CYBG

A DIFFERENT WAY OF BANKING

PILLAR 3 DISCLOSURES 2017

Who we are

CYBG PLC is a full-service bank focused on UK consumers and small- and medium-sized enterprises (SMEs), operating under the Clydesdale Bank, Yorkshire Bank and B brands.

We serve nearly three million customers through an omni-channel model of online, mobile and telephone banking, together with a network of 169 branches and 40 business banking centres, located mostly in the UK's economic heartlands of Scotland, the north of England and the Midlands.

What's inside this report

1 Executive summary

1.1 Introduction

This document presents the consolidated Pillar 3 disclosures of CYBG PLC and its controlled entities (the Group) as at 30 September 2017. This report should be read in conjunction with the CYBG PLC Annual Report and Accounts.

The analysis provided within the Pillar 3 disclosures gives detail on aspects of the Group's risk profile and, along with detail on the Risk Management Framework (RMF), supports the Group's position as a strongly capitalised firm which employs robust systems and processes in order to assess, manage and mitigate risk.

1.2 Who we are and strategic priorities

Our business is delivered through our key brands …
CYBG operates through the retail and commercial banks Clydesdale Bank, established in 1838 in Glasgow, Yorkshire Bank, founded in 1859 in Halifax, and through the digital banking service B, created in 2016.

… underpinned by our three strategic priorities …

- Drive sustainable customer growth by investing to broaden the franchise across our target segments and core regions while enhancing the customer experience.
- Improve efficiency by making our network, operations and organisation more efficient and agile for staff and customers.
- Capital optimisation by securing Internal ratings-based (IRB) accreditation and deploying our capital to support our business ambitions while balancing risk and reward.

… and distributed through our omni-channel model
The Group's omni-channel model is focused on delivering an improved service across every channel where we serve and support our customers. Our strong and growing digital offering, combined with the branch network, contact centre and extensive broker channel, provides an enviable position from which to grow our business.

To achieve our objectives, we are streamlining our front and back office, investing in our digital platform to accelerate the adoption of mobile and online tools and increasing in-branch automation.

1.3 Summary of risk profile

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy. The Group has continued to advance and strengthen its risk management capabilities, evolving in line with industry developments and best practice.

The Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve its strategic objectives. As part of its viability assessment under UK Corporate Governance Code requirements, the Directors have performed a robust assessment of the principal risks facing the Group, including those that would threaten its business model and future performance, solvency or liquidity.

The principal risks the Group actively monitors and manages and the Group's key ratios are described below. Further information on the Board's assessment is provided in the Strategic report in the Group's Annual Report and Accounts.

CYBG's principal risks	How risks are managed
Credit risk is the risk of loss of principal or interest stemming from a borrower's failure to meet contracted obligations to the Group in accordance with the terms agreed. Credit risk is evident at both a portfolio and transactional level.	– Significant credit risk strategies, credit risk appetite and tolerances for credit risk are approved and reviewed by the Board and Boards' Risk Committee. – The credit portfolio is closely monitored with actions initiated where required.
Balance sheet and prudential regulation risk covers a number of categories of risk, which affect the manner in which the Group can support its customers in a safe and sound manner. The risks include the need to withstand times of stress for the loss of funding (liquidity), the impact of restricted access to future sources of deposits (funding), the impact of providing a defined benefit scheme to colleagues (pension) and the need to withstand severe unexpected losses (capital).	– Liquidity is managed in accordance with standards that are approved by the Board and supported by annual Funding and Contingency Funding Plans. The Group also completes a formal annual assessment of liquidity adequacy which is shared with the Prudential Regulation Authority (PRA). – The Group completes a formal annual assessment of its capital requirements which is shared with the PRA. – The Group's Pension Risk Management Committee has implemented a range of reforms to benefits to reduce the Group's exposure to Pension Risk.
Regulatory and compliance risk is the risk of failing to identify, understand, monitor and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives. In doing so, the Group risks damaging its relationship with its regulator. It is also the failure of not keeping regulators informed of relevant issues and not responding effectively to information requests and regulatory reviews.	– Continued and significant Board and senior management focus is directed towards maintaining regulatory compliance. The Board or Executive Risk Committee approves all material changes to regulatory policy and protocols.
Conduct risk is the risk of undertaking business in a way which is contrary to the interests of our customers, resulting in the delivery of inappropriate customer outcomes, customer detriment, regulatory censure, redress costs and/or reputational damage.	– The Group has a Conduct Framework, with supporting target outcomes and operating principles. Governance oversight and reporting are in place to ensure those objectives are met.
Operational risk is the risk of loss resulting from inadequate or failed internal processes and systems or from external events. It includes legal risk, and operational risks associated with the execution of the strategy.	– The Group has an established Operational Risk Framework to enable identification, management and mitigation of operational risks. Risk categories are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.
Financial crime risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties.	– The Group has an established Financial Crime Framework supporting ongoing management, monitoring and mitigation of financial crime risk. The Group operates zero tolerance for financial crime risk and has a control framework in place to mitigate this risk.
Strategic, business and financial performance risk is the risk of significant loss, loss of earnings and/or damage arising from business decisions that impact the long-term interests of stakeholders or from an inability to adapt to external developments.	– The Board approves and oversees the execution of the Strategic Plan and associated strategic risk following the recommendations of the Chief Executive Officer (CEO) and Executive Leadership Team. The Group's risk appetite statement (RAS) sets out the risks it is able and willing to take to achieve its strategic objectives.
People risk is the risk of not having sufficiently skilled and motivated colleagues who are clear on their responsibilities and accountabilities and who behave in an ethical way.	– Roles, responsibilities and performance expectations are defined in role profiles and expanded through objective setting and ongoing performance management. – The quality and continuity of our leadership is reviewed and assessed through succession planning and talent management activity.

1 Executive summary

The key ratios for the Group are presented below.

Table 1: Key ratios

	2017	2016
Common Equity Tier 1 (CET1) ratio	**12.4%**	12.6%
Tier 1 capital ratio	**14.7%**	15.0%
Total capital ratio	**17.9%**	18.2%
Leverage ratio	**6.3%**	6.8%
Modified leverage ratio(1)	**7.4%**	8.0%
Liquidity Coverage Ratio	**164%**	140%
	£m	£m
Risk Weighted Assets (RWAs)	**19,678**	19,029
Total assets	**43,231**	39,929

Underlying capital generation by the core business post additional tier 1 (AT1) distribution was 13bps, largely driven by strong underlying profits offset by growth in mortgages and SME lending and investment spend, with RWAs increasing by £649m. After absorbing the net impact of AT1 distributions, pension movements, and exceptional charges such as restructuring charges, separation costs and the Group's proportion of conduct provision charges, the Group's CET1 ratio was 20bps lower at 12.4%.

As announced in the Strategic report of the Group's Annual Report and Accounts the Board has recommended a 1.0p per share dividend. The dividend would equate to approximately £9m of CET1 (equivalent to 4bps of CET1 based on RWAs as at 30 September 2017).

The Group's leverage ratio is 6.3% which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018. The Group is not currently subject to the Bank of England's (BoE) UK leverage ratio framework. However, under this framework leverage ratios will be calculated on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017. The Group's modified leverage ratio is 7.4%, well in excess of the PRA minimum of 3.25%. The Group will continue to closely monitor the leverage ratio against emerging rules and minimum calibration.

Further details on the Group's capital ratios, RWAs and leverage ratio are presented in section 4. Required disclosures for Clydesdale Bank PLC are presented in Appendix 1.

(1) The Group's leverage ratio on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017. The Group is currently excluded from the full reporting requirements of the UK leverage ratio framework.

2 Overview

2.1 Basis of preparation and frequency of disclosures

This document sets out the 2017 Pillar 3 disclosures for the Group, comprising CYBG PLC (the Company) and its controlled entities, including Clydesdale Bank PLC (the Bank) in accordance with the rules laid out in the Capital Requirements Regulation (CRR) (Part 8).

The Group uses the standardised approach (SA) for credit risk, operational risk, market risk and credit valuation adjustment. This approach uses standard risk weighting percentages prescribed within the CRR and PRA implementing rules. The disclosures in this document are based on these approaches.

Throughout the document, unless otherwise specified, credit risk exposures are defined as the aggregate of drawn (on-balance sheet) balances, undrawn (off-balance sheet) commitments and contingent liabilities prior to the application of credit risk mitigation and prior to the application of credit conversion factors. The disclosures may therefore differ from similar information in the Group's Annual Report and Accounts for the year ended 30 September 2017, which are prepared in accordance with International Financial Reporting Standards. The information in these disclosures is prepared in accordance with regulatory requirements and may therefore not be directly comparable with that information.

Unless otherwise stated, all figures are as at 30 September 2017, the Group's financial year end, with comparative figures as at 30 September 2016 where relevant.

The Group has a policy for complying with Pillar 3 disclosures, in line with the European Banking Authority (EBA) guidelines on materiality, proprietary and confidential information and on disclosure frequency. These disclosures are published annually, and concurrently with the Group's Annual Report and Accounts in accordance with regulatory guidelines. The Group publishes specific information more frequently where it is required under EBA guidelines. No disclosures have been omitted on the basis of them being regarded as proprietary or confidential.

Omissions of disclosures within this report on grounds of materiality are:

- disclosures relating to 'Exposures in equities not included in the trading book'. See note 3.18 in the Group's Annual Report and Accounts for further information on valuation and key assumptions and methodologies used in valuation;
- separate disclosure of the geographical distribution of lending credit risk exposures to areas outside of the UK. Such exposures are not material and have been classified as 'other' within table 19; and
- additional credit risk mitigation, credit risk adjustment and capital buffer disclosures in relation to the Bank on an individual consolidated basis. These disclosures are materially the same as those provided for the Group. Further information is provided in Appendix 1.

The Group's remuneration disclosures can be found within the Directors' Remuneration Report in the Group's Annual Report and Accounts.

In December 2016 the EBA published final Guidelines on Pillar 3 disclosures following the revised international Basel Committee on Banking Supervision (BCBS) Pillar 3 requirements (issued January 2015). Globally and Other Systemically Important Institutions (G-SII and O-SII), and any other institution that has been advised by competent authorities to make every effort to comply with the guidelines, were recommended to implement a limited subset of the disclosures for year-end 2016. While the Group does not fall into these categories, where appropriate, these templates have been adopted and disclosed within this report (refer to tables 11, 23, 24 and 28). Further consideration of the full set of templates will be given ahead of the Group's September 2018 reporting.

In March 2017 the EBA published final draft Regulatory Technical Standards (RTS) on the disclosure of Encumbered and Unencumbered Assets. At the time of approval of this Report the RTS were not yet in force. The revised disclosures will therefore be included for September 2018 reporting.

2.2 Scope of disclosures

The Pillar 3 disclosures in this document relate to the Group, with the exception of Appendix 1 which contains the disclosures required for the Bank (PRA firm reference number 121873), the Group's principal subsidiary.

There is a requirement to calculate and maintain regulatory capital ratios on both a Group basis and on an Individual Consolidated (or Solo) basis for the Bank. There are no differences between the bases of consolidation of the Group for accounting and prudential purposes. All of the Group's subsidiary undertakings are included in the data provided in the Pillar 3 disclosures. Full details of the Group's subsidiaries are provided in note 6.2 of the Group's Annual Report and Accounts for the year ended 30 September 2017 (cybg.com/investor-centre/financial-results/).

The subsidiaries included on the Individual Consolidation basis are:

- Yorkshire Bank Home Loans Limited;
- Clydesdale Bank Asset Finance Limited;
- CGF No. 9 Limited;
- CB Nominees Limited;
- CYB Intermediaries Limited;
- CYB Intermediaries Holdings Limited (in liquidation); and
- CYB Services Limited (in liquidation).

The Group's capital resources are presented in section 4 of this document and the Bank's Individual Consolidated capital resources are presented in Appendix 1 to this document.

The differences between the Group and the Bank are primarily due to:

- reserves held by entities that sit outside of the scope of the Bank's Individual Consolidation that are included in the Group consolidation;
- amounts included in the Bank's results in relation to transactions with the Group's securitisation vehicles or other Group entities which are eliminated on consolidation;
- a small impact from the RWAs of those entities outside of the scope of the Bank's Individual Consolidation; and
- the conduct indemnity deed[(2)] between the Group's former parent National Australia Bank Limited (NAB) and the Company which results in different accounting treatment to the Bank but a consistent economic outcome on total capital.

As a result of these differences, the Bank's Individual Consolidated capital requirements as at 30 September 2017 exceeded the Group's capital requirements.

The following companies are securitisation vehicles established in connection with the Group's securitisation programme. Although the share capital of these securitisation vehicles is not owned by the Group, these vehicles are included in the consolidated financial statements as they are controlled by the Group:

- Lanark Holdings Limited;
- Lanark Trustees Limited;
- Lanark Funding Limited;
- Lanark Master Issuer plc;
- Lanark Options Limited;
- Lannraig Holdings Limited;
- Lannraig Funding Limited;
- Lannraig Master Issuer plc; and
- Lannraig Trustees Limited.

There are no current or foreseen material practical or legal impediments to the transfer of capital resources or the repayment of liabilities between consolidated entities within the Group, with the exception of assets and liabilities of the Group's securitisation vehicles (including the covered bond vehicle), and Red Grey Square Funding LLP (see note 5.3 in the Group's Annual Report and Accounts for further details) which are not immediately available to other members of the Group.

2.3 Key matters arising during the year

The following significant events, which had an impact on the Group's capital and risk management, took place during the year ended 30 September 2017:

The Group issued its first minimum requirement for own funds and eligible liabilities (MREL) Senior debt in June 2017 (£300m). The Bank of England has set the Group an interim MREL requirement of 18% of RWAs from 1 January 2020 until 31 December 2021. Final end-state MREL will be advised by the end of 2020 and this will need to be met in full by 2022.

During the year the Group implemented a new reward programme for colleagues across the business, including a revised pensions proposition. As part of these reforms, the Group closed the defined benefit pension scheme (the Scheme) to future accrual on 1 August 2017, for the majority of current employees, with affected employees' future benefits being provided through an enhanced defined contribution scheme. The capital position benefited from the closure of the Scheme to future accrual for the majority of employees, improving the International Accounting Standard (IAS) 19 position by £88m and contributing to an IAS 19 surplus of £207m at the year end. In addition, the trustees completed the 2016 triennial valuation, which resulted in a reduction in the Scheme deficit (on a trustee funding basis) from £450m to £290m and no change to the existing deficit repayment schedule agreed with the Trustee in June 2014.

On 2 May 2017 the Group made a deficit reduction contribution to the Scheme. This payment was originally planned for October 2017 but was accelerated following agreement with the Pension Trustees. This payment has the effect of reducing the Group's CET1 ratio by 20bps.

In April 2017 the Group submitted an application to the PRA for permission to adopt the IRB approach for the calculation of credit RWAs. The Group is now in active dialogue with the PRA in relation to the application. The IRB programme is also supporting changes in the Collective Provision calculations required by International Financial Reporting Standard (IFRS) 9 which will be adopted on 1 October 2018; the programme is on track to commence parallel-run activities in early FY2018.

(2) A Conduct Indemnity Deed exists where NAB has agreed to provide the Group with a capped indemnity in respect of certain historic liabilities relating to conduct in the period prior to the demerger date.

2.4 Review and challenge

These disclosures have been subject to internal verification and are reviewed by the Board's Risk Committee (Risk Committee) and the Board's Audit Committee (Audit Committee) on behalf of the Board. The disclosures have not been, and are not required to be, subject to independent external audit and do not constitute any part of the Group's Annual Report and Accounts.

The effectiveness of the risk management and internal control systems is reviewed regularly by the Risk Committee and the Audit Committee, including an annual review. The Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures. The Audit Committee assists the Board in discharging its responsibilities with regard to external and internal audit activities and controls including reviewing audit reports, internal controls and risk management systems.

The Group's risk management and internal control systems are regularly reviewed by the Board and are consistent with the guidance on Risk Management, Internal Control and Related Financial and Business Reporting issued by the Financial Reporting Council and compliant with the requirements of the Capital Requirements Directive (CRD) IV. They have been in place for the year under review and up to the date of the approval of the Group's Annual Report and Accounts.

A review of the effectiveness of controls is regularly undertaken across the Group, providing an assessment and statement on the effectiveness of the Group's control environment. This provides assurance to the Risk Committee that no new material control issues have been identified and that robust management actions are in place to address specific known gaps.

Over the past year, the Group has further enhanced the RMF, simplifying and improving the risk categories and impact classification. The control environment remains stable with the 2017 Control Effectiveness Statement providing assurance that ineffective controls are escalated appropriately and have adequate action plans in place.

The Risk Committee, in conjunction with the Audit Committee, concluded that the Group's risk management and internal control framework in relation to the Group's risk profile and strategy was effective and adequate, and was recommended to and approved by the Board.

3 Risk management

For further information on the Group's approach to risk management refer to the Risk Report section of the Group's Annual Report and Accounts.

3.1 Risk principles

The Group's approach to risk management is based on the principle that risk management capability must be embedded across all areas of the Group to be effective. This overriding principle embodies the following concepts:

- commercial decisions are made on the basis of proactive consideration of risk and the potential impact on customers;
- business managers use the RMF to support decision-making involving risk and reward trade-offs; and
- colleagues are responsible for risk management in their day to day activities.

Risk culture

Central to the Group's risk culture is the fair treatment of customers and meeting obligations to stakeholders, including shareholders, regulators and colleagues. The Board and senior management are responsible for setting and clearly communicating a strong risk culture through their actions and words, and proactively addressing any identified areas of weakness or concern.

Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships.

Initiatives that support appropriate risk culture include: the performance management framework; the formal whistleblowing framework that allows colleagues, in confidence and anonymously, to raise concerns about matters of conduct; and messaging from the CEO and members of the Executive Leadership Team emphasising the importance of risk identification, management and mitigation.

Underpinning the RMF and at the heart of the Group's risk culture, is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model and a formal delegation framework through which colleagues are able to make risk based decisions.

Risk strategy

The Group has a clearly defined strategy in order to manage and mitigate risk in the daily course of its business. The strategy consists of:

- ensuring all principal and emerging risks are identified and assessed;
- ensuring risk appetite is clearly articulated and influences the Group's strategic plan;
- a clearly defined risk culture which emphasises risk management throughout all areas of the business while maintaining independent oversight;
- ongoing analysis of the environment in which the Group operates to proactively address potential risk issues as they arise; and
- supporting commercial decisions and people with appropriate risk processes, systems and controls.

Risk appetite statement

Risk Appetite is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives. The RAS articulates and supports communication of the Group's appetite to stakeholders. This is important as it provides the definitive view of risk taking activity the Board is comfortable that the Group undertakes and allows decision makers (including those with delegated authority and also those providing oversight) to exercise judgement with greater confidence and speed.

The RAS aligns to the risks identified and defined in the RMF. The design and structure of the RAS has taken into consideration best practice articulated by the European Central Bank which is aimed at ensuring Boards should be strongly involved in the validation process and monitoring of the RAS.

The Group's RAS is prepared by the Group Chief Risk Officer (CRO) with consideration of the strategic objectives and business model, as well as the environment in which the Group operates. Monthly reporting to Executive Committees and Board includes details of performance against relevant RAS settings, breaches and trends.

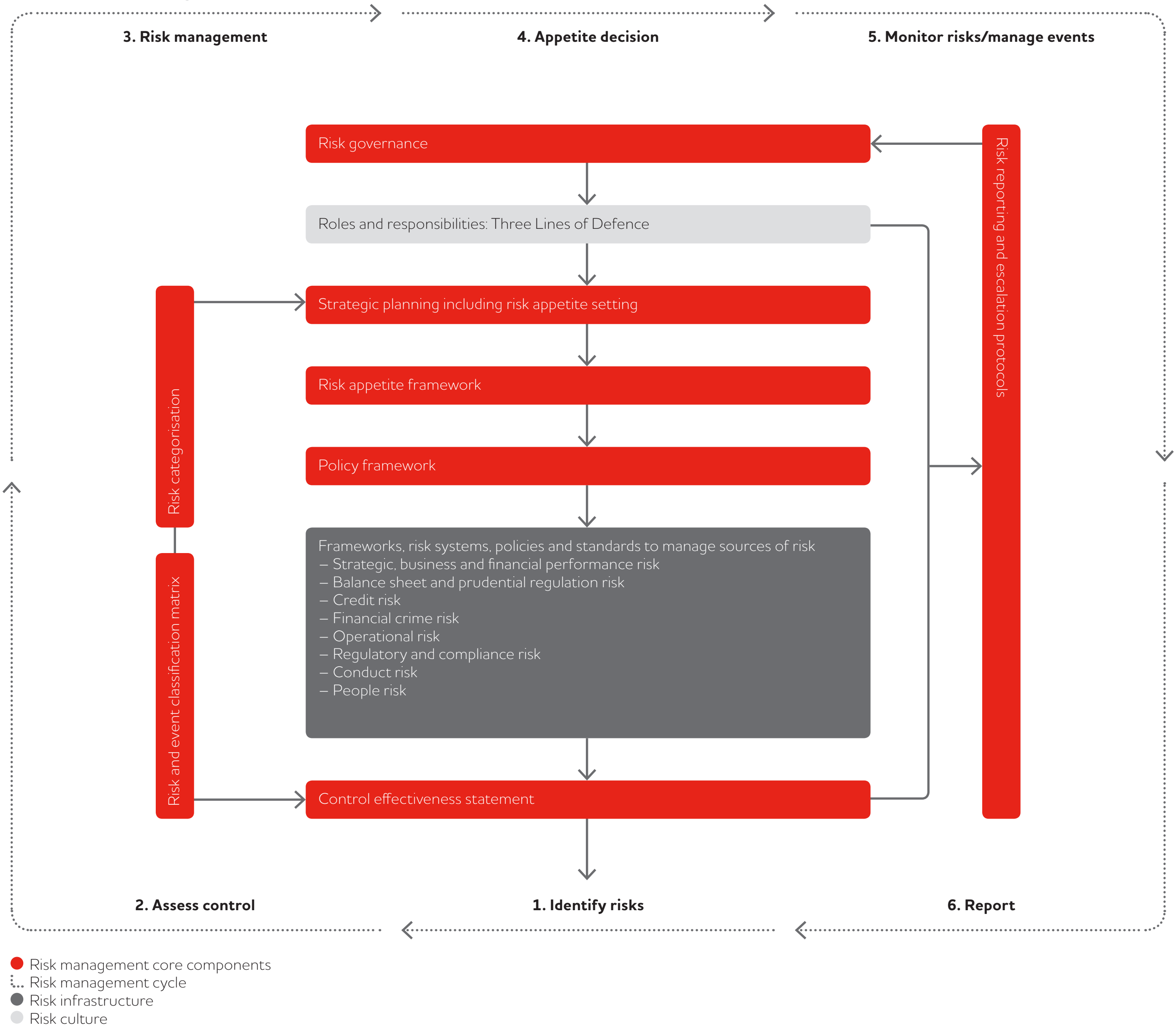
Risk policies and procedures

The policy framework is a key component of the Group's RMF providing structure and governance for the consistent, effective management of policies. In developing the policy framework the Group sets the tone that demonstrates the risk culture expected across the organisation. This aligns with the behavioural expectations for all colleagues which form a core part of our performance management approach. Policy statements and supporting policy standards define the minimum control requirements which must be observed across the Group to manage material sources of risk within risk appetite.

Risk management framework

The Group identifies and manages risk using the RMF (see diagram below), which is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, control, mitigate, monitor and report all internal and external sources of material risk.

Chart 1: Risk management framework



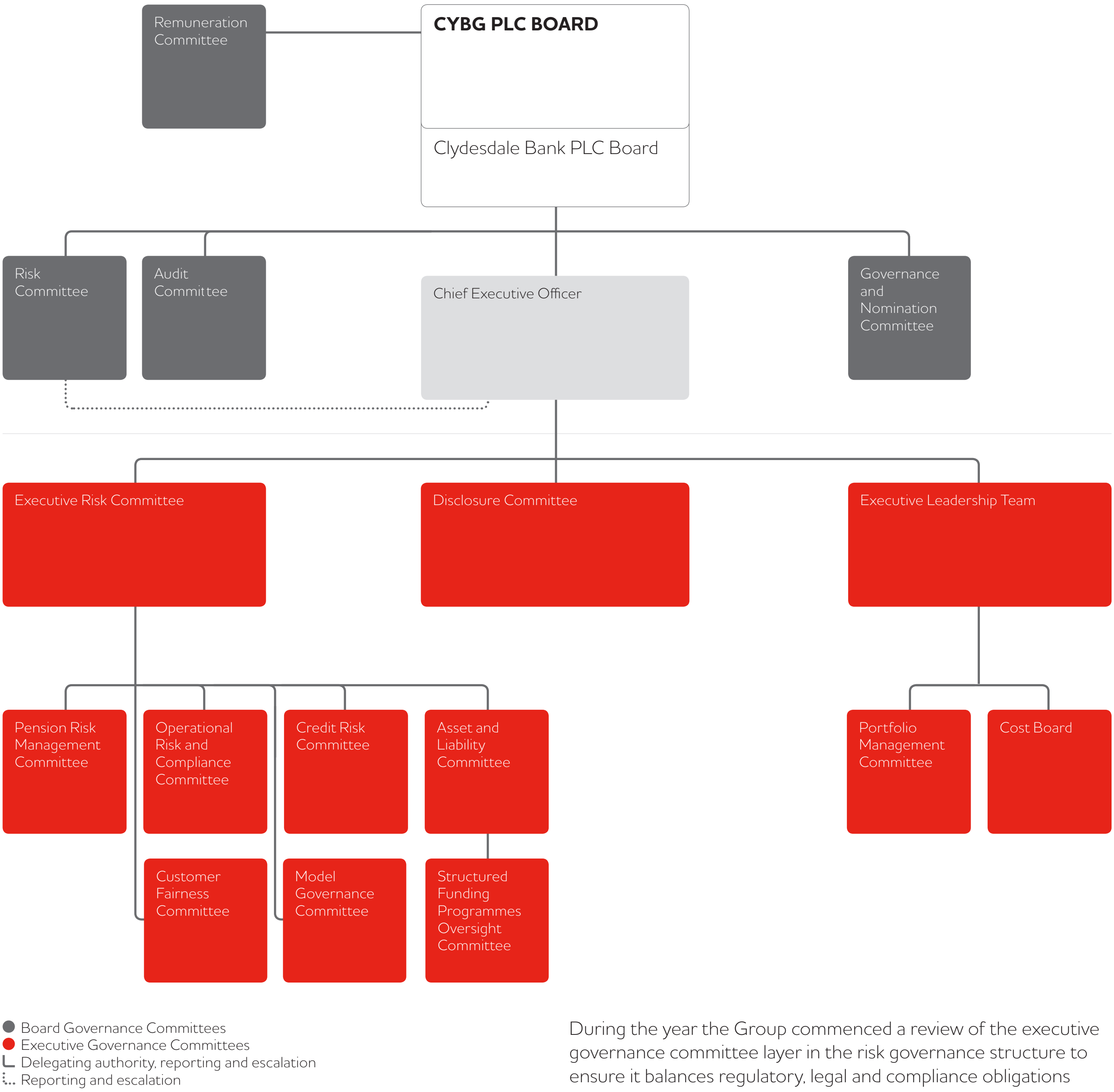
3.2 Risk governance and oversight

The Group's risk governance structure strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

A description of the key roles of the Risk Committee is included in the Risk Committee report within the Group's Annual Report and Accounts. This includes a description of the information flow on risk to the management body and related risk reporting, and details of Risk Committee meetings.

The Group's risk management is governed via a series of committees, as represented within the diagram which follows.

Chart 2: Governance Committee framework



During the year the Group commenced a review of the executive governance committee layer in the risk governance structure to ensure it balances regulatory, legal and compliance obligations while making timely, customer focused decisions that drive the business forward with any changes expected to be made during 2018 to ensure the framework is both optimal and efficient.

Table 2: Governance Committees

The following Executive level Committees have been established under the authority of the CEO:

Committees	Risk focus
Executive Leadership Team	The Executive Leadership Team supports the CEO to lead the Group to be a strong, customer-focused bank for its communities, by focusing on three business priorities: sustainable growth; efficiency; and capital optimisation.
Executive Risk Committee	The Executive Risk Committee supports the CEO in respect of risk and control accountabilities and serves to provide leadership focus on key risk issues including: – endorsing the RAS for approval by the Board; – overseeing and challenging the enterprise wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools; – monitoring the status of regulatory relationships, the reputation of the Group in relation to its regulators and the changing state of the regulatory landscape including the impacts for and readiness of the Group; – monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and – reviewing and endorsing risk policies, frameworks and tools for use across the Group.
Disclosure Committee	The Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations for exchanges on which it has equity and debt securities listed.

The Executive Risk Committee is supported by the following committees:

Pension Risk Management Committee	The Pension Risk Management Committee is responsible for overseeing pension risk management and strategy. This committee also oversees the interaction with the pension scheme trustees in relation to the risks within the Scheme.
Operational Risk and Compliance Committee	The Operational Risk and Compliance Committee is responsible for ensuring that the RMF and associated policies and standards are fit for purpose and implemented effectively.
Credit Risk Committee	The Credit Risk Committee is responsible for ensuring that the Credit RMF and associated policies remain effective. The committee has oversight of the quality, composition and concentrations of the credit risk portfolio and recommends strategies to adjust the portfolio to react to changes in market conditions.
Asset and Liability Committee (ALCO)	ALCO is responsible for monitoring the performance of the Group against the Board approved capital and funding plans. The committee focuses on the Group's non-traded market risks including capital, funding, liquidity and interest rate risk to ensure that the Group's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives. The impact of pension risk on capital is also assessed by ALCO.
Structured Funding Programmes Oversight Committee	The Structured Funding Programmes Oversight Committee is responsible for supporting the ALCO in relation to its risk monitoring and oversight responsibilities for all secured funding programmes and supporting the Group Chief Financial Officer (CFO) and Treasurer in relation to the compliance of the Regulated Covered Bond (RCB) Programme with Financial Conduct Authority (FCA) regulations and the RCB Sourcebook.
Customer Fairness Committee	The Customer Fairness Committee oversees the effective execution and ongoing development of the Conduct Framework and Customer Fairness Model. It also ensures conduct issues and remediation activities are effectively managed at the appropriate level.
Model Governance Committee	The Model Governance Committee supports the Board in fulfilling its governance responsibilities for material models and rating systems. The Committee oversees the integration and ongoing use of models across the Group, specifically considering the fitness for purpose, usability and scalability of models.

The Executive Leadership Team is supported by the following committees:

Portfolio Management Committee	The Portfolio Management Committee is responsible for the oversight and management of capital allocation and funding decisions for the product portfolio, related to pricing and sustainable returns.
Cost Board	The Cost Board is the primary forum for the management of costs across the Group. Its primary responsibilities are to approve expenditure within agreed delegated authorities, to oversee business unit expenditure and expense performance and to support the development of a strong expense control culture within the Group.

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3.3 The Board and governance

The number of directorships held by Executive and Non-Executive Directors including those in CYBG PLC Group are shown below. In line with the relevant rules[3], directorships in organisations which don't pursue predominantly commercial objectives have been excluded. In addition, where a Director has a number of directorships within one group these are counted as a single directorship.

Table 3: Directorships held

Name	Directorships held
James Pettigrew[4]	5
David Duffy	1
Debbie Crosbie	1
Ian Smith	2
Clive Adamson	4
David Bennett[5]	5
Paul Coby	1
Adrian Grace	2
David Browne	2
Fiona MacLeod	2
Teresa Robson-Capps	3
Tim Wade	4

Board recruitment

When considering the recruitment of a new Director, the Governance and Nomination Committee (Committee) adopts a formal, rigorous and transparent procedure with due regard to diversity, including gender. Before commencing the recruitment process, the Committee evaluates the balance of skills, knowledge, experience, independence and diversity on the Board and, in light of this evaluation, prepares a description of the role and capabilities required. In identifying suitable candidates, the Committee:

– uses open advertising or the services of external advisers to facilitate the search;

– considers candidates from different genders and a wide range of backgrounds;

– considers candidates on merit and against objective criteria ensuring that appointees have sufficient time to devote to the position, in light of other potential significant positions; and

– engages from time to time with the Group's major shareholders in future skills requirements and ideas for potential candidates.

The skills and experience of each Director are described within the Governance Report in the Group's Annual Report and Accounts.

Board diversity

The Board recognises the value of achieving diversity on the Board and throughout the Group. Although new appointments are based on merit, careful consideration is given to the benefits of improving and complementing the diversity, skills, experience and knowledge of the Board. The Board recognises and is committed to creating the conditions that foster talent for women to achieve their full potential by building strong female representation at Board level, Executive Leadership Team level and throughout the Group. During the year the Committee reviewed and recommended to the Board an updated Board Inclusion and Diversity Policy Statement to include a target of 33% female representation on the Board by 2020, achieved through the natural cycle of Board renewal. It is also the Board's intention to broaden diversity on the Board beyond gender diversity alone, to reflect the communities in which the Group operates and serves. As at 30 September 2017, there were three female Directors (25%) on the Board.

(3) PRA Rulebook 'General Organisational Requirements 5.4' (having regard to General Organisational Requirements 5.5 and 5.6) and FCA Handbook Senior Management Arrangements, Systems and Controls (SYSC) 4.3A.5R (having regard to SYSC 4.3A.6R and 4.3A.7R).

(4) The Prudential Regulation Authority and the Financial Conduct Authority jointly approved a modification of 'General Organisation Requirements' 5.5 and SYSC 4.3A.6R in relation to Mr Pettigrew's directorship portfolio, effective from 1 March 2017 until 31 December 2017. The modification is published on the Financial Services Register.

(5) The Prudential Regulation Authority and the Financial Conduct Authority jointly approved a modification of 'General Organisation Requirements' 5.5 and SYSC 4.3A.6R in relation to Mr Bennett's directorship portfolio, effective from 14 December 2016 to 13 December 2017. The modification is published on the Financial Services Register.

3.4 Three Lines of Defence

Effective operation of a Three Lines of Defence model is integral to the Group's approach to risk management and is based on the overriding principle that risk capability must be embedded within the first line of defence teams to be effective. This principle embodies the following concepts:

– commercial decisions are made on the basis of proactive consideration of risk and the impact on customers;

– risk management activities are focused on enhancing sustainable business performance;

– management must use the RMF to support decision-making involving risk and reward trade-offs;

– regular assessments are undertaken to confirm the effectiveness of the risk and control frameworks in relation to both the current and emerging risk profile; and

– risk management responsibilities are clearly understood by all colleagues when carrying out their day to day activities.

Control is exercised through a clearly defined delegation of authority, with communication and escalation channels throughout the Group.

Chart 3: Three Lines of Defence

1st

Business and enterprise assurance
Responsibility for risk management resides with the business unit director in each area. They are each responsible for ensuring that they have adequate risk coverage and processes in place to ensure they are managing the risks they own within risk appetite and within the guidelines of the RMF. A monthly report of key risks, issues and horizon risks is provided to the Executive Risk Committee. The enterprise assurance function focuses on end-to-end assurance of key processes as well as ensuring risks and controls are being managed appropriately. Reporting is provided to each business unit director as appropriate and to the Executive Risk Committee.

2nd

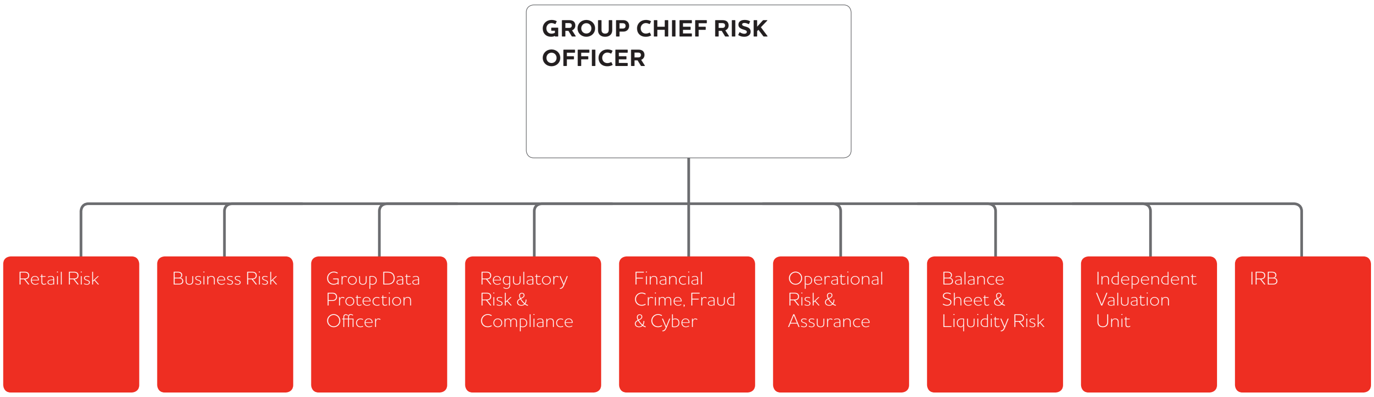
Risk Management
The risk management team under the Group CRO independently monitors and systematically assesses the Group's risk profile against established risk appetite parameters. Risk management also develops and defines the Group's RMF. They also assist the first line business units in the design and implementation of appropriate risk management policies and strategies and work with the business units to promote awareness of the need to manage risk.

3rd

Internal Audit
Internal Audit's role is to provide independent assurance over the governance, risk management and control framework.

The Group's risk management function as at 30 September 2017 is represented below:

Chart 4: Group risk management function



3.5 Stress testing

Stress testing is an important and recognised risk management tool, used to assess the vulnerability of financial institutions through the modelling of adverse scenarios. The Group undertakes stress testing, following the Basel Committee principles, and utilising, where appropriate, scenarios provided by the PRA, aimed at understanding potential impacts arising from adverse conditions relevant to its business and to aid the development and understanding of potential management actions and contingency plans.

Stress testing forms an integral part of the overall governance and risk management culture. Involvement from the Board and senior management in the stress-testing programme is essential for its effective operation.

Methodology

Stress testing within the Group complies with regulatory requirements and is subject to a rigorous review and challenge process. The Group's approach ensures that a clear link exists between the economic scenarios and stress-testing outputs, supported by a structured review and sign off process.

While the stress testing process is underpinned by models, it is also reliant on judgements made by senior management and key personnel across the Group who:

- manage the macroeconomic scenario process and prepare and review stressed business plans;
- prepare and review credit stress outputs including impairment charges, RWAs and write offs;
- provide funding and liquidity impacts and construct capital plans based on the outcomes of stress testing; and
- guide on potential management actions in response to stress scenario mitigation.

Reverse stress testing

Reverse stress testing requires a different approach. It starts from an outcome of business failure and identifies instances where this might occur. Severe but plausible scenarios with an unacceptably high risk are used to inform business planning to prevent or mitigate specific business risks. Reverse stress tests are also utilised as the start point for recovery and resolution planning scenarios. The Group also monitors a range of early warning indicators to give management early visibility of potential risks that could give rise to the need to invoke actions in recovery plans.

Stress testing within the Group's risk governance and capital framework

Stress testing outputs are used to inform the strategic planning process and the RAS. The plan is subjected to sensitivity analysis, forming a key element of the planning process from an overall risk assessment perspective, and provides the Board with further detail when looking to approve the plan.

Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the Internal Capital Adequacy Assessment Process (ICAAP). The Group runs a number of adverse macroeconomic stresses in order to determine the impacts on the Group's financial and capital position, considering changes to impairments, margins, volumes and costs relative to the base case plan and considers the actions which the Group may choose to deploy in response to such events materialising.

Stress testing is also a key feature of the Internal Liquidity Adequacy Assessment Process (ILAAP) where stress testing scenarios are modelled regularly to provide insight into potential vulnerabilities in the Group's funding and liquidity strategies. Stress-testing results of liquidity are also reported to ALCO on a monthly basis.

The Executive Leadership Team and Board engages at critical points of the stress-testing cycle to provide a robust challenge in relation to the selection and development of scenarios and, thereafter, considers how the results are integrated into future strategic decision-making, contingency planning, capital and business planning and risk appetite.

In advance of Board submission, ALCO reviews the scenarios, assumptions and results of liquidity and capital stress testing and provides an initial review and challenge of outputs.

3.6 Principal risks

The Group's principal risks are summarised in section 1. Further information on these risks are included in the Risk report within the Group's Annual Report and Accounts.

3.6.1 Credit risk

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument.

Credit risk manifests itself in the financial instruments and/or products that the Group offers, and those in which the Group invests (including, among others, loans, guarantees, credit-related commitments, letters of credit, acceptances, inter-bank transactions, foreign exchange transactions, swaps and bonds). Credit risk can be found both on- and off-balance sheet.

Risk appetite

The Group controls the levels of credit risk it takes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to geographical, product and industry segments. The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions, regular asset quality analysis of the performance of the various credit risk portfolios, and the independent oversight of credit portfolios across the Group.

Credit strategies and policies

Credit risks associated with lending are managed through the application of detailed lending policies and standards which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Group maintains a dynamic approach to credit management and aims to take necessary steps if individual issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to borrower, economic or sector-specific weaknesses.

Roles and responsibilities for the management, monitoring and mitigation of credit risk within the Group are clearly defined in line with the Group's RMF.

Significant credit risk strategies and policies are approved, and reviewed annually, by the Credit Risk Committee. For complex credit products and services, the Head of Business Risk, Head of Retail Risk and Credit Risk Committee provide a policy framework which identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management, with appropriate oversight through governance committees.

Exposures

Credit risk exposures are categorised as Retail (secured and unsecured) and SME.

In terms of loans and advances, credit risk arises both from amounts loaned and commitments to extend credit to customers. To ensure appropriate credit limits exist, especially for SME lending, a single large exposure policy is in place within the Group and forms part of the risk appetite measures that are monitored and reported on a monthly basis. The overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board and, where required, to the relevant supervisory authorities.

Exposures are also managed in accordance with the large exposure reporting requirements of the CRR.

Measurement

The Group uses statistical models to measure credit risk exposures. Models are supported by both internal and external data. The probability of default (that borrowers will not meet their contractual obligations), current exposures, and the likely loss ratio on defaulted obligations are calculated to measure and mitigate credit risk. Portfolios are assessed using segmentation for measurement, reporting and monitoring purposes.

Subject to regulatory approval, the Group is progressing toward attaining permission to use IRB models to measure the credit risk of loans and advances to customers. Meantime, all exposures are measured under the standardised approach for regulatory capital.

3.6.2 Balance sheet and prudential regulation risks

Balance sheet risks in the financial services industry are highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. The key risks include capital, liquidity and funding risks, market risk which in the case of the Group is non-traded market risk (incorporating interest rate and foreign exchange risks), pension risk and non-traded equity risk.

Risk appetite

The primary objective for the management of balance sheet risks is to maintain the risk profile within approved risk limits and to maintain the confidence of the Group's customers and other stakeholders. Balance sheet risks are also managed to protect current and future earnings from the impact of market volatility. The Group applies a prudent approach to balance sheet risks in order to safeguard the ongoing strength and resilience of the balance sheet.

Risk appetite is approved for balance sheet risks by the Board, with authority delegated to ALCO for subsequent implementation and monitoring. The Board has established a range of measures of risk appetite for capital including CET1, leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet and include, among others, measures relating to the proportion of customer funding, the Group's overall funding profile and an overall liquidity adequacy rule (OLAR). The OLAR covers the Board's appetite in relation to regulatory liquidity requirements and also covers the need to maintain access to liquidity resources sufficient to accommodate outflows of funds in a range of stress scenarios over a three-month period.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities. The Group establishes an appetite for these risks based on an overriding principle that the Group will not engage in proprietary risk taking.

Capital
Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support the Group's strategy of sustainable growth. Capital risk is the risk that the Group has insufficient quantity or quality of capital to support its operations.

Further information on capital risk management is provided in section 5.1.

Funding and liquidity risk
Funding risk relates to the impact on the Group's strategy of being unable to raise funds from customers and the wholesale markets of sufficient quantity and of appropriate mix and tenor. An inability to raise sufficient funds may lead to a reduction in lending growth or a requirement to raise the price paid for deposits, both outcomes having an adverse effect on shareholder value. Where funding risk manifests itself in an adverse effect on mix and tenor, for example, a high proportion of short-term wholesale deposits, there is an increased liquidity risk to the Group.

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Risk assessment
The framework for the Group's approach to funding risk leads to the development of a Group funding plan that is subject to approval by the Board and is consistent with risk appetite and the Group's strategic objectives. The development of the Group's funding plan is informed by the requirements of the Group's Balance Sheet Risk Policy Standards.

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. Exposures relate to the outflow of funds under a series of stress scenarios less the impact of inflows from assets, liquidation of high-quality liquid assets or through other actions instigated by the Group. Liquidity within the Group is managed in accordance with the ILAAP that is approved by the Board. The ILAAP documents the manner in which the Group meets its OLAR which covers all regulatory and internal liquidity requirements. In addition, the Group has a policy standard which details, among other items, the control standards and risk measurement requirements for liquidity, authorities and responsibilities.

Oversight of liquidity risk is undertaken by ALCO. To meet the requirements of regulatory authorities the liquidity of the Group is managed on a daily basis using a combination of cumulative cash flow mismatch, scenario analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. ALCO delegates daily management responsibilities to the Treasury function within agreed tolerances. All balance sheet risks are subject to independent oversight from the second line balance sheet and liquidity risk oversight function.

Stress testing of the Group's liquidity risk is undertaken on a frequent basis and results are provided to ALCO and the Board. The ILAAP is used to establish key risk drivers and assumptions for liquidity risk and these provide the framework for ongoing stress testing. Stress testing considers the impact of severe yet plausible scenarios to consider the potential impact on the Group's funding and liquidity profile. The Group holds a portfolio of high-quality assets that acts as a buffer against the impact of liquidity risk. Funding plans take a long-term view and these consider the impact of prolonged periods of market disruption in order to identify potential vulnerabilities in the profile of the Group's funding.

A Contingency Funding Plan has been established for management of an escalated liquidity requirement if the Group experiences either restricted access to wholesale funding or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a time frame and defines a management committee to manage the action plan.

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, counterparty, term structure and market.

The Group can source funding through a range of channels including the following:

- customer deposits;
- access to short-term money market funding;
- term structured funding through Lanark residential mortgage securitisation programme (owner occupied);
- Lannraig buy-to-let (BTL) mortgage securitisation programme;
- RCB programme;
- senior unsecured funding; and
- access to facilities within the BoE Sterling Monetary Framework and the Term Funding Scheme (TFS) (the TFS closes to new drawings in February 2018).

The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage-backed debt. These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet.

Monitoring
The Treasury function is responsible for the development and execution of strategy subject to oversight from the risk management function. In relation to funding and liquidity risk, the primary management committee is ALCO. ALCO meets monthly and reports to the Executive Risk Committee.

The Group continues to have a strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and liquidity risk. Funding is predominantly provided by Retail and SME customers and this is supported by medium-term secured funding issuance from the Group's Lanark and Lannraig securitisation programmes, and its RCB platform and TFS. These funding programmes are a source of strength for the Group and leverage the Group's high-quality mortgage book as a source of collateral for secured funding.

The Group monitors liquidity and funding with reference to a number of measures including liquidity coverage ratio, loan to deposit ratio and net stable funding ratio.

Market risks
Market risk is the risk associated with adverse changes in the fair value, or accrual income and expense, of assets and liabilities held by the Group as a result of movements in market factors such as interest rates, foreign exchange rates, volatility and credit spreads. The Group's balance sheet is predominantly UK based and is denominated in GBP, therefore foreign exchange risk is not a major part of the Group's risk profile.

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income and economic value to movements in market interest rates. The major contributors to interest rate risk are:

- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities;
- basis risk, for example, the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets or the risk arising from changing relationships between different interest rate yield curves; and
- customer optionality, e.g. the right to repay borrowing in advance of contract maturity dates.

Pension risk
The Group operates a defined benefit (DB) pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the Scheme). Clydesdale Bank PLC is the Scheme's principal employer and there are no other participating employers. Following a consultation process the Scheme was closed to future accrual on 1 August 2017 for the majority of members. A small number of members elected to keep DB accruals subject to making an increased contribution to the Scheme and to also forego other remuneration benefits.

DB pension schemes provide a promise to pay members a pre-determined level of income at retirement which is independent of the contributions and investment returns (assets) used to fund these benefit promises (collectively the liabilities). As such, there are significant risks associated with managing a DB scheme. These risks will continue until the Scheme is formally wound up, either in the event that all the liabilities are transferred to a third party (for example an insurer) or once all individual member benefits are paid.

The Scheme's assets are held under a separate trust and the Scheme is managed by a corporate Trustee Board independently of the Group, per the Scheme Trust Deed and Rules. Therefore, the Group's ability to directly manage the Scheme is limited to certain powers within the governing documentation. Aside from the Group's role to sponsor the Scheme to ensure there are sufficient assets to meet benefit payments as they fall due, the Group's focus is directed on mitigating the impact on capital and earnings through working with the trustee to implement risk reduction initiatives. Several activities have been implemented since 2003 with the specific aim of reducing risk in the Scheme, including a de-risking journey plan, benefit reforms and the outcome of the 2017 consultation on future accruals.

Further information on pension risk is provided in note 3.16 of the Group's Annual Report and Accounts.

3.6.3 Regulatory, compliance and conduct risk

Regulatory and compliance risk
Regulatory and compliance risk is the risk of: failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives; failing to identify, monitor and respond to changes in the regulatory environment; damaging the Group's relationship with its regulators through non-compliance with requirements, not keeping regulators informed of relevant issues that affect (or which may affect) the Group, not responding effectively to the information requests and review findings of the regulators, by providing incorrect or inadequate information, not meeting regulatory deadlines or obstructing the regulator from fulfilling its role.

Risk appetite
The Group has no appetite for actions resulting in breaches of regulation or for inaction to address systemic process and control failures leading to material non-compliance.

Mitigation measures
- The Group has a regulatory engagement policy designed to ensure an open and cooperative relationship is maintained with regulators at all times, ensuring that all key interactions with regulators are managed, recorded and escalated as appropriate.
- All colleagues are required to achieve mandated standards to meet their 'compliance gateway' obligations.
- Material changes to regulatory policies and protocols are approved by either the Executive Leadership Team or the Board.
- The Group CRO and Risk Leadership Team consider compliance risk topics when setting risk appetite and through ongoing risk assessment, profiling and reporting.

Monitoring
A risk management oversight and compliance monitoring plan is approved by Board's Risk Committee on an annual basis which independently assesses the control framework underpinning compliance with laws and regulations.

Conduct risk
Conduct risk is the risk of undertaking business in a way which is contrary to the interests of our customers resulting in the delivery of inappropriate customer outcomes, customer detriment, regulatory censure, redress costs and/or reputational damage.

Risk appetite
The Group is committed to acting in the interests of its customers, and has no appetite for conduct risk.

Mitigation measures
The Group has a conduct framework which recognises the key conduct risks inherent in the Group's strategy through which it seeks to apply the highest standards in the design and sale of products, and the treatment of its customers. The framework ensures fair customer outcomes supported by a good customer experience. This is achieved in a number of ways including continuous monitoring and responding to customer feedback and complaints. In addition, if things do go wrong, action is taken to ensure we put things right for our customers.

Products are designed and sold to meet customer needs and expectations with governance processes embedded to ensure those objectives are met.

Consideration of customer outcomes is embedded within the Group's operating processes, and metrics are regularly monitored to help ensure outcomes are appropriate.

Exposures
As part of the demerger from NAB in 2016, NAB and the Group have entered into a Conduct Indemnity Deed where NAB has agreed to provide the Group with an indemnity in respect of certain historic liabilities relating to conduct in the period prior to the demerger date. Details of the Conduct Indemnity Deed are included in note 3.14 in the Group's Annual Report and Accounts.

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk-related liabilities with note 3.14 in the Group's Annual Report and Accounts reflecting the Group's current position in relation to redress provisions for payment protection insurance, interest rate hedging products and other smaller historic conduct matters. The final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

Monitoring
This is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly and products are designed and sold to meet their needs. The Group also works to ensure that customer expectations are met and complaints are dealt with effectively and fairly. All Three Lines of Defence consider conduct risk as part of their oversight and assurance activities.

3.6.4 Operational risk (including people risks)
Operational risk (including people risks) is the risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events including, for example, the prospect of a cyber attack. It is a core component of the RMF and is embedded in day-to-day business activities. Responsibilities are set out in a structured operational risk framework that seeks to identify, assess, mitigate, monitor, and report the operational risks and events that could impact the achievement of business objectives or impact core business processes.

Business units are responsible for the day-to-day management of operational risk, with oversight from the risk management function, and independent assurance activities undertaken by internal audit.

The requirements of the operational RMF are defined in an overarching operational risk policy and related minimum standards, and reflect the Group's operational risk appetite.

Risk appetite
The Group is prepared to tolerate a level of operational risk exposure within agreed thresholds and limits. Operational risks arise from day-to-day business activities, which may result in direct or indirect losses and could adversely impact the Group's financial performance, levels of customer care and reputation.

Further information on operational risk is provided in section 7.

3.6.5 Financial crime risk
Financial crime risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes. It also includes risks associated with external or internal acts intended to defraud, misappropriate, and circumvent policy, funds, information, regulations and property. The Group maintains an overarching financial crime policy and four policy standards aligned to each material financial crime risk. These are:

Sanctions – The Group has no appetite for non-compliance with the legal and regulatory obligations relating to sanctions and embargoes. To reflect the Group's risk appetite and to protect the Group from financial and reputational damage, including regulatory censure, fines and enforcement action, the Sanctions and Embargoes Policy articulates a set of minimum standards and requirements which must be complied with.

Anti-money laundering – The Group applies a prescribed high-risk customer model which sets out the types of customer it has no risk appetite to onboard, as well as customers with whom the Group is prohibited from entering into or maintaining a customer relationship. All other customers who are not prescribed shall be subject to controls commensurate with their risk.

Anti-bribery and corruption – The Group does not tolerate the direct or indirect offer, payment, solicitation or acceptance of bribes in any form. The Group has in place risk assessments, policies and guidelines on interacting with customers, suppliers and agents, including specific policies for gifts and hospitality. Senior managers across the business are required to complete an evaluation of risk areas as part of the risk assessment process.

Fraud – The Group accepts that, in order to conduct business in a commercially viable manner, it is willing to sustain fraud losses within an agreed set of parameters. The application of fraud risk management considers customer impacts, industry trends and financial impacts of fraud which, on occasion, provide conflicting priorities. Emerging risks are identified and assessed with action taken to mitigate them. An agreed loss plan is set and performance against this is overseen by the policy owner and reported through the appropriate governance committees. With regard to internal fraud, the Group recognises the risk of internal fraud but has no appetite for it. Consequently there is a control framework in place to mitigate that risk.

Exposures
There are currently no significant exposures to report. The Group continues to review the external environment for any change in regulatory or legislative direction, taking action as appropriate.

Mitigation measures
Risk assessments against the four financial crime policy standards take place on an annual basis. Over and above these assessments, regular oversight of higher-risk activities takes place as part of the formal oversight plan and embedded activity takes place throughout the year. Key performance metrics relative to critical financial crime systems are kept under review to ensure ongoing effectiveness. Third party tools are used to test system effectiveness where available and appropriate. Training completion and compliance is subject to annual oversight.

All standards are reflected in the Group policy and standards and financial crime prevention manual, the content of which is provided by financial crime risk and updated as appropriate.

Monitoring
The financial crime team is responsible for strategy, governance, standard setting, oversight, training and reporting to the competent authorities and governance committees/Board.

The control framework is owned by financial crime risk but management and execution of customer identity and verification, customer due diligence, enhanced due diligence, identifying high-risk customers, including correspondent banking relationships and record keeping is the responsibility of first line business units.

Account opening pass rates are overseen as part of a regular process undertaken by financial crime risk and reported monthly.

Higher-risk customers are referred to financial crime risk and senior management within Customer Banking for agreement and sign off that business is within appetite and then continue to be monitored on an ongoing basis.

Screening customers for sanctions or politically exposed persons and transaction monitoring is carried out by financial crime risk. Sanctions screening for payments is carried out by the Payments team in the first line. Critical financial crime systems oversight is independently tested by Internal Audit.

4 Capital resources

4.1 Own funds

The table below shows the composition of the Group's regulatory capital position as at 30 September 2017 on a CRD IV basis. The table includes 2016 comparatives prepared on the same basis. The table follows the disclosure format required by the EBA Implementing Technical Standard on Disclosure for Own Funds, however only items applicable to the Group are shown.

The capital resources of the Bank are presented in Appendix 1 of this document.

Table 4: Capital composition

As at 30 September		**2017 £m**	2016 £m
	Common Equity Tier 1 capital: Instruments and reserves		
1	Capital instruments and the related share premium accounts	**88**	88
1a	*Of which: ordinary shares*	**88**	88
2	Retained earnings	**2,857**	2,771
3	Accumulated other comprehensive income (and other reserves)	**7**	94
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(10)**	–
6	**Common Equity Tier 1 capital before regulatory adjustments**	**2,942**	2,953
	Common Equity Tier 1 capital: regulatory adjustments		
7	Additional value adjustments	**(4)**	(7)
8	Intangible assets	**(339)**	(256)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	**(28)**	(35)
11	Fair value reserves related to gains or losses on cash flow hedges	**1**	(66)
15	Defined benefit pension fund assets	**(135)**	–
25a	Losses and distributions for the current financial year (negative amount)	**–**	(192)
28	**Total regulatory adjustments to Common Equity Tier 1**	**(505)**	(556)
29	**Common Equity Tier 1 capital**	**2,437**	2,397
	Additional Tier 1 capital: instruments		
30	Capital instruments and the related share premium accounts	**450**	450
31	*Of which: classified as equity under applicable accounting standards*	**450**	450
36	**Additional Tier 1 capital before regulatory adjustments**	**450**	450
44	**Additional Tier 1 capital**	**450**	450
45	**Tier 1 Capital**	**2,887**	2,847
	Tier 2 capital: Instruments and provisions		
46	Capital instruments and the related share premium accounts	**473**	474
50	Credit risk adjustments	**154**	151
51	**Tier 2 capital before regulatory adjustments**	**627**	625
58	**Tier 2 capital**	**627**	625
59	**Total capital**	**3,514**	3,472
60	**Total risk weighted assets**	**19,678**	19,029
	Capital ratios and buffers		
61	Common Equity Tier 1	**12.4%**	12.6%
62	Tier 1	**14.7%**	15.0%
63	Total capital	**17.9%**	18.2%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements plus a systemic risk buffer, plus systemically important institution buffer expressed as a percentage of total risk exposure amount)	**5.8%**	5.1%
65	*Of which: capital conservation buffer requirement*	**1.3%**	0.6%
66	*Of which: countercyclical buffer requirement*	**0.0%**	0.0%
67	*Of which: systemic risk buffer requirement*	**0.0%**	0.0%
67a	*Of which: Global Systemically Important Institution or Other Systemically Important Institution buffer*	**0.0%**	0.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**7.9%**	8.1%
	Applicable caps on the inclusion of provisions in Tier 2		
76	Credit risk adjustments included in Tier 2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**154**	151
77	Cap on inclusion of credit risk adjustments in Tier 2 under standardised approach	**224**	214

Significant movements in capital and related deductions are described at section 4.2.

Tier 1 capital
Tier 1 capital comprises:

- ordinary shares;
- share premium;
- retained earnings;
- accumulated other comprehensive income (and other reserves);
- AT1 instruments; and
- adjustments as set out by the regulatory requirements governing capital resources.

Accumulated other comprehensive income (and other reserves) represents adjustments for asset revaluation, cash flow hedge and available for sale reserves. The inclusion of available for sale asset reserves became a requirement under CRR with effect from 1 January 2015.

Additional details of the perpetual capital notes are included in Appendix 2 and note 4.1 to the Annual Report and Accounts for the year ended 30 September 2017.

Tier 2 capital
Tier 2 capital comprises:

- subordinated loan debt;
- eligible collective impairment allowances; and
- adjustments as set out by the regulatory requirements governing capital resources.

Subordinated loan debt is unsecured and ranks below the claims of all depositors and other ordinary creditors. Additional details of the subordinated notes are included in Appendix 2 and in note 3.15 to the Group's Annual Report and Accounts for the year ended 30 September 2017.

Under the regulatory rules, the percentage of subordinated loan debt permitted to be included as qualifying regulatory capital is limited to a maximum of 25% of total capital.

Full terms and conditions for the Group's marketed debt securities are available on the Group's website (cybg.com/investor-centre/debt-investors/capital-instruments).

4.2 Movements in capital

While RWAs increased by £649m, driven by growth in mortgages, underlying capital generation post AT1 distribution of 13bps (before the net impact of pension movements, and below-the-line charges such as the Group's proportion of conduct provision charges and exceptional restructuring charges) (referred to on page 46 of the Group's Annual Report and Accounts) ensured the CET1 ratio remained robust at 12.4%. The underlying capital generation was sufficient to offset the exceptional items raised during the year and the key reason for the reduction in CET1 ratio from 12.6% to 12.4% was the acceleration of a £50m payment to the Yorkshire and Clydesdale Bank Pension Scheme made in May 2017 rather than October 2017 as originally planned. On a pro forma basis excluding the impact of this payment the CET1 ratio would have remained at 12.6%.

Table 5: Capital flow statement

	2017 £m	2016 £m
Common Equity Tier 1 capital		
Common Equity Tier 1 capital at 1 October	**2,397**	2,405
Share capital: ordinary share new issuance	**–**	–
Share for share exchange and nominal reduction	**–**	(135)
Share premium	**–**	(670)
Share capital: redenomination	**–**	–
Retained earnings and other reserves	**(11)**	525
Prudent valuation adjustment	**3**	(2)
Intangible assets	**(83)**	9
Deferred tax assets relying on future profitability	**7**	238
Defined benefit pension fund assets	**(135)**	42
Fair value reserves related to gains or losses on cash flow hedges	**67**	(66)
Losses for the current financial year	**192**	51
	2,437	2,397
Tier 1 capital		
Tier 1 capital at 1 October	**450**	450
Share capital repurchased: perpetual non-cumulative preference shares	**–**	(450)
Share capital issued: perpetual subordinated contingent convertible notes	**–**	450
Share capital issued: Additional Tier 1 capital perpetual notes	**–**	–
	450	450
Total Tier 1 capital	**2,887**	2,847
Tier 2 capital		
Tier 2 capital at 1 October	**625**	598
Subordinated debt repurchase	**–**	(475)
Capital instruments issued: Subordinated debt	**–**	474
Credit risk adjustments	**3**	13
Removal of minority interest deduction of subordinated debt	**–**	15
Other movements	**(1)**	–
	627	625
Total capital at 30 September	**3,514**	3,472

A number of deductions are applied in calculating regulatory capital under CRD IV. These include deductions for: intangible assets, deferred tax assets (DTAs) that rely on future profitability, defined benefit pension scheme IAS 19 surpluses and prudent valuation adjustments.

The most significant of these are:

- the IAS 19 valuation of defined benefit pension schemes is included in accounting reserves. This means that an IAS 19 deficit position is automatically reflected in regulatory capital. If the IAS 19 valuation is a surplus, the regulatory rules do not permit this to contribute towards regulatory capital and this figure must be deducted. At 30 September 2016, the IAS 19 valuation was a deficit of £75m. At 30 September 2017, the IAS 19 valuation was a surplus of £207m, resulting in the net of tax movement of £135m seen in the table above. The position benefitted from the closure of the Scheme to future accrual, updates to actuarial assumptions post the 2016 Triennial and the accelerated £50m payment to the Scheme;
- the regulatory adjustment required in respect of deferred tax assets that rely on future profitability. At 30 September 2016 £35m was deducted from CET1 capital and this decreased to £28m resulting in a movement of £7m;
- the regulatory adjustment required in respect of intangible assets (computer software and other IT development which has been capitalised). At 30 September 2016 £256m was deducted from CET1 capital and this increased to £339m resulting in a movement of £83m; and
- the adjustment for fair value reserves related to gains or losses on cash flow hedges has increased during the year following an unwind of market volatility arising from the UK's referendum vote to leave the EU.

Table 6 shows the capital position on a transitional and a 'fully loaded' CRD IV basis. All of the Group's capital instruments are fully compliant with CRD IV, therefore the only difference shown is in respect of transitional capital buffers.

Table 6: CRD IV end-point vs transitional comparison

		Current rules		Full impact	
	As at 30 September	**2017 £m**	2016 £m	**2017 £m**	2016 £m
	Common Equity Tier 1 capital: Instruments and reserves				
1	Capital instruments and the related share premium accounts	**88**	88	**88**	88
1a	*Of which: ordinary shares*	**88**	88	**88**	88
2	Retained earnings	**2,857**	2,771	**2,857**	2,771
3	Accumulated other comprehensive income (and other reserves)	**7**	94	**7**	94
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(10)**	–	**(10)**	–
6	**Common Equity Tier 1 capital before regulatory adjustments**	**2,942**	2,953	**2,942**	2,953
	Common Equity Tier 1 capital: regulatory adjustments				
7	Additional value adjustments	**(4)**	(7)	**(4)**	(7)
8	Intangible assets	**(339)**	(256)	**(339)**	(256)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	**(28)**	(35)	**(28)**	(35)
11	Fair value reserves related to gains or losses on cash flow hedges	**1**	(66)	**1**	(66)
15	Defined benefit pension fund assets	**(135)**	–	**(135)**	–
25a	Losses and distributions for the current financial year (negative amount)	**–**	(192)	**–**	(192)
28	**Total regulatory adjustments to Common Equity Tier 1**	**(505)**	(556)	**(505)**	(556)
29	**Common Equity Tier 1 capital**	**2,437**	2,397	**2,437**	2,397
	Additional Tier 1 capital: instruments				
30	Capital instruments and the related share premium accounts	**450**	450	**450**	450
31	*Of which: classified as equity under applicable accounting standards*	**450**	450	**450**	450
36	**Additional Tier 1 capital before regulatory adjustments**	**450**	450	**450**	450
44	**Additional Tier 1 capital**	**450**	450	**450**	450
45	**Tier 1 capital**	**2,887**	2,847	**2,887**	2,847

As at 30 September		Current rules 2017 £m	Current rules 2016 £m	Full impact 2017 £m	Full impact 2016 £m
	Tier 2 capital: Instruments and provisions				
46	Capital instruments and the related share premium accounts	**473**	474	**473**	474
50	Credit risk adjustments	**154**	151	**154**	151
51	**Tier 2 capital before regulatory adjustments**	**627**	625	**627**	625
58	**Tier 2 capital**	**627**	625	**627**	625
59	**Total capital**	**3,514**	3,472	**3,514**	3,472
60	**Total risk weighted assets**	**19,678**	19,029	**19,678**	19,029
	Capital ratios and buffers				
61	Common Equity Tier 1	**12.4%**	12.6%	**12.4%**	12.6%
62	Tier 1	**14.7%**	15.0%	**14.7%**	15.0%
63	Total capital	**17.9%**	18.2%	**17.9%**	18.2%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements plus a systemic risk buffer, plus systemically important institution buffer expressed as a percentage of total risk exposure amount)	**5.8%**	5.1%	**7.0%**	7.0%
65	*Of which: capital conservation buffer requirement*	**1.3%**	0.6%	**2.5%**	2.5%
66	*Of which: countercyclical buffer requirement*	**0.0%**	0.0%	**0.5%**	0.0%
67	*Of which: systemic risk buffer requirement*	**0.0%**	0.0%	**0.0%**	0.0%
67a	*Of which: Global Systemically Important Institution or Other Systemically Important Institution buffer*	**0.0%**	0.0%	**0.0%**	0.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**7.9%**	8.1%	**7.9%**	8.1%
	Applicable caps on the inclusion of provisions in Tier 2				
76	Credit risk adjustments included in Tier 2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**154**	151	**154**	151
77	Cap on inclusion of credit risk adjustments in Tier 2 under standardised approach	**224**	214	**224**	214

4.3 Reconciliation of statutory equity to regulatory capital

Table 7: Reconciliation of statutory equity to regulatory capital

As at 30 September	2017 £m	2016 £m
Statutory total equity	**3,402**	3,211
Less pension regulatory adjustments	**(135)**	–
Less additional value adjustment	**(4)**	(7)
Less intangible assets	**(339)**	(256)
Less share option reserve	**–**	–
Less deferred tax assets relying on future profitability	**(28)**	(35)
Less cash flow hedge	**1**	(66)
Additional Tier 1 foreseeable dividend	**(10)**	–
Regulatory Tier 1 capital	**2,887**	2,847
Statutory Tier 2 subordinated debt	**476**	477
Less unamortised hedge on issuance	**(3)**	(3)
Minority interest deduction of subordinated debt	**–**	–
Regulatory Tier 2 subordinated debt	**473**	474

4.4 Leverage ratio

Management of excessive leverage

The leverage ratio is monitored against a Board set RAS with the responsibility for managing the ratio delegated to ALCO, which monitors it on a monthly basis.

The leverage ratio is the ratio of Tier 1 capital to total exposure. Tier 1 capital is defined according to CRD IV and, for this purpose, the full impact of CRD IV requirements on Tier 1 capital are assumed to be in force. Exposures are defined as the total on- and off-balance sheet exposures (after application of credit conversion factors). This follows the definition given in the Delegated Act amending CRR article 429, and includes deductions applied to Tier 1 capital.

Tables 8, 9 and 10 below show the leverage ratio disclosure templates required by the EBA's Implementing Technical Standards on disclosure of the leverage ratio.

Table 8: LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

		2017 £m	2016 £m
1	Total assets as per published financial statements	**43,231**	39,929
4	Adjustments for derivative financial instruments	**(228)**	(399)
5	Adjustments for securities financing transactions (SFTs)	**1,461**	601
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**2,019**	1,982
7	Other adjustments	**(505)**	(364)
8	Total leverage ratio exposure	**45,978**	41,749

4 Capital resources

Table 9: LRCom: Leverage ratio common disclosure

		2017 £m	2016 £m
	On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**42,949**	39,344
2	(Asset amounts deducted in determining Tier 1 capital)	**(505)**	(364)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**42,444**	38,980
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)[6]	**192**	340
5	Add-on amounts for potential future exposure (PFE) associated with all derivatives transactions (mark-to-market method)[6]	**200**	183
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(338)**	(337)
11	Total derivative exposures	**54**	186
	Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**5,235**	1,827
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	**(3,774)**	(1,226)
16	Total securities financing transaction exposures	**1,461**	601
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**8,519**	7,813
18	(Adjustments for conversion to credit equivalent amounts)	**(6,500)**	(5,831)
19	Other off-balance sheet exposures	**2,019**	1,982
	Capital and total exposures		
20	Tier 1 capital	**2,887**	2,847
21	Total leverage ratio exposures	**45,978**	41,749
	Leverage ratio		
22	Leverage ratio	**6.3%**	6.8%
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Fully phased in**	Fully phased in

(6) FY2016 comparatives have been represented for the following, with no impact to the leverage ratio: £56m of derivatives reallocated from replacement costs (line 4) to PFE add-on (line 5).

Table 10: LRSpl: Split-up of on-balance sheet exposures

		2017 £m	2016 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**42,949**	39,344
EU-3	Banking book exposures, of which:	**42,949**	39,344
EU-4	Covered bonds	**477**	191
EU-5	Exposures treated as sovereigns(7)	**8,523**	7,307
EU-6	Exposures to regional governments, multilateral development banks, international organisations and public sector entities NOT treated as sovereigns	**157**	12
EU-7	Institutions	**495**	762
EU-8	Secured by mortgages of immovable properties	**27,451**	25,807
EU-9	Retail exposures	**1,134**	1,124
EU-10	Corporate(7)	**2,924**	2,719
EU-11	Exposures in default	**472**	337
EU-12	Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)(7)	**1,316**	1,085

The Group's leverage ratio is 6.3% which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018. The movement in the year has been driven by an increase in total exposures as a result of balance sheet growth during the period, partially offset by an increase in Tier 1 capital. The Group will continue to closely monitor the leverage ratio against emerging rules and minimum calibration.

The UK leverage ratio framework, which came in to force on 1 January 2016, is relevant to PRA regulated banks and building societies with consolidated retail deposits equal to or greater than £50bn. The Group is currently excluded from these requirements. On 3 October 2017, the PRA published a policy statement – 'UK Leverage Ratio treatment of claims on central banks'.

The PRA Rulebook has been amended to:

– align with its July 2016 modification by consent to exclude central bank claims matched by deposits in the same currency and of identical or longer maturity from the definition of the total leverage exposure measure in the UK leverage ratio framework;

– increase the minimum leverage ratio requirement from 3% to 3.25% of total exposures; and

– align the UK leverage ratio reporting and disclosure requirements to the proposed definition of the total exposure measure and 3.25% minimum leverage ratio requirement.

If these modifications are applied to the Group, this results in an increase in the leverage ratio from 6.3% under CRD IV to 7.4% on the PRA modified basis as a result of the Group's significant exposures to central banks within its liquid asset portfolio and Note Cover.

(7) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
– £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
– £114m exposure reallocated from Corporates to Other items asset class.

5 Capital requirements

5.1 Capital management

The Group's Capital Risk Policy Standard provides the framework for the manner in which capital is managed within the Group. The objectives of the policy standard are to manage efficiently the capital base to optimise shareholder returns while maintaining robust capital adequacy, meeting regulators' requirements, managing the ratings agencies' assessment of the Group and ensuring that excessive leverage is not taken. A shortfall in capital resources would occur when the Group exceeds its risk appetite and is at risk of not having sufficient capital to support future growth objectives.

Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, which implemented CRD IV legislation with effect from 1 January 2014. The Group's approach to Pillar 1 is to use the standardised approaches to calculating RWAs. The standardised approaches are inherently conservative and the Group is developing the capability to utilise IRB methods for the calculation of credit risk capital. A waiver to utilise IRB models was submitted to the PRA during 2017.

A rigorous approach is taken to assess risks that are not adequately covered by Pillar 1, including interest rate risk and pension risk. The Group also undertakes a range of stress scenarios in order to test the impact on capital arising from severe yet plausible scenarios. These approaches to capital are thoroughly documented in the Group's ICAAP and this is subject to review, challenge and approval by the Board.

Capital buffers

The regulatory capital buffer framework is intended to ensure firms maintain a sufficient amount of capital above their regulatory minimum in order to withstand periods of stress. The UK is implementing the provisions on capital buffers outlined in the CRD to create combined capital buffers including a Capital Conservation Buffer (CCB); a Countercyclical Capital Buffer (CCyB); a Global Systemically Important Institution Buffer; and a Systemic Risk Buffer (SRB). In the UK, the CCB has been introduced with transitional provisions from 2016 (0.625%) to 2019 (2.5%).

The CCyB has been effective from 1 May 2014 and is dependent upon the BoE view of credit conditions in the economy. On 27 June 2017, the BoE Financial Policy Committee (FPC) increased the UK CCyB rate to 0.5%, from 0%, to take effect from 27 June 2018. Absent a change in the outlook, and consistent with its stated policy for a standard risk environment and of moving gradually, the FPC expects to increase the rate to 1% at its November 2017 meeting which will take effect in November 2018.

The Group's capital planning considers the impact of all relevant capital buffers.

The PRA's final rules on the approach to identifying other systemically important institutions were published in February 2016. In line with expectations, the Group's principal subsidiary, Clydesdale Bank PLC was not designated an O-SII. Similarly the FPC issued its final framework for setting the SRB in May 2016. This confirmed that banks with total assets of less than £175bn (which includes the Group) will be subject to a 0% SRB.

Minimum requirement for own funds and eligible liabilities

In November 2016, the BoE provided additional information on how MREL will be applied to firms that are subject to the use of resolution tools that the BoE would employ in the event of a firm entering resolution. From 1 January 2022, those firms, which include the Group, will be required to hold both their going-concern requirements together with additional MREL of an amount equal to those going concern requirements. The timetable for meeting MREL has been extended to 2022 and the BoE will review calibration and transition by the end of 2020, before setting end-state MREL. Interim MREL has been established for the transitional period.

Monitoring

The capital plan is approved by the Board on an annual basis. The Group's ALCO monitors the capital plan and forecast positions on a monthly basis. This ensures that performance trends are appropriately reviewed and that there is transparency on the impact on capital ratios, risk appetite and the future outlook.

Recent Developments

Information on banking reform, ring-fencing and resolution, all of which may impact the Group's capital and funding structures, are provided in the regulatory and political environment update in the Strategic report of the Group's Annual Report and Accounts.

5.2 Minimum capital requirement

To determine minimum capital requirements under the CRD IV Framework, the Group applies the standardised approach to measure credit risk and for operational risk. Under the approach the Group calculates its Pillar 1 capital requirement based on 8% of total RWAs. This covers credit risk, operational risk, counterparty credit risk and credit valuation adjustment (CVA). The table below sets out the risk weighted assets and Pillar 1 capital requirements of the Group.

Table 11: EU OV1 – Overview of risk weighted assets

		RWAs		Minimum capital requirements
		2017 £m	2016 £m	**2017 £m**
1	Credit risk (excluding CCR)	**17,442**	16,604	**1,395**
2	*Of which the standardised approach*	**17,442**	16,604	**1,395**
6	CCR	**305**	500	**24**
7	*Of which mark to market*	**138**	214	**11**
12	*Of which CVA*	**167**	286	**13**
23	Operational risk	**1,621**	1,623	**130**
25	*Of which standardised approach*	**1,621**	1,623	**130**
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	**310**	302	**25**
29	Total	**19,678**	19,029	**1,574**

The table below shows the Group's RWAs and capital requirements under Pillar 1.

Table 12: Pillar 1 capital requirements

	2017		2016	
Pillar 1 capital requirements	**RWA £m**	**Capital £m**	RWA £m	Capital £m
Central governments or central banks	**–**	**–**	–	–
Regional government or local authority	**19**	**2**	20	2
Public sector entities	**5**	**–**	5	–
Multilateral development banks	**–**	**–**	–	–
Institutions	**163**	**13**	234	19
Corporates[(8)]	**3,418**	**273**	3,419	273
Retail	**905**	**72**	897	72
Secured by mortgages on immovable property	**12,001**	**961**	11,242	897
Exposures in default	**590**	**47**	408	33
Items associated with particularly high risk	**40**	**3**	15	1
Covered bonds	**48**	**4**	19	2
Claims in the form of collective investment undertakings (CIU)	**1**	**–**	3	–
Equity exposures	**5**	**–**	11	1
Other items[(8)]	**557**	**45**	633	52
Total credit risk	**17,752**	**1,420**	16,906	1,352
Counterparty credit risk	**138**	**11**	214	17
Credit valuation adjustment	**167**	**13**	286	23
Operational risk	**1,621**	**130**	1,623	130
	19,678	**1,574**	19,029	1,522

The items included in the 'Other items' exposure class that attract a capital charge include items in the course of collection, fixed assets and DTAs which have not been deducted.

(8) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
- £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
- £114m exposure reallocated from Corporates to Other items asset class.

5 Capital requirements

The countercyclical capital buffer is an additional requirement, introduced by CRD IV, to the overall capital requirement of the Group. The tables below disclose relevant information for the calculation of the Group's countercyclical capital buffer as at 30 September 2017 in line with EBA/RTS/2014/17. As permitted by the RTS, as the Group's relevant foreign credit exposures are below 2% of aggregate risk weighted exposures the Group has chosen to allocate these to the UK.

Table 13: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

		2017											
		General credit exposures		**Trading book exposures**		**Securitisation exposures**		**Own funds requirements**					
		Exposure value for SA 010	**Exposure value for IRB 020**	**Sum of long and short positions of trading book exposures for SA 030**	**Value of trading book exposures for internal models 040**	**Exposure value for SA 050**	**Exposure value for IRB 060**	**Of which: General credit exposures 070**	**Of which: Trading book exposures 080**	**Of which: Securitisation exposures 090**	**Total 100**	**Own funds requirements weights 110**	**Countercyclical capital buffer rates 120**
Row		**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**		**%**
010	Breakdown by country: UK	**34,708**	**–**	**–**	**–**	**–**	**–**	**1,455**	**–**	**–**	**1,455**	**1.00**	**0.0%**
020	Total	**34,708**	**–**	**–**	**–**	**–**	**–**	**1,455**	**–**	**–**	**1,455**	**1.00**	**0.0%**

		2016											
		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
		Exposure value for SA 010	Exposure value for IRB 020	Sum of long and short positions of trading book exposures for SA 030	Value of trading book exposures for internal models 040	Exposure value for SA 050	Exposure value for IRB 060	Of which: General credit exposures 070	Of which: Trading book exposures 080	Of which: Securitisation exposures 090	Total 100	Own funds requirements weights 110	Countercyclical capital buffer rates 120
Row		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m		%
010	Breakdown by country: UK	32,548	–	–	–	–	–	1,388	–	–	1,388	1.00	0.0%
020	Total	32,548	–	–	–	–	–	1,388	–	–	1,388	1.00	0.0%

Table 14: Amount of institution-specific countercyclical capital buffer

Row		**2017 £m**
010	Total risk exposure amount	**19,678**
020	Institution specific countercyclical capital buffer rate	**0.0%**
030	Institution specific countercyclical capital buffer requirement	**–**

Row		2016 £m
010	Total risk exposure amount	19,029
020	Institution specific countercyclical capital buffer rate	0.0%
030	Institution specific countercyclical capital buffer requirement	–

6.1 Credit risk exposure: analysis by exposure class

As at 30 September 2017, the total credit risk exposures of the Group amounted to £56.5bn (2016: £48.6bn). The overall capital requirement for credit risk has increased by 5.0% from £1,352m in 2016 to £1,420m in 2017.

The table below shows movements in credit risk RWAs from 1 October 2016 to 30 September 2017, with movements ascribed to changes in book size, book quality and methodology.

Table 15: Credit risk RWAs

	Credit risk RWAs £m
RWAs at 1 October 2016	16,906
Book size growth	726
Book quality improvement	(28)
Methodology and policy[9]	148
RWAs at 30 September 2017	**17,752**

Credit risk exposures by exposure class are provided in the table below, together with the associated average credit risk exposure.

Table 16: Credit risk exposure by exposure class[10]

The credit risk exposures at 30 September 2017 and the average for the year are summarised as follows:

	2017		2016	
Exposure class	**Credit risk exposure £m**	**Average credit risk exposure £m**	Credit risk exposure £m	Average credit risk exposure £m
Central governments or central banks[11]	**12,948**	**10,036**	8,139	7,747
Regional government or local authority	**496**	**504**	527	580
Public sector entities	**196**	**127**	63	29
Multilateral development banks	**205**	**211**	195	174
Institutions	**1,465**	**1,573**	1,345	1,064
Corporates[11]	**6,120**	**6,260**	6,001	5,951
Retail	**3,077**	**3,051**	3,053	3,126
Secured by mortgages on immovable property	**30,395**	**29,291**	28,046	27,750
Exposures in default	**510**	**501**	346	368
Items associated with particularly high risk	**40**	**31**	15	10
Covered bonds	**477**	**400**	191	48
Claims in the form of CIU	**1**	**2**	4	4
Equity exposure	**3**	**19**	9	11
Other items[11]	**586**	**585**	627	936
Total	**56,519**	**52,591**	48,561	47,798

Total exposure value for credit risk as at 30 September 2017 was 16.4% higher compared to 30 September 2016. The increase in the Central Governments and Central Bank credit risk exposure class between reporting periods is due to increased repurchase (repo) and similar transactions outstanding at 30 September 2017 (including Term Funding Scheme drawings). The increase in the Institutions credit risk exposure class between reporting periods is due to an increase in the reimbursement receivable from NAB in relation to the conduct indemnity deed (described further in note 3.14 of the Group's Annual Report and Accounts).

The exposure amounts disclosed are pre-application of credit risk mitigation and pre-application of credit conversion factors, unless otherwise stated. This contrasts with the exposures disclosed within the Risk report in the Group's Annual Report and Accounts for the year ended 30 September 2017, which are disclosed before any relevant credit risk mitigation and after credit conversion factors have been applied.

(9) Methodology and policy represents a change to the definition of default which was enhanced to capture a broader interpretation of the regulatory requirements as part of the Groups' programme of activity to prepare for IRB which led to an increase in RWAs. This change does not reflect any movement in the underlying risk profile of the portfolio.
(10) Average credit risk exposure is calculated using the previous four quarters exposure per the EBA's Common Reporting 'Credit Risk Standardised Approach' returns.
(11) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
– £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
– £114m exposure reallocated from Corporates to Other items asset class.

Table 17: Credit risk exposure by industry

The table below shows credit risk exposure by the customer industry classification, including SME exposures. The regulatory SME definition is based on customers with an annual turnover not exceeding EUR 50m. This is consistent with the SME definition in CRR article 501, which states that among the criteria listed in Commission Recommendation 2003/361/EC (concerning the definition of micro, small- and medium-sized enterprises) only the annual turnover is to be taken into account. The table below is based on the customer industry identifier used for credit risk purposes and may differ from classifications used for other external reporting.

As at 30 September 2017

Exposure type	Government and public authorities £m	Agriculture forestry, fishing and mining £m	Financial, investment and insurance £m	Real estate – construction £m	Manu-facturing £m	Personal lending £m	Real estate – mortgage £m	Asset and lease financing £m	Other commercial and industrial £m	Non-customer assets £m	**Total £m**
Central governments or central banks	2,889	–	10,059	–	–	–	–	–	–	–	**12,948**
Regional government or local authority	496	–	–	–	–	–	–	–	–	–	**496**
Public sector entities	177	–	–	–	–	–	–	–	19	–	**196**
Multilateral development banks	–	–	205	–	–	–	–	–	–	–	**205**
Institutions	–	–	1,465	–	–	–	–	–	–	–	**1,465**
Corporates	–	445	360	220	1,037	–	–	316	3,742	–	**6,120**
Retail	–	–	–	–	–	3,077	–	–	–	–	**3,077**
Secured by mortgages on immovable property	–	1,586	21	51	243	–	25,607	19	2,868	–	**30,395**
Exposures in default	–	92	–	1	13	20	241	–	143	–	**510**
Items associated with particularly high risk	–	–	–	–	–	–	–	–	40	–	**40**
Covered bonds	–	–	477	–	–	–	–	–	–	–	**477**
Claims in the form of CIU	–	–	–	–	–	–	–	–	1	–	**1**
Equity exposures	–	–	–	–	–	–	–	–	3	–	**3**
Other items	123	–	218	–	–	–	1	–	50	194	**586**
Total exposure	3,685	2,123	12,805	272	1,293	3,097	25,849	335	6,866	194	**56,519**
Of which: SME	–	1,847	110	195	896	–	–	190	4,126	–	**7,364**

As at 30 September 2016

Exposure type	Government and public authorities £m	Agriculture forestry, fishing and mining £m	Financial, investment and insurance £m	Real estate – construction £m	Manu-facturing £m	Personal lending £m	Real estate – mortgage £m	Asset and lease financing £m	Other commercial and industrial £m	Non-customer assets £m	Total £m
Central governments or central banks(12)	2,469	–	5,670	–	–	–	–	–	–	–	8,139
Regional government or local authority	527	–	–	–	–	–	–	–	–	–	527
Public sector entities	45	–	–	–	–	–	–	–	18	–	63
Multilateral development banks	–	–	195	–	–	–	–	–	–	–	195
Institutions	–	–	1,345	–	–	–	–	–	–	–	1,345
Corporates(12)	–	460	201	269	1,069	–	–	283	3,719	–	6,001
Retail	–	–	–	–	–	3,053	–	–	–	–	3,053
Secured by mortgages on immovable property	–	1,646	24	53	274	–	23,501	16	2,532	–	28,046
Exposures in default	–	33	1	3	5	14	162	–	128	–	346
Items associated with particularly high risk	–	–	–	–	–	–	–	–	15	–	15
Covered bonds	–	–	191	–	–	–	–	–	–	–	191
Claims in the form of CIU	–	–	–	–	–	–	–	–	4	–	4
Equity exposures	–	–	–	–	–	–	–	–	9	–	9
Other items(12)	121	–	289	–	–	–	1	–	81	135	627
Total exposure	3,162	2,139	7,916	325	1,348	3,067	23,664	299	6,506	135	48,561
Of which: SME	–	1,905	102	178	872	–	–	179	3,831	–	7,067

(12) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
- £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
- £114m exposure reallocated from Corporates to Other items asset class.

6.2 Credit risk exposure: analysis by residual maturity

Table 18: Credit risk exposure by residual maturity

	At 30 September 2017				
Exposure type	<=1 year £m	>1 year, <=5 years £m	>5 years £m	Undated £m	**Total £m**
Central governments or central banks	7,283	2,735	1,215	1,715	**12,948**
Regional government or local authority	484	1	11	–	**496**
Public sector entities	51	130	15	–	**196**
Multilateral development banks	50	155	–	–	**205**
Institutions	695	10	2	758	**1,465**
Corporates	3,503	2,194	396	27	**6,120**
Retail	2,399	574	104	–	**3,077**
Secured by mortgages on immovable property	2,990	3,377	24,028	–	**30,395**
Exposures in default	155	120	235	–	**510**
Items associated with particularly high risk	9	17	14	–	**40**
Covered bonds	95	200	182	–	**477**
Claims in the form of CIU	–	1	–	–	**1**
Equity exposures	2	–	1	–	**3**
Other items	–	–	–	586	**586**
Total	**17,716**	**9,514**	**26,203**	**3,086**	**56,519**

	At 30 September 2016				
Exposure type	<=1 year £m	>1 year, <=5 years £m	>5 years £m	Undated £m	Total £m
Central governments or central banks(13)	5,629	21	1,285	1,204	8,139
Regional government or local authority	515	1	11	–	527
Public sector entities	63	–	–	–	63
Multilateral development banks	–	170	25	–	195
Institutions	180	600	2	563	1,345
Corporates(13)	3,373	2,333	295	–	6,001
Retail	2,399	566	88	–	3,053
Secured by mortgages on immovable property	2,561	2,875	22,610	–	28,046
Exposures in default	120	85	141	–	346
Items associated with particularly high risk	10	5	–	–	15
Covered bonds	20	145	26	–	191
Claims in the form of CIU	–	–	4	–	4
Equity exposures	9	–	–	–	9
Other items(13)	–	–	–	627	627
Total	14,879	6,801	24,487	2,394	48,561

The maturity of exposures is shown on a contractual basis rather than the actual redemptions experienced by the Group. Undrawn values have been allocated to the contractual maturity of the underlying exposure.

(13) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
– £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
– £114m exposure reallocated from Corporates to Other items asset class.

6.3 Credit risk exposure: analysis by geography

Table 19: Credit risk exposure by geography

	At 30 September 2017		
Exposure type	UK £m	Other £m	**Total £m**
Central governments or central banks	12,948	–	**12,948**
Regional government or local authority	496	–	**496**
Public sector entities	51	145	**196**
Multilateral development banks	–	205	**205**
Institutions	1,091	374	**1,465**
Corporates	6,097	23	**6,120**
Retail	3,068	9	**3,077**
Secured by mortgages on immovable property	30,359	36	**30,395**
Exposures in default	510	–	**510**
Items associated with particularly high risk	40	–	**40**
Covered bonds	477	–	**477**
Claims in the form of CIU	1	–	**1**
Equity exposures	3	–	**3**
Other items	586	–	**586**
Total exposure	**55,727**	**792**	**56,519**

	At 30 September 2016		
Exposure type	UK £m	Other £m	Total £m
Central governments or central banks[14]	8,118	21	8,139
Regional government or local authority	527	–	527
Public sector entities	63	–	63
Multilateral development banks	–	195	195
Institutions	1,315	30	1,345
Corporates[14]	6,000	1	6,001
Retail	3,040	13	3,053
Secured by mortgages on immovable property	28,005	41	28,046
Exposures in default	346	–	346
Items associated with particularly high risk	15	–	15
Covered bonds	191	–	191
Claims in the form of CIU	4	–	4
Equity exposures	9	–	9
Other items[14]	627	–	627
Total exposure	48,260	301	48,561

Credit risk exposures outside of the UK arising on lending are not material and have been classified as 'Other'. The geographical location is based on the physical location of the counterparty with which the Group deals. In some cases this may differ from the location of the counterparty's ultimate parent company. Exposures arising on supranational bonds issued by multilateral development banks are held as part of the Group's liquidity buffer. In line with guidance issued by the EBA, these have been classified to the geographical area 'Other' irrespective of the location of the issuer.

(14) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
- £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
- £114m exposure reallocated from Corporates to Other items asset class.

6.4 Impaired lending and provisions

6.4.1 Definition

The following definitions are employed:

- past due but not impaired: loans that are in arrears but have not been individually assessed as impaired;
- impaired: loans which have been individually assessed for impairment as there is objective evidence of impairment, including changes in customer circumstances;
- impairment provisions: a provision held on-balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level;
- a collective impairment provision: an impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- specific provision: relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.

6.4.2 Managing impaired exposures and impairment provisions

Provisioning policy

The management of impaired assets, the setting of impairment provisions and the write-off of impaired assets are included with the Group's Credit Policy and Procedures, and are reviewed on an annual basis. The treatment of impaired assets is determined by the Risk function and the calculation of impairment provisions aligns with current accounting policy, as agreed with the Finance function.

Accounting policy

The Group first assesses whether objective evidence of impairment exists individually for loans and advances that are individually significant, and individually or collectively for loans and advances that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment. The amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is included in the income statement.

For the purposes of a collective evaluation of impairment, loans and advances are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated. The Group uses historical loss experience and its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process.

Adequacy reviews

All impaired lending assets are reviewed on a continual basis and must be formally reviewed at least quarterly.

All non-impaired lending is subject to a collective assessment for pools of assets with similar credit risk characteristics where no objective evidence of impairment exists. The provisioning policy requires impairment losses to be based on events which have already taken place and prevailing economic conditions.

Reporting

The formal reporting of impaired lending, provisions and associated relevant asset quality metrics and trends are completed on a monthly basis and distributed to the appropriate portfolio managers, Senior Managers, Executive Committees, Risk Committee and Board.

The Group reviews, at least bi-annually, its provision reserves against actual experience to identify whether its policies have resulted in over or under provisioning across the economic cycle. The responsibility for the review rests with the Risk function which reports its findings and recommendations to the Risk Committee, and the Board.

Management of customers experiencing financial difficulties

Information and analysis on the measures adopted by the Group to support customers experiencing financial difficulties are detailed in the Risk Report section of the Group's Annual Report and Accounts.

6.5 Analysis of past due and impaired loans and advances to customers

As at 30 September 2017, past due but not impaired exposures in respect of loans and advances to customers amounted to £513m (Sep 2016: £473m). Impaired exposures in respect of loans and advances to customers amounted to £179m (including £4m of fair value loans) (Sep 2016: £233m, including £19m of fair value loans).

6.6 Analysis by industry sector

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers, by industry sector, is provided in the table below:

Table 20: All past due and impaired loans and advances to customers by industry

As at 30 September	2017 Past due but not impaired £m	2017 Impaired £m	2016 Past due but not impaired £m	2016 Impaired £m
Agriculture, forestry, fishing and mining	**68**	**19**	64	20
Asset and lease financing	**16**	**6**	5	3
Financial, investment and insurance	**1**	**–**	2	–
Personal lending	**37**	**–**	33	–
Manufacturing	**6**	**3**	6	22
Other commercial and industrial	**56**	**101**	76	121
Real estate – construction	**2**	**1**	2	1
Real estate – mortgage	**327**	**49**	285	66
Total	**513**	**179**	473	233

6.7 Analysis by geography

All past due but not impaired loans and advances to customers and impaired loans and advances to customers are categorised as being in the United Kingdom. All closing impairment provisions, the net charge to the income statement, and advances written off in respect of loans and advances to customers are categorised as being in the United Kingdom.

6.8 Analysis of impairment provisions in respect of loans and advances to customers

The movement in impairment provisions, from 1 October 2016 to 30 September 2017, is provided below:

Table 21: The movement in impairment provisions (includes fair value)

	Specific provisions		Collective provisions		Total provisions	
	2017 £m	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Opening balance	**72**	103	**167**	165	**239**	268
Other adjustments[15]	**(3)**	(3)	**–**	–	**(3)**	(3)
Advances written off	**(75)**	(71)	**–**	–	**(75)**	(71)
Recoveries of advances written off in previous years	**18**	18	**–**	–	**18**	18
Charge to the income statement	**46**	25	**(4)**	2	**42**	27
Closing balance	**58**	72	**163**	167	**221**	239

6.9 Analysis by industry

The movement in total impairment provisions, from 1 October 2016 to 30 September 2017, by industry sector is provided below:

Table 22: Analysis of impairment provisions by industry (including fair value)

As at 30 September	2017 Impairment provisions £m	2017 Net charge £m	2017 Advances written off £m	2016 Impairment provisions £m	2016 Net charge £m	2016 Advances written off £m
Agriculture, forestry, fishing and mining	**22**	**1**	**(1)**	23	4	(3)
Asset and lease financing	**7**	**7**	**–**	2	1	–
Financial, investment and insurance	**2**	**–**	**–**	2	2	(3)
Personal lending	**24**	**11**	**(28)**	19	7	(27)
Manufacturing	**17**	**12**	**(17)**	22	8	(8)
Other commercial and industrial	**113**	**13**	**(24)**	129	4	(27)
Real estate – construction	**3**	**–**	**(1)**	3	–	(1)
Real estate – mortgage	**33**	**(2)**	**(4)**	39	1	(2)
Total	**221**	**42**	**(75)**	239	27	(71)

(15) Other adjustments relate to transfers to Net Present Value Provision Amortisation and Fair Value Accounting Adjustments.

6.10 Use of External Credit Assessment Institutions (ECAIs)

The Group makes limited use of credit assessments by ECAIs in assigning risk weights to credit risk exposures under the standardised approach. This typically applies in the case of certain Central Government, Central Bank and Institution exposures.

The appropriate risk weight to apply to the credit risk exposure is determined by assigning the exposure to the relevant credit quality step under CRR Part 3, Title II, Chapter 2 (Standardised Credit Risk), based on the EBA's mapping of credit assessments to credit quality steps. Where appropriate, the Group makes use of credit assessments provided by Moody's.

Table 23 below, shows a breakdown of exposures under the standardised approach pre and post application of credit conversion factors (CCF) and credit risk mitigation (CRM). Table 24 shows a breakdown of exposures post CCF and post CRM. For retail exposures secured by mortgages the protection effect of mortgage collateral is intrinsically part of the definition of the original exposure class.

Table 23: EU CR4 – Standardised approach – credit risk exposure and CRM effects

		2017					
		Exposures before CCF and CRM		**Exposures post CCF and CRM**		**RWAs and RWA density**	
	Exposure classes	**On-balance sheet amount £m**	**Off-balance sheet amount £m**	**On-balance sheet amount £m**	**Off-balance sheet amount £m**	**RWAs £m**	**RWA density[16] %**
1	Central governments or central banks	**12,947**	**1**	**10,502**	**–**	**–**	**0**
2	Regional government or local authority	**71**	**425**	**12**	**85**	**19**	**20**
3	Public sector entities	**145**	**51**	**145**	**10**	**5**	**3**
4	Multilateral development banks	**205**	**–**	**205**	**–**	**–**	**0**
6	Institutions	**1,440**	**25**	**595**	**13**	**163**	**27**
7	Corporates	**3,016**	**3,104**	**2,924**	**775**	**3,418**	**92**
8	Retail	**1,134**	**1,943**	**1,134**	**73**	**905**	**75**
9	Secured by mortgages on immovable property	**27,489**	**2,906**	**27,452**	**712**	**12,001**	**43**
10	Exposures in default	**473**	**37**	**473**	**10**	**590**	**122**
11	Items associated with particularly high risk	**15**	**25**	**15**	**11**	**40**	**150**
12	Covered bonds	**477**	**–**	**477**	**–**	**48**	**10**
14	Claims in the form of CIU	**1**	**–**	**1**	**–**	**1**	**100**
15	Equity exposures	**3**	**–**	**3**	**–**	**5**	**145**
16	Other items	**586**	**–**	**585**	**–**	**557**	**95**
17	Total	**48,002**	**8,517**	**44,523**	**1,689**	**17,752**	**38**

Explanations on key movements in exposure classes during the year are shown in section 6.1.

		2016					
		Exposures before CCF and CRM		Exposures post CCF and CRM		RWAs and RWA density	
	Exposure classes	On-balance sheet amount £m	Off-balance sheet amount £m	On-balance sheet amount £m	Off-balance sheet amount £m	RWAs £m	RWA density[16] %
1	Central governments or central banks	8,138	1	7,599	–	–	0
2	Regional government or local authority	106	421	12	85	20	20
3	Public sector entities	–	63	–	13	5	41
4	Multilateral development banks	195	–	195	–	–	0
6	Institutions	1,322	23	875	15	234	26
7	Corporates	2,839	3,162	2,718	893	3,419	95
8	Retail	1,124	1,929	1,124	72	897	75
9	Secured by mortgages on immovable property	25,848	2,198	25,807	634	11,242	43
10	Exposures in default	337	9	338	2	408	120
11	Items associated with particularly high risk	7	8	7	3	15	150
12	Covered bonds	191	–	191	–	19	10
14	Claims in the form of CIU	2	2	2	1	3	100
15	Equity exposures	9	–	9	–	11	122
16	Other items	627	–	627	–	633	101
17	Total	40,745	7,816	39,504	1,718	16,906	41

(16) RWA density calculation has been performed on unrounded figures.

Table 24: EU CR5 – Standardised approach

		2017																
	Exposure classes	0% £m	2% £m	4% £m	10% £m	20% £m	35% £m	50% £m	70% £m	75% £m	100% £m	150% £m	250% £m	370% £m	1250% £m	Others £m	**Total £m**	**Of which unrated £m**
1	Central governments or central banks	10,502	–	–	–	–	–	–	–	–	–	–	–	–	–	–	**10,502**	**–**
2	Regional government or local authorities	–	–	–	–	97	–	–	–	–	–	–	–	–	–	–	**97**	**97**
3	Public sector entities	144	–	–	–	7	–	–	–	–	4	–	–	–	–	–	**155**	**10**
4	Multilateral development banks	205	–	–	–	–	–	–	–	–	–	–	–	–	–	–	**205**	**–**
6	Institutions	–	–	–	–	478	–	126	–	–	4	–	–	–	–	–	**608**	**69**
7	Corporates	–	–	–	–	109	–	–	–	–	3,590	–	–	–	–	–	**3,699**	**3,589**
8	Retail	–	–	–	–	–	–	–	–	1,207	–	–	–	–	–	–	**1,207**	**1,207**
9	Secured by mortgages on immovable property	–	–	–	–	–	24,226	–	–	189	3,749	–	–	–	–	–	**28,164**	**28,090**
10	Exposures in default	–	–	–	–	–	–	–	–	–	269	214	–	–	–	–	**483**	**483**
11	Higher-risk categories	–	–	–	–	–	–	–	–	–	–	26	–	–	–	–	**26**	**26**
12	Covered bonds	–	–	–	477	–	–	–	–	–	–	–	–	–	–	–	**477**	**–**
14	Collective investment undertakings	–	–	–	–	–	–	–	–	–	1	–	–	–	–	–	**1**	**1**
15	Equity	–	–	–	–	–	–	–	–	–	2	–	1	–	–	–	**3**	**3**
16	Other items	212	–	–	–	–	–	–	–	–	251	–	122	–	–	–	**585**	**354**
17	Total	11,063	–	–	477	691	24,226	126	–	1,396	7,870	240	123	–	–	–	**46,212**	**33,929**

Explanations on key movements in exposure classes during the year are shown in section 6.1.

		2016																
	Exposure classes	0% £m	2% £m	4% £m	10% £m	20% £m	35% £m	50% £m	70% £m	75% £m	100% £m	150% £m	250% £m	370% £m	1250% £m	Others £m	**Total £m**	**Of which unrated £m**
1	Central governments or central banks	7,599	–	–	–	–	–	–	–	–	–	–	–	–	–	–	7,599	–
2	Regional government or local authorities	–	–	–	–	97	–	–	–	–	–	–	–	–	–	–	97	97
3	Public sector entities	–	–	–	–	10	–	–	–	–	3	–	–	–	–	–	13	13
4	Multilateral development banks	195	–	–	–	–	–	–	–	–	–	–	–	–	–	–	195	–
6	Institutions	–	–	–	–	708	–	179	–	–	3	–	–	–	–	–	890	78
7	Corporates	–	–	–	–	1	–	–	–	–	3,610	–	–	–	–	–	3,611	3,594
8	Retail	–	–	–	–	–	–	–	–	1,196	–	–	–	–	–	–	1,196	1,196
9	Secured by mortgages on immovable property	–	–	–	–	–	22,730	–	–	116	3,595	–	–	–	–	–	26,441	26,436
10	Exposures in default	–	–	–	–	–	–	–	–	–	203	137	–	–	–	–	340	340
11	Higher-risk categories	–	–	–	–	–	–	–	–	–	–	10	–	–	–	–	10	10
12	Covered bonds	–	–	–	191	–	–	–	–	–	–	–	–	–	–	–	191	–
14	Collective investment undertakings	–	–	–	–	–	–	–	–	–	3	–	–	–	–	–	3	3
15	Equity	–	–	–	–	–	–	–	–	–	8	–	1	–	–	–	9	9
16	Other items	175	–	–	–	–	–	–	–	–	331	–	121	–	–	–	627	519
17	Total	7,969	–	–	191	816	22,730	179	–	1,312	7,756	147	122	–	–	–	41,222	32,295

6.11 Credit risk mitigation

The Group uses a range of approaches to mitigate credit risk. The Group has a RAS and comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries.

6.11.1 Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held can vary, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties with the proceeds used to reduce or repay the outstanding balance. In general, the Group does not occupy repossessed properties for its own business use.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of the default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional or indexed (subject to policy rules and confidence levels) valuations.

Commercial property

Commercial property is the Group's main source of collateral on SME lending and means of mitigating loss in the event of default. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

Non-property related collateral

In addition to residential and commercial property based security, the Group also takes other forms of collateral when lending. This can involve obtaining security against the underlying loan through the use of cash collateral and/or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt. Table 25 shows the non-property collateral held at 30 September 2017 in terms of cash and guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high credit quality).

Monitoring

Credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

- *Credit Risk Committee (CRC):* The CRC ensures that the credit RMF and associated policies remain effective. The Committee has oversight of the quality, composition and concentrations of the credit risk portfolio and considers strategies to adjust the portfolio to react to changes in market conditions.
- *RAS measures:* Measures are monitored monthly and reviewed bi-annually, at a minimum, to ensure that the measures accurately reflect the Group's risk appetite, strategy and concerns relative to the wider macro environment. All measures are subject to extensive engagement with the Executive Leadership Team and the Board, and are subject to endorsement from executive governance committees prior to Board approval. Regulatory engagement is also scheduled as appropriate.
- *Risk concentration:* Concentration of risk is managed by client/counterparty, product, geographical region and industry sector. In addition, single name exposure limits exist to control exposures to a single entity/counterparty. Concentrations are also considered through the RAS process focusing particularly on comparing the portfolio against market benchmarks.
- *Single large exposure excesses:* All excesses are reported to the Transactional Credit Committee (TCC) and relevant Head of Risk. Any exposure which continues or is expected to continue beyond 30 days will also be submitted to the TCC with proposals to correct the exposure within an agreed period, not to exceed 12 months.

The table below shows separately for each exposure class, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by (i) eligible collateral; and, (ii) guarantees.

Table 25: Use of credit risk mitigation techniques
As at 30 September

	2017		2016	
Exposure type	**Guarantees £m**	**Eligible collateral £m**	Guarantees £m	Eligible collateral £m
Central governments or central banks	**–**	**3,264**	–	721
Institutions	**–**	**874**	–	504
Corporates	**25**	**27**	40	49
Secured by mortgages on immovable property	**–**	**4**	–	6
Total	**25**	**4,169**	40	1,280

The increase in eligible collateral held and corresponding exposure is due to increased repurchase (repo) and similar transactions outstanding at 30 September 2017 (including TFS drawings), reflected within Central Governments or Central Banks. The increase in cash collateral held and corresponding exposure in financial institutions is due to an increase in the reimbursement receivable from NAB in relation to the conduct indemnity deed (described further in note 3.14 of the Group's Annual Report and Accounts).

Corporates is the largest sector utilising other risk mitigation techniques, with all three methods utilised dependent on credit quality. The extent to which these will be used is dependent on the specific circumstances of the customer. As at 30 September 2017 the Group held £135m of collateral in relation to on-balance sheet netting (2016: £164m).

6.11.2 Treasury

Derivatives

The Group maintains control limits on net open derivative positions. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which, in relation to derivatives, may only be a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk is managed as part of the customers overall exposure together with potential exposures from market movements.

Master netting agreements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with whom it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that, if any counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis. Derivative financial instrument contracts are typically subject to the International Swaps and Derivatives Association (ISDA) master netting agreements, as well as Credit Support Annexes (CSA), where relevant, around collateral arrangements attached to those ISDA agreements. Derivative exchange or clearing counterparty agreements exist where contracts are settled via an exchange or clearing house.

7 Operational risk

7.1 Approach to monitoring and mitigating exposures

Losses may result from both internal and external events, and are categorised using risk categories aligned to Basel II. The Basel II categories are used to ensure that data can be reported externally and compared with other industry data.

The Group has identified, assessed and is currently monitoring all key operational risks across the above noted categories, including undertaking an assessment of control effectiveness, monitoring trends in key risk indicators and escalating events, in accordance with policy requirements.

Stress testing

The Group undertakes scenario analysis to gain insights into the stresses the business could be subject to in the event of this type of operational risk materialising. The Group maintains a suite of operational risk scenarios covering top operational risks relevant to its business. As part of the scenario analysis approach, the suite of operational risk scenarios are reviewed and updated on a regular basis for existing potential impacts and identification of potential new risk events. Management then document a proposed response to identify how the scenarios would be managed and monitored if they occurred.

Risk category

Operational resilience risk	The risks associated with the ability of the Group to quickly adapt to disruptions while maintaining continuous business operations and safeguarding people, assets and overall brand equity, even in the face of adverse events, shocks and chronic or incremental changes.
Information technology risk	The risks associated with inadequate and failed information technology processes and components (including hardware, software and networking components).
Change risk	The risks associated with a failure to execute and deliver change that could result in an inability to meet our strategic objectives, including failing to meet our customer, regulator, colleague, or shareholders' expectations, at a Group level and local management level.
Third-party risk	The risks associated with ensuring the Group's outsourced and offshoring arrangements are controlled effectively, including the risk of failure to service existing and new customers, and the potential cessation of specific activities, or the risk of personally identifiable information or Group sensitive data being exposed or exploited, or the risk of financial, reputational and regulatory censure if the third party enters into any illegal or unethical activities.
Data risk	The risks associated with the accuracy, management and use of data that underpins decision-making at every level across the organisation.

7.2 Measurement

The Group calculates its operational risk capital requirements under the standardised approach. The capital requirement is calculated using the historic three year average risk weighted income method where different income streams are allocated a different risk weighting.

7.3 Operational risk RWAs and capital requirement

The capital requirement calculated under the standardised approach at 30 September 2017 was £130m (2016: £130m). The capital charge is included in Table 12.

The table below shows movements in RWAs for operational risk from 1 October 2016 to 30 September 2017.

Table 26: Operational risk RWAs

Operational risk RWAs	£m
As at 1 October 2016	1,623
Movement	(2)
As at 30 September 2017	**1,621**

The decrease in RWAs for operational risk is due to the decrease in revenue generated by the Group over the last three years compared to the three years prior to 30 September 2016. The Group recognises the limitations of the standardised approach and applies a more granular firm specific assessment as part of Pillar 2.

8 Counterparty credit risk

8.1 Definition

The Group provides products to its customers in order to manage their interest rate, currency and commodity risk, and the Group in turn hedges this risk with other financial counterparties. In addition, the Group enters into sale and repurchase agreements with other financial counterparties for the purpose of liquidity risk management and funding.

Derivative and repo transactions give rise to credit exposures to counterparties. Counterparty credit risk (CCR) is the risk that a counterparty to a transaction may default before the final settlement of the transaction's cash flows. This section describes the Group's approach to managing CCR concerning financial instruments, including derivatives and repurchase agreements.

8.2 Internal capital and credit limits

Counterparty credit limits for derivatives are approved and assigned by an appropriately authorised Delegated Commitment Authority (DCA). Limits are based on the credit quality of the counterparty and the appetite for the projected maximum potential future exposure of anticipated derivative transactions. They also reflect the nature of the relevant documentation, including whether or not the transaction is subject to regular exchange of margin. Credit exposures for each transaction are measured as the current mark-to-market value and the potential credit exposure which is an estimate of possible future changes in mark-to-market value replacement cost. Limit excesses, whether they are active or passive, are subject to formal approval by a DCA.

8.3 Securing collateral and establishing credit reserves

The risk that counterparties could default is mitigated by offsetting the amounts due to the same counterparties (i.e. netting) and by cash collateral deposited by counterparties (i.e. collateralisation).

Collateralisation reduces the credit exposure recorded against market transactions. Counterparty credit exposures may be collateralised by an approved list of eligible collateral via market standard master agreements (such as CSAs to ISDA Master Agreements and Global Master Repurchase Agreements). CCR policy governs types of acceptable collateral and that collateral which may be subject to haircuts depending on asset type. Systems support daily marking-to-market of net exposures and margin requirements, marking-to-market of collateral value and reconciliation of collateral receipt and holdings against collateral due.

8.4 Wrong way risk

Wrong way risk occurs when exposure to a counterparty increases when the credit quality of that counterparty deteriorates. This could happen, for example, where CCR is mitigated through the use of collateral issued by the counterparty. Our high quality collateral requirements mitigate this risk to a material extent. This is not considered to be a material risk to the Group due to the types of credit mitigation that are in place.

8.5 Downgrade impact

The Group calculates, as part of its regular liquidity reporting, the amount of any additional collateral that would have to be posted in the event of a downgrade in its external rating. For transactions that would be affected by a downgrade clause, planning for, and the impact of, the event for the Group is managed by the Group's Treasury division.

8.6 Exposures

Counterparty credit risk exposures are first measured using the mark-to-market method and subsequently risk weighted under the standardised approach. The Group calculates a CVA on external derivative transactions with financial counterparties. The Group has no exposures to credit derivatives as at 30 September 2017 (30 September 2016: £nil).

8.7 Counterparty credit risk exposures

An analysis by measurement approach, by exposure class, by risk weight approach and by contract type is presented in the table below:

Table 27: Counterparty credit risk exposure

	2017 Exposure £m	2017 RWA £m	2016 Exposure £m	2016 RWA £m
Mark to market approach:				
Interest rate contracts	**234**	**66**	312	99
Foreign exchange contracts	**153**	**67**	198	102
Commodities contracts	**5**	**5**	13	13
	392	**138**	523	214

The table below presents a breakdown of counterparty credit risk exposures by exposure class and by risk weight.

Table 28: EU CCR3 – Standardised approach – CCR exposures by regulatory portfolio and risk

2017

	Exposure classes	0% £m	2% £m	4% £m	10% £m	20% £m	50% £m	70% £m	75% £m	100% £m	150% £m	Others £m	**Total £m**	**Of which unrated £m**
6	Institutions	–	–	–	–	296	33	–	–	–	–	–	**329**	**–**
7	Corporates	–	–	–	–	–	–	–	–	63	–	–	**63**	**63**
11	Total	–	–	–	–	296	33	–	–	63	–	–	**392**	**63**

2016

	Exposure classes	0% £m	2% £m	4% £m	10% £m	20% £m	50% £m	70% £m	75% £m	100% £m	150% £m	Others £m	Total £m	Of which unrated £m
6	Institutions	–	–	–	–	361	40	–	–	1	–	–	402	1
7	Corporates	–	–	–	–	–	–	–	–	121	–	–	121	121
11	Total	–	–	–	–	361	40	–	–	122	–	–	523	122

8.8 Net derivatives credit exposure

Details of the net derivatives credit exposure are set out below:

Table 29: Net derivatives credit exposure

As at 30 September	**2017 £m**	2016 £m
Gross positive fair value of contracts	**282**	585
Potential future credit exposure	**357**	270
Netting benefits	**(216)**	(277)
Net current credit exposures	**423**	578
Collateral pledged	**(31)**	(55)
Net derivative credit exposure	**392**	523

CRD IV introduced a regulatory capital charge to cover credit valuation adjustment risk, the risk of adverse moves in the credit valuation adjustments taken for expected credit losses on derivative transactions. Certain counterparty exposures are exempt from CVA, such as non-financial counterparties and sovereigns. Details of the CVA capital charge are set out below:

Table 30: Credit valuation adjustment capital charge

	2017 Exposure £m	2017 RWA £m	2016 Exposure £m	2016 RWA £m
All portfolios subject to the standardised CVA capital charge	**329**	**167**	402	286
	329	**167**	402	286

9 Market risks

9.1 Exposures

The focus of the Group's activity is to provide high-quality banking services to its customers. These services include the provision of foreign exchange products and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. Controls include the hedging of these products as and when they arise.

9.2 Measurement

Interest rate risk in the banking book (IRRBB) is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings-based approaches. In accordance with the Group IRRBB Policy Standard risk measurement techniques include: basis point sensitivity; value at risk (VaR), earnings at risk (EaR), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- the use of basis point sensitivity analysis;
- VaR and EaR are measured on a statistical basis: 99% confidence level with appropriate holding periods depending on varying risk types;
- historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short- or long-term interest rates;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- investment term for capital is modelled with a benchmark term agreed by ALCO;
- investment term for core non-interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by ALCO; and
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO.

Foreign exchange risk is assessed based on the absolute exposure in each currency.

9.3 Mitigation measures

Market risks are overseen by ALCO with delegation for day-to-day management given to Treasury. Treasury use a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange. Basis risk is managed through a combination of wholesale market basis risk management products, pricing strategies and product innovation. As part of an objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest bearing deposits targeting the stability of net interest income. The use of derivatives gives rise to the need to apportion transactions into hedge relationships.

Fair value hedges

The Group hedges part of its existing interest rate risk, resulting from potential movements in the fair value of fixed rate assets and liabilities. The fair value of these swaps is disclosed in note 3.18 of the Group's Annual Report and Accounts. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate and foreign currency risk. The interest and foreign currency risk arise from variable interest rate assets and liabilities which are hedged using cross currency and interest rate swaps, and material non-GBP denominated assets which are hedged using foreign exchange forward contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the period as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed in note 3.18 of the Group's Annual Report and Accounts.

9.4 Monitoring

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of ALCO. Oversight of market risk is conducted by the Group's balance sheet and liquidity risk oversight team that is independent of the Treasury function. The Board and Executive Risk Committee, through ALCO's oversight, monitors risk to ensure it remains within approved policy limits and Board requirements.

The table below provides the increase or decrease in economic value for upward and downward rate shocks.

Table 31: Interest rate risk in the banking book

	2017		2016	
As at 30 September	**200bp parallel increase £m**	**200bp parallel decrease £m**	200bp parallel increase £m	200bp parallel decrease £m
Change in economic value	**8**	**(10)**	44	(48)

Note: Assuming that rates are floored at zero, the impact of the downward rate shock as at 30 September 2017 is £(14)m.

Treasury monitor basis point sensitivity of economic value on a daily basis, and all other limits no less frequently than monthly.

10 Securitisation

10.1 Objectives and roles in relation to securitisation activity

The Group has established two master trust Residential Mortgage Backed Security (RMBS) securitisation programmes which provide the Group with term funding via public debt capital markets and contingent liquidity. The master trust structure facilitates the issuance of multiple series of notes which can have differently rated tranches, tenor and repayment features tailored specifically to investor preference. Each series of notes is supported by the same pool of mortgage assets that can be replenished, subject to eligibility criteria, as the trust reduces in size due to prepayments.

The master trust structure comprises three Special Purpose Vehicles (SPVs) which legally isolate the underlying mortgage assets beyond the reach of the Group and its creditors in a bankruptcy, winding-up or receivership event. The three SPVs are:

- Mortgages Trustee: the purpose of which is to acquire mortgage assets and their related security from the Bank and Yorkshire Bank Home Loans Limited and hold such mortgage assets and their related security on trust;
- Funding: the purpose of which is to purchase a beneficiary share in the trust property, using the proceeds of an inter-company loan from the Master Issuer; and
- Master Issuer: the purpose of which is to issue RMBS notes which represent the mortgage-backed obligations, and to lend the note proceeds to Funding under the inter-company loan arrangements.

10.2 Roles

The Group's roles in the securitisation programmes are sponsor, originator, servicer, cash manager, asset swap provider(17) and transaction account provider. The obligations in these roles are outlined in the transaction documents in accordance with market practice and regulatory requirements.

The master trust structures are supported by fully funded reserve accounts that are sized according to rating agency requirements. The reserve accounts are funded from a subordinated loan from the Bank. The Bank also provides a start-up loan for each issuance. This loan provides for fees charged in relation to new issuances and is repaid from revenue receipts generated by the asset pool.

The Group is under no obligation to support any losses incurred by the securitisation programmes or noteholders. The principal and interest received from the mortgage assets are used to repay note principal and meet interest payments.

10.3 Associated risks

The Group has not sought to obtain regulatory capital relief from securitisation as significant risk transfer is not achieved. Capital is therefore calculated in accordance with the underlying risk weighting on the balance sheet. The principal risks within the securitised transformation are:

- credit risk: the risk that borrowers fail to meet their obligations as and when they fall due. This risk is assessed by credit rating agencies both at note issuances and on an ongoing basis. All Class A notes have Aaa credit ratings from Moody's, AAA from Fitch and AAA from Standard and Poor's (S&P). The Group monitors the performance of its mortgage book and the securitisation portfolio by assessing key metrics such as arrears, loan-to-value and geographic distributions;
- prepayment risk: the risk that Customers could prepay all or part of their outstanding debt before the maturity of outstanding bonds. This risk is factored into credit rating agencies cash flow models and is mitigated through mortgage substitution or pool replenishment;
- basis risk: there is a fixed-floating interest rate mismatch between the mortgage pool assets and the three month Sterling LIBOR linked intercompany loan. To mitigate this risk, Funding has entered into interest rate swap agreements;
- foreign exchange rate risk: there is a mismatch between the GBP denominated intercompany loan between Funding and Master Issuer, and the amounts payable to non-GBP denominated noteholders. This risk is mitigated by a balance guaranteed cross currency swap. Where there are non-GBP tranches, cross currency swaps have been executed with suitably rated counterparties to mitigate foreign exchange currency risk;
- call risk: there is a risk that any notes are not called on their respective call dates; and
- liquidity risk: there is a mismatch between the capital and interest payments on the underlying mortgage assets and the capital and interest payments through securitisation structures to investors.

The Group retains credit risks associated with the mortgage assets as these remain on-balance sheet. The risk to the programme is mitigated by the over collateralisation of mortgage assets, seller share and reserve accounts.

(17) The Bank is the asset swap provider for SVR loans for Lannraig Funding.

10.4 Issuer and retained positions

In August 2007, the Group launched the inaugural issuance from Lanark Master Trust (Lanark). The asset pool originally comprised of owner-occupied residential mortgage loans and a small amount of BTL loans. In June 2011, BTL loans were removed from the Lanark mortgage pool and replaced with owner-occupied residential mortgage loans.

To date, there have been nine issuances from Lanark. An external credit rating assessment is provided and monitored by Moody's, Fitch and S&P.

Credit enhancement for the securitisation structures is provided by a subordinated Class Z Variable Funding Note (Z VFN) representing specific reserves and excess spread. The Group retains the Class Z VFN in the form of an amortising note. The Group utilised the Lanark programme in July 2017 with the issuance of £1,550m GBP-denominated floating rate notes in Lanark 2017-1. £800m of the notes were retained by the Group.

In September 2011, the Group established Lannraig Master Trust (Lannraig). The asset pool is made up exclusively of BTL mortgage loans. To date, there have been two issuances from Lannraig. External credit rating assessments are provided by Moody's, Fitch and S&P. All outstanding Class A notes are rated AAA and have been sold or retained by the Group. Credit enhancement for the securitisation structures is provided by a subordinated Class Z VFN representing specific reserves and excess spread. The Group retains the Class Z VFN Note in the form of an amortising Z VFN.

Table 32: Outstanding notes

As at 30 September 2017, the outstanding notes are:

Issuer	Class A notes	Class Z notes	Total retained position
Lanark Master Issuer plc	£3,716m	£672m	£1,472m
Lannraig Master Issuer plc	£1,152m	£184m	£1,010m

Table 33: On-balance sheet securitised exposures

As at 30 September 2017, on-balance sheet securitised exposures are:

Issuer	Mortgage asset pool	Impaired and 90 days past due
Lanark Trustee Ltd	£4,844m	£24m
Lannraig Trustee Ltd	£1,338m	£9m

The SPVs are fully consolidated in the Group's Annual Report and Accounts.

The Group does not have any synthetic securitisations outstanding or any re-securitisations.

10.5 Securitisation accounting policies

The Bank has sold mortgages to the securitisation vehicles. However, these mortgages continue to be recognised on the Group's balance sheet. The mortgages do not qualify for de-recognition from the balance sheet because the Group remains exposed to the risks and rewards of ownership on an ongoing basis. It is exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration.

The externally held Class A Notes are disclosed in note 3.15 in the Group's Annual Report and Accounts. The Notes are initially recognised at fair value, being the issue proceeds net of transaction costs incurred, and are subsequently measured at amortised cost using the effective interest method. To avoid grossing up the balance sheet the retained Class A and Z Notes and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Bank or Group's Annual Report and Accounts.

11 Asset encumbrance

11.1 Overview

The term encumbrance is used to denote those assets on a bank's balance sheet which have been pledged as security, collateral or legally 'ring-fenced' in some other way which prevents the firm from being able to transfer, pledge, sell or otherwise use/dispose of these assets.

These disclosures are based on the EBA guidelines on disclosure of encumbered and unencumbered assets, the PRA's Supervisory Statement 11/14 and the 'Dear CFO' letter from the PRA dated December 2015.

11.2 Debt securities

Sale and repo transactions are used, in the ordinary course of business, to manage short-term cash flow requirements and mismatches. A repo transaction involves the pledge of marketable securities as security in exchange for receiving a deposit. During the period of the repo, the securities pledged become encumbered. The Group has entered into a number of repo agreements with a range of market counterparties.

In addition, the Group has an outstanding term repo transaction using self-issued RMBS notes as collateral. This transaction provides term funding to the Group.

The Bank is a direct participant in a number of payment and clearing systems, all of which require collateral to be posted to support its obligations. Where the collateral requirements are met with marketable securities, the securities pledged become encumbered.

11.3 Loans and advances – mortgage encumbrance

The Group has three structured funding programmes: two securitisation Master Trust structures as outlined in section 10 and one RCB programme (Clydesdale Covered Bonds No. 2 LLP), also backed by residential mortgages. Term funding issuance from these platforms results in a portion of the Group's mortgage assets becoming encumbered.

Over-collateralisation levels are embedded in each programme to meet the minimum levels as specified by the programme documents and as agreed with the ratings agencies and regulators to mitigate certain legal risks, such as set-off rights.

The SPVs also hold cash balances in segregated Guaranteed Investment Contract (GIC) bank accounts with NAB. The use of these balances is restricted to the repayment of debt securities issued by the SPVs and other legal obligations associated with these structures. These balances are, therefore, considered by the Group to be encumbered.

From time to time cash held in the GIC accounts is invested for a short term in Certificates of Deposit (CDs) issued by highly rated counterparties. The purpose of these transactions is to manage concentration risk. The use of these CDs is similarly restricted so they are also considered to be encumbered.

The Group has also utilised whole mortgage pools and self-issued RMBS notes with the Bank of England to support collateral requirements of central bank operations and for secured funding as part of the Bank of England's Term Funding Scheme. Assets utilised through these facilities are treated as encumbered. Additional information is provided in the Risk Report in the Group's Annual Report and Accounts, page 164.

11.4 Other assets

Note cover

Under Part 6 of the Banking Act 2009, banks in Scotland and Northern Ireland which issue bank notes are required at all times to hold backing assets equivalent to 100% of their bank notes in circulation. Banks may use a combination of Bank of England notes, UK coin and funds held in specific bank accounts at the Bank of England. As a result, note cover backing assets held with the Bank of England are considered to be encumbered assets. If note issuance increases then additional cash balances are required to be placed with the Bank of England. However, as this process creates equal and offsetting liabilities for the encumbered assets there is no material risk to depositors or the Group.

Cash ratio deposit

Cash Ratio Deposits are non-interest bearing deposits lodged with the Bank of England by eligible institutions (i.e. banks and building societies), who have reported average eligible liabilities of over £600m over a calculation period. The level of each institution's Cash Ratio Deposit is calculated twice-yearly (currently in May and November) at 0.18% of average eligible liabilities, over the previous six end-calendar months, in excess of £600m. Due to the permanent nature of the Cash Ratio Deposit, the requirement is considered to be an encumbered asset.

Cash margin

As noted above, a repo transaction involves the pledge of marketable securities in exchange for receiving a deposit. During the period of the repo, the market value of the securities pledged fluctuates whilst the value of the underlying cash deposit remains fixed. To account for the fluctuations in the market value of the securities, additional cash ('margin') is passed between the parties. Cash margin paid out by the Group in respect of repo transactions is treated as encumbered.

Likewise, where the Group has entered into a derivative transaction with another market counterparty, the market value of the derivative fluctuates with changes in market rates. To account for the fluctuations in market value, additional margin is passed between the parties. Cash margin paid out by the Group in respect of derivative transactions is treated as encumbered.

Payment system collateral
The Group (via the Bank) is a direct participant in a number of UK payment and clearing systems, all of which require collateral to be posted to support the Group's obligations. Collateral posted up to the minima required to pre-fund deferred net settlement payment systems is treated as encumbered. Balances in collateralisation accounts in excess of the minima required is not treated as encumbered.

The Group is a direct member of Trans-European Automated Real-time Gross Settlement Express Transfer (Target2). This is facilitated via an account held with the Dutch Central Bank which is funded as and when required to meet payments. The balance of this account is, therefore, treated as encumbered by the Group.

In general, intangible assets, deferred tax assets, derivative fair values and other assets are not considered to be available for encumbrance in the normal course of business. Additional information is provided in the Risk Report in the Group's Annual Report and Accounts, page 164.

11.5 Encumbered assets

The amounts disclosed in table 34 and table 35 below are median values for the financial year 2017 calculated using quarterly data.

Table 34 shows the carrying and, where included in the regulatory templates, the fair value of encumbered and unencumbered assets by asset category. Table 35 shows the carrying value of encumbered assets and associated liabilities by sources of encumbrance. The disclosures are in accordance with PRA/EBA regulatory reporting requirements and as such differ from the disclosures contained in the Group's Annual Report and Accounts as at 30 September 2017. Volatility in the level of encumbered assets is not significant and the use of monthly data is not expected to result in materially different information compared to the data below.

Table 34: Fair value of encumbered assets (Template A)

	2017			
	Carrying amount of encumbered assets £m	**Fair value of encumbered assets £m**	**Carrying amount of unencumbered assets £m**	**Fair value of unencumbered assets £m**
Assets of the reporting institutions	**12,871**		**27,815**	
Equity instruments	**–**	**–**	**15**	**15**
Debt securities	**225**	**225**	**1,793**	**1,793**
Other assets	**391**		**799**	

	2016			
	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Assets of the reporting institutions	10,201		29,125	
Equity instruments	–	–	10	10
Debt securities	118	118	1,454	1,454
Other assets	459		1,007	

Table 35: Encumbered assets/collateral received and associated liabilities (Template C)

	2017		2016	
	Matching liabilities, contingent liabilities or securities lent £m	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m**	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	**7,162**	**10,089**	5,092	7,681

The Group has elected to apply the waiver available under PRA Supervisory Statement 11/14 regarding disclosure of details of collateral received and therefore Template B has not been disclosed.

APPENDICES

Appendix 1: Disclosures for Clydesdale Bank PLC

The following tables present the disclosures required for the Bank on an individual consolidated basis. The differences between the Group and the Bank relate primarily to reserves held by entities that sit outside of the scope of the Bank solo consolidation that are included in the Group consolidation, a small impact from the risk weighted assets of these entities and AT1 capital issued by the Group.

Table 36: Capital composition

	As at 30 September	**2017 £m**	2016 £m
	Common Equity Tier 1 capital: Instruments and reserves		
1	Capital instruments and the related share premium accounts	**502**	324
1a	*Of which: ordinary shares*	**502**	324
2	Retained earnings	**2,555**	2,983
3	Accumulated other comprehensive income (and other reserves)	**312**	102
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(10)**	–
6	**Common Equity Tier 1 capital before regulatory adjustments**	**3,359**	3,409
	Common Equity Tier 1 capital: regulatory adjustments		
7	Additional value adjustments	**(4)**	(7)
8	Intangible assets	**(339)**	(256)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	**(110)**	(71)
11	Fair value reserves related to gains or losses on cash flow hedges	**(1)**	(67)
15	Defined benefit pension fund assets	**(135)**	–
19	Direct, indirect and synthetic holdings of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	–
25a	Losses for the current financial year (negative amount)	**(328)**	(617)
28	**Total regulatory adjustments to Common Equity Tier 1**	**(917)**	(1,018)
29	**Common Equity Tier 1 capital**	**2,442**	2,391
	Additional Tier 1 capital: instruments		
30	Capital instruments and the related share premium accounts	**425**	425
31	*Of which: classified as equity under applicable accounting standards*	**425**	425
36	**Additional Tier 1 capital before regulatory adjustments**	**425**	425
44	**Additional Tier 1 capital**	**425**	425
45	**Tier 1 capital**	**2,867**	2,816
	Tier 2 capital: Instruments and provisions		
46	Capital instruments and the related share premium accounts	**476**	479
50	Credit risk adjustments	**154**	151
51	**Tier 2 capital before regulatory adjustments**	**630**	630
58	**Tier 2 capital**	**630**	630
59	**Total capital**	**3,497**	3,446
60	**Total risk weighted assets**	**19,885**	18,873
	Capital ratios and buffers		
61	Common Equity Tier 1	**12.3%**	12.7%
62	Tier 1	**14.4%**	14.9%
63	Total capital	**17.6%**	18.3%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements plus a systemic risk buffer, plus systemically important institution buffer expressed as a percentage of total risk exposure amount)	**5.8%**	5.1%
65	*Of which: capital conservation buffer requirement*	**1.3%**	0.6%
66	*Of which: countercyclical buffer requirement*	**0.0%**	0.0%
67	*Of which: systemic risk buffer requirement*	**0.0%**	0.0%
67a	*Of which: Global Systemically Important Institution or Other Systemically Important Institution buffer*	**0.0%**	0.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**7.8%**	8.2%
	Applicable caps on the inclusion of provisions in Tier 2		
76	Credit risk adjustments included in Tier 2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**154**	151
77	Cap on inclusion of credit risk adjustments in Tier 2 under standardised approach	**227**	213

The Bank's individually consolidated CET1 ratio at 30 September 2017 is 12.3%, with the movement driven by similar factors as those driving the movement in the Group's ratio. The Bank's CET1 ratio is lower than the Group's as a result of higher RWAs. This is due to an exposure to the Bank's Holding Company under a Conduct Indemnity in favour of the Bank at 30 September 2017.

The table below shows movements in the Bank's capital during 2017.

Table 37: Capital flow statement

	2017 £m	2016 £m
Common Equity Tier 1 capital		
Common Equity Tier 1 capital at 1 October	**2,391**	2,355
Share capital: ordinary share new issuance	**178**	426
Share premium transfer	**–**	–
Retained earnings and other reserves	**(228)**	2,651
Prudent valuation adjustment	**3**	(5)
Intangible assets	**(83)**	(256)
Deferred tax assets relying on future profitability	**(39)**	202
Defined benefit pension fund assets	**(135)**	42
Share redenomination	**–**	(2,914)
Fair value reserves related to gains or losses on cash flow hedges	**66**	(67)
Losses for the current financial year	**289**	(361)
Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment	**–**	318
	2,442	2,391
Tier 1 capital		
Tier 1 capital at 1 October	**425**	450
Share capital repurchased: perpetual non-cumulative preference shares	**–**	(450)
Share capital issued: perpetual subordinated contingent convertible notes	**–**	425
	425	425
Total Tier 1 capital	**2,867**	2,816
Tier 2 capital		
Tier 2 capital at 1 October	**630**	613
Capital instruments repurchased: subordinated debt redemption	**–**	(475)
Capital instruments issued: subordinated debt	**–**	479
Credit risk adjustments	**3**	13
Other movements	**(3)**	–
	630	630
Total capital at 30 September	**3,497**	3,446

Tier 1 capital
The Bank's Tier 1 capital comprises:

– ordinary shares;

– retained earnings;

– accumulated other comprehensive income (and other reserves);

– AT1 instruments; and

– adjustments as set out by the regulatory requirements governing capital resources.

Regulatory adjustments are made where appropriate. These are made on a consistent basis as the Group, described in section 4.

Tier 2 capital
Tier 2 capital comprises:

– subordinated loan debt;

– eligible collective impairment allowances; and

– adjustments as set out by the regulatory requirements governing capital resources.

Table 38: CRD IV end-point vs transitional comparison

		Current rules		Full impact	
	As at 30 September	**2017 £m**	2016 £m	**2017 £m**	2016 £m
	Common Equity Tier 1 capital: Instruments and reserves				
1	Capital instruments and the related share premium accounts	**502**	324	**502**	324
1a	*Of which: ordinary shares*	**502**	324	**502**	324
2	Retained earnings	**2,555**	2,983	**2,555**	2,983
3	Accumulated other comprehensive income (and other reserves)	**312**	102	**312**	102
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(10)**	–	**(10)**	–
6	**Common Equity Tier 1 capital before regulatory adjustments**	**3,359**	3,409	**3,359**	3,409
	Common Equity Tier 1 capital: regulatory adjustments				
7	Additional value adjustments	**(4)**	(7)	**(4)**	(7)
8	Intangible assets (net of related tax liability)	**(339)**	(256)	**(339)**	(256)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	**(110)**	(71)	**(110)**	(71)
11	Fair value reserves related to gains or losses on cash flow hedges	**(1)**	(67)	**(1)**	(67)
15	Defined benefit pension fund assets	**(135)**	–	**(135)**	–
25a	Losses for the current financial year (negative amount)	**(328)**	(617)	**(328)**	(617)
28	**Total regulatory adjustments to Common Equity Tier 1**	**(917)**	(1,018)	**(917)**	(1,018)
29	**Common Equity Tier 1 capital**	**2,442**	2,391	**2,442**	2,391
	Additional Tier 1 capital: instruments				
30	Capital instruments and the related share premium accounts	**425**	425	**425**	425
31	*Of which: classified as equity under applicable accounting standards*	**425**	425	**425**	425
36	**Additional Tier 1 capital before regulatory adjustments**	**425**	425	**425**	425
44	**Additional Tier 1 capital**	**425**	425	**425**	425
45	**Tier 1 capital**	**2,867**	2,816	**2,867**	2,816
	Tier 2 capital: Instruments and provisions				
46	Capital instruments and the related share premium accounts	**476**	479	**476**	479
50	Credit risk adjustments	**154**	151	**154**	151
51	**Tier 2 capital before regulatory adjustments**	**630**	630	**630**	630
58	**Tier 2 capital**	**630**	630	**630**	630
59	**Total capital**	**3,497**	3,446	**3,497**	3,446
60	**Total risk weighted assets**	**19,885**	18,873	**19,885**	18,873
	Capital ratios and buffers				
61	Common Equity Tier 1	**12.3%**	12.7%	**12.3%**	12.7%
62	Tier 1	**14.4%**	14.9%	**14.4%**	14.9%
63	Total capital	**17.6%**	18.3%	**17.6%**	18.3%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements plus a systemic risk buffer, plus systemically important institution buffer expressed as a percentage of total risk exposure amount)	**5.8%**	5.1%	**7.0%**	7.0%
65	*Of which: capital conservation buffer requirement*	**1.3%**	0.6%	**2.5%**	2.5%
66	*Of which: countercyclical buffer requirement*	**0.0%**	0.0%	**0.5%**	0.0%
67	*Of which: systemic risk buffer requirement*	**0.0%**	0.0%	**0.0%**	0.0%
67a	*Of which: Global Systemically Important Institution or Other Systemically Important Institution buffer*	**0.0%**	0.0%	**0.0%**	0.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**7.8%**	8.2%	**7.8%**	8.2%
	Applicable caps on inclusion of provisions in Tier 2				
76	Credit risk adjustments included in Tier 2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**154**	151	**154**	151
77	Cap on inclusion of credit risk adjustments in Tier 2 under standardised approach	**227**	213	**227**	213

Table 39: Reconciliation of statutory equity to regulatory capital

	2017 £m	2016 £m
Statutory total equity	**3,466**	3,217
Less pension regulatory adjustments	**(135)**	–
Less additional value adjustment	**(4)**	(7)
Less intangible assets	**(339)**	(256)
Less deferred tax asset relying on future profitability	**(110)**	(71)
Less cash flow hedge	**(1)**	(67)
Additional Tier 1 foreseeable dividend	**(10)**	–
Regulatory Tier 1 capital	**2,867**	2,816
Statutory Tier 2 subordinated debt	**476**	479
Regulatory Tier 2 subordinated debt	**476**	479

The Bank's individual consolidated leverage ratio is calculated on a basis consistent with that of the Group, as set out in section 4.4. The tables below show the calculation of the leverage ratio for the Bank as at 30 September.

Table 40: LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

		2017 £m	2016 £m
1	Total assets as per published financial statements[18]	**42,895**	41,696
4	Adjustments for derivative financial instruments	**(245)**	(359)
5	Adjustments for securities financing transactions	**1,461**	601
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**2,019**	1,982
7	Other adjustments	**(589)**	(402)
8	Total leverage ratio exposure	**45,541**	43,518

(18) The Bank does not publish financial statements on an individual consolidation basis.

Appendix 1: Disclosures for Clydesdale Bank PLC

Table 41: LRCom: Leverage ratio common disclosure

		2017 £m	2016 £m
	On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**42,759**	41,308
2	(Asset amounts deducted in determining Tier 1 capital)	**(589)**	(402)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**42,170**	40,906
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)(19)	**83**	235
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)(19)	**146**	131
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(338)**	(337)
11	Total derivative exposures	**(109)**	29
	Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**5,235**	1,827
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	**(3,774)**	(1,226)
16	Total securities financing transaction exposures	**1,461**	601
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**8,519**	7,813
18	(Adjustments for conversion to credit equivalent amounts)	**(6,500)**	(5,831)
19	Other off-balance sheet exposures	**2,019**	1,982
	Capital and total exposures		
20	Tier 1 capital	**2,867**	2,816
21	Total leverage ratio exposures	**45,541**	43,518
	Leverage ratio		
22	Leverage ratio	**6.3%**	6.5%
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Fully phased in**	Fully phased in

(19) FY2016 comparatives have been represented for the following, with no impact to the leverage ratio: £56m of derivatives reallocated from replacement costs (line 4) to PFE add-on (line 5).

Table 42: LRSpl: Split-up of on-balance sheet exposures

		2017 £m	2016 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**42,759**	41,308
EU-3	Banking book exposures, of which:	**42,759**	41,308
EU-4	Covered bonds	**477**	191
EU-5	Exposures treated as sovereigns[20]	**8,158**	7,291
EU-6	Exposures to regional governments, multilateral development banks, international organisations and public sector entities NOT treated as sovereigns	**157**	12
EU-7	Institutions	**201**	324
EU-8	Secured by mortgages of immovable properties	**27,451**	25,807
EU-9	Retail exposures	**1,134**	1,124
EU-10	Corporate[20]	**3,179**	2,733
EU-11	Exposures in default	**472**	337
EU-12	Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)[20]	**1,530**	3,489

The following table shows the Bank's individual consolidated capital resources requirement under Pillar 1 as at 30 September 2017.

Table 43: Pillar 1 capital requirements

	2017		2016	
Pillar 1 capital requirements	RWA £m	Capital £m	RWA £m	Capital £m
Regional government or local authority	**19**	**2**	20	2
Public sector entities	**5**	**–**	5	–
Institutions	**104**	**8**	147	12
Corporates	**3,760**	**301**	3,547	284
Retail	**905**	**72**	897	72
Secured by mortgages on immovable property	**12,001**	**961**	11,241	899
Exposures in default	**590**	**47**	408	33
Exposures associated with particularly high risk	**40**	**3**	15	1
Covered bonds	**48**	**4**	19	2
Claims in the form of CIU	**1**	**–**	3	–
Equity exposures	**5**	**–**	26	2
Other items	**557**	**45**	518	41
Total credit risk	**18,035**	**1,443**	16,846	1,348
Counterparty credit risk	**99**	**8**	174	14
Credit valuation adjustment	**116**	**9**	248	20
Operational risk	**1,636**	**131**	1,605	128
	19,886	**1,591**	18,873	1,510

The differences between the credit RWAs for the Group and those of the Bank relate primarily to exposures arising within the Group's securitisation vehicles in relation to the GIC account, partially offset by intercompany exposures which exist at Bank level but not at Group level. The difference in RWAs for counterparty credit risk relates to derivatives within the Group's securitisation vehicles.

(20) FY2016 comparatives have been restated for the following with no impact to total RWAs or capital requirement:
- £1,100m of BoE backing assets reallocated from Other items to Central government or central banks asset class; and
- £114m exposure reallocated from Corporates to Other items asset class.

Appendix 2: Main features of regulatory capital instruments

1	Issuer	CYBG PLC	CYBG PLC	CYBG PLC	Clydesdale Bank PLC	Clydesdale Bank PLC	Clydesdale Bank PLC
2	ISIN	GB00BD6GN030	XS1346644799	XS1346646901	n/a	n/a	n/a
3	Governing law	English	English	English	English	English	English
Regulatory treatment							
4	Transitional CRR rules	Common Equity Tier 1	Additional Tier 1	Tier 2	Common Equity Tier 1	Additional Tier 1	Tier 2
5	Post-transitional CRR rules	Common Equity Tier 1	Additional Tier 1	Tier 2	Common Equity Tier 1	Additional Tier 1	Tier 2
6	Eligible at Group or Bank	CYBG Group	CYBG Group	CYBG Group	CB Solo Consolidated	CB Solo Consolidated	CB Solo Consolidated
7	Instrument type (type to be specified by each jurisdiction)	Ordinary Shares	Additional Tier 1 – Fixed Rate Reset Perpetual Subordinated Contingent Convertible Notes	Fixed Rate Reset Callable Subordinated Tier 2 Notes due 2026	Ordinary Shares	Additional Tier 1 – Fixed Rate Reset Perpetual Subordinated Permanent Write Down Notes	Fixed Rate Reset Callable Subordinated Tier 2 Notes due 2026
8	Regulatory capital value	88,360,607	449,658,000	472,650,429	502,470,583	425,431,130	475,598,288
9	Nominal value (£)	88,360,607	450,000,000	475,000,000	502,470,583	450,000,000	475,000,000
9a	Issue price (£)	88,360,607	449,658,000	473,318,500	502,470,583	425,431,130	479,998,226
9b	Redemption price (£)	88,360,607	450,000,000	475,000,000	502,470,583	450,000,000	475,000,000
10	Accounting classification	Equity	Equity	Liability – amortised cost	Equity	Equity	Liability – amortised cost
11	Original date of issue	Various	8 February 2016	8 February 2016	Various	8 February 2016	8 February 2016
12	Perpetual or dated	Perpetual	Perpetual	10-year non-call 5-years	Perpetual	Perpetual	10-year non-call 5-years
13	Original maturity date	n/a	n/a	9 February 2026	n/a	n/a	9 February 2026
14	Issuer call subject to prior supervisory approval	n/a	Yes	Yes	n/a	Yes	Yes
15	First call date	n/a	8 December 2022	8 February 2021	n/a	8 December 2022	8 February 2021
16	Subsequent call dates	n/a	Any Distribution payment date thereafter	Any interest payment date thereafter	n/a	Any Distribution payment date thereafter	Any interest payment date thereafter

Coupons/dividends

17	Fixed or floating dividend/coupon	n/a	Fixed	Fixed	n/a	Fixed	Fixed
18	Coupon rate and any related index	n/a	8%	5%	n/a	8%	5%
19	Existence of a dividend stopper	n/a	No	No	n/a	No	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Fully discretionary	Mandatory	Fully discretionary	Fully discretionary	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Mandatory	Fully discretionary	Fully discretionary	Mandatory
21	Existence of step up or other incentive to redeem	n/a	No	No	n/a	No	No
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	n/a	Non-cumulative	Non-cumulative	n/a
23	Convertible or non-convertible	n/a	Equity Conversion	Non-convertible	n/a	Non-convertible	Non-convertible
24	If convertible, conversion triggers	n/a	CYBG Group CET1 < 7%	n/a	n/a	n/a	n/a
25	If convertible, fully or partially	n/a	Fully	n/a	n/a	n/a	n/a
26	If convertible, conversion rate	n/a	119p (66% of IPO share price)	n/a	n/a	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	Mandatory	n/a	n/a	n/a	n/a
28	If convertible, specify instrument type convertible into	n/a	Ordinary Shares	n/a	n/a	n/a	n/a

29	If convertible, specify issuer of instrument it converts into	n/a	CYBG PLC	n/a	n/a	n/a	n/a
30	Write-down feature	n/a	No	None contractual, statutory via bail-in	n/a	Yes – full permanent	None contractual, statutory via bail-in
31	If write-down, trigger(s)	n/a	n/a	n/a	n/a	CB Group CET1 < 7% or CB Solo CET1 < 7%	n/a
32	If write-down, full or partial	n/a	n/a	n/a	n/a	Full	n/a
33	If write-down, permanent or temporary	n/a	n/a	n/a	n/a	Permanent	n/a
34	If temporary write-down, description of write-up mechanism	n/a	n/a	n/a	n/a	n/a	n/a
35	Instrument type immediately senior	n/a	Tier 2	Senior Unsecured	n/a	Tier 2	Senior Unsecured
36	Non-compliant transitioned features	n/a	No	No	n/a	No	No
37	If yes, specify non-compliant features	n/a	n/a	n/a	n/a	n/a	n/a

Appendix 3: Tables

Appendix 4: Glossary

	Term	Description
B	**Backing assets**	Backing assets relate to obligations to place collateral with the BoE as part of the regulations that allow certain firms, including the Bank, to issue Scottish bank notes.
	Basel II	The capital adequacy framework issued by the BCBS in June 2006 defining how firms should calculate their regulatory capital requirements.
	Basel III	Reforms issued by the BCBS in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In Europe the new requirements were implemented by 'CRD IV', on a phased basis from 1 January 2014 with full implementation by 1 January 2019.
	Basis points (bps)	One hundredth of a percent (0.01%); meaning that 100 basis points is equal to 1%. This term is commonly used in describing interest rate movements.
C	**Capital buffers**	Capital conservation buffer – A buffer set for all banks that can be used to absorb losses while avoiding breaching minimum requirements. It is designed to ensure that banks build up capital outside periods of stress which can be drawn down as losses are incurred.
		Systemic risk buffer – A buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress. It is commensurate with the greater cost that their failure or distress would have for the UK economy. Firms with total assets less than £175 billion are subject to a 0% SRB.
		Countercyclical capital buffer – A capital buffer to ensure eligible firms have a sufficient capital base to absorb losses in stressed periods. The CCyB aims to ensure that banking sector capital requirements take account of the macroeconomic financial environment in which banks operate. It enables the Bank of England's Financial Policy Committee to adjust the resilience of the banking system to the changing scale of risk the system faces over time.
		PRA buffer – A buffer set using supervisory judgement informed by the impact of stress scenarios on a firm's capital requirements and resources, and taking account where appropriate of other factors including leverage, systemic importance and weaknesses in firms' risk management and governance. This is set on a firm-specific basis.
	Capital conservation buffer (CCB)	Refer to 'Capital buffers'.
	Capital Requirements Directive IV (CRD IV)	European legislation to implement Basel III. It replaces earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. CRD IV sets out capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also 'Basel III'.
	Cash ratio deposit	Non-interest bearing deposits lodged with the Bank of England (BoE) by eligible institutions.
	CIU	Collective investment undertaking.
	Collateral	The assets of a borrower that are used as security against a loan facility.
	Common Equity Tier 1 (CET1) capital	The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
	Common Equity Tier 1 (CET1) ratio	CET1 capital divided by RWAs at a given date.
	Countercyclical capital buffer (CCyB)	Refer to 'Capital buffers'.
	Counterparty credit risk (CCR)	Counterparty credit risk is the risk that a counterparty to a transaction may default before the final settlement of the transaction's cash flows. This risk concerns financial instruments, including derivatives and repurchase agreements.
	Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.

	Term	Description
C	**Credit conversion factor (CCF)**	Credit conversion factors are used in determining the exposure at default in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn and off-balance sheet commitments expected to be drawn down at the point of default.
	Credit quality steps	A credit quality assessment scale as set out in CRD IV.
	Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
	Credit risk mitigation (CRM)	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.
E	**Earnings at risk (EaR)**	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
	EBA Implementing Technical Standard on Disclosure for Own Funds	Commission Implementing Regulation (EU) No 1423/2013 of 20 December 2013 laying down implementing technical standards with regard to disclosure of own funds requirements for institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council.
	EBA/RTS/2014/17	EBA Final draft Regulatory Technical Standards on disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer under Article 440 of Regulation (EU) No 575/2013.
	Encumbered assets	Assets that have been pledged as security, collateral or legally 'ring fenced' in some other way which prevents those assets being transferred, pledged, sold or otherwise disposed.
	External Credit Assessment Institutions (ECAIs)	ECAIs include external credit rating agencies such as Moody's, Fitch and S&P.
F	**FCA**	Financial Conduct Authority.
G	**Group**	CYBG and its controlled entities.
I	**Interest rate risk in the banking book (IRRBB)**	IRRBB arises from changes in interest rates that may impact the Group's financial condition in terms of earnings (net interest income) or economic value of the balance sheet.
	Internal Capital Adequacy Assessment Process (ICAAP)	The Group's assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
	Internal Liquidity Adequacy Assessment Process (ILAAP)	The Group's assessment and management of balance sheet risks relating to funding and liquidity.
	Internal ratings-based approach (IRB)	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
L	**Leverage ratio**	This is a regulatory standard ratio proposed by the Basel III as a supplementary measure to the risk based capital requirements. It is intended to constrain the build-up of excess leverage in the banking sector and is calculated by dividing Tier 1 capital resources by a defined measure of on- and off-balance sheet items plus derivatives.
M	**Market risk**	The risk that movements in market risk factors (including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices) will reduce income or portfolio values.
	Minimum requirement for own funds and eligible liabilities (MREL)	MREL is a minimum requirement for institutions to maintain equity and eligible debt liabilities, to help ensure that when an institution fails the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business. The BoE set out its approach to setting banks' MREL in November 2016.
O	**Operational risk**	The risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events.

Appendix 4: Glossary

	Term	Description
P	**Pillar 1**	The quantitative elements of the Basel III framework including the minimum regulatory capital requirements for credit, operational and market risks.
	Pillar 2	The qualitative expectations of the Basel III framework to be met through the supervisory review process. This includes the ICAAP, governance process and the supervisory review and evaluation process.
	Pillar 3	The final pillar of the Basel III framework which aims to encourage market discipline by improving the information made available to the market. This pillar sets out disclosure requirements for banks on their capital, risk exposures and risk assessment processes.
	PRA	Prudential Regulation Authority.
	PRA Buffer	Refer to 'Capital buffers'.
R	**Regulatory capital**	The capital which banks hold, determined in accordance with rules established by the relevant regulatory bodies.
	Repurchase (repo) agreement	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counterparty (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
	Residential mortgage-backed securities (RMBS)	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
	Risk appetite	The level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives.
	Risk weighted assets (RWA)	On- and off-balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
	Risk management framework (RMF)	The Group identifies and manages risk using the RMF which is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, control, mitigate, monitor and report all internal and external sources of material risk.
S	**The Scheme**	Yorkshire and Clydesdale Bank defined benefit pension scheme.
	Securities financing transaction (SFT)	Repurchase transactions, securities or commodities lending or borrowing transactions or other capital market driven transactions.
	Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding that can achieve a reduction in funding costs by offering typically 'AAA' rated securities secured by the underlying financial asset.
	Standardised approach (SA)	In relation to credit risk, a method for calculating credit risk capital requirements using ECAI ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
	Stress testing	The term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds or liquidity which a bank holds.
	Systemic risk buffer (SRB)	Refer to 'Capital buffers'.
T	**Tier 1 capital**	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, subject to deductions.
	Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
	Tier 2 capital	A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV.

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