TSB Banking Group plc

Significant Subsidiary Disclosures
31 December 2018

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1. Introduction

This document presents the Pillar III Significant Subsidiary Disclosures at 31 December 2018 relating to TSB Banking Group plc (TSB Group), a subsidiary undertaking of Banco de Sabadell Group (Sabadell). TSB Group's risk disclosures presented in this document are included in Sabadell's consolidated Pillar III disclosures.

The purpose of Pillar III is to make certain capital and risk management disclosures available to the market. In compiling this significant subsidiary disclosure, best practice guidelines and interpretations of standards issued by the European Banking Authority (EBA), the Enhanced Disclosure Task Force (EDTF) and national and international trade associations have been taken into account. The tables, which have been aligned to the standard templates specified by the EBA guidelines published in December 2017, have been labelled in accordance with these guidelines. An analysis of compliance with Capital Requirements Directive IV (CRD IV) requirements in respect of significant subsidiary disclosure is set out in Appendix I.

This document should be considered in conjunction with the TSB Group's 2018 Annual Report and Accounts (ARA), where a number of supporting disclosures are presented.

A detailed overview of the governance arrangements within TSB Group is provided in the Risk Management section within pages 19 to 26 and the Corporate Governance section within pages 28 to 58 of TSB Group's ARA and are not repeated in this document.

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

As of 1 January 2018, TSB Group has adopted the International Financial Reporting Standard 9 (IFRS 9) transitional arrangements within Capital Requirements Regulation (CRR) Article 473a published by the European Union (EU) on 27 December 2017. These arrangements allow banks to add back to their capital base on a temporary basis a proportion of the impact of IFRS 9 loss allowances.

2. Executive summary

TSB Group's 2018 financial performance was significantly impacted by the IT migration and subsequent service disruption. As a result, TSB Group incurred a statutory loss before tax of £105.4 million, compared to the profit of £162.7 million in 2017. This was predominantly driven by charges associated with the post migration service disruption and is further analysed in the TSB Group ARA.

Around 140,000 customers opened a new bank account or switched their account to TSB Group in 2018, and TSB Group now has 3.8 million current account customers and over 5 million customers in total. Around 80,000 customers switched their bank account away from TSB Group in 2018 with volumes peaking when TSB Group experienced IT issues in the second quarter of the year. This compares with around 50,000 customers switching their account away from TSB Group in 2017.

Loans to customers decreased by £0.9 billion to £30.0 billion. The decline in mortgage balances was due to customer repayments and the expected reduction in the closed Whistletree portfolio, in addition to lower origination activity than prior year. New mortgage lending decreased to £4.8 billion (2017: £7.0 billion) reflecting curtailed lending activity both pre and post migration as customer service levels were prioritised. The 17.7% decrease in unsecured balances was driven by lower unsecured personal loan balances as post migration operational constraints limited new lending.

TSB Group's capital position remains strong with a Common Equity Tier 1 (CET1) Capital ratio of 19.7% and a leverage ratio of 4.4% which is sufficient to support the delivery of TSB Group's growth strategy. The CET1 capital ratio decreased by 0.3% year on year, primarily due to the losses incurred in 2018.

Risk weighted assets (RWAs) reduced by £233.1 million during 2018 to £9,257.6 million at 31 December 2018 reflecting lower lending exposure levels.

TSB Group's leverage ratio at 4.4% continues to comfortably exceed the Basel Committee's proposed minimum of 3%. Under the Bank of England's (BoE) UK leverage ratio framework, leverage ratios are calculated on a modified basis, excluding qualifying central bank claims from the exposure measure, in accordance with the PRA policy statement issued in October 2017. While TSB Group is not currently to be subject to this framework, under this measure TSB Group's modified leverage ratio is 5.3%, in excess of the PRA minimum of 3.25%.

Table 1: Key metrics (KM1/IFRS 9-FL)

The table below reflects the key metrics and the IFRS 9 transitional capital metrics:

£000	2018	2017
Available capital (amounts)		
Common Equity Tier 1 (CET1)	**1,821,180**	1,898,142
CET1 as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,805,472**	n/a
Tier 1 capital	**1,821,180**	1,898,142
Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,805,472**	n/a
Total capital	**2,205,528**	2,282,211
Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**2,196,027**	n/a
Risk-weighted assets (amounts)		
Total Risk-weighted assets (RWA)	**9,257,644**	9,490,710
Total Risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**9,271,050**	n/a
Risk-based capital ratios as a percentage of RWA		
CET1 (as a percentage of risk exposure amount)	**19.7%**	20.0%
CET1 ratio (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**19.5%**	n/a
Tier 1 capital ratio (as a percentage of risk exposure amount)	**19.7%**	20.0%
Tier 1 capital ratio (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**19.5%**	n/a
Total capital ratio (as a percentage of risk exposure amount)	**23.8%**	24.0%
Total capital ratio (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**23.7%**	n/a
Additional CET1 buffer requirements as a percentage of RWA		
Capital conservation buffer requirement (2.5% from 2019)	**1.88%**	1.25%
Countercyclical buffer requirement	**1.00%**	0.00%
Bank G-SIB and/or D-SIB additional requirement	**n/a**	n/a
Total CET1 specific buffer requirements	**2.88%**	1.25%
CET1 available after meeting minimum capital requirements[(1)]	**15.2%**	15.5%
Leverage ratio		
Leverage ratio exposure measure	**41,466,642**	42,626,131
Leverage ratio	**4.4%**	4.5%
Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**4.4%**	n/a

Footnote

(1) CET1 less requirement of Pillar 1 of 4.5%.

Location of risk disclosures

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

Own Funds
Pages 7-10

Pillar 1 Capital Requirements
Pages 11-12

Pillar 2 Capital Requirements
Pages 13-14

Pillar 3
Credit Risk Pages 15-30
Leverage Ratio Pages 31-33
Remuneration Pages 34-36

3. Own funds

3.1 Capital adequacy risk

Definition
TSB Group defines capital adequacy risk as the risk associated with the failure to retain sufficient reserves or quality of capital to cover the firm's statutory requirements and operational losses and to support business strategy.

Risk appetite
TSB Group's risk appetite methodology is set out on page 21 of TSB Group's ARA. TSB Group maintains a strong capital base which meets both its regulatory requirements and supports the growth of the business, including under stressed conditions. The Board approves TSB Group's risk appetite.

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

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

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

TSB Group can accumulate additional capital through profit retention and, if required, subject to market conditions, issue eligible capital instruments.

Monitoring
Capital adequacy policies and procedures are subject to independent oversight by the Risk function and Internal Audit. Regular reporting of actual and projected capital ratios against risk appetite is provided to appropriate committees within TSB Group's governance and risk management framework as outlined in pages 29 to 36 of TSB Group's ARA. These include the Bank Executive Committee (BEC), the Asset and Liability Committee (ALCO), Board Risk Committee (BRC) and the Board.

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

3.2 TSB Group's own funds

TSB Group's own funds as at 31 December 2018 are presented in the table below. This table follows the disclosure format required by the EBA Implementing Technical Standard on Disclosure for Own Funds published in July 2013, however only items applicable to TSB Group are detailed.

Table 2: Own Funds (OFD2)

31 December	2018 £000	2017 £000
CET1 capital : instruments and reserves		
Capital instruments and related share premium accounts	970,050	970,050
Of which: ordinary shares	5,000	5,000
Retained earnings	1,163,409	1,292,336
Accumulated other comprehensive income (and any other reserves)	(269,559)	(266,739)
CET1 capital before regulatory adjustments	**1,863,900**	**1,995,648**
CET1 capital: regulatory adjustments		
Prudent value adjustment	(2,926)	(2,989)
Intangible assets (net of related tax liability)	(18,375)	(10,146)
Fair value reserve relating to gains and losses on cash flow hedges	695	461
Negative amounts resulting from the calculation of expected loss amounts	-	(84,831)
Deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	(37,823)	-
IFRS 9 transitional adjustments to CET1 Capital	15,709	-
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(42,720)**	**(97,506)**
CET1 capital / Tier 1 capital[(1)]	**1,821,180**	**1,898,142**
Tier 2 capital: instruments and provisions		
Capital instruments and related share premium accounts	384,348	384,070
Credit risk adjustments	6,208	-
IFRS 9 transitional adjustments to Tier 2 capital	(6,208)	
Tier 2 capital	**384,348**	**384,070**
Total capital	**2,205,528**	**2,282,212**
Total Risk Weighted Assets	**9,257,644**	**9,490,710**
Capital Ratios		
Common Equity Tier 1 (as a percentage of total risk exposure amount)	19.7%	20.0%
Tier 1 (as a percentage of total risk exposure amount)	19.7%	20.0%
Total capital (as a percentage of total risk exposure amount)	23.8%	24.0%
Amounts below the threshold for deduction (before risk weighting)		
Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	7,000
Direct and indirect holdings of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	4,622	17,164
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)	69,798	68,557
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)	6,208	-
Cap for inclusion of credit risk adjustments in Tier 2 under internal ratings based approach	36,597	36,571

Footnote

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

With effect from 1 January 2018, TSB Group adopted IFRS 9 transitional arrangements within CRR Article 473a published by the EU on 27 December 2017. The adoption of these arrangements resulted in an increase of £9.5 million to total capital, made up of an increase of £15.7 million CET1 and reduction of £6.2 million in Tier 2 capital.

3.3 Movements in capital

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

Table 3: Movements in capital (OFD3)

	CET1 Capital £000	AT1 Capital £000	Tier 2 Capital £000	Total £000
At 31 December 2017	**1,898,142**	**-**	**384,070**	**2,282,212**
Loss attributable to the ordinary shareholder	(63,030)	-	-	(63,030)
Application of IFRS 9 and IFRS 15	(67,593)	-	-	(67,593)
Movement in other comprehensive income (including available for sale)	(1,124)	-	-	(1,124)
Cash flow hedging reserve regulatory adjustment	234	-	-	234
Change in excess of expected losses over impairment allowances	84,831	-	-	84,831
Change in subordinated liabilities	-	-	278	278
Change in excess of default provision over default expected loss	-	-	6,208	6,208
Change in intangible fixed assets	(8,229)	-	-	(8,229)
Movement in prudent valuation adjustment	63	-	-	63
IFRS 9 transitional adjustments	15,709	-	(6,208)	9,501
Movement in deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	(37,823)	-	-	(37,823)
At 31 December 2018	**1,821,180**	**-**	**384,348**	**2,205,528**

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

Tier 1 Capital decreased by £77.0 million during 2018. This was primarily due to attributable loss of £63.0 million for the year, the regulatory adjustment for deferred tax (that relies on future profits and not from temporary differences) of £37.8 million and an increase in intangible fixed assets of £8.2 million. These movements were partly offset by the application of IFRS 9 which although reducing shareholder's equity by £71.9 million, was more than offset by a reduction in excess expected losses of £81.7 million at 1 January 2018. Excess expected loss was reduced further by £3.1 million during the course of 2018 from increased IFRS 9 provisions. Further to this, following PRA and EBA guidance (CRR Article 473a), TSB Group's CET1 Capital benefits from IFRS 9 transitional adjustment of £15.7 million.

Tier 2 Capital balance relates to the issuance of subordinated debt in prior years. The add back of excess provision over expected losses was eliminated by IFRS 9 transitional adjustment referred to on page 8.

3.4 Other capital disclosures

3.4.1 Table 4: Reconciliation between statutory and regulatory capital (OFDR)

	2018 Statutory balance £000	**2018 Regulatory adjustments £000**	**2018 Regulatory balance £000**	2017 Statutory balance £000	2017 Regulatory adjustments £000	2017 Regulatory balance £000
Own funds	**1,848,459**	-	**1,848,459**	1,977,386	-	1,977,386
Capital	5,000	-	5,000	5,000	-	5,000
Share premium	965,050	-	965,050	965,050	-	965,050
Other reserves	(285,000)	-	(285,000)	(285,000)	-	(285,000)
Retained earnings	1,163,409	-	1,163,409	1,292,336	-	1,292,336
Value adjustments	**15,441**	-	**15,441**	18,262	-	18,262
Cash flow hedging reserve	(3,195)	-	(3,195)	(461)	-	(461)
Other value adjustments	18,636	-	18,636	18,723	-	18,722
Total equity	**1,863,900**	-	**1,863,900**	1,995,648	-	1,995,648
Cash flow hedging reserve	-	695	695	-	461	461
Intangible assets	-	(18,375)	(18,375)	-	(10,146)	(10,146)
Prudent valuation adjustment	-	(2,926)	(2,926)	-	(2,989)	(2,989)
Negative amounts resulting from the calculation of expected loss amounts				-	(84,831)	(84,831)
Adjustment for deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	-	(37,823)	(37,823)	-	-	-
Other transitional adjustments (IFRS 9)	-	15,709	15,709	-	-	-
Tier 1 Capital	**1,863,900**	**(42,720)**	**1,821,180**	1,995,648	(97,506)	1,898,142
Subordinated debt	384,348	-	384,348	384,070	-	384,070
Generic funds and provision excess	-	6,208	6,208	-	-	-
Other transitional adjustments (IFRS 9)	-	(6,208)	(6,208)	-	-	-
Tier 2 Capital	**384,348**	**-**	**384,348**	384,070	-	384,070
Total Regulatory Capital	**2,248,248**	**(42,720)**	**2,205,528**	2,379,718	(97,506)	2,282,212

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

4. Capital requirements

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

The risk weighted assets and Pillar 1 capital requirements of TSB Group as at 31 December 2018 are presented in the following table:

Table 5: Overview of RWAs (EU OV1)

	RWAs		Minimum capital requirements (2)
	2018 £000	2017 £000	**2018 £000**
Credit risk (excluding counterparty credit risk - CCR)	**7,474,110**	7,693,148	**597,929**
Of which the standardised approach (1)	1,374,588	1,597,993	109,967
Of which the foundation IRB (FIRB) approach	-	-	-
Of which the advanced IRB (AIRB) approach	6,099,522	6,095,155	487,962
Of which equity IRB under the simple risk-weighted approach or the IMA	-	-	-
Counterparty credit risk (CCR)	**109,867**	119,566	**8,789**
Of which mark to market (1)	67,159	53,969	5,373
Of which original exposure	-	-	-
Of which the standardised approach	-	-	-
Of which internal model method (IMM)	-	-	-
Of which risk exposure amounts for contributions to the default fund of a CCP	2,618	4,634	209
Of which CVA	40,090	60,963	3,207
Settlement risk	-	-	-
Securitisation exposures in banking book (after cap)	-	-	-
Of which IRB ratings-based approach	-	-	-
Of which IRB Supervisory Formula Approach (SFA)	-	-	-
Of which Internal assessment approach (IAA)	-	-	-
Of which Standardised approach	-	-	-
Market risk	-	-	-
Of which standardised approach	-	-	-
Of which internal model approaches (IMA)	-	-	-
Large exposures	-	-	-
Operational risk	**1,487,617**	1,463,693	**119,009**
Of which Basic Indicator Approach	-	-	-
Of which Standardised Approach	1,487,617	1,463,693	119,009
Of which Advanced Measurement Approach	-	-	-
Amounts below the thresholds for deduction (subject to 250% risk weight) (1)	**186,050**	214,303	**14,884**
Floor adjustment	-	-	-
Total	**9,257,644**	9,490,710	**740,611**

Footnotes

(1) In Table 6, the standardised credit risk amounts include CCR mark to market and amounts subject to 250% risk weight.

(2) Under Pillar 1, firms are required to maintain minimum regulatory capital levels at 8% of RWAs.

RWAs decreased during 2018 by £233.1 million. The decrease in RWAs measured under the standardised approach is mainly due to the expected repayments in the closed Whistletree portfolio and institutional portfolios. RWAs measured under the internal rating based (IRB) approach are broadly constant during 2018 with a reduction in the personal loans portfolio offset by increases in RWAs arising in the other lending portfolio. The reduction in the personal loan portfolio reflects temporary post migration operational constraints on new lending. The increase in RWAs in other product portfolios reflects increased secured mortgages RWAs resulting from the net effect of new business and maturing loans on the composition of the portfolio.

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

Exposure classes and risk types	2018 RWA £000	2018 Minimum Capital Requirements £000	2017 RWA £000	2017 Minimum Capital Requirements £000
Credit risk (standardised approach)	**1,627,797**	**130,224**	1,866,265	149,301
Central governments and central banks	174,496	13,960	171,393	13,711
Institutions	161,606	12,928	263,103	21,048
Corporates	16,609	1,329	19,676	1,574
Retail	109,466	8,757	141,003	11,280
Exposures collateralised with residential or commercial property	587,584	47,007	689,199	55,136
Exposures in default status	110,172	8,814	160,252	12,820
Equity exposures	11,555	924	49,910	3,993
Other exposures	456,309	36,505	371,730	29,738
Credit risk (internal ratings-based approach)	**6,099,522**	**487,962**	6,095,155	487,612
Retail	6,099,522	487,962	6,095,155	487,612
i) Mortgages for residential or commercial property	3,269,521	261,562	3,044,919	243,594
ii) Eligible revolving exposures	1,342,751	107,420	1,306,178	104,494
iii) Other retail	1,487,250	118,980	1,744,058	139,525
Contribution to default guarantee fund of a CCP	**2,618**	**209**	4,634	371
Operational risk	**1,487,617**	**119,009**	1,463,693	117,095
Operational risk (standardised approach)	1,487,617	119,009	1,463,693	117,095
Credit valuation adjustment risk	**40,090**	**3,207**	60,963	4,877
Total minimum own funds requirement	**9,257,644**	**740,611**	9,490,710	759,257

4.2 TSB Group’s risk weighted assets movements by key driver

The table below analyses movements in IRB credit risk RWAs from 31 December 2017 to 31 December 2018:

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

	RWA £000	**Capital requirements £000**
At 31 December 2017	**6,095,155**	**487,612**
Asset size	314,078	25,126
Asset quality	(299,481)	(23,958)
Model updates	(17,633)	(1,410)
Methodology and policy	-	-
Acquisitions and disposals	-	-
Foreign exchange movements	-	-
Other	7,403	592
At 31 December 2018	**6,099,522**	**487,962**

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

During 2018, IRB credit risk RWAs have remained relatively flat due to the following factors:

- Asset size reflects changes in the size of the portfolio and it’s composition. The increase in assets size reflects the net effect of the origination of new business with higher risk weight and repayment of mature loans with lower risk weight. The £314.1 million increase in RWAs relates mainly to changes in the mortgage portfolio, partially offset by a reduction in unsecured lending; and
- Asset quality refers to a reduction in RWAs of £229.5 million arising from improved default losses and probability of losses.

4.3 TSB Group's Pillar 2 capital requirement

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

Pillar 2a
TSB Group's internal assessment of its capital adequacy process (ICAAP), is a key input to the PRA's Supervisory Review and Evaluation Process (SREP) and determination of Pillar 2a.

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

TSB Group updates the ICAAP at least annually and is subject to review by ALCO, BRC and the Board. The PRA undertakes a regular review of TSB Group's capital adequacy and its approach to capital management. As part of this review, the PRA determines the amount of supplementary capital required under Pillar 2a.

TSB Group's capital requirements, therefore, include Pillar 2a which may be specified by the PRA as a percentage of RWAs and/or as an absolute value. Certain elements of the Pillar 2a requirement are a fixed quantum whilst others are a proportion of RWAs and are based on a point in time assessment.

As at 31 December 2018, TSB Group's total Pillar 1 plus Pillar 2a capital requirement was 14.9% of RWAs (8% Pillar 1 plus 6.9% Pillar 2a). At least 56.25% of this requirement needs to be met in the form of CET1, equating to 8.4% of RWAs.

Effective 1 March 2019, TSB Group's total Pillar 1 plus Pillar 2a capital requirement reduced to 14.5% of RWAs (8% Pillar 1 plus 6.5% Pillar 2a based on 31 December RWAs). At least 56.25% is required to be met in the form of CET1, equating to 8.2% of RWAs.

TSB Group is also required to comply with PRA buffer and capital conservation buffer (as part of Pillar 2b requirements), plus systemic risk buffer (SRB) and countercyclical capital buffer (CCyB) requirements.

PRA buffer
As part of the capital planning process, forecast capital positions are subjected to a range of macroeconomic stresses to determine whether TSB Group's own funds are adequate to meet minimum requirements at all times. The PRA uses the output from these stresses to set a PRA buffer for TSB Group.

Capital conservation buffer
The capital conservation buffer is designed to ensure that institutions build up capital buffers outside times of stress that can be drawn upon if required. During 2018, the transitional regulations set this at 1.875% rising to 2.5% (fully transitioned) of RWAs from 1 January 2019.

Systemic risk buffer
The Financial Policy Committee (FPC) systemic risk buffer framework will be introduced by the PRA from 1 January 2019. The FPC have stated in their framework document that firms with less than £175 billion assets will attract a 0% buffer hence we expect TSB Group to receive a 0% SRB rate.

Countercyclical capital buffer (CCyB)
The FPC sets the UK CCyB. The FPC has set the UK CCyB rate at 1.0% effective from November 2018. The rate had previously increased from 0.0% to 0.5% effective from June 2018. All TSB Group exposures are categorised as UK, due to non-UK relevant credit exposure RWAs being less than 2% of total RWAs.

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

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

	General credit exposures		Trading book exposure		Securitisation exposure		Own funds requirements					
31 December 2018	Exposure value for SA	Exposure value IRB	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own funds requirement weights	Counter-cyclical capital buffer rate
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**%**	**%**
Breakdown by country	2,466,403	33,322,548	-	-	-	-	591,297	-	-	591,297	100%	1.00%
Country: Great Britain	2,466,403	33,322,548	-	-	-	-	591,297	-	-	591,297	100%	1.00%
Total	**2,466,403**	**33,322,548**	**-**	**-**	**-**	**-**	**591,297**	**-**	**-**	**591,297**	**100%**	**1.00%**

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

31 December 2018	**£000**
Total risk exposure amount	9,257,644
Institution specific countercyclical buffer rate %	1.00%
Institution specific countercyclical buffer requirement	92,576

5. Credit risk

5.1 Overview

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

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

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

Occasionally, customer circumstance can change which could impact their ability to repay borrowings. TSB Group understands this and works with its customers to improve their position by offering various treatment strategies and support.

Risk appetite
TSB Group defines risk appetite as the amount and type of risk that it is willing to take in pursuit of its mission to bring more competition to UK banking whilst creating a sustainable long-term business. Within each planning cycle, the Board approves TSB Group's risk appetite and strategy. Through clear and consistent communication and monitoring, the Board ensures that senior management stays within risk appetite through risk policies that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the risk profile of TSB Group. For credit risk, TSB maintains a well-balanced, capital efficient portfolio, focused on UK customers and assets, and prime lending criteria.

Exposures
A range of approaches are available under the CRD IV framework to measure credit risk and to determine the minimum level of capital required.

Under CRD IV, TSB Group's credit risk exposures are classified into broad categories, as defined under:
- **The retail IRB approach:** Use of internal models to calculate Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD); and
- **The standardised approach:** Portfolios whose associated internal models have yet to roll out or where no model roll out is planned.

The principal source of credit risk within TSB Group arises from loans and advances to retail and business banking customers. TSB Group's retail credit risk exposures include:
- Retail exposures secured by real estate collateral - residential mortgages;
- Qualifying revolving retail exposures - overdrafts and credit cards;
- Other retail exposures - unsecured personal lending; and
- Retail SME - lending to sole traders, small partnerships and small limited companies.

Credit risk arises principally from TSB Group's lending activities through adverse changes in the credit quality of customers and macro-economic disruptions to credit markets. TSB Group also manages credit risk by seeking to avoid geographical concentrations of its credit portfolio in the UK.

Additional sources of credit risk are managed in TSB Group's Treasury function. These include:
- Placing surplus funds with financial institutions and sovereign counterparties e.g. the BoE;
- Holding government securities, e.g. UK gilts, for liquidity management; and
- Hedging its interest rate risk position with clearing houses and other market facing counterparties. This counterparty credit risk depends on the underlying valuation of the derivatives, the majority of which are collateralised and cleared.

Sections 5.2 – 5.16 provide an overview of TSB Group's credit risk exposures. Tables 12, 13, 14, 15, 19, 20 and 25 are disclosing TSB Group's credit risk exposures excluding the exposures subject to the counterparty credit risk.

5.2 Consolidated balance sheet under the regulatory scope of consolidation

The following table shows that there are no differences in the scope of consolidation of the TSB Group's consolidated balance sheet on an accounting basis (as presented on page 63 of TSB Group's ARA) to the consolidated balance sheet on a regulatory basis. The table also provides a mapping of financial statement categories to regulatory risk categories.

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

			Carrying value of items:				
31 December 2018 £000	**Carrying values as reported in published financial statements**	**Carrying values under scope of regulatory consolidation**	**Subject to the credit risk framework**	**Subject to the CCR framework**	**Subject to the securitisation framework**	**Subject to the market risk framework**	**Not subject to capital requirements or subject to deduction from capital**
Assets							
Cash, cash balances at central banks and other demand deposits	7,135,946	7,135,946	7,135,946	-	-	-	-
Financial assets held for trading:							
Derivative financial assets	88,387	88,387	-	88,387	-	-	-
Financial assets designated at fair value through profit or loss:							
Equity instruments	2,221	2,221	2,221	-	-	-	-
Financial assets at fair value through other comprehensive income	2,387,849	2,387,849	2,387,849	-	-	-	-
Financial assets designated at amortised cost							
Debt securities	96,234	96,234	96,234	-	-	-	-
Loans to central banks	87,794	87,794	87,794	-	-	-	-
Loans to credit institutions	370,607	370,607	370,607		-	-	-
Loans and advances to customers	30,008,465	30,008,465	30,008,465	-	-	-	-
Other advances	382,120	382,120	39,877	342,243	-	-	-
Hedging derivative assets	106,610	106,610	-	106,610	-	-	-
Fair value adjustments for portfolio hedged risk	(37,313)	(37,313)	-	-	-	-	(37,313)
Property, plant and equipment	163,055	163,055	163,055	-	-	-	-
Intangible Assets	18,375	18,375	-	-	-	-	18,375
Current tax assets	20,369	20,369	20,369	-	-	-	-
Deferred tax assets	112,984	112,984	69,798	-	-	-	43,186
Other assets	180,538	180,538	180,538	-	-	-	-
Total Assets	**41,124,242**	**41,124,242**	**40,562,754**	**537,240**	-	-	**24,248**
Liabilities							
Financial liabilities held for trading:							
Derivative financial liabilities	93,962	93,962	-	-	-	-	93,962
Financial liabilities at amortised cost:							
Borrowings from central banks	6,482,231	6,482,231	-	-	-	-	6,482,231
Deposits from credit institutions	3,427	3,427	-	-	-	-	3,427
Customer deposits	29,084,220	29,084,220	-	-	-	-	29,084,220
Repurchase agreements	1,084,778	1,084,778	-	1,084,778	-	-	-
Debt securities in issue	1,122,623	1,122,623	-	-	-	-	1,122,623
Subordinated liabilities	398,190	398,190	-	-	-	-	398,190
Other financial liabilities	66,393	66,393	-	-	-	-	66,393
Hedging derivative liabilities	346,041	346,041	-	346,041	-	-	-
Fair value adjustments for portfolio hedged risk	19,439	19,439	-	-	-	-	19,439
Provisions	63,611	63,611	-	-	-	-	63,611
Current tax liabilities	-	-	-	-	-	-	-
Other liabilities	495,427	495,427	-	-	-	-	495,427
Total Liabilities	**39,260,342**	**39,260,342**	-	**1,430,819**	-	-	**37,829,523**
Shareholder's equity	**1,863,900**	**1,863,900**	-	-	-	-	**1,863,900**
Total equity and liabilities	**41,124,242**	**41,124,242**	-	**1,430,819**	-	-	**39,693,423**

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

		Items subject to			
31 December 2018	**Total**	**Credit risk framework**	**CCR framework**	**Securitisation framework**	**Market risk framework**
	£000	**£000**	**£000**	**£000**	**£000**
Assets carrying value amount under the scope of regulatory consolidation (as per template EU LI1)	41,099,994	40,562,754	537,240	-	-
Liabilities carrying value amount under the regulatory scope of consolidation (as per template EU LI1)	1,430,819	-	1,430,819	-	-
Total net amount under the regulatory scope of consolidation	39,669,175	40,562,754	(893,579)	-	-
Off-balance-sheet amounts	4,777,872	4,777,872	-	-	-
Removal of accounting values for CCR	893,579	-	893,579	-	-
Regulatory CCR Exposure	447,956	-	447,956	-	-
Differences due to consideration of provisions	184,129	184,129	-	-	-
Differences due to prudential filters	-	-	-	-	-
Difference in valuation methodologies / regulatory adjustments	1,259,525	1,259,525	-	-	-
Differences due to CCFs	(823,970)	(823,970)	-	-	-
Exposure amounts considered for regulatory purposes	**46,408,266**	**45,960,310**	**447,956**	-	-

5.3 Credit Risk exposure: Analysis by exposure class

The net value of exposures as at 31 December 2018 and the average over 2018 is set out in the table below.

Table 12: Total and average net amount of exposures (EU CRB-B)

31 December 2018	Net value of exposures at the end of the period £000	Average net exposures over the period £000
Central governments or central banks	-	-
Institutions	-	-
Multilateral development banks	-	-
Corporates	-	-
Of which: Specialised lending	-	-
Of which: SMEs	-	-
Retail	32,509,928	32,851,521
Secured by real estate property	27,230,982	27,373,631
SMEs	-	-
Non-SMEs	27,230,982	27,373,631
Qualifying revolving	4,160,294	4,174,696
Exposures in default	-	-
Other retail	1,118,652	1,303,194
SMEs	-	-
Non-SMEs	1,118,652	1,303,194
Equity	-	-
Total IRB approach	**32,509,928**	**32,851,521**
Central governments or central banks	9,524,277	9,275,444
Regional governments or local authorities	-	-
Public sector entities	-	-
Multilateral development banks	232,668	235,494
International organisations	-	-
Institutions	414,414	465,662
Corporates	18,959	20,234
Of which: SMEs	10,159	11,043
Retail	193,075	213,695
Of which: SMEs	117,118	124,236
Secured by mortgages on immovable property	1,822,132	1,974,504
Of which: SMEs	29,691	32,038
Exposures in default	110,295	133,987
Items associated with particularly high risk	-	-
Covered bonds	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-
Collective investments undertakings	-	-
Equity exposures	4,622	19,958
Other exposures	484,997	639,290
Total standardised approach	**12,805,439**	**12,978,268**
Total	**45,315,367**	**45,829,789**

Net exposure value at 31 December 2018 decreased by £1,069.2 million compared to December 2017. This is driven by the ongoing and expected repayment of the Whistletree loan portfolio (within the Retail, Secured and Default categories of the standardised approach), a reduction in personal loan book (within the other retail of the IRB approach) as post IT migration operational constraints limited new lending and a reduction in other exposures with standardised approach.

5.4 Concentration of exposures: By industry and counterparty types

Net exposures as at 31 December 2018, analysed by major industrial sector and counterparty type, are provided in the table below:

Table 13: Concentration of exposures by industry and counterparty types (EU CRB-D)

31 December 2018 £000	Agriculture, forestry and fishing	Mining and quarrying	Manufacturing	Electricity, gas, steam and air conditioning supply	*Water supply*	Construction	Wholesale and retail trade	Transport and storage	Accommodation and food service activities	Information and communication	Real estate activities	Professional, scientific and technical activities	Administrative and support service activities	Public administration and defence, compulsory social security	Education	Human health services and social work activities	Arts, entertainment and recreation	Financial and Insurance activities	Other services	Personal	Total
Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Corporates	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Retail	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	32,509,928	**32,509,928**
Equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Total IRB approach	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**32,509,928**	**32,509,928**
Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	9,524,277	-	-	-	-	-	-	**9,524,277**
Regional governments or local authorities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Public sector entities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Multilateral Development Banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	232,668	-	-	**232,668**
International Organisations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	414,414	-	-	**414,414**
Corporates	-	-	97	-	-	1,501	565	1,202	167	-	14,463	-	-	-	-	-	964	-	-	-	**18,959**
Retail	16,742	-	4,652	12	57	11,298	18,644	2,716	15,990	1,033	21,930	7,318	2,173	167	638	4,511	2,603	777	6,004	75,810	**193,075**
Secured by mortgages on immovable property	797	166	511	93	-	990	2,521	663	2,338	342	18,612	655	512	-	-	877	92	129	12,673	1,780,161	**1,822,132**
Exposures in default	110	-	43	-	2	302	35	21	437	-	851	6	13	-	1	3	5	1	2	108,463	**110,295**
Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Collective investments undertakings (CIU)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Equity exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4,622	-	-	**4,622**
Other exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	484,997	-	-	**484,997**
Total standardised approach	**17,649**	**166**	**5,303**	**105**	**59**	**14,091**	**21,765**	**4,602**	**18,932**	**1,375**	**55,856**	**7,979**	**2,698**	**9,524,444**	**639**	**5,391**	**3,664**	**1,137,608**	**18,679**	**1,964,434**	**12,805,439**
Total	**17,649**	**166**	**5,303**	**105**	**59**	**14,091**	**21,765**	**4,602**	**18,932**	**1,375**	**55,856**	**7,979**	**2,698**	**9,524,444**	**639**	**5,391**	**3,664**	**1,137,608**	**18,679**	**34,474,362**	**45,315,367**

5.5 Credit risk exposure: Geographical breakdown of exposures

Under CRD IV Article 432, institutions may omit certain disclosures if the information is not regarded as material or is deemed to be confidential. TSB Group has opted to use this materiality provision in respect of an election not to disclose the geographical distribution of £905.9 million of exposures to institutions and customers not resident in the UK. These exposures reflect retail mortgages to customers currently resident overseas, but secured on residential properties in the UK, and certain Treasury exposures. These exposures are not deemed material in the context of TSB Group's balance sheet and meet the EBA reporting thresholds applied for regulatory reporting.

All credit risk exposures as at 31 December 2018 and at 31 December 2017 are therefore categorised as being in the UK.

5.6 Credit risk exposure: Analysis by maturity

Net on balance sheet credit risk exposures as at 31 December 2018, analysed by residual contractual maturity, are provided in table 14 below:

Table 14: Maturity of exposures (EU CRB-E)

	Net exposure value					
31 December 2018	**On Demand**	**≤ 1 year**	**> 1 year ≤ 5 years**	**> 5 years**	**No stated maturity**	**Total**
	£000	£000	£000	£000	£000	**£000**
Central governments or central banks	-	-	-	-	-	-
Institutions	-	-	-	-	-	-
Corporates	-	-	-	-	-	-
Retail	746,303	252,699	2,022,520	25,076,572	23,598	**28,121,692**
Equity	-	-	-	-	-	-
Total IRB approach	**746,303**	**252,699**	**2,022,520**	**25,076,572**	**23,598**	**28,121,692**
Central governments or central banks	6,954,870	16,896	47,470	2,256,847	248,194	**9,524,277**
Regional governments or local authorities	-	-	-	-	-	**-**
Public sector entities	-	-	-	-	-	**-**
Multilateral Development Banks	-	-	-	232,668	-	**232,668**
International Organisations	-	-	-	-	-	**-**
Institutions	17,897	246,287	124,321	25,909	-	**414,414**
Corporates	4,893	387	3,513	10,166	-	**18,959**
Retail	18,420	1,359	15,299	124,598	-	**159,676**
Secured by mortgages on immovable property	16,831	13,027	116,883	1,394,394	-	**1,541,135**
Exposures in default	2,314	552	4,028	101,414	975	**109,283**
Items associated with particularly high risk	-	-	-	-	-	**-**
Covered bonds	-	-	-	-	-	**-**
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	**-**
Collective investments undertakings (CIU)	-	-	-	-	-	**-**
Equity exposures	-	-	-	-	2,221	**2,221**
Other exposures	-	20,369	-	-	403,553	**423,922**
Total standardised approach	**7,015,225**	**298,877**	**311,514**	**4,145,996**	**654,943**	**12,426,555**
Total exposures	**7,761,528**	**551,575**	**2,334,034**	**29,222,568**	**678,541**	**40,548,247**

5.7 Standardised approach: Credit risk exposure and CRM effects

Table 15: Standardised approach - Credit risk exposure and CRM effects (EU CR4)

Table 15 provides a measure on the riskiness of each portfolio by analysing the RWA density:

31 December 2018	Exposures before CCF and CRM On-balance-sheet amount	Exposures before CCF and CRM Off-balance-sheet amount	Exposures post CCF and CRM On-balance-sheet amount	Exposures post CCF and CRM Off-balance-sheet amount	RWAs	RWA density
	£000	£000	£000	£000	£000	%
Central governments or central banks	9,524,277	-	9,524,277	-	174,496	2%
Regional government or local authorities	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-
Multilateral development banks	232,668	-	232,668	-	-	0%
International organisations	-	-	-	-	-	-
Institutions	414,414	-	414,414	-	94,447	23%
Corporates	18,959	-	18,959	-	16,609	88%
Retail	159,676	33,399	159,676	7,032	109,466	66%
Secured by mortgages on immovable property	1,541,135	280,997	1,541,135	140,203	587,584	35%
Exposures in default	109,283	1,012	109,283	495	110,172	100%
Exposures associated with particularly high risk	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-
Institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-	-
Equity	2,221	2,401	2,221	2,401	11,555	250%
Other items	423,922	61,075	423,922	61,075	456,309	94%
Total	**12,426,555**	**378,884**	**12,426,555**	**211,206**	**1,560,638**	**12%**

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

5.8 Exposures subject to the Retail IRB approach

Table 16: Portfolios subject to the Retail IRB approach and subject to roll-out for calculating IRB parameters

Regulatory Exposure Portfolio	Internal Portfolio	Internal Estimates Used	Approach	Status
Retail	Residential Mortgages	Probability of default (PD) Loss given default (LGD) Credit conversion factor (CCF)	Retail IRB	Authorised in 06/2014
Retail	Consumer Loans	PD LGD CCF	Retail IRB	Authorised in 10/2014
Retail	Consumer Credit Cards	PD LGD CCF	Retail IRB	Authorised in 06/2015
Retail	Personal Current Accounts	PD LGD CCF	Retail IRB	Authorised in 06/2015
Retail	Retail SME	-	Standardised	Under roll-out plan to IRB
Retail	Whistletree - Residential Mortgages	-	Standardised	Under roll-out plan to IRB

Internal rating scales

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

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

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

Table 17: IRB approach – Credit risk exposures by exposure class and PD range (EU CR6)

	PD scale	Original on-balance sheet gross exposure	Off-balance sheet exposures pre CCF	Total	Average CCF	On-balance sheet EAD	Off-balance sheet EAD	EAD post CRM and post-CCF	Average PD	Number of obligors	Average LGD	RWA	RWA density	EL	Value adjustments and provisions
31 December 2018		**£000**	**£000**	**£000**	**%**	**£000**	**£000**	**£000**	**%**	**000's**	**%**	**£000**	**%**	**£000**	**£000**
Exposure Class: Retail mortgage (1), (2)	0.00 to <0.15	23,751,060	813,115	24,564,175	100.00%	24,890,009	852,649	25,742,658	0.43%	207	9.80%	2,135,096	8.29%	12,297	14,000
	0.15 to <0.25	1,173,911	79,480	1,253,391	100.00%	1,231,348	83,345	1,314,693	1.72%	10	11.72%	371,590	28.26%	2,955	2,451
	0.25 to <0.50	745,423	68,145	813,568	100.00%	781,918	71,463	853,381	2.88%	7	12.68%	362,996	42.54%	3,455	2,161
	0.50 to <0.75	96,373	11,460	107,833	100.00%	101,112	12,018	113,130	5.31%	1	11.94%	63,585	56.21%	794	457
	0.75 to <2.50	165,388	5,724	171,112	100.00%	173,165	6,005	179,170	11.24%	2	10.29%	109,338	61.02%	2,330	1,247
	2.50 to <10.00	146,935	1,899	148,834	100.00%	153,288	1,991	155,279	33.46%	2	11.23%	123,135	79.30%	6,588	3,010
	10.00 to <100.00	115,074	4,018	119,093	100.00%	118,170	4,213	122,383	79.31%	1	10.57%	37,617	30.74%	11,542	2,218
	100.00 (Default)	81,919	-	81,919	0.00%	81,919	-	81,919	100.00%	1	10.09%	66,163	80.77%	2,982	3,398
	Sub-total	**26,276,083**	**983,841**	**27,259,925**	**100.00%**	**27,530,929**	**1,031,684**	**28,562,613**	**1.45%**	**231**	**10.00%**	**3,269,520**	**11.45%**	**42,943**	**28,942**
Exposure Class: Qualifying Revolving Retail Exposures	0.00 to <0.15	61,779	1,551,259	1,613,038	66.70%	61,791	1,034,742	1,096,533	0.08%	1,108	77.07%	42,849	3.91%	654	790
	0.15 to <0.25	42,039	503,235	545,274	73.91%	42,057	371,918	413,975	0.19%	468	77.93%	35,451	8.57%	625	842
	0.25 to <0.50	81,311	561,669	642,980	97.35%	81,359	546,792	628,151	0.35%	1,172	79.02%	88,721	14.12%	1,753	2,079
	0.50 to <0.75	55,090	201,526	256,616	86.48%	55,134	174,282	229,417	0.62%	283	80.54%	51,539	22.47%	1,141	2,121
	0.75 to <2.50	231,274	422,366	653,640	87.98%	231,649	371,595	603,244	1.51%	583	80.96%	266,888	44.26%	7,402	12,734
	2.50 to <10.00	224,481	132,753	357,234	131.14%	225,121	174,093	399,215	4.85%	440	82.87%	408,526	102.31%	16,057	23,049
	10.00 to <100.00	93,289	31,413	124,702	117.11%	95,113	36,788	131,901	20.36%	112	82.97%	282,698	214.36%	22,337	26,409
	100.00 (Default)	49,145	12,926	62,071	6.15%	49,146	795	49,941	100.00%	32	81.52%	166,080	332.73%	26,920	27,237
	Sub-total	**838,408**	**3,417,147**	**4,255,555**	**79.34%**	**841,370**	**2,711,007**	**3,552,377**	**3.11%**	**4,198**	**79.33%**	1,342,752	37.80%	**76,889**	**95,261**
Exposure Class: Retail Loans	0.00 to <0.15	36,642	-	36,642	0.00%	37,535	-	37,535	0.04%	5	84.84%	4,149	11.05%	13	224
	0.15 to <0.25	8,313	-	8,313	0.00%	8,478	-	8,478	0.20%	2	83.62%	3,137	37.00%	15	31
	0.25 to <0.50	46,875	-	46,875	0.00%	47,810	-	47,810	0.38%	12	80.37%	25,515	53.37%	151	257
	0.50 to <0.75	70,937	-	70,937	0.00%	72,347	-	72,347	0.65%	15	82.65%	54,092	74.77%	402	485
	0.75 to <2.50	486,099	12	486,111	20.00%	496,595	2	496,598	1.52%	76	87.19%	550,718	110.90%	6,825	7,256
	2.50 to <10.00	456,516	-	456,516	0.00%	467,387	-	467,387	3.68%	64	88.50%	641,996	137.36%	16,144	18,070
	10.00 to <100.00	34,513	8	34,521	20.00%	35,758	2	35,759	40.25%	7	92.13%	69,510	194.38%	13,359	11,622
	100.00 (Default)	41,639	-	41,639	0.00%	41,644	-	41,644	100.00%	5	89.47%	138,133	331.74%	24,157	24,958
	Sub-total	**1,181,534**	**20**	**1,181,554**	**20.00%**	**1,207,554**	4	**1,207,558**	**6.74%**	**186**	**87.28%**	**1,487,250**	**123.16%**	**61,066**	**62,903**
Total value (all portfolios)		**28,296,025**	**4,401,008**	**32,697,034**	**85.04%**	**29,579,853**	**3,742,695**	**33,322,548**	**1.82%**	**4,615**	**20.19%**	**6,099,522**	**18.30%**	**180,898**	**187,106**

Footnotes

(1) The Retail mortgages PD model uses a through-the-cycle approach. Whereas the RMS Grades (PD Scale) is based on PiT (point in time) PDs.

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

5.9 Model performance

This section provides analysis of TSB Group's IRB PD model performance as at 30 November 2018 for Residential Mortgages, Loans, Cards and PCA.

Table 18 compares the estimated (weighted and arithmetic average PDs) and actual (average historical annual default rate) PDs by exposure class, along with the number of default and non-default obligors at current and previous year ends. The values are taken from TSB's Group regulatory capital calculation models, including the application of regulatory floors. Both arithmetic and EAD weighting have been used throughout.

Table 18: IRB approach – Backtesting of PD per exposure class (EU CR9)

	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	End of previous year	End of the year	Default obligors in the year	Of which: new obligors	Average historical annual default rate
31 December 2018			%	%	Number of obligors				%
Retail - Loans	0.00 to <0.15	**TSB**	0.04%	0.05%	1,270	4,720	3	1	0.07%
	0.15 to <0.25		0.20%	0.20%	2,714	2,249	9	-	0.16%
	0.25 to <0.50		0.38%	0.38%	14,921	12,552	78	2	0.49%
	0.50 to <0.75		0.65%	0.65%	17,370	15,138	90	4	0.53%
	0.75 to <2.50		1.51%	1.48%	105,794	78,543	1,308	30	1.12%
	2.50 to <10.00		3.70%	3.76%	58,202	63,659	2,398	147	3.77%
	10.00 to <100.00		36.04%	36.81%	6,986	6,380	2,424	126	32.06%
	100.00 (Default)		100.00%	100.00%	1,941	5,260	1,997	118	96.47%
	Subtotal		**5.78%**	**6.00%**	**209,198**	**188,501**	**8,307**	**428**	**4.17%**
Retail - Cards	0.00 to <0.15	**TSB**	0.07%	0.08%	229,860	259,318	556	4	0.08%
	0.15 to <0.25		0.19%	0.19%	87,716	87,509	324	13	0.17%
	0.25 to <0.50		0.35%	0.35%	95,663	93,722	501	28	0.27%
	0.50 to <0.75		0.62%	0.62%	43,529	38,086	359	11	0.47%
	0.75 to <2.50		1.44%	1.41%	93,597	80,582	1,577	67	1.12%
	2.50 to <10.00		4.91%	4.93%	61,173	52,853	3,446	71	4.26%
	10.00 to <100.00		19.04%	18.88%	20,415	24,829	5,043	119	19.62%
	100.00 (Default)		100.00%	100.00%	8,027	13,645	8,676	773	97.91%
	Subtotal		**3.07%**	**3.54%**	**639,980**	**650,544**	**20,482**	**1,086**	**2.79%**
Retail - Personal Current Accounts (PCA)	0.00 to <0.15	**TSB**	0.08%	0.08%	989,337	863,512	483	5	0.04%
	0.15 to <0.25		0.19%	0.20%	342,411	386,125	438	1	0.10%
	0.25 to <0.50		0.35%	0.35%	1,006,358	1,110,483	6,100	17	0.29%
	0.50 to <0.75		0.61%	0.61%	241,176	256,979	1,254	7	0.41%
	0.75 to <2.50		1.43%	1.40%	541,397	515,129	6,243	114	1.15%
	2.50 to <10.00		4.90%	4.97%	314,990	307,796	13,776	1,095	4.32%
	10.00 to <100.00		22.88%	22.09%	103,949	89,766	18,702	396	20.11%
	100.00 (Default)		100.00%	100.00%	18,547	18,743	17,274	158	91.72%
	Subtotal		**2.88%**	**1.92%**	**3,558,165**	**3,548,533**	**64,270**	**1,793**	**2.26%**
Retail - Mortgages	0.00 to <0.15	**TSB**	0.11%	0.10%	35,816	25,769	4	-	0.03%
	0.15 to <0.25		0.20%	0.20%	44,859	41,018	12	-	0.04%
	0.25 to <0.50		0.35%	0.35%	77,846	82,546	27	-	0.05%
	0.50 to <0.75		0.60%	0.60%	26,949	33,238	18	-	0.10%
	0.75 to <2.50		1.25%	1.25%	38,013	37,322	64	-	0.20%
	2.50 to <10.00		4.06%	4.14%	7,175	6,073	43	-	0.81%
	10.00 to <100.00		43.10%	42.79%	3,771	3,433	425	-	13.34%
	100.00 (Default)		100.00%	100.00%	695	749	647	-	98.75%
	Subtotal		**1.40%**	**1.53%**	**235,124**	**230,148**	**1,240**	**-**	**0.86%**

A number of factors impact default rates, including 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.

A temporary cessation in unsecured charge-off activity in the post migration period impacted the volumes of accounts in the default PD bucket and resulted in a temporary increase. Underlying charge off and collection activities have subsequently returned to levels closer to normalised pre-migration levels.

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

Specifically, it is noted that:

- The Mortgage PD model uses a TTC approach and, as a result, the gap between estimated and actual default rates will narrow or widen to reflect the economic environment at the point of measurement.
- The Loans, Cards and PCA PD models use a PiT approach which means that the regulatory PD calculation is calibrated to reflect the cyclicality of defaults. A PD buffer is applied to compensate for any potential underestimation from increasing default rates between calibrations.
- All PDs are calculated using the IRB approach and IFRS 9 considerations have not been taken into account here.

5.10 Impaired lending and provisions

Definition

The following definitions are employed:

- **Past due exposures**: An exposure is past due when a counterparty has failed to make a payment when contractually due.

- **Impaired exposures**: In respect of secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans are those six months or more in arrears (or where the underlying security is in possession or in cases where the borrower is bankrupt). This aligns to the CRR which gives national supervisors discretion to extend the days past due definition of default to 180 days for secured assets. The PRA has extended this discretion to UK banks. For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out below;
  - Delinquency in contractual payments of principal and or interest;
  - Indications that the borrower or group of borrowers is experiencing significant financial difficulty;
  - Restructuring of debt to reduce the burden on the borrower;
  - Breach of loan covenants or conditions; and
  - Initiation of bankruptcy or individual voluntary arrangement proceedings.

- **Allowance for credit impairment losses**: Provision held on the balance sheet as a result of raising a charge against profit for expected losses in the lending book. The allowance may be either individually or collectively assessed.

Impairment provisions are required to be categorised as either general or specific credit risk adjustments as part of the capital requirements calculation process. All TSB Group's impairment provisions (whether individually or collectively assessed) are considered to be specific credit risk adjustments as they are recognised in accordance with IFRS 9.

Accounting policy

The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and debt instruments measured at Fair Value through Other Comprehensive Income (FVOCI). At initial recognition, an impairment allowance is required for expected credit losses (ECL) resulting from default events expected within the next 12 months (12 month ECL). In the event of a significant increase in credit risk, allowance is required for ECL resulting from default events expected over the estimated life of the financial instrument (lifetime ECL). IFRS 9 requires the financial asset to be allocated to one of the following three 'stages':

- **Stage 1:** Financial assets which have not experienced a significant increase in credit risk since they were originated. Recognition of a 12 month ECL is required. Interest income on stage 1 financial assets is calculated on the gross carrying amount of the financial asset;

- **Stage 2:** Financial assets which have experienced a significant increase in credit risk. For financial assets in stage 2, recognition of a lifetime ECL impairment allowance is required. Interest income on stage 2 financial assets is calculated on the gross carrying amount of the financial asset; and

- **Stage 3:** Financial assets which have experienced one or more events that have had a detrimental impact on the estimated future cash flows and are credit impaired. Like stage 2, recognition of a lifetime expected ECL impairment allowance is required. However, interest income on stage 3 loans is calculated on the financial asset balance net of the impairment allowance.

- **Purchased or originated credit impairment (POCI):** Financial assets that are credit impaired at the date of their purchase or origination will be reported in a separate POCI category and will recognise the cumulative change in lifetime expected credit loss since origination as a loss allowance. Subsequent to origination, POCI financial assets that no longer meet stage 3 criteria will no longer be considered to be credit impaired but will continue to be reported as POCI.

TSB Group's accounting policy in respect of impairment of financial assets is detailed in the notes to the financial statements in TSB Group's ARA on pages 74 to 75.

5.11 Credit quality of exposures by exposure class and instruments

As at 31 December 2018, the total net exposures of TSB Group amounted to £45.3 billion (2017: £46.4 billion). The table below provides an analysis of credit risk adjustments and write-offs.

Table 19: Credit quality of exposures by exposure class and instrument (EU CR1-A)

	Gross Carrying Values of		Specific credit risk adjustment					
31 December 2018 £000	**Defaulted Exposures**	**Non-defaulted exposures**	**Defaulted Exposures**	**Non-defaulted exposures**	**General credit risk adjustment**	**Accumulated write-offs**	**Credit risk adjustment charges of the period [1]**	**Net values**
Central governments or central banks	-	-	-	-	-	-	-	-
Institutions	-	-	-	-	-	-	-	-
Corporates	-	-	-	-	-	-	-	-
Of which: Specialised lending	-	-	-	-	-	-	-	-
Of which: SMEs	-	-	-	-	-	-	-	-
Retail	185,629	32,511,405	55,594	131,512	-	264,987	72,836	32,509,928
Secured by real estate property	81,919	27,178,005	3,398	25,544	-	-	4,020	27,230,982
SMEs	-	-	-	-	-	-	-	-
Non-SMEs	81,919	27,178,005	3,398	25,544	-	-	4,020	27,230,982
Qualifying revolving	62,071	4,193,484	27,237	68,024	-	157,860	35,664	4,160,294
Other retail	41,639	1,139,916	24,959	37,944	-	107,127	33,152	1,118,652
SMEs	-	-	-	-	-	-	-	-
Non-SMEs	41,639	1,139,916	24,959	37,944	-	107,127	33,152	1,118,652
Equity	-	-	-	-	-	-	-	-
Total IRB approach	**185,629**	**32,511,405**	**55,594**	**131,512**	**-**	**264,987**	**72,836**	**32,509,928**
Central governments or central banks	-	9,524,277	-	-	-	-	-	9,524,277
Regional governments or local authorities	-	-	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-	-	-
Multilateral development banks	-	232,668	-	-	-	-	-	232,668
International organisations	-	-	-	-	-	-	-	-
Institutions	-	414,414	-	-	-	-	-	414,414
Corporates	860	19,449	355	490	-	-	(1)	19,464
Of which: SMEs	860	10,617	355	457	-	-	(1)	10,665
Retail	5,805	197,166	2,789	4,090	-	1,061	(503)	196,092
Of which: SMEs	1,493	118,652	-	1,534	-	1,061	(275)	118,611
Secured by mortgages on immovable property	109,961	1,825,820	3,187	3,688	-	-	(488)	1,928,906
Of which: SMEs	69	30,060	236	370	-	-	-	29,523
Exposures in default	116,626	-	6,331	-	-	-	-	110,295
Items associated with particularly high risk	-	-	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-
Collective investments undertakings	-	-	-	-	-	-	-	-
Equity exposures	-	4,622	-	-	-	-	-	4,622
Other exposures	-	484,997	-	-	-	-	-	484,997
Total standardised approach	**116,626**	**12,703,413**	**6,331**	**8,268**	**-**	**1,061**	**(992)**	**12,805,440**
Total	**302,255**	**45,214,818**	**61,925**	**139,780**	**-**	**266,048**	**71,844**	**45,315,368**
Of which: Loans	288,317	37,404,776	61,850	126,496	-	266,048	68,866	37,504,747
Of which: Debt securities	-	2,484,083	-	-	-	-	-	2,484,083
Of which: Off-balance-sheet exposures	13,938	4,766,541	75	13,284	-	-	2,978	4,767,120

Footnote

(1) In addition to the amounts reported in table 19, a further credit risk adjustment of £1.4 million had been charged directly to the income statement.

Accumulated write-offs reported above reflect the accumulated partial and total amounts of principal and accrued past due interest and fees that have been de-recognised because there is no reasonable expectation of recovering contractual cash flows. Write-offs are reported above until the right to recovery is extinguished by expiry of the statute-of-limitations period, forgiveness or other causes, or until recovery. Therefore, where written-off amounts are not yet recovered, and TSB Group continues to have a claim, they continue to be reported above. The equivalent accumulated amounts written-off to 31 December 2017 is £234.0 million. In prior periods the equivalent table reported amounts written-off in the year. Credit risk adjustments in the table above report impairment losses incurred in the year on loans and advances to customers including provisions and write-offs. In prior years this column excluded the write-offs in the reporting period. The restated credit risk adjustments for 2017 was £77.8 million.

Further information on impairment losses on loans is reported with TSB Group's ARA consolidated statement of comprehensive income on page 66 and the note to the consolidated financial statements on page 80.

5.12 Managing impaired exposures and impairment provisions

Provisioning policy

Under IFRS 9, TSB Group's policies and standards in respect of the management of Impairment Provisions consider forward looking ECL for all exposures. These are set out in TSB Group's IFRS 9 provisioning policies. These policies are reviewed and approved on an annual basis.

Adequacy and reporting

All lending assets are assessed for ECL on a monthly basis.

The process for assessing ECL considers information and events that have occurred in the context of current expectations of the future economic environment. IFRS 9 requires that financial assets be allocated to one of three 'stages' as described on page 24.

Assets are reviewed to ensure that the stage allocation remains valid, that cash flow projections remain appropriate (including any potential net proceeds from the realisation of collateral) and that the projected macro-economic outcomes and associated probability weightings used to derive ECL amounts recorded in TSB Group's books and records continue to remain appropriate. 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 credit 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 examined.

TSB Group reviews, at least annually, its provision forecast against actual loss experience to identify whether its policies have resulted in over or under provisioning across the economic cycle.

Stress and scenario testing are widely used throughout TSB Group to assess the potential impact on impaired exposures and related provisions.

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

5.13 Management of customers experiencing financial difficulties

Forbearance

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

For reporting purposes, TSB Group's definition of a restructured exposure is where terms of lending agreements have been renegotiated by either capitalisation of arrears, interest rate adjustment, payment holidays, interest capitalisation, lending that would otherwise be past due or impaired but whose terms have been renegotiated. For further details on forbearance, please refer to page 96 of the TSB Group's ARA.

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

Table 20: Non-performing and forborne exposures (EU CR1-E)

31 December 2018 £000	Gross carrying values of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
				Of which non-performing				On performing exposures		On non-performing exposures			
		Of which performing but past due > 30 days and <= 90 days	Of which performing forborne		Of which defaulted	Of which impaired	Of which forborne		Of which forborne		Of which forborne	On non-performing exposures	Of which forborne exposures
Debt securities	2,484,083	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances	37,693,093	69,491	134,441	502,237	264,090	400,223	107,300	(123,148)	(2,766)	(75,580)	(24,734)	6	7
Off-balance-sheet exposures	4,870,479	-	1,088	18,622	11,296	-	2,020	(13,284)	-	(75)	-	1	-

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

As at 31 December 2018, past due exposures in respect of loans and advances to customers, regardless of impairment status, amounted to £571.7 million.

Table 21: Ageing of past-due exposures (EU CR1-D)

	Gross carrying values					
31 December 2018	≤ 30 days	> 30 days ≤ 60 days	> 60 days ≤ 90 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year
	£000	£000	£000	£000	£000	£000
Loans	207,517	31,990	66,175	74,196	85,584	106,265
Debt securities	-	-	-	-	-	-
Total exposures	**207,517**	**31,990**	**66,175**	**74,196**	**85,584**	**106,265**

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 2018 are categorised as being in the United Kingdom, based on the materiality assumptions, outlined on page 20.

Analysis by industry
An analysis of credit quality of exposures by industry is not provided as TSB Group does not have significant impairment provisions in respect of industry sectors other than personal customers. As at 31 December 2018, impairment provisions for non-personal customers are £2.9 million.

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

The movement in impairment provisions, from 1 January 2018 to 31 December 2018, in respect of loans and advances to customers is provided below:

Table 22: Changes in the stock of general and specific credit risk adjustments (EU CR2-A) [1]

	Accumulated specific credit risk adjustment [2] £000	Accumulated general credit risk adjustment £000
Opening balance as at 31 December 2017	**71,583**	-
Impact of first application of IFRS 9 from January 1, 2018	96,205	-
Increases due to origination and acquisition	9,375	-
Decreases due to derecognition	(10,622)	-
Changes due to change in credit risk (net)	76,069	-
Decrease in allowance due to write-offs	(37,927)	-
Other adjustments	(2,977)	-
Closing balance as at 31 December 2018	**201,706**	-
Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	-	-
Amounts written-off directly to the statement of profit or loss	-	-

Footnotes
(1) The breakdown of information in the table has been adapted to the new FINREP 12.1 format.
(2) In addition to the amounts reported in table 22, a credit risk adjustment of £1.4 million has been charged directly to the income statement.

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

Table 23: Changes in stock of defaulted and impaired loans and debt securities (EU CR2-B)

	Gross carrying value defaulted exposures £000
Opening balance as at 31 December 2017	**293,141**
Loans and debt securities that have defaulted or impaired since the last reporting period	152,574
Returned to non-defaulted status	(65,010)
Amounts written off	(46,930)
Other changes	(31,520)
Closing balance as at 31 December 2018	**302,255**

5.16 Credit risk mitigation

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

Credit policies and standards

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

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

Retail credit assessment

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

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

Business banking credit assessment

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

Concentration risk

Concentration risk is the risk of losses arising as a result of concentrations of exposures due to imperfect diversification. TSB Group manages credit concentration risk in relation to the geographical spread of its secured mortgage portfolio in the UK.

Master netting

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

Table 24: Impact of netting and collateral held on exposure values (EU CCR5-A)

31 December 2018	Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held	Net credit exposure
	£000	£000	£000	£000	£000
Derivatives	205,497	450,038	(244,542)	448,746	204,204
SFT	1,084,455	1,053,844	30,612	60,103	90,715
Cross-product netting	-	-	-	-	-
Total	**1,289,952**	**1,503,882**	**(213,930)**	**508,849**	**294,919**

Collateral

The principal collateral types for loans and advances are:

- Mortgages over residential and commercial real estate;
- Charges over business assets such as premises, inventory and accounts receivables; and
- Guarantees received from third parties.

It is TSB Group's policy that collateral should be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral is reviewed on a regular basis in accordance with business unit credit standards, which will vary according to the type of lending and collateral involved. For retail residential mortgages, collateral valuation is reviewed quarterly using external house price indices. LGD estimates for the secured IRB portfolio include adjustments to realisable collateral values through the application of recession house prices movements and forced sale discounts.

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

Exposures covered by eligible collateral and guarantees

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

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

TSB Group uses the financial collateral comprehensive method for treasury exposures and applies the relevant adjustments for volatility and maturity mismatches for all collateral types. The regulatory requirements for recognition include a number of considerations including legal certainty of charge, frequency and independence of revaluation and correlation of the value of the underlying asset to the obligor. For counterparty credit risk exposure calculations, TSB Group uses the current exposure method.

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

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

Table 25: CRM techniques – Overview (EU CR3)

31 December 2018	Exposures unsecured – Carrying amount	Exposures secured – Carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
	£000	£000	£000	£000	£000
Total loans	13,108,458	29,163,409	29,163,409	-	-
Total debt securities	2,484,083	-	-	-	-
Total exposures	**15,592,541**	**29,163,409**	**29,163,409**	**-**	**-**
Of which defaulted	58,180	182,151	182,151	-	-

6. Leverage ratio

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

6.1 Leverage ratio exposure

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

Basel III basis	**2018** **£000**	2017 £000
Total assets as per published financial statements	41,124,242	42,525,462
Adjustments for derivative financial instruments	(288,916)	(507,966)
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	712,652	688,012
Other regulatory adjustments	(81,336)	(79,377)
Total leverage ratio exposure	**41,466,642**	42,626,131

TSB Group calculates its leverage based on the exposure measure in CRR as amended by the EU Delegated Regulation 2016/62 published in January 2016, and the CRR definition of Tier 1. The leverage ratio measure is defined as the ratio of Tier 1 capital to total exposure. Items deducted from Tier 1 capital are also deducted from the exposure measure to ensure consistency between the capital and exposure components of the ratio. The leverage ratio is intended to complement the risk based capital requirements with a simple, non-risk based 'backstop' measure.

TSB Group's leverage ratio is 4.4% which comfortably exceeds the Basel Committee's proposed minimum of 3.0%, applicable from 2018. TSB Group will continue to monitor closely the leverage ratio against the emerging rules and minimum calibration. The leverage ratio has decreased from 4.5% to 4.4% in 2018. Tier 1 capital decreased by £77.0 million, largely due to losses incurred in 2018, whilst the leverage exposure decreased by £1,159.5 million, largely driven by reduction in cash balances at central bank, reduced personal loan book due to customer repayments and operational constraints on new lending and expected reduction in the closed Whistletree portfolio.

Table 27: Leverage ratio common disclosure (LRCom)

CRR leverage ratio exposures	**2018** **£000**	2017 £000
On-balance sheet exposures (excluding derivatives and SFTs)		
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	40,906,337	42,328,718
(Asset amounts deducted in determining Basel III Tier 1 capital)	(58,428)	(97,506)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**40,847,909**	42,231,212
Derivative exposures		
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	70,749	49,756
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	153,037	115,103
Exposure determined under Original Exposure Method	-	-
Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(317,705)	(457,995)
(Exempted CCP leg of client-cleared trade exposures)	-	-
Adjusted effective notional amount of written credit derivatives	-	-
(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
Total derivative exposures	**(93,919)**	(293,136)
Securities financing transaction exposures		
Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	-	43
(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
Counterparty credit risk exposure for SFT assets	-	-
Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	-	-
Agent transaction exposures	-	-
(Exempted CCP leg of client-cleared SFT exposure)	-	-
Total securities financing transaction exposures	-	43
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	4,780,479	4,693,882
(Adjustments for conversion to credit equivalent amounts)	(4,067,827)	(4,005,870)
Other off-balance sheet exposures	712,652	688,012
	41,466,642	42,626,131
Exempted exposures in accordance with Article 429(7) and (14) of Regulation (EU) No 575/2013 (on and off balance sheet)		
(Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
Capital and total exposures measure		
Tier 1 capital	1,821,180	1,898,142
Total leverage total exposure measure	41,466,642	42,626,131
Leverage ratio	**4.4%**	4.5%
Choice on transitional arrangements and amount of derecognised fiduciary items		
Choice on transitional arrangements for the definition of the capital measure	-	-
Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	-	-

Table 28: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures) (LRSpl)

CRR leverage ratio exposures	**2018** **£000**	2017 £000
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**40,588,632**	41,870,723
Trading book exposures	-	-
Banking book exposures, of which:	40,588,632	41,870,723
Covered bonds	-	-
Exposures treated as sovereigns	9,756,945	9,677,048
Exposures to regional governments, MDB, international organisations and PSE NOT treated as sovereigns	-	-
Institutions	414,414	490,964
Secured by mortgages of immovable properties	27,710,682	28,083,624
Retail exposures	1,981,683	2,431,630
Corporate	18,959	21,893
Exposures in default	239,421	265,485
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	466,528	900,079

Exempted exposures consist of collateral of £317.7 million in 2018 and £458.0 million in 2017.

6.2 Management of excessive leverage

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

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

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

7. Remuneration

As a 'Level 2' firm, under PRA Supervisory Statement 2/17, TSB Group presents the undernoted remuneration disclosures in accordance with Article 450 of the CRR having applied the proportionality criteria referenced in Article 450 (2).

In the five years since TSB Group was relaunched onto high streets across Britain, our remuneration approach has remained consistent: it is designed to be simple, fair and in line with our core values. This underlying set of principles remains integral to our reward philosophy.

The Remuneration Committee is authorised by the Board to consider and recommend to the Board the framework of the remuneration policy. Policy is considered regularly by the Remuneration Committee, taking account of changes in regulation and the wider market. The TSB Remuneration Committee met 9 times during 2018. Further information on the composition of the Remuneration Committee is provided on page 53 in TSB's Group ARA.

Our remuneration policy
The aim of our remuneration policy as outlined on page 51 in TSB's Group ARA, is to provide competitive remuneration aligned to the delivery of our strategic goals (providing the kind of banking experience people want and deserve, providing great banking to more people, and helping more people to borrow well). It is designed to attract and retain talented individuals, to promote TSB Group's values, to generate sustainable business performance, while taking into account effective risk management and acceptable conduct.

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

Individual briefing sessions are held for all new Material Risk Takers (MRTs) hosted by Human Resources and Risk Functions. At the briefings new MRTs are provided with relevant materials explaining their MRT status and the impact of this status on their remuneration. TSB Group writes to all MRTs to confirm to them that they are a MRT. Each MRT is required to confirm that they accept that malus and / or clawback arrangements could be applied to any future variable remuneration awards made to them.

The remuneration policy applies to all Partners of TSB Group. There are no differences in remuneration policy for different categories of Partners at TSB Group; nor are there regional differences. No changes were made to the TSB Group's remuneration policy in 2018.

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

- How TSB Group's remuneration policy continues to meet regulatory requirements (page 50);
- A summary of the key components of TSB Group's remuneration and its link to performance (page 51); and
- The governance procedure relating to the development of the remuneration policy, information about the bodies that played a significant role in its development and the role of external consultants (page 53).

The number of identified employees broken down by business area and senior management function is set out in the table below. There has been a small increase in the number of MRT's from 2017.

Table 29: Analysis of identified staff remuneration employees (REM1)

31 December 2018	MB Supervisory function	MB Management function	Retail Banking	Corporate functions	Independent control functions	All Other	Total
Total Remuneration 2018 £000	926	7,521	3,426	5,445	2,347	-	19,665
No. of identified employees	11	14	17	24	13	-	79

Our remuneration system
Our remuneration is structured into four main elements: competitive fixed pay, benefits, the TSB Award (short term incentive) for all Partners and the Sustainable Performance Award (SPA) (long term incentive) for our more senior Partners.

The key elements of our reward approach are as follows:

- **Basic salary** provides core remuneration taking into account relevant market benchmarks, complexity of the role and the individual's experience and performance.
- **Market appropriate benefits**, principally pension contributions to a defined contribution scheme or, where appropriate, an equivalent cash payment; 4% of basic salary available to use in our flexible benefits offering; and an employer provided car or alternative cash allowance.
- **Role based allowance**: This was received only by Paul Pester as CEO to reflect the change in his role and specific duties following the acquisition of TSB Group by Banco Sabadell in 2015.
- The **TSB Award,** which provides an 'on-target' annual short-term incentive award opportunity of 10% of basic salary and applies to every Partner, from the CEO to those on the front line. The 10% on-target award may increase, in an exceptional year, to a maximum award of 15% of basic salaries. In any given year the very best performers, whom we call Pioneers, may receive up to twice the on-target award. The TSB Award reflects the collective effort made by all Partners to deliver business success. Awards are made only if certain 'gateways', including risk, profitability and individual conduct are satisfied and corporate performance targets are met. Any TSB Award made to MRTs is paid in a mix of cash and Sabadell shares (50% cash / 50% shares). The shares are subject to a retention period to comply with the Remuneration Code's requirements. Whilst the TSB award is normally paid when due, a portion of any TSB Award may be deferred should that be required to comply with the Remuneration Code. For all other participants, the TSB Award is paid in cash.
- The **Sustainable Performance Award (SPA)**, which is designed to support achievement of targets based on sustained business and individual performance. This award is granted annually to a limited number of senior Partners and is funded after the TSB Award is funded, if sufficient profit is made and risk management gateways have been satisfied. Any SPA award made to MRTs is paid in a mixture of shares and cash (50% cash / 50% shares). Grants are released to the extent that performance underpins are met between years 3 and 7 post grant for Senior Managers, between years 1 and 5 post grant for Risk Managers and between years 1 and 3 for other MRTs. There were no SPAs awarded in respect of the 2018 performance year.
- We will not exceed an **annual cap** on total variable remuneration of **one times fixed pay** (basic salary plus pension and other benefits) calculated in accordance with the Prudential Regulatory Authority's (PRA) remuneration code, other than in rare exceptional circumstances (e.g. migration and integration) as approved by the Sabadell Remuneration Committee following Sabadell's acquisition of TSB Group.

The rationale for the fixed elements of remuneration is based on common market practice, the nature of these payments being fixed and not performance related.

The final levels of the TSB and SPA Awards are determined by the Remuneration Committee by assessing whether profitability and risk management threshold gateways have been satisfied at a corporate level in addition to assessment of corporate performance against pre-determined Key Performance Indicators (KPIs), which include customer outcomes, financial resilience metrics and achievement of strategic business objectives.

Each tranche of the SPA is released subject to satisfactory individual conduct and performance if the sustainable performance conditions have been met at each release date. These conditions are as follows:

- Capital and liquidity: No significant breach of Board risk appetite in the year.
- Regulatory and compliance: No material regulatory issues and a satisfactory internal control environment in the year.
- Sustained financial performance: Performance against a pre-determined financial target (cumulative return on equity) has been achieved.

The testing of the metrics will determine, subject to the Remuneration Committee's discretion, the extent to which a tranche is released. The award amounts may be reduced, ultimately to zero, depending on the testing outcome and Remuneration Committee discretion.

In terms of unvested prior year SPA awards due to vest in March 2019, these awards will not vest due to performance against the Cumulative Return on Equity not having been achieved.

Considerations of risk and conduct

The Remuneration Committee takes risk and conduct issues very seriously. Risk profile and behaviours are a key gateway that must be satisfied for any of the incentive awards to pay out to individuals. Incentive pools and awards may be adjusted, including to zero, in the event of any material breaches. All elements of variable remuneration for MRTs are subject to malus and clawback provisions in line with regulatory requirements. TSB Group is fully compliant with the Remuneration Code for MRTs.

A Remuneration Governance Group (RGG) was established in 2017 to assist the Remuneration Committee in identifying MRTs across the bank and in considering risk-based adjustments to reward outcomes.

2018 reward outcomes for TSB partners are set out in the Remuneration Report on page 50 of TSB Group's ARA.

There is no difference in award allocations for MRTs in control functions. The Control Functions' heads (Chief Risk Officer (CRO) and Chief Audit Officer (CAO)) are members of the BEC and all Partners engaged in each discipline have direct reporting lines within that function. The Control Function heads have dual reporting lines to the CEO and to the Chairs of the Risk and Audit Committee respectively. The TSB Remuneration Committee receives input from the relevant Committee Chair in making reward decisions for the CRO and CAO.

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

For staff in the Control Functions who are not MRTs, reviews of fixed and variable pay are managed by the line with oversight from the HR department, based on external market data, internal relativities and corporate and individual performance. Final approval of reward outcomes for all staff sits with the CEO after review by the HR Director.

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

Other aspects

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

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

Severance payments are made in line with contractual obligations and, in terms of variable remuneration, in line with the relevant scheme rules. For MRTs any variable remuneration which subsist post severance remain subject to the requirements on performance, deferral and holding post vesting. In addition, malus and clawback provisions continue to apply.

Remuneration for the year ended 31 December 2018

Table 30: Details of remuneration for the year ended 31 December 2018 (REM2)

31 December 2018	Board members	Senior management	Other management	Total
Fixed remuneration £000	**2,786**	**4,735**	**11,157**	**18,678**
Variable remuneration £000	**-**	**-**	**61**	**61**
Instant payment				
Cash £000	-	-	61	**61**
Shares £000	-	-	-	**-**
Number of Banco Sabadell equity shares '000	-	-	-	**-**
Deferred payment				
Cash £000	-	-	-	**-**
Shares £000	-	-	-	**-**
Number of Banco Sabadell equity shares '000	-	-	-	**-**
Other types of remuneration	**-**	**-**	**-**	**-**
Remuneration as Directors of the Group £000	**926**	**-**	**-**	**926**
Number of identified employees	13	12	54	**79**
Amount of annual compensation payments £000	-	161	-	**161**
Number of employees with compensation	-	1	-	**1**

One individual earned remuneration between EUR 2 million and EUR 2.5 million (as at 31 December 2018 equating to £1.8 million and £2.3 million). Additional information on highest paid director is provided within TSB's Group ARA on page 52.

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Glossary

Adjusted exposure	Original exposure net of value adjustments and provisions.
Basel Committee	The Basel Committee is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. The Committee reports to the Group of Governors and Heads of Supervision (GHOS).
Basel III Leverage Ratio	A non-risk-based leverage ratio is calculated by dividing Tier 1 capital by a defined measure of on and off-balance sheet items. Banks are expected to maintain a leverage ratio in excess of 3% under Basel III.
Buy-to-let mortgages	Buy-to-let mortgages are those mortgages offered to customers purchasing residential property as a rental investment.
Capital Requirements Directive IV (CRD IV)	European legislation to implement Basel III. It replaced earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation.
Capital Requirements Regulation (CRR)	The Capital Requirements Regulation No. 575/2013 is an EU law that aims to decrease the likelihood that banks go insolvent.
Claw-back	The recovery of part or all of a remuneration award post vesting.
CCP (Central Counterparty)	A central counterparty (CCP) is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. For the purposes of the capital framework, a qualifying CCP is a financial institution.
Commercial real estate	Commercial real estate includes office buildings, medical centres, hotels, malls, retail stores, shopping centres, farm land, housing buildings, warehouses, garages, and industrial properties among others.
Common Equity Tier 1 (CET1) capital	The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
Common Equity Tier 1 ratio	Common Equity Tier 1 Capital as a percentage of risk weighted assets.
Contingent leverage	Contingent leverage represents off-balance sheet items which could convert into on-balance items e.g. unutilised credit limits could be utilised in future.
Core Tier 1 capital	As defined by the Prudential Regulation Authority (PRA) mainly comprising shareholders' equity after regulatory deductions.
Counterparty credit risk (CCR)	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and include derivative contracts and repo contracts.
Credit Conversion Factor (CCF)	Credit conversion factors (CCF) are used in determining the exposure at default (EAD) in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn commitments expected to be drawn down at the point of default.
Credit risk	The risk of reductions in earnings and / or value, through financial loss, as a result of the failure of the party with whom the TSB Group has contracted to meet its obligations (both on and off-balance sheet).
Credit risk mitigation (CRM)	A technique used to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantees and credit protection.
Debt securities	Debt securities are assets held by the TSB Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	These are unsubordinated liabilities issued by the TSB Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Enhanced Disclosure Task Force (EDTF)	The Enhanced Disclosure Task Force (EDTF) was established by the Financial Stability Board in May 2012 with the goal for improving the quality, comparability and transparency of risk disclosures. The EDTF issued a report in October 2012 setting out 32 recommendations across seven risk areas.

European Banking Authority (EBA)	The European Banking Authority (EBA) is a regulatory agency of the European Union headquartered in London, United Kingdom. Its activities include conducting stress tests on European banks to increase transparency in the European financial system and identifying weaknesses in banks' capital structures. The EBA was established on 1 January 2011, upon which date it inherited all of the tasks and responsibilities of the Committee of European Banking Supervisors (CEBS).
Expected Loss (EL)	Expected loss represents the anticipated loss, in the event of default, on a credit risk exposure modelled under the internal ratings based approach. EL is determined by multiplying the associated probability of default, loss given default and exposure at default together and assumes a 12-month time horizon.
Exposure at Default (EAD)	Exposure at default represents the estimated exposure to a customer in the event of default. In determining EAD amounts, consideration is made of the extent to which undrawn commitments may be drawn down at the point of default (see Credit Conversion Factors) and the application of credit risk mitigation (i.e. eligible financial collateral).
FINREP	Financial Reporting Standards framework represents a common standardised reporting framework with the objective to increase comparability of financial information produced by credit institutions for their respective national supervisory authorities.
Fully adjusted exposure On Balance Sheet	Amount of the exposure net of value adjustments after taking into account outflows and inflows due to Credit Risk Mitigation (CRM). Article 220 (4), Article 223 (2) to (5) and Article 228 (1) of Capital Requirements Regulation.
Fully adjusted exposure Off Balance Sheet	Amount of the exposure net of value adjustments after taking into account outflows and inflows due to Credit Risk Mitigation (CRM) pre-application of the Credit Conversion Factors.
General Credit Risk Adjustment (GCRA)	Those credit risk adjustments that are freely and fully available, about to timing and amount, to meet losses that are not yet materialised or where no evidence of a loss event has occurred.
Identified Employee	Any employee identified by TSB Group as a 'Material Risk Taker' for 2017 under paragraph 3.1 of the Remuneration Section of the PRA Rulebook.
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 expected losses in the lending book. An impairment allowance may be either individual or collective.
Individually / collectively assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Interest Rate Risk in the Banking Book (IRRBB)	The risk of losses that TSB may incur as a result of outright movements in interest rates or the widening of the spread between TSB Group Base Rate and LIBOR rates.
Internal Capital Adequacy Assessment Process (ICAAP)	The TSB Group's own assessment, based on CRD IV requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.
IT	Information Technology.
Internal Ratings Based Approach (IRB)	A methodology of estimating the credit risk within a portfolio by utilising internal risk parameters to calculate credit risk regulatory capital requirements.
Leverage Ratio	Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure.
Leverage Ratio exposure	The Leverage Ratio exposure measure is the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items. The specific treatments for these four main exposure types are defined by the Basel III leverage ratio framework disclosure requirements.

Lifetime Expected Credit Losses (Lifetime ECL)	The allowance required for Expected Credit Losses resulting from default events expected over the estimated life of the financial instrument, in the event of a significant increase in credit risk.
Loss Given Default (LGD)	Loss given default represents the estimated proportion of an EAD amount that will be lost in the event of default. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.
Material Risk Takers	Employees who have a material impact on TSB Group's risk profile.
Malus	The reduction or cancellation of remuneration awards prior to vesting.
Market risk	The risk that unfavourable market movements (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and / or value.
Minimum capital requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Pillar 1 requirements for credit, market and operational risk.
Model validation	The process of assessing and providing evidence that the TSB Group's models perform as planned and adequately reflect the risk profile of the business, and that there are no material misstatements of the capital requirement.
Multilateral development banks (MBD)	An institution created by a group of countries to provide financing for the purpose of development.
Netting	The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.
Non-performing exposures	Non-performing are those that satisfy either or both of the following criteria: a) material exposures which are more than 90 days past-due; b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.
Operational risk	The risk of reductions in earnings and / or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people-related or external events.
Original exposure	The exposure value without taking into account value adjustments and provisions, conversion factors and the effect of credit risk mitigation techniques.
Pillar 1	The first pillar of the Basel III framework sets out the quantitative elements – the minimum regulatory capital requirements for credit, operational and market risks.
Pillar 2	The second pillar of the Basel III framework sets out the qualitative expectations that should be met through the supervisory review process. This includes the ICAAP, governance process and the Supervisory Review Process.
Pillar 3	The third pillar of the Basel III framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.
Point-in-Time (PiT)	Estimates of PD (or other measures) made on a point-in-time (PiT) basis generally cover a short time horizon (usually a 12-month period) and are sensitive to changes in the economic cycle. This differs from a through-the-cycle (TTC) basis which uses long run average economic and risk data to reduce such sensitivity.
Probability of Default (PD)	Probability of default represents an estimate of the likelihood that a customer will default on their obligation within a 12-month time horizon.
Public Sector Entity (PSE)	A non-commercial administrative bodies responsible to central governments, regional governments or local authorities; or authorities that exercise the same responsibilities as regional and local authorities; or non-commercial undertakings owned by central governments that have explicit guarantee arrangements; or self-administered bodies governed by law that are under public supervision.
Qualifying Revolving Retail Exposure (QRRE)	Qualifying Revolving Retail Exposures (QRRE) relate to revolving, unsecured retail exposures that, to the extent they are not drawn, are immediately and unconditionally cancellable. Such exposures include credit cards and overdraft facilities.
Regulatory capital	The amount of capital that the TSB Group holds, determined in accordance with rules established by the PRA.

Repurchase agreements or 'repos'	Short-term funding agreements which allow a borrower to sell a financial asset as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.
Residual Maturity	The remaining time in years that a borrower is permitted to take to fully discharge its contractual obligation (principal, interest and fees) under the terms of a loan agreement.
Retail Internal Ratings Based (Retail IRB) Approach	The Retail Internal Ratings Based (Retail IRB) Approach allows internal estimates of PD, LGD and EAD to be used in determining credit risk capital requirements for retail portfolios.
Retail SME	A small or medium sized entity, an exposure to which may be treated as a retail exposure.
Risk appetite	The amount and type of risk that the TSB Group is prepared to seek, accept or tolerate.
Risk weighted assets (RWAs)	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with CRR.
RWA density	RWAs divided by exposure after default (post credit risk mitigation and the application of credit conversion factors).
Securities financing transactions (SFTs)	Securities financing transactions are repurchase and reverse repurchase agreements, buy / sell backs and securities lending. For the lender (seller) of the securities it is usually a way to raise funds to finance the securities positions. For the borrower (buyer) of the securities it is a way to invest short–term funds or to cover short (bond) positions.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.
Specific Credit Risk Adjustment (SCRA)	Those credit risk adjustments that do not meet the criteria to be recognised as GCRAs. Credit risk adjustments recognised via an incurred loss model under IAS 39 are classed as SCRAs.
Standardised Approach	The Standardised Approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by External Credit Rating Agencies to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements.
Stress testing	Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds which are required to be held.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Supervisory Review and Evaluation Process (SREP)	The appropriate supervisor's assessment of the adequacy of certain firms' capital.
Through-The-Cycle (TTC)	See Point-in-time (PiT).
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A component of regulatory capital defined by CRD IV, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances.
Total capital ratio	Total capital as a percentage risk weighted assets.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
UK Leverage Ratio	A PRA defined modified measure of the Basel III leverage ratio which excludes qualifying central bank claims from the exposure measure. The PRA has set the minimum ratio at 3.25%.
Whistletree	Whistletree Loans is a portfolio of former Northern Rock mortgages and unsecured loans which was acquired with effect from 7 December 2015.

APPENDIX I – CRD IV Index

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

CCR Ref (575/2013) Part 8	High-Level Summary	Compliance reference
Own Funds		
437 (1)	Disclosure of the following information relating to Own Funds:	
437 (1)(a)	a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and filters and deductions applied to own funds and the statutory balance sheet	Table 4: Reconciliation between statutory and regulatory capital (OFDR) - page 10
437 (1)(b)	a description of the main features of Common Equity Tier1, Additional Tier 1 and Tier 2 instruments	Appendix II - Capital instruments main features (OFD1) - page 44
437 (1)(c)	the full terms and conditions of all common Equity Tier 1, Additional Tier 1 and Tier 2 instruments	Appendix II - Capital instruments main features (OFD1) - page 44
437 (1)(d)	Disclosure of the nature and amounts of the following:	
437 (1)(d)(i)	each prudential filter applied pursuant to Articles 32 to 35;	Table 2: Own Funds (OFD2) - page 8
437 (1)(d)(ii)	each deduction made pursuant to Article 36, 56 and 66;	Table 2: Own Funds (OFD2) - page 8
437 (1)(d)(iii)	items not deducted in accordance with Articles 47, 48, 56, 66 and 79;	Table 2: Own Funds (OFD2) - page 8
437 (1) (e)	Description of all restrictions applied to the calculation of own funds and the instruments, prudential filters and deductions to which those restrictions apply	Table 2: Own Funds (OFD2) - page 8
437 (1) (f)	A comprehensive explanation where institutions disclose capital ratios calculated using elements of own funds determined on a different basis	N/A
Capital requirements		
438 (a)	Institutions approach to assessing the adequacy of capital levels	Section 3.1 Capital Adequacy Risk - page 7
438 (b)	ICAAP result on demand from reporting authorities	Section 4.3 TSB Group's Pillar 2 capital requirement – page 13
438 (c)	Capital requirements for each Standardised credit risk exposure class (excluding CCR)	Table 5: Overview of RWAs (EU OV1) & Table 6: Total amount of risk weighted assets and minimum own funds requirements - pages 11 and 12
438 (d)	Capital requirements for each Internal Ratings Based (IRB) credit risk exposure class	Table 5: Overview of RWAs (EU OV1) & Table 6: Total amount of risk weighted assets and minimum own funds requirements - pages 11 and 12
438 (e)	Capital requirements for Large Exposures, Settlement risk or market risk	Table 5 Overview of RWAs (EU OV1) – page 11
438 (f)	Operational risk capital requirements of which; the basic indicator, standardised and advanced measurement approach	Table 5: Overview of RWAs & Table 6: Total amount of risk weighted assets and minimum own funds requirements - pages 11 and 12
438 (endnote)	Disclosure of specialised lending exposures and equity exposures in the banking book which fall under the simple risk weight approach	N/A
Capital buffers		
440 (1)(a)	Geographical distribution of credit exposures relevant for calculation of countercyclical capital buffer	Section 4.3 Pillar 2 Capital Requirement Table 8 (BUF1) Geographical distribution of relevant credit exposures for the calculation of the countercyclical capital buffer - page 15
440 (1)(b)	Amount of the institution specific counter cyclical capital buffer	Table 9 (BUF2): Amount of institution specific countercyclical capital buffer - page 15

CCR Ref (575/2013) Part 8	High-Level Summary	Compliance reference
Credit risk adjustments		
442 (a)	Definitions of past due and impaired	Section 5.10 Impaired lending and provisions - page 25
442 (b)	Methodology applied to determine general and specific credit risk adjustments	Section 5.10 Impaired lending and provisions and 5.12 Managing impaired exposures and impairment provisions - page 25 and 27
442 (c)	Net exposure and average net exposure by exposure class	Section 5.3 - Credit risk exposure by exposure class - Table 12 (EU CRB-B) – page 19
442 (d)	Net exposure by Geography	Section 5.5 Credit risk exposure: geographical breakdown of exposures – page 21
442 (e)	Net exposure by Industry	Section 5.4 Concentration of exposures by industry and counterparty type – Table 13 (EU CRB-D) - page 20
442 (f)	Net exposure by residual maturity	Section 5.6 Credit risk exposure: analysis by maturity – Table 14 (EU CRB-E) – page 21
442 (g)	Defaulted and non-defaulted exposures by exposure classes	Section 5.11 Credit quality of exposures by exposure class and instrument - Table 19 (EU CR1-A) – page 26
442 (g)(i) 442 (g)(ii) 442 (g)(iii)	A breakdown of impaired, past due, specific and general credit risk adjustments for the period by exposure classes, industry or counterparty type as deemed material	Section 5.14 Analysis for past due and impaired loans and advances to customers– page 29
442 (h)	A breakdown of impaired, past due, specific and general credit risk adjustments for the period by exposure classes, industry or counterparty type as deemed material	Section 5.14 Analysis for past due and impaired loans and advances to customers - page 29
442 (i) 442 (i)(i) 442 (i)(ii) 442 (i)(iii) 442 (i)(iv) 442 (i)(v)	Reconciliation of changes in specific and general credit risk adjustments for impaired exposures	Section 5.15 Changes in the stock of general and specific credit risk adjustments - Table 22 (EU CR2-A) – page 29
442 (endnote)	Specific credit risk adjustments recorded to income statement to be disclosed separately	Section 5.15 Changes in the stock of general and specific credit risk adjustments - Table 22 (EU CR2-A) – page 29
Remuneration disclosures		
450	Remuneration disclosures	Section 7 pages 35-37. Cross references are also provided to the TSB Group Annual report and accounts
Leverage		
451 (1)(a) 451 (1)(b) 451 (1)(c)	Leverage ratio and a breakdown of total exposure measure including reconciliation to financial statements and derecognised fiduciary items	Section 6 Table 26 Summary reconciliation of accounting assets and Leverage Ratio exposure (LRSum) and Table 27 Leverage ratio common disclosure (LRCom) - page 32 and 33
451 (1)(d)	Description of the risk management approach to mitigate excessive leverage	Section 6.2 Management of excessive leverage - page 34
451 (1)(e)	Description of the factors that impacted the leverage ratio during the year	Section 6.1 Leverage Ratio Exposure - page 32
Use of credit risk mitigation techniques		
453 (a)	Use of off and on balance sheet netting	Section 5.16 Credit Risk Mitigation - page 30 - master netting
453 (b)	Management of collateral valuation	Section 5.16 Credit Risk Mitigation - page 31 collateral
453 (c)	Description of the types of collateral used by the institution	Section 5.16 Credit Risk Mitigation - page 31 – collateral
453 (d)	Creditworthiness and types of guarantor and credit derivative counterparty	N/A as explained on - page 31
453 (e)	Market or Credit risk concentrations within risk mitigation exposures	Section 5.16 Credit Risk Mitigation - page 30 - concentration risk
453 (f)	For exposures under the Standardised or Foundation IRB approach, disclosure of exposure value covered by eligible collateral	Section 5.16 Credit Risk Mitigation - Overview Table 25 (EU CR3) - page 31
453 (g)	Exposures covered by guarantees or credit derivatives	N/A as explained on page 31
Transitional period for the impact of the introduction of IFRS 9		
473a (10)	Transitional arrangements for IFRS 9	Table 1 Key Metrics (KM1/IFRS 9-FL) – page5 Section 3.2 TSB Group's Own Funds Section 3.3 Movements in Capital

Appendix II – Capital instruments' main features (OFD1)

Capital instruments' main features (1)	Share Capital 1	Share Capital 2	Subordinated Liabilities
Issuer	TSB Banking Group plc	TSB Banking Group plc	TSB Banking Group plc
Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement	N/A	N/A	XS1061206337
Governing law(s) of the instrument	English	English	English
Regulatory treatment			
Transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Post-transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Eligible at solo/(sub-) consolidated/solo & (sub-) consolidated	Solo and (Sub-) Consolidated	Solo and (Sub-) Consolidated	Solo and (Sub-) Consolidated
Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Ordinary Shares	Subordinated Tier 2 Notes
Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	£1,386.5 million	£200.0 million	£384.3 million
Nominal amount of instrument	£0.5 million	£4.4 million	£385.0 million
Issue price	The nominal value of shares issued was £0.5 million and a minimum premium amount required by the Companies Act 2006 of £769.5 million was transferred to share premium. The balance of £616.5 million was transferred to the Merger Reserve.	£0.4494 per share	£0.9949
Redemption price	N/A	N/A	£1.00
Accounting classification	Shareholders' equity	Shareholders' equity	Liability - amortised cost
Original date of issuance	25 April 2014	19 May 2014	01 May 2014
Perpetual or dated	Perpetual	Perpetual	Dated
Original maturity date	No Maturity	No Maturity	06/05/2026
Issuer call subject to prior supervisory approval	No	No	Yes
Optional call date, contingent call dates, and redemption amount	N/A	N/A	6 May 2021 - the Notes may be redeemed, in whole but not in part, at the option of the Issuer on any Call Date, subject if so required at the relevant time to the Issuer giving prior written notice and receiving permission therefore from the Relevant Regulator. Redemption price £385 million.
Subsequent call dates, if applicable	N/A	N/A	Each subsequent Interest Payment Date after the first call option.
Coupons / dividends			
Fixed or floating dividend/coupon	N/A	N/A	Fixed to floating
Coupon rate and any related index	N/A	N/A	The notes pay interest at a rate of 5.75% per annum, payable semi-annually in arrears until 6 May 2021 at which time the interest rate becomes 3 month LIBOR plus 3.43% per annum payable quarterly in arrears.

Capital instruments' main features	Share Capital 1	Share Capital 2	Subordinated Liabilities
Existence of a dividend stopper	No	No	No
Fully discretionary, partially discretionary or mandatory (in terms of timing	Fully discretionary	Fully discretionary	Mandatory
Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Mandatory
Existence of step up or other incentive to redeem	No	No	No
Noncumulative or cumulative	Non-cumulative	Non-cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
If convertible, conversion trigger (s)	N/A	N/A	N/A
If convertible, fully or partially	N/A	N/A	N/A
If convertible, conversion rate	N/A	N/A	N/A
If convertible, mandatory or optional conversion	N/A	N/A	N/A
If convertible, specify instrument type convertible into	N/A	N/A	N/A
If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A
Write-down features	No	No	No
If write-down, write-down trigger (s)	N/A	N/A	N/A
If write-down, full or partial	N/A	N/A	N/A
If write-down, permanent or temporary	N/A	N/A	N/A
If temporary write-down, description of write-up mechanism	N/A	N/A	N/A
Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Subordinated in right of payment to the claims of depositors, other unsubordinated creditors and the subordinated debt of the issuer.	Subordinated in right of payment to the claims of depositors, other unsubordinated creditors and the subordinated debt of the issuer.	Subordinated in right of payment to the claims of depositors and other unsubordinated creditors of the issuer
Non-compliant transitioned features	No	No	No
If yes, specify non-compliant features	N/A	N/A	N/A

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

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