Marsden Building Society

Pillar 3 Disclosure

31 December 2020

CONTENTS

Executive Summary

Key metrics	31 December 2020 (£m)	31 December 2019 (£m)
Available Capital		
Common Equity Tier 1 (CET1)	42.142	40.356
Tier 2	0.433	0.454
Total Capital	42.575	40.810
Total Risk Weighted Assets	218.669	189.160
Capital Ratios		
CET1 Ratio	19.27%	21.33%
Total Capital Ratio	19.47%	21.57%
Leverage Ratio		
Leverage Ratio Exposure Measure	641.706	578.331
Leverage Ratio	6.57%	6.98%
Liquidity Coverage Ratio		
Total High Quality Liquid Assets (HQLA)	82.846	89.703
Total Net Cash Outflow	21.116	19.087
Liquidity Coverage Ratio	392.3%	470.0%

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 2020 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 Strategic Overview

The Society defines risk as the possibility that events will occur that adversely affect the achievement of strategy and business objectives.

The Society is committed to managing risk in line with statutory/regulatory requirements, to enable the Board to discharge their obligations under the UK Corporate Governance Code in respect of principal risks, to the extent that member's interests are best served and it is cost effective to do so. The Society seeks to adopt and build on industry best practise wherever possible, and to manage risk in a way that reinforces, and ensures delivery of, the Society's values: making lasting positive impressions, sustainable decision making, passion, teamwork and accountability.

2.1.2 Risk Management Strategic Principles

To effectively manage risk, the Society:

- Sets out a clear statement of risk appetite to provide clear guidance on the level of risk to which the Society is willing to be exposed, aligning this to the business objectives and strategy;
- Implement, where appropriate, limits (for example lending and financial risk limits) to ensure that activities are undertaken within risk appetite;
- Considers opportunities to take risks where this is within appetite and where there is appropriate reward or benefit to members;
- Promotes a risk aware culture. Defining risk management requirements in simple, clear terms and communicating this to all staff;
- Utilises a range of risk treatment options including controls designed to reduce a risk's likelihood and/or consequences, insurance and outsourcing; and
- Includes the management of risk amongst the criteria for assessing performance and setting remuneration for all employees;

2.1.3 Three Lines of Defence Model

All staff are responsible for the management of risk within the Society. Within this, the Society operates an industry best practice "three lines of defence" model:

First Line of Defence:

The first line of defence “owns” the risk and is responsible for:

- The identification, assessment and management of risk within the Society;
- Implementing actions and controls to ensure the effective management of risk on a day-to-day basis;
- Ensuring compliance with the risk management framework and associated policies;
- Ensuring that all activities are undertaken within risk appetite;
- Undertake risk assessments and quality assurance; and
- Implement corrective actions to address deficiencies and any control breakdowns.

Second Line of defence:

The second line of defence is comprised of the Society’s Risk and Compliance functions who are responsible for:

- Independent oversight and challenge on the management of risk by the first line.
- Setting and maintaining the risk management framework and associated policies
- Setting out and gaining Board approval for risk appetite and associated limits
- Providing risk reporting to senior management and the Board
- Ensuring compliance with applicable laws and regulations

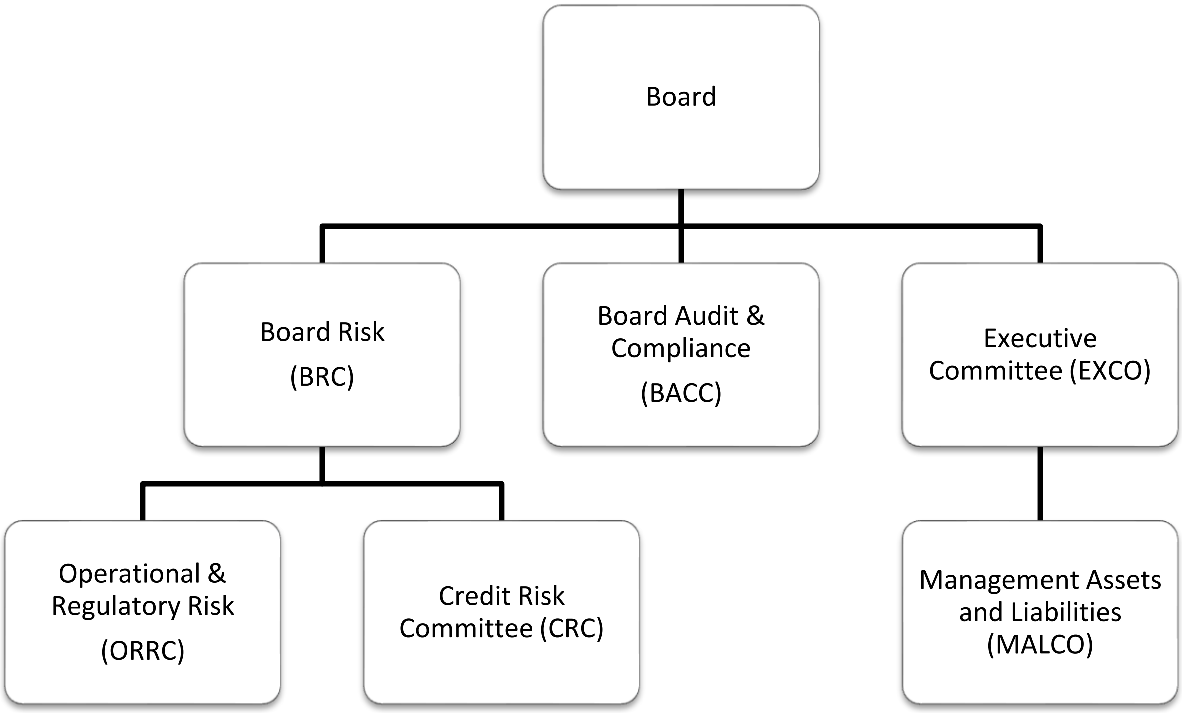
Third line of defence:

The third line of defence, currently provided by RSM as outsourced provider of internal audit services to the Society, provides independent assurance to the Board of the adequacy and effectiveness of systems and controls via the Board Audit & Compliance Committee.

2.2 Risk Governance Structure

2.2.1 Board of Directors

The Board of Directors is responsible for overall risk management and internal control, and for reporting on both to members in the annual financial statements. Also responsible for determining which types of risk are acceptable and which are not; defining appetite; fostering an appropriate risk culture; and approving the Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment Process (ILAAP) and Recovery Planning. 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 below:



2.2.2 Board Committees

2.2.2.1 Board Risk Committee

Responsible for the risk management framework, monitoring and oversight of significant risk positions and advising the Board on overall and local risk appetite. Reviews and recommends to the Board in relation to the Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment Process (ILAAP) and Recovery Planning.

2.2.2.2 Board, Audit and Compliance Committee

Responsible for ensuring the integrity of financial reporting and reviewing significant financial reporting judgements contained in them, systems of internal control, the internal and external audit process, compliance with applicable laws and regulations and the Society's ethical and business standards and conduct.

2.2.3 Management Committees

2.2.3.1 Executive Committee

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

2.2.3.2 Assets & Liabilities Committee

The management committee responsible for identifying, managing and controlling all of the Society's balance sheet risks and capital management in executing its chosen business strategy. Balance sheet risks are managed by setting limits, monitoring exposures and implementing controls across the dimensions of capital, credit, funding, liquidity and interest rate risk.

2.2.3.3 Credit Risk Committee

Responsible for reviewing changes in the credit risk profile of the Society, discussing and, where appropriate, recommending changes to lending policy.

2.2.3.4 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.

2.3 Principal Risk Overview

The table below lists sets out the risks faced by the Society:

Risk	Description	Reference
Strategic (including, change competition and concentration risk	Strategic risks are those risks that are most consequential to the organisation's ability to execute its strategies and achieve its business objectives. These are the risk exposures that can ultimately affect member value or the viability of the organisation.	Section 5.1 Page 17
Climate Change	Risks arising from the impacts of climate change, through either long-term shifts in the climate or as a result of transitioning to a low carbon economy.	Section 5.1 Page 17
Credit	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 risk that Market Counterparties will fail to meet their obligations as they fall due and subsequently default resulting in a loss.	Section 5.2 Pages 18-22
Interest Rate	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 the 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	Section 5.3 Page 23
Liquidity	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. This includes funding and asset encumbrance risks	Section 5.4 Pages 24-25
Capital	The risk that the Society is holding insufficient levels of capital.	Sections 3 & 4 Pages 11-17
Pension	The risk that the Society will be required to provide additional funds to meet its obligations due to a change in actuarial assumptions	Section 5.5 Page 25
Operational & Business Continuity	The risk of loss resulting from inadequate or failed internal processes and systems. The risk of suffering disruption to business or incurring loss as a result of failure to implement effective controls to enable ongoing operations before and during execution of disaster recovery.	Section 5.6 Page 26
Cyber, Information Security & Information Technology	The risk of i) harm to the Society as a result of breaches of, or attacks on, information systems. Ii) loss of data due to inadequate security arrangements iii) failure to achieve business objectives attributable to the use, ownership, operation, involvement, influence and adoption of IT within the Society including performance/availability, system/project delivery and realisation of benefits/enabling efficiency/enabling access to markets	Section 5.7 Page 26

Conduct	Any action, either by the Society or staff, that leads to customer detriment or has an adverse impact on market stability or effective competition. “The wrong products ending up in the wrong hands and the detriment to people of not being able to get access to the right products”	Section 5.8 Page 26
Financial Crime & Fraud	Risks associated with; i) criminals using the financial system to facilitate illegal activities. For example, money laundering, human trafficking or terrorist financing; ii) either internal or external fraud	Section 5.6 Page 26
People & Resources	The risk of failure to achieve business objectives attributable to key person dependencies, insufficient or inappropriately skilled staff.	Section 5.6 Page 26
Legal & Regulatory	The potential for negative publicity or public perception to have an impact on the Society.	Section 5.6 Page 26
Supply Chain	The risk of not selecting appropriate supply chains in line with company values or that suppliers/service providers do not deliver to required standards or timetables.	Section 5.6 Page 26
Model Risk	The potential for adverse consequences to arise as a result of decisions based on either incorrect or misused model outputs.	Section 5.6 Page 26

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 2020 the Capital Resources of the Society are broken down as follows:

	2020 (£m)	2019 (£m)
Common Equity Tier 1 Capital (CET 1)		
General Reserves	42.242	40.475
Intangible Assets	(0.100)	(0.119)
Total Tier 1	42.142	40.356
Tier 2 Capital		
Collective Impairment Provisions	0.433	0.454
Total Tier 2 Capital	0.433	0.454
Total Tier 1 and Tier 2 Capital (Total Capital)	42.575	40.810

3.2 Reconciliation of Regulatory Capital

	2020 (£m)	2019 (£m)
Total Reserves in the Statement of Financial Position		
General Reserves	42.242	40.475
Total Reserves	42.242	40.475
Intangible Assets	(0.100)	(0.119)
Collective Impairment Provisions	0.433	0.454
Regulatory Capital	42.575	40.810

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 Total Capital Requirement (TCR)

The TCR is set by the Society's regulator as part of the Supervisory Review and Evaluation Process (SREP). The requirement comprises of a variable capital requirement as a proportion of risk weighted assets (RWA's) and a fixed element. The table below sets out the Society's TCR.

All figures £m unless indicated otherwise	2020	2019
Risk Weighted Assets (RWA)		
Credit Risk RWA	198.013	172.263
Operational Risk RWA	17.549	15.862
Credit Valuation Adjustment RWA	3.107	1.035
Total Risk Weighted Assets	218.669	189.160
Capital Requirements		
Pillar 1 Variable Capital Requirement	8.00%	8.00%
Pillar 2 Variable Capital Requirement	0.00%	0.00%
Pillar 2 Fixed Capital Requirement	0.167	0.167
Total Capital Requirement (TCR)	17.660	15.300
Capital Resources		
Total Capital Resources	42.575	40.810
Excess over Capital Requirements	24.915	25.510

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% (100%). The Society is required to hold a minimum of £9.8890m in Core Equity Tier 1 Capital (2019: £8.568m), a minimum of £13.245m in Tier 1 Capital (including the minimum CET1 plus £3.356m Tier 1) and a maximum of 4.415m in Tier 2 Capital (2019: £11.475m Tier 1 and £3.825m Tier 2). Regulatory Capital held by the Society at the balance sheet date was £42.575m of which £42.142m was CET1 and £0.433m Tier 2, well in excess of Individual Capital Guidance (2019: £40.810m of which £40.357m CET1 and £0.453m Tier 2).

4.3 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 below 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	82.849	-	-
Institutions	6.675	1.335	0.107
Total Treasury Assets	**89.524**	**1.335**	**0.107**
Real Estate, Retail and Past Due Assets			
Residential Real Estate - Performing	542.293	189.802	15.184
Retail (Secured by Real Estate Collateral)	1.712	1.284	0.103
Residential Real Estate - Past Due	1.435	1.435	0.115
Commercial Real Estate – Performing	0.896	0.896	0.071
Commercial Real Estate – Past Due	0.000	0.000	0.000
Total Real Estate, Retail and Past Due Assets *1	**546.336**	**193.417**	**15.473**
Other Assets			
Other Items	3.124	3.024	0.242
Total Other Assets	**3.124**	**3.024**	**0.242**
Total Statement of Financial Position	**638.984**	**197.776**	**15.822**
Off Balance Sheet:			
Institutions (Derivatives)	0.205	0.075	0.006
Secured on Real Estate (Pipeline)	25.061	0.162	0.013
Total Off Balance Sheet	**25.266**	**0.237**	**0.019**
Total Exposure Value	**664.250**	**198.013**	**15.841**

*1 Assets are gross of general loss provisions of £0.433m at 31 December 2020

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 £664.250m. This reconciles to the Annual Report and Accounts as follows:

	£m
Exposure Amount as per Basel II	**664.250**
Less:	
Off Balance Sheet Derivatives	(0.205)
Off Balance Sheet Pipeline	(25.061)
Statement of Financial Position exposure as per Basel II	**638.984**
Less:	
General Mortgage Loss Provisions	(0.433)
Total Society Assets as at 31 December 2020	**638.551**

The exposures in each asset class as at 31 December 2020 and average exposures held in each asset class during the financial year is detailed below.

Exposure Class	2020 Total Asset (£m)	2020 Average Asset (£m)	2019 Total Asset (£m)	2019 Average Asset (£m)
Statement of Financial Position:				
Treasury Assets				
Central Government/Central Banks	82.849	82.270	91.870	86.743
Institutions	6.675	6.895	7.486	6.829
Total Treasury Assets	**89.524**	**89.165**	**99.356**	**93.572**
Real Estate, Retail and Past Due Assets				
Residential Real Estate - Performing	542.293	505.671	469.072	446.529
Retail (Secured by Real Estate Collateral)	1.712	1.738	2.376	3.430
Residential Real Estate - Past Due	1.435	0.903	0.548	0.379
Commercial Real Estate – Performing	0.896	0.973	1.121	1.126
Commercial Real Estate – Past Due	0.000	0.000	0.000	0.000
Total Real Estate, Retail and Past Due Assets	**546.336**	**509.285**	**473.117**	**451.464**
Other Assets				
Other Items	3.124	2.927	3.196	3.359
Total Other Assets	**3.124**	**2.927**	**3.196**	**3.359**
Total Statement of Financial Position	**638.984**	**601.377**	**575.669**	**548.395**
Off Balance Sheet:				
Institutions (Derivatives)	0.205	0.129	0.071	0.067
Secured on Real Estate (Pipeline)	25.061	24.066	26.789	22.829
Total Off Balance Sheet	**25.266**	**24.195**	**26.860**	**22.896**
Total Exposure Value	**664.250**	**625.572**	**602.529**	**571.291**

4.4 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:

All figures £m unless indicated otherwise	2020	2019
Three years prior	8.648	7.316
Two years prior	9.416	8.648
Prior year	10.014	9.416
Basic Indicator (3 year average)	9.359	8.460
Own funds requirement (15% Basic Indicator)	1.404	1.269
Operational Risk RWA's	17.549	15.862

4.5 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:

All figures £m unless indicated otherwise	2020	2019
All portfolios subject to the standardised method (RWA)	3.107	1.035
CVA Capital Requirement	0.249	0.083

4.6 Capital Buffers

4.6.1 Capital Conservation Buffer (CCB)

The purpose of the CCB Buffer is to ensure firms hold sufficient capital to withstand future shocks without breaching their minimum capital guidance requirements. The CCB is set as a percentage of Total RWA's.

At 31 December 2020 the CCB was 2.5%.

4.6.2 Countercyclical Buffer (CCyB)

The purpose of the CCYB is to limit excessive credit growth in the market or by the individual firm. It is set as a percentage of RWAs. The Institution Specific CCyB is calculated as the weighted average of the buffers in effect in the jurisdictions in which the borrower is resident on the exposure amount. As a result of the Society's exposure to Residential and Buy to Let Lending secured on UK property to UK Expatriates resident outside the UK, this involves a number of jurisdictions where a CCyB rate is set and a number where it is not. In jurisdictions where a CCyB is set a number have reduced the rate to zero in the year due to the global pandemic.

At 31 December 2020 the weighted average CCyB was 0.023% of Total RWA's.

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.

CRD IV requires a minimum leverage ratio of 3% and at 31 December 2020 the Society had a leverage ratio of 6.57% (2019: 6.98%).

Table LRSum: Summary Reconciliation of accounting assets and leverage ratio exposures	2020 (£m)	2019 (£m)
Total assets per the financial statements	638.550	575.212
Adjustments for derivative financial instruments	0.206	0.071
Adjustments for off balance sheet items	2.617	2.715
Adjustments for other assets	0.333	0.335
Leverage ratio total exposure measure	**641.706**	**578.333**

Table LRCom: Leverage ratio common disclosure	2020 (£m)	2019 (£m)
On balance sheet items (excluding derivatives and SFT's but including collateral)	638.983	575.666
Asset amounts deducted from Tier 1 Capital	(0.100)	(0.119)
Total on balance sheet exposures (excluding derivatives and SFT's)	**638.884**	**575.547**
Replacement cost of derivative transactions	0.001	0.003
Add on amounts for PFE associated with derivative transactions	0.205	0.068
Total derivative exposures	**0.206**	**0.071**
Off balance sheet exposures at gross notional amount		
Adjustments for conversion to credit equivalent amounts		
Total off balance sheet exposures	**2.617**	**2.715**
Tier 1 Capital	**42.142**	**40.356**
Total Exposures	**641.706**	**578.333**
Leverage Ratio	**6.57%**	**6.98%**

Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives)	2020 (£m)	2019 (£m)
Total on balance sheet exposures (excluding derivatives)	638.983	575.666
Total Trading book exposures	-	-
Total on banking book exposures (excluding derivatives)	**638.983**	**575.666**
Of which:		
Exposures treated as sovereigns	82.849	91.870
Institutions	6.674	7.486
Secured by mortgages on immovable properties	544.901	472.569
Exposures in default	1.435	0.548
Other exposures	3.124	3.193

5 Risk Management Objectives and Policies

5.1 Strategic Risk

Strategic risks are those risks that are most consequential to the organisation's ability to execute its strategies and achieve its business objectives. These are the risk exposures that can ultimately affect member value or the viability of the organisation.

The principal strategic risks facing the Society are summarised below:

5.1.1 COVID-19, Brexit and the Impact on the Economic Environment

COVID-19 is having a widespread impact on the economic environment and there is considerable uncertainty as to the severity and timing of unemployment increases and the extent to which the government's initiatives to support the housing market will be effective. Whilst the UK Government has negotiated a Trade Deal with the EU on 24 December 2020, the impact of this on the UK economy remains unclear. As a UK mortgage lender these present a risk that the Society's customers will be unable to continue to afford their mortgage repayments, as well as reducing the value of the mortgage security. A further risk arises from the Bank of England's monetary policy, in that the Building Society Model performs less well in a low interest rate environment because the return on unremunerated capital is reduced as the average return on total assets decreases. In addition, as the Net Interest Margin compresses, the larger the cost base of the institution, the greater the pressure on trading profitability. Nevertheless, through the process of prudent balance sheet risk management, business, capital and liquidity planning, including stress testing of economic scenarios, the Directors have concluded that the Society has more than sufficient capital and liquidity resources to weather the storm.

5.1.2 Competition

With competition in the mortgage market continuing to remain high there is a risk that yields will be further compressed resulting in deterioration in the risk reward relationship in established lending markets. As some markets become less attractive this may prompt the Society to increase or decrease its appetite for particular types of lending in existing markets and extend into new forms of lending secured on residential property in order to strike an appropriate balance between return and capital at risk. Whilst this process is a continuing feature of the lending market, the compression of yields at low level of interest rates and level of competition makes the degree of disruption more broad-based than usual.

5.1.3 Climate change

The risks to the Society arising from Climate change are recognised in terms of both physical and transition risks. Physical risks arise from a number of factors, most notably extreme weather events and longer terms shifts in the climate. Primary drivers of physical risks on the Society include increased risk of flooding, subsidence and coastal erosion impacting on the value of, and longer-term ability to insure, mortgaged properties resulting in increased risk of financial loss. Transition risks arise from the process of adjustment to a low carbon economy, driven by a number of factors, most notably changes in policy and regulation, shifting sentiment and societal preference and emergence of disruptive technology and business models. The Society is increasingly cognisant of these risks and is continuing to refine its approach to managing the financial risks associated with climate change.

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 and Guernsey economies leading to higher unemployment and falling house prices which would result in increased arrears and impairment losses.

Risk control and mitigation is exercised by the following means:

- All mortgage loans are manually underwritten according to a Board-approved Credit Risk Management Policy to assess the credit quality of the customer, their ongoing ability to continue to be able to afford their mortgage repayments and the value of the Society's security.
- The Society has a series of Board approved risk appetite limits and all lending must be done within appetite.
- The performance of the loan portfolio is monitored closely to ensure it is performing as expected so that swift action can be taken if necessary.
- The Society is monitoring the performance of accounts post COVID 19 payment deferral to assess the risk of this translating into increased losses.

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 2020, separated by material industry type and including details of mortgages past due, is detailed below. A loan is past due when it is 3 months or more in arrears.

Loans Secured on Residential Property

Geographical Area	Performing (£000)	Past Due (£000)	Total (£000)
North	16,179	131	16,310
Yorkshire & Humberside	36,075	134	36,209
North West	70,194	168	70,362
East Midlands	28,005	-	28,005
West Midlands	34,794	-	34,794
East Anglia	17,738	-	17,738
South West	54,828	102	54,930
South East	142,804	210	143,014
Greater London	101,310	692	102,002
Wales	21,011	-	21,011
Guernsey	21,070	-	21,070
Total	544,008	1,437	545,445

Loans Secured on Commercial Real Estate

Geographical Area	Performing (£000)	Past Due (£000)	Total (£000)
Yorkshire & Humberside	320	-	320
North West	619	-	619
Total	939	-	939

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 2020 is detailed below:

	(£m)
In not more than 3 months	3.575
In more than 3 months but not more than one year	9.784
In more than 1 year but not more than 5 years	86.533
In more than 5 years	447.146
	547.038
Less: provisions	(0.480)
Total	**546.558**

5.2.1.3 Provisioning

Provisions for losses are based upon an appraisal of loans, advances and other assets and provided for on an incurred loss basis.

	Loans Secured on Residential Property (£m)	**Other Loans Fully Secured on Land (£m)**	**Total (£m)**
At 01 January 2020			
Individual Impairment	0.044	0.021	0.065
Collective Impairment	0.438	0.016	0.454
Total	**0.483**	**0.037**	**0.519**
Written Off			
Individual Impairment	-	-	-
Collective Impairment	-	-	-
Total	**-**	**-**	**-**
Movement			
Individual Impairment	(0.040)	0.022	(0.018)
Collective Impairment	(0.009)	(0.012)	(0.021)
Total	**(0.049)**	**0.010**	**(0.039)**
At 31 December 2020			
Individual Impairment	0.004	0.043	0.047
Collective Impairment	0.429	0.004	0.433
Total	**0.433**	**0.047**	**0.480**

Individual provisions of £0.047m 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.

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 2020, 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-	82.849	-	0.617	-	83.466
2	A+ to A-	-	-	6.263	-	6.263
3	BBB+ to BBB-	-	-	-		-
4	BB+ to BB-	-	-	-	-	-
5	B+ to B-	-	-	-	-	-
6	CCC+ and below	-	-	-	-	-
Unrated	-	-	-	-	-	-
Total		**82.849**	**-**	**6.880**	**-**	**89.729**

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 2020 is detailed below:

Geographical Area	Central Government/ Central Banks (£m)	Regional Government/ Local Authorities (£m)	Institutions (£m)	Total (£m)
United Kingdom	82.849	-	6.880	89.729
European Union (excl .UK)	-	-	-	-
Non European Union	-	-	-	-
Total	**82.849**	**-**	**6.880**	**89.729**

5.2.2.3 Maturity Analysis

A residual maturity breakdown of exposures to Credit Institutions as at 31 December 2020 is detailed below:

	(£m)
Repayable on Demand	6.674
In not more than 3 months	-
In more than 3 months but not more than one year	
In more then one year but less than five years	0.206
Total	**6.880**

5.3 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. The outlook for UK interest rates varies considerably, both upward and downward including the risk of negative interest rates, with the market view of the timing and degree of potential of rate increases/decreases varying considerably.

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
- Exposure is stressed monthly to ensure it is managed in compliance with the policy

The Society ensures compliance with risk appetite through monitoring interest rate risk exposure by the Board Assets and Liabilities Committee across Economic Value, Earnings and Basis Risk. In addition to this a range of variations in different interest rate bases outside the control of the Society are stressed, including LIBOR, SONIA 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 following is an analysis of the Society's sensitivity to an increase or decrease 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)	2020 £000	2019 £000
At 31 December	**(306)**	**(90)**
Average for the period	**(86)**	**(41)**
Maximum for the period	**309**	**512**
Minimum for the period	**(564)**	**(621)**

Sensitivity of projected net interest income to +100bps interest rate movement (earnings)	2020 £000	2019 £000
At 31 December	**466**	**453**
Average for the period	**457**	**461**
Maximum for the period	**576**	**543**
Minimum for the period	**368**	**368**

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.

5.4 Liquidity Risk

5.4.1 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 table below sets out the Society’s average quarterly Liquidity Coverage Ratio for the 12month period ending 31 December 2020.

Liquidity Coverage Ratio %	31-Mar-20 (£m)	30-Jun-20 (£m)	30-Sep-20 (£m)	31-Dec-20 (£m)
Liquidity Buffer	88.344	85.721	79.248	85.014
Total Net Cash Outflows	19.085	20.542	18.830	24.225
Liquidity Coverage Ratio %	462.9%	417.3%	420.9%	350.9%

5.4.2 Asset Encumbrance

Asset encumbrance is the risk that unsecured creditors are unable to benefit from liquidation of encumbered assets in the event of insolvency and encumbered assets are not available to secure emergency liquidity in case of an unforeseen stress event

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 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 2020 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	31.615	-	558.741	-
Loans on demand	-	-	78.243	-
Equity Instruments	-	-	-	-
Debt securities	-	-	12.989	12.989
Loans and advances other than on demand	31.515	-	464.514	-
Other Assets	0.100	-	2.995	-

Sources of Encumbrance	Matching Liabilities, contingent liabilities or securities lent	Assets and collateral received encumbered
Carrying amount of selected financial liabilities	17.426	31.615

5.5 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.

5.6 Operational Risk and Resilience

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 & security, people and resources, process, supply chain and model risk.

Operational resilience is the Society's ability to maintain important business services in the event of experiencing adverse external or internal events.

With COVID19 operational risk has increased as the Society has moved much of the Principal Office staff to working from home.

Risk control and mitigation is exercised by the following means:

- The Society has processes and procedures in place to manage operational losses, and the effectiveness of these controls are managed through the Operational and Regulatory Risk Committee.
- The Society has undertaken Business Impact Assessments to identify and map Important Business Services and set specific impact tolerances that are consistent with Board risk appetite.
- To manage the additional risks of how working and changes to working practice additional controls have been implemented to manage risk.

5.7 Cyber Risk

Cyber risk is the risk of harm to the Society as a result of breaches of, or attacks on, information systems.

The Society recognises the increasing threat that cyber attacks present to the financial system so this is a distinct risk in the Society's Risk Management Framework.

Failure to protect the Society from cyber attacks poses risks of direct financial losses as well as impacting the ability to perform significant business operations.

Risk control and mitigation is exercised by the following means:

- Cyber security forms part of the Society's Information Security Policy Framework.
- The Society has chosen to base its Cyber Security Strategy around the National Cyber Security Centre's (NCSC) framework pillars and continues to have regard to the FCA initiative Cyber Coordination Group that maintains a cyber risk 'radar'.

5.8 Conduct Risk

Conduct risk is the risk that any action, either by the Society or staff, that leads to customer detriment or has an adverse impact on market stability or effective competition.

The Society is committed to the fair treatment of customers, to ensure that the systems and controls in place both prevent and detect misconduct and to ensure that all staff adhere to the FCA's conduct rules at all times.

Risk control and mitigation is exercised by the following means:

- The Society has policies and procedures in place to ensure that fair customer outcomes are delivered.
- The Society's Compliance function is in place to ensure that the Society and staff comply with all applicable legislation and regulation.

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 2020.

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 2020 to 31 December 2020 and the number of beneficiaries.

Staff Type	Number	Fixed Remuneration	Variable Remuneration	Total Remuneration
Non-executive Directors	6	184,800	-	184,800
Executive Directors	2	413,502	19,716	433,218
Other SMT	2	135,831	7,584	143,415
Total	10	734,133	27,300	761,433

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:

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