TSB Banking Group plc

Significant Subsidiary Disclosures
31 December 2016

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1. Introduction

This document presents the Pillar III Significant Subsidiary Disclosures at 31 December 2016 relating to TSB Banking Group plc (TSB Group), a subsidiary undertaking of Banco de Sabadell Group (Sabadell). TSB Group's risk disclosures presented in this document are included in Sabadell's consolidated Pillar III disclosures.

The purpose of Pillar III is to make certain capital and risk management disclosures available to the market. In compiling this significant subsidiary disclosure, best practice guidelines and interpretations of standards issued by the European Banking Authority (EBA), the Enhanced Disclosure Task Force (EDTF) and national and international trade associations have been taken into account. The tables, which have been aligned to the standard templates specified by the EBA Guidelines published in December 2016, have been labelled in accordance with these guidelines.

This document should be considered in conjunction with the TSB Group's 2016 Annual Report and Accounts (ARA), where a number of supporting disclosures are presented.

A detailed overview of the governance arrangements within TSB Group is provided in the Risk Management section within pages 8 to 13 and the Corporate Governance section within pages 24 to 54 of TSB Group's ARA and are not repeated in this document.

TSB Group operates as a UK Group authorised and regulated by the Prudential Regulation Authority (PRA). TSB Group also operates within relevant Sabadell policies and its regulatory requirements.

2. Executive summary

Since launching TSB back on to high streets across Britain just over three years ago, TSB's three strategic pillars have remained the same: to provide great banking to more people; to help more people borrow well with TSB; and to provide the kind of banking people tell us they want and we believe they deserve.

In 2016 customer lending grew by 11.4%, meaning that in the third quarter we achieved our June 2014 IPO target of growing customer lending by 40% to 50% over a five year period, three years early.

Growth in customer lending was supported by our mortgage offering. Franchise mortgage balances increased by 21.0%, driven by the continued success of TSB's award winning mortgage broker service, attracting £6.8 billion of applications and generating £5.1 billion of advances, 63.5% higher than in 2015.

Following on from developments in 2015 to make personal unsecured loans available to non bank account customers through our branch network, we extended this offering through our digital channels from Q3 2016. Unsecured lending balances remained broadly flat year on year and represent an area of focus in 2017. Our ambitions to help more people borrow well are evidenced by improvements in both the proportion of good quality lending and reductions in the volume and proportion of impaired exposures and are further supported by the average mortgage loan to value which remains low at 42%.

The capital position of TSB Group remains strong with a Common Equity Tier 1 (CET1) Capital ratio of 18.5% and a leverage ratio of 4.8% and is sufficient to support the delivery of TSB Group's growth strategy.

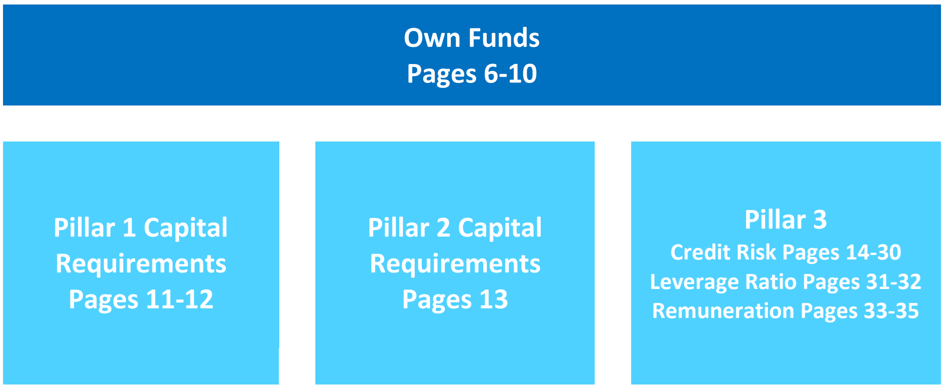
Key metrics	**2016**	2015
Common Equity Tier 1	£1.8bn	£1.7bn
Common Equity Tier 1 ratio	18.5%	17.8%
Total Capital	£2.2bn	£2.1bn
Total Capital ratio	22.4%	21.9%
Credit Risk Exposure at Default (EAD)	£42.6bn	£36.8bn
Credit Risk Weighted Assets (RWAs)	£8.3bn	£8.0bn
Operational Risk RWAs	£1.4bn	£1.4bn
Total RWAs	£9.7bn	£9.4bn
Basel III Leverage ratio	4.8%	5.2%

CET 1 / Total Tier 1 capital increased by £113 million during 2016. This was primarily due to attributable profit of £128 million for the year. This increase was partly offset by small decreases in other comprehensive income. During 2016 RWAs increased by £272 million (2.9%). This was due primarily to growth in TSB's Franchise Mortgage book and balances held with other institutions, partly offset by the expected decreases in the Mortgage Enhancement and Whistletree portfolios.

TSB Group's leverage ratio continues to comfortably exceed the Basel Committee's proposed minimum of 3%, applicable from 1 January 2018.

Location of risk disclosures

The diagram below summarises the structure of this report and notes the location of the required disclosures on own funds, capital requirements and the Group's main Pillar 3 disclosures as appropriate for a Significant Subsidiary Disclosures document.



3. Own funds

3.1. Capital risk

Definition
TSB defines capital risk as the risk of having insufficient or sub-optimal amount or quality of capital to support its business strategy.

Risk appetite
TSB Group's risk appetite methodology is set out on page 8 of the TSB Group's ARA. TSB Group maintains a strong capital base which meets both its regulatory requirements and supports the growth of the business, including under stressed conditions. The Board approves TSB's risk appetite and strategy.

Exposure
A capital exposure arises where TSB Group has insufficient capital to support its strategic objectives and plans, or to meet external stakeholder requirements and expectations. TSB Group's capital management approach is focused on maintaining sufficient capital whilst optimising value for shareholders.

Measurement
Capital adequacy is measured in accordance with regulatory requirements and TSB's Internal Capital Adequacy Assessment Process (ICAAP).

Mitigation
Compliance with capital risk appetite is actively managed and monitored through TSB Group's planning, forecasting and stress testing processes. Five year forecasts of TSB Group's capital position are produced at least annually to inform capital strategy and form part of the Board approved operating plan. Business plans are tested for capital adequacy using a range of stress scenarios covering adverse economic conditions as well as other potential adverse developments. TSB Group, additionally, maintains a Recovery Plan which sets out a range of potential mitigating actions that could be taken in response to stress. The Recovery Plan is reviewed annually and approved by the Board.

TSB Group is able to accumulate additional capital through profit retention and, if required, subject to market conditions, issuance of eligible capital instruments.

Monitoring
Capital policies and procedures are subject to independent oversight by second line and Internal Audit. Regular reporting of actual and projected capital ratios against risk appetite is provided to appropriate committees within TSB Group's governance and risk management framework as outlined in page 8 of TSB Group's ARA. These include the Bank Executive Committee (BEC), Executive Risk Committee, the Asset and Liability Committee (ALCO), Board Risk Committee and the Board.

The regulatory framework within which TSB Group operates continues to be subject to global banking reforms. TSB Group monitors these developments and analyses the potential impacts, ensuring that TSB Group continues to meet the regulatory requirements and operates within risk appetite.

3.2. TSB Group's own funds

TSB Group's own funds as at 31 December 2016 are presented in the table below. This table follows the disclosure format required by the EBA Implementing Technical Standard on Disclosure for Own Funds published in July 2013, however only items applicable to TSB Group are detailed.

Table 1: Own funds

	2016	2015
	£000	£000
CET1 capital : instruments and reserves		
Capital instruments and related share premium accounts	970,050	970,050
Of which: ordinary shares	5,000	5,000
Retained earnings	1,173,675	1,045,834
Accumulated other comprehensive income (and any other reserves)	(278,741)	(269,565)
CET1 capital before regulatory adjustments	**1,864,984**	1,746,319
CET1 capital: regulatory adjustments		
Additional value adjustment	(3,071)	(1,642)
Intangible assets (net of related tax liability)	(2,571)	(1,011)
Fair value reserve relating to gains and losses on cash flow hedges	(366)	861
Negative amounts resulting from the calculation of expected loss amounts	(73,539)	(72,069)
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(79,547)**	(73,861)
CET1 capital / Tier 1 capital[(*)]	**1,785,437**	1,672,458
Tier 2 capital: instruments and provisions		
Capital instruments and related share premium accounts	383,792	383,513
Credit risk adjustments	142	-
Tier 2 capital	**383,934**	383,513
Total capital	**2,169,371**	2,055,971
Total Risk Weighted Assets	**9,674,544**	9,402,364
Capital Ratios		
Common Equity Tier 1 (as a percentage of total risk exposure amount)	18.5%	17.8%
Tier 1 (as a percentage of total risk exposure amount)	18.5%	17.8%
Total capital (as a percentage of total risk exposure amount)	22.4%	21.9%
Amounts below the threshold for deduction (before risk weighting)		
Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	5,200	22,400
Direct and indirect holdings of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	8,663	5,301
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	99,563	121,055
Applicable caps on the inclusion of provisions in Tier 2		
Credit risk adjustments included in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	142	-
Cap for inclusion of credit risk adjustments in Tier 2 under internal ratings based approach	32,720	29,481

[(*)] TSB Group does not hold additional Tier 1 capital, hence the CET1 capital and Tier 1 capital have equal values.

As TSB does not apply any transitional arrangements in respect of own funds, transitional own funds disclosures are not provided.

3.3. Movements in capital

The movements in CET1/Tier 1 Capital, Tier 2 Capital and total capital in the year are shown below:

Table 2: Movements in capital

	CET1/Tier 1 Capital £000	Tier 2 Capital £000	Total Capital £000
At 31 December 2015	**1,672,458**	**383,513**	**2,055,971**
Profit attributable to the ordinary shareholder	127,841	-	127,841
Movement in other comprehensive income (including available for sale)	(9,176)	-	(9,176)
Cash flow hedging reserve regulatory adjustment	(1,227)	-	(1,227)
Change in excess of expected losses over impairment provisions	(1,470)	-	(1,470)
Movement in tier 2 subordinated liabilities	-	279	279
Change in excess of default provision over default expected loss	-	142	142
Change in intangible assets	(1,560)	-	(1,560)
Movement in prudent valuation adjustment	(1,429)	-	(1,429)
At 31 December 2016	**1,785,437**	**383,934**	**2,169,371**

	CET1 Capital £000	Tier 2 Capital £000	Total £000
At 31 December 2014	1,592,956	384,341	1,977,297
Profit attributable to the ordinary shareholder	88,724	-	88,724
Movement in other comprehensive income (including available for sale)	15,035	-	15,035
Movement in other reserves	8,159	-	8,159
Cash flow hedging reserve regulatory adjustment	861		861
Change in excess of expected losses over impairment provisions	(31,032)	-	(31,032)
Movement in tier 2 subordinated liabilities	-	287	287
Change in excess of default provision over default expected loss	-	(1,115)	(1,115)
Change in intangible assets	(603)	-	(603)
Movement in prudent valuation adjustment	(1,642)	-	(1,642)
At 31 December 2015	1,672,458	383,513	2,055,971

Tier 1 Capital increased by £113 million during 2016, primarily due to attributable profit of £128 million for the year. This increase was partly offset by a decrease in other comprehensive income of £9 million and movements in other reserves and regulatory adjustments of £6 million.

Tier 2 Capital includes subordinated debt issuance and excess of impairment provisions over expected loss.

3.4. Other capital disclosures

Table 3: Reconciliation between statutory and regulatory capital

	2016 Statutory balance	**2016 Regulatory adjustments**	**2016 Regulatory balance**	2015 Statutory balance	2015 Regulatory adjustments	2015 Regulatory balance
	£000	**£000**	**£000**	£000	£000	£000
Own funds	**1,858,725**	-	**1,858,725**	1,730,884	-	1,730,884
Capital	5,000	-	5,000	5,000	-	5,000
Share premium	965,050	-	965,050	965,050	-	965,050
Other reserves	(285,000)	-	(285,000)	(285,000)	-	(285,000)
Retained earnings	1,173,675	-	1,173,675	1,045,834	-	1,045,834
Value adjustments	**6,259**	-	**6,259**	15,435	-	15,435
Cash flow hedging reserve	366	-	366	(861)	-	(861)
Other value adjustments	5,893	-	5,893	16,296	-	16,296
Total equity	**1,864,984**	-	**1,864,984**	1,746,319	-	1,746,319
Cash flow hedging reserve	-	(366)	(366)	-	861	861
Intangible assets	-	(2,571)	(2,571)	-	(1,011)	(1,011)
Prudent valuation adjustment	-	(3,071)	(3,071)	-	(1,642)	(1,642)
Negative amounts resulting from the calculation of expected loss amounts	-	(73,539)	(73,539)	-	(72,069)	(72,069)
Tier 1 Capital	**1,864,984**	**(79,547)**	**1,785,437**	1,746,319	(73,861)	1,672,458
Subordinated debt	383,792	-	383,792	383,513	-	383,513
Generic funds and provision excess	-	142	142	-	-	-
Tier 2 Capital	**383,792**	**-**	**383,934**	383,513	-	383,513
Total Regulatory Capital	**2,248,776**	**(79,405)**	**2,169,371**	2,129,832	(73,861)	2,055,971

Table 4: Principal features of TSB Group's capital instruments[1]

	Share Capital 1	Share Capital 2	Subordinated Liabilities
Issuer	TSB Banking Group plc	TSB Banking Group plc	TSB Banking Group plc
Unique identifier (ISIN)	N/A	N/A	XS1061206337
Governing law(s) of the instrument	English	English	English
Regulatory treatment			
Transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Post-transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Eligible at solo/(sub-)consolidated/ solo and (sub-)consolidated	Solo and (Sub-)Consolidated	Solo and (Sub-)Consolidated	Solo and (Sub-)Consolidated
Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Ordinary Shares	Subordinated Tier 2 Notes
Amount recognised in regulatory capital	£1,386.5 million	£200.0 million	£383.8 million
Nominal amount of instrument	£0.5 million	£4.4 million	£385.0 million
Issue price	The nominal value of shares issued was £0.5 million and a minimum premium amount required by the Companies Act 2006 of £769.5 million was transferred to share premium. The balance of £616.5 million was transferred to the Merger Reserve.	£0.4494 per share	99.49%
Redemption price	n/a	n/a	100%
Accounting classification	Shareholder's equity	Shareholder's equity	Liability - amortised cost
Original date of issuance	25 April 2014	19 May 2014	01 May 2014
Perpetual or dated	Perpetual	Perpetual	Dated
Original maturity date	no maturity	no maturity	06 May 2026
Issuer call subject to prior supervisory approval	No	No	Yes
Optional call date, contingent call dates and redemption amount	n/a	n/a	6 May 2021 - the Notes may be redeemed, in whole but not in part, at the option of the Issuer on any Call Date, subject if so required at the relevant time to the Issuer giving prior written notice and receiving permission therefore from the Relevant Regulator. Redemption price £385 million.
Subsequent call dates, if applicable	n/a	n/a	Each subsequent Interest Payment Date after the first call option.
Coupons / dividends			
Fixed or floating dividend/coupon	n/a	n/a	Fixed to floating
Coupon rate and any related index	n/a	n/a	The notes pay interest at a rate of 5.75% per annum, payable semi-annually in arrears until 6 May 2021 at which time the interest rate becomes 3 month LIBOR plus 3.43% per annum payable quarterly in arrears.
Existence of a dividend stopper	No	No	No
Fully discretionary, partially or mandatory	Fully discretionary	Fully discretionary	Mandatory
Fully discretionary, partially or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Mandatory
Existence of step up or other incentive to redeem	No	No	No
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
Write-down features	No	No	No
Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Subordinated in right of payment to the claims of depositors, other unsubordinated creditors and the subordinated debt of the issuer.	Subordinated in right of payment to the claims of depositors, other unsubordinated creditors and the subordinated debt of the issuer.	Subordinated in right of payment to the claims of depositors and other unsubordinated creditors of the issuer
Non-compliant transitioned features	No	No	No

[1] The Group has opted to omit disclosures with regards to original capitalisation of the Group of £50,000 by LBG on the basis of materiality. This capital displays the same capital features as the ordinary shares disclosed in table 4.

4. Capital requirements

4.1. TSB Group's risk weighted assets and Pillar 1 capital requirements

The risk weighted assets and Pillar 1 capital requirements of TSB Group as at 31 December 2016 are presented in the following table:

Table 5: Overview of RWAs (EU OV1)

	Notes	2016 RWA £000	2015 RWA £000	2016 Minimum capital requirements £000
Credit risk (excluding counterparty credit risk)		**7,796,692**	7,618,079	**623,736**
Of which standardised approach (SA)	(3)	2,343,426	2,704,648	187,475
Of which the advanced IRB (AIRB) approach	(1)	5,453,266	4,913,431	436,261
Counterparty credit risk	(2)	**206,645**	52,017	**16,532**
Of which mark to market		137,221	18,332	10,978
Of which risk exposure amounts for contributions to the default fund of a CCP		513	735	41
Of which CVA		68,911	32,950	5,513
Operational risk		**1,400,642**	1,416,377	**112,051**
Of which Standardised Approach		1,400,642	1,416,377	112,051
Amounts below the thresholds for deduction (subject to 250% risk weight)		**270,565**	315,891	**21,645**
Total		**9,674,544**	9,402,364	**773,964**

TSB Group's risk weighted assets have increased in 2016 from £9.4 billion to £9.7 billion due to the following factors:

(1) Net asset increase due to the continued growth in the mortgage franchise since the launch of TSB's mortgage intermediary distribution channel in 2015, partly offset by decline in RWAs due to improvement in the quality of the lending and the lending environment;
(2) Increase in the volume of derivatives and securities financing transactions; and are partially offset by:
(3) Mortgage Enhancement and Whistletree loan balances which have reduced in line with the expected run-off of these books.

Table 6: Total amount of risk weighted assets and minimum own funds requirements

Exposure classes and risk types	2016 RWA £000	2016 Capital Requirements £000	2015 RWA £000	2015 Capital Requirements £000
Credit risk (standardised approach)	**2,751,212**	**220,098**	3,038,871	243,110
Central governments and central banks	248,907	19,913	302,639	24,211
Institutions	290,193	23,215	98,766	7,901
Corporates	845	68	858	69
Retail	186,714	14,937	255,907	20,473
Exposures collateralised with residential or commercial property	1,438,153	115,052	1,721,748	137,740
Exposures in default status	214,401	17,152	275,208	22,017
Equity exposures	26,858	2,149	35,652	2,852
Other exposures	345,141	27,612	348,093	27,847
Credit risk (internal ratings-based approach)	**5,453,266**	**436,261**	4,913,431	393,074
Retail	5,453,266	436,261	4,913,431	393,074
i) Mortgages for residential or commercial property	2,668,788	213,503	2,202,723	176,218
ii) Eligible revolving exposures	1,286,364	102,909	1,272,382	101,790
iii) Other retail	1,498,114	119,849	1,438,326	115,066
Contribution to default guarantee fund of a CCP	**513**	**41**	735	59
Operational risk	**1,400,642**	**112,051**	1,416,377	113,310
Operational risk (standardised approach)	1,400,642	112,051	1,416,377	113,310
Credit valuation adjustment risk	**68,911**	**5,513**	32,950	2,636
Total minimum own funds requirement	**9,674,544**	**773,964**	9,402,364	752,189

4.2. TSB Group's risk weighted assets movements by key driver

The table below analyses movements in IRB credit risk RWAs from 31 December 2015 to 31 December 2016:

Table 7: RWA flow statement of credit risk exposures under IRB (EU CR8)

	RWA	**Capital requirements**
	£000	**£000**
At 31 December 2015	**4,913,431**	**393,074**
Asset size	881,143	70,492
Asset quality	(337,735)	(27,019)
Model updates	(3,397)	(272)
Methodology and policy	-	-
Other	(176)	(14)
At 31 December 2016	**5,453,266**	**436,261**

	RWA	Capital requirements
	£000	£000
At December 2014	3,187,287	254,983
Asset size	648,423	51,874
Asset quality	(193,502)	(15,480)
Model updates	(129,899)	(10,392)
Methodology and policy	1,403,138	112,251
Other	(2,016)	(162)
At 31 December 2015	4,913,431	393,074

During 2016, IRB credit risk RWAs have increased by £0.5 billion (11.0%) due to the following factors:

- Net asset growth which resulted in increased RWAs of £881 million, mainly from the continued growth in the mortgage franchise since the launch of TSB's mortgage intermediary distribution channel in 2015; offset by
- A reduction in RWAs of £338 million arising from a better quality of lending and improved lending environment.

Standardised RWAs have decreased by £0.3 billion (2016: £2.7 billion; 2015: £3.0 billion) mainly due to a decrease in asset size of the Mortgage Enhancement and Whistletree loan portfolios in line with the expected run-off of these portfolios, partially offset by an uplift in counterparty credit risk RWAs due to the increase in the asset size of derivatives and securities financing transactions.

4.3. Segmental risk weighted assets

TSB Group's risk weighted assets are presented on a segmental basis in the table below. At 31 December 2016, TSB Group had 3 reporting segments: Franchise, Mortgage Enhancement and Whistletree Loans.

Table 8: Segmental analysis of total risk weighted assets

	2016 RWA	**2016 Capital requirements**	2015 RWA	2015 Capital requirements
	£000	**£000**	£000	£000
Total Credit risk:	**8,273,902**	**661,913**	7,985,987	638,879
Total Franchise	6,281,211	502,497	5,739,860	459,188
Of which: Franchise standardised approach	827,945	66,236	826,429	66,114
Franchise IRB approach	5,453,266	436,261	4,913,431	393,074
Mortgage Enhancement standardised approach	654,166	52,333	802,341	64,187
Whistletree standardised approach	1,131,880	90,550	1,391,769	111,342
Counterparty credit risk	206,645	16,533	52,017	4,162
Of which contributions to default fund of a Central Clearing Counterparty	513	41	735	59
Of which Credit Valuation Adjustment risk	68,911	5,513	32,950	2,636
Operational risk	**1,400,642**	**112,051**	1,416,377	113,310
Total risk weighted assets	**9,674,544**	**773,964**	9,402,364	752,189

4.4. TSB Group's Pillar 2 capital requirement

In order to address the requirements of Pillar 2 of the Basel III framework, the PRA has set additional requirements through the issuance of Individual Capital Guidance (ICG) (Pillar 2a) and PRA buffer (Pillar 2b).

Pillar 2a

TSB Group's internal assessment of its capital adequacy, a process known as the Internal Capital Adequacy Assessment Process (ICAAP) is a key input to the PRA's Supervisory Review and Evaluation Process (SREP) and determination of ICG.

TSB Group's ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk and operational risk through the assessment of material risks not covered or not fully captured under Pillar 1.

TSB Group updates the ICAAP at least annually. The PRA undertakes regular review of a firm's capital adequacy and its approach to capital management. As part of this review, the PRA determines the amount of supplementary capital required under Pillar 2A to cover risks not covered in Pillar 1 and issues the firm with ICG.

TSB Group's ICAAP document is subject to a robust review process by the Asset and Liability Committee and the Board.

Some of the key risks assessed within the ICAAP include:

Risks not fully captured under Pillar 1

- **Concentration Risk:** Credit concentration risk is the risk of losses arising as a result of concentrations of exposures due to imperfect diversification. This imperfect diversification can arise from the small size of a portfolio or a large number of exposures to specific obligors (single name concentration) or from imperfect diversification with respect to economic sectors or geographical regions. Pillar 1 credit risk capital requirements assume no significant concentrations. Where there are concentrations of exposures, additional capital is required under Pillar 2a.
- **Operational Risk:** Pillar 1 standardised approach for operational risk uses gross income as a measure of risk. This is not risk sensitive. The PRA therefore assesses operational risk further as part of its Pillar 2 review of firms' capital adequacy.

Risks not covered by Pillar 1

- **Interest Rate Risk in the Banking Book (IRRBB):** The potential losses in the non-trading book resulting from interest rate changes or widening of the spread between Base Rate and LIBOR.

Pillar 2b

As part of the capital planning process, forecast capital positions are subjected to extensive stress analyses to determine that TSB Group's own funds are adequate to meet minimum requirements. The PRA uses the output from these stress analyses to set a PRA buffer for TSB Group that should be maintained as mitigation against potential future periods of stress.

The PRA buffer is set in addition to the CRD IV Countercyclical capital buffer (CCB). The Financial Policy Committee has set the UK CCB rate at 0%. TSB Group has total relevant credit exposures of £35.7 billion with associated RWAs of £7.6 billion. All exposures are categorised as UK, due to non-UK RWAs being less than 2% of total RWAs.

5. Credit risk

5.1. Overview

Definition
TSB Group defines credit risk as the risk that parties with whom TSB has contracted, fail to meet their obligations to settle outstanding amounts when due, both on and off balance sheet.

By adopting decision making processes and systems geared to provide affordable lending, based on individual needs and circumstances at the time of application, TSB Group is able to help customers borrow well and limit the risks associated with non-repayment. To assist with this, TSB Group's Risk Appetite, which is regularly subject to oversight, and has been set for controlled growth, has measures and limits in place to act as a mechanism to prevent the bank and its customers from overreaching their ability to manage credit. These measures include loan-to-income ratios, limits on interest-only mortgage lending and maximum loan-to-value thresholds. Risk appetite metrics apply to all acquisition channels and where appropriate to specific segments such as buy-to-let mortgages. However, TSB Group understands that occasionally customer circumstances change which could impact on their ability to pay back borrowing. In these situations, TSB Group works with its customers to improve their position by offering various treatment strategies and support.

Risk Appetite
TSB Group defines risk appetite as the amount and type of risk that it is prepared to seek, accept or tolerate. Within each planning cycle, the Board approves TSB Group's risk appetite and strategy. Through clear and consistent communication, the Board ensures that senior management stays within risk appetite through risk policies that either limit or, where appropriate, prohibits activities, relationships and situations that could be detrimental to the risk profile of TSB Group. For credit risk, TSB Group aims to have an appropriate and well balanced loan portfolio through the economic cycle.

Exposures
A range of approaches, varying in sophistication, are available under the CRD IV Framework to use in measuring credit risk and to determine the minimum level of capital required.

Under CRD IV, TSB's credit risk exposures are classified into broad categories, as defined under:

1. **The Retail IRB Approach:** Use of internal models to calculate Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD); and
2. **The Standardised Approach:** Portfolios whose associated models have yet to roll out or where no model roll out is planned, are risk weighted under this approach.

The principal source of credit risk within TSB arises from loans and advances to retail and business banking customers. TSB Group's retail credit risk exposures include:

- Retail exposures secured by real estate collateral - residential mortgages;
- Qualifying revolving retail exposures - overdrafts and credit cards;
- Other retail exposures - unsecured personal lending; and
- Retail SME - lending to sole traders, small partnerships and small limited companies.

Credit risk arises principally from TSB Group's lending activities through adverse changes in the credit quality of customers and macro-economic disruptions to credit markets. TSB Group also faces credit risk in relation to the geographic concentration of its credit portfolio in the UK generally, and particularly, in Scotland and the South East of England. Additional credit risks also arise in relation to the processes by which TSB Group assesses customer credit quality, which requires difficult, subjective and complex judgements, including forecasts of how changing macro-economic conditions might impair the ability of customers to repay their loans.

Additional sources of credit risk are managed in TSB Group's treasury function. These include:

- Placing surplus funds with financial institution and sovereign counterparties e.g. the Bank of England;
- Holding government securities, e.g. UK gilts, for liquidity management; and
- Hedging its interest rate risk position with clearing houses and other market facing counterparties. This counterparty credit risk depends on the underlying valuation of the derivatives, the majority of which are collateralised and cleared.

Sections 5.2 - 5.15 provide an overview of TSB Group credit risk exposures.

5.2. Consolidated balance sheet under the regulatory scope of consolidation

The following table provides a reconciliation of the TSB Group's consolidated balance sheet on an accounting basis (as presented on page 58 of TSB Group's ARA) to the consolidated balance sheet on a regulatory basis.

Table 9: Consolidated regulatory balance sheet at 31 December 2016

Balance Sheet Category	2016 TSB Statutory Balance Sheet	2016 Regulatory Reallocations[1]	2016 TSB Regulatory Balance Sheet
	£000	£000	£000
Assets			
Cash and balances at central banks	3,698,334	(174,204)	3,524,130
Financial assets held for trading:			
Equity instruments	8,663	5,200	13,863
Trading derivative assets	143,174		143,174
Available-for-sale financial assets	2,103,539		2,103,539
Loans and receivables:			
Loans and advances to credit institutions	550,400		550,400
Loans and advances to customers	29,419,047	42,516	29,461,563
Fair value adjustments for portfolio hedged risk	826		826
Hedging derivative assets	104,315		104,315
Items in course of collection from banks	213,806		213,806
Deferred tax assets	99,563		99,563
Property, plant and equipment	168,251		168,251
Other assets	685,785	200,231	886,016
Total assets	**37,195,703**	**73,743**	**37,269,446**
Liabilities			
Financial liabilities held for trading:			
Trading derivative liabilities	97,650		97,650
Financial liabilities at amortised cost:			
Deposits from credit institutions	49,620		49,620
Repurchase agreements with credit institutions	750,990		750,990
Repurchase agreements with non credit institutions	658,552		658,552
Customer deposits	29,383,825		29,383,825
Debt securities in issue	2,940,055		2,940,055
Subordinated liabilities	413,321		413,321
Fair value adjustments for portfolio hedged risk	70,736		70,736
Hedging derivative liabilities	529,061		529,061
Provisions	-	73,743	73,743
Current tax liabilities	14,684		14,684
Items in course of transmission to banks	176,136		176,136
Other liabilities	246,089		246,089
Total liabilities	**35,330,719**	**73,743**	**35,404,462**
Equity			
Share capital	5,000		5,000
Share premium	965,050		965,050
Merger reserve	616,451		616,451
Capital reorganisation reserve	(1,311,451)		(1,311,451)
Capital reserve	410,000		410,000
Retained profits	1,173,675		1,173,675
Valuation adjustments:			
Available-for-sale reserve	5,893		5,893
Cash flow hedging reserve	366		366
Shareholder's equity	**1,864,984**		**1,864,984**
Total equity and liabilities	**37,195,703**	**73,743**	**37,269,446**

(1) Regulatory reallocations are made in accordance with PRA reporting requirements. In particular, various balances categorised as other assets or liabilities are separated out for regulatory reporting purposes. The net difference is largely due to the reclassification of certain loan impairment provisions, previously netted against asset balances, to liabilities on the regulatory balance sheet.

Balance Sheet Category	2015 TSB Statutory Balance Sheet £000	2015 Regulatory Reallocations[(2)] £000	2015 TSB Regulatory Balance Sheet £000
Assets			
Cash and balances at central banks	2,755,639	(164,035)	2,591,604
Financial assets held for trading:			
Equity instruments	5,301	22,400	27,701
Trading derivative assets	47,884		47,884
Available-for-sale financial assets	1,262,829		1,262,829
Loans and receivables:			
Loans and advances to credit institutions	311,383		311,383
Reverse repurchase agreements with credit institutions	20,291		20,291
Loans and advances to customers	26,398,070	41,756	26,439,826
Fair value adjustments for portfolio hedged risk	4,104		4,104
Hedging derivative assets	42,639		42,639
Items in course of collection from banks	163,030		163,030
Current tax assets	5,084		5,084
Deferred tax assets	121,055		121,055
Property, plant and equipment	161,054		161,054
Other assets	319,609	171,107	490,716
Total assets	31,617,972	71,228	31,689,200
Liabilities			
Financial liabilities held for trading:			
Trading derivative liabilities	43,530		43,530
Financial liabilities at amortised cost:			
Deposits from credit institutions	802		802
Customer deposits	25,874,154		25,874,154
Debt securities in issue	2,899,596		2,899,596
Subordinated liabilities	402,147		402,147
Fair value adjustments for portfolio hedged risk	41,535		41,535
Hedging derivative liabilities	239,807		239,807
Provisions	-	71,228	71,228
Items in course of transmission to banks	152,312		152,312
Other liabilities	217,770		217,770
Total liabilities	29,871,653	71,228	29,942,881
Equity			
Share capital	5,000		5,000
Share premium	965,050		965,050
Merger reserve	616,451		616,451
Capital reorganisation reserve	(1,311,451)		(1,311,451)
Capital reserve	410,000		410,000
Retained profits	1,045,834		1,045,834
Valuation adjustments:	-		-
Available-for-sale reserve	16,296		16,296
Cash flow hedging reserve	(861)		(861)
Shareholder's equity	1,746,319		1,746,319
Total equity and liabilities	31,617,972	71,228	31,689,200

(2) Regulatory reallocations are made in accordance with PRA reporting requirements. In particular, various balances categorised as other assets or liabilities are separated out for regulatory reporting purposes. The net difference is largely due to the reclassification of certain loan impairment provisions, previously netted against asset balances, to liabilities on the regulatory balance sheet.

5.3. Regulatory balance sheet assets to total credit risk exposure

A reconciliation of consolidated regulatory balance sheet assets to total credit risk exposures is presented in the table below:

Table 10: Credit risk exposures at 31 December 2016

31 December 2016	Consolidated Regulatory Balance Sheet	Assets Linked to Market Risk / Counterparty Credit Risk	Other Regulatory Adjustments [1]	Gross Drawn Credit Risk Exposures	Gross Undrawn Exposures incl.CCR	Credit conversion factors/ Model overlays	Total credit risk exposure
	£000	£000	£000	£000	£000	£000	£000
Cash and balances at central banks	3,524,130	-	-	3,524,130	101,793	-	3,625,923
Equity instruments	13,863	-	-	13,863	-	-	13,863
Items in the course of collection from banks	213,806	-	-	213,806	-	-	213,806
Derivative financial instruments	247,489	(247,489)	-	-	224,861	-	224,861
Loans and receivables	30,011,963	(19,515)	(13,603)	29,978,845	5,518,173	345,728	35,842,746
Available for sale financial assets	2,103,539	-	-	2,103,539	-	-	2,103,539
Property plant and equipment	168,251	-	-	168,251	-	-	168,251
Deferred tax assets	99,563	-	-	99,563	-	-	99,563
Other assets	886,842	(559,100)	(793)	326,949	13,147	-	340,096
Total	**37,269,446**	**(826,104)**	**(14,396)**	**36,428,946**	**5,857,974**	**345,728**	**42,632,648**

31 December 2015	Consolidated Regulatory Balance Sheet	Assets Linked to Market Risk / Counterparty Credit Risk	Other Regulatory Adjustments [1]	Gross Drawn Credit Risk Exposures	Gross Undrawn Exposures incl. CCR	Credit conversion factors/ Model overlays	Total credit risk exposure
	£000	£000	£000	£000	£000	£000	£000
Cash and balances at central banks	2,591,604	-	-	2,591,604	-	-	2,591,604
Equity instruments	27,701	-	-	27,701	-	-	27,701
Items in the course of collection from banks	163,030	-	-	163,030	-	-	163,030
Derivative financial instruments	90,523	(90,523)	-	-	96,743	-	96,743
Loans and receivables	26,775,605	(21,611)	27,079	26,781,073	5,135,052	195,193	32,111,318
Available for sale financial assets	1,262,829	-	-	1,262,829	-	-	1,262,829
Property plant and equipment	161,054	-	(1,011)	160,043	-	-	160,043
Deferred tax assets	121,055	-	-	121,055	-	-	121,055
Other assets	495,799	(229,799)	(625)	265,375	30,250	(529)	295,096
Total	31,689,200	(341,933)	25,443	31,372,710	5,262,045	194,664	36,829,419

[1] Other regulatory adjustments reflect specific regulatory treatments and valuation methodologies.

5.4. Credit risk exposure: analysis by exposure class

As at 31 December 2016, the total original exposures of TSB Group amounted to £42.3 billion (2015: £36.6 billion).

Table 11: Reconciliation of original exposure to adjusted exposure pre-Credit Risk Mitigation

Exposure Class	2016 Original exposure	2016 Impairment Allowances	2016 Fully adjusted exposure value(*)	2015 Fully adjusted exposure value(*)
	£000	£000	£000	£000
Standardised approach	**12,385,662**	**(7,167)**	**12,378,495**	10,686,525
Central governments and central banks	5,697,690	-	5,697,690	3,958,076
Multilateral development banks	126,134	-	126,134	-
Institutions	1,058,816	-	1,058,816	435,047
Corporates	847	(2)	845	865
Retail	312,118	(1,330)	310,788	411,480
Exposures secured by real estate property	4,259,780	(2,547)	4,257,233	4,929,055
Defaulted exposures	216,295	(3,288)	213,007	270,805
Equity exposures	13,863	-	13,863	27,701
Other exposures	700,119	-	700,119	653,496
Internal Ratings Based Approach (IRB)	**29,908,425**	**-**	**29,908,425**	25,948,230
Retail	29,908,425	-	29,908,425	25,948,230
Total exposure	**42,294,087**	**(7,167)**	**42,286,920**	36,634,755

(*) Value adjustments are not deducted to determine the adjusted exposure under the IRB approach.

Table 12: Reconciliation of fully adjusted exposure pre CCF to EAD post CRM

Exposure Class	2016 Fully adjusted exposure value on balance sheet	2016 Fully adjusted exposure value off balance sheet [1]	2016 Average CCF	2016 EAD	2015 EAD
	£000	£000	%	£000	£000
Standardised approach	**11,463,137**	**915,358**	**99%**	**12,202,852**	10,651,355
Central governments and central banks	5,595,897	101,793	100%	5,697,690	3,958,076
Multilateral development banks	126,134	-	100%	126,134	-
Institutions	587,309	471,507	100%	1,058,816	435,047
Corporates	845	-	100%	845	858
Retail	273,004	37,785	90%	281,019	378,452
Exposures secured by real estate property	3,967,148	290,084	97%	4,111,919	4,927,564
Defaulted exposures	211,965	1,042	100%	212,447	270,692
Equity exposures	13,863	-	100%	13,863	27,701
Other exposures	686,972	13,147	100%	700,119	652,965
Internal Ratings Based Approach (IRB)	**24,965,809**	**4,942,616**	**100%**	**30,429,796**	26,178,064
Retail[2]	24,965,809	4,942,616	100%	30,429,796	26,178,064
Total exposure	**36,428,946**	**5,857,974**		**42,632,648**	36,829,419

[1] Fully adjusted exposure value off balance sheet includes exposures to SFTs and Derivatives.

[2] IRB EAD includes impact of additional fees and interest receivable in the event of customer default.

Table 13: Average EAD by exposure class

Exposure Class	Notes	2016 Average EAD	2015 Average EAD
		£000	£000
Standardised approach		**11,607,720**	9,086,611
Central governments and central banks		4,857,894	5,071,217
Multilateral development banks		60,230	-
Institutions	(1)	836,647	265,562
Corporates		4,781	1,044
Retail	(2)	318,021	511,451
Exposures secured by real estate property	(3)	4,522,316	2,576,618
Defaulted exposures	(3)	240,201	22,869
Equity exposures		13,806	4,422
Other exposures		753,824	633,428
Internal Ratings Based Approach (IRB)	(4)	**28,204,439**	22,147,916
Retail		28,204,439	22,147,916
Total exposure		**39,812,159**	31,234,527

The average EAD presented in the table above was calculated based on month end balances from 31 December 2015 to 31 December 2016.

Key Movements:

(1) Balances held with institutions grew to £837 million largely in support of repo activity.
(2) Reduction in standardised retail assets relates to the transition from the standardised to IRB approach of £801 million of franchise credit card and personal overdraft exposures in June 2015.
(3) £2.2 billion average EAD increase in standardised exposures secured by real estate property and defaulted exposures was driven by the acquisition of £3.0 billion of Whistletree book in December 2015.
(4) The increase in IRB exposures represents the following;
- Growth in TSB's franchise mortgage book; and
- Transition between standardised to IRB rating of franchise credit card and personal overdraft exposure in June 2015.

5.5. Original exposure: analysis by industry

Original risk exposures as at 31 December 2016, analysed by major industrial sector, are provided in the table below:

Table 14: Distribution of original exposures due to credit risk by industry (EU CRB-D)

£000	Agriculture, forestry and fishing	Mining and quarrying	Manufacturing	Electricity, gas, steam and air conditioning supply	Water supply	Construction	Wholesale and retail trade	Transport and storage	Accommodation and food service activities	Information and communication	Real estate activities	Professional, scientific and technical activities	Administrative and support service activities	Public administration and defence, compulsory social security	Education	Human health services and social work activities	Arts, entertainment and recreation	Financial and Insurance activities	Other services	Personal	Total
Retail	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	29,908,425	29,908,425
Total IRB approach	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**29,908,425**	**29,908,425**
Central governments or central banks														5,697,690							5,697,690
Multilateral Development Banks																		126,134			126,134
Institutions																		1,058,816			1,058,816
Corporates	93	1	34	1	-	144	128	20	106	6	159	48	2	-	5	41	19	6	34	-	847
Retail	18,582	192	6,803	191	45	28,729	25,616	4,021	21,230	1,147	31,732	9,478	463	90	959	8,225	3,738	940	6,703	143,234	312,118
Secured by mortgages on immovable property	3,018	31	1,105	31	7	4,666	4,161	653	3,448	186	5,154	1,540	75	15	156	1,336	606	153	1,089	4,232,350	4,259,780
Exposures in default	353	4	129	4	1	546	487	77	404	22	603	180	9	2	18	156	71	18	127	213,084	216,295
Equity exposures																		13,863			13,863
Other exposures																		378,968	3,084	318,067	700,119
Total Standardised approach	**22,046**	**228**	**8,071**	**227**	**53**	**34,085**	**30,392**	**4,771**	**25,188**	**1,361**	**37,648**	**11,246**	**549**	**5,697,797**	**1,138**	**9,758**	**4,434**	**1,578,898**	**11,037**	**4,906,735**	**12,385,662**
Total	**22,046**	**228**	**8,071**	**227**	**53**	**34,085**	**30,392**	**4,771**	**25,188**	**1,361**	**37,648**	**11,246**	**549**	**5,697,797**	**1,138**	**9,758**	**4,434**	**1,578,898**	**11,037**	**34,815,160**	**42,294,087**

5.6. Credit risk exposure: analysis by geography

Under CRD IV Article 432, institutions may omit certain disclosures if the information is not regarded as material or is deemed to be confidential. TSB Group has opted to use this materiality provision in respect of an election not to disclose the geographical distribution of £676 million of exposures to customers and institutions not resident in the UK. These exposures reflect retail mortgages to customers currently resident overseas, but secured on residential properties in the UK and certain Treasury exposures. These exposures are not deemed material in the context of the TSB Group's balance sheet and EBA reporting thresholds applied for regulatory reporting.

All credit risk exposures as at 31 December 2016 and at 31 December 2015 are categorised as being in the United Kingdom.

5.7. Credit risk exposure: analysis by residual maturity

Credit risk exposures as at 31 December 2016, analysed by residual contractual maturity, are provided in table 15 below:

Table 15: Analysis of EAD by residual maturity (EU CRB-E)

31 December 2016	On demand £000	Less than 1 year £000	Repayable between 1 and 5 years £000	Repayable over 5 years or undated £000	No stated maturity £000	TOTAL £000
Retail	3,621,351	376,175	2,522,701	23,909,569	-	30,429,796
Total IRB approach	**3,621,351**	**376,175**	**2,522,701**	**23,909,569**	**-**	**30,429,796**
Central governments or central banks	3,473,102	-	101,793	2,122,795	-	5,697,690
Multilateral Development Banks	-	-	-	126,134	-	126,134
Institutions	355,527	335,547	98,369	261,353	8,020	1,058,816
Corporates	-	17	96	732	-	845
Retail	26,621	2,538	14,957	236,903	-	281,019
Secured by mortgages on immovable property	32,520	39,782	262,149	3,777,468	-	4,111,919
Exposures in default	3,240	1,659	7,404	200,144	-	212,447
Equity exposures	-	-	-	-	13,863	13,863
Other exposures	2,835	-	-	-	697,284	700,119
Total Standardised approach	**3,893,845**	**379,543**	**484,768**	**6,725,529**	**719,167**	**12,202,852**
Total	**7,515,196**	**755,718**	**3,007,469**	**30,635,098**	**719,167**	**42,632,648**

5.8. Exposures subject to the Retail IRB approach

This section provides a summary of the TSB Group's portfolios subject to the retail IRB approach and a detailed analysis, by portfolio type and Probability of Default (PD) grade, of retail credit risk exposures subject to the Retail IRB Approach.

Table 16: Portfolios subject to the retail IRB approach

Regulatory Exposure Portfolio	Internal Portfolio	Internal Estimates Used	Internal ratings-based approach	Status
Retail	Residential Mortgages	Probability of default (PD) Loss given default (LGD) Credit conversion factor (CCF)	Advanced IRB	Authorised on 06/2014
Retail	Consumer Loans	Probability of default Loss given default Credit conversion factor	Advanced IRB	Authorised on 10/2014
Retail	Consumer Credit Cards	Probability of default Loss given default Credit conversion factor	Advanced IRB	Authorised on 06/2015
Retail	Personal Current Accounts	Probability of default Loss given default Credit conversion factor	Advanced IRB	Authorised on 06/2015

Disclosures provided in the tables below take into account PD floors and Loss Given Default (LGD) floors specified by regulators in respect of the calculation of regulatory capital requirements.

Internal rating scales

PD internal rating scales are used within TSB Group in assessing the credit quality of the Retail IRB unsecured lending and Franchise mortgages portfolios. One scale exists within the business, Retail Master Scale, which covers all relevant retail portfolios. TSB uses a continuous PD scale where customers are allocated to rating buckets for the purposes of reporting.

A detailed analysis, by portfolio type and by PD Grade, of credit risk exposures subject to the Retail IRB approach is provided in the sections that follow.

Table 17: Retail mortgage exposures by PD grade[1]

At 31 December 2016 PD Grade	Credit Risk Exposure £000	Exposure weighted average PD %	Exposure weighted average LGD[1] %	Average risk weight[2] %	Undrawn commitments (gross) £000	Undrawn commitments (post CCF) £000
0	21,701,533	0.4%	9.7%	6.9%	832,463	867,905
1	2,978,831	1.6%	12.1%	23.5%	581,183	609,251
2	309,895	4.6%	12.4%	45.2%	66,085	69,313
3	115,955	7.8%	10.6%	51.6%	7,359	7,720
4	107,580	13.7%	10.4%	63.1%	1,748	1,833
5	88,462	23.4%	10.0%	68.7%	410	430
6	43,781	34.3%	9.9%	68.7%	-	-
7	35,752	44.3%	9.3%	60.2%	-	-
8	33,569	55.6%	11.1%	62.2%	-	-
9	8,302	58.8%	10.7%	56.6%	-	-
10	25,548	74.6%	9.7%	34.2%	-	-
11	17,537	83.9%	10.2%	23.4%	-	-
12	13,780	89.7%	17.3%	26.0%	594	623
Default	66,618	100%	10.2%	80.7%	-	-
Total	**25,547,143**	**1.4%**	**10.0%**	**10.4%**	**1,489,842**	**1,557,075**

At 31 December 2015 PD Grade	Credit Risk Exposure £000	Exposure weighted average PD %	Exposure weighted average LGD[1] %	Average risk weight[2] %	Undrawn commitments (gross) £000	Undrawn commitments (post CCF) £000
0	16,894,529	0.3%	9.5%	5.4%	759,700	793,696
1	3,272,478	1.3%	12.1%	19.7%	553,124	579,777
2	473,469	3.5%	13.1%	40.1%	103,985	109,053
3	158,606	6.4%	11.8%	50.1%	19,847	20,821
4	153,586	10.8%	10.7%	57.8%	3,166	3,323
5	109,882	20.1%	11.4%	75.9%	51	54
6	52,269	29.7%	11.3%	80.5%	-	-
7	29,582	41.8%	10.2%	71.5%	113	118
8	36,528	49.9%	10.6%	69.8%	-	-
9	11,517	61.3%	11.8%	68.4%	-	-
10	15,117	75.7%	11.8%	52.3%	-	-
11	20,188	87.4%	10.4%	33.0%	-	-
12	24,284	99.9%	10.2%	16.3%	547	574
Default	96,534	100.0%	10.7%	92.5%	-	-
Total	21,348,569	1.7%	10.0%	10.3%	1,440,533	1,507,416

(1) The Mortgage PD model uses a Through-The-Cycle approach. Where portfolio level downturn LGD is lower than 10%, adjustments are made to individual account level LGDs so that downturn LGD for the TSB portfolio is equal to the 10% regulatory floor.

(2) The average risk weight includes post model adjustments applied directly to the risk weighted assets value.

Table 18: Other retail: personal loan exposures by PD grade

At 31 December 2016 PD Grade	Credit Risk Exposure	Exposure weighted average PD	Exposure weighted average LGD	Average risk weight	Undrawn commitments (gross)	Undrawn commitments (post CCF)
	£000	%	%	%	£000	£000
0	1,770	0.1%	80.1%	17.5%	4	1
1	40,867	0.3%	78.2%	42.4%	108	22
2	146,943	0.6%	80.5%	68.8%	382	76
3	253,554	1.0%	85.4%	93.3%	708	142
4	468,898	1.8%	89.6%	117.5%	1,626	325
5	229,762	3.2%	92.6%	137.7%	965	193
6	57,383	5.7%	94.1%	149.3%	317	63
7	13,626	8.6%	94.9%	161.6%	86	17
8	9,213	11.7%	95.4%	179.5%	59	12
9	5,301	17.3%	95.0%	210.4%	30	6
10	3,018	24.2%	95.3%	241.0%	19	4
11	2,414	37.2%	94.5%	263.5%	15	3
12	8,192	66.1%	94.1%	199.9%	34	7
Default	22,838	100%	89.8%	482.3%	-	-
Total	**1,263,779**	**4.4%**	**88.2%**	**118.5%**	**4,353**	**871**

At 31 December 2015 PD Grade	Credit Risk Exposure	Exposure weighted average PD	Exposure weighted average LGD	Average risk weight	Undrawn commitments (gross)	Undrawn commitments (post CCF)
	£000	%	%	%	£000	£000
0	1,347	0.1%	79.9%	19.1%	5	1
1	56,637	0.3%	81.2%	43.3%	206	41
2	133,492	0.6%	82.6%	70.0%	568	114
3	187,028	1.0%	84.6%	91.3%	901	180
4	480,592	1.8%	86.0%	113.0%	2,859	572
5	238,294	3.3%	87.5%	130.6%	1,718	344
6	86,305	5.6%	88.1%	139.7%	732	146
7	21,117	8.6%	88.7%	151.3%	209	42
8	14,187	11.6%	89.3%	167.8%	149	30
9	5,614	16.8%	89.8%	196.6%	47	9
10	2,642	24.2%	89.6%	226.7%	25	5
11	2,895	38.2%	88.5%	247.3%	26	5
12	9,262	66.2%	88.6%	184.8%	57	11
Default	23,279	100.0%	87.5%	333.1%	-	-
Total	1,262,691	4.7%	85.8%	113.9%	7,502	1,500

Table 19: Other retail: qualifying revolving exposures by PD grade: PCA

At 31 December 2016 **PD Grade**	**Credit Risk Exposure**	**Exposure weighted average PD**	**Exposure weighted average LGD**	**Average risk weight**	**Undrawn commitments (gross)**	**Undrawn commitments (post CCF)**
	£000	**%**	**%**	**%**	**£000**	**£000**
0	287,893	0.1%	81.6%	3.4%	163,333	286,753
1	569,319	0.2%	80.1%	10.4%	290,245	557,855
2	220,475	0.6%	79.9%	21.1%	119,400	197,503
3	115,282	1.0%	79.8%	32.1%	56,951	94,375
4	182,416	1.7%	79.2%	48.6%	78,226	131,158
5	104,671	3.3%	79.6%	77.7%	36,067	62,246
6	56,309	5.8%	80.1%	113.6%	13,742	30,484
7	23,931	8.6%	79.8%	144.6%	4,654	11,347
8	18,038	11.9%	79.9%	173.3%	3,001	7,736
9	12,906	16.6%	80.2%	205.5%	1,661	4,865
10	9,385	24.0%	80.2%	236.9%	1,055	3,314
11	5,553	36.0%	80.6%	259.3%	375	1,783
12	7,851	75.7%	79.5%	145.7%	643	2,326
Default	15,200	100%	77.7%	540.8%	496	-
Total	**1,629,229**	**2.8%**	**80.2%**	**37.4%**	**769,849**	**1,391,745**

At 31 December 2015 PD Grade	Credit Risk Exposure	Exposure weighted average PD	Exposure weighted average LGD	Average risk weight	Undrawn commitments (gross)	Undrawn commitments (post CCF)
	£000	%	%	%	£000	£000
0	295,022	0.1%	82.8%	3.4%	168,281	294,015
1	533,359	0.2%	81.5%	10.8%	272,436	521,968
2	204,042	0.6%	80.2%	21.0%	111,344	182,330
3	122,838	1.0%	79.9%	31.9%	60,050	98,895
4	190,088	1.8%	79.4%	49.0%	80,343	134,941
5	104,208	3.3%	79.6%	77.8%	34,029	61,215
6	61,297	5.7%	80.2%	112.8%	14,269	32,711
7	25,583	8.5%	79.5%	143.2%	5,257	11,794
8	19,696	11.8%	79.5%	171.6%	3,280	8,145
9	13,800	16.7%	79.8%	204.9%	1,744	4,943
10	9,622	24.2%	79.9%	236.7%	967	3,088
11	6,106	36.1%	79.9%	257.1%	385	1,695
12	7,221	71.5%	80.9%	168.0%	400	1,688
Default	14,574	100.0%	76.0%	482.4%	368	-
Total	1,607,456	2.8%	80.9%	38.1%	753,153	1,357,428

Table 20: Other retail: qualifying revolving exposures by PD grade: Credit Cards

At 31 December 2016 PD Grade	Credit Risk Exposure	Exposure weighted average PD	Exposure weighted average LGD	Average risk weight	Undrawn commitments (gross)	Undrawn commitments (post CCF)
	£000	%	%	%	£000	£000
0	639,285	0.1%	70.5%	2.7%	1,089,855	608,480
1	558,053	0.2%	75.6%	9.0%	958,840	462,430
2	203,936	0.6%	82.7%	22.0%	276,362	125,786
3	109,101	1.0%	85.6%	34.5%	114,528	52,724
4	183,246	1.8%	87.7%	54.1%	140,451	68,469
5	118,680	3.3%	90.1%	88.3%	52,582	29,872
6	74,426	5.8%	91.3%	128.5%	20,145	14,333
7	26,067	8.6%	91.9%	166.5%	5,010	4,322
8	24,767	11.7%	90.4%	194.7%	8,194	6,425
9	13,448	16.6%	92.3%	236.4%	1,641	1,968
10	8,415	24.3%	92.7%	275.4%	875	1,205
11	4,459	36.0%	93.6%	301.4%	398	631
12	4,180	64.7%	94.3%	232.8%	275	525
Default	21,582	100%	81.8%	268.6%	9,415	-
Total	**1,989,645**	**2.5%**	**78.5%**	**34.0%**	**2,678,571**	**1,377,170**

At 31 December 2015 PD Grade	Credit Risk Exposure	Exposure weighted average PD	Exposure weighted average LGD	Average risk weight	Undrawn commitments (gross)	Undrawn commitments (post CCF)
	£000	%	%	%	£000	£000
0	667,430	0.1%	70.1%	2.6%	1,174,562	637,495
1	532,598	0.2%	75.2%	8.8%	931,745	451,932
2	189,276	0.6%	82.1%	21.6%	272,092	122,288
3	110,893	1.0%	85.1%	34.2%	124,845	56,013
4	168,140	1.8%	87.7%	54.0%	135,561	64,039
5	115,363	3.3%	90.0%	88.0%	53,854	28,497
6	68,659	5.7%	91.5%	128.7%	19,557	12,644
7	33,485	8.8%	89.8%	164.7%	14,678	9,149
8	19,476	11.7%	92.4%	198.2%	3,490	2,888
9	12,803	16.7%	92.6%	237.5%	1,895	1,782
10	8,540	24.3%	93.0%	276.2%	1,144	1,174
11	5,550	36.1%	93.5%	301.0%	589	711
12	5,179	62.3%	94.7%	245.0%	336	561
Default	21,956	100.0%	81.7%	264.4%	9,515	-
Total	1,959,348	2.6%	78.0%	33.7%	2,743,863	1,389,173

5.9. Model performance

This section provides an analysis of the performance of IRB models as at 30 November 2016 for Residential Mortgages - Secured and Retail – Loans, Cards and Personal Current Account (PCA).

Table 21 compares the estimated and actual Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD) ratio by exposure class. The values are taken from the Group's regulatory capital calculation models, including the application of regulatory floors. For the purposes of comparison, EAD weighting has been used throughout.

The validation of model parameters and outputs forms part of the control framework surrounding the development and monitoring of Retail IRB models

Table 21: PD, LGD and EAD by exposure class

IRB Exposure Class			Loss Given Default of Defaulted Assets		Exposure at Default of Defaulted Assets
	Probability of Default	Observed default rate	Estimated	Actual	Ratio of Predicted to Actual
	Nov-15	Nov-16	Nov-15	Nov-16	Nov-16
	%	%	%	%	%
Retail - Loans	**2.77%**	**2.59%**	**87.53%**	**76.05%**	**106.75%**
Retail - Cards	**1.55%**	**1.16%**	**91.96%**	**71.73%**	**103.65%**
Retail - PCA	**2.15%**	**1.87%**	**80.16%**	**74.31%**	**111.35%**
Residential Mortgages	**1.09%**	**0.26%**	**10.97%**	**6.11%**	**103.31%**

A number of factors impact on the metrics shown, for example changes in portfolio composition arising from risk appetite realignment, changes in the risk profile of the portfolio, economic factors, movement in individual model parameters and prudence within the models. Models are refreshed through recalibration or are replaced as required.

In terms of components within the submission:

- The Mortgage PD model uses a Through-The-Cycle (TTC) approach which means that the gap between estimated and actual default rates will narrow or widen to reflect the cyclical nature of defaults.
- The Loans, Cards and PCA PD models use a Point-In-Time (PiT) approach which means that the regulatory PD calculation is calibrated to reflect the cyclicality of defaults. A PD buffer is applied to the PiT estimate to capture any movements in default rates between calibration and implementation and to ensure that PiT PD estimates are prudent. The methodology described is authorised by the PRA in accordance with Supervisory Statement 11/13 on IRB approaches and the specific characteristics of those portfolios. This approach is different from that used by Sabadell Group which is based on a long run or through the cycle PD.
- The LGD models are downturn calibrated resulting in the actual LGD being below predicted losses. For those assets where losses are not yet realised, the determination of actual LGD also includes the use of the PiT model estimates.
- The EAD ratio is provided as a proxy for the regulatory requirement to disclose information about credit conversion factors. The ratio provides a consistent measurement across the Secured and Unsecured rating systems. When a ratio is greater than one the predicted EAD is greater than the actual exposure on the date of default.

5.10. Impaired lending and provisions

Definition

The following definitions are employed:

- **Past due but not impaired exposures**: An exposure is past due when a counterparty has failed to make a payment when contractually due, but TSB continues to expect to collect the amounts due.
- **Impaired exposures**: In respect of secured mortgage portfolios, impaired loans are those six months or more in arrears (or in certain cases where the borrower is bankrupt or the underlying security is in possession). Accounts less than 90 days who are not in possession and not bankrupt are not considered impaired. This aligns to the CRR which gives national supervisors discretion to extend the days past due definition of default to 180 days. The PRA has extended this discretion to UK banks. For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above.
- **Impairment provisions**: Impairment provisions are a provision held on the balance sheet as a result of raising a charge against profit for the incurred loss in the lending book. An impairment provision may either be individually or collectively assessed.

Impairment provisions are required to be categorised as either General or Specific Credit Risk Adjustments as part of the capital requirements calculation process. All TSB Group's impairment provisions (whether individually or collectively assessed) are considered to be Specific Credit Risk Adjustments as they are recognised in accordance with International Accounting Standard 39 under an 'incurred loss' model.

Accounting Policy

At each balance sheet date TSB Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired.

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate (EIR). If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current EIR.

Impairment is assessed on a collective basis for homogenous groups of loans that are not considered individually impaired. The asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

Impairment allowances for portfolios of homogenous loans such as residential mortgages, personal loans and credit card balances, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses.

TSB Group's accounting policy in respect of impaired exposures (financial assets) and impairment provisions raised in respect of loans and receivables is detailed in the Notes to the Financial Statements in TSB Group's ARA on pages 66 to 67.

Implications for disclosures in respect of adoption of IFRS 9 '*Financial Instruments*' from 2018 are included in TSB Group's ARA on pages 73 to 75.

5.11. Managing impaired exposures and impairment provisions

Provisioning Policy

TSB Group's high level policies and standards in respect of the management of impaired exposures, the setting of impairment provisions and the write-off of impaired exposures are contained within the Risk function's Impairment Policies, and are reviewed and approved on an annual basis.

Adequacy Reviews

All lending assets are considered for impairment on a monthly basis.

Any assessment of impairment must be based on the information and events that have already occurred as at the review or balance sheet date. Events that occur after such date may be taken into account only where they inform the position at review or balance sheet date.

The process for estimating impairment must consider all credit exposures and not only those in default or of low credit quality.

Assets previously identified as impaired are reviewed to ensure that the objective evidence of impairment remains valid, that cash flow projections (including any potential net proceeds from the realisation of collateral) remain appropriate and that the impairment loss recorded in TSB Group's books and records continues to reflect the difference between the net present value and the carrying value of the asset. In the event that the future expected cash flow has changed from the previous assessment, an adjustment to the level of loss allowance is made as appropriate.

Where these impaired assets are within a pool of similar assets and are assessed collectively, the relevance of the pool within which the asset has been placed and the assumptions regarding cash flow emanating from the pool is considered. Upon review, if it can be evidenced that the impairment event has passed without detriment to the future expected cash flow and the net present value is greater than the carrying value of the asset, the asset can be re-categorised as unimpaired and the loss allowance released.

Reporting

All significant new impaired assets are reported by their respective business areas as soon as they arise. This supports the regular analysis of impairment exposures (including levels and trends) along with related provisions.

TSB Group reviews, at least annually, its provision forecast 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.

Stress and scenario testing are widely used throughout TSB Group to assess and support the business strategy.

A robust governance framework has been established to monitor impairment exposures, provisions and the impact of stress scenarios. Findings and recommendations are reported to regular Portfolio Quality Review meetings, Executive Risk Committees and the Board.

5.12. Management of customers experiencing financial difficulties

Forbearance

TSB Group operates a number of schemes to assist borrowers who are experiencing financial difficulties. Forbearance solutions may offer temporary relief in the form of reductions to contractual payments, and for customers who have longer term financial difficulties, term extensions and 'repair' approaches such as capitalisation of arrears.

For reporting purposes, TSB Group's definition of a restructured exposure is where terms of lending agreements have been renegotiated by either capitalisation of arrears, interest rate adjustment, payment holidays, interest capitalisation, forbearance of principal and gross lending that would otherwise be past due or impaired but whose terms have been renegotiated. For further details on forbearance, please refer to page 90 of the TSB Group's ARA.

5.13. Analysis of past due and impaired loans and advances to customers

As at 31 December 2016, past due but not impaired exposures in respect of loans and advances to customers amounted to £453 million (2015: £528 million). Impaired exposures in respect of loans and advances to customers amounted to £140 million (2015: £159 million), all of which were classified as 'impaired – provision held'.

Analysis by Industry

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2016, by industrial sector, is provided in the table below:

Table 22: Past due and impaired loans and advances to customers analysed by industry

	Past due but not impaired		Impaired		Of which	
At 31 December 2016	**£000**	**As a % of credit risk exposure**	**£000**	**As a % of credit risk exposure**	*Due to Arrears £000*	*Due to other reasons £000*
Agriculture, forestry and fishing	483	2.9%	215	0.7%	215	-
Energy and water supply	13	3.9%	-	0.1%	-	-
Manufacturing	96	1.3%	169	2.2%	168	-
Construction	483	4.7%	115	0.5%	109	6
Transport, distribution and hotels	1,384	2.7%	644	0.7%	605	39
Property companies	300	3.5%	451	0.7%	450	2
Financial, business and other services	833	1.4%	191	0.8%	185	5
Personal	449,326	1.3%	138,195	0.4%	113,806	24,390
Total	**452,918**	**1.3%**	**139,980**	**0.4%**	**115,538**	**24,442**

At 31 December 2015	Past due but not impaired £000	As a % of credit risk exposure	Impaired £000	As a % of credit risk exposure	Of which: Due to Arrears £000	Due to other reasons £000
Agriculture, forestry and fishing	390	1.6%	253	1.0%	253	-
Energy and water supply	-	0.0%	-	0.0%	-	-
Manufacturing	357	6.9%	79	1.5%	79	-
Construction	1,355	4.9%	318	1.1%	318	-
Transport, distribution and hotels	1,880	3.2%	1,177	2.0%	1,177	-
Property companies	1,597	2.8%	399	0.7%	399	-
Financial, business and other services	1,001	0.0%	218	0.0%	218	-
Personal	521,572	1.8%	156,512	0.5%	137,086	19,426
Total	528,152	1.4%	158,956	0.4%	139,530	19,426

Analysis by Geography

All past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2016 and at 31 December 2015 are categorised as being in the United Kingdom, based on the materiality assumptions, outlined on page 20.

5.14. Analysis of impairment provisions in respect of loans and advances to customers

Analysis by Industry

An analysis of closing impairment provisions, the net charge to the income statement and advances written off in respect of loans and advances to customers, by major industrial sector, is provided below:

Table 23: Analysis of impairment provisions by industry

	2016 Impairment provisions £000	**2016 Net charge £000**	**2016 Advances written off £000**	2015 Impairment provisions £000	2015 Net charge £000	2015 Advances written off £000
Agriculture, forestry and fishing	81	59	73	95	81	183
Energy and water supply	1	1	1	1	1	2
Manufacturing	38	21	57	74	63	143
Construction	145	86	197	256	219	493
Transport, distribution and hotels	288	139	497	646	553	1,245
Property companies	244	223	69	90	77	174
Financial, business and other services	171	110	203	264	226	610
Personal	72,775	86,669	86696	69,802	81,091	111,445
Total	**73,743**	**87,308**	**84,793**	71,228	82,311	114,295

The movement in impairment provisions, from 1 January 2016 to 31 December 2016, in respect of loans and advances to customers is provided below:

Table 24: Movement in impairment provisions

	Specific coverage determined individually £000	**Specific coverage determined collectively £000**	**Incurred but not reported coverage £000**	**Total £000**
At 1 January 2015	**1,396**	**61,641**	**23,021**	**86,058**
Movements reflected in the income statement	2,144	85,706	(5,539)	82,311
Movements not reflected in the income statement:	(2,395)	(94,746)	-	(97,141)
Utilisations	(2,395)	(111,800)	-	(114,195)
Other movements	-	17,054	-	17,054
At 31 December 2015	**1,145**	**52,601**	**17,482**	**71,228**
Movements reflected in the income statement	436	84,321	2,551	87,308
Movements not reflected in the income statement:	(956)	(83,837)	-	(84,793)
Utilisations	(956)	(100,900)	-	(101,856)
Other movements	-	17,063	-	17,063
At 31 December 2016	**625**	**53,085**	**20,033**	**73,743**

5.15. Credit risk mitigation

TSB Group uses a range of approaches to mitigate credit risk.

Credit policies and standards

TSB Group's Credit Risk function sets out credit policies and procedures according to which credit risk is managed. These are reviewed at least annually, and any changes are subject to a review and approval process. Policies and procedures are reviewed as appropriate to help anticipate future areas of concern and allow TSB Group to take early and proactive mitigating actions.

Portfolio Risk teams define credit strategies, aligned to credit policies and procedures, to manage the credit risk of TSB Group's portfolios, both on and off-balance sheet. Business area processes and procedures provide guidance to operational areas on the management of the portfolios where manual intervention is required. This includes documented guidance on lending for, and explicit limitations on, any discretionary powers held by sanctioners and underwriters; ensuring a consistent and controlled approach to making credit decisions.

Retail credit assessment

TSB Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit scorecards and involves a review of an applicant's previous credit history in the form of information held by credit reference agencies. For mortgage lending, TSB Group also assesses the affordability of lending to the customer under stressed scenarios including increased interest rates. In addition, TSB Group has in place limits such as maximum loan amounts, the level of borrowing to income and the ratio of borrowing to collateral. Certain limits are subject to internal approval levels while others are hard limits above which TSB Group will reject the application. TSB Group also has certain criteria applicable to specific products such as for buy-to-let mortgage applications.

Business banking credit assessment

Credit risk in the SME Retail customer portfolio is subject to individual credit assessments which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities and limit guidelines. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk.

Concentration risk

Concentration risk is the risk of losses arising as a result of concentrations of exposures due to imperfect diversification. TSB Group faces credit concentration risk in relation to the geographical spread of its secured mortgage portfolio in the UK generally, but specifically in Scotland and the South East of England. Concentration risks are monitored as part of TSB Group's lending strategy, with geographic and individual sectors measured to ensure an acceptable spread of risk is maintained in line with TSB Group's risk appetite. Where appropriate, TSB Group employs limits to control the level of exposure in certain product areas and commercial sectors.

Collateral

The principal collateral types for loans and advances are:

- mortgages over residential and commercial real estate;
- charges over business assets such as premises, inventory and accounts receivables; and
- guarantees received from third parties.

It is TSB Group's policy that collateral should be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral is reviewed on a regular basis in accordance with business unit credit standards, which will vary according to the type of lending and collateral involved. For retail residential mortgages, collateral valuation is reviewed quarterly using external house price indices.

Master netting

TSB Group's credit risk exposure on derivative and repo instruments is subject to master netting agreements in accordance with TSB Treasury Risk Counterparty Credit Risk policy. Although these do not always result in an offset of balance sheet assets and liabilities, as many transactions are settled on a gross basis, they do reduce credit exposures by ensuring amounts due on all instruments covered under the agreement are settled on a net basis in the event of a default.

Table 25: Net derivatives credit exposure

	2016 £000	2015 £000
Gross positive fair value of contracts	291,105	103,917
Netting benefits	657,666	290,460
Current credit exposure after netting benefits and before collateral	(262,982)	(133,193)
Collateral held	(35,275)	-
Collateral pledged	523,118	227,401
Derivatives credit exposure after netting benefits and collateral	**224,861**	94,208

Exposures covered by eligible collateral and guarantees
The criteria for recognising eligible collateral, the treatments that apply and the extent to which adjustments are made are set out under the relevant CRD IV provisions governing the application of credit risk mitigation under the IRB Approach (CRD IV Chapter 3) and the Standardised Approach (CRD IV Chapter 2).

Where a credit risk exposure subject to the IRB Approach is covered by a form of credit risk mitigation, this can result in an adjustment to the LGD value used in the calculation of the risk weighted asset amount.

TSB Group uses the Financial Collateral Comprehensive Method and applies the relevant adjustments for volatility and maturity mismatches for all collateral types. The regulatory requirements for recognition include a number of considerations including legal certainty of charge, frequency and independence of revaluation and correlation of the value of the underlying asset to the obligor. For counterparty credit risk, TSB Group uses the Current Exposure Method.

TSB Group does not make use of credit derivatives and does not rely on guarantees received for regulatory capital purposes.

6. Leverage ratio

The following tables present the disclosures required by the EBA Implementing Technical Standards (ITS) on disclosure for leverage ratio. Only items applicable to TSB Group are presented.

Table 26: Summary reconciliation of accounting assets and leverage ratio exposures

Basel III basis	**2016** **£000**	2015 £000
Total assets as per published financial statements	**37,195,703**	31,617,972
Adjustments for derivative financial instruments	(546,192)	(228,172)
Adjustments for securities financing transactions (SFTs)	163,764	597
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	798,264	709,656
Other regulatory adjustments	(85,727)	(73,861)
Total leverage ratio exposure	**37,525,812**	32,026,192

TSB Group calculates its leverage based on the exposure measure in CRR as amended by the EU Delegated Regulation 2015/62 published in January 2015, and the CRR definition of Tier 1. Final adjustments to the definition and calibration of the leverage ratio are expected in 2017, with a view to migrating to a Pillar 1 treatment in 2018. TSB Group continues to monitor developments in Basel III and their adoption in the CRD IV framework.

The leverage ratio measure is defined as the ratio of Tier 1 capital to total exposure. Items deducted from Tier 1 capital are also deducted from the exposure measure to ensure consistency between the capital and exposure components of the ratio. The Leverage Ratio is intended to complement the risk based capital requirements with a simple, non-risk based 'backstop' measure.

TSB Group's leverage ratio is 4.8% which comfortably exceeds the Basel Committee's proposed minimum of 3.0%, applicable from 2018. TSB Group will continue to monitor closely the leverage ratio against the emerging rules and minimum calibration. The leverage ratio has decreased from 5.2% to 4.8% in 2016. Although Tier 1 capital increased by £113m, largely from profits for the year, the leverage exposure grew by £5.5 billion, led by the growth in the mortgage franchise book.

Table 27: Leverage ratio disclosure

CRR leverage ratio exposures	**2016** **£000**	2015 £000
On-balance sheet exposures (excluding derivatives and SFTs)		
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	36,888,059	31,527,449
(Asset amounts deducted in determining Basel III Tier 1 capital)	(79,547)	(73,861)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**36,808,512**	31,453,588
Derivative exposures		
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	33,264	5,804
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	103,579	53,349
(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(435,546)	(196,802)
Total derivative exposures	**(298,703)**	(137,649)
Securities financing transaction exposures		
Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	25	-
Counterparty credit risk exposure for SFT assets	217,714	597
Total securities financing transaction exposures	**217,739**	597
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	5,284,671	5,311,578
(Adjustments for conversion to credit equivalent amounts)	(4,486,407)	(4,601,922)
Other off-balance sheet exposures	**798,264**	709,656
	37,525,812	32,026,192
Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)		
(Exemption of intra group exposures (solo basis) in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
Capital and total exposures		
Tier 1 capital	1,785,437	1,672,458
Total leverage ratio exposures	37,525,812	32,026,192
Leverage ratio	**4.8%**	5.2%

Table 28: Analysis of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

CRR leverage ratio exposures	2016 £000	2015 £000
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**36,452,514**	31,277,793
Banking book exposures, of which:	36,452,514	31,277,793
Exposures treated as sovereigns	5,722,031	3,958,076
Institutions	587,309	340,059
Secured by mortgages of immovable properties	26,764,401	23,625,733
Retail exposures	2,263,826	2,292,752
Corporate	845	856
Exposures in default	323,124	407,986
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	790,978	652,331

2016 exempted exposures consist of collateral of £465 million in 2016 and £250 million in 2015.

6.1. Management of excessive leverage

The risk of excessive leverage is the risk resulting from an institution's vulnerability to leverage or contingent leverage that may require unintended corrective measures to the business plan, including distressed selling of assets which might result in losses or in valuation adjustments to the remaining assets.

TSB Group monitors the risk of excessive leverage through the leverage ratio which is calculated and reported to Board, BEC and ALCO on a monthly basis.

A Board approved leverage ratio risk appetite is set above the minimum regulatory requirements.

The medium term plan (MTP), updated at least annually, considers compliance with the leverage ratio risk appetite. Where the risk of excessive leverage is identified in the MTP, the business plans are reconsidered to mitigate that risk.

7. Remuneration

TSB's remuneration is designed to be simple and fair, putting great customer service at the heart of what we do. Our reward philosophy, and the reward practices that underpin it, were established at IPO in 2014 and remain fundamentally unchanged.

The TSB Remuneration Committee is authorised by the Board to consider and recommend to the Board the framework of the remuneration policy of TSB. The TSB Remuneration Committee met 9 times during 2016.

Our Remuneration Policy

The aim of our remuneration policy remains to provide competitive remuneration aligned to the delivery of our strategic goals as outlined on page 4 of TSB Group's ARA. It is designed to attract and retain talented individuals; to promote TSB's values; to generate sustainable business performance, while taking into account effective risk management and acceptable conduct; and, given the particular challenges of 2016 and 2017, to focus on the successful delivery of the IT migration programme put in place following TSB's acquisition by Sabadell.

TSB has an Internal Remuneration Policy which sets out for management the Bank's overall approach to remuneration and how it impacts identified Partners. That information is readily available internally.

In addition, briefing sessions are held on an annual basis for Material Risk Takers (MRTs) hosted by the Human Resources and Risk Functions. At the briefings new MRTs are provided with relevant materials explaining their MRT status and the impact of this status on their remuneration. We subsequently write to all MRTs to confirm to them that they are a MRT. Each MRT is required to confirm that they accept that malus and/ or claw-back arrangements could be applied to any future variable remuneration awards made to them. For MRTs who join TSB or for Partners who become MRTs during the course of the year, individual briefings are arranged.

There are no differences in remuneration policy for different categories of partners at TSB; nor are there regional differences. The Remuneration Policy applies to all Partners of TSB. There have been no material changes to the remuneration policy during 2016.

The Remuneration Report in the TSB Group's ARA sets out:

- how TSB's remuneration policy continues to meet regulatory requirements (page 44);
- a summary of the key components of TSB's remuneration and its link to performance, including the main quantitative and qualitative performance and risk metrics (pages 44-47); and
- the governance procedure relating to the development of the remuneration policy, information about the bodies that played a significant role in its development and the role of external consultants (page 49).

The number of identified employees broken down by business area and senior management function is set out in the table below. There have been no significant changes in the number of MRT's from 2015.

Table 29: Identified employees

Data	MB Supervisory function £000	MB Management function £000	Retail Banking £000	Corporate functions £000	Independent control functions £000	All Other £000	Total £000
Total Remuneration 2016	659	15,450	3,878	5,216	4,098	-	**29,301**
No. of identified employees	5	14	15	14	15	-	**63**

The above table includes remuneration from Sabadell earned by 5 employees in respect of the 2016 performance year before their transfer to TSB Group from Sabadell.

Our Remuneration System

Our remuneration is structured into three main elements: competitive fixed pay, the TSB Award (short term incentive) for all partners and the Sustainable Performance Award (SPA) (long term incentive) for our more senior partners. In addition, a small number of senior partners are eligible to receive Sabadell Integration Awards (SIA) during the delivery of TSB's migration programme through to the end of 2017. An overview of TSB remuneration structures, an explanation of the consideration of risk and information on the application of ex ante and ex post risk adjustments are set out in the Remuneration Report on pages 44 and 47 of TSB Group's ARA.

Total remuneration for MRTs comprises the following elements:

- Fixed remuneration: Basic salary, pension (or cash in lieu of pension), participation in a flexible benefits scheme, a car allowance, access to all-employee share plans and, in the case of the Chief Executive Officer (CEO) only, a role based allowance.
- Variable remuneration: an annual TSB Award for all partners, and an annual Sustainable Performance Award grant for our more senior partners. Additionally, selected MRTs are eligible for the Sabadell Integration Award.

The rationale for the fixed elements of remuneration is based on common market practice, the nature of these payments being fixed and not performance related. The CEO is the only Partner who additionally receives a role-based allowance, which meets the EBA requirements in this respect. The role based allowance paid to the CEO is paid in cash and is not subject to deferral or performance conditions. It is intended as a fixed and permanent part of the CEO's total remuneration to reflect the change in his role following the acquisition of TSB by Banco Sabadell in 2015. The structure has not changed since it was introduced in June 2015 and no amendment to the nature or quantum of the allowance was made in 2016.

In making reward decisions, the TSB Remuneration Committee takes into account a report from the Chief Risk Officer (CRO), TSB Group's medium term plan, the risks (external and internal) to meeting the plan and the impact of stress tests.

The TSB Remuneration Committee retains the right throughout the process to make discretionary adjustments to reflect risk outcomes.

All elements of variable remuneration for MRTs are subject to ex post risk adjustment using malus and claw-back provisions in line with regulatory requirements.

A Remuneration Governance Group (RGG) has been established to assist the Remuneration Committee in identifying MRTs across the bank and in considering risk based adjustments to reward outcomes.

TSB is fully compliant with the Remuneration Code for Material Risk Takers. The percentage allocation between cash and equity for the TSB Award, Sustainable Performance Award and Sabadell Integration Award is as follows:

- TSB Award: The TSB Award made to Material Risk Takers is paid in a mix of cash and Sabadell shares (typically a 50% cash /50% shares division, but 40% cash/ 60% shares for BEC members). The shares are subject to a retention period to comply with the Remuneration Code's requirements. Whilst the TSB award is normally paid when due, a portion of any TSB Award may be deferred, should that be required to comply with the Remuneration Code. For all other participants, the TSB Award is paid in cash.
- Sustainable Performance Award: Any award is a mixture of shares and cash, with a 70% shares/30% cash split for the CEO and Chief Financial Officer (CFO), 60%/40% for all other BEC members and 50%/50% for any other Material Risk Takers. Both the level of award and the share price are set at the time of grant. Grants vest to the extent performance conditions are met between years 3 and 7 post grant for Senior Managers and between years 1 and 5 post grant for all other MRTs.
- Sabadell Integration Award: Any 2016 awards will be made in line with SPA allocations, i.e., 70% shares and 30% cash for the CEO, 60% shares/ 40% cash for other BEC members, 50% shares and 50% cash for other MRTs and in cash for other participants. A portion of any award vests when due with remainder vesting between years 3 and 7 post grant for Senior Managers and between years 1 and 5 post grant for all other MRTs.

There is no difference in award allocations for Material Risk Takers in control functions.

The Control Functions' heads (CRO and Chief Audit Officer (CAO)) are members of the BEC and all Partners engaged in each discipline have direct reporting lines within that function. The Control Function heads have dual reporting lines to the CEO and to the Chair of the Risk and Audit Committee respectively. The TSB Remuneration Committee receives input from the relevant Committee Chair in making reward decisions for the CRO and CAO.

The CRO, CAO and their direct reports are Material Risk Takers and their remuneration is overseen directly by the TSB Remuneration Committee.

For non-Material Risk Takers staff in the Control Functions, reviews of fixed and variable pay are managed by the line with oversight from the HR department, based on external market data, internal relativities and corporate and individual performance, with individual balanced scorecards reflecting the delivery of personal objectives linked to the delivery of the Risk and Audit annual work cycles. Final approval of reward outcomes for all staff sits with the CEO after review by the HR Director.

As explained on page 33, the quantum of fixed and variable pay for relevant MRTs is approved by the Remuneration Committee based on input from the CRO and the CFO. Additionally, a balanced scorecard is agreed for each Control Function area with objectives linked to the deliverables of that particular function rather than the Bank as a whole.

Following the acquisition of TSB by Sabadell in 2015, the TSB Remuneration Committee agreed that BEC members were no longer required to build a personal shareholding in the business. This reflects the practice of the parent company and is in line with market practice for subsidiaries. However, the deferred nature of a significant proportion of variable remuneration and holding requirements on shares post vesting means that at any point our BEC members have their interests aligned with our shareholder through their shareholding in the parent company.

Guaranteed bonus payments may only be offered for a period of no more than one year and only in exceptional circumstances to new hires for the first year of service. It must be in line with the terms in place with the previous employer and have performance conditions attached to it. Guaranteed variable awards are not common practice for Material Risk Takers and will be limited to rare and infrequent occurrences.

Severance payments are made in line with contractual obligations and, in terms of variable remuneration, in line with the relevant scheme rules. For MRTs any variable remuneration which subsist post severance remain subject to the requirements on performance, deferral and holding post vesting. In addition, malus and claw-back provisions continue to apply. Severance payments are paid in line with the principle of “no reward for failure”.

Information on the ratio between the variable and fixed remuneration components of total remuneration is set out in the Remuneration Report on page 44 of the TSB Group’s ARA.

The Remuneration Committee has discretion as to whether and in what circumstances a discount factor should be applied. A discount may be applied to the SPA and the Sabadell Integration Award in accordance with EU published guidance to reflect the five year release cycle of the plans (seven for Senior Managers).

In practice, TSB’s remuneration package would not ordinarily require a discount to be calculated in order to comply with the variable pay cap for most partners, although as a matter of principle the discount is applied annually to the variable remuneration of relevant identified staff. The relevant discount factor is calculated annually using the EBA methodology and varies by individual depending on the exact nature of their remuneration outcomes, but the number of identified staff for whom the discount rate was applied in respect of 2016 remuneration was 13 and the maximum discount applied to relevant 2016 variable remuneration was 14.6%.

Remuneration for the year ended 31 December 2016

Table 30: Details of remuneration for the year ended 31 December 2016

	Board members £000	Senior management £000	Other management £000	Total £000
Fixed remuneration	**1,620**	**4,865**	**8,028**	**14,513**
Variable remuneration	**2,979**	**5,986**	**5,165**	**14,130**
Instant payment				
Cash	250	701	871	**1,822**
Shares	534	1,010	838	**2,382**
Number of Banco Sabadell equity shares	472	891	740	**2,103**
Deferred payment				
Cash	659	1,717	1,728	**4,104**
Shares	1,536	2,558	1,728	**5,822**
Number of Banco Sabadell equity shares	1,356	2,258	1,526	**5,140**
Other types of remuneration	**-**	**-**	**-**	**-**
Remuneration as Directors of the Group	**659**	**-**	**-**	**659**
Number of identified employees	7	12	44	**63**
Amount of annual compensation payments	-	14	30	**44**
Number of employees with compensation	-	1	1	**2**

The above table includes remuneration from Sabadell earned by 5 employees in respect of the 2016 performance year before their transfer to TSB Group from Sabadell.

Glossary

Adjusted exposure	Original exposure net of value adjustments and provisions.
Basel Committee	The Basel Committee is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. The Committee reports to the Group of Governors and Heads of Supervision (GHOS).
Buy-to-let mortgages	Buy-to-let mortgages are those mortgages offered to customers purchasing residential property as a rental investment.
Capital Requirements Directive IV (CRD IV)	On 27 June 2013, the European Commission published, through the official journal of the European Union, its legislation for a Capital Requirements Directive and Capital Requirements Regulation (CRR), which form the CRD IV package. Amendments were subsequently made to the Regulation published on 30 November 2013. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance and remuneration. The rules were implemented from 1 January 2014 onwards, with certain sections yet to be phased in.
Claw-back	The recovery of part or all of a remuneration award post vesting.
CCP (Central Counterparty)	A central counterparty (CCP) is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. For the purposes of the capital framework, a CCP is a financial institution.
Commercial real estate	Commercial real estate includes office buildings, medical centres, hotels, malls, retail stores, shopping centres, farm land, housing buildings, warehouses, garages, and industrial properties.
Common Equity Tier 1 (CET1) capital	The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
Common Equity Tier 1 ratio	Common Equity Tier 1 Capital as a percentage of risk weighted assets.
Contingent leverage	Contingent leverage represents off-balance sheet items which could convert into on-balance items e.g. unutilised credit limits could be utilised in future.
Core Tier 1 capital	As defined by the Prudential Regulation Authority (PRA) mainly comprising shareholders' equity after regulatory deductions.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and include derivative contracts and repo contracts.
Credit Conversion Factor (CCF)	Credit conversion factors (CCF) are used in determining the exposure at default (EAD) in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn commitments expected to be drawn down at the point of default.
Credit risk	The risk of reductions in earnings and / or value, through financial loss, as a result of the failure of the party with whom the TSB Group has contracted to meet its obligations (both on and off balance sheet).
Credit risk mitigation (CRM)	A technique used to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantees and credit protection.
Debt securities	Debt securities are assets held by the TSB Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	These are unsubordinated liabilities issued by the TSB Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Enhanced Disclosure Task Force (EDTF)	The Enhanced Disclosure Task Force (EDTF) was established by the Financial Stability Board in May 2012 with the goal for improving the quality, comparability and transparency of risk disclosures. The EDTF issued a report in October 2012 setting out 32 recommendations across seven risk areas.
European Banking Authority (EBA)	The European Banking Authority (EBA) is a regulatory agency of the European Union headquartered in London, United Kingdom. Its activities include conducting stress tests on European banks to increase transparency in the European financial system and identifying weaknesses in banks' capital structures.[2] The EBA was established on 1 January 2011,

upon which date it inherited all of the tasks and responsibilities of the Committee of European Banking Supervisors (CEBS).

Ex ante and ex post risk adjustments Reduction or cancellation of awards prior to vesting and recovery of part or all of an award post vesting.

Expected Loss (EL) Expected loss represents the anticipated loss, in the event of default, on a credit risk exposure modelled under the internal ratings based approach. EL is determined by multiplying the associated probability of default, loss given default and exposure at default together and assumes a 12 month time horizon.

Exposure at Default (EAD) Exposure at default represents the estimated exposure to a customer in the event of default. In determining EAD amounts, consideration is made of the extent to which undrawn commitments may be drawn down at the point of default (see Credit Conversion Factors) and the application of credit risk mitigation (i.e. eligible financial collateral).

Franchise TSB's business excluding the Mortgage Enhancement transaction and acquired Whistletree assets.

Fully adjusted exposure On Balance Sheet Amount of the exposure net of value adjustments after taking into account outflows and inflows due to Credit Risk Mitigation (CRM). Article 220 (4), Article 223 (2) to (5) and Article 228 (1) of Capital Requirements Regulation.

Fully adjusted exposure Off Balance Sheet Amount of the exposure net of value adjustments after taking into account outflows and inflows due to Credit Risk Mitigation (CRM) pre application of the Credit Conversion Factors.

General Credit Risk Adjustment (GCRA) Those credit risk adjustments that are freely and fully available, as regards to timing and amount, to meet losses that are not yet materialised or where no evidence of a loss event has occurred.

Impaired loans Impaired loans are loans where the TSB Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.

Impairment allowances Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may be either individual or collective.

Impairment losses An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the asset's value is lower than its carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate.

Incurred loss model An incurred loss model assumes that all loans will be repaid until evidence to the contrary (known as a loss or trigger event) is identified. Only at that point is the impaired loan (or portfolio of loans) written down to a lower value.

Individually / collectively assessed Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.

Interest Rate Risk in the Banking Book (IRRBB) The risk of losses that TSB may incur as a result of outright movements in interest rates or the widening of the spread between TSB Group Base Rate and LIBOR rates.

Internal Capital Adequacy Assessment Process (ICAAP) The TSB Group's own assessment, based on CRD IV requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.

Internal Ratings Based Approach (IRB) A methodology of estimating the credit risk within a portfolio by utilising internal risk parameters to calculate credit risk regulatory capital requirements.

Leverage Ratio Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure.

Leverage Ratio exposure The Leverage Ratio exposure measure is the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items. The specific treatments for these four main exposure types are defined by the Basel III leverage ratio framework disclosure requirements.

Lifetime Expected Loss (LEL) The predicted expected loss over the whole term of the transaction in question.

Loss Given Default (LGD) Loss given default represents the estimated proportion of an EAD amount that will be lost in the event of default. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.

Material Risk Takers	Employees who have a material impact on TSB's risk profile.
Malus	The reduction or cancellation of remuneration awards prior to vesting.
Market risk	The risk that unfavourable market movements (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and / or value.
Model validation	The process of assessing and providing evidence that the TSB Group's models perform as planned and adequately reflect the risk profile of the business, and that there are no material misstatements of the capital requirement.
Mortgage Enhancement	The business segment created to reflect the transfer of the economic benefit of a £3.4 billion portfolio of mortgages to the TSB Group from LBG with effect from 28 February 2014.
Operational risk	The risk of reductions in earnings and / or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people-related or external events.
Original exposure	The exposure value without taking into account value adjustments and provisions, conversion factors and the effect of credit risk mitigation techniques.
Pillar 1	The first pillar of the Basel III framework sets out the quantitative elements – the minimum regulatory capital requirements for credit, operational and market risks.
Pillar 2	The second pillar of the Basel III framework sets out the qualitative expectations that should be met through the supervisory review process. This includes the ICAAP, governance process and the Supervisory Review Process. It sets out the review process for a bank's capital adequacy; the process under which the supervisors evaluate how well financial institutions are assessing their risks and the actions taken as a result of these assessments.
Pillar 3	The third pillar of the Basel III framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.
Point-in-Time (PiT)	Estimates of PD (or other measures) made on a point-in-time (PiT) basis generally cover a short time horizon (usually a 12 month period) and are sensitive to changes in the economic cycle. This differs from a through-the-cycle (TTC) basis which uses long run average economic and risk data to reduce such sensitivity.
Probability of Default (PD)	Probability of default represents an estimate of the likelihood that a customer will default on their obligation within a 12 month time horizon.
Qualifying Revolving Retail Exposure (QRRE)	Qualifying Revolving Retail Exposures (QRRE) relate to revolving, unsecured retail exposures that, to the extent they are not drawn, are immediately and unconditionally cancellable. Such exposures include credit cards and overdraft facilities.
Regulatory capital	The amount of capital that the TSB Group holds, determined in accordance with rules established by the PRA.
Repurchase agreements or 'repos'	Short-term funding agreements which allow a borrower to sell a financial asset as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.
Residual Maturity	The remaining time in years that a borrower is permitted to take to fully discharge its contractual obligation (principal, interest and fees) under the terms of a loan agreement.
Retail Internal Ratings Based (Retail IRB) Approach	The Retail Internal Ratings Based (Retail IRB) Approach allows internal estimates of PD, LGD and EAD to be used in determining credit risk capital requirements for retail portfolios.
Retail SME	A small or medium sized entity, an exposure to which may be treated as a retail exposure.
Risk appetite	The amount and type of risk that the TSB Group is prepared to seek, accept or tolerate.
Risk weighted assets (RWAs)	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with CRD IV.
Securities financing transactions (SFTs)	Securities financing transactions are repurchase and reverse repurchase agreements, buy / sell backs and securities lending. For the lender (seller) of the securities it is usually a way to raise funds to finance the securities positions. For the borrower (buyer) of the securities it is a way to invest short–term funds or to cover short (bond) positions.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.

Specific Credit Risk Adjustment (SCRA)	Those credit risk adjustments that do not meet the criteria to be recognised as GCRAs. Credit risk adjustments recognised via an incurred loss model under IAS 39 are classed as SCRAs.
Standardised Approach	The Standardised Approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by External Credit Rating Agencies to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements.
Stress testing	Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds which are required to be held.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Supervisory Review and Evaluation Process (SREP)	The appropriate regulator's assessment of the adequacy of certain firms' capital.
The Standardised Approach (SA)	A standardised measure for calculating operational risk capital requirements based on the three year average of the aggregate risk weighted relevant indicators of the underlying business. The relevant indicators are derived from total income.
Through-The-Cycle (TTC)	See Point-in-time (PiT).
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 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A component of regulatory capital defined by CRD IV, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
Undrawn commitments	Assets / Liabilities that have been committed but not yet transacted. In terms of credit risk, these are obligations to make loans or other payments in the future.
Whistletree	Whistletree Loans is a separate portfolio of former Northern Rock mortgages and unsecured loans which was acquired with effect from 7 December 2015.

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