Penrith building society
Listening and Supporting, Since 1877

Pillar 3 Disclosures

Year ended 31 December 2023

(FRN: 164473)

Contents

1. Introduction

Penrith Building Society comprises the building society and its 100% owned subsidiary, Cumbria Mortgage Centre Limited. The principal activity of the subsidiary is the provision of mortgage advice, which is aligned to the activities of the building society. Therefore, references and results reported throughout the Pillar 3 disclosures reflected the consolidated position of the building society and subsidiary, unless specifically noted otherwise.

The regulatory framework under which we operate is as set out in the 'PRA Rulebook: CRR Leverage Instrument 2021' as implemented in the UK by the Prudential Regulation Authority (PRA). These rules replaced the previous Capital Requirements Regulation (CRR) with effect from 1 January 2022.

We meet the criteria for being a "small and non-complex" institution under Article 433b of the PRA Rulebook which confirms reduced disclosures requirements (defined in Article 4 as balance sheets less than £13 billion). The following Pillar 3 disclosures aim to meet the requirements of these articles, recognising our position as a small and non-complex institution.

Our aim is to ensure that members' savings are protected by maintaining sufficient levels of capital even at times of significant economic downturn.

Below are the three main 'Pillars' which govern minimum capital requirements:

- Pillar 1 – Sets out the minimum capital requirements and uses a risk-based capital calculation focusing on credit and operational risk.
- Pillar 2 – Assesses whether there are further capital requirements beyond Pillar 1. We carry out an annual exercise, the Internal Capital Adequacy Assessment Process (ICAAP) to consider the key risk factors we face under stressed conditions and determines additional capital requirements to manage these risks. The most recent review was completed in June 2023.
- Pillar 3 – This looks at disclosure under the CRR in relation to key information about risk management and capital. This document discloses the information in accordance with regulatory guidance.

Our overall capital requirement is reviewed by the PRA under the Supervisory Review and Evaluation Process (SREP), considering the ICAAP. From this an Individual Capital Guidance (ICG), being the regulatory minimum capital, we should hold, is set. Our latest review by the PRA of the capital requirements was completed in October 2022 and we continue to maintain a capital base significantly above the minimum regulatory requirements.

The figures quoted in this disclosure document are drawn from our Annual Report and Accounts, year ended 31 December 2023, as published on our website, www.penrithbs.co.uk but are not subject to audit. They do not constitute any form of financial statement and must not be relied upon in making any judgement on us.

2. Risk assessment

We are primarily a producer and retailer of financial products, mainly in the form of mortgages and savings. These products give rise to a financial asset or liability and are termed financial instruments. In addition to mortgages and savings, we use wholesale financial instruments to invest in liquid assets. We also raise funds from the wholesale market to meet liquidity requirements.

The Board has an established risk management framework for us that is proportionate to both our size and the risks to which we are exposed. This framework enables the Board to identify, monitor, control and report on the key risks faced by us.

The Board has developed from our vision, a statement of overall risk appetite, being that we will:

"Put in place an appropriate risk management framework that sets out the amount of risk we are prepared to accept in pursuit of our objectives, being to achieve our strategic aims, support, and direct financial stability, focus on treating our customers fairly and creating a Society built on trust. We would not knowingly take risks that threaten our capital position and the ability to continue as an independent building society".

We look to manage the risks that arise from our operations. The ways in which risks are managed include using forecasting and stress test models to help guide business strategies; producing key risk information and indicators to manage and monitor performance; and using management and Board committees to monitor and control specific risks.

Three lines of defence

In considering risk within the business risk management has been set up using the three lines of defence model. This can be summarised as follows:

First line of defence	Second line of defence	Third line of defence
Management controls **(Individual Heads of Areas)**	**Oversight function** **(Risk & Compliance Department)**	**Independent assurance** **(Internal Audit)**
- Takes risks in pursuit of business objectives. - Ownership, accountability, and responsibility for risk - Implement, maintain, and monitor controls to mitigate risks identified	- Develops a risk management framework. - Oversees and challenges risk management in the first line. - Assists management in managing risks and issues	- Provides independent assurance over risks and the risk management framework. - Reports to the Audit, Risk and Compliance Committee (ARCC) in order to perform its duties independently

Each area of risk, as defined below, has been assigned to an individual risk owner, or group of owners as appropriate, who are the first line of defence and are responsible for the day-to-day management of risks across the business through effective procedures and a robust control framework to which they attest on a quarterly basis.

For the second line of defence, we have a dedicated Risk & Compliance function, reporting into the Board through the Finance Director and members of ARCC, who provide an independent internal control over how risk is being managed and responded to.

For the third line of defence, we outsource our internal audit services to a third party. The third party reviews our risk environment on an annual basis through discussions with the Executive Directors and members of ARCC and from this formulates a risk based internal audit plan.

Changes to the risk environment during the year are monitored by the ERC monthly and ARCC on a quarterly basis. A summarised report is provided to the Board monthly. Any adjustments to the coverage of risk in any of the lines of defence can be made through either the Board, or more commonly the ARCC, to ensure we are not unduly exposed to changes in an existing area of risk or new areas of risk.

Requirements to react to changes in risks are initially tasked to the first line of defence, but as appropriate second and third lines of defence will undertake reviews to satisfy the ARCC and Board that risks are being appropriately controlled and mitigated in line with the approved risk appetite statement.

Consideration of the main risks faced by us is as follows:

Area of risk	Description
Operational	The risk of loss arising from failed or inadequate internal processes or systems, human error, or other external factors. Within operational risk we include process, technology, personnel, and physical risks. We manage our operational risks through internal controls and various risk mitigation techniques, such as insurance cover and business continuity planning. Separate incident response plans have been put in place as part of our work on operational resilience. Certain roles require specialist skills, which can be difficult to resource at short notice. To mitigate this risk, we have a Succession Plan for all directors and senior staff. We adopt the Basic Indicator Approach (BIA) to operational risk which is expressed as a percentage of the average of the latest three years of the sum of net interest income and net non-interest income.
Mortgage credit	Credit risk arising from mortgage loans to customers is managed through the Responsible Lending Policy, which reflects our low credit risk appetite for arrears and includes how we monitor and proactively manage of arrear. Concentration risk arises from concentration of exposures within the same category including product, industry sector and geographical location. Our main concentration risk is geographical as a large proportion of our lending is in our heartland of the Eden Valley and Cumbria. We also insure our residential mortgage book against losses using Mortgage Indemnity (MIG) insurance. MIG is taken out on all lending where the loan to value (LTV) exceeds 80% at origination.
Counterparty credit	The risk that losses may arise due to the failure of a counterparty in a treasury investment, to meet the obligation to repay. It is the responsibility of ALCO to manage this risk, through the maintenance of approved counterparties listings and monitoring of activity against the limits set in the Liquidity and Funding policies. The Liquidity and Funding policies have been drawn up to ensure that we can obtain the best possible return on our investments whilst operating within prudential limits in respect of counterparties. In selecting counterparties and limits to be applied to them, we make use of rating information, balance sheet data, and any other background information available. Our policies require that funds are only invested in Government backed securities (Gilts or Treasury Bills), financial institutions with a minimum Fitch IBCA short term rating of F2 (unless a counterparty with a lower rating is expressly approved by the Board) and building societies which satisfy our requirements in respect of the level of free capital available. The limits applied to counterparties and the appointment of new counterparties must be approved by the Board. All counterparties and limits are reviewed as a minimum annually and more often as circumstances dictate.
Funding	This is the risk that we are unable to attract the right level of funding to manage its growth ambitions. The Funding Policy specifies the types and limits on different funding sources available to us, which include both retail and wholesale options. It also considers how we manage the administered versus non-administered assets on the balance sheet, particularly from a margin management perspective as we use a straightforward matching of assets and liabilities to manage this aspect of the balance sheet. Monitoring of compliance with the Funding Policy is reported through the ALCO to Board.
Interest Rate (including Basis Risk)	This is the risk of changes to our financial position caused by changes in market interest rates. We have limited exposure to this risk as any fixed rate mortgage lending undertaken is matched by fixed rate retail savings and no derivative financial instruments are used. Our balance sheet is tested on a monthly basis for the effects of a 2% parallel shift in interest rates and is monitored by ALCO.

Area of risk	Description
Liquidity	The risk that we will be unable to meet our financial obligations as they fall due. The Liquidity Policy specifies the minimum levels of liquidity which must be held and the financial instruments in which that liquidity may be invested to ensure that there are always sufficient funds available to meet all calls, foreseen and unforeseen, on us. Monitoring of compliance with the Liquidity Policy is reported through the ALCO to the Board. Liquidity stress testing regime is reviewed annually as part of the Internal Liquidity Adequacy Assessment Process (ILAAP) to ensure that all liquidity risk drivers are considered. The ILAAP is an assessment of our current and future exposure to liquidity risk and was last approved by the Board in July 2023.
Conduct	The risk we are not being fair to members in all dealings with them. The work to embed Consumer Duty is enhancing our controls in this area, which includes the monitoring of new product development, existing product performance, member feedback, complaints and other associated areas in line with the pillars underpinning Consumer Duty. Conduct risk is acknowledged as a recurrent and potentially material source of loss, but this is not addressed in any of the Pillar 1 calculations, although aspects are captured in the BIA calculation for operational risk. We closely monitor conduct, across the six customer outcome areas as set out by the FCA and now the four pillars within the Consumer Duty, through a series of internally set metrics, both qualitative and quantitative and encourages member engagement and feedback to develop our conduct approach processes on a regular basis.
Cyber and Data Security	These are key risk areas for us because of the increasing profile of both, and potential significant detriment for both us and our members if issues were to arise. We outsource our cyber risk management to a third party which specialises in this area and continues to review and strengthen it data security measures around our perimeter. Penetration testing is conducted on a regular basis. Data security has continued to evolve since the introduction of the General Data Protection Regulation and regular training of staff in both this area and that of cyber security continues, as one of the key risks is human error, either intentional or otherwise, which leads to data loss or a cyber breach.
Climate Change	The risk due to the changes in the climate and is split into physical and transitional risk areas. Physical risks could create a direct impact, such as properties over which we hold a mortgage becoming uninhabitable or unsaleable due to increased risk of flooding. Transition risks could include developments such as potential disruption to certain sectors of the economy as the world moves from higher to lower levels of carbon production in energy generation. In recent years we have seen increased risks due to floods and other factors for properties in the mortgage book and are assessing the risk of modern methods of construction when considering how a loan can be underwritten. We have combined this risk with other risk areas from a policy perspective and report as a sub-set of a number of the other risks above, rather than as a separate risk area.
Model Risk	This it the risk that we make a financial loss due to decisions that could be principally based on the output of models, due to errors in the development, implementation, or use of such models. It could arise if we do not effectively operate and control the models, we have developed to support the delivery of our strategic objectives, both financially and non-financially. This risk is the responsibility of the management team with oversight from the Board, monitored by the Technology & Security Risk Committee (TSRC)

3. Capital adequacy assessment

Capital requirement

It is essential that we maintain sufficient capital to support our ongoing activities and this requirement is an integral part of our corporate planning process. Our Corporate Plan projects forward three years and takes into account the need to maintain adequate financial and non-financial resources to support the Corporate Plan objectives.

We also review our capital position via the ICAAP, which considers our capital requirement in normal and stressed conditions, taking into consideration all our business activities and key areas of risk, and determining levels of capital required to support each area.

The ICAAP acts as our capital planning document for the period of the Corporate Plan.

It includes a calculation of the minimum Pillar 1 capital requirements for each year of the plan using:

- the Standardised Approach, applying a risk weighting of 8% to the risk weighted asset values (RWA's) to determine the minimum requirement for credit risk; and
- the Basic Indicator Approach, applying a risk weighting of 15% to the average net income over the previous three years to determine the minimum requirement for operational risk.

We are provided with a Total Capital Requirement (TCR) by the PRA, with the latest issued TCR set at 8% of risk weighted assets. TCR is the amount and quality of capital we must maintain to comply with the minimum capital requirements under the Capital Requirements Regulations (575/2013) (CRR) (Pillar 1) and the Pillar 2A capital requirements.

Capital buffers

We are required to hold a Countercyclical Buffer (CCYB) dependent on the geographical breakdown of our assets. It is set by individual countries and is designed to limit excessive credit growth. As we are wholly located in the UK, the UK element of the CCYB is set by the Financial Policy Committee (FPC) and can range from 0% to 2.5%. On 2 July 2023 it increased to 2.0% following the reduction in response to COVID-19.

Additionally, as with other UK financial institutions, we are required to hold a Capital Conservation Buffer (CCOB), which can be used to absorb losses during periods of economic and financial stress, to avoid breaching minimum capital requirements. The CCOB is also set as a percentage of RWA's. At 31 December 2023 was 2.5%.

Leverage ratio

The leverage ratio is a simple, transparent, non-risk-based measure that allows a comparison between financial institutions. It is calculated as Tier 1 Capital divided by the adjusted balance sheet exposures.

CRD IV requires a minimum leverage ratio of 3%.

4. Key Disclosures

An overview of our prudential regulatory metrics is summarised below:

Table 1: UK M1- Key Metrics

		2023 £000	2022 £000
Available own funds (amounts)			
1	Common Equity Tier 1 (CET1) capital	12,863	12,422
2	Tier 1 capital	12,863	12,422
3	Total capital	13,037	12,598
Risk-Weighted exposure amounts			
4	Total risk-weighted exposure amount	48,297	50,354
Capital ratios (as a percentage of risk-weighted exposure amount)			
5	Common Equity Tier 1 ratio (%)	26.62%	24.67%
6	Tier 1 ratio (%)	26.62%	24.67%
7	Total capital ratio (%)	26.99%	25.02%
Additional own funds requirements based on SREP (as a percentage of risk-weighted exposure amount)			
UK 7a	Additional CET1 SREP requirements (%)	2.31%	2.22%
UK 7b	Additional AT1 SREP requirements (%)	-	-
UK 7c	Additional T2 SREP requirements (%)	-	-
UK 7d	Total SREP own funds requirements (%)	10.31%	10.22%
Combined buffer requirement (as a percentage of risk-weighted exposure amount)			
8	Capital conservation buffer (%)	2.50%	2.50%
9	Institution specific countercyclical capital buffer (%)	-	-
UK 9a	Systemic risk buffer (%)	-	-
11	Combined buffer requirement (%)	2.50%	2.50%
UK 11a	Overall capital requirements (%)	12.81%	12.72%
12	CET1 available after meeting the total SREP own funds requirements (%)	16.31%	14.45%
Leverage ratio			
13	Total exposure measure excluding claims on central banks	130,588	141,093
14	Leverage ratio excluding claims on central banks (%)	9.85%	8.80%
Liquidity Coverage Ratio			
15	Total high-quality liquid assets (HQLA) (Weighted value -average)	11,249	11,240
UK 16a	Cash outflows - Total weighted value	8,169	10,426
UK 16b	Cash inflows - Total weighted value	7,125	8,973
16	Total net cash outflows (adjusted value)	1,045	1,453
17	Liquidity coverage ratio (%)	525.22%	399.66%
Net Stable Funding Ratio			
18	Total available stable funding	119,681	126,601
19	Total required stable funding	69,441	71,425
20	NSFR ratio (%)	172%	177%

5. Total capital requirements

The table below summarises our risk weighted exposures related to the standardised model:

Table 3: UK OV1- Overview of risk weighted exposure amounts

		Risk weighted exposure amounts (RWEAs)		Total own fund requirements
		2023	2022	2023
		£000	£000	£000
1	**Credit risk (excluding CCR)**	**43,411**	**46,019**	**3,473**
2	Of which the standardised approach	43,411	46,019	3,473
3	Of which the foundation IRB (FIRB) approach	-	-	-
4	Of which slotting approach	-	-	-
UK 4a	Of which equities under the simple risk weighted approach	-	-	-
5	Of which the advanced IRB (AIRB) approach	-	-	-
6	**Counterparty credit risk - CCR**	-	-	-
7	Of which the standardised approach	-	-	-
8	Of which internal model method (IMM)	-	-	-
UK 8a	Of which exposures to a CCP	-	-	-
UK 8b	Of which credit valuation adjustment - CVA	-	-	-
9	Of which other CCR	-	-	-
15	Settlement risk	-	-	-
UK 22a	**Large exposures**	-	-	-
23	**Operational risk**	**4,886**	**4,335**	**391**
UK 23a	Of which basic indicator approach	4,886	4,335	391
UK 23b	Of which standardised approach	-	-	-
UK 23c	Of which advanced measurement approach	-	-	-
24	Amounts below the thresholds for deduction (subject to 250% risk weight) (For information)	-	-	-
29	**Total**	**48,297**	**50,354**	**3,864**

6. Remuneration policies and practices

The Remuneration Policy ('the Policy') follows the 'Remuneration Code' guidelines put in place by the FCA, which sets out the standards and policies we are required to meet when setting pay for Directors, focusing on the risks around the structure of remuneration arrangements rather than the absolute amount of remuneration.

The Policy is to reward Directors through salary or fees according to their skills, expertise, experience, and overall contribution, considering salary and fee levels in comparable organisations. The Policy is to set remuneration at levels sufficient to attract and retain Executive and Non-Executive Directors of sufficient calibre and expertise.

Executive Directors' remuneration comprises basic salary and pension benefits. We do not have bonus or share option schemes. Their salaries are considered by the Remuneration Committee which meets at least once a year. Salary levels are set having regard to job content and responsibilities, the performance of the individual and salaries in similar organisations. We do not have a defined benefit or final salary pension scheme. We make contributions to the private pension arrangements of the Executive Directors.

The remuneration of all Non-Executive Directors is fee based and is reviewed annually by the Board. They do not participate in any performance pay scheme, pension arrangements or other benefits and do not have service contracts. The Chair of Board and Chair of ARCC receive higher fees than other Non-Executive Directors in recognition of the additional workload and responsibilities incumbent on those positions.

An advisory vote on the Directors Remuneration Policy is taken at every Annual General Meeting.

Information on the relevant experience of the Executive and Non-executive Directors and details of their remuneration is provided in the Annual Review for the year ended 31 December 2023, which is available to download on our website www.penrithbs.co.uk

Remuneration Staff

The Remuneration Committee has determined that as of 31 December 2023, that the Chief Executive, former Chief Executive and Finance Director, were designated as having a material impact on the risk profile of the institution, as per Article 450 (CRR).

The table below sets out the aggregate remuneration for staff who are MRTs in relation to their services to the business for the year ended 31 December 2023. The variable remuneration reflects a discretionary bonus payment made to the individuals and is not based on a contractual agreement.

Table 3: UK REM1- Remuneration awarded for the financial year

			a
			MB Supervisory function
1	Fixed Remuneration	Number of identified staff	3
2		**Total fixed remuneration**	**211**
3		Of which: cash-based	211
9	Variable Remuneration	Number of identified staff	3
10		**Total variable remuneration**	**14**
11		Of which: cash-based	14
17	**Total Remuneration (2+10)**		**225**

There were no special payments (UK REM2) or deferred remuneration (UK REM3) made to staff whose professional activities have a material impact on the institutions' risk profile.

7. Conclusion

This disclosure document, prepared in accordance with the requirements of the PRA Rulebook Articles 431-455, is intended to provide background information on our approach to risk management. It also provides asset information and capital calculations under both Pillar 1 and Pillar 2. It is reviewed annually and published on our website to coincide with the release of our Annual Report and Accounts for the financial year end.

In the event that a reader of this document needs additional information, a request should be made in writing to the Finance Director at Penrith Building Society, 7 King Street, Penrith, CA11 7AR.