Marsden Building Society

Pillar 3 Disclosure

31 December 2017

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1 Overview

1.1 Background

The European Union Capital Requirements Directive (CRD) came into effect on 1 January 2007. This introduced both consistent capital adequacy standards and a common supervisory framework in the European Union (EU).

This was replaced by the Capital Requirements Regulation (CRR, 575/2013) and Capital Requirements Directive (CRD, 2013/36/EU), together known as CRD IV, on 1 January 2014.

CRD IV consists of three 'Pillars' detailed within the table below:

PILLAR 1	PILLAR 2	PILLAR 3
Minimum Capital Requirements	Supervisory Review Process	Disclosure

Pillar 1 sets out regulatory minimum capital requirements for credit, operational and market risk.

Pillar 2 involves the Supervisory Review and Evaluation Process to assess whether Pillar 1 Requirements are sufficient and whether additional capital should be held in Pillar 2.

Pillar 3 involves Disclosure requirements designed to promote market discipline through disclosure of key information about risk exposures and risk management processes.

1.2 Scope of Application, Basis and Frequency of Disclosures

This document sets out the Pillar 3 Disclosures for Marsden Building Society in accordance with the requirements of Part VIII of the CRR and the Society Pillar 3 Disclosure Policy.

This disclosure document applies only to Marsden Building Society (FRN 206050). All figures within this document are correct as at 31 December 2017 unless otherwise stated. Disclosures are issued on an annual basis, unless more frequent disclosure is deemed as warranted by the Board, and published in conjunction with the Annual Report and Accounts.

These disclosures have been reviewed by the Society's Board and are published on the Society Website (www.themarsden.co.uk). These disclosures are not subject to external audit except where they are equivalent to those prepared under accounting requirements for inclusion within the Annual Accounts.

1.3 Changes to Disclosure Requirements

The Society continues to develop its disclosures to ensure they are as clear and informative as possible. As outlined above the CRR and CRD, together known as CRD IV, were implemented on 1 January 2014. CRD set disclosure requirements for Financial Institutions, which are included within this document or the annual report and accounts as appropriate.

2 Risk Management

2.1 Risk Management Framework

2.1.1 Purpose

The Society is committed to establishing and maintaining a framework to:

[1] identify, assess and report on the risks facing its business
[2] embed the framework in the Society's day to day management and governance processes and
[3] maintain a sound system of internal control to mitigate these risks and protect the interests of members and the assets of the Society.

2.1.2 Risk Management Strategic Principles

To effectively manage risk requires an appreciation of the likelihood and consequences of a risk being realised as well as the conscious action to reduce the exposure to the risk to the extent that:

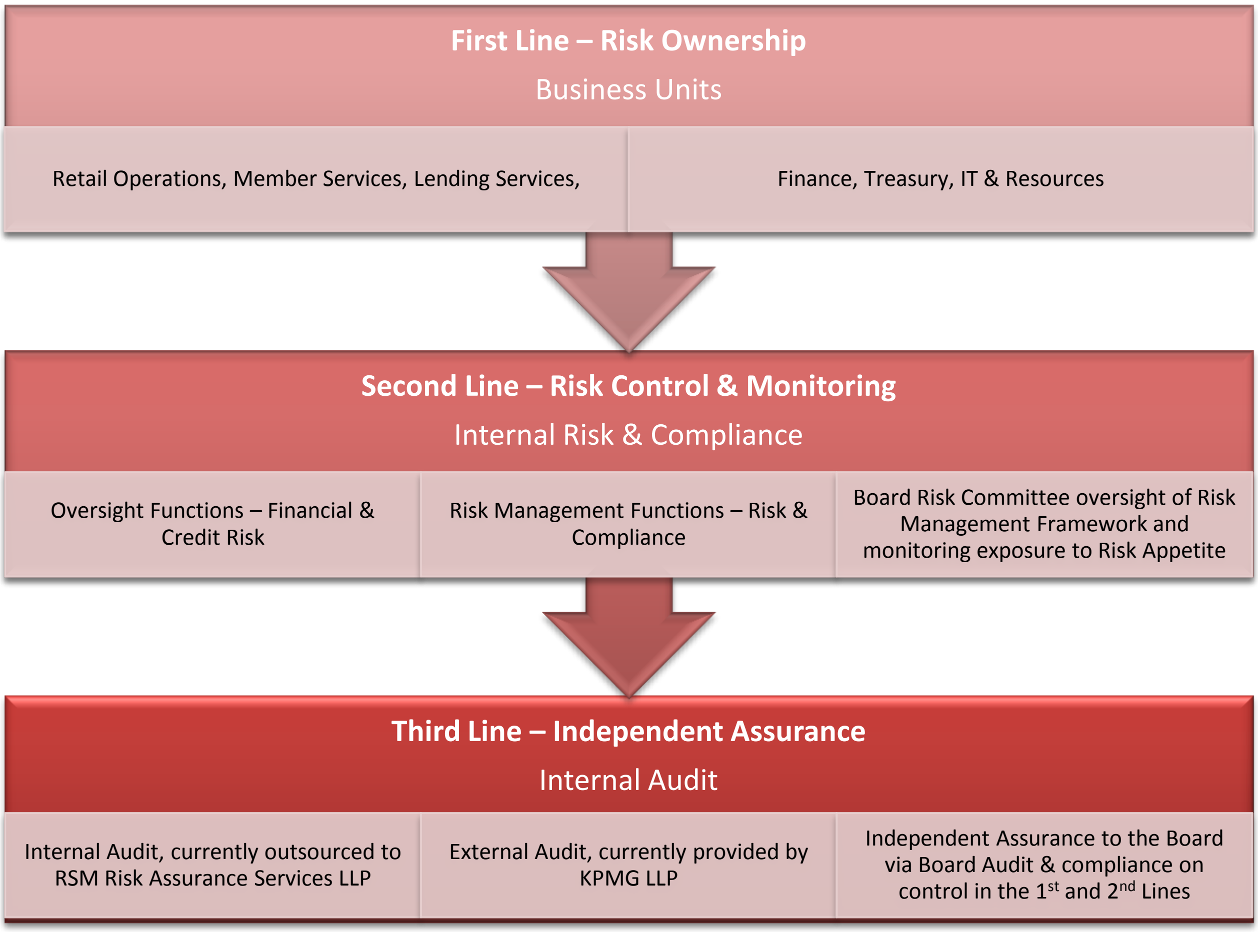
- it is cost effective to do so;
- Members' interests are best-served;
- There is a statutory obligation to do so

To effectively manage risk, the Society:

- Incorporates appropriate effective techniques to pursue its goals and objectives
- Does not carry unnecessary risks – it does not engage in activities where the residual risk exceeds Society's capacity to maintain its core services to its members
- Defines its risk management requirements in simple, clear terms and communicates this to all staff
- Adopts a systematic, clear approach to the identification, evaluation and assessment of risks associated with business activities
- Considers risks throughout its operations including strategic, financial and operational risks, Reputational Risk not being classified specifically given it is viewed as an effect of crystallisation of all types of risk.
- Develops a clear statement of risk appetite, expressed in a common language to provide clear guidance for decision making, act as a constraint on risk and a basis for monitoring where risk increases through early warning signals & triggers
- Considers appropriate strategies to:
  - reduce the risk e.g. by improving systems and controls
  - reduce the likelihood of the risk e.g. through early warning mechanisms
  - reduce the consequences of the risk e.g. by contingency planning
  - transfer the risk to third parties e.g. by insurance or outsourcing
- Identifies and allocates clear lines of responsibility for the management and reporting of risk within a 'Three Lines of Defence' model
- Provides relevant and appropriate risk information to monitor performance
- Conducts independent assessments of the efficiency and effectiveness of the risk management and control processes adopted across the Society
- Requires the Board (at least annually) to conduct a review of the effectiveness of the Society's system of internal control and to report to the members that it has done so

2.1.3 Three Lines of Defence Model

The risk management framework is based on a 'Three Lines of Defence' model as summarised below:



The first line of defence is management within the business which through implementation of the Society risk framework is accountable for identification, assessment and management of risk.

The second line of defence is comprised of independent risk functions, in the case of the Society the Risk and Compliance Functions. These functions are accountable for challenging and guiding the business in managing risk exposure. These functions are represented on various risk committees detailed overleaf which feed up to the Board Risk Committee, which is responsible for oversight of the risk management framework and monitoring risk profile against Board Risk Appetite

The third line of defence, currently provided by RSM Risk Assurance Services LLP, provides independent assurance to the Board, via the Board Audit and Compliance Committee of the adequacy and effectiveness of systems and controls in the first and second lines in identifying and managing risk

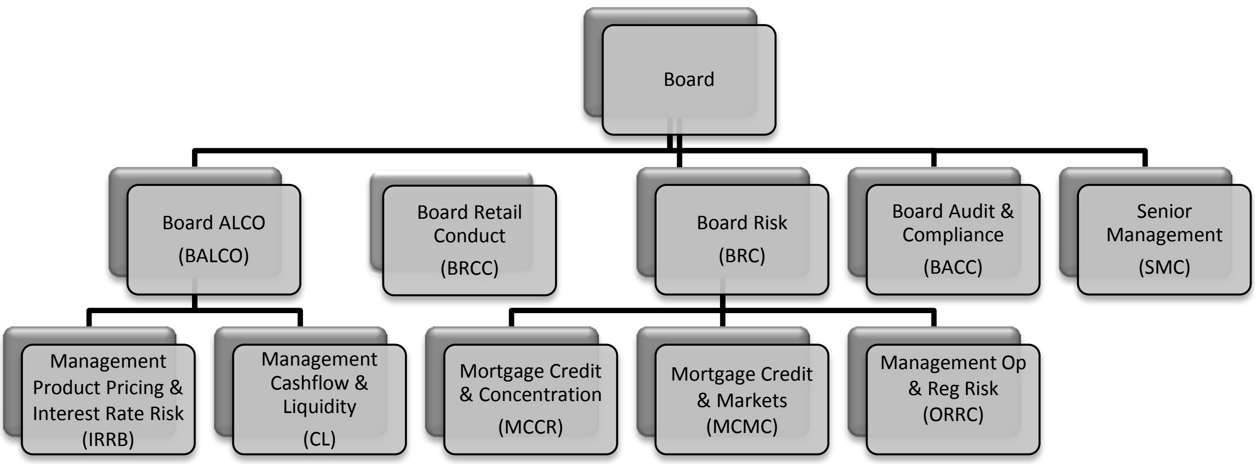
2.2 Risk Governance Structure

2.2.1 Board of Directors

The Board of Directors has overall responsibility for the Society's internal control system and for reporting its effectiveness to the members in the annual financial statements. The Board is also responsible for defining and influencing the culture of risk management across the Society including:

[1] Determining the Society's appetite for risk;
[2] Determining which types of risk are acceptable and which are not;
[3] Providing guidance to management on conduct and probity.
[4] Review and approval of the Society Internal Capital Adequacy Assessment Process (ICAAP), ILAAP (Individual Liquidity Adequacy Assessment Process) and Recovery and Resolution Plan (RRP)

The Board has overall responsibility for ensuring the Society maintains adequate financial resources, both in terms of capital and liquidity, through review and approval of both the Society Internal Capital Adequacy Assessment Process (ICAAP) and ILAAP (Individual Liquidity Adequacy Assessment Process). The Board monitors the role of Management in identification, monitoring and review of major risks facing the Society through the following Committee Structure, further details of which are provided overleaf:



2.2.2 Board Risk Committee

Responsible for ensuring that both the entire risk management framework and monitoring and oversight of significant risk positions are effective and advising the Board on overall and local risk appetite

2.2.3 Board, Audit and Compliance Committee

Responsible for ensuring that monitoring of the effectiveness of systems and controls over the whole risk universe, in particular control over significant risks, is effective.

2.2.4 Board Assets & Liabilities Committee

Responsible for monitoring significant Financial Risks and Market Counterparty Credit Risks including all types of Interest Rate Risk, Credit Risk (Market Counterparty), Liquidity Risk and Concentration Risk (Non Mortgage).

2.2.5 Board Retail Conduct Committee

Responsible for monitoring Conduct Risks.

2.2.6 Senior Management Committee

The management committee responsible for monitoring and review of strategic risks prior to review at Board. Meets once monthly.

2.2.7 Mortgage Credit & Markets Committee

The management committee responsible for monitoring both existing and new credit markets. Meets as required.

2.2.8 Mortgage Credit & Concentration Risk Committee

The management committee responsible for monitoring and review of mortgage credit and concentration risks prior to review at the Board Risk Committee. Meets monthly.

2.2.9 Operational & Regulatory Risk Committee

The management committee responsible for monitoring and review of operational and regulatory risks prior to review at the Board Risk Committee. Meets monthly.

2.2.10 Interest Rate Risk & Product Pricing Committee

The management committee responsible for monitoring and review of product pricing and interest rate risk prior to review at the Board Risk Committee. Meets monthly.

2.2.11 Cashflow & Liquidity Risk Committee

The management committee responsible for maintaining a rolling cashflow forecast and monitoring and review of liquidity prior to review at the Board Assets & Liabilities Committee. Meets once weekly.

3 Capital Resources

3.1 Regulatory Capital

As outlined in Section 1 above on 1 January 2014 the Capital Requirements Regulation (CRR) and Capital Requirements Directive, together known as CRD IV, came into effect. Society Capital Resources are the same on transition as on full CRD IV end point definitions. At 31 December 2017 the Capital Resources of the Society are broken down as follows:

	Amount (£m)
Common Equity Tier 1 Capital (CET 1)	
General Reserves	36.905
Available for Sale Reserve	0.000
Intangible Assets	(0.154)
Total Tier 1	36.751
Tier 2 Capital	
Collective Impairment Provisions	0.514
Total Tier 2 Capital	0.514
Total Tier 1 and Tier 2 Capital (Total Capital)	37.265

3.2 Reconciliation of Regulatory Capital

	Amount (£m)
Total Reserves in the Statement of Financial Position	
General Reserves	36.905
Available for sale Reserve	0.000
Total Reserves	36.905
Intangible Assets	(0.154)
Collective Impairment Provisions	0.514
Regulatory Capital	37.265

4 Capital Requirements

4.1 Approach to assessment of adequacy of capital

Internal capital is held to protect the solvency of the Society. Capital is required not only to meet the Society's business requirements, cover unexpected and possible losses but also to ensure that sufficient regulatory capital is available to satisfy the Society's obligations. Accordingly, the Society needs to generate and retain a sufficient profit to add to the General Reserve which becomes the main source of capital. The Society utilises a five year Business Plan, the content of which is reviewed at least annually by the Board, taking account of changes in the business and economic environment. The plan establishes strategic and business objectives. It is an essential part of this process to ensure that the Society has sufficient financial and non-financial resources to meet these objectives.

The Society's Internal Capital Adequacy Assessment Process (ICAAP) ensures that the capital resources of the Society are sufficient to support its Business Plan both in normal and stressed conditions. The process reviews objectives and projects the capital requirement for all material risks, both in normal and stressed conditions, over the planning period. This ensures that the potential risk and associated capital requirements are consistent with the capital resources available. The ICAAP is submitted to the Board for approval with the necessary supporting stress testing. Having regard to the projected capital requirement within the ICAAP and Individual Capital Guidance provided by the Prudential Regulation Authority (PRA), the Board sets an internal limit for the minimum amount of regulatory capital. This limit is in excess of the level required by the PRA providing a further amount of capital above the required level.

4.2 Credit Risk Capital Requirement

The Society adopted the Standardised Approach to calculation of credit risk weightings from 1 January 2008, the Board having reviewed the requirements to implement the Internal Ratings Based approach to credit risk and concluded that the cost to the Society of complying with the requirements currently exceeds any possible benefit.

Credit risk using the standardised approach is assessed using the following formula:

Credit risk capital requirement = exposure value x the risk weight (depending on type of asset, counterparty, maturity, security and LTV) x 8%. The table overleaf shows the minimum capital requirement for credit risk by exposure class.

Exposure Class	Asset (£m)	Risk Weighted Asset (£m)	Capital (£m)
Statement of Financial Position:			
Treasury Assets			
Central Government/Central Banks	79.493	-	-
Regional Governments/Local Authorities	-	-	-
Institutions	6.423	1.285	0.103
Total Treasury Assets	**85.916**	**1.285**	**0.103**
Real Estate, Retail and Past Due Assets			
Residential Real Estate - Performing	377.802	132.432	10.594
Retail (Secured by Real Estate Collateral)	3.154	2.365	0.189
Residential Real Estate - Past Due	0.364	0.364	0.029
Commercial Real Estate – Performing	3.207	3.207	0.256
Commercial Real Estate – Past Due	0.332	0.332	0.027
Total Real Estate, Retail and Past Due Assets *1	**384.859**	**138.700**	**11.095**
Other Assets			
Other Items	2.575	2.420	0.194
Total Other Assets	**2.575**	**2.420**	**0.194**
Total Statement of Financial Position	**473.350**	**142.405**	**11.392**
Off Balance Sheet:			
Institutions (Derivatives)	0.069	0.031	0.003
Secured on Real Estate (Pipeline)	16.969	0.078	0.006
Total Off Balance Sheet	**17.038**	**0.109**	**0.009**
Total Exposure Value	**490.388**	**142.514**	**11.401**

*1 Assets are gross of general loss provisions of £0.514m at 31 December 2017

4.3 Operational Risk Capital Requirement

The Society uses the Basic Indicator Approach (BIA) for the calculation of capital required to cover Operational Risk under Pillar 1. Operational Risk Capital Requirement = Net Interest and Net Non-interest income over the past three accounting periods x 15% x 8%. The Society's minimum capital requirement for Operational Risk under the basic indicator approach is:

	Capital Resources Requirement – Operational Risk (£m)
Basic Indicator Approach	0.984

4.4 Credit Valuation Adjustment (CVA) Capital Requirement

Under the CRR, credit institutions and investment firms are required to hold additional own funds due to CVA risk arising from Over The Counter (OTC) derivatives. The charge is applicable to derivatives not subject to centralised clearing or a credit support annex. Derivatives entered into by the Society in the past were negotiated on the basis they were not subject to clearing or credit support and are currently in a negative mark to market position and are anticipated to remain so. Accordingly the Society plans to allow this exposure to trade out over time given there is no material credit risk to the Society unless regulatory requirements compel the Society to do otherwise.

An overview of the CVA capital requirement is detailed below:

Exposure Class	Asset (£m)	Risk Weighted Asset (£m)	Capital (£m)
CVA Risk	-	0.847	0.068

4.5 Pillar 1 plus Pillar 2A Capital Resource Requirement

The minimum capital resource requirement under Pillar 1 is determined by adding the credit risk capital requirement to the operational risk capital requirement detailed above. Pillar 2A capital resource requirement is set by the PRA following the Supervisory Review and Evaluation Process (SREP) of the Society ICAAP.

The following table shows the minimum Pillar 1 plus Pillar 2A Capital Resource Requirement relative to Capital Resources at 31 December 2017

Pillar 1 Capital Resource Requirement	(£m)
Credit Risk	11.401
Operational Risk	0.984
Market Risk	-
CVA Risk	0.068
Total Pillar 1 Capital Resource Requirement	**12.453**
Pillar 2A Capital Resource Requirement	**1.599**
Total Pillar 1 plus Pillar 2A Capital Requirement (Individual Capital Guidance (ICG))	**14.052**
Capital Resources	37.265
Excess of Capital Resources over Pillar 1 plus Pillar 2A Capital Resource Requirement	**23.213**

In terms of quality of capital Article 92 of the Capital Requirements Regulations require a Core Tier 1 requirement of 4.5% (56%), a Total Tier 1 requirement of 6% (75%) and a Total Capital Ratio of 8% (25%) Society is required to hold a minimum of £7.904m in Core Equity Tier 1 Capital, a minimum of £10.539m in Tier 1 Capital (including the minimum CET1 plus £2.635m Tier 1) and a maximum of £3.513m in Tier 2 Capital. Regulatory Capital held by the Society at the balance sheet date was £37.265m of which £36.751m was CET1 and £0.514m Tier 2, well in excess of Individual Capital Guidance.

Credit risk, the risk of loss arising from the failure of customers or counterparties to meet their obligations to the Society, is of paramount importance. The total credit risk exposure is £490.388m. This reconciles to the Annual Report and Accounts as follows:

	£m
Exposure Amount as per Basel II	**490.388**
Less:	
Off Balance Sheet Derivatives	(0.069)
Off Balance Sheet Pipeline	(16.969)
Statement of Financial Position exposure as per Basel II	**473.350**
Less:	
General Mortgage Loss Provisions	(0.514)
Total Society Assets as at 31 December 2016	**472.836**

The exposures in each asset class as at 31 December 2017 and average exposures held in each asset class during the financial year is detailed below.

Exposure Class	Total Asset (£m)	Average Asset (£m)
Statement of Financial Position:		
Treasury Assets		
Central Government/Central Banks	79.493	59.799
Regional Governments/Local Authorities		-
Institutions	6.423	7.781
Total Treasury Assets	**85.916**	**67.620**
Real Estate, Retail and Past Due Assets		
Residential Real Estate - Performing	377.802	363.517
Retail (Secured by Real Estate Collateral)	3.154	1.943
Residential Real Estate - Past Due	0.364	0.151
Commercial Real Estate – Performing	3.207	3.294
Commercial Real Estate – Past Due	0.332	0.275
Total Real Estate, Retail and Past Due Assets	**384.859**	**369.180**
Other Assets		
Other Items	2.575	2.433
Total Other Assets	**2.575**	**2.433**
Total Statement of Financial Position	**473.350**	**439.233**
Off Balance Sheet:		
Institutions (Derivatives)	0.069	0.049
Secured on Real Estate (Pipeline)	16.969	17.433
Total Off Balance Sheet	**17.038**	**17.482**
Total Exposure Value	**490.388**	**456.715**

4.6 Asset Encumbrance

The Society has pledged part of its loan book as collateral with the Bank of England, in order to participate in the both the Sterling Monetary Framework and other schemes such as the Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS). These schemes provide the Society with an additional source of funding. Although the loans remain fully owned and administered by the Society they are classified as encumbered.

Details of encumbered and unencumbered assets and sources of encumbrance using median values of quarterly data during the 12 months preceding 31 December 2017 and, as a result, may differ from other information provided in this disclosure.

Overview of Encumbered and Unencumbered Assets	Encumbered Assets		Unencumbered Assets	
	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Assets of the Reporting Institution	47.059	-	388.034	-
Loans on demand	-	-	63.162	-
Equity Instruments	-	-	-	-
Debt securities	-	-	-	-
Loans and advances other than on demand	47.059	-	322.205	-
Other Assets	-	-	2.667	-

Sources of Encumbrance	Matching Liabilities, contingent liabilities or securities lent	Assets and collateral received encumbered
Carrying amount of selected financial liabilities	25.476	47.558

4.7 Leverage Ratio

The CRD IV framework requires firms to calculate a simple, transparent, non-risk based leverage ratio that is supplementary measure to the risk-based capital requirements.

The ratio is defined as the Capital Measure divided by the Exposure Measure, with this ratio expressed as a percentage.

The capital measure for the leverage ratio is Tier 1 capital from the risk-based capital framework as defined in paragraphs 49 to 96 of the Basel III framework (see table in Section 3.1), taking account of the transitional arrangements.

The Exposure measure is the total on and off balance sheet exposures less the deductions applied to Tier 1 capital as per Basel III December 2010 requirements. In January 2014 the Basel Committee on Banking Supervision (BCBS) published a revised definition for calculating the leverage ratio which requires off-balance sheet items e.g. commitments, to be converted into credit exposure equivalents through the use of credit conversion factors (CCFs) resulting in reduced exposure measure. Therefore, the table below also shows the Society leverage ratio according to this revised Basel Committee of Banking Supervisors (BCBS) definition.

Leverage	Amount (£m)
Total Tier 1 Capital	36.751
Capital Measure	36.751
Statement of Financial Position (less intangible assets)	473.196
Post Offer Mortgage Commitments	1.676
Retentions	0.107
Derivatives	0.069
Exposure Measure	475.048
Leverage Ratio	7.74%

As Society Capital Resources are the same on transition as on full CRD IV end point definitions the Leverage Ratio under both transitional and full implementation of CRD IV Rules is the same.

At the 31 December 2017 the leverage ratio of the Society was well above the 3% regulatory minimum at 7.74%.

The Society will continue to operate at a level considerably in excess of the regulatory minimum.

5 Risk Management Objectives and Policies

5.1 Overview

5.2 Credit & Concentration Risk

5.2.1 Mortgage Credit & Concentration Risk

The Society is exposed to the risk that mortgagors will fail to meet their obligations as they fall due which results in a potential loss following enforcement of the loan and realisation of the mortgage security and related additional security.

The principal driver of credit risk in relation to mortgage lending remains a slowdown in the UK economy leading to higher unemployment and falling house prices which would result in increased arrears and impairment losses. Whilst the economy continues to improve the ratio of house prices to earnings continues to deteriorate, particularly in London and the South East. Due to its lending criteria the Society is not active in lending in London with lending diversified across the rest of the UK.

Risk control and mitigation is exercised by the following means:

- All mortgage loans are manually underwritten according to a Board approved Lending Policy
- The performance of the loan portfolio is monitored closely with action taken to manage the collection and recovery process
- All portfolios are subject to periodic stress testing to ensure the remain within the quantified risk appetite of the Board

5.2.1.1 Geographic Concentration Risk

A high level exposure to a single borrower or a particular type of loan may create a concentration risk. The Society's lending portfolio is heavily concentrated on residential mortgages representing a product concentration risk.

The Marsden is a regional Society but ensures that lending is spread across England and Wales to avoid any high level local concentrations. A detailed analysis of lending by region is set out below. The geographic distribution of assets secured by real estate as at 31 December 2017, separated by material industry type and including details of mortgages past due, is detailed below. A loan is past due when it 3 months or more in arrears.

Loans Secured on Residential Property

Geographical Area	Performing (£000)	Past Due (£000)	Total (£000)
North	16,671	226	16,897
Yorkshire & Humberside	35,871	95	35,966
North West	66,821	53	66,874
East Midlands	27,667	46	27,713
West Midlands	27,897	-	27,897
East Anglia	14,110	-	14,110
South West	40,315	-	40,315
South East	88,329	-	88,329
Greater London	46,704	-	46,704
Wales	16,265	-	16,265
Scotland	-	-	-
Northern Ireland	-	-	-
UK	380,650	420	381,070

Loans Secured on Commercial Real Estate

Geographical Area	Performing (£000)	Past Due (£000)	Total (£000)
North	508	-	508
Yorkshire & Humberside	320	-	320
North West	2,563	715	3,278
East Midlands	-	-	-
West Midlands	-	-	-
East Anglia	-	-	-
South West	-	-	-
South East	-	-	-
Greater London	-	-	-
Wales	-	-	-
Scotland	-	-	-
Northern Ireland	-	-	-
UK	3,391	715	4,106

5.2.1.2 Maturity Analysis

A residual maturity breakdown of combined exposures to loans secured on real estate and past due loans as at 31 December 2017 is detailed below:

	(£m)
In not more than 3 months	2.948
In more than 3 months but not more than one year	8.296
In more than 1 year but not more than 5 years	57.125
In more than 5 years	317.115
	385.484
Less: provisions	(1.139)
Total	**384.345**

5.2.1.3 Provisioning

Provisions for losses are based upon an appraisal of loans, advances and other assets.

	Loans Secured on Residential Property (£m)	**Other Loans Fully Secured on Land (£m)**	**Total (£m)**
At 01 January 2017			
Individual Impairment	0.025	0.563	0.588
Collective Impairment	0.452	0.016	0.468
Total	**0.477**	**0.579**	**1.056**
Written Off			
Individual Impairment	-	-	-
Collective Impairment	-	-	-
Total	**-**	**-**	**-**
Movement			
Individual Impairment	0.033	4	37
Collective Impairment	0.046	-	46
Total	**0.079**	**4**	**83**
At 31 December 2017			
Individual Impairment	0.058	0.567	0.625
Collective Impairment	0.498	0.016	0.514
Total	**0.556**	**0.583**	**1.139**

Individual provisions of £0.625m have been utilised to adjust downwards the value of the exposure used in capital calculations.

At each reporting date, the Society assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

- significant financial difficulty of the borrower or issuer;
- default or delinquency by a borrower;
- breach of contract or terms;

- the restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise, including forbearance granted to the borrower or issuer;
- indications that a borrower or issuer will enter bankruptcy;
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuer in the Society, or economic conditions that correlate with defaults in the Society; or
- Any other information discovered during regular review suggesting a risk of loss in the short to medium term.

The Society considers evidence of impairment for loans and advances at both a specific asset and a collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

In assessing collective impairment, the Society uses relevant peer group experience for comparable groups of assets due to the lack of a material amount of historical trends of probability of default, the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by peer group experience. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset’s original effective interest rate. In considering expected future cashflow, account is taken of any discount required against the value of the security at the statement of financial position date thought necessary to achieve as sale, anticipated foreclosure timing, anticipated realisation costs and amounts recoverable under mortgage indemnity policies.

Loans and advances in the statement of financial position are shown net of provisions, individual and collective. The charge or credit to the income statement comprises the movement in the provisions together with the losses written off in the year.

5.2.2 Market Counterparty Credit & Concentration Risk

The Society is exposed to the risk that Market Counterparties will fail to meet their obligations as they fall due and subsequently default resulting in a loss. Credit risk arises primarily from the lending of liquid assets, entering into interest rate swaps with or insuring risks with financial institutions.

Since the financial crisis there has been a shift away from unsecured lending towards secured funding and retail funding. Prudential regulation requires that regulatory liquidity is held in high quality liquid assets reducing risk exposure. Due to a range of prudential regulatory reforms the health of the UK Banking System has improved however the risk of counterparty default remains.

Risk control and mitigation is exercised by the following means:

- Liquidity invested according to a Board approved policy and risk appetite
- A significant majority of liquidity is invested with the Bank of England and UK Government Treasury Bills
- Limited short term deposits with approved Bank and Building Society counterparties domiciled and authorised in the UK

5.2.2.1 External Credit Assessment Institutions (ECAI's)

The Society has nominated Fitch Ratings as its External Credit Assessment Institution (ECAI).

Fitch Ratings are applied to the following standardised credit risk exposure classes:

- Central Government/Central Banks
- Regional Governments/Local Authorities
- Institutions

A summary of the credit risk exposure at 31 December 2017, including both on and off balance sheet exposures, associated with each of the six credit quality steps is detailed below:

Credit Quality Step	Fitch Rating	Central Government (£m)	Local Authorities (£m)	Banks (£m)	Building Societies (£m)	Total (£m)
1	AAA to AA-	79.493	-	0.614	-	80.107
2	A+ to A-	-	-	1.763	-	1.763
3	BBB+ to BBB-	-	-	4.115		4.115
4	BB+ to BB-	-	-	-	-	-
5	B+ to B-	-	-	-	-	-
6	CCC+ and below	-	-	-	-	-
Unrated	-	-	-	-	-	-
Total		**79.493**	**-**	**6.492**	**-**	**85.985**

The Society has no credit quality exposures within credit quality steps 4 to 6. Unrated exposures are limited to unrated UK building societies.

5.2.2.2 Geographic Concentration Risk

The distribution of Treasury Assets by exposure class as at 31 December 2017 is detailed below:

Geographical Area	Central Government/ Central Banks (£m)	Regional Government/ Local Authorities (£m)	Institutions (£m)	Total (£m)
United Kingdom	79.493	-	6.492	85.985
European Union (excl .UK)	-	-	-	-
Non European Union	-	-	-	-
Total	**58205**	**-**	**6.492**	**85.985**

5.2.2.3 Maturity Analysis

A residual maturity breakdown of exposures to Credit Institutions as at 31 December 2017 is detailed below:

	(£m)
Repayable on Demand	6.423
In not more than 3 months	-
In more than 3 months but not more than one year	-
Total	**6.423**

5.3 Other Financial Risks

5.3.1 Interest Rate Risk in the Banking Book

IRRB is the adverse impact on the Society's future cashflows arising from changes in interest rates including:

- Economic Value (NPV) – The risk to the capital value of Society as a result of changes in interest rates.
- Earnings Risk (NII) – The risk to profitability of the Society as a result of changes in interest rates.
- Basis Risk – The risk to profitability arising from non-parallel movement in net exposures to different interest rate bases.
- Optionality – The risk to profit arising from provision of embedded optionality in products such as early prepayment or access with or without penalty.

The Society is exposed to this risk as a retailer of financial instruments, mainly in the form of mortgage and savings products and the investment of both liquid assets and wholesale borrowing. Risk control and mitigation is exercised by the following means:

- The risk is either managed on balance sheet or through interest rate swaps in a manner consistent with the Building Societies Act 1986
- Interest rate risk is managed within a Board Approved Financial Risk Management Policy
- The Board has set out clear quantified statements of risk appetite for each aspect of Interest Rate Risk

The Society ensures compliance with risk appetite through monitoring interest rate risk exposure by the Board Assets and Liabilities Committee with the following metrics:

- Economic Value +/-200bps with +/-100bps and 300bps parallel yield curve shift and 4 non parallel shifts in the yield curve
- Earnings +/-100bps with +/-200bps and 300bps static earnings at risk over a 12m period

In addition to this a range of variations in different interest rate bases outside the control of the Society are stressed, including LIBOR and Bank Rate Exposures. Balance sheet composition is also monitored to determine the extent to which the Society maintains control over the level of interest rates across the balance sheet through administered rate mortgages and savings balances.

The Society's sensitivity to an increase in market rates assuming no non-parallel movement in yield curves, deviation from base behavioural prepayment assumptions and a constant financial position.

Sensitivity of reported reserves to +200bps interest rate movement (economic value)	£000
At 31 December 2017	**53**
Average for the period	**(365)**
Maximum for the period	**53**
Minimum for the period	**(684)**

Sensitivity of projected net interest income to +100bps interest rate movement (earnings)	£000
At 31 December 2017	**426**
Average for the period	**316**
Maximum for the period	**426**
Minimum for the period	**263**

The Society only deals with products denominated in sterling so is not directly affected by currency risk. Society products are also only interest orientated products so are not exposed to other pricing risks.

5.3.2 Liquidity Risk

Liquidity risk is the risk that the Society, though solvent, either does not have sufficient financial resources available to enable it to meet its obligations when they fall due, or can secure them only at excessive cost. These obligations include share and deposit balances and mortgage lending commitments.

Risk control and mitigation is exercised by the following means:

- Continuous forecasting of cashflow requirements and assessment of retail and wholesale funding risk.
- The required amount, quality and type of liquid assets required to ensure obligations can be met at all times is maintained in accordance with the Liquidity and Funding Policy and Board Risk Appetite
- Periodic stress testing is performed to ensure obligations can be met in both normal and stressed circumstances.

The Liquidity Coverage ratio is a measure designed to ensure a common reporting standard for banks and building societies under the European Capital Requirements Regulation (CRR) and a key component of liquidity regulation under CRD IV.

The measure is designed to ensure that banks and building societies have sufficient high quality unencumbered liquid assets to meet a stressed liabilities outflow over a 30 day time horizon.

High Quality Assets are stocks of assets which can quickly be converted into cash within the market and have an appropriate reduction in value under the measure to recognise realisation and the qualifying stock is known as the Liquidity Buffer.

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

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

Liquidity Coverage Ratio %	31-Mar-17 (£m)	30-Jun-17 (£m)	30-Sep-17 (£m)	31-Dec-17 (£m)
Liquidity Buffer	70.711	73.092	72.846	75.069
Total Net Cash Outflows	12.214	12.429	14.337	13.738
Liquidity Coverage Ratio %	578.9%	588.1%	508.10%	546.4%

5.3.3 Pension Risk

The Society contributes to a defined contribution group personal pension scheme which is open to contracted employees over eighteen years of age. The Scheme is funded separately through a life assurance company and the funding is independent of the Society's finances. The Society's contributions are charged against profits in the year in which they are made.

The Society pays to certain pensioners amounts outside of the Society pension scheme. The cost of these pensions is provided for in the provision for liabilities.

5.4 Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The scope of operational risks includes legal and regulatory, financial crime, business continuity, information technology, people and resources, process and conduct.

The principal operational risks facing the Society are fraud, unauthorised disclosure of customer data, provision of inappropriate advice to consumers, non-compliance with regulation, key person risk and business interruption.

Risk control and mitigation is exercised by the following means:

- Risks and controls are reviewed periodically with a report on the significant operational risks to the Board Risk Committee (BRC).
- In respect of regulatory risks, the Society has an independent compliance function which monitors compliance with existing legislation, controls implemented to ensure compliance and the impact of new requirements.

6 Remuneration

A risk arises if the Society's remuneration policies and practices could result in staff being rewarded for decisions inconsistent with the Board's risk appetite. It is therefore the Society's policy on remuneration to seek to ensure that its remuneration decisions are in line with effective risk management.

The Society seeks to ensure that its remuneration decisions are in line with its business strategy and long term objectives, and consistent with the Society's current financial condition and future prospects. It also seeks to establish an appropriate balance between the fixed and variable elements of remuneration. The level of variable remuneration paid is based on criteria set by the Board each year linked to the overall performance of the Society including both business and risk management objectives. Guaranteed incentive payments do not form part of any remuneration package and all incentive schemes are non-contractual.

Information concerning the mandate of the Remuneration Committee and the decision-making process it uses in determining the remuneration policy for the executive directors and the rest of the Senior Management Team (SMT), and, information on the link between pay and performance, is contained in the Directors' Remuneration Report in the Society's Annual Report and Accounts 2017.

From 1 January 2011, the Society came within the scope of the Remuneration Code. On the same date, BIPRU 11 was amended to require the publication of aggregate remuneration data for senior managers and members of staff whose actions have a material impact on the risk profile of the Society (Code Staff). This includes executive and non-executive directors.

The following table sets out the aggregate quantitative remuneration for code staff for the period 1 January 2017 to 31 December 2017 and the number of beneficiaries.

Staff Type	Number	Fixed Remuneration	Variable Remuneration	Total Remuneration
Non-executive Directors	6	161,418	-	161,418
Executive Directors	2	355,767	50,151	405,918
Other SMT	6	421,733	33,512	455,245
Total	14	938,918	83,663	1,022,581

In the case of the Executive Directors and other members of the SMT, fixed remuneration includes pension contributions made by the Society on behalf of the employees, and the value of taxable benefits.

7 Contacts

Should you have any questions please contact Neal Walker, Finance Director and Chief Risk Officer at n.walker@themarsden.co.uk.