Melton
Building
Society

Pillar 3
Disclosures Document

31 December 2021

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1. Introduction

1.1 Background

The Capital Requirements Regulations (CRR) and Capital Requirements Directive (CRD) together referred to as CRD IV came into force on 1 January 2014. CRD IV provides for consistent capital adequacy standards for banks and building societies and an associated supervisory framework which is 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 under Basel III, 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. The results of this additional capital assessment are subject to review by the PRA through the Supervisory Review and Evaluation Process (SREP).

Pillar 3 Disclosure requirements for firms to publish key information about their risk assessment process and resulting capital adequacy. The external disclosures are designed to promote market discipline and raise standards through greater transparency of a firm's risk management framework and risk exposures.

1.2 Scope of application

This document sets out the Pillar 3 disclosures as at the 31 December 2021 for the Melton Mowbray Building Society (the 'Society') and two of its subsidiaries (together the 'Group') which are aggregated on a solo-consolidated basis.

The two subsidiaries, 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 of its subsidiary undertakings.

- MBS Lending Limited is a specialist mortgage lender.
- Nexa Finance Limited is 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 Limited has a wholly owned subsidiary, Nexa Lending & Security Services Limited (a company limited by guarantee) which holds the securities for the benefit of investors.

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 solo-consolidated

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 (disclosures) 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 2021.

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

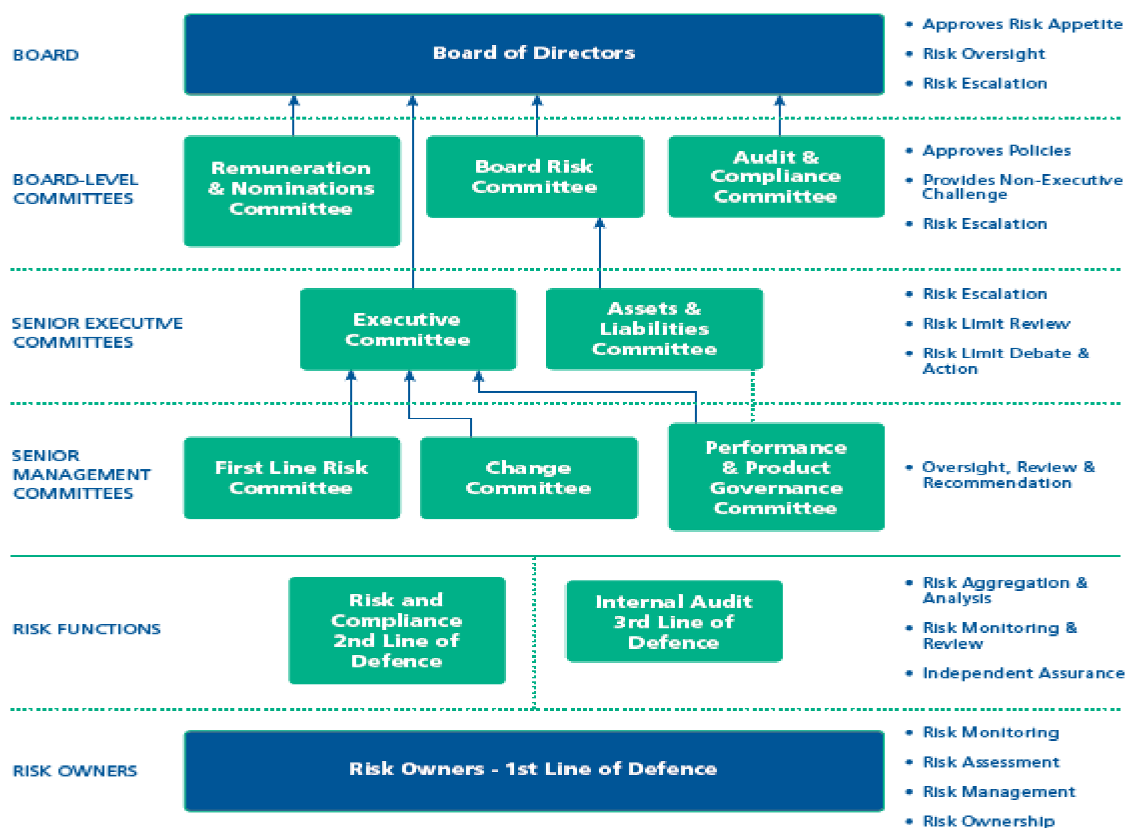
The Group has a governance framework which facilitates the identification, assessment, treatment and monitoring of risk across the Group. The key elements of the framework, which have been designed to take into consideration the Systems and Controls (SYSC) requirements contained in the PRA/FCA Rulebooks, 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 Committee structure to manage risks across the business. An organigram outlining the Committee structure is shown below:



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	
Membership	All Board members
Responsibilities	• Accountability to the members of the Society; • Establish and oversee the purpose, strategy and values of the Group and review the performance of the Group in light of these; • Approval of the Group's risk appetite and oversight of the risk management framework; • Lead, develop and oversee the Group's culture; and • Approval of the Group's ICAAP, ILAAP and Recovery Plan.
Frequency	At least 8 times per year

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)	
Membership	At least 3 Non-Executive Directors
Responsibilities	• Oversight and challenge of risk management across the Group; • Ensure the overall approach to identification, assessment, management and mitigation of risk is appropriate and undertaken in an integrated manner; • Review and recommend to the Board risk strategy, policies and risk limits in accordance with the overall risk appetite; • Detailed review of the risks and assessment included within the ICAAP, ILAAP and Recovery Plan; and • Consideration and assessment of the emergence of new risks impacting the Group.
Frequency	At least 4 times per year

Audit and Compliance Committee (ACC)	
Membership	At least 3 Non-Executive Directors
Responsibilities	• Monitor and review the integrity of the Group's financial statements and accounting policies; • Monitor and review the external auditor's independence and objectivity; • Monitor and review the effectiveness of the Group's outsourced internal audit function; • Oversee the effectiveness of the Group's control functions and policies; and • Monitor the Group's compliance with appropriate codes of governance having due regard to evolving best practice.
Frequency	At least 5 times a year

Remuneration and Nominations Committee	
Membership	At least 3 Non-Executive Directors
Responsibilities	• Oversee the development and implementation of remuneration policies; • Ensure the Directors and Senior Management have appropriate skills, experience and competencies to perform their role; and • Develop succession plans for key roles and make recommendations to the Board for the appointment of new Directors and Senior Managers.
Frequency	At least 4 times a year

Executive Committee (EXCO)	
Membership	Chief Executive, Chief Financial Officer, Chief Risk Officer, Chief Customer Officer, Director of Operations, Director of IT and Change, Chief Operations Officer (Nexa) and the Programme Director
Responsibilities	• Implement and deliver the strategy approved by the Board; • Oversight and management of operational risk, conduct risk and business risk across the Group; • Ensure the Group's risk management and control frameworks are

	operating effectively with resourcing appropriate to current business levels and expected future demands; and • Assess new initiatives and monitor major projects.
Frequency	Weekly

Assets & Liabilities Committee (ALCO)	
Membership	Chief Financial Officer, Chief Executive Officer, Chief Risk Officer, Chief Customer Officer, Director of Operations and the Head of Finance
Responsibilities	• Monitor and manage mortgage credit risk, treasury credit risk, liquidity risk, interest rate risk, pension obligation risk and specific areas of business risk consisting of all asset and liability product management, net interest margin management and capital management.
Frequency	At least 11 times a year

First Line Risk Committee	
Membership	Chief Risk Officer, Director of Operations, Head of Risk and Compliance, Head of Products, Head of Partnerships, Financial Controller, Head of IT Planning & Operations, Quality Assurance Manager, Lending Operations Manager, Mortgage Operations Manager, Retail Operations Manager and People & Development Manager
Responsibilities	• Holistically review and monitor the Enterprise Risks to which the Group is exposed; • Review and monitor output from supporting risk processes; • Review and monitor risk related management information, including key risk indicators, conduct risk management information, complaints, and incident data; and • Review and monitor output from first and second line assurance activity, including identified trends and remedial actions.
Frequency	Bi-monthly

Change Committee	
Membership	Director of IT and Change, Director of Operations, Chief Customer Officer, Chief Financial Officer, Chief Risk Officer, Head of Finance, Head of Marketing, People & Development Manager, Head of IT Planning Operations, Chief Operating Officer for Nexa.
Responsibilities	• Provide oversight, leadership, governance and assurance of all change across the Group; and • Ensure the change portfolio remains aligned to the agreed Group strategy and its timescales, investment, quality, customer and regulatory commitments.
Frequency	Bi-weekly

Performance & Product Governance Committee	
Membership	Chief Customer Officer, Chief Financial Officer, Head of Finance, Head of Marketing, Head of Intermediaries, Head of Partnerships, Head of Risk and Compliance, Head of Retail Distribution, Head of Mortgage Operations and the Lending Manager
Responsibilities	• Manage the successful delivery of the Society's income budgets with a particular focus on interest receivable and interest payable; • Cashflow management; • Trading performance of key business areas including Society, subsidiaries and partnership product lines; and • Oversight of the execution of the Product Governance Framework
Frequency	Bi-weekly

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 (ACC) 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

The Risk Governance Framework is supported by the Group's three lines of defence approach with risk responsibilities extending throughout all business areas and functions:

- **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;

- **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; and

- **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 Chair 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 Nominations Committee, EXCO and ALCO to enable it to obtain an 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: The Group regularly reviews and monitors all of the key risks to which it is exposed. The risks that are identified are recorded, managed and monitored within the Group's Governance Risk and Compliance system (GRC). First Line Risk Owners carry out regular reviews, assessing: the current probability of occurrence; the current magnitude of impact; any changes to the risk or risk environment; any new or evolving risks; and assessment of the associated controls. Second Line own and manage the GRC, ensuring that reviews are scheduled in line

with its Enterprise Risk Management Framework (ERMF) and overseeing and reporting on changes as appropriate;

- Risk monitoring: First Line Risk Owners manage and monitor their risks on a day-to-day basis including managing the business in accordance with the Group's Risk Appetite. There are 3 key sub-executive committees which help provide oversight of the management of risk in the First Line, these are: Performance and Product Governance (PPG), Change Committee and First Line Risk Committee (FLRC). The Executive Committee and the Assets and Liabilities Committee have the final oversight responsibility in their respective areas of expertise. In addition, the Incident Management Framework sets out the process for reporting and managing incidents, with impact identification and a clear escalation path. This process is managed by the Second Line within the GRC system; and

- Risk reporting: First Line Risk Owners produce regular reporting for both Executive and sub-Executive Committees on a regular basis covering Operational, Conduct, Prudential, Strategic and Credit Risk. The Chief Risk Officer (CRO) produces an independent overview of risks, including reporting on the Group's Risk Appetite metrics, details of emerging risks and movement in the Group's top risks. The Risk Committee reviews the CRO's report at each meeting. The Board also receives 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 ERMF. It clearly defines the amount and type of risks the Group is willing to take to meet its 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; and

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 2021-2024 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 in 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; and

- **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 three 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 principal risks that 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 the portfolio by lending category, mortgage arrears, forbearance, provisions analysis, ICAAP assumptions, mortgage concentration analysis, lending limit monitoring 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 report 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;

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

- 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 guarantee policies to insure the Group against the risk of lending at higher LTV ratios; and

- 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.

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 primary physical financial risk from climate change is the impact to property valuations from exposure to climate change risks including:

- Flood Risk;
- Subsidence Risk; and
- Coastal Erosion Risk

The Group also considers transitionary risks that it might be exposed to as a result of increased climate change risk.

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

3.4 Operational risk

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

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 which is 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 and Compliance team and Internal Audit function. Key decisions taken at First Line Risk Committee are reported to EXCO.

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 that oversees conduct risk, ensuring there are adequate controls implemented and that these are effective in managing conduct risk and delivering good customer outcomes. Key decisions taken at EXCO are reported to the Group's Risk Committee.

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 Strategic Plan;
- 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;
- Risk identification, monitoring and reporting in line with the Board approved Risk Management Framework;
- Regular review by the Board of key performance indicators, key risk indicators and economic data relating to all elements of the strategic plan;
- Approval by the Board of all new business initiatives following an appropriate assessment of the risks involved;
- The new product development process owned by PPG which has a reporting line in to ALCO;
- Monitoring of external markets and competitors by PPG; 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 an appropriate 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.

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).

The Group's risk appetite, policies, systems and controls relating to the management of interest rate 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.

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; and
- An increase in life expectancy and so 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 2021 by an independent actuary in accordance with International Accounting Standard 19. At 31 December 2021 the defined benefit pension scheme showed a post-tax surplus of £4.8m. Despite the surplus, the Board continues to regularly monitor the funding level of the scheme.

4. Capital resources

As at the 31 December 2021 the Group had total regulatory capital of £35.1m; this is predominately made up of Common Equity Tier 1 (CET1) capital which consists of the Group's reserves:

	31 Dec 21 £m
Common Equity Tier 1 (CET 1) Capital	
General reserves	40.7
Revaluation reserve	(0.3)
CET 1 capital before regulatory adjustments	**40.4**
CET 1 Regulatory Adjustments	
Prudent valuation adjustment	-
Intangible assets	(0.5)
Defined benefit pension asset (post-tax, based on IAS 19 accounting valuation)	(4.8)
IFRS 9 transition adjustment	-
Total Regulatory Adjustments	**(5.3)**
CET 1 Capital	**35.1**
Total Tier 1 Capital	**35.1**
Total Regulatory Capital	**35.1**
Total Risk Weighted Assets (RWA)	**219.5**
Capital Ratios and buffers	
CET 1 Ratio (as a % of RWA)	**16.0%**
Tier 1 Ratio (as a % of RWA)	**16.0%**
Total Capital (as a % of RWA)	**16.0%**

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. Pillar 1 also includes market risk but this is not relevant for a building society that does not run a trading book.

In addition to the risks covered under Pillar 1, 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%

Mortgage asset risk weightings take into account 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 2021 by exposure class:

Exposure class	**Gross credit risk exposure 31 Dec 21 £m**	**Net credit risk exposure 31 Dec 21 £m**	**Risk weighted exposures 31 Dec 21 £m**	**Capital requirement 31 Dec 21 £m**
Central governments or central banks	112.3	112.3	-	-
Multilateral development banks	-	-	-	-
Institutions	13.5	13.5	3.0	0.2
Liquid assets	**125.8**	**125.8**	**3.0**	**0.2**
Secured by mortgages on immovable property	479.2	479.2	180.1	14.3
Exposures in default	3.2	2.6	3.3	0.3
Mortgage assets	**482.4**	**481.8**	**183.4**	**14.6**
Off-balance sheet commitments (pipeline to be secured on immovable property)	59.4	17.7	10.6	0.9
Other assets	8.4	8.4	7.4	0.6
Total: Credit risk	**676.0**	**633.7**	**204.4**	**16.3**
Operational risk			**14.5**	**1.2**
Credit valuation adjustment			**0.6**	**0.1**
Total Pillar 1 capital requirement			**219.5**	**17.6**
Pillar 2A capital requirement				**-**
Total Capital Requirement				**17.6**
Total capital resources (section 4)				**35.1**
Surplus of capital resources over Pillar 1 + 2A capital requirement				**17.5**

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 7.1. At 31 December 2021 the notional value of the derivatives was £105.3m, the risk weighted exposure of the derivatives was £0.6m and the replacement cost of the derivatives with a positive market value was £1.2m.

The difference between total gross credit risk exposures shown above of £676.0m and total assets per the Group's balance sheet of £622.3m in the Annual Report & Accounts for the year ended 31 December 2021 is shown below.

Reconciliation of Gross Credit Risk Exposures to Total Assets per Balance Sheet	**31 Dec 21 £m**
Total gross credit risk exposures (as shown in table above)	676.0
Less: Individual impairment provisions held against mortgage assets	(0.7)
Off-balance sheet commitments	(59.4)
Derivatives (potential future credit exposure)	(0.4)
Investment in subsidiary outside the scope of regulatory consolidation	(0.1)
Add: Defined benefit pension asset before tax	6.4
Intangible assets	0.5
Total assets per the Group's balance sheet	**622.3**

5.3 Capital buffers

Capital Conservation Buffer

Along with all other UK financial institutions the Group is required to hold a Capital Conservation Buffer (CCoB). The CCoB can be used to absorb losses during periods of economic and financial stress to avoid breaching minimum capital requirements. The CCoB is set as a percentage of the RWAs and is 2.5% as at the 31 December 2021.

Countercyclical Buffer

The Group is required to hold a countercyclical buffer (CCyB) depending on the geographical breakdown of its assets. The CCyB is set by individual country and is designed to increase resilience by requiring additional capital to be held. The requirement is calculated by multiplying the total credit risk exposure by the buffer rate for that country and totalling the result.

The Group's assets are wholly located in the United Kingdom (UK) and the CCyB is set by the Bank of England's Financial Policy Committee (FPC), and can range from 0% to 2.5%. At 31 December 2021 the UK's CCyB was 0%.

Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer.

			Own funds requirements				
	General credit exposures	**Trading book exposures**	**Of which: General credit exposures**	**Of which: Trading book exposures**	**Total**	**Own funds requirement weights**	**Counter-cyclical capital buffer rate**
Breakdown by country	**£m**	**£m**	**£m**	**£m**	**£m**	**%**	**%**
United Kingdom	633.7	-	16.3	-	16.3	100%	0%
Total	**633.7**	**-**	**16.3**	**-**	**16.3**	**100%**	**0%**

The table below shows the amount of institution specific CCyB as at the 31 December 2021

	31 Dec 21
Total risk exposure amount (£m)	**204.4**
Institution specific countercyclical buffer rate (%)	0.0%
Institution specific countercyclical capital buffer requirement (£m)	-

The CCyB will increase to 1% effective from the 13 December 2022 as agreed at the Financial Policy Committee (FPC) meeting in December 2021.

5.4 Capital and Leverage ratios

At 31 December 2021, the Group's Total Capital Requirement set by the Prudential Regulation Authority was £17.6m (8.00% of total risk weighted exposures), with £17.6m relating to Pillar 1 (8.00% of total risk weighted exposures,) and £nil 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 2021 was £35.1m, representing 16.0% 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 2021 are shown below.

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

	31 Dec 21 £m
Total assets as per published financial statements	622.3
Adjustment for entities outside the scope of regulatory consolidation	0.1
Adjustments for derivative financial instruments	0.4
Adjustment for off-balance sheet items	17.7
Other adjustments (defined benefit pension scheme asset and intangible assets)	(7.0)
Leverage ratio total exposure measure	**633.7**

Table LRCom: Leverage ratio common disclosure

	31 Dec 21 £m
On-balance sheet items (excluding derivatives and Securities Financing Transactions (SFTs), but including collateral)	622.3
Asset amounts deducted in determining Tier 1 capital	(6.8)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**615.5**
Replacement cost associated with all derivatives transactions	1.2
Add-on amounts for PFE associated with all derivatives transactions	0.4
Total derivative exposures	**1.6**
Off-balance sheet exposures at gross notional amount	59.4
Adjustments for conversion to credit equivalent amounts	(41.7)
Total off-balance sheet exposures	**17.7**
Tier 1 capital	**35.1**
Leverage ratio total exposure measure	**633.7**
Leverage ratio	**5.5%**

Table LRSpl: Split-up of on-balance sheet exposures (excluding derivatives and SFTs)	31 Dec 21 £m
Total on-balance sheet exposures (excluding derivatives and SFTs)	**615.5**
Of which:	
Exposures treated as sovereigns	112.3
Institutions	13.5
Secured by mortgages on immovable properties	479.2
Exposures in default	2.6
Other exposures	7.9

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 21 £m
Available capital	
Common Equity Tier (CET) 1 / Tier 1 / Total capital	35.1
Common Equity Tier (CET) 1 / Tier 1 / Total capital as if IFRS 9 transitional arrangements had not been applied	35.1
Risk-weighted assets	
Total risk-weighted assets	204.4
Total risk-weighted assets as if IFRS 9 transitional arrangements had not been applied	204.4
Capital ratios	
Common Equity Tier (CET) 1 / Tier 1 / Total capital (as a percentage of risk exposure amount)	16.0%
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	16.0%
Leverage ratio	
Leverage ratio total exposure measure	633.7
Leverage ratio	5.5%
Leverage ratio as if IFRS 9 transitional arrangements had not been applied	5.5%

6. Credit risk reporting

At 31 December 2021 all exposures were solely concentrated in the UK.

The residual maturities of the exposures at 31 December 2021 were 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	108.1	0.8	3.4	-	112.3
Multilateral development banks	-	-	-	-	-
Institutions	12.5	1.0	-	-	13.5
Secured by mortgages on immovable property	7.1	19.7	78.8	373.6	479.2
Exposures in default	-	-	-	2.6	2.6
Total	**127.7**	**21.5**	**82.2**	**376.2**	**607.6**

In addition to the exposures above, Treasury credit risk exposures also arise from counterparties in respect of derivative financial instruments which are used to hedge exposure to interest rate risk. Note 13 in the Group's Annual Report & Accounts 2021 provides full details of the Group's use of off-balance sheet instruments including the fair value of financial instruments. All the Group's derivative financial instruments are bilateral in nature and transacted Over-the-Counter (OTC).

All the Group's derivative transactions are governed by agreements based on the International Swaps and Derivatives Association (ISDA) documentation which are supported by a Credit Support Annex (CSA). The CSA governs the process of mitigating credit risk by detailing the frequency and movement of collateral between the Group and the swap counterparty.

Derivative exposures are calculated using the mark to market method as described in the CRR. Counterparty limits are inclusive of any such exposures.

Table: CCR1	Replacement cost	Potential Future Exposure	Exposure at default	Risk weighted assets
	£m	£m	£m	£m
Mark to market	1.2	0.4	1.6	0.6

The Group does not currently centrally clear its derivatives and therefore the risk weighting includes a credit valuation adjustment to reflect this.

Table CCR2: CVA capital charge	31 Dec 21
	£m
All portfolios subject to the standardised method	1.6
Total subject to the CVA capital charge	**1.6**

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 2021 were as follows:

Credit quality step	Risk Weighting	Fitch rating	Exposure value £m
1	0%/20%	AAA to AA-	122.3
2	20%/50%	A+ to A-	3.5
3	20%/50%	BBB+ to BBB-	-
4	50%/100%	BB+ to BB-	-
Unrated	20%	-	-
Total			**125.8**

6.2 Mortgage assets

The geographical distribution of mortgage asset exposures to UK customers at 31 December 2021 was as follows:

Location	Residential mortgage assets £m	Commercial mortgage assets £m	Exposures in Default £m	Total £m
East Midlands	100.6	7.8	1.8	110.2
South East	82.0	-	0.2	82.2
South West	67.5	-	-	67.5
East	61.8	-	0.3	62.1
North West	37.6	-	0.2	37.8
West Midlands	35.0	3.6	0.1	38.7
Yorkshire & Humberside	31.9	0.5	-	32.4
Wales	25.1	-	-	25.1
London	17.0	-	-	17.0
North East	8.8	-	-	8.8
Total	**467.3**	**11.9**	**2.6**	**481.8**

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 with additional incentives for SMEs (TFSME). Participation in 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 2021 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	**126.6**		**487.3**	
Loans on demand	-		133.4	
Equity instruments	-	-	-	-
Debt securities	-	-	7.0	7.0
Loans & advances other than loans on demand	126.6		332.9	
Other assets	-		14.0	

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 2021 are shown below. The Group has encumbered more assets than it receives in funding because counterparties require a buffer against potential non-performance of some of the encumbered assets.

	Matching liabilities, contingent liabilities or securities lent £m	Assets and collateral received encumbered £m
Carrying amount of selected financial liabilities	75.0	126.6

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); and
- 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:

- The loan is greater than or equal to three 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;
- The loan is greater than or equal to one month in arrears (but less than three 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 changes, unemployment assumptions and GDP, 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 2021 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	125.8	450.9	0.8	577.5
Underperforming loans				
Current and past due up to 1 month	-	13.0	11.2	24.2
Past due 1 to 3 months	-	0.9	-	0.9
Non-performing loans				
Current and past due up to 1 month	-	1.3	-	1.3
Past due 1 to 3 months	-	1.1	-	1.1
Past due over 3 months (in default)	-	1.4	1.2	2.6
Total exposures	**125.8**	**468.6**	**13.2**	**607.6**

The movements in loss provisions and charges to the Income Statement for the year ended 31 December 2021 were as follows:

	Residential mortgage assets £m	**Commercial mortgage assets £m**	**Total £m**
Loss provision			
Balance at 1 January 2021	0.22	0.40	0.62
Credit for the year	(0.12)	0.26	0.14
Provision utilised	-	(0.06)	(0.06)
Balance at 31 December 2021	0.10	0.60	0.70
The amount recognised in the Income Statement during the year was:			
Movement in provisions (as per above)	(0.12)	0.26	0.14
Recoveries	-	-	-
Credit to the Income Statement	**(0.12)**	**0.26**	**0.14**

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).

7.1 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 as follows: 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.

The table below shows the Group's sensitivity to this measure (in terms of economic value):

	+2% shift in interest rates £m	**-2% shift in interest rates £m**
31 December 2021	(0.474)	0.474

In addition to the risk appetite, the Board has set individual and cumulative gap limits for each time period analysed.

7.2 Basis risk

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, reserve account deposits with the Bank of England and TFSME funding;

- 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 – managed (or administered) rate mortgages and savings products.

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.

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.

8. Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people, financial crime, the Group's IT systems, information security or from other external events. The Group mitigates operational risk through a robust and effective internal control environment as part of its Risk Management Framework. In addition, insurance is used to transfer some areas of operational risk.

8.1 Minimum capital requirements for operation risk

The Group calculates its operational risk capital requirement using the Basic Indicator Approach (BIA). This is calculated as 15% of the Society's net income averaged over the previous three years.

	31 Dec 21
	£m
Three years prior	7.554
Two years prior	7.605
Prior year	8.039
Basic Indicator (3 year average)	7.733
Own funds requirement (15% Basic Indicator)	1.160

In addition, the Group assesses the potential additional capital requirement by assessing the impact of individual risks or a combination of risks crystallising under different scenarios.

9. 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 an appropriate 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 as a minimum;

- 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 ensuring, on a day to day basis, adherence 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;

- 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; and

- 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 Recovery 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;
- Cash flow forecasts (12 months);
- Forthcoming liquid asset maturities; and
- Forthcoming wholesale borrowing maturities

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

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 2021.

Quarter ending on	**31 Mar 2021**	**30 Jun 2021**	**30 Sep 2021**	**31 Dec 2021**
Liquid Assets Buffer (£m)	124.0	122.5	117.4	112.4
Total Net Cash Outflows (£m)	27.9	21.9	21.9	19.2
Liquidity Coverage Ratio (%)	444.8%	560.4%	536.3%	586.0%

10. Remuneration disclosures

10.1 Remuneration policy

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

The Group Remuneration Policy has a number of key principles:

- Attract and retain directors and senior managers with the right skills and competencies by offering a fair and competitive total reward benchmarked against the external market;
- Recognise the importance of total reward including benefits and flexible working in attracting, engaging and retaining a diverse and talented workforce;
- Recognise the business benefits of promoting diversity and inclusion;
- Reward colleagues based on both the Group and individual performance with a focus on demonstrating the right behaviours in carrying out their performance;
- Ensure good and effective risk management and promote the highest standards of professional conduct; and
- Take into account the Group's strategic and business plans ensuring that the objectives and long term interests, including maintaining a strong capital base, are not compromised.

Executive Directors' and senior managements' remuneration reflects the individuals' specific responsibilities, experience and performance and comprises a number of elements, including basic salary, pension, annual bonus and other taxable benefits as details below:

Component	Level	Basis
Basic Salary	Set annually following review by the Remuneration and Nominations Committee.	Based on job specific responsibilities using financial services market benchmarking for similar roles.
Pension	Contribution of 10% of base salary (before salary sacrifice) in line with contributions for all colleagues, or paid as a cash allowance as an alternative.	Executive directors are invited to join the Group's defined contribution scheme.
Annual Bonus	The annual bonus will only be awarded if the minimum threshold criteria are achieved linked to delivery of the Group's strategic objectives. On target performance will result in a bonus award of 20% of base salary with the ability to earn up to a maximum of 30% for overall	Variable pay is linked to the delivery of the Group's strategic objectives with both financial and non-financial targets alongside individual performance to safeguard against poor conduct or risk-taking outside appetite. The Board Risk Committee has a

	performance. 50% of any bonus awarded in the year is deferred for three years.	power of veto over any variable remuneration payments. They may be reduced or withdrawn if there is an item of material importance or relevance that has a significant negative influence on the regulatory status, financial performance or financial statements of the Society.
Other benefits	The Group provides other taxable benefits including a car allowance and health care provision.	Set at a level considered appropriate for each Executive Director by the Committee in line with market practice.

The Chair and Non-Executive Directors (NEDs) each receive an annual fee for their services which reflect the time commitment and responsibilities of their roles and is commensurate with those paid by other Societies of a similar size and structure. Fees are structured such that NEDs with additional responsibly of chairing a board committee or being a director of a subsidiary board are paid an additional fee. They do not receive any salary, performance incentives or pension.

NEDs are reimbursed for reasonable expenses incurred during the course of their work on Group business.

The Society's Rules limit NED remuneration to 2.5 x the annual salary of the lowest paid full-time clerical employee.

2021 Performance and awards

The Chair's Statement, Chief Executive's Review and Strategic Report in the Group's Annual Report and Accounts describe 2021 as a year of strong financial performance and strategic progression against a background of continued uncertain public health and economic environments.

It is in this context that performance related pay awards to all staff have been determined. The detail for performance related pay to Executive Directors is set out in the Directors' Remuneration report of the Group's Annual Report & Accounts.

Further information on the role of the Remuneration & Nominations 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 2021.

10.2 Remuneration code staff

The Board has determined that for the year ended 31 December 2021:

- Six non-executive directors; and
- Seven members of senior management (Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Chief Customer Officer, Director of Operations, Director of IT & Change and Chief Operating Officer (Nexa))

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 Remuneration Code Staff for the year ended 31 December 2021 is given below.

Category	Number	Fixed remuneration £	Variable remuneration £	Total remuneration £
Non-executive directors	6	206,529	-	206,529
Senior management (including executive directors)	7	1,124,615	255,888	1,380,503
Total	**13**	**1,331,144**	**255,888**	**1,587,032**

Variable remuneration shown above was earned in 2021 with 50% of the payment deferred until 2024.

11. 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.

Appendix - Non-performing and forborne exposures

Table 1: Credit quality of forborne disclosures

£m	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment		Collateral received and financial guarantees received on forborne exposures	
	Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures	Total	Of which: received on non-performing exposures
		Total	Of which: defaulted	Of which: impaired				
Loans and advances	**0.8**	**0.3**	**-**	**0.3**	**0.1**	**-**	**-**	**-**
Households	0.5	0.3	-	0.3	-	-	-	-
Commercial	0.3	-	-	-	0.1	-	-	-
Loan commitments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**0.8**	**0.3**	**-**	**0.3**	**0.1**	**-**	**-**	**-**

Table 2: Credit quality of performing and non-performing exposures

£m	Gross carrying amount / nominal amount											
	Performing exposures			Non-performing exposures								
	Total	**Not past due or past due ≤ 30 days**	**Past due > 30 days ≤ 90 days**	**Total**	**Unlikely to pay that are not past due or are past due ≤ 90 days**	**Past due > 90 days ≤ 180 days**	**Past due > 180 days ≤ 1 year**	**Past due > 1 year ≤ 2 years**	**Past due > 2 years ≤ 5 years**	**Past due > 5 years ≤ 7 years**	**Past due > 7 years**	**Of which defaulted**
Loans and advances	**606.2**	**604.6**	**1.6**	**3.2**	**0.3**	**1.4**	**1.5**	**-**	**-**	**-**	**-**	**1.3**
Central banks	112.3	112.3	-	-	-	-	-	-	-	-	-	-
Credit institutions	14.7	14.7	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	12.1	12.1	-	1.8	-	0.7	1.1	-	-	-	-	1.3
Of which: SMEs	12.0	12.0	-	0.8	-	0.3	0.5	-	-	-	-	0.7
Households	467.1	465.5	1.6	1.4	0.3	0.7	0.4	-	-	-	-	-
Off-balance sheet exposures	**59.8**			**-**								
Credit institutions	0.4			-								
Non-financial corporations	9.5			-								
Households	49.9			-								
Total	**666.0**	**604.6**	**1.6**	**3.2**	**0.3**	**1.4**	**1.5**	**-**	**-**	**-**	**-**	**1.3**

Table 3: Performing and non-performing exposures and related provisions

£m	Gross carrying amount / nominal value					Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures		Performing exposures – accumulated impairment and provisions			Non-performing exposures accumulated impairment and provisions		On performing exposures	On non-performing exposures
		Of which stage 1	Of which stage 2		Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 3		
Loans and advances	**606.2**	**592.2**	**14.0**	**3.2**	**3.2**	**0.3**	**0.2**	**0.1**	**0.4**	**0.4**	**-**	**-**
Central banks	112.3	112.3	-	-	-	-	-	-	-	-	-	-
Credit Institutions	14.7	14.7	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	12.1	12.1	-	1.8	1.8	0.2	0.2	-	0.4	0.4	-	-
Of which: SME's	12.0	12.0	-	0.8	0.8	-	-	-	0.3	0.3	-	-
Households	467.1	453.1	14.0	1.4	1.4	0.1	-	0.1	-	-	-	-
Off balance sheet exposures	**59.8**	**59.7**	**0.1**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Credit institutions	0.4	0.4	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	9.5	9.5	-	-	-	-	-	-	-	-	-	-
Households	49.9	49.8	0.1	-	-	-	-	-	-	-	-	-
Total	**666.0**	**651.9**	**14.1**	**3.2**	**3.2**	**0.3**	**0.2**	**0.1**	**0.4**	**0.4**	**-**	**-**

Table 4: Collateral obtained by taking possession and execution processes

£m	Collateral obtained by taking possession	
	Value at initial recognition	Accumulated negative changes
Property, plant and equipment (PP&E)	-	-
Other than PP&E	-	-
Residential immoveable property	-	-
Commercial immovable property	-	-
Total	-	-