TSB Banking Group plc

Significant Subsidiary Disclosures 31 December 2017

Contents

Index of tables

1. Introduction

This document presents the Pillar III Significant Subsidiary Disclosures at 31 December 2017 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 2017, have been labelled in accordance with these guidelines. An analysis of compliance with CRD IV requirements in respect of significant subsidiary disclosure is set out in Appendix I.

This document should be considered in conjunction with the TSB Group's 2017 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 58 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

During 2017 TSB continued to deliver on its mission to bring more competition to UK banking. It's now four years since we launched and we continue to demonstrate that a bank focused on serving local communities really can thrive. The Bank is growing, and our high-tech transformation has gathered pace in 2017.

In 2017 customer lending grew by 4.9% to over £30 billion; this has now grown by over 50% since launch. Growth in customer lending was supported by our mortgage offering with Franchise mortgage balances increasing by 15.1% to £26 billion.

Following on from developments in 2016, TSB's personal unsecured loans were made available through our branch network and digital channels during 2017 to customers who do not yet have a TSB bank account. This supported the growth of 16.9% in personal unsecured loans balances.

We have continued to grow TSB in a responsible way, evidenced by the average mortgage loan to value which remains low at 44.2%.

TSB Group's capital position remains strong with a Common Equity Tier 1 (CET1) Capital ratio of 20.0% and a leverage ratio of 4.5% which is sufficient to support the delivery of TSB Group's growth strategy.

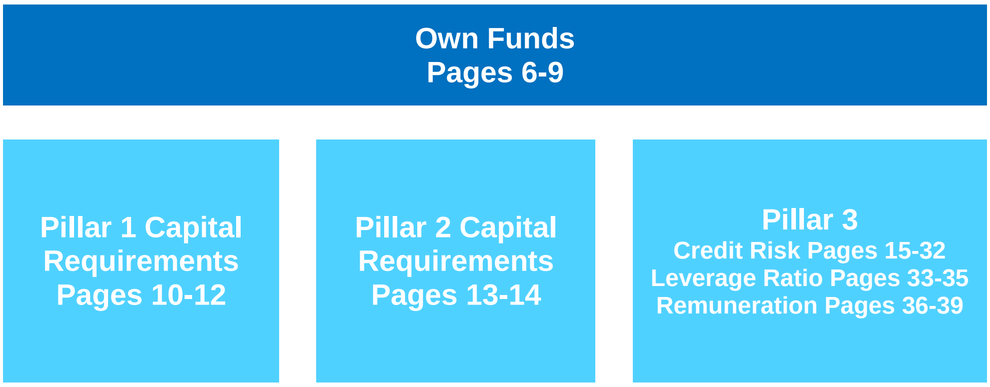
Key metrics	**2017**	2016
Common Equity Tier 1	£1.9bn	£1.8bn
Common Equity Tier 1 ratio	20.0%	18.5%
Total Capital	£2.3bn	£2.2bn
Total Capital ratio	24.0%	22.4%
Credit Risk Exposure at Default (EAD)	£47.3bn	£42.6bn
Credit Risk Weighted Assets (RWAs)	£8.0bn	£8.3bn
Operational Risk RWAs	£1.5bn	£1.4bn
Total RWAs	£9.5bn	£9.7bn
Basel III Leverage ratio	4.5%	4.8%
UK Leverage Ratio	5.4%	5.3%

The CET 1 capital ratio increased by 150bps to 20.0% at December 2017 primarily due to attributable profit of £118.7 million earned in 2017. RWAs at 31 December 2017 decreased by £183.8 million compared to December 2016 due to the effect of the early return of the Mortgage Enhancement portfolio, the ongoing and expected repayment of the Whistletree loan portfolio, and lower balances held with other institutions, partially offset by growth in the Franchise IRB portfolio.

TSB Group's leverage ratio continues to comfortably exceed the Basel Committee's proposed minimum of 3%, applicable from 1 January 2018. TSB Group is not currently subject to the Bank of England's (BoE) UK leverage ratio framework. However, under this framework leverage ratios will be calculated on a modified basis, excluding qualifying central bank claims from the exposure measure, in accordance with the PRA policy statement issued in October 2017. TSB Group's modified leverage ratio is 5.4%, well in excess of the PRA minimum of 3.25%.

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 Group 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 9 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.

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 the shareholder.

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, also, 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), 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 2017 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 (OFD2)

31 December	2017	2016
	£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	1,292,336	1,173,675
Accumulated other comprehensive income (and any other reserves)	(266,739)	(278,741)
CET1 capital before regulatory adjustments	**1,995,648**	1,864,984
CET1 capital: regulatory adjustments		
Additional value adjustment	(2,989)	(3,071)
Intangible assets (net of related tax liability)	(10,146)	(2,571)
Fair value reserve relating to gains and losses on cash flow hedges	461	(366)
Negative amounts resulting from the calculation of expected loss amounts	(84,831)	(73,539)
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(97,506)**	(79,547)
CET1 capital / Tier 1 capital[(1)]	**1,898,142**	1,785,437
Tier 2 capital: instruments and provisions		
Capital instruments and related share premium accounts	384,070	383,792
Credit risk adjustments	-	142
Tier 2 capital	**384,070**	383,934
Total capital	**2,282,212**	2,169,371
Total Risk Weighted Assets	**9,490,710**	9,674,544
Capital Ratios		
Common Equity Tier 1 (as a percentage of total risk exposure amount)	20.0%	18.5%
Tier 1 (as a percentage of total risk exposure amount)	20.0%	18.5%
Total capital (as a percentage of total risk exposure amount)	24.0%	22.4%
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)	7,000	5,200
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)	17,164	8,663
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)	68,557	99,563
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	36,571	32,720

(1) 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 (OFD3)

	CET1 Capital	AT1 Capital	Tier 2 Capital	Total
	£000	£000	£000	£000
At 31 December 2016	**1,785,437**	**-**	**383,934**	**2,169,371**
Profit attributable to the ordinary shareholder	118,662	-	-	118,662
Movement in other comprehensive income (including available for sale)	12,001	-	-	12,001
Movement in other reserves	-	-	-	-
Cash flow hedging reserve regulatory adjustment	827	-	-	827
Change in excess of expected losses over impairment allowances	(11,292)	-	-	(11,292)
Issuances of subordinated liabilities	-	-	279	279
Change in excess of default provision over default expected loss	-	-	(142)	(142)
Change in intangible fixed assets	(7,575)	-	-	(7,575)
Movement in prudent valuation adjustment	82	-	-	82
Movement in deferred tax above 10% threshold	-	-	-	-
At 31 December 2017	**1,898,142**	**-**	**384,070**	**2,282,212**

	CET1 Capital	AT1 Capital	Tier 2 Capital	Total
	£000	£000	£000	£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)
Movement in other reserves	-	-	-	-
Cash flow hedging reserve regulatory adjustment	(1,227)	-	-	(1,227)
Change in excess of expected losses over impairment allowances	(1,470)	-	-	(1,470)
Issuances of subordinated liabilities	-	-	279	279
Change in excess of default provision over default expected loss	-	-	142	142
Change in intangible fixed assets	(1,560)	-	-	(1,560)
Movement in prudent valuation adjustment	(1,429)	-	-	(1,429)
Movement in deferred tax above 10% threshold	-	-	-	-
At 31 December 2016	1,785,437	-	383,934	2,169,371

Tier 1 Capital increased by £113 million during 2017. This was primarily due to attributable profit of £118 million for the year and an increase in other comprehensive income of £12 million and was partially offset by movements in excess expected loss and intangible assets.

Tier 2 Capital is subordinated debt issuance.

With effect from 1 January 2018, TSB Group adopted IFRS 9 Financial Instruments. This is expected to result in an increase in the allowance for loan losses of £96 million at 1 January 2018 which, after tax, would reduce shareholder's equity by £72 million. The impact on TSB Group's regulatory capital position at 1 January 2018 is not expected to be significant, as the effect of the increase in impairment allowance is more than offset by a reduction in excess expected losses and the effect of optional transitional arrangements permitted by regulators to absorb the full impact of IFRS 9 in regulatory capital calculations over the five year period to 2022. As a result, the adoption of IFRS 9 is expected to result in a decrease in the CET 1 ratio at 1 January 2018 of circa 2 bps, on a fully loaded basis, and an increase of circa 10 bps on a transitional basis.

3.4 Other capital disclosures

Table 3: Reconciliation between statutory and regulatory capital (OFDR)

	2017 Statutory balance	**2017 Regulatory adjustments**	**2017 Regulatory balance**	2016 Statutory balance	2016 Regulatory adjustments	2016 Regulatory balance
	£000	**£000**	**£000**	£000	£000	£000
Own funds	**1,977,386**	-	**1,977,386**	1,858,725	-	1,858,725
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	1,292,336	-	1,292,336	1,173,675	-	1,173,675
Value adjustments	**18,262**	-	**18,262**	6,259	-	6,259
Cash flow hedging reserve	(461)	-	(461)	366	-	366
Other value adjustments	18,723	-	18,722	5,893	-	5,893
Total equity	**1,995,648**	-	**1,995,648**	1,864,984	-	1,864,984
Cash flow hedging reserve	-	461	461	-	(366)	(366)
Intangible assets	-	(10,146)	(10,146)	-	(2,571)	(2,571)
Prudent valuation adjustment	-	(2,989)	(2,989)	-	(3,071)	(3,071)
Negative amounts resulting from the calculation of expected loss amounts	-	(84,831)	(84,831)	-	(73,539)	(73,539)
Tier 1 Capital	**1,995,648**	**(97,506)**	**1,898,142**	1,864,984	(79,547)	1,785,437
Subordinated debt	384,070	-	384,070	383,792	-	383,792
Generic funds and provision excess	-	-	-	-	142	142
Tier 2 Capital	**384,070**	**-**	**384,070**	383,792	-	383,934
Total Regulatory Capital	**2,379,718**	**(97,506)**	**2,282,212**	2,248,776	(79,405)	2,169,371

The principal features of TSB Group's capital instruments are outlined in Appendix II.

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 2017 are presented in the following table:

Table 4: Overview of RWAs (EU OV1)

	RWAs		Minimum capital requirements
	2017 £000	2016 £000	**2017 £000**
Credit risk (excluding counterparty credit risk)(CCR)	**7,693,148**	7,796,692	**615,453**
Of which the standardised approach	1,597,993	2,343,426	127,840
Of which the foundation IRB (FIRB) approach	-	-	-
Of which the advanced IRB (AIRB) approach	6,095,155	5,453,266	487,612
Of which equity IRB under the simple risk-weighted approach or the IMA	-	-	-
Counterparty credit risk (CCR)	**119,566**	206,645	**9,565**
Of which mark to market	53,969	137,221	4,318
Of which original exposure	-	-	-
Of which the standardised approach	-	-	-
Of which internal model method (IMM)	-	-	-
Of which risk exposure amounts for contributions to the default fund of a CCP	4,634	513	371
Of which CVA	60,963	68,911	4,877
Settlement risk	-	-	-
Securitisation exposures in banking book (after cap)	-	-	-
Of which IRB ratings-based approach	-	-	-
Of which IRB Supervisory Formula Approach (SFA)	-	-	-
Of which Internal assessment approach (IAA)	-	-	-
Of which Standardised approach	-	-	-
Market risk	-	-	-
Of which standardised approach	-	-	-
Of which internal model approaches (IMA)	-	-	-
Large exposures	-	-	-
Operational risk	**1,463,693**	1,400,642	**117,095**
Of which Basic Indicator Approach	-	-	-
Of which Standardised Approach	1,463,693	1,400,642	117,095
Of which Advanced Measurement Approach	-	-	-
Amounts below the thresholds for deduction (subject to 250% risk weight)	**214,303**	270,565	**17,144**
Floor adjustment	-	-	-
Total	**9,490,710**	9,674,544	**759,257**

RWAs at 31 December 2017 decreased by £183.8 million mainly due to the early return of the Mortgage Enhancement portfolio and in line with the expected run off of the Whistletree portfolio, partly offset by growth in the Franchise IRB portfolio.

Table 5: Total amount of risk weighted assets and minimum own funds requirements

Exposure classes and risk types	**2017 RWA £000**	**2017 Minimum Capital Requirements £000**	2016 RWA £000	2016 Minimum Capital Requirements £000
Credit risk (standardised approach)	**1,866,265**	**149,301**	2,751,212	220,098
Central governments and central banks	**171,393**	**13,711**	248,907	19,913
Institutions	263,103	21,048	290,193	23,215
Corporates	19,676	1,574	845	68
Retail	141,003	11,280	186,714	14,937
Exposures collateralised with residential or commercial property	689,199	55,136	1,438,153	115,052
Exposures in default status	160,252	12,820	214,401	17,152
Equity exposures	49,910	3,993	26,858	2,149
Other exposures	371,730	29,738	345,141	27,612
Credit risk (internal ratings-based approach)	**6,095,155**	**487,612**	5,453,266	436,261
Retail	6,095,155	487,612	5,453,266	436,261
i) Mortgages for residential or commercial property	3,044,919	243,594	2,668,788	213,503
ii) Eligible revolving exposures	1,306,178	104,494	1,286,364	102,909
iii) Other retail	1,744,058	139,525	1,498,114	119,849
Contribution to default guarantee fund of a CCP	**4,634**	**371**	513	41
Operational risk	**1,463,693**	**117,095**	1,400,642	112,051
Operational risk (standardised approach)	1,463,693	117,095	1,400,642	112,051
Credit valuation adjustment risk	**60,963**	**4,877**	68,911	5,513
Total minimum own funds requirement	**9,490,710**	**759,257**	9,674,544	773,964

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 2016 to 31 December 2017:

Table 6: RWA flow statement of credit risk exposures under IRB (EU CR8)

	RWA £000	**Capital requirements £000**
At 31 December 2016	**5,453,266**	**436,261**
Asset size	1,219,475	97,558
Asset quality	(671,462)	(53,716)
Model updates	94,504	7,560
Methodology and policy	-	-
Acquisitions and disposals	-	-
Foreign exchange movements	-	-
Other	(629)	(51)
At 31 December 2017	**6,095,155**	**487,612**

	RWA £000	Capital requirements £000
At 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	-	-
Acquisitions and disposals	-	-
Foreign exchange movements	-	-
Other	(176)	(14)
At 31 December 2016	5,453,266	436,261

During 2017, IRB credit risk RWAs have increased by £0.6 billion (11.0%) due to the following factors:

- Net asset growth which resulted in increased RWAs of £1.2 billion, mainly from the continued growth in franchise mortgages; and
- A reduction in RWAs of £0.7 billion arising from a better quality of lending and improved lending environment.

Standardised Credit Risk RWAs have decreased by £0.9 billion (2017: £1.9 billion; 2016: £2.8 billion) mainly due to the early return of the Mortgage Enhancement portfolio, the expected run off of the Whistletree portfolio and a reduction in counterparty credit risk RWAs.

4.3 Segmental risk weighted assets

TSB Group's risk weighted assets are presented on a segmental basis in the table below. During 2017, the Whistletree and Franchise segments were combined, reflecting the direct nature of the relationship between TSB and Whistletree branded customers. The Mortgage Enhancement portfolio of assets, which was assigned to TSB Group in 2014, was returned early to LBG in June 2017, having achieved its profit target.

Table 7: Segmental analysis of total risk weighted assets

	2017 RWA £000	**2017 Capital requirements £000**	2016 RWA £000	2016 Capital requirements £000
Total Credit Risk:	**8,027,017**	**642,161**	8,067,257	645,381
Total Franchise Credit Risk [(1)]	7,907,451	**632,596**	7,413,091	593,047
Of which: Franchise standardised approach	845,344	**67,628**	827,945	66,236
Of which: Franchise IRB approach	6,095,155	**487,612**	5,453,266	435,261
Of which: Whistletree standardised approach	966,952	**77,356**	1,131,880	90,550
Mortgage Enhancement standardised approach	**-**	**-**	654,166	52,333
Total Counterparty credit risk:	**119,566**	**9,565**	206,645	16,532
Of which: contributions to default fund or a Central Clearing Counterparty	4,634	**371**	513	41
Of which: Credit Valuation Adjustment risk	60,963	**4,877**	68,911	5,513
Total Credit Risk and Counterparty Credit Risk	**8,027,017**	**642,161**	8,273,902	661,912
Operational Risk	**1,463,693**	**117,095**	1,400,642	112,051
Total risk weighted assets	**9,490,710**	**759,257**	9,674,544	773,964

(1) 2016 comparative figures have been restated to reflect the new segments explained above.

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 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 Pillar 2a.

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 a 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.

TSB Group's capital requirements, therefore, include Pillar 2a which may be specified by the PRA as a percentage of RWAs or as an absolute value.

TSB Group's ICAAP 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 operational risk therefore is assessed further as part of Pillar 2a.

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.

TSB is also required to comply with Capital Conservation Buffer, Countercyclical Buffer and PRA Buffer requirements.

Pillar 2b
As part of the capital planning process, forecast capital positions are subjected to stress to determine whether TSB Group's own funds are adequate to meet minimum requirements. The PRA uses the output from these stresses to set a PRA buffer for TSB Group that should be maintained as mitigation against potential future periods of stress.

Countercyclical buffer
The Financial Policy Committee (FPC) sets the Counter cyclical Capital Buffer (CCyB). The FPC has set the UK CCyB rate at 0.5% effective from June 2018 which will increase to 1% from November 2018. TSB Group has total relevant credit exposures of £36.7 billion with associated RWAs of £7.5 billion. All exposures are categorised as UK, due to non-UK relevant credit exposure RWAs being less than 2% of total RWAs.

Relevant credit exposures set out in table 8 are net exposure values of assets excluding the following exposure classes: exposures to central governments or central banks; exposures to regional governments or local authorities; exposures to public sector entities; exposures to multilateral development banks; exposures to international organisations and exposures to institutions.

Table 8: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer (BUF1)

	General credit exposures		Trading book exposure		Securitisation exposure		Own funds requirements					
31 December 2017	Exposure value for SA	Exposure value IRB	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own funds requirement weights	Counter-cyclical capital buffer rate
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**%**	**%**
Breakdown by country	3,104,318	33,675,160	-	-	-	-	602,154	-	-	602,154	100%	0.00%
Country: GB	3,104,318	33,675,160	-	-	-	-	602,154	-	-	602,154	100%	0.00%
Total	**3,104,318**	**33,675,160**	**-**	**-**	**-**	**-**	**602,154**	**-**	**-**	**602,154**	**100%**	**0.00%**

Table 9: Amount of institution-specific countercyclical capital buffer (BUF2)

31 December 2017	**£000**
Total risk exposure amount	9,490,710
Institution specific countercyclical buffer rate %	-
Institution specific countercyclical buffer requirement	-

5. Credit risk

5.1 Overview Definition

TSB Group defines credit risk as the risk that a genuine or fraudulent borrower, or counterparty, fails to pay the interest or to repay the principal on a loan or other financial instrument as they fall due.

TSB Group adopts decision making processes and systems geared to provide affordable lending. The assessment of a customer's creditworthiness is based on individual needs and circumstances at the time of application. This approach helps customers borrow well and limits the risks associated with non-repayment.

Credit risk appetite is set for responsible and controlled growth and has measures and limits in place to act as a mechanism to prevent the bank and its customers from overreaching their ability to manage their borrowing. These measures include loan-to-value thresholds, loan-to-income ratios and credit concentration limits.

Occasionally, customer circumstance can change which could impact their ability to repay borrowings. TSB Group understands this and 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 willing to take in pursuit of its mission to bring more competition to UK banking whilst creating a sustainable long-term business. 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 maintains a well-balanced, capital efficient portfolio, focused on UK customers and assets, and prime lending criteria.

Exposures

A range of approaches are available under the CRD IV Framework to measure 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 manages credit risk in relation to the geographical concentration of its credit portfolio in the UK.

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 shows that there are no differences in the scope of consolidation of the TSB Group's consolidated balance sheet on an accounting basis (as presented on page 64 of TSB Group's ARA) to the consolidated balance sheet on a regulatory basis. A mapping of financial statement categories with regulatory risk categories is also provided.

Table 10: Differences between accounting and regulatory scopes of consolidation and the mapping of financial statement categories with regulatory risk categories (EU LI1)

			Carrying value of items				
31 December 2017 £000	**Carrying values as reported in published financial statements**	**Carrying values under scope of regulatory consolidation**	**Subject to the credit risk framework**	**Subject to the CCR framework**	**Subject to the securitisation framework**	**Subject to the market risk framework**	**Not subject to capital requirements or subject to deduction from capital**
Assets							
Cash, cash balances at central banks and other demand deposits	7,563,718	7,563,718	7,563,718	-	-	-	-
Financial assets held for trading:	-	-	-	-	-	-	-
Derivative financial assets	111,091	111,091	-	111,091	-	-	-
Financial assets designated at fair value through profit or loss:	-	-	-	-	-	-	-
Equity instruments	17,164	17,164	17,164	-	-	-	-
Available-for-sale financial assets	2,123,311	2,123,311	2,123,311	-	-	-	-
Loans and receivables:	-	-	-	-	-	-	-
Loans to central banks	56,030	56,030	56,030	-	-	-	-
Loans to credit institutions	329,158	329,158	26,217	302,941	-	-	-
Loans and advances to customers	30,854,243	30,854,243	30,854,243	-	-	-	-
Other advances	895,977	895,977	260,707	635,270	-	-	-
Hedging derivative assets	103,739	103,739	-	103,739	-	-	-
Fair value adjustments for portfolio hedged risk	(22,199)	(22,199)	(22,199)	-	-	-	-
Property, plant and equipment	172,678	172,678	172,678	-	-	-	-
Intangible Assets	10,146	10,146	-	-	-	-	10,146
Deferred tax assets	68,557	68,557	68,557	-	-	-	-
Other assets	241,850	241,850	241,850	-	-	-	-
Total Assets	**42,525,462**	**42,525,462**	**41,362,275**	**1,153,041**	-	-	**10,146**
Liabilities							
Financial liabilities held for trading:	-	-	-	-	-	-	-
Derivative financial liabilities	37,479	37,479	-	-	-	-	37,479
Financial liabilities at amortised cost:	-	-	-	-	-	-	-
Borrowings from central banks	5,625,738	5,625,738	-	-	-	-	5,625,738
Deposits from credit institutions	-	-	-	-	-	-	-
Customer deposits	30,520,564	30,520,564	-	-	-	-	30,520,564
Repurchase agreements	1,446,411	1,446,411	-	1,446,411	-	-	-
Debt securities in issue	1,318,746	1,318,746	-	-	-	-	1,318,746
Subordinated liabilities	405,312	405,312	-	-	-	-	405,312
Other financial liabilities	247,342	247,342	-	-	-	-	247,342
Hedging derivative liabilities	566,498	566,498	-	566,498	-	-	-
Fair value adjustments for portfolio hedged risk	42,185	42,185	-	-	-	-	42,185
Provisions	34,500	34,500	-	-	-	-	34,500
Current tax liabilities	6,843	6,843	-	-	-	-	6,843
Other liabilities	278,195	278,195	-	-	-	-	278,195
Total Liabilities	**40,529,815**	**40,529,815**	-	**2,012,910**	-	-	**38,516,905**
Shareholder's equity	**1,995,647**	**1,995,647**	-	-	-	-	**1,995,647**
Total equity and liabilities	**42,525,462**	**42,525,462**	-	**2,012,910**	-	-	**40,512,553**

Table 11: Main sources of differences between regulatory exposure amounts and carrying values in financial statements (EU LI2)

31 December 2017	Total	Credit risk framework	CCR framework	Securitisation framework	Market risk framework
		Items subject to			
	£000	£000	£000	£000	£000
Assets carrying value amount under the scope of regulatory consolidation (as per template EU LI1)	42,525,462	41,372,421	1,153,041	-	-
Liabilities carrying value amount under the regulatory scope of consolidation (as per template EU LI1)	42,525,462	-	2,012,910	-	-
Total net amount under the regulatory scope of consolidation	42,525,462	41,372,421	1,153,041	-	-
Off-balance-sheet amounts	4,682,575	5,191,873	-	-	-
Removal of accounting values for CCR	(850,403)	-	(850,403)	-	-
Regulatory CCR Exposure	373,152	-	373,152	-	-
Differences due to consideration of provisions	65,901	65,901	-	-	-
Differences due to prudential filters	(10,146)	(10,146)	-	-	-
Difference in valuation methodologies / regulatory adjustments	24,803	24,803	-	-	-
Exposure amounts considered for regulatory purposes	**46,811,343**	**46,644,852**	**675,790**	-	-

Table 12: Credit Risk Exposures

31 December 2017	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	7,619,748	-	(143,014)	7,476,734	-	-	7,476,734
Equity instruments	17,164	-	7,000	24,164	-	-	24,164
Derivative financial instruments	214,830	(214,830)	-	-	256,326	-	256,326
Loans and receivables	31,183,401	(635,573)	46,255	30,594,083	4,791,495	496,980	35,882,558
Available for sale financial assets	2,123,311	-	-	2,123,311	-	-	2,123,311
Property plant and equipment	172,678	-	-	172,678	-	-	172,678
Deferred tax assets	68,557	-	-	68,557	-	-	68,557
Other assets (1)	1,125,774	-	170,316	1,296,091	20,223	-	1,316,314
Total	**42,525,462**	**(850,403)**	**80,557**	**41,755,617**	**5,068,045**	**496,980**	**47,320,642**

(1) In 2017 Items in the course of collection are included in Other Assets

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**

5.3 Credit Risk exposure: analysis by exposure class (excluding counterparty credit risk)

The net value of exposures as at 31 December 2017 and the average over 2017 is set out in the table below.

Table 13: Total and average net amount of exposures (EU CRB-B)

31 December 2017	Net value of exposures at the end of the period £000	Average net exposures over the period £000
Central governments or central banks	-	-
Institutions	-	-
Multilateral development banks	-	-
Corporates	-	-
Of which: Specialised lending	-	-
Of which: SMEs	-	-
Retail	32,941,689	32,246,095
Secured by real estate property	27,314,681	26,726,715
SMEs	-	-
Non-SMEs	27,314,681	26,726,715
Qualifying revolving	4,195,434	4,121,919
Exposures in default		
Other retail	1,431,574	1,397,461
SMEs	-	-
Non-SMEs	1,431,574	1,397,461
Equity	-	-
Total IRB approach	**32,941,689**	**32,246,095**
Central governments or central banks	9,436,824	8,291,233
Regional governments or local authorities	-	-
Public sector entities	-	-
Multilateral development banks	240,224	202,800
International organisations	-	-
Institutions	490,964	453,309
Corporates	21,893	22,180
Of which: SMEs	11,838	11,804
Retail	240,098	263,454
Of which: SMEs	137,347	144,851
Secured by mortgages on immovable property	2,116,070	2,679,760
Of which: SMEs	34,285	37,172
Exposures in default	158,947	182,499
Items associated with particularly high risk	-	-
Covered bonds	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-
Collective investments undertakings	-	-
Equity exposures	24,164	23,891
Other exposures	713,736	773,234
Total standardised approach	**13,442,920**	**12,892,361**
Total	**46,384,609**	**45,138,456**

Net exposure value at 31 December 2017 increased by £4.7bn compared to December 2016. This is driven by growth in the Franchise IRB portfolio of £3.1bn franchise and growth in the standardised net exposure of £1.6bn. The standardised exposure increase is driven by larger central government and central bank balances offset by the early return of the Mortgage Enhancement portfolio, the ongoing and expected repayment of the Whistletree loan portfolio, and lower balances held with other institutions.

5.4 Concentration of exposures: by industry and counterparty types (excluding counterparty credit risk)

Net Exposures as at 31 December 2017, analysed by major industrial sector and counterparty type, are provided in the table below:

Table 14: Concentration of exposures by industry and counterparty types (EU CRB-D)

31 December 2017 £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
Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Corporates	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Retail	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	32,941,689	**32,941,689**
Equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Total IRB approach	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**32,941,689**	**32,941,689**
Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	9,436,824	-	-	-	-	-	-	**9,436,824**
Regional governments or local authorities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Public sector entities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Multilateral Development Banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	240,224	-	-	**240,224**
International Organisations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	490,964	-	-	**490,964**
Corporates	277	1	21	1		74	123	14	122	3	15,837	32	1	-	4	47	18	5	5,313	-	**21,893**
Retail	14,858	177	3,499	129	13	12,090	20,044	2,269	19,888	445	40,900	5,306	163	35	669	7,665	2,914	851	5,410	102,774	**240,098**
Secured by mortgages on immovable property	3,361	40	792	29	3	2,735	4,535	513	4,499	101	9,088	1,200	37	8	151	1,734	659	192	1,224	2,085,167	**2,116,070**
Exposures in default	198	2	47	2		161	267	30	265	6	1,398	71	2	-	9	102	39	11	851	155,484	**158,947**
Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Covered bonds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Collective investments undertakings (CIU)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Equity exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	24,164	-	-	**24,164**
Other exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	430,680	3,381	279,674	**713,736**
Total Standardised approach	**18,695**	**221**	**4,358**	**160**	**17**	**15,061**	**24,969**	**2,826**	**24,774**	**555**	**67,223**	**6,609**	**203**	**9,436,868**	**833**	**9,548**	**3,629**	**1,187,093**	**16,179**	**2,623,100**	**13,442,920**
Total	**18,695**	**221**	**4,358**	**160**	**17**	**15,061**	**24,969**	**2,826**	**24,774**	**555**	**67,223**	**6,609**	**203**	**9,436,868**	**833**	**9,548**	**3,629**	**1,187,093**	**16,179**	**35,564,790**	**46,384,609**

5.5 Credit risk exposure: Geographical breakdown of exposures

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 £1 billion 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 2017 and at 31 December 2016 are categorised as being in the United Kingdom.

5.6 Credit risk exposure: analysis by maturity (excluding counterparty credit risk)

Net on balance sheet credit risk exposures as at 31 December 2017, analysed by residual contractual maturity, are provided in table 15 below:

Table 15: Maturity of exposures (EU CRB-E)

	Net exposure value					
31 December 2017	**On Demand**	**≤ 1 year**	**> 1 year ≤ 5 years**	**> 5 years**	**No stated maturity**	**Total**
	£000	£000	£000	£000	£000	**£000**
Central governments or central banks	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	**-**
Corporates	-	-	-	-	-	**-**
Retail	849,351	350,718	2,414,630	24,970,487	-	**28,585,186**
Equity	-	-	-	-	-	**-**
Total IRB approach	**849,351**	**350,718**	**2,414,630**	**24,970,487**	**-**	**28,585,186**
Central governments or central banks	7,419,853	-	-	1,876,086	140,885	**9,436,824**
Regional governments or local authorities	-	-	-	-	-	**-**
Public sector entities	-	-	-	-	-	**-**
Multilateral Development Banks	-	-	-	240,224	-	**240,224**
International Organisations	-	-	-	-	-	**-**
Institutions	329,224	-	-	159,465	2,275	**490,964**
Corporates	620	803	7,694	12,776	-	**21,893**
Retail	23,539	1,622	11,831	169,576	-	**206,568**
Secured by mortgages on immovable property	25,205	12,939	126,930	1,666,359	-	**1,831,433**
Exposures in default	4,479	600	6,346	146,127	-	**157,552**
Items associated with particularly high risk	-	-	-	-	-	**-**
Covered bonds	-	-	-	-	-	**-**
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	**-**
Collective investments undertakings (CIU)	-	-	-	-	-	**-**
Equity exposures	-	-	-	-	24,164	**24,164**
Other exposures	-	-	-	2,370	692,538	**694,908**
Total standardised approach	**7,802,920**	**15,964**	**152,801**	**4,272,983**	**859,862**	**13,104,530**
Total exposures	**8,652,271**	**366,682**	**2,567,431**	**29,243,470**	**859,862**	**41,689,716**

5.7 Standardised approach - Credit risk exposure and CRM effects (excluding counterparty credit risk)

Table 16: Standardised approach - Credit risk exposure and CRM effects (EU CR4)

	Exposures before CCF and CRM		Exposures post CCF and CRM		RWAs and RWA density	
31 December 2017	**On-balance-sheet amount**	**Off-balance-sheet amount**	**On-balance-sheet amount**	**Off-balance-sheet amount**	**RWAs**	**RWA density**
	£000	**£000**	**£000**	**£000**	**£000**	**%**
Central governments or central banks	9,436,824	-	9,436,824	-	171,393	2%
Regional government or local authorities	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-
Multilateral development banks	240,224	-	240,224	-	-	0%
International organisations	-	-	-	-	-	-
Institutions	490,964	-	490,964	-	209,134	43%
Corporates	21,893	-	21,893	-	19,676	90%
Retail	206,568	33,530	206,568	7,021	141,003	66%
Secured by mortgages on immovable property	1,831,433	284,637	1,831,433	142,082	689,199	35%
Exposures in default	157,552	1,395	157,552	679	160,252	101%
Exposures associated with particularly high risk	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-
Institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-	-
Equity	24,164	-	24,164	-	49,910	207%
Other items	694,908	18,828	694,908	18,019	371,730	52%
Total	**13,104,530**	**338,390**	**13,104,530**	**167,801**	**1,812,296**	**14%**

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. Detailed analysis, by portfolio type and Probability of Default (PD) grade, of retail credit risk exposures subject to the Retail IRB Approach.

Table 17: Portfolios subject to the Retail IRB approach

Regulatory Exposure Portfolio	Internal Portfolio	Internal Estimates Used	Internal ratings-based approach (IRB)	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

Internal rating scales

PD internal rating scales are used within TSB Group in assessing the credit quality of the Retail IRB unsecured lending and TSB mortgage 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.

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

Table 18: IRB approach – Credit risk exposures by exposure class and PD range (EU CR6)

	PD scale	Original on-balance sheet gross exposure	Off-balance sheet exposures pre CCF	Average CCF	EAD post CRM and post-CCF	Average PD	Number of obligors	Average LGD	RWA	RWA density	EL
31 December 2017		**£000**	**£000**	**%**	**£000**	**%**	**000's**	**%**	**£000**	**%**	**£000**
Exposure Class: Retail mortgage (1), (2)	0.00 to <0.15	24,130,006	650,129	100.00%	25,971,008	0.42%	211	9.82%	2,048,942	7.89%	12,277
	0.15 to <0.25	1,034,646	185,761	100.00%	1,280,171	1.76%	11	12.08%	333,883	26.08%	3,034
	0.25 to <0.50	544,816	133,331	100.00%	711,448	3.03%	7	12.34%	259,885	36.53%	2,951
	0.50 to <0.75	106,295	23,703	100.00%	136,403	5.33%	1	11.92%	65,786	48.23%	962
	0.75 to <2.50	190,777	10,503	100.00%	211,173	11.29%	2	10.39%	123,947	58.69%	2,765
	2.50 to <10.00	166,294	78	100.00%	173,743	31.63%	2	9.72%	118,034	67.94%	6,091
	10.00 to <100.00	97,102	731	100.00%	100,454	69.07%	1	11.20%	46,775	46.56%	8,868
	100.00 (Default)	62,317	-	0.00%	62,317	100.00%	1	9.97%	47,666	76.49%	2,414
	Sub-total	**26,332,253**	**1,004,236**	**100.00%**	**28,646,717**	**1.29%**	**235**	**10.00%**	**3,044,919**	**10.63%**	**39,363**
Exposure Class: Qualifying Revolving Retail Exposures	0.00 to <0.15	62,627	1,565,740	70.13%	1,160,677	0.08%	1,273	76.16%	45,119	3.89%	691
	0.15 to <0.25	45,861	494,284	71.23%	397,938	0.20%	429	77.65%	35,132	8.83%	623
	0.25 to <0.50	82,587	520,757	95.61%	580,475	0.35%	1,073	79.37%	81,409	14.02%	1,605
	0.50 to <0.75	61,846	215,797	80.71%	236,018	0.62%	262	81.30%	53,422	22.63%	1,182
	0.75 to <2.50	249,489	393,622	94.21%	620,324	1.42%	647	82.05%	266,099	42.90%	7,256
	2.50 to <10.00	244,973	126,079	122.09%	398,897	4.86%	373	84.04%	414,190	103.83%	16,314
	10.00 to <100.00	92,235	21,962	152.10%	125,639	22.67%	117	84.99%	268,320	213.56%	24,239
	100.00 (Default)	35,072	10,278	0.00%	35,072	100.00%	28	82.23%	142,487	406.27%	13,791
	Sub-total	**874,690**	**3,348,518**	**80.05%**	**3,555,039**	**2.73%**	**4,203**	**79.48%**	**1,306,178**	**36.74%**	**65,702**
Exposure Class: Retail Loans	0.00 to <0.15	6,721	13	20.00%	6,820	0.11%	2	83.36%	1,549	22.71%	6
	0.15 to <0.25	11,136	22	20.00%	11,304	0.21%	3	82.73%	4,152	36.73%	20
	0.25 to <0.50	67,600	127	20.00%	68,592	0.40%	15	79.23%	36,195	52.77%	218
	0.50 to <0.75	81,619	160	20.00%	82,865	0.63%	15	82.35%	59,018	71.22%	432
	0.75 to <2.50	778,248	1,884	20.00%	792,955	1.50%	108	86.75%	845,690	106.65%	10,355
	2.50 to <10.00	437,958	1,363	20.00%	448,596	3.69%	57	90.10%	608,862	135.73%	14,943
	10.00 to <100.00	36,992	181	20.00%	38,401	31.41%	7	90.92%	74,178	193.17%	10,970
	100.00 (Default)	23,870	-	0.00%	23,870	100.00%	2	90.72%	114,413	479.31%	8,725
	Sub-total	**1,444,144**	**3,749**	**20.00%**	**1,473,404**	**4.42%**	**209**	**87.30%**	**1,744,058**	**118.37%**	**45,668**
Total value (all portfolios)		**28,651,087**	**4,356,503**	**85.56%**	**33,675,160**	**1.58%**	**4,647**	**20.72%**	**6,095,155**	**18.10%**	**150,733**

(1) The Retail mortgages PD model uses a through-the-cycle approach. The Average PD is a calculated PD, derived using EL/LGD. Whereas the RMS Grades (PD Scale) is based on PiT (point in time) PDs.
(2) IRB EAD includes impact of additional fees and interest receivable in the event of customer default.

5.9 Model performance

This section provides analysis of TSB's IRB PD model performance as at 31 December 2017 for Residential Mortgages, Loans, Cards and PCA.

Table 19 compares the estimated (weighted and arithmetic average PDs) and actual (average historical annual default rate) PDs by exposure class, along with the number of default and non-default obligors at current and previous year ends. The values are taken from TSB's regulatory capital calculation models, including the application of regulatory floors. Both arithmetic and EAD weighting have been used throughout.

Table 19: IRB approach – Backtesting of PD per exposure class (EU CR9)

	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	End of previous year	End of the year	Default obligors in the year	Of which: new obligors	Average historical annual default rate
31 December 2017			**%**	**%**	**Number of obligors**				**%**
Retail - Loans	0.00 to <0.15	**TSB**	0.10%	0.10%	1,159	1,496	-	-	0.03%
	0.15 to <0.25		0.20%	0.20%	2,077	2,430	4	1	0.17%
	0.25 to <0.50		0.39%	0.39%	13,973	15,368	91	2	0.48%
	0.50 to <0.75		0.63%	0.63%	17,108	15,488	86	8	0.54%
	0.75 to <2.50		1.49%	1.45%	104,226	107,143	1,344	80	1.13%
	2.50 to <10.00		3.68%	3.82%	42,610	57,563	2,036	199	3.62%
	10.00 to <100.00		31.41%	31.53%	5,645	7,050	1,898	69	29.05%
	100.00 (Default)		100.00%	100.00%	2,051	2,046	1,983	7	96.58%
	Subtotal		**3.61%**	**3.92%**	**188,849**	**208,584**	**7,442**	**366**	**4.29%**
Retail - Cards	0.00 to <0.15	**TSB**	0.07%	0.08%	260,650	237,368	120	-	0.05%
	0.15 to <0.25		0.19%	0.19%	82,647	90,698	89	5	0.11%
	0.25 to <0.50		0.35%	0.35%	92,293	93,295	202	5	0.23%
	0.50 to <0.75		0.61%	0.61%	44,107	41,610	158	6	0.38%
	0.75 to <2.50		1.40%	1.38%	102,320	92,444	1,050	64	0.99%
	2.50 to <10.00		4.85%	4.87%	65,119	58,647	2,911	87	4.07%
	10.00 to <100.00		20.34%	20.82%	18,519	20,465	3,518	26	18.42%
	100.00 (Default)		100.00%	100.00%	8,279	8,096	8,174	66	97.67%
	Subtotal		**2.28%**	**2.71%**	**673,934**	**642,623**	**16,222**	**259**	**2.68%**
Retail - Personal Current Accounts (PCA)	0.00 to <0.15	**TSB**	0.08%	0.07%	893,172	993,263	420	-	0.06%
	0.15 to <0.25		0.20%	0.20%	312,653	362,640	386	4	0.14%
	0.25 to <0.50		0.33%	0.32%	1,007,768	978,664	2,727	33	0.24%
	0.50 to <0.75		0.61%	0.61%	230,285	238,686	1,229	22	0.51%
	0.75 to <2.50		1.44%	1.42%	550,404	555,601	7,303	220	1.25%
	2.50 to <10.00		4.79%	4.87%	290,702	309,072	16,106	1,805	4.52%
	10.00 to <100.00		24.57%	23.88%	87,023	102,116	18,681	778	20.61%
	100.00 (Default)		100.00%	100.00%	29,710	19,920	25,388	23	92.83%
	Subtotal		**2.48%**	**2.06%**	**3,401,717**	**3,559,962**	**72,240**	**2,885**	**2.40%**
Retail - Mortgages	0.00 to <0.15	**TSB**	0.11%	0.11%	38,526	38,974	10	-	0.03%
	0.15 to <0.25		0.20%	0.20%	44,389	43,217	9	-	0.04%
	0.25 to <0.50		0.34%	0.35%	65,139	78,761	33	-	0.05%
	0.50 to <0.75		0.60%	0.60%	26,573	23,439	19	1	0.11%
	0.75 to <2.50		1.26%	1.27%	33,030	38,831	46	-	0.19%
	2.50 to <10.00		4.17%	4.28%	6,824	7,417	34	-	0.79%
	10.00 to <100.00		36.46%	36.90%	3,738	3,880	403	-	13.59%
	100.00 (Default)		100.00%	100.00%	712	651	710	-	99.58%
	Subtotal		**1.27%**	**1.46%**	**218,931**	**235,170**	**1,264**	**1**	**0.94%**

A number of factors impact the metrics shown, e.g. 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 quarterly recalibration and are replaced as required.

A 'Through the Cycle' (TTC) approach to PD estimation reduces cyclicality in estimates, leading to capital requirements that are less influenced by changes in the economic environment. A Point in Time (PiT) approach for PD leads to capital requirements that are affected directly by changes in economic conditions, increasing during a downturn while decreasing as conditions improve. Both approaches are deemed compliant by the PRA.

Specifically, it is noted that:

- The Mortgage PD model uses a TTC approach and, as a result, the gap between estimated and actual default rates will narrow or widen to reflect the economic environment at the point of measurement.
- The Loans, Cards and PCA PD models use a PiT approach which means that the regulatory PD calculation is calibrated to reflect the cyclicality of defaults. A PD buffer is applied to compensate for any potential underestimation from increasing default rates between calibrations.

The annual historical default rate is based on a four-year period instead of the five-year period as set out in the guidelines due to the establishment of TSB in 2013 following the separation from Lloyds Banking Group. Therefore, some of the differences seen in the Actual and Expected comparison can be explained by comparison of an estimated PD metric with a 12 months outcome against a 4 year average default rate.

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 where the underlying security is in possession or in certain cases where the borrower is bankrupt). 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 for secured assets. 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 72 to 73.

Disclosures in respect of the adoption of IFRS 9 '*Financial Instruments*' from 2018 are included in TSB Group's ARA on pages 79 to 81.

5.11 Credit quality of exposures by exposure class and instruments (excluding counterparty credit risk)

As at 31 December 2017, the total net exposures of TSB Group amounted to £46.4 billion (2016: £41.6 billion). The table below provides an analysis of credit risk adjustments and write-offs.

Table 20: Credit quality of exposures by exposure class and instrument (EU CR1-A)

	Gross Carrying Values of						
31 December 2017 £000	**Defaulted Exposures**	**Non-defaulted exposures**	**Specific credit risk adjustment**	**General credit risk adjustment**	**Accumulated write-offs**	**Credit risk adjustment charges of the period**	**Net values**
Central governments or central banks	-	-	-	-	-	-	-
Institutions	-	-	-	-	-	-	-
Corporates	-	-	-	-	-	-	-
Of which: Specialised lending	-	-	-	-	-	-	-
Of which: SMEs	-	-	-	-	-	-	-
Retail	131,537	32,876,053	65,901	-	75,237	(2,080)	32,941,689
Secured by real estate property	62,317	27,274,172	21,808	-	2,013	-	27,314,681
SMEs	-	-	-	-	-	-	-
Non-SMEs	62,317	27,274,172	21,808	-	2,013	-	27,314,681
Qualifying revolving	45,350	4,177,859	27,774	-	43,210	(2,080)	4,195,434
Other retail	23,870	1,424,022	16,319	-	30,014	-	1,431,574
SMEs	-	-	-	-	-	-	-
Non-SMEs	23,870	1,424,022	16,319	-	30,014	-	1,431,574
Equity							
Total IRB approach	**131,537**	**32,876,053**	**65,901**	**-**	**75,237**	**(2,080)**	**32,941,689**
Central governments or central banks	-	9,436,824	-	-	-	-	9,436,824
Regional governments or local authorities	-	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-	-
Multilateral development banks	-	240,224	-	-	-	-	240,224
International organisations	-	-	-	-	-	-	-
Institutions	-	490,964	-	-	-	-	490,964
Corporates	-	22,098	206	-	-	1,048	21,893
Of which: SMEs	-	12,017	179	-	-	1,048	11,838
Retail	-	241,044	946	-	972	20	240,098
Of which: SMEs	-	137,677	330	-	972	-	137,347
Secured by mortgages on immovable property	-	2,117,943	1,873	-	-	(708)	2,116,070
Of which: SMEs	-	34,315	30	-	-	-	34,285
Exposures in default	161,604	-	2,657	-	-	-	158,947
Items associated with particularly high risk	-	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-
Collective investments undertakings	-	-	-	-	-	-	-
Equity exposures	-	24,164	-	-	-	-	24,164
Other exposures	-	713,736	-	-	-	-	713,736
Total standardised approach	**161,604**	**13,286,998**	**5,682**	**-**	**972**	**361**	**13,442,920**
Total	**293,141**	**46,163,051**	**71,583**	**-**	**76,209**	**(1,720)**	**46,384,609**
Of which: Loans	281,469	39,363,520	71,583	-	76,209	(1,720)	39,573,405
Of which: Debt securities	-	2,116,311	-	-	-	-	2,116,311
Of which: Off-balance-sheet exposures	11,672	4,683,221	-	-	-	-	4,694,893

5.12 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 are 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.

5.13 Management of customers experiencing financial difficulties (excluding counterparty credit risk)

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 94 of the TSB Group’s ARA.

An analysis of non-performing and forborne exposures is presented in the table below.

Table 21: Non-performing and forborne exposures (EU CR1-E)

31 December 2017 £000	Gross carrying values of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
		Of which performing but past due > 30 days and <= 90 days	Of which performing forborne	Of which non-performing				On performing exposures		On non-performing exposures		On non-performing exposures	Of which forborne exposures
					Of which defaulted	Of which impaired	Of which forborne		Of which forborne		Of which forborne		
Debt securities	2,116,311	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances	39,644,989	59,772	170,248	400,631	281,469	128,013	114,207	(34,136)	(733)	(37,447)	(12,450)	322,629	309,212
Off-balance-sheet exposures	4,694,893	-	-	16,966	11,672	-	-	-	-	-	-	3	-

5.14 Analysis of past due and impaired loans and advances to customers regardless of impairment status

As at 31 December 2017, past due exposures in respect of loans and advances to customers, regardless of impairment status, amounted to £460 million.

Table 22: Ageing of past-due exposures (EU CR1-D)

	Gross carrying values					
31 December 2017	**≤ 30 days**	**> 30 days ≤ 60 days**	**> 60 days ≤ 90 days**	**> 90 days ≤ 180 days**	**> 180 days ≤ 1 year**	**> 1 year**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Loans	165,445	73,112	48,375	70,837	52,341	50,008
Debt securities	-	-	-	-	-	-
Total exposures	**165,445**	**73,112**	**48,375**	**70,837**	**52,341**	**50,008**

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 2017 and at 31 December 2016 are categorised as being in the United Kingdom, based on the materiality assumptions, outlined on page 20.

Analysis by Industry

An analysis of credit quality of exposures by industry is not provided as TSB Group does not have significant impairment provisions in respect of industry sectors other than personal customers. As at 31 December 2017, impairment provisions for non-personal customers are £510k.

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

The movement in impairment provisions, from 1 January 2017 to 31 December 2017, in respect of loans and advances to customers is provided below:

Table 23: Changes in the stock of general and specific credit risk adjustments (EU CR2-A)

	Accumulated specific credit risk adjustment £000	Accumulated general credit risk adjustment £000
Opening balance as at 31 December 2016	73,743	-
Increases due to amounts set aside for estimated loan losses during the period	80,222	-
Decreases due to amounts reversed for estimated loan losses during the period	(2,426)	-
Decreases due to amounts taken against accumulated credit risk adjustments	(90,476)	-
Transfers between credit risk adjustments	-	-
Impact of exchange rate differences	-	-
Business combinations, including acquisitions and disposals of subsidiaries	-	-
Other adjustments	10,521	-
Closing balance as at 31 December 2017	**71,583**	-
Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	-	-
Specific credit risk adjustments directly recorded to the statement of profit or loss	-	-

The movement in defaulted and impaired loans is provided in the table below:

Table: 24 Changes in stock of defaulted and impaired loans and debt securities (EU CR2-B)

	Gross carrying value defaulted exposures £000
Opening balance as at 31 December 2016	352,445
Loans and debt securities that have defaulted or impaired since the last reporting period	57,040
Returned to non-defaulted status	(63,107)
Amounts written off	(20,199)
Other changes	(33,037)
Closing balance as at 31 December 2017	**293,141**

5.16 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 actively monitor and 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. Portfolio and customer performance against TSB policy is regularly assessed in the Portfolio Quality Review.

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 lending 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. Credit scorecards and limits are subject to ongoing review and approval in line with TSB governance, to ensure they remain appropriate and effective TSB Group also has certain criteria applicable to specific products such as for buy-to-let mortgage applications.

TSB also provides active support to customers experiencing financial difficulties, including the extension of forbearance measures where appropriate.

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 manages credit concentration risk in relation to the geographical spread of its secured mortgage portfolio in the UK where there is an inherent regional bias towards lending in Scotland due to the heritage portfolio.

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: Impact of netting and collateral held on exposure values (EU CCR5-A)

31 December 2017	Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held	Net credit exposure
	£000	£000	£000	£000	£000
Derivatives	233,372	620,943	(387,570)	528,794	141,223
SFT	1,444,708	1,405,481	39,228	77,598	116,825
Cross-product netting	-	-	-	-	-
Total	**1,678,081**	**2,026,424**	**(348,343)**	**606,391**	**258,048**

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. LGD estimates for the secured IRB portfolio include adjustments to realisable collateral values through the application of recessionary house prices movements and forced sale discounts.

Only mortgages over residential property result in a beneficial risk weight applied in capital calculations.

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 for Treasury exposures 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 exposure calculations, 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.

The net carrying value of TSB's unsecured and secured exposures is set out in the table below. Secured exposures are those exposures secured by residential property. Unsecured exposures include unsecured retail lending, balances with central governments and central banks, balances with institutions and other assets.

Table 26: CRM techniques – Overview (EU CR3) (excluding counterparty credit risk)

31 December 2017	Exposures unsecured – Carrying amount	Exposures secured – Carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
	£000	£000	£000	£000	£000
Total loans	14,837,548	29,430,751	29,430,751	-	-
Total debt securities	2,116,311	-	-	-	-
Total exposures	16,953,859	29,430,751	29,430,751	-	-
Of which defaulted	31,311	193,272	193,272	-	-

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.

6.1 Leverage Ratio Exposure

Table 27: Summary reconciliation of accounting assets and leverage ratio exposures (LRSum)

Basel III basis	2017 £000	2016 £000
Total assets as per published financial statements	**42,525,462**	**37,195,703**
Adjustments for derivative financial instruments	(507,966)	(546,192)
Adjustments for securities financing transactions (SFTs)	-	163,764
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	688,012	798,264
Other regulatory adjustments	(79,377)	(85,727)
Total leverage ratio exposure	**42,626,131**	**37,525,812**

TSB Group calculates its leverage based on the exposure measure in CRR as amended by the EU Delegated Regulation 2015/62 published in January 2016, and the CRR definition of Tier 1. 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 4.5% 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 4.8% to 4.5% in 2017. Although Tier 1 capital increased by £113 million, largely from profits for the year, the leverage exposure grew by £5.1 billion, largely driven by the growth in the mortgage franchise book.

Table 28: Leverage ratio common disclosure (LRCom)

CRR leverage ratio exposures	**2017** **£000**	2016 £000
On-balance sheet exposures (excluding derivatives and SFTs)		
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	42,328,718	36,888,059
(Asset amounts deducted in determining Basel III Tier 1 capital)	(97,506)	(79,547)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**42,231,212**	36,808,512
Derivative exposures		
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	49,756	33,264
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	115,103	103,579
Exposure determined under Original Exposure Method	-	-
Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(457,995)	(435,546)
(Exempted CCP leg of client-cleared trade exposures)	-	-
Adjusted effective notional amount of written credit derivatives	-	-
(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
Total derivative exposures	**(293,136)**	(298,703)
Securities financing transaction exposures		
Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	43	25
(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
Counterparty credit risk exposure for SFT assets	-	217,714
Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	-	-
Agent transaction exposures	-	-
(Exempted CCP leg of client-cleared SFT exposure)	-	-
Total securities financing transaction exposures	**43**	217,739
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	4,693,882	5,284,671
(Adjustments for conversion to credit equivalent amounts)	(4,005,870)	(4,486,407)
Other off-balance sheet exposures	688,012	798,264
	42,626,131	37,525,812
Exempted exposures in accordance with Article 429(7) and (14) of Regulation (EU) No 575/2013 (on and off balance sheet)		
(Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
Capital and total exposures measure		
Tier 1 capital	1,898,142	1,785,437
Total leverage total exposure measure	42,626,131	37,525,812
Leverage ratio	**4.5%**	4.8%
Choice on transitional arrangements and amount of derecognised fiduciary items		
Choice on transitional arrangements for the definition of the capital measure	-	-
Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	-	-

Table 29: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures) (LRSpl)

CRR leverage ratio exposures	**2017** **£000**	2016 £000
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**41,870,723**	36,452,514
Trading book exposures	-	-
Banking book exposures, of which:	41,870,723	36,452,514
Covered bonds	-	-
Exposures treated as sovereigns	9,677,048	5,722,031
Exposures to regional governments, MDB, international organisations and PSE NOT treated as sovereigns	-	-
Institutions	490,964	587,309
Secured by mortgages of immovable properties	28,083,624	26,764,401
Retail exposures	2,431,630	2,263,826
Corporate	21,893	845
Exposures in default	265,485	323,124
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	900,079	790,978

2017 exempted exposures consist of collateral of £457 million in 2017 and £435 million in 2016.

6.2 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

At the time of initial public offering in June 2014, TSB created a remuneration approach intended to be simple, fair and in line with our core values. This underlying principle remains integral to our reward philosophy.
The Remuneration Committee is authorised by the Board to consider and recommend to the Board the framework of the remuneration policy. Policy is considered regularly by the Remuneration Committee, taking account of changes in regulation and the wider market. The TSB Remuneration Committee met 6 times during 2017.

Our Remuneration Policy

The aim of our remuneration policy as outlined on page 46 of TSB's Group ARA, is to provide competitive remuneration aligned to the delivery of our strategic goals (providing the kind of banking experience people want and deserve, providing great banking to more people, and helping more people to borrow well). 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.

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

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. TSB Group writes 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 clawback 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.

The Remuneration Policy applies to all Partners of TSB. There are no differences in remuneration policy for different categories of Partners at TSB; nor are there regional differences.

- The Remuneration Committee conducted a review of remuneration policy in 2017 and approved a few minor changes: The TSB Award and SPA Award will be delivered 50% in cash and 50% in shares for the CEO and other senior Partners in line with minimum regulatory requirements;
- MRTs that are not "Risk Managers" under EBA guidelines will have the deferral period on SPA awards reduced from five years to three years in line with minimum regulatory requirements; and
- The maximum SPA award level is increased from 100% to 125% of basic salary for the Board Executive Committee (BEC) and from 75% to 90% for other senior participants. These maximums have been increased to enable us to recognise exceptional circumstances such as demonstrable outstanding personal performance. Total variable pay will remain within the 1:1 cap given the ratio is calculated using fixed pay (i.e. basic salary plus pension and other benefits) whereas the SPA award is calculated as a percentage of basic salary only. We will also utilise the EBA Guidelines discount rate where appropriate. Should the EBA Guidelines discount rate be applied to any percentage of variable pay, we will disclose details of this in the 2018 Annual Report and Accounts in accordance with the requirements of the EBA Guidelines.

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

- How TSB's remuneration policy continues to meet regulatory requirements (page 48);
- 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 49-50); 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 52).

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 2016.

Table 30: Identified employees

31 December 2017	MB Supervisory function	MB Management function	Retail Banking	Corporate functions	Independent control functions	All Other	Total
Total Remuneration 2017 £000	868	16,836	3,653	6,309	2,176	-	**29,842**
No. of identified employees	10	14	12	19	9	-	**64**

Our Remuneration System

Our remuneration is structured into four main elements: competitive fixed pay, benefits, 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 have been eligible to receive Sabadell Integration Awards (SIA) during the delivery of TSB's migration programme. An overview of TSB remuneration structures, an explanation of the consideration of risk and information on the reduction or cancellation of awards prior to vesting and the recovery of part or all of an award post vesting are set out in the Remuneration Report on pages 46-52 of TSB Group's ARA.

The key elements of our reward approach are as follows:

- **Basic salary** provides core remuneration taking into account relevant market benchmarks, complexity of the role and the individual's experience and performance.
- **Market appropriate benefits**, principally pension contributions to a defined contribution scheme or, where appropriate, an equivalent cash payment; 4% of basic salary available to use in our flexible benefits offering; and an employer provided car or alternative cash allowance.
- The **TSB Award,** which provides an 'on-target' annual short term incentive award opportunity of 10% of basic salary and applies to every Partner, from the Chief Executive Officer to those on the front line. The 10% on-target award may increase, in an exceptional year, to a maximum award of 15% of basic salaries. In any given year the very best performers, whom we call Pioneers, may receive up to twice the on-target award. The TSB Award reflects the collective effort made by all Partners to deliver business success. Awards are made only if certain 'gateways', including risk, profitability and individual conduct are satisfied and corporate performance targets are met.
- The **Sustainable Performance Award (SPA)**, which is designed to support achievement of targets based on sustained business and individual performance. This award is granted annually to a limited number of senior Partners and is funded after the TSB Award is funded, if sufficient profit is made and risk management gateways have been satisfied.
- In addition, a small number of Partners were granted Sabadell Integration Awards (SIA) in 2017 to support the design and build of our new state-of-the-art banking platform. These awards will vest only to the extent that key migration and integration objectives are met, while ensuring underlying sustainability of the business.
- We will not exceed an **annual cap** on total variable remuneration of **one times fixed pay** (basic salary plus pension and other benefits) calculated in accordance with TSB Group Remuneration Policy, as approved by the TSB Group Remuneration Committee and Board, and in line with the Prudential Regulatory Authority's (PRA) remuneration code, other than in rare and exceptional circumstances (e.g. migration and integration) as approved by the Sabadell Remuneration Committee.

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.

Considerations of Risk and Conduct
The Remuneration Committee takes risk and conduct issues very seriously. Risk profile and behaviours are a key gateway that must be satisfied for any of the incentive awards to pay out to individuals. Incentive pools and awards may be adjusted, including to zero, in the event of any material breaches. All elements of variable remuneration for MRTs are subject to malus and clawback 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 MRTs. 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 MRTs is paid in a mix of cash and Sabadell shares (a 50% cash / 50% shares division). 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 (50% / 50%). Both the level of award and the share price are set at the time of grant. Grants are released to the extent performance underpins are met between years 3 and 7 post grant for Senior Managers, between years 1 and 5 post grant for Risk Managers and between years 1 and 3 for Other MRTs.
- **Sabadell Integration Award**: Any 2017 awards will be made as follows: 70% shares and 30% cash for the CEO and CFO, 60% shares / 40% cash for other Bank Executive Committee (BEC) members, 50% shares and 50% cash for other MRTs and in cash for other participants. A portion of any award is released as soon as the performance conditions are met with remainder released between years 3 and 7 post grant for Senior Managers and between years 1 and 5 post grant for all other MRTs.

2017 reward outcomes for TSB partners are set out in the Remuneration Report on page 47 of TSB Group's ARA. The Remuneration Committee has deferred the decision regarding the release of the outstanding Sabadell Integration Awards until migration and integration have been successfully completed in 2018.

There is no difference in award allocations for MRTs in control functions.

The Control Functions' heads (Chief Risk Officer (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 Chairs 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 MRTs and their remuneration is overseen directly by the TSB Remuneration Committee.

For staff in the Control Functions who are not MRTs, 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. Final approval of reward outcomes for all staff sits with the CEO after review by the HR Director.

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.

Other aspects
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 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. Any buyout 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 MRTs 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 clawback provisions continue to apply. Severance payments are paid in line with the principle of "no reward for failure".

The Remuneration Committee has discretion as to whether and in what circumstances a discount factor should be applied to variable remuneration. 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 for Risk Managers (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 1:1 variable pay cap for most partners, although as a matter of principle the discount is applied annually to the variable remuneration of BEC members. The relevant discount factor is calculated annually using the EBA methodology. The number of identified staff for whom the discount rate was applied in respect of 2017 remuneration was 13 and the maximum discount applied to relevant 2017 variable remuneration was 15.3%.

Remuneration for the year ended 31 December 2017

Table 31: Details of remuneration for the year ended 31 December 2017

31 December 2017	Board members	Senior management	Other management	Total
Fixed remuneration £000	**1,938**	**4,767**	**7,169**	**13,874**
Variable remuneration £000	**3,648**	**6,482**	**4,969**	**15,099**
Instant payment				
Cash £000	353	776	637	**1,767**
Shares £000	689	1,041	637	**2,368**
Number of Banco Sabadell equity shares '000	469	708	433	**1,610**
Deferred payment				
Cash £000	1,051	2,134	1,847	**5,032**
Shares £000	1,555	2,531	1,847	**5,933**
Number of Banco Sabadell equity shares '000	1,057	1,721	1,256	**4,034**
Other types of remuneration	**-**	**-**	**-**	**-**
Remuneration as Directors of the Group £000	**868**	**-**	**-**	**868**
Number of identified employees	12	12	40	**64**
Amount of annual compensation payments	-	30	103	**133**
Number of employees with compensation	-	1	4	**5**

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).
Basel III Leverage Ratio	A non-risk-based leverage ratio is calculated by dividing Tier 1 capital by a defined measure of on and off balance sheet items. Banks are expected to maintain a leverage ratio in excess of 3% under Basel III.
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)	European legislation to implement Basel III. It replaced earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation.
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 qualifying 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 among others.
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 (CCR)	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. 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).
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.
Identified Employee	Any employee identified by TSB as a 'Material Risk Taker' for 2017 under paragraph 3.1 of the Remuneration Section of the PRA Rulebook.
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.

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 CRR.
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 supervisor's assessment of the adequacy of certain firms' capital.
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.
Total capital ratio	Total capital as a percentage risk weighted assets.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
UK Leverage Ratio	A PRA defined modified measure of the Basel III leverage ratio which excludes qualifying central bank claims from the exposure measure. The PRA has set the minimum ratio at 3.25%.

APPENDIX I

CRD IV Index

Article 13 of the Capital Requirements Regulation (CRR) 575/2013 establishes that EU parent institutions are obliged to comply with the disclosure requirements laid down in Part Eight of the CRR on the basis of their consolidated situation. Similarly, significant subsidiaries shall publish information required by the relevant articles in Part Eight of that regulation which can be referenced in the disclosure index detailed below:

CCR Ref (575/2013) Part 8	High-Level Summary	Compliance reference
Own Funds		
437 (1)	Disclosure of the following information relating to Own Funds:	
437 (1)(a)	a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and filters and deductions applied to own funds and the statutory balance sheet	Table 3: Reconciliation between statutory and regulatory capital (OFDR) - page 9
437 (1)(b)	a description of the main features of Common Equity Tier1, Additional Tier 1 and Tier 2 instruments	Appendix II - Capital instruments main features (OFD1) - page 46
437 (1)(c)	the full terms and conditions of all common Equity Tier 1, Additional Tier 1 and Tier 2 instruments	Appendix II - Capital instruments main features (OFD1) - page 46
437 (1)(d)	Disclosure of the nature and amounts of the following:	
437 (1)(d)(i)	each prudential filter applied pursuant to articles 32 to 35;	Table 1: Own Funds (OFD2) - page 7
437 (1)(d)(ii)	each deduction made pursuant to Article 36, 56 and 66;	Table 1: Own Funds (OFD2) - page 7
437 (1)(d)(iii)	items not deducted in accordance with Articles 47, 48, 56, 66 and 79;	Table 1: Own Funds (OFD2) - page 7
437 (1) (e)	Description of all restrictions applied to the calculation of own funds and the instruments, prudential filters and deductions to which those restrictions apply	Table 1: Own Funds (OFD2) - page 7
437 (1) (f)	A comprehensive explanation where institutions disclose capital ratios calculated using elements of own funds determined on a different basis	N/A
Capital requirements		
438 (a)	Institutions approach to assessing the adequacy of capital levels	Section 3.1 Capital risk - page 6
438 (b)	ICAAP result on demand from reporting authorities	Section 4.4 TSB Group's Pillar 2 capital requirement – page 13
438 (c)	Capital requirements for each Standardised credit risk exposure class (excluding CCR)	Table 4: Overview of RWAs (EU OV1) & Table 5: Total amount of risk weighted assets and minimum own funds requirements - pages 10 and 11
438 (d)	Capital requirements for each Internal Ratings Based (IRB) credit risk exposure class	Table 4: Overview of RWAs (EU OV1) & Table 5: Total amount of risk weighted assets and minimum own funds requirements - pages 10 and 11
438 (e)	Capital requirements for Large Exposures, Settlement risk or market risk	Table 4 Overview of RWAs (EU OV1) – page 10
438 (f)	Operational risk capital requirements of which; the basic indicator, standardised and advanced measurement approach	Table 4: Overview of RWAs & Table 5: Total amount of risk weighted assets and minimum own funds requirements - pages 10 and 11
438 (endnote)	Disclosure of specialised lending exposures and equity exposures in the banking book which fall under the simple risk weight approach	N/A
Capital buffers		
440 (1)(a)	Geographical distribution of credit exposures relevant for calculation of countercyclical capital buffer	Section 4.4 Pillar 2 Capital Requirement Table 8 (BUF1) Geographical distribution of relevant credit exposures for the calculation of the countercyclical capital buffer - page 14
440 (1)(b)	Amount of the institution specific counter cyclical capital buffer	Table 9 (BUF2): Amount of institution specific countercyclical capital buffer - page 14

Credit risk adjustments		
442 (a)	Definitions of past due and impaired	Section 5.10 Impaired lending and provisions - page 25
442 (b)	Methodology applied to determine general and specific credit risk adjustments	Section 5.10 Impaired lending and provisions and 5.12 Managing impaired exposures and impairment provisions - page 25 and 27
442 (c)	Net exposure and average net exposure by exposure class	Section 5.3 - Credit risk exposure by exposure class - Table 13 (EU CRB-B) – page 18
442 (d)	Net exposure by Geography	Section 5.5 Credit risk exposure: geographical breakdown of exposures – page 20
442 (e)	Net exposure by Industry	Section 5.4 Concentration of exposures by industry and counterparty type – Table 14 (EU CRB-D) - page 19
442 (f)	Net exposure by residual maturity	Section 5.7 Credit risk exposure: analysis by maturity – Table 15 (EU CRB-E) – page 20
442 (g)	Defaulted and non-defaulted exposures by exposure classes	Section 5.11 Credit quality of exposures by exposure class and instrument - Table 20 (EU CR1-A) – page 26
442 (g)(i) 442 (g)(ii) 442 (g)(iii)	A breakdown of impaired, past due, specific and general credit risk adjustments for the period by exposure classes, industry or counterparty type as deemed material	Section 5.14 Analysis for past due and impaired loans and advances to customers– page 29 qualitative disclosure
442 (h)	A breakdown of impaired, past due, specific and general credit risk adjustments for the period by exposure classes, industry or counterparty type as deemed material	Section 5.14 Analysis for past due and impaired loans and advances to customers - page 29
442 (i) 442 (i)(i) 442 (i)(ii) 442 (i)(iii) 442 (i)(iv) 442 (i)(v)	Reconciliation of changes in specific and general credit risk adjustments for impaired exposures	Section 5.15 Changes in the stock of general and specific credit risk adjustments - Table 23 (EU CR2-A) – page 30
442 (endnote)	Specific credit risk adjustments recorded to income statement to be disclosed separately	Section 5.15 Changes in the stock of general and specific credit risk adjustments - Table 23 (EU CR2-A) – page 30
Remuneration disclosures		
450	Remuneration disclosures	Section 7 pages 36-39. Cross references are also provided to the TSB Banking Group Annual report and accounts
Leverage		
451 (1)(a) 451 (1)(b) 451 (1)(c)	Leverage ratio and a breakdown of total exposure measure including reconciliation to financial statements and derecognised fiduciary items	Section 6 Table 27 Summary reconciliation of accounting assets and Leverage Ratio exposure (LRSum) and Table 28 Leverage ratio common disclosure (LRCom) - page 33 and 34
451 (1)(d)	Description of the risk management approach to mitigate excessive leverage	Section 6.2 Management of excessive leverage - page 35
451 (1)(e)	Description of the factors that impacted the leverage ratio during the year	Section 6.1 Leverage Ratio Exposure - page 33
Use of credit risk mitigation techniques		
453 (a)	Use of off and on balance sheet netting	Section 5.16 Credit Risk Mitigation - page 31 - master netting
453 (b)	Management of collateral valuation	Section 5.16 Credit Risk Mitigation - page 31-32 collateral
453 (c)	Description of the types of collateral used by the institution	Section 5.16 Credit Risk Mitigation - page 31-32 – collateral
453 (d)	Creditworthiness and types of guarantor and credit derivative counterparty	N/A as explained on - page 32
453 (e)	Market or Credit risk concentrations within risk mitigation exposures	Section 5.16 Credit Risk Mitigation - page 31 - concentration risk
453 (f)	For exposures under the Standardised or Foundation IRB approach, disclosure of exposure value covered by eligible collateral	Section 5.16 Credit Risk Mitigation - Overview Table 26 (EU CR3) - page 32
453 (g)	Exposures covered by guarantees or credit derivatives	N/A as explained on page 32

Appendix II

Capital instrument's main features (OFD1) (1)

Capital instruments' main features template	Share Capital 1	Share Capital 2	Subordinated Liabilities
Issuer	TSB Banking Group plc	TSB Banking Group plc	TSB Banking Group plc
Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement	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 & (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 (currency in million, as of most recent reporting date)	£1,386.5 million	£200.0 million	£384.1 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	£0.9949
Redemption price	N/A	N/A	£1.00
Accounting classification	Shareholders' equity	Shareholders' 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	06/05/2026
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 discretionary or mandatory (in terms of timing	Fully discretionary	Fully discretionary	Mandatory
Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Mandatory
Existence of step up or other incentive to redeem	No	No	No
Noncumulative or cumulative	Non-cumulative	Non-cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
If convertible, conversion trigger (s)	N/A	N/A	N/A
If convertible, fully or partially	N/A	N/A	N/A
If convertible, conversion rate	N/A	N/A	N/A
If convertible, mandatory or optional conversion	N/A	N/A	N/A
If convertible, specify instrument type convertible into	N/A	N/A	N/A
If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A
Write-down features	No	No	No
If write-down, write-down trigger (s)	N/A	N/A	N/A
If write-down, full or partial	N/A	N/A	N/A
If write-down, permanent or temporary	N/A	N/A	N/A
If temporary write-down, description of write-up mechanism	N/A	N/A	N/A
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
If yes, specify non-compliant features	N/A	N/A	N/A

(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 Appendix II.

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