Pillar 3
Disclosures Document

31 December 2020

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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 Limited – specialist mortgage lender.

- Nexa Finance Limited – an alternative lending business, which arranges secured finance for commercial SME borrowers for residential property development, with funding provided on a peer-to-peer lending basis by the Society and other institutional investors. Nexa Finance commenced trading in 2019. A new subsidiary of Nexa Finance, Nexa Lending & Security Services Limited (a company limited by guarantee) was set up to hold security for the benefit of investors.

MBS Lending Limited and Nexa Finance Limited 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, which was dormant until August 2020 and does not form part of the consolidation group for regulatory capital purposes. The results of this subsidiary are not material to the Group and therefore for Capital purposes the results of the solo consolidation and the results of the Group are assumed to be the same. MMBS Services trades as an appointed representative of the Mortgage Advice Bureau.

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 2020.

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.

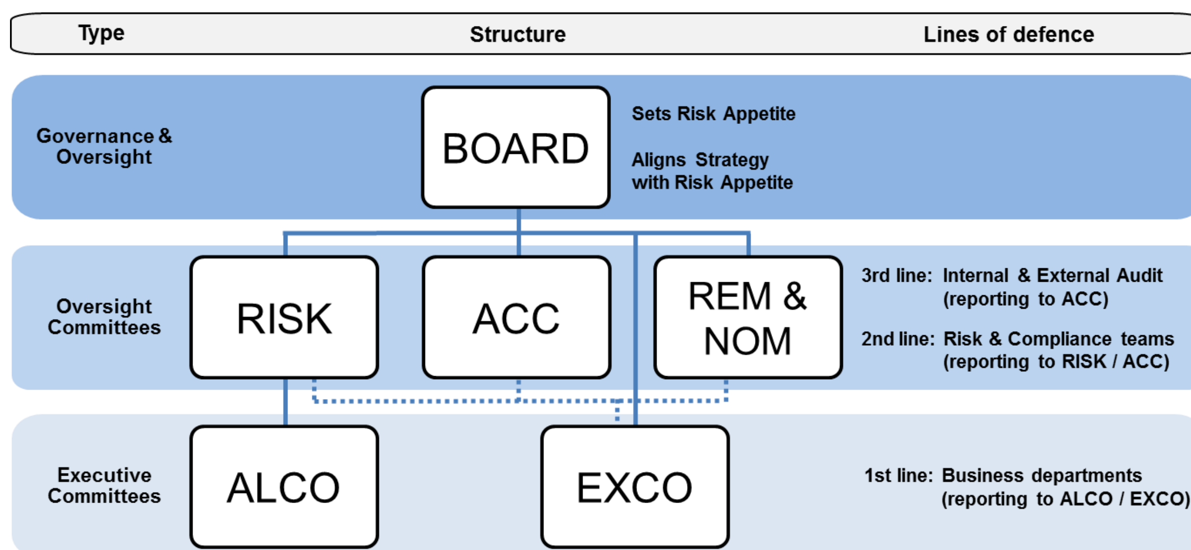
2.1 Risk management framework

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 and challenge of risk management across the Group. The overall purpose of the Committee is to ensure that the overall approach to the identification, assessment, management and mitigation 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, approving the Group's combined assurance plan and for monitoring the independence and 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. The Committee is supported by a HR specialist whose role it is to provide HR support and advice to the Board and Remuneration and Nomination Committee.

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 oversight and management of operational risk, conduct risk and 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.

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, determining strategies for maintaining appropriate levels of liquidity and funding, monitoring the results of liquidity stress tests and ensuring appropriate financial risk management controls are in place. A non-executive director attends each ALCO meeting as an observer.

Nexa Finance Limited Committee Structure

Nexa Finance Limited has its own Board which has representatives from the Group Board and key executives who oversee the investment the Group has made in the Company. The Company Board has adopted the clearly defined risk management framework operated by the Group Board and reports key decisions into the Group Board.

The Nexa Finance Limited Board has an established sub-committee named the Risk and Compliance Committee. The Risk and Compliance Committee is responsible for the overall approach to the identification and management of risk associated with Nexa Finance Limited.

Review of governance and risk management

The Board undertakes a formal annual assessment of its performance and effectiveness (this is completed annually on an internal basis and once every three years by an external facilitator) 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. 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, ACC, Remuneration and Nomination Committee and EXCO to enable 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 forms part of the Group's Enterprise Risk Framework and Risk Appetite 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 and the Financial Risk Management Policy, which includes the Liquidity 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 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 Register is in place containing all the key risks to which the Group is exposed. The register is formally reviewed by Risk and Compliance 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. Incident reports are completed by managers and reported to the Risk & Compliance function and Control & Risk Self-Assessments are completed by all managers on a regular basis. Issues identified are escalated to EXCO and, if appropriate, to the Risk Committee and the Board.

- Risk reporting: The Chief Risk Officer produces an independent analysis of risk across the board, including exception reporting of key risk indicators, details of

emerging risks and additional detail covering the Group's top risks. Any amber or red indicators are reported to the Risk Committee together with details of management actions. The Risk Committee reviews this risk information at each meeting. The Board also monitors key risk information through the monthly Board Report.

2.5 Internal control framework

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 Register.

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

2.6 Alignment of Risk Appetite with Strategy

Risk Appetite is a core part of the Group's Enterprise Risk Management Framework (ERMF). It clearly defines the amount and type of risks the Group is willing to take to meet our strategic and financial objectives.

It is created in conjunction with the Group Strategy and ensures that the business has clear guidelines and boundaries in relation to its risk-taking and business activities. It does this by:

- Providing a clear framework within which the strategy is executed and the business operates;
- Providing clear thresholds that are there to both prevent excessive risk-taking; and to support the Group's strategy by preventing strategic drift; and
- Protecting the Group against external economic impacts.

When setting Risk Appetite in relation to the Group's Strategy the Board has four key objectives:

i) Protect its Financial Stability - The Group will look to minimise those impacts to its financial performance, that could threaten the Group's solvency; or its ability to perform its obligations to its customers and employees;

ii) Maintain Capital Adequacy - The Group must always maintain capital within the minimum regulatory requirement. It will actively seek to minimise risks that would threaten the level of capital below its regulatory minimum;

iii) Protect its Reputation - The Group must protect against risks that could damage its reputation expressed, for example, through: regulatory censure or fines; operational errors; poor service provision; and poor employee engagement;

iv) Provide Fair Customer Outcomes - The Group must strive to provide fair outcomes for customers. This encompasses ensuring there is appropriate allocation of resources to support customers' needs; and facilitating and embedding a positive conduct and culture environment.

The Strategic Plan for 2021-2023 evolves the strategy to use our financial strength and

experience to ensure we remain relevant in a changing financial services market for our existing members and to continue to attract new members to the Group. As the Society enters the next phase of its journey working to build a relevant mutual Society it will aim to strike a balance between digital and physical customers. In this context our new vision is to BUILD A MODERN MUTUAL SOCIETY, which is built on four pillars:

- RELEVANCE – To ensure we remain relevant today, tomorrow and into the future
- SIMPLIFY/DIGITISE – To make it easier for all stakeholders to do more business with us and remove process friction, creating more simplified, more efficient customer journeys
- GROW – to grow our membership, grow our assets, grow our capability, grow our profit and grow our people
- BEST – To be the best version of us, best partner, best regional society, best community partner

The strategy seeks a balance evidencing sound risk management and exercising financial resilience whilst achieving the four pillars. 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 Enterprise 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 at each meeting. The Board also monitors strategic risk information through the monthly Board Report.

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. Some of the most material risks the Group is exposed to are:

- mortgage credit risk;
- treasury credit risk;
- climate change;
- operational risk, including financial crime;
- 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 its underwriters. The Group is on the PRA’s Limited Approach (as set out in Supervisory Statement 20/15) for Mortgage Lending. The Group has no appetite for 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 analysis, mortgage loss 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 risks across the board review 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 Group 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 ALCO for consideration before recommendation to the Risk Committee for approval.

A detailed quantitative analysis of the Group's mortgage 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 ALCO for consideration before recommendation to the Risk Committee 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 Risk Committee 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 review of risks across the board from the Chief Risk Officer, and has access to all ALCO papers.

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

3.3 Climate Change

The Group considers climate risk to be a key risk, with a widespread impact, that cuts across all existing principal risks, including: Operational; Credit; Strategic and Business.

The Group has already begun to formulate its strategic approach in 2020; and this will continue to be an area of ongoing focus in 2021, where we will be looking to further embed this within our Risk Management Framework.

In 2020 the Group commissioned Landmark to carry out an assessment of the direct physical and transitional impacts of Climate Change on its entire retail mortgage portfolio. This concluded that whilst the Group will be exposed to losses, it had a lower-than-average exposure to flooding and subsidence. Noting that even in a downturn, losses remain within the Board's Key Risk Appetite Objectives of Financial Stability and Capital Adequacy.

3.4 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 the key sub-categories of operational risk, and policies and procedures are maintained for all key internal processes. The EXCO is the senior committee responsible for overseeing operational risk. It delegates this to the First Line Risk Committee, who are responsible for reviewing the management information and assessing whether any further action needs to be taken. The Committee also considers the results of reviews undertaken by the Risk, Compliance and Internal Audit functions. Key decisions taken at First Line Risk Committee are reported to EXCO.

A summary of incidents is also included in the Risk and Compliance reporting to the Group's Risk Committee, which is responsible for the oversight of risk management across the Group; and within the ACC reporting.

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

3.4.1 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 developed a people strategy which focuses on providing both a short-term and long-term plan for engaging, developing and managing our people. There are six key areas of the plan:

- Leadership
- Performance and Review
- Talent Acquisition
- Talent Development
- Engagement and Inclusion
- HR Service excellence

Development of the strategy included engaging with our colleagues to invite their ideas to help in the production and build on the Society purpose and future direction. Regular engagement with colleagues takes place across the year to share business performance as well as surveys to gain feedback to help us improve and achieve our people strategy.

3.4.2 Information security, including cyber crime

The Group's core IT system is operated by Newcastle Strategic Solutions 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.

3.5 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 and Culture Framework sets out the high-level values that staff are expected to demonstrate in all their dealings with consumers. In addition, the Group has detailed

‘conduct’ metrics to alert it to potential consumer detriment, ensuring that appropriate and timely action can be taken.

As with Operational risk, the EXCO is the senior committee which oversees 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.

3.6 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 a management Committee;
- 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 Performance and Product Governance Committee (PPG) which has a reporting line in to ALCO; and
- review and approval of all key policies and changes to existing policies as necessary by the Board or its committees.

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

3.7 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 Risk Committee 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 Group 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 (the 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, which is integrated within the Group's Recovery Plan, is maintained that sets out the governance processes and the options available to the Group if it experienced a 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 has 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 net cash outflows over a 30 day time period. The measure must meet a minimum regulatory requirement of 100%.

The table below sets out the Group's average quarterly Liquidity Coverage Ratio for the 12 month period ending 31 December 2020.

Quarter ending on	**31 Mar 2020**	**30 Jun 2020**	**30 Sep 2020**	**31 Dec 2020**
Liquid Assets Buffer (£m)	54.0	55.3	52.2	118.8
Total Net Cash Outflows (£m)	13.9	14.0	21.3	24.5
Liquidity Coverage Ratio (%)	387.2%	391.9%	249.3%	484.8%

3.8 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).

3.8.1 Re-pricing date mismatch risk

Interest Rate Risk in the Banking Book (IRRBB) 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 assesses 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 an increase in interest rates results in a reduction in the economic value of the Group, while a decrease in rates increases economic value. The impact of a 2% increase in interest rates on the Group's economic value at 31 December 2020 was an increase of £0.06m, representing 0.2% of total capital resources of £33.1m at that date (see section 4), against a limit of £0.66m (2.0% of capital resources).

3.8.2 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 – base rate linked mortgages and reserve account deposits with the Bank of England;
- LIBOR – fixed rate mortgages and savings that are the subject of a LIBOR based interest rate swap and LIBOR based floating rate treasury instruments;
- SONIA - fixed rate mortgages and savings that are the subject of a SONIA based interest rate swap and SONIA based floating rate treasury instruments;
- 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 and the maximum overall exposure to different interest rate bases. The Board is managing its exposure to LIBOR in line with the transition date of December 2021.

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.

3.9 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.

3.10 Pension obligation risk

Pension obligation risk is the risk to earnings and capital due to the Group, 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 purchases of insurance policy assets in December 2008 and November 2020 that match a significant proportion of the scheme liabilities 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 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 2020 by an independent actuary, in accordance with International Accounting Standard 19. At 31 December 2020 the defined benefit pension scheme showed a post-tax surplus of £5.4m. Despite the surplus, the Board continues to regularly monitor the funding level of the scheme.

4. Capital resources

As at 31 December 2020 the Group's capital resources were as follows:

	31 Dec 2020 £m
Tier 1 capital (all Common Equity Tier 1 capital)	
General reserves	39.0
Revaluation reserve	(0.2)
Less: Prudent valuation adjustment	(0.0)
Less: Intangible assets	(0.3)
Less: Defined benefit pension asset (post-tax, based on IAS 19 accounting valuation)	(5.4)
IFRS 9 transition adjustment	0.0
Total Common Equity Tier 1 (CET1) capital	**33.1**
Total Risk Exposures	**192.3**
CET1 / Tier 1 / Total capital ratios	**17.2%**

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 2020 by exposure class:

Exposure class	Gross credit risk exposure 31 Dec 20 £m	Net credit risk exposure 31 Dec 20 £m	Risk weighted exposures 31 Dec 20 £m	Capital requirement 31 Dec 20 £m
Central governments or central banks	132.9	132.9	-	-
Multilateral development banks	-	-	-	-
Institutions	25.8	25.8	7.0	0.6
Liquid assets	**158.7**	**158.7**	**7.0**	**0.6**
Secured by mortgages on immovable property	411.4	410.8	153.4	12.3
Exposures in default	1.0	1.0	1.0	0.1
Mortgage assets	**412.4**	**411.8**	**154.4**	**12.4**
Off-balance sheet commitments (pipeline to be secured on immovable property)	60.5	16.9	9.9	0.8
Other assets	6.9	6.9	6.8	0.5
Total: Credit risk	**638.5**	**594.3**	**178.1**	**14.3**
Operational risk			**14.1**	**1.1**
Credit valuation adjustment			**0.1**	**-**
Total Pillar 1 capital requirement			**192.3**	**15.4**
Pillar 2A capital requirement				**0.0**
Total Capital Requirement				**15.4**
Total capital resources (section 4)				**33.1**
Surplus of capital resources over Pillar 1 + 2A capital requirement				**17.7**

Notes:

- Mortgages are defined as ‘in default’ if they are 90 days or more in arrears.
- Off-balance sheet commitments consist of mortgage offers to borrowers that have yet to complete.
- Included within the Institutions are interest rate swap contracts entered into by the Group for the purpose of interest rate risk management as detailed in section 3.5. At 31 December 2020, the notional value of the derivatives was £39.5m, the risk weighted exposure of the derivatives was £78k and the replacement cost of the derivatives with a positive market value was £22k.

The difference between total gross credit risk exposures shown above of £638.5m and total assets per the Group’s balance sheet of £584.0m in the Annual Report & Accounts for the year ended 31 December 2020 is shown below.

Reconciliation of Gross Credit Risk Exposures to Total Assets per Balance Sheet	31 Dec 20 £m
Total gross credit risk exposures (as shown in table above)	638.5
Less: Individual impairment provisions held against mortgage assets	(0.6)
Off-balance sheet commitments	(60.5)
Derivatives (potential future credit exposure)	(0.2)
Investment in subsidiary outside the scope of regulatory consolidation	(0.1)
Add: Defined benefit pension asset before tax	6.6
Intangible assets	0.3
Total assets per the Group's balance sheet	**584.0**

5.3 Capital and Leverage ratios

At 31 December 2020, the Group's Total Capital Requirement set by the Prudential Regulation Authority was £15.4m (8.00% of total risk weighted exposures), with £15.4m relating to Pillar 1 (8.00% of total risk weighted exposures,) and £0.0m relating to Pillar 2A (0.00% total risk weighted exposures) as shown in section 5.2. The identified Pillar 2A capital add-ons have been offset by the conservatism inherent within the Pillar 1 credit risk capital requirement. Regulatory capital held by the Group at 31 December 2020 was £33.1m, representing 17.2% of the total risk weighted exposures and well in excess of the minimum Total Capital Requirement.

Details of the Group's leverage ratio calculation at 31 December 2020 are shown below.

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures	31 Dec 20 £m
Total assets as per published financial statements	584.0
Adjustment for entities outside the scope of regulatory consolidation	0.1
Adjustments for derivative financial instruments	0.2
Adjustment for off-balance sheet items	16.9
Other adjustments (defined benefit pension scheme asset and intangible assets)	(6.9)
Leverage ratio total exposure measure	**594.3**

Table LRCom: Leverage ratio common disclosure	31 Dec 20 £m
On-balance sheet items (excluding derivatives and Securities Financing Transactions (SFTs), but including collateral)	584.0
Asset amounts deducted in determining Tier 1 capital	(6.8)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**577.2**
Replacement cost associated with all derivatives transactions	0.0
Add-on amounts for PFE associated with all derivatives transactions	0.2
Total derivative exposures	**0.2**
Off-balance sheet exposures at gross notional amount	60.5
Adjustments for conversion to credit equivalent amounts	(43.6)
Total off-balance sheet exposures	**16.9**
Tier 1 capital	**33.1**
Leverage ratio total exposure measure	**594.3**
Leverage ratio	**5.6%**

Table LRSpl: Split-up of on-balance sheet exposures (excluding derivatives and SFTs)	31 Dec 20 £m
Total on-balance sheet exposures (excluding derivatives and SFTs)	**577.2**
Of which:	
Exposures treated as sovereigns	132.9
Institutions	25.6
Secured by mortgages on immovable properties	410.8
Exposures in default	1.0
Other exposures	6.9

The Group adopted IFRS 9 ‘Financial Instruments’ on 1 January 2018 and took advantage of the transitional arrangements available under Article 473a of the CRR. The table shows the capital arrangements before and after the transitional arrangements.

Comparison of own funds and capital and leverage ratios with and without the application of transitional arrangements for IFRS 9	31 Dec 20 £m
Available capital	
Common Equity Tier (CET) 1 / Tier 1 / Total capital	33.1
Common Equity Tier (CET) 1 / Tier 1 / Total capital as if IFRS 9 transitional arrangements had not been applied	33.1
Risk-weighted assets	
Total risk-weighted assets	178.2
Total risk-weighted assets as if IFRS 9 transitional arrangements had not been applied	178.2
Capital ratios	
Common Equity Tier (CET) 1 / Tier 1 / Total capital (as a percentage of risk exposure amount)	17.2%
Common Equity Tier (CET) 1 / Tier 1 / Total capital (as a percentage of risk exposure amount) as if IFRS 9 transitional arrangements had not been applied	17.2%
Leverage ratio	
Leverage ratio total exposure measure	594.2
Leverage ratio	5.6%
Leverage ratio as if IFRS 9 transitional arrangements had not been applied	5.6%

6. Credit risk reporting

At 31 December 2020 all exposures were solely concentrated in the UK.

The residual maturity of the exposures at 31 December 2020 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	127.8	0.8	4.3	-	132.9
Multilateral development banks	-	-	-	-	-
Institutions	19.8	6.0	-	-	25.8
Secured by mortgages on immovable property	4.0	13.9	72.8	320.1	410.8
Exposures in default	0.0	-	0.0	1.0	1.0
Total	**151.6**	**20.7**	**77.1**	**321.1**	**570.5**

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 2020 were as follows:

Credit quality step	Risk Weighting	Fitch rating	Exposure value £m
1	0%/20%	AAA to AA-	145.2
2	20%/50%	A+ to A-	13.5
3	20%/50%	BBB+ to BBB-	-
4	50%/100%	BB+ to BB-	-
Unrated	20%	-	-
Total			**158.7**

6.2 Mortgage assets

The geographical distribution of mortgage asset exposures to UK customers at 31 December 2020 was as follows:

Location	Residential mortgage assets £m	Commercial mortgage assets £m	Exposures in Default £m	Total £m
East Midlands	99.4	7.8	0.2	107.4
South East	69.3	-	0.4	69.7
South West	51.5	-	-	51.5
East	45.7	-	0.2	45.9
North West	34.4	-	0.1	34.5
West Midlands	32.4	-	-	32.4
Yorkshire & Humberside	26.8	-	0.1	26.9
Wales	18.5	-	-	18.5
London	18.3	-	-	18.3
North East	6.7	-	-	6.7
Total	**403.0**	**7.8**	**1.0**	**411.8**

6.3 Encumbered assets

The Group has pledged mortgage assets as collateral with the Bank of England, in order to participate in the Bank's Term Funding Scheme (TFS) and Term Funding Scheme with additional incentives for SMEs (TFSME). Participation in the TFS and TFSME provides the Group 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 2020 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	**49.3**		**429.8**	
Loans on demand	-		56.8	
Equity instruments	-	-	-	-
Debt securities	-	-	29.2	29.2
Loans & advances other than loans on demand	49.3		328.0	
Other assets	-		15.8	

A proportion of the unencumbered other assets is not considered by the Group 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 2020 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	34.1	49.3

6.4 Impairment provisions

The Group recognises loan loss provisions on loans and advances to customers using a forward-looking expected credit loss (ECL) model.

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 ECLs requires an assessment of forward looking economic assumptions which are determined on a probability-weighted basis.

A three stage approach to loan loss provisioning is used:

- Credit risk has increased such that losses are incurred or the asset is considered credit impaired ('Non-performing loans')
- A significant increase in credit risk has occurred since origination ('Underperforming loans')
- No significant increase in credit risk since origination ('Performing loans')

The Group has characterised a loan as Non-performing when it meets any of the following criteria:

- Loan is greater than or equal to 3 months in arrears including for interest-only mortgages where the capital repayment is not made at maturity, even if monthly repayments continue; or
- Borrower is deceased or declared bankrupt.

The Group has characterised a loan as Underperforming when it meets any of the following criteria:

- A significant increase in the likelihood of default by the borrower since origination of the loan as evidenced by an external credit score;

- Loan is greater than or equal to 1 month in arrears (but less than 3 months in arrears) including for interest-only mortgages where the capital repayment is not made at maturity, even if monthly repayments continue;

- Forbearance has been applied to the loan, such as granting an interest-only period, a reduced monthly payment or a full payment holiday; or

- Other evidence of potential impairment, such as evidence that the borrower is in financial difficulty.

All other loans are classified as Performing. Provisions for Performing loans are based on an ECL over a 12 month period. Provisions for Non-performing and Underperforming loans are based on an ECL over the expected life of the loan.

In determining ECLs, the Group has considered four economic scenarios, based on different house price index and unemployment assumptions, and weighted these according to their likely occurrence. The scenarios include a Central scenario, based on the current economic environment, an Upside scenario, a Downside scenario and a Severe downturn scenario based on that used by the Bank of England to test the capital adequacy of firms within the UK banking system.

The PD, LGD and economic scenario assumptions are subject to periodic reassessment, on at least an annual basis. PD and LGD assumptions are assessed using actual arrears and loss experience for validation purposes, while economic scenario assumptions are based on external data where possible to ensure the scenarios are unbiased. Sensitivity analysis is undertaken to assess the significance of assumptions used. As a result, the following areas are considered to be the key assumptions:

- Future economic forecasts, particularly relating to changes in house prices;

- The weighting given to the different economic scenarios; and

- The extent to which the borrower credit score can reduce before it is considered to constitute a significant increase in credit risk.

In addition to the above, additional provisions may be made on an individual basis where there are significant emerging impairment characteristics, further evidence of impairment or where the standard provision calculations do not reduce the carrying value of the mortgage asset to the expected recoverable amount.

The following table details the past due exposures of the Group at 31 December 2020, with the amounts shown representing the total amount of the outstanding exposure, not just the amount that is overdue.

	Liquid assets £m	Residential mortgage assets £m	Commercial mortgage assets £m	Total £m
Performing loans				
Current and past due up to 1 month	158.7	378.0	5.7	542.4
Underperforming loans				
Current and past due up to 1 month	-	21.1	0.4	21.5
Past due 1 to 3 months	-	0.9	0.3	1.2
Non-performing loans				
Current and past due up to 1 month	-	2.3	0.5	2.8
Past due 1 to 3 months	-	0.7	0.9	1.6
Past due over 3 months (in default)	-	0.8	0.2	1.0
Total exposures	**158.7**	**403.8**	**8.0**	**570.5**

The movement in loss provisions and charges to the Income Statement for the year ended 31 December 2020 were as follows:

	Residential mortgage assets £m	Commercial mortgage assets £m	Total £m
Loss provision			
Balance at 1 January 2020	0.35	0.30	0.65
Credit for the year	(0.10)	0.10	-
Provision utilised	(0.03)	-	(0.03)
Balance at 31 December 2020	0.22	0.40	0.62
The amount recognised in the Income Statement during the year was:			
Movement in provisions (as per above)	(0.10)	0.10	-
Recoveries	-	-	-
Credit to the Income Statement	**(0.10)**	**0.10**	**-**

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 and employs the services of independent consultants at least every three years to ensure that the salary and benefits packages offered are commensurate with those available in the market place and enable the attracting and retaining of the best talent across the Group.

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 Committee has established an annual bonus scheme, which is in place in order to recognise the contribution of all staff members to the maintenance and improvement of underlying financial performance, customer outcomes and enhancements made to the Group's risk management framework and control environment and which takes into account the individual performance of staff members against their own agreed objectives. There is a grading assessment which is consistently operated across the Group and which forms part of an annual staff appraisal process. The quantum of the bonus paid is linked directly to the performance of each member of staff and to the overall performance of the Group, and is capped at a maximum of 10% of an individual's basic salary (prior to any salary sacrifice). All payments under the annual bonus scheme are made in cash and there are no deferral or clawback provisions.

The Committee had also previously established a Medium Term Incentive Plan (MTIP) for members of the Executive Team, which comprised pre-agreed targets, which were set annually and based on key performance indicators that formed part of the 2017-2019 Strategic Plan agreed by the Board. Annual payments under the MTIP, which are made in cash, are capped at 10% of an individual's basic 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. The final payment relating to the MTIP will be made in 2022. A new MTIP for 2020 and beyond has not been established.

Payments under the annual bonus scheme and MTIP, together being capped at 20% of an individual's basic salary in any one year, are also in accordance with PRA and FCA guidelines as to the extent and proportionality of the bonus payments and incentive that are considered appropriate within this type of financial institution.

Payments under both the annual bonus scheme and MTIP are discretionary, non-contractual and are not guaranteed and are subject to review and recommendation by the Committee to the Risk Committee for consideration. The latter takes account of the overall performance and capital position of the Group before it makes an onward recommendation to the Board for ultimate approval.

No annual bonus will be paid in relation to 2020. Following the approval of the new strategic plan a revised bonus scheme will be presented to the Remuneration & Nomination Committee and the Board in 2021.

Further information on the role of the Remuneration & Nomination Committee in determining remuneration policy and practice is set out in the Directors' Remuneration Report and the 'Remuneration' section of the Corporate Governance Report within the Group's Annual Report & Accounts for the year ended 31 December 2020.

7.2 Remuneration Code Staff and remuneration

The Board has determined that for the year ended 31 December 2020:

- 6 non-executive directors (one resigned in January 2020); and
- 5 members of senior management (Chief Executive Officer, Group Finance Director, Chief Risk Officer, Director of Operations and Director of IT & Change),

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 2020 is given below.

Category	**Number**	**Fixed remuneration £**	**Variable remuneration £**	**Total remuneration £**
Non-executive directors	6	182,640	-	182,640
Senior management (including executive directors)	5	896,843	11,434	908,277
Total	**11**	**1,079,483**	**11,434**	**1,090,917**

Variable remuneration shown above was earned in 2017-2019 and is due to be paid in 2021. Additional variable remuneration of £5,061.82 was earned in 2019 with payment deferred until 2022 and is subject to approval by the Committee.

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.

The document has been reviewed by both the Risk Committee and the Audit and Compliance Committee before receiving final sign off from the Board.

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