Pillar 3
Disclosures document

31 December 2017

Contents

1. Introduction

1.1 Background

Melton Mowbray Building Society (the 'Society') is subject to the European Union Capital Requirements Directive (CRD) and Capital Requirements Regulations (CRR) implemented on 1 January 2014. The CRR and CRD, commonly known as CRD IV, provide for consistent capital adequacy standards for banks and building societies and an associated supervisory framework across the European Union and are enforced in the UK by the Prudential Regulation Authority (PRA). The legislation sets out the rules that determine the amount of capital such institutions must hold in order to provide security for members and depositors.

The rules include:

Pillar 1	Minimum regulatory capital requirements, relating to credit, market and operational risks. The Society meets the minimum capital requirements by applying the Standardised Approach to credit risk and the Basic Indicator Approach to operational risk.
Pillar 2	Internal assessment of additional capital requirements relating to specific risks faced by the organisation in addition to the Pillar 1 minimum regulatory capital requirement. This additional capital requirement is reviewed by the PRA.
Pillar 3	Disclosure of information relating to the risk assessment process and resulting capital adequacy.

The Pillar 3 Disclosures are designed to promote market discipline through external disclosure of a firm's risk management framework and risk exposures.

1.2 Scope of application

This document contains the Pillar 3 disclosures for the Society and two of its subsidiaries (together the 'Group') which are aggregated on a solo-consolidated basis:

- MBS Lending Ltd – specialist mortgage lender.

- MMBS Trading Ltd – owned and managed certain Group and investment properties. At the end of 2016, all assets and liabilities were transferred to the Society and the entity ceased trading.

These subsidiaries are wholly owned and funded by the Society. There are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources between the Society and any subsidiary undertaking.

The Group financial statements also include the results of a third subsidiary, MMBS Services Ltd (formerly Sesame Bankhall Specialist Lending Services Ltd). The results of this subsidiary are not reflected in these Pillar 3 disclosures.

1.3 Basis and frequency of disclosures

This document deals with the requirements for Pillar 3 (disclosure) and the information provided here is in accordance with the rules and guidance contained in CRD IV.

Unless stated otherwise, all data is as at 31 December 2017.

This document will be updated at least annually and will be based on the Group's most recent audited financial statements.

1.4 External audit

The disclosures provided in this document have not been subjected to external audit except where they are equivalent to those prepared under accounting standards for inclusion in the Group's audited financial statements.

2. Risk management approach

This section sets out the Group's approach to managing risk.

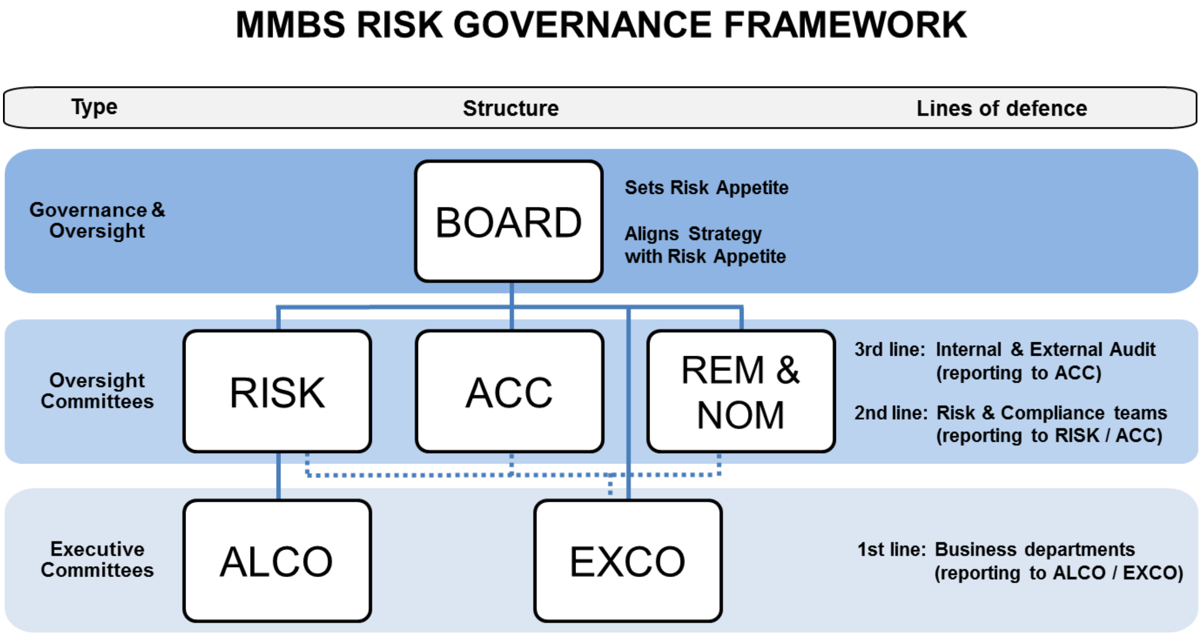
2.1 Risk management framework

The Group has a clearly defined Risk Policy that sets out the framework that has been established to ensure that risks are appropriately managed. The key elements of the framework, which have been designed to take into consideration the Systems and Controls (SYSC) requirements contained in the PRA/FCA Rulebooks, are set out below:

- 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.

In addition, the risk management framework incorporates the requirements of the PRA's Supervisory Statement 20/15 "Supervising building societies' treasury and lending activities" In particular, the Society has adopted the Limited lending approach and the Matched treasury approach to risk management, as set out in this statement.

2.2 Governance structure



The Group has developed a proportionate Board and Committee structure to manage risks across the business. Key features of the structure are as follows:

Board of Directors (Board)

The responsibility for the overall risk management framework lies with the Board of Directors. The Board is responsible for setting the Group's strategy and risk appetite, and ensuring risk management is appropriate and functioning effectively. These duties also include the responsibility for bringing together the risk management framework and the financial disciplines of business planning and capital management in order to assess:

- the significant risks to which the Group is exposed;
- management information, including early warning indicators that enable management action to be taken;
- the adequacy of the Group's risk assessment and management; and
- the capital resources needed by the Group to address its risk exposures over its planning horizon.

The Board has established sub-committees to assist in the implementation and monitoring of risk management across the Group. These committees have their own terms of reference and details are set out below.

Risk Committee (Risk)

The Risk Committee, a non-executive committee, is responsible for the oversight of risk management across the Group. The overall purpose of the Committee is to ensure that the overall approach to the identification and management of risk is adequate and managed cost effectively and in an integrated manner. This includes ensuring that key risks and controls are monitored adequately, overseeing, at a high level, the operation of the Internal Capital Adequacy Assessement Process (ICAAP), monitoring the Group's overall capital adequacy and exposure to risk, and ensuring that effective stress and scenario tests are carried out.

Audit & Compliance Committee (ACC)

The Audit & Compliance Committee, a non-executive committee, has responsibility for ensuring that the Group's accounting and reporting systems provide accurate information, ensuring appropriate internal controls reflecting the Group's risk profile are in place and that these are reviewed regularly, and for monitoring the effectiveness of the compliance and internal audit functions.

Remuneration & Nomination Committee (Rem & Nom)

The Remuneration & Nomination Committee, a non-executive committee, has responsibility for determining remuneration policy across the Group, ensuring the directors and senior management have appropriate skills, experience and competencies to perform their roles, developing succession plans for key roles, and making recommendations to the Board for the selection of new directors and senior managers.

Executive Committee (EXCO)

The EXCO is an executive committee that is primarily responsible for implementing the strategy approved by the Board. It is also responsible for the management of operational risk, conduct risk and certain business risks across the Group. This includes the reviewing of risk events, near misses and operational losses and, where necessary, ensuring controls are amended to prevent recurrences. The committee also ensures that Internal Audit, Risk and Compliance activity is co-ordinated. A non-executive director attends each EXCO meeting as an observer.

Assets & Liabilities Committee (ALCO)

The ALCO is an executive committee that is primarily responsible for the management of credit risk, liquidity risk, interest rate risk (including basis risk), pension obligation risk and certain business risks. This includes determining the composition of assets and liabilities, monitoring customer arrears levels, strategies for maintaining appropriate levels of liquidity and funding, monitoring the results of liquidity stress tests, the approval of new products and ensuring appropriate financial risk management controls are in place. A non-executive director attends each ALCO meeting as an observer.

Review of governance and risk management

The Board undertakes a formal annual assessment of its performance and effectiveness and the performance and effectiveness of its sub Committees, with actions recorded and placed on the Board's formal action log.

In addition, the Audit & Compliance Committee undertakes an annual review of the effectiveness of the Group's system of internal controls and risk management and the Chair of the Risk Committee prepares an annual review of risk management. The reviews detail the current status of the internal controls and the risk management framework, including enhancements made in the year and key areas for further improvement.

Other responsibilities

While the Board of Directors is ultimately accountable for the risk management framework, all staff within the Group have responsibility for risk management.

The Group operates a 'three lines of defence' model:

- **First line of defence:** Line management within each business area is responsible for the identification, measurement and management of the risks within the Group's risk appetite, ensuring appropriate controls are in place and operating effectively. Management Information relating to Prudential risks (credit, liquidity, interest rate, pension obligation risks and certain business risks) is reported to ALCO. Management Information relating to Operational risks (operational, conduct and certain business risks) is reported to EXCO.

- **Second line of defence:** The Risk & Compliance function provides risk management expertise, challenge and support to the Board, management and staff. All key controls and documentary evidence demonstrating their effective operation are reviewed by the risk function on an annual basis. Independent views are reported to the Risk Committee and ACC utilising management information from across the business, external intelligence and bespoke assurance activity in accordance with the Combined Assurance Plan approved by the ACC.

- **Third line of defence:** The Internal Audit function is responsible for independently reviewing the effectiveness of the internal control environment. The Internal Audit function reports to the Chairman of ACC. The ACC approves the risk-based work programme of Internal Audit and receives reports of the results of the work performed. In addition to the third line of defence, external audit also reports into the ACC, providing independent assurance of financial statement risks and controls.

The Board sits above the three lines of defence and provides oversight to each line, setting the risk appetite for the Group and receiving reports from the Risk Committee and ACC enabling it to obtain a holistic view of the Group's risk management framework.

2.3 Risk Appetite, Risk policy statements and risk limits

The Board has approved a risk appetite for each risk category to which the Group is exposed and this form's part of the Group's Risk Policy.

Risk policy statements, which articulate policy and risk limits in more detail for specific risk categories, have been implemented to manage the risks faced by the Group within the defined risk appetite. The key policies include the Lending Policy, the Financial Risk Management Policy, which includes the Liquidity Policy, and the Conduct Risk Policy. These contain detailed criteria and risk limits within which the business is managed. A Stress Testing Policy sets out the Group's stress testing framework, including the scope, nature and frequency of stress testing across the Group and the risk categories. The policies are reviewed by the Risk Committee, and amendments approved by the Board on a regular basis to ensure they remain relevant and appropriate.

2.4 Risk identification, monitoring and reporting

The Group operates formal processes to identify, monitor and report on risks to which it is exposed:

- Risk identification: A Risk & Controls Register is in place containing all the key risks to which the Group is exposed. The register is formally reviewed by the Chief Risk Officer and each Executive risk owner on a quarterly basis and updated with new or evolving risks, changing controls and control effectiveness assessments. The risks identified on the register are graded, according to their probability of occurrence and magnitude of impact after the effect of internal controls.

- Risk monitoring: The EXCO and the ALCO monitor risk metrics relating to their respective areas of responsibility. In addition, Risk Reporting Forms are produced by staff if they identify new risks or changes to existing risks, staff are involved in risk workshops to brainstorm potential risks, Operational Incidents reports are reported to EXCO and Quarterly Risk & Control Self-Assessments are completed by all managers. Issues identified are escalated to EXCO and, if appropriate, to the Risk Committee and the Board.

- Risk reporting: The Risk function monitors risk indicators, trends, external information and emerging risks, and the Chief Risk Officer presents an independent analysis of risk within the Group to the Risk Committee. The Risk Committee reviews this risk analysis on a quarterly basis and a summary of the strategic risks is presented to the Board on a quarterly basis. The Board also monitors key risk information through reports and a balanced scorecard.

2.5 Internal control framework

The Group has in place an Internal Control Framework covering all key functions and processes. Internal controls are implemented to mitigate risks identified within each process to an acceptable level and are operated by staff and management within the first line of defence. All key controls are documented in the Risk & Controls Register. In addition to control activities, such as preventative and detective controls, the framework incorporates the control environment present within the Group, and risk assessment, monitoring and communication stages to ensure that controls are designed and operating effectively.

The Risk, Compliance & Internal Audit functions undertake risk based work programmes in accordance with a Combined Assurance Plan approved by ACC. This includes the independent assessment of the effectiveness of key internal controls and the results of the work performed are reported to the Risk Committee and ACC.

2.6 Alignment of Risk Appetite with Strategy

During 2016, the Board developed and approved the Strategic Plan for 2017-2019. This process included an assessment of the key strategic risks to which the Group is exposed and focusing activities around mitigating these risks. This has been achieved by ensuring that the activities included within the Plan are aligned with the Group's Risk Appetite for all risk categories.

The Plan builds significantly on the previous 3 year plan and the innovations and enhancements introduced to the business model during that period, seeking a balance between delivering a good customer experience, evidencing sound risk management, and exercising financial prudence. The sustainability of all elements of this Plan are seen as key by the Board. The main sustainability factors are:

- resilience across the whole business to prevent or withstand any form of impact; and
- the strategic agility to ensure the Group is aware of, and acts on, internal or external factors that may require enhancements to the agreed activities.

The Board undertakes an annual review of the strategy to consider progress against the Plan, ensure that the agreed activities remain appropriate and to identify any new initiatives or amendments required in light of the internal and external operating environment at the time. This includes the identification and mitigation of any new strategic risks.

2.7 Embeddedness of the Risk Management Framework

The Risk Committee periodically, but at least annually, considers the embeddedness of the Risk Management Framework across the Group. This assessment includes consideration of reports from the first, second and third lines of defence.

The Group's internal audit function (the third line) specifically reviews elements of the Group's risk management framework and its embeddedness over a 3 year planning cycle. The results of these reviews, initially reported to ACC, also inform the Risk Committee assessment.

2.8 Management Information

The Group continuously assesses and seeks to improve management information to assist the Committees and the Board in discharging their terms of reference and improving risk management.

As noted above, the EXCO and the ALCO monitor risk metrics relating to their respective areas of responsibility. The Risk function monitors risk indicators, trends, external information and emerging risks, and the Chief Risk Officer presents an independent analysis of risk within the Group to the Risk Committee. The Risk Committee reviews this risk analysis on a quarterly basis and a summary of the strategic risks is presented to the Board on a quarterly basis. The Board also monitors strategic risk information through reports a balanced scorecard.

The Group has focused on forward looking management information to ensure the Committees and the Board are well sighted on emerging risks and can take action at an early stage if necessary.

3. Risk management policies and objectives

The Melton Mowbray Building Society Group is primarily a retailer of financial products, mostly in the form of mortgages and savings. Surplus funds are invested in liquid assets with a range of counterparties.

The Group identifies, assesses and controls risks that arise from the above activities through the risk management framework as set out in section 2. The most significant risks to which the Group is exposed are:

- mortgage credit risk;
- treasury credit risk
- operational risk;
- conduct risk;
- business risk;
- liquidity risk;
- interest rate risk (including basis risk);
- concentration risk; and
- pension obligation risk.

Details of these risks are set out below. The Group is exposed to market risk through interest rate risk and pension obligation risk as described below. The Group does not operate a trading book and all assets and liabilities are denominated in Sterling.

3.1 Mortgage credit risk

Mortgage credit risk is the risk of loss if a borrower fails to make timely repayment of a loan or other credit commitment.

The Board has designed the Risk Appetite to avoid losses by targeting the origination of a balanced portfolio of assets that match the expertise and experience of underwriters. The Group is on the PRA's Limited Approach (as set out in Supervisory Statement 20/15) for Mortgage Lending, and the Group's appetite is to remain at all times within the applicable lending limits agreed with the PRA. The Group has no appetite for commercial syndicated lending, shared equity lending, high Loan-To-Value (LTV) lending without external insurance, lifetime mortgages, lending to social landlords or non-sterling mortgages.

ALCO is responsible for monitoring credit risk associated with mortgage assets. This is undertaken through the review of credit portfolio analysis, mortgage arrears, forbearance and provisions schedules, mortgage stress testing analysis, mortgage concentration analysis, lending limit monitoring and stress testing, and the rating of and exposure to external insurance providers. ALCO reports into the Risk Committee, which receives reports relating to key decisions made at ALCO, an independent view of each risk category from the Chief Risk Officer, and access to all ALCO papers.

The Group has documented its general principles for mortgage lending and the detailed systems and controls for mitigating credit risk within its Lending Policy. These systems and controls include:

- The setting and regular monitoring of applicable lending limits, including product, borrower and loan related limits, to avoid concentrations of exposures in higher risk lending categories.

- The setting of full underwriting criteria for each product category, designed to ensure the adequacy of security, the creditworthiness of borrowers and the affordability of mortgage repayments.

- The manual assessment of all new mortgage applications by staff who are experienced in residential property finance and are accredited through a formal training and competence scheme. Mortgage applications are approved by staff with specific underwriting mandates approved by the Board.

- The use of appropriately qualified and experienced external property surveyors, solicitors and accountants as necessary to assist the assessment of mortgage applications.

- The prevention of mortgage fraud through thorough mortgage application assessment and use of external fraud prevention systems.

- The pricing of all new mortgage products using a model that incorporates an expected Probability of Default (PD) and Loss Given Default (LGD) to ensure that the margin received appropriately reflects the risks involved.

- The use of mortgage indemnity policies to insure the Society against the risk of lending at higher LTV ratios.

- The use of insurance warranties to provide specialist cover in self-build and renovation lending.

All new mortgages are secured by a first charge over property in England & Wales.

The Group has a separate Arrears Policy covering the systems and controls relating to the processes for dealing with arrears and forbearance. 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.

Any changes in policy are submitted to the Risk Committee for consideration before recommendation to the Board for approval.

A detailed quantitative analysis of the Group's credit risk exposures is set out in section 6.

3.2 Treasury credit risk

Treasury credit risk is the risk of loss if a treasury counterparty fails to make timely repayment of a loan or other credit commitment.

The Board has set the credit risk appetite for liquid assets by defining within the Financial Risk Management Policy the permissible instruments that can be used, the minimum counterparty credit ratings required and maximum counterparty and sector exposure limits. Any changes in policy are submitted to the Risk Committee for consideration before recommendation to the Board for approval.

Permissible counterparties include supranational bodies, the UK government, UK banks and building societies. The limits for all rated counterparty exposures are linked to Fitch credit ratings in addition to management's own assessment. Unrated building societies are assessed by ALCO.

The Finance department monitors counterparty exposures against the limits on a daily basis, with a report to ALCO on a monthly basis. New counterparties or changes to existing counterparty limits are approved by ALCO and ratified by the Board following due diligence by management. The Board receives information weekly from senior management, including details of any changes in the assessment of liquidity counterparties.

ALCO reports into the Risk Committee, which receives reports relating to key decisions made at ALCO, an independent view of each risk category from the Chief Risk Officer, and access to all ALCO papers.

3.3 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, the actions of people, the Group's IT systems, information security and financial crime.

The Board has set a risk appetite for each category of operational risk, and policies and procedures are maintained for all key internal processes. The EXCO is the Group's principal forum for monitoring operational risk. Through the review of the management information, and reports and explanations received from management and staff, the EXCO ensures that appropriate actions are taken and internal controls implemented or enhanced across the business to manage operational risk within the risk appetite. The management information reviewed includes key risk indicators relating to service levels within the Group's operations, staff and resource levels, the security and capacity of the Group's IT systems, and reports relating to operational incidents and complaints. The Committee also considers the results of reviews undertaken by the Risk, Compliance and Internal Audit functions.

A summary of key decisions made by EXCO is passed to the Group's Risk Committee, which is responsible for the oversight of risk management across the Group. Board members have access to all EXCO papers.

Further information is provided below on two key areas of operational risk.

3.3.1 People risk

The most important asset of the Group is its people. The Board aims to have sufficient people resources of the right calibre to meet business needs and ensure risks are appropriately managed.

To mitigate these people risks, the Group has a well developed and tested succession plan for its key personnel, undertakes resource planning, identifies professional development opportunities for staff and supports these with training, and rewards staff at market tested rates.

3.3.2 Information security, including cyber crime

The Group's core IT system is operated by Newcastle Systems Management Limited, a subsidiary of Newcastle Building Society.

Cyber security has been, and continues to be, an area of focus for the Group. The Group has implemented controls to mitigate information security and cyber related risks, including anti-virus software, real-time email and internet filtering, daily back-ups, physical and logical access controls, internal segregation of duties, and internal and external firewalls with appropriate monitoring systems. Regular internal and external penetration testing is carried out by third parties to identify areas for continuous improvement.

Given the importance of information security, the Group will continue to invest in appropriate controls, resource and systems capability and ensure that it always takes appropriate and proportionate steps to protect the ongoing integrity of its operations.

3.4 Conduct risk

Conduct risk is the risk of detrimental outcomes to customers derived from staff interaction throughout the product lifecycle.

The Group's aim in relation to all conduct matters is to ensure that good consumer outcomes arise from all customer interaction and to achieve customer satisfaction at all times. Where this does not occur, the Group will endeavour to rectify the outcome as appropriate.

The Conduct Risk Policy sets out the high level values that staff are expected to demonstrate in all their dealings with consumers and the detailed metrics that are monitored, which may indicate consumer detriment, to ensure that appropriate and timely action can be taken.

As with Operational risk, the EXCO is the principal forum for monitoring conduct risk, ensuring there are adequate controls implemented and that these are effective in managing conduct risk and delivering good customer outcomes. A summary of key decisions made by EXCO is passed to the Group's Risk Committee, which is responsible for the oversight of risk management across the Group. Board members have access to all EXCO papers.

3.5 Business risk

Business risk is the risk of loss or reduction in profitability due to failure to achieve business objectives.

The Group's Strategic 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 financial and capital plans and the monitoring of actual performance against these plans by the Board. The Board and its committees mitigate business risk through:

- approval by the Board of the medium term Strategic Plan;
- monitoring by the Risk Committee to ensure all key business risks are identified, assessed and monitored;
- approval by the Board of the annual budget, including detailed assumptions on business volumes, asset composition, margins, other income and expenditure. Key sensitivities to achievement of the plan are also included and monitored on an on-going basis;
- approval by the Board of all new business initiatives following an appropriate assessment of the risks involved;

- new products or amendments to existing products are approved by ALCO and reported to the Board;

- review by the Board of financial, strategic risk and customer experience reports and commentary, including key performance indicators, key risk indicators and economic data;

- monitoring of external markets and competitors by ALCO; and

- review and approval of all key policies and changes to existing policies as necessary by the Board.

At a management level, ALCO and EXCO each monitor specific areas of business risk. Oversight over both committees is provided by the Risk Committee, which receives an independent view of each risk category from the Chief Risk Officer and has access to all ALCO and EXCO papers.

3.6 Liquidity risk

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its liabilities as they fall due, or can secure them only at an excessive cost.

The Group's policy is to hold a significant amount of its total assets in the form of readily realisable assets in order to:

- maintain liquidity resources 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.

- smooth out the effect of maturity mismatches between assets and liabilities; and

- maintain the highest level of public confidence in the Group.

The Group's risk appetite, policies, systems and controls relating to the management of liquidity risk are set out in the Financial Risk Management Policy which is approved by the Board and reviewed at least annually to ensure it remains appropriate and adequate.

The key aspects of the control framework to mitigate liquidity risk are as follows:

- The Internal Liquidity Adequacy Assessment Process (ILAAP) determines the quality and quantity of liquid assets that the Group is required to hold to achieve its policy objectives as set out above. The ILAAP incorporates severe stress testing linked to the Board's formal assessment of the liquidity risks to which the Group is exposed. The ILAAP is reviewed by the Risk Committee and approved by the Board on an annual basis.

- The holding of a high quality Liquid Assets Buffer, the size of which is determined by the ILAAP. In accordance with the PRA ILAA Rulebook, and in order to meet the Group's policy, the Society holds a Liquid Assets Buffer of high quality, unencumbered liquid assets. Assets meeting the requirements of the Liquid Asset Buffer include deposits with the Bank of England, UK Government Treasury Bills and Gilts, and supranational debt securities.

- The setting and regular monitoring of applicable liquidity limits, including those covering the amount, instrument type and maturity of liquidity held.

- The monitoring of both short-term and long-term liquidity ratios, including the Liquidity Coverage Ratio and Net Stable Funding Ratio, to ensure that these are maintained above minimum levels.

- Segregated treasury front and back offices. The front office is responsible for adherence on a day-to-day basis to the liquidity limits set by the Board. The Group's liquidity position against all key liquidity limits is calculated and monitored on a daily basis by the treasury back office (Finance department).

- Monthly liquidity stress testing, to ensure that the level of the Liquid Assets Buffer and total liquidity held are sufficient to meet liabilities under severe but plausible stressed conditions.

- A Liquidity Contingency Plan is maintained that sets out the governance processes and the options available to the Society if it experienced liquidity stress event. The Plan includes a menu of possible actions depending on the severity of the liquidity event.

The ALCO monitors management information relating to liquidity risk on a monthly basis. Such information includes:

- Financial Risk Management Policy limits (including liquidity and funding limits)
- Liquid Asset Buffer levels and composition
- Liquidity stress testing, including survival days analysis
- Long term cash flow forecast (12 months)
- Forthcoming liquid asset maturities
- Forthcoming wholesale borrowing maturities

ALCO reports into the Risk Committee, which receives reports relating to key decisions made at ALCO, an independent view of each risk category from the Chief Risk Officer, and access to all ALCO papers. A non-executive director also attends each ALCO meeting.

The Liquidity Coverage Ratio is a measure of the Liquid Assets Buffer held by an institution to meet a stressed liabilities outflow over a 30 day time period.

The measure must meet a minimum phased requirement of 100% from 2018 onwards, with a minimum requirement of 90% at 31 December 2017.

The table below sets out the Society's average quarterly Liquidity Coverage Ratio for the 12 month period ending 31 December 2017.

Quarter ending on	**31 Mar 2017**	**30 Jun 2017**	**30 Sep 2017**	**31 Dec 2017**
Liquid Assets Buffer (£m)	51.0	49.1	52.5	51.4
Total Net Cash Outflows (£m)	16.5	16.7	16.3	15.0
Liquidity Coverage Ratio (%)	309.8%	294.5%	322.1%	342.5%

3.7 Interest rate risk

Interest rate risk is 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 (Re-pricing date mismatch risk); and

- The re-pricing of assets and liabilities according to different interest bases (Basis risk).

3.7.1 Re-pricing date mismatch risk

This risk arises from mismatches of the re-pricing or maturity of assets and liabilities as interest rates change, with the main cause being the imperfect matching of fixed rate mortgages and savings products. While the Group aims to match fixed rate assets with liabilities, it is not always possible to achieve exact matches due to the need to estimate initial customer demand for mortgage and savings products and the early repayment of mortgages. Interest rate swaps are utilised to reduce mismatches where economic to do so, but remain susceptible to early repayment of fixed rate products by customers.

In order to manage interest rate risk, an interest rate gap report is prepared showing how assets and liabilities re-price or mature over time and any mismatches. On a monthly basis, the ALCO monitors both historic and projected gap analyses and stress tests assessing the impact of a shift in interest rates as a percentage of capital in order that action can be taken to minimise the risk. Various interest rate shift stress tests are modelled to ensure that capital allocated against this risk remains appropriate across a range of scenarios.

The Board has set the risk appetite for exposure to this risk: the overall impact of a 2% shift in rates on the economic value of the Group must not be greater than 2% of total capital resources. In addition to the risk appetite, the Board has set individual and cumulative gap limits for each time band analysed.

The Group's assets and liabilities are currently structured such that a decrease in interest rates results in a reduction in earnings, while an increase in rates improves financial performance. The impact of a 2% increase in interest rates on the Group's economic value at 31 December 2017 was an increase of £0.49m, representing 01.6% of total capital resources of £30.9m at that date (see section 4), against a limit of £0.62m (2.0% of capital resources).

3.7.2 Basis risk

Basis risk is the risk of reductions in income or economic value arising from the re-pricing of assets and liabilities according to different interest rate bases.

The Group's exposure to basis risk arises from assets and liabilities being linked to different interest rate types including:

- Bank of England base rate (BBR) – BBR tracker mortgages and reserve account deposits with the Bank of England;

- LIBOR – fixed rate mortgages and savings that are the subject of an interest rate swap are linked to 3 month LIBOR;

- Fixed rates – fixed rate treasury investments, mortgages and savings products; and
- Managed (or administered) rates – the majority of mortgages, shares and deposits are linked to managed rates.

The Board has set limits for the maximum permitted net exposure to each interest rate basis.

A basis risk analysis is prepared on a monthly basis and includes stress testing relating to both increasing and decreasing interest rate scenarios. This is reviewed by the ALCO to ensure that all limits are adhered to. New products and treasury activities are assessed by the ALCO taking into account their impact on the Group's basis risk exposure.

3.8 Concentration risk

Concentration risk is the risk of loss due to either a large individual or connected exposure, or significant exposures to groups of counterparties who could be affected by common factors, including geographical location.

The Board has set limits for the geographical concentration of mortgage assets within all UK regions and the maximum value of large exposures to single or connected mortgage borrowers and treasury counterparties. These concentrations are reviewed monthly by ALCO. Details of certain asset concentrations are set out in section 6.

3.9 Pension obligation risk

Pension obligation risk is the risk to earnings and capital due to the Society, as the principal employer and funder of last resort, having to make significant contributions to the defined benefit section of the Group's pension scheme.

The Group's defined benefit scheme was closed to future accrual with effect from 30 September 2008. However pension obligation risk may arise due to a number of factors including:

- A fall in the market value of investments held reducing the fair value of scheme assets.
- A fall in the discount rate increasing the present value of scheme liabilities.
- An increase in life expectancy increasing the present value of scheme liabilities.

Various actions have been taken since September 2008 to reduce the risk to the Group, including the purchase of an insurance policy asset that exactly matches a significant element of the scheme liabilities, the transfer out by some members of their benefits, and the investment of scheme assets in corporate bonds and a long dated index-linked government gilt fund to reduce market risk and inflation risk.

The trustees of the scheme use the services of external professional pension advisers to provide advice regarding investment decisions, liability management and the on-going reduction of risk within the scheme.

An accounting valuation of the scheme was undertaken at 31 December 2017 by an independent actuary, in accordance with International Accounting Standard 19. At 31 December 2017 the defined benefit pension scheme showed a post-tax surplus of £7.3m. Despite the surplus, the Board continues to regularly monitor the funding level of the scheme.

4. Capital resources

As at 31 December 2017 the Group's capital resources were as follows:

	31 Dec 2017 £m
Tier 1 capital (all Common Equity Tier 1 capital)	
General reserves	38.0
Revaluation reserve	0.1
Available for sale reserve	0.0
Less: Defined benefit pension asset (post-tax, based on IAS 19 accounting valuation)	(7.3)
Less: Intangible assets	(0.1)
	30.7
Tier 2 capital	
Collective impairment provisions	0.2
Total capital resources	**30.9**

5. Capital adequacy

5.1 Assessment process

The Group has adopted the Standardised Approach to credit risk and the Basic Indicator Approach to operational risk since 1 January 2008 to calculate the minimum Pillar 1 capital requirement.

In addition to the risks covered under Pillar 1 (credit, market and operational risks), all other material risks to which the Group is exposed were assessed as part of the Internal Capital Adequacy Assessment Process (ICAAP). Financial and capital forecasts were prepared covering a five year period incorporating all current and planned strategic initiatives, products and services, enabling the Board to assess the levels of capital required to support both current and future activities.

The ICAAP is undertaken at least annually, and more frequently should the Group's strategic plans, forecasts or risk profile change. The results of the ICAAP indicate the minimum capital required to be maintained by the Group to support current and future activities. The results are documented, reviewed by the Risk Committee and approved by the Board, and are assessed by the PRA as part of their supervisory review of the Group.

The ICAAP is integrated into normal business activities. The impact on capital requirements of new, and changes to existing, business processes, products and services are assessed. Strategic decisions are made following an assessment of their impact on capital, ensuring adequate capital is maintained at all times and that it is efficiently utilised.

Capital adequacy is monitored against the minimum capital requirements by ALCO, with oversight by the Risk Committee.

5.2 Pillar 1 capital requirement

The Group has adopted the Standardised Approach to credit risk to calculate its minimum capital requirement. Under the Standardised Approach the level of capital required against a given level of exposure to credit risk is calculated as:

Credit risk capital requirement = Exposure value x Risk weighting x 8%

Risk weightings for each exposure class are provided by the EU Capital Requirement Regulations. Mortgage asset risk weightings take into account Loan-To-Value (LTV) ratios, security type and arrears and impairment provision levels. Wholesale liquid asset risk weightings are dependent on counterparty credit rating and deposit duration.

The Group has adopted the Basic Indicator Approach to operational risk to calculate its minimum capital requirement. Under the Basic Indicator Approach the level of capital required is calculated as 15% of the Group's average net income over the previous 3 years.

The resulting Pillar 1 capital requirement is shown in the following table, analysed into its credit risk and operational risk components. For credit risk, the table shows the gross credit risk exposure, the risk weighted exposure and the minimum credit risk capital requirement at 31 December 2017 by exposure class:

Exposure class	Gross credit risk exposure 31 Dec 17 £m	Risk weighted exposures 31 Dec 17 £m	Capital requirement 31 Dec 17 £m
Central governments or central banks	38.0	-	-
Multilateral development banks	8.0	-	-
Institutions	31.3	11.2	0.9
Liquid assets	**77.3**	**11.2**	**0.9**
Secured by mortgages on immovable property	357.4	128.4	10.2
Exposures in default	2.3	2.2	0.2
Mortgage assets	**359.7**	**130.6**	**10.4**
Off-balance sheet commitments (pipeline to be secured on immovable property)	6.0	2.2	0.2
Other assets	7.1	7.1	0.6
Total: Credit risk	**450.1**	**151.1**	**12.1**
Operational risk		**11.5**	**0.9**
Credit valuation adjustment		**0.1**	**-**
Total Pillar 1 capital requirement		**162.7**	**13.0**
Total capital resources (section 4)			**30.9**
Surplus of capital resources over Pillar 1 capital requirement			**17.9**

Notes:

- Mortgages are defined as 'in default' if they are 90 days or more in arrears.
- Off-balance sheet commitments relate to mortgage offers to borrowers that have yet to complete.
- Included within the Institutions are interest rate swap contracts entered into by the Society for the purpose of interest rate risk management as detailed in section 3.5. At 31 December 2017, the notional value of the derivatives was £28.0m, the risk weighted exposure of the derivatives was £75k and the replacement cost of the derivatives with a positive market value was £66k.

The difference between total gross credit risk exposures shown above of £450.1m and total assets per the Group's balance sheet of £451.9m in the Annual Report & Accounts for the year ended 31 December 2017 is shown below.

Reconciliation of Gross Credit Risk Exposures to Total Assets per Balance Sheet	**31 Dec 17 £m**
Total gross credit risk exposures (as shown in table above)	450.1
Less: Individual and collective provisions held against mortgage assets	(1.0)
Off-balance sheet commitments	(6.0)
Derivatives (potential future credit exposure)	(0.1)
Add: Defined benefit pension asset before tax	8.8
Intangible assets	0.1
Total assets per the Group's balance sheet	**451.9**

5.3 Capital and Leverage ratios

At 31 December 2017, the Group's Individual Capital Guidance set by the Prudential Regulation Authority was £15.0m (9.21% of total risk weighted exposures), with £13.0m relating to Pillar 1 (8.00% of total risk weighted exposures, as shown in section 5.2) and £2.0m relating to Pillar 2A (1.21% total risk weighted exposures). Regulatory capital held by the Group at 31 December 2017 was £30.9m, representing 19.0% of the total risk weighted exposures and well in excess of the minimum Individual Capital Guidance.

Further details of the Group's capital and leverage ratios at 31 December 2017 are shown below, along with minimum requirements for the quality of regulatory capital set out in the Capital Requirements Regulations.

Capital ratios	Regulatory Minimum %	**31 Dec 17 %**
Core Equity Tier 1 (CET1) capital ratio (CET1 capital resources as % of total risk weighted exposures)	4.5	**18.9**
Tier 1 capital ratio (Tier 1 capital resources as % of total risk weighted exposures)	6.0	**18.9**
Total capital ratio (Total capital resources as % of total risk weighted exposures)	8.0	**19.0**

Leverage ratio	Regulatory Minimum %	**31 Dec 17 £**
Total Tier 1 capital		**30.7**
Exposures		
Balance sheet exposure (excluding derivatives)		443.2
Derivatives		0.2
Off-balance sheet commitments		6.0
On and off balance sheet exposures		**449.4**
Leverage ratio	3.0%	**6.8%**

6. Credit risk reporting

At 31 December 2017, the multilateral development bank credit risk exposures set out in section 5.2 were concentrated in Europe, with all other exposures solely concentrated in the UK.

The residual maturity of the exposures at 31 December 2017 was as follows:

Exposure class	Less than 3 months £m	3 months – 1 year £m	1 – 5 years £m	More than 5 years £m	Total £m
Central government & central banks	33.3	1.0	3.7	-	38.0
Multilateral development banks	-	2.0	6.0	-	8.0
Institutions	13.1	18.0	0.2	-	31.3
Secured by mortgages on immovable property	3.1	9.2	48.3	296.8	357.4
Exposures in default	0.1	0.1	0.5	1.6	2.3
Total	**49.6**	**30.3**	**58.7**	**298.4**	**437.0**

6.1 Liquid assets

The primary source for obtaining information on wholesale counterparty creditworthiness is Fitch, an external credit assessment institution. Fitch ratings are applied to Group liquid asset exposures in order to establish their risk weighted value for capital adequacy purposes, in line with the Standardised Approach using credit quality steps as set out in the EU Capital Requirement Regulations.

Unrated exposures are restricted to UK building societies which have not obtained a Fitch rating and are considered to be of high standing.

The credit ratings of liquid asset exposures at 31 December 2017 were as follows:

Credit quality step	Risk Weighting	Fitch rating	Exposure value £m
1	0%/20%	AAA to AA-	52.6
2	20%/50%	A+ to A-	20.2
3	20%/50%	BBB+ to BBB-	1.0
4	50%/100%	BB+ to BB-	-
Unrated	20%	-	3.5
Total			**77.3**

6.2 Mortgage assets

The geographical distribution of mortgage asset exposures to UK customers at 31 December 2017 was as follows:

Location	Residential mortgage assets £m	Commercial mortgage assets £m	Past due items £m	Total £m	Of which: Not past due but impaired £m
East Midlands	102.0	2.8	0.7	105.5	2.7
South East	57.3	-	0.4	57.7	-
North West	32.4	-	0.1	32.5	0.5
South West	31.9	-	-	31.9	-
East	31.0	0.1	0.4	31.5	-
West Midlands	31.2	-	0.2	31.4	0.3
Yorkshire & Humberside	27.2	-	0.3	27.5	0.4
London	18.6	-	0.1	18.7	0.7
Wales	15.3	-	0.1	15.4	-
North East	7.6	-	-	7.6	-
Total	**354.5**	**2.9**	**2.3**	**359.7**	**4.6**

6.3 Encumbered assets

The Society has pledged mortgage assets as collateral with the Bank of England, in order to participate in the Bank's Term Funding Scheme (TFS). The Society has also provided security in the form of a fixed charge as security for a large corporate depositor. Participation in the TFS and the provision of other security provides the Society with additional sources of funding and reduces the overall funding cost.

Details of the encumbered assets are set out below. This information is required to be disclosed as median values over quarterly positions during the 12 months preceding 31 December 2017 rather than being the year-end position. As a result, values shown may differ from other information provided in this document.

	Encumbered assets		**Unencumbered assets**	
	Carrying amount £m	**Fair value £m**	**Carrying amount £m**	**Fair value £m**
Assets of the reporting institution	**47.6**		**404.0**	
Loans on demand	-		40.3	
Equity instruments	-	-	-	-
Debt securities	-	-	35.8	35.8
Loans & advances other than loans on demand	47.6		312.3	
Other assets	-		15.6	

A proportion of the unencumbered other assets are not considered by the Society as available for encumbrance in the normal course of business since they relate to, for example, pension scheme assets, intangible assets, other fixed assets and deferred tax assets.

The median encumbered assets and collateral received against selected financial liabilities during the 12 months preceding 31 December 2017 are shown below. The Group has encumbered more assets than it receives in funding, since counterparties require a buffer against potential non-performance of the encumbered assets.

	Matching liabilities, contingent liabilities or securities lent £m	**Assets and collateral received encumbered £m**
Carrying amount of selected financial liabilities	28.0	47.6

6.4 Impairment provisions

Throughout the year and at each year-end, individual assessments are made of all mortgage assets which are in arrears, in possession, subject to forbearance activities or if there is any other significant concern. Individual impairment provision is made against those mortgage assets where there is objective evidence of impairment.

Objective evidence of impairment may include:

- significant financial difficulty of the borrower;
- deterioration in payment status;
- granting a concession or forbearance to the borrower;
- any other information suggesting that a loss is likely in the short to medium term.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Estimated future cash flows will take into account the sale proceeds of the property, including any discount required to achieve a sale, the costs of sale and amounts recoverable under mortgage indemnity guarantee policies if applicable.

Where no objective evidence of impairment exists for an individually assessed asset, it is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Assets that are individually assessed for impairment, and for which an impairment loss is or continues to be recognised, are not included in a collective assessment of impairment.

A collective provision is made against a group of assets where there is objective evidence that credit losses have been incurred but not identified at the reporting date. The collective impairment calculation takes into account a number of factors, including historic experience of default and loss emergence periods (the period from a credit loss being incurred to it being identified).

Individual and collection impairment provisions are deducted from the relevant asset values in the balance sheet.

The following table details the past due exposures of the Group at 31 December 2017.

	Liquid assets £m	**Residential mortgage assets £m**	**Commercial mortgage assets £m**	**Total £m**
Not impaired				
Neither impaired nor past due	77.3	350.2	0.6	428.1
Past due up to 3 months	-	2.0	-	2.0
Past due 3 to 6 months	-	0.9	-	0.9
Past due 6 to 12 months	-	0.8	-	0.8
Past due over 12 months	-	-	-	-
Possessions	-	-	-	-
Impaired				
Not past due	-	1.1	2.3	3.4
Past due up to 3 months	-	1.2	-	1.2
Past due 3 to 6 months	-	0.3	-	0.3
Past due 6 to 12 months	-	0.1	-	0.1
Past due over 12 months	-	0.2	-	0.2
Possessions	-	-	-	-
Total exposures	**77.3**	**356.8**	**2.9**	**437.0**

The amounts shown as past due represent the total amount of the outstanding exposure not just the amount that is overdue.

The movement in impairment provisions for the year ended 31 December 2017 and charges to the Income Statement for the year ended 31 December 2017 were as follows:

	Residential mortgage assets £m	**Commercial mortgage assets £m**	**Total £m**
Individual impairment provision			
Balance at 1 January 2017	0.30	0.52	0.82
Impairment credit for the year	(0.03)	-	(0.03)
Provision utilised	(0.04)	-	(0.04)
Balance at 31 December 2017	0.23	0.52	0.75
Collective impairment provision			
Balance at 1 January 2017	0.29	-	0.29
Impairment credit for the year	(0.04)	-	(0.04)
Balance at 31 December 2017	0.25	-	0.25
Total impairment provision at 31 December 2016	**0.48**	**0.52**	**1.00**
The amount recognised in the Income Statement during the year was:			
Movement in provisions (as per above)	(0.07)	-	(0.07)
Impairment recoveries	-	-	-
Credit to the Income Statement	**(0.07)**	**-**	**(0.07)**

7. Remuneration disclosures

7.1 Remuneration policy

The Remuneration & Nomination Committee, comprising non-executive directors, has responsibility for determining remuneration policy across the Group.

The Committee's objectives in setting remuneration policy are to ensure that:

- the Group attracts and retains directors and senior management possessing the skills and experience to lead the Group and develop it for the long term advantage of members;
- remuneration decisions are consistent with the Group's long term objectives, business strategy and risk appetite set by the Board of Directors;
- staff are provided a fair and reasonable reward for their contribution to the business; and
- the Group maintains a sustainable business model and a strong capital base.

In setting remuneration, the Committee takes into account salaries, fees and benefits offered for comparable positions within similar financial services organisations.

Non-executive directors are remunerated solely by fees. They do not receive any salary, performance incentives or pension. The Society's Rules limit non-executive director remuneration to 2.5 x the annual salary of the lowest paid full-time clerical employee.

Remuneration of the Group's executive directors and senior management comprise a number of elements: basic salary, annual bonus scheme, medium term incentive plan, membership of a pension scheme and other benefits.

The annual bonus scheme is in place in order to recognise the contribution of individuals to the overall recovery in underlying financial performance and enhancements made to the Group's risk management framework and control environment. Annual bonuses are discretionary, non-contractual and not guaranteed, are capped at 10% of basic salary (prior to any salary sacrifice) and are subject to approval by the Remuneration & Nomination Committee. All payments under the discretionary bonus scheme are in cash with no deferral.

A medium term incentive plan (MTIP) was introduced by the Committee to commence on 1 January 2017. MTIPs are set annually, based on performance measured against objectives set within the Society's Strategic Plan relating to profitability, mortgage growth and customer service. Payments under each MTIP are capped at 10% of salary (prior to any salary sacrifice) and, subject to performance, are paid over a three year period, with 25% payable after each of the first two years and 50% after the third year. All payments under the MTIP are reviewed by the Risk Committee, discretionary and subject to approval by the Remuneration & Nomination Committee.

Further information on the role of the Remuneration & Nomination Committee in determining remuneration policy and practice is set out in the Directors' Remuneration Report within the Group's Annual Report & Accounts for the year ended 31 December 2017.

7.2 Remuneration Code Staff and remuneration

The Board has determined that for the year ended 31 December 2017:

- 7 non-executive directors (including 3 that held office for part of the year); and
- 4 members of senior management (including 2 executive directors) (including 1 that held office for part of the year),

are designated as being subject to the Remuneration Code and are considered to be the material risk takers within the Group. The Board considers that these directors and staff, referred to as Remuneration Code Staff, are those whose professional activities have a material impact on the Group's risk profile.

Aggregate information on the remuneration of Code Staff for the year ended 31 December 2017 is given below.

Category	**Number**	**Fixed remuneration £**	**Variable remuneration £**	**Total remuneration £**
Non-executive directors	7	163,398	-	163,398
Senior management (including executive directors)	4	446,682	35,689	482,371
Total	**11**	**610,080**	**35,689**	**645,769**

Variable remuneration shown above was earned in 2017 and will be paid in 2018. Additional variable remuneration of £23,503 was earned in 2017 with payment deferred until 2019 and 2020.

8. Conclusion

This Pillar 3 disclosures document has been prepared in accordance with the requirements of the PRA, as appropriate to the size and complexity of the Melton Mowbray Building Society Group.

In the event that a user of this disclosures document requires further information, application should be made in writing to The Secretary, Melton Mowbray Building Society, Mutual House, Leicester Road, Melton Mowbray, Leicestershire LE13 0DB.