Present value of defined benefit obligation	(10,823)	(10,290)	(11,029)	(10,747)	(7,878)
Fair value of plan assets	10,230	8,861	9,460	8,842	7,643
Plan (deficit)	(593)	(1,429)	(1,569)	(1,905)	(235)
Experience adjustments on plan liabilities	(119)	(7)	(3)	(32)	263
Percentage of scheme liabilities	1.1%	0.1%	0.0%	0.3%	-3.3%

The Society has agreed a schedule of contributions with the pension scheme expiring in June 2021, with the intention of eliminating the deficit.

Defined contribution scheme

Since April 2005 the Society has operated a defined contribution group personal pension scheme for eligible employees. Contributions of £281k were paid in 2019 (2018: £167k) to personal pension plans held in the names of individual employees with a major UK insurance company.

There were no outstanding contributions at the beginning or end of the year.

Notes to the Annual Report and Accounts (continued)

25. GENERAL RESERVE

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
At 1 January	40,077	36,722	38,892	35,537
Profit for the financial year	2,732	3,197	2,732	3,197
Net gain recognised directly in other comprehensive income	603	158	603	158
At 31 December	**43,412**	**40,077**	**42,227**	**38,892**

26. CASH AND CASH EQUIVALENTS

All figures £'000	2019 Group	2018 Group	2019 Society	2018 Society
Cash in hand	199	200	199	200
Balances with Bank of England	97,412	48,481	97,412	48,481
Loans and advances to credit institutions (note 11)	5,992	6,369	5,992	6,369
Total	**103,603**	**55,050**	**103,603**	**55,050**

Notes to the Annual Report and Accounts (continued)

27. FINANCIAL INSTRUMENTS

The Group is a retailer of financial instruments, mainly in the form of mortgages, savings and an introducer for insurance products. Through its normal operations it is exposed to a number of risks, the most significant of which are liquidity, credit risk in the mortgage book, credit risk in the treasury portfolio and interest rate risks (see below). The Group has a formal structure for managing these, including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Society's Board when considering the responsibility for managing and controlling the balance sheet exposures of the Group. The Assets and Liabilities Committee monitors interest rate risk in the balance sheet, including in accordance with the Society's policy regarding interest rate risk in the banking book as approved by the Board. The Risk Committee monitors other risk against the Board risk appetite statements.

Instruments used for risk management purposes include derivative financial instruments (derivatives). Derivatives are financial contracts or agreements whose value is derived from one (or more) underlying price, rate or index inherent in the contract or agreement, such as the interest rate. The principal derivatives used by the Group in balance sheet risk management are interest rate swaps, caps and collars which are used to hedge Group balance sheet exposures arising from fixed and capped rate mortgage lending, and fixed rate savings products. Such derivatives are only used in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors specified in the legislation. They are not used in trading activity or for speculative purposes.

The fair values of these hedges at 31 December 2019 are shown in note 12.

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised.

The tables below analyse the Group's assets and liabilities by financial classification:

Group & Society 2019 **All figures £'000**	**Amortised cost**	**Mandatorily at FVTPL**	**Total**
Cash and balances at central banks	97,611	-	97,611
Loans and advances to credit institutions	6,017	-	6,017
Derivative financial instruments	-	73	73
Loans and advances to customers	424,783	-	424,783
Total financial assets	**528,411**	**73**	**528,484**
Shares	394,896	-	394,896
Amounts owed to credit institutions	45,113	-	45,113
Amounts owed to other customers	45,895	-	45,895
Derivative financial instruments	-	356	356
Other financial liabilities	792	-	792
Total financial liabilities	**486,696**	**356**	**487,052**

Notes to the Annual Report and Accounts (continued)

FINANCIAL INSTRUMENTS (Continued)

Group & Society 2018 **All figures £'000**	**Amortised cost**	**Mandatorily at FVTPL**	**Total**
Cash and balances at central banks	48,681	-	48,681
Loans and advances to credit institutions	6,379	-	6,379
Derivative financial instruments	-	230	230
Loans and advances to customers	411,125	-	411,125
Total financial assets	**466,185**	**230**	**466,415**
Shares	340,246	-	340,246
Amounts owed to credit institutions	45,130	-	45,130
Amounts owed to other customers	40,887	-	40,887
Derivative financial instruments	-	97	97
Other financial liabilities	753	-	753
Total financial liabilities	**427,016**	**97**	**427,113**

The Society has an additional financial liability to its subsidiary of £1.185k (2018: £1.185k).

There have been no reclassifications other than those caused by the adoption of IFRS 9 on 1 January 2018.

Amounts owed to credit institutions are borrowings from the Bank of England under the Term Funding Scheme.

Fair value of financial assets and liabilities

Fair value is the value for which an asset or liability could be exchanged or settled between knowledgeable willing parties in an arm's length transaction. The estimated fair value of the financial assets and liabilities above has been calculated using the following valuation methodology (which is explained in note 1):

Note	**Valuation Category**	**Methodology**
1	Level 1	The fair value of cash in hand and deposits with central banks is the amount repayable on demand.
2	Level 2	The fair value of overnight deposits is the amount repayable on demand. The estimated fair value of loans and advances to credit institutions is calculated based on discounted expected future cash flows.
3	Level 3	Loans and advances are recorded net of provisions for impairment together with the fair value adjustment for hedged items as required by IFRS 9. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received taking account of expected prepayment rates. Estimated cash flows are discounted at prevailing market rates for items of similar remaining maturity. The fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.
4	Level 3	The fair value of shares and deposits and other borrowings with no stated maturity is the amount repayable on demand. The fair value of fixed interest bearing deposits and other borrowings without a quoted market price is based on expected future cash flows determined by the contractual terms and conditions discounted at prevailing market rates for items of similar remaining maturity.

Notes to the Annual Report and Accounts (continued)

FINANCIAL INSTRUMENTS (Continued)

The table below analyses the book and fair values of the Group's financial instruments held at amortised cost at 31 December.

Group & Society All figures £'000	Note	2019 Book value	2019 Fair value	2018 Book value	2018 Fair value
Financial assets					
Cash and balances at central banks	1	97,611	97,611	48,681	48,681
Loans and advances to credit institutions	2	6,017	6,017	6,379	6,379
Loans and advances to customers	3	424,783	430,250	411,125	412,167
Financial liabilities					
Shares	4	394,896	395,695	340,246	340,478
Amounts owed to credit institutions	4	45,113	45,113	45,130	45,130
Amounts owed to other customers	4	45,895	45,895	40,887	40,887

Fair value of financial assets and liabilities carried at fair value

The table below summarises the fair values of the Group's financial assets and liabilities that are accounted for at fair value, analysed by the valuation methodology used by the Group to derive the financial instruments fair value:

Group & Society 2019 All figures £'000	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial instruments		73		73
Financial liabilities				
Derivative financial instruments		(356)		(356)

Group & Society 2018 All figures £'000	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial instruments		230		230
Financial liabilities				
Derivative financial instruments		(97)		(97)

Notes to the Annual Report and Accounts (continued)

FINANCIAL INSTRUMENTS (Continued)

Valuation techniques

The following is a description of the determination of fair value for financial instruments which are accounted for at fair value using valuation techniques. The fair value hierarchy detailed in IFRS 13: 'Fair Value Measurement' splits the source of input when deriving fair values into three levels, as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly
- Level 3 – inputs for the asset or liability that are not based on observable market data

The main valuation techniques employed by the Group to establish fair value of the financial instruments disclosed above are set out below:

Interest rate swaps

- Level 2 - Interest rate swaps valuation is also based on the 'present value' method. Expected interest cash flows are discounted using the prevailing applicable rate: For swaps which are linked to 3 month LIBOR the 3 month LIBOR yield curves is used. For swaps which are linked to SONIA, the SONIA yield curve is used. The 3 month LIBOR and SONIA yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments.

The Society will be impacted by IBOR reform when existing LIBOR linked derivatives may re-designate to link to SONIA.

The impact will not be significant. Further detail is provided in note 12.

28. CREDIT RISK

Credit risk is the risk that the Group incurs a financial loss arising from the failure of a customer or counterparty to meet their contractual obligations. The Group structures the level of credit risk it undertakes, by maintaining a credit governance framework involving delegated approval authority levels and credit procedures, the objective of which is to build and maintain risk asset portfolios of high quality.

The Group's maximum credit risk exposure is detailed in the table below:

Group and Society **All figures £'000**	**2019**	**2018**
Cash and balances at central banks	97,611	48,681
Loans and advances to credit institutions	6,017	6,379
Other debtors	43	5
Derivative financial instruments	73	230
Loans and advances to customers	424,551	411,240
Total statement of financial position exposure	**528,295**	**466,535**
Off balance sheet exposure – mortgage commitments	22,501	14,896
Total credit risk exposure	**549,130**	**481,431**

Notes to the Annual Report and Accounts (continued)

29. TREASURY CREDIT RISK

Treasury credit risk is the risk that the counterparty may default. The elements on the statement of financial position that represent treasury credit risk are:

- Loans and advances to credit institutions
- Debt securities
- Derivative financial instruments

ALCO is responsible for approving treasury counterparties for both derivatives and investment purposes. Limits are placed on the amount of risk accepted in relation to one counterparty, or group of counterparties, and to industry sectors. This is monitored daily by the Society's Finance team and reviewed by the ALCO.

The Group's policy only permits lending to central government (which includes the Bank of England), banks with a high credit rating and certain building societies. Regular analysis of counterparty credit risk and monitoring of publicly available information is performed to highlight possible exposures.

An analysis of the Group's treasury asset concentration is shown in the table below:

Group & Society	2019 £'000	2019 %	2018 £'000	2018 %
Bank of England (AA)	97,414	94%	48,483	89%
AA to AA-	-	0%	3,479	6%
A+ to A	6,066	6%	2,898	5%
Other	221	0%	200	0%
Total	**103,701**	**100%**	**55,060**	**100%**

The Group has no exposure to foreign exchange risk. All instruments are denominated in Sterling.

All treasury exposures qualify as 'stage 1' exposures under IFRS 9 for impairment provisioning. The Society has Credit Support Annex agreements with all swap counterparties. These agreements have reciprocal arrangements that collateral be exchanged with a minimum threshold of £250k. At 31 December 2019 the Society had placed £520k of cash collateral with Lloyds Bank Corporate Markets PLC.

30. CUSTOMER CREDIT RISK

All mortgage loan applications are assessed with reference to the Group's lending policy, which includes assessing applicants for potential fraud risk, and which is approved by the Board.

The lending portfolio is monitored by the Risk Committee to ensure that it remains in line with the stated risk appetite of the Group, including adherence to the lending principles, policies and lending limits.

Credit risk management information is comprehensive and is circulated to the Risk Committee to ensure that the portfolio remains within the Group's risk appetite.

It is the Group's policy to strive for good customer outcomes and lend responsibly by verifying at the outset that the customer can meet the mortgage repayments. This is achieved by obtaining specific information from the customer concerning income and expenditure but also external credit reference agency data.

The Group does not have any exposure to the sub-prime market.

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (Continued)

Impairment of Financial Assets

IFRS 9 bases the recognition of impairment of financial assets on an expected credit loss ('ECL') approach for financial assets held at amortised cost and fair value.

ECLs are based on an assessment of the probability of default ('PD'), loss given default ('LGD') and exposure at default ('EAD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes.

IFRS 9 divides loans into three classes:

- No significant increase in credit risk since advance ('Performing')
- A significant increase in credit risk ('Underperforming')
- Impaired loans ('Non-Performing')

The Group's definition of a 'significant increase in credit risk' that results in a loan being categorised as Underperforming is determined by a combination of information available about the customer (e.g. credit bureau information) as well as the actual performance of the account. A loan is considered to be Underperforming when it meets any of the following criteria:

- A material reduction in the creditworthiness of the customer since inception as evidenced by an external credit score.
- Over 30 days in arrears
- Subject to forbearance. Loans subject to forbearance can be considered in two main categories; those which are loans which are on interest only to owner-occupier borrowers who will be aged over 70 at the maturity of the loan, where there is insufficient equity to sell and downsize, and others where the Society is in an arrangement with the borrower. The latter can be 'repaired' whereas this is very unlikely for the former.
- A high risk repayment strategy for owner-occupier interest only properties with insufficient equity for the borrower to sell and downsize.
- Other material information that has come to light since the loans inception (e.g. the customer entering into a debt management plan)
- No reliance is placed on mortgage indemnity guarantee insurance which the Society may have in place

A loan is characterised as a Non-Performing loan when it meets any of the following criteria:

- Over 90 days in arrears
- Customer is declared bankrupt
- Owner-occupied interest only mortgage where there is no strategy of repayment, the strategy is described as 'sale and downsize' but there is insufficient equity, or the strategy is simply described as 'other' with no detail.

Where a loan which was previously underperforming or non-performing becomes a performing loan, the balance will move back to the relevant category.

The provisions on performing loans are equal to the level of expected credit default events within the next year.

The provisions on both Underperforming and Non-Performing loans are made based on the expected credit losses over the expected life of the loan taking account of forward looking economic assumptions and a range of possible outcomes. The Group has decided to consider the impairment position under four economic scenarios of increasing severity ranging from a benign scenario that is based on the current position to the most severe scenario that is based on that used by the Bank of England to stress test the banking system.

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Impairment Implementation

The areas of key judgements within the IFRS 9 provisions are:

- Future economic forecasts and the linkage to arrears levels.
- The weighting that should be given to the different economic forecasts.
- The extent to which the customer credit score can reduce before it is considered to constitute a material reduction in credit-worthiness.
- The degree of management override that should be applied to circumstances where a probability of default / exposure at default approach is unsuitable (such as older interest only borrowers).

All scenarios are based upon creating an expected loss through applying:

- A probability of default
- A loss given default. This is a function of the erosion of the underlying security.

The approach is to separately evaluate the incremental risks posed to the security value and to the customer's probability of default. Risk drivers are separately considered to establish how they will cumulatively impact the risk to the security or the probability of default.

The result of this evaluation is to allocate the loan into a high, medium or low category for both security and probability of default as well as a numeric value to use for the erosion of security and the probability of default that could be used for each loan.

The probability weighting for the four scenarios chosen are:

- Benign (neutral economic scenario) – 45%
- Base (allied to the Society's expectations in its Corporate Plan)– 25%
- Downturn (economic recession) – 25%
- Severe ('tail event' downturn) – 5%

The key sensitivities that have been considered and modelled are:

- Changed weightings between the economic scenarios
- Increasing the probability of default by +/- 25% in each scenario
- Increasing the reduction in the value of security by 5% in each scenario
- Reducing the expected life of the portfolio

Changes to the economic scenario weightings will have the greatest impact upon the results. If the weightings are changed as below:

- Benign – 35%
- Base – 30%
- Downturn – 25%
- Severe ('tail event' downturn) – 10%

The resulting provision would be £290k higher

If the weightings are changed as below:

- Benign – 32%
- Base – 25%
- Downturn – 33%
- Severe ('tail event' downturn) – 10%

The resulting provision would be £368k higher

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

If the weightings are changed as below:

- Benign – 35%
- Base – 25%
- Downturn – 35%
- Severe ('tail event' downturn) – 5%

The resulting provision would be £119k higher

The key weightings are therefore those impacting the Downturn and Severe scenarios. The Severe scenario is designed to be such an 'outlier' that the probability of it happening more than once a century is considered remote (e.g. 1930s depression occurring in a home-owning economy). Thus the key weighting is that attaching to the Downturn, and a c£60k movement for each 5% increase in probability (where Base decreases by 5%) is not especially volatile.

The expected life impacts the proportion of the whole life credit loss that is used for performing loans. The remaining life is estimated at 1.25 years, if it were to reduce to 1 year the provision would increase by c£120k.

If the probability of default were to increase by 25% in each scenario then the provision would increase by c£70k. If it were to decrease by 25% then the provision would fall by c£170k.

If the post haircut property values fell by a further 5% in all scenarios this would increase the provision requirement by c£175k. If the post haircut security values were to increase by 5% in all scenarios this would reduce the provision by c£140k (2018: £249k).

The Group monitors concentration of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from loans and advances is shown below:

Group and Society **All figures £'000**	**2019**	**2018**
Loans and Advances to Customers (Gross Receivables)		
Loans fully secured on residential property	415,697	401,591
Other loans fully secured on land	9,544	10,292
Total	**425,241**	**411,883**

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Loans fully secured on residential property

The maximum credit risk exposure is detailed below:

Group and Society All figures £'000	2019	2018
Greater London	132,183	115,411
East Midlands	43,311	46,367
South East	86,583	86,483
South West	47,981	52,085
East of England	34,787	29,908
North West	24,495	21,611
West Midlands	17,640	18,557
Yorkshire and The Humber	12,204	14,631
Wales	10,299	9,989
North East	5,402	5,553
Scotland	812	996
Total	**415,697**	**401,591**

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears with only 0.1% (2018: 0.2%) of loan balances being three months or more in arrears.

Loans fully secured on residential property (Continued)

The credit risk exposure by loan to value band is detailed below:

Group and Society All figures £'000	Stage 1	Stage 2	Stage 3	2019 Total	2018 Total
Under 50%	185,379	9,367	527	**195,273**	206,962
50% to 75%	198,150	9,979	0	**208,129**	184,284
75% to 85%	8,066	161	0	**8,227**	6,783
Over 85%	3,907	161	0	**4,068**	3,562
Total	**395,502**	**19,668**	**527**	**415,697**	**401,591**

The average loan to value of residential mortgages is 48% (2018: 47%); indexed using the House Price Index published by the Land Registry.

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

The following table sets out information about the overdue status of loans and advances to customers in Stages 1,2 and 3 for 2019 under IFRS 9:

Group & Society				**2019**
All figures £'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Current	395,502	19,125	0	414,627
Past due up to 3 months	0	543	0	543
Past due over 3 months	0	0	527	527
Total	**395,502**	**19,668**	**527**	**415,697**

Group & Society				**2018**
All figures £'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Current	376,088	22,633	0	398,721
Past due up to 3 months	0	2,204	0	2,204
Past due over 3 months	0	0	666	666
Total	**376,088**	**24,836**	**666**	**401,591**

Loan commitments are considered to be in Stage 1 and have loan to values consistent with the existing portfolio of loans and advances.

The main factor for loans moving into arrears tends to be the condition of the general economic environment.

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Loans fully secured on residential property (Continued)

The value of collateral held is detailed below:

Group & Society **All figures £'000**	**Unindexed** **2019**	**Indexed** **2019**
Stage 1	990,297	1,191,189
Stage 2	43,805	56,790
Stage 3	1,245	2,168
Total	**1,035,348**	**1,250,147**

Group & Society **All figures £'000**	**Unindexed** **2018**	**Indexed** **2018**
Stage 1	958,831	1,219,318
Stage 2	52,560	70,848
Stage 3	1,374	3,229
Total	**1,012,765**	**1,293,394**

The collateral consists of residential property. Collateral values are adjusted by the Land Registry House Price Index to derive the indexed valuation at 31 December. This Index takes into account regional data from the 12 standard planning regions of the UK. The Group uses the Index to update the property values of its residential and buy-to-let portfolios on a quarterly basis.

With collateral capped to the amount of outstanding debt, the value of collateral held against loans past due and in 'Stage 2' at 31 December is £0.5m (2018:£2.2m) against outstanding debt of £0.5m (2018:£2.2m). In addition, the value of collateral held against loans past due and in 'Stage 3' at 31 December is £0.5m (2018:£0.7m) against outstanding debt of £0.5m (2018:£0.7m).

Mortgage indemnity insurance acts as additional security. It is taken out for all residential loans where the borrowing exceeds 75% of the value of the property at the point of application. However, no reliance is placed on this insurance when calculating any ECL.

The Group has various forbearance options to support customers who may find themselves in financial difficulty. These include payment plans, term extensions and reduced payment concessions. There were no properties in possession at 31 December 2019 (31 December 2018:0) and none taken into possession during the year.

Forbearance

Temporary interest only concessions are offered to customers in financial difficulty on a temporary basis with formal periodic review. The concessions allow customers to reduce monthly payments to cover interest only, and, if made, the arrears status would not increase. Reduced payment concessions allow a customer to make an agreed underpayment for a specific period of time. The monthly underpaid amount accrues as arrears and agreement is reached at the end of the concession period on how the arrears will be repaid.

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Loans fully secured on residential property (Continued)

Payment plans are agreed to enable customers to reduce their arrears balances by an agreed amount per month which is paid in addition to their standard monthly repayment.

The term of the mortgage is extended in order to reduce payments to a level which is affordable to the customer based on their current financial circumstances.

From the above list, only the suitable forbearance options will be offered to a customer when appropriate.

All forbearance arrangements are formally discussed with the customer and reviewed by management prior to acceptance of the forbearance arrangement. By offering customers in financial difficulty the option of forbearance the Society potentially exposes itself to an increased level of risk through prolonging the period of non-contractual payment and/or potentially placing the customer into a detrimental position at the end of the forbearance period.

Regular monitoring of the level and different types of forbearance activity are reported to the Board on a periodic basis. The Board monitors the level of arrears and forbearance cases. In addition all forbearance arrangements are reviewed and discussed with the customer on a regular basis to assess the ongoing potential risk to the Society and suitability of the arrangement for the customer.

The table below details the loan balances of forbearance cases:

Group and Society				**2019**	**2018**
All figures £'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	
Interest only concessions	0	773	0	773	293
Reduced payment concessions	0	69	0	69	181
Payment plans	0	579	95	674	323
Mortgage term extensions	0	3,139	0	3,139	3,467
Total	**0**	**4,560**	**95**	**4,655**	**4,263**

Other loans fully secured on land

The maximum credit risk exposure is detailed below:

Group and Society	**2019**	**2018**
All figures £'000		
Greater London	5,006	5,078
East Midlands	1	1
South East	1,433	1,813
South West	1,310	1,482
East of England	979	980
North West	353	354
West Midlands	0	78
Yorkshire and The Humber	321	354
North East	141	152
Total	**9,544**	**10,292**

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Other loans fully secured on land (Continued)

The credit risk exposure by loan to value band is detailed below:

Group and Society All figures £'000	Stage 1	Stage 2	Stage 3	2019 Total	2018 Total
Under 50%	4,008	0	0	**4,008**	**3,828**
50% to 75%	5,536	0	0	**5,536**	**6,464**
Over 75%	0	0	0	**0**	**0**
Total	**9,544**	**0**	**0**	**9,544**	**10,292**

The average loan to value of other loans fully secured on land is 54% (2018: 55%).

The quality of the Group's mortgage book secured on commercial property is reflected in the number and value of accounts in arrears with £nil (2017: £nil) of loan balances being three months or more in arrears.

The main factor for loans moving into arrears tends to be the condition of the general economic environment. The table below provides information on commercial loans by payment due status:

The following table sets out information about the overdue status of loans and advances to customers in Stages 1,2 and 3 for 2019 under IFRS 9:

Group & Society All figures £'000	Stage 1	Stage 2	Stage 3	2019 Total
Current	9,544	0	0	**9,544**
Overdue > 30 days	0	0	0	**0**
Total	**9,544**	**0**	**0**	**9,544**

Group & Society All figures £'000	Stage 1	Stage 2	Stage 3	2018 Total
Current	9,786	506	0	**10,292**
Overdue > 30 days	0	0	0	**0**
Total	**9,786**	**506**	**0**	**10,292**

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Other loans fully secured on land (Continued)

The value of collateral held is detailed below:

Group & Society All figures £'000	Unindexed 2019	Indexed 2019
Stage 1	18,577	18,577
Stage 2	0	0
Stage 3	0	0
Total	**18,577**	**18,577**

Group & Society All figures £'000	Unindexed 2018	Indexed 2018
Stage 1	19,057	19,057
Stage 2	750	750
Stage 3	0	0
Total	**19,807**	**19,807**

The collateral consists of commercial property. Collateral is capped at the amount of outstanding exposure.

There were no properties in possession or repossessed in the year. The Group has various forbearance options to support customers who may find themselves in financial difficulty. These include payment plans, term extensions and reduced payment concessions.

Forbearance

The forbearance policy for loans fully secured on land is the same as that for loans fully secured on residential property.

There was one mortgage in forbearance or impaired at 31 December 2019 (2018: £nil). Provisions of £27k (2018:£55k) are made for loans fully secured on land.

Group and Society All figures £'000	Stage 1	Stage 2	Stage 3	2019 Total	2018
Reduced payment concessions	0	0	0	0	**506**
Total	**0**	**0**	**0**	**0**	**506**

Provisions for loans fully secured on land are reported in Note 13.

Notes to the Annual Report and Accounts (continued)

31. LIQUIDITY RISK

The Group's policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to maintain public confidence in the solvency of the Group and to enable it to meet its financial obligations as they arise. This is achieved through maintaining a prudent level of liquid assets and through control of the growth of the business. A significant proportion of the Society's liquidity is held either at call or in the form of debt securities and treasury bills, which are capable of being sold at short notice to meet unexpected and severe adverse cash flows. Stress tests are undertaken to measure the Society's ability to meet such adverse flows, the results of which are reviewed by ALCO. The Board is confident that the Society will continue to be able to meet its future financial obligations as they arise.

The table below analyses the Group's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the statement of financial position date. This is not representative of the Group's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. The average life of a mortgage at the Group is c 2.5 years. Conversely, retail deposits repayable on demand generally remain on balance sheet much longer.

Group 2019 **All figures £'000**	**On demand**	**Not more than 3 months**	**More than 3 months but not more than a year**	**More than a year but not more than 5 years**	**More than 5 years**	**Total**
Cash and balances at central banks	97,611	0	0	0	0	97,611
Loans and advances to credit institutions	6,017	0	0	0	0	6,017
Derivative financial instruments	0	0	73	0	0	73
Loans and advances to customers	1,070	3,745	25,397	92,158	302,413	424,783
Total assets	**104,698**	**3,745**	**25,470**	**92,158**	**302,413**	**528,484**
Shares	157,568	117,815	91,161	28,352	0	394,896
Amounts owed to credit institutions	113	0	0	45,000	0	45,113
Amounts owed to other customers	6,486	34,579	4,404	426	0	45,895
Derivative financial instruments	2	54	300	0	0	356
Total liabilities and reserves	**164,169**	**152,448**	**95,865**	**73,778**	**0**	**486,260**

Notes to the Annual Report and Accounts (continued)

LIQUIDITY RISK (Continued)

Group 2018 **All figures £'000**	**On demand**	**Not more than 3 months**	**More than 3 months but not more than a year**	**More than a year but not more than 5 years**	**More than 5 years**	**Total**
Cash and balances at central banks	48,681	0	0	0	0	48,681
Loans and advances to credit institutions	6,379	0	0	0	0	6,379
Derivative financial instruments	0	2	16	212	0	230
Loans and advances to customers	3,429	2,547	19,965	83,591	301,593	411,125
Non-financial assets	0	0	0	0	2,618	2,618
Total assets	**58,489**	**2,549**	**19,981**	**83,803**	**304,211**	**469,033**
Shares	157,594	131,692	46,906	4,054	0	340,246
Amounts owed to credit institutions	130	0	0	45,000	0	45,130
Amounts owed to other customers	7,219	33,668	0	0	0	40,887
Derivative financial instruments	0	0	1	96	0	97
Non-financial liabilities	0	0	0	0	2,596	2,596
Reserves	0	0	0	0	40,077	40,077
Total liabilities and reserves	**164,943**	**165,360**	**46,907**	**49,150**	**42,673**	**469,033**

The following is an analysis of the gross contractual cash flows payable under financial liabilities:

Group and Society 2019 **All figures £'000**	**On demand**	**Not more than 3 months**	**More than 3 months but not more than a year**	**More than a year but not more than 5 years**	**More than 5 years**	**Total**
Shares	157,568	118,094	91,773	29,606	0	397,041
Amounts owed to credit institutions	113	0	0	45,000	0	45,113
Amounts owed to other customers	6,486	32,522	5,433	1,549	0	45,990
Derivative financial instruments	2	54	300	0	0	356
Total financial liabilities	**164,169**	**150,670**	**97,506**	**76,155**	**0**	**488,500**

Notes to the Annual Report and Accounts (continued)

LIQUIDITY RISK (Continued)

Group and Society 2018 **All figures £'000**	**On demand**	**Not more than 3 months**	**More than 3 months but not more than a year**	**More than a year but not more than 5 years**	**More than 5 years**	**Total**
Shares	157,594	131,938	47,366	4,159	0	341,057
Amounts owed to credit institutions	130	0	0	45,000	0	45,130
Amounts owed to other customers	7,219	33,723	0	0	0	40,942
Derivative financial instruments	0	0	1	96	0	97
Total financial liabilities	**164,943**	**165,661**	**47,367**	**49,255**	**0**	**427,226**

32. MARKET RISK

Market risk is the risk of changes to the Society's financial condition caused by market interest rates. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk).

The Society has adopted the 'Matched Plus' approach to interest rate risk, as agreed with the PRA, which aims to manage interest rate exposures to within Board agreed limits through the use of either a natural hedge or an interest rate derivative.

The management of interest rate risk is based, inter alia, on a full statement of financial position gap analysis. The statement of financial position is subjected to a number of stress tests. On a monthly basis, these stress tests include stressing interest rates by 2.5%, short term increases or decreases followed by longer term flattening of interest rates and gradual movements in interest rates. In addition management review interest rate basis risk; stressing the statement of financial position by both expected and a severe stress scenarios. Both sets of results are measured against the Board's appetite for risk. The Board has set a risk appetite for market risk measured in the stressed gap analysis of £1.5m of capital. The Board has set a risk appetite for basis risk based on minimum margins which are revised annually. These stress tests and their results are monitored by the ALCO and reported to the Board.

Notes to the Annual Report and Accounts (continued)

MARKET RISK (Continued)

The tables below summarise the Group's exposure to interest rate risk. Included in the tables are Group assets and liabilities, including derivative financial instruments which are principally used to reduce exposure to interest rate risk, categorised by re-pricing date.

Group 2019 **All figures £'000**	**Not more than 3 months**	**More than 3 months but not more than a year**	**More than a year but not more than 5 years**	**Non-interest bearing**	**Total**
Cash and balances at central banks	97,412	0	0	198	97,610
Loans and advances to credit institutions	5,472	0	0	545	6,017
Derivative financial instruments	0	0	0	73	73
Loans and advances to customers	317,555	21,765	85,463	0	424,783
Non-financial assets	0	0	0	2,766	2,766
Total assets	420,439	21,765	85,463	3,583	531,250
Shares	363,164	2,455	28,107	1,170	394,896
Amounts owed to credit institutions	45,113	0	0	0	45,113
Amounts owed to other customers	38,734	5,382	1,536	243	45,895
Derivative financial instruments	0	0	0	356	356
Non-financial liabilities	0	0	0	1,578	1,578
Reserves	0	0	0	43,412	43,412
Total liabilities and reserves	447,011	7,837	29,643	46,759	531,250
Impact of derivative instruments	81,000	(59,000)	(22,000)	0	0
Interest rate sensitivity gap	54,428	(45,072)	33,820	(43,176)	0
Sensitivity to movement in interest rates on profit and reserves					
Parallel shift of + 2%	(91)	(23)	312	0	198
Parallel shift of - 2%	91	23	(312)	0	(198)

Notes to the Annual Report and Accounts (continued)

MARKET RISK (Continued)

Group 2018 All figures £'000	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	Non-interest bearing	Total
Cash and balances at central banks	48,481	0	0	200	48,681
Loans and advances to credit institutions	6,379	0	0	0	6,379
Derivative financial instruments	0	0	0	230	230
Loans and advances to customers	332,656	18,048	60,421	0	411,125
Non-financial assets	0	0	0	2,618	2,618
Total assets	**387,516**	**18,048**	**60,421**	**3,048**	**469,033**
Shares	314,124	2,075	23,000	1,047	340,246
Amounts owed to credit institutions	45,130	0	0	0	45,130
Amounts owed to other customers	40,729	0	0	158	40,887
Derivative financial instruments	0	0	0	97	97
Non-financial liabilities	0	0	0	2,596	2,596
Reserves	0	0	0	40,077	40,077
Total liabilities and reserves	**399,983**	**2,075**	**23,000**	**43,975**	**469,033**
Impact of derivative instruments	60,000	(7,000)	(53,000)	0	0
Interest rate sensitivity gap	**47,533**	**8,973**	**(15,579)**	**(40,927)**	**(0)**
Sensitivity to profit and reserves					
Parallel shift of + 2%	(141)	179	(187)	0	(149)
Parallel shift of - 2%	141	(179)	187	0	149

There is no material difference between the interest rate risk profile for the Group and that for the Society.

The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the statement of financial position as IAS 32 'Financial Instruments – Presentation' requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society.

All financial assets and liabilities are presented on a gross basis in the statement of financial position.

The Society and Group, at December 2019, have entered into Credit Support Annexes (CSAs) for its derivative instruments which provide for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure. These are set to a minimum threshold of £250k. At 31 December 2019 the Society had provided £520k (2018:£nil) cash collateral under such agreements.

Notes to the Annual Report and Accounts (continued)

33. CAPITAL STRUCTURE

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal ICAAP process (Internal Capital Adequacy Assessment Process) assists the Society with its management of capital. The business planning updates enable the board to monitor the Society's capital position to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Society's actual and expected capital position is reviewed against stated risk appetite which aims to maintain capital at a specific level above its Internal Capital Guidance (ICG).

The Board manages the Society's capital and risk exposures to maintain capital in line with regulatory requirements. This is subjected to regular stress tests to ensure the Society maintains sufficient capital for future possible events.

The Group's capital requirements are set and monitored by the PRA. During 2019 the Society has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III).

There were no reported breaches of capital requirements during the year. There have been no material changes in the Society's management of capital during the year. At 31 December 2019 the Group had CET1 (Common Equity Tier 1) capital of £43m (2018:£40m) comprising of general reserves less intangible assets and other regulatory adjustments. The Group had no tier 2 capital, meaning that total regulatory capital was also £43m (2018:£40m).

Under Basel III Pillar 3 the Society is required to publish further information regarding its capital position and exposures. The Society's Pillar 3 disclosures are available on our website www.mhbs.co.uk.

Lending and Business Decisions

The Society manually underwrites all lending decisions to enable it to make appropriate decisions based on an individual's circumstances. Once loan funds have been advanced detailed portfolio management information is used to review the ongoing risk profile of both the portfolios and individual customers. In addition, for residential and buy-to-let mortgages, property values are updated on a quarterly basis.

Pricing

Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.

Counterparty risk

Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits. The limits are monitored daily to ensure the Society remains within risk appetite.

34. GUARANTEES AND FINANCIAL COMMITMENTS

The Society and Group have capital expenditure contracted for but not provided for in the accounts at 31 December 2019 £137k (2018:£nil).

The total of future minimum lease payments under non-cancellable operating leases at 31 December 2019 is £88k, expiring between five and ten years (2018:£95k).

Notes to the Annual Report and Accounts (continued)

35. RELATED PARTY TRANSACTIONS

Key management personnel compensation

The directors of the Society are considered to be the only key management personnel as defined by IAS 24. Total compensation for key management personnel was as follows and a breakdown is disclosed on page 57 in the Directors' remuneration report.

Group and Society All figures £'000	2019	2018
Key management personnel compensation	**701**	672

Transactions with key management personnel and their close family members

The following transactions were undertaken through the normal course of business:

Group & Society	2019 £'000	2019 Number of people	2018 £'000	2018 Number of people
Deposits, share accounts and investments				
Net movement in the year	43		11	
Balance at 31 December	105	11	86	9

Key management personnel and members of close family received interest of less than £1k in total (2018: less than £1k in total) during the year.

Secured loans made to key management personnel and members of their close family would be on the same terms and conditions that are applicable to all other employees and members of Market Harborough Building Society.

Amounts deposited by key management personnel and members of their close family earn interest at the same rates and on the same terms and conditions as applicable to all other employees and members of Market Harborough Building Society.

Directors' loans and transactions

At 31 December 2019 there were no outstanding secured mortgage loans (2018: nil) to directors and their connected persons. A register is maintained at the Head Office of the Society which shows details of all loans, transactions and arrangements with directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 December 2019, will be available for inspection at the Head Office for a period of 15 days up to and including the annual general meeting.

Subsidiary Company

The Society directly holds 100% of the issued ordinary share capital of Market Harborough Mortgages Limited. The principal activity of the company is mortgage related finance. Its share capital is £1 (2018: £1). Its principal place of business is Welland House, The Square, Market Harborough, Leicestershire, LE16 7PD. It is registered in England and Wales. There have been no additions or disposals of investments during the year. Market Harborough Mortgages Limited became dormant from 1 January 2016. There were no transactions between the entities during the year.

Notes to the Annual Report and Accounts (continued)

36. COUNTRY BY COUNTRY REPORTING

Article 89 of the Capital Requirements Directive IV requires credit institutions and investments firms in the EU to disclose annually, specifying by Member State in which it has an establishment, the following information on a consolidated basis for the year: name, nature of activities, geographical location, turnover, number of employees, profit before tax, corporation tax paid and public subsidies received.

The principal activities of Market Harborough Building Society are provision of residential mortgages and retail savings products.

Market Harborough Building Society and its subsidiary operate only in the United Kingdom. Details of the Society's trading subsidiaries are disclosed in Note 14.

Average employee numbers are disclosed in Note 8.

Group All figures £'000	2019	2018
Turnover	11,183	11,116
Profit before tax	3,316	4,008
Corporation tax paid	725	667

Turnover consists of net interest income, net fees and commissions received or paid and other income.

No public subsidies were received by the Group.

Basis of preparation

The Country by Country information for the year ended 31 December 2019 has been prepared on the following basis:

The number of employees has been calculated as the average number of full and part-time employees, on a monthly basis, as disclosed in note 8.

Turnover represents total operating income as disclosed in the Group Income Statement. Total operating income comprises net interest income, fees and commissions receivable and payable and other income.

Pre-tax profit or loss represents the Group profit or loss before tax, as reported in the Group Income Statement.

Corporation tax paid represents the cash amount of corporation tax paid during the year, as disclosed in the Group Statement of Cash Flow.

No public subsidies were received during the year, however the Society is a participant of the Term Funding Scheme. Borrowings from the scheme are shown in note 27.

Statement of Directors' responsibilities in relation to the Country by Country Reporting (CBCR) Information

The Directors of the Society are responsible for preparing the CBCR Information for the year ended 31 December 2019 in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013. In preparing the CBCR Information, the Directors are responsible for:

- interpreting the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013;
- determining the acceptability of the basis of preparation set out above to the CBCR information;
- making judgements and estimates that are reasonable and prudent; and
- establishing such internal control as the Directors determine is necessary to enable the preparation of CBCR Information that is free from material misstatement, whether due to fraud or error.

Annual Business Statement

1. STATUTORY RATIOS AND OTHER PERCENTAGES

Group	2019	Statutory limit
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	2.6%	25%
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	19.0%	50%

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 (as amended by the Building Societies Act 1997) and are based on the statement of financial position.

Business assets are the total assets of the Group as shown in the statement of financial position plus provisions for impairment, less tangible fixed assets and liquid assets.

Loans fully secured on residential property are the amount of principal owed by borrowers and interest accrued not yet payable. This is the amount shown in the statement of financial position plus provisions for bad and doubtful debts and interest in suspense.

2. OTHER PERCENTAGES

Group	2019	2018
As a percentage of shares and borrowings		
Gross capital	8.9%	9.4%
Free capital	8.7%	9.2%
Liquid assets	21.3%	12.9%
Liquid assets (including off balance sheet FLS funding)	21.3%	17.8%
As a percentage of mean total assets		
Profit after taxation	0.5%	0.7%
Management expenses (Group)	1.6%	1.5%
Management expenses (Society)	1.6%	1.5%
As a percentage of total assets at year end		
Return on assets	0.5%	0.7%

The above percentages have been calculated from the Group Annual Report and Accounts.

Definitions

'Gross capital' represents the general reserve.

'Free capital' represents the general reserve plus provisions for bad and doubtful debts less tangible fixed assets.

'Mean total assets' is the average of the 2019 and 2018 year-end total assets.

'Liquid assets' represents available liquidity on the Group’s balance sheet.

'Liquid assets (including off balance sheet FLS funding)' represents both available liquidity on the Group’s balance sheet and Treasury Bills borrowed under the Funding for Lending Scheme, which would have to be sold to convert to readily available liquidity.

Annual Business Statement (continued)

3. INFORMATION RELATING TO THE DIRECTORS

Director	Occupation / Professional Qualification	Other Directorships	Year of Birth	Date of Appointment
Michael Bury	Company Director & Chartered Accountant & Corporate Treasurer	Benenden Hospital Trust The Benenden Healthcare Society Limited Royal Voluntary Service JMSM Investments Limited	1961	01-05-19
Nicholas Fielden	Finance Director	Market Harborough Mortgages Ltd	1965	09-12-13
Lindsay Forster	Company Director		1974	01-07-19
Jonathan Fox	Company Director	Fox 65 Racing Ltd	1965	01-09-15
Justin Fox	Company Director	Calumet Management Consulting Ltd Chadlington Brewery Ltd	1970	01-05-19
Nicholas Johnston	Chartered Accountant	Market Harborough Mortgages Ltd	1959	01-08-09
Andrew Merrick	Company Director & Chartered Accountant	Yorkshire Water Services Ltd Kelda Finance (No3) Plc	1961	01-01-18
Mark Robinson	Chief Executive	Market Harborough Mortgages Ltd Market Harborough Cottage Hospital Portico Great War Memorial Project	1957	17-09-07
Zoe Shapiro	Company Director		1969	01-02-16
Michael Thomas	Company Director & Corporate Treasurer & Chartered Accountant	AST Language Services Ltd	1964	10-07-13

The Chief Executive has a notice period of twelve months by the Society and six months by the executive, and the Finance Director has a notice period of 6 months by both the executive and the Society. The contract for Mark Robinson was entered into on 17 September 2007 and for Nicholas Fielden on 4 November 2013.

Documents may be served on any of the directors, marked as “private and confidential” to the Secretary at the offices of the Society at Welland House, The Square, Market Harborough, LE16 7PD.

Annual Business Statement (continued)

4. OTHER SENIOR EXECUTIVES

Name	Occupation	Directorships
Stephen Barringer	Head of Lending	None
Michelle Pledger	Head of Risk	None
Elizabeth Souter	Financial Controller & Secretary	Uppingham Community College
Annie Cossar	Head of Operations	None

5. NEW ACTIVITIES

No new powers were exercised for the first time during the year.

Glossary

Term	Definition
Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Basel III	The Basel Committee on Banking Supervision issued the Basel III rules text in December 2010, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. Basel III became effective from 1 January 2014 through CRD IV.
Buy to let loans	Buy to let loans are those loans which are offered to customers buying residential property specifically to let out. Common Equity Tier 1 capital (CET1)
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Core Tier 1 capital	Core Tier 1 capital comprises general reserves, other reserves less intangible assets and other regulatory deductions.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
Capital Requirements Directive (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It has revised the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Deferred tax asset	Corporation tax recoverable (or payable) in future periods resulting from temporary or timing differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rates.
Expected credit loss (ECL)	Expected credit loss is a calculation of the present value of the amount expected to be lost on a financial asset over its expected life.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid and received between parties which are integral to the contract.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms

Glossary (continued)

Term	Definition
Financial Services Compensation Scheme	The UK's compensation fund of last resort for customers of authorised financial services firm. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession.
Free Capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding Limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
General reserves	The accumulation of the Society's historic and current year profits which is the main component of Common Equity Tier 1 capital.
Gross capital	General reserves
Impaired loans	Loans which have been classified as Stage 3 (see definition below).
Individual liquidity adequacy assessment (ILAA)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments.
Interest rate risk	The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Leverage ratio	Leverage ratio is defined as Tier 1 capital divided by the total exposures which includes on and off balance sheet items, with this ratio expressed as a percentage.
Liquid Assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
Liquidity risk	Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Loans past due	Loans are past due when a loan payment that has not been made as of its due date.

Glossary (continued)

Term	Definition
Management expenses	The aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will create potential losses or decrease the value of the Society balance sheet.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Renegotiated loans	Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan may no longer be treated as past due or impaired.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel II capital rules to reflect the degree of risk they represent.
Residential loans	Loans that are loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK from the 1 April 2013. The PRA is a subsidiary of the Bank of England.
Secured business lending (SBL)	Loans secured on commercial property which is only made available to Small and Medium sized Enterprises.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The aggregate of shares, amounts owed to credit institutions, amounts owed to other customers.
Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the balance sheet. 12 month ECL are recognised as the impairment provision for all financial assets on initial recognition.
Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision.
Stage 3	Stage 3 assets are those which are credit impaired. Lifetime ECL is also recognised as an impairment provision.

Standardised approach	The basic method used to calculate capital requirements for credit risk under Basel II. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Tier 1 capital	A measure of financial strength as defined by the FSA. Comprises general reserves from retained profits and permanent interest bearing shares (PIBS), less intangible assets and other regulatory adjustments.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Basel II Standardised basis), less certain regulatory deductions.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
Wholesale funding	The total of amounts owed to credit institutions, amounts owed to other customers.

Head Office

Market Harborough Building Society

Welland House

The Square

Leicestershire

LE16 7PD

Telephone: 01858 412250

Fax: 01858 412254

DX No. 27312 Market Harborough

Website: **mhbs.co.uk**

Email: **CustomersFirst@mhbs.co.uk**