Pillar 3 Disclosures

31st December 2020

PROGRESSIVE

BUILDING SOCIETY

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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 2020, the Society's financial year end.

Country by Country Reporting

Country by country reporting is detailed on page 16 of the 2020 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. The disclosures are first reviewed by the Deputy Chief Executive & Finance Director acting as the 'first line' under the three lines of defence Model. The Chief Risk Officer, acting as the second line, will then review the disclosure prior to presentation to the Management Risk Committee and Board Risk Committee for challenge. The Board Risk Committee recommends the disclosure to the Board for review and approval. The Society's Board reviewed and approved these disclosures in March 2021.

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 endeavors 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's Risk Management Framework comprises five elements:

a. Articulation of Society's Risk Appetite by the Board of Directors

An effective governance framework is in place within which the Board provides clear and transparent direction to management on the Society's risk appetite and related strategy. Further, the Society's remuneration and incentive structures are aligned with its strategy and risk appetite and appropriate to the Society's objectives.

b. Board Committee structures overseeing the Risk Management and Internal Control Framework

Board committee structures are in place to enable the effective oversight of the Risk Management Framework (including internal controls) within the Society and to support and provide guidance to the management committees and to the risk function in the execution of their roles.

These Committees include:

- Audit Committee
- Risk Committee

c. Internal Governance Framework

The Society operates an Internal Governance Framework that reflects the model promulgated by the Committee of Sponsoring Organisations (COSO), the European Banking Authority (EBA) and the Prudential Regulation Authority (PRA).

The Society's internal governance framework includes:

(i) A three lines of defence model

(ii) Chief Risk Officer position with direct access to the Chair and non-executive Directors.

(iii) Management Committees (Asset and Liability Committee (ALCO), Senior Management Committee, Management Risk Committee) support the Risk Management Framework on a day to day basis. Critically, there is clear and appropriate delineation of the management and oversight roles of the management and Board Committees. This is reflected in management and Board Committee Terms of Reference.

d. Appropriate Management Information

Management information is provided to the Board and Board Committees based on reporting parameters defined between the Board and management and it is directly related to the risk appetite and strategic objectives defined by the Board.

e. Continuous Process of Risk Assessment

It is important that the Society has the agility to respond to changes in the macro-economic environment, to new competition and to regulatory change and that the Society's Risk Management Framework supports a continuous approach of risk assessment and the determination of risk appetite and strategy. The 'three lines of defence' model ensures that there is an effective assessment of risks within the Society. The information provided to the Board by management directly and via the management Committees continually supports the Board's consideration of the risks attached to the Society's business, the nature and strength of internal controls and the strategic options.

Three Lines of Defence

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.

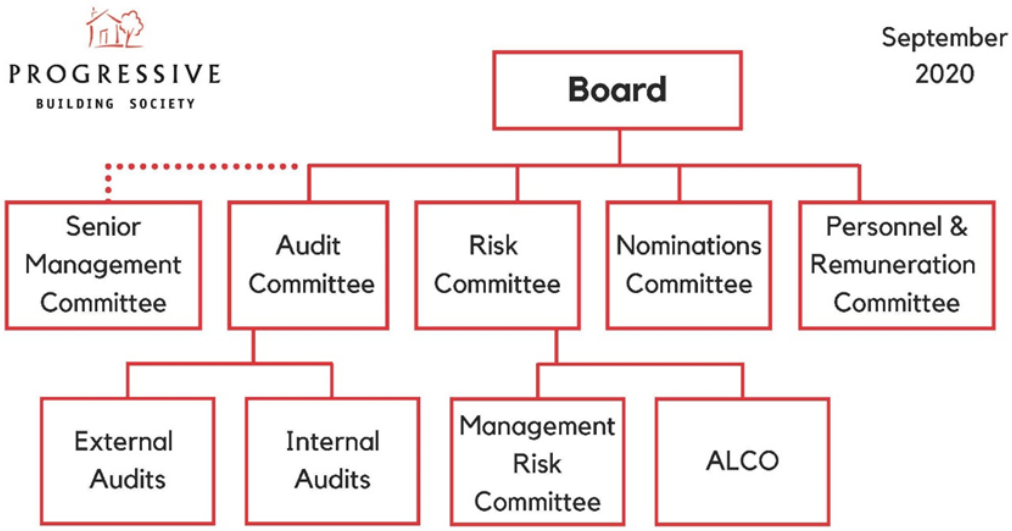
- First Line: Primary responsibility for managing risk and ensuring controls are in place lies with the business units within the Society – the 'first line of defence'. Management have a responsibility to understand how risks impact their area of the Society and to put in place controls or mitigating 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 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. Internal Audit is an outsourced function and the Head of Internal Audit 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 2020 is as below:



Board

Composition: In 2020, the Board consisted of seven Non-executive Directors 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 Risk Committee. 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: In 2020, the Audit Committee consisted of four 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.

Risk Committee

Composition: Four Non-executive Directors. The Chief Executive and the Deputy Chief Executive and Finance Director attend by invitation. 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 Committee is responsible for setting the Society's risk appetite, for risk monitoring and for its capital and liquidity management frameworks. The Committee is also responsible for reviewing and challenging the Society's assessment and measurement of key risks, and for providing oversight and challenge to the design and execution of stress testing. The Risk Committee discusses the Individual Liquidity Adequacy Assessment Process and Internal Capital Adequacy Assessment Process, evaluates lending and liquidity quality and reviews business continuity arrangements.

The principal management committees reporting to the Risk Committee are the Management Risk Committee and the Asset and Liability Committee. The Management Risk Committee is responsible for the ongoing identification and management of risks to the Society's business. The Asset and Liability Committee is responsible for the management and composition of the Society's assets and liabilities, monitoring the Society's exposure to interest rate variations, and monitoring and managing the operation of the Society's liquidity, wholesale funding and hedging policies.

Frequency: The Committee normally meets four times per year. The Committee met seven times in 2020 to address the challenges on the COVID 19 pandemic.

Nominations Committee

Composition: Three Non-executive directors (being the Chair, Vice Chair & Senior Independent Director) & the Chief Executive.

Main Functions: The Committee is responsible for reviewing the size, composition, skills, knowledge and experience required of the Board. Suitable candidates for membership of the Board are normally identified by independent search consultants for the consideration of the Committee and recommendations are then made to the Board.

Frequency: The Committee meets at least three times per year.

Personnel and Remuneration Committee

Composition: In 2020, the Personnel and Remuneration Committee consisted of four Non-executive Directors. The Chief Executive and the Deputy Chief Executive and Finance Director attend by invitation.

Main Functions: This Committee considers remuneration and contractual arrangements of executive Directors and the terms and conditions of employment for staff. Details of the Remuneration Policy can be found in the Directors' Remuneration Report.

Frequency: The Committee normally meets four times per year.

Member Engagement & Conduct Committee

Until February 2020 this Committee was responsible for ensuring that the Society meets its regulatory and legal obligations with regard to delivering business in a clear, transparent and fair manner. It performed its role by defining the components and evidential requirements of the Society's Conduct of Business regime and by ensuring effective governance was in place, maintained and monitored, leading to good customer outcomes. In February 2020 the Board concluded, on the recommendation of the Member Engagement & Conduct Committee, that the work of the Committee could be more effectively undertaken by absorbing its areas of responsibility into other Committees. As a result it was decided to dissolve the Committee and its work is now principally undertaken by the Risk Committee, and also the Board. A Management Engagement Committee was also established. At the end of the year the Board considered if the matters previously reviewed and monitored by the Member Engagement & Conduct Committee were adequately and appropriately captured elsewhere and was content this was the case.

Risk Strategy

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 Committee 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 exposure 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 2020, 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 the pandemic and Brexit throughout 2020 and this process will continue throughout 2021. The impact of the pandemic and 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 daily to monthly basis and reported to Board on a monthly basis.

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 pandemic and 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 an analysis of the Society's 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 has historically used Swaps based on LIBOR. LIBOR will no longer be used for new Swaps from 1st Jan 2021, with SONIA based Swaps being utilized by the Society. The Society has a detailed plan in place to deal with the requirements of historic LIBOR based Swaps.

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 2020 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 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 an analysis of the Society's 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) against 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 2020 the effect of a 2% parallel shift in interest rates was £4.5m being well within the 5% of CET1 limit (£6.0m).

The Society also monitors the six prescribed interest rate shocks devised by the European Banking Authority (EBA). The 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.

The Society's positions against these shocks as at 31 December 2020 were as follows:

Interest Rate Sensitivity Scenario	**EV Impact £m**
Interest rate shift of +2.5%	-£5.2m
Interest rate shift of -2.5%	+£2.1m*
Short Rates Up	-£1.9m
Short Rates Down	+£2.1m
Shock Flattener	-£0.1m
Shock Steepener	+£0.5m

*-100bps floor is utilised in this scenario.

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 Chief Executive or Deputy Chief Executive & 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 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 2020 was 354% (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 Committee 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 2019, the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) issued joint consultation papers 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 the Society's 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. 100% of the mortgage book is in Northern Ireland. This risk is carefully managed through 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 Risk Committee on a quarterly basis.

Sectoral concentrations are managed and monitored through compliance with the Lending and Treasury policies and reporting to the 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 Risk Committee forms part of the Society's overall governance and control framework and is tasked with oversight of the Society's conduct in relation to its members.. 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.

Environmental Risk

As the climate alters the risks associated with this change also impact the Society's markets and regulatory frameworks. The Society has introduced an Environmental Strategy to assist in addressing these risks over the coming years.

More specifically the Society has introduced controls regarding the physical and transition risks associated with environmental alteration and the move to a low carbon economy. All of the Society's Mortgage assets are based in Northern Ireland. Environmental change is a real and unprecedented challenge for Northern Ireland. Adaptation action and planning is essential to managing the resilience of the Society during the move to a low carbon economy. The Society has reviewed NI's Climate Change Adaptation Programme (NICCAP) and understood the impact of this programme when designing additional controls regarding current and future lending.

4. CAPITAL RESOURCES

The Society has no transitional arrangements under CRD IV

	31 December 2020 CRD IV Final £000's
Total equity attributable to members per the Statement of Financial Position	
- General reserves	120,660
- Revaluation reserve	67
- Available-for-sale reserve	3
- Intangible fixed assets (Prudential valuation adjustment)*	(1,269)
- Deferred tax liabilities associated to intangible fixed assets	-
Total Common Equity Tier 1 Capital	**119, 461**
Adjustments to Tier 2 Capital: -Add back: Collective impairment	1,894
Regulatory Capital (Total Capital)	**121, 355**

* Intangible fixed assets are computer software and system development costs after amortisation. Capital Requirements Regulation (CRR) requires intangible fixed assets to be fully deducted from CET1 capital. CRR was updated in 2020 (CRR2) which exempts CET1 deduction of software assets that are prudently valued, the value of which is not negatively affected by resolution, insolvency or liquidation of the financial institution,

Common Equity Tier 1 capital

The majority of the Society's own funds are in the form of Common Equity Tier 1 (CET1), which consists of mainly retained earnings. The Prudential treatment of intangible assets is to deduct a proportion of intangible assets 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 2020, the Society's CET1 ratio was 20.06%.

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 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 Finance Department overseen by the Deputy Chief Executive and Finance Director in the first line of the three lines of defence model. The Chief Risk Officer, acting as the second line, then reviews the ICAAP prior to presentation to the Management Risk Committee and Board Risk Committee for challenge. 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 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 (Prudential treatment of intangible 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 qualifies as CET1 Capital, which is considered the highest possible quality of capital under regulatory rules.

Leverage Ratio

The leverage ratio at 31 December 2020, applying the CRR Article 499 (2) and (3) is 6.27%

Leverage ratio	
Capital measure - CET1 (£m)	**119.5**
Exposure measure (£m)	**1,905.2**
Leverage ratio (%)	**6.27%**

Leverage ratio exposure measure	**£m**
On-balance sheet exposure (excluding derivatives)	
Total on-balance sheet exposures (excluding derivatives)	**1,815.8**
Asset amounts deducted in determining Tier 1 Capital	**(1.3)**
Derivative exposures	
Replacement cost associated with all derivatives transactions	**-**
Other off-balance transaction exposures	
Off-balance sheet exposures at gross notional amount	**90.7**
Leverage ratio total exposure measure	
Leverage ratio exposure measure	**1,905.2**

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 (fully phased in from 1 January 2019) and a Counter Cyclical Capital Buffer (CCyB) of up to 2.5% of Risk Weighted Assets which can be applied by regulators when macroeconomic conditions dictate. The CCyB rate reduced from 1% to 0% in March 2020.

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 2020 was £595.4m. As the Society currently has £68.5m of CET 1 capital in excess of Pillar 1 minimum capital requirements, this is more than sufficient to meet any additional regulatory capital buffer requirements. The Society's surplus capital continues to be in excess of £53.6m after applying the combined buffer capital requirement (CCB 2.5% and CCyB 0%, further confirming the Society's strong capital position and adherence to regulatory requirements. See page 24 for a breakdown of the Society's Pillar 1 minimum capital requirement.

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.

The Society's encumbrance position as at 31 December 2020 is shown in the following table:

Encumbered and Unencumbered Assets

	Carrying amount of encumbered assets £000	**Fair value amount on encumbered assets £000**	**Carrying amount of unencumbered assets £000**	**Fair value amount on unencumbered assets £000**
Assets of the reporting institution	141,096	-	1,674,700	-
Loans on demand	-	-	275,474	-
Debt securities	-	-	10,070	10,075
Loans & advances other than loans on demand	141,096	-	1,376,066	-
Other assets	-	-	13,090	-

Collateral Received

	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Collateral received by the reporting institution	Nil	Nil

Sources of Encumbrance

	Matching liabilities, contingent liabilities or securities lent £000	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £000
Carrying amount of selected financial liabilities	54,248	141,096
Of which:		
Derivatives: Over-The-Counter	4,248	5,640
Collateralised deposits other than repurchase agreements	50,000	135,456
Total	54,248	141,096

As at 31 December 2020 the Society held £141.1m in encumbered assets. £135.5m of loans have been pledged as collateral to the Bank of England to facilitate funding under the Term Funding Scheme (TFS) and £5.6m was in relation to collateral deposited 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 2020		
Exposure Class	Exposure Value £000	Pillar1 Credit Risk Weighted Assets £000
Residential Mortgage Assets	1,465,664	527,078
Commercial Mortgage Assets	6,302	6,445
Treasury Assets (Inc. swap replacement cost)	326,983	15,649
Other Assets	14,412	14,412
Mortgage Pipeline	90,726	31,849
Total	1,904,087	595,433

Credit Risk Capital Requirement = 595,433 X 8% = £47.6m

Credit Risk Exposures & Credit Risk Capital Requirement as at 31 December 2019		
Exposure Class	Exposure Value £000	Pillar1 Credit Risk Weighted Assets £000
Residential Mortgage Assets	1,490,593	542,194
Commercial Mortgage Assets	6,478	6,624
Treasury Assets (Inc. swap replacement cost)	329,872	20,291
Other Assets	10,815	10,815
Mortgage Pipeline	75,168	26,463
Total	1,912,926	606,387

Credit Risk Capital Requirement = 606,387 X 8% = £48.5m

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 2020 was:

	Pillar 1 Operational Risk Capital Requirement
Basic Indicator Approach	£000
	3,314

Progressive's minimum (Pillar 1) capital requirement for operational risk at 31 December 2019 was:

	Pillar 1 Operational Risk Capital Requirement
Basic Indicator Approach	£000
	3,549

Minimum Capital Requirement – Pillar 1 as at 31 December 2020

	£000
Pillar 1 - Credit Risk Capital Requirement	47,635
- Operational Risk Capital Requirement	3,314
- Market Risk Capital Requirement (CVA Requirement*)	22
Minimum Capital Requirement (Pillar 1)	50,971
Capital Resources – CET1	119,461
Excess of Capital Resources over Minimum Capital Requirement	68,490

*Credit Value Adjustment

The Society has adequate capital resources showing an excess of £68.5 million of capital resources over minimum capital requirements as at 31 December 2020.

Minimum Capital Requirement – Pillar 1 as at 31 December 2019

	£000
Pillar 1 - Credit Risk Capital Requirement	48,511
- Operational Risk Capital Requirement	3,549
- Market Risk Capital Requirement (CVA Requirement*)	35
Minimum Capital Requirement (Pillar 1)	52,095
Capital Resources – CET1	122,753
Excess of Capital Resources over Minimum Capital Requirement	70,658

*Credit Value Adjustment

8. PERSONNEL & 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.

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 2020 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 nine 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	568.8
Variable remuneration	38.2
Total	**607**

Other Code Staff

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

	£000
Fixed remuneration	531
Variable remuneration	31
Total	**562**

Appendix 1 – Analysis of Mortgage Assets

Maturity Analysis of Mortgage Assets

As at 31 December 2020	Maturity Analysis				
	0←3 months £000	3←12 months £000	1←5 years £000	→5 years	Total £000
Mortgage Assets	23,116	61,080	306,058	1,086,611	1,476,865
Provisions					(5,647)
Other*					3,792
Balance Sheet Total					1,475,010

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

As at 31 December 2019	Maturity Analysis				
	0←3 months £000	3←12 months £000	1←5 years £000	→5 years	Total £000
Mortgage Assets	20,130	56,121	303,270	1,121,163	1,500,684
Provisions					(4,263)
Other*					1,931
Balance Sheet Total					1,498,352

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

Geographical Analysis of Mortgage Assets

As a regional building society 100% of the Society's lending is secured on properties in Northern Ireland.

Appendix 2 – Analysis of Treasury Assets

Maturity Analysis of Treasury Assets

Fitch long term ratings as at 31 December 2020	Maturity Analysis			
	0←3 month £000's	3←12 month £000's	1←5 year £000's	→5 year £000's
Central Bank	256,000	0	0	0
Gilts/TBills	10,000	0	0	0
AAA to AA-	0	0	0	0
A+ to A-	22,140	7,500	0	0
BBB+ and below	3,000	5,000	0	0
Unrated Building Societies	0	0	0	0
Other		2,805		
Repayable on demand	19,786			
Total	310,926	15,305	0	0
Accrued Interest	67.3			
Gilt Interest Accrual, Gilt FV & Premium	74.7			
Balance Sheet Total	326,373			

Geographical Analysis of Treasury Assets

As at 31 December 2020	UK £000	Rest of Europe £000	Rest of World £000	Total £000
Treasury Assets	326,231	0	0	326,231
Accrued Interest				67.3
Gilt Interest Accrual, Gilt FV & Premium				74.7
Balance Sheet Total				326,373

Fitch Long Term Ratings as at 31 December 2019	Maturity Analysis			
	0←3 month £000's	3←12 month £000's	1←5 year £000's	→5 year £000's
Central Bank	166,500	0	0	0
Gilts/TBills	0	75,692	10,000	0
AAA to AA-	0	0	0	0
A+ to A-	36,600	17,000	0	0
BBB+ and below	8,000	0	0	0
Unrated Building Societies	3,500	0	0	0
Other		2,657		
Repayable on demand	7,978			
Total	222,578	95,349	10,000	0
Accrued Interest	505			
Fair Value and Gilt Premium	407			
Balance Sheet Total	328,839			

Geographical Analysis of Treasury Assets

As at 31 December 2019	UK £000	Rest of Europe £000	Rest of World £000	Total £000
Treasury Assets	327,927	0	0	327,927
Accrued Interest				505
Fair Value and Gilt Premium				407
Balance Sheet Total				328,839

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

Arrears % of mortgage balance	2020 Loan balance outstanding £m	2019 Loan balance outstanding £m
2.50% - 5.00%	3.20	2.90
5.00% - 7.50%	1.60	2.60
7.50% - 10.00%	0.70	0.50
10.00% +	2.50	1.40
Total	**8.00**	**7.40**

	2020 Loan balance outstanding £m	2019 Loan balance outstanding £m
Possessions	1.90	1.90

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 increased slightly in 2020. Provisions for bad debts saw a charge of £1.6 million during the year (2019: £0.3m net write back) due to more people struggling with household finances through reductions in income or job losses. The Government's intervention to prop up the economy through a number of initiatives including the Job Retention Scheme, also known as furlough, may mask the full impacts of the pandemic. This may result in additional bad debt charge requirements in 2021. However, the job market statistics and local house prices have remained buoyant in the face of this adversity, so there are reasons for optimism.