Vernon Building Society

Pillar 3 Disclosures

31 December 2023

Contents

TABLES

1. OVERVIEW

1.1 Purpose
The purpose of this document is to provide background information on the Society's capital position and approach to risk management.

1.2 Scope of application
This disclosure document applies to Vernon Building Society (PRA Firm Number 195475) for the year ended 31 December 2023.

1.3 Regulatory framework for disclosures
The Basel framework is structured around three pillars which govern minimum capital requirements, outline the supervisory review framework and promote market discipline through disclosure requirements.

Pillar 1	Minimum regulatory capital requirements relating to credit, market and operational risks. The Society meets the minimum capital requirements by applying the standardised approach to credit risk and the Basic Indicator Approach to operational risk;
Pillar 2	Assessment of capital requirements by the Society through the Internal Capital Adequacy Assessment Process (ICAAP) and the Prudential Regulation Authority (PRA) through the Supervisory Review and Evaluation Process (SREP) to determine whether additional capital should be held for specific risks not covered under Pillar 1
Pillar 3	Disclosure of key information about risk exposures, the management of those risks and capital adequacy.

The Pillar 3 Disclosures have been prepared in accordance with the Disclosure Part of the PRA Rulebook which includes revised disclosure requirements applicable from 1 January 2022 following the UK implementation of the remaining provisions from Capital Requirements Regulation II (CRR II).

This Pillar 3 Disclosure document should also be read in conjunction with the Society's Annual Report & Accounts for the year ended 31 December 2023.

1.4 Basis of preparation
The Society meets the criteria for being a small and non-complex institution as introduced in the CRR II and incorporated into the Disclosure section of the PRA Rulebook under Article 433b. The disclosures in this document have been prepared applying the concept of derogation for small and noncomplex organisations.
Unless otherwise stated all information relates to the Society's assets as at 31 December 2023.

Row numbers in the tables provided, where shown, relate to the PRA prescribed references included within the prescribed templates. Rows have been excluded where not relevant to the Society, although in some instances a row may be shown containing a nil value where it is considered to enhance the readability and understandability of the disclosures.

1.5 Frequency of disclosure
Pillar 3 disclosures are prepared annually to 31 December and are published on the Society's website at the same time as the Annual Report and Accounts in accordance with Article 433 of the CRR.

1.6 Review and verification
The disclosures presented within this document are subject to the same level of internal verification as that applicable to the directors' report included in the Society's financial statement disclosures. Where appropriate the Pillar 3 disclosures are reconciled to and conform with the externally audited information in the Society's Annual Report & Accounts. This document has also been subject to second-line oversight, reviewed by

the Risk & Compliance Committee and approved by the Society's Board in February 2024 alongside the Annual Report & Accounts.

1.7 Summary of key disclosures

As at 31 December 2023 the Society held capital resources in excess of the regulatory requirements. The table below provides an overview of the Society's prudential regulatory metrics.

Table 1: UKM1 – Key Metrics

		31 Dec 2023	31 Dec 2022
Available own funds			
1	Common Equity Tier 1 (CET1)	£29.4m	£27.8m
2	Tier 1 capital	£29.4m	£27.8m
3	Total capital	£29.9m	£28.0m
Risk-weighted exposure amounts			
4	Total risk weighted exposure amounts	£163.7m	£147.6m
Capital Ratios (expressed as a percentage of risk weighted exposure amounts)			
5	Common Equity Tier 1 ratio	17.9%	18.8%
6	Tier 1 ratio	17.9%	18.8%
7	Total capital ratio	18.3%	19.0%
Additional own-funds requirements based on SREP (expressed as a % of risk weighted exposure amounts)			
7a	Additional CET1 SREP requirements	-	-
7b	Additional AT1 SREP requirements	-	-
7c	Additional T2 SREP requirements	-	-
7d	Total SREP own funds requirements	8%	8%
Combined buffer requirement (expressed as a percentage of risk weighted exposure amounts)			
8	Capital conservation buffer	2.5%	2.5%
9	Institution specific countercyclical capital buffer	2.0%	1.0%
9a	Systemic risk buffer	-	-
11	Combined buffer requirements	4.5%	3.5%
11a	Overall capital requirements	12.5%	11.5%
12	CET1 available after meeting the total SREP own funds requirement	9.9%	10.8%
Leverage ratio (A)			
13	Leverage ratio total exposure measure	£470.5m	£426.1m
14	Leverage ratio	6.2%	6.5%
Liquidity Coverage Ratio (B)			
15	Total high quality liquid assets (HQLA) (Weighted value-average)	£56.5m	£49.1m
16a	Cash outflows – total weighted value	£33.8m	£31.7m
16b	Cash inflows – total weighted value	£9.4m	£9.7m
16	Total net cash outflows (adjusted value)	£24.4m	£22.0m
17	Liquidity Coverage Ratio	231%	223%
Net Stable Funding Ratio			
18	Total available stable funding	£412.7m	£360.9m
19	Total required stable funding	£261.9m	£236.1m
20	NSFR ratio	157.6%	152.9%

Notes
A - Leverage ratio stated after exclusion of qualifying central bank exposures
B - Additional disclosures provided in section 5

1.8 Overview of Risk Weighted Exposure Amounts (RWEAs)

Table 2: UK OV1 – Overview of risk weighted exposure amounts

		Risk weighted exposure amounts (RWEAs)		Total own funds requirements
		2023 £m	2022 £m	2023 £m
1	**Credit Risk (excluding CRR)** *Of which:*	**147.3**	**132.4**	**11.8**
2	The standardised approach	147.3	132.4	11.8
3	The foundation IRB (FIRB) approach	-	-	-
4	Slotting approach	-	-	-
4a	Equities under the simple risk weighted approach	-	-	-
5	Advanced IRB (AIRB) approach	-	-	-
6	**Counterparty Credit Risk (CRR)** *Of which:*	**2.5**	**2.8**	**0.2**
7	The standardised approach	2.5	2.8	0.2
8	Internal model method (IMM)	-	-	-
8a	Exposures to CCP	-	-	-
8b	Credit valuation adjustment (CVA)	0.8	1.0	0.1
9	Other CRR	-	-	-
15	Settlement risk	-	-	-
22a	**Large Exposures**	**-**	**-**	**-**
23	**Operational Risk** *Of which:*	**13.1**	**11.4**	**1.0**
23a	Basic indicator approach	13.1	11.4	1.0
23b	Standardised approach	-	-	-
23c	Advanced measurement approach	-	-	-
24	Amounts below the thresholds for deduction (subject to 250% risk weight) (for information)	-	-	-
29	**Total**	**163.7**	**147.6**	**13.1**

2. RISK MANAGEMENT APPROACH

2.1 Risk Statement

Risk appetite is the level of risk the Society is prepared to accept whilst pursuing its business strategy as a mutual organisation set up for the benefit of its members, recognising a range of possible outcomes as the business plan is implemented. The Board will not seek out strategic options which have a potential to create material losses to capital.

The Society's Risk Appetite Statement consists of an overall Risk Appetite Statement followed by the individual Principal Risk Appetite. The risk culture is normal behaviour exhibited by all employees regarding risk awareness, risk taking, risk management and treating customers fairly. The Board sets the tone from the top and first and second line implement this tone throughout the Society. The overall tone set by the Board is underpinned by various policies. The Risk & Compliance Committee reviews both the key risk indicators for each principal risk and the forecast outlook to ensure that risk levels remain, and will continue to remain, within the Society's agreed risk appetite.

The Society has elected to omit specific details relating to individual risk appetite measures as they are considered proprietary information as per CRR article 432.

2.2 Declaration

In accordance with the requirements of CRR article 435(1) the Society's Board are satisfied that the risk arrangements in place at the Society are adequate with regard to the Society's profile and strategy.

2.3 Strategies and Processes to manage Risk

The Society's Board is responsible for ensuring that an effective framework is in place to promote and embed a risk culture which identifies, mitigates and manages the risks which the Society faces in the course of delivering its strategic objectives.

The Board annually reviews and approves risk appetite statements for each principal risk type, and each sub type of risk for Operational Risk.

Within its risk appetite statements, the Society has defined a range of quantitative and qualitative risk measures and limits within which it is prepared to operate. These measures and limits are designed to ensure the Society delivers acceptable returns and generates sufficient capital to support the delivery of the business plan. The Society's performance against these risk measures and operational limits, supported by a wide range of additional Key Risk Indicators, is reviewed regularly by the Society's Management Committees and the Risk & Compliance Committee.

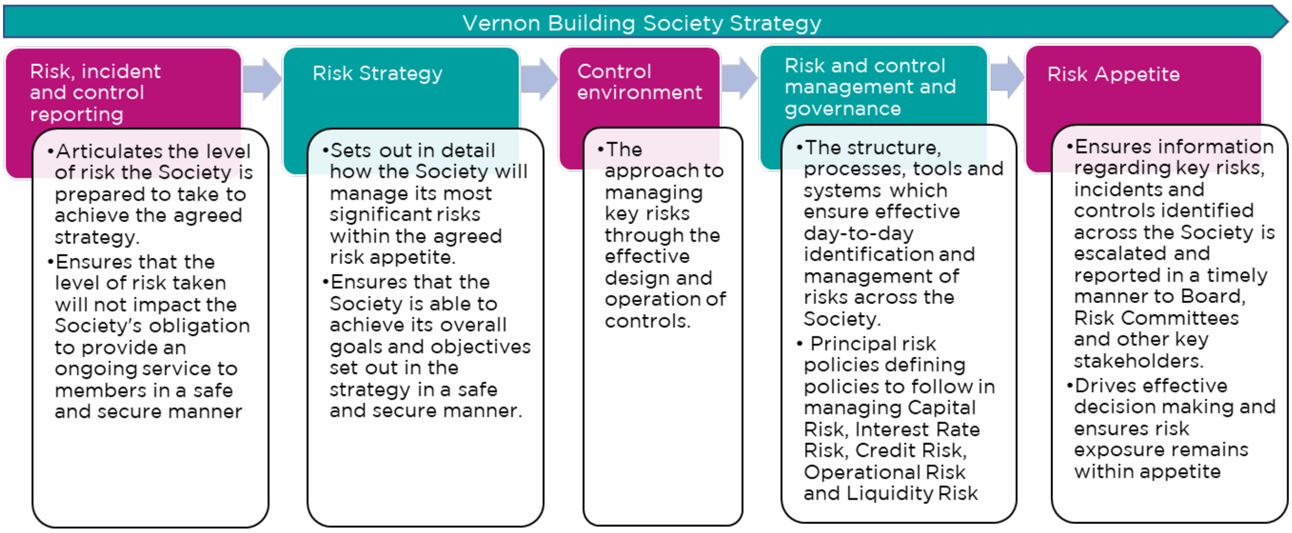
The Society uses stress testing as a key management tool to gain a better understanding of the resilience of the Society to external and internal shocks. These tests form a key part of the Society's capital and liquidity assessment and are designed to confirm that the Society has sufficient capital and liquid resources to support forward-looking strategic plans and to ensure that the Society stays within its risk appetite.

The Society undertakes scenario tests to understand and manage the impact of these events. The Society has developed a Recovery Plan for more severe scenarios which details the options available to the Society should it be adversely impacted by a severe stress.

In pursuing its strategic objectives, the Board ensures that there are appropriate capabilities and resources available, along with sufficient capital and liquidity.

2.4 Risk Management Framework

The Risk Management Framework (RMF) sets out a structured approach to identifying assessing, controlling and monitoring risks. It is used to inform decision making at both strategic and operational levels.



The Risk Management Framework includes the use of Board approved risk appetite statements covering capital, liquidity, operational risk, credit risk, interest rate risk, and conduct risk. They set out key limits and escalation triggers. The risk position is reported to the Board on a monthly basis and risk appetites are formally approved annually.

The Risk Management Framework makes use of stress testing and scenario testing. Stress tests consider the potential outcomes for portfolios and for the Society in the event of stressed scenarios incorporating, for example, falling house prices and rising unemployment. Scenario tests consider the outcome in relation to the occurrence of a particular risk or event, and are used to help evaluate the controls, and assess the adequacy of the Society's incident management and business continuity plans.

The Board is ultimately responsible for the effective management of risk. The RMF, including the risk appetite statement and principal risk policies, are approved by the Board following a review and recommendation by the Risk & Compliance Committee. The Board delegates oversight of the implementation of the RMF to the Risk & Compliance Committee. The Chief Risk Officer oversees the effective implementation of the RMF, including the review of risks and uncertainties in the business.

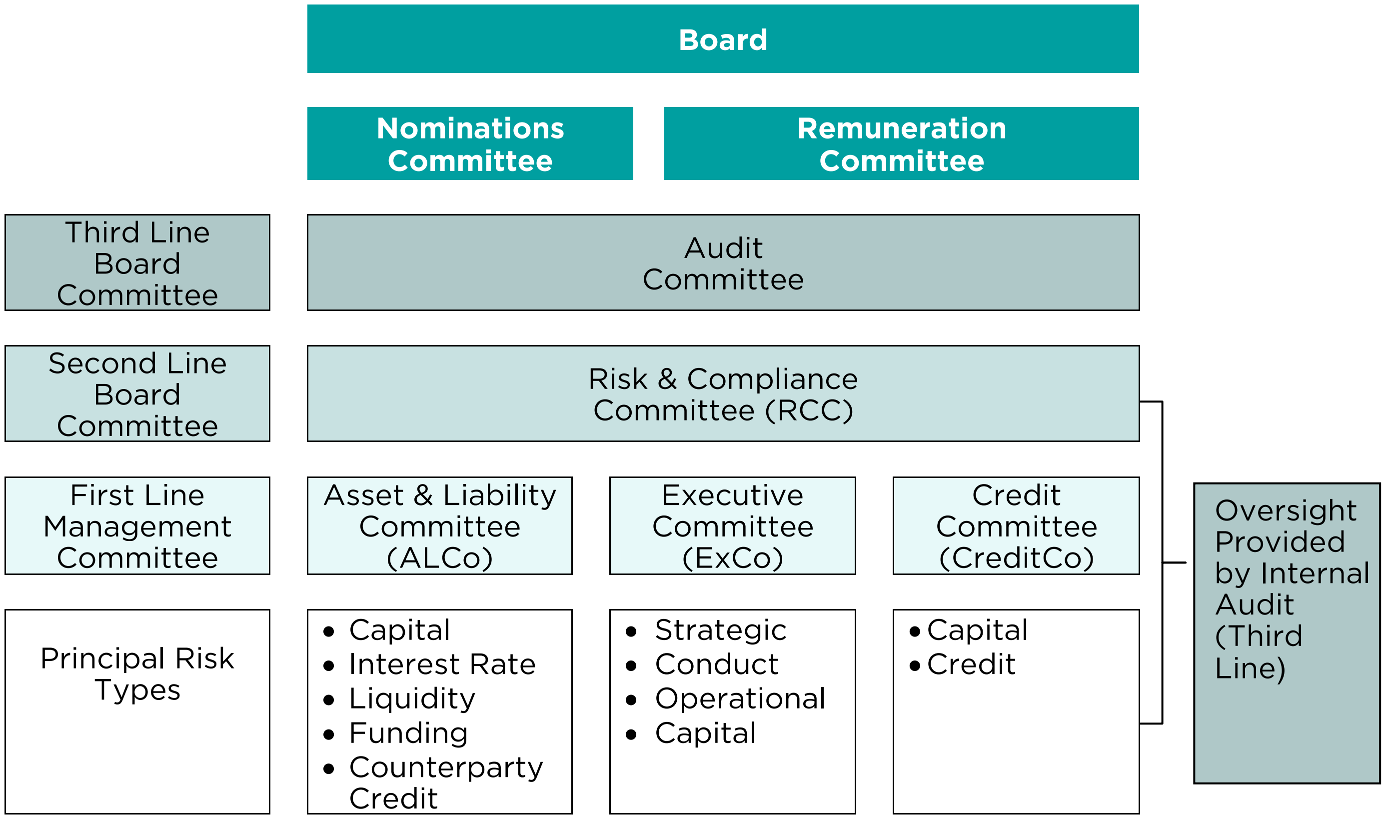
The Society's Risk Management Framework operates under the "Three Lines of Defence" principle.

Line	Focus	Core Responsibility
1st Line – Front Line Function	Control	Day to day management and control of risk
2nd Line – Risk Management & Compliance	Oversight	Oversight and challenge of 1st line
3rd Line – Internal Audit	Assurance	Independent assurance of 1st and 2nd line

This model provides a simple and effective way to enhance communications on risk management and control by clarifying essential roles and duties. This provides clarity regarding responsibility for risks and controls and helps to improve the effectiveness of risk management within the Society.

2.5 Risk and control management and governance

The Board has in place a governance framework which includes both Non-Executive and Executive led committees. The Executive-led committees are Credit, ALCO and ExCo. The Board receive minutes of all the meetings.



A description of the responsibilities and activities of the Board and Board Committees is provided in the Society's Annual Report & Accounts.

2.5.1. Stress testing

Stress testing is a risk management tool used by the Society to understand the impact of severe but plausible scenarios on its business model. The objectives of the Society's stress testing programme and scenario analysis are to:

1. Understand the levels of capital and liquidity that is required to ensure sustainability of the Society in all reasonably foreseeable circumstances; and
2. Understand the level of extreme stress that would cause failure (reverse stress testing) so the Board can consider whether this is acceptable or should be further mitigated. This will inform the level of the Society's risk appetite and the resulting key risk indicators.

Capital : The Society uses a prescribed Internal Capital Adequacy Assessment Process (ICAAP) to identify capital risks and stress testing is undertaken as part of this process.

Liquidity : The Society uses a prescribed Internal Liquidity Adequacy Assessment Process (ILAAP) to identify liquidity risks and stress testing is also undertaken as part of this process. Liquidity stress tests are performed on a monthly basis with results reported to ALCO and Board. These stress tests help identify any shortfalls in the Society's levels of liquidity in a range of scenarios.

The PRA carry out an assessment of the Society and issue firm-specific minimum capital and liquidity levels based on their assessment of the risks faced by the Society, including under stressed conditions.

Other : The Society also undertakes interest rate risk stress testing to ensure that the impact of changes in interest rates on its earnings and economic value remains within risk appetite and that the Society holds sufficient capital to cover potential losses arising from changes in interest rates. Interest rate risk scenarios model and evaluate the impact of a range of positive and negative changes to interest rate bases (Bank Rate and Sonia) on interest income. The output from all processes is used to inform Board risk appetite, policies, management actions and contingency plans.

2.6. Strategies and process for managing each category of risk

2.6.1. Principal risks

The principal risks are those risks that the Board has defined as being of primary importance to the Society and which must be managed to achieve its objectives. Formally defining the principal risks enables communication to all stakeholders, by the Board, on how it stays in control by aligning risk/reward decisions to its business model and strategy.

Each principal risk has a Risk Owner within the Society and a committee which is responsible for its management. The Board approves the policies which set out how the principal risks are managed. The Risk & Compliance Committee's review all policies annually and recommend to the Board for approval on a three yearly cycle.

The Society's principal risks are: Strategic, Capital, Market Risk, Credit Risk (Mortgage & Counterparty), Conduct Risk, Operational Risk, Liquidity Risk and Funding Risks. Each are covered below.

2.7. Strategic risk

Strategic risk is the risk of the Society failing to achieve its corporate objectives. The Society has a simple business model which focuses on mortgage and funding. There is a robust Corporate Planning process which is subject to stress testing and the strategic planning assumptions are regularly reviewed for risks which could become a threat to the Corporate Plan.

Strategic issues are regularly discussed at Board meetings and the Board provides robust challenge of the Corporate Plan. The Society maintains strong levels of capital and liquidity which provide financial resilience in periods of stress. This is assessed through regular stress testing of both capital and liquidity.

2.8. Capital risk

Capital risk is the risk of having insufficient capital to support the business in a severe but plausible downturn. The Society maintains its capital level at a level significantly in excess of regulatory requirements and internal risk appetite limits. The Internal Capital Adequacy Assessment Process (ICAAP) provides a qualitative and quantitative assessment of the level of capital needed to support the Society's current risks and future risks, including under stressed scenarios. It is updated on an annual basis and approved by the Board following recommendation from the Risk & Compliance Committee

2.9. Market Risk (including Interest rate risk in the banking book (IRRBB))

Market Risk is the risk of loss of income from movements in interest rates and includes interest rate risk and basis risk.

The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk). The Society is not directly exposed to equity, foreign currency or commodity risk.

Market risk is controlled by setting Board approved limits to control non-administered business (e.g. fixed rate mortgages) therefore ensuring the majority of assets are on an administered interest rate. To mitigate the risks associated with non-administered assets, hedging contracts are used in accordance with the Board-approved Structural Risk Policy. Market risk is regularly reviewed by the ALCO.

The Society has adopted the "Matched" approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position.

The sensitivity to changes in interest rates impacts the following activities:
1. Management of the investment of reserves and other net non-interest-bearing liabilities;
2. Fixed rate funding; and
3. Fixed rate mortgage and treasury lending.

Interest rate swaps are used, where appropriate, to manage the above risks. The Society also monitors prepayment levels on fixed rate mortgages and aims to hedge the exposure post adjusting for this exposure.

To quantify the risk across the entire balance sheet the interest rate gap is stressed for parallel interest rate stress. The Society uses a parallel shift in interest rates of 2% and sets a risk appetite for the outcome not to result in a loss of economic value exceeding 5% of the Society's capital. The results are reported to ALCO at each meeting.

2.10. Credit risk

Credit risk is the risk that mortgage loan customers or treasury counterparties do not meet their obligations when they become due.

2.10.1. Mortgage Credit Risk – Loans and advances to customers

Mortgage credit risk is controlled in accordance with the Board-approved Lending Policy, which is aligned with a cautious risk appetite, and by strict controls over lending mandates. Lending is done on prudent terms, is maintained within carefully controlled limits and is subject to regular Credit Committee and Board reviews, together with reviews undertaken by 2nd and 3rd line risk functions. The Risk & Compliance Committee also reviews the risk appetite position, market conditions and the Society's credit performance.

Whilst the Policy allows lending in a limited number of niche areas which may be considered to have a greater degree of risk, this is mitigated by the fact that these are areas where the Society either has significant experience or has set non-material limits and each application is carefully underwritten by an experienced team.

Forbearance

The Society has a range of forbearance options available to support customers who are experiencing financial difficulty and has also signed up to the Mortgage Charter. Full consideration is given to understand customers' individual circumstances to ensure that the options offered are appropriate and in the mutual interest of the customer and lender. Options include:

- Temporary conversion from capital and interest to interest only repayment (interest only concessions)
- Temporary extension of mortgage term to reduce monthly repayments (term extensions)
- Reduced payment concessions, where the customer makes an agreed underpayment for a period
- Arrangements to make part payments to repay arrears over an agreed period (payment plans)
- Payment holidays where previous overpayments have accrued
- Capitalisation of arrears where borrower has maintained repayments for an agreed period
- Freezing of interest on arrears where borrower has been granted breathing space under the Government Debt Respite Scheme.

In some cases, more than one forbearance solution is offered, for example where a customer can afford to pay more than just interest and combines with a part repayment. Capitalisation is usually an exception and is approved by Credit Committee.

2.10.2. Counterparty credit risk

Counterparty credit risk is controlled through adherence to the Board-approved Treasury Operations Policy and is regularly reviewed by ALCO with oversight by the Risk & Compliance Committee. The Policy defines prudent limits, relating to quality and quantity, on credit exposures to individual and groups of counterparties. The counterparty limits are developed predominantly by reference to credit ratings and other market and financial data, and any new counterparties are approved by the ALCO in accordance with the Treasury Policy. Management monitor limits on a daily basis and ALCO monitors limits and KPIs on a monthly basis. Treasury activities are tightly controlled and are also a focused area of internal and external audit.

On-balance sheet items

The Society has exposures to banks in its treasury portfolio. These exposures are held for liquidity management purposes. The Society's longstanding bankers are Barclays and NatWest (RBS), which are A+ rated. The Society's Board approved Treasury Operations Policy also permits the Society to hold exposures with unrated institutions in the form of deposits placed with other building societies. The Society conducts an internal credit assessment on these institutions. Exposures to these institutions are assigned a risk weight according to the credit quality step they fall into.

Table 7 on page 18 sets out the maturity and credit profile of treasury investments at 31 December 2023.

Off-balance sheet items

With regard to off-balance sheet items the Society has interest rate swaps (IRS) with single A rated counterparties (or better).

Interest rate swap derivative instruments are covered under collateralised agreements. Depending on the market value of the instruments this results in either the Society or the swap counterparty depositing collateral funds with the corresponding counterparty. This mitigates the credit risk to either counterparty from any exposure created by movement in the market value of derivatives. Any movement in collateral is based on the market value of the swaps and does not consider the creditworthiness of the swap counterparty or the Society (although the Society is an unrated institution and therefore cannot be subject to a ratings downgrade).

The Society does not use credit derivatives and therefore has not provided disclosures required under CRR article 439.

2.11. Conduct risk

Conduct risk is the risk that actions or the failure to take actions results in members and/or customers suffering unfair outcomes.

The Society has no appetite but minimal tolerance for the delivery of unfair customer outcomes and will continuously monitor the delivery of customer outcomes to ensure these are fair. The Risk Tone and Culture are established by Board and enacted by Senior Management, with Society wide promotion through the Society Values. In addition, the policies of third party suppliers are considered.

The monthly Conduct risk dashboard covering indicators such as complaints, vulnerable customers, risk events and customer feedback. The implementation of the new Consumer Duty was overseen by the Board, with a dedicated non-executive sponsor.

2.12. Operational Risk

Operational risk is the risk of the risk of losses, customer detriment, or reputational damage due to inadequate or failed internal processes, or systems, human error or external events. Therefore, operational risks can potentially arise from all the Society's activities, across all business areas.

The Society maintains a robust control environment which seeks to restrict losses and limit the impact of reputational damage, resulting from inadequate or failed internal processes, people and systems, or from external events.

To manage operational risks the following approaches are considered:-

i) Maintain and accept risk which is not possible or necessarily desirable to eliminate. A risk acceptance process provides guidance regarding the approval and ongoing requirements relating to accepted risk.
ii) Manage and control the risk, primarily via the RCSA, which captures controls to limit the impact should risks materialise.
iii) Contract out the risk to a third party who can mitigate the risk to acceptable levels, eg insurance.
iv) To terminate activity to avoid risk

To ensure operational resilience, the Society has an operational resilience dashboard which sets clear tolerances on what can be absorbed and actions are in place to respond beyond these points. The Business Continuity Plan, which is kept under regular review, is designed to ensure that any breakdown in systems would not cause significant business disruption. The Society also maintains insurance arrangements to cover certain operational losses including, for example, cyber disruption. A range of metrics and risk limits are used to monitor the Society's ability to recover from an operational risk event in line with the defined risk tolerances for the key business services.

The Board is aware of the significant operational losses that have occurred in other businesses, particularly relating to cyber-attacks. The security of systems is always a key focus and the Society has a security provider engaged for increased monitoring and threat prevention.

The Operational Risk framework contains eleven sub-categories:

- Regulatory, Legal and Accounting
- Business Interruption
- Financial Crime
- Third Party Management
- IT Operations & Development
- Information and Data Security
- Information Management
- Model and Spreadsheet Risk
- People
- Process & Change
- Physical Security

It is reviewed by ExCo and Risk & Compliance Committee and they also receive management information relating to operational risk and resilience. The Audit Committee is responsible for assessing the effectiveness of the system of inspection and control.

To monitor its operational risks, the Society records all its risks and quantifies these through risk likelihood and impact, together with a reduction in impact from application of the controls assigned to each risk. This allows us to establish a residual risk remaining after operation of controls for each business area within the Society.

The Society operates the Basic Indicator Approach for the purpose of calculating its operational risk Pillar 1 capital requirement. In addition, the Society conducts stress testing to determine whether additional capital should be held in Pillar 2A.

2.13. Liquidity Risks

Liquidity risk is the risk of being unable to meet financial obligations as they fall due, including any unexpected cash flows that could arise under stress.

The Society relies on its access to sources of funding to finance the origination of new mortgage business and working capital. If access to funding became restricted, either through market movements or regulatory or government action, this might result in the scaling back or cessation of new lending or other actions as set out in the Society's Recovery Plan.

The Liquidity Policy is reviewed annually by the ALCO, the Risk & Compliance Committee and approved by the Board. Liquidity is maintained within the Board approved risk appetite limits. Monthly stress tests are conducted which help to determine the level of liquidity required to withstand all reasonably foreseeable liquidity stresses. The Society also has a Liquidity Contingency Plan in place to manage sudden or extreme outflows. The results of stress testing and the liquidity position are reported to the ALCO and Board and appropriate action is undertaken, if required.

Liquidity stress testing is reviewed annually as part of the Internal Liquidity Adequacy Assessment Process (ILAAP) to ensure that all liquidity risk drivers are considered. The ILAAP is an assessment of the Society's exposure to liquidity risk across its planning horizon. The ILAAP is reviewed by the Risk & Compliance Committee and approved by the Board at least annually.

The Society's policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain public confidence and to enable the Society to meet its financial obligations. This is achieved through maintaining an adequate level and quality of liquid assets, through wholesale funding and through management control of the growth of the business. This results in the Society holding a significant amount of highly liquid assets, mostly in the form of deposits with the Bank of England.

It is a requirement for all Banks and Building Societies to construct plans that detect possible failure and minimise the consequences of failure should it occur. The Society has a Board-approved Recovery Plan that outlines a menu of options the Society could credibly take to recover from a stress – whether Society specific or market-wide. The Society also has a Board-approved Resolution Plan containing prescribed information necessary for the Bank of England to establish an orderly resolution of the Society in the event that recovery cannot be achieved. Both documents are updated at least annually.

2.14. Funding Risks

Funding risk is the risk of higher funding costs or a lack of availability of funds and the risk arising from a maturity mismatch between funding and lending. The inherent problem the Society faces with regards to funding risk is the problem of maturity mismatches due to the long-term nature of mortgage lending funded by shorter term borrowings. The Funding Policy aims to monitor and control the way in which both wholesale and retail funds are raised to reduce the exposure to the funding mismatch risk.

The Society manages funding risk by maintaining a diverse funding base and ensures compliance with applicable regulatory requirements. This in turn determines the overall level of liquidity to be maintained. The Society's Internal Liquidity Adequacy Assessment Process (ILAAP) is reviewed annually and approved by the Board. The ILAAP forms a central part of the Society's risk management and includes stress testing which analyses a range of severe yet plausible scenarios to confirm that the Society holds an adequate amount of available liquidity.

2.15. Other risks

2.15.1. Climate change

The Society also recognises the risks and challenges posed by climate change. While the financial risks from climate change may only crystallise in full over longer time horizons, they are becoming apparent now.

The Society recognises two risks, physical and transitional:

Physical risks relate to specific weather events such as flooding, or longer-term events such as rising sea levels. A key element of this risk is to property, both the Society's own properties and properties held as security for lending. The stress testing of these risks within the mortgage portfolio has been completed and this did not highlight any concerning areas of risk within the portfolio.

Transitional risks can arise from the process of adjustment towards a low-carbon economy. This could lead to a changing regulatory expectation in terms of the way the Society is expected to run its own business and in particular the energy efficiency expectations of properties held as security.
The Society is increasingly mindful of these risks when making business decisions, including mortgage underwriting.

3. CAPITAL RESOURCES

The Society's capital resources are calculated in accordance with Pillar 1 of the CRD. The scope of these resources as at 31 December 2023 relate to the Society only. The Society has no subordinated debt, permanent interest-bearing shares, core capital deferred shares or any other capital instruments.

3.1 Tier 1 capital

Tier 1 capital comprises the general reserve, which contains the accumulated profits of the Society and available for sale reserve, all net of regulatory adjustments. For this reason, the prescribed disclosures on "capital main features" or "terms and conditions" are not provided.

3.2 Tier 2 capital

Tier 2 capital is comprised of the collective provision for bad and doubtful debts.

3.3 Capital Composition (own funds)

The following table is a summary of the Society's capital resources as at 31 December 2023:

Table 3: CC1 – Composition of regulatory own funds

Common Equity Tier 1 (CET1) capital: instruments and reserves		£m
1	Capital instruments and related share premium accounts	-
2	Retained earnings	29.4
3	Accumulated other comprehensive income (and other reserves)	-
Common Equity Tier 1 (CET1) capital: regulatory adjustments		
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	29.4
7	Additional value adjustments (negative amount)	-
8	Intangible assets (net of related tax liability) (negative amount)	(0.1)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38(3) CRR are met) (negative amount)	-
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	(0.1)
29	Common Equity Tier 1 (CET1) capital	29.3
Tier 2 (T2) capital: instruments		
50	Credit risk adjustments	-
58	Tier 2 (T2) capital	0.6
59	Total capital (TC = T1 +T2)	29.9

60	Total risk exposure amount	163.7
Capital ratios and buffers		
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	17.9%
62	Tier 1 (as a percentage of total risk exposure amount)	17.9%
63	Total capital (as a percentage of total risk exposure amount)	18.3%
64	Institution CET1 overall capital requirement (CET1 requirement in accordance with Article 92(1) CRR, plus additional CET1 requirement which the institution is required to hold in accordance with point (a) of Article 104(1) CRD , plus combined buffer requirement in accordance with Article 128(6) CRE) expressed as a percentage of total risk exposure amount)	12.5%
65	Of which: capital conservation buffer requirement	2.5%
66	Of which: countercyclical buffer requirement	2.0%
68	Common Equity tier 1 available to meet buffers (as a percentage of total risk exposure amount)	9.9%

3.4 Reconciliation of regulatory own funds to balance sheet in the audited financial statements

There are no differences between the scope of regulatory and accounting consolidation. A reconciliation of equity attributable to members per the Statement of Financial Position to regulatory capital is shown below.

Table 4: CC2 - Reconciliation of regulatory own funds to balance sheet in the audited financial statement

Assets per published financial statements	£m
Society Assets per statutory balance sheet	**461.0**
Adjustments:	
Derivatives adjustment*	0.9
Accounting Adjustments**	0.4
Regulatory deductions: Intangible assets	(0.1)
Off balance sheet items	22.7
Credit Risk exposure	**484.9**
Reserves per published financial statements	
Accounting capital resources – reserves	**29.4**
Adjustments:	
Collective impairment provisions	0.6
Regulatory deductions: Intangible assets	(0.1)
Regulatory capital resources	**29.9**

*Derivative adjustment relates to the difference between the statutory and regulatory valuation approaches of the interest rate swap derivatives held for market risk management purposes (£4.3m). The adjustment also includes the related, offsetting hedge risk fair value adjustment against *loans and advances to customers* on the statutory balance sheet (£5.2m).
**Accounting adjustments is the net of the loan impairment provisions (£0.6m) and effective interest rate adjustment (£0.2m).

3.5 Adequacy of capital resources

The Total Capital Requirement (TCR) is the amount and quality of capital that a firm must hold to comply with its capital requirements under Pillar 1 and Pillar 2A, as confirmed by the PRA. The Overall Capital Requirement takes into account requirements arising from the application of capital buffers.

The Society seeks to maintain at all times capital resources that are considerably in excess of regulatory requirements. The Society undertakes an Internal Capital Adequacy Assessment Process (ICAAP) each year which is designed to ensure the Society at all times maintains sufficient levels of capital resources to mitigate the principal risks set out in section 2 above across the Society's financial planning period under normal and severe but plausible stressed conditions.

As at 31 December 2023 the Society held capital resources in excess of the regulatory requirements as set out below.

	Note	£m
Amount of regulatory capital resources		
Capital requirements:		
- Pillar 1 capital requirements		13.1
- Pillar 2A requirements		-
Total Capital Requirement (TCR)		**13.1**
- Capital Conservation buffer	1	4.1
- Countercyclical buffer	1	3.3
Overall Capital Requirement (OCR)		**20.5**
Excess capital resources		**9.4**

Note
1 - As at 31 December 2023 the Society was required to hold 2.5% of risk weighted assets as its Capital Conservation Buffer. The UK Countercyclical Buffer increased to 2% with binding effect from 5 July 2023.

4. STANDARDISED APPROACH

4.1 Credit risk exposure and CRM effects

Standardised exposures in the table below are stated on two different bases (pre credit conversion factor (CCF) and pre credit risk mitigation (CRM) and post-CCF and CRM. Exposures are stated net of credit risk adjustment exposures.

Table 5: CR4 - standardised approach – Credit risk exposure and CRM effects

	Exposure Classes	Exposures before CCF and before CRM		Exposures post CCF and post CRM		RWAs and RWAs density	
		On-balance sheet exposures £m	Off-balance sheet exposures £m	On-balance sheet exposures £m	Off-balance sheet amount £m	RWAs £m	RWAs density %
1	Central governments or central banks	52.5		52.5			0.0%
2	Regional government or local authorities						
3	Public sector entities						
4	Multilateral development banks	4.4		4.4			
5	International organisations						
6	Institutions	7.2		7.2		2.5	26.8%
7	Corporates						
8	Retail	4.0	1.7	4.0	0.8	3.6	75.0%
9	Secured by mortgages on immovable property	386.7	21.0	386.7	5.7	138.7	35.3%
10	Exposures in default	2.0		2.0		2.0	100.0%
11	Exposures associated with particularly high risk						
12	Covered bonds						
13	Institutions and corporates with a short-term credit assessment						
14	Collective investment undertakings						
15	Equity						
16	Other items	3.3	-	3.3	-	3.0	93.8%
17	**TOTAL**	**460.1**	**22.7**	**460.1**	**6.5**	**149.8**	

4.2 Exposures by asset class

Table 6: CR5 – standardised approach

	Exposure Class £m	0%	10%	20%	35%	50%	75%	100%	150%	TOTAL	Of which unrated
1	Central governments or central banks	52.5	-	-	-	-	-	-	-	52.5	-
2	Regional government of local authorities	-	-	-	-	-	-	-	-	-	-
3	Public sector entities	-	-	-	-	-	-	-	-	-	-
4	Multilateral development banks	4.4	-	-	-	-	-	-	-	4.4	-
5	International organisations	-	-	-	-	-	-	-	-	-	-
6	Institutions	-	-	7.2	-	2.1	-	-	-	9.3	-
7	Corporates	-	-	-	-	-	-	-	-	-	-
8	Retail exposures	-	-	-	-	-	5.7	-	-	5.7	5.7
9	Exposures secured by mortgages on immovable property	-	-	-	405.7	-	-	2.0	-	407.7	407.7
10	Exposures in default	-	-	-	-	-	-	2.0	-	2.0	2.0
11	Exposures associated with particularly high risk	-	-	-	-	-	-	-	-	-	
12	Covered bonds	-	-	-	-	-	-	-	-	-	
13	Institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	
14	Collective investment undertakings	-	-	-	-	-	-	-	-	-	
15	Equity	-	-	-	-	-	-	-	-	-	
16	Other items	0.2	-	-	-	-	-	3.1	-	3.3	3.3
17	**TOTAL**	**57.1**	**-**	**7.2**	**405.7**	**2.1**	**5.7**	**7.1**	**-**	**484.9**	**418.7**

4.3 Use of external credit assessment institutions

The Society makes limited use of External Credit Assessment Institutions (ECAIs) for its standardised exposures, applying only to the Institutions Exposure Class. The table below sets out the maturity and credit profile of treasury investments at 31 December 2023.

Table 7

Minimum Credit rating	Maturity Profile £m				
	<8 days	<1month	<3 months	>3 months	Total
AAA to AA-	-	-	-	4.4	4.4
A+ to A-	7.2	-	-	2.1	9.3
Building Societies (unrated)	-	-	-	-	-
Central government and banks	49.0	0.5	1.0	2.0	52.5
TOTAL	**56.2**	**0.5**	**1.0**	**8.6**	**66.2**

5. LIQUIDITY METRICS

5.1 Liquidity Metrics

The Society calculates and expresses its liquidity requirement in terms of a percentage of savings and deposits liabilities (SDL) and also in terms of survival days in a prescribed stress. The Society also reports liquidity using the regulatory measures of Liquidity Coverage Ratio (LCR) and Net Stable Funding Requirement (NSFR).

5.2 LCR

The Society's LCR at 31 December 2023 was 231% (2022: 223%) point in time, highlighting a strong liquidity position compared to the minimum regulatory requirement for 100%. The information in table 8 presents the Society's average LCR based on end of month observations over the preceding 12 months to each quarter end date for the financial year ended 31 December 2023.

Table 8: LIQ1 Quantitative information of LCR

		Quarter ended on			
	Number of data points used in the calculation of averages	March 23	June 23	Sept 23	Dec 23
		12	12	12	12
1	High Quality Liquid Assets £m	49.1	49.9	51.6	52.8
16	Total cash outflows £m	30.7	33.0	34.2	34.2
20	Total Cash inflows £m	9.7	9.8	9.5	10.2
23	LCR %	242.1%	219.4%	211.0%	220.0%

The LCR reported at 31 December 2023 (231%) point in time was slightly higher than the average LCR maintained throughout the year principally due to slightly slower mortgage completions toward the end of the year.

The Society's liquidity comprises predominantly of amounts deposited with the Bank of England. All of the Society's liquidity is sterling denominated. There are no currency mismatches.

5.3 NSFR

The Society reports its NSFR on a quarterly basis. The table below sets out the Society's NSFR as at 31 December 2023 and for the three preceding quarters.

Table 9: LIQ2 Net Stable Funding Ratio

		Quarter ended on			
		March 23	June 23	Sept 23	Dec 23
14	Total available stable funding (ASF) £m	381.6	394.7	408.2	416.2
33	Total required Stable Funding (RSF) £m	243.8	253.1	258.7	261.8
34	Net Stable Funding Ratio %	156.5%	155.9%	157.8%	159.0%

The growth in available stable funding can be attributed to growth in retail balances across the period. The increase in required stable funding reflects growth in mortgage balances and a higher requirement for other assets. There have been no material changes to the Society's funding strategy or structure during the year.

6. REMUNERATION DISCLOSURES

6.1. Information relating to the bodies that oversee remuneration

Composition and mandate of remuneration committee

The Board has established a Remuneration Committee, which consists of three members, all of whom are Non-Executive Directors. A summary of the terms of reference for the Committee is set out below:

- Ensure the Society complies with best practice and the applicable legal and regulatory requirements
- Set, and recommend to the Board, a Remuneration Policy for Non-Executive Directors, Executive Directors, Material Risk Takers and all employees

- Set remuneration, including the approval of targets and performance related pay schemes
- Ensure role profiles and service contracts of Executive Directors are aligned to the Remuneration Policy

The Remuneration Committee assesses whether any performance related payments should be made taking into account reports, where applicable, from the Risk and Compliance functions.

Whilst a binding vote on Remuneration report is not considered appropriate for a building society of our size and nature, if more than 25% of the turnout vote against the report, the Remuneration Committee will take steps to ascertain and address the concerns of the Membership.

The Committee met three times during the financial year ended 31 December 2023. Proceedings are formally minuted and minutes are available to all Board members.

Use of external consultants

In setting remuneration, the Committee considers the remuneration levels and structure of other building societies that are similar in size and complexity, as well as external market conditions. Periodically, a report may be commissioned from external consultants to assist in this process. The Committee did not use the services of an external consultant during the reporting period.

Material risk takers

The Nomination Committee has determined that, as at 31 December 2023, all of the current Non-Executive Directors and the two Executive Directors, as well as the senior leadership team roles, are classified as Material Risk Takers (MRTs) and subject to the Remuneration Code.
The individuals in the senior leadership team roles are subject to the same variable pay performance targets and rewards as the Executive Directors.
The Remuneration and Nomination Committees do not consider that any members of staff who are not members of the Board or the Senior Leadership team should be classified as MRTs.

6.2. Information relating to the design and structure of the remuneration system

Overview of the key features of and objectives of remuneration policy

The Society's objective when setting remuneration is to ensure that it supports the Society's business strategy, risk appetite and long-term objectives, and is consistent with the interests of the Society's members. Remuneration is set at a level to be sufficiently attractive to recruit and retain and the right people. The Remuneration Committee also ensures that variable remuneration does not undermine the objectivity of the risk and compliance functions.
The Policy is written to take account of six potential impacts:
- the Society's risk profile
- the internal culture of the Society and fair treatment of customers
- aligning remuneration with strategy and avoiding conflicts between those interests and those of the individual
- the demands and responsibilities of the roles
- market comparatives from similar financial institutions
- each individual's personal development and contribution to the Society's performance

As well as recruiting the right people, the Society believes Performance Related Pay (PRP) helps to motivate employees to maximise achievements for the Society. We use the following principles to ensure schemes meet this objective:
- The PRP scheme targets and objectives must be communicated to employees at the outset and employees will be given the resources to make targets achievable, albeit stretching.
- The PRP scheme is based on a balanced scorecard of measures designed to meet the objectives of the Society.

- The Society does not offer any guaranteed bonuses. Any payment will only be made after rigorous performance evaluation.
- The scheme must be affordable for the Society, so payment will only be made if there is sufficient profit during the period.

There are no individuals currently remunerated at EUR 1 million equivalent or more.

Information on the criteria used for performance measurement and ex ante and ex post risk adjustment.

The financial and non-financial metrics included in the PRP scheme rules are clear, measurable and agreed by the Remuneration Committee at the start of each performance year. Risk and Controls objectives are clearly stated as part of these objectives. Individuals have objectives set for the performance year which are documented and measured and assessed during the end of year appraisal process. The CEO will make recommendations to the Remuneration Committee who have the discretion to decide whether the Society's performance is such that the payment of variable remuneration is justified.
The recommendation is made at the end of the financial year and paid after the external audit is completed to allow for any risks to be taken into consideration by the Remuneration Committee. Malus and Clawback are not included in the scheme rules due to the low levels of PRP paid.

Information of how the institution ensures that staff in internal control functions are remunerated independently of the businesses they oversee.

Employees in control functions are subject to the same remuneration and reward process as all other employees in the Society. In accordance with its terms of reference, the Remuneration Committee oversees the remuneration of the senior leader in the risk management and compliance function, ensuring it is not appropriately weighted to variable pay and that the method for determining remuneration does not compromise the objectivity of that individual.

Policies and criteria applied for the award of guaranteed variable remuneration and severance payments.

There is no guaranteed variable remuneration and therefore the Society has no specific policy on this matter. The Society does not have a redundancy policy and only statutory redundancy payments would be made.

6.3. Description of the ways in which current and future risks are taken into account in the remuneration processes.

The remuneration targets and objectives are based on the approved corporate plan. The plan considers a range of risks and is stress-tested to ensure the level of risk it contains is consistent with the Society's risk appetite. The plan risks are assessed by the CRO and reviewed by the Risk Committee in advance of its approval by the Board.
The PRP scheme includes risk measures that reduce payments if they are not met.

6.4. The ratios between fixed and variable remuneration set in accordance with point (g) of Article 94(1) CRD.

The ratios for annual variable remuneration range from 0% to 10% which ensures that no employee earns more than one third of total remuneration in the form of variable remuneration.

6.5. Description of the ways in which the institution seeks to link performance during a performance measurement period with levels of remuneration.

An overview of main performance criteria and metrics for institution, business lines and individuals.

The Society operates one performance related pay scheme with objectives relating to a balanced scorecard of Financial Stewardship & Risk Management; People; Process & Performance and Customer & Community.

1. Financial Stewardship & Risk Management – includes financial objectives of growth and profit, as well as risk management objectives including compliance and climate change.
2. People – includes self development, branch refurbishment and culture and values
3. Process & Performance – includes IT developments, email and social media engagement and data integrity
4. Customer & Community – includes volunteering days, customer satisfaction and greener initiatives

A maximum of 10% of salary can be earned annually for exceeding in personal objectives and achievement of these targets. Performance related payments are not pensionable and are paid in cash through payroll.

Fundamental prerequisites for any performance related payments include compliance, ethical standards and appropriate risk management. Misconduct or misstatement would lead to non-payment of performance related pay.

Non-Executive directors

The level of fees payable to Non-Executive Directors is assessed using information from comparable organisations. Remuneration comprises a basic fee with supplementary payments for the Chair of the Board, Vice Chair and Chair of the Risk & Compliance Committee to reflect the additional responsibilities of these positions.

Fees for Non-Executive Directors are not pensionable and Non-Executive Directors do not participate in any incentive schemes or receive any other benefits. Non-Executive Directors have letters of appointment and these are available for inspection at the Society's registered address.

6.6. An overview of how amounts of individual variable remuneration are linked to institution-wide and individual performance.

Awards are made based on an assessment of Society-wide performance and individual performance against an agreed set of corporate plan objectives.

Awards are also subject to review and approval by the Remuneration Committee, with recommendations from the Chief Executive.

6.7. Information on the criteria used to determine the balance between different types of instruments awarded including shares, equivalent ownership interest, options and other instruments.

The Society's only instrument is cash, reflecting our mutual status and the absence of any other instruments listed on capital markets.

Information of the measures the institution will implement to adjust variable remuneration in the event that performance metrics are weak, including the institution's criteria for determining "weak" performance metrics.

When setting annual targets, the Remuneration Committee agree an appropriate performance level. This is clearly stated in advance of the objectives being agreed and communicated. The Remuneration Committee have the discretion to decide whether the Society performance is such that the payment of variable remuneration is not justified.

6.8. Description of the ways in which the institution seeks to adjust remuneration to take account of long-term performance.

An overview of the institution's policy on deferral, payout in instrument, retention periods and vesting of variable remuneration including where it is different among staff or categories of staff.

The Society's only instrument is cash, reflecting our mutual status and the absence of any other instruments listed on capital markets. No variable pay is deferred as there is a three month period from approval to payment for issues to come to light regarding the performance of the individual or performance of the Society.

Information of the institution' criteria for ex post adjustments (malus during deferral and clawback after vesting, if permitted by national law).

Malus applies until payment is made and there is no clawback provision.

6.9. Quantitative information on remuneration

Table 10: UK REM1 Remuneration awarded in the financial year

£'000			Management Body			
			Supervisory Function	Management Function	Other senior management	Other identified staff
1	Fixed remuneration	Number of identified staff	8	3	-	-
2		**Total fixed remuneration**	**543**	**343**	**-**	**-**
3		Of which: cash based	543	343	-	-
7		Of which: other forms	-	-	-	-
9	Variable remuneration	Number of identified staff	2	3	-	-
10		**Total variable remuneration**	21	14	-	-
11		Of which: cash based	21	14	-	-
12		Of which: other forms	-	-	-	-
17	**Total remuneration (2+10)**		**564**	**357**	**-**	-

No special payments were made to any staff whose professional activities have a material impact on the Society's risk profile.
There was no deferred remuneration payable in the last financial year.

Table 11: UK REM5 – Information on remuneration of staff whose professional activities have a material impact on institutions' risk profile (identified staff) awarded in the financial year

		Management body remuneration			Business areas						TOTAL
	£'000	MB Supervisory function	MB Management function	TOTAL MB	Investment Banking	Retail banking	Asset management	Corporate Functions	Independent internal control functions	All other	
1	Total number of identified staff										11
2	Of which: members of the MB	8	3	11							
3	Of which: other senior management	-	-	-							
4	Of which: other identified staff	-	-	-							
5	Total remuneration of identified staff	563	357	920							
6	Of which: variable remuneration	21	14	35							
7	Of which: fixed remuneration	542	343	885							

7. ATTESTATION

The Board confirms to the best of its knowledge that the disclosures provided according to the Disclosure Part of the PRA Rulebook (CRR) instrument 2021 have been prepared in accordance with the internal control processes agreed upon at the management body level.

Approved by the Vernon Building Society Board and signed on its behalf by:

Judith Aspin Finance Director
22 February 2024

Contact information

In the event that a user of this disclosure document should require further explanation on the disclosures given, please write to the
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