Shawbrook Bank Limited

Pillar 3 Disclosures

December 2012

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1 Introduction

1.1 Objective

This document provides the disclosures required of Shawbrook Bank Limited ('Shawbrook Bank' or 'the Bank') in accordance with the Pillar 3 disclosure requirements set forth under the Basel II Accord transposed as BIPRU 11 by the UK regulator. Shawbrook is regulated by the successor organisations to the Financial Services Authority ('FSA'), the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').

In particular, it describes the Bank's capital adequacy, its risk-assessment methods and the level of risk taken at the bank.

1.2 Disclosure policy

As Shawbrook Bank is regulated in accordance with Basel II this report is updated at least on an annual basis. This document corresponds with the financial year ended 31 December 2012. The description of the Bank's governance, methods and processes reflects the situation at 31 December 2012; subsequent changes are not included.

The data contained in the Bank's Pillar 3 disclosures is calculated in accordance with Basel II regulatory capital requirements.

The Pillar 3 disclosures have been approved by the Board. The disclosures are published on the Bank's website. https://www.shawbrook.co.uk/

1.3 Scope

The monitoring and controlling of risk is a fundamental part of the management process. All senior management are involved in the development of risk management policies and in monitoring their application.

The Basel Committee on Banking Supervision introduced the Basel II framework ('Basel II') for calculating how much capital all banks must hold to protect their depositors and shareholders. The EU Capital Requirements Directive (CRD III) is the means by which Basel II was implemented in the EU at the beginning of 2007. In the UK, it has been transposed by the FSA into BIPRU, the FSA Prudential sourcebook for Banks, that came into effect on 1 January 2007.

The Basel II framework also requires that banks publish an overview of how their risk management framework operates and describe the key risks which the Bank faces.

The Basel II framework consists of regulatory requirements that fall within 3 pillars:

- Pillar 1: defines the minimum capital requirements that firms are required to hold for credit, market and operational risks. The Pillar 1[1] capital requirement is calculated for Shawbrook Bank using the following approach:
  - Credit Risk – Standardised Approach
  - Operational Risk – Basic Indicator Approach
- Pillar 2: builds on Pillar 1 and incorporates the Bank's own assessment of additional capital resources needed in order to cover specific risks[2] that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of any additional capital requirement is also assessed by the PRA during its Supervisory Review and Evaluation Process ('SREP') and is used to determine the overall capital resources required by the Bank
- Pillar 3: is to improve market discipline by requiring firms to publish information on their principal risks, capital structure and risk management

This document outlines the capital required under Pillar 1 and in accordance with Pillar 2, details specific risks which the Bank faces, and how these risks are managed.

This document forms a key part of Shawbrook's compliance with the relevant BIPRU 11 rules regarding the Pillar 3 policy on disclosure. This policy requires the disclosure of a range of key information, such as material risk exposures, risk management processes and capital, the aim being to promote management discipline via enhanced external reporting.

All figures within this document are correct as at 31 December 2012 unless otherwise stated.

[1] The Bank does not have a trading book so the Pillar 1 for Market Risk is nil.

[2] See section 2.5 for details

Shawbrook Bank Limited is a subsidiary of Laidlaw Acquisitions Limited which acquired the business from Manchester Building Society ('MBS'). Laidlaw Acquisitions is 100% owned by the Special Opportunities Fund ('SOF'), an investment vehicle managed by RBS Asset Management Limited ('RBS AM'). Shawbrook Bank is operationally and strategically independent of RBS and is regulated by the PRA/FCA on a standalone basis.

This document is applicable only to Shawbrook Bank Limited and it makes no reference to any other group entity. However it includes the management of risks associated with the acquired businesses of Singers Asset Finance and Link Loans whose assets and liabilities were brought into the Shawbrook balance sheet.

This Pillar 3 disclosure document is applicable only to Shawbrook Bank Limited and the following entities that are consolidated for regulatory purposes:

- Link Loans Limited
- WLB Buildings & Protection Limited

Prior to acquisition in July 2011, Link Loans provided secured loans to retail customers. Link Loans no longer trades, all of the assets and liabilities have been transferred onto Shawbrook's balance sheet, the staff have transferred to Shawbrook as at the date of acquisition and all new loan originations are made by Shawbrook. WLB Buildings & Protection introduces leads to insurance companies for which it receives a commission (activity in this business is immaterial).

1.4 Relevant Changes

1.4.1 Group Changes

Shawbrook acquired Singers Asset Finance Holdings Limited ('SAF') in March 2012. This business is not consolidated into Shawbrook's regulatory framework, however all of the assets and liabilities of SAF have been transferred onto Shawbrook's balance sheet and Shawbrook reimburses SAF for its overheads. The Shawbrook financial position therefore fully reflects the impact of the SAF business.

Shawbrook acquired 100% of the share capital of Money2Improve Limited ('M2i') in November 2012. The Company operated as a business development team that generated relationships with key retail intermediaries in support of the Consumer Lending division. It had negligible assets (under £50k) which have not been transferred onto the Shawbrook balance sheet.

The disclosures in this Pillar 3 document reflect the position of the regulated entity. This differs from the position in the Shawbrook consolidated accounts as follows:

- The definition and calculation of intangible assets (the SAF and M2i goodwill are not brought into the regulated position and the cost of the investment is treated as written off) which results in a reduced deduction from capital
- The accumulated losses are higher in the regulated entity (as a consequence of the write off of the costs of investment) thereby largely offsetting the reduced deduction for intangible assets described above
- The SAF loan book values exclude the fair value increases arising on consolidation

1.4.2 Regulatory Changes

The proposed Basel III regulations are being transposed into EU and UK law in the form of a Regulation and Directive commonly known as CRD IV. Implementation of these new rules is subject to the discretion of the relevant regulator, authority and political agreement so these regulations may be subject to change and the implementation date(s) may also change. At present an implementation date of 1st January 2014 is expected. These rules make substantial changes to the definition of capital resources and include additional capital requirements (for example, for counterparty credit risk). A leverage ratio measure is also introduced under the proposals.

The expected implementation of CRD IV in 2014 introduces stricter definitions of the components of capital. Some instruments (such as subordinated debt and Permanent Interest Bearing Shares) will be gradually derecognised for capital purposes, over a ten year period, starting in 2014. These changes relate to types of capital that the Bank does not currently have.

BASEL III had no effect in 2012 and the Bank has considered the impact of these rules on future levels of capitalisation, including under stress testing. The Directors consider that the Bank will continue to remain well capitalised.

The CRD IV changes may be compounded by several domestic UK regulatory initiatives including :

- The implementation of the Independent Commission on Banking reforms
- Recovery and Resolution Planning

- The FSA moving to a 'twin peaks' regulatory approach

The Bank has allocated resource to meet emerging regulation in order to future proof the regulatory compliance framework and will continue to monitor forthcoming key regulatory changes and proactively manage its capital adequacy to ensure compliance.

2 Risk Management

2.1 Risk Oversight Framework

The governance framework is designed to deliver the agreed strategic plan in line with the Board's overall risk appetite and is based upon the best practice 'three lines of defence' model.

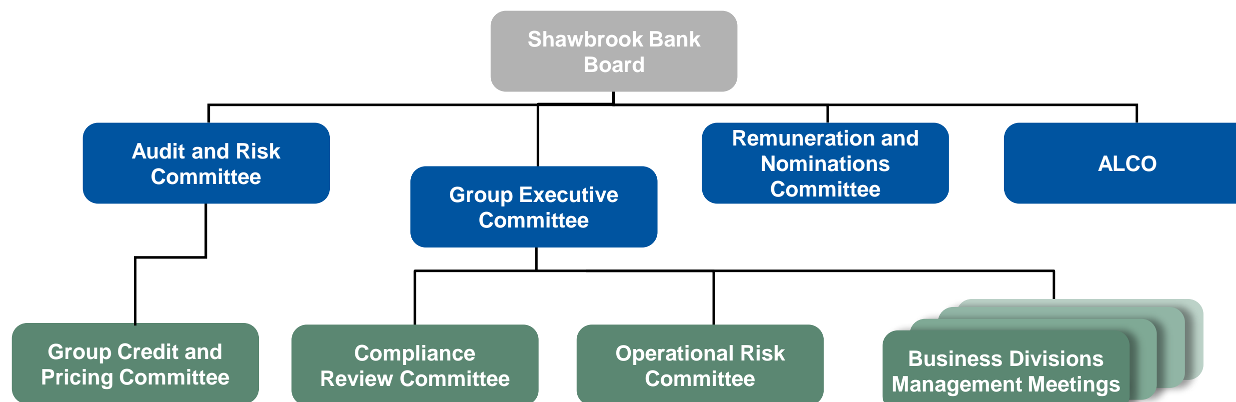
The first line of defence comprises line management within the business areas which, through the implementation of the organisation's risk framework, identify, assess and manage risk.

The second line of defence which comprises the Bank's independent Risk function that addresses Operational, Credit, Market and Liquidity risk and the related independent Compliance function. These functions set policy, challenge, monitor, guide and support the business areas in managing their risk exposures. The Bank's risk framework includes a number of risk management committees, which are responsible for setting and monitoring the Bank's adherence to policy.

The Bank's independent risk function is represented on each of these risk committees and each committee has established Terms of Reference. A Board Audit and Risk Committee, headed by a Non-Executive Chairman, is responsible for oversight of the risk management framework and monitoring of the business risk profile against Board approved risk appetites.

The third line of defence, Internal Audit is outsourced and provided by PKF, an independent third party firm of accountants and business advisers. The work of internal audit is designed to provide independent assurance to the Board (via the Board Audit and Risk Committee) of the adequacy and effectiveness of control systems operating within the first and second lines in identifying and managing risk.

The key committees are a mixture of Board sub committees and key executive management committees. The framework is detailed below:



2.2 Board Committees

- Audit & Risk Committee ('ARC')
- Group Credit and Pricing Committee ('GCPC')
- Assets and Liabilities Committee ('ALCO')
- Remuneration and Nominations Committee ('RemCo')

2.2.1 Audit & Risk Committee

ARC is a Board sub-committee that is responsible for reviewing the effectiveness of the Bank's internal controls. The Committee meets quarterly and monitors and considers the internal control environment focusing on operational risks, internal and external audits and compliance matters.

The Committee is chaired by a Non-Executive Director, and comprises a further two Non-Executive Directors with the Chief Executive Officer, the Chief Financial Officer and the Chief Risk Officer attending.

The Internal Audit function reports directly to the ARC under the terms of reference of the committee. The ARC approves the terms of appointment and receives reports from the external auditors independently from the Board.

2.2.2 Group Credit & Pricing Committee

This is a sub-committee of Audit & Risk. It reviews portfolio monitoring reports to ensure the performance and quality of credit portfolios remains within agreed risk appetite limits, arrears management and provisioning policy for ratification by the ARC. It is also responsible for sanctioning all new lending products.

2.2.3 Assets and Liabilities Committee

The ALCO is a sub-committee of the Board and oversees the asset, liability and other solvency risks, specifically market risk, wholesale credit risk and liquidity risk. The ALCO also recommends to the Board for its approval, policies and frameworks that ensure optimal risk processes and outcomes for the Bank in relation to market risks and liquidity risk.

2.2.4 Remuneration & Nominations Committee

RemCo is a Board sub-committee is responsible for both reviewing levels of remuneration to ensure they remain competitive in the relevant marketplace (specifically including performance related bonuses and long term incentive plans) and for considering all senior appointments both at Board and executive levels (including Non-Executive Directors).

2.3 Management Committees

- Group Executive Committee (‘ExCo’)
- Compliance Review Committee (‘CRC’)
- Operational Risk Committee (‘ORC’)
- Business Divisions Management Meetings

2.3.1 Group Executive Committee

The Board delegates daily management responsibility of the Bank to the ExCo. The ExCo seek to ensure the Bank meets its strategic and operational objectives. ExCo is responsible for:

- Developing the business and delivering against a Board approved strategy, and for ensuring the effective and smooth running of the business within Board approved Risk Appetites;
- Putting in place effective monitoring and control mechanisms which enable it to have appropriate oversight of business activities;
- Setting out a framework of reporting to the Board, which is sufficient to enable the Board to fulfil its responsibilities.

The Management team employs 3 types of sub-committee: Compliance Review, Business Divisions Management Meetings and Operational Risk. The Compliance Review and the Operational Risk committees meet quarterly, all others meet monthly.

2.3.2 Compliance Review Committee

This oversees all compliance and regulatory matters including the consistent and effective use of Treating Customers Fairly and sales standards, adherence to operational procedures, Anti Money Laundering, Data Protection, and other applicable legislation.

2.3.3 Operational Risk Committee

This reviews all operational risks, mitigating actions and losses in line with Risk Appetite and budgets, and it also reviews other significant risk events and failures along with regulated product complaint trends.

2.3.4 Business Divisions Management Meetings

The Business Divisions Management Meetings are responsible for sales and service performance (which includes product, distribution, and sales process changes review and approval), cost management and delivery of the business plan.

2.4 Risk Appetite Framework

2.4.1 Classification of risks

1. In classifying risk the Bank assesses three factors: The existence of a risk factor, i.e., a source of uncertainty relative to the Bank's interests (e.g., the uncertain financial situation of one of the Bank's counterparties)
2. The occurrence of a risk event, which is a situation that has an adverse effect on the Bank's interests and that is caused by the deterioration of a risk factor (e.g., if one of the Bank's counterparties does not meet its financial obligations)
3. The assessment of the negative impact that the risk event would have on the Bank's interests (e.g., the need to create a credit-risk provision)

For all risk types, the Bank seeks to protect itself against three types of potential impact:

1. The financial impact, that is, a decrease in the Bank's net profit and/or a change in the Bank's capital
2. The regulatory impact, that is, inquiries, sanctions, increased monitoring or a restriction on banking activities
3. The reputational impact, that is, the image the Bank projects to the outside world

Through its risk management framework and governance structure, the Bank has a formal mechanism for identifying and addressing risks throughout the business.

2.4.2 Risk assessment

Throughout the Bank's businesses the Bank assesses and monitors its risk profile, i.e., its exposure to strategic, business, credit, market and operational risks. The Bank assesses the potential financial, regulatory and reputational impact of these risks.

Risk assessment generally involves analysing the following:

1. Risk exposures. This involves determining whether the Bank is exposed to certain risks as a result of its activities or operational processes
2. Risk factors and events. This involves identifying relevant risk factors and determining potential risk events. For strategic and business risk, this includes all economic and regulatory factors that may affect the Bank's business activities and its operational processes. For credit, market and operational risk, the relevant risk factors and risk events are defined according to the nature of the Bank's activities
3. Impact of risks. This involves determining the potential financial, regulatory and reputational impact. For risks with a potential financial impact, this means defining loss metrics and risk metrics and determining capital requirements
4. Loss metrics, which are used to determine the potential financial impact, are calculated in accordance with the guidelines set out in the Bank's Risk Appetite; they are developed for each risk category set out above

Generally speaking, the Bank uses effective loss, expected loss and accounting loss to measure loss. Which risk metrics are applied depends on the relevant risk factors and the risk categories in question. These metrics reflect the methods and tools currently available to the Bank. The Bank continually improves and implements the risk metrics to make them more integrated and consistent across the Bank's various activities and risk categories. In terms of capital requirements, the Bank monitors its capital situation in accordance with the SREP framework.

2.4.3 Risk Appetite Statement

Risk Appetite forms an essential part of the Bank's overall approach to corporate governance and risk management. It recognises that a certain level of risk is inherent in any business, particularly in the financial services sector, and that the Board must have suitable tools to set the level of risk that is acceptable given the Bank's business environment and strategy.

The Group's business plan and ICAAP have been predicated on the basis that the Group is willing to take a balanced view towards risk and return. The business plan includes a number of lines of business, spread across personal customers, SMEs and regional government entities. The planned growth in the business over the medium term is well spread across the business lines. The Group reviews its Risk Appetite Statement as described below as part of its annual review process.

Stress testing and scenario analysis outputs and the annual planning exercise are demonstrably used to inform the setting of risk appetite and limits.

The Group has a low to moderate risk appetite fully aligned with the scale and nature of the business model. The Group is exposed to liquidity and credit risks as a consequence of its activities and the Group chooses to accept these

risks subject to the constraints and framework established in this risk appetite statement. The Risk Appetite Statement is for the Group to:

- Achieve business objectives as stated in the Board approved business plan
- Maintain a comprehensive credit risk management framework focused on only the UK retail market, commercial mortgage lending, second charge lending and asset finance business
- Invest in the money market restricted to counterparties with a minimum rating of Moody's long-term A3 or equivalent or systematically critical clearers or invest in other products with an equivalent risk profile
- Maintain a robust capital and liquidity management under "normal" and "stressed" conditions
- Manage balance sheet and market risks to ensure minimal earnings volatility
- Operate with low tolerances for operational and compliance risk exposures by ensuring that staff are properly trained, procedures are documented and supervisory controls are in place to ensure that the controls continue to operate effectively
- Ensure full compliance with all relevant legal and regulatory requirements
- Maintain a level of capital determined by the Board and that is at least equal to that set by the relevant regulatory authorities

2.5 Risks Categories

The Bank's management team have reviewed all the risks faced by Shawbrook Bank and identified the significant risks to which the Bank is exposed. These are explained in more detail in section 3, and are summarised below following the SREP framework (e.g. the Pillar 1 and Pillar 2 risks are categorised using the current ICAAP calculation).

Risk Category	Description
Credit Risk (Pillar 1)	Current or prospective risk to earnings and capital arising from a customer or a treasury counterparty default. This is a function of the probability of default and the amount of security (if any) that would be realised when called after taking into account realisation costs.
Operational Risk (Pillar 1)	The risk of loss arising from inadequate or failed internal processes, people and systems or from external events. This will include reputational risk.
Liquidity Risk (Pillar 2)	The risk of loss arising from inability to meet repayments when they become due.
Systems and Change Risks (Pillar 2)	The risk that transition and business integration changes in the business will be improperly implemented
Market Risk (Pillar 2)	The current or prospective risk to earnings and capital arising from adverse movements in market prices such as interest rate and bond prices.
Concentration Risk (Pillar 2)	The risk of loss arising from significant or connected exposures, with strong likelihood of default correlation.
Strategy Risk (Pillar 2)	The risk of loss arising from adverse business decisions, improper business implementation or a lack of responsiveness to changes in the business environment.

3 Risks Categories

3.1 Credit Risk

Credit risk is the risk arising from failures by borrowers or counterparties to perform their payment, guarantee and/or other obligations, or failure by a sovereign to honour its domestic obligations.

The controlled management of credit risk is critical to the Bank's overall strategy. The Bank has therefore embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

The Bank has effective processes and policies to monitor, control, mitigate and manage credit risk within the Bank's risk appetite. The GCPC provides oversight to the effectiveness of all credit management across the Bank and the controls in place ensure lending is within the Board approved credit risk appetite.

The Bank's collections and recoveries processes aim to provide a responsive and effective operation for the arrears management process. We seek to engage in early communication with borrowers experiencing difficulty in meeting their repayments, to obtain their commitment to maintaining or re-establishing a regular payment plan.

Effective management of credit risk is key business line management accountability. In support of this primary accountability, the Chief Risk Officer is accountable for formulating, communicating, and maintaining a risk control framework to help line managers in the business deliver against the credit risk control requirements.

The Board recognises that credit risk quantification is highly complex and an area of rapid development. It expects the Risk Function to employ and develop experienced and qualified expert credit professionals and to have appropriate depth of experience and specialist knowledge to support the business line management in their control of credit risks.

The following list contains the second order risks of credit risk and the related control requirements:

3.1.1 Credit risk acceptance process at origination

- Implement a thorough credit risk acceptance process, including robust assessment and monitoring procedures at individual customer level, to generate quality credit assets relative to the risk/reward inherent in the transaction
- Establish controls that regulate the growth and composition/profile of the Bank's credit assets encompassing both the flow of new assets and the stock of existing assets, in accordance with the Bank's credit risk appetite

3.1.2 Credit risk measurement

- Take a consistent approach to the identification, measurement, recording, monitoring and management of credit risk across all businesses, adopting a common framework and language. Ensure processes are established for the provision of timely, accurate and complete Management Information
- Subject the Bank's credit risk systems and processes to rigorous testing to ensure they perform satisfactorily for the purpose of identifying all expected and unexpected losses on both an individual customer level and also on a portfolio basis
- Identify and accurately record Collective and Specific Provisions using processes and methodologies at least in accordance with those required by the Board, regulators and other relevant external bodies
- Validate credit risk models on an on-going basis including back and stress testing as appropriate

3.1.3 Portfolio management

- Establish controls that regulate the growth and composition/profile of the Bank's credit assets, encompassing both the flow of new assets and the stock of existing assets, in accordance with the Bank's credit risk appetite
- Manage credit risk by taking account of market liquidity and customer sentiment

3.1.4 Concentration Risk

- Ensure that appropriate controls and processes operate to regulate asset quality, size and exposure concentration
- Maintain and enforce policies that monitor and limit credit risk concentrations at the portfolio level
- Maintain and enforce policies that monitor and limit credit risk concentrations at the customer level

3.1.5 Residual Value Risk

This risk arises when an asset is returned to the Bank at the end of the term of a lease and the value realised is less than that assumed. For Shawbrook Bank this risk is normally associated with specialist medical equipment and is mitigated by adopting a conservative approach to estimates of future value plus the active involvement of an asset management team dedicated to realising additional value from such equipment in the secondary market.

3.1.6 Asset Classification

The table below represents the maximum credit risk exposure at 31 December 2012 analysed by behavioural maturity, without taking account of any underlying security.

Exposure Category	Under 3 Months £k	3 Months to 1 Year £k	Over 1 Year to 5 Years £k	Over 5 Years £k	Exposure Value £k
Secured Lending	3,653	11,527	127,402	20,512	163,094
Commercial Lending	1,717	11,659	170,307	16,947	200,630
Consumer Lending	1,293	3,837	23,879	426	29,435
Asset Finance	41,469	119,206	183,193	4,625	348,493
Total	**48,132**	**146,229**	**504,781**	**42,510**	**741,652**

3.1.6.1 Asset Finance

The Asset Finance division provides specialist financing to UK SMEs, equipment leasing solutions to NHS Trusts and public and private sector healthcare providers. It finances a range of business critical asset classes including commercial and haulage vehicles, vehicle rental fleets, taxis, machine tools, plant and healthcare equipment. Shawbrook acquired Singers Asset Finance in March 2012, providing the Bank with an established and profitable lending platform and a highly respected management team which has been lending in the Asset Finance segment since 1996. A large number of Asset Finance customers have had a relationship with the business for many years. The integration of the Asset Finance business is complete and it now operates as a division of Shawbrook.

The loan book stood at £348.5m at 31 December 2012 (2011: £nil), making it the largest component of the Shawbrook asset base.

3.1.6.2 Commercial Lending

The Commercial Lending division focuses on four complementary product categories: residential investment (experienced buy-to-let property investors); short term facilities (to high net worth individuals for property refurbishment); semi commercial (mixed use residential and commercial property operated by seasoned SMEs); and commercial properties (also operated by seasoned SMEs).

Shawbrook has developed the business around a best in class service proposition (including an underwriting decision within 48 hours) and a product range designed around customer needs. Experience has shown that speed of response and speed of execution following a decision are services that customers value, but are not currently delivered by many of Shawbrook's larger and less flexible competitors. Shawbrook does not require that customers purchase ancillary products or transfer their bank accounts to Shawbrook as part of the transaction.

Shawbrook achieved its first completion in May 2011 and, as at December 2012 Shawbrook had c.870 customers and a loan book of £200.6m (2011: £45.9m), and there were no loans in arrears.

3.1.6.3 Consumer Lending

The Consumer Lending division provides a range of unsecured personal loans for a variety of purposes currently primarily focused on home improvement and holiday ownership. All of the division's loans are regulated under the Consumer Credit Act. As at 31 December 2012, the Consumer Lending loan book stood at £29.4m (2011: £1.7m). Only 0.42% of the loan book had agreements more than 3 months in arrears, reflecting a disciplined application of strict underwriting procedures.

3.1.6.4 Secured Lending

The Secured Lending division provides loans secured by way of a second charge on the customer's primary residential property. Lending is provided for a wide variety of purposes including home improvements, loan consolidation and large consumer purchases. The loan book has grown to £163.1m as at 31 December 2012 (2011: £61.0m) with very limited arrears - only 0.3% of the loan book having agreements more than 3 months in arrears.

Credit risk is analysed by geography in the table below:

Exposure Category	Secured Lending £k	Commercial Lending £k	Consumer Lending £k	Asset Finance £k	Exposure Value £k
East Anglia	5,349	10,880	903	25,614	42,746
East Midlands	7,071	6,373	2,442	19,232	35,118
Greater London	36,101	73,394	2,040	67,278	178,813
North East	3,707	2,851	1,592	5,752	13,902
North West	13,845	16,570	3,202	35,329	68,946
Northern Ireland	-	-	-	6,769	6,769
Scotland	13,413	5,253	7,280	62,568	88,514
South East	42,819	39,468	4,004	63,232	149,523
South West	15,153	19,938	2,233	22,363	59,687
Wales	5,743	4,889	365	7,365	18,362
West Midlands	10,464	7,065	2,860	18,312	38,701
Yorkshire & Humberside	9,384	13,568	1,638	14,679	39,269
Other	45	381	876	-	1,302
Total	**163,094**	**200,630**	**29,435**	**348,493**	**741,652**

3.1.7 Non-Performing Loans & Provisioning

On an on-going basis the Bank assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of impairment loss include, but are not limited to, the following:

- Delinquency in contractual payments of principal or interest
- Cash flow difficulties experience by the borrower, and
- Initiation of bankruptcy proceedings

If there is objective evidence that an impairment loss on a financial asset has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a

variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

When a financial asset is uncollectible it is written off against the related provision for impairment. Such financial assets are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for impairment in the income statement.

Financial assets that are not written down individually become part of a portfolio which will be collectively assessed for impairment. Assessment of a portfolio assumes that loans, leases and instalment credit receivables have similar credit risk characteristics. Objective evidence of impairment of a portfolio of receivables exists if objective data indicates a decrease in expected future cash flows from a portfolio of receivables and the decrease can be measured reliably but cannot be identified with the individual receivables in the portfolio in which case a collective provision is applied.

A consistent approach to provisioning applies to all lending activities within the Bank. A collective provision is raised against performing balances and specific provisions are raised against non-performing or defaulted agreements.

In the case of property based lending (secured or commercial lending) specific provisions are raised when more than three contractual monthly instalments have been missed. The bank will also assign an individual provision for these loans if it has commenced legal proceedings even if the arrears multiple is 3 or less. The provision is determined by comparing outstanding loan balance against the stressed value of security.

Consumer loans have specific provisions raised when the loan goes into arrears, and the provision is incrementally increased at each further month in arrears until it is fully provided at 4 payments in arrears.

Asset Finance's specific provisioning is determined for agreements in arrears by the asset value with less emphasis being placed on ancillary security such as guarantees, supplier repurchase undertakings and third party liabilities. Asset values are initially attributed on a desktop basis and adjusted on inspection post recovery.

The Bank's impairment charge increased year on year by £0.7m to £0.9m (2011: £0.2m). The increase in the charge has arisen due to the growth in the business with loan assets and operating leases increasing by £631.8m to £743.2m (2011: £111.4m). The charge of 12bps is in line with expectations, and the business has benefited from an exceptional performance in respect of loan impairment charges in 2012, a combination of our strong underwriting criteria, collections performance and a relatively benign external environment.

The impairment charge on financial assets is broken down as follows:

	Group 2012 £'000	**Group 2011 £'000**
Secured Lending	793	47
Consumer Lending	168	25
Commercial Lending	313	-
Asset Finance	(243)	-
Other	(118)	114
	913	186

The Group operates a forbearance policy in situations where it becomes aware that an individual customer is experiencing financial hardship. Repayment options are discussed with the customer as are appropriate to the customer's specific situation. The Group will not seek to repossess a property unless all other reasonable attempts to resolve the position have failed. As at 31 December 2012, the number of such forbearance arrangements in place was 11, the carrying value of which was £419,000 against which impairment provisions of £107,000 were held.

3.1.8 Summary Credit Risk Exposure

The Bank uses the Standardised Approach in determining the level of capital necessary for regulatory purposes. Under the Standardised Approach the level of capital required against a given level of exposure to credit risk is calculated as:

Credit risk capital requirement = Exposure value x Risk weighting* x 8%.

* The risk weighting applied will vary depending on whether the asset is retail or wholesale. For retail assets, variables such as loan to value and security will impact the risk weighting. Wholesale assets are dependent on counterparty, duration and credit rating.

The table below shows the total exposure by regulatory exposure class as at 31 December 2012.

Exposure Category	Exposure Value £k	Pillar 1 Capital £k
Government & central banks	145,097	-
Financial institutions	116,385	1,862
Sub- total : Total Treasury Counterparty Credit Risk	**261,482**	**1,862**
Regional government & local government	51,722	828
Retail *	282,910	16,975
Mortgages on residential property	293,613	8,221
Past due items **	3,111	249
Other items ***	110,296	8,824
Sub- total : Total Lending Credit Risk	**741,652**	**35,097**
Miscellaneous items	8,389	671
Total	**1,011,523**	**37,630**

* Retail lending comprises loans that are not secured on residential property where the total exposure to the borrower is less than the GBP equivalent of 1 million Euros.

** Past due items are defined as those agreements that are over 3 months behind their scheduled contractual payment position.

*** The 'Other items' within the retail credit risk are loans that do not fall into any of the other loan categories. The 'Other items' that are not within the retail credit risk sub category are other balance sheet items such as fixed assets and other debtors and prepayments.

3.1.9 Treasury Counterparty credit risk

Counterparty credit risk arises from the wholesale investments made by the Bank's Treasury function in order to meet liquidity requirements. The Treasury function is responsible for managing this aspect of credit risk in line with Board approved risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the ALCO based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within the defined Risk Appetite. The wholesale credit risk is analysed by its contractual maturity profile in the table below:

Exposure Category	Under 3 Months £k	3 Months to 1 Year £k	Over 1 Year to 5 Years £k	Over 5 Years £k	Exposure Value £k
Cash & Balances at Central Banks	229				229
UK Government Gilts & Treasury Bills	142,870	1,998			144,868
Aa3 Rated UK Banks	4,961				4,961
A2 Rated UK Banks	78,495				78,495
A3 Rated UK Banks	32,929				32,929
Total	**259,484**	**1,998**	**-**	**-**	**261,482**

3.2 Operational risk

The bank has adopted the Basic Indicator Approach (under BIPRU 6.3) approach to operating risk, and thus will hold, as a minimum, capital against the risk equal to 15% of annual operating income averaged over the preceding 3 years audited results. As at December 2012 this was £244k.

3.2.1 Operational risk

Operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes or systems, human error or external events.

The Bank maintains a system of internal controls commensurate with the characteristics of the business, the markets in which it operates and regulatory considerations. Operational Risk is monitored using the maintenance of an Operational Risk Register and the use of Event Logs to record individual occurrences and departmental self-assessments. It is managed by establishing mitigating action plans where weaknesses have been identified, maintaining good practice with regard to updating policies and reviewing procedures, sample file and process inspection audits, quality assurance and model validation.

Individual departments are expected to conduct their own operational risk self-assessments and measure operational risk against Key Risk Indicators, which are subject to challenge and review by the Operational Risk Manager. These feed into the Bank's Operational Risk Register which allows us to gain a holistic view of operational risk across Business Units and determine if we are over controlled against the Bank's risk appetite.

The Operational Risk Committee meets quarterly to review risk identified in the Event Logs, Operational Risk Register and self-assessments.

The role of the Bank's operational risk management function is to ensure appropriate strategies are in place to manage, control and mitigate the risks that could impact the ability of the Bank to meet its business objectives whilst protecting its reputation, operating within the Board approved operational risk appetite.

Through the operational risk management framework, the Board ensures the management and oversight of the key risk exposures facing the Bank in the following risk categories:

- Business Continuity
- Customer Experience
- Financial Management and other Management Information
- Fraud
- Information Security and Technology
- Legal and Regulatory
- People
- Premises
- Process
- Third Party Relationships

The Bank's operational risk management framework sets out the strategy for identifying, assessing and managing operational risk. Senior management is responsible for understanding the nature and extent of the impact on each business area and for embedding appropriate controls to mitigate those risks. The framework is updated periodically to take account of changes in business profile, new product development, and the external operating environment. The ORC provides oversight and assesses the Bank's exposure to operational risks based on both quantitative and qualitative considerations. The crystallisation of operational risks is captured through the recording and analysis of operational losses (and near misses) which is used to identify any potential systemic weaknesses in operational processes.

Given the nature of the regulated sectors in which the Bank operates one of the key operational risks is the potential failure to maintain on-going compliance with relevant external regulation across the Bank. Oversight is provided by a central Bank Compliance function which ensures best practice is adhered to and shared across the Bank as appropriate.

3.2.2 Regulatory risk

Regulatory risk is the risk that the Bank does not adhere to the fast changing regulatory environment in which it operates.

The Board requires standards and controls to be in place across all the Bank's operations that:

(i) Are at least compliant with applicable UK regulatory requirements, and;
(ii) At least be consistent with the risk control framework required by banks using a Standardised approach for capital adequacy, as outlined within the relevant BIPRU and GENPRU requirements.

3.2.3 Reputational risk

Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion. Management has considered how this might arise and what the impact could be. The consequences would adversely impact the future prospects of the Bank and could expose the Bank to litigation and financial loss.

Reputational risk is inherent across the Bank. Senior Management manages this risk in the following ways:

- Management of the Bank's reputation through marketing and external communications
- By ensuring compliance with all regulatory requirements
- Through the risk management framework which has reputational risk as a key consideration

3.3 Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. The Bank has, therefore, developed comprehensive funding and liquidity policies to ensure that it maintains sufficient liquid assets to be able to meet all financial obligations and maintain public confidence.

Shawbrook Bank's liquidity risk appetite is set by the Board. Discussions around liquidity risk appetite are minuted and the risk appetite is documented in the Bank's Liquidity Policy. ALCO and the Board have discussed and challenged the appropriateness of the Bank's liquidity risk appetite in view of the Bank's business strategy particularly with regard to level of anticipated growth in the balance sheet over the medium term.

The Bank's ILAA, liquidity risk appetite and supporting policy framework are currently reviewed and approved by the Board on at least an annual basis.

The Bank's Treasury function is responsible for the day to day management of the Bank's liquidity and wholesale funding. The Board sets limits over the level, composition and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk personnel (i.e. independent of Treasury) and additionally, a series of liquidity stress tests are performed weekly by Risk and formally reported to ALCO and the Board to ensure that the Bank maintains adequate liquidity for business purposes even under stressed conditions.

The Bank reports its liquidity position against Individual Liquidity Guidance ('ILG') provided by the PRA for regulatory purposes. The Bank continues to exceed both the ILG requirement and satisfy its own internal liquidity risk appetite.

The Group maintains sufficient liquidity resources to enable it to survive for over 3 months under any combination of idiosyncratic, market wide and combination stresses. A liquid assets buffer of high quality UK Treasury Bills or reserves with the Bank of England is used to create a source of highly liquid assets that can be called upon to create sufficient liquidity to meet liabilities on demand.

The Board's liquidity risk appetite is as follows:

- The Bank shall have sufficient liquidity resources so as to be able to survive the combined stress outflows for a period of 90 days. If this amount is less than 8% of the deposit book, then it shall hold additional liquidity resource to reach this 8% floor
- It shall be able to survive this stress by relying purely on its BIPRU 12.7 eligible assets

The Bank believes that this risk appetite is appropriate because:

- A liquidity stress may be temporary, and so the Bank should be able to withstand a short severe liquidity shock through first line of defence contingency funding plan actions, and then recover
- If the first line of defence fails, the Bank must then be able to secure recovery through secondary management actions as described in the contingency funding plan (such as the application of re-pricing to encourage funding/discourage borrowing and, more fundamentally, securing a further capital or debt injection), which may take up to three months to secure and complete
- It has been set within the context of the Bank's stable deposit business model. 99% of the current deposit book is made up of notice and fixed rate deposit accounts where the balances cannot be withdrawn before their contractual maturity date

- The Bank also tracks its exposure to outflows from notice accounts and maturing fixed rate deposits on a daily basis and will ensure that operationally it pre-funds maturing deposits in advance of their ultimate maturity date

3.3.1 Key Liquidity Risks

The key risks are set out below:

- Retail Funding Risk - Shawbrook Bank is exposed to retail funding risk through its deposit book. A portion of the book is originated from SME type customers but the bulk of the book has been sourced from more traditional retail depositors. The vast majority of the book, around 90%, has a residual contractual maturity over three months (the calculation takes into account amounts under notice or approaching maturity). Over 78% of the total book has balances that are below the current Financial Services Compensation Scheme (‘FSCS’) limit of £85,000
- Wholesale Funding Risk - Shawbrook Bank is currently funded 100% by a mixture of capital, SME and retail deposits and therefore has no exposure to traditional wholesale funding markets. BIPRU 12.5.18 contains typical examples of funding that could be construed as being “wholesale”. The Bank does not currently source funding from these types of customers
- Intra-day Funding Risk - to ensure that funds are always available the Bank aims to maintain a minimum deposit with its clearing bank to ensure that payments can be processed even in the event of disruption to the wider payment system. This guidance is included in the Bank’s liquidity policy. The Bank therefore considers it has sufficient liquidity to cover intra-day liquidity risk with a buffer
- Pipeline Funding Risk – this is the risk that the bank will not be able to pay out requirement to outstanding loan offers as they are taken up. Shawbrook holds liquidity to ensure that it can meet this pipeline of new lending offers

3.4 Systems and change risk

Systems and Change Risk is the risk that transition and business integration changes in the business will be improperly implemented. This is closely aligned to Operational risk. The Change Committee is responsible for managing all anticipated changes by considering, taking appropriate action, allocating resource and documenting changes.

The Project Management Committee, a sub-committee of the Group Executive Committee keeps a register of all bank projects and determine approval process for each and every project.

3.5 Market risk

Market risk is the risk that the value of, or income arising from, the Bank’s assets and liabilities changes as a result of changes in market prices, the principal element being interest rate risk.

The Bank has no foreign currency exposure and does not engage in any trading operations.

The Bank’s treasury function is responsible for managing the Bank’s exposure to all aspects of market risk within the operational limits set out in the Bank’s treasury policies. ALCO approves the Bank’s treasury policies and receives regular reports on all aspects of market risk exposure, including interest rate risk.

3.5.1 Interest rate risk

Interest rate risk is the risk of loss arising from adverse movements in market interest rates. Interest rate risk arises from the loan and savings products that Shawbrook offers. This risk is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures.

3.5.2 Basis rate risk

Basis rate risk is the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics (for example, LIBOR and Bank of England Base Rate). This is monitored closely and regularly reported to ALCO. This risk is managed where appropriate, through the use of derivatives, with established risk limits and other control procedures.

Derivatives are only used to limit the extent to which the Bank will be affected by changes in London Interbank Offered Rate (‘LIBOR’ or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Bank are interest rate exchange contracts, commonly

known as interest rate swaps and caps. The Bank's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.

3.5.3 Interest rate sensitivity gap

The Group considers a 200 basis points movement to be appropriate for scenario testing given the current economic outlook and industry expectations. The change in equity as a result, based on the present value of future cash flows discount using the London Interbank Offered Rate ('LIBOR'), would be as follows:

- Increase in rates of 200 bps – negative £804k
- Fall in rates of 200 bps – positive £1,612k

3.6 Concentration risk

Concentration risk is the additional risk, primarily credit risk, arising from having exposures concentrated in one sector, geographical area or product. Concentrations also can arise from a large individual exposure or a number of exposures to a group of related counterparties.

The Group benefits from product diversity between both personal and corporate customers and secured and unsecured products and also from geographic diversity throughout the UK.

3.7 Strategy risk

Strategic risk is the risk to earnings or capital arising from changes to the business environment, from adverse business decisions, from improper implementation of business decisions, or from lack of responsiveness to changes in the business environment. This risk is managed through:

- A structured focus upon the areas in which the business operates with a competitive advantage
- Careful development of business plans
- Appropriate management oversight
- Effective corporate governance framework
- A comprehensive Strategic Risk Register

The Risk Department presents the Strategic Risk Register to the board on a monthly basis. This categorises, updates and seeks to quantify the key risks that the bank is exposed to. Whereas the functional Risk Registers will be department specific, the Strategic Risk Register will be Group wide and therefore only focus on the high level Risks that could impact the whole bank. The Strategic Risk register will thus take feeds from the functional Risk Registers but it can also take input, such as Market and Liquidity Risk, indicators from ALCO, GCPC, the Operational Risk Committee and the Compliance Review Committee.

Business risk is the risk of changes in the environment in which the Bank operates or the occurrence of events which damage the franchise or operating economics of the Bank's businesses. If the Bank does not deliver its plans as anticipated, its earnings could grow more slowly or decline. In addition, potential sources of business risk include revenue volatility due to factors such as market positioning, macroeconomic conditions, inflexible cost structures, uncompetitive products or pricing and structural inefficiencies.

The Bank addresses this risk within its corporate strategy and plan which is approved by the Board and the Board is regularly provided with updates on the Bank's key strategies and plans to ensure progress is consistent with the Bank's risk appetite. Shawbrook Bank also ensures on-going compliance with the prevailing regulatory framework relating to risk management and corporate governance.

3.8 Other Matters

3.8.1 Taxation risk[3]

Taxation risk is the risk associated with changes in tax law or in the interpretation of tax law. It also includes the risk of changes in tax rates and the risk of failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to an additional tax charge. It could also lead to reputational damage or financial penalties. The Bank has effective, well-documented and controlled processes in place to ensure compliance with tax disclosure and

[3] Due to its low impact this risk is not included in the core seven business risks listed in Section 2.5 given that is not explicitly accounted for in the ICAAP.

filing obligations and employs its own tax professionals who take appropriate advice from reputable professional firms when necessary.

3.8.2 Pension obligation risk

The bank operates a defined contribution pension arrangement for staff and has no exposure to defined benefit arrangements. This risk is not included in the core seven business risks listed in Section 2.5 given the lack of exposure to defined benefit arrangements. Therefore the ICAAP does not contain a capital charge under Element 3 (Risks not covered by Pillar 1) for this risk.

3.8.3 Stress Testing

Stress Testing and Scenario Analysis is a vital part of the Bank's risk measurement process, particularly in business planning and risk assessment processes. Senior Management are an integral part of the stress testing process and are able to identify and articulate the Group's risk appetite and understand the implications of stress events within this context.

All Divisional credit risk portfolios are tested as part of the annual ICAAP and business planning cycle. Consideration is given to the potential impact on all credit risk portfolios of extreme and plausible events. This analysis complements any extreme event stress testing and scenario analysis undertaken as part of the Recovery and Resolution Planning activity.

Whilst the general economy remains uncertain, the ability of the Bank to maintain and improve profitability and as a consequence generate capital, in what continues to be a tough external environment, provides confidence that the Bank will withstand the on-going economic uncertainty. Key risk drivers to be examined and considered during stress testing process are chosen to be appropriate to business needs and include inter alia:

- Interest rates
- House prices
- Unemployment rates
- Gross Domestic Product trends
- Other Economic factors; these may be general or sector specific (for example consumer or business confidence, relevant stock exchange information)

There is, however, the risk that the Bank may need to raise additional capital due to changes in business cycles, deteriorating economic conditions or competitive pressures. The mitigation actions are considered through stress testing and scenario analysis for key risk events both at a firm wide level and for specific businesses.

The main credit risk stress testing and scenarios setting include, inter alia

- the prospect for a further slowdown in the UK economy which could lead to higher unemployment, deterioration in household finances and falls in house prices, all of which could increase arrears and defaults
- A hike in interest rates and inflationary pressures
- A sustained deflation

An analysis of profit and loss impact is made over a period of at least 12 months (or longer if appropriate) in relation to business needs. Analysis is focused on the profit and loss impact of non-performing assets, provisions and write-offs. In addition, material direct operational costs (particularly collection/recoveries costs) should also be considered.

Where the projected crystallisation of the event gives rise to a loss, or a lower level of profit than expected under the business plan, when taking into account the impact of management actions, the Bank will hold capital in respect of that business risk arising. The Board and Governance structure enables the identification and challenge of suitable management actions to ensure effective responsiveness to changes in the environment.

4 Capital risk and management

The Bank conducts an ICAAP at least annually, which is approved by the Board. This is used to assess the Bank's capital adequacy and determine the levels of capital required to support the current and future risks in the business derived from the corporate plan. The ICAAP addresses all the Bank's material risks and includes Board approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is used by the PRA to set the Bank's Individual Capital Guidance ('ICG') requirements.

The amount and composition of the Bank's capital requirement is determined by assessing the Basel II Pillar 1 minimum capital requirement, the impact of stress and scenario tests under Pillar 2, and the Bank's ICG.

The Board is ultimately responsible for capital management. The Board and Executive Management Committee monitor the capital position of the Group on a monthly basis. The ICAAP is central to the capital management framework and is used to inform the Board of the on-going assessment and quantification of the Group's risks, how the Bank mitigates those risks and capital adequacy of the Bank.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar I plus" approach to determine the level of capital the Group needs to hold. This method takes the Pillar I capital formula calculations (standardised approach for credit and market risk, and Basic Indicator approach for operational risk) as a starting point, and then considers whether each of the calculations deliver a sufficient capital sum adequately to cover management's anticipated risks. Where the Board considered that the Pillar I calculations did not reflect the risk, an additional capital add-on in Pillar II is applied, as per the ICG issued by the PRA.

At all times the Group's capital position must be aligned with the capital adequacy limits approved by the Board in the risk appetite statement, which is to maintain a robust capital and liquidity management under "normal" and "stressed" conditions. With regard to capital management this means:

- Maintain a level of capital equal to the minimum that is set by the PRA in the ICG
- All capital will be Core Tier 1 capital. Any change to this policy must be agreed by the Board

The following shows the regulatory capital resources managed by Shawbrook at 31 December 2012:

	£k
Share Capital	111,990
Accumulated Losses	(24,074)
Intangible Assets	(5,362)
Total Capital	**82,554**

The pillar 1 requirements against which the bank holds this capital are detailed below:

	£k
Credit Risk (see 3.1.8)	37,630
Operational Risk (see **3.2**)	244
Total Pillar 1 Requirement	**37,874**

Shawbrook has complied with the externally imposed capital requirements at all times during the year.

5 Remuneration

In accordance with the principles of SYSC 19A, a firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management. Policies and procedures must be comprehensive and proportionate to the nature, scale and complexity of the firm's activities.

The Remuneration and Nominations Committee (the 'RemCo') is made up of 3 Non-Executive Directors. On an annual basis the RemCo formally reviews and (where applicable) updates it Remuneration Policy and submits this to the Board for approval. As the bank falls within the scope of the PRA remuneration code, all code staff also fall within the remit of the RemCo. This therefore means that the RemCo also has oversight of the remuneration of the senior management team.

The bank maintains a record of its remuneration code staff (those whose activities have a material impact on the firm's risk profile) and takes reasonable steps to ensure they understand the implications of the code.

The RemCo recognises the need to be competitive within the UK banking market, however the RemCo's policy is to set remuneration levels which are aligned within the overall Bank stated risk appetite and ICAAP measures. We ensure that the executive directors, senior management and employees are fairly and responsibly rewarded in return for high levels of individual and business performance.

In relation to 2012 the Bank paid the following remuneration:-

Total 2012 Bank Remuneration	£15,749k
2012 Fixed Remuneration of current Code Staff (as at 31.12.12)	£ 2,227k
2012 Variable Remuneration of current Code Staff (as at 31.12.12)	£ 856k
Total number of Code Staff during 2012	13

Glosary of Terms

Basel II Framework	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. The Accord is structured around Pillars 1, 2 & 3, became law in the EU Capital Requirements Directive, and was implemented in the UK in the FSA Handbook.
BIPRU	The Prudential Sourcebook for banks, building societies and investment firms which forms part of the Regulatory Handbook for Basel II.
Counterparty Credit Risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Credit risk	The potential to incur losses from the failure of a borrower or counterparty to meet its obligation to pay interest or repay capital on an outstanding loan.
Credit risk mitigation	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set off or netting.
FSA	Financial Services Authority. The financial services industry regulator in the UK. In April 2013 the responsibilities of the FSA were split into the Prudential Regulation Authority and the Financial Conduct Authority
FCA	Financial Conduct Authority. The financial services industry conduct regulator in the UK.
Guarantee	An agreement by a third party to cover the potential loss to a credit institution should a specified counterparty default on their obligations.
ICA	Internal Capital Assessment – the document produced as a result of the ICAAP.
ICAAP	Internal Capital Adequacy Assessment Process. The process the Group follows to determine capital requirements under Pillar 2.
ICG	Individual Capital Guidance. The minimum amount of capital the Group should hold as set by the FSA under Basel II Pillar 2.
ILAA	Individual Liquidity Adequacy Assessment. The Group's internal assessment of the levels of liquidity that need to be held by the Bank to meet its regulatory liquidity requirements.
Interest rate risk	Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates.
LIBOR	London Inter-Bank Offered Rate.
LTV	Loan-To-Value. The ratio of current exposure value as a proportion of the value of the asset held as security (usually residential property) expressed as a percentage.
Maturity	The remaining time in years that a borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement.
Minimum Capital Requirement	The minimum amount of regulatory capital that a financial institution must

	hold to meet the Basel II Pillar 1 requirements for credit and operational risk.
Netting	The ability to reduce credit risk exposures by offsetting the value of deposits against loans to the same counterparty
Operational risk	Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events; it includes the risk of non-compliance with laws and regulations, and the risk of internal or external fraud.
Operational Risk Basic Indicator Approach	The ORCR under the basic indicator approach is equal to 15% of the relevant indicator defined in this section. The relevant indicator is the three-year average of the sum of: (a) net interest income; and (b) net non-interest income. The three-year average is calculated on the basis of the last three yearly observations at the end of the financial year. When audited figures are not available, business estimates were used. The relevant indicator for the basic indicator approach is calculated before the deduction of any provisions and operating expenses.
Pillar 1	The part of the Basel II Framework which sets out the regulatory minimum capital requirements for credit and operational risk.
Pillar 2	The part of the Basel II Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – ICG is an outcome from Pillar 2.
Pillar 3	The part of the Basel II Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.
Provisions	Amounts set aside to cover incurred losses associated with credit risks. Collective provisions reflect the estimated amount of losses incurred on a collective basis, but which have yet to be individually identified. The collective provision is maintained to reduce the carrying amount of portfolios of similar loans and advances to their estimated recoverable amounts at the balance sheet date. The evaluation process is subject to a series of estimates and judgements. The calculation of the Collective Provision requires model estimates of probability of default, exposure at default and loss given default. The calculation occurs at account level and is aggregated to portfolio level for reporting purposes. Collective provisions are raised when the probability of default of a counterparty has increased relative to the probability of default at origination. The size of the collective provision is a function of the model estimates. The segmentation of assets into those which are assessed individually and those which are assessed on the portfolio basis in order to identify loss event: • Individually significant items are assessed individually • Individually insignificant items are assessed either individually or on the portfolio basis (portfolios built based on similar credit risk

	characteristics) • Assessment of significance should take into account actual management of an exposure (managed on individual basis or group basis) • Those which have been identified as impaired during individual assessment are excluded from the collective assessment • Collective assessment is not possible if the number of homogenous transactions is insufficient • Need to compare model results with the actual losses
Retail Exposure Classification	To be eligible for the retail exposure class, an exposure must meet the following conditions: (1) the exposure must be either to an individual person or persons, or to a small or medium sized entity; (2) the exposure must be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced; and (3) the total amount owed to the firm, its parent undertakings and its subsidiary undertakings, including any past due exposure, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential real estate collateral, must not, to the knowledge of the firm, exceed €1 million.
PRA	Prudential Regulation Authority, the prudential regulator of UK Banks, part of the Bank of England.
RWA	Risk weighted assets. The value of an on- or off-balance sheet exposure adjusted under Pillar 1 rules to reflect the degree of risk it presents.
Securitisation	A transaction or scheme where assets are sold to a Special Purpose Vehicle (SPV) in return for immediate cash payment. That vehicle raises the immediate cash payment by issuing debt securities in the form of tradable notes or commercial paper to wholesale investors who receive an income from the underlying assets. Some risk is retained on the balance sheet while the remaining risk is transferred to investors. Securitisations may be purchased or retained.
SREP	Supervisory Review and Evaluation Process, the PRA assessment of a firm's own capital assessment (ICA) under Basel II
Stress testing	Various techniques that are used to gauge the potential vulnerability to exceptional but plausible events.
The Standardised Approach (credit risks)	The standardised approach to credit risk, calculated by applying varying RWA percentages to credit exposures, depending on the underlying risk.
Tier 1 capital	A core measure of financial strength as defined by the prudential regulator.