Capital Requirements Directive
Pillar 3 Disclosures
March 2021

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 IV in the UK. The Society has been operating under the Basel III regime since 1 January 2014. It has adopted the Standardised Approach for Credit risk and the Basic Indicator Approach for Operational risk.

The CRD IV consists of three elements, or 'Pillars', which represent the key principles of the Basel III regime:

Pillar 1

This covers the minimum capital requirements of Basel III 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.

The Society has processes in place to 'horizon scan' for future regulatory developments including consultation papers, discussion papers that may impact the future requirements for capital and liquidity requirements. The Society ensures that forward looking business and financial plans make provision for such changes to the extent that their impacts can be sufficiently quantified. The Society follows the PRA's guidance on CRD IV implementation insofar as it relates to UK Building Societies.

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 September 2020.

The Society's regulator conducted the most recent SREP during March 2019, the conclusion of which was that the actual level of the Society's capital was significantly in excess of the minimum regulatory 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 2020. 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:

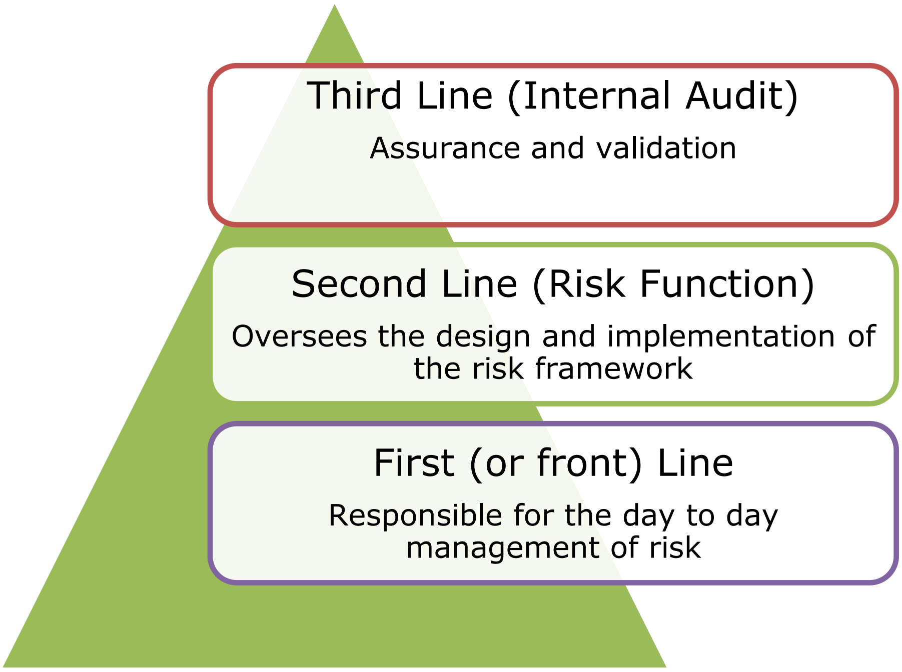
	2020	2019
Common Equity Tier 1 (CET1) ratio	24.4%	23.9%
Total Capital Ratio	24.4%	23.9%
Risk Weighted Assets (£k)	181,937	180,022
Leverage Ratio	8.07%	7.80%

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:



RISK APPETITE

It is neither possible nor desirable to eliminate all risk from the Society's business. The risk appetite statement is the description of the amount of risk the business is willing to take in pursuit of the Society's strategy.

In setting this risk appetite, the Board has put it into the context within which a building society operates. This is that:

- The mortgage market generates assets giving a relatively low return on capital – thus the ability to bear the costs of credit loss is low and this needs to be reflected in the origination strategy and where on the risk curve the Society will operate (i.e. low).
- There is very limited access to additional sources of capital – the cost is likely to be prohibitive and the market will be limited. Thus any growth must be from retained earnings and a significant buffer needs to be held against future losses.
- The Society is a small organisation which can only afford a limited number of specialists. This precludes the business from getting into highly complex solutions in the fields of both lending policy and treasury management.

- The ethos of the 'stewardship' of the organisation in which the creation of a long term business model is more important than profit or balance sheet growth alone.

As a consequence of these factors the overall risk appetite statement is:

"To maintain a business that will make steady returns over the economic cycle with low levels of volatility, that will remain well capitalised and highly liquid such that it will be capable of remaining independent for the foreseeable future. It will be professionally managed such that it will have a low propensity for operational failures and resultant losses or damage to the Society's reputation."

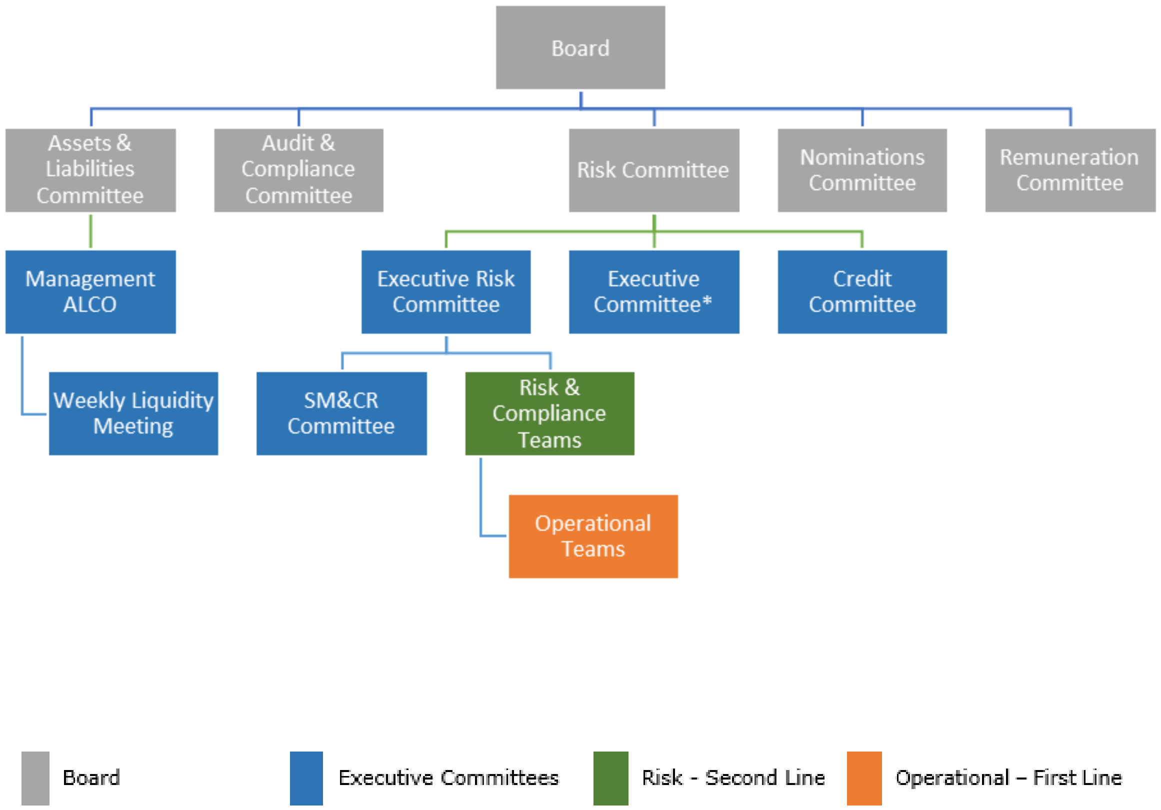
The underlined terms are defined in the table below:

Term	Definition
Steady returns over the economic cycle with low levels of volatility	The Society aims to generate minimum profits averaging 0.3% of lending balances over the economic cycle, with a minimum level of 0.1% for any year.
Well capitalised	The Society aims to meet the 'fully loaded' regulatory capital requirement (i.e. including all buffer requirements).
Highly liquid	The Society aims to have a minimum survival horizon in a stressed environment of 90 days
Professionally managed	The Society aims to have no regulatory breaches or lapses in controls. The culture to support this is evidenced by the internal and external audit findings.

In order to implement the risk appetite the Society has established a Risk Management Policy and Framework, and this is described below.

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 six 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, three-year Corporate Plan, the Recovery Plan (RP), the ILAAP 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 five of the larger or more complex loans a month to need NED referral. The purpose being to critique not only the individual loan, but also Management rationale for recommending the loan in the first place.

Remuneration Committee

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

Nominations Committee

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

Audit & Compliance Committee

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 at least four times a year, and comprises of not less than three Non-Executive Directors (including the Chair). 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 four times a year, and comprises of not less than three Non-Executive Directors (including the Chair). 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 four NEDs, the two Executive Directors and the Head of Risk. The Financial Controller and Treasury & MI Manager are management attendees to the Committee. It meets at least four times a year.

Management Committees

Executive Risk Committee

This meets four 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. In addition, the Committee considers both the mortgage interest, and currency stress rates applied to mortgage contracts. The Committee comprises the full executive team including the two Executive Directors.

SM&CR Committee

This is the Senior Managers and Certification Regime committee, meeting not less than four times a year. The committee is responsible for maintaining the responsibility map, statements of responsibilities, allocation of all existing and new senior management functions, prescribed responsibilities and business activities. The committee comprises of the Chief Executive, Head of Risk, Financial Controller & Secretary and HR & Premises Manager.

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. It reviews the same limits and monitoring 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 full ALCO meeting. Membership comprises the Executive Directors, the Head of Risk, and management attendees are those who attend (Board) ALCO.

Weekly Liquidity Meeting

This is a meeting of the CEO, FD, Financial Controller and Treasury & MI Manager 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. The Head of Risk has an open invitation to the meeting.

INFORMATION RELATING TO THE DIRECTORS

Information relating to the Directors is provided in Appendix C: Director Details.

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. 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.

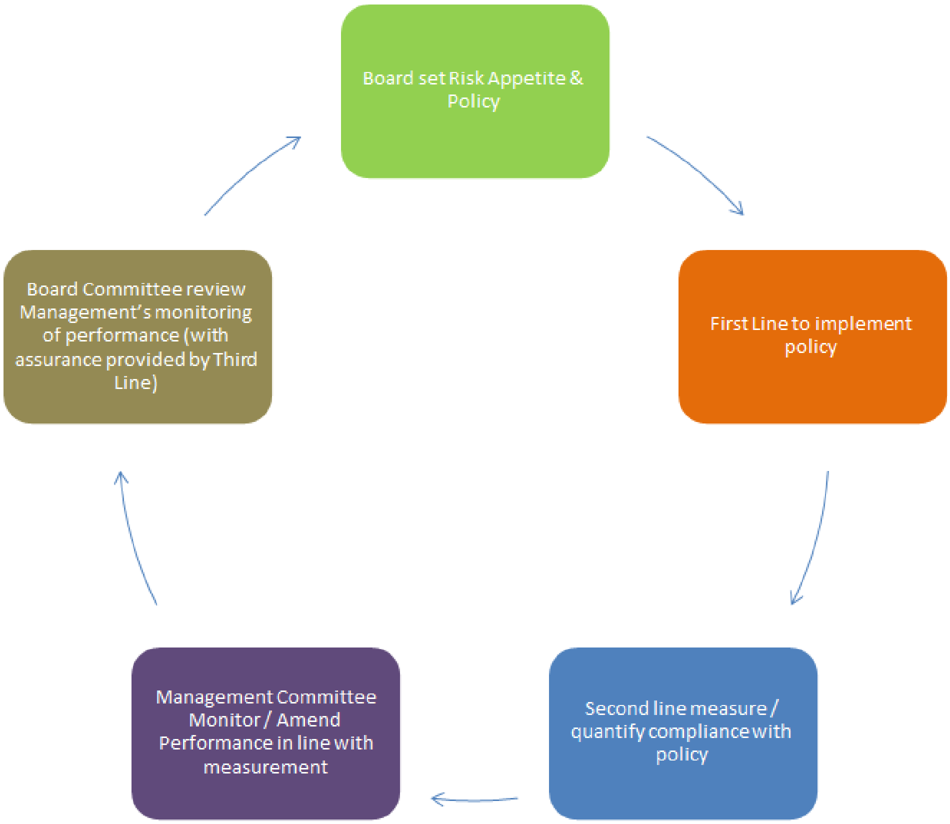
In sourcing suitable candidates for consideration, the Committee uses one or more of the following methods:

- 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.

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	Board	Risk Board
Policy Control	Lending Policy including mandates	Liquidity Contingency Plan Counterparty Policy Liquidity & Funding Policy ILAAP	Interest Rate Risk in the Banking Book (IRRBB) Pension Obligation	Conduct Risk Appetite Statement Conflicts of Interest and Anti-Bribery Policy	Corporate Plan Annual Budget Project Governance ICAAP	IT and Data Security BCP Op Risk Policy & Framework Staff Handbook (cyber elements) Financial Crime Policy Cyber Policy
First Line	Underwriting Team	Finance	Finance	Sales / Operations	CEO	All areas
Management Information	Portfolio Review Pack Concentration & Exposure Limit Reporting Stress Test Outputs	Daily Liquidity Report Rolling 3 Month Liquidity Forecast Monthly Stress Tests ALCO pack	Gaps Report Basis Risk Report Basis Risk Stress Test Actuarial Pension Report ALCO pack	Conduct Risk Report Conduct Risk Map	Chief Executive Report Finance Reporting Pack	Risk Report Op Risk Report Conduct Risk Report Risk Appetite Dashboard Key Risks (Outsourcing)
Second line responsible for monitoring	Head of Risk*	Head of Risk/ALCO*	Head of Risk/ALCO *	Head of Risk	FD*	Head of Risk*
Management Committee responsible for performance	Credit Executive Risk	MALCO	MALCO	Audit & Compliance	Executive	Executive Risk
Third Line	Internal Audit					

*In certain circumstances it may be more cost effective to place reliance on the role of Internal Audit, under instruction from the Audit & Compliance Committee, to review the effectiveness of the controls in respect of technical aspects rather than using the second line for example - liquidity, capital matters and IT/Cyber.

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 2020 amounted to £44m. These capital resources are made up entirely of Core Equity Tier 1 capital (CET1 capital). The Society has no Tier 2 capital.

TIER 1 AND TIER 2 CAPITAL RESOURCES

All figures £k	2020	2019
General Reserves	44,954	43,412
Deduction – Intangible Assets	(591)	(380)
IFRS9 Transitional Relief	8	0
CET1 Capital	**44,371**	**43,032**
Total Capital Resources	**44,371**	**43,032**

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	2020	2019
General Reserves	44,954	43,412
Intangible Assets	(591)	(380)
IFRS9 Transitional Relief	8	0
Collective Impairment Provisions	0	0
Total Capital Resources	**44,371**	**43,032**

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 and estimates any additional capital requirements under Pillar 2 that are not felt to be adequately captured in Pillar 1. The ICAAP assesses 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.

TOTAL CAPITAL REQUIREMENT

The Total Capital Requirement (TCR) was set by the Society's regulator as part of the March 2019 SREP and revised in December 2020. The requirement comprises a variable element as a proportion of risk weighted assets (RWAs) and a fixed element. The table below sets out the Society's TCR:

All figures £k	**2020**	**2019**
Credit risk weighted assets	161,650	160,952
Operational risk weighted assets	20,287	19,044
Total Risk Weighted Assets	181,937	179,996
Variable capital requirement % RWAs	8.88%	9.38%
Variable capital requirement	16,150	16,886
Fixed capital Requirement	3,000	3,000
Total Capital Requirement (TCR)	19,150	19,886
Capital Resources	44,371	43,032
Excess over Capital Requirements	**25,222**	**23,146**

CREDIT RISK CAPITAL REQUIREMENT

The table below details the minimum capital requirement by standardised credit exposure class at 31 December 2020.

Pillar 1 Capital Resources Requirement (all numbers £k)	Exposure	Risk Weighted Assets	Minimum Capital Required
Central government and Bank of England	93,357	0	0
Credit institutions	7,555	1,511	121
Derivative asset replacement cost	0	0	0
Treasury credit risk	**100,912**	**1,511**	**121**
Non-residential and business - performing loans	9,170	9,170	734
Non-residential and business - past due loans	0	0	0
Residential use - performing loans	417,538	146,239	11,699
Residential use - past due loans	381	381	30
Customer credit risk	**427,089**	**155,790**	**12,463**
Fixed and other assets	3,083	2,966	237
Total on-balance sheet exposures	**531,084**	**160,187**	**12,815**
Derivatives credit valuation adjustment	265	53	4
Future lending commitments	18,995	1,330	106
Total off-balance sheet exposures	19,260	1,383	111
TOTAL CREDIT RISK EXPOSURE	**550,344**	**161,650**	**12,932**

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)	**2020**	**2019**	**Average**
Central government and Bank of England[1]	93,357	97,611	95,484
Credit institutions	7,555	6,017	6,786
Derivative asset replacement cost	0	73	37
Treasury credit risk	**100,912**	**103,701**	**102,306**
Non-residential and business - performing loans	9,170	9,544	9,357
Non-residential and business - past due loans	0	0	0
Residential use - performing loans	417,538	415,154	416,346
Residential use - past due loans	381	543	462
Customer credit risk	**427,089**	**425,241**	**426,165**
Fixed and other assets	3,083	2,308	2,696
Total on-balance sheet exposures	**531,084**	**531,250**	**531,167**
Derivatives credit valuation adjustment	265	318	292
Future lending commitments	18,995	22,501	20,748
Total off-balance sheet exposures	18,995	22,819	21,039
TOTAL CREDIT RISK EXPOSURE	**550,344**	**554,069**	**552,206**

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 or Management-ALCO (depending which committee is meeting in any particular month).

The Society's exposure to treasury counterparty risk is restricted under the Liquidity Policy to banks (including the central bank) 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-.

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.

Exposures to unrated counterparties are restricted to UK building societies. Only certain UK building societies meet management's credit assessment criteria, and their recommendation must be supported by ALCO. 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 27 in the Society's Annual Report and Accounts 2020 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 2020 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**	**Credit Quality Step**
AA – Bank of England	93,107	0	0	93,107	1
AA to AA-	1,936	0	0	1,936	1
A+ to A	5,615	0	0	5,615	2
Unrated building societies	0		0	0	3
Other - cash	254	0	0	254	1
Total	**100,912**	**0**	**0**	**100,912**	

The Society does not make use of any credit mitigation techniques in respect of counterparty liquidity exposures.

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).

The Society holds derivative instruments exposed to sterling Libor (subject to the market-wide benchmarks reform) and SONIA. Any remaining derivatives that are designated in relationships referencing sterling Libor will transition to the risk-free rate ('RFR'), sterling overnight ('SONIA'), by the end of September 2021. Some hedges may need to be de-designated and new relationships entered into.

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. Collateral movement is subject to a minimum threshold of £250k. At 31 December 2020 the Society had provided £780k (2019: £520) cash collateral under such agreements.

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	0	265	265	53

The replacement cost is the fair value of the positive cash flows attaching to the derivative. The potential future exposure is based on a prescribed EBA formula that attempts to quantify how large the exposure could expand to, based upon certain parameters. The exposure at default is the sum of the current replacement cost and the future exposure.

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	**2020**	**2019**
All portfolios subject to the standardised method	265	391
Total subject to the CVA capital charge	**265**	**391**

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 2020 indicates that its main concentration risk is geographical, as by value 33% of its mortgages are in Greater London, 22% in the South East and 12% in the South West. 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 2020.

Pillar 1 Capital Resources Requirement (all numbers £k)	**Exposure**	**Risk Weighted Assets**	**Minimum Capital Required**
Non-residential and business - performing loans	9,170	9,170	734
Non-residential and business - past due loans	0	0	0
Residential use - performing loans	417,538	146,239	11,699
Residential use - past due loans	381	381	30
Gross loan receivables	**427,089**	**155,790**	**12,463**

The following table provides a reconciliation of the above table to 'Loans and advances to customers' in the Annual Report and Accounts 2020:

All numbers £k	£k
Gross loan receivables	427,089
Fair value adjustment for hedged risk	659
Provision for impairment losses on loans and advances	(918)
Total loans and advances to customers	**426,830**

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 2020:

Region (all numbers £k)	Residential Exposure	Commercial Exposure	Total Exposure	% of Total
Greater London	136,465	4,896	141,361	33%
South East	92,581	1,365	93,946	22%
South West	49,064	1,280	50,344	12%
East Midlands	36,441	1	36,442	9%
East of England	35,870	986	36,856	9%
North West	23,170	354	23,524	6%
West Midlands	17,587	0	17,587	4%
Yorkshire	12,145	288	12,433	3%
Wales	9,363	0	9,363	2%
North East	4,713	0	4,713	1%
Scotland	520	0	520	0%
Total	**417,919**	**9,170**	**427,089**	**100%**

RESIDUAL MATURITY

A residual maturity analysis of Loans and Advances to customers is provided at Note 31 of the Annual Report and Accounts 2020. 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
Residential exposures	46,851	90,200	280,868	417,919
Commercial exposures	464	1,814	6,892	9,170
Total loans and advances to customers	**47,315**	**92,014**	**287,760**	**427,089**

MORTGAGE PROVISIONS

The Society implemented IFRS 9 from 1 January 2018. IFRS9 operates 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.
- Subject to a Covid repayment holiday. The experience is that once the Covid repayment holiday ends that customers restart paying normally. On this basis the

loan will be deemed to be 'repaired' once the repayment holiday ends.

- 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)

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

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 2020.

As at 31 December 2020 the total provision for impairment losses on loans and advances was £918k comprising of Stage 1 £555k, Stage 2 £362k and Stage 3 £1k.

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

Group and Society 2020 **All figures £'000**	**Loans fully secured on residential property**	**Other loans fully secured on land**	**Total**
Stage 1 provision at 1 January	457	27	484
New assets originated	187	0	187
(Decrease)/Increase due to change in credit risk	(64)	28	(36)
Assets derecognised	(80)	0	(80)
Stage 1 provision at 31 December	**500**	**55**	**555**
Stage 2 provision at 1 January	206	0	206
New assets originated	0	0	0
Increase due to change in credit risk	168	0	168
Assets derecognised	(12)	0	(12)
Stage 2 provision At 31 December	**362**	**0**	**362**
Stage 3 provision at 1 January	0	0	0
New assets originated	0	0	0
Increase due to change in credit risk	1	0	1
Assets derecognised	0	0	0
Stage 3 provision at 31 December	**1**	**0**	**1**

The "Impairment losses on loans and advances" in the accounts comprises:

All numbers £k	Residential	Commercial	Total
Provision movement	200	28	228
Operational losses	0	0	0
Recoveries	(4)	0	(4)
Total Impairment Losses	**196**	**28**	**224**

IMPAIRED & PAST DUE EXPOSURES

The distribution of the impaired and past due exposures by geography is provided below:

Region All numbers £k	Past due	Impaired	Total
London	961	0	961
South East	1,631	0	1,631
South West	1,711	114	1,824
East Midlands	929	84	1,014
East of England	430	0	430
West Midlands	168	98	266
North West	1,034	85	1,119
North East	85	0	85
Yorkshire and The Humber	198	0	198
Total	**7,147**	**381**	**7,528**

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.

GAPS RISK

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 and fall in interest rates on a monthly basis, alongside a set of six stressed scenarios as prescribed by the EBA 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 £2m. 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 2020	671	2,000

For the purpose of calculating Gap exposures the following approach has been taken:

- 75% fixed rate mortgages in the pipeline which have reached Offer stage are included in the analysis.
- 40% of the value of fixed rate mortgages in the pipeline at Application stage. This is deliberately below the 60% conversion average rate that is usually achieved, to minimise the impact of over hedging. This is a combination of both new business and product roll-overs (retention).
- Where applicable, 80% of reservations of funds in respect of fixed rate investment products, however, the Society does not tend to get reservations for fixed rate deposits.
- Residential mortgages are assumed to follow their contractual repayment profile and no allowance has been made for overpayments
- Product interest rate floors have not been modelled. These only impact mortgages thus it will result in an overstatement of risk. This is considered unlikely to be material, and the benefit is outweighed by the cost of amending processes to model this.
- The cash flows modelled in respect of interest bearing assets and liabilities are solely based on the balance sheet carrying position which is based on amortised costs. The interest element of the cash flows has not been modelled.
- Treasury assets are assumed to mature at their book values at their maturity date
- Free reserves have not been allocated to a specific time bucket, rather they have been treated the same as non-interest bearing assets /liabilities, which are deemed not to reprice.

- The Society does not operate current accounts or other non-interest bearing deposits thus no policy is required for them.
- The discount rate used for the central assumption is the zero coupon 3ML yield curve.

BASIS RISK

Basis risk arises from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest reference rates. Basis risk arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics.

The Society's basis risk exposure arises from the mismatch between the interest rate derivatives (which are used to manage gaps risk) which pay interest to the Society based on 3-month LIBOR or the sterling overnight ('SONIA'), and the funding cost paid by the Society where the rate is linked to the general state of the retail deposit market (not 3-month LIBOR). The risk would crystallise in a situation where 3-month LIBOR or SONIA rates fell but the general rate of retail deposits did not.

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 under:

- Expected interest movements between interest bases
- An extreme set of circumstances
- A 2% parallel shift in current interest rate expectations.

The risk appetite limit on the expected interest rate movements is that the impact on net interest income (NII) should not exceed £0.5m in the first year or £2m in total over the three years.

The risk appetite limit for the other (stressed) circumstances is that the NII impact should not exceed £1m in any single year or £3m in total over the three years.

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	2020	2019
Three Years Prior	10,162	9,192
Two Years Prior	11,116	10,162
Prior Year	11,184	11,116
Basic indicator (3 year Average)	10,820	10,157
Own funds requirement (15% Basic Indicator)	1,623	1,524
Operational risk weighted asset	20,287	19,044

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. The Society carried out several cyber related projects and has recruited an additional specialist to significantly enhance its resilience and combat risks from cybercrime. Since 2018 the Society has been awarded annually 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.

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.

RISKS ASSOCIATED WITH THE UK LEAVING THE EU

The effects on the UK economy post Brexit are only just starting to materialise and 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. Post Brexit, lending to customers residing in the EU27 was withdrawn as this was not included in the trade agreement. The decision to withdraw from this market will be kept under review pending future developments. 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)

The Covid-19 pandemic, which began to have significant impacts in early 2020, presents a major risk to the global economy. The Society continues to monitor the impact of the virus. In March 2020 the Society moved largely to home based working. A pandemic planning committee met regularly throughout 2020. It continues to assess the needs of the business and has modelled various scenarios for operational and staff resilience. Particular consideration has been given to the increased cyber risks because of home-working and the increased level of cyber threats in recent months. Impacts to the Society's markets have been modelled and are within stressed capabilities for the business.

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. As a result, the risks arising from climate change are embedded into the Risk Management Framework and managed on an ongoing basis.

PENSION OBLIGATION

This is 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. 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 increased each year to a maximum of 2.50% of RWAs by 2019. At 31 December 2020 the buffer was 2.5% 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 2020 the UK specific element of the CCYB was 1%. This was reduced to 0% in March 2020 in response to the coronavirus crisis.

The Society received guidance in October 2020 to hold an institution specific countercyclical buffer effective from December 2020 of 0.28%.

The required disclosure format for the countercyclical buffer is shown in Appendix B: Countercyclical Buffer.

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 2020 the Society had a leverage ratio of 8.07%.

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	**2020**	**2019**
Total assets as per published financial statements	531,084	531,250
Adjustments for derivative financial instruments	0	(73)
Adjustment for off-balance sheet items	0	0
Other adjustments	0	0
Leverage ratio exposure	**531,084**	**531,177**

Table LRCom: Leverage ratio common disclosure		
All figures £k	**2020**	**2019**
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	531,084	531,177
Asset amounts deducted in determining Tier 1 capital	(591)	(380)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**530,493**	**530,796**
Replacement cost associated with derivatives transactions	0	73
Add-on amounts for PFE associated with derivatives transactions	265	318
Exposure determined under Original Exposure Method		
Total derivative exposures	**265**	**391**
Off-balance sheet exposures at gross notional amount	18,995	22,501
Adjustments for conversion to credit equivalent amounts	0	0
Total off-balance sheet exposures	**18,995**	**22,501**
Tier 1 capital	44,371	43,032
Total Exposures	549,753	553,688
Leverage Ratio	**8.07%**	**7.80%**

Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives)		
All figures £k	**2020**	**2019**
Covered bonds	0	0
Exposures treated as sovereigns	93,357	97,611
Institutions	7,555	6,017
Secured by mortgages of immovable properties	426,467	423,165
Retail exposures	241	657
Corporate	0	857
Exposures in default	381	562
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	3,083	2,308
EU-3 Banking book exposures	**531,084**	**531,177**
Trading book exposures	0	0
EU-1 Total on-balance sheet exposures (excluding derivatives)	**531,084**	**531,177**

PROCESS TO MANAGE RISK OF EXCESSIVE LEVERAGE

Excessive leverage results when a business has insufficient capital relative to its asset base. The Society's primary method of managing its capital position is through ensuring that the Society's capital resources exceed its regulatory capital requirements. The regulatory capital requirements are derived from the Standardised risk weights, which by their nature create a capital requirement that is of such a scale that prevents an excessively leveraged position being created where a business is exceeding these.

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 Term Funding Scheme (TFS) and Term Funding Scheme with additional incentives for SMEs (TFSME). The collateral also provides the Society with access to contingency funding by auction under the ILTR facility (indexed Long term Repo), should the Society require access to additional liquidity. Participation in TFS and TFSME provides the Society with a source of funding that diversifies the funding portfolio and reduces the overall funding cost, allowing 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 repaid £35m of TFS during January 2020 as part of planned refinancing. The Society has drawn £11.5m of TFSME funding during 2020.

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 rather 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**
		Of which notionally eligible HQLA			**Of which notionally eligible HQLA**	
Loans and advances other than loans on demand	46,662	0	0	385,684	0	0
Equity instruments	0	0	0	0	0	0
Other Assets	650	0	0	3,889	0	0
Assets of the reporting institution	**47,312**	**0**	**0**	**389,573**	**0**	**0**

Template B – Collateral received

The EBA Guidelines allow competent authorities to waive the requirement to disclose Template B – Collateral received and in Supervisory Statement SS 6/17 the PRA waived the Template B requirement subject to a firm meeting certain criteria. MHBS meets the criteria and therefore Template B is not disclosed.

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	10,000	46,662
Carrying amount of selected financial liabilities	**10,000**	**46,662**

The encumbered assets disclosed above are supporting £10m (median during year) of combined drawings from TFS and TFSME.

Template D: Information on importance of encumbrance
Assets are encumbered as part of the Society's funding arrangements. The main activities relate to loans encumbered with the Bank of England to support the £10m TFS and £11.5m TFSME drawings at 31 December 2020. Excess collateral can be utilised to draw further TFSME funding of up to a further estimated £21m by the end of October 2021 and supports application at auction of ILTR funding should the Society require additional liquidity. The Society also holds £49m of loans as collateral in a pre-positioned pool with the Bank of England at 31 December 2020, these are considered unencumbered assets. At 31 December 2020 the Society had provided £780k cash collateral, as per the Society's Credit Support Annexes (CSAs) for its derivative instruments, mitigating net mark to market credit exposure. These are subject to a minimum threshold of £250k.Other Assets items, which are incapable of being encumbered, include intangible assets, deferred tax asset, property, plant and equipment, derivative assets and sundry debtors. The Society's ALCO reviews the asset encumbrance of the institution on a regular basis.

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.

LIQUIDITY RISK APPETITE

The liquidity risk appetite is that the Society will at all times hold sufficient 'near sight' liquidity to survive under stressed conditions for a minimum of 90 days without any management actions.

In addition a minimum of £20m of this near sight liquidity must always be held in 'cash equivalent' products. For the avoidance of doubt, this excludes any liquid assets which would require monetising.

The 90 day period reflects the availability and timescale of reliable short term recovery responses which are to either raise new deposits or to draw additional funds from the Bank of England.

LIQUIDITY GOVERNANCE

The Board is ultimately responsible for overseeing the management of key risks, including liquidity, across the organisation. The Board reviews, challenges and approves the ILAAP, the Liquidity Contingency Plan and the Liquidity & Funding Policy.

The Board has delegated the monthly monitoring of liquidity risk management to ALCO (or Management -ALCO in the alternate months ALCO does not meet). The accountable executive for liquidity risk is the Finance Director ('FD').

The Board has also delegated responsibility to the FD, with input and challenge from ALCO, to draft the ILAAP along with the accompanying policies and stress assumptions before they are challenged and ultimately approved by the Board.

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 daily basis to confirm that the Society can withstand normal and extreme cash outflows.

The roles and responsibilities for the control of liquidity risk are set out below.

Role	Responsibility
Set liquidity risk appetite and own ILAAP	Board
Own Liquidity Policy and Liquidity Contingency Plan	Board
Approve ILAAP stresses and assumptions	Board (with ALCO input)
Strategic management of interest rate margin	Board
Manage day to day liquidity	FD and FC
Approve deposit and wholesale raising strategy	ALCO
Receive daily liquidity update confirming compliance with liquidity risk appetite	CEO, FD, FC, Head of Risk
Receive monthly update confirming compliance with regulatory liquidity requirements	ALCO / Mgt-ALCO
Role	**Responsibility**
Produce liquidity MI	Finance
Monitor compliance with policies	Risk

KEY LIQUIDITY METRICS

The Board is satisfied that liquidity risk management arrangements described above are adequate to control and monitor the Society's liquidity profile and strategy.

The key metrics that are used to monitor liquidity are the:

- Liquidity to funding ratio
- Surplus over a stressed 90 day outflow
- Daily retail deposit outflow
- LCR
- OLAR surplus
- Granular LCR stress
- Combined benchmark stress

The key liquidity metric is the compliance with the Society's own assessment of its liquidity requirement. This is based on ensuring that the overall liquidity adequacy requirement (OLAR) will be met over period of the 90 day risk appetite. The OLAR position is forecast on a daily basis covering the next 6 months to ensure that the Society will remain compliant in the future.

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. The requirement is that the LCR will exceed 100%.

The table below summarises the average HQLA, net cash outflow and LCR position by quarter:

	2020 Q1	2020 Q2	2020 Q3	2020 Q4
HQLA	63,614	66,189	79,323	90,274
Total net cash outflow	12,846	11,610	15,128	20,077
Liquidity coverage ratio %	**495%**	**570%**	**524%**	**450%**

No HQLAs are held to cover Pillar 2 risks

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 2020 Annual Report and Accounts.

The Society's total operating income and the number of full time equivalent employees during the year to 31 December 2020 were:

All numbers £k	**2020**	**2019**
Turnover £k	10,853	11,183
Profit Before Tax £k	2,668	3,316
Tax on Profit on Ordinary Activities £k	506	584
Profit After Tax £k	**2,162**	**2,732**
Employees (on a full time equivalent basis)	105	101

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.

The Society only has one material business area, therefore there is no requirement under Article 450 of the CRR to provide additional breakdowns of remuneration information by business area.

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 2020.

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

All numbers £k	**2020**
Fixed Remuneration	219
Variable Remuneration	0
Total	**219**

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 2020.

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

All numbers £k	2020
Fixed Remuneration	391
Variable Remuneration	85
Total	**476**

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 2020 these staff were as follows:

- Executive Management Team
- Senior and Mandated Mortgage Underwriters
- New Business Lead
- Senior Lending Specialist
- Lending Operations and Support Lead
- Intermediary Team Lead
- Customer Protection Manager
- Direct Sales Mortgage Advisers
- Human Resources and Premises Manager
- IT Infrastructure Manager
- MI & System Development Manager

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

All numbers £k	2020
Fixed Remuneration	1,087
Variable Remuneration	155
Total	**1,242**

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	93,358									93,358	0
Institutions		7,555							265	7,820	0
Corporates										0	0
Retail					241					241	241
Secured by mortgages on immovable property			417,296			9,170			18,995	445,461	445,461
Exposures in default						381				381	381
Other items	396					2,481		206		3,083	3,083
Total	**93,754**	**7,555**	**417,296**	**0**	**241**	**12,033**	**0**	**206**	**19,260**	**550,344**	**449,167**

18. Appendix B: Countercyclical Buffer Detail

Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer												
	General credit exposures		Trading book exposure		Securitisation exposure		Own funds requirements				Own funds requirement weights	Countercyclical capital buffer rate
All figures £k	Exposure value for SA	Exposure value IRB	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total		
	010	020	030	040	050	060	070	080	090	100	110	120
United Kingdom	550,344	0	0	0	0	0	12,932	0	0	0	0	0%

Amount of institution-specific countercyclical capital buffer	
Total risk exposure amount	550,344
Institution specific countercyclical buffer rate	0.28%
Institution specific countercyclical buffer requirement	509

19. Appendix C: Director Details

Director	Occupation / Professional Qualification	Other Directorships
Michael Bury	Company Director & Chartered Accountant & Corporate Treasurer	Benenden Hospital Trust The Benenden Healthcare Society Limited Royal Voluntary Service JMSM Investments Limited
Nicholas Fielden	Finance Director	Market Harborough Mortgages Ltd
Lindsay Forster	Company Director	
Jonathan Fox	Company Director	Fox 65 Racing Ltd
Andrew Merrick	Company Director & Chartered Accountant	Yorkshire Water Services Ltd Kelda Finance (No3) Plc Trustee of the Nell Bank Charitable Trust Ilkley Lawn Tennis & Squash Club Ltd
Mark Robinson	Chief Executive	Market Harborough Mortgages Ltd Market Harborough Building Society Charitable Foundation
Zoe Shapiro	Company Director	
David Stunell	Company Director & Corporate Treasurer	Hounte Ltd The Asset and Liability Management Association Ltd
Michael Thomas	Company Director & Corporate Treasurer & Chartered Accountant	AST Language Services Ltd
Nala Worsfold	Company Director & Qualified Accountant	