Capital Requirements Directive
Pillar 3 Disclosures
March 2023

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1. Overview

This document presents the Pillar 3 disclosures on capital and risk management of Market Harborough Building Society (the 'Society') and its subsidiary (the 'Group') for the year ended 31 December 2022.

The Group meets the definition of a 'small and non-complex institution' and complies with the requirements in accordance with Article 433b of the Disclosure (CRR) Part of the PRA Rulebook.

PURPOSE OF THIS DOCUMENT

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 in relation to key information about risk exposures, the management of those risks, capital adequacy and liquidity position.

The PRA has issued the following consultations which are likely to impact on the Group's Pillar 1 and 2 exposures and metrics and Pillar 3 disclosures:

- CP 16/22 'Implementation of the Basel 3.1 standards' (issued November 2022 with proposed implementation of 1 January 2025)
- CP 4/23 'The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms (issued February 2023 with proposed implementation of early H2 2024.
- CP 5/23 'Remuneration: Enhancing proportionality for small firms' (issued February 2023 with proposed implementation of 1 January 2024.

The Society is evaluating these proposals.

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 Group's Pillar 3 disclosures are based on its interpretation of the requirements of CRD IV, Capital Requirements Regulation 2 (CRR2) and the Prudential Regulatory Authority's (PRA) Rulebook as relevant to the size and complexity of the Society. 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.

2. Key Metrics

The table below provides an overview of the Group's prudential regulatory metrics.

UK KM1 - Key Metrics

		2022 £'000	2021 £'000
	Available own funds (amounts)		
1	Common Equity Tier 1 (CET1) capital	53,188	49,078
2	Tier 1 capital	53,188	49,078
3	Total capital	53,188	49,078
	Risk-weighted exposure amounts		
4	Total risk-weighted exposure amount	225,141	185,378
	Capital ratios (as a percentage of risk-weighted exposure amount)		
5	Common Equity Tier 1 ratio (%)	23.6%	26.5%
6	Tier 1 ratio (%)	23.6%	26.5%
7	Total capital ratio (%)	23.6%	26.5%
	Additional own funds requirements based on SREP (as a percentage of risk-weighted exposure amount)		
UK 7a	Additional CET1 SREP requirements (%)	2.3%	2.5%
UK 7b	Additional AT1 SREP requirements (%)	-	-
UK 7c	Additional T2 SREP requirements (%)	-	-
UK 7d	Total SREP own funds requirements (%)	10.3%	10.5%
	Combined buffer requirement (as a percentage of risk-weighted exposure amount)		
8	Capital conservation buffer (%)	2.5%	2.5%
9	Institution specific countercyclical capital buffer (%)	0.8%	0.0%
11	Combined buffer requirement (%)	3.3%	2.5%
UK 11a	Overall capital requirements (%)	13.6%	13.0%
12	CET1 available after meeting the total SREP own funds requirements (%)	13.3%	16.0%
	Leverage ratio		
13	Total exposure measure excluding claims on central banks	623,778[1]	564,734
14	Leverage ratio excluding claims on central banks (%)	8.5%[1]	9.4%
	Liquidity Coverage Ratio		
15	Total high-quality liquid assets (HQLA) (Weighted value -average)	95,947	94,181
UK 16a	Cash outflows - Total weighted value	30,955	31,118
UK 16b	Cash inflows - Total weighted value	11,679	10,971
16	Total net cash outflows (adjusted value)	19,276	20,146
17	Liquidity coverage ratio (%)	501%	549%
	Net Stable Funding Ratio		
18	Total available stable funding	546,833	502,528
19	Total required stable funding	341,654	311,569
20	NSFR ratio (%)	160%	161%

[1] After exclusion of qualifying central bank exposure

3. Overview of Risk Weighted Exposure Amounts (RWEAs)

The RWEAs and credit risk exposures related to the standardised model for the Group are as below.

UK OV1 - Overview of risk weighted exposure amounts

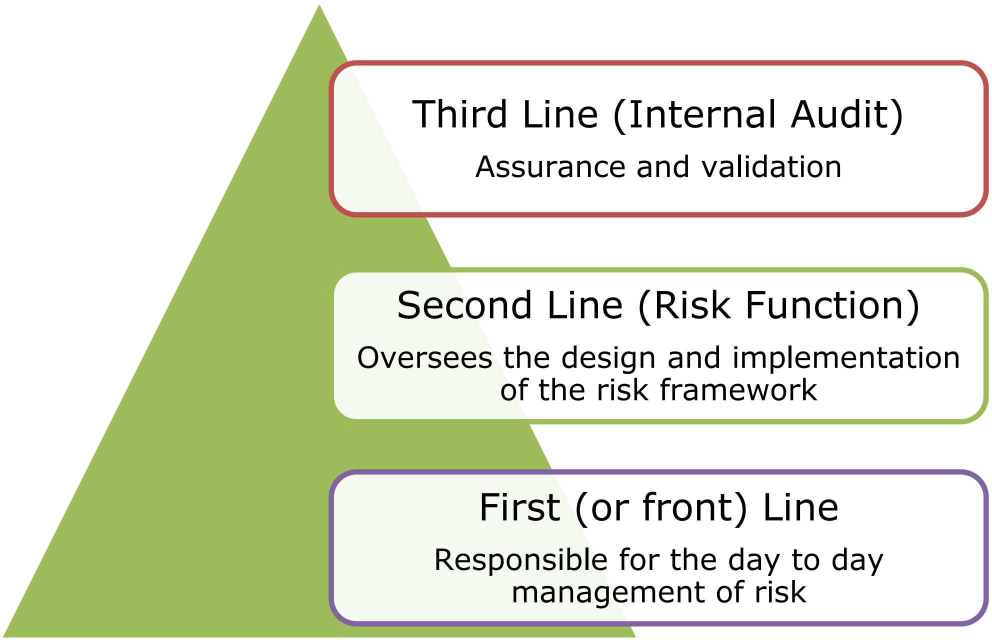
		Risk weighted exposure amounts (RWEAs)		Total own funds requirements
		2022 £ '000	**2021 £ '000**	**2022 £ '000**
1	**Credit risk (excluding CCR)**	**202,557**	**164,531**	**20,787**
2	Of which the standardised approach	202,557	164,531	20,787
3	Of which the foundation IRB (FIRB) approach	-	-	-
4	Of which slotting approach	-	-	-
UK 4a	Of which equities under the simple risk weighted approach	-	-	-
5	Of which the advanced IRB (AIRB) approach	-	-	-
6	**Counterparty credit risk - CCR**	**421**	**126**	**43**
7	Of which the standardised approach	216	92	22
8	Of which internal model method (IMM)	-	-	-
UK 8a	Of which exposures to a CCP	-	-	-
UK 8b	Of which credit valuation adjustment - CVA	206	34	21
9	Of which other CCR	-	-	-
15	**Settlement risk**	**-**	**-**	**-**
16	**Securitisation exposures in the non-trading book (after the cap)**	**-**	**-**	**-**
20	**Position, foreign exchange and commodities risks (Market risk)**	**-**	**-**	**-**
UK 22a	**Large exposures**	**-**	**-**	**-**
23	**Operational risk**	**22,163**	**20,720**	**2,274**
UK 23a	Of which basic indicator approach	22,163	20,720	2,274
UK 23b	Of which standardised approach	-	-	-
UK 23c	Of which advanced measurement approach	-	-	-
24	Amounts below the thresholds for deduction (subject to 250% risk weight) (For information)	-	79	-
29	**Total**	**225,141**	**185,377**	**23,105**

4. Risk Management objectives and policies

RISK STATEMENT APPROVED BY THE MANAGEMENT BODY (POINT (F) OF ARTICLE 435(1) CRR)

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:



The Group's risk appetite statement is as follows:

"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 that comprises the following features:

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

The Board has established Committees to assist in the implementation and monitoring of risk management across the Group, including the Audit & Compliance Committee, the Risk Committee, the Assets and Liabilities Committee (ALCO), the Remuneration Committee and the Nominations Committee.

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

The Society has elected to omit disclosing key ratios and figures relating to its risk appetite, as they are proprietary information as per CRR Article 432.

STRATEGIES AND PROCESSES TO MANAGE RISKS FOR EACH SEPARATE CATEGORY OF RISK (POINT (A) OF ARTICLE 435(1) CRR)

Business risk and margin compression

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

- Competitive mortgage and retail savings markets. There is a risk that increased competition reduces mortgage yields and increases the cost paid for retail savings. The Directors closely monitor the economic environment, the mortgage and savings markets, the balance sheet composition of the Group and product pricing to ensure that the Society's product mix remains appropriate and that net interest margin remains in line with the Corporate Plan;
- Increasing management expenses. Operating costs are likely to increase in the short-term as investment is made in services to improve growth prospects and deliver operating efficiencies. There is a risk that costs continue to increase over and above the growth in interest margin; and
- Climate change will bring financial risks to the Society's business. The Risk Committee assesses all risks in the Society's risk register in light of the risks arising from climate change and considers emerging risks to the Society's business model. The Committee considers both physical and transitional risks relating to the Society's business and lending security. Stress testing of the mortgage book has been enhanced to include the assessment of flood risk and poor Energy Performance Certification. 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.

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. 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.

Market Risk

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

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

The management of interest rate risk is based, inter alia, on a full statement of financial position gap analysis. The statement of financial position is subjected to a number of stress tests. On a monthly basis, these stress tests include stressing interest rates by an increase and decrease of 2%, short term increases or decreases followed by longer term flattening and steepening of interest rates and gradual movements in interest rates. In addition management review interest rate basis risk; stressing the statement of financial position by both expected and a severe stress scenarios. Both sets of results are measured against the Board's appetite for risk. The Board has set a risk appetite for market risk measured in the stressed gap analysis of £2m value of capital. The Board has set a risk appetite for basis risk based on minimum margins which are revised annually. The Board has also set a risk appetite for reduction in Net Interest Income (NII) also revised annually. These stress tests and their results are monitored by the ALCO and reported to the Board.

Liquidity risk

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

Concentration risk

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

Operational risk

This is the risk of loss arising from inadequate or failed internal processes, the actions of people, the Group's IT systems, regulatory compliance, fraud and financial crime. The Group maintains policies and procedures for all key internal processes. The Risk and Compliance function is responsible for monitoring operational risk and ensuring that appropriate actions are taken to strengthen internal controls implemented across the business to manage operational risk. The Society recognises that the risks from cybercrime are of growing concern. The Society recognises this risk to our customers and processes. The Society carried out several cyber related projects and employs dedicated resource 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.

Pension risk

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.

Conduct risk

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

DECLARATION (POINT (E) OF ARTICLE 435(1) CRR)

In accordance with the requirements of point (e) of Article 435(1) CRR, the Society's Board, as the ultimate management body, is satisfied that the risk arrangements in place at the Society are adequate with regard to the Society's profile and strategy.

5. 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 and members of the Executive team. Two members of the Executive team, the Chief Executive and the Finance Director, are Executive Directors.

INFORMATION RELATING TO BODY THAT OVERSEES REMUNERATION

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

The Committee consists of no less than two independent Non-Executive Directors. The Committee is chaired by an independent Non-Executive Director who is not the Chair of the Board. The Committee's Chair had served more than 12 months on the Committee prior to appointment as Chair of the Remuneration Committee. The Society's Chief Executive and Finance Director comment upon proposals and provide information, as and when required, and attend meetings at the Committee's request.

In making its decisions and recommendations, the Committee takes into account all relevant factors, including a review of comparative benefit packages from similar financial organisations and the internal consistency between roles and recognition. The Committee seeks independent professional advice on Director and Senior Executive pay on a periodic basis. The Committee supports linking reward to performance. In doing so, it pays close attention to the performance of the Society and the risks to which it is exposed, external market conditions, and its overall responsibility to members within a framework of good corporate governance. Levels of remuneration for the Chair and all Non-Executive Directors reflect the time commitment and responsibilities of their roles and do not contain any elements of performance related pay.

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

- The need to recruit, retain and motivate staff with appropriate skills and experience to make an effective contribution to the Society's strategy and operations, and so to act in the long-term interests of the Society's members;
- The link between individual awards, the delivery of strategy and the long-term performance of the Society being clearly defined. There is no reward for poor performance;
- The Society's incentive schemes driving behaviours consistent with the Society's purpose, values and strategy;
- The need for a clear and uncomplicated link between performance and remuneration;
- The Society's remuneration arrangements being transparent and promoting effective engagement with stakeholders and colleagues;
- The range of possible values of rewards to individual Directors and any other limits or discretions being identified and explained;
- The levels of remuneration, as a reference, for similar jobs within the UK financial services sector;

- The need for pay arrangements not to directly or indirectly expose the Society to inappropriate risk;
- The structure of remuneration, avoiding complexity and that the rationale and operation are easy to understand;
- The PRA Rulebook;
- The application of provisions of the FCA's Remuneration Code for dual regulated firms (PRA and FCA regulated); and
- The provisions of the UK Corporate Governance Code insofar as they relate to Building Societies.

During 2022 the Committee considered these policy aims and objectives ensuring that Executive remuneration policy and practices reflected: clarity, simplicity, risk, predictability, proportionality and alignment to the Society's culture. For example the Committee ensured that the design of Executive incentive scheme was clearly defined and communicated, rewards were capped and proportionate and Executives were required to demonstrate how they had promoted values aligned with the desired culture of the Society.

No payments under incentive schemes are guaranteed and all schemes are non-contractual. The Society's Remuneration Committee uses its discretion to override formulaic outcomes. The Committee considers the outcome of the incentive schemes on an annual basis, adjusting incentive payments as it sees fit.

Policies and incentive schemes are reviewed on an annual basis and revised as appropriate. The remuneration policies in place during 2022 were reviewed by the Committee and were considered to be effective.

UK REM1 - Remuneration awarded for the financial year

			MB Supervisory function	MB Management function	Other senior management	Other identified staff
1	Fixed remuneration	Number of identified staff	7	3	4	-
2		Total fixed remuneration	£220,638	£494,040	£411,115	-
3		Of which: cash-based	£220,638	£494,040	£411,115	-
UK-4a		Of which: shares or equivalent ownership interests	-	-	-	-
5		Of which: share-linked instruments or equivalent non-cash instruments	-	-	-	-
UK-5x		Of which: other instruments	-	-	-	-
7		Of which: other forms	-	-	-	-
9	Variable remuneration	Number of identified staff	-	3	4	-
10		Total variable remuneration	-	£164,056	£117,958	-
11		Of which: cash-based	-	£164,056	£117,958	-
12		Of which: deferred	-	-	-	-
UK-13a		Of which: shares or equivalent ownership interests	-	-	-	-
UK-14a		Of which: deferred	-	-	-	-
UK-13b		Of which: share-linked instruments or equivalent non-cash instruments	-	-	-	-
UK-14b		Of which: deferred	-	-	-	-
UK-14x		Of which: other instruments	-	-	-	-
UK-14y		Of which: deferred	-	-	-	-
15		Of which: other forms	-	-	-	-
16		Of which: deferred	-	-	-	-
17	Total remuneration (2 + 10)		£220,638	£658,096	£529,073	-

UK REM5 - Remuneration information on MRT staff

		Management body remuneration			Business areas	-
		MB Supervisory function	MB Management function	Total MB	Corporate functions	Total
1	**Total number of identified staff**					**14**
2	Of which: members of the MB	7	3	10		
3	Of which: other senior management				4	
4	Of which: other identified staff				-	
5	Total remuneration of identified staff	£220,638	£658,096	£878,734	£529,073	
6	Of which: variable remuneration	-	£164,056	£164,056	£117,958	
7	Of which: fixed remuneration	£220,638	£494,040	£714,678	£411,115	

Template 'UK REM2 - Special payments to staff whose professional activities have a material impact on institutions' risk profile' has been omitted as no such payments were made in 2022.

Template 'UK REM3 - Deferred remuneration' has been omitted as no remuneration was awarded in 2022 that has been deferred.

Template 'UK REM4 - Remuneration of 1 million EUR or more per year' has been omitted as no such remuneration was awarded in 2022.

THE RATIOS BETWEEN FIXED AND VARIABLE REMUNERATION SET IN ACCORDANCE WITH ARTICLE 94(1) OF CRD

The ratios for annual variable remuneration range from 0-25% which ensures that no colleagues earn more than one fourth of the total annual remuneration in variable remuneration.