TSB Banking Group plc

Pillar 3 Disclosures

31 December 2014

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Certain Pillar 3 disclosure obligations are satisfied by inclusion in the 2014 TSB Banking Group plc Annual Report and Accounts. This document should be read in conjunction with the Annual Report and Accounts and, in particular, whenever the '♣' symbol appears in this document.

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1. Foreword

This document presents the first consolidated Pillar 3 disclosures of TSB Banking Group plc (the Group) as at 31 December 2014. TSB Banking Group plc's risk disclosures are included in the Lloyds Banking Group plc (LBG) consolidated Pillar 3 disclosures on a management basis and will continue to be included until the Group is no longer consolidated within LBG.

The disclosures have been prepared in accordance with the Capital Requirements Directive and Regulation (CRD IV). CRD IV is designed to implement the Basel III reforms of the Basel Committee on Banking Supervision and came into force within the European Union (EU) on 1 January 2014.

CRD IV introduced enhancements to Pillar 3 disclosure obligations in respect of risk management, corporate governance, own funds, capital buffers, encumbered and unencumbered assets, leverage and remuneration. In addition the European Banking Authority (EBA) issued guidelines and technical standards during 2014 in relation to both general principles on disclosure and specific disclosure requirements.

In complying with these obligations, the Group has considered best practice guidelines and interpretation of standards issued by the EBA, the Enhanced Disclosure Task Force (EDTF) and both national and international trade associations.

2. Development of TSB Banking Group plc

2014 has been a year of significant achievements and developments at TSB. The Group's financial position, and in particular its strong capital and funding position, provides a sound platform from which to deliver the growth strategy over the coming years.

During 2013 a significant number of customers and their accounts were added to the Group's existing business following their transfer from other LBG entities in preparation for the Group's listing. In May 2013, 3.5 million customers transferred together with their deposit balances of £17.3 billion and loan balances of £2.1 billion. A further £13.0 billion of mortgage balances transferred to the Group in July 2013. This, along with the transfer of a number of branches and associated business infrastructure, transformed the Group's size and capabilities.

During 2014, the Group has continued to build on this transformation with the following key developments:

Corporate structuring and associated transactions

During the course of 2014, the Group made the necessary changes to its corporate structure establishing TSB as a strong, independent competitor in the UK banking market. These included:

Transferring colleagues to the Group
On 31 March 2014, TSB Partners were transferred to TSB from LBG under the terms of the Transfer of Undertakings (Protection of Employment) (TUPE) Regulations 2006. At this point, those who were members of LBG defined benefit pension schemes became deferred members of those schemes and our defined benefit pension scheme deficit was transferred to Lloyds Bank plc. No settlement payment was required and consequently the Group recorded a one-off gain of £63.7 million.

Establishing a Group holding company
On 25 April 2014, TSB Banking Group plc became the holding company of the TSB Group following a share for share exchange in which it acquired 100% of the issued share capital of TSB Bank plc from Lloyds Bank plc.

Capitalising the Group for growth
On 1 May 2014, TSB Banking Group plc issued £385.0 million of Tier 2 dated subordinated liabilities (for proceeds of £383.0 million) and, on 19 May 2014, issued 445 million ordinary shares for proceeds of £200.0 million. Both issues of capital were wholly subscribed for by Lloyds Bank plc.

Listing the Group
On 25 June 2014, TSB Banking Group plc achieved a premium listing on the London Stock Exchange, with a free-float of 38.5%. The free-float increased to approximately 50% on 26 September 2014 following a further partial sell-down by LBG.

Formalising arrangements and agreements with LBG

As part of the listing process, a number of agreements were signed with LBG to ensure that the Group is able to operate effectively and independently. These agreements are outlined in more detail on page 135 of the Annual Report and Accounts within our related party disclosures ♣.

Enhancing the Group's medium term profitability

In establishing TSB as a strong competitor in the UK banking market, and in response to a review by the Office of Fair Trading of the effect on competition of the divestment of TSB from LBG, two significant developments took place in 2014 that were designed to enhance the Group's medium term profit earning capacity:

Mortgage Enhancement
With effect from 28 February 2014, the economic benefit of a £3.4 billion portfolio of mortgage loans was assigned to the Group by LBG. This is designed to enhance the Group's profit before tax (PBT) by a cumulative £230 million over approximately five years and, during 2014, increased the Group's PBT by £71.7 million. This portfolio is subject to a call option exercisable by LBG, after the £230 million profit target has been achieved including at least £30 million in 2017.

Services arrangements with LBG
On 1 January 2014, the Group transitioned from operating within the LBG shared service model to a standalone business cost structure. IT services and certain operational activities are however still being provided by LBG under a Transitional Services Agreement (TSA). The TSA runs until the end of 2016 when it will be replaced by the Long Term Services Agreement, which is expected to increase the Group's cost base by more than £100 million p.a. from 2017.

The net result of these developments during 2013 and 2014 is the formation of a UK bank with a very sound financial standing that is well positioned to deliver its growth strategy.

3. Executive summary

As any bank grows it requires capital to support a larger loan book and this is an area in which TSB is particularly strong. TSB currently has common equity capital equivalent to 19.7% of its risk adjusted loan book on a pro forma basis. This is very high compared to many other banks and together with our franchise loan to deposit ratio of 76.5% ensures that we are pre-positioned to support our lending growth targets.

The table below highlights key metrics in respect of capital ratios and risk weighted assets:

Key metrics	2014 CRD IV	2013[2] CRD IV	2013[2] Basel II
Pro forma Common Equity Tier 1 ratio[1]	19.7%	n/a	n/a
Common Equity Tier 1 ratio	23.0%	19.0%	19.5%
Total Capital ratio	28.5%	19.0%	19.5%
Credit Risk Weighted Assets (RWAs)	£5.5 billion	£5.8 billion	£5.7 billion
Operational Risk RWAs	£1.4 billion	£0.4 billion	£0.4 billion
Total RWAs	£6.9 billion	£6.2 billion	£6.1 billion
Basel III Leverage ratio	5.8%	4.7%	n/a

Capital adequacy improved over the year driven by the issue of ordinary shares, current year retained profits and a reduction in the excess of expected losses over impairment allowances. In addition, the Total Capital ratio also benefitted from the issuance of subordinated liabilities in May 2014. More information about the capital ratios is set out on page 17.

The year-on-year movements in the table above also reflect the Group's exit from LBG waivers in respect of the measurement of credit risk and a transition to TSB waivers. At 31 December 2014, this transition had been completed in respect of franchise mortgages and unsecured personal loans which are now assessed on an Internal Ratings Based (IRB) approach. Full details are given on page 22.

The increase in leverage ratio reflects the issue of shares and the retained profit for the year. It comfortably exceeds the Basel Committee's proposed minimum of 3%, applicable from 1 January 2018. The leverage ratio is considered in greater detail on page 20.

Credit Risk Weighted Assets decreased during 2014 by £0.3 billion reflecting the net impact of:

- Transfer from LBG of the Mortgage Enhancement portfolio (+ £1.0 billion RWAs);
- The transfer of certain lending books to the standardised basis of measurement (- £0.9 billion); and
- Improvements in credit quality of exposures and decrease in customer lending books (- £0.4 billion).

The RWAs in respect of Operational Risk have increased by £1.0 billion due to a change in methodology to more accurately reflect the scale of TSB. Further details of movements in RWAs are shown on page 22.

(1) The Pro forma Common Equity Tier 1 ratio has been calculated on the basis of all Franchise lending portfolios being measured on an IRB basis.
(2) At 31 December 2014, Pillar 3 Disclosures were prepared on a CRD IV basis. For the equivalent 31 December 2013 disclosures a Basel II basis applied. These figures have however been restated on a CRD IV basis to provide a more useful comparison with the 2014 disclosures.

4. Disclosure policy

Key aspects of the Group's disclosure policy applied to the Group Pillar 3 Disclosures include the basis of preparation, risk profile disclosure, frequency, media, location and verification which are summarised in this section.

Basis of preparation

This document contains the Pillar 3 Disclosures of the Group as at 31 December 2014, prepared in accordance with the requirements of CRD IV.

Prudential requirements under the Basel III Framework are categorised under three pillars. The third pillar addresses market discipline and requires the disclosures of a firm's risk management practices, its approach to capital management, its own funds and capital requirements, a detailed analysis of its credit, market and operational risk exposures and additional remuneration disclosures.

Throughout this document, unless otherwise specified, credit risk exposures are defined as the exposure at default (EAD) prior to the application of credit risk mitigation. EAD is defined as the aggregate of drawn (on balance sheet) exposures, undrawn (off balance sheet) commitments and contingent liabilities, after the application of credit conversion factors, and other relevant regulatory adjustments. Notable exceptions to this definition include counterparty credit risk exposures and past due and impaired exposures. A summary, noting the definitions applied, is provided below:

Exposure type	Portfolio	Definition applied
Credit risk exposures	Retail	EAD pre Credit Risk Mitigation (CRM)
Counterparty credit risk exposures	Treasury	EAD post CRM
Past due and impaired exposures	Retail	Accounting balance, defined in accordance with International Financial Reporting Standards

Frequency, media and location

The Group makes available its Pillar 3 Disclosures on an annual basis on the date of publication of the Annual Report and Accounts. A copy of these disclosures will be located on the Group's website (www.tsb.co.uk/investors/).

Verification

The disclosures have been verified and approved through internal governance procedures in line with the Group's Pillar 3 Disclosure Policy. This includes the review and approval of the disclosures by the Group's Audit and Board Risk Committees and the Board following the receipt of attestations in respect of the quantitative and qualitative disclosures from the Chief Financial Officer, Chief Risk Officer and other senior Finance and Risk Partners. The Group's governance structure is detailed on pages 10 to 12.

Risk profile disclosures

In accordance with the Group's Pillar 3 Disclosure Policy, the Group is required to assess whether its external disclosures taken as a whole (including the Group's Preliminary Results News Release, Annual Report and Accounts and Pillar 3 Disclosures) comprehensively portray its risk profile.

In this respect, the Group's Annual Report and Accounts provides an analysis of the principal risks and uncertainties to which the Group is exposed, also disclosing the mitigating actions taken to address these risks.

♣ The relevant analysis is presented in the Strategic Report of the TSB Banking Group's 2014 Annual Report and Accounts, Risk report, pages 86 to 98.

The Group's Pillar 3 Disclosures focus primarily on capital risk and the key risk drivers behind the Group's Pillar 1 capital requirements (i.e. credit, market and operational risks) and provide granular information and analysis in addition to that presented within the Annual Report and Accounts.

Non disclosure of immaterial 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. The Group has opted to use this materiality provision in respect of an election not to disclose the geographical distribution of £303.0 million of exposures to customers not resident in the UK. These exposures predominately reflect retail mortgages to customers currently resident overseas but secured on residential properties in the UK and are not deemed material in the context of the Group's balance sheet. The Group does not proactively seek non-UK business.

The Group has also opted to omit disclosures with regards to original capitalisation of the Group of £50,000 by LBG on the basis of materiality. This capital displays the same capital features as the ordinary shares disclosed in table 8.

Location of risk disclosures

The diagram below summarises the structure of this report and notes the location of the required disclosures on the risk management framework, the capital requirements and the Group's main business risks.

5. Scope of consolidation

These disclosures are presented for TSB Banking Group plc which has two immediate subsidiary companies:

- TSB Bank plc (Bank); and
- TSB Banking Group plc Employee Share Trust.

In addition, TSB Bank plc has three subsidiary companies:

- Cape Funding No.1 plc;
- TSB Scotland (Investment) Nominees Ltd (dormant); and
- TSB Scotland Nominees Ltd (dormant).

TSB is managed and reported across two business streams:

- Franchise, the Group's multi-channel retail banking business; and
- Mortgage Enhancement, a mortgage loan portfolio assigned to the Group by LBG with effect from 28 February 2014, in response to a review by the Office of Fair Trading of the effect on competition of the divestment of TSB, which is designed to enhance the Group's profitability by over £230 million, over the life of the transaction.

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when it is exposed to, or has the right to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Such power generally, but not exclusively, accompanies a shareholding of more than half the voting rights.

Subsidiary undertakings are included within the regulatory consolidation and are fully consolidated, with own funds determined on a line-by-line (accounting) consolidation basis. Risk capital requirements are also determined on a line-by-line (accounting) consolidation basis.

Consolidated balance sheet under the regulatory scope of consolidation

The following table provides a reconciliation of the Group's consolidated balance sheet on an accounting consolidation basis (♣ as presented on page 102 of the 2014 TSB Banking Group plc Annual Report and Accounts) to the Group's consolidated balance sheet under the regulatory scope of consolidation.

Table 1: Consolidated regulatory balance sheet at 31 December 2014

Balance Sheet Category	TSB Statutory Balance Sheet £million	Regulatory Reallocations[1] £million	TSB Regulatory Balance Sheet £million
Cash and balances at central banks	4,396.3	(180.0)	4,216.3
Loans and advances to customers	21,641.4	51.8	21,693.2
Loans and advances to banks	134.5	-	134.5
Available for sale financial assets	339.7	-	339.7
Items in course of collection from banks	135.7	-	135.7
Deferred tax assets	108.1	-	108.1
Property, plant and equipment	149.2	-	149.2
Prepayments and accrued income	-	30.7	30.7
Other assets	143.4	183.6	327.0
Derivative financial assets	123.1	-	123.1
Total Assets	**27,171.4**	**86.1**	**27,257.5**
Customer deposits	24,624.9	-	24,624.9
Deposits from banks	32.5	-	32.5
Debt securities in issue	10.0	-	10.0
Subordinated liabilities	405.5	-	405.5
Items in course of transmission to banks	144.6	-	144.6
Other liabilities	202.8	(116.4)	86.4
Accruals and deferred income	-	116.4	116.4
Other provisions	-	86.1	86.1
Derivative financial liabilities	116.7	-	116.7
Total Liabilities	**25,537.0**	**86.1**	**25,623.1**
Total Equity [2]	**1,634.4**	**-**	**1,634.4**
Total Equity and Liabilities	**27,171.4**	**86.1**	**27,257.5**

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

(2) A reconciliation of total equity to core Tier 1 capital is presented on page 17.

Regulatory balance sheet assets to gross drawn credit risk exposure

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

Table 2: Credit risk exposures at 31 December 2014

	TSB Regulatory Balance Sheet	Assets Linked to Market Risk / Counterparty Credit Risk	Other Regulatory Adjustments(1)	Gross Drawn Credit risk Exposures	Gross Undrawn exposures	Credit conversion factors/ Model overlays	Total credit risk exposure
	£million	£million	£million	£million	£million	£million	£million
Cash and balances at central banks	**4,216.3**	-	-	**4,216.3**	-	-	**4,216.3**
Derivative financial instruments	**123.1**	(123.1)	-	-	-	-	**-**
Loans and receivables	**21,827.7**	-	44.6	**21,872.3**	3,707.7	(2,654.0)	**22,926.0**
Available for sale financial assets	**339.7**	-	(15.6)	**324.1**	-	-	**324.1**
Deferred tax assets	**108.1**	-	-	**108.1**	-	-	**108.1**
Other assets	**642.6**	(53.3)	(42.9)	**546.4**	19.0	(19.0)	**546.4**
Total	**27,257.5**	(176.4)	(13.9)	**27,067.2**	3,726.7	(2,673.0)	**28,120.9**

(1) Other regulatory adjustments reflect specific regulatory treatments and valuation methodologies.

6. Risk management

Effective risk management is a key component of the Group's strategy to deliver local banking for Britain, and is at the heart of everything the Group does for customers and communities.

The Group's straightforward business model is supported by a risk culture grounded in ensuring a sustainable appetite for risk.

The Group's risk culture is designed to ensure that all Partners deliver the right outcomes for customers and other stakeholders through their approach to their work and the decisions and actions they take. Risks are owned and managed by all Partners, not just by specialist risk teams. The risk culture encourages all Partners to focus on identifying, assessing and managing risk within their areas of responsibility and supports clear escalation and reporting of risks to senior management and the Board. The Group's risk management culture is reinforced by its approach to remuneration throughout the business.

Risk management framework

The Group's risk framework is built upon three key principles:

Straightforward

A consistent risk management approach across its business, with simple reporting requirements to provide a holistic view of risk throughout the Group's operations.

Transparent

A clear risk management approach which is understood across the business. By working collaboratively, all Partners are able to share findings and approaches to help ensure adequate controls and processes are in place.

Responsible

Clear ownership of risks within the Group and empowerment of Partners to manage risk exposures in line with expected values and behaviours.

♣ Key measures used to manage our principal risks are presented in the Group's Annual Report and Accounts, on pages 86 to 98.

Risk appetite

The Board and senior management set risk appetite. This is achieved through clear and consistent communication of the approach to risk and cascading accountability to appropriately qualified individuals throughout the Group. The Board ensures that senior management implements risk policies and risk appetite that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the Group's risk profile.

The Group maintains a sustainable appetite for risk which supports the delivery of its growth strategy, whilst protecting customers, shareholders and Partners.

Three lines of defence

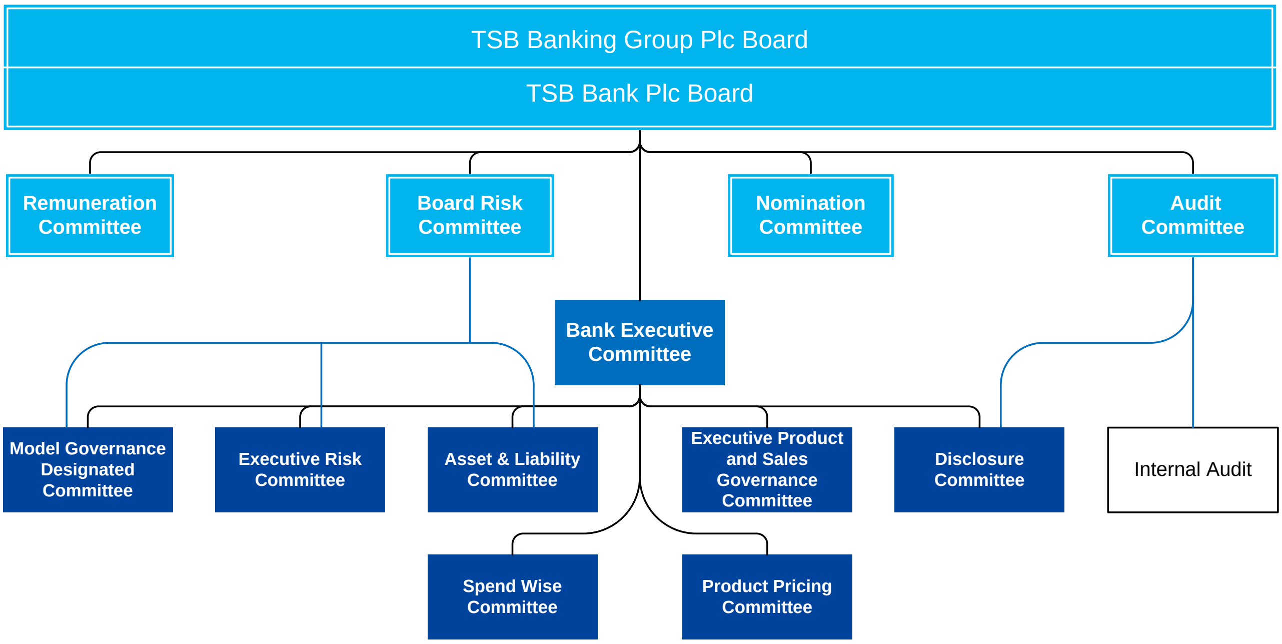
The Group organises its risk management activities across three lines of defence. These aim to ensure that risk management responsibilities and accountabilities are clearly defined and effective, and independent oversight processes are in place.

- **First line of defence: Business line**
  Each business line has primary responsibility for risk decisions and actions as well as measuring, monitoring and controlling risks within its area of accountability. Business lines identify, assess, manage and mitigate the risks relevant to their lines. They establish controls to ensure compliance with the Group's policies and the risk appetite parameters set out and approved by the Board.
- **Second line of defence: Risk function**
  The Group's risk function provides independent oversight and challenge through testing the effectiveness of business line risk management, as well as providing Group- wide risk reporting. It recommends risk strategy and the Group's risk appetite to the Board. It also acts as a trusted advisor to the business and its expertise facilitates the effective design and embedding of policy and compliance.
- **Third line of defence: Internal Audit**
  The Group's Internal Audit function provides independent and objective assessment of the risk management activities of both the business lines and the risk function. Internal Audit reports on the effectiveness of the Group's risk management activities to the Board and senior management.

Governance of risk

The Group's committees monitor and challenge risk exposures against approved risk appetite. Each committee within the governance structure, shown below, is responsible for ensuring the risk and control environment is established within its area of authority. This enables day-to-day decisions to be made, with clear reporting lines established through the Executive and Board Risk committees, and ultimately to the Board.

♣ The annual review of the adequacy and effectiveness of the Group's internal control and risk management systems is discussed in more detail within the Audit Committee Report contained in the Group's Annual Report and Accounts on pages 49 to 53.



The TSB Board

The Board ensures the Group manages risk effectively through review and oversight by:

- Approving the Group's risk appetite and risk management framework and monitoring the Group's aggregate risk exposure.
- Ensuring the executive management of the bank has established and maintains appropriate systems to plan and control operations and risks which are compliant with relevant legislation and regulations.
- Ensuring the executive management provides regular and sufficient information to the Board and the Bank Board to enable them to discharge their monitoring duties in relation to risk management.
- The number of directorships held by the Board members is disclosed on pages 38 to 41 of the Annual Report and Accounts♣.
- Details of the recruitment policy for the Group's Board in relation to diversity can be found on page on page 48 of the Annual Report and Accounts♣.

The Board committees noted below meet with agendas covering both Group and Bank matters, although discussion may only pertain to one entity. Details of meetings held can be found on page 45 of the Annual Report and Accounts♣.

Board committees

- **Audit Committee** oversees the Group's financial statements and reporting. It also oversees internal controls and risk management systems, whistleblowing, fraud, TSB's Internal Audit function and the Group's relationship with its external auditors.
- **Board Risk Committee** considers and recommends the risk appetite of TSB Banking Group. It oversees the Group's risk management framework including consideration of risk exposures and risk versus reward returns. The Board Risk Committee takes a forward-looking perspective, anticipating changes in business conditions and ensuring that top and emerging risks are identified.
- **Remuneration Committee** sets the principles and parameters of remuneration policy for TSB Banking Group and oversees the remuneration policy and outcomes for specified employees.
- **Nomination Committee** assists the Chairman in keeping the composition of the Board under review and leads the appointment process for nominations to the Board of TSB Banking Group.

Executive committees

TSB Bank Board sub-committee

- **Bank Executive Committee:** Chaired by the Chief Executive Officer, the Bank Executive Committee is the Group's principal executive committee. The Bank Executive Committee collectively supports the Chief Executive Officer in developing and implementing the Group's strategy, monitoring business performance and agreeing any actions that are required to manage issues that affect the Group. Consideration is given to the interests of all stakeholders, including customers, shareholders and Partners.

  All members of the Bank Executive Committee report to the Chief Executive Officer. In addition, the Chief Risk Officer has a reporting line to the Chair of the Board Risk Committee. To protect the independence of Internal Audit, the Chief Audit Officer's primary reporting line is to the Chair of the Audit Committee with a secondary reporting line to the Chief Executive Officer.

Bank Executive Committee sub-committees

- **Executive Risk Committee:** Chaired by the Chief Risk Officer, the Executive Risk Committee reviews and recommends overall risk appetite, including its allocation within the Group. This Committee provides oversight to assure the effective operation of governance, risk and control frameworks across the Group. The Executive Risk Committee also regularly reviews aggregate risk exposures, concentrations of risk and risk versus reward returns and ensures that appropriate action is taken where risk positions are considered inappropriate.
- **Model Governance Designated Committee:** Chaired by the Chief Risk Officer, the Model Governance Designated Committee approves, monitors and reviews material risk models across the Group. This is also the Board's designated model governance committee.
- **Product Pricing Committee:** The Product Pricing Committee is chaired by the Chief Financial Officer and is responsible for reviewing and approving pricing strategy and any decisions in relation to the pricing of the Group's products. The Committee provides oversight over the management of the relevant categories of risk, including conduct risk, associated with product pricing strategies.
- **Asset and Liability Committee:** Chaired by the Chief Financial Officer, the Asset and Liability Committee reports to the Board Risk Committee and is responsible for the strategic management of the Group's balance sheet and the risk management framework for all treasury risks. These are principally market, liquidity, capital and counterparty credit risks and earnings volatility.
- **Spend Wise Committee:** Chaired by the Chief Operating Officer, the Spend Wise Committee is responsible for the Group's expenditure. The Committee ensures that the Group spends efficiently and reviews cost budgets and forecasts to ensure that they support the delivery of the Group's strategy. The Committee also considers requests for expenditure that are over certain limits or are outside of forecast and budgets before they are spent to ensure these requests represent value for money.
- **Disclosure Committee:** Chaired by the Chief Financial Officer and overseen by the Audit Committee, the Disclosure Committee is responsible for identifying inside information and determining how and when the Group should disclose that information in accordance with the Listing Rules. The Committee also reviews and recommends to the Board or Audit Committee items for approval, including, but not limited to, the Annual Report and Accounts, preliminary announcement of annual results, half-year report and interim management statements.
- **Executive Product and Sales Governance Committee:** The Executive Product and Sales Governance Committee is chaired by the Chief Risk Officer and is responsible for ensuring effective execution of the five key stages of the product lifecycle, providing strategic and senior oversight over the Product and Sales Governance Policy to identify, measure, monitor and control risks associated with product and sales process activities.

Stress testing and planning

The Group's stress testing and scenario analysis programme is central to the analysis of top and emerging risks. It helps the Group to understand the impact of adverse effects of extreme but plausible events on the assumptions in its capital plans and is an integral part of the annual business planning process. This ensures the financial position and risk profile of the Group provide sufficient resilience to withstand shocks, such as:

- The impact of stressed economic and market conditions (systemic stress); and
- Stress events that would be particular to and impact only the Group.

A review of the Group's stress testing and scenario analysis programme can be found within the Board Risk Committee report presented in the Group's Annual Report and Accounts, on page 55♣.

7. Summary analysis of risk disclosures

A summary analysis of the consolidated risk weighted assets, Pillar 3 capital requirements and credit risk exposures of the Group as at 31 December 2014 is provided below:

Risk weighted assets and Pillar 1 capital requirements

Total risk weighted assets (RWAs) as at 31 December 2014 amounted to £6.9 billion (2013: £6.1 billion), generating a Pillar 1 capital requirement of £554.3 million (2013: £490.0 million). A summary analysis of total RWAs by risk type is provided in the table below:

Table 3: Summary risk weighted assets and Pillar 1 capital requirements

	2014 CRD IV		2013 Basel II	
	Risk weighted assets £ million	Capital requirements £ million	Risk weighted assets £ million	Capital requirements £ million
Credit risk (Internal Ratings Based Approach)	**3,187.3**	**255.0**	5,307.8	424.8
Credit risk (Standardised Approach)	**2,285.4**	**182.7**	382.0	30.5
Contributions to the default fund of a Central Counterparty	**1.0**	**0.1**	-	-
Total Credit Risk	**5,473.7**	**437.8**	5,689.8	455.3
Counterparty credit risk	**4.3**	**0.3**	-	-
Credit valuation risk	**0.7**	**0.1**	-	-
Market risk[(1)]	**-**	**-**	-	-
Operational risk	**1,451.5**	**116.1**	433.7	34.7
Total	**6,930.2**	**554.3**	6,123.5	490.0

(1) As the Group's total net foreign exchange position is less than 2% of total own funds, The Group is not required by CRD IV to calculate an own funds requirement for foreign exchange risk. Foreign exchange risk positions of the Group relate to foreign travel money held in branches.

Key Movements

- Internal Ratings Based Approach (IRB) RWAs decreased in 2014 primarily as a result of a change in the IRB RWA calculation method to the Standardised Approach for credit cards, overdrafts and business banking lending portfolios. This change has caused a corresponding increase in Standardised RWAs.

- As explained on page 8, in response to the review by the Office of Fair Trading on the effect on competition of divestment of the Group from LBG, the transfer of the Mortgage Enhancement loan portfolio resulted in a further increase in the RWAs calculated on a Standardised basis.

- The increase in operational risk RWAs of £1.0 billion reflects the change in methodology by using a steady state income basis, which is more reflective of the scale of the Group's business than the historic three year method.

Table 4: Summary segmental analysis of risk weighted assets

Segment	2014 Risk Weighted Assets £million	2013 Risk Weighted Assets £million
Franchise	**5,945.4**	6,123.5
Mortgage Enhancement	**984.8**	-
Total Risk Weighted Assets	**6,930.2**	6,123.5

Key Movements

- The Mortgage Enhancement portfolio, as outlined on page 8, was transferred to the Group on 28 February 2014.

Credit risk exposures

Total credit risk exposures (excluding counterparty credit risk exposures) as at 31 December 2014 amounted to £28.1 billion (2013: £28.8 billion) on an EAD basis.

This comprises £18.9 billion (67%) of exposures risk weighted under the IRB approach (2013: £24.0 billion, 83%) and £9.2 billion (33%) of exposures risk weighted under the Standardised Approach (2013: £4.8 billion, 17%). A summary analysis of credit risk exposures is provided in the table below:

Table 5: Summary credit risk exposures by exposure category and risk class

	2014 Credit Risk Exposure £million	**2014 Risk Weighted Assets £million**	**2014 Average Risk Weight %**	2013 Credit Risk Exposure £million	2013 Risk Weighted Assets £million	2013 Average Risk Weight %
Corporates	**-**	**-**	**-**	15.5	16.9	109.0%
Retail	**18,924.0**	**3,187.3**	**16.8%**	23,962.2	5,290.9	22.1%
Total – IRB Approach	**18,924.0**	**3,187.3**	**16.8%**	23,977.7	5,307.8	22.1%
Central governments & central banks	**4,648.5**	**270.3**	**5.8%**	25.8	-	-
Institutions	**178.6**	**49.1**	**27.5%**	4,115.5	-	-
Corporates	**1.7**	**1.7**	**100.0%**	-	-	-
Retail	**962.0**	**686.6**	**71.4%**	1.8	1.8	100.0%
Secured by mortgages on immovable property	**2,829.2**	**987.4**	**34.9%**	-	-	-
Exposures in default	**30.5**	**32.8**	**107.5%**	-	-	-
Other exposures	**544.4**	**257.5**	**47.3%**	673.3	380.2	56.5%
Total – Standardised Approach	**9,194.9**	**2,285.4**	**24.9%**	4,816.4	382.0	7.9%
Contributions to the default fund of a Central Counterparty	**2.0**	**1.0**	**50.0%**	-	-	-
Total Credit Risk	**28,120.9**	**5,473.7**	**19.5%**	28,794.1	5,689.8	19.8%

Key Movements

- The total IRB exposures have decreased primarily as a result of a change in the approach from the IRB to the Standardised basis for credit cards, overdrafts and business banking lending portfolios. Additionally, Franchise mortgage portfolio exposures have decreased from £18.8 billion at 31 December 2013 to £17.6 billion at 31 December 2014 due to lower mortgage balances or repayments on exposures that were originated through both direct and intermediary channels exceeding new loan origination which is temporarily limited to sales from direct channels only.

- The increase in total Standardised credit risk exposures is largely due to the move to the Standardised approach for the portfolios referred to above, and £2.8 billion (as at 31 December 2014) of Mortgage Enhancement exposures in 2014 as noted on page 5.

- In 2013, the £4.1 billion exposure with institutions reflected a deposit with LBG. In May 2014, following the Group’s exit from LBG's UK Liquidity Group, the funds were transferred to a Bank of England operational account and are therefore reported under the central governments and central banks risk class.

8. Own funds

Capital risk

Definition

Capital risk is defined as the risk of the Group having insufficient capital, by quantity or quality, to meet current or future requirements.

Risk appetite

The Group's risk appetite methodology is set out on page 10. The Group maintains a strong capital base which meets both its regulatory requirements and supports the growth of the business, even under stressed conditions.

Exposure

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

Measurement

From 1 January 2014 capital adequacy has been measured in accordance with CRD IV. Prior to this, capital adequacy was measured under the Prudential Regulation Authority (PRA) Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) framework. Therefore, in order to aid comparison, comparatives for December 2013 have also been prepared on a CRD IV basis.

As part of the capital planning process, capital positions are subject to an extensive stress analysis to determine the adequacy of the Group's own funds against the minimum requirements including Individual Capital Guidance (ICG) over the forecast period. The outputs from these stress analyses are used by the PRA to set a Capital Planning Buffer (CPB) for the Group. This comprises higher levels of capital buffers over and above the minimum regulatory requirements that should be maintained in non-stressed conditions as mitigation against potential future periods of stress.

The PRA requires ICG and CPB to remain confidential between the Group and the PRA.

Mitigation

The Group has developed procedures aligned with policies and risk appetite to ensure that it complies with current regulatory requirements and is positioned to meet anticipated future requirements.

The Group is able to accumulate additional capital through profit retention and by raising equity or other capital instruments taking account of the potential eligibility requirements under CRD IV.

Monitoring

Capital is actively managed and compliance with capital requirements is a key factor in the Group's planning processes and stress analysis. Five year forecasts of the Group's capital position, based upon the Group's operating plan, are produced at least annually to inform the Group's capital strategy, whilst shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan. The business plans are tested for capital adequacy using a range of stress scenarios covering adverse economic conditions as well as other adverse factors that could impact the Group. The Group additionally maintains a Recovery and Resolution Plan which sets out a range of potential mitigating actions that could be taken in response to a stress.

Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios is provided to the Bank Executive Committee, Executive Risk Committee, Asset and Liability Committee, Audit Committee, Board Risk Committee and the Board.

The regulatory framework within which the Group operates continues to be enhanced as part of global banking reforms. The Group monitors these developments very closely and analyses the potential financial impacts, ensuring that the Group continues to meet the regulatory requirements and the Group's risk appetite.

TSB Group's own funds

The Group's own funds as at 31 December 2014 are presented in the table below. This table follows the disclosure format required by the EBA Implementing Technical Standard on Disclosure for Own Funds, however only items applicable to TSB are detailed.

In order to aid comparison, where appropriate, comparatives for December 2013 have been prepared on a CRD IV basis.

Table 6: Own funds

	2014 CRD IV £million	2013 CRD IV £million	2013 Basel II £million
Capital instruments and related share premium accounts	**275.4**	75.0	75.0
Retained earnings	**949.0**	821.7	821.7
Accumulated other comprehensive income (and other reserves)	**410.0**	410.0	410.0
Total equity / CET1 capital before regulatory adjustments	**1,634.4**	1,306.7	1,306.7
Negative amounts resulting from the calculation of expected loss amounts	**(41.0)**	(110.6)	(110.6)
Deferred tax asset	**-**	(14.1)	-
Intangible fixed assets	**(0.4)**	-	-
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(41.4)**	(124.7)	(110.6)
CET1 capital / Tier 1 capital1[(1)]	**1,593.0**	1,182.0	1,196.1
Capital instruments and the related share premium accounts	**383.2**	-	-
Credit risk adjustments	**1.1**	-	-
Tier 2 capital	**384.3**	-	-
Total capital	**1,977.3**	1,182.0	1,196.1
Total Risk Weighted Assets	**6,930.2**	6,214.5	6,123.5
Common Equity Tier 1 (as a percentage of total risk exposure amount)	**23.0%**	19.0%	19.5%
Tier 1 (as a percentage of total risk exposure amount)	**23.0%**	19.0%	19.5%
Total capital (as a percentage of total risk exposure amount)	**28.5%**	19.0%	19.5%
Amounts below the threshold for deduction (before risk weighting)			
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)	**108.1**	119.6	n/a
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)	**1.1**	-	n/a
Cap for inclusion of credit risk adjustments in Tier 2 under internal ratings based approach	**19.1**	31.8	n/a

(1) The Group does not hold additional Tier 1 capital, hence the CET1 capital and Tier 1 capital have equal values.

Movements in capital

Common equity tier 1 capital
CET1 Capital has increased by £411.0 million during 2014 due to the issuance of new shares, the increase of the attributable profit for the period and the reduction in the excess of expected losses over impairment allowances as a result of the movement from IRB to Standardised RWA calculation methodology for credit cards, overdrafts and business banking portfolios.

On 1 May 2014, TSB Banking Group plc issued £385.0 million of Tier 2 dated subordinated liabilities (for proceeds of £383.0 million) and, on 19 May 2014, issued 445 million ordinary shares for proceeds of £200.0 million. Both issues of capital were wholly subscribed for by Lloyds Bank plc.

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

Table 7: Movements in capital

	CET1/ Total Tier 1 £million	Tier 2 £million	Total £million
At 31 December 2013 (CRD IV basis)	**1,182.0**	**-**	**1,182.0**
Profit available to ordinary shareholders	134.5	-	134.5
Share issuance	200.0	-	200.0
Available for reserve movements	0.4	-	0.4
Treasury shares	(9.1)	-	(9.1)
Share based compensation reserve	1.9	-	1.9
Reduction in excess of expected losses over impairment allowances	69.6	-	69.6
Issuance of subordinated liabilities	-	383.2	383.2
Change in excess of default provision over default expected loss	-	1.1	1.1
Change in intangible fixed assets	(0.4)	-	(0.4)
Movement in deferred tax above 10% threshold	14.1	-	14.1
At 31 December 2014	**1,593.0**	**384.3**	**1,977.3**

	CET1/ Total Tier 1 £million	Tier 2 £million	Total £million
At 31 December 2012 (Basel II basis)	**685.1**	**-**	**685.1**
Capital injection – debt forgiveness	410.0	-	410.0
Increase in excess of expected losses over impairment allowances	(86.7)	-	(86.7)
Prior year profit adjustment	11.4	-	11.4
Profit attributable to ordinary shareholders	177.1	-	177.1
Movement in other comprehensive income	(0.8)	-	(0.8)
At 31 December 2013 Basel II basis	**1,196.1**	**-**	**1,196.1**
Deferred tax movement	(14.1)	-	(14.1)
At 31 December 2013 restated for CRD IV	**1,182.0**	**-**	**1,182.0**

The principal features of the Group's Capital Instruments are shown in the following table:

Table 8: Capital instruments

	Share Capital 1	Share Capital 2	Subordinated Liabilities
Issuer	TSB Banking Group plc	TSB Banking Group plc	TSB Banking Group plc
Unique identifier (ISIN)	GB00BMQX2Q65	GB00BMQX2Q65	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	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Eligible at solo/(sub-consolidated/ solo and (sub-) consolidated	Solo and (Sub-)Consolidated	Solo and (Sub-) Consolidated	Solo and (Sub-)Consolidated
Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Ordinary Shares	Subordinated Tier 2 Notes
Amount recognised in regulatory capital	£1,386.5 million	£200.0 million	£383.0 million
Nominal amount of instrument	£0.5 million	£4.4 million	£385.0 million
Issue price	The nominal value of shares issued was £0.5 million and a minimum premium amount required by the Companies Act 2006 of £769.5 million was transferred to share premium. The balance of £616.5 million was transferred to the Merger Reserve.	£0.4494 per share	99.49%
Redemption price	n/a	n/a	100%
Accounting classification	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 May 2026
Issuer call subject to prior supervisory	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	Interest will be payable (i) semi-annually in arrear in respect of each Interest Period commencing prior to the Reset Date at a rate of 5.75% per annum (the "Fixed Rate Period") and (ii) quarterly in arrear in respect of each Interest Period commencing on or following the Reset Date at a rate of interest per annum determined on the relevant Interest Period commencement date to be equal to the 3 month GBP LIBOR rate plus the Initial Margin (no step up).
Existence of a dividend stopper	No	No	No
Fully discretionary, partially or mandatory (in terms of timing)	Fully discretionary	Fully discretionary	Mandatory
Fully discretionary, partially or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Mandatory
Existence of step up or other incentive to redeem	No	No	No
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible

Leverage ratio

The Group calculates its leverage ratio based on the exposure measure in the revised Basel III leverage ratio framework published in January 2014, and the CRR definition of Tier 1.

The Basel Committee has proposed that final adjustments to the definition and calibration of the leverage ratio are carried out in 2017, with a view to migrating to a Pillar 1 treatment in 2018. The Group continues to monitor Basel III developments and their adoption in the CRD IV framework.

The leverage ratio measure is defined as the ratio of Tier 1 capital to total exposure. This is intended to complement the risk based capital requirements with a simple, non-risk based 'backstop' measure.

Table 9: Leverage ratio

	2014 Basel III £million	2013 Basel III £million	2013 CRD IV £million
Tier 1 capital			
CET1 capital	**1,634.4**	1,306.7	1,306.7
Tier 1 deductions	**(41.4)**	(124.7)	(124.7)
Total Tier 1 capital	**1,593.0**	1,182.0	1,182.0
Exposures measure			
Total statutory balance sheet assets	**27,171.4**	24,954.4	24,954.4
Removal of accounting values for derivatives	**(123.1)**	(99.4)	(99.4)
Exposure value for derivatives	**28.1**	46.1	145.6
Exposure value for securities financing transactions	**0.4**	-	-
Off-balance sheet items including unconditionally cancellable exposures	**405.0**	375.0	604.0
Other regulatory adjustments	**(41.4)**	(124.7)	(124.7)
Total exposures	**27,440.4**	25,151.4	25,479.9
CRD IV Leverage ratio (%)	**n/a**	n/a	4.6%
Basel III Leverage ratio (%)	**5.8%**	4.7%	n/a

The Group's leverage ratio is 5.8% which comfortably exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018. The Group will continue to monitor closely the leverage ratio against the emerging rules and minimum calibration.

Other regulatory adjustments consist of adjustments that are required under CRD IV to be deducted from Tier 1 capital. The removal of these from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

The leverage ratio has increased in 2014 mainly due to the higher increase in total Tier 1 capital (34.8%) compared to the increase in leverage exposures (9.1%). Total Tier 1 capital increase is mainly attributable to the share issuance of £200.0 million, prior year profits and the decrease in the Tier 1 capital deductions by £83.3 million compared to previous year.

Management of excessive leverage risk

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.

The Group monitors its risk of excessive leverage through the leverage ratio which is calculated and reported both internally and to the regulator on a monthly basis.

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

The medium term plan (MTP) considers compliance with the leverage ratio risk appetite. In case of any risk of excessive leverage identified by the MTP, the business plans are reconsidered to mitigate the impact of the risk.

9. Capital requirements

TSB Group risk weighted assets and Pillar 1 capital requirements

The risk weighted assets and Pillar 1 capital requirements of the Group as at 31 December 2014 are presented in the following table:

Table 10: Risk weighted assets and capital requirements

	2014 Risk Weighted Assets £million	**2014 Pillar 1 Capital Requirements £million**	2013 Risk Weighted Assets £million	2013 Pillar 1 Capital Requirements £million
Foundation IRB Approach				
Corporates - SME	**-**	**-**	16.9	1.4
Retail IRB Approach				
Retail - Secured by mortgages on immovable property	**1,672.7**	**133.8**	2,032.1	162.6
Retail - Qualifying revolving retail exposures	**-**	**-**	1,454.6	116.4
Retail - Other retail	**1,514.6**	**121.2**	1,652.0	132.2
Retail - SME	**-**	**-**	152.2	12.2
Total – IRB Approach	**3,187.3**	**255.0**	5,307.8	424.8
Standardised Approach				
Central governments and central banks	**270.3**	**21.6**	-	-
Institutions	**49.1**	**3.9**	-	-
Corporates	**1.7**	**0.1**	-	-
Retail	**686.6**	**54.9**	1.8	0.1
Secured by mortgages on immovable property	**987.4**	**79.0**	-	-
Exposures in default	**32.8**	**2.6**	-	-
Other items	**257.5**	**20.6**	380.2	30.4
Total - Standardised Approach	**2,285.4**	**182.7**	382.0	30.5
Contributions to the default fund of a Central Counterparty	**1.0**	**0.1**	-	-
Total Credit Risk	**5,473.7**	**437.8**	5,689.8	455.3
Counterparty Credit Risk				
Standardised Approach	**4.3**	**0.3**	-	-
Total Counterparty Credit Risk	**4.3**	**0.3**	-	-
Credit Valuation Adjustment				
CVA Risk according to Standardised Method	**0.7**	**0.1**	-	-
Total Credit Valuation Adjustment	**0.7**	**0.1**	-	-
Operational Risk				
Standardised Approach	**1,451.5**	**116.1**	433.7	34.7
Total Operational Risk	**1,451.5**	**116.1**	433.7	34.7
Total	**6,930.2**	**554.3**	6,123.5	490.0

Key Movements

RWAs have increased from £6.1 billion to £6.9 billion during the year. Please refer to table 11 on page 22 for a detailed analysis of RWA movements. Movements in Pillar 1 capital requirements reflect the movements in RWAs.

TSB risk weighted assets movements by key driver

The table below analyses movements in total RWAs from 31 December 2013 to 31 December 2014:

Table 11: Risk weighted assets movements

	£million
At 31 December 2013 (Basel II basis)	**6,123.5**
Implementation of CRD IV/CRR	
Deferred tax asset movement	165.5
SME supporting factor	(74.5)
At 1 January 2014 (CRD IV basis)	**6,214.5**
Operational risk methodology change	1,018.0
Mortgage Enhancement transfer from LBG	984.8
Establishing TSB on a standalone basis	55.0
Methodology changes - IRB to Standardised	(930.7)
Credit risk movements	(177.4)
Book size reduction	(234.0)
At 31 December 2014	**6,930.2**

The Group's total RWAs have increased by £806.7 million (13.2%) since 31 December 2013.

The RWAs as at 31 December 2013 are reported on a Basel II basis and have been restated for CRD IV impact as follows:

- Increase of £165.5 million RWAs due to CRD IV requirement to risk weight deferred tax assets that rely on future profitability but arise from temporary differences at 250% (compared to 100% under Basel II), subject to being below the 10% CET1 threshold.

- Decrease of £74.5 million RWAs due to reduction in the capital for exposures to SMEs as introduced by CRD IV.

During 2014, RWAs have increased by £715.7 million due to the following factors:

- Increase in operational risk RWAs of £1,018.0 million reflects the change in methodology to use forecast steady-state income, which is more reflective of the scale of the Group's business than the historic three year method.

- In response to the review by Office of Fair Trading on effect on competition of divestment of the Group from LBG, the economic benefit of a portfolio of mortgage loans (referred to as Mortgage Enhancement) was assigned to the Group by LBG resulting in the year end £984.8 million increase in the RWAs.

- The Group's RWAs have further increased by £55.0 million as a result of the Group establishing a standalone liquid asset portfolio and market facing Treasury function as part of its exit from the LBG UK Defined Liquidity Group in preparation for the Initial Public Offering which took place in June 2014. As a result of the Group's exit from the LBG Core group in 2014, its exposures with LBG are no longer being risk weighted at 0%, as was the case in 2013.

- At 31 December 2013, lending assets were risk weighted under LBG's IRB approach. The subsequent transition is set out in the table below:

Portfolio	31 December 2013	2014 Transition	31 December 2014	Future movements
Franchise Mortgages	IRB – LBG waiver	IRB – TSB waiver from IPO	IRB – TSB Waiver	n/a
Qualifying revolving retail exposures	IRB – LBG waiver	Standardised from IPO	Standardised	IRB – TSB waiver from 2015
Other Retail	IRB – LBG waiver	Standardised from IPO, IRB – TSB waiver from October	IRB – TSB Waiver	n/a
SME	IRB – LBG waiver	Standardised from IPO	Standardised	IRB – TSB waiver from 2017
Mortgage enhancement	n/a	IRB – LBG waiver at inception, standardised from IPO	Standardised	IRB – TSB waiver from 2018

  The Franchise portfolios remaining on a standardised basis result in a reduction to the Group's RWAs of £930.7 million largely due to treatment of the off balance sheet exposures under the standardised approach.

- Credit risk movements of £177.4 million reflect improvements in the underlying economy as well as ongoing active management of the customer portfolio which has resulted in improvements in book quality.

- Book size reductions amounting to £234.0 million are explained below:
  - Unsecured loan balances decreased reflecting increased competition within this product segment and the expected time lag between attracting new personal bank account customers to the TSB franchise and such customers purchasing unsecured products.
  - Business banking loan balances decreased primarily due to the planned transfer to LBG of certain customers who have banking requirements that are not currently met by TSB's business banking proposition.
  - Mortgage franchise loan balances decreased, reflecting a continuation of the trend in 2013 where repayments on the mortgage portfolio, originated through both direct and intermediary channels, continued to exceed the growth achieved in new loan origination which was limited to sales from direct channels only.

Segmental risk weighted assets

The risk weighted assets of the Group's segments as at 31 December 2014 are presented in the table below. At 31 December 2013, the Group had only one segment, its Franchise business which is laid out at Table 10 on page 21.

Table 12: Segmental risk weighted assets

	2014 Franchise £million	2014 Mortgage Enhancement £million	2014 Total £million
Credit Risk			
Exposures subject to the IRB Approach			
Retail - Secured by mortgages on immovable property	1,672.7	-	1,672.7
Retail - Qualifying revolving retail exposures	-	-	-
Retail - Other retail	1,514.6	-	1,514.6
Retail - SME	-	-	-
Total - IRB Approach	**3,187.3**	**-**	**3,187.3**
Exposures subject to the Standardised Approach			
Central governments and central banks	270.3	-	270.3
Institutions	49.1	-	49.1
Corporates	1.7	-	1.7
Retail	686.6	-	686.6
Secured by mortgages on immovable property	8.8	978.6	987.4
Exposures in default	26.6	6.2	32.8
Other items(1)	257.5	-	257.5
Total - Standardised Approach	**1,300.6**	**984.8**	**2,285.4**
Contributions to the default fund of a Central Counterparty	1.0	-	1.0
Total Credit Risk	**4,488.9**	**984.8**	**5,473.7**
COUNTERPARTY CREDIT RISK			
Standardised Approach	4.3	-	4.3
Total Counterparty Credit Risk	**4.3**	**-**	**4.3**
Credit Valuation Adjustment			
CVA Risk according to Standardised Method	0.7	-	0.7
Total Credit Valuation Adjustment	**0.7**	**-**	**0.7**
OPERATIONAL RISK			
Standardised Approach	1,451.5	-	1,451.5
Total Operational Risk	**1,451.5**	**-**	**1,451.5**
Total	**5,945.4**	**984.8**	**6,930.2**

(1) Other items (Standardised Approach) predominantly relate to other balance sheet assets that have no or very limited associated credit risk. These comprise various non-financial assets, including fixed assets, cash, items in the course of collection, prepayments, sundry debtors and deferred tax assets.

TSB Group Pillar 2 capital requirement

In order to address the requirements of Pillar 2 of the Basel III framework, the PRA currently sets additional requirements through the issuance of Individual Capital Guidance (ICG) (Pillar 2a) and a Capital Planning Buffer (Pillar 2b).

Pillar 2a
The Group's internal assessment of its capital adequacy, a process known as Internal Capital Adequacy Assessment Process (ICAAP) is a key input to the PRA's Supervisory Review and Evaluation Process (SREP) determination of ICG.

The Group's ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk, operational risk and market risk through the assessments of material risks not covered or not fully captured under Pillar 1. The detailed ICAAP document is subject to a robust review process, approved by the TSB Board and submitted to the PRA.

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.
- **Operational Risk:** Pillar 1 standardised approach for operational risk uses gross income as a measure of risk. This is not risk sensitive. The PRA therefore assesses operational risk further as part of its Pillar 2 review of firms' capital adequacy. Further detail on the Group's approach to Operational Risk is presented on pages 51 & 52.

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 rates.

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

Capital Buffers
The Group continues to monitor PRA progress on implementing CRD IV capital buffers requirements. The Financial Policy Committee has set the UK Countercyclical Capital Buffer (CCB) rate at 0%. The Group's exposures are categorised as UK, due to non-UK exposures being less than 2% of total exposures. The Capital Conservation Buffer is to be phased in from 1 January 2016.

In addition, the Group is not required to make any disclosures on indicators of global systemic importance as TSB has not been classified as a Global-Systemically Important Institution (G-SII).

10. Credit risk

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

To help customers borrow well, the Group assesses each credit application based on individual circumstances at the time of application, reviewing whether or not customers can afford to repay any commitments and that they are applying for a product which meets their needs. Occasionally, customers' circumstances can change and they are unable to repay the money that they borrow from the Group. In these situations the Group will work with its customers to improve their position by offering various temporary treatment strategies and support.

Risk appetite
The Group's risk appetite methodology is set out on page 10. For credit risk, the Group aims to have an appropriate and well balanced loan portfolio through the economic cycle.

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

Under CRD IV credit risk exposures are classified into broad categories, as defined under the IRB Approach and Standardised Approach.

- **Standardised Approach:** Portfolios whose associated models have yet to roll out (i.e. transition to an IRB approach described below), or where no model roll out is planned, are risk weighted under this approach. The latter includes portfolios that are permanently exempt from an IRB approach. Existing permanent exemptions comprise small or immaterial portfolios, where it is impractical to apply an IRB approach. The Group's permanent exemption list together with the IRB roll-out plan is reviewed on a regular basis by the PRA.
- **Retail IRB Approach**: Use of internal models to calculate Probability of Default (PD), EAD and Loss Given Default (LGD).

Retail Exposures
The Group's credit risk exposures categorised as retail 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.

The principal source of credit risk within the Group arises from loans and advances to both retail and business banking customers.

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

Additional sources of credit risk arise from the Group's Treasury function:

- 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 is collateralised and cleared.

Monitoring
In conjunction with the Risk function, Portfolio Quality Review meetings are held monthly in order to monitor and review the performance of the business against approved risk appetite, performance metrics and credit risk controls.

An aggregated review of credit risk throughout the Group is subsequently produced and is reviewed by the Executive Risk Committee, Bank Executive Committee, Board Risk Committee and the Board.

Credit risk exposure: analysis by exposure class

As at 31 December 2014, the total credit risk exposures of the Group amounted to £28.1 billion (2013: £28.8 billion).

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

Table 13: Analysis by exposure class

Exposure Class at 31 December 2014	**Credit Risk Exposure £million**	**Risk Weighted Assets £million**	**Average Risk Weight %**	**Average Credit Risk Exposure[1] £million**
Foundation IRB Approach				
Corporate - SME	-	-	-	5.0
Retail IRB Approach				
Retail - Secured by mortgages on immovable property	17,640.9	1,672.7	9.5%	19,112.1
of which: Retail - Residential & commercial mortgages (SME)	-	-	-	-
of which: Retail - Residential mortgages (Non-SME)	17,640.9	1,672.7	9.5%	19,112.1
Retail - Qualifying revolving retail exposures	-	-	-	1,591.7
Retail - Other retail	1,283.1	1,514.6	118.0%	901.2
Retail – SME	-	-	-	57.7
Total - IRB Approach	**18,924.0**	**3,187.3**	**16.8%**	**21,667.7**
Exposures subject to the Standardised Approach				
Central governments and central banks	4,648.5	270.3	5.8%	2,224.3
Institutions	178.6	49.1	27.5%	1,796.8
Corporates	1.7	1.7	100.0%	1.9
Retail	962.0	686.6	71.4%	898.2
Secured by mortgages on immovable property	2,829.2	987.4	34.9%	1,611.0
Exposures in default	30.5	32.8	107.5%	18.0
Other items[2]	544.4	257.5	47.3%	633.2
Total - Standardised Approach	**9,194.9**	**2,285.4**	**24.9%**	**7,183.4**
Contributions to the default fund of a Central Counterparty	**2.0**	**1.0**	**50.0%**	**0.9**
TOTAL	**28,120.9**	**5,473.7**	**19.5%**	**28,852.0**

Exposure Class at 31 December 2013	Credit Risk Exposure £million	Risk Weighted Assets £million	Average Risk Weight %	Average Credit Risk Exposure [1] £million
Foundation IRB Approach				
Corporate – SME	15.5	16.9	109.0%	16.8
Retail IRB Approach				
Retail - Secured by mortgages on immovable property	19,094.7	2,032.1	10.6%	12,299.6
of which: Retail - Residential & commercial mortgages (SME)	285.9	143.5	50.2%	196.9
of which: Retail - Residential mortgages (Non-SME)	18,808.8	1,888.6	10.0%	12,102.7
Retail - Qualifying revolving retail exposures	3,423.6	1,454.6	42.5%	3,369.7
Retail - Other retail	1,313.5	1,652.0	125.8%	1,336.5
Retail – SME	130.4	152.2	116.7%	84.8
Total - IRB Approach	23,977.7	5,307.8	22.1%	17,107.4
Exposures subject to the Standardised Approach				
Central governments and central banks	25.8	-	-	15.9
Institutions	4,115.5	-	-	2,064.0
Retail	1.8	1.8	100.0%	2.0
Other items[3]	673.3	380.2	56.5%	329.1
Total - Standardised Approach	4,816.4	382.0	7.9%	2,411.0
Contributions to the default fund of a Central Counterparty	-	-	-	-
TOTAL	28,794.1	5,689.8	19.8%	19,518.4

Key Movements:
Please see key explanations for RWA movements in table 11, page 22.

Notes

(1) Average credit risk exposure represents the average exposure across the year to 31 December. The large variance in average credit risk exposures year-on-year is explained by the transfer of lending books from LBG entities to the Group during May - July 2013, in preparation for the divestment of the Group by LBG.

(2) Other items (Standardised Approach) predominantly relate to other balance sheet assets that have no or limited associated credit risk. These comprise various assets, including fixed assets, cash, items in the course of collection, prepayments and sundry debtors

(3) Deferred tax assets which were previously included in the Other items category were transferred to the Central governments and central banks category in 2014 following an update from the EBA.

Credit risk exposure: analysis by industry

Credit risk exposures (CREs) as at 31 December 2014, analysed by major industrial sector, are provided in the table below:

Table 14: Credit risk exposure by industry

At 31 December 2014	Agriculture, forestry and fishing £million	Manufacturing £million	Construction £million	Transport, distribution and hotels £million	Property companies £million	Financial, business and other services £million	Personal mortgages £million	Personal other £million	TOTAL £million
Exposures subject to Retail IRB Approach									
Retail - Secured by mortgages on immovable property	-	-	-	-	-	-	17,640.9	-	**17,640.9**
of which: Retail - Residential & commercial mortgages (SME)	-	-	-	-	-	-	-	-	**-**
of which: Retail - Residential mortgages (Non-SME)	-	-	-	-	-	-	17,640.9	-	**17,640.9**
Retail - Other retail	-	-	-	-	-	-	-	1,283.1	**1,283.1**
Total – IRB Approach	**-**	**-**	**-**	**-**	**-**	**-**	**17,640.9**	**1,283.1**	**18,924.0**
Exposures subject to the Standardised Approach									
Central governments and central banks	-	-	-	-	-	4,648.5	-	-	**4,648.5**
Institutions	-	-	-	-	-	178.6	-	-	**178.6**
Corporates	0.2	-	0.2	0.5	0.5	0.3	-	-	**1.7**
Retail	20.6	5.5	25.8	60.7	57.6	25.1	-	766.7	**962.0**
Secured by mortgages on immovable property	3.5	0.9	4.4	10.4	9.8	4.2	2,796.0	-	**2,829.2**
Exposures in default	0.6	0.2	0.8	1.9	1.8	0.7	6.2	18.3	**30.5**
Other items	-	-	-	-	-	292.8	2.1	249.5	**544.4**
Total – Standardised Approach	**24.9**	**6.6**	**31.2**	**73.5**	**69.7**	**5,150.2**	**2,804.3**	**1,034.5**	**9,194.9**
Total[1]	**24.9**	**6.6**	**31.2**	**73.5**	**69.7**	**5,150.2**	**20,445.2**	**2,317.6**	**28,118.9**

(1) The total amount excludes the contribution to the default fund of a Central Counterparty exposure of £2.0m.

Credit risk exposures as at 31 December 2013, analysed by major industrial sector, are provided in the table below:

At 31 December 2013	Agriculture, forestry and fishing £million	Manufacturing £million	Construction £million	Transport, distribution and hotels £million	Property companies £million	Financial, business and other services £million	Personal mortgages £million	Personal other £million	TOTAL £million
Exposures subject to the IRB Approach									
Foundation IRB Approach									
Corporate – SME	4.4	-	0.3	2.3	5.8	2.7	-	-	15.5
Retail IRB Approach									-
Secured by mortgages on immovable property	58.6	6.4	7.1	77.5	95.1	40.7	18,808.8	0.5	19,094.7
of which: Retail - Residential & commercial mortgages (SME)	58.6	6.4	7.1	77.5	95.1	40.7	-	0.5	285.9
of which: Retail - Residential mortgages (Non-SME)	-	-	-	-	-	-	18,808.8	-	18,808.8
Retail - Qualifying revolving retail exposures	-	-	-	-	-	-	-	3,423.6	3,423.6
Retail - Other retail	-	-	-	-	-	-	-	1,313.5	1,313.5
Retail - SME	18.2	10.1	21.1	33.1	11.7	35.8	-	0.4	130.4
Total – IRB Approach	81.2	16.5	28.5	112.9	112.6	79.2	18,808.8	4,738.0	23,977.7
Exposures subject to the Standardised Approach									
Central governments and central banks	-	-	-	-	-	25.8	-	-	25.8
Institutions	-	-	-	-	-	4,115.5	-	-	4,115.5
Retail	-	-	-	-	-	-	-	1.8	1.8
Other items	-	-	-	-	-	492.5	0.3	180.5	673.3
Total – Standardised Approach	-	-	-	-	-	4,633.8	0.3	182.3	4,816.4
Total	81.2	16.5	28.5	112.9	112.6	4,713.0	18,809.1	4,920.3	28,794.1

Key Movements

- The £4.1 billion exposure under Institutions at 31 December 2013 reflected a deposit with LBG, which following the Group's exit from LBG's UK Liquidity Group and the listing on the London Stock Exchange on 25 June 2014, was largely transferred to an operational account with the Bank of England.

- The increase in CREs relating to Personal Mortgages (Standardised) in 2014 reflects the Mortgage Enhancement portfolio.

- The movement in CREs relating to the classification Personal: Other is explained by the change in the approach from the Internal Ratings Based Approach (IRB) to the Standardised basis for credit cards, overdrafts and business banking lending portfolios. Additionally, the Franchise mortgage portfolio exposures have decreased from £18.8 billion in 2013 to £17.6 billion as at 31 December 2014 due to repayments exceeding the new loan origination which was limited to sales from direct channels only.

Credit risk exposure: analysis by geography

All credit risk exposures as at 31 December 2014 and at 31 December 2013 are categorised as being in the United Kingdom.

Credit risk exposure: analysis by residual maturity

Credit risk exposures as at 31 December 2014, analysed by residual contractual maturity, are provided in table 15 below:

Table 15: Credit risk exposure by maturity

	2014						2013					
	On demand £million	**Repayable in 3 months or less £million**	**Repayable between 3 months and 1 year £million**	**Repayable between 1 and 5 years £million**	**Repayable over 5 years or undated £million**	**TOTAL £million**	On demand £million	Repayable in 3 months or less £million	Repayable between 3 months and 1 year £million	Repayable between 1 and 5 years £million	Repayable over 5 years or undated £million	TOTAL £million
Exposures subject to IRB Approach												
Foundation IRB Approach												
Corporate - SME	**-**	**-**	**-**	**-**	**-**	**-**	1.8	0.5	0.6	0.2	12.4	15.5
Retail IRB Approach												
Secured by mortgages on immovable property	**5.9**	**87.5**	**160.2**	**1,380.4**	**16,006.9**	**17,640.9**	28.8	119.3	174.9	1,393.5	17,378.2	19,094.7
of which: Retail - Residential & commercial mortgages (SME)	**-**	**-**	**-**	**-**	**-**	**-**	23.2	13.0	15.1	35.5	199.1	285.9
of which: Retail - Residential mortgages (Non-SME)	**5.9**	**87.5**	**160.2**	**1,380.4**	**16,006.9**	**17,640.9**	5.6	106.3	159.8	1,358.0	17,179.1	18,808.8
Retail - Qualifying revolving retail exposures	**-**	**-**	**-**	**-**	**-**	**-**	3,423.6	-	-	-	-	3,423.6
Retail - Other retail	**-**	**9.5**	**53.5**	**981.9**	**238.2**	**1,283.1**	-	8.2	56.1	1,004.1	245.1	1,313.5
Retail - SME	**-**	**-**	**-**	**-**	**-**	**-**	31.7	20.0	21.6	18.8	38.3	130.4
Total – IRB Approach	**5.9**	**97.0**	**213.7**	**2,362.3**	**16,245.1**	**18,924.0**	3,485.9	148.0	253.2	2,416.6	17,674.0	23,977.7
Standardised Approach												
Central governments and central banks	**4,169.3**	**-**	**13.5**	**54.0**	**411.7**	**4,648.5**	-	-	-	-	25.8	25.8
Institutions	**155.7**	**3.2**	**-**	**-**	**19.7**	**178.6**	-	-	4,115.5	-	-	4,115.5
Corporates	**-**	**-**	**-**	**0.5**	**1.2**	**1.7**	-	-	-	-	-	-
Retail	**795.1**	**0.6**	**2.0**	**39.7**	**124.6**	**962.0**	-	-	0.1	1.4	0.3	1.8
Secured by mortgages on immovable property	**3.8**	**3.0**	**17.0**	**175.6**	**2,629.8**	**2,829.2**	-	-	-	-	-	-
Exposures in default	**18.7**	**-**	**0.1**	**1.4**	**10.3**	**30.5**	-	-	-	-	-	-
Other Items	**251.6**	**-**	**-**	**-**	**292.8**	**544.4**	177.2	-	-	-	496.1	673.3
Total – Standardised Approach	**5,394.2**	**6.8**	**32.6**	**271.2**	**3,490.1**	**9,194.9**	177.2	-	4,115.6	1.4	522.2	4,816.4
Total[(1)]	**5,400.1**	**103.8**	**246.3**	**2,633.5**	**19,735.2**	**28,118.9**	3,663.1	148.0	4,368.8	2,418.0	18,196.2	28,794.1

(1) The total amount excludes the contribution to the default fund of a Central Counterparty exposure of £2.0m.

Key Movements

- In 2013, £4.1 billion CRE relating to Institutions classified in the 3 month to 1 year maturity category reflected a deposit with LBG which in May 2014 transferred to an on demand Bank of England operational account within Central Government and Central Banks.
- The increase in exposures rated on the Standardised approach in the repayable over 5 year maturity category is attributable to the Mortgage Enhancement portfolio.
- IRB CREs decreased in 2014 primarily as a result of credit cards, overdrafts and business banking portfolios transitioning to a Standardised basis.

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 does not meet the definition of impairment.
- **Impaired exposures**: An exposure where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.
- **Impairment provisions**: Impairment provisions 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 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 the 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

The 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 the Group's Annual Report and Accounts.

♣ Financial assets, Note (b) (Accounting policies) and Impairment of financial assets, Note (c) (Accounting policies), 2014 TSB Banking Group plc Annual Report and Accounts pages 109 to 110.

Managing impaired exposures and impairment provisions

Provisioning Policy

The 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.

The policy for the treatment of impaired assets has been developed and is maintained by the Risk function and agreed in conjunction with the Finance function.

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 that 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 the 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

The Board, Board Risk Committee, Bank Executive Committee, Executive Risk Committee and Risk function monitor impairment provisions on a frequent basis throughout the year. All significant new impaired asset exposures are reported by their respective business area as soon as they arise. The Group's approach to stress testing is noted on page 13.

On a regular basis, an analysis of significant impaired exposures (including levels and trends in impaired exposures) is provided to the Portfolio Quality Review meetings, Executive Risk Committee, Bank Executive Committee, Board Risk Committee and Board.

The 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 which reports its findings and recommendations to the Executive Risk Committee, Bank Executive Committee, Board Risk Committee and the Board.

Management of customers experiencing financial difficulties

Information and analysis on the measures adopted by the Group to support customers experiencing financial difficulties are detailed in the TSB Group plc Annual Report and Accounts:

- Treatment of customers experiencing financial difficulties is presented within the 2014 TSB Group plc Annual Report and Accounts in the Forbearance section on pages 93 to 94.

Analysis of past due and impaired loans and advances to customers

As at 31 December 2014, past due but not impaired exposures in respect of loans and advances to customers amounted to £347.3 million (2013: £389.7 million). Impaired exposures in respect of loans and advances to customers amounted to £205.0 million (2013: £241.7 million), all of which were classified as 'impaired – provision held'.

Analysis by Industry

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2014, by major industrial sector, is provided in the table below:

Table 16: Past due and impaired loans and advances to customers analysed by industry

	2014				2013			
	Past due but not impaired		**Impaired**		Past due but not impaired		Impaired	
	£million	**As a % of credit risk exposure**	**£million**	**As a % of credit risk exposure**	£million	As a % of credit risk exposure	£million	As a % of credit risk exposure
Agriculture, forestry and fishing	**1.1**	**4.4%**	**0.3**	**1.2%**	3.2	3.9%	1.3	1.6%
Manufacturing	**0.6**	**9.0%**	**0.4**	**6.0%**	0.6	3.8%	0.2	1.0%
Construction	**0.7**	**2.2%**	**0.8**	**2.6%**	3.4	12.0%	0.4	1.5%
Transport, distribution and hotels	**2.6**	**3.5%**	**2.2**	**3.0%**	10.6	9.4%	2.9	2.6%
Property companies	**3.3**	**4.7%**	**1.4**	**2.0%**	5.7	5.1%	4.4	3.9%
Financial, business and other services	**0.9**	**0.0%**	**0.7**	**0.0%**	6.9	0.1%	5.7	0.0%
Personal mortgages	**307.4**	**1.5%**	**127.7**	**0.6%**	326.2	1.7%	138.7	0.7%
Personal other	**30.7**	**1.3%**	**71.5**	**3.1%**	33.1	1.0%	88.1	2.7%
Total	**347.3**	**1.2%**	**205.0**	**0.7%**	389.7	1.4%	241.7	0.8%

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 2014 and at 31 December 2013 are categorised as being in the United Kingdom.

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

The movement in impairment provisions, from 31 December 2013 to 31 December 2014, in respect of loans and advances to customers is provided below:

Table 17: Movement in impairment provisions

	2014 £million	2013 £million
Opening balance	96.8	35.9
Other adjustments(1)	-	66.8
Advances written off	(122.1)	(99.7)
Recoveries of advances written off in previous years	13.8	13.5
Charge to the income statement	97.6	80.3
Closing balance	**86.1**	96.8

♣ TSB Banking Group plc Annual Report and Accounts 2014, page 111

(1) Other adjustments during 2013 relate to the transfer of lending from LBG entities to the Group in preparation for the Group's divestment.

Analysis by Industry

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

Table 18: Analysis of impairment provisions by industry

	2014			2013		
	Impairment provisions £million	Net charge £million	Advances written off £million	Impairment provisions £million	Net charge £million	Advances written off £million
Agriculture, forestry and fishing	**0.3**	**0.2**	**0.5**	0.5	0.5	0.2
Manufacturing	**0.1**	**0.1**	**0.1**	0.1	0.1	-
Construction	**0.4**	**0.3**	**0.7**	0.6	0.5	0.2
Transport, distribution and hotels	**0.9**	**0.6**	**1.5**	1.8	1.7	0.7
Property companies	**0.9**	**0.6**	**1.6**	1.0	0.9	0.4
Financial, business and other services	**0.4**	**0.9**	**0.5**	1.1	1.1	0.4
Personal mortgages	**19.9**	**(0.1)**	**3.9**	24.0	2.9	3.2
Personal other	**63.2**	**95.0**	**113.3**	67.7	72.6	94.6
Total	**86.1**	**97.6**	**122.1**	96.8	80.3	99.7

Analysis by Geography

All closing impairment provisions, the net charge to the income statement, and advances written off in respect of loans and advances to customers are categorised as being in the United Kingdom.

Credit risk capital requirements

The Group operates a range of models for calculating credit risk capital requirements under the Retail IRB approaches.

Development, implementation and use of Retail IRB models are rigorously controlled through the application of a policy framework defining their development, validation and ongoing governance approach.

Stringent internal assessment, approval and monitoring, including independent review, is undertaken to ensure IRB models are robust. Appropriate conservatism is applied to ensure capital adequacy. New IRB models and all material model changes are subject to additional scrutiny and approval by the PRA before they are implemented for regulatory capital calculation purposes.

Scope of the IRB permission

The Group has regulatory approval under the TSB IRB permission to use its internal credit models in the calculation of credit risk capital requirements for the Franchise mortgage portfolio, granted in June 2014, and the Personal Loans portfolio, granted in October 2014. This permission also contains the agreed IRB rollout plan for the Group's other retail unsecured and business banking portfolios.

The principal portfolios within the Group that use the Standardised and Retail IRB approaches are summarised in Table 19.

Table 19: Application of standardised and IRB approaches to group portfolios

Portfolio	Standardised Approach	IRB Supervisory Slotting Approach	Foundation IRB Approach	Retail IRB Approach
Retail Asset Class	Portfolios where associated models have yet to roll out (transition to an IRB approach described below), or where no model roll out is planned, are risk weighted under this approach. The latter includes portfolios that are permanently exempt from an IRB approach. Existing permanent exemptions are comprised of small or immaterial portfolios, where it is impractical to apply an IRB approach.	None	None	Franchise Mortgage and Personal Loan portfolios

Internal development and monitoring of IRB models

As designated by the TSB Board, the Model Governance Designated Committee (MGDC) has responsibility for both:

- The establishment and review of the TSB model governance framework; and
- The approval of Level 1 risk models (those categorised as most material to the Group).

The MGDC is chaired by the Chief Risk Officer, with the remaining voting membership comprising the Chief Financial Officer, the Products Director and the Chief Digital Officer. MGDC has delegated approval responsibility for all non-Level 1 models to the Model Governance Advisory Committee (MGAC) which is chaired by the Director of Governance, Oversight and Reporting. The MGAC membership also comprises the Director of Decision Science, Director of Portfolio Management, Director of Market & Liquidity Risk or their delegates.

TSB Model Governance Policy, and associated Minimum Standards, sets out the risk model control framework as well as defining minimum technical principles. The Policy prescribes the overarching development, approval and ongoing governance framework that applies to IRB and other risk models. The Minimum Standards provide principles and baseline requirements for all risk models and risk model related activity covering data integrity, development and validation, model review and approval, model implementation and use of IRB credit models.

An inventory of approved risk models is maintained centrally and is used to ensure that all models are reviewed at least annually. These reviews consider data, design, validation, conservatism, calibration, sensitivity analysis, stress testing, implementation, operational aspects, usage, governance, independence, regulatory compliance, performance monitoring and reporting.

Independent ongoing assessments of adherence to the Risk Model Policy is undertaken through a combination of first line technical review forums, independent assessment by second line oversight teams within Risk and periodic third line review by Internal Audit. Model Risk is reported monthly to the MGAC and MGDC with key risks reported through to the Executive Risk Committee, Bank Executive Committee and Board Risk Committee. Model performance monitoring is reviewed through business line forums, with quarterly reporting to MGAC and MGDC.

Internal application of the IRB approach

In line with TSB's IRB Permission, only the Mortgages and Personal Loans IRB Rating Systems are used to calculate regulatory capital at 31 December 2014. However, the Group has IRB Rating Systems in place for its other Retail Unsecured portfolios for which IRB Permission has been requested, for implementation in the first half of 2015. The application of the business banking and Mortgage Enhancement IRB approach will be rolled out in 2017 and by the end of 2018 respectively. These IRB models are already used widely throughout the business, as set out below.

Credit approval

The Risk function sets out the TSB credit principles and policy which in turn is the basis for business line credit procedures and strategies. In line with this framework, credit approval decisions are primarily driven by a combination of defined credit policy rules and by the use of operational scorecards (both application and behavioural). These operational scorecards are integral components within the Bank's IRB PD models, providing a strong link between IRB models and the credit approval process, although the precise nature of this link differs between products.

Credit limits

IRB model outputs are used in a number of ways within the limit setting process:

- **Individual Limit Setting:** For the Mortgages portfolio, score-bands produced by the application scorecard suite, are a key determinant of a customer's maximum Loan-to-Value Ratio (LTV). For Unsecured portfolios, operational scores are used in combination with customer's income and expenditure data to set shadow limits. As a responsible lender, TSB also undertakes additional detailed affordability assessments prior to approval, where appropriate, and does not rely solely on shadow limits.
- **Portfolio Limits / Risk Appetite:** IRB models are used to set and monitor a number of portfolio limits, including RWA, credit risk grade, and Lifetime Expected Loss (LEL) based limits.
- **Corrective action:** Portfolio limits are monitored at Portfolio Quality Review meetings, Executive Risk Committee, Bank Executive Committee, Board Risk Committee and TSB Board. Where appropriate, corrective action will be taken to ensure any limit breaches are appropriately addressed. From an IRB model perspective, this may include changing scorecard cut-offs to manage new business, credit quality or adjusting maximum LTVs / shadow limits.

Pricing

The pricing process reflects the principle of the risk and reward relationship which is a significant consideration within the Risk Appetite defined by the TSB Board, whilst recognising that no reward can justify the acceptance of excessive risk. Each business line has established guidelines for its range of products that reflect upside revenue potential and opportunities as well as downside procedural and control aspects.

The Group's IRB models are used as inputs within a range of product area pricing models to ensure that estimated returns are adjusted to reflect expected credit losses and capital costs. These pricing models are used as a control mechanism to:

- evaluate the expected profitability of proposed product launches and pricing changes; and
- assess whether existing products remain profitable.

Portfolio reporting

Bank level credit risk reporting is conducted across the business lines, embedding IRB parameters into management information. This includes analysis of the core IRB model outputs, being PD, LGD, EAD and EL measures. Model performance and parameter assessment are also presented within both technical forums and throughout the model governance framework.

Impairment forecasting

The calculation of impairment levels within each portfolio is undertaken by risk teams and is subject to rigorous challenge and oversight through the bank's model governance framework. IRB model outputs are used to inform the impairment forecasting process and where appropriate may be used as inputs to impairment models.

Model construction

Statistical techniques (predominantly regression) are used to construct capital models, but the actual methodology and approach used to construct individual models depends upon the availability of data, the history of the portfolio and the perceived sensitivity to the economic environment. This results in a suite of models that vary by lending product, however the majority of the Group's models are data driven models e.g. representative data exists. In some instances there is greater reliance on expert judgement and external benchmarking based models e.g. where data is comparatively sparse.

Where model weaknesses are identified suitable levels of conservatism are included in the model build. This ensures that model outputs provide appropriate capital requirements. The level to which any such conservatism is deemed adequate is robustly challenged through our internal review and approval process and ultimately by the PRA.

Residential mortgages

Point-in-Time (PiT) PDs are produced by calibrating customer scores, whether application or behavioural, to an IRB compliant definition of default. Calibrations occur quarterly to ensure PiT PDs reflect the most recently observed default rates. For capital calculation purposes, a variable scalar is then applied to produce Through-the-Cycle (TTC) PDs, based on long-run default rates.

The mortgages EAD and LGD models produce PiT estimates and also downturn estimates for use in the capital calculation. The EAD model applies a simple approach based on current balance plus an estimated number of months missed interest that has been determined based on recent downturn data. The key components of the LGD model are Probability of Possession Given Default (PPD) and expected shortfall. The expected shortfall takes into account an indexed property valuation, forced sale discount, costs and standard discounting driven by time to possession and time to sale parameters.

Appropriate data covering a period back to 1987 has been used in the development of the Bank's PD and LGD models.

Unsecured loan exposures

PiT PDs are produced by calibrating customer scores, whether application or behavioural, to an IRB compliant definition of default. Calibrations occur quarterly to ensure PiT PDs reflect the most recent observed default rates. A buffer is applied to these PDs to cover potential changes in default rates between calibrations. The Group bases the buffer on the largest observed movement in PD estimates between calibration periods.

The EAD models predict the balance at default by assessing historical balance migration trends alongside observed behavioural elements specific to the operation of the product. Credit conversion factors are derived as necessary for reporting. For capital calculation purposes, downturn buffers will be applied to these estimates in line with PRA guidance.

The key components of the LGD models are Probability of Charge Off (PCO) and a loss severity calibration. The loss severity calibration takes account of balance at default, collections costs, balance at charge off and a charge off loss rate. The models are calibrated to recent charge off rates and loss data, with recalibrations occurring when defined accuracy thresholds are breached. For capital calculation purposes, the PiT LGDs produced by this approach will be calibrated to a PRA stipulated downturn target LGD.

Retail SME

In line with the Group's IRB Permission, we intend to roll out IRB models for this portfolio in 2017.

Key characteristics of material group ratings systems

The table below shows key characteristics of the most significant models within the Group that drive the capital calculation. Models used in the calculation of regulatory capital are subject to parameters and floors as determined by the regulator.

Table 20: Key characteristics of material group ratings systems

Ratings System	Associated portfolio (RWAs)	Model	Model Description and Methodology	Number of years of loss data	Basel Asset Class	Applicable industry-wide regulatory thresholds
Franchise Mortgages	£1,672.7 million	PD	• Operational Scorecards, estimated using standard regression techniques • PiT PD Calibration applied quarterly to reflect current default rates • Simple Variable Scalar, converts output to Through-the-Cycle PD using long run data	>10 years	Retail Residential Mortgages	PD Floor 0.03%
		EAD	Simple approach based on current balance plus an estimated number of months missed interest			EAD at least equal to current balance utilisation
		LGD	Data Driven models predicting: • Downturn Probability of Possession given Default • Downturn Time from Default to Repossession • Downturn Time from Repossession to Sale • Downturn Force Sale Discount • Downturn Sales Costs			Portfolio LGD Floor 10%
Franchise Personal Loans	£1,514.6 million	PD	• Operational Scorecards, estimated using standard regression techniques • PiT PD Calibration, applied quarterly to reflect current default rates • Capital PD Buffer, reflecting largest observed shift in PDs between calibrations	>10 years	Retail Other	PD Floor 0.03%
		EAD	Simple approach based on assessing historical balance migration alongside behavioural elements specific to the operation of Personal Loans.			EAD at least equal to current balance utilisation
		LGD	Two stage model comprising: • Probability of Charge Off, standard regression based scorecards; • Capital LGD Calibration, which captures loss severity For capital calculation purposes, the outputs produced by this approach are subsequently calibrated to a PRA stipulated Downturn target LGD.			

Internal rating scales

PD internal rating scales are used within the Group in assessing the credit quality of the Retail IRB loans and Franchise mortgages portfolios. One scale exists within the business – Retail Master Scale - which covers all relevant retail portfolios.

Table 21: Retail master scale

PD Grade	Range		
	Lower	Mid	Upper
0	0.000%	0.050%	0.100%
1	0.101%	0.251%	0.400%
2	0.401%	0.601%	0.800%
3	0.801%	1.001%	1.200%
4	1.201%	1.851%	2.500%
5	2.501%	3.501%	4.500%
6	4.501%	6.001%	7.500%
7	7.501%	8.751%	10.000%
8	10.001%	12.001%	14.000%
9	14.001%	17.001%	20.000%
10	20.001%	25.001%	30.000%
11	30.001%	37.501%	45.000%
12	45.001%	72.500%	99.999%
Default	100.000%	-	-

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

Exposures subject to the retail IRB approach

This section provides a detailed analysis, by PD grade, of retail credit risk exposures subject to the Retail IRB Approach.

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.

At 31 December 2014, retail exposures subject to the Retail IRB Approach totalled £18.9 billion (2013: £24.0 billion) comprising Retail Mortgages of £17.6 billion (2013: £19.1 billion) and Other Retail of £1.3 billion (2013: £1.3 billion). At 31 December 2013, there were also Qualifying Revolving Retail exposures and Retail SME exposures amounting to £3.6 billion. These exposures are nil at 31 December 2014 due to a change in the risk weighting methodology from the IRB to the Standardised approach.

Table 22: Retail mortgage exposures by PD grade (1)

			2014			
PD Grade	**Credit Risk Exposure £million**	**Exposure Weighted Average PD %**	**Exposure Weighted Average LGD (2) %**	**Average Risk Weight %**	**Undrawn Commitments (Gross) £million**	**Undrawn Commitments (Post CCF) £million**
0	**12,546.6**	**0.18%**	**9.39%**	**4.02%**	**116.7**	**116.7**
1	**3,646.9**	**0.71%**	**11.18%**	**12.71%**	**76.4**	**76.4**
2	**603.8**	**2.06%**	**12.91%**	**29.96%**	**32.0**	**32.0**
3	**151.9**	**3.61%**	**12.85%**	**41.53%**	**10.3**	**10.3**
4	**192.0**	**6.13%**	**11.50%**	**48.87%**	**8.0**	**8.0**
5	**74.7**	**11.77%**	**12.23%**	**69.37%**	**0.3**	**0.3**
6	**60.4**	**19.63%**	**11.50%**	**75.83%**	**-**	**-**
7	**56.9**	**25.64%**	**11.15%**	**76.59%**	**-**	**-**
8	**12.3**	**35.26%**	**12.48%**	**84.71%**	**-**	**-**
9	**46.0**	**43.59%**	**11.84%**	**75.81%**	**-**	**-**
10	**35.9**	**53.89%**	**11.61%**	**65.49%**	**-**	**-**
11	**35.4**	**67.18%**	**12.18%**	**52.54%**	**-**	**-**
12	**46.7**	**86.80%**	**12.75%**	**23.94%**	**3.6**	**3.6**
Default	**131.4**	**100.00%**	**11.71%**	**96.63%**	**-**	**-**
Total	**17,640.9**	**2.00%**	**10.00%**	**9.48%**	**247.3**	**247.3**

			2013			
PD Grade	Credit Risk Exposure £million	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £million	Undrawn Commitments (Post CCF) £million
0	10,074.0	0.16%	8.72%	3.11%	201.6	201.6
1	6,172.0	0.56%	10.74%	9.44%	1.8	1.8
2	1,349.9	1.50%	13.48%	23.39%	9.7	9.6
3	376.4	2.44%	13.77%	33.25%	3.1	3.1
4	359.4	4.26%	13.18%	42.75%	1.5	1.5
5	174.5	8.00%	13.79%	61.71%	1.0	1.0
6	140.8	13.16%	11.76%	65.01%	0.8	0.8
7	66.9	20.48%	12.46%	74.33%	-	-
8	47.8	20.10%	12.53%	98.39%	0.6	0.6
9	54.8	31.13%	13.21%	94.91%	0.3	0.3
10	37.1	46.50%	12.24%	67.87%	-	-
11	52.0	57.62%	12.97%	74.20%	0.1	0.1
12	42.2	80.55%	15.20%	39.01%	-	-
Default	146.9	100.00%	10.99%	77.03%	-	-
Total	19,094.7	2.08%	10.04%	10.64%	220.5	220.4

Key movements

Credit risk exposure has fallen by £1.5 billion in 2014 resulting from £285.9 million of retail SME mortgages no longer being assessed under the IRB approach and the reduction in the Franchise mortgage portfolio.

Notes

(1) The Mortgage PD model uses a TTC approach.

(2) The 10% LGD floor that applies to residential mortgage exposures is applied at portfolio level rather than at account level. The weighted average LGDs disclosed for PD Grade 0 falls below the floor as a result of the underlying accounts being allocated across the PD Grades. The accounts residing within PD Grade 0 represent the highest quality accounts within the portfolio and may individually receive an LGD of less than 10%. However, the LGD for the entire portfolio is floored at 10%.

Table 23: Other retail: personal loan exposures by PD grade

	2014					
PD Grade	**Credit Risk Exposure £million**	**Exposure Weighted Average PD %**	**Exposure Weighted Average LGD %**	**Average Risk Weight %**	**Undrawn Commitments (Gross) £million**	**Undrawn Commitments (Post CCF) £million**
0	**0.5**	**0.09%**	**82.47%**	**20.64%**	**-**	**-**
1	**45.0**	**0.30%**	**83.63%**	**45.95%**	**0.9**	**0.2**
2	**109.0**	**0.61%**	**84.66%**	**71.54%**	**1.9**	**0.4**
3	**161.3**	**1.03%**	**85.47%**	**93.03%**	**1.7**	**0.4**
4	**409.3**	**1.79%**	**86.68%**	**114.08%**	**3.2**	**0.6**
5	**303.8**	**3.27%**	**87.34%**	**130.23%**	**2.1**	**0.4**
6	**147.9**	**5.91%**	**87.60%**	**139.70%**	**1.6**	**0.3**
7	**36.1**	**8.36%**	**87.87%**	**148.78%**	**0.4**	**0.1**
8	**19.9**	**11.26%**	**87.86%**	**163.00%**	**0.3**	**-**
9	**8.6**	**16.31%**	**87.91%**	**190.00%**	**0.1**	**-**
10	**3.4**	**23.96%**	**87.94%**	**221.75%**	**-**	**-**
11	**2.3**	**37.36%**	**86.91%**	**242.36%**	**-**	**-**
12	**12.2**	**68.34%**	**86.49%**	**176.58%**	**0.3**	**0.1**
Default	**23.8**	**100.00%**	**87.76%**	**250.20%**	**-**	
Total	**1,283.1**	**5.38%**	**86.59%**	**118.05%**	**12.5**	**2.5**

	2013					
PD Grade	Credit Risk Exposure £million	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £million	Undrawn Commitments (Post CCF) £million
0	0.3	0.09%	85.25%	20.00%	-	-
1	29.8	0.29%	82.31%	44.70%	0.4	0.1
2	79.5	0.61%	83.89%	70.87%	1.2	0.2
3	102.2	1.02%	85.08%	92.01%	1.2	0.2
4	389.9	1.83%	87.72%	115.81%	2.8	0.6
5	361.2	3.34%	89.96%	134.37%	2.0	0.4
6	193.8	5.83%	90.72%	144.41%	1.4	0.3
7	57.0	8.39%	91.07%	154.27%	0.4	0.1
8	34.2	11.44%	91.26%	170.35%	0.3	0.1
9	14.1	16.25%	91.56%	197.60%	0.1	-
10	6.3	24.07%	91.85%	231.88%	0.1	-
11	3.2	36.65%	90.96%	253.44%	-	-
12	17.7	75.15%	91.03%	153.54%	0.2	-
Default	24.3	100.00%	89.31%	196.01%	-	-
Total	1,313.5	6.35%	85.39%	125.77%	10.1	2.0

Table 24: Residential mortgage exposures by major portfolio

At 31 Dec 2014	**Credit Risk Exposure £million**	**Exposure Weighted Average PD %**	**Exposure Weighted Average LGD %**	**Average Risk Weight %**	**Undrawn Commitments (Gross £million**	**Undrawn Commitments (Post CCF) £million**
UK Prime	**15,306.3**	**2.13%**	**10.07%**	**9.53%**	**246.3**	**246.3**
UK Buy-to-let	**2,334.6**	**1.15%**	**9.57%**	**9.16%**	**1.0**	**1.0**
Total	**17,640.9**	**2.00%**	**10.00%**	**9.48%**	**247.3**	**247.3**

At 31 Dec 2013	£million	%	%	%	£million	£million
UK Prime	16,325.7	2.14%	10.07%	10.13%	203.5	203.5
UK Buy-to-let	2,483.1	1.24%	9.53%	9.45%	0.2	0.2
Total	18,808.8	2.02%	10.00%	10.04%	203.7	203.7

Qualifying revolving retail exposures by PD grade and retail SME exposures by PD grade

Qualifying revolving retail exposures and retail SME exposures were risk weighted using the IRB approach under the LBG IRB waiver permission until 31 December 2013. The total value of these exposures at 31 December 2013 was £3.6 billion. From 26 June 2014 onwards, these portfolios were risk weighted under the Standardised approach under the Group's waiver permission, details of which are included in the 2014 values shown on page 41.

Comparison of expected losses to accounting impairment losses

Table 25 provides a comparison of regulatory expected losses to the accounting allowance for impairment losses on loans and receivables (impairment provisions), in respect of credit risk exposures subject to the IRB Approach. Expected losses in relation to the Group's IRB portfolios are derived from the underlying IRB models, being a function of the associated PD, LGD and EAD estimates, and represent the potential loss on a portfolio over a 12 month period, subject to downturns and regulatory floors. Where expected losses for the Group exceed the current impairment provisions raised, the excess is deducted from capital and where impairment provisions exceed expected losses, the excess is added to Tier 2 capital, subject to threshold limits (0.6% of IRB RWAs).

As IRB models are developed to meet precise regulatory requirements under the Capital Requirement Regulation (CRR), the expected losses generated by these models are not directly comparable to impairment losses derived under International Financial Reporting Standards (IFRS) accounting standards. In particular:

- IFRS accounting impairment losses seek to measure loss on the basis of the economic conditions at the balance sheet date. However CRR expected loss calculations are predicated on loss estimates reflecting longer term economic conditions.
- Expected loss calculations forecast potential losses arising from all accounts including those that currently exhibit no indication of impairment.
- Expected losses in relation to portfolios that are based on through-the-cycle PD estimates utilise historic default experience, whereas IFRS accounting impairment losses are based on the loss incurred at a point-in-time.
- Expected loss calculations anticipate additional drawings made by customers who are yet to default (EAD estimate). IFRS accounting impairment losses reflect exposures value and conditions at the balance sheet date.

Impairment losses for the year will reflect losses in relation to all portfolios that were subject to the IRB Approach during the year. In comparing expected losses to accounting impairment losses, consideration of the above should be taken into account.

♣ Financial assets, Note (b) (Accounting policies) and Impairment of financial assets, Note (c) (Accounting policies), 2014 TSB Banking Group plc Annual Report and Accounts pages 109 to 110.

Table 25: Expected losses and allowance for impairment

	2014		2013	
	Regulatory Expected Losses £million	**Allowance for Impairment Losses on Loans and Receivables £million**	Regulatory Expected Losses £million	Allowance for Impairment Losses on Loans and Receivables £million
Foundation IRB Approach				
Corporates - SME	-	-	0.2	0.3
Retail IRB Approach				
Retail - Residential mortgages	**31.2**	**19.3**	38.7	26.2
Retail - Qualifying revolving retail exposures	**-**	**-**	91.1	38.1
Retail - Other retail	**53.9**	**25.9**	71.2	29.6
Retail - SME	**-**	**-**	6.2	2.6
Total IRB approach	**85.1**	**45.2**	207.4	96.8

Model performance

This section provides an analysis of the performance of IRB models as at 30 November 2014 for Residential Mortgages - Secured and Retail - Loans.

Table 26 compares the estimated and actual Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD) ratio by exposure class. The values are taken from the Group's regulatory capital calculation models, including the application of regulatory floors. For the purposes of comparison, EAD weighting has been used throughout.

The validation of model parameters and outputs forms part of the control framework surrounding the development and monitoring of Retail IRB models which begins on page 33.

Table 26: PD, LGD and EAD by exposure class

IRB Exposure Class	Probability of Default		Loss Given Default of Defaulted Assets		Exposure at Default of Defaulted Assets
	Estimated Nov 13 %	Actual Nov 14 %	Estimated Nov 13 %	Actual Nov 14 %	Ratio of Predicted to Actual %
Retail - Loans	**4.71%**	**3.82%**	**91.19%**	**78.17%**	**103.25%**
Residential Mortgages	**1.26%**	**0.54%**	**12.64%**	**3.63%**	**103.28%**

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

The Mortgage PD model uses a TTC approach and this means that the gap between estimated and actual default rates will therefore narrow or widen to reflect the cyclical nature of defaults. The Loans PD model uses a PiT approach which means that the regulatory PD calculation is calibrated to reflect the cyclicality of defaults. A PD buffer is applied to the PiT estimate to capture any movements in default rates between calibration and implementation and to ensure that PiT PD estimates are prudent.

The LGD models are downturn calibrated resulting in the actual LGD being below predicted losses. For those assets where losses are not yet realised, the determination of actual LGD also includes the use of the model estimates.

The EAD ratio is provided as a proxy for the regulatory requirement to disclose information about credit conversion factors. The ratio provides a consistent measurement across the Secured and Loans rating systems. When a ratio is greater than one the predicted EAD is greater than the actual exposure on the date of default.

Exposures subject to the standardised approach

As at 31 December 2014, credit risk exposures evaluated under the Standardised Approach amounted to £9.2 billion (2013: £4.8 billion), generating risk weighted assets of £2.3 billion (2013: £0.4 billion) and a capital requirement of £182.7 million (2013: £30.5 million).

The Group makes limited use of credit assessments by external credit assessment institutions (ECAIs) in assigning risk weights to credit risk exposures under the Standardised Approach. This typically applies in the case of certain Central Government, Central Bank and institution exposures.

Where a credit assessment is used this must be provided by an eligible ECAI from the PRA's approved list. The appropriate risk weight to apply to the credit risk exposure is determined by assigning the exposure to the relevant credit quality step under CRD IV Chapter 3 (Standardised Credit Risk), based on the PRA's mapping of credit assessments to credit quality steps. A table containing the current mappings is published on the PRA's website. Where appropriate, the Group makes use of credit assessments provided by Standard & Poor's and Moody's.

The following table indicates the risk weights applied to credit risk exposures subject to the Standardised Approach, by exposure class, together with the associated RWA. The appropriate risk weight is applied to the exposure after consideration of any eligible forms of credit risk mitigation.

Table 27: Risk weights subject to the standardised approach

		2014		2013	
	Risk Weight	Credit Risk Exposure £million	Risk Weighted Asset £million	Credit Risk Exposure £million	Risk Weighted Asset £million
Central governments and central banks	0%	4,540.4	-	25.8	-
	250%	108.1	270.3	-	-
Institutions	0%	-	-	4,115.5	-
	20%	134.0	26.8	-	-
	50%	44.6	22.3	-	-
Retail[(1)]	75%	962.0	686.6	-	-
	100%	-	-	1.8	1.8
Secured by mortgages on immovable property[(1)]	35%	2,829.2	987.4	-	-
Exposures in default	100%	25.8	25.8	-	-
	150%	4.7	7.0	-	-
Other items	0%	180.0	-	176.9	-
	20%	133.6	26.7	116.6	23.3
	100%	230.8	230.8	379.8	356.9
Corporates	100%	1.7	1.7	-	-
Total		9,194.9	2,285.4	4,816.4	382.0

Key Movements

- In 2014, the exposure with central government and central banks includes deposits with Bank of England and Treasury gilts risk weighted at 0% and a deferred tax asset risk weighted at 250%.
- In 2013, CREs under Institutions reflects the deposit with LBG which following the Group's exit from LBG's UK Liquidity Group and listing on the London Stock Exchange, was largely transferred to an operational account with the Bank of England, reflected under risk class Central governments and central banks.
- The increase in the Retail exposures is due to the change in risk calculation methodology for credit cards, overdrafts and business banking exposures from IRB to Standardised during 2014.
- CREs under Secured by mortgages on immovable property reflect the Mortgage Enhancement exposures transferred to the Group in February 2014.

(1) Retail and Secured by mortgages on immovable property credit risk exposures include balances relating to Retail SME exposures. These exposures are risk weighted at 75% and 35%, then subject to a further SME supporting factor scalar adjustment, introduced by CRD IV, which provides a more beneficial final RWA.

Credit risk mitigation

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

Credit policies and standards
The 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 the Group to take early and proactive mitigating actions.

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

Retail credit assessment
The 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. The Group also assesses the affordability of borrowings to the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits such as maximum loan amounts, the level of borrowing to income and the ratio of borrowing to collateral. Certain limits are subject to internal approval levels while others are hard limits above which the Group will reject the application. The Group also has certain criteria applicable to specific products such as for buy-to-let mortgage applications.

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

Concentration risk
The Group considers risk concentrations by collateral providers and collateral type, as appropriate, with a view to ensuring that any potential undue concentrations of risk are identified and suitably managed by changes to strategy, policy or business plans.

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 the Group's policy that collateral should always 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.

Master netting

The Bank's credit risk exposure on derivative and repo instruments is subject to master netting agreements. 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.

Exposures covered by eligible collateral and guarantees

The Group will always consider techniques to mitigate credit risk. This may include a charge over collateral, guarantees and use of netting and set off agreements.

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 PD, LGD or EAD values used in the calculation of the risk weighted asset amount.

The Group uses the Financial Collateral Comprehensive Method and applies the relevant adjustments for volatility, in addition to 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.

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).

11. Securitisation

Retail deposits form the majority of the Group's liabilities, creating a concentration of liquidity risk [(1)]. The Group currently makes limited use of the wholesale markets, including residential mortgage backed securitisation, but has established capabilities and plans to reduce liquidity risk and diversify funding sources should this be required.

In May 2014, the Group entered into a securitisation transaction with LBG. This transaction provides a flexible funding facility for the Group for the period that the Group holds the Mortgage Enhancement portfolio which is expected to mature during 2018.

- The Group has sold a portfolio of ring-fenced mortgage assets to a bankruptcy-remote Special Purpose Vehicle (SPV) named Cape Funding No. 1 plc. The SPV is a newly established company which is neither owned nor controlled, either directly or indirectly, by the Group. However, the Group does administer the SPV and receives fees from the SPV for continuing to service the mortgage loans.

- The purchase of the mortgage assets by Cape Funding was funded by the issuance of limited recourse notes to the Group and LBG. The Group issued a Variable Funding Note (VFN) to LBG with a maximum drawing capacity of £2.5 billion. The Group holds a corresponding VFN which reflects the balance of the facility not drawn from LBG. The Group also holds £425.0 million of subordinated notes. At 31 December 2014 £10.0 million had been drawn against the LBG VFN with the corresponding £2.49 billion drawn from the Group's VFN. The Group-held subordinated note and a Group-provided reserve fund provide the required level of credit enhancement to achieve the required AAA credit rating.

- The interest received from the underlying mortgage assets is used to fund the payment of the note interest and other fees and operating costs with any residual income distributed back to the Group. Principal repayments from the underlying mortgage assets are used to purchase further mortgage assets, subject to certain criteria, to maintain the note balance for a set period, after which principal receipts will be used to repay the principal of the notes.

The Group's securitisation programme, together with the balances of the underlying assets subject to securitisation and the carrying value of the notes in issue at 31 December 2014, are summarised in the table below:

Table 28: Securitisation programme

Securitisation Programme	2014 Gross Assets Securitised £million	2013 Gross Assets Securitised £million	Movement £million	2014 Notes in Issue £million	2013 Notes in Issue £million	Movement £million
Cape Funding (UK residential mortgages)	2,876.3	-	2,876.3	10.0	-	10.0
Total	**2,876.3**	**-**	**2,876.3**	**10.0**	**-**	**10.0**

Through the provision of the credit enhancement to the SPV the Group retains the majority of the risk in the underlying mortgage assets, therefore it does not meet the regulatory conditions for establishing significant risk transfer and consequently capital is calculated on the underlying mortgage assets exposure.

The facility is capped at the lower of the balance of the Mortgage Enhancement portfolio and £2.5 billion and is therefore expected to decline as the Mortgage Enhancement portfolio reduces.

♣ A description of the accounting treatment for securitisation can be found in Loans Note (b) on page 109 of the Group's Annual Report and Accounts.

(1) Liquidity risk disclosures are presented in Note 26 on page 129 of the Group's Annual Report and Accounts♣.

12. Asset encumbrance

These disclosures are based on the EBA guidelines on disclosure of encumbered and unencumbered assets and PRA Supervisory Statement 11/14.

The Group's wholesale term funding requirements are currently met by the securitisation structure described in Section 11, which encumbers certain mortgage assets on the Group's balance sheet.

Loans on demand

The SPV (described on page 44) holds bank balances which are restricted in use to the repayment of the debt securities issued by the structured entity and other legal obligations. These are considered as encumbered by the Group, with the bank balance varying over time and at 31 December 2014 was £132.6 million.

Debt securities

At 31 December 2014, the Group had £32.9 million of UK treasury gilts pledged against repurchase with LBG, the repo deposit received amounting to £32.5 million.

Loans and advances other than on demand

The level of encumbrance of the securitised mortgage assets is proportional to the amount of external funding obtained by the Group, which has varied between £10.0 million and £250.0 million for the reporting period from the transaction's inception in May 2014, with £10.0 million outstanding at 31 December 2014. The encumbrance of the mortgage portfolio held by the SPV is approximately 15% higher than the external funding to reflect the credit enhancement within the transaction, and may be increased over time to support the rating of the external notes, if required.

Further mortgages assets are held within the SPV to support the issuance of debt securities to the Group. These are not considered as encumbered as Group has access to the economic interest in the portfolio.

Other assets

The encumbered other assets include cash ratio deposit with the Bank of England, initial and variation margin collateral with LBG and London Clearing House (LCH) Swapclear and Repoclear.

Collateral is utilised to reduce credit risks in various portfolios. This includes taking and providing collateral, principally cash, government securities and guarantees. For certain derivative transactions which meet eligibility for clearing at a Central Counterparty (CCP), bilateral counterparty credit risk is replaced by an exposure against the CCP.

As at 31 December 2014, the Group maintained an active relationship with LCH Swapclear for swap clearing activity and LCH Repoclear for repo clearing activity. Under the agreement with LCH Swapclear, the Group had received cash collateral of £54.6 million.

Initial margin, excess margin and default fund contributions to LCH Swapclear and LCH Repoclear totalled £51.6 million pledged in cash.

The table below lays out the encumbered and unencumbered assets in carrying and fair value amounts by categories of asset type:

Table 29: Encumbered and unencumbered assets by asset type at 31 December 2014

	Carrying amount of encumbered assets £million	Fair value of encumbered assets £million	Carrying amount of unencumbered assets £million	Fair value of unencumbered assets £million	Total £million
Assets of the reporting institution	**277.6**	**32.9**	**26,893.8**	**306.8**	**27,171.4**
Comprising:					
Loans on demand	132.6	-	4,171.2	-	4,303.8
Debt securities	32.9	32.9	306.8	306.8	339.7
Loans and advances other than loans on demand	11.5	-	21,629.9	-	21,641.4
Other assets	100.6	-	785.9	-	886.5

The Group does not deem available for encumbrance in the normal course of its business the other unencumbered assets of £785.9 million disclosed in table 29. These assets include property, plant and equipment, deferred tax assets, derivative assets, items in collection from banks, other assets and prepayments.

The Group opted to use the waiver available under PRA Supervisory Statement 11/14 to waive the requirement to disclose details of collateral received.

The table below outlines the carrying amount of encumbered assets, collateral received and associated liabilities by sources of encumbrance:

Table 30: Sources of encumbrance at 31 December 2014

	Matching liabilities, contingent liabilities or securities lent £million	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £million
Carrying amount of selected financial liabilities	**45.5**	**98.0**
Comprising:		
Derivatives	3.0	51.6
Deposits	32.5	34.9
Debt securities issued	10.0	11.5
Other sources of encumbrance	**-**	**179.6**
Total sources of encumbrance	**45.5**	**277.6**

Due to the development of the Group's Treasury function during 2014, the use of monthly median values would result in an inaccurate view of the Group's encumbered assets. The amounts disclosed therefore are based on spot values due to low monthly volatility of the Group's encumbered assets.

The Board monitors and manages total balance sheet encumbrance via a risk appetite metric. All transactions that encumber assets are subject to a formal approval process.

13. Counterparty credit risk

Definition

Counterparty credit risk is the risk that the counterparty to a transaction fails to honour its obligations under a contract as they fall due. This typically relates to contracts for financial instruments including derivative contracts and repurchase agreements. As a consequence of hedging market risk with other financial counterparties and placing surplus liquidity with appropriate counterparties, including the Bank of England, the Group has credit exposures to these counterparties.

Internal capital and credit limits

The Group's counterparty credit risk appetite is determined by quantifying the aggregate risk arising from the financial instruments that the Group's Treasury function uses to manage the Group's capital, funding and market risks and the counterparty's credit quality. In general, the Group's Treasury activity is conducted with counterparties that have external obligor ratings equivalent to investment grade as measured by external credit rating agencies.

Once due diligence is completed and commercial approval has been obtained for a counterparty, credit limits are established through the Group's counterparty credit approval framework based on credit risk equivalents. For derivatives this includes a component for potential future exposure, calculated on the basis of the maximum projected mark to market exposure of the derivatives for a 95th percentile assumption. For regulatory credit risk assessment and reporting, the prescribed formulae under the mark to market method are used.

Credit limits are set by counterparty risk type and reflect documentation held for netting or collateral management purposes. Outstanding exposures are calculated on a current plus potential future exposure basis, based upon the transaction characteristics and documentation.

Securing collateral and establishing credit reserves

Use is made of collateral and risk mitigation techniques to reduce credit risks in various portfolios. These include taking collateral (principally cash, government securities and guarantees), break clauses (on an ad hoc basis) and netting. For certain derivative transactions which meet eligibility for clearing at a Central Counterparty (CCP), bilateral counterparty credit risk is replaced by an exposure against the CCP.

The Counterparty Credit Risk Policy governs types of acceptable collateral and haircuts, in line with industry norms.

Collateral arrangements are governed by standard agreements (such as Global Master Repurchase Agreements and Credit Support Annexes to ISDA Master Agreements). It is Group policy that an appropriate master agreement is put in place for all counterparties prior to trading, any exceptions being subject to specific approval from a senior credit risk officer. This policy also defines minimum acceptable requirements for the negotiation of ISDA and CSA documentation.

To recognise the effects of credit risk mitigation, agreements must be valid, enforceable, unconditional and irrevocable. In addition, collateral must be transferred to the Group through the passing of title and be nettable on a portfolio basis. Once these conditions are met, the effect of collateral received is reflected in reductions to all applicable credit exposures and in capital adequacy calculations.

Collateral received is reviewed daily to ensure quality is maintained and concentrations are avoided. Correlation between the approved counterparties and issuers of collateral held is assessed for wrong way risk and, where required, collateral is either substituted or the exposure reported separately.

Derivative valuation adjustments

The Group calculates a Credit Valuation Adjustment on all external derivative transactions; however, due to clearing through CCPs, collateralisation is immaterial.

Exposures

Counterparty credit risk exposures are first measured under the Mark-to-Market Method, prior to being risk weighted under the Standardised Approach.

Counterparty credit risk exposures

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

Table 31: Counterparty credit risk exposures

	2014 Credit Risk Exposure £million	**2014 Risk Weighted Assets £million**	2013 Credit Risk Exposure £million	2013 Risk Weighted Assets[1] £million
CCR Mark to Market Method				
Standardised approach				
Institutions				
Interest rate contracts	**1.9**	**0.9**	60.5	-
Securities financing transactions	**1.3**	**0.3**	-	-
CCR Central Counterparty				
Standardised approach				
Institutions				
Interest rate contracts	**76.3**	**3.0**	-	-
Securities financing transactions	**2.7**	**0.1**	-	-
Total	**82.2**	**4.3**	60.5	-

(1) At 31 December 2013, all counterparty credit risk exposures were with LBG and risk weighted at 0% as the Group was fully owned by LBG and covered by the LBG Core Group waiver.

Net derivatives credit exposure

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

Table 32: Net derivatives credit exposure

	2014 £million	**2013 £million**
Gross positive fair value of contracts	**123.1**	99.4
Netting benefits	**(116.7)**	(85.6)
Netted current credit exposure	**6.4**	13.8
Net potential future credit exposure	**29.1**	46.7
Net collateral pledged / received	**42.7**	-
Total net derivatives credit exposure	**78.2**	60.5
Securities financing transactions	**4.0**	-
Total counterparty credit risk exposure	**82.2**	60.5

14. Market risk

Definition

Market risk occurs from a reduction in earnings, value or reserves caused by changes in the prices of financial instruments. In addition, market risk can arise as a result of changes in customer behaviour, which may affect the maturity profiles of the Group's assets and liabilities. The Group aims to maximise the value of its business by preserving its margins through management of market risk positions that arise through the natural course of business.

The Group's primary market risk is the interest rate risk arising from the Group's banking activities and as a result is exposed to the following categories of risk:

- **Re-pricing risk:** The risk that assets and liabilities have a maturity mismatch, or re-price at different times to each other, exposing the Group's income and underlying value to unanticipated fluctuations as interest rates vary and the shape of the yield curve changes. This includes the risk from the investment of the Group's equity and bank account balances.
- **Basis risk:** The risk that assets and liabilities re-price based on different interest rate indices (such as LIBOR or Base Rate) and expose the Group's earnings and margins to changes in the spread between indices.
- **Optionality risk:** The risk from options embedded in retail and business banking assets and liabilities, such as the right for customers to top-up fixed rate savings accounts or to prepay mortgages.
- **Behavioural risk:** The risk that maturity assumptions applied to retail and business banking products may change over time, or may themselves be a function of interest rate levels.
- **Residual risk:** The small amount of interest rate risk to which the Group is exposed either prior to hedging with the external market or where the hedging is not entirely effective in mitigating such risk.
- **Margin compression:** The risk of lower net interest margins in the current low interest rate environment, as the Group may be unable to pass on any rate reductions in full on rates paid on customer deposits.

Risk appetite

The Group's risk appetite methodology is set out on page 10. For Market Risk, the Group takes minimal proprietary trading risk, relating purely to the management of the balance sheet, reflecting the retail customer focussed nature of the Bank's activities.

Exposures

Market risk in the Retail and Retail SME books consists almost entirely of exposure to changes in interest rates including the margin between customer and market rates. This is the potential impact on earnings and value that could occur when, if rates fall, liabilities cannot be re-priced as quickly or by as much as assets; or when, if rates rise, assets cannot be re-priced as quickly or by as much as liabilities.

Risk exposure is monitored monthly using, primarily, Net Interest Income (NII) and earnings sensitivity. This methodology considers all re-pricing mismatches in the current balance sheet and calculates the change in earnings that would result from a set of defined interest rate shocks. Where the re-pricing maturity is based on assumptions about customer behaviour these assumptions are also reviewed monthly. A limit structure exists to ensure that risks stemming from residual and temporary positions or from changes in assumptions about customer behaviour remain within the Group's risk appetite.

Base case 12 month NII is calculated on the basis of the Group's current balance sheet with re-pricing dates adjusted according to behavioural assumptions. The sensitivities outlined in the table below show projected changes in 12 month NII in response to an immediate parallel shift to all relevant interest rates – market and administered. The measure, however, is simplified in that it assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

A further business risk arises from competitive pressures on product terms in existing loans and deposits, which sometimes restricts the Group's ability to change interest rates applying to customers in response to changes in market rates.

These risks are assessed under Pillar 2. As the Group has no trading book or material foreign exchange positions, there is no market risk capital requirement under Pillar 1.

The table below shows an illustration of how 12 month Net Interest Income (NII) would change in response to an immediate parallel shift to all relevant interest rates – market and administered:

Table 33: Banking activities: earnings sensitivity (12 month net interest income)

	2014 Up 25bps £million	**2014 Down 25bps £million**	2013 Up 25bps £million	2013 Down 25bps £million
12 month NII Sensitivity	**0.7**	**(8.2)**	0.7	(10.5)

As at 31st December 2014, the Group has a sterling only balance sheet. The numbers above represent Retail, a small Retail SME book, and external hedges only.

Measurement

The Group maintains systems and controls sufficient to provide reliable market risk estimates. These include documented policies, clearly defined roles and responsibilities and departments accountable for verification that are independent of the front office. The key elements of the control framework for the valuation of financial instruments include product implementation review and independent price verification.

Exposures are monitored at various intervals from daily in the case of hedging portfolios to monthly in the case of the Retail / Retail SME book. Levels of exposures compared to approved limits and triggers are monitored by Market Risk and where appropriate, escalation procedures are in place.

- Earnings and value based risk metrics are used to ensure the Group's market risk position is within the Board risk appetite.
- Customer product proposals are reviewed and any embedded market risk identified and noted within the product approval process. Product pricing is reviewed to ensure embedded risks are included in the final customer rate.
- Accuracy and timeliness of market risk reporting is tracked and escalated where appropriate.

Mitigation

The Group's Treasury function has responsibility for managing interest rate risk within a Board approved risk appetite and governance framework. High level market risk exposure is reported regularly to the Group's Asset and Liabilities Committee (ALCo), Executive Risk Committee, Bank Executive Committee, Board Risk Committee and Board.

The Group seeks to maintain minimal interest rate re-pricing risk in its banking book. At any point in time, however, some small level of transitory risk will exist pending, for example, contrary offsetting flows and the efficient hedging of the net position with the external market.

Monitoring and management

ALCo regularly reviews market risk exposures as part of the wider risk management framework. ALCo also makes recommendations to the Board Risk Committee and Board concerning overall market risk appetite and market risk policy. Exposures are monitored at various intervals from daily in the case of hedging portfolios to monthly in the case of the Retail and Retail SME book. Levels of exposures are compared to approved limits and triggers and monitored by Market Risk function and where appropriate, escalated through established procedures. Product pipeline hedging is managed by the Balance Sheet Management Committee weekly.

Management of the balance sheet is centralised and overseen by ALCo. Interest rate risk arising from the different re-pricing characteristics of the retail and business banking assets and liabilities, and from the mismatch between interest rate insensitive assets and interest rate sensitive liabilities, is managed centrally. Matching assets and liabilities are offset against each other and interest rate swaps are used to manage the residual exposure within the market risk appetite.

Valuation principles

The financial statements of the Group are prepared in accordance with International Financial Reporting Standards. Financial assets and liabilities at fair value through profit or loss, derivatives and available-for-sale financial assets are stated at fair value.

♣ Full details on the use of valuation models and related adjustments are provided in Pages 106 – 113 of Notes to the Financial Statements in the 2014 TSB Banking Group plc Annual Report and Accounts.

15. Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Risk appetite

The Group's risk appetite methodology is set out on page 10. The Group has established robust controls to manage operational losses, reputational events and regulatory breaches. The Group identifies and assesses emerging risks and acts to mitigate these.

Exposure

The Group calculates its operational risk capital requirements under the Standardised Approach. The actual capital requirement can be found within the operational risk RWAs and capital requirement section below.

In 2013, the capital requirement was calculated based on the historic three year average risk weighted income flows method. In 2014, the Group changed the methodology to utilise the forecast steady-state income basis as it better reflects the scale of the Group's business.

Measurement

Operational risks impact the way the Group does business and how it can serve its customers and local businesses. It is important that the Group operates in line with its values to protect customers, Partners, shareholders and the wider communities in which it serves.

There are several activities undertaken by the Group that create operational risk, and each of them could result in a loss for the Group resulting from external events, or from failed internal processes, people risk, supplier management or systems failure. The Group employs a robust operational risk management framework, with controls to prevent, detect and mitigate the consequences of operational risk events. These are described in greater detail on page 98 of the Group's 2014 Annual report and Accounts♣.

The Group continues to benefit from the Transitional Services Agreement (TSA) with Lloyds Banking Group and the support they provide for core Group IT systems continuity, regular updates and improvements to system architectures, resilience and security.

A Group Operational Risk Policy is in place supported by a Business Risk Framework, Risk & Control Standards and Loss & Material Event Escalation Standards. These apply the Board risk appetite and detailed processes and procedures to support the successful execution of the business strategy.

The Group defines an operational risk event as an incident where controls either did not exist or did not operate as required or proved ineffective. This could result in either financial impacts or non financial impacts (such as an impact on customers, reputational damage or regulatory censure).

The Group reports operational risk events against internal risk categories which are aligned to Basel II categories. The analysis in Table 34 presents the Group's operational risk events by the Group's internal risk categories. Operational risk events are recorded on an individual basis where the operational loss is £5,000 or more and fraud losses are £20,000 or more. For 2014, events of £1.2million were recorded. This shows external fraud by value as the largest cost, reflecting broad industry trends within the financial sector. The Board monitors the total operational losses as a percentage of budgeted income which remained within the Group's risk appetite of 2.5% for the year.

Table 34: Operational risk events by risk category

Risk Category	% of total volume 2014(1)	% of total value 2014
Customer processes and treatment	51%	5%
Financial crime and fraud	16%	74%
IT systems development and management	10%	-
Legal & regulatory	5%	-
Information and physical security	7%	21%
Supplier management	6%	-
Others(2)	5%	-
Total	**100%**	**100%**

(1) The Group became responsible for recording Operational Loss data following separation from LBG during September 2013 so a review alongside last year's data does not provide a meaningful comparison.

(2) Remaining seven categories contribute to 5% of the volume of events however no material financial losses have been recorded against these risk categories.

Fraud Losses

The Group faces potential fraud and financial crime risk in each area of operation. A strong education and awareness training programme is undertaken regularly by all Partners to ensure an understanding of the threats the Group faces from fraudsters and other criminals including methods used such as cyber crime. This includes the relevant controls and reporting processes that are in place for dealing with suspicious activity and complying with regulatory obligations. The Group employs robust transaction monitoring systems that report any unusual customer activity to the appropriate authorities. Reviews are regularly undertaken, along with business line reporting of key risk indicators, to confirm the effectiveness of the controls the Group has in place to protect against financial crime.

Systems

A number of systems are provided and supported by LBG under the TSA. Operational risk events associated with these are reported under the Supplier Management category and separate from TSB's internal system related events, which are recorded against the IT Systems and Development category.

Mitigation

Operational risk is relevant to every aspect of the Group's business and activities. The Group's operational risk framework consists of the following key components:

- Identification and categorisation of the key operational risks facing a business area, including defining risk appetite.
- Risk assessment, including impact assessment of financial and non-financial impacts (e.g. reputational risk) for each of the key risks to which the business area is exposed.
- Control assessment, evaluating the effectiveness of the control framework covering each of the key risks to which the business area is exposed.
- Loss and incident management, capturing actions to manage any losses facing a business area.
- The development of Key Risk Indicators for management reporting, including the monitoring of risk appetite.
- Oversight and assurance of the risk management framework in businesses.
- Scenarios for estimation of potential loss exposures for material risks.

Where appropriate, the Group purchases insurance to mitigate or transfer elements of operational risk which it considers outside of risk appetite due to its quantum or type.

Monitoring

Monitoring and reporting is undertaken at the Business Risk Forum, Executive Risk Committee, Bank Executive Committee, Board Risk Committee and Board levels in accordance with delegated levels of authority which are themselves regularly reviewed and refreshed. A combination of systems and monthly reports from business areas ensures that key risk measures are reviewed and debated on a monthly basis.

The Group has adopted a formal approach to operational risk event escalation. This involves event identification assessment of the materiality of the event in accordance with a risk event impact matrix, and appropriate escalation and action plans.

Operational risk RWAs and capital requirement

As at 31 December 2014, the RWAs in respect of operational risk were £1,451.5 million (2013: £433.7 million). The increase is attributable to a change in methodology for calculating operational risk RWAs to use a forecast steady-state income basis rather than the historic three year position used to calculate the operational risk RWAs in 2013. The capital requirement amounted to £116.1 million (2013: £34.7million), as determined under the Standardised Approach.

16. Remuneration

TSB wants its reward approach to be simple and fair, putting customer service at the heart of what we do. We believe we will deliver best shareholder value by focussing on sustainable business growth and rewarding behaviours that are consistent with our values.

- ♣ This approach to remuneration is covered in detail in the Directors' remuneration report in the Group's 2014 Annual Report and Accounts, pages 56-78 where remuneration disclosures produced in compliance with the appropriate CRD IV requirements can also be found.

Further disclosures in respect of remuneration paid to Remuneration Code Staff and others as required by CRD IV are set out in the tables below:

Table 35: Additional remuneration information in respect of code staff

	Senior Management £million
Aggregate variable remuneration by remuneration type	
Cash award	0.6
Shares	0.7
Outstanding deferred remuneration at 31 December 2014	
Vested	-
Unvested	-
Deferred remuneration during the year ended 31 December 2014	
Awarded during the year	4.9
Paid out during the year	-
Performance adjustments	-

Code Staff are those individuals whose actions have a material impact on the risk profile of the Group and include executive and non-executive directors. During the year there were a total of 21 Code Staff with all falling within the Senior Management category (being the executive and non-executive members of the Board and members of BEC). Aggregate remuneration expenditure in respect of all Code Staff was £10.4 million of which on average 40% represented fixed remuneration and 60% represented variable remuneration.

There were no sign-on or severance payments awarded to Code Staff during 2014.

Table 36: Remuneration by band

Remuneration Band Million Euros	Number of Code Staff
< 1.0	15
1.0 – 1.5	5
1.5 – 2.0	-
2.0 – 2.5	1
> 2.5	-

Total remuneration has been calculated including base salary, allowances, performance pay in relation to the performance year, and fees for non- executive directors. Performance pay comprises the Legacy LBG award, TSB Award, Sustainable Performance Award and Transitional Award.

GLOSSARY

Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
Basel III	The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and phased in through CRD IV from 1 January 2014 onward.
Basis point (bps)	One hundredth of a per cent (0.01%). 100 basis points is 1%. Used in quoting movements in interest rates.
Buy-to-let mortgages	Buy-to-let mortgages are those mortgages offered to customers purchasing residential property as a rental investment.
Capital Requirements Directive IV (CRD IV)	On 27 June 2013, the European Commission published, through the official journal of the European Union, its legislation for a Capital Requirements Directive and Capital Requirements Regulation (CRR), which form the CRD IV package. Amendments were subsequently made to the Regulation published on 30 November 2013. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance and remuneration. The rules were implemented from 1 January 2014 onwards, with certain sections yet to be phased in.
Commercial real estate	Commercial real estate includes office buildings, medical centres, hotels, malls, retail stores, shopping centres, farm land, housing buildings, warehouses, garages, and industrial properties.
Common Equity Tier 1 (CET1) capital	The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
Common Equity Tier 1 ratio	Common Equity Tier 1 Capital as a percentage of risk weighted assets.
Contingent leverage	Contingent leverage represents off-balance sheet items which could convert into on-balance items e.g. unutilised credit limits could be utilised in future.
Core Tier 1 capital	As defined by the Prudential Regulation Authority (PRA) mainly comprising shareholders' equity after regulatory deductions.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and include derivative contracts and repo contracts.
Credit Conversion Factor (CCF)	Credit conversion factors (CCF) are used in determining the exposure at default (EAD) in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn commitments expected to be drawn down at the point of default.
Credit risk	The risk of reductions in earnings and / or value, through financial loss, as a result of the failure of the party with whom the Group has contracted to meet its obligations (both on and off balance sheet).
Credit risk mitigation	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.
Credit support annexe	A legal document which provides credit mitigation by setting forth the rules governing the mutual posting of collateral under derivative transactions or portfolios thereof.
Debt securities	Debt securities are assets held by the 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 Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Encumbrance	The use of assets to secure liabilities, such as by way of a lien or charge.
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).

External Credit Assessment Institutions (ECAI)	External Credit Assessment Institutions (ECAIs) include external credit rating agencies such as Standard & Poor's, Moody's and Fitch.
Financial Collateral Comprehensive Method	A method for the recognition of certain collateral within the calculation of regulatory capital as defined under Article 223 of the Capital Requirements Regulation (EU No 575/2013).
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to an obligor's financial difficulties.
Foundation Internal Ratings Based (Foundation IRB) Approach	Application of the Foundation Internal Ratings Based (Foundation IRB) Approach allows internal estimates of PD to be used by the Group in determining credit risk capital requirements for wholesale portfolios. However, LGD and EAD under the Foundation IRB Approach are determined in accordance with standard parameters set by the regulator rather than on the basis of internal estimates. The Foundation IRB Approach cannot be applied to retail portfolios.
Franchise	TSB's business excluding the Mortgage Enhancement transaction.
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.
Global Master Repurchase Agreement	A master netting agreement used as the standard contract for documenting transactions in the international repo markets.
Global-Systemically Important Institution (G-SII)	Institutions identified by the national regulators in EU Member States, based on the methodology set out in EBA/RTS/2014/07, as representing a higher risk to the global financial system.
Impaired loans	Impaired loans are loans where the 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 Group Base Rate and LIBOR rates.
Internal Capital Adequacy Assessment Process (ICAAP)	The 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.
International Swaps and Derivatives Association (ISDA) Master Agreement	A global standard master netting agreement used to document over-the-counter derivatives transactions.
Investment grade	This refers to the highest range of credit ratings, from 'AAA' to 'BBB' as measured by external credit rating agencies.
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.
Lifetime Expected Loss (LEL)	The predicted expected loss over the whole term of the transaction in question.
Loan-to-Value Ratio (LTV)	The loan-to-value ratio is a mathematical calculation which expresses the amount of a mortgage balance outstanding as a percentage of the total appraised value of the property. A high LTV indicates that there is less value to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance of the loan.

Loss emergence period	The loss emergence period is the estimated period between impairment occurring and the loss being specifically identified and evidenced by the establishment of an appropriate impairment allowance.
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.
Mark-to-Market (MTM) Approach	The Mark-to-Market Approach is one of three methods available to calculate exposure values for counterparty credit risk. The method adjusts daily to account for profits and losses in the value of related assets and liabilities.
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.
Master netting agreement	An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.
Model validation	The process of assessing and providing evidence that the 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 Group from LBG with effect from 28 February 2014.
Net Interest Income (NII)	The difference between interest received on assets and interest paid on liabilities.
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.
Pillar 1	The first pillar of the Basel III framework sets out the quantitative elements – the minimum regulatory capital requirements for credit, operational and market risks.
Pillar 2	The second pillar of the Basel III framework sets out the qualitative expectations that should be met through the supervisory review process. This includes the ICAAP, governance process and the Supervisory Review Process. It sets out the review process for a bank's capital adequacy; the process under which the supervisors evaluate how well financial institutions are assessing their risks and the actions taken as a result of these assessments.
Pillar 3	The third pillar of the Basel III framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.
Point-in-time (PiT)	Estimates of PD (or other measures) made on a point-in-time (PiT) basis generally cover a short time horizon (usually a 12 month period) and are sensitive to changes in the economic cycle. This differs from a through-the-cycle (TTC) basis which uses long run average economic and risk data to reduce such sensitivity.
Probability of Default (PD)	Probability of default represents an estimate of the likelihood that a customer will default on their obligation within a 12 month time horizon.
Qualifying Revolving Retail Exposure (QRRE)	Qualifying Revolving Retail Exposures (QRRE) relate to revolving, unsecured retail exposures that, to the extent they are not drawn, are immediately and unconditionally cancellable. Such exposures include credit cards and overdraft facilities.
Regulatory capital	The amount of capital that the 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.
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 Group is prepared to seek, accept or tolerate.
Risk weighted assets (RWAs)	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with CRD IV.

Securities financing transactions (SFTs)	Securities financing transactions are repurchase and reverse repurchase agreements, buy / sell backs and securities lending. For the lender (seller) of the securities it is usually a way to raise funds to finance the securities positions. For the borrower (buyer) of the securities it is a way to invest short–term funds or to cover short (bond) positions.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.
Simple Variable Scalar	Variable scalar approaches transform the outputs of relative Point in Time PD models to produce final estimates for IRB purposes that are based on portfolio level long run average default rates, with the consequence that they reduce/eliminate the cyclicality of the regulatory capital requirements as far as the PD parameter is concerned.
Special Purpose Vehicle (SPV)	SPVs are entities that have been designed so that voting or similar rights are not the dominant factor in determining who controls the entity, such as which voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SPVs often have specific restrictions around their ongoing activities and are created to accomplish a narrow and well-defined objective.
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 ECAIs to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements.
Stress testing	Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds which are required to be held.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Supervisory Review and Evaluation Process (SREP)	The appropriate regulator's assessment of the adequacy of certain firms' capital.
The Standardised Approach (TSA)	A standardised measure for calculating operational risk capital requirements based on the three year average of the aggregate risk weighted relevant indicators of the underlying business. The relevant indicators are derived from total income.
Through-the-cycle (TTC)	See Point-in-time (PiT).
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A component of regulatory capital defined by CRD IV, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
Variable Scalar	A methodology for the transformation of the outputs of relatively PiT PD models into final estimates for IRB purposes that are based on portfolio-level long-run average default rates, with the consequence that they reduce/eliminate the cyclicality of the regulatory capital requirements in respect of PD.
Write downs	The depreciation or lowering of the value of an asset in the books to reflect a decline in their value, or expected cash flows.
Wrong way risk	The risk that arises from the correlation between a counterparty exposure and the credit quality of the counterparty. It is therefore the risk that the probability of default of the counterparty increases with the exposure.

Forward looking statements

The Group's Pillar 3 Disclosures document contains forward looking statements with respect to the business, strategy and plans of TSB Banking Group, its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group or the Group's management's beliefs and expectations are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to future events and circumstances that will or may occur. The Group's actual future business, strategy, plans and/or results may differ materially from those expressed or implied in these forward looking statements as a result of a variety of factors, including, but not limited to, UK domestic and global economic and business conditions; the ability to access sufficient funding to meet the Group's liquidity needs; risks concerning borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; market-related risks including changes in interest rates and exchange rates; changing demographics and market-related trends; changes in customer preferences; changes to laws, regulation, accounting standards or taxation, including changes to regulatory capital or liquidity requirements; the policies and actions of governmental or regulatory authorities in the UK or the European Union or other jurisdictions in which the Group operates; the implementation of the Recovery and Resolution Directive and banking reform following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; the effects of competition and the actions of competitors, including non-bank financial services and lending companies; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints and other factors. The forward looking statements contained in this document are made as at the publication date and the Group undertakes no obligation to update any of its forward looking statements.

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