PROGRESSIVE

BUILDING SOCIETY

Pillar 3 Disclosures

31 December 2018

CONTENTS

Appendices

1. Overview

The Basel Committee on Banking Supervision introduced the Basel legislative framework governing how much capital all banks and building societies must hold to protect their members, depositors and shareholders. The EU Capital Requirements Directive (CRD) is the means by which Basel III was implemented in the EU. In the UK this has been implemented through rules introduced by the Prudential Regulation Authority (PRA).

The Basel framework consists of three main pillars:

- Pillar 1 – Minimum Capital Standards
- Pillar 2 – Supervisory Review Process
- Pillar 3 – Disclosure

Pillar 1 determines the minimum capital standards required by the firm focusing on credit, market and operational risks.

Pillar 2 requires the firm to set aside adequate additional capital to cover the risks not already provided for under Pillar 1. The Board of Progressive Building Society assessed all major risks in the business and determined the capital required under a severe economic downturn.

Pillar 3 complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). Its aim is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes. The disclosures are made to the market for the benefit of the market.

Basis of Preparation

The sole purpose of these disclosures is to give information on the basis of calculating capital requirements and on the management of the risks faced by the Society. This is in accordance with the rules laid out in the PRA handbook and CRD IV as applicable.

Frequency of Disclosure

Disclosures will be issued at least annually on the Progressive website www.theprogressive.com based on the most recent published Annual Report and Accounts. All figures are based on 31 December 2018, the Society's financial year end.

Country by Country Reporting

Country by country reporting is detailed on page 16 of the 2018 Annual Report and Accounts.

Verification and Sign-off

These disclosures are not subject to external audit except where they are equivalent to those prepared under accounting requirements for inclusion in the Society's audited Annual Report and Accounts. They are verified internally by the Society's Prudential Risk Committee in accordance with the Society's reporting and governance process. The Society's Board reviewed and approved these disclosures in May 2019.

2. Risk Management Framework

Progressive Building Society is a mutual organisation owned by and run for the long term benefit of its Members. The Board accepts risks as a natural occurrence in the provision of mortgages and savings products, but endeavours to mitigate and manage these risks. The main risks within the business are credit, market (including interest rate risk), capital, liquidity and operational risk.

The Society has a formal structure for managing risks and operates a 'three lines on defence' model which is recognised as an industry standard for risk management. The management of risks is detailed in risk management policies which are set by the Board.

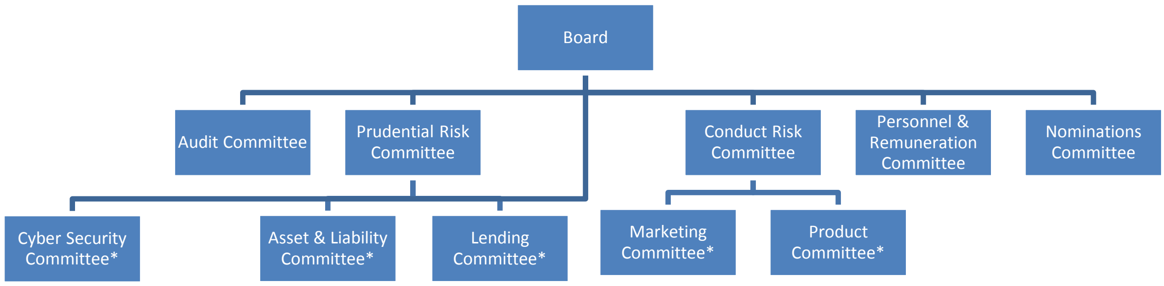
- First Line: Primary responsibility for managing risk and ensuring controls are in place lies with the business units within the Society – the 'first line of defence'. Management have a responsibility to understand how risks impact their area of the Society and to put in place controls or mitigating activities.

- Second Line: The 'second line of defence' comprises risk management and compliance functions, whose key duties are to monitor and report risk – related practices and information, and to oversee all types of compliance and financial reporting issues.

  The 'second line of defence' defines preventive and detective control requirements, and ensure that such requirements are embedded in the policies and procedures of the first line. It is independent of the first line and applies controls either on an ongoing (e.g. daily) or periodic basis. The second line consists primarily of risk and compliance departments (Prudential and Conduct Risk). The Chief Information Security Officer (CISO) also operates solely in the second line and seeks to continually improve the processes and controls around information governance and security.

- Third Line: Internal Audit provides the 'third line of defence' with independent assurance regarding the activities of the various business units, including the Prudential and Conduct Risk functions. The Head of Internal Audit, an outsourced function, has an independent reporting line directly to the Chair of the Audit Committee. The Audit Committee approves the work programme of internal audit and receives reports on the results of the work performed.

The Society's Board and Committee structure in 2018 is as below:



Denotes Management Committee

Board

Composition: Five Non-executive Directors (six as at 1 January 2019) and three Executive Directors. The Chief Risk Officer attends by invitation. Details of the Board composition are provided in the Directors' Profiles in the Annual Report and Accounts.

Main Functions: The Board has responsibility for setting the Society's risk strategy and risk appetite and ensuring the Risk Management function is adequately and appropriately resourced via the Prudential and Conduct Risk Committees. The Board has responsibility for approving all of the Society's key policies as recommended by the various committees.

Frequency: The Board normally meets at least eleven times per year.

Audit Committee

Composition: Three Non-executive Directors. Other Non-executive Directors, Executive Directors and Senior Managers attend by invitation.

Main Functions: The Committee considers matters relating to internal and external audit arrangements and systems of control. The Society is required to take reasonable care to establish and maintain such systems and controls as are appropriate to its business. The Committee receives an Internal Audit report at each meeting on the risk management and adequacy of controls within particular business areas. The Committee reviews and challenges, where necessary, the actions and judgements of management.

Frequency: The Committee normally meets five times per year.

Conduct Risk Committee *

Composition: Three Non-executive Directors, the Chief Executive, and the Operations Director. The Head of Internal Audit also attends all meetings. Other individuals such as, the Deputy Chief Executive and Finance Director, Head of Conduct & Compliance, Chief Risk Officer, and external audit may be invited to attend all or part of any meeting as and when appropriate and necessary.

Main Functions: The Conduct Risk Committee (CRC), as a Board committee, supports the Board by overseeing the manner in which Progressive Building Society conducts business with its members. This is to ensure that the Society's conduct meets Progressive's objectives in delivering business in a clear, transparent and fair manner; whether that is by Progressive Building Society itself or by effecting oversight of any third party's conduct with Progressive's members. The Committee will also ensure that Progressive meets its regulatory and legal obligations with regard to Conduct of Business as laid out by its regulator.

Frequency: The Committee normally meets four times per year.

* Conduct Risk Committee is now called Member Engagement and Conduct Committee (effective March 2019).

Prudential Risk Committee **

Composition: Three Non-executive Directors, Chief Executive, and the Deputy Chief Executive and Finance Director. The Head of Internal Audit also attends all meetings. Other individuals such as the Operations Director, Chief Risk Officer, Head of Conduct & Compliance and Treasury Manager may be invited to attend all or part of any meeting as and when appropriate and necessary.

Main Functions: The Board has established a committee to be known as the Prudential Risk Committee to support it in achieving its objectives and in overseeing the management of prudential risk across the Society. The Committee advises the Board on the Society's overall risk appetite and tolerance. The Committee recommends the ICAAP, ILAAP and Lending Policies to the Board for approval.

Frequency: The Committee normally meets four times per year.

** The Prudential Risk Committee is now called Risk Committee with remit for all risks (effective March 2019).

The Board has reviewed the Terms of Reference of Committees and concluded from 2019 all Society Risks will be overseen by a single Risk Committee.

<u>Nominations Committee</u>

Composition: Three Non-executive directors & the Chief Executive.

Main Functions: The Committee reviews the Society's Board Nomination requirements. The Committee evaluates the plans for orderly succession aimed at ensuring an appropriate balance of skills, diversity and experience on the Board.

Frequency: The Committee meets at least twice per year.

<u>Personnel and Remuneration Committee</u>

Composition: Three Non-executive directors. The Chief Executive and the Deputy Chief Executive and Finance Director attend by invitation.

Main Functions: The Committee reviews the Society's overall personnel and remuneration strategies and revises as deemed necessary. It identifies Human resources related initiatives and monitors staff well-being.

Frequency: The Committee normally meets four times per year.

<u>Risk Strategy</u>

The Society's risk strategy reflects its committee structure. As such the Board approves the Board Risk Appetite Statement which contains both quantitative and qualitative risk measures. This statement is supported by a suite of risk metrics, limits and triggers designed to ensure the Society stays within risk appetite.

Secondary, more granular, risk statements are reviewed by the Board Risk Committees for approval by the Board. These risk statements set out the key risks, how they are managed and incorporate further limits and triggers which articulate the Society's Risk

Appetite across all pertinent areas. This appetite is then monitored by the individual management level risk committees.

In addition the third line of defence reviews the operation of controls during their assessments to provide assurance to the Board that controls are designed appropriately, operating as expected or where weaknesses are identified to assist the strengthening of the risk management framework.

During 2018, the information received and considered by the Board and its Committees provided reasonable assurance that during the year there were no material breaches of control or regulatory standards and that the Society maintained an appropriate system of internal control. Where weaknesses in controls are identified by the three lines of defence the Board monitors the steps taken to remedy the issues and to ensure that the Society responds to changing external threats and economic circumstances and to the changing regulatory environment.

The Board and senior management of the Society have been monitoring the impact of Brexit throughout 2018 and this process will continue throughout 2019. The impact of Brexit has also been included within the Society's Stress Testing Framework.

Risk Appetite

The Society is a mutual organisation with no shareholders and is the custodian of its Members' long term financial interests. The Members are entitled to take for granted that their money is safe. The Society's Board adopts a prudent attitude to risk when setting its risk appetite.

There is no one single measure that defines the Board's risk appetite, but rather, a framework through which the Board has set overarching parameters within which the business is managed and performance monitored. The Board's Statement of Risk Appetite is expressed to reflect the strategy, overall objectives and business plans of the Society and is linked to the core elements of the business. Adherence to the Board appetite is monitored on a quarterly basis through structured KPIs and early warning indicators reported to the Prudential and Conduct Risk Committees.

The risk appetite statements span across all key areas of the Society incorporate measures which are reviewed at least annually or in the event that there are significant changes in strategy that require an adjustment to Risk Appetite.

Stress Testing

The Society has a Stress Testing Framework in place to ensure it meets regulatory and business requirements. The objective of the framework is to be used as a risk management tool and inform business decisions.

Society-wide stress tests are an integral part of the annual business planning process and annual review of risk appetite. Tests are designed to ensure that the Society's financial position and risk profile provide sufficient resilience to withstand the impact of severe economic stress on the market (systemic stress) or stress events that would only impact the Society (idiosyncratic stress). The Society has also devised a variety of stress scenarios in relation to the ongoing Brexit uncertainty.

Stress testing also informs early-warning triggers, management actions, contingency and recovery plans to mitigate potential stresses and vulnerabilities and as such is integral to the Society's risk management framework.

The stress testing framework also includes reverse stress testing techniques which aim to identify circumstances under which the Society's business model is no longer viable, leading to a significant change in business strategy. Stress testing is used to identify and review the potential effectiveness of management actions that would be taken to mitigate the impact of a stress.

3. Risk Management Objectives and Policies

Progressive Building Society looks to manage the risks that arise from its operations of providing financial products. These risks are managed using forecasts and stress testing models to help guide the business strategies and use the Board, committees and management to monitor and control specific risks.

Credit Risk

Credit risk is the risk that a financial loss arises from the failure of a customer or counterparty to meet their contractual obligations. Credit risk arises primarily from mortgage lending and treasury operations.

All mortgage applications are assessed with reference to the Board approved lending policy and considering the affordability of the borrowers' loan repayments. Loans are only granted against valuations based on physical inspections of the properties. For analysis of Mortgage Assets see Appendix 1. Details of mortgage provisions are analysed in Appendix 3.

The Society utilises derivative instruments to hedge its exposure to interest rate risk. All of the Society's derivatives are bilateral and conducted over-the-counter (OTC). All of the Society's derivatives transactions are governed by agreements based on documentation provided by the International Swaps and Derivatives Association (ISDA). Each of the ISDA agreements is supported by a Credit Support Annex (CSA). The CSAs govern the process of mitigating any credit risk that may result from the derivatives. This includes the frequency and method of valuing any credit risk exposure and the movement of margin collateral between the Society and the counterparty.

The Society posts margin (collateral) when marked to market (MTM) interest rate swap values move against the Society and calls margin should MTM values move in the Society's favour. Exposure is monitored on a daily basis and compared to counterparty valuations, which are then reviewed to ensure valuations are reasonable.

The Society's Board approved Treasury Policy statement sets out exposure limits for individual counterparties, groups of counterparties, industry sectors and countries. During 2018 the Society maintained a very prudent approach to liquidity management, placing funds with the Bank of England, in UK Government debt, and for shorter periods, with highly rated financial institutions.

The purpose of the Society's counterparty treasury credit risk management policy is to ensure that the Society can obtain the best possible return whilst operating within prudent limits in respect of counterparties. The methodology for establishing counterparty limits involves consideration of the background rating information from the Fitch ratings agency and balance sheet data relevant to the counterparty.

New credit limits are recommended to the Board by the Prudential Risk Committee for ratification. Existing credit limits may be removed or suspended with immediate effect due to rating downgrades or adverse market intelligence. All limits are reviewed on a regular basis by the Asset and Liabilities Committee (ALCO) and monitored by Treasury staff on a daily basis. No dealing will take place with counterparties which do not have a pre-approved limit. For analysis of Treasury Assets see Appendix 2.

The Society has adopted the Standardised Approach (Basel III) for the calculation of the credit risk capital requirement.

Market Risk

Market risk is the risk that the value of income arising from the Society's assets and liabilities may change adversely as a result of changes in interest rates or exchange rates. For capital adequacy purposes the Society is not directly exposed to this risk because it does not engage in trading activity and all assets and liabilities are denominated in sterling.

Interest Rate Risk

The Society is exposed to interest rate risk, principally arising from the provision of fixed rate lending and savings products. The various features and maturity profiles for these products, create interest rate risk exposures due to the imperfect matching of interest bases between different financial instruments and the timing differences on the re-pricing of assets and liabilities.

A parallel shift in interest rates of 2% is used to assess the effects of an interest rate shock. The Society's risk appetite in this area has been established by the Board as 5% of Common Equity Tier 1 (CET1) Capital for a movement in economic value (EV) for a shift in interest rates of this magnitude. The Society also utilises an operating range of 3.5% of CET1 to ensure the 5% limit is not breached. Once the 3.5% operating range has been surpassed, the Society takes decisive action to reduce the potential impact of interest rate risk on the balance sheet. As at 31st December 2018 the effect of a 2% parallel shift in interest rates was £2.8m being well within the 5% of CET1 limit which was £6m.

The Society also monitors the six newly prescribed interest rate shocks devised by the EBA which are expected to be implemented by 31 December 2019. The European Banking Authority (EBA) expects these shocks to act as an early warning indicator should the decline in EV be greater than 15% of CET1. The Society's exposure to EV against the six interest rate shock scenarios is significantly lower than regulatory requirements.

Derivatives are used to limit the extent to which the Society will be affected by changes in interest rates. Derivatives are used exclusively to hedge risk exposures.

The principal derivatives currently used by the Society are interest rate exchange contracts, commonly known as interest rate swaps. The Society uses derivatives in accordance with the terms of the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and, accordingly, they are used exclusively to reduce the risk of loss arising from changes in interest rates.

Another significant form of interest rate risk arises from the imperfect correlation between re-pricing of interest rates on different assets and liabilities, often referred to as basis risk. Basis risk is monitored by ALCO on a monthly basis and is kept within set Board limits by adjusting product prices and availability.

Liquidity Risk

Liquidity risk is the risk that the Society cannot satisfy the Overall Liquidity Adequacy Rule (OLAR) by having insufficient liquidity resources to meet its financial obligations as they fall due. The risk is managed principally by the holding of cash and other readily realisable assets in order to meet daily business requirements, to meet any unexpected cash needs and to maintain public confidence.

The Society is responsible for the effective management of its liquidity and funding risks. The Society defines its liquidity risk appetite through adherence to OLAR. The Society's OLAR provides a risk appetite level which ensures prudent levels of liquid assets to meet obligations in normal and stressed conditions.

The Treasury back office function monitors adherence to the Funding and Liquidity policies on a daily basis. Any breaches are referred to the Finance Director in the first instance and then ALCO and the Board. The Society also has a Liquidity Contingency Plan in place which sets out steps the Society would take if faced by a liquidity stressed event of varying degrees of seriousness.

The Society conducts an Individual Liquidity Adequacy Assessment Process (ILAAP) at least annually, which is reviewed by the Prudential Risk Committee and approved by the Board. The ILAAP identifies all the major liquidity risks faced by the Society and ensures adequate liquidity is maintained.

The Society expresses its daily liquidity needs as an internal liquidity requirement, which is based on estimated requirements for liquid assets in a severe but plausible stress scenario. Additionally, the regulatory Liquidity Coverage Ratio (LCR) expresses the Society's liquidity holdings and requirements using a short-term 30-day stress scenario. The Society's LCR at 31 December 2018 was 338% (minimum 100% regulatory requirement).

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This risk is managed by individual business areas through a series of appropriate controls and procedures. Reporting is by exception to the Risk Committees and ultimately the Board.

The Society's operational risk management framework sets out the strategy to identify, assess and manage operational risk with senior management having responsibility for understanding the nature and extent of the impacts on each business area and for embedding the appropriate controls to mitigate those risks. The framework is reviewed periodically to take account of changes in business profile, new product development and the external operating environment.

During 2018, the Financial Conduct Authority (FCA) and Prudential Regulation Authority

(PRA) issued a joint discussion paper on the UK financial sector's operational resilience. Operational Resilience forms an integral part of the Society's overall strategy. Plans are in place to deliver critical services, no matter what the cause of the disruption. This extends beyond business continuity and disaster recovery, and also includes man-made threats such as physical and cyber-attacks, IT system outages and third-party supplier failure as well as natural hazards such as fire, flood, severe weather and pandemic flu. The Society has clearly articulated and formally adopted objectives with regard to Operational Resilience. The objective is to ensure that Society operational resilience arrangements meets the regulatory and business requirements and provides key stakeholders with appropriate assurance regarding the Society's preparedness in the event of an operational resilience incident.

Risk appetite for all risk categories is expressed by the Board by reference to the most significant net risks recorded in the Society's risk registers. Each risk on the risk register is assessed using a 'Probability/Impact' matrix which is used to quantify, in financial terms, potential risk to the Society, before and after taking into account the effectiveness of management controls, and other forms of mitigation. Risk appetite is quantified in terms of a limit which a single risk exposure should not exceed. For individual risks which are deemed unacceptable, remedial action is taken including introducing or enhancing the operational controls and/or risk mitigants related to the individual risk, or taking appropriate action to eliminate the risk altogether.

All key Society controls are documented and reviewed annually with any control changes being formally reviewed by the Risk and Compliance department.

The risk registers are subject to regular review by each risk owner and Society Risk and Compliance Department with the highest scoring risks for the Society as a whole reported to the Board periodically.

The risk registers and risk assurance framework are subject to review by Society Internal Audit. The focus and prioritisation of the Internal Audit annual programme is linked closely to an assessment of the risk registers and highest scoring risks.

The Society has adopted the Basic Indicator Approach (Basel III) for calculation of the operational risk capital requirement.

Concentration Risk

Concentration risk is the risk of loss arising from over-exposure to a single borrower or group of borrowers. This may arise through geographical region or industry sector concentrations.

As a regional building society, Progressive has a geographical lending concentration in Northern Ireland. 99.9% of the mortgage book is in Northern Ireland. This risk is carefully managed through very prudent lending criteria. Lending is spread throughout the Province by virtue of branches and agents in all of the major cities and towns and is monitored by the Prudential Risk Committee on a quarterly basis.

Sectoral concentrations are managed and monitored through compliance with the

Lending and Treasury policies and reporting to the Prudential Risk Committee by ALCO and ultimately the Board.

Business Risk

Business risk is the exposure of the Society's performance caused by uncertainty in the economy. It is any risk that may affect the Society's ability to meet its core objectives. Progressive looks to mitigate this risk by having a range of products so that its income source is not reliant on one product or one area of business.

Pension Liability Risk

Pension liability risk is the risk that there may be a shortfall with respect to benefits due to employees/former employees within a defined benefit pension scheme. The Society operates a defined benefit pension scheme which is closed to new members. The Executive Directors are members but also participate in an unfunded arrangement. New members of staff are eligible to join the Society's defined contribution pension scheme.

The possibility exists of further detrimental impact on the Society's reserves due to increased life expectancy, falling interest and equity prices and increased staff salaries.

Progressive is advised by a major actuarial consulting firm specialising in pension administration and advice.

Conduct Risk

Conduct risk is the risk of the Society treating its retail members unfairly and delivering inappropriate customer outcomes.

The sustainability of the Society's business model, and achievement of its longer term strategy are dependent upon the consistent and fair treatment of members. The regulatory regime reflects the increasing scrutiny of the measures adopted by firms in relation to business conduct. This has been mirrored by the Society's approach towards the governance of conduct risk.

The Conduct Risk Committee forms part of the Society's overall governance and control framework. Pursuing good member outcomes is integral to the Society's culture. Internal and external independent reviews are undertaken to evaluate the effectiveness of the Society's culture.

4. Capital Resources

The Society has no transitional arrangements under CRD IV

	31 December 2018 CRD IV Final £000's
Total equity attributable to members per the Statement of Financial Position	
- General reserves	122,302
- Revaluation reserve	(659)
- Available-for-sale reserve	71
- Intangible fixed assets	(1,528)
- Deferred tax liabilities associated to intangible fixed assets	-
Total Common Equity Tier 1 Capital	**120,186**
Adjustments to Tier 2 Capital: -Add back: Collective impairment	962
Regulatory Capital	**121,148**

Common Equity Tier 1 capital

The majority of the Society's own funds are in the form of Common Equity Tier1 (CET1), which consists of mainly retained earnings. Intangible assets recognised on the Society's balance sheet are required to be deducted from CET1 capital and the corresponding tax liability may be added back. The Society's collective impairment is included as part of Tier 2 Capital. At 31 December 2018, the Society's CET1 ratio was 19.63%.

5. Capital Adequacy

Capital Management

Principle 4 of the FCA's Principles for Businesses requires a firm to maintain adequate capital resources. Chapter 2 of the ICAA rules within the PRA Rulebook states that a firm must at all times maintain overall financial resources, including own funds and liquidity resources, which are adequate both as to amount and quality, to ensure there is no significant risk that its liabilities cannot be met as they fall due.

The Society continues to comply with the capital adequacy rules of the PRA by adopting the Standardised Approach to credit risk and the Basic Indicator Approach to operational risk. The Society conducts an Internal Capital Adequacy Assessment Process (ICAAP) at least annually, which is approved by the Board. The ICAAP identifies all the major risks faced by the Society and allocates capital as appropriate. The ICAAP is reviewed by the PRA in setting the Society's capital requirements. The Society maintains capital far in excess of that required by the regulator.

Progressive Building Society aims to maintain sufficient capital resources to ensure the financial security of the Society. In order to maintain this capital the Society needs to generate and retain profits that will add to the general reserves, the main source of capital.

Challenge and Adoption of Individual Capital Adequacy Assessment Process (ICAAP)

The Prudential Risk Committee monitors the Society's capital position with the aid of its ICAAP, which brings together the Risk Management Framework, corporate planning and capital management. The ICAAP involves discussions with the various business areas and how their current profiles may change, together with assessments for capital allocation. The ICAAP is prepared by the Chief Risk Officer and reviewed by the Chief Executive and Deputy Chief Executive and Finance Director before being reviewed by the Prudential Risk Committee. This provides the non-executive directors with a forum to challenge the scope of the risk and the severity of the underlying stress-testing assumptions. After review, the ICAAP is recommended by the Prudential Risk Committee to the Board for final review and adoption.

Quality of Capital

The objective of the Basel rules is to increase the ability of financial institutions to deal with shocks and stresses related to financial and economic factors. Common Equity Tier 1 is regarded as the highest quality of capital and Basel III rules state that a greater proportion of the Pillar I capital requirement must be met from common equity tier 1 (4.5% of the total 8.0%). For the Society CET1 capital is in the form of retained earnings (reserves) adjusted for items not eligible for inclusion in CET1 capital (Intangible fixed assets). The Society also has a small balance of Tier 2 Capital held in the form of a collective provision. All of the Society's historical capital still qualifies as CET1 Capital, which is considered the highest possible quality of capital under regulatory rules.

Leverage Ratio

The leverage ratio at 31 December 2018, applying the CRR Article 499 (2) and (3) is 6.27%

Leverage ratio	
Capital measure – CET1 (£m)	**120.2**
Exposure measure (£m)	**1,914.4**
Leverage ratio (%)	**6.27%**

Leverage ratio exposure measure	£m
On-balance sheet exposure (excluding derivatives)	
Total on-balance sheet exposures (excluding derivatives)	**1,838.1**
Asset amounts deducted in determining Tier 1 Capital	**(1.5)**
Derivative exposures	
Replacement cost associated with all derivatives transactions	**1.0**
Other off-balance transaction exposures	
Off-balance sheet exposures at gross notional amount	**76.8**
Leverage ratio total exposure measure	
Leverage ratio exposure measure	**1,914.4**

Basel III introduces a non-risk based leverage ratio to supplement the risk based capital requirements. The ratio shows CET1 capital as a proportion of balance sheet assets. The ratio does not distinguish between the credit quality of loans and acts as a primary constraint to excessive lending in proportion to the capital base. The Society is already well in excess of regulatory requirements.

Capital Buffers

To encourage adequate build-up of loss absorbing capital that can be used in times of stress Basel III requires the use of common equity capital buffers. These include a Capital Conservation Buffer (CCB) of 2.5% of Risk Weighted Assets and a Counter Cyclical Capital Buffer (CCCB) of up to 2.5% of Risk Weighted Assets which can be applied by regulators when macroeconomic conditions dictate. The CCB rate was 1.875% at 31 December 2018, increasing to 2.5% from 1 January 2019 at which point becomes fully phased in. The CCCB rate was 0.5% from June 2018, increasing to 1% from November 2018.

In addition, globally systemically important banks are expected to hold a buffer of up to 2.5%. This is not applicable to the Society.

The available Common Equity Tier 1 capital as a percentage of risk weighted assets to meet these buffers when they are implemented is shown in Section 7. Total Risk Weighted Assets for the Society as at 31 December 2018 was £612.2m. As the Society currently has £67.4m of capital in excess of minimum capital requirements this is more than sufficient to meet any additional regulatory capital buffer requirements. The Society's capital continues to be in excess of £46m after applying the fully phased in capital buffer requirements (CCB 2.5% and CCCB 1%), further confirming the Society's strong capital position and adherence to regulatory requirements.

Counterparty Credit Risk

As part of the Basel III rules a capital charge for credit valuation adjustment (CVA) risk is required. The additional requirement is based on derivative instrument exposures that have not been cleared through a central counterparty. The impact on risk weighted assets is not currently material for the Society due to the current derivative profile, however the Society includes this within the Pillar 1 calculation.

6. Asset Encumbrance

Article 100 of the Capital Requirements Regulation (CRR) requires institutions to report the level of their asset encumbrance. Asset encumbrance is a claim against an asset by another party, often in the form of security interests given on assets by a borrower to a lender.

The Society has pledged part of its loan book as collateral with the Bank of England, in order to participate in the Bank's Term Funding Scheme (TFS). Participation in this scheme provides the Society with a source of funding that diversifies the funding portfolio and reduces the overall funding cost. The loans remain fully owned and managed by the Society but are reported as encumbered assets.

Other encumbered assets are collateral posted for the derivative portfolio that supports the management of interest rate risk.

As at 31 December 2018, the Society has £177m assets encumbered and comprises of:

- £176m of mortgage assets pledged to the Bank of England to support TFS borrowings. The Society has £50m TFS borrowings as at 31 December 2018.
- £1m cash deposited as collateral under Credit Support Annex (CSA) agreements.

7. Measurement of Credit and Operational Risk Capital

Credit Risk Capital Requirement

Progressive Building Society has adopted the Standardised Approach to assess its credit risk weightings. Under this approach the level of capital required is calculated as:

Credit risk capital requirement = Credit Risk Weighted Assets X 8%
Credit Risk Weighted Assets = exposure value X risk weighting

Credit Risk Exposures & Credit Risk Capital Requirement as at 31 December 2018		
Exposure Class	Exposure Value £000	Pillar 1 Credit Risk Weighted Assets £000
Residential Mortgage Assets	1,506,739	548,580
Commercial Mortgage Assets	6,836	6,925
Treasury Assets	315,398	17,137
Other Assets	11,273	11,273
Mortgage Pipeline	76,797	28,295
Total	1,917,043	612,210

Credit Risk Capital Requirement = 612,210 X 8% = £49m

Operational Risk Capital Requirement

An evaluation of capital required to cover Operational Risk is calculated under the Basic Indicator Approach and determined by reference to the Society's net income, averaged over the previous 3 years. Progressive's minimum (Pillar 1) capital requirement for operational risk at 31 December 2018 was:

	Pillar 1 Operational Risk Capital Requirement
	£000
Basic Indicator Approach	3,723

Progressive's minimum (Pillar 1) capital requirement for operational risk at 31 December 2017 was:

	Pillar 1 Operational Risk Capital Requirement
	£000
Basic Indicator Approach	3,957

Minimum Capital Requirement – Pillar 1 as at 31 December 2018

	£000
Pillar 1 - Credit Risk Capital Requirement	48,977
- Operational Risk Capital Requirement	3,723
- Market Risk Capital Requirement (CVA Requirement*)	110
Minimum Capital Requirement (Pillar 1)	52,810
Capital Resources – CET1	120,186
Excess of Capital Resources over Minimum Capital Requirement	67,376

*Credit Value Adjustment

The Society has adequate capital resources showing an excess of £67.4 million of capital resources over minimum capital requirements.

Minimum Capital Requirement – Pillar 1 as at 31 December 2017

	£000
Pillar 1 - Credit Risk Capital Requirement	47,733
- Operational Risk Capital Requirement	3,957
- Market Risk Capital Requirement (CVA Requirement*)	81

Minimum Capital Requirement (Pillar 1)	51,771
Capital Resources	111,248
Excess of Capital Resources over Minimum Capital Requirement	59,477

8. Remuneration Committee and Policy

A key objective of the Committee is to make recommendations to the Board on the remuneration policy of the Society and in particular the remuneration of Executive Directors and Senior Management.

The Society's objective in setting remuneration policies is to ensure that they are in line with its business strategy, risk appetite and long-term objectives and that remuneration is set at a level to retain, attract and motivate high quality staff.

The Committee is comprised of three Non-executive Directors. The Chief Executive, the Deputy Chief Executive and Finance Director and the Head of Human Resources attend by invitation.

Further details regarding the remuneration policy and the decision-making process used in determining remuneration, are set out in the Directors Remuneration Report in the 2018 Annual Report and Accounts.

Remuneration Code Staff

The Board has identified that those staff whose professional activities have a material impact on the Society's risk profile are the eight members of the senior management team, three of whom are executive directors. These staff are designated as being subject to the PRA Remuneration Code as set out in SYSC 19A.

Executive Directors

Aggregate information on the remuneration of the three executive directors who were in post during the year, is given below:

	£000
Fixed remuneration	543
Variable remuneration	62
Total	**605**

Other Code Staff

Aggregate information on the remuneration of other code staff is given below:

	£000
Fixed remuneration	513
Variable remuneration	54
Total	**567**

Appendix 1 – Analysis of Mortgage Assets

Maturity Analysis of Mortgage Assets

As at 31 December 2018	Maturity Analysis				
	0<3 months £000	3<12 months £000	1<5 years £000	>5 years £000	Total £000
Mortgage Assets	18,044	53,787	299,276	1,146,929	1,518,036
Provisions					(5,291)
Other*Balance Sheet					(333)
Total					1,512,412

As at 31 December 2017	Maturity Analysis				
	0<3 months £000	3<12 months £000	1<5 years £000	>5 years £000	Total £000
Mortgage Assets	17,789	49,848	277,973	1,122,949	1,468,559
Provisions					(5,864)
Other*					216
Balance Sheet Total					1,462,911

*other – Fair Value Adjustment for Hedged Risk & Unamortised loan origination fees

Geographical Analysis of Mortgage Assets

As a regional building society 99.9% of the Society's lending is secured on properties in Northern Ireland. The remaining mortgages are in Great Britain.

Appendix 2 – Analysis of Treasury Assets

Maturity Analysis of Treasury Assets

Fitch Long Term Ratings as at 31 December 2018	Maturity Analysis			
	0<3 month	3<12 month	1<5 year	>5 year
	£000's	£000's	£000's	£000's
Central Bank	170,636	0	0	0
Gilts/Tbills	40,119	20,111	25,749	0
AAA to AA-	0	0	0	0
A+ to A-	17,500	11,000	1,000	0
BBB+ and below	9,000	1,000	0	0
Unrated Building Societies	5,000	5,500	0	0
Repayable on demand	7,934			
Total	250,189	37,611	26,749	0
Accrued Interest	849			
Balance Sheet Total	315,398			

Geographical Analysis of Treasury Assets

As at 31 December 2018	UK £000	Rest of Europe	Rest of World £000	Total £000
Treasury Assets	314,549	0	0	314,549
Accrued Interest				849
Balance Sheet Total				315,398

Fitch Long Term Ratings as at 31 December 2017	Maturity Analysis				
	0<3 months £000	3<12 months £000	1<5 years £000	>5 years £000	Total £000
Central Bank*	234,000	5,026	15,398	0	254,424
AAA to AA-	1,000	1,806	0	0	2,806
A+ to A-	23,500	8,000	0	0	31,500
BBB+ and below	6,000	1,000	0	0	7,000
Unrated Building Societies	7,500	3,500	0	0	11,000
Repayable on demand	6,569				6,569
Total	278,569	19,332	15,398	0	313,299
Accrued Interest					269
Balance Sheet Total					313,568

*includes £20m Gilts

Geographical Analysis of Treasury Assets

As at 31 December 2017	UK £000	Rest of Europe £000	Rest of World £000	Total £000
Treasury Assets	313,299	0	0	313,299
Accrued Interest				269
Balance Sheet Total				313,568

Appendix 3 - Provisions

A loan loss provision is an expense set aside as an allowance for uncollected loans and loans payments. This provision is used to cover a number of factors associated with potential loan losses.

The Society operates a loan loss provisioning model to calculate provisions on loans showing evidence of impairment. Evidence of impairment may include indications that the borrower(s) are experiencing significant financial difficulty, default or delinquency in interest or principal payments, etc.

If there is objective evidence that an impairment loss has been incurred, the amount of the loan is measured as the difference between the asset's carrying amount and the net present value of estimated future cash flows discounted at the asset's effective interest rate.

The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. To calculate the specific provisions required for each impaired loan the Society has developed a bespoke loan loss provisioning model which uses the following methodology:

- Account information is imported from the Society's core system into the model
- The original property values are revalued by the model in line with the Northern Ireland House Price Index (as compiled by the University of Ulster)
- Discount factors are applied to the revaluation to take account of a forced sale situation and discounts by post code, property type, year built and value are also applied
- Assumed possession costs and sale costs are added to the balance outstanding which is then compared with the revaluation giving the gross loss (if any)
- The gross provision is reduced by amounts recoverable from mortgage indemnity guarantee policies
- A propensity to possess factor is finally applied in order to adjust the provision for cases where arrears and loan to value are low and possession is less likely.

Collective provisions are made where it is considered that there is impairment in the value of assets that is not already covered by specific provisions.

Analysis of Society's Arrears

As at 31 December 2018	>2.5% in arrears	Provisions	Performing Loans	Loans per Balance Sheet
Mortgage Loans	£10.4m	£(5.3)m	£1,502m	£1,512.4m

As at 31 December 2017	>2.5% in arrears	Provisions	Performing Loans	Loans per Balance Sheet

Mortgage Loans	£9.7m	£(5.8)m	£1,453.3m	£1,463m

The amount shown as greater than 2.5% in arrears represents the full amount of the loan outstanding, not just the amount of the arrears. The Society's provision in relation to the arrears amount reduced slightly in 2018. The reduction in provisions resulted from modest increases in Northern Ireland property prices and a stronger local economy leading to lower significant arrears.