



Annual Report and Accounts 2021

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Chair's Statement

2021 was a challenging year for many of our members, staff and suppliers. The pandemic was the backdrop to the Society's business activities and the economic impacts of Covid-19 and government initiatives were significant factors.

I am pleased to report that our services were however maintained with minimal disruption to customers and in fact we delivered record mortgage lending and profits.

ECONOMY

We entered 2021 with new Covid-19 restrictions which severely slowed the economy but after the so called Freedom Day in July the relaxation of those restrictions resulted in pent up demand moving quickly into a boost to consumption. In the housing market the temporary reduction in Stamp Duty (worth up to £15,000) intensified the housing market into record volumes of transactions in June as well as strong house price inflation – which reached 10% nationally by December, as reported by the Office of National Statistics (ONS).

Twelve-month CPI inflation rose from 3.1% in September to 4.8% in December (ONS) and the Bank of England forecast inflation to peak at around 6% in April 2022, with the impact on utility bills following rises in wholesale gas prices. This level of inflation (a 30 year high) is significantly ahead of the Monetary Policy Committee's (MPC) target of 2% and they voted by a majority of 8-1 in December 2021 to increase Bank Rate by 0.15 percentage points, to 0.25%. A further rate rise followed in February when the Committee voted 5-4 to increase by another 0.25% to 0.5%, with the minority 4 members voting for a 50 percentage points rise to 0.75%. Further base rate rises are therefore expected this year.

This restarting of the economy has led to staff shortages across the economy and by December the number of job vacancies rose to a record 1.2 million. At the same time the unemployment rate at year end fell back almost to its pre Covid-19 level of 4.1% (ONS). Wage inflation, although negative in real terms, was 3.7% in December (ONS) with prospects of increasing further in 2022.

The surge in activity meant that year on year GDP growth accelerated to 7.5% in the 4th quarter and economic output now exceeds pre-pandemic levels (ONS).

Levels of Covid-19 infection across the UK have fallen dramatically since their peak at the end of 2021. The Omicron variant proved to be more transmissible but less dangerous than previous Covid-19 variants. Whilst restrictions are now being lifted, a new threat to the world economy is emerging with the invasion of Ukraine by Russia. Oil and gas prices have risen significantly and stock prices fallen. It is anticipated that sanctions will impact the global economy, leading to higher prices and inflation. With the continuing risks from Covid-19 and Russia there will be ongoing global cost pressures making for an uncertain medium term outlook for both output and inflation.

BUSINESS RESULTS

Our financial strength since 1870 has been built on our focus on savers' and borrowers' needs. We delivered very competitive savings rates in 2021 and continued to provide bespoke mortgage solutions to poorly served markets both locally and nationally. On the back of strong pre-tax profits of £5.0m the Group's reserves grew by £4.7m to £49.6m maintaining MHBS' position as one of the best capitalised building societies (9.2% reserves/total assets).

New mortgages advances of £132m were more than 140% of 2020's (£94m). The lively housing market combined with the removal of Stamp Duty concessions saw a significant concentration of demand and June saw us complete £30m of loans in a single month. Both that month's total and the year's advances were records and service standards were met as we improved our processes while we temporarily paused our lending to grow our capacity. Mortgage growth in the year was however a modest £12m.

Brokers are essential partners in our mortgage success and we place great importance on providing them with quality service. Feedback is collected through the independent web platform Feefo and we work hard to maintain our 5 star scores.

The Society's mortgage book continues to perform better than the sectoral average and 99% of mortgage balances were up to date and not subject to any form of forbearance at the year end. The number of accounts which were 12 or more months in arrears at 31 December 2021 was 1 (2020: 3). The total balance outstanding on these accounts was £87k (2020: £220k) with arrears of £13k (2020: £24k). In fact the ending of the furlough scheme led to no appreciable rise in arrears. Of course the pandemic meant some borrowers faced challenges and we supported them by offering payment holidays or other suitable forbearance. However, by the end of the year, the total balance of accounts in arrears was only £4.0m.

As you would expect, the Society followed Government Covid-19 rules and guidance throughout 2021. Health and safety reviews allowed branch staff to work safely with customers and all branches remained open. Head Office staff continued to work from home, however we hope to move to permanent hybrid (home/office) based working as conditions allow in 2022.

Chair's Statement (continued)

YOUR SOCIETY

The Board met in Market Harbourough and by video in the year and plan to adopt this mix going forward. Unfortunately our forthcoming AGM will be held only as a virtual meeting due to continued uncertainties over pandemic guidance.

As I mentioned last year, Mike Bury who succeeded Nick Johnston as our Chair became unwell in 2020 and I assumed the Chair. Tragically, Mike died last year and I want to record my recognition of his contribution and offer our deepest sympathies to his widow Stella.

2022 will see our long standing CEO Mark Robinson retire later in the year. We have commenced the search for his successor and I will update you as that process progresses. The Board wish Mark all the best in his next ventures and thank him for his service.

Finally I want to say thank you to all our members – savers and borrowers - for their support in 2021. I also want to recognise the Society's loyal staff, suppliers and business partners for their vital contributions in a challenging, but very successful year.

Michael Thomas
Chair
11 March 2022

Chief Executive's Review

Reviews of this kind often focus on the numbers – asset size, profits and credit performance. These are of course essential elements but I want to start by recognising the people who have been directly responsible for the Society's success in 2021 which was another extraordinary year.

MHBS is a mutual organisation and members are the reason for its existence. Life had been especially challenging over the last two years with the pandemic and the variants of Covid-19 impacting everyday life and the economy. Our members' commitment to MHBS has been outstanding in supporting our savings and mortgage business and I hope we have rewarded this loyalty with good service and positivity. I want to thank our staff who have handled these immense changes in working practices in such a cheerful way and continued to deliver quality service.

2021's success is built on this foundation – and I offer my thanks to both members and the MHBS team.

MORTGAGES

The housing market is an important influence on our mortgage lending. 2021 saw record sales of homes as the Stamp Duty concession and buyers who were re-evaluating their lives fuelled transactions. House prices rose by around 10% in the year and detached homes with gardens were especially in demand as lockdowns and homeworking became normalised. June saw the peak of business volumes as the Stamp Duty holiday stepped down and we advanced £30m of mortgages in a single month – a record. Over the year mortgage lending was £132m – 40% more than our lending in 2020 (£94m) and also a record. We were able to handle these high levels of business as we had built capacity by recruiting skilled staff and simplifying our processes.

This focus on scaling up our lending progressed further in the autumn with the launch of a new online portal (Case Hub) which allows online application and "straight through" processing of applications. This scalable technology will allow us to update our processes as significant changes impact our industry in the next few years.

Mortgage brokers are key partners and we listen carefully to our customers' needs. I am pleased to report that satisfaction levels collected via independent organisation Feefo ran at 5 star in 2021 and we were given many positive testimonials which we proudly share on our website (mhbs.co.uk).

FUNDING

As an essential service we never closed our branches and when lockdowns relaxed we saw withdrawals pick up as many members made long delayed "big ticket" purchases. As a result the significant net inflow of 2020 reversed in 2021 and to fund our mortgage growth we took advantage of the government funded TFSME scheme. We ended the year with £59m of this four year funding and replaced all our previous drawings under earlier schemes.

We value our savers and keep our rates under constant review and chose to not accept new accounts rather than punish loyal members by dropping rates to push them away. Our strong mortgage revenues also allowed us to do this whilst increasing profits.

FINANCIAL STRENGTH

Our focus on high quality but more complex mortgages meant that growth has been profitable. Growing the Society whilst diluting our key ratios has little attraction. On the back of record lending we delivered record profits of £5.0m (2020: £2.6m). This was despite significant investment in the business and only slightly boosted by a modest release of mortgage provision (£0.27m).

Capital has grown to £49m and year end liquidity was 20% of funding.

OUR COMMUNITIES AND STAFF

Our staff are encouraged to support local good causes through a Charity Day off scheme where the Society allows paid absence. Despite the restrictions arising from lockdowns staff collectively notched up 1,486 hours of charitable work under the scheme – double that for 2020.

The Society also supports a member nominated Charity of the year and in 2021 this was the Derbyshire, Leicestershire & Rutland Air Ambulance. In total staff, the Society and members raised £7,450 for this fantastic organisation.

In total the Society directly donated £32k to Charities including £25k to its Charitable Foundation which supported many smaller local good causes, particularly those impacted by the pandemic.

OUTLOOK

Cost pressures on both individuals and the Society are increasing and the outlook is for base rates to rise further in 2022. Inflationary pressures have been further exacerbated by the global response to Russia's invasion of Ukraine. However, the credit quality of our loan book has proved resilient and we expect this to remain the case as rates rise because of our prudent affordability stress tests and conservative Loan to Value ratios. Pandemic restrictions are easing across the UK and it is to be hoped that this provides a more stable basis for the economy.

Chief Executive's Review (continued)

In 2021 we made progress on our journey in tackling the climate crisis. The Board agreed an Environmental Policy during the year and considered various initiatives about how the Society will improve its carbon emissions.

The Society is moving back to its office base as part of hybrid working where this makes sense. Balancing the business' needs with staff preferences is the right way to ensure the best outcome for members.

2022 will be the year I leave MHBS to retire. It has been a privilege to lead this 152 year old business and I thank my team for the success we have had over the years. The process of recruitment has begun and I wish the new CEO and the team every success in the next chapter of MHBS' story.

Mark Robinson
Chief Executive
11 March 2022

Corporate Governance Report

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

BOARD LEADERSHIP AND COMPANY PURPOSE

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

The Board's role is to focus on strategic decisions within a framework of prudent and effective controls, which enable risk to be assessed and managed. The Board has a general duty to take decisions objectively in the interests of the Society and to ensure that the Society operates within its Rules and Memorandum, regulations and guidance issued by relevant regulatory authorities and all relevant legislation. In addition, it ensures that appropriate systems of control, human resources and risk management are in place to safeguard Members' interests. The Board normally meets six times a year and holds further meetings as and when required. The Board met on six occasions during 2021 to attend to normal governance matters. The Board maintained focus on operational resilience and staff wellbeing throughout the year, bearing in mind the change in working environment brought about by the Covid-19 pandemic.

At least once a year, the Non-Executive Directors meet without the executive Directors present. A schedule of retained powers and those delegated by the Board is maintained. The day to day running of the Society is delegated to members of the senior management team and management Committees.

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

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

BOARD COMMITTEES

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

Audit and Compliance Committee

The Audit and Compliance Committee meets at least four times a year and is chaired by Andrew Merrick, its other members being Lindsay Forster (until 31 October 2021), Zoe Shapiro, David Stunell and Nala Worsfold. All members of the Committee have experience that is relevant to the role, with at least one member being required to have recent and relevant financial experience. All are Non-Executive Directors.

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

Corporate Governance Report (continued)

BOARD COMMITTEES (Continued)

Risk Committee

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

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

The Committee was chaired by Zoe Shapiro; other members being Michael Bury (until 31 July 2021), Lindsay Forster, Jonathan Fox, Andrew Merrick, David Stunell (until 31 August 2021), Michael Thomas, and Nala Worsfold; all of whom are, or were, Non-Executive Directors.

Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) meets at least four times each year and is responsible for the management and composition of the Society's balance sheet, monitoring the Society's exposure to interest rate variations and monitoring compliance with the Society's liquidity and funding, counterparty and IRRBB (interest rate risk in the banking book) management policies. It recommends, as appropriate, changes to these policies. The Committee is chaired by David Stunell (from 1 September 2021) and members included: Michael Bury (until 31 July 2021), Nicholas Fielden, Michelle Pledger, Mark Robinson, Andrew Merrick (until 31 August 2021) Michael Thomas, and Nala Worsfold. All are Directors of the Society, with the exception of Michelle Pledger and five of whom are, or were, Non-Executive Directors.

Nominations Committee

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

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

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

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

Further information about the Committee, including its responsibilities and activities, can be found in the Nominations Committee Report.

Remuneration Committee

The Committee meets at least three times each year and is responsible for determining the remuneration of the Chair, executive Directors and other senior managers, and for making recommendations to the Board on remuneration for staff and Non-Executive Directors. It consists of no less than two Non-Executive Directors: Jonathan Fox (Chair), Lindsay Forster and David Stunell (from 1 September 2021). The remuneration policies for executive and Non-Executive Directors are set out in the Directors' Remuneration Report.

Corporate Governance Report (continued)

BOARD COMMITTEES (continued)

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

Board Member	Board	Audit & Compliance	Risk	Assets & Liabilities	Nominations	Remuneration
Michael Thomas (Chair)	7 (7)	1*	4 (4)	4 (4)	5 (5) Ch	-
Andrew Merrick (Vice Chair)	6 (7)	4 (4) Ch	4 (4)	3 (3)	-	-
Jonathan Fox (SID)	6 (7)	-	4 (4)	-	5 (5)	2 (2) Ch
Michael Bury	3 (4)	-	2 (2)	2 (3)	-	-
Lindsay Forster	6 (7)	3*	3 (4)	-	-	2 (2)
Zoe Shapiro	7 (7)	4 (4)	4 (4) Ch	-	5 (5)	-
David Stunell	7 (7)	4 (4)	3 (3)	4 (4) Ch	-	1 (1)
Nala Worsfold	7 (7)	4 (4)	4 (4)	4 (4)	-	-
Nicholas Fielden	7 (7)	4*	4*	4 (4)	-	2*
Mark Robinson	7 (7)	4*	4*	4 (4)	5*	2*

Ch - denotes Chair at 31 December 2021

() = number of meetings eligible to attend. Attendance by invitation is marked with *

Michael Bury was excused from a number of meetings during the year due to illness.

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

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

DIVISION OF RESPONSIBILITIES

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

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

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

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

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

Corporate Governance Report (continued)

DIVISION OF RESPONSIBILITIES (Continued)

The Non-Executive Directors meet without the executives present on a regular basis.

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

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

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

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

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

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

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

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

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

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

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

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

One of the independent Non-Executive Directors is appointed as the Senior Independent Director, to provide a sounding board for the Chair and to serve as an intermediary for the other Directors as necessary.

Corporate Governance Report (continued)

COMPOSITION, SUCCESSION AND EVALUATION

The Board and each Committee reviewed its own effectiveness in 2021 by means of a self-assessment questionnaire. The results of the Board Committee assessments are in turn reviewed by the Board. The Board is mindful of the Code requirement for FTSE 350 companies to conduct an external evaluation every three years and whilst this requirement would not apply to the Society, the Board considers annually whether such an evaluation would be beneficial. As part of the internal audit service provided by Deloitte, their representative attends at least one Board meeting and one of each Audit, Risk, Assets & Liabilities Committee meetings annually. Deloitte provide feedback on the performance of the Board and Committees. In 2021 attendance at meetings was disrupted due to the Covid-19 pandemic, however attendance is scheduled again for 2022.

AUDIT, RISK AND INTERNAL CONTROL

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

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

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

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

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

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

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

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

The Internal Audit function is outsourced to Deloitte LLP under specific terms of reference and provides independent and objective assurance that these processes are adequate and applied effectively. A copy of the Internal Audit Charter is available to members from the Society's Secretary upon request and from the Society's website www.mhbs.co.uk.

The external auditors may provide non-audit services on a consultancy basis to the Society. The extent and cost of the work is reported to the Audit and Compliance Committee for approval in advance of any such engagement. The Revised Ethical Standard 2016 introduced restrictions around the provision of non-audit services, including tax services. The Society has ensured compliance with these regulations. The Society is of the opinion that auditor objectivity and independence is not challenged by provision of services allowable under the Revised Ethical Standard.

REMUNERATION

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

SUBSIDIARY COMPANY

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

Corporate Governance Report (continued)

RELATIONS WITH MEMBERS

Dialogue with members

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

The Society is keen to find out its members' views so that it can continually improve. It provides them with a number of ways and opportunities to give their feedback. A dedicated email address (asktheboard@mhbs.co.uk) is promoted, inviting members to engage with the Board. Each enquiry receives a response and questions and answers are shared on the Society's website. The Society surveys a selection of its members on a regular basis through its customer satisfaction survey to provide input into the services and products it offers. The results of this feedback and other complaints or praise received are shared in Board meetings. Members of the Board visit branches and meet with members as part of their role. During 2021 branch visits were conducted virtually so that Directors retained the opportunity to engage with Society colleagues. The Society also encourages its members to attend its annual general meeting where they are able to ask questions and voice their opinions.

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

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

CONSTRUCTIVE USE OF THE ANNUAL GENERAL MEETING

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

All postal and proxy votes are counted using independent scrutineers.

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

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

Due to the lockdown in place during early 2021, the Society elected to hold its annual general meeting virtually over an electronic platform. Due to the continued uncertainties of the pandemic during the planning period, the 2022 meeting will again be held virtually, with members invited to attend. Members are encouraged to send in questions ahead of the meeting.

RELATIONS WITH SOCIETY COLLEAGUES

The Board engages with the Society's colleagues through employee surveys and Non-Executive Director visits to Branches and Departments. A staff engagement Committee has also been established to facilitate staff discussion, in the absence of management, on matters of importance to them and these may be escalated to the Society's Senior Management Committee for consideration. The Society's Senior Independent Director is also available for staff to raise matters that may need to be considered independently from the Chair or Chief Executive and to whom whistleblowing reports may be made in accordance with the Society's whistleblowing policy. The Society's Senior Independent Director formally meets with the staff engagement Committee and reports back to the Board, or follows up issues raised in confidence, as appropriate. Further to discussions with Society colleagues, increased pension contributions were made available to all members of staff and a medical cash plan introduced. Feedback on the enhanced pension provisions and benefits was reported as very positive.

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

On behalf of the Board of Directors:

Michael Thomas
Chair
11 March 2022

Nominations Committee Report

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

NOMINATIONS COMMITTEE

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

The Committee is chaired by Michael Thomas, other members during 2021 comprised Jonathan Fox and Zoe Shapiro.

FREQUENCY

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

EQUALITY, DIVERSITY AND INCLUSION (DIVERSITY PIPELINE)

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

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

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

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

GENDER DIVERSITY

31 December 2021	Male	Female	Total	% Female
Board of Directors	6	3	9	33%
Executive Management	3	3	6	50%
Executive Management Direct Reports	4	12	16	75%
All Society Colleagues	32	88	120	70%

Nominations Committee Report (continued)

GENDER DIVERSITY (continued)

31 December 2020	Male	Female	Total	% Female
Board of Directors	7	3	10	30%
Executive Management	3	3	6	50%
Executive Management Direct Reports	3	15	18	83%
All Society Colleagues	29	89	118	75%

ETHNIC DIVERSITY

All Employees	White British	Other Ethnicity	Total	% Other
31 December 2021	117	9	126	7%
31 December 2020	119	5	124	4%

The most recent comparative data from the local community is from the 2011 Population Census. For Market Harbourough, the census reported 3.7% of the population were from an ethnic minority. The Society's customer-base is national and the 2011 census for England and Wales reported that 20% of respondents stated their ethnicity as Non-White British. For the East Midlands this was 14.6%. The Society's ethnic mix is in line with the Market Harbourough area which continues to be a less diverse ethnic mix than the East Midlands region as a whole. The data from the 2021 Census will be released in June 2022.

SUCCESSION PLANNING

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

The Committee takes into account:

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

The Committee ensures that each Non-Executive Director is independent whilst serving as a Director. All Directors are subject to re-election every two years. The Committee believes this provides members with the opportunity to refresh the Board in a timely manner without leaving the Society at risk of having no Directors in place to lead the Society. The Committee keeps this policy under review. The Committee ensures that the Chair and all Non-Executive Directors do not remain in post beyond nine years from the date of their first election to the Board.

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

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

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

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

Nominations Committee Report (continued)

BOARD EVALUATION

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

The Board considers annually whether to undertake an independent effectiveness review by a professional third party. No such review was carried out in 2021.

Each year the performance of the Board and its Committees is observed by Deloitte in its capacity as internal auditor to the Society. Deloitte comment on the performance in its Annual Conclusion provided under the Audit Charter. The Board considers this feedback and acts upon the comments made. In its latest report, received during 2021, Deloitte concluded that the level of governance and challenge to senior management provided by the Society's Board remained appropriate and had not been adversely impacted by the pandemic and remote working.

On behalf of the Board of Directors

Michael Thomas
Chair of Nominations Committee
11 March 2022

Audit and Compliance Committee Report

This report explains how the Society applies the principles of the UK Corporate Governance Code relating to the operation of the Audit and Compliance Committee and the system of internal control. The report details how the Committee discharged its responsibilities in line with the provisions of the Financial Reporting Council's 'Guidance on Audit and Compliance Committees'. In particular it details the significant issues reviewed and concluded on including the Committee's assessment of those areas on which accounting judgement was exercised.

The Audit and Compliance Committee met four times for scheduled meetings during 2021 and in addition met with the external and internal auditors without the executive Directors present. The Committee also considers matters arising during intervening periods, typically by email correspondence.

FINANCIAL AND BUSINESS REPORTING

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

The Directors are responsible for preparing the Annual Report and Accounts. At the request of the Board, the Committee considered whether the 2021 Report and Accounts are fair, balanced and understandable and whether it provided the necessary information for members and other stakeholders to assess the Society's position and performance, business model and strategy. In order to do this, the Committee considered the accounting policies adopted by the Society, the presentation and disclosure of financial information and, in particular, the key judgements made by management.

In evaluating this year's financial reporting process, the Committee focussed on critical estimates, judgments and material policies. It reviewed the reports at an early stage, providing comment and challenge as part of a robust verification process.

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

Current economic impacts

The Committee considered the risks to the Society's business and resources from inflation, Brexit and the ongoing Covid-19 pandemic. Modelling of various economic downturns has been carried out to predict the potential impact on loan losses and provisioning. Operational impacts have also been considered such as the availability of skilled resource and the impact on suppliers with global connections. The Committee noted that the liability arising from the defined benefit retirement scheme had been and would continue to be impacted due to the economic impact from Brexit, changes in security values and interest rates. It also noted such impact driven by the global pandemic caused by Covid-19. The Society considered that it was well placed to cope with the potential risks arising from Brexit and coronavirus. More details can be found in the Principal risks and uncertainties on page 24.

Provisioning for loan impairment

The Committee monitored loan impairment provisions by considering key assumptions contained in the Society's provisioning model and the relevant disclosure in the Report and Accounts. In particular, the Committee examined and challenged the assumptions adopted and the impact of the low level of impairment data, and has satisfied itself with the level of impairment provisions made for the mortgage portfolio. During 2021 the Society introduced scenario testing for climate related risks such as flooding and energy performance for housing. It continued to monitor the potential impact from the direct and indirect consequences of the Covid-19 pandemic on arrears and subsequent reposessions and losses. The Committee monitored payment deferrals agreed as a result of the pandemic and the ongoing performance of these accounts. Further information about these assumptions can be found in note 28 to the accounts.

Effective Interest Rate

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

Retirement Benefit Liabilities

The Society operates one defined benefit pension scheme. This was closed to future accrual in 2005, however the Society remains responsible for making good the liabilities under the scheme. The scheme is revalued under the requirements of IAS 19 each year and the movements in the deficit are reflected in the Group's accounts. The current deficit is £0.3m (2020: £1.2m). The Committee has considered the valuation assumptions used by the Actuary and satisfied itself that these assumptions are appropriate. The Society holds capital to cover fluctuations in this deficit.

Audit and Compliance Committee Report (continued)

EXTERNAL AUDIT

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

In light of its enquiries above, the Committee is satisfied that, taken as a whole, the 2021 Annual Report and Accounts is fair, balanced and understandable and provides a clear presentation of the Society's position and prospects.

Audit and Compliance Committee and Auditor

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

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

As a result of its considerations, the Committee ensures that the policy to provide non-audit services is appropriately applied. During 2021 BDO LLP provided an additional non-audit service comprising an assurance reporting for the loan data submitted to the Bank of England due to the Society's participation in the TFSME Scheme (a central bank funding scheme for lenders). The service was required by the Bank of England as part of the scheme participation. The Committee considered that this service did not impede the independence of BDO LLP in its position as external auditor. In order to retain independence and objectivity, the Society's policy is to tender for audit services on a regular basis. External audit was put out to tender in 2019. Presentations from three audit firms were received by a panel consisting of Executive and Non-Executive Directors. As a result of the tender, BDO LLP were recommended by the Audit and Compliance Committee and appointed by the Board. Further to consideration by the Committee, BDO LLP are recommended as external auditor to the Society at the 2022 annual general meeting. The Committee considers this appointment on an annual basis.

INTERNAL CONTROLS

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

Management is responsible for designing an appropriate internal control framework whereas the Audit and Compliance Committee is responsible for ensuring that the Board receives appropriate assurance over the effective operation as well as design of this framework. Consistent with these responsibilities, the Committee undertook the following activities during 2021 to satisfy itself over the robustness of the internal control framework:

- Compliance

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

- Internal Audit

The Society's Internal Audit function provides independent assurance to the Board, via the Audit and Compliance Committee, on the effectiveness of the internal control framework. The information received and considered by the Committee during 2021 provided assurance that there were no material breaches of control and that the Society maintained an adequate internal control framework that met the principles of the UK Corporate Governance Code. The Audit and Compliance Committee is also responsible for agreeing the annual budget of Internal Audit and for approving its annual risk based plan of work. Internal Audit provides the Committee with reports on its findings and recommendations as well as updates on the progress made by management in addressing these findings, including verification that actions have been accurately reported as complete.

Audit and Compliance Committee Report (continued)

INTERNAL CONTROLS (continued)

The Committee is satisfied that, throughout 2021, Internal Audit had an appropriate level of resource to deliver its plan of work and that it discharged its responsibilities effectively. Internal audit was last put out to tender in October 2014, further to which Deloitte LLP was appointed internal auditor. The Committee considers annually whether to retender for internal audit services. The internal audit partner responsible for the Society changed at the end of 2021. This is in line with internal audit best practice and there were no issues arising.

Andrew Merrick
Chair of the Audit and Compliance Committee
11 March 2022

Remuneration Report

This report explains how the Society has applied the principles of the UK Corporate Governance Code July 2018 (the Code) relating to the operation of the Remuneration Committee in 2021. The report details how the Committee discharged its responsibilities in line with the provision of the July 2018 version of the Financial Reporting Council's 'Remuneration' principles.

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

The Society had a successful year in 2021 despite the challenging conditions caused by the global coronavirus pandemic, delivering post-tax profits of £4m. In addition, the Society's strong capital position was preserved and good progress was made against strategic objectives. The Remuneration Committee has taken these factors into account when considering the appropriateness of remuneration at the Society.

REMUNERATION COMMITTEE

The Remuneration Committee is responsible for determining the remuneration of the Chair and the remuneration and other benefits of the Executive Directors and Senior Managers, and makes recommendations to the Board concerning the remuneration of Non-Executive Directors and other staff. The Committee has reviewed 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's terms of reference were last reviewed and updated in September 2021 and they are available on the Society's website. The Committee meets at least twice each year.

The Committee consists of no less than two independent Non-Executive Directors. In 2021 the members were: Jonathan Fox (Chair), Lindsay Forster and David Stunell (from 1 September 2021). 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.

COLLEAGUE AND STAKEHOLDER ENGAGEMENT

The Senior Independent Director ('SID') has been appointed as the principal contact for colleague engagement. The SID meets with colleague representatives twice each year and reports back to the Board on each occasion. There is a mechanism to provide for feedback to be made in confidence, as appropriate. Following discussions with colleagues, increased pension contributions were made available to all members of staff and a medical cash plan introduced. The pension scheme was aligned for all employees, including Executives. Feedback on the enhanced pension provisions and benefits was reported as very positive.

During the year, the Committee considered the incentive schemes available to Executives, senior leaders and other employees. The Committee reviewed the internal consistency of the schemes available to senior leaders and those available to Executives. The Schemes were affirmed.

The Society's Remuneration Policy applies to all employees and all incentive schemes are aligned to the Society's strategic objectives, which are shared with colleagues.

The Remuneration Report is provided to the Society's membership for annual consideration and approval at the Annual General Meeting. At the 2021 Annual General Meeting, 89% of votes were cast in favour of the Report. No adverse comments were received from members in regards to the Report or Executive pay.

Remuneration Report (continued)

POLICY AIMS AND OBJECTIVES

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

- The need to recruit, retain and motivate staff with appropriate skills and experience to make an effective contribution to the Society's strategy and operations, and so to act in the long-term interests of the Society's members;
- The link between individual awards, the delivery of strategy and the long-term performance of the Society being clearly defined. 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 2021 the Committee considered these policy aims and objectives ensuring that Executive remuneration policy and practices reflected: clarity, simplicity, risk, predictability, proportionality and alignment to the Society's culture. For example the Committee ensured that the design of Executive incentive scheme was clearly defined and communicated, rewards were capped and proportionate and Executives were required to demonstrate how they had promoted values aligned with the desired culture of the Society.

No payments under incentive schemes are guaranteed and all schemes are non-contractual. The Society's Remuneration Committee uses its discretion to override formulaic outcomes. The Committee considers the outcome of the incentive schemes on an annual basis, adjusting incentive payments as it sees fit. This review was carried out in 2021 and payments were aligned to anticipated outcome with regard to Society and individual performance.

Policies and incentive schemes are reviewed on an annual basis and revised as appropriate. The remuneration policies in place during 2021 were reviewed by the Committee and were considered to be effective. In 2021 objectives were set to support the development of the members of the wider leadership team.

CONFLICTS OF INTEREST

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

CONTRACTUAL ARRANGEMENTS

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

Remuneration Report (continued)

STATUTORY CONSIDERATIONS

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

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

EXECUTIVE DIRECTORS

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

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

The main components of the Executive Directors' remuneration are:

- Base salary and core benefits; and
- Variable remuneration incentive scheme.

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

Pension Benefits

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

Other Benefits

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

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

VARIABLE REMUNERATION

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

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

Annual Incentive Scheme

Annual incentives are paid in cash on the achievement of key targets which will be of benefit to the Society and its members, and which take into account individual performance. The structure of the scheme is approved by the Remuneration Committee at the beginning of each financial year. The rewards for 2021 were dependent on the Society meeting its business performance targets and the personal performance of the individual (including a component relating to culture). The scheme was subject to a cap of 20% of base salary (excluding allowances).

Long Term Incentive Scheme

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

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

Remuneration Report (continued)

EXECUTIVE DIRECTORS' REMUNERATION

The emoluments below represent audited information.

2021 All figures £	Base Salary	Benefits & Allowances	Performance pay annual incentive scheme	Performance pay long-term incentive scheme	Pension Contribution	Total
Mark Robinson	176,604	35,415	31,815	17,475	10,000	271,310
Nicholas Fielden	142,329	16,502	25,641	14,073	14,233	212,779
Total	318,933	51,916	57,456	31,548	24,233	484,089

2020 All figures £	Base Salary	Benefits & Allowances	Performance pay annual incentive scheme	Performance pay long-term incentive scheme	Pension Contribution	Total
Mark Robinson	174,792	34,605	31,500	15,475	10,000	266,372
Nicholas Fielden	140,813	16,369	25,380	12,451	14,313	209,326
Total	315,605	50,974	56,880	27,926	24,313	475,698

The benefits and allowances received by Executive Directors relate to private medical insurance, the provision of a car allowance and pension allowance in lieu of contribution. Only base salaries are pensionable. Mark Robinson gave notice in 2021 of his intention to retire in 2022 and the Board agreed to make a non-pensionable payment of £55,000 to him in return for extending his notice period by six months. It is envisaged he will retire in October 2022 and receive this payment, unless the Board agrees to release him from his contract prior to this date. In addition, and in order to help provide a smooth transition for the incoming Chief Executive, Nicholas Fielden (Finance Director) will receive a payment of 50% of salary provided he is still in post once the new Chief Executive has been employed for twelve months.

NON-EXECUTIVE DIRECTORS

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

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

Remuneration Report (continued)

NON-EXECUTIVE DIRECTORS' REMUNERATION

Directors' fees	2021	2020
All figures £		
Nicholas Johnston to 30 April 2020	0	14,329
Michael Thomas	43,462	39,255
Michael Bury to 31 July 2021	17,625	35,966
Lindsay Forster	23,917	24,504
Jonathan Fox	30,963	29,355
Justin Fox to 30 June 2020	0	12,496
Andrew Merrick	33,125	31,268
Zoe Shapiro	27,213	27,642
David Stunell from 1 December 2020	24,946	1,958
Nala Worsfold from 1 December 2020	24,792	1,958
Total	226,042	218,731

Fees include amounts paid to the Chairs of the Assets & Liabilities Committee, Audit & Compliance Committee, Risk Committee and Remuneration Committee of £3,400 in 2021 (2020: £3,400) and an annual fee of £1,500 to the Chair of the associated Pension and Life Assurance Scheme commenced during 2021. (2020: nil). A taxable annual travel allowance of £1,875/£2,500 (2020: £1,875/£2,500) was paid to Non-Executive Directors travelling more than 35/80 miles to meetings at the Society, which is included in the fees above. This allowance was suspended during 2021 and 2020 while meetings were held virtually.

Jonathan Fox
Chair of Remuneration Committee
11 March 2022

Directors' Report

Your Directors have pleasure in presenting their Annual Report for the year ended 31 December 2021.

BUSINESS OBJECTIVES

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

BUSINESS REVIEW

A review of the Society's business performance during 2021 is included in the Chair's Statement and the Chief Executive's Review. These reports include information about donations to charity (page 5) and mortgage arrears (page 3). No political donations were made during the year (2020: nil).

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

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

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

The financial instruments used by the Group to mitigate certain risks, particularly interest rate risk, are set out in Note 25 of the accounts.

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

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

PRINCIPAL RISKS AND UNCERTAINTIES

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

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

- Competitive mortgage and retail savings markets. There is a risk that increased competition reduces mortgage yields and increases the cost paid for retail savings. The Directors continue to closely monitor the economic environment, the mortgage and savings markets, the balance sheet composition of the Group and product pricing to ensure that the Society's product mix remains appropriate and that net interest margin remains in line with the Corporate Plan;
- Prolonged low and negative interest rates. The Society's net interest margin remains robust despite the low interest rate environment. The Directors model the impacts of near zero and negative rates and assess the impacts on the net interest margin to ensure the results remain inside of the Board's risk appetite. The Board noted the impacts of high inflation towards the end of 2021 and the forecasts into 2022. The Society is well placed to withstand these impacts and the Board continue to monitor the situation;
- 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

Directors' Report (continued)

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

- Climate change will bring financial risks to the Society's business. The Risk Committee has assessed all risks in the Society's risk register in light of the risks arising from climate change and considered emerging risks to the Society's business model. The Committee considered both physical and transitional risks relating to its business and lending security. Stress testing of the mortgage book was enhanced to include the assessment of flood risk and poor Energy Performance Certification. During 2021 the Board approved a new environmental policy and in 2022 will be progressing its journey to carbon neutrality. A commitment has been made to reduce phase one emissions to zero by 2030. Initial actions will be to assess the Society's current carbon footprint. As well as introducing measures to reduce direct carbon emissions from the Society's own operations, it will consider the emissions related to its mortgage lending.

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.

Operational risk: the risk of loss arising from inadequate or failed internal processes, the actions of people, the Group's IT systems, regulatory compliance, fraud and financial crime. The Group maintains policies and procedures for all key internal processes. The Risk and Compliance function is 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. The Society continues to maintain a sustained focus in this area.

Pension obligation risk: the risk of a reduction in profit resulting from the Society, being the funder of last resort, having to make significant contributions to the Society's defined benefit pension scheme. Since 2005, the Group has embarked upon a programme of measures to reduce its pension scheme liabilities for the benefit of pension scheme members and the long-term interests of Society members. Details of the Group's pension scheme including the cost to the Society for the year and the updated scheme valuation (IAS 19) at 31 December 2021 are set out in Note 6 and Note 22 of the accounts.

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

All mortgage applications are assessed with reference to the credit and underwriting criteria set out in the Group's Lending Policies. Details of the Group's arrears performance are set out in the Chief Executive's Review. The Group recognises that the personal and financial circumstances of our borrowers can be affected by deteriorating economic conditions and unplanned events. When this happens, we apply a formal policy directed towards forbearance and fair treatment of customers. The Group uses a number of forbearance measures to assist those borrowers including agreeing a temporary payment concession or a temporary transfer to interest only payments in order to reduce the borrowers' financial pressures. We expect borrowers to resume normal payments once they are able. The Society was pleased to support its borrowing members in 2020 and 2021 by offering deferred payment concessions where they were impacted by Covid-19 (coronavirus) related financial stress. Borrowers are supported through this period and individualised ongoing forbearance has been offered where necessary, although this has been in relatively few scenarios. The Board continue to monitor this situation and provide for potential losses as appropriate.

The ultimate protection against any downturn is loan to value (LTV). The Society has a low LTV portfolio, with only 1.1% of balances exceeding 75% LTV. Furthermore, the stress tests it carries out include severe scenarios with low probability. These stress tests are also incorporated into the IFRS 9 provisioning approach. Differing economic scenarios are probability weighted within the approach – the most severe scenario (based on that used by the Bank of England to stress test the banking system) is given a 10% (2020:12.5%) probability weighting, with the most likely economic scenario a 40% (2020:37.5%) probability weighting.

Conduct risk: the risk of loss arising through interaction with the customer throughout the product lifecycle that causes some form of consumer detriment. The Conduct Risk Policy sets out the values that staff are expected to demonstrate in all their dealings with consumers and the detailed metrics that are monitored that may indicate consumer detriment to ensure that appropriate and timely action can be taken. 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. The Risk Committee noted the FCA's consultation on Consumer Duty which will be implemented in 2022 and continues to monitor developments.

Directors' Report (continued)

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

Interest rate risk: the risk of reductions in net interest margin arising from unfavourable movements in interest rates due to mismatches between the dates on which interest receivable on assets and interest payable on liabilities are reset to market rates or from the re-pricing of assets and liabilities according to different interest bases. This risk is managed within approved limits set by the Board within the Financial Risk Management Policies using a combination of on and off balance sheet financial instruments and is monitored by ALCO. During 2021 the ALCO also considered the risks arising from very low and negative interest rates, the cessation of IBOR and increasing market rates.

Further to the monitoring by ALCO, the Board manages this risk via the corporate plan, budgets and forecasts. Details of the Group's interest rate sensitivity and the use of derivatives for hedging purposes are set out in Note 30 of the accounts.

Risks associated with the UK leaving the EU: The effects on the UK economy post Brexit are starting to materialise. Whilst 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 arising from higher prices and inflation. 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 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 and has not been adversely impacted by supply chain constraints to date.

Risks associated with pandemic: The Covid-19 pandemic, 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 and 2021. 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 and employee resilience because of home-working and the increased level of cyber threats. Impacts to the Society's markets have been modelled and are within stressed capabilities for the business.

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

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

Directors' Report (continued)

BOARD RISK FRAMEWORK

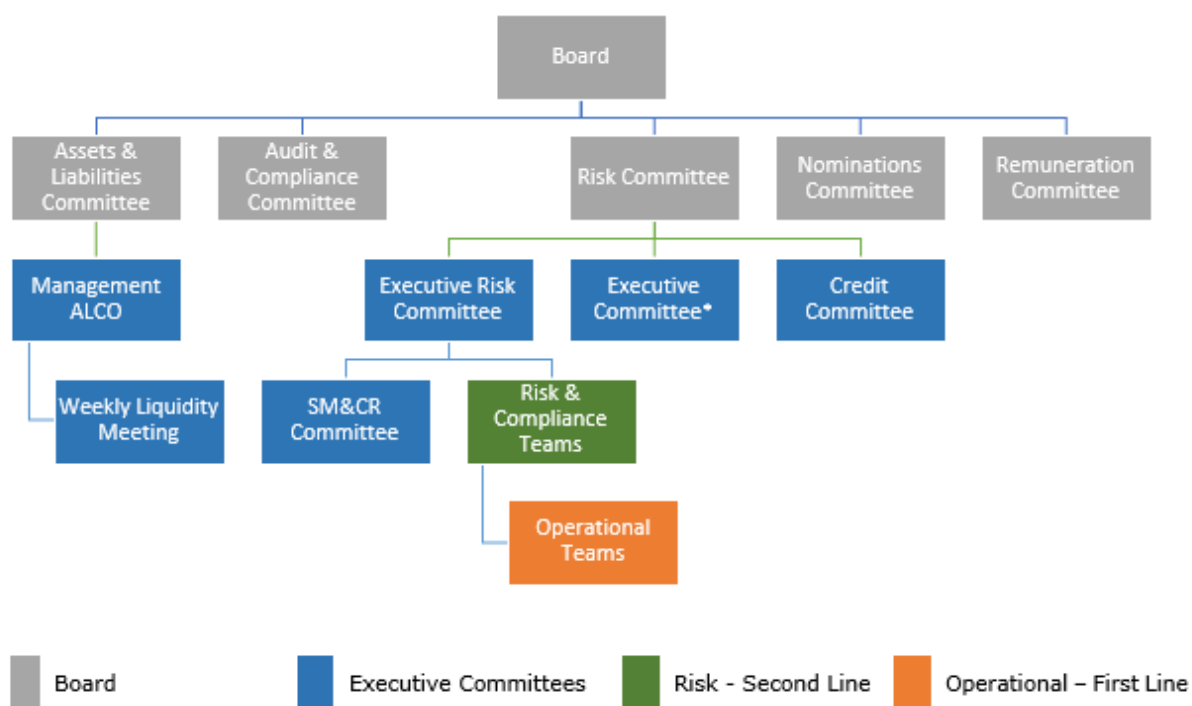
The risk management framework is designed to safely deliver the Corporate Plan in line with the Board's risk appetite. The Board is responsible for ratification of all policies. All of the senior management are involved in the development of risk management policies and their subsequent monitoring as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

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

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

The Group's objective is to minimise the impact of financial and other risks upon its performance. An explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in notes 25 to 0 to the annual accounts.

The Society's risk governance structure is detailed below:



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

Directors' Report (continued)

KEY PERFORMANCE INDICATORS

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

	2021 Group	2020 Group	2019 Group
Total assets	£541m	£531m	£469m
New mortgage lending	£132m	£94m	£101m
Growth in mortgage assets	2.4%	0.5%	5.5%
Net (decrease)/increase in retail deposits	(£30m)	£21m	£15m
Liquidity to funding ratio	20.4%	20.9%	17.8%
Management expenses as a percentage of mean total assets	1.6%	1.5%	1.5%
Pre-tax profit	£5.0m	£2.7m	£3.3m
Post-tax profit	£4.0m	£2.2m	£2.7m
Profit as a percentage of mean total assets	0.8%	0.4%	0.7%
Net interest receivable as a percentage of mean total assets	3.0%	3.1%	3.4%
Gross capital as a percentage of shares and borrowings	10.1%	9.3%	9.4%
Free capital as a percentage of shares and borrowings	9.9%	9.1%	9.2%

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

NON-FINANCIAL INDICATORS

Customer surveys in 2021 showed that 90% (2020: 89%) of new savers and mortgage customers would recommend us. In December 2021 92% (2020: 92%) of employees responded to a satisfaction survey; 84% (2020: 89%) of respondents agreed that they enjoyed their job. During 2021 the Society continued to support the development of its staff; four employees celebrated examination passes and the achievement of qualifications in four different professional subjects.

PROPERTY PLANT AND EQUIPMENT

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

Directors' Report (continued)

DIRECTORS

As at 31 December 2021 the Board comprised seven Non-Executive Directors and two Executive Directors. The Board meets at least six times a year with the addition of two strategy sessions. Board Committees meet at intervening times. Any additional meetings are held as required.

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

Non-Executive Directors	Executive Directors
Michael Thomas	Mark Robinson : Chief Executive
Lindsay Forster	Nicholas Fielden : Finance Director
Jonathan Fox	
Andrew Merrick	
Zoe Shapiro	
David Stunell	
Nala Worsfold	

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

Directors' interests are reported in Note 33 to the accounts.

LONG TERM VIABILITY STATEMENT AND GOING CONCERN

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

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

The ICAAP ensures that the plan projections for capital requirements and capital generation are resilient to stresses should the environment deteriorate beyond the levels currently envisaged in the Corporate Plan. A capital buffer is held to ensure the Group can deal with any erosion in its capital and meet its capital requirements at all times. The ILAAP test ensures that the Group holds sufficient liquid assets to meet its liquidity needs not only under normal circumstances but if the Group were to enter into a period of stress. Brexit and Covid-19 have caused significant disruption to the UK economy and the markets within which the Society operates. The Group recognises that inflation and higher prices may well impact house prices. However, the Society remains confident that its high quality balance sheet, robust capital ratios and careful approach to managing risk will continue to underpin its financial strength and place it in a strong position to continue to grow. During 2021 the Society reviewed its stress scenarios to ensure they reflected the latest forecasts on the potential economic stress which may be forthcoming. The Society's ICAAP uses the Bank of England's stress testing scenarios and has found its capital position to be robust enough to withstand the suggested stressed scenarios.

Directors' Report (continued)

LONG TERM VIABILITY STATEMENT AND GOING CONCERN (CONTINUED)

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

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

OTHER MATTERS

Corporate and Social Responsibility

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

Capital Adequacy

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

Supplier Payment Policy

It is the Society's policy to agree the terms of payment with suppliers in advance and to make payment within the agreed terms of credit once the supplier has performed in accordance with the terms of the contract. The number of creditor days was 2 at 31 December 2021 (31 December 2020: 3).

Post Balance Sheet Events

There were no post balance sheet events to report.

Auditor

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

The Auditor, BDO LLP, has indicated their willingness to continue as external auditors to the Society and therefore a resolution for their election will be put to the Annual General Meeting in 2022.

On behalf of the Board of Directors:

Michael Thomas
Chair
11 March 2022

Statement of Directors' Responsibilities

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

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

The Building Societies Act 1986 ("the Act") requires the Directors to prepare Group and Society annual accounts for each financial year. Under that law they have elected to prepare the Group and Society annual accounts in accordance with UK adopted international accounting standards; and have been prepared in accordance with the requirements of the Building Societies Act 1986 and in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998.

The Group and Society annual accounts are required by law to be prepared in accordance with the requirements of the Building Societies Act 1986 and in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998, to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 provides in relation to such annual accounts that references in the relevant part of that Act to annual accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Society annual accounts, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with applicable International Accounting Standards;
- state whether they have been prepared in accordance with the Building Societies Act 1986;
- assess the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

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

DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROLS

The Directors are responsible for ensuring that the Group: and

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

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

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

Michael Thomas
Chair
11 March 2022

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

OPINION ON THE FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the Society's affairs as at 31 December 2021 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRS) ; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

We have audited the financial statements of Market Harborough Building Society (the 'Society') and its subsidiaries (the 'Group') for the year ended 31 December 2021 which comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests, the Group and Society Cash Flow Statements, and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) and as regards the Society's financial statements, as applied in accordance with the requirements of the Building Societies Act 1986.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit opinion is consistent with the additional report to the audit committee.

Independence

Following the recommendation of the audit committee, we were appointed by the Members of the Society on 29 April 2021 to audit the financial statements for the year ending 31 December 2021 and subsequent financial periods. The period of total uninterrupted engagement including retenders and reappointments is 3 years, covering the years ending 31 December 2019 to

31 December 2021. We remain independent of the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services prohibited by that standard were not provided to the Society.

CONCLUSIONS RELATING TO GOING CONCERN

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the Directors' assessment of the Society's ability to continue to adopt the going concern basis of accounting included:

- Obtaining and evaluating management's assessment of going concern, challenging this in light of our understanding of the Group's and Society's strategy, forecasts, capital adequacy and liquidity positions and current assessment of the impact of various stress scenarios. Further, we have used publicly available information, for example on the housing market including the house price index, to challenge and assess the reasonableness of certain assumptions used to derive the forecasts and stress applied.
- In understanding the capital and liquidity of the Society, we have reviewed the ICAAP, ILAAP and capital adequacy ratio with the help of our regulatory specialists. We have used this understanding to assess the Society's capital and liquidity position and their ability to remain compliant with the required regulatory requirements.
- Enquiring with management and assessing continued economic impact of Covid-19 on the business and whether the impact thereof has been adequately factored into management's assessment of going concern.
- Assessing the forecast used to support the Going Concern assessment for arithmetical accuracy.

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

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and the Society's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

OVERVIEW

	2021	2020
Key audit matters		
Revenue Recognition	✓	✓
Loan Loss Provisioning	✓	✓
Materiality	£496k based on Net Assets in the current year (2020: £337k based on Tier 1 Capital)	

AN OVERVIEW OF THE SCOPE OF OUR AUDIT

Our audit approach was developed by obtaining an understanding of the Group and its environment, including the Group's system of internal control, and assessing the risks of material misstatement in the financial statements. We also addressed the risk of management override of internal controls, including assessing whether there was evidence of bias by the Directors that may have represented a risk of material misstatement.

The Group is made up of the Society and its wholly owned subsidiary. The significant component is Market Harbour Building Society, with the remaining subsidiary being a dormant company. This component was subject to a desktop review performed by the Group audit team. The Society accounts for 98% (2020:97%) of the Group's net assets, 100% (2020:100%) of the Group's revenue and 100% (2020:100%) of the Group's profit before tax.

Key audit matters

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

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

Key audit matter		How the scope of our audit addressed the key audit matter
Revenue Recognition Refer to page 16 (Audit Committee Report), note 1 (accounting policy: pages 46-55) and note 3.	<p>The Group has recognised interest income of £16,308k (2020: £16,301k) under the effective interest rate ("EIR") method.</p> <p>The loans and advances to customers of £437,080k (2020: £426,830k) contain prepaid fees that are integral to the EIR as well as accrued interest income, both are spread over the behavioural life of the loans and advances using EIR method. The net EIR liability at year end is £279k (2020: £270k).</p>	<p>We addressed the key audit matter by performing the following procedures:</p> <ul style="list-style-type: none"> • Evaluated the design and implementation of controls over the review and approval of EIR assumptions. • Assessed the design, implementation and operating effectiveness of business process controls over loan origination including the initial recording of contractual interest rates and associated loan amounts which form key inputs into the effective interest income calculations. • Substantiated the completeness and accuracy of data and key model inputs feeding into the EIR adjustment model and assessed whether the model performs the EIR calculation in line with the Society's policy, by assessing the code underpinning the model calculations through reconciliation to underlying records. • Utilised data analytics to perform a full recalculation of the contractual interest recognised during the financial year on loans advanced. • Assessed the models for their sensitivities to changes in the key assumptions by extending the time spent on Standard Variable Rate by one month. • Challenged the reasonableness of the loan behavioural life assumptions used by management considering recent historical experience of loan behavioural lives based on customer behaviour, product type, market factors, performance and external data where applicable. • Assessed whether the revenue recognition policies adopted by the Society are in accordance with requirements of relevant accounting standards. • Assessed how the Society's model calculates EIR adjustments by recalculating one loan and have tested the integrity of the model calculations to ensure these are consistent. • Through inspection of contractual terms we challenged the fees and costs included or excluded from the EIR estimates (including early redemption charges) which involved assessing the types of fees being spread. <p>Key observations: We did not identify any indicators that the assumptions included in the EIR model are unreasonable in consideration of the Society's mortgage portfolios, historic behaviours and current economic and market conditions.</p>
	<p>The Society's interest income on mortgages is recognised on EIR basis in accordance with IFRS 9. The calculation of EIR is complex and relies heavily on the quality of data in the EIR models. Significant management judgement is required to determine the expected cash flows for the Society's loans and advances within these models, which give rise to fraud risk in revenue recognition. EIR adjustment is expected to be materially sensitive to key assumptions used by management and for that reason we consider this to be a key audit matter.</p>	

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

<p>Loan Loss Provisioning</p> <p>Refer to page 16 (Audit Committee Report), note 1 (accounting policy: pages 44-54) and note 13.</p>	<p>Provision for impairment losses on loans and advances to customers is £651,000, (2020: £918,000).</p> <p>Commensurate with the activities of the Society, the total loan loss provision is a material balance. Under IFRS 9, the Society is required to assess the recoverability of the loan portfolio for all items and not just those specifically identified. Therefore the Society is required to assess the Expected Credit Loss ("ECL") provision for all performing loan book taking into account economic factors (including assessment of Probability of Default (PDs), Loss Given Default (LGDs) and Exposure at Default (EADs) along with the staging, to ensure that credit impaired loans are presented and valued accurately. These are subject to significant management judgement and estimation and for that reason we consider this to be a key audit matter.</p>	<p>We addressed the key audit matter by performing the following procedures:</p> <ul style="list-style-type: none"> Assessed the completeness and accuracy of the underlying data feeding into the Society's ECL model by agreeing on a sample basis the arithmetical accuracy and the completeness and accuracy of the data feeding into the model to the underlying documentation. Assessed whether the model performs the impairment calculation in line with the Society's policy, by assessing the code underpinning the model calculations. On a sample basis, performed our own assessment of the valuation and recoverability of security by reviewing the recent sold prices for similar properties. On a sample basis for Stage 3 loans, gained an understanding of the default trigger, management strategy and the basis for the collateral valuation. Challenged the reasonableness of the Society's key assumptions, including the adjustments to implied PDs, haircuts applied to the collateral values, and Exposure at Default and further discussed these with the management and the Audit and Compliance Committee. We also performed sensitivity analysis, to identify those inputs to which the provisioning is most sensitive. Assessed the staging of loans based on management's definition of significant increase in credit risk, to ensure the loans have been allocated to the correct stage. Compared the Society's total impairment provision to those of comparable organisations. Considered the reasonability of multiple economic scenarios used, including weighting and probability changes. <p>Key observations:</p> <p>We did not identify any indicators that the provision for loans and advances is unreasonably estimated in consideration of the key assumptions and judgements made.</p>
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Independent auditor's report to the members of Market Harborough Building Society (continued)

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements.

In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole and performance materiality as follows:

	Group financial statements		Society financial statements	
	2021 £k	2020 £k	2021 £k	2020 £k
Materiality	496	337	486	332
Basis for determining materiality	1% of Net Assets	0.75% Tier 1 capital	1% of Net Assets	0.75% Tier 1 capital
Rationale for the benchmark applied	We determined that Net Assets was the most appropriate benchmark considering the different stakeholders. The benchmark was changed to net assets as this is considered the GAAP measure which closely corresponds to regulatory capital, being the main driver for the Society as the purpose of the Society is to optimise rather than maximise profits.	We determined that Tier 1 capital was the most appropriate benchmark as regulatory stability is considered to be a main driver for the Group and the Society as well as the purpose of the Group and Society which is to optimise rather than maximise profits.	Materiality for the Society was set at 98% of the Group's materiality, based on the fact that the Society accounts for 98% of net assets of the Group and 100% of its revenues and profits	Materiality for the Society was set at 98.5% of the Group's materiality, based on the fact that the Society accounts for 97% of net assets of the Group and 100% of its revenues and profits

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

Performance materiality	372	235.9	364	232
Basis for determining performance materiality	75% of materiality, determined on the basis of our risk assessment together with our assessment of the overall control environment.	70% of materiality, determined on the basis of our risk assessment together with our assessment of the overall control environment.	75% of materiality, determined on the basis of our risk assessment together with our assessment of the overall control environment.	70% of materiality, determined on the basis of our risk assessment together with our assessment of the overall control environment.

Reporting threshold

We agreed with the Audit Committee that we would report to them all individual audit differences in excess of £9,900 (2020: £6,300). We also agreed to report differences below this threshold that, in our view, warranted reporting on qualitative grounds.

OTHER INFORMATION

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

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

OTHER BUILDING SOCIETIES ACT 1986 REPORTING

Based on the responsibilities described below and our work performed during the course of the audit, we are required by the Building Societies Act 1986 and ISAs (UK) to report on certain opinions and matters as described below.

Annual business statement and Directors' report	<p>In our opinion, based on the work undertaken in the course of the audit:</p> <ul style="list-style-type: none"> • The annual business statement and the Directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986; • The information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and • The information given in the annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given. • In the light of the knowledge and understanding of the Society and its environment obtained in the course of the audit, we have not identified any material misstatements in the Directors' report.
Matters on which we are required to report by exception	<p>We have nothing to report in respect of the following matters in relation to which the Building Societies Act 1986 requires us to report to you if, in our opinion:</p> <ul style="list-style-type: none"> • adequate accounting records have not been kept by the Group and the Society; or • the financial statements of the Group and Society are not in agreement with the accounting records; or • we have not received all the information and explanations we require for our audit.

OPINION ON OTHER MATTER PRESCRIBED BY THE CAPITAL REQUIREMENTS (COUNTRY-BY-COUNTRY REPORTING) REGULATIONS 2013

In our opinion the information given on Page 97 the financial year ended 31 December 2021 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

RESPONSIBILITIES OF DIRECTORS

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

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

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

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Extent to which the audit was capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below:

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

We focused on laws and regulations non-compliance with which could give rise to a material misstatement in the company financial statements. Our tests included, but were not limited to:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, and the audit committee;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and correspondence with the Financial Conduct Authority and the Prudential Regulation Authority;
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments;
- assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit. As part of this discussion, we identified potential for fraud in relation to accounting estimates such as EIR and expected credit losses.

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

Our audit procedures were designed to respond to risks of material misstatement in the financial statements, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery, misrepresentations or through collusion. There are inherent limitations in the audit procedures performed and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we are to become aware of it.

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

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

USE OF OUR REPORT

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

Matthew Hopkins (Senior Statutory Auditor)
For and on behalf of BDO LLP, Statutory Auditor London, UK
11 March 2022

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

Income Statements

For the year ended 31 December 2021	Note	2021	2020	2021	2020
All figures £'000		Group	Group	Society	Society
Interest income calculated using the effective interest method	3	16,308	16,301	16,308	16,301
Interest payable and similar charges	4	(3,189)	(5,498)	(3,189)	(5,498)
Net Interest Income		13,119	10,803	13,119	10,803
Fees and commissions receivable		451	388	451	388
Fees and commissions payable		(347)	(280)	(347)	(280)
Other operating income		15	13	15	13
Net gain/(loss) from derivative financial instruments	5	185	(71)	185	(71)
Total Net Income		13,423	10,853	13,423	10,853
Administrative expenses	6	(8,300)	(7,620)	(8,300)	(7,620)
Depreciation and amortisation	14, 15,16	(341)	(281)	(341)	(281)
Other operating charges		(32)	(50)	(32)	(50)
Other finance cost		(16)	(10)	(16)	(10)
Operating Profit		4,734	2,892	4,734	2,892
Impairment gain/(losses) on loans and advances	0	267	(224)	267	(224)
Profit Before Tax		5,001	2,668	5,001	2,668
Tax on profit on ordinary activities	8	(967)	(506)	(967)	(506)
Profit For The Financial Year	8	4,034	2,162	4,034	2,162

All of the above arise from continuing operations. All of the above arose in the UK.

Statements of Comprehensive Income

For the year ended 31 December 2021	Note	2021	2020	2021	2020
All figures £'000		Group	Group	Society	Society
Profit For The Financial Year		4,034	2,162	4,034	2,162
<i>Items that will not be reclassified to the income statement</i>					
Re-measurement of defined benefit obligation	22	801	(770)	801	(770)
Tax on items that will not be reclassified to the income statement		(144)	150	(144)	150
Other comprehensive (expense)/income for the period net of income tax		657	(620)	657	(620)
Total Comprehensive Income For The Period		4,691	1,542	4,691	1,542

The notes on pages 46 to 96 form part of these Annual Report and Accounts.

Statements of Financial Position

As at 31 December 2021	Note	2021	2020	2021	2020
All figures £'000		Group	Group	Society	Society
Cash in hand and balances at central banks		93,866	93,357	93,866	93,357
Loans and advances to credit institutions	0	6,091	7,555	6,091	7,555
Derivative financial instruments	10	1,021	0	1,021	0
Loans and advances to customers	11	437,080	426,830	437,080	426,830
Other assets	13	733	676	733	676
Property, plant and equipment	0	1,723	1,789	1,723	1,789
Right of use assets	16	60	80	60	80
Intangible assets	15	567	591	567	591
Deferred tax asset	17	28	206	28	206
Total Assets		541,169	531,084	541,169	531,084
Shares	18	395,419	420,526	395,419	420,526
Amounts owed to credit institutions	19	58,518	21,511	58,518	21,511
Amounts owed to other customers	20	35,438	40,447	35,438	40,447
Derivative financial instruments	10	86	782	86	782
Other Liabilities and accruals	21	1,133	1,268	2,318	2,453
Lease Liabilities		56	81	56	81
Current tax liabilities		535	267	535	267
Retirement benefit liabilities	22	339	1,248	339	1,248
Total Liabilities		491,524	486,130	492,709	487,315
General reserve	23	49,645	44,954	48,460	43,769
Total Reserves		49,645	44,954	48,460	43,769
Total Reserves and Liabilities		541,169	531,084	541,169	531,084

The notes on pages 46 to 96 form part of these Annual Report and Accounts.

Approved by the Board of Directors on 11 March 2022, and signed on its behalf by:

Michael Thomas
Chair

Mark Robinson
Chief Executive

Nicholas Fielden
Finance Director

Statements of Changes in Members' Interests

Group 2021	General reserve	Total
All figures £'000		
Balance at 1 January 2021	44,954	44,954
Profit for the year	4,034	4,034
<i>Other comprehensive income for the year (net of tax)</i>		
Re-measurement of defined benefit obligation	657	657
Total Other Comprehensive Income	657	657
Total comprehensive income	4,691	4,691
Balance At 31 December 2021	49,645	49,645

Society 2021	General reserve	Total
All figures £'000		
Balance at 1 January 2021	43,769	43,769
Profit for the year	4,034	4,034
<i>Other comprehensive income for the year (net of tax)</i>		
Re-measurement of defined benefit obligation	657	657
Total Other Comprehensive Income	657	657
Total comprehensive income	4,691	4,691
Balance At 31 December 2021	48,460	48,460

Statements of Changes in Members' Interests (continued)

Group 2020	General reserve	Total
All figures £'000		
Balance at 1 January 2020	43,412	43,412
Profit for the year	2,162	2,162
<i>Other comprehensive income for the year (net of tax)</i>		
Re-measurement of defined benefit obligation	(620)	(620)
Total Other Comprehensive Expense	(620)	(620)
Total comprehensive income	1,542	1,542
Balance At 31 December 2020	44,954	44,954

Society 2020	General reserve	Total
All figures £'000		
Balance at 1 January 2020	42,227	42,227
Profit for the year	2,162	2,162
<i>Other comprehensive income for the year (net of tax)</i>		
Re-measurement of defined benefit obligation	(620)	(620)
Total Other Comprehensive Expense	(620)	(620)
Total comprehensive income	1,542	1,542
Balance At 31 December 2020	43,769	43,769

The notes on pages 46 to 96 form part of these Annual Report and Accounts.

Cash Flow Statements

For the year ended 31 December 2021	Note	2021	2020	2021	2020
All figures £'000		Group	Group	Society	Society
Profit before tax		5,001	2,668	5,001	2,668
Depreciation and amortisation		341	281	341	281
(Profit) on disposal of property, plant and equipment		0	(4)	0	(4)
Fair value (gain)/loss on derivative instruments		(185)	71	(185)	71
Interest on lease payments		1	1	1	1
(Decrease)/Increase in impairment of loans and advances		(267)	228	(267)	228
Total Cash Flows From Operating Activities		4,891	3,245	4,891	3,245
(Increase) in other assets		(64)	(99)	(64)	(99)
(Decrease)/increase in other liabilities		(746)	572	(746)	572
(Increase) in loans and advances to customers		(11,515)	(1,848)	(11,515)	(1,848)
(Decrease)/increase in shares		(24,660)	25,421	(24,660)	25,421
Increase/(decrease) in amounts owed to other credit institutions		37,000	(23,500)	37,000	(23,500)
(Decrease) in amounts owed to other customers		(4,842)	(5,437)	(4,842)	(5,437)
(Decrease) in retirement benefit obligation		(109)	(115)	(109)	(115)
Taxation paid		(666)	(316)	(666)	(316)
Net Cash Used in Operating Activities		(711)	(2,077)	(711)	(2,077)
Proceeds from disposal of property, plant and equipment		0	4	0	4
Purchase of property, plant and equipment		(55)	(241)	(55)	(241)
Purchase of intangible assets		(174)	(362)	(174)	(362)
Net Cash Used in Investing Activities		(229)	(599)	(229)	(599)
Principal element of lease payments		(21)	(19)	(21)	(19)
Net Cash Used in Financing Activities		(21)	(19)	(21)	(19)
Net Change In Cash Or Cash Equivalents		(962)	(2,695)	(962)	(2,695)
Cash and cash equivalents at 1 January		100,908	103,603	100,908	103,603
Cash And Cash Equivalents At 31 December	24	99,946	100,908	99,946	100,908

Interest received was £15.2m (2020 £15.2m) and interest paid was £453k (2020 £805k).

The notes on pages 46 to 96 form part of these Annual Report and Accounts.

Notes to the Annual Report and Accounts

1. PRINCIPAL ACCOUNTING POLICIES

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

Basis of accounting

Both the Society and Group annual accounts are prepared and approved by the Directors in accordance with UK adopted international accounting standards; and have been prepared in accordance with the requirements of the Building Societies Act 1986 and in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998. The statements of the Society are presented in GB pounds sterling (GBP), which is the functional and presentation currency of the Society as it represents the primary currency of the underlying transactions, assets, funding and revenues. Amounts are rounded to the nearest thousand unless otherwise stated.

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

The Directors have considered the impacts of the Covid-19 pandemic and the UK leaving the EEA and have concluded that this would not impact the going concern basis under which these accounts have been prepared.

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

Use of judgements and estimates

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

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

Judgements

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

- Note 11: loans and advances to customers – the assessment of the expected life of mortgages will change the timescale over which interest income is released and thus impact the gross carrying value of the mortgages.
- Note 25: classification of financial assets - the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest (SPPI) on the principal amount outstanding.
- Note 28: establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of expected credit loss (ECL) and selection and approval of models used to measure ECL.

Assumptions and estimation uncertainties

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

- Note 22: measurement of defined benefit obligations: key actuarial assumptions.
- Note 28: impairment of financial instruments: key assumptions used in estimating recoverable cash flows.
- Note 28: impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information.

Changes in accounting policies

The IASB has not published any new standards effective from 1 January 2021, however it has published some minor amendments effective from 1 January 2021 that are adopted by the UK Endorsement Board and are applicable to the Society.

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 Interest Rate Benchmark Reform – Phase 2 (see note 10 for further details)
- Amendment to IFRS 16 for Covid-19 rent concessions beyond 30 June 2021, effective from 1 April 2021.

The Society has assessed that they will have an insignificant effect on the consolidated financial statements of the Group and Society.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Basis of consolidation

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

The results of subsidiary undertakings acquired or disposed of during the year are included in the income statements from the effective date of acquisition or up to the effective date that ownership ceases. The Society has one subsidiary company which remained dormant throughout the financial period; no acquisitions or disposals were made during 2021.

Interest income and expense

Effective interest rate

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

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

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

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

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

Fees and commission

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

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

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

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

Leases

Lessee accounting

A right-of-use asset is recognised on the balance sheet for all leases, based on discounted future commitments. A corresponding liability arises representing the present value of future lease commitments. Leases of low value and those with a short term are excluded from this treatment, in which case rental charges are charged to the income statement on a straight-line basis over the life of the lease.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Taxation

Income Tax

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

Current Tax

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

Deferred Tax

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

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

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

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

Financial assets and financial liabilities

Recognition and initial measurement

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

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

Note 25 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class. Note 25 discloses the levels of the fair value hierarchy and how it is applied in accordance with IFRS13.

Estimates and judgements

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

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

A one month increase in average life of a mortgage, allied to the assumption that this additional time would be on SVR would result in an increase in the value of loans on the statement of financial position by approximately £207k (2020:£104k).

Classification

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

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

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

All other financial assets are classified as measured at FVTPL.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Classification – Business model assessment

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

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

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

Classification – Assessment of whether contractual cash flows are SPPI

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

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

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

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

Financial liabilities

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL as classified in Note 25 Financial Instruments.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Fair Value Measurement

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

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

Derecognition of financial liabilities

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

Impairment

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

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

The Group measures loss allowances at an amount equal to lifetime ECL except for other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 28).

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

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

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'. These financial instruments have experienced a significant increase in credit risk since inception, further detail is provided in Note 28. As a backstop all financial instrument 30 days past due will be included in 'Stage 2'.

Estimates and judgements

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

Impairment losses on loans and advances to customers

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

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

A sensitivity analysis of these assumptions is provided in Note 28 of the Accounts.

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Measurement of ECL

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

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

See also Note 28.

Credit-impaired financial assets

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

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

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

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

Presentation of allowance for ECL in the statement of financial position

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

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

Write-off

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

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

Cash and cash equivalents

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

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

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Derivatives held for risk management purposes and hedge accounting

Hedge accounting continues to be accounted for under IAS 39.

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

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

These hedging relationships are discussed below.

Fair value hedges

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

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a Central Clearing Counterparty (CCP) by both parties as a consequence of laws or regulations or contract changes due to commercial reasons without changes in its terms except for those that are necessary for the novation, then the derivative is not considered expired or terminated. At 31 December 2021 the Society had no derivatives novated to a CCP (2020: nil).

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

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

Estimates and judgements

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

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

An increase/decrease in the yield curve of 1% would change the total net fair value of derivative financial instruments by £2,223k/£2,306k. (2020: £1,295k/£1,339k).

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

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

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

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

Loans and advances

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

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Property and equipment

Recognition and measurement

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

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

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

Depreciation

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

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

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

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

Intangible assets

Software

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

Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate: that the product is technically feasible, 'its intention and ability to complete the development and use the software in a manner that will generate future economic benefits', and that it can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and capitalised borrowing costs, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and any accumulated impairment losses. The Society does not currently have any internally developed software (2020: nil).

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

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

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

Impairment of non-financial assets

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

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

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

Provisions

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

Notes to the Annual Report and Accounts (continued)

PRINCIPAL ACCOUNTING POLICIES (continued)

Loan commitments

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

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

Employee benefits

Defined contribution plans

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

Defined benefit plans

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

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

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

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

Estimates and judgements

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

The assumptions are outlined in note 22 to the accounts. Of these assumptions, the main determinant of the liability is the discount rate. A variation of +0.5% / -0.5% in the discount rate will change liabilities by approximately -8% / 9% ((£915k)/£1,030k).

Other long-term employee benefits

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

Notes to the Annual Report and Accounts (continued)

2. FUTURE ACCOUNTING DEVELOPMENTS

The IASB has published a number of minor amendments to IFRSs that are effective from 1 January 2022 and 1 January 2023. The Society expects they will have an insignificant effect, when adopted, on the consolidated financial statements of the Group and Society.

3. INTEREST INCOME CALCULATED USING THE EFFECTIVE INTEREST METHOD

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
On loans fully secured on residential property	16,258	16,116	16,258	16,116
On other loans	369	386	369	386
On liquid assets	101	179	101	179
Net interest (expense) on derivatives	(420)	(380)	(420)	(380)
Total	16,308	16,301	16,308	16,301

Included within interest income is £0.4k (2020: £3k) in respect of interest income accrued on impaired loans two or more months in arrears.

4. INTEREST PAYABLE AND SIMILAR CHARGES

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
On shares held by individuals	2,843	4,989	2,843	4,989
On deposits and other borrowings	345	508	345	508
On leases	1	1	1	1
Net interest (income) on derivatives	0	0	0	0
Total	3,189	5,498	3,189	5,498

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

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Derivatives in designated fair value hedge relationships	1,715	(485)	1,715	(485)
Adjustments to hedged items in fair value hedge accounting relationships	(1,531)	427	(1,531)	427
Derivatives not in designated fair value hedge relationships	1	(13)	1	(13)
Total	185	(71)	185	(71)

The net gain from derivative financial instruments of £185k (2020: loss of £71k) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis.

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

Notes to the Annual Report and Accounts (continued)

6. ADMINISTRATIVE EXPENSES

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
<i>Staff costs</i>				
Wages and salaries	4,347	3,965	4,347	3,965
Social security costs	473	412	473	412
Other pension costs	357	319	357	319
Total staff costs	5,177	4,696	5,177	4,696
Other administrative costs	3,123	2,924	3,123	2,924
Total	8,300	7,620	8,300	7,620

Auditor's Remuneration

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

All figures £'000 and exclude VAT	2021 Group	2020 Group	2021 Society	2020 Society
Audit of these Annual Report and Accounts	150	103	150	103
Other assurance services	16	2	16	2
Total	166	105	166	105

Staff Numbers

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

Full Time Equivalents	2021 Group	2020 Group	2021 Society	2020 Society
Full time employees	74	69	74	69
Part time employees	36	36	36	36
Total	110	105	110	105

Full Time Equivalents	2021 Group	2020 Group	2021 Society	2020 Society
Head office	98	91	98	91
Branches	12	14	12	14
Total	110	105	110	105

Notes to the Annual Report and Accounts (continued)

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

Headcount Numbers	2021 Group	2020 Group	2021 Society	2020 Society
Branch Full time employees	2	2	2	2
Branch Part time employees	18	21	18	21
Total	20	23	20	23

Headcount Numbers	2021 Group	2020 Group	2021 Society	2020 Society
Head Office Full time employees	72	67	72	67
Head Office Part time employees	42	42	42	42
Total	114	109	114	109

Headcount Numbers	2021 Group	2020 Group	2021 Society	2020 Society
Total Branch employees	20	23	20	23
Total Head Office employees	114	109	114	109
Total	134	132	134	132

Directors' Emoluments and Transactions

Directors' Emoluments

Group and Society	2021	2020
All figures £'000		
For services as Non-Executive Directors	226	219
For services as Executive Directors	484	476
Total	710	695

Directors' Transactions

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

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

A register is maintained in accordance with the requirements of Section 68 of the Building Societies Act 1986, and the requisite particulars are available for inspection at the Society's head office during the period of 15 days expiring with the annual general meeting, and at the annual general meeting on 28 April 2022.

Notes to the Annual Report and Accounts (continued)

7. IMPAIRMENT LOSSES ON LOANS AND ADVANCES

The table below shows charge/(credit) to the income statement which comprises:

All figures £'000	2021 Loans fully secured on residential property	2021 Other loans fully secured on land	2021 Total	2020 Loans fully secured on residential property	2020 Other loans fully secured on land	2020 Total
Charge/(release) of provision for impairment	(270)	3	(267)	200	28	228
Recoveries of debts previously written off	(2)	0	(2)	(4)	0	(4)
Operational losses	2	0	2	0	0	0
Total	(270)	3	(267)	196	28	224

8. TAX ON PROFIT ON ORDINARY ACTIVITIES

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Current tax	925	388	925	388
Adjustment in respect of prior years	8	2	8	2
Total current tax	933	390	933	390
Origination and reversal of temporary difference	29	122	29	122
Effect of change in tax rate on deferred tax	15	(16)	15	(16)
Adjustment in respect of prior years	(10)	10	(10)	10
Total deferred tax	34	116	34	116
Total tax expense	967	506	967	506

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

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Profit before tax	5,001	2,667	5,001	2,668
Expected tax at 19%	951	506	951	506
Expenses not deductible for corporation tax purposes	4	4	4	4
Effect of change in tax rate on deferred tax	14	(16)	14	(16)
Adjustment in respect of prior years	(2)	12	(2)	12
Total tax expense	967	506	967	506

Notes to the Annual Report and Accounts (continued)

9. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Repayable on call and short notice (included within cash and cash equivalents)	6,080	7,551	6,080	7,551
Other loans and advances to credit institutions	11	4	11	4
Total	6,091	7,555	6,091	7,555

At 31 December 2021 the Group and Society had £270k (2020:£780k) deposited against derivative contracts (this is included in the above figures). For further details see note 10.

10. DERIVATIVE FINANCIAL INSTRUMENTS

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

Derivative transactions are entered into under International Swaps and Derivatives Association (ISDA) master agreements. In general, under these agreements, in certain circumstances – e.g. when a credit event such as a default occurs – all outstanding transactions under the agreement with the counterparty are terminated. The termination values are therefore assessed for settlement of all transactions with the counterparty. There is no right of set off. The Group executes a credit support annex in conjunction with each ISDA agreement, which requires the Group and its counterparties to post collateral to mitigate counterparty credit risk, where collateral is only posted should the minimum threshold amount of £250,000 be reached. At 31 December 2021, £270k (2020: £780k) was placed as cash collateral with swap counterparties.

The Society does not transact derivatives on exchanges or with Central Clearing Parties.

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

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

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

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

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

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

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

Notes to the Annual Report and Accounts (continued)

DERIVATIVE FINANCIAL INSTRUMENTS (continued)

At 31 December 2021, the Group held the following interest rate swaps as hedging instruments in fair value hedges of interest rate risk.

Group and Society As at December 2021 All figures £'000	Maturity		
	Less than 1 year	1 – 5 years	More than 5 years
Hedge of loans and advances			
Nominal amount	35,500	92,000	0
Average fixed interest rate	0.23%	0.55%	0

Group and Society As at December 2020 All figures £'000	Maturity		
	Less than 1 year	1 – 5 years	More than 5 years
Hedge of loans and advances			
Nominal amount	41,500	53,000	0
Average fixed interest rate	0.78%	0.46%	0

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

Group and Society As at December 2021 All figures £'000	Nominal	Fair Value Assets	Fair Value Liabilities	Change in fair value used for calculating hedge ineffectiveness for 2021	Ineffectiveness recognised in profit or loss
Derivatives designated as fair value hedges – interest rate swaps	117,500	1,021	(75)	1,715	184

Group and Society As at December 2020 All figures £'000	Nominal	Fair Value Assets	Fair Value Liabilities	Change in fair value used for calculating hedge ineffectiveness for 2020	Ineffectiveness recognised in profit or loss
Derivatives designated as fair value hedges – interest rate swaps	81,500	0	(767)	(485)	(58)

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

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

Notes to the Annual Report and Accounts (continued)

DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

Group and Society As at December 2021 All figures £'000	Carrying amount		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Change in value used for calculating hedge ineffectiveness
	Assets	Liabilities	Assets	Liabilities	
Loans and advances	116,771	0	(872)	0	(1,531)

Group and Society As at December 2020 All figures £'000	Carrying amount		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Change in value used for calculating hedge ineffectiveness
	Assets	Liabilities	Assets	Liabilities	
Loans and advances	72,821	0	659	0	427

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

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

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

The application of this set of temporary exceptions was mandatory for accounting periods starting on or after 1 January 2020. Significant judgement is required in determining when uncertainty is expected to be resolved and therefore when the temporary exceptions will cease to apply.

However, at 31 December 2020, the uncertainty continued to exist and so the temporary exceptions applied to all of the Group's hedge accounting relationships that referenced benchmarks subject to reform or replacement.

At 1 January 2021 the Group had fair value hedge accounting relationships that were exposed to sterling Libor as well as overnight rates subject to the market-wide benchmarks reform, such as the sterling overnight index ('SONIA'). The existing derivatives that were designated in relationships referencing sterling Libor transitioned to new risk-free rates ('RFRs') during 2021. A smooth transition for the Group's hedge accounting relationships was achieved and no de-designation occurred. The Group had no exposures to IBOR rates at 31 December 2021.

Notes to the Annual Report and Accounts (continued)

DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Interest Rate Benchmark Reform Phase 2, the amendments to IFRS issued in August 2020, represents the second phase of the IASB's project on the effects of interest rate benchmark reform. The amendments address issues affecting financial statements when changes are made to contractual cash flows and hedging relationships. Under these amendments, changes made to a financial instrument measured at other than fair value through profit or loss that are economically equivalent and required by interest rate benchmark reform, do not result in the derecognition or a change in the carrying amount of the financial instrument. Instead they require the effective interest rate to be updated to reflect the change in the interest rate benchmark. These amendments applied from 1 January 2021 with early adoption permitted. The Society adopted the amendments from 1 January 2020.

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

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

As at 31 December 2021 all the instruments have been updated to the new rate as a result of the IBOR reform, there are no more instruments impacted by IBOR reform.

Group and Society As at December 2021		Not impacted by IBOR reform	Notional amount
All figures £'000		Impacted by IBOR reform	
Fair value hedges	0	127,500	127,500

Group and Society As at December 2020		Not impacted by IBOR reform	Notional amount
All figures £'000		Impacted by IBOR reform	
Fair value hedges	13,000	68,500	81,500

Notes to the Annual Report and Accounts (continued)

11. LOANS AND ADVANCES TO CUSTOMERS

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Loans fully secured on residential property	429,584	417,919	429,584	417,919
Other loans fully secured on land	9,020	9,170	9,020	9,170
Gross loan receivables	438,604	427,089	438,604	427,089
Stage 1 (see below)	(409)	(555)	(409)	(555)
Stage 2 (see below)	(242)	(362)	(242)	(362)
Stage 3 (see below)	0	(1)	0	(1)
Provision for impairment losses on loans and advances	(651)	(918)	(651)	(918)
Net loan receivables	437,953	426,171	437,953	426,171
Fair value adjustment for hedged risk	(872)	659	(872)	659
Total	437,080	426,830	437,080	426,830

The Group has pledged £112m (2020: £89m) of mortgage loan pools with the Bank of England. Of these mortgage loan pools £77m (2020: £48m) are encumbered mortgage assets supporting the TFSME scheme.

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

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

A one month increase in average life of a mortgage, allied to the assumption that this additional time would be on SVR would result in a £207k (2020: £104k) increase in the gross carrying value of loans and advances.

Notes to the Annual Report and Accounts (continued)

LOANS AND ADVANCES TO CUSTOMERS (continued)

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

Society and Group	Stage 1	Stage 2	Stage 3	2021
All figures £'000				Total
Loan Balance at 1 January 2021	404,907	21,801	381	427,089
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(15,989)	15,989	0	0
From Stage 1 to Stage 3	0	0	0	0
From Stage 2 to Stage 3	0	(5)	5	0
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	9,526	(9,526)	0	0
From Stage 3 to Stage 1	21	0	(21)	0
From Stage 3 to Stage 2	0	1	(1)	0
New Advances	132,355	0	0	132,355
Redemptions and Repayments	(114,461)	(6,107)	(272)	(120,840)
Loan Balance at 31 December 2021	416,359	22,153	92	438,604

Group and Society	Stage 1	Stage 2	Stage 3	2021
All figures £'000				Total
Provision at 1 January 2021	555	362	1	918
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(128)	171	0	43
From Stage 1 to Stage 3	0	0	0	0
From Stage 2 to Stage 3	0	0	0	0
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	3	(160)	0	(157)
From Stage 3 to Stage 1	0	0	0	0
From Stage 3 to Stage 2	0	0	0	0
New Advances	275	0	0	275
Redemptions and Repayments	(98)	(58)	(1)	(157)
Other remeasurement of impairment loss provision (no movement in stage)	(198)	(73)	0	(271)
Write offs	0	0	0	0
Provision at 31 December 2021	409	242	0	651

Presentation of the movements has changed in 2021 as data granularity was improved during the year.

Notes to the Annual Report and Accounts (continued)

LOANS AND ADVANCES TO CUSTOMERS (continued)

Group and Society 2020	Loans fully secured on residential property	Other loans fully secured on land	Total
All figures £'000			
Stage 1 provision at 1 January	457	27	484
New assets originated	187	0	187
Transfer (from)/to Stage 1 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
Decrease 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
Transfer to Stage 3 due to change in credit risk	1	0	1
Assets derecognised	0	0	0
Stage 3 provision at 31 December	1	0	1

Group and Society 2020	Loans fully secured on residential property	Other loans fully secured on land	Total
All figures £'000			
Stage 1 balance at 1 January	395,502	9,544	405,046
New assets originated	85,275	308	85,583
(Decrease)/Increase due to change in credit risk	(19,128)	(211)	(19,339)
Assets derecognised	(65,912)	(471)	(66,383)
Stage 1 balance at 31 December	395,737	9,170	404,907
Stage 2 balance at 1 January	19,668	0	19,668
New assets originated	0	0	0
Transfer to Stage 2 due to change in credit risk	5,295	0	5,295
Assets derecognised	(3,162)	0	(3,162)
Stage 2 balance At 31 December	21,801	0	21,801
Stage 3 balance at 1 January	527	0	527
New assets originated	0	0	0
Transfer to Stage 3 due to change in credit risk	(124)	0	(124)
Assets derecognised	(22)	0	(22)
Stage 3 balance at 31 December	381	0	381

Notes to the Annual Report and Accounts (continued)

12. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

The Society directly holds 100% of the issued ordinary share capital of Market Harbour Mortgages Limited. The principal activity of the company is mortgage related finance. Its share capital is £1 (2020: £1). Its principal place of business is Welland House, The Square, Market Harbour, Leicestershire, LE16 7PD. It is registered in England and Wales. There have been no additions or disposals of investments during the year. Market Harbour Mortgages Limited became dormant from 1 January 2016.

13. OTHER ASSETS

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Prepayments and accrued income	722	633	722	633
Other debtors	11	43	11	43
Total	733	676	733	676

The fair value of other financial assets approximates the book value.

14. PROPERTY PLANT AND EQUIPMENT

Group & Society 2021 All figures £'000	Freehold Property	Leasehold Property	Equipment Fixtures & Fittings	Motor Vehicles	Total
At 1 January	1,640	73	3,634	40	5,387
Additions	0	0	55	0	55
Disposals	0	0	(47)	0	(47)
Total cost at 31 December	1,640	73	3,642	40	5,395
At 1 January	128	73	3,384	13	3,598
Charge for the year	5	0	112	4	121
On disposals	0	0	(47)	0	(47)
Total depreciation at 31 December	133	73	3,449	17	3,672
Net book value at 31 December	1,507	0	193	23	1,723

Notes to the Annual Report and Accounts (continued)

PROPERTY PLANT AND EQUIPMENT (continued)

Group & Society 2020 All figures £'000	Freehold Property	Leasehold Property	Equipment Fixtures & Fittings	Motor Vehicles	Total
At 1 January	1,640	73	3,429	25	5,167
Additions	0	0	214	27	241
Disposals	0	0	(9)	(12)	(21)
Total cost at 31 December	1,640	73	3,634	40	5,387
At 1 January	123	73	3,291	22	3,509
Charge for the year	5	0	102	3	110
On disposals	0	0	(9)	(12)	(21)
Total depreciation at 31 December	128	73	3,384	13	3,598
Net book value at 31 December	1,512	0	250	27	1,789

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

15. INTANGIBLE ASSETS

Group & Society 2021 All figures £'000	Purchased Software
At 1 January	3,858
Additions	174
Total cost at 31 December	4,032
At 1 January	3,267
Charge for the year	198
Total amortisation at 31 December	3,465
Net book value at 31 December	567

Notes to the Annual Report and Accounts (continued)

INTANGIBLE ASSETS (continued)

Group & Society 2020	Purchased Software
All figures £'000	
At 1 January	3,496
Additions	362
Written off in the year	(0)
Total cost at 31 December	3,858
At 1 January	3,116
Charge for the year	151
Written off in the year	0
Total amortisation at 31 December	3,267
Net book value at 31 December	591

16.LEASES

During 2021 the Society had one financial lease contract relating to a branch building lease.

The statement of financial position shows the following amounts relating to leases:

Group & Society	2021	2020
All figures £'000	£'000	£'000
Right-of-use assets as at 1 January	80	0
Additions	0	100
Amortisation	(20)	(20)
Right-of-use assets as at 31 December	60	80

Lease liability maturity analysis:

Group & Society	2021	2020
All figures £'000	£'000	£'000
Less than one year	20	20
One to five years	41	61
More than five years	0	0
Total lease liabilities as at 31 December	61	81

The income statement shows the following amounts relating to leases:

Group & Society	2021	2020
All figures £'000	£'000	£'000
Depreciation charge for right-of-use assets	20	20
Interest expense (included in interest payable and similar charges)	1	1

Notes to the Annual Report and Accounts (continued)

17.DEFERRED TAX

Deferred tax movement	2021	2020	2021	2020
All figures £'000	Group	Group	Society	Society
At 1 January	206	172	206	172
Income statement credit	(34)	(116)	(34)	(116)
Recognised directly in other comprehensive income	(144)	150	(144)	150
At 31 December	28	206	28	206

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

All figures £'000	2021	2020	2021	2020
	Group	Group	Society	Society
Property, plant and equipment and intangibles	12	(78)	12	(78)
IFRS 9 transitional adjustment	5	5	5	5
Pensions and other post tax retirement benefits	(20)	(22)	(20)	(22)
Effect of change in tax rate	(15)	16	(15)	16
Adjustment for prior years	10	(10)	10	(10)
Other provisions	(26)	(27)	(26)	(27)
Total	(34)	(116)	(34)	(116)

Deferred income tax assets are attributable to the following items:

All figures £'000	2021	2020	2021	2020
	Group	Group	Society	Society
Pensions and other post-retirement benefits	85	237	85	237
Property, plant and equipment	(10)	(15)	(10)	(15)
Other	(47)	(16)	(47)	(16)
Total	28	206	28	206

All deferred tax balances have been recognised at 19%, being the tax rate enacted at the balance sheet date at which the balances are expected to reverse.

18.SHARES

Group and Society	2021	2020
All figures £'000		
Held by individuals	394,185	419,211
Other shares	1,234	1,315
Total	395,419	420,526

Notes to the Annual Report and Accounts (continued)

19.AMOUNTS OWED TO CREDIT INSTITUTIONS

Group and Society	2021	2020
All figures £'000		
Amounts owed to credit institutions	58,518	21,511
Total	58,518	21,511

At 31 December 2021 the Society has drawn £58.5m under the Term Funding Scheme with additional incentives for SMEs (TFSME), included above. The drawings are repayable to the Bank of England £11.5m by 2024 and £47m by 2025. At 31 December 2020 the Society had drawn £10m under the Term Funding Scheme (TFS) and £11.5m under the Term Funding Scheme with additional incentives for SMEs (TFSME), included above, the TFS funding was repaid in full in January 2020.

20.AMOUNTS OWED TO OTHER CUSTOMERS

Group and Society	2021	2020
All figures £'000		
<i>Retail customers:</i>		
On demand	6,261	6,170
Notice	28,074	32,730
Term	0	432
<i>Local authorities</i>		
Term	1,103	1,115
Total	35,438	40,447

21.OTHER LIABILITIES AND ACCRUALS

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Accruals and deferred income	861	653	861	653
Other taxes and social security	208	171	208	171
Amounts due to subsidiary	0	0	1,185	1,185
Other creditors	64	444	64	444
Total	1,133	1,268	2,318	2,453

The fair value of other financial liabilities and accruals approximates the book value.

Notes to the Annual Report and Accounts (continued)

22. RETIREMENT BENEFIT LIABILITIES

Defined benefit scheme

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

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme which has been completed was at 6 April 2018 and takes into account the closure of the scheme for future service accrual. This review showed that the market value of the scheme assets at 6 April 2018 was £9.2 million and that the actuarial value of those assets represented 93% of the benefits that had accrued to members after allowing for expected future increase in salaries. The Preliminary Triannual Actuarial Report at 6 April 2021 estimated an updated valuation of assets would be £9.6m and that the scheme remained 94% funded.

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

An updated actuarial valuation at 31 December 2021 was carried out in line with IAS 19 by a qualified independent actuary, as follows:

Group and Society	2021	2020
Growth and rates of return		
Discount rate	1.8	1.2
Rate of increase in salaries	3.9	3.4
Rate of increase in pensions	3.4	2.9
Inflation	3.4	2.9

Group and Society	2021	2020
Expected life at 31 December (normal retirement age of 65)		
Expected life at retirement for a new pensioner (yrs) - Male	21.9	21.9
Expected life at retirement for a new pensioner (yrs) - Female	24.3	24.3
Expected life at retirement in 20 years' time (yrs) - Male	23.3	23.3
Expected life at retirement in 20 years' time (yrs) - Female	25.8	25.7

Notes to the Annual Report and Accounts (continued)

RETIREMENT BENEFIT LIABILITIES (continued)

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

Group and Society	Change in assumption	2021	2020
All figures £'000			
Discount rate	Decrease by 0.5%	Increase by 9%	Increase by 9%
Rate of inflation	Increase by 0.5%	Increase by 3%	Increase by 3%
Rate of increase in salaries	Increase by 0.5%	Increase by less than 1%	Increase by less than 1%
Life expectancy	Increase by 1 year	Increase by 5%	Increase by 5%

Fair Value of scheme assets	2021	2020
Group and Society		
All figures £'000		
As at 1 January	11,272	10,230
Interest on pension scheme assets	134	203
Contributions by employer	199	199
Benefits paid	(385)	(339)
Administration costs	(61)	(58)
Loss on asset returns	(57)	1,037
At 31 December	11,102	11,272

Present value of defined benefit obligations	2021	2020
Group and Society		
All figures £'000		
As at 1 January	(12,520)	(10,823)
Interest on pension scheme liabilities	(164)	(229)
Benefits paid	385	339
Experience gain/loss on liabilities	98	0
Gain on changes in assumptions	760	(1,807)
At 31 December	(11,441)	(12,520)

Notes to the Annual Report and Accounts (continued)

RETIREMENT BENEFIT LIABILITIES (continued)

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

Group and Society	2021	2020
All figures £'000		
Present value of funded obligations	(11,441)	(12,520)
Fair value of plan assets	11,102	11,272
Liability in the statement of financial position	(339)	(1,248)

The actual return on plan assets was a gain of £57k (2020: £1,240k gain). The amounts recognised in the income statement are as follows:

Group and Society	2021	2020
All figures £'000		
Amounts recognised in finance income		
Interest cost	(164)	(229)
Administration costs	(61)	(58)
Interest on pension scheme assets	134	203
Total	(91)	(84)

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

Group and Society	2021	2020
All figures £'000		
Opening defined benefit obligation	(1,248)	(593)
Total as above	(91)	(84)
Employer contributions	199	199
Re-measurement gains/(losses)	801	(770)
Closing defined benefit obligation	(339)	(1,248)

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

Group and Society	2021	2020
All figures £'000		
Actual return less interest on pension scheme assets	(57)	1,037
Experience gain arising on scheme liabilities	98	0
Changes in assumptions underlying the present value of the scheme liabilities	760	(1,807)
Re-measurement of defined benefit obligation	801	(770)

Notes to the Annual Report and Accounts (continued)

RETIREMENT BENEFIT LIABILITIES (continued)

The major categories of plan assets are:

Group and Society	2021	2020
All figures £'000		
Equities	2,324	2,209
Bonds	0	8,296
Cash	58	54
Property	920	713
Liability Driven Investment (LDI)	2,151	0
Diversified Growth Funds (DGFs)	1,972	0
Diversified Credit Funds (DCFs)	3,677	0
Total	11,102	11,272

Diversified Growth Funds (DGFs) are an actively managed multi-asset portfolio that aims to deliver returns comparable to global equities over the medium term, but with lower volatility Share Class - A Acc.

Diversified Credit Funds (DCFs) are a fund that has invested in many different types of securities in order to hedge against the securities already in the fund.

Liability driven investment (LDI) LDI is a form of investing in which the main goal is to gain sufficient assets to meet all liabilities. During 2021 the Trustees reviewed its investment strategy and commenced investment in LDIs.

The average duration of the defined benefit obligation at 31 December 2021 is 16 years (2020: 17 years).

During 2021 the Group made additional contributions of £199k (2020: £199k) as part of its funding plan. The Group and Society expect to contribute £199k to the fund during 2022. History of gains and losses for the current and previous four years is as follows:

Group & Society	2021	2020	2019	2018	2017
All figures £'000					
Present value of defined benefit obligation	(11,441)	(12,520)	(10,823)	(10,290)	(11,029)
Fair value of plan assets	11,102	11,272	10,230	8,861	9,460
Plan (deficit)	(339)	(1,248)	(593)	(1,429)	(1,569)
Experience adjustments on plan liabilities	(98)	0	(119)	(7)	(3)
Percentage of scheme liabilities	0.9%	0.0%	1.1%	0.1%	0.0%

The Society has agreed a schedule of contributions with the pension scheme expiring in April 2023, with the intention of eliminating the deficit.

Defined contribution scheme

Since April 2005 the Society has operated a defined contribution group personal pension scheme for eligible employees. Contributions of £357k were paid in 2021 (2020: £316k) to personal pension plans held in the names of individual employees with a major UK insurance company.

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

Notes to the Annual Report and Accounts (continued)

23. GENERAL RESERVE

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
At 1 January	44,954	43,412	43,769	42,227
Profit for the financial year	4,034	2,162	4,034	2,162
Net gain recognised directly in other comprehensive income	657	(620)	657	(620)
At 31 December	49,645	44,954	48,460	43,769

24. CASH AND CASH EQUIVALENTS

All figures £'000	2021 Group	2020 Group	2021 Society	2020 Society
Cash in hand	164	250	164	250
Balances with Bank of England	93,702	93,107	93,702	93,107
Loans and advances to credit institutions (note 9)	6,080	7,551	6,080	7,551
Total	99,946	100,908	99,946	100,908

25. FINANCIAL INSTRUMENTS

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

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

The fair values of these hedges at 31 December 2021 are shown in note 10.

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

Notes to the Annual Report and Accounts (continued)

FINANCIAL INSTRUMENTS (continued)

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

Group & Society 2021			Total
All figures £'000	Amortised cost	Mandatorily at FVTPL	
Cash and balances at central banks	93,866	0	93,866
Loans and advances to credit institutions	6,091	0	6,091
Derivative financial instruments	0	1,021	1021
Loans and advances to customers	437,080	0	437,080
Total financial assets	537,037	1021	538,058
Shares	395,419	0	395,419
Amounts owed to credit institutions	58,518	0	58,518
Amounts owed to other customers	35,438	0	35,438
Derivative financial instruments	0	86	86
Other financial liabilities	925	0	925
Total financial liabilities	490,300	86	490,386

Group & Society 2020			Total
All figures £'000	Amortised cost	Mandatorily at FVTPL	
Cash and balances at central banks	93,357	-	93,357
Loans and advances to credit institutions	7,555	-	7,555
Loans and advances to customers	426,830	-	426,830
Total financial assets	527,742	-	527,742
Shares	420,526	-	420,526
Amounts owed to credit institutions	21,511	-	21,511
Amounts owed to other customers	40,447	-	40,447
Derivative financial instruments	-	782	782
Other financial liabilities*	1097	0	1097
Total financial liabilities	483,581	782	484,363

*Other financial liabilities disclosed in the prior year have been restated in the current year to exclude the non-financial liabilities that were inadvertently included in the prior year disclosure.

The Society has an additional financial liability to its subsidiary of £1,185k (2020: £1,185k).

Amounts owed to credit institutions are borrowings from the Bank of England under the Term Funding Scheme with additional incentives for SMEs.

Notes to the Annual Report and Accounts (continued)

FINANCIAL INSTRUMENTS (continued)

Fair value of financial assets and liabilities

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

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

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

Group & Society	Note	2021	2021	2020	2020
All figures £'000		Book value	Fair value	Book value	Fair value
Financial assets					
Cash and balances at central banks	1	93,866	93,866	93,357	93,357
Loans and advances to credit institutions	2	6,091	6,091	7,555	7,555
Loans and advances to customers	3	437,080	443,690	426,830	432,297
Financial liabilities					
Shares	4	395,419	395,597	420,526	421,395
Amounts owed to credit institutions	4	58,518	58,518	21,511	21,511
Amounts owed to other customers	4	35,438	35,438	40,447	40,447

Notes to the Annual Report and Accounts (continued)

FINANCIAL INSTRUMENTS (continued)

Fair value of financial assets and liabilities carried at fair value

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

Group & Society 2021	Level 1	Level 2	Level 3	Total
All figures £'000				
Financial assets				
Derivative financial instruments	0	1,021	0	1,021
Financial liabilities				
Derivative financial instruments	0	(86)	0	(86)

Group & Society 2020	Level 1	Level 2	Level 3	Total
All figures £'000				
Financial assets				
Derivative financial instruments	0	0	0	0
Financial liabilities				
Derivative financial instruments	0	(782)	0	(782)

Valuation techniques

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

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

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

Interest rate swaps

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

The Society has been impacted by IBOR reform where existing LIBOR linked derivatives have re-designated to link to SONIA.

The impact has not been significant. Further detail is provided in note 10.

Notes to the Annual Report and Accounts (continued)

26. CREDIT RISK

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

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

Group and Society	2021	2020
All figures £'000		
Cash and balances at central banks	93,866	93,357
Loans and advances to credit institutions	6,091	7,555
Other debtors	11	43
Derivative financial instruments	1,021	0
Loans and advances to customers	437,953	426,171
Total statement of financial position exposure	538,942	527,126
Off balance sheet exposure – mortgage commitments	25,423	18,995
Total credit risk exposure	564,365	546,121

27. TREASURY CREDIT RISK

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

- Loans and advances to credit institutions; and
- Cash and balances at central banks; and
- Derivative financial instruments.

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

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

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

Group & Society	2021 £'000	2020 %	2021 £'000	2020 %
Bank of England (AA)	93,702	93%	93,107	92%
AA to AA-	2,487	2%	1,936	2%
A+ to A	4,615	5%	5,615	6%
Other including cash in hand	174	0%	254	0%
Total	100,978	100%	100,912	100%

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

Notes to the Annual Report and Accounts (continued)

TREASURY CREDIT RISK (continued)

All treasury exposures qualify as 'stage 1' exposures under IFRS 9 for impairment provisioning. The Society has Credit Support Annex agreements with all swap counterparties. These agreements have reciprocal arrangements that collateral be exchanged with a minimum threshold of £250k. At 31 December 2021 the Society had placed £270k of cash collateral with counterparties. At 31 December 2020 the Society had placed £780k of cash collateral with counterparties.

28. CUSTOMER CREDIT RISK

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

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

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

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

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

Impairment of Financial Assets

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

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

IFRS 9 divides loans into three classes:

- No significant increase in credit risk since advance ('Performing');
- A significant increase in credit risk ('Underperforming'); and
- 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-19 repayment holiday;
- 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); and
- No reliance is placed on mortgage indemnity guarantee insurance which the Society may have in place.

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

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

Notes to the Annual Report and Accounts (continued)

TREASURY CREDIT RISK (continued)

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

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

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

Impairment Implementation

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

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

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

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

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

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

The probability weighting for the four scenarios chosen are:

- Benign (neutral economic scenario) – 20% (2020: 12.5%);
- Base (allied to the Society's expectations in its Corporate Plan) – 30% (2020: 37.5%);
- Downturn (economic recession) – 40% (2020: 37.5%); and
- Severe ('tail event' downturn) – 10% (2020: 12.5%).

If the weighting were unchanged from 2020 the provision increase would be c£90k higher at c£740k

If the weightings are changed as below:

- Benign – 25%
- Base – 25%
- Downturn – 25%
- Tail Event – 25%

The resulting provision would be c£500k higher at c£1,150k

If the weightings are changed back to the December 2019 position as below:

- Benign – 45%
- Base – 25%
- Downturn – 25%
- Tail Event – 5%

The resulting provision would be c£290k lower at £360k

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

If the weightings are changed as below:

- Benign – 0%
- Base – 25%
- Downturn – 45%
- Tail Event – 30%

The resulting provision would be c£800k higher at £1,460k

The key weightings are therefore those impacting the Downturn and Tail Event scenarios. The Tail Event scenario is designed to be such an 'outlier' that the probability of it happening more than once a century is considered remote (think of the 1930s depression occurring in a home-owning economy). Thus the key weighting is that attaching to the Downturn, and a c£30k movement for each 5% increase in probability (where Base decreases by 5%) is not especially volatile.

The expected life impacts the proportion of the whole life credit loss that is used for performing loans. The remaining life is estimated at 1.25 years (2020: 1.25 years), if it were to reduce to 1 year the provision would increase by c£100k.

If the probability of default were to increase by 3% in each scenario then the provision would increase by c£90k.

If the security values fell by a further 5% in all scenarios this would increase the provision requirement by c£400k. If the security values were to increase by 5% in all scenarios this would reduce the provision by c£300k.

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

Group and Society	2021	2020
All figures £'000		
Loans and Advances to Customers (Gross Receivables)		
Loans fully secured on residential property	429,584	417,919
Other loans fully secured on land	9,020	9,170
Total	438,604	427,089

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Loans fully secured on residential property

The maximum credit risk exposure is detailed below:

Group and Society	2021	2020
All figures £'000		
Greater London	135,161	136,465
East Midlands	29,844	36,441
South East	91,611	92,581
South West	60,790	49,064
East of England	31,757	35,870
North West	26,264	23,170
West Midlands	22,659	17,587
Yorkshire and The Humber	16,898	12,145
Wales	9,404	9,363
North East	4,845	4,713
Scotland	351	520
Total	429,584	417,919

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears with less than 0.1% (2020: 0.1%) of loan balances being three months or more in arrears.

Loans fully secured on residential property (Continued)

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

Group and Society	Stage 1	Stage 2	Stage 3	2021	2020
All figures £'000				Total	Total
Under 50%	211,374	12,243	92	223,709	212,141
50% to 75%	191,196	9,810	0	201,006	197,821
75% to 85%	4,769	100	0	4,869	5,987
Over 85%	0	0	0	0	1,970
Total	407,339	22,153	92	429,584	417,919

The average loan to value of residential mortgages is 46% (2020: 47%); indexed using the House Price Index published by the Land Registry.

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

The following table sets out information about the overdue status of loans and advances to customers in Stages 1, 2 and 3 for 2021 under IFRS 9:

Group & Society				2021
All figures £'000	Stage 1	Stage 2	Stage 3	Total
Current	407,339	18,272	0	425,611
Past due up to 3 months	0	3,881	0	3,881
Past due over 3 months	0	0	92	92
Total	407,339	22,153	92	429,584

Group & Society				2020
All figures £'000	Stage 1	Stage 2	Stage 3	Total
Current	395,737	14,654	0	410,391
Past due up to 3 months	0	7,147	0	7,147
Past due over 3 months	0	0	381	381
Total	395,737	21,801	381	417,919

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

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

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Loans fully secured on residential property (Continued)

The value of collateral held is detailed below:

Group & Society All figures £'000	Unindexed 2021	Indexed 2021
Stage 1	986,203	1,237,865
Stage 2	51,455	71,178
Stage 3	166	424
Total	1,037,823	1,309,468

Group & Society All figures £'000	Unindexed 2020	Indexed 2020
Stage 1	1,004,517	1,213,551
Stage 2	46,211	65,886
Stage 3	1,069	1,570
Total	1,051,797	1,281,007

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

With collateral capped to the amount of outstanding debt, the value of collateral held against loans past due and in 'Stage 2' at 31 December is £3.9m (2020:£7.1m) against outstanding debt of £3.9m (2020:£7.1m). In addition, the value of collateral held against loans past due and in 'Stage 3' at 31 December is £0.1m (2019:£0.4m) against outstanding debt of £0.1m (2020:£0.4m).

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

The Group has various forbearance options to support customers who may find themselves in financial difficulty. These include payment plans, term extensions and reduced payment concessions. There were no properties in possession at 31 December 2021 (31 December 2020:0) and none taken into possession during the year.

Forbearance

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

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Loans fully secured on residential property (Continued)

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

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

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

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

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

The table below details the loan balances of forbearance cases:

Group and Society				2021	2020
All figures £'000	Stage 1	Stage 2	Stage 3	Total	
Interest only concessions	0	0	0	0	1,106
Reduced payment concessions	0	233	87	320	177
Payment plans	0	342	5	347	577
Mortgage term extensions	0	3,171	0	3,171	548
Total	0	3,746	92	3,838	2,408

Other loans fully secured on land

The maximum credit risk exposure is detailed below:

Group and Society	2021	2020
All figures £'000		
Greater London	4,534	4,896
East Midlands	1	1
South East	1,367	1,365
South West	1,503	1,280
East of England	984	986
North West	354	354
West Midlands	0	0
Yorkshire and The Humber	277	288
North East	0	0
Scotland	0	0
Total	9,020	9,170

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Other loans fully secured on land (Continued)

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

Group and Society All figures £'000	Stage 1	Stage 2	Stage 3	2021 Total	2020 Total
Under 50%	2,970	0	0	2,970	2,998
50% to 75%	6,050	0	0	6,050	6,172
Total	9,020	0	0	9,020	9,170

The average loan to value of other loans fully secured on land is 52% (2020:53%).

The quality of the Group's mortgage book secured on commercial property is reflected in the number and value of accounts in arrears with £nil (2020: £nil) of loan balances being three months or more in arrears. The main factor for loans moving into arrears tends to be the condition of the general economic environment.

The following table sets out information about the overdue status of loans and advances to customers in Stages 1,2 and 3 for 2021 under IFRS 9:

Group & Society All figures £'000	Stage 1	Stage 2	Stage 3	2021 Total
Current	9,020	0	0	9,020
Overdue > 30 days	0	0	0	0
Total	9,020	0	0	9,020

Group & Society All figures £'000	Stage 1	Stage 2	Stage 3	2020 Total
Current	9,170	0	0	9,170
Overdue > 30 days	0	0	0	0
Total	9,170	0	0	9,170

Notes to the Annual Report and Accounts (continued)

CUSTOMER CREDIT RISK (continued)

Other loans fully secured on land (Continued)

The value of collateral held is detailed below:

Group & Society All figures £'000	Unindexed 2021	Indexed 2021
Stage 1	17,822	17,822
Stage 2	0	0
Stage 3	0	0
Total	17,822	17,822

Group & Society All figures £'000	Unindexed 2020	Indexed 2020
Stage 1	17,957	17,957
Stage 2	0	0
Stage 3	0	0
Total	17,957	17,957

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

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

Forbearance

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

There were no mortgages in forbearance or impaired at 31 December 2021 (2020: none). Provisions of £58k (2020:£55k) are made for loans fully secured on land.

Provisions for loans fully secured on land are included in the provisions reported in Note 11.

Notes to the Annual Report and Accounts (continued)

29. LIQUIDITY RISK

The Group's policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to maintain public confidence in the sustainability of the Group and to enable it to meet its financial obligations as they arise. This is achieved through maintaining a prudent level of liquid assets and through control of the growth of the business. A significant proportion of the Society's liquidity is held either at call or in the form of debt securities and treasury bills, which are capable of being sold at short notice to meet unexpected and severe adverse cash flows. No debt securities or treasury bills were held at 31 December 2021 (2020: nil). Stress tests are undertaken to measure the Society's ability to meet such adverse flows, the results of which are reviewed by ALCO. The Board is confident that the Society will continue to be able to meet its future financial obligations as they arise.

The table below analyses the Group's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the statement of financial position date. This is not representative of the Group's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. The average life of a mortgage at the Group is less than 10 years. Conversely, retail deposits repayable on demand generally remain on balance sheet much longer.

Group 2021 All figures £'000	On demand	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	More than 5 years	Total
Cash and balances at central banks	93,866	0	0	0	0	93,866
Loans and advances to credit institutions	6,091	0	0	0	0	6,091
Derivative financial instruments	0	0	119	902	0	1,021
Loans and advances to customers	0	16,471	19,887	103,282	297,440	437,080
Total assets	99,957	16,471	20,006	104,184	297,440	538,058
Shares	187,948	141,988	57,001	8,482	0	395,419
Amounts owed to credit institutions	18	0	0	58,500	0	58,518
Amounts owed to other customers	6,261	24,933	4,244	0	0	35,438
Derivative financial instruments	0	1	18	67	0	86
Other financial liabilities	4	921	0	0	0	925
Total liabilities	194,231	167,843	61,263	67,049	0	490,386

Notes to the Annual Report and Accounts (continued)

LIQUIDITY RISK (Continued)

Group 2020 All figures £'000	On demand	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	More than 5 years	Total
Cash and balances at central banks	93,357	0	0	0	0	93,357
Loans and advances to credit institutions	7,555	0	0	0	0	7,555
Derivative financial instruments	0	0	0	0	0	0
Loans and advances to customers	0	10,988	36,327	92,673	286,842	426,830
Total assets	100,912	10,988	36,327	92,673	286,842	527,742
Shares	177,566	123,974	102,188	16,798	0	420,526
Amounts owed to credit institutions	11	0	5,000	16,500	0	21,511
Amounts owed to other customers	6,170	29,771	4,506	0	0	40,447
Derivative financial instruments	0	11	151	620	0	782
Other Financial Liabilities*	4	1,093	0	0	0	1,097
Total liabilities	183,751	154,849	111,845	33,918	0	484,363

*Other financial liabilities' disclosed in the prior year have been restated in the current year to exclude the non-financial liabilities that were inadvertently included in the prior year disclosure.

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

Group and Society 2021 All figures £'000	On demand	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	More than 5 years	Total
Shares	187,948	142,161	57,189	8,734	0	396,031
Amounts owed to credit institutions	18	0	0	58,500	0	58,518
Amounts owed to other customers	6,261	24,950	4,252	0	0	35,463
Derivative financial instruments	0	1	18	67	0	86
Other financial liabilities	4	921	0	0	0	925
Total financial liabilities	194,231	168,032	61,459	67,301	0	491,023

The Society has an additional financial liability to its subsidiary of £1,185k (2020: £1,185k) which is repayable on demand.

Notes to the Annual Report and Accounts (continued)

LIQUIDITY RISK (Continued)

Group and Society 2020 All figures £'000	On demand	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	More than 5 years	Total
Shares	177,566	124,190	102,944	17,499	0	422,199
Amounts owed to credit institutions	11	0	5,000	16,500	0	21,511
Amounts owed to other customers	6,170	29,803	4,526	0	0	40,500
Derivative financial instruments	0	11	151	620	0	782
Other Financial Liabilities*	4	1,093	0	0	0	1,097
Total financial liabilities	183,751	155,098	112,621	34,619	0	486,088

*Other financial liabilities' disclosed in the prior year have been restated in the current year to exclude the non-financial liabilities that were inadvertently included in the prior year disclosure.

30. MARKET RISK

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

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

The management of interest rate risk is based, inter alia, on a full statement of financial position gap analysis. The statement of financial position is subjected to a number of stress tests. On a monthly basis, these stress tests include stressing interest rates by 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. These stress tests and their results are monitored by the ALCO and reported to the Board.

Notes to the Annual Report and Accounts (continued)

MARKET RISK (Continued)

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

Group 2021 All figures £'000	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	Non-interest bearing	Total
Cash and balances at central banks	93,702	0	0	164	93,866
Loans and advances to credit institutions	5,821	0	0	270	6,091
Derivative financial instruments	0	119	902	0	1,021
Loans and advances to customers	292,356	38,754	105,970	0	437,080
Non-financial assets	0	0	0	3,111	3,111
Total assets	391,879	38,873	106,872	3,545	541,169
Shares	378,221	7,791	8,477	930	395,419
Amounts owed to credit institutions	58,518	0	0	0	58,518
Amounts owed to other customers	35,351	0	0	87	35,438
Derivative financial instruments	1	18	67	0	86
Other financial liabilities	0	0	0	925	925
Non-financial liabilities	0	0	0	1,138	1,138
Reserves	0	0	0	49,645	49,645
Total liabilities and reserves	472,091	7,809	8,544	52,725	541,169
Impact of derivative instruments	124,500	(32,500)	(92,000)	0	0
Interest rate sensitivity gap	44,288	(1,436)	6,328	(49,180)	(0)
Changes in market value from a shift in interest rates					
Parallel shift of + 2%	(198)	17	(105)	0	(286)
Parallel shift of - 2%	198	(17)	105	0	286

Notes to the Annual Report and Accounts (continued)

MARKET RISK (Continued)

Group 2020 All figures £'000	Not more than 3 months	More than 3 months but not more than a year	More than a year but not more than 5 years	Non-interest bearing	Total
Cash and balances at central banks	93,108	0	0	249	93,357
Loans and advances to credit institutions	6,775	0	0	780	7,555
Derivative financial instruments	0	0	0	0	0
Loans and advances to customers	310,644	42,522	73,664	0	426,830
Non-financial assets	0	0	0	3,342	3,342
Total assets	410,527	42,522	73,664	4,372	531,084
Shares	390,225	12,232	16,692	1,378	420,527
Amounts owed to credit institutions	21,511	0	0	0	21,511
Amounts owed to other customers	40,191	0	0	255	40,446
Derivative financial instruments	11	151	619	0	782
Other financial liabilities*	0	0	0	1,097	1,097
Non-financial liabilities*	0	0	0	1,767	1,767
Reserves	0	0	0	44,954	44,954
Total liabilities and reserves	451,938	12,383	17,311	49,451	531,084
Impact of derivative instruments	84,500	(63,000)	(21,500)	0	0
Interest rate sensitivity gap	43,088	(32,861)	34,853	(45,079)	1
Changes in market value from a shift in interest rates					
Parallel shift of + 2%	(43)	10	(638)	0	(671)
Parallel shift of - 2%	43	(10)	638	0	671

*Non-financial liabilities disclosed in the prior year have been restated in the current year to exclude the financial liabilities that were inadvertently included in the prior year disclosure. Other financial liabilities have been appropriately included in a separate line item as this was erroneously not included in the prior year.

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

The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the statement of financial position as IAS 32 'Financial Instruments – Presentation' requires:

- both an enforceable right to set off and the intention to settle on a net basis or;
- to realise the asset and settle the liability simultaneously.

Neither of these conditions are met by the Society.

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

Notes to the Annual Report and Accounts (continued)

MARKET RISK (Continued)

The Society and Group, at December 2021, have entered into Credit Support Annexes (CSAs) for its derivative instruments which provide for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure. These are set to a minimum threshold of £250k. At 31 December 2021 the Society had provided £270k (2020:£780k) cash collateral under such agreements.

31.CAPITAL STRUCTURE

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

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

The Group's capital requirements are set and monitored by the PRA. During 2021 the Society has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III).

There were no reported breaches of capital requirements during the year. There have been no material changes in the Society's management of capital during the year. At 31 December 2021 the Group had CET1 (Common Equity Tier 1) capital of £49m (2020:£45m) comprising of general reserves less intangible assets and other regulatory adjustments. The Group had no tier 2 capital, meaning that total regulatory capital was also £49m (2020:£45m).

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

Lending and Business Decisions

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

Pricing

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

Counterparty risk

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

32.GUARANTEES AND FINANCIAL COMMITMENTS

The Society and Group have capital expenditure contracted for but not provided for in the accounts at 31 December 2021: £114K (2020: £132k).

Notes to the Annual Report and Accounts (continued)

33. RELATED PARTY TRANSACTIONS

Key management personnel compensation

The Directors of the Society are considered to be the only key management personnel as defined by IAS 24. Total compensation for key management personnel was as follows and a breakdown is disclosed on pages 22 and 23 in the Directors' remuneration report.

Group and Society	2021	2020
All figures £'000		
Key management personnel compensation	710	694

Transactions with key management personnel and their close family members

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

Group & Society	2021 £'000	2021 Number of people	2020 £'000	2020 Number of people
Deposits, share accounts and investments				
Net movement in the year	27		54	
Balance at 31 December	180	12	153	12

Key management personnel and members of close family received £1.2k of interest in total (2020: £1k) during the year.

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

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

Directors' loans and transactions

At 31 December 2021 there were no outstanding secured mortgage loans (2020: nil) to Directors and their connected persons. A register is maintained at the Head Office of the Society which shows details of all loans, transactions and arrangements with Directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 December 2021, will be available for inspection at the Head Office for a period of 15 days up to and including the annual general meeting.

Notes to the Annual Report and Accounts (continued)

34. COUNTRY BY COUNTRY REPORTING

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

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

Market Harbour Building Society and its subsidiary operate only in the United Kingdom. Details of the Society's trading subsidiaries are disclosed in Note 12.

Average employee numbers are disclosed in Note 6.

Group	2021	2020
All figures £'000		
Turnover	13,423	10,853
Profit before tax	5,001	2,668
Corporation tax paid	666	316

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

No public subsidies were received by the Group.

Basis of preparation

The Country by Country information for the year ended 31 December 2021 has been prepared on the following basis:

The number of employees has been calculated as the average number of full and part-time employees, on a monthly basis, as disclosed in note 6.

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

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

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

No public subsidies were received during the year, however the Society is a participant of the Term Funding Scheme and Term Funding Scheme with additional incentives for SMEs. Borrowings from the scheme are shown in note 25.

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

The Directors of the Society are responsible for preparing the CBCR Information for the year ended 31 December 2021 in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013. In preparing the CBCR Information, the Directors are responsible for:

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

Annual Business Statement

1. STATUTORY RATIOS AND OTHER PERCENTAGES

Group	2021	Statutory limit
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	2.4%	25%
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	19.45%	50%

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

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

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

2. OTHER PERCENTAGES

Group	2021	2020
As a percentage of shares and borrowings		
Gross capital	10.1%	9.3%
Free capital	9.9%	9.1%
Liquid assets	20.4%	20.9%
As a percentage of mean total assets		
Profit after taxation	0.8%	0.4%
Management expenses (Group)	1.6%	1.5%
Management expenses (Society)	1.6%	1.5%
As a percentage of total assets at year end		
Return on assets	0.7%	0.4%

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

Definitions

'Gross capital' represents the general reserve.

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

'Mean total assets' is the average of the 2021 and 2020 year-end total assets.

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

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

Annual Business Statement (continued)

3. INFORMATION RELATING TO THE DIRECTORS

Director	Occupation / Professional Qualification	Other Directorships	Year of Birth	Date of Appointment
Nicholas Fielden	Finance Director & Chartered Accountant	Market Harborough Mortgages Ltd	1965	09-12-13
Lindsay Forster	Company Director	Shepper	1974	01-07-19
Jonathan Fox	Company Director		1965	01-09-15
Andrew Merrick	Company Director & Chartered Accountant	Yorkshire Water Services Ltd Trustee of the Nell Bank Charitable Trust Ilkley Lawn Tennis & Squash Club Ltd ILTSC Events Ltd	1961	01-01-18
Mark Robinson	Chief Executive	Market Harborough Mortgages Ltd	1957	17-09-07
Zoe Shapiro	Company Director		1969	01-02-16
David Stunell	Company Director & Corporate Treasurer	Hounte Ltd The Asset and Liability Management Association Ltd	1958	01-12-20
Michael Thomas	Company Director & Corporate Treasurer & Chartered Accountant	AST Language Services Ltd Market Harborough Mortgages Ltd	1964	10-07-13
Nala Worsfold	Company Director & Accountant		1965	01-12-20

The Chief Executive has a notice period of twelve months by the Society and six months by the executive, and the Finance Director has a notice period of 6 months by both the executive and the Society. The contract for Mark Robinson was entered into on 17 September 2007 and for Nicholas Fielden on 4 November 2013. Mark Robinson gave notice in 2021 of his intention to retire in 2022 and the Board agreed to make a non-pensionable payment to him in return for extending his notice period by six months. It is envisaged he will retire in October 2022, unless the Board agrees to release him from his contract prior to this date. In addition, and in order to help provide a smooth transition for the incoming Chief Executive, Nicholas Fielden will receive a payment provided he is still in post once the new Chief Executive has been employed for twelve months.

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

Annual Business Statement (continued)

4. OTHER SENIOR EXECUTIVES

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

5. NEW ACTIVITIES

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

Glossary

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

Glossary (continued)

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

Glossary (continued)

Term	Definition
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Renegotiated loans	Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan might not be treated as past due or impaired.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel III capital rules to reflect the degree of risk they represent.
Residential loans	Loans that are loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK from the 1 April 2013. The PRA is a subsidiary of the Bank of England.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The aggregate of shares, amounts owed to credit institutions, amounts owed to other customers.
SPPI test	An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payments of principal and interest.
Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the balance sheet. 12 month ECL are recognised as the impairment provision for all financial assets on initial recognition.
Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision.
Stage 3	Stage 3 assets are those which are credit impaired. Lifetime ECL is also recognised as an impairment provision.
Standardised approach	The basic method used to calculate capital requirements for credit risk under Basel III. In this approach the risk weightings used in the capital calculation are determined by specified percentages.
Standard Variable Rate (SVR)	Variable rate on mortgage loans set by the lender.
Wholesale funding	The total of amounts owed to credit institutions, amounts owed to other non-retail customers.

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