Capital Requirements Directive
Pillar 3 Disclosures
March 2018

Contents

1. Background

PURPOSE

The purpose of this document is to provide members and other stakeholders with background information on the Society's approach to risk management and the maintenance of its capital strength. As such, it includes details of the Society's:

- Approach to risk management
- Governance structure
- Capital resources
- Regulatory capital requirements
- Compliance with the EU Capital Requirements Regulation.

LEGISLATIVE FRAMEWORK

A legislative capital adequacy framework, the Capital Requirements Directive (CRD - also known as Basel II) was introduced in the European Union in 2007 which governs the amount of capital that banks and building societies are required to hold in order to protect their members, depositors and shareholders. The Society seeks to ensure that it protects its members by holding sufficient capital at all times.

The Prudential Regulation Authority (PRA), Market Harborough Building Society's (the Society) prudential regulator, is the body responsible for implementing the CRD in the UK. The Society has been operating under the Basel II regime since 1 January 2008. It has adopted the Standardised Approach for Credit risk and the Basic Indicator Approach for Operational risk.

The CRD consists of 3 elements, or 'Pillars', which represent the key principles of the Basel II regime:

Pillar 1

This covers the minimum capital requirements of Basel II and focuses on credit, operational and market risk in determining the Society's minimum regulatory capital requirement, Capital Resources Requirement (CRR).

Pillar 2

This covers the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP). Under the ICAAP the Society's Board has undertaken an assessment of all of the key risks facing the Society's business for which capital has not been provided under the Pillar 1 requirements. The results of the Board's assessment are subject to review by the PRA under the SREP arrangements.

Pillar 3

This covers the disclosures that the Society is required to publish under the CRD in relation to key information about its underlying risks, capital and risk management. This document discloses that information and is in accordance with regulatory requirements.

CRD ADOPTION

The Society's Board first approved the ICAAP in December 2007 in advance of its adoption of the CRD's requirements from 1 January 2008. Since then the ICAAP has been updated and approved by the Board at least annually, most recently in June 2017.

The Society's regulator conducted the most recent SREP during April 2016, the conclusion of which was that the actual level of the Society's capital was significantly in excess of the minimum requirements.

BASIS & FREQUENCY OF DISCLOSURES

This Pillar 3 disclosure covers Market Harborough Building Society Group ('the Group') which is made up of the Society and Market Harborough Mortgages Limited. These bodies are regulated as a single entity and this disclosure treats them as such. References to the Society in this document, therefore, includes Market Harborough Mortgages Limited.

The figures in this Pillar 3 disclosure are drawn from the Group's Annual Report and Accounts as at 31 December 2017. The Board's Disclosure Policy for its Pillar 3 disclosures is based on its interpretation of the requirements of CRD IV. The Pillar 3 disclosures are updated, and published on the Society's website on an annual basis, following publication of the Annual Report and Accounts.

SUMMARY OF KEY CAPITAL RATIOS

The key capital ratios under CRDIV are presented below:

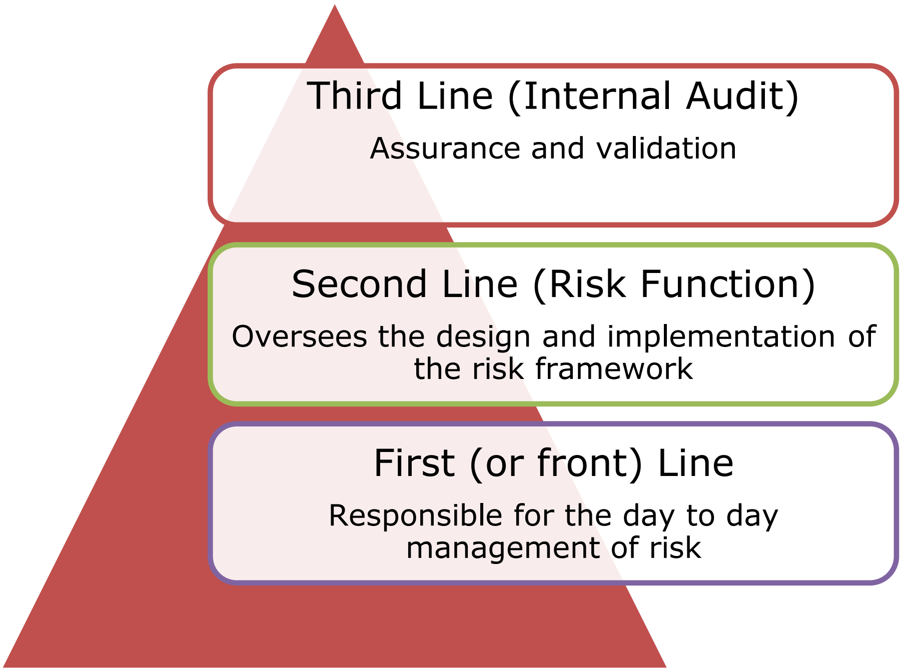
	2017	**2016**
Common Equity Tier 1 (CET1) ratio	23.6%	22.5%
Total Capital Ratio	23.9%	22.9%
Risk Weighted Assets (£k)	153,893	147,571
Leverage Ratio	7.4%	6.9%

2. Risk Management Objectives and Policies

INTRODUCTION

Risk is a natural consequence of the Society's business activities and environment. Through prudent management, the Society aims to manage risk in a manner that supports achievement of its strategic objectives and business plans, whilst protecting members' interests and its financial resources.

The Board is responsible for ensuring that an effective framework is in place to promote and embed an effective risk-aware culture that identifies, appropriately mitigates and manages the risks which the Society faces, in the course of delivering its strategic objectives. The Society has adopted a 'three lines of defence' approach to the allocation of responsibilities for risk identification and management. This is illustrated in the following diagram:



GOVERNANCE STRUCTURE

The Society's risk governance structure is detailed below:

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

Board Committees

Board

The Board meets at least 6 times a year in addition to two additional strategy sessions, and provides oversight and detailed review over the Society. The risk management framework and key policies all originate from the Board. It is specifically responsible for the review and approval of the strategy, 3 year Corporate Plan, the Recovery & Resolution Plan (RRP) and the ICAAP.

In addition, the non executive directors (NEDs) are required to review all lending above the criteria set out in the Lending Policy – these criteria have deliberately been set reasonably low such that it is usual for around 5 of the larger or more complex loans a month to need NED approval. The purpose being to critique not only the individual loan, but also Management rationale for recommending the loan in the first place.

Rem Co

The Remuneration Committee is responsible for setting Executive pay levels and approving all Executive bonus schemes. It comprises 3 NEDs and meets at least three times a year.

Nom Co

The Nominations Committee is responsible for all senior appointments and Board employment decisions. It comprises 3 NEDs and meets not less than twice each year.

Audit & Compliance

The purpose of the Committee is to ensure the integrity of the control environment and the Society's adherence to the regulatory requirements. The Committee meets 4 times a year and is chaired by a NED, and comprises 3 other NEDs. The Chief Executive Officer (CEO), Finance Director (FD), Financial Controller and Head of Risk are Management attendees.

The Committee is responsible for ensuring that the Society remains compliant with regulation and the approval of, and monitoring the progress with, the Annual Compliance Plan.

The internal audit function reports to the Committee and the terms of appointment and external audit process are overseen by the Committee.

Risk Committee

The Committee meets 4 times a year, and is chaired by a NED, and comprises 2 other NEDs. The CEO, FD, Financial Controller and Head of Risk are Management attendees.

It is responsible for the development of the Risk Framework (see below), and is the Committee responsible for the detailed examination of the stress-tests in the ICAAP (although the approval of the document remains with the Board). The Risk Committee reviews the Risk Register presented by Management and is responsible for the review of operational risk reports.

This Committee specifically reviews the composition of the lending book through the review of an enhanced set of portfolio reports, and instructs thematic 'dives' into areas that are considered emerging risks. All changes and developments to the Lending Policies are approved by the Committee for recommendation by the full Board. The Committee is also responsible for approving any proposed changes to the underwriting framework, such as individual mandate limits.

The Committee is also responsible for the monitoring of Conduct Risk, with reporting to the full Board.

Assets & Liabilities Committee (ALCO)

This oversees the Treasury activities of the Society and is responsible for anticipating and identifying emerging risks to the Society's position in relation to its balance sheet structure, and to approve or recommend changes to financial policies or limits. Specifically this requires the management of market (interest rate) risk, liquidity risk and counterparty credit risk.

Membership currently comprises 3 NEDs and the 2 Executive Directors. The Financial Controller and Head of Risk are management attendees to the Committee. It meets 6 times a year.

Management Committees

Executive Risk Committee

This meets 4 times a year and identifies and monitors risks and / or control weaknesses to the Society's strategy, operations and performance and acts as the platform from which material issues can be escalated to the Board or Board Sub Committees. The Committee comprises the full executive team including the 2 Executive Directors.

Credit Committee

This is responsible for approving all loan decisions above the level of the underwriting team (but below Board), and for escalating loans that it recommends but are above its mandate to the full Board. It meets as required and comprises the CEO, FD, Financial Controller, the Head of Risk and the Head of Mortgages and Savings (for non-Commercial cases only) and the Head of Sales and Marketing (for Commercial cases only).

Management ALCO

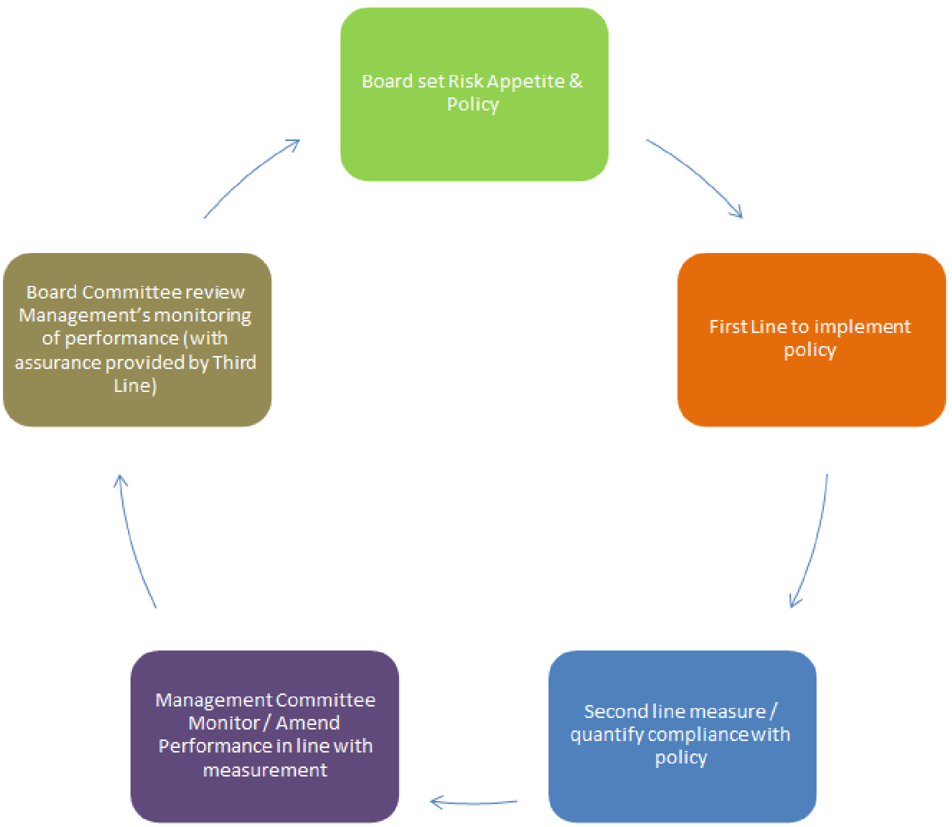
This Committee meets in those months that ALCO does not (i.e. 6 times a year). It reviews the same core reports as ALCO and is a check to ensure that the balance sheet structure remains within limits set by (Board) ALCO. If any issue was identified it would be escalated to the (Board) ALCO rather than waiting for the next month. Membership comprises the Executive Directors, the Management attendees on (Board) ALCO and the Treasury Analyst.

Weekly Liquidity Meeting

This is a meeting of the CEO, FD and Financial Controller to review the current liquidity position and the expected movements over the next three months. On the back of the discussions held, decisions as to the pricing that can influence wholesale and retail flows are made.

RISK MANAGEMENT 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 policy (albeit the discussion and setting of the proposed limits, but not ultimate ratification, is sometimes delegated to a Board Sub-Committee) and 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 diagram below shows the manner in which risk appetite is set and then subsequently monitored.



The intention is to produce a form of 'three lines of defence' model that is appropriate to a business of this scale.

This 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, there is a member of the Executive accountable for implementing that policy, there is an agreed set of metrics to demonstrate control over the risk which are produced by a second line for review by Management and / or Board Committees.

The graphic below attempts to show this relationship in respect of the key risks that the business faces.

Risk	**Credit**	**Liquidity**	**Market**	**Conduct**	**Business & Strategic**	**Operational**
Board Committee	Risk	ALCO	ALCO	Risk	Board	Risk / Audit & Compliance
Policy Control	Lending Policy including mandates Risk Appetite	Counterparty Policy Liquidity Policy	Structural Risk Policy Pension Obligation	Conduct Risk Appetite Statement Conflicts of Interest and Anti-Bribery Policy	Corporate Plan Annual Budget Project Governance	IT and Data Security Policy BCP Op Risk Policy Financial Crime Cyber Risk Data Governance
First Line	Underwriting Team	Finance	Finance	Sales / Operations	CEO	All areas
Second line responsible for monitoring	Head of Risk	Head of Risk	Head of Risk	Head of Risk	FD	Head of Risk
Mgt Committee responsible for performance	Credit Committee Executive Risk Committee	M-ALCO	M- ALCO	Executive Risk Committee	Executive Risk Committee	Executive Risk Committee
Third Line	Internal Audit					

A Risk Register, which forms part of the ICAAP document, records the key risks to which the Society is exposed and includes an assessment of their likelihood and impact. This is reviewed by the Board at least twice a year and forms a basis for the identification of the risks for which capital is provided under Pillar 2.

3. Capital Resources

The Society's capital resources as at 31 December 2017 amounted to £36.7m. These capital resources are predominantly made up of Core Equity Tier 1 capital (CET1 capital). The Tier 2 capital is made up of the collective impairment provision.

TIER 1 AND TIER 2 CAPITAL RESOURCES

All figures £k	**2017**	**2016**
General Reserves	36,512	33,637
Deduction – Intangible Assets	(229)	(364)
CET1 Capital	**36,283**	**33,273**
Tier 2 Capital - Collective Impairment Provisions	430	570
Total Capital Resources	**36,713**	**33,843**

RECONCILIATION OF REGULATORY CAPITAL

The table below shows the reconciliation between the Total Reserves in the balance sheet and the CET1 capital after deductions in the table above.

All figures £k	**2017**	**2016**
General Reserves	36,512	33,637
Intangible Assets	(229)	(364)
Collective Impairment Provisions	430	570
Total Capital Resources	**36,713**	**33,843**

4. Capital Adequacy

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

The Society maintains a three-year strategic planning framework which is reviewed by the Board annually and takes account of current and changing economic conditions. The process culminates in the production of a three-year Corporate Plan. The Corporate Plan includes calculations of what the Pillar 1 Capital Resources Requirement is expected to be for each year of the Plan.

These calculations use the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk. A risk weighting of 8% is applied to risk-weighted asset values calculated in accordance with CRR to determine the minimum Pillar 1 capital requirement for credit risk. The minimum Pillar 1 capital requirement for operational risk is 15% of the Society's average net income over the previous three years.

The ICAAP is the Society's capital planning document for the period of the Corporate Plan. It identifies the Society's current Pillar 1 Capital Resources Requirement, the impacts of any changes arising from the Corporate Plan, and models the impact of a series of adverse stresses upon future capital requirements.

The combination of the Corporate Plan and the ICAAP ensures that the Society's capital resources can be expected to be sufficient to support its corporate objectives.

CAPITAL REQUIREMENT

The Individual Capital Guidance (ICG) is the sum of the Society's Pillar 1 and Pillar 2a capital requirements. The table below sets out the Society's ICG:

All figures £k	**2017**	**2016**
Total Credit Risk	12,311	11,806
Operational Risk	1,264	1,111
Pillar 1 Minimum Capital Requirement	**13,575**	**12,917**
Pillar 2a Capital Requirement	4,272	4,168
Individual Capital Guidance	**17,847**	**17,085**
Capital Resources	36,713	33,843
Excess over Individual Capital Guidance	**18,866**	**16,758**

CREDIT RISK CAPITAL REQUIREMENT

The table below details the minimum capital requirement by standardised credit exposure class at 31 December 2017.

Pillar 1 Capital Resources Requirement (all numbers £k)	Exposure	Risk Weighted Assets	Minimum Capital Required
Central government and Bank of England	25,485	0	0
Credit institutions	5,372	1,074	86
Derivative asset replacement cost	166	33	3
Treasury credit risk	**31,023**	**1,108**	**89**
Non-residential and business - performing loans	12,548	12,548	1,004
Non-residential and business - past due loans	0	0	0
Residential use - performing loans	377,215	132,073	10,566
Residential use - past due loans	983	983	79
Customer credit risk	**390,746**	**145,604**	**11,648**
Fixed and other assets	2,025	3,270	262
Total on-balance sheet exposures	**423,794**	**149,981**	**11,998**
Derivatives credit valuation adjustment	178	48	4
FLS Treasury Bills [1]	45,403	0	0
Future lending commitments	19,086	3,865	309
Total off-balance sheet exposures	**64,667**	**3,912**	**313**
TOTAL CREDIT RISK EXPOSURE	**488,461**	**153,893**	**12,311**

Notes:

[1] – These relate to drawings under the Funding for Lending Scheme (FLS). The Society has placed collateral with the Bank of England (see section 12)

[2] – A detailed analysis of the risk weightings is provided in Appendix A: Exposures by Asset Classes and Risk Weights

The table below shows the average exposure by asset class:

Period end exposure (all numbers £k)	**2017**	**2016**	**Average**
Central government and Bank of England	25,485	41,434	33,460
Credit institutions	5,372	5,703	5,538
Derivative asset replacement cost	166	152	159
Treasury credit risk	**31,023**	**47,289**	**39,156**
Non-residential and business - performing loans	12,548	12,149	12,349
Non-residential and business - past due loans	0	0	0
Residential use - performing loans	377,215	354,614	365,915
Residential use - past due loans	983	1,191	1,087
Customer credit risk	**390,746**	**367,954**	**379,350**
Fixed and other assets	2,025	2,448	2,236
Total on-balance sheet exposures	**423,794**	**417,691**	**420,743**
Derivatives credit valuation adjustment	178	160	169
FLS Treasury Bills [1]	45,403	50,432	47,917
Future lending commitments	19,086	24,991	22,039
Total off-balance sheet exposures	**64,667**	**75,583**	**70,125**
TOTAL CREDIT RISK EXPOSURE	**488,461**	**493,274**	**490,867**

5. Treasury Credit Risk

LIQUIDITY ASSETS

The Society's Counterparty Policy statement is used to manage the credit risk that arises from exposures to treasury counterparties. This Policy includes limits for the exposure to counterparties on both an individual and geographical basis. Counterparty exposures are reviewed monthly by the ALCO.

The Society's exposure to treasury counterparty risk is restricted under the Liquidity Policy to banks and building societies. To assist in determining counterparty credit quality the Society has nominated the Fitch ratings agency as its External Credit Assessment Institution (ECAI). Exposure limits for individual banks on the Society's list of authorised counterparties are set taking into account Fitch's Short Term and Long Term Ratings. No bank is included on the list unless it has, as a minimum, a Short Term rating of F1 and a Long Term rating of A-. Exposures to unrated counterparties are restricted to UK building societies. In addition to the use of Fitch ratings, market intelligence is used in assessing counterparty risk, in recognition that there may be a delay between a counterparty being in difficulty and this being reflected in a downgrading of its Fitch rating. A process is in place to reduce counterparty exposure limits, or to remove counterparties from the approved list, immediately without reference to the ALCO or the Board, but counterparties cannot be added without Board approval.

Exposures to counterparties in respect of derivative instruments are calculated using marked to market valuations and counterparty limits are inclusive of any such exposures. Note 28 in the Society's Annual Report and Accounts 2017 provides full details on the Society's use of these instruments.

The following table shows the breakdown of the Society's liquid assets by maturity and Fitch rating as at 31 December 2017 under the Standardised Approach; none of these exposures are impaired or past due and all of the exposures are to UK institutions.

Fitch Rating (all numbers £k)	**Maturity Under 3 Months**	**Between 3 Months to 1 Year**	**Maturity Over 1 Year to 5 Years**	**Total**
AAA – Bank of England	25,256	0	0	25,256
AA to AA-	1,562	0	0	1,562
A+ to A	3,810	0	0	3,810
Unrated building societies	0		0	0
Other	229	0	0	229
Total	30,857	0	0	30,857

DERIVATIVE EXPOSURES

In addition to the exposures above that relate to liquid assets, the Society has exposures relating to derivative instruments.

The Society uses derivative instruments to hedge its exposure to interest rate risk (interest rate swaps). Counterparty credit risk includes the risk that the derivatives counterparty will default on the transaction. All of the Society's derivatives are bilateral and conducted over-the-counter (OTC).

All of the Society's derivatives transactions are governed by agreements based on documentation provided by the International Swaps and Derivatives Association (ISDA). Each of the ISDA agreements is supported by a Credit Support Annex (CSA). The CSAs govern the process of mitigating any credit risk that may result from the derivatives. This includes the frequency and method of valuing any credit risk exposure and the movement of margin collateral between the Society and the counterparty.

Wrong way risk occurs when the exposure to a counterparty is adversely correlated with the credit quality of that counterparty. Specific wrong way credit risk can occur where transactions are collateralised by related party securities. General wrong way credit risk can arise where the credit quality of the counterparty may be correlated with a macroeconomic factor which affects the value of derivative transactions, such as the impact of interest rate movements on derivatives or on securities held as collateral. The CSAs mitigate wrong way risk by ensuring that exposures on derivatives are regularly re-valued and are collateralised with cash.

The movement of collateral defined in the CSAs is based entirely on the market value of the swaps and does not include a factor for the Society's, or the counterparty's creditworthiness so a change in creditworthiness would not result in a change in the amount of collateral held. In any case, as the Society is an unrated institution, it is not subject to a potential ratings downgrade.

The derivative exposure is the sum of the on balance sheet replacement cost and the off balance sheet potential increase in the value (and therefore the exposure to the counterparty) resulting from a change in interest rates.

The tables CCR1 below provide details of the treasury instruments counterparty credit risk.

Table CCR1: Analysis of CCR exposure by approach				
All figures £k	**Replacement Cost**	**Potential Future Exposure**	**Exposure at Default**	**RWA**
Standardised approach	166	178	344	81

CREDIT VALUATION ADJUSTMENT (CVA)

The Society does not centrally clear its derivatives (it is not required to) and therefore the risk weighting includes a credit valuation adjustment to reflect this.

Table CCR2: CVA capital charge		
All figures £k	**2017**	**2016**
All portfolios subject to the standardised method	344	312
Total subject to the CVA capital charge	**344**	**312**

6. Customer Credit Risk

This is the risk that losses may arise as a result of failure by borrowers or market counterparties to meet their obligations to repay. Credit risk arises primarily from mortgage loans to customers and from investments of liquid assets as part of the Society's treasury operations.

A component of credit risk is concentration risk, which arises where there is a concentration of exposures within the same category, whether it is geographical location, product type, industry sector or counterparty type.

Credit risk is managed through adherence to Board-approved Lending and Treasury Policy Statements, which set out limits that are reviewed in light of changes in economic conditions and in the Society's objectives. The ALCO monitors the Society's exposure to treasury counterparties on the Board's behalf. The performance of the mortgage book is monitored by the Board.

The Society is almost exclusively a residential mortgage lender and is exposed only to the UK market. An analysis of its portfolio of mortgages as at 31 December 2017 indicates that its main concentration risk is geographical, as by value 29% of its mortgages are in the Greater London, 20% in the South East and 13% in the East Midlands. A full analysis of geographical exposures can be seen in the table below.

The Society has only a modest exposure to commercial and buy-to-let mortgages and has not undertaken sub-prime lending. Exposures are monitored regularly by the Board to ensure that policy limits are not exceeded.

In addition to the capital provided under Pillar 1, capital is provided under Pillar 2b to cover mortgage losses that may arise in an economic downturn.

The table below details the minimum capital requirement by standardised credit exposure class at 31 December 2017.

Pillar 1 Capital Resources Requirement (all numbers £k)	**Exposure**	**Risk Weighted Assets**	**Minimum Capital Required**
Non-residential and business - performing loans	12,548	12,548	1,004
Non-residential and business - past due loans	0	0	0
Residential use - performing loans	377,215	132,073	10,566
Residential use - past due loans	983	983	79
Gross loans receivables	390,746	145,604	11,649

The following table provides a reconciliation of the above table to 'Loans and advances to customers' in the Annual Report and Accounts 2017:

	£k
Gross loan receivables	390,746
Fair value adjustment for hedged risk	(27)
Provision for impairment losses on loans and advances	(910)
Total loans and advances to customers	389,809

EXPOSURE BY REGION

The following table provides an analysis for capital adequacy purposes, and by geographical region, of the Society's lending assets as at 31 December 2017:

Region (all numbers £k)	**Residential Exposure**	**Commercial Exposure**	**Total Exposure**	**% of Total**
Greater London	105,297	6,340	111,637	29%
South East	77,453	2,529	79,982	20%
East Midlands	51,410	1	51,411	13%
South West	41,310	1,660	42,970	11%
East of England	32,206	982	33,188	9%
North West	20,054	354	20,408	5%
West Midlands	19,924	119	20,043	5%
Yorkshire	14,379	400	14,779	4%
Wales	9,043	0	9,043	2%
North East	5,534	163	5,697	2%
Scotland	1,588	0	1,588	0%
Total	378,198	12,548	390,746	100%

RESIDUAL MATURITY

A residual maturity analysis of Loans and Advances to customers is provided at Note 32 of the Annual Report and Accounts 2017. It should be noted that the analysis may not reflect actual experience of repayments since many mortgage loans are repaid early.

All numbers £k	**Within 1 Year**	**More than a year but not more than 5 years**	**More than 5 years**	**Total**
Total loans and advances to customers	21,192	79,791	289,763	390,746

MORTGAGE PROVISIONS

Under the CRD mortgages are 'past due' if repayments are 90 days or more in arrears at the accounting date. The Society closely monitors arrears of mortgage repayments and specific and general provisions are made if appropriate. The Society's loan book is performing well compared with national arrears statistics. In 2017, however the Society reluctantly made a small number of repossessions.

The Society's accounting policy in relation to provisions for bad and doubtful mortgage debts is set out in full in Note 1, Principal Accounting Policies, to the Annual Report and Accounts 2017.

As at 31 December 2017 the total provision for impairment losses on loans and advances was £910k comprising an individual provision of £480k and a collective provision of £430k. For capital adequacy purposes, collective provisions are regarded as Tier 2 capital.

Full details of the movements on provisions for bad and doubtful mortgage debts are provided below:

All numbers £k	Residential	Commercial	Total
Individual Impairment			
At 1 January 2017	550	0	550
Provision for loan impairment	(70)	0	(70)
Provision utilised	0	0	0
At 31 December 2017	480	0	480
Collective Impairment			
At 1 January 2017	570	0	570
Provision for loan impairment	(140)	0	(140)
Provision utilised	0	0	0
At 31 December 2017	430	0	430
Overall Impairment			
At 1 January 2017	1,120	0	1,120
Provision for loan impairment	(210)	0	(210)
Provision utilised	0	0	0
At 31 December 2017	910	0	910

7. Interest Rate Risk

Interest rate risk is the risk of changes to the financial position caused by market changes in interest rates. The interest rate characteristics between assets and liabilities can vary in either:

- The difference in the length of time between which fixed and variable rate items re-price (aka interest rate gaps or re-pricing risk). An example would be a two year fixed mortgage funded by variable deposits.
- The divergence of underlying interest basis that the variable assets and liabilities are linked to (aka basis risk). An example would be a variable rate treasury asset linked to 3-month LIBOR being funded by a base rate linked deposit.

The principal method of reducing interest rate risk is managed through the use of derivative financial instruments. The objective of the Society in using derivatives is in accordance with the Building Societies Act 1986, and is to limit the extent to which the Society will be affected by changes in interest rates. The Finance team is responsible for the management of market risks and the balance sheet is subjected to a stress-test of a 2% rise in interest rates on a monthly basis and the results are reported monthly to the ALCO or Management ALCO as appropriate.

The risk appetite for interest rate risk arising from interest rate gaps is currently set at a maximum of £1.5m. A capital provision has been made under Pillar 2 as part of the ICAAP to cover the impact that a 2% parallel shift in interest rates would have on the Society's capital. The Society's exposure to this measurement (in terms of economic value) was:

All figures £k	2% shift in interest rates	Risk Appetite
31 December 2017	244	1,500

The basis risk exposure arises from the interest rate derivatives entered into to manage re-pricing risk that pay variable rates and are linked to 3-month LIBOR against the variable rate deposits that are linked to the general state of the retail deposit market.

Basis risk is managed through the setting of limits upon the maximum negative impact that the movement between interest bases will have. This is modelled both under current interest expectations of the likely movement between interest bases and under an extreme set of circumstances. The limit is currently set to £1.5m capital impact in the first 12 months of the projection. The risk appetite is set such that under the expected scenario, the Society will achieve the level of profitability set out in the Corporate Plan, and that under the extreme scenario the Society will remain profitable. Management review interest rate basis risk on a monthly basis.

The ALCO is responsible for reviewing treasury activity, performance and compliance with approved policy statements.

8. Operational Risk

This is the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events. The Society operates a robust control environment to mitigate operational losses, including the maintenance of insurance policies.

All of the Society's teams and functions are required to identify and assess their operational risks via an agreed framework. The output of this process is the Risk Register which is reviewed by the Risk Committee and approved by the full Board.

In addition, Line Management are held directly responsible for the assessment and management of the operational risks and associated controls that fall within their area of responsibility.

Risk events and 'near misses' identified from the business are reported to the Risk Function where they are assessed and any resultant changes in processes, or training for example, will be recommended for consideration to the business.

A Business Continuity Plan is in place to ensure that disruptions to the Society's business can be appropriately managed.

OPERATIONAL RISK CAPITAL REQUIREMENT

The Society calculates its operational risk capital requirement using the Basic Indicator Approach. This is calculated as 15% Society's net income averaged over the previous 3 years.

All numbers £k	**2017**	**2016**
Three Years Prior	7,371	6,122
Two Years Prior	8,718	7,371
Prior Year	9,192	8,718
Basic indicator (3 year Average)	8,427	7,404
Own funds requirement (15% Basic Indicator)	**1,264**	**1,111**

9. Other Material Risks

CYBER

This risk is an important element of operational risk, and it comprises threats to hardware, software, infrastructure and sensitive data. Threats may arise from unauthorised access, harm or misuse. This includes harm caused intentionally, or accidentally, as a result of failing to follow security procedures. The Board has approved a Cyber Risk Policy which it reviews at least annually. Processes are in place which provide the Board with the assurance that the Society's cyber security arrangements are robust.

BUSINESS AND STRATEGY

This is the risk that the Society may not be able to carry out its corporate objectives due to changes in its operating environment. The Society manages this risk through carefully thought-through and detailed business plans and policies. This includes the approval each year of a detailed budget for the forthcoming year and a medium term Corporate Plan covering five years. The assumptions in the Corporate Plan are stress-tested to ensure that the Society's business model is robust enough to meet unexpected changes in its operating environment.

PENSION OBLIGATION

This is the risk that the Society will be required to fund a deficit in the defined benefit pension scheme as a result of a fall in the value of the scheme's assets or an increase in the scheme's liabilities due to a change in actuarial assumptions. A capital provision for this risk has been made under Pillar 2 as part of the ICAAP.

CONDUCT

This risk concerns the way in which the Society conducts its business with its customers. This includes, for example, the way that it deals with borrowers in arrears, complaints handling and behaving in a way that treats all customers fairly. The Board has approved a Conduct Risk Appetite Statement which it reviews at least annually. It receives regular reports on the way that the Society conducts its business relative to its risk appetite. The Board is satisfied that the Society's approach to conduct risk is both appropriate and robust.

FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)

As a 'deposit taker', the Society is liable to any claims on the FSCS as a result of the failure of other 'deposit takers'.

LOSS OF KEY PERSONNEL

Many of a building society's activities require specialist skills which, by their nature, can be considered to be scarce. To mitigate this risk the Society has in place a comprehensive succession plan for both NEDs and senior staff.

INSURANCE

This is the risk that there may be gaps in the risks covered by the Society's insurances, that there is insufficient cover in place, or that the covenant of the insurer is defective. Processes are in place which provide the Board with the assurance that the Society's insurance arrangements are robust.

10. Regulatory Capital Buffers

From 1 January 2014 the PRA adopted the Capital Requirements Directive known as CRD IV (or otherwise known as Basel III). One of the objectives of the new regulation was to improve the banking sector's ability to absorb shocks arising from financial and / or economic stress. This is to be achieved through increasing the quantity of regulatory capital firms will be required to hold through the introduction of new regulatory buffers that firms will have to hold in addition to the Pillar 1 and Pillar 2a requirements described above.

CAPITAL CONSERVATION BUFFER (CCOB)

The purpose of the CCOB buffer is to ensure firms hold sufficient capital to withstand future shocks without breaching their minimum capital guidance requirements. The CCOB is set as a percentage of RWAs. It came into force from 2016 at a level of 0.625% of RWAs and is set to increase each year to a maximum of 2.50% of RWAs by 2019. At 31 December 2017 the buffer was 1.25% of RWAs.

COUNTERCYCLICAL CAPITAL BUFFER (CCYB)

The purpose of the CCYB is to limit excessive credit growth in the market or by the individual firm. It is set as a percentage of RWAs.

The CCYB comprises a UK specific element and for some, a firm-specific element. The Society is not required to hold a firm-specific element. The UK specific element of the CCYB is set by the Bank of England and can range from 0% to 2.5% of RWA.

At 31 December 2017 the UK specific element of the CCYB was 0%. The Bank of England have announced that this will increase to 0.5% in June 2018, and then increase to 1.0% in November 2018.

11. Leverage Ratio

The leverage ratio is a measure that is not impacted by risk weightings and therefore allows a comparison between firms that is not impacted by risk weightings. It is calculated as Tier 1 capital divided by the adjusted balance sheet exposure.

A further requirement of the CRD IV is the introduction of a leverage ratio which measures the levels of Tier 1 capital against both on and off-balance sheet exposures. CRD IV requires a minimum ratio of 3% and at the 31 December 2017 the Society had a leverage ratio of 7.4%.

The following tables follow the prescribed formats set out by the European Banking Authority (EBA) in EBA/ITS/2014/04.

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

All figures £k	**2017**	**2016**
Total assets as per published financial statements	423,794	417,691
Adjustments for derivative financial instruments	(166)	(152)
Adjustment for off-balance sheet items		
Other adjustments		
Leverage ratio exposure	**423,628**	**417,539**

Table LRCom: Leverage ratio common disclosure		
All figures £k	**2017**	**2016**
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	423,628	417,539
Asset amounts deducted in determining Tier 1 capital	(229)	(364)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**423,399**	**417,175**
Replacement cost associated with derivatives transactions	166	152
Add-on amounts for PFE associated with derivatives transactions	178	160
Exposure determined under Original Exposure Method		
Total derivative exposures	**344**	**312**
Off-balance sheet exposures at gross notional amount	19,086	24,991
Adjustments for conversion to credit equivalent amounts	45,403	40,484
Total off-balance sheet exposures	**64,489**	**65,475**
Tier 1 capital	36,283	33,273
Total Exposures	488,232	482,962
Leverage Ratio	**7.4%**	**6.9%**

Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives)		
All figures £k	**2017**	**2016**
Covered bonds		
Exposures treated as sovereigns	25,485	41,434
Institutions	5,372	5,703
Secured by mortgages of immovable properties	387,506	364,511
Retail exposures	142	123
Corporate	2,115	2,129
Exposures in default	983	1,191
Other exposures (eg equity, securitisations, and other non-credit obligation assets)	2,025	2,448
EU-3 Banking book exposures	**423,628**	**417,539**
Trading book exposures		
EU-1 Total on-balance sheet exposures (excluding derivatives)	**423,628**	**417,539**

12. Asset Encumbrance

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn.

The Society has pledged part of its loan book as collateral with the Bank of England, in order to participate in the Bank's Funding for Lending Scheme (FLS) and the Term Funding Scheme (TFS). Participation in FLS and TFS provides the Society with a source of funding that diversifies the funding portfolio and reduces the overall funding cost, and allows the Society to optimise mortgage rates for its members. Although the loans remain fully owned and operated by the Society, they are reported as encumbered.

The Society monitors overall balance sheet encumbrance levels to ensure that it remains within its risk appetite limits.

The Pillar 3 asset encumbrance disclosure templates, shown below, have been compiled in accordance with PRA and EBA regulatory reporting requirements, specifically the PRA's supervisory statement SS11/14 ("CRD IV: Compliance with the EBA's Guidelines on the disclosure of encumbered and unencumbered assets"). These require that the median than the end of year position are reported, thus the amounts will differ to those in other disclosures in this document.

Template A: Encumbered and unencumbered assets				
All figures £k	**Encumbered Assets**		**Unencumbered Assets**	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Loans and advances other than loans on demand	70,576	0	306,606	0
Equity instruments	0	0	32,405	0
Other Assets	0	0	3,156	0
Assets of the reporting institution	**70,576**	**0**	**342,167**	**0**

Template C: Sources of encumbrance		
All figures £k	**Matching liabilities, contingent liabilities or securities lent**	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered**
Collateralised deposits to central banks	6,250	70,576
Carrying amount of selected financial liabilities	6,250	70576

The encumbered assets disclosed above are supporting £55m (average during year) of combined (on and off balance sheet) drawings from TFS and FLS.

13. Liquidity Risk

Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due under either normal or stressed business conditions.

The ALCO is the Board committee responsible for monitoring this risk. Responsibility for the daily management of the risk, including the monitoring of both retail and wholesale funding, lies with the Finance Director.

This risk is managed by maintaining a prudent level of liquid resources at all times in accordance with limits (of both the quantity and the type of liquid assets) as set out in the Liquidity and Funding Policy.

Liquidity stress testing is carried out on a monthly basis to confirm that the Society can withstand normal and extreme cash outflows.

The key regulatory metric to monitor short term liquidity risk is the liquidity coverage ratio (LCR) which measures the potential net cash outflow under a prescribed set of assumptions as a proportion of the high quality liquid assets that are held as a Liquidity Buffer. The requirement is that the LCR will exceed 100%.

The table below summarises the average LCR position for by quarter:

	2017 Q1	**2017 Q2**	**2017 Q3**	**2017 Q4**
Liquidity Buffer	90,547	84,556	71,570	67,501
Total net cash outflow	29,322	27,213	28,312	26,242
Liquidity coverage ratio %	**309%**	**311%**	**253%**	**257%**

It should be noted that the off balance sheet FLS Treasury Bills count as part of the Liquidity Buffer.

14. Country By Country Reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the EU Capital Requirements Directive IV (CRD IV).

The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the Financial Institution's income and the locations of its operations.

The Society and its (dormant) subsidiary are both UK registered entities, the activities of which are disclosed on page 5 of the 2017 Annual Report and Accounts.

The Society's total operating income and the number of full time equivalent employees during the year to 31 December 2017 were:

All numbers £k	2017	2016
Turnover £k	10,162	9,192
Profit Before Tax £k	3,336	2,993
Tax on Profit on Ordinary Activities £k	655	722
Profit After Tax £k	2,681	2,271
Employees (on a full time equivalent basis)	97	99

15. Remuneration Policies and Practices

A risk arises if the Society's remuneration policies and practices could result in its Directors and staff being rewarded for decisions inconsistent with the Board's risk appetite. It is therefore the Society's policy on remuneration to seek to ensure that its remuneration decisions are in line with effective risk management.

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. It also seeks to establish an appropriate balance between the fixed and variable elements of remuneration, although this balance will vary depending on the seniority and nature of an individual's employment. Performance measurements used to calculate variable remuneration are, therefore, adjusted to take into account current or potential risks to the business and are consistent with the need to retain a strong capital base. Variable remuneration is not paid unless it is sustainable within the Society's situation as a whole. Guaranteed incentive payments do not form part of any remuneration package and all incentive schemes are non-contractual.

The Board has identified that the personnel whose professional activities have a material impact on the Society's risk profile are the Directors, members of the Executive team, and the Compliance Manager. Two members of the Executive team, the Chief Executive and the Finance Director, are Executive Directors.

The above personnel are considered by the Society to be Remuneration Code staff under the remuneration of the Financial Conduct Authority Handbook and the Prudential Regulation Authority Rulebook.

NON-EXECUTIVE DIRECTORS

Information concerning the mandate of the Remuneration Committee and the decision-making process for determining the remuneration policy for the NEDs is contained in the Directors' Remuneration Report in the Society's Annual Report and Accounts 2017.

Aggregate information on the remuneration of the non-executive directors is given below:

All numbers £k	2017
Fixed Remuneration	177
Variable Remuneration	0
Total	177

EXECUTIVE DIRECTORS

Information concerning the mandate of the Remuneration Committee and the decision-making process it uses in determining the remuneration policy for the Executive Directors, and information on the link between pay and performance, is contained in the Directors' Remuneration Report in the Society's Annual Report and Accounts 2017.

Aggregate information on the remuneration of the two Executive Directors who served in the year is given below:

All numbers £k	2017
Fixed Remuneration	378
Variable Remuneration	77
Total	455

OTHER REMUNERATION CODE STAFF

The Remuneration Committee is also responsible for determining the terms and conditions of other Remuneration Code staff after consultation with the Chief Executive. During 2017 these staff were as follows:

- Executive Management Team
- Senior Mortgage Underwriters
- New Business Lead
- Commercial Lending Manager
- Direct Sales Mortgage Advisers
- Human Resources and Premises Manager
- IT Infrastructure Manager

Aggregate information on remuneration in respect of these members of staff is given below:

All numbers £k	**2017**
Fixed Remuneration	940
Variable Remuneration	100
Total	**1,040**

As a result of the introduction of the Senior Management Regime there has been a significant increase in the number of people who are defined as remuneration code staff. The aggregate remuneration of these staff has therefore increased in line with the increase in number of staff included.

16. Conclusion

This Pillar 3 disclosure document has been prepared in accordance with regulatory requirements, and provides information on the Society's approach to risk management based on its size and the complexity of its business operations.

It is updated annually within four months of the Society's financial year end.

If a further explanation of the disclosures is required this should be requested in writing from The Secretary, Market Harborough Building Society, Welland House, The Square, Market Harborough, Leicestershire, LE16 7PD.

17. Appendix A: Exposures by Asset Classes and Risk Weights

Table CR5: Standardised approach											
All figures £k	**0%**	**20%**	**35%**	**50%**	**75%**	**100%**	**150%**	**250%**	**Others**	**Total**	**Unrated**
Central governments or central banks	70,888									70,888	0
Institutions		5,538								5,538	0
Corporates						12,548				12,548	12,548
Retail					142					142	142
Secured by mortgages on immovable property			377,073							377,073	377,073
Exposures in default						983				983	983
Other items	(201)	178	(507)			2,263		470	19,086	21,289	21,289
Total	**70,687**	**5,716**	**376,566**	**0**	**142**	**15,794**	**0**	**470**	**19,086**	**488,461**	**412,035**