HARPENDEN BUILDING SOCIETY

Pillar 3 Disclosure Document
31 December 2019

CONTENTS

1. Introduction

1.1. Legislative Framework

The Capital Requirements collectively known as CRD IV, came into force on 1 January 2014 with the aim of improving the banking sector's ability to absorb shocks arising from financial or economic stress.

This framework establishes European standards for capital and liquidity requirements for banks, building societies and related institutions. It establishes the minimum amount of capital that Harpenden Building Society ('the Society') must hold in order to protect its members and depositors. The Society aims to continue to maintain sufficient capital resources at all times to protect its members. CRD IV introduced an increase in capital requirements, new capital buffers with higher thresholds and the introduction of a minimum leverage ratio requirement.

The Society is regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority. The PRA is responsible for monitoring capital adequacy and implementing CRD IV in the UK through the PRA Rulebook.

The CRD IV is based on three 'Pillars':

- **Pillar 1** - Minimum capital requirements for credit, market and operational risks.

- **Pillar 2** – Assessment of capital adequacy. The Internal Capital Adequacy and Assessment Process (ICAAP) and the Supervisory Review & Evaluation Process (SREP), undertaken by the PRA in the UK, assesses additional capital requirements not captured by Pillar 1.

- **Pillar 3** - Market discipline – the requirement for public disclosure of prescribed information, including key information on capital, exposures and risk management, in order to demonstrate that the Society holds an appropriate level of capital.

1.2. Harpenden Building Society Approach

The approach adopted by the Society is suitable for the nature and complexity of its business activities:

- **Pillar 1** - the Society has adopted the 'Standardised Approach' (SA) to complete a risk-based capital calculation, focusing on credit and operational risks to determine its Capital Resources Requirement.

- **Pillar 2** - consideration of all other risks not fully assessed within Pillar 1, with the determination of any additional capital needed to be held accordingly. The Society's Board has undertaken an assessment of all of the key risks facing the Society. The ICAAP is completed annually, or more frequently as appropriate, and this is reviewed by the PRA as part of their SREP. Additionally, the Society performs stress testing to establish whether additional capital should be held under Pillar 2.

- **Pillar 3** - consideration of all necessary disclosures. This annual disclosure document covers the requirements under Pillar 3 for the Society to disclose specific information in accordance with the requirements set out in CRD IV, including the requirement to disclose the Total Capital Requirement (TCR), comprising Pillar 1 and Pillar 2A.

This approach is a process that brings together the risk management framework (i.e. the policies, procedures, strategies and systems that the Society has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management.

These disclosures are subject to internal verification, and are reviewed and approved by the Assets and Liabilities Committee (ALCO), and the Board Risk Committee, to ensure appropriate oversight and governance. All figures quoted in this document are aligned with the Society's audited Annual Report and Accounts, as at 31 December 2019.

2. CRD IV Disclosures

Article 89 of the CRD requires the Society to disclose the following information for the year ended 31 December 2019:

Name:	Harpenden Building Society
Type of entity:	Building Society
Nature of activity:	Secured lending and deposit taking
Location:	United Kingdom
Turnover:	£9.4m (interest receivable and similar income), £7.1m (total net income) (2018: £9.7m and £7.3m respectively)
Profit before tax:	£701k (2018: £1,915k)
Tax:	£146k (2018: £341k)
Public subsidies received:	£nil (2018: £nil)
Number of employees:	63 FTE (2018: 59 FTE)

The Society has no subsidiaries and is not part of a group. Consequently, the disclosure requirements contained in Article 436 of the CRR are considered as not applicable to the scope of the Society's Pillar 3 Disclosures.

3. Risk Management Objectives and Policies

The Board is responsible for determining a framework for risk management and control. It approves all policies and Committee terms of reference. The Senior Management Team (SMT), with the assistance of the Risk Team, is responsible for designing, operating and monitoring risk management and internal control processes.

The Board of Directors is committed to best practice in corporate governance and applies the principles within the UK Corporate Governance Code, insofar as the guidance applies to building societies. As at 31 December 2019, the Board comprised two executive, five non-executive directors and a non-executive Chair. It meets formally eight times a year. All directors, both on appointment and thereafter, must meet the tests of fitness and propriety prescribed by the FCA.

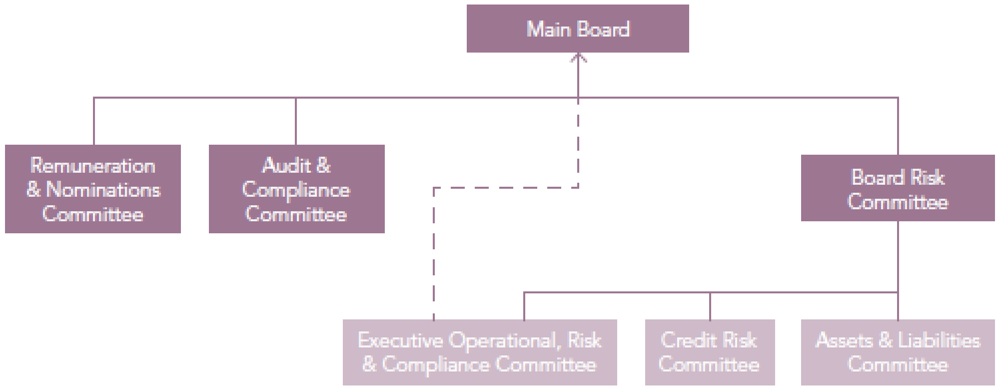
As well as attending Board meetings, all non-executive directors are required to serve on one or more of the Society's Board sub-committees.

3.1. Risk Governance

The Board of Directors determines the responsibilities and composition of the Board Committees, which are authorised to make decisions within agreed parameters and/or make recommendations to the full Board of Directors, as appropriate. The terms of reference for the following committees can be obtained by writing to the Secretary at the Society's Head Office.

The Executive Committee, Operational & Conduct Risk Committee, Assets & Liabilities Committee (ALCO) and Credit Committee are management committees that report to either the Board or the Board Risk Committee.

As at 31 December 2019, the Society's Board committee structure was:



3.2. Board Risk Committee

The Risk committee is responsible for recommending to the Board the Society's risk appetite. It ensures that an appropriate risk management framework and underlying policies are in place and it reviews the adequacy of the Society's risk reporting, including the Society's Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process.

As at 31 December 2019, the membership of the Board Risk Committee comprised four Non-Executive Directors and meets quarterly. The Chief Executive, Finance Director and Chief Risk Officer are normally invited to attend all, or part, of the meetings, but they are not members of the Committee.

3.3. Audit & Compliance Committee

This committee is responsible for reviewing the integrity of financial statements, providing appropriate oversight of financial reporting, the effectiveness of internal controls and compliance. It considers and recommends the appointment of the internal and external auditors and monitors their effectiveness and independence.

The Committee comprises three non-executive directors. The Chief Executive, Finance Director and Chief Risk Officer are normally invited to attend, but they are not members of the Committee. It meets quarterly, with both the Society's Internal and External Auditors in attendance.

3.4. Remuneration & Nominations Committee

This committee is responsible for recommending the appointment and remuneration of Non-Executive Directors, as well as the appointment, terms of employment and remuneration of Executive Directors.

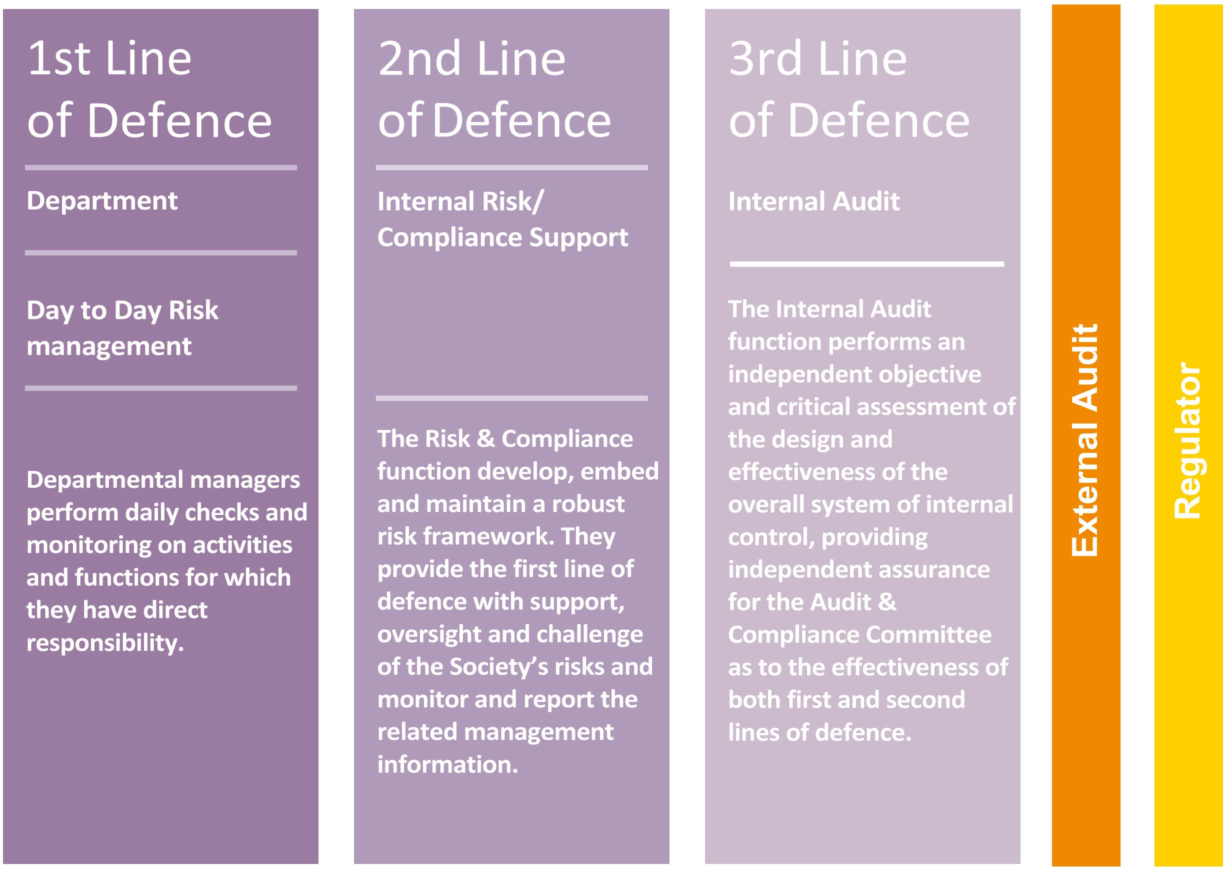
Directors' remuneration is benchmarked annually against peers, both within and outside the building Society sector and the local area, taking into account the Society's performance.

The Committee comprises three Non-Executive Directors and meets as required, but at least twice a year. The Chief Executive and Finance Director are normally invited to attend, but they are not members of the Committee. No member is involved in setting their own remuneration and the remuneration of all Directors is agreed by the full Board.

4. Risk Management

The Society has a formal risk management structure in place with established Risk Policy Statements, including risk limits, reporting lines through committees, mandates, risk management software, management information and review processes and other controls procedures. This structure is reviewed periodically by the Board.

The Society operates a 'three lines of defence' model to manage risk and internal controls across the business.



4.1. First Line of Defence

The first line is operated by the Society's management team which, through the implementation of the Risk Management Framework, identifies, assesses, mitigates and monitors those risks to which the Society is exposed. The Society's Senior Management Team has day-to-day responsibility for the management and control of risk.

4.2. Second Line of Defence

The second line of defence is achieved through the Society's risk and compliance activities. These activities are undertaken by the Risk Team and Compliance Function. The second line provides the policies, frameworks and support to enable risk and compliance to be managed in the first line, conducts monitoring to judge how effectively they are undertaking it, and helps ensure consistency of the measurement of risk.

4.3. Third Line of Defence

The third line of defence is provided by Internal Audit. The Society's Internal Audit function is outsourced, under specific terms of reference, and provides independent objective assurance that these control processes and systems are appropriate and are applied effectively. Sitting outside the risk management processes of the first two lines of defence, its main roles are to ensure that the first two lines are operating effectively and to advise on how they could be improved.

Internal audit is directed by, and reports to, the Audit & Compliance Committee. It provides an evaluation, through a risk-based approach, on the effectiveness of governance, risk management and internal control across the Society. It can also give assurance to the Society's regulators and external auditors that appropriate controls and processes are in place and are operating effectively.

4.4. Approach to Capital Risk Management

Key risks to which the Society is exposed are monitored through the Society's risk register. The risk register is maintained through active monitoring by senior management. At each meeting, the Board sub-committees each consider the risk over which they have responsibility. The Board has overall responsibility for reviewing risks and their interdependencies across the Society. The Board Risk Committee has responsibility for the risk management framework. The Society's internal audit programme is tailored to ensure that the key risks are incorporated into, and challenged as part of, that programme.

The Board has articulated the Society's risk approach and strategy regarding capital management as:

"The Society holds capital to ensure that it can meet regulatory needs and business objectives. The Society approaches business decisions in a prudent manner, with due consideration of its fundamental responsibilities to its members. To manage the Society prudently, the Society will hold adequate capital to ensure that it is able to meet its Pillar 1 minimum requirements and hold additional capital to cover any additional risks that the Board considers may impact the Society. The Board will continue to satisfy itself that these risks are appropriately managed and assessed on an ongoing basis as economic and financial market conditions change."

This risk approach is reviewed annually by the Board, in line with the Society's Internal Capital Adequacy Assessment Process (ICAAP) and Corporate Plan. The Board considers whether the Society's actual performance is consistent with this risk appetite, if necessary adjusting the relevant risk appetite, business plan, budget, or policy statements.

The system of internal control is designed to enable the Society to achieve its corporate objectives within a managed risk profile. The internal audit function provides independent and objective assurance that these processes are appropriate and effectively applied.

5. Risk Management Policy

The principal risks and uncertainties to which the Society is exposed are detailed below:

5.1. Covid 19 Uncertainty

The UK's economic position is exacerbated when viewed in the context of a slowing global economy. In addition, the impact on the economy from Covid-19 adds to the level of uncertainty we currently face with a range of government initiatives put in place in an attempt to provide economic stimulus and support during this period. This includes a cut in Base Rate to 0.10% and a range of business loans and additional financial support. The base rate reduction by the Bank of England to 0.10% will naturally reduce income receivable from the Central bank, but this has been managed by a reduction in a number of savings products. UK unemployment rate is reported on quarterly basis and is expected to rise towards end of 2020, as a result furlough scheme coming to an end. UK GDP (Nominal) Annual Growth Rate has seen reductions in 2020, as a result of lockdown restrictions whilst, after an initial reduction, there has been an increase in housing prices as the mortgage market has started to 'open up' again.

The COVID-19 pandemic is a global stress event that is testing the financial and operational resilience of most firms. The Society adapted rapidly to the impact and market conditions by prioritising activities that ensure it was able to maintain core business activities. As the months have passed it has been able to ensure that the continuum of operational and conduct risks have continued to be managed appropriately whilst ensuring the safety of both its workforce and customers.

The Society has implemented a range of initiatives to manage the financial related risks from the Covid 19 pandemic including increased and granular credit risk monitoring of arrears and forbearance cases, increased liquidity reporting, removal of certain savings products and cost saving initiatives. To ensure vulnerable customers continue to have access to funds, we have amended processes to support these individuals. In addition, with a more 'remote working environment', the Society has also added additional controls to protect both our customers and the Society.

5.2. Brexit Uncertainty

The Society is subject to the uncertainties resulting from the impact of the 'Brexit' negotiations. The continued lack of clarity on the ongoing relationship of the UK with the EU, combined with a global slowdown and the increase in protectionist rhetoric and actions on trade tariffs, all create an environment that is expected to be challenging for the mortgage and savings market.

The Society has assessed the impact of Brexit, together with the associated risks, in order to ensure that it is well placed to operate effectively, based on a range of scenarios that have been assessed within its ICAAP and ILAAP; this includes the UK leaving the EU with no deal in place, commonly referred to as a "Hard Brexit". The Society continues to take a cautious approach to lending that provides protection in the event of a severe impact on the economy, and many of macroeconomic impacts from COVID 19 uncertainty are coupled also with Brexit uncertainty.

5.3. Credit Risk

'Credit risk' is the risk that a financial loss will arise from a borrower or counterparty failing to meet their obligations. This risk arises from the Society's lending and treasury management activities.

The Society has a formal structure for managing risk, including formal risk policies, risk appetites and limits, early warning indicators (EWIs), reporting structures, mandates and other control procedures. This structure is reviewed regularly by the Board of Directors.

All loan applications are assessed with reference to the Society's Lending Policy Statement and lending mandates are strictly controlled. The Lending Policy Statement is regularly reviewed by the Credit Committee, with review and approval by the Risk Committee. The Society's approach to lending is to avoid a 'tick-box' approach. Rather, the Society ensures that the individual position and specific risks and affordability of each application are fully understood and assessed.

The Society include policies that cover counterparty limits derived using credit ratings from an external credit assessment institution for credit exposures to rated individual and group counterparties. Whilst credit ratings can provide an indication of the creditworthiness of a counterparty, the Society supplements this information with market knowledge, and observation of the actions of monetary authorities, to generate a more complete view of its counterparties. In addition, the Society undertakes a defined due diligence assessment of unrated treasury counterparties. This is subject to review by the ALCO, with review and approval by the Risk Committee, at least annually. The Society operates and adheres to internal limits that are more stringent than the respective regulatory limits.

5.4. Liquidity and funding Risk

Liquidity risk is the risk that the Society, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.

The Society's policy is to maintain adequate liquidity resources, both in amount and quality in order to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This is achieved through maintaining a prudent level and sensible mix of liquid assets, and through control of the growth of the business, to provide flexibility in the management of liquidity. Stress testing is undertaken within the ILAAP to assist the Society in setting appropriate limits for its liquidity portfolio in terms of quality and maturity profile.

5.5. Interest Rate Risk in the Banking Book (IRRBB) and Basis Risk

This is the risk of a decline in earnings or a decrease in value due to a shift in interest rates. Basis Risk is a sub-set of IRRBB and is the risk is generated by banking book items that re-price in relation to different reference rates. The most common and material basis risks derive from products re-pricing against policy rates (e.g. Bank Rate) and market rates (e.g. LIBOR).

The Society manages this exposure continually by matching the maturity dates of assets and liabilities in line with its Financial Risk Management Policy.

Interest rate risk is specifically the risk that future changes in interest rates will impact the amount and value of future net interest cash flows of the Society due to mismatches in the interest rate repricing characteristics of interest bearing assets and liabilities within the balance sheet. The Society manages this risk by setting overall limits for interest rate risk as a proportion of capital, both in terms of changes in Net Interest Income and changes in the Economic Value of Equity.

Interest rate risk is overseen by the ALCO with interest rate risk limits approved annually by the Board Risk Committee, or more frequently if deemed appropriate. IRRBB risk is also approved by Board upon approval of the Risk Appetite Statement.

5.6. Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes or systems, human error or external events that the firm needs to manage in running its business. The Society has controls in place that are designed to mitigate these risks.

The Risk Committee is responsible for assessing the effectiveness of the risk management processes and the system of inspection and control.

The Society manages operational risks through implementing a strong internal control environment. There is a dedicated risk function, whose responsibilities include supporting and overseeing the business in managing operational risks and ensuring that key control effectiveness is measured and that managerial actions are in place to mitigate risk. The Society uses the risk system in order to assess all operational risks by business area, including all mitigating actions, which are periodically reviewed.

The Board recognises that there are residual operational risks inherent in any business, which may not be specifically identified. The Society undertakes an internal assessment of operational risks and any add-on thereby identified is added to the Pillar 1 Standardised Approach calculation.

Within Pillar 1, the Basic Indicator Approach (BIA) is used to assess the minimum capital requirement for operational risk. This is calculated as being 15% of the average net income over the previous three years. Operational risk is assessed in more detail under Pillar 2 through operational stress test scenarios within the Society's risk management framework.

5.7. Cyber Risk

This is a subset of operational risk and is defined as the risk that a cyber-attack results in financial loss, loss of data, business disruption or damage to the reputation of the Society.

Cyber risk is a key component of operational resilience and the Society has a Business Resilience Committee, which is as a sub-committee of the Executive Operational, Risk and Compliance Committee, to manage the threat of these risks. On a regular basis, the Business Resilience Committee reports its findings directly to Executive Operational, Risk and Compliance Committee. The Society has employed specialist resources to monitor, test, maintain and continuously improve the effectiveness of the Society's cyber defences and operational resilience.

5.8. Conduct Risk

This is the risk the Society's behaviour will result in poor outcomes for customers. Customer service and outcomes have always been at the heart of decision making and product design at the Society, as represented in the first of its core values. The Society continues to develop its approach to ensure that products and services provide fair customer outcomes and operate as customers would expect.

The Society takes its conduct responsibilities to customers very seriously and ensures that they are firmly embedded within the culture and practices of the business. Good customer outcomes remain at the heart of the Society's values. The Society aligns conduct with the overall risk management framework and this is overseen by the Risk Committee.

5.9. Regulatory Risk

This is the risk that the volume and complexity of regulatory issues may impact the Society's ability to compete or the Society breaches a regulatory requirement. The Society has policies and procedures in place to ensure compliance with the regulations and the Board monitors regulatory changes to ensure that the Society continues to meet all of its regulatory requirements.
The Society manages this risk by ensuring that staff are adequately trained and that appropriate advice is sought from external sources, as appropriate. This enables the Society to review and to plan ahead for regulatory changes, by assessing the impact on the Society's processes, reporting requirements and strategic planning.

5.10. Business Risk

Business risk is that which the Society faces as a result of macroeconomic changes and market uncertainties. The Board considers that the impact of changes in the housing market, particularly a severe housing market recession, significant changes in interest rates and an increase in unemployment are the main business risks to which the Society is exposed. The Society takes a range of potential business risks into account within its strategic planning process and ICAAP document.

5.11. Concentration Risk

Credit concentration risk is the risk of losses arising as a result of concentrations of exposures due to imperfect diversification. This imperfect diversification can arise due to the small size of a portfolio or a large number of exposures to specific obligors (single name concentration), sectors or geographical regions. As a local building society, saving and borrowing membership is traditionally concentrated in London and the Northern home counties, specifically Hertfordshire, Bedfordshire and Buckinghamshire. The Society is therefore exposed to geographical concentration risk, both in terms of its retail funding and its mortgage lending.

These risks are managed through adherence to Board-approved lending and liquidity policies, which provide for a range of limits that are regularly monitored and reviewed in the light of changing economic conditions and the Society's objectives and risk appetite.

Through the ICAAP, the Board has assessed the requirement for additional capital to be made available to cover a downturn in house prices, or increased levels of mortgage arrears and losses due to macro-economic changes.

5.12. Environmental and Climate Change Risk

During 2019 the Society undertook an assessment of the risks and threats posed by climate change. Risks were identified for both physical risk (such as fire and floods) and transitional risk (moving to a 'carbon neutral' society) with work in progress to assess existing controls in place to manage those risks within existing Board risk appetite.

6. Capital Resources

To evaluate the overall quality of capital resources, commonly referred to as 'own funds' under CRD IV, capital is split into tiers - based on their availability and ability to absorb losses. The highest quality items are Common Equity Tier 1 (CET1), followed by Tier 1 and finally Tier 2.

The capital buffers, as set out in Section 9.1, are required to be covered entirely by CET1 capital. The Society has remained within these limits at all times.

With the exception of c.£0.2m, the Society's total own funds are comprised of its general reserves, which are classified as CET1 capital. The Society's audited capital resources under CRD IV, as at 31 December 2019, are presented in the table below:

Capital Composition	**2019 £000**	**2018 £000**
Common Equity Tier 1 (CET1)		
General reserves	26,420	25,865
Revaluation reserve	1,720	1,720
Intangible assets	(26)	(36)
	28,114	**27,549**
Tier 2 Capital		
Collective provision	**228**	**284**
Total Capital	**28,342**	**27,833**

7. Capital Risk and Adequacy Assessment

The Society completes its corporate plan annually, incorporating projected strategic business growth, forecasting and capital requirements. This planning cycle is driven by current market and economic conditions and is underpinned by the Society's risk appetite. Risk strategy is an additional support for the Corporate Plan.

The ICAAP is core to this process, specifically the assessment of the adequacy of the Society's capital to underpin projected growth and potential stresses over the planning horizon. In order to produce a detailed capital plan, the ICAAP contains calculations of the capital resources requirement using the Standardised approach for credit risk and the Basic Indicator Approach (BIA) for operational risk.

Under the Standardised approach for credit risk, the Society applies a risk weighting to each of its assets according to their risk attributes in order to derive its Pillar 1 minimum requirement. For the Society's assets, these risk weightings range from 0% to 150%, depending on the type and characteristics of the asset. The Society then allocates capital to its assets based on 8% of the risk weighted assets (RWA), thus arriving at the minimum capital requirement for credit risk.

As required under Pillar 2, the Society's management performs a further assessment of the risks not included, or adequately considered, within Pillar 1 and calculates the additional amount of capital that it considers may be necessary to cover these risks. Based on the ICAAP assessment and results, the Board closely monitors the Society's capital metrics and limits to ensure that all requirements continue to be met and to understand the capital position to support the Society's ongoing activities.

8. Pillar 1 Requirement

The following table provides details on the calculations of the minimum capital resource requirements (Pillar 1) for the Society under the Standardised Approach as at 31 December 2019:

	Exposure £000	Risk Weighted Amount £000	Minimum Capital Requirement £000
Liquid Assets			
- Balances at the Bank of England	46,708	-	-
- Loans & advances to Credit Institutions	12,321	2,462	197
- Debt Securities	2,013	1,006	80
	61,042	**3,468**	**277**
Loans and Advances to Customers			
- Fully secured on residential property	226,512	88,563	7,085
- Fully secured on land	4,437	4,437	355
	230,949	**93,000**	**7,440**
Other Exposures			
- Investments	163	163	13
- Cash and coins	115	-	-
- Tangible & Intangible fixed assets	287	287	23
- Freehold property assets	3,870	3,870	310
- Other debtors	493	493	39
	4,927	**4,813**	**385**
Off-balance sheet (Mortgage commitments)	18,733	3,683	295
Total Credit Risk	**315,652**	**104,964**	**8,397**
Operational Risk		13,508	1,081
Total RWA / Pillar 1 Requirement		**118,472**	**9,478**
Pillar 2A Requirement			1,592
Total Capital Requirement (TCR)			**11,070**

The following table provides a reconciliation of statutory and regulatory asset exposures:

Reconciliation of statutory assets and regulatory exposures	**2019 £000**	**2018 £000**
Total Assets reported in statutory accounts	**296,333**	**306,669**
Impairment provision	228	284
Effective interest rate adjustment	384	434
Mortgage commitments	18,733	21,570
Deduction for intangible assets	(26)	(36)
Total Regulatory Exposures	**315,652**	**328,920**

9. Total Capital Requirement

A comparison of the above TCR of **£11,070k** - **9.34% of the RWA of £118,472k** - with the total capital resources figure of £28,342k provides the Board with assurance that the Society has adequate capital resources in terms of amount and quality. In addition, the results of the Pillar 2B scenario testing set out within the Society's ICAAP provides further assurance across the planning horizon.

The Society's CET1 ratio provides a risk-based measure of capital adequacy. It is calculated as audited CET1 capital as a proportion of RWA. As at 31 December 2019, using audited CET1 capital, this was **23.73%** (Dec 2018 audited CET1 ratio: 22.3%), compared with the current minimum CRD IV requirement of 4.5% under Basel III.

9.1. Capital Buffers

The Society is subject to capital buffers set by the PRA, in accordance with the Bank of England's Financial Policy Committee (FPC). These buffers are assessed and applied, as required, as part of the regular review of capital adequacy. The relevant buffers comprise:

- **Countercyclical Capital Buffer (CCyB)** – this is a capital buffer and is a tool that enables the Bank of England's Financial Policy Committee to adjust the resilience of the UK banking system. As at 31 December 2019 it was set at 1.00% of RWA, but in March 2020 the Financial Policy Committee (FPC) reduced the countercyclical capital buffer rate to 0%.

- **Capital Conservation Buffer (CCoB)** – this is a capital buffer that is designed to ensure that banks build up capital buffers outside periods of stress that can then be drawn down as losses are incurred. Having been fully phased in, it is currently set at 2.50% of RWA.

- **PRA Buffer** – this is a firm-specific buffer, which is set at a percentage of RWA. This buffer is a further regulatory-set amount of capital that the Society must hold, in addition to its total Pillar 1 requirements, in order to cover any losses that may arise under a severe stress scenario, but avoiding duplication with the CRD IV buffers.

9.2. Leverage Ratio

Basel III requires the calculation and disclosure of the Society's leverage ratio, which provides a non-risk-based measure to supplement the risk-based capital adequacy assessment. The leverage ratio is a measure of Tier 1 capital as a proportion of total on- and off-balance sheet assets.

The leverage ratio does not distinguish between the credit quality of loans and acts as a primary constraint to excessive leverage of the Society's capital due to growth.

The Society's leverage ratio, as at 31 December 2019 using audited capital, was 8.91% (December 2018: 8.38%), remaining well above the current 3.0% regulatory minimum requirement. The calculation of leverage ratio is shown below.

Leverage Ratio	**2019 £000**	**2018 £000**
Total Tier 1 Capital	28,114	27,549
Total Regulatory Exposures	315,652	328,920
Leverage Ratio	**8.91%**	**8.38%**

10. Credit Risk

10.1. Credit Risk – Loans and Advances to Customers

The Society has exposures to mortgages loans that are fully secured on residential property (FSRP) and a small legacy portfolio of mortgages that are fully secured on land (FSOL).

The Society defines any mortgage account where more than three monthly payments have not been made as at the accounting date as being past due and therefore non-performing.

As at 31 December 2019, the Society's performing and non-performing loans and advances to customers analysed by exposure, RWA and capital requirement, is shown in the following table:

	Exposure £000	Risk Weighted Amount £000	Minimum Capital Requirement £000
Loans and Advances to Customers (Total)			
Fully secured on residential property	226,512	88,563	7,085
Fully secured on land	4,437	4,437	355
	230,949	**93,000**	**7,440**
Loans and Advances to Customers (Performing)			
Fully secured on residential property	220,841	82,894	6,632
Fully secured on land	3,824	3,824	306
	224,667	**86,718**	**6,938**
Loans and Advances to Customers (Non-Performing)			
Fully secured on residential property	5,669	5,669	453
Fully secured on land	613	613	49
	6,282	**6,282**	**502**

A geographic analysis of the Society's loans and advances to customers by FSRP and FSOL portfolios is set out below.

Region	FSRP Exposure £000	FSRP Exposure %	FSOL Exposure £000	FSOL Exposure %
Outer Metropolitan	68,335	30.2%	2,376	53.6%
Greater London	66,696	29.4%	1,123	25.3%
Outer South East	30,801	13.6%	548	12.3%
South West	24,469	10.8%	-	0.0%
East Anglia	13,352	5.9%	155	3.5%
West Midlands	7,030	3.1%	-	0.0%
Yorkshire & Humberside	4,982	2.2%	127	2.9%
East Midlands	3,751	1.7%	108	2.4%
North West	3,395	1.5%	-	0.0%
Wales	2,335	1.0%	-	0.0%
North	1,366	0.6%	-	0.0%
	226,512	**100.0%**	**4,437**	**100.0%**

10.2. Asset Encumbrance

As at 31 December 2019, all of the Society's assets remained free from encumbrance, with no assets pledged, or subject to any form of arrangement to secure, collateralise or credit-enhance any on- or off-balance-sheet transaction from which it cannot be freely withdrawn.

10.3. Credit risk adjustments - Impairment Provisions

Provisions (under CRR, referred to as credit risk adjustments) on commercial and residential mortgages are made to reduce the value of loans and advances to the amount that is considered likely to be recoverable in the event of the property held as security being sold in possession by the Society.

Provisions for mortgages in arrears and properties in possession are assessed on an individual basis. The Society takes into account the current indexed valuation of the property, the value of the outstanding mortgage plus outstanding repayments, any discount likely to be required to sell the property and any costs associated with the sales process. The Society recognises that not all accounts in arrears will result in possession and that not all sales of properties in possession will result in credit losses and judgement is therefore used to determine where losses are likely to crystallise.

The Society's accounting policy in relation to impairment provisioning for loans and advances is set out in the "Financial Accounts: Note 1, Accounting Policies", in the Society's Statutory Accounts.

Collective provisions are treated as Tier 2 capital. The movements in impairment is summarised below:

Impairment summary	**FSRP £000**	**FSOL £000**	**Total £000**
As at 1 January 2019			
Individual Impairment	-	-	-
Collective Impairment	266	18	284
Total	**266**	**18**	**284**
(Credit)/charge for the year			
Individual impairment	-	-	-
Collective impairment	(51)	(5)	(56)
Total	**(51)**	**(5)**	**(56)**
As at 31 December 2019			
Individual Impairment	-	**-**	**-**
Collective impairment	215	13	228
Total	**215**	**13**	**228**

10.4. Credit Risk – Liquid Assets

The Society's policy on the assessment of the creditworthiness of approved counterparties states that a counterparty should be listed by Fitch Ratings, with a long-term rating of at least 'A-' and a short-term rating of at least 'F1'.

The Society can place deposits with lower-rated and unrated counterparties, following a thorough due diligence review of financial indicators. This includes building societies that are unrated. The Society continues to use Fitch ratings. The details of the Society's liquid assets portfolio by residual maturity and credit rating, as at 31 December 2019, are shown in the table below:

Credit Quality Step	Credit Rating	< 3 months £000	3 months to 1 year £000	>1 year £000	Total £000
1	*HQLA*[1]	*46,719*	*-*	*-*	***46,719***
1	*AAA+ to AA-*	*3,326*		*-*	***3,326***
2	*A+ to A-*	*2,978*	*2,013*	*-*	***4,991***
3	*BBB+ and below*	*-*	*-*	*-*	**-**
-	*Unrated*	*4,005*	*2,001*	*-*	***6,006***
		57,029	**4,014**	**-**	**61,043**

10.5. Wholesale (Non – Financial Service) funding risk

Per SS20/ 15 wholesale funding on the Administered approach is restricted to non-financial service entities, and historically these entities have been from Local Authorities. The Society had no wholesale funding exposures as at 31 December 2019 (31 Dec 2018: nil).

10.6. Interest Rate Risk

The Society does not have any long-term fixed rate products on either side of its balance sheet. The Society does have short-term fixed rate products in the form of liquid asset deposits and deposit liabilities, but interest rates on these positions are fixed for a maximum of up to twelve months. As the vast majority of interest-bearing assets and liabilities are held at variable interest rates, the Society is able to react quickly in the event of a change in market interest rates.

The Society's balance sheet is stress tested on a daily basis to assess the impact of a severe 200 basis point parallel shift in market interest rates (both upwards and downwards). The results of this testing does not indicate that there would be a material impact on the business in the event of such a severe stress. As at 31 December 2019, the interest rate stress testing using this 2% parallel shift indicated a maximum negative impact of £318k in net present value (31 Dec 2018: £171k).

10.7. Basis Risk

Basis Risk is considered to be an internal risk to the Society, as it can largely be controlled by the decisions that the Society makes in respect of its product range and pricing. The Society manages this exposure continually by matching the maturity dates and interest rate bases of assets and liabilities in line with its Financial Risk Management Policy, which is reviewed and approved by the Board Risk Committee.

The Society does not currently have any liabilities with interest rates linked to the Bank Base Rate, SONIA or LIBOR. All of the Society's mortgages are lent at rates based upon its Standard Variable Rate, except one which is linked to the Bank of England Base Rate or fixed for a term. The Society is on the 'Administered' Treasury approach and the 'Limited' Mortgage approach. At 31 December 2019, £0.3m of fixed rate mortgages were naturally hedged against £0.3m against fixed rate savings.

The Society retains a small portfolio of 3-month LIBOR-linked exposures in the form of floating rate term deposits, as at the reporting date. The Society's basis risk position continues to be managed within its Board approved limits.

[1] High Quality Liquid Assets – per the Delegated Act, liquid assets of the highest credit quality, in line with the Society's Overall Liquidity Adequacy Rule (OLAR) and Liquidity Coverage Ratio (LCR) requirements.

11. Remuneration

The purpose of this section is to explain how the Society complies with the principles relating to remuneration under the "UK Corporate Governance Code, April 2016". The Society has adopted a Remuneration Policy that describes how the Society complies with the FCA's Remuneration Code.

Code Principle: Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

Board comment: The Remuneration Policy is designed to attract, retain and encourage high calibre executives to manage and develop the Society's business. Basic salaries are reviewed annually by reference to jobs carrying similar responsibilities in comparable organisations and in the light of market conditions generally.

11.1. Executive Directors' Remuneration

The Remuneration Policy is designed to attract, retain and encourage high calibre executives to manage and develop business for the Society. Total remuneration includes basic salary, performance related pay bonus, benefits and pension.

a) Basic Salary - takes into account duties, responsibilities, performance and levels for comparable positions in other organisations.

b) Bonus – an annual performance-related pay scheme that is linked to the achievement of the Society's objectives, including customer satisfaction, financial performance and staff engagement. This is reviewed by the Remuneration & Nominations Committee annually to ensure that the measures are appropriate. The bonus payment is not pensionable and the scheme was designed to deliver a maximum award of 20% of basic salary. The Society does not operate a long-term incentive scheme.

c) Pension - the Executive Directors have defined contribution pension plans, to which the Society and employee both contribute. The Society makes a contribution of 10% of salary.

d) Benefits – the Executive Directors are entitled to a car allowance, family private medical insurance and Death-in-Service at the rate of three times annual salary.

e) Contractual Terms – the Executive Directors are employed under a Service Contract that is terminable by the Society or by the individual on six months' notice.

11.2. Non-Executive Directors

Fees are based on comparable data from similar financial service organisations and are reviewed annually. Non-Executive Directors do not qualify for a pension or a bonus, but do qualify for Death-in-Service benefit at the rate of three times annual fees. Performance of individual Directors is assessed by the Chair and their fellow Board members. The Chair is assessed by all members of the Board.

11.3. The Procedure for Determining Remuneration

Code Principle: There should be a formal and transparent procedure for developing policy on Executive remuneration and for fixing the remuneration packages of individual Directors. No Director should be involved in deciding his or her own remuneration.

Board comment: The Remuneration and Nominations Committee reviews the Society's Remuneration Policy annually. The Committee consists of three Non-Executive Directors, one of whom chairs the Committee. The Chief Executive attends by invitation, but take no part in the discussion of their own salaries. The Committee reviews Directors' and senior management's remuneration annually, using data from comparable organisations and taking advice from external consultants, when appropriate.

11.4. Code Staff Remuneration

In accordance with regulation the Society has considered staff that fall under the scope of “material risk takers” (ie. “Code Staff”). These activities may have a material impact on the risk profile of the firm with the Society classifying its material risk takers to be Executive Directors, Non-Executive Directors and the Senior Management Team.

Aggregate remuneration for the years ended 31 December 2019 and 2018 are provided below. Additional information on Executive and Non-Executive Directors is disclosed within the Statutory Accounts.

Year Ended 31 December 2019	**Number of Staff**	**Fixed Remuneration**	**Pension**	**Variable Remuneration**	**Total**
Executive Directors	2	333	34	74	441
Non-Executive Directors	7	210	-	-	210
Other Material Risk Takers	7	487	41	126	654
Total	**16**	**1,030**	**75**	**200**	**1,305**

Year Ended 31 December 2018	**Number of Staff**	**Fixed Remuneration**	**Pension**	**Variable Remuneration**	**Total**
Executive Directors	2	189	19	126	334
Non-Executive Directors	6	191	-	-	191
Other Material Risk Takers	5	399	40	62	501
Total	**13**	**779**	**59**	**188**	**1,026**

The variable pay in the year ended 31 December 2018, included a contractual payment of £94k to the previous Chief Executive Officer.

12. Conclusion

This Pillar 3 disclosure document is prepared in accordance with CRD IV, as interpreted by the Society, based on its size and complexity, and is updated and presented annually alongside the publication of the Society’s Directors’ Report, Accounts and Annual Business Statement. The Pillar 3 disclosures have been prepared under CRDIV rules; the Accounts and Annual Business Statement are prepared in line with FRS102 accounting standards.

An assessment of the need to publish more frequently is reviewed in light of any changes in the relevant characteristics of the Society. The Society has no plan to alter the nature of its business activities during the year. The frequency and content of Pillar 3 reporting will continue to be reviewed on an ongoing basis to ensure that they are appropriate and informative.

This document is published on Harpenden Building Society’s website – www.harpendenbs.co.uk.

For further explanation of these disclosures, an application can be made in writing to: The Society Secretary, Harpenden Building Society, Mardall House, 9-11 Vaughan Road, Harpenden, Hertfordshire, AL5 4HU.