

Market Harborough
BUILDING SOCIETY

Capital Requirements Directive

Pillar 3 Disclosures

March 2024

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1. OVERVIEW

This Pillar 3 disclosure covers Market Harborough Building Society Group ('the Society') 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.

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 PRA, the Society's 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 Society's Pillar 1 and 2 exposures and metrics, and Pillar 3 disclosures:

- Part one of PS 17/23 'Implementation of the Basel 3.1 standards' (issued December 2023 with proposed implementation of 1 January 2025). Part two is expected in Q2 2024 and will primarily cover credit risk methodology.
- PS 15/23 'The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms' (issued December 2023 with proposed implementation of H2 2024). The Society will meet the definition of a 'simple' firm, to be known as a 'Small Domestic Deposit Taker'.

The Society is awaiting the release of part two of PS 17/23 to evaluate the new rules in full before committing to a regime.

OVERVIEW (continued)

BASIS & FREQUENCY OF DISCLOSURES

The Society's Pillar 3 disclosures are based on its interpretation of the requirements of CRD IV, CRR2 and the PRA's 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.

The Society meets the definition of a Small Domestic Deposit Taker (SDDT) and since it does not have any listed instruments, it is allowed to derogate from some disclosures set out in Article 433b of the Disclosure (CRR) Part of the Prudential Regulation Authority (PRA) Rulebook.

2. KEY METRICS

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

UK KM1 - Key Metrics

		2023 £'000	2022 £'000
	Available own funds (amounts)		
1	Common Equity Tier 1 (CET1) capital	56,668	53,188
2	Tier 1 capital	56,668	53,188
3	Total capital	56,668	53,188
	Risk-weighted exposure amounts		
4	Total risk-weighted exposure amount	260,957	225,141
	Capital ratios (as a percentage of risk-weighted exposure amount)		
5	Common Equity Tier 1 ratio (%)	21.7%	23.6%
6	Tier 1 ratio (%)	21.7%	23.6%
7	Total capital ratio (%)	21.7%	23.6%
	Additional own funds requirements based on SREP (as a percentage of risk-weighted exposure amount)		
UK 7a	Additional CET1 SREP requirements (%)	2.1%	2.3%
UK 7b	Additional AT1 SREP requirements (%)	-	-
UK 7c	Additional T2 SREP requirements (%)	-	-
UK 7d	Total SREP own funds requirements (%)	10.1%	10.3%
	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 (%)	1.7%	0.8%
11	Combined buffer requirement (%)	4.2%	3.3%
UK 11a	Overall capital requirements (%)	14.3%	13.6%
12	CET1 available after meeting the total SREP own funds requirements (%)	11.6%	13.3%
	Leverage ratio		
13	Total exposure measure excluding claims on central banks	659,136 ¹	639,801 ¹
14	Leverage ratio excluding claims on central banks (%)	8.6% ¹	8.9% ¹
	Liquidity Coverage Ratio		
15	Total high-quality liquid assets (HQLA) (Weighted value - average)	114,313	95,947
UK 16a	Cash outflows - Total weighted value	32,576	30,955
UK 16b	Cash inflows - Total weighted value	13,727	11,914
16	Total net cash outflows (adjusted value)	18,850	19,041
17	Liquidity coverage ratio (%)	635%	506%
	Net Stable Funding Ratio		
18	Total available stable funding	645,192	543,878
19	Total required stable funding	402,500	342,597
20	NSFR ratio (%)	160%	159%

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 Society are as below.

UK OV1 - Overview of risk weighted exposure amounts

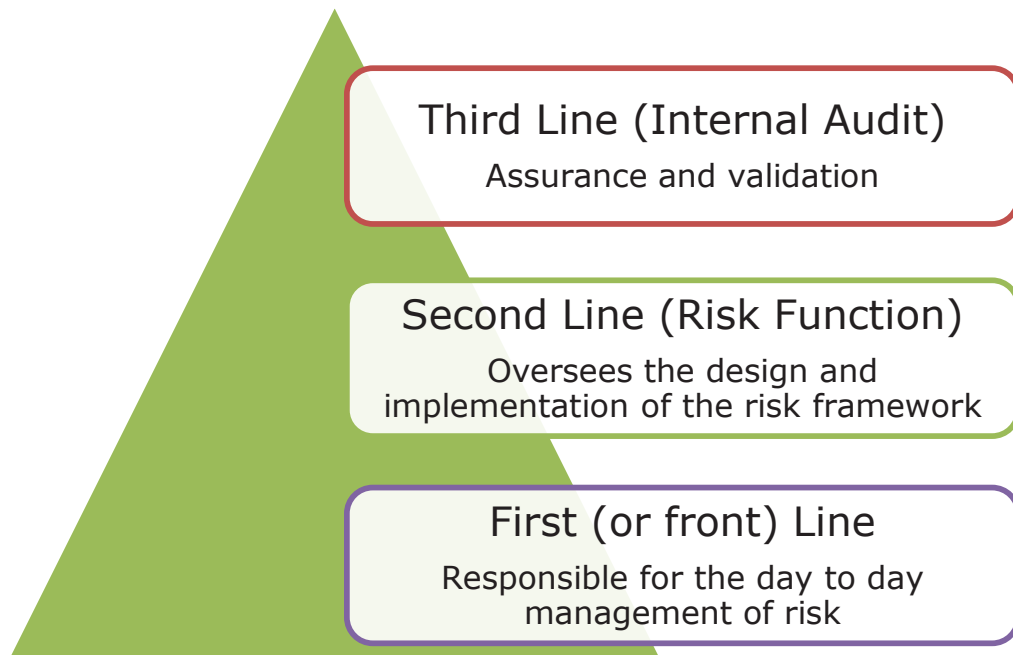
		Risk weighted exposure amounts (RWEAs)		Total own funds requirements
		2023 £ '000	2022 £ '000	2023 £ '000
1	Credit risk (excluding CCR)	235,908	202,597	23,827
2	Of which the standardised approach	235,908	202,597	23,827
3	Of which the foundation IRB (FIRB) approach	-	-	-
4	Of which slotting approach	-	-	-
UK 4a	Of which equities under the simple risk weighted approach	-	-	-
5	Of which the advanced IRB (AIRB) approach	-	-	-
6	Counterparty credit risk - CCR	255	421	26
7	Of which the standardised approach	175	216	18
8	Of which internal model method (IMM)	-	-	-
UK 8a	Of which exposures to a CCP	-	-	-
UK 8b	Of which credit valuation adjustment - CVA	80	206	8
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	24,794	22,163	2,504
UK 23a	Of which basic indicator approach	24,794	22,163	2,504
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)	-	-	-
29	Total	260,957	225,181	26,357

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:



Furthermore, the Society'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.

RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

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 Society, 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 Society 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 Society's Corporate Plan, approved by the Board, sets out the key objectives and how key risks to achieving those objectives will be managed. The Society 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 Society 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.

RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

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 earnings and capital 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 manages interest rate exposures to within Board agreed limits firstly through the use of a natural hedge, whereby mortgage and savings products with similar maturity dates offset each other, or an interest rate derivative.

The management of interest rate risk is based, inter alia, on a full statement of financial position gap analysis, then is subjected to a number of stress tests which include parallel and non-parallel shifts to interest rates. In addition, management review interest rate basis risk; stressing the statement of financial position by both an expected or 'base case' and a severe stress scenario. 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 and 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) and this too is revised annually. The stress tests and their results are monitored by the ALCo and reported to the Board.

Liquidity risk

Liquidity risk is the risk that the Society does not have sufficient financial resources to meet its obligations as they fall due, or can secure them only at an excessive cost. It arises from the maturity mismatch of the Society's assets and liabilities. The Society'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 obligations cannot be met as they fall due. That applies to both 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 Society. The Financial Risk Management Policies detail liquidity risk limits set by the Board and these are reviewed daily by the Society's Finance & Treasury departments. They are also monitored every month in Management ALCo meetings and quarterly in the ALCo. 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 Society's IT systems, regulatory compliance, fraud and financial crime. The Society 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.

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 Society 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.

RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

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. To counter this the Society's policy on remuneration seeks 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. Three members of the Executive team, the Chief Executive, Chief Finance Officer and Chief Customer Officer, 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.

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. 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.

During 2023 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 2023 were reviewed by the Committee and were considered to be effective.

REMUNERATION POLICIES AND PRACTICES (continued)

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	£239,850	£681,199	£325,522	-
3		Of which: cash-based	£239,850	£681,199	£325,522	-
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	-	-	-	-
8		(Not applicable in the UK)	-	-	-	-
10	Variable remuneration	Total variable remuneration	-	£125,943	£84,848	-
17	Total remuneration (2 + 10)		£239,850	£807,142	£410,370	-

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 2023.

Template 'UK REM3 - Deferred remuneration' has been omitted as no remuneration was awarded in 2023 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 2023.

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