HODGE

Hodge Bank
Pillar 3 Disclosures

Period ended 30 September 2020

Our Mission

We use finance for good, opening up possibilities in the moments that matter, for people and businesses.

Our Strategy

The Board has adopted a strategic plan with the long-term aim of achieving stable and strong returns for our shareholder. At the heart of the Bank's philosophy is a wish to protect its capital base for the benefit of its depositors and shareholders by conducting business in those areas where it has the greatest expertise and experience and best understands the risks which it is taking.

A rolling five-year strategy is approved by the Board annually, complemented by a detailed business plan for the forthcoming financial year. The Board sets aside specific time during the year to review its strategy and to gauge progress towards its achievement.

The Board's strategy will see the Bank growing its retail mortgage business in specialised areas, including buy-to-let and later life lending and where the changing demographic of the UK mortgage market is not being adequately met by the mainstream lenders.

To facilitate this growth, we will be expanding our savings capability and product range to add further support to our existing customers as well as attract new savers using both traditional and digital channels.

The Bank's commercial business will remain a critically important aspect, with the objective of maximising the capital supporting this business area through a manageable number of important, long term relationships where our expertise can be fully utilised.

Our Business

Specialist mortgages

Hodge Bank's specialist mortgage business combines our expertise in both residential and later-life lending. We work in partnership with our trusted network of intermediaries, serving professional landlords through our buy-to-let mortgages and personal customers through our later-life lending activities.

Later life

Having been established in 1965, we were the first entrant into the equity release market and have been a constant presence ever since. We have developed our later life lending proposition over the last few years through the addition of our retirement mortgage (a hybrid lifetime mortgage), a 50+ mortgage (a standard residential mortgage with a fixed maturity date) and a RIO mortgage (a 50+ mortgage without a fixed maturity date) to our product range.

Buy-to-let

Alongside our later life proposition, we operate in other specialist residential mortgage markets offering portfolio buy-to-let and holiday buy-to-let products.

Commercial lending

The focus of our commercial business is to be a long-term lending partner for our clients.

Our core proposition remains the provision of bespoke real estate funding solutions to experienced property investors and developers.

Savings

We continue to manage over £1bn of our customers' savings balances providing competitive interest rates and an efficient personalised service.

The Bank is also a participant in both the original Bank of England's Term Funding Scheme ('TFS') and the new scheme launched in 2020 with additional incentives for SME's ('TFSME'). These schemes provide a cost-effective source of funding in the form of central bank reserves to support additional lending to the economy.

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01 Introduction

1. Introduction

This document constitutes the Pillar 3 disclosures of Julian Hodge Bank Limited ("the Bank") as required under the Capital Requirements Directive and Regulation (CRD IV).

The purpose of this document is to provide information and disclosure to the Bank's depositors, borrowers and other stakeholders in relation to the internal procedures and policies adopted by the Bank to manage and mitigate its key risks. The Pillar 3 disclosures also provide numerical disclosures about the Bank's assets, liabilities, capital resources and liquidity over and above those disclosed in its financial statements.

This document should be read in conjunction with the 2020 Annual Report and Financial Statements.

1.1 Background

The Bank's principal lending activities comprise of residential mortgages, lifetime mortgages, buy-to-let and commercial lending. Residential and lifetime mortgages involve the provision of loan facilities to enable people to use their homes as security to raise money. Commercial lending involves the provision of finance to clients operating within the property and renewable energy sectors. Buy-to-let mortgages are aimed at individuals with holiday lets and portfolio landlords who want a single lender relationship, flexibility to move properties in and out and the ability to grow. The Bank also invests in other financial instruments (for example covered bonds) as a means of managing its liquidity profile. The Bank's lending is primarily funded using its own capital resources and customer deposits.

1.2 Basis and Frequency of Disclosure

The Bank has changed its reporting period from 31 October to 30 September. All numerical disclosures within this document have been prepared as at 30 September 2020, which is the Bank's most recent financial period-end. Pillar 3 disclosures are issued on an annual basis and are made available concurrently with the audited financial statements, as required by the CRR.

The document has been prepared in accordance with the Capital Requirements Directive (CRD) and the Capital Requirements Regulations (CRR) which is the legislative package for implementing the Basel III framework within the EU. This came into effect from 1 January 2014 and was enforced in the UK, together with local implementing rules and guidance, by the Prudential Regulatory Authority ("PRA").

CRD IV is a means of regulating banks and provides a common framework for the assessment of the individual risk profile of each financial institution. This includes determining the level of capital that banks must hold having regard to the individual risk profile of each bank. The purpose of a bank's capital resources is to act as a buffer to absorb potential future losses incurred by the Bank and to ensure that the Bank's depositors and other stakeholders are protected.

The requirements of the framework are divided into three 'pillars' as described below:

Pillar 1 – these requirements set out the minimum capital requirements that each bank must adhere to.

The Pillar 1 capital requirement is calculated for the Bank using the following approach:

- Credit Risk - Standardised Approach
- Counterparty Credit Risk - Standardised Approach
- Operational Risk - Basic Indicator Approach

Pillar 2 – builds on Pillar 1 and incorporates the Bank's own assessment of additional capital resources needed to cover specific risks that are not covered by Pillar 1. The Bank has calculated the amount of capital that it considers necessary to cover these risks within its Internal Capital Adequacy Assessment Process (ICAAP). The amount of additional capital required is also considered by the PRA as part of the Supervisory Review and Evaluation Process (SREP) and this determines the overall level of capital required to be held by the Bank.

Pillar 3 – these rules are designed to promote market discipline and transparency by enhancing the level of disclosure made by banks to its stakeholders by allowing them to assess the Bank's key risk exposures and the adequacy of the Bank's risk management processes to mitigate these risks.

1.3 Summary of Key Regulatory Metrics

	30 September 2020	31 October 2019
Total capital (£m)	136.4	156.6
Total risk-weighted assets (RWA) (£m)	693.8	681.9
Common Equity Tier 1 ratio (%)	19.7%	23.0%
Basel III leverage ratio (%)	9.6%	11.2%
LCR ratio (%)	272.9%	516.9%
NSFR ratio (%)	154.6%	217.6%

1.4 Verification of Information

The Bank's Pillar 3 disclosures are subject to internal verification and have been reviewed by the Bank's Audit Committee and are published on the Bank's website: **https://www.hodgebank.co.uk/financial-information/**.

These disclosures are not subject to external audit except where they are equivalent to those prepared under accounting requirements for inclusion in the Bank's audited Financial Statements.

1.5 Scope of Pillar 3

This document contains the Pillar 3 disclosures of Julian Hodge Bank Limited as a standalone separate entity. A summary of the main differences between the Financial Statements carrying amounts and the regulatory exposures has been included within Appendix 1.

1.6 Regulatory Horizon

Disclosures

In December 2016, the European Banking Authority (EBA) published its final guidelines on regulatory disclosure requirements (amended June 2017) following an update of the Pillar 3 requirements by the Basel Committee in January 2015 (update March 2017 and further consultation February 2018). The Board aims to implement the EBA guidelines in terms of quantitative and qualitative disclosures in this report in line with best practice. This document also includes additional qualitative and quantitative disclosures that the Board considers useful to the users of this document.

CRD V

Published in the Official journal of the European Union in 2019 the CRD V & CRR II package is intended to implement further reforms to Basel III agreed internationally following the 2007-2008 financial crisis. The majority of CRR II is due to come into force on 28 June 2021. The Bank has assessed the impacts of the change to the CRD V & CRR II package and is satisfied that there is no material impact.

Basel III Final Reforms

During December 2017, the Basel Committee on Banking Supervision (BCBS) published a package of regulation titled "Finalising Basel III post-crisis reforms". This package was due to come into force on 1 January 2022 but due to COVID-19 the implementation date has been delayed by 12 months to 1 January 2023. The Bank will continue to monitor regulatory publications for any further changes and has assessed the impacts of the change from this package. As it currently stands, the Board is satisfied that forecast levels of capital are sufficient to meet the requirements associated with the changes.

COVID-19

As a result of the COVID-19 pandemic certain regulatory changes have been made during the financial period ended 30 September 2020. The main changes that impact the Bank are the introduction of an adjustment to the IFRS 9 transitional relief that allows for 100% of provisions raised since 1 January 2020 to be added back to CET1 capital and the reduction of the Countercyclical Buffer from 1% to 0% which was announced in March 2020.

Withdrawal from the EU

The UK's exit from the EU on 31 December 2020 will have no direct impact on the Bank at the time of writing. It is feasible that a different approach could be undertaken by the UK in respect of the implementation of future regulatory changes and therefore the outline of EU changes provided in the sections above may not necessarily represent the UK approach at the time such changes are implemented.

02 Risk Management Objectives and Policies

2. Risk Management Objectives and Policies

2.1 Risk Management Objectives

Managing risk effectively is fundamental to our strategy and to operating successfully. Hodge has a strong culture of risk awareness and control and actively monitors and manages the risks of its business, as well as emerging industry risks which may have an impact on those activities, through a robust and embedded risk management framework. The Bank's risk management framework has an integral role in the Bank:

- Delivering against its strategy within an appropriate risk culture;
- Building greater resilience to organisational threats;
- Protecting its customers from unfair outcomes.

The Bank's strategy and business model is underpinned by strong risk governance, ensuring alignment with the Board's appetite for risk. A risk management framework, supported by a three lines of defence governance model, ensures strong risk awareness, assessment, monitoring and management across all principal and emerging risks. Risks are managed within the risk appetite set by the Board and stress testing is undertaken to ensure that the capital and liquidity of the Bank would enable it to survive severe but plausible market-wide and firm specific stresses.

2.2 Three Lines of Defence Model

First line of defence - day-to-day risk management

The first line of defence has responsibility for implementation of the Bank's strategy and for the management of risk across the organisation and comprises executive committees, management and staff.

The first line of defence:

- Owns and manages the Bank's risks;
- Responsible for compliance with relevant regulation & legislation;
- Identifies, manages and mitigates the risks of the Bank;
- Defines and operates controls;
- Assess key risk indicators and market conditions;
- Produces management information and reports on risks.

Second line of defence - risk oversight

The second line of defence is responsible for providing independent oversight and challenge of activities undertaken by the first line and provides guidance on risks relevant to the strategy. This is provided through the Risk function, which is led by the Chief Risk Officer (CRO), who reports to the CEO and has an independent reporting line to the Chairman of the Risk and Conduct Committee. It maintains and reports an aggregate view of risks and performance in relation to risk appetite to the Risk and Conduct Committee. The Risk function is not customer facing and has no responsibility for business targets or performance.

The Second line of defence:

- Designs, interprets and develops the risk management framework and monitors business as usual adherence to the framework;
- Advises the Board on risk appetite;
- Provides oversight, challenge and assurance over the management of risks;
- Develops compliance policies, supports delivery of regulatory change and monitors and reports on regulatory issues.

Third line of defence - internal audit

The third line of defence provides objective assurance on the effectiveness of the Bank's governance and risk management processes and controls. This assurance is obtained through the use of internal audit services provided by Deloitte. Internal audit report directly to the Chair of the Audit Committee as well as the CEO and is independent of the first and second lines of defence.

The Third line of defence:

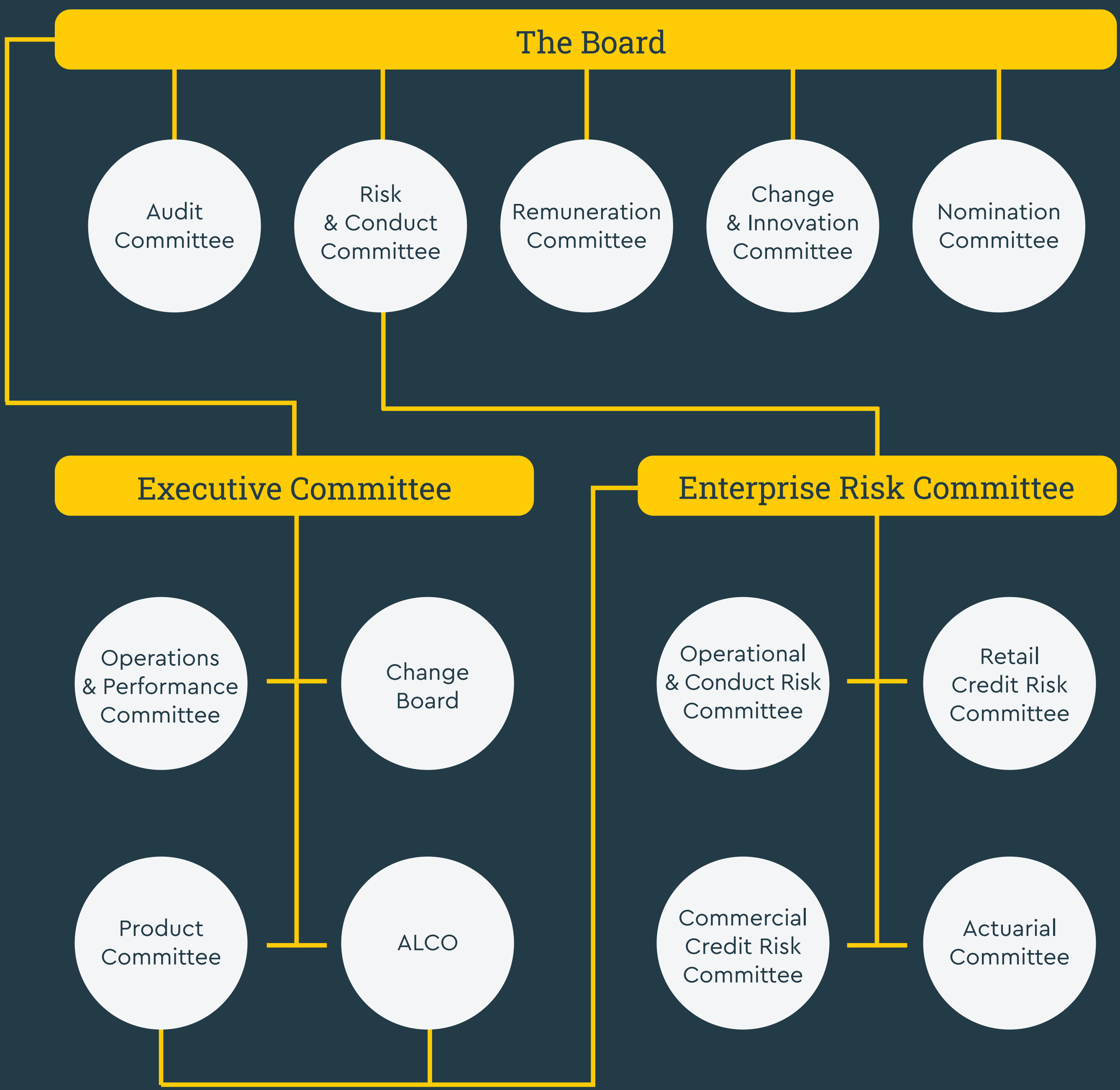
- Conducts independent testing and verification of the efficacy of the Bank's business model, controls, policies, processes and business line compliance; and
- Provides assurance that the risk management process is functioning as designed.

2.3 Risk Governance Structures

The Board is ultimately responsible for the overall risk governance and effective management of risk within the Bank. The Board determines the risk strategy and ensures that risk is monitored and controlled effectively. The Risk and Conduct Committee is a board committee that reviews, on behalf of the Board, the key risks inherent in the business and the control framework in place to manage such risks, presenting its findings to the Board.

There is a formal structure of risk management policies in place, setting out risk limits and triggers and minimum operating standards, which are aligned to the Board's risk appetite.

Risk governance is supported by a structure comprising executive committees, each with escalation routes through the Risk and Conduct Committee and board as shown below:



Executive Committees

Each committee includes appropriate representation from the Executive Committee and risk specialists. The responsibilities of each of the Committees are set out below:

Operations & Performance Committee
The Operations & Performance Committee is an executive committee chaired by the Chief Operations Officer. The Committee's purpose is to provide operational governance across the firm. This governance covers a range of key activities inclusive of oversight of internal and outsourced operations, operational resilience and forward-looking operational impacts to the business.

Change Board
The Change Board is an executive committee chaired by the Chief Technology Officer. The purpose of the Change Board is to ensure the Bank's Change Programme is aligned with the Bank's strategy and business plans and to monitor programme delivery, budget and resources.

Product Committee
The Product Committee is an executive committee chaired by the CEO. The purpose of the Committee is to assist and encourage new product developments by developing and recommending new product ideas and significant changes to existing products.

Assets & Liabilities Committee (ALCo)
ALCo is an executive committee, chaired by the Chief Financial Officer. The Committee is responsible for the implementation and maintenance of the overall risk management framework relating to liquidity, capital, interest rate risk and asset/liability management.

Operations & Conduct Risk Committee
The Operational & Conduct Risk Committee is an executive committee chaired by the CRO. The purpose of the Committee is to assist the CRO in the development and implementation of a risk management framework to manage the operational and conduct risk profile, and to ensure the adequacy of the internal control environment.

Retail Credit Risk Committee
The Retail Credit Committee is an executive committee chaired by the Group Retail Director and Deputy CEO. The scope of the Committee covers all retail lending activity. The Committee is responsible for the implementation and maintenance of the overall risk management framework relating to retail credit risk. This framework includes risk assessment and internal controls, prudential risk and underwriting relating to retail credit risk.

Commercial Credit Risk Committee
The Commercial Credit Committee is an executive committee chaired by the Managing Director of Commercial Lending. The Committee is responsible for the implementation and maintenance of the overall risk management framework relating to commercial credit risk. It is also responsible for reviewing, challenging and if appropriate, approving credit proposals for new commercial lending deals that are below the authority thresholds which require approval by the Board or Special Committee.

Actuarial Committee
The Actuarial Committee monitors and provides input to the methods and assumptions used to undertake actuarial valuations of the Bank's assets and liabilities. The Committee meets as required, but as a minimum will meet four times per annum.

2.4 Risk Categories

Credit risk

Credit risk is the risk that a counterparty will be unable or unwilling to meet a commitment that it has entered into with the Bank. Credit risk is inherent in the Bank's lending activities and may arise from changes in credit quality of individuals, or as a result of adverse economic conditions.

The principal tool to mitigate credit risk is through assessment of the borrower's creditworthiness at origination and all lending is secured against residential or commercial property. The credit risk policies for retail and commercial lending are approved by the Board.

The Bank manages its credit risk through the Retail Credit Risk Committee, Commercial Credit Risk Committee and the Assets and Liabilities Committee. Regular credit exposure reports are produced which include information on credit and property underwriting, large exposures, asset concentrations, industry exposure and levels of bad debt provisioning.

Liquidity risk

Liquidity risk is defined as the inability of the Bank to meet its liabilities as they fall due, due to shortfalls in cash flows arising from the daily operation of its business, the sale of assets or the raising of finance.

The Bank manages its liquidity risk through its Assets and Liabilities Committee and monitors its liquidity position on a daily basis. The Bank has adopted a policy to ensure that it has adequate resources to enable it to conduct its normal business activities without interruption.

An Internal Liquidity Adequacy Assessment Process (ILAAP) has been approved by the Board in accordance with the PRA's liquidity guidelines. The Board is satisfied that the Bank has sufficient liquid assets at its disposal, even under stressed scenarios, to meet its liabilities as they fall due.

The Board has approved a liquidity risk management policy that sets out the liquidity requirements with which the Bank must comply. The principal liquidity risk mitigations used by management are:

- A buffer of high-quality liquid assets (comprising of high-quality government, covered bonds and multilateral development bank securities) which can be realised to meet cash requirements;
- Cash reserves held with the Bank of England;
- Cash resources held at other financial institutions.

Interest rate risk

Interest rate risk can be defined as the impact on the earnings and economic value of the Bank that arises from adverse movements in market interest rates.

Interest rate risk is the risk that arises when there is an imbalance between the maturity dates of rate sensitive assets, liabilities and off-Balance Sheet items. The Bank manages its interest rate risk through its Assets and Liabilities Committee. The Bank's policy is to maintain interest rate risk at a controlled level within limits set by the Board.

The principal risk management tool to mitigate interest rate risk is the use of derivatives to align the interest rate re-pricing profile of assets and liabilities. All the derivatives used by the Bank are interest rate swap contracts of varying maturities and start dates.

The policy for, and use of, derivatives by the Bank is approved by the Board and overseen by ALCo. All of the Bank's derivative transactions are undertaken by the Bank's treasury function and are subject to review and approval at the dealing stage.

The Treasurer, who is responsible for treasury matters on a day-to-day basis, prepares a treasury report for the Board, which includes analysis of interest rate risk exposures.

Property price risk

Property price risk is the risk that arises when there is an adverse mismatch between actual house prices and those implicit in the costing of the Bank's lending into retirement products, such that the ultimate realisation of the property would not yield the expected return to the Bank and could, in certain circumstances, result in a capital loss. The risk is managed by setting a maximum loan to value at inception of each loan. In addition, the Bank has exposure to property price risk through its reversionary asset portfolio. An ICAAP is undertaken annually which assesses the Bank's exposure to property price risk.

Conduct risk

Conduct risk is defined as the risk that the Bank's behaviour will result in poor outcomes for customers. The Board strongly believes in the requirement to ensure that the Bank pays due regard to the interests of its customers and treats them fairly at all times recognising they are core to building a sustainable business. These principles are firmly embedded within the organisation's culture and work practices and on-going monitoring is in place to ensure that good customer outcomes are met. The Enterprise Risk Committee has responsibility for implementing and monitoring principles, frameworks, policies and limits.

Operational risk

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

The Bank's risk management framework includes specific assessments for all significant operational risks faced by the Bank and maintenance of a risk register that ranks each risk using a 'probability/impact' matrix and assesses the effectiveness of the respective control environments. Procedure manuals are also in place for each area of the business to set out the processes and controls all staff are expected to follow.

On a quarterly basis, the Risk and Conduct Committee receives a report of all the losses or near-miss events that have taken place in the quarter and any mitigating actions undertaken, in addition to monitoring emerging risks.

The Bank plans to have a greater digital presence, which combined with the growth plans of the Bank, increases the inherent risk exposure to cyber risk.

Strategic risk
Strategic risk can arise from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, political, regulatory or other impacts. The risk to delivery of the strategy is deemed to be the principal risk. Close management and monitoring of the strategic plan along with in-depth stress testing is reported regularly through the Bank's committee structure to the Board and senior management. This is supported through additional risk reporting and monitoring of the key threats to the business on risk registers and horizon scanning to ensure the business can respond appropriately.

Underwriting risk
There are two risks that relate to underwriting risk. Mortality risk is the risk that shorter life expectancy results in financial losses for the Bank. Prepayment risk is the risk that a high rate of mortgage prepayments results in financial losses for the Bank. The exposure to prepayment risk is primarily driven by equity release and retirement mortgages and is heightened in times of low interest rates and increased competitor activity.

Strong expertise is maintained within the first line Actuarial function to support the active management and monitoring of underwriting risk exposure. The Chief Actuary is treated as a first line role rather than formal second line oversight.

Concentration risk
Concentration risk is defined as the risk of any single exposure or group of exposures with the potential to produce losses large enough to threaten an institution's health or ability to maintain its core operations. Credit risk concentrations, by their nature, are based on common or correlated risk factors, which, in times of stress, have an adverse effect on the creditworthiness of each of the individual counterparties making up the concentration.

As a regional property-based lending business, the Bank's Commercial division has a geographic concentration in Wales, the West and London, though this has reduced considerably over recent years. The Mortgage business unit operates on a national basis, and the distribution of its residential property portfolio follows the distribution of the population within the UK. The buy-to-let portfolio is geographically concentrated in the London area due to the relatively small size of the portfolio; however, this is expected to reduce over time.

Portfolio performance statistics are used to ensure that any emerging concentration risks are identified and addressed through future business development initiatives. A policy has been approved by the Board in relation to the permitted large exposure limits for each portfolio. Concentration risk is also assessed as part of the Pillar 2 framework.

Pension risk
Pension risk is the risk to the Bank's financial condition that arises from a funding deficit within its defined benefit pension plan. A deficit may increase as a result of increasing longevity, a fall in asset values or low investment returns, or a change in the economic assumptions used to value long-term pension liabilities.

The Bank's defined benefit pension scheme remains open to existing and new employees. However, final pension benefits are based on career-average earnings as opposed to final salary. This gives an overall lower cost to the Bank when compared with operating a final salary scheme.

The financial condition of the pension scheme is reviewed on a quarterly basis, using the advice of independent actuarial advisors, and is subject to a formal triennial revaluation.

Climate risk
Financial risks from climate change arise through two primary channels; physical i.e. specific weather events & damage to assets and transition risks i.e. increased regulation to adjust to low carbon economy. These manifest as increasing underwriting, credit, or market risk for firms.

A climate change policy has been implemented outlining governance structures, disclosures, risk management approach, SMF responsibility allocated in the business and an internal working group established to develop the Bank's approach and understanding of the risk posed by climate change. Climate change is being addressed specifically as part of the ICAAP regulatory risk management document.

Other notable risks
IBOR Reform - in July 2017, the Financial Conduct Authority announced a transition away from LIBOR. The Bank set-up a LIBOR working group in 2020 to assess the impact and manage this change and has made progress during the year to transition away from LIBOR. This work will conclude by the end of 2021.

Pandemic risk - whilst not a principal risk category we consider the risk of economic loss as a result of the COVID-19 pandemic. The Bank runs a variety of stress test scenarios as part of its ICAAP, including stress tests which are more severe than that observed during the COVID-19 pandemic to date. The Bank also has a Recovery Plan which is reviewed annually by the Board and documents the plans in place and actions to be taken to recover from a severe stress event.

03 Key Regulatory Metrics

3. Key Regulatory Metrics

As at 30 September 2020, and throughout the period to 30 September 2020, the Bank maintained its capital resources, leverage ratio, liquidity coverage ratio and net stable funding ratio at a level above the minimum regulatory requirements.

The following table provides a summary of the key regulatory metrics for the Bank as at 30 September 2020:

	30 September 2020	31 October 2019
Available capital (amounts)		
Common Equity Tier 1 (CET1) (£m)	136.4	156.6
Tier 1 (£m)	136.4	156.6
Tier 2 (£m)	-	-
Total capital (£m)	**136.4**	**156.6**
Risk weighted assets (amounts)		
Total risk-weighted assets (RWA) (£m)	693.8	681.9
Risk-based capital ratios as a percentage of RWA		
Common Equity Tier 1 ratio (%)	19.7%	23.0%
Tier 1 ratio (%)	19.7%	23.0%
Total capital ratio (%)	**19.7%**	**23.0%**
Additional CET1 buffer requirements as a percentage of RWA		
Capital conservation buffer requirement (%)	2.50%	2.50%
Countercyclical buffer requirement (%)	0.00%	1.00%
Total of bank CET1 specific buffer requirements (%)	**2.50%**	**3.50%**
Basel III leverage ratio		
Total Basel III leverage ratio exposure measure (£m)	1,423.5	1,393.2
Basel III leverage ratio (%)	**9.6%**	**11.2%**
Liquidity Coverage Ratio		
Total HQLA after haircuts (£m)	196.4	346.4
Total net cash outflow (£m)	72.0	67.0
LCR ratio (%)	**272.9%**	**516.9%**
Net Stable Funding Ratio		
Total available stable funding	1,226.2	1,279.0
Total required stable funding	793.3	587.6
NSFR	**154.6%**	**217.6%**

04 Capital Resources

4. Capital Resources

The table below summarises the composition of regulatory capital. The Bank has complied with all the externally imposed capital requirements to which it is subject for the financial periods ended 30 September 2020 and 31 October 2019.

Composition of regulatory capital (£m)	30 September 2020	31 October 2019
CET1 capital		
Share capital	105.0	105.0
Retained earnings	50.5	66.6
Accumulated other comprehensive income	(14.4)	(11.4)
CET1 capital before regulatory adjustments	**141.1**	**160.2**
Regulatory adjustment to CET1:		
Intangible assets (1)	(7.0)	(5.6)
IFRS 9 transitional adjustment (2)	2.7	2.4
Prudent valuation adjustment (3)	(0.4)	(0.4)
CET1 and Tier 1 capital (T1)	**136.4**	**156.6**
Tier 2 capital (T2)	-	-
Total regulatory capital (TC = T1 + T2)	**136.4**	**156.6**
Total risk-weighted assets	**693.8**	**681.9**
Common Equity Tier 1 (as a percentage of RWA)	19.7%	23.0%
Tier 1 (as a percentage of RWA)	19.7%	23.0%
Total capital (as a percentage of RWA)	**19.7%**	**23.0%**
Institution specific buffer requirement	**2.50%**	**3.50%**
Of which: capital conservation buffer requirement	2.50%	2.50%
Of which: bank specific countercyclical buffer requirement	0.0%	1.00%
Amounts below threshold for deduction		
Deferred tax assets arising from temporary differences (4)	9.5	6.6

(1) An adjustment is required to the Bank's Common Equity Tier 1 capital in respect of intangible assets, as set out in CRDIV. For regulatory purposes intangible assets are deducted from capital.
(2) Article 473a of the CRR provides a framework for the transitional adoption of the IFRS 9 standards into the Bank's own funds calculation. Due to the COVID-19 pandemic additional IFRS 9 transitional relief was introduced during 2020. As at 30 September 2020 the Bank can recognise transitional relief of 85% of the IFRS 9 Stage 1 and 2 ECL provisions raised to 1 January 2020 and 100% against the Stage 1 and 2 ECL provisions raised post 1 January 2020.
(3) A regulatory adjustment is required to be made to the Bank's Common Equity Tier 1 capital in respect of the Prudent Valuation Adjustment.
(4) As the Bank's deferred tax asset balance is lower than 10% of Common Equity Tier 1 Capital it is below the threshold for deduction as per the requirements set-out within Article 48(1) of the CRR.

Tier 1 Capital
The Bank's Tier 1 capital comprises of issued share capital, accumulated accounting profits and other reserve balances.

The following table shows the movement in CET1 capital during the 11-month period to 30 September 2020:

CET1 Movements (£m)	30 September 2020	31 October 2019
CET1 capital at 1 November	**156.6**	**168.0**
Loss for the financial period	(16.1)	(5.6)
Impact on adoption of IFRS 9	-	(3.4)
IFRS 9 transitional relief	0.3	2.4
Movement in other reserves	(3.0)	(2.7)
Movement due to other regulatory adjustments	(1.4)	(2.1)
CET1 Capital	**136.4**	**156.6**

Tier 2 Capital
The Bank currently has no Tier 2 instruments.

05 Capital Adequacy

5. Capital Adequacy

5.1 Capital Management

The Bank's policy is to maintain a strong capital base to maintain market confidence and to sustain future business volumes.

Pillar 1

The Pillar 1 capital requirements set out the minimum capital requirement that the Bank must adhere to and consists of the following components:

- **Credit and Counterparty Credit risk** – reflects the risk that a counterparty will be unable or unwilling to meet a commitment that it has entered into with the Bank. The Bank has adopted the standardised approach to determine its Pillar 1 credit risk capital requirement. This involves the application of standard rules applied to each exposure class.
- **Operational risk** – is the risk of direct or indirect loss resulting from inadequate or failed internal processes and controls, people or systems, or from external events. The Bank has adopted the basic indicator approach to determine its Pillar 1 operational risk capital requirement. This calculation is based on the Bank's average income for the past three years.
- **Market risk** – the Bank does not have a trading book and is not exposed to commodity or foreign exchange risk positions and accordingly it does not have a requirement for market risk capital.

Pillar 1 capital adequacy is monitored by ALCo and reviewed by the Risk and Conduct Committee monthly. Capital adequacy is also reported to the regulator on a quarterly basis. Capital forecasts are prepared on an annual basis, as part of the Bank's annual budgeting and forecasting cycle. During the year, reforecasting is performed and presented to the Board to consider the impact of events that were not reflected in the original budget.

Pillar 2

The Bank must set also set aside additional 'Pillar 2' capital to provide for additional risks. The Bank's Pillar 2 capital requirements are reviewed formally at least annually, and additional reviews are undertaken in the intervening periods if management become aware of a significant change in the business or a change in the Bank's risk profile. The Bank has calculated the amount of capital that it considers necessary to cover these risks within its Internal Capital Adequacy Assessment Process (ICAAP). The Bank's Pillar 2 requirements also reflect the capital required to support future growth.

5.2 Internal Capital Adequacy Assessment Process

On at least an annual basis, the Bank undertakes an Internal Capital Adequacy Assessment Process (ICAAP), which is an internal assessment of its capital requirements. This internal process is designed to take account of other risks not covered by the minimum capital requirement.

Included within the ICAAP are capital projections covering a 5-year time horizon, which reflect not only the Bank's chosen strategy and potential growth prospects, but also the results of stress testing this strategic plan. This process is designed to ensure that adequate capital is retained by the Bank to meet its current requirements, and to cover increases resulting from the Bank's proposed strategy and any additional risks that might entail.

The ICAAP is presented to the Board for challenge and approval with the most recent review being completed in March 2020. In addition to the ICAAP stress testing, enterprise-wide stress testing on capital, liquidity, operational risk and reverse stress testing is performed.

The ICAAP is assessed by the PRA and used to determine and set the Bank's Total Capital Requirement (TCR) and the PRA buffer, if required. The TCR was last recalibrated by Management and agreed with the PRA during the Bank's Supervisory Review and Evaluation Process (SREP) in 2020. The next review by the PRA is scheduled to take place in 2022.

The amounts and composition of the Bank's capital requirements are determined by assessing the relevant Basel Pillar 1 minimum capital requirement, the requirement for other risks not included in Pillar 1, and the impact of stress and scenario tests under Pillar 2.

At 30 September 2020, the Bank's TCR as a proportion of Risk Weighted Asset (RWA) equates to 14.40% of which 8.10% must be covered by CET1 capital. This reflects a point-in-time estimate by Management and the PRA, which may change over time. The Bank is not permitted by the PRA to provide any further details regarding the individual components in respect of its Pillar 2A assessment.

The Bank manages its capital above the minimum TCR threshold, including a capital buffer (further detail on which is included in Section 6), at all times.

5.3 Pillar 1 Capital Requirement

Exposure Class Summary

The table below sets out the Pillar 1 capital requirements by exposure class. The Pillar 1 requirement in respect of credit risk is based on 8% of the risk weighted exposure for each of the following standardised exposure classes. The Pillar 1 capital requirement is calculated as follows:

Credit risk capital required = Exposure value x Risk weighting x 8%

As at 30 September 2020	Exposure Value £m	RWAs £m	Pillar 1 Capital £m
Government and central banks	196.5	-	-
Multilateral development banks	17.4	-	-
Financial institutions	109.1	5.7	0.4
Covered bonds	33.3	3.3	0.3
Mortgages secured on residential/ commercial real estate	913.6	464.9	37.2
Items associated with particularly high risk	26.9	40.4	3.2
Exposures in default	7.5	7.5	0.6
Other items	119.2	133.5	10.7
Total credit risk	**1,423.5**	**655.3**	**52.4**
Operational risk – basic indicator approach	-	36.2	2.9
CVA – standardised approach	-	2.3	0.2
Total	**1,423.5**	**693.8**	**55.5**

As at 31 October 2019	Exposure Value £m	RWAs £m	Pillar 1 Capital £m
Government and central banks	343.7	-	-
Multilateral development banks	13.1	-	-
Financial institutions	91.2	3.7	0.3
Covered bonds	41.7	4.2	0.3
Mortgages secured on residential/ commercial real estate	733.4	431.9	34.5
Items associated with particularly high risk	36.8	55.2	4.4
Exposures in default	19.6	26.7	2.2
Other items	114.0	123.7	9.9
Total credit risk	**1,393.5**	**645.4**	**51.6**
Operational risk – basic indicator approach	-	34.0	2.7
CVA – standardised approach	-	2.5	0.2
Total	**1,393.5**	**681.9**	**54.5**

Credit valuation adjustment
The Bank holds additional capital in the form of the CVA to address the risk of loss as a result of a deterioration in the creditworthiness of counterparties to derivative transactions.

A breakdown of the exposure value by on and off-Balance Sheet exposures is shown in section 7.1.

Risk Type Breakdown
The following table shows the Bank's RWA's and Pillar 1 requirements by risk type.

Overview of RWA	30 September 2020	
	RWA £m	Pillar 1 £m
Credit risk (excluding counterparty risk)		
Standardised approach	627.3	50.2
Counterparty credit risk (CCR)		
Standardised approach	4.2	0.3
Credit valuation adjustment (CVA)		
Standardised approach	2.3	0.2
Operational risk		
Basic indicator approach	36.2	2.9
Amounts below thresholds for deduction (250% risk weight)		
Deferred tax asset	23.8	1.9
Total	**693.8**	**55.5**

Overview of RWA	31 October 2019	
	RWA £m	Pillar 1 £m
Credit risk (excluding counterparty risk)		
Standardised approach	626.8	50.1
Counterparty credit risk (CCR)		
Standardised approach	2.1	0.2
Credit valuation adjustment (CVA)		
Standardised approach	2.5	0.2
Operational risk		
Basic indicator approach	34.0	2.7
Amounts below thresholds for deduction (250% risk weight)		
Deferred tax asset	16.5	1.3
Total	**681.9**	**54.5**

Counterparty credit risk adjustment
The Bank holds additional capital in the form of the CCR adjustment to address the risk of loss as a result of the default of a counterparty to a derivative transaction before the final settlement of the cash flows.

5.4 Risk Weight Breakdown

The following table provides a summary of the risk weightings applied to the exposure value to calculate the RWA.

As at 30 September 2020 £m	Risk Weightings									Exposure Value
	0%	10%	20%	35%	50%	75%	100%	150%	250%	
Government and central banks	196.5	-	-	-	-	-	-	-	-	196.5
Multilateral development banks	17.4	-	-	-	-	-	-	-	-	17.4
Financial institutions	86.1	-	19.4	-	3.6	-	-	-	-	109.1
Covered bonds	-	33.3	-	-	-	-	-	-	-	33.3
Mortgages secured on residential/commercial real estate	-	-	-	690.2	-	0.1	223.3	-	-	913.6
Items associated with particularly high risk	-	-	-	-	-	-	-	26.9	-	26.9
Exposures in default	-	-	-	-	-	-	7.5	-	-	7.5
Other items	-	-	-	-	-	-	109.7	-	9.5	119.2
Total	**300.0**	**33.3**	**19.4**	**690.2**	**3.6**	**0.1**	**340.5**	**26.9**	**9.5**	**1,423.5**

As at 31 October 2019 £m	Risk Weightings									Exposure Value
	0%	10%	20%	35%	50%	75%	100%	150%	250%	
Government and central banks	343.7	-	-	-	-	-	-	-	-	343.7
Multilateral development banks	13.1	-	-	-	-	-	-	-	-	13.1
Financial institutions	79.5	-	7.2	-	4.5	-	-	-	-	91.2
Covered bonds	-	41.7	-	-	-	-	-	-	-	41.7
Mortgages secured on residential/commercial real estate	-	-	-	463.8	-	0.3	269.3	-	-	733.4
Items associated with particularly high risk	-	-	-	-	-	-	-	36.8	-	36.8
Exposures in default	-	-	-	-	-	-	5.6	14.0	-	19.6
Other items	-	-	-	-	-	-	107.4	-	6.6	114.0
Total	**436.3**	**41.7**	**7.2**	**463.8**	**4.5**	**0.3**	**382.3**	**50.8**	**6.6**	**1,393.5**

06 Regulatory Capital Buffers and IFRS 9 Transitional Adjustments

6. Regulatory Capital Buffers and IFRS 9 Transitional Adjustments

6.1 Buffers

In 2016, the CRR introduced regulatory capital buffers of which the following apply to the Bank:

Capital Conservation Buffer ("CCoB")
The CCoB is a buffer for all banks that can be used to absorb losses while avoiding breaching minimum capital requirements and is set at 2.5% of an institutions RWA's, the table below shows the Bank's CCoB requirement:

	30 September 2020	31 October 2019
Total RWA (£m)	693.8	681.9
Institution specific CCoB rate (%)	2.5	2.5
Institution specific CCoB requirement (£m)	**17.3**	**17.0**

Countercyclical Capital Buffer ("CCyB")
In March 2020 in response to the COVID-19 pandemic the FPC reduced the CCyB from 1% to 0% with immediate effect.

The table below shows from the CCyB requirement:

	30 September 2020	31 October 2019
Total RWA (£m)	693.8	681.9
Institution specific CCyB rate (%)	-	1.0
Institution specific CCyB requirement (£m)	**-**	**6.8**

The Bank allocates all non-UK exposures to the UK for the purposes of calculating the countercyclical buffer, due to the fact that the Bank has a non-material foreign exposure.

The table below demonstrates the geographical distribution of credit exposures relevant for the calculation of the CCyB requirement:

Exposures by Country		Exposure values £m	RWA £m	CCyB rate £m	CCyB amount £m
30 September 2020	UK	1,423.5	693.8	-	-
31 October 2019	UK	1,393.5	681.9	1.0	6.8

6.2 IFRS 9 Transitional Adjustment

Upon implementation of IFRS 9, the PRA advised that all financial institutions could make use of transitional adjustments to gradually introduce the capital impact of IFRS 9; the Bank elected to make use of these transitional adjustments.

As a result of the COVID-19 pandemic, additional transitional measures were introduced which results in different transitional allowances being applied for Stage 1 and 2 provisions raised before and after 1 January 2020. The following table provides a summary of the rates used in determining the IFRS 9 transitional adjustment which is treated as an addition in calculating the Bank's CET1 capital position.

Transitional CET1 Adjustment %	Provisions raised pre 1 January 2020	Provisions raised post 1 January 2020
Financial period ended 30 September 2020	85%	100%
Financial period ended 30 September 2021	70%	100%
Financial period ended 30 September 2022	50%	100%
Financial period ended 30 September 2023	25%	75%
Financial period ended 30 September 2024	-	50%
Financial period ended 30 September 2025	-	25%

The following tables provides a summary of the Bank's key regulatory metrics both with and without the transitional relief being applied:

	30 September 2020	
	With Transitional Relief	Without Transitional Relief
Common Equity Tier 1 Capital (£m)	136.4	133.7
Common Equity Tier 1 ratio (%)	19.7	19.3
Basel III leverage ratio (%)	9.6	9.4

	31 October 2019	
	With Transitional Relief	Without Transitional Relief
Common Equity Tier 1 Capital (£m)	156.6	154.2
Common Equity Tier 1 ratio (%)	23.0	22.6
Basel III leverage ratio (%)	11.2	11.1

As demonstrated in the table above, the Bank can meet all regulatory requirements both with and without the application of the transitional reliefs available.

07 Credit Risk

7. Credit Risk

Credit risk is the risk that a counterparty will be unable or unwilling to meet a commitment that it has entered into with the Bank. The Bank follows the Standardised Approach in relation to credit risk.

7.1 Summary of the Bank's Credit Risk Exposures

The exposures are summarised as follows at 30 September 2020:

£m	Gross Exposures (Pre CCF)		Gross Exposures (Post CCF)		ECL Provision	Total Exposure	RWA	RWA Density
	On-Balance Sheet	Off-Balance Sheet	On-Balance Sheet	Off-Balance Sheet				
Government and central banks	196.5	-	196.5	-	-	196.5	-	0.0%
Multilateral development banks	17.4	-	17.4	-	-	17.4	-	0.0%
Financial institutions	109.1	-	109.1	-	-	109.1	5.7	0.9%
Covered bonds	33.3	-	33.3	-	-	33.3	3.3	0.5%
Mortgages on residential/ commercial real estate	898.4	56.7	898.4	15.7	(0.5)	913.6	464.9	70.9%
Items associated with particularly high risk	30.1	-	30.1	-	(3.2)	26.9	40.4	6.2%
Exposures in default	9.0	-	9.0	-	(1.5)	7.5	7.5	1.1%
Other items (1)	119.2	-	119.2	-	-	119.2	133.5	20.4%
Total	**1,413.0**	**56.7**	**1,413.0**	**15.7**	**(5.2)**	**1,423.5**	**655.3**	**100.0%**

The exposures are summarised as follows at 31 October 2019:

£m	Gross Exposures (Pre CCF)		Gross Exposures (Post CCF)		ECL Provision	Total Exposure	RWA	RWA Density
	On-Balance Sheet	Off-Balance Sheet	On-Balance Sheet	Off-Balance Sheet				
Government and central banks	343.7	-	343.7	-	-	343.7	-	0.0%
Multilateral development banks	13.1	-	13.1	-	-	13.1	-	0.0%
Financial institutions	91.2	-	91.2	-	-	91.2	3.7	0.6%
Covered bonds	41.7	-	41.7	-	-	41.7	4.2	0.6%
Mortgages on residential/ commercial real estate	713.9	71.0	713.9	19.6	(0.1)	733.4	431.9	66.9%
Items associated with particularly high risk	36.9	-	36.9	-	(0.1)	36.8	55.2	8.6%
Exposures in default	27.0	-	27.0	-	(7.4)	19.6	26.7	4.1%
Other items (1)	114.0	-	114.0	-	-	114.0	123.7	19.2%
Total	**1,381.5**	**71.0**	**1,381.5**	**19.6**	**(7.6)**	**1,393.5**	**645.4**	**100.0%**

(1) The 'Other items' include items such as reversionary interests in properties, deferred tax assets, fixed assets and other debtors.

7.2 Credit Risk by Geographic Distribution

The geographic distribution of these exposures as at 30 September 2020 is shown below:

£m	UK	Europe	USA	Total
Government and central banks	196.5	-	-	196.5
Multilateral development banks	11.4	6.0	-	17.4
Financial institutions	107.0	2.1	-	109.1
Covered bonds	29.0	4.3	-	33.3
Mortgages secured on residential/ commercial real estate	913.6	-	-	913.6
Items associated with particularly high risk	26.9	-	-	26.9
Exposures in default	7.5	-	-	7.5
Other items	119.2	-	-	119.2
Total	**1,411.1**	**12.4**	**-**	**1,423.5**

The geographic distribution of these exposures as at 31 October 2019 is shown below:

£m	UK	Europe	USA	Total
Government and central banks	340.7	3.0	-	343.7
Multilateral development banks	-	13.1	-	13.1
Financial institutions	88.1	1.9	1.2	91.2
Covered bonds	37.4	4.3	-	41.7
Mortgages secured on residential/ commercial real estate	733.4	-	-	733.4
Items associated with particularly high risk	36.8	-	-	36.8
Exposures in default	19.6	-	-	19.6
Other items	114.0	-	-	114.0
Total	**1,370.0**	**22.3**	**1.2**	**1,393.5**

7.3 Credit Risk by Residual Maturity

The residual maturity of the exposures as at 30 September 2020 is shown below:

£m	Within 1 year	After 1 year but within 5 years	More than 5 years	No Contractual Maturity	Total
Government and central banks	166.0	-	30.5	-	196.5
Multilateral development banks	4.2	10.2	3.0	-	17.4
Financial institutions	109.1	-	-	-	109.1
Covered bonds	4.0	27.0	2.3	-	33.3
Mortgages on residential/ commercial real estate	259.5	274.3	379.8	-	913.6
Items associated with particularly high risk	20.4	4.2	2.3	-	26.9
Exposures in default	7.5	-	-	-	7.5
Other items	-	-	-	119.2	119.2
Total	**570.7**	**315.7**	**417.9**	**119.2**	**1,423.5**

The residual maturity of the exposures as at 31 October 2019 is shown below:

£m	Within 1 year	After 1 year but within 5 years	More than 5 years	No Contractual Maturity	Total
Government and central banks	329.9	6.1	7.7	-	343.7
Multilateral development banks	-	10.2	2.9	-	13.1
Financial institutions	85.6	5.6	-	-	91.2
Covered bonds	4.5	30.5	6.7	-	41.7
Mortgages on residential/ commercial real estate	79.3	215.4	438.7	-	733.4
Items associated with particularly high risk	27.9	5.7	3.2	-	36.8
Exposures in default	19.6	-	-	-	19.6
Other items	-	-	-	114.0	114.0
Total	**546.8**	**273.5**	**459.2**	**114.0**	**1,393.5**

Residual maturity has been defined as the contractual maturity of the loan. In the case of equity release, retirement and 50+ RIO mortgages, the contractual maturity is determined based on the life expectancy of the customers. Reversionary interests in property are classified within other items.

7.4 Commercial Lending Credit Risk Secured on Real Estate Property

The nature of the Bank's commercial lending business is that, in some cases, a defined repayment plan is not in place. This is because, for loans made for the purposes of the construction or refurbishment of a property, the repayment of the loan is made from the sale proceeds of that asset, and the timing of these sales cannot be forecast precisely.

The principal mechanism by which the Bank is alerted to potential problem accounts is a common risk rating system. The system is designed to link directly to procedures for identifying, sanctioning and management of deteriorating risk positions and is aligned to the IFRS 9 risk staging criteria. A defined set of criteria has been approved by the Board to determine the risk grade of a loan.

The risk rating system is used to demonstrably review and re-classify the risk characteristics of an exposure at least annually through the annual facility review process, or more frequently if relevant new information comes to light. The system also facilitates regular and consistent oversight by the Commercial Credit Risk Committee as movements in individual account level ratings and weighted portfolio risk position are reviewed and challenged quarterly by this forum.

Where exposures enter the highest risk grade, a recovery strategy is approved by the Commercial Credit Risk Committee. The strategy is unique to each account, and is based on the nature of the project, the stage of completion and current market demand.

7.5 Credit Risk on Mortgages Secured on Residential Property

Borrowers are not required to make any repayments on roll-up equity release mortgages as the full amount of the debt is repaid either when the borrower dies or moves into long term care, at which point the property is sold. Borrowers are, however, required to make interest payments in respect of the retirement, holiday buy-to-let, portfolio buy-to-let, 50+ and 50+ RIO mortgages.

The Bank's credit risk for roll-up equity release mortgages and the capital element of the retirement, holiday buy-to-let, portfolio buy-to-let, 50+ and 50+ RIO mortgages, crystallises at the point of maturity. A loss would be incurred if the value of the property is lower than the value of the debt. By virtue of the 'no negative equity' guarantee offered to borrowers of roll-up equity release and retirement mortgage, the Bank is not able to recover any shortfall from the client's estate for these products.

Credit risk also arises with respect to the regular payment of interest amounts for the interest-only retirement, holiday buy-to-let, portfolio buy-to-let, 50+ and 50+ RIO mortgages.

The maximum amount that the Bank will lend to borrowers of roll-up equity release mortgages is age-related. For borrowers of the retirement, holiday buy-to-let, portfolio buy-to-let, 50+ and 50+ RIO mortgages, the maximum amount the Bank will lend is linked to the customers' ability to service the loan requested, for the buy-to-let loans this will be dependent on the expected performance of the property's rental potential in conjunction with other measures such as credit score. These measures minimise the extent to which the Bank is exposed to a risk of loss.

The Retail Credit Risk Committee monitors the potential exposure that arises from property risk by tracking house price indices and comparing the performance of its own property portfolio against these indices.

7.6 Non-performing loans and impairment

The Bank monitors credit risk by regularly reviewing loans and advances to customers for impairment. IFRS 9 stipulates that the impairment of loans and advances to customers is calculated using a forward-looking Expected Credit Loss (ECL) model. Loans are categorised in accordance with IFRS 9 as Stage 1, Stage 2, or Stage 3:

- **Stage 1:** when a financial asset is first recognised it is assigned to Stage 1. If there is no significant increase in credit risk from initial recognition the financial asset remains in Stage 1. Stage 1 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 2. For financial assets in Stage 1, a 12-month ECL is recognised.
- **Stage 2:** when a financial asset demonstrates a significant increase in credit risk from initial recognition it is moved to Stage 2. Stage 2 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 3. For financial assets in Stage 2, a lifetime ECL is recognised.
- **Stage 3:** when there is objective evidence of impairment and the financial asset is considered to be in default, or otherwise credit impaired, it is moved to Stage 3. For financial assets in Stage 3, a lifetime ECL is recognised.

For more information regarding the Bank's IFRS 9 policy and methodology for calculating ECL provisions please review the Financial Statements for the 11-month period ended 30 September 2020.

7.7 Impairment Provisions on Loans and Advances to Customers

The table below summarises the bad debt provisions held against financial assets classified at Amortised Cost and held on the Bank's Balance Sheet by stage classification at 30 September 2020:

£m	Commercial	Portfolio Buy-to-Let	Residential
Stage 1	235.7	63.7	340.4
Stage 2	49.5	-	4.6
Stage 3	14.7	-	0.6
Gross Loans and Advances	**299.9**	**63.7**	**345.6**
Stage 1	(1.1)	(0.4)	(0.1)
Stage 2	(1.7)	-	(0.0)
Stage 3	(4.6)	-	(0.0)
Loss allowance	**(7.4)**	**(0.4)**	**(0.1)**
Loan fee deferral	(2.0)	(0.2)	1.5
Loans and advances to customers	**290.5**	**63.1**	**347.0**

The stage classification at 31 October 2019 is shown below:

£m	Commercial	Portfolio Buy-to-Let	Residential
Stage 1	286.7	21.3	176.6
Stage 2	14.3	-	1.9
Stage 3	25.7	-	-
Gross Loans and Advances	**326.7**	**21.3**	**178.5**
Stage 1	(2.1)	(0.3)	(0.0)
Stage 2	(0.1)	-	(0.1)
Stage 3	(7.3)	-	-
Loss allowance	**(9.5)**	**(0.3)**	**(0.1)**
Loan fee deferral	(2.0)	(0.1)	0.4
Loans and advances to customers	**315.2**	**20.9**	**178.8**

7.8 Reversionary Interests in Property

Reversionary interests in property are included in the financial statements within investment properties. They are initially recognised at cost, being the amount of cash advanced to the customer, plus any associated costs, and subsequently fair value. The property will be sold when the customer dies or moves into long term care. Credit risk arises as a result of property price risk where the Bank could suffer losses if the value of the property falls below the carrying value of the loan at redemption, mitigation of this risk is discussed in section 7.10 below.

Other risks associated with the reversionary interest in properties include prepayment and mortality risk, the Bank could suffer a loss of interest income if the customer either dies or prepays earlier than expected. The Bank undertakes periodic actuarial investigations of actual mortality and morbidity experience compared with that assumed within its pricing assumptions. The findings from these investigations are fed back into credit risk analysis.

7.9 Treasury Credit Risk

The treasury portfolio contains a mix of debt securities issued by sovereign states, highly rated banks and cash deposits. The treasury portfolio also comprises of sterling deposits placed with or received from counterparties as collateral supporting the Bank's derivative portfolio.

All the Bank's exposures within the treasury asset portfolio are rated by major credit rating agencies. The Bank uses these ratings in line with the CRR to calculate the capital requirements determined by the credit rating, counterparty and asset class of each of the assets.

The table below provides a summary of the External Credit Assessment Institution ratings mapped to credit quality steps:

Credit Quality Step	Moody's rating	Fitch's rating	S&P's rating
1	Aaa to Aa3	AAA to AA-	AAA to AA-
2	A1 to A3	A+ to A-	A+ to A-
3	Baa1 to Baa3	BBB+ to BBB-	BBB+ to BBB-
4	Ba1 to Ba3	BB+ to BB-	BB+ to BB-
5	B1 to B3	B+ to B-	B+ to B-
6	Caa1 and below	CCC+ and below	CCC+ and below

The Bank's exposures at 30 September 2020, analysed by credit rating, are summarised in the tables below:

Central governments or central banks

Rating – S&P / Fitch	30 September 2020	31 October 2019
AAA to AA-	196.5	343.7
Total	**196.5**	**343.7**

Multilateral development banks

Rating	30 September 2020	31 October 2019
AAA to AA-	17.4	13.1
Total	**17.4**	**13.1**

Financial Institutions

Rating – S&P / Fitch	30 September 2020	31 October 2019
AAA to AA-	86.1	79.5
A+ to A-	23.0	11.7
Total	**109.1**	**91.2**

Covered bonds

Rating	30 September 2020	31 October 2019
AAA to AA-	33.3	41.7
Total	**33.3**	**41.7**

Derivatives and Collateral
The Bank uses financial derivatives to manage interest rate risk. All derivatives are governed by appropriate legal documentation known as Master Agreements and are supported by a Credit Support Annex.

It is the Bank's policy to enter into netting agreements and margining agreements with all counterparties. In general, under master netting agreements the amounts owed to each counterparty on a single day are aggregated into a single net amount to be payable by one counterparty to another. This process is performed daily and for some derivatives intraday.

Cash collateral is pledged against the Bank's derivative liabilities to the underlying counterparties to reduce their exposure to the Bank. The Bank places cash collateral with its derivative counterparties in the event of a negative mark-to-market valuation. A Credit Support Annex ('CSA') agreement is in place which provides a two-way legal agreement allowing a legal right of set off between any derivative (liability or asset) and collateral (liability or asset).The exposure is considered to be any collateral held by the counterparty in excess of the derivative liability due to the timing of payments and receipts.

Collateral posted is measured against counterparty mark-to-market values which is assessed for reasonableness against the Bank's internal valuation of its derivative exposures.

The risk of a default from a derivative counterparty is minimised as all derivative exposures are covered by a CSA whereby, in the event of a positive mark-to-market valuation, the counterparty must post cash collateral to the Bank.

The following table shows the exposure to counterparty credit risk for derivative contracts as at 30 September 2020 and 31 October 2019:

£m	30 September 2020	31 October 2019
Negative fair value (inclusive of potential future exposure)	(81.8)	(80.4)
Add: cash collateral held by financial institutions	86.1	79.5
Net derivative exposure	**4.3**	**(0.9)**

The Bank holds additional capital in the form of the CVA and CCR adjustment to protect against either the risk of the deterioration in the creditworthiness or default of counterparties. These are applicable to derivatives which are not centrally cleared through a central clearing counterparty.

7.10 Credit Risk Mitigation

For treasury credit risk, ALCo is responsible for the review and management of the Bank's cash portfolio and must approve all counterparties in advance (based on their credit rating and ALCo's own assessment of future prospects). The Bank's treasury credit risk policy sets exposure limits for each approved counterparty and this is reviewed regularly in light of market developments.

For both commercial lending and residential mortgages, the Bank takes security in the form of legal charges over the property against which funds are advanced. This is the primary method used by the Bank to mitigate credit risk.

For commercial lending, each security is valued at inception by a RICS-qualified surveyor. Further valuations are also requested by the Bank if evidence comes to light that the security may have become impaired, or where the value of the security has been enhanced as a result of development activity. Additionally, there is a rolling review programme whereby valuations are updated on a regular cycle. In isolated cases, the Bank may also hold cash collateral in relation to certain commercial lending schemes, with the collateral used as security against any residual liabilities associated with a development scheme.

Properties secured against residential mortgages and reversionary interests in properties are also valued at inception of the loan by a RICS-qualified surveyor. Further inspections take place depending upon the inherent risk of the case to ensure that the Bank's security is maintained in an adequate state of repair. The Bank does not use derivatives or other financial instruments (for example insurance) as a means of mitigating credit risk.

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Interest Rate Risk in the Banking Book

8. Interest Rate Risk in the Banking Book

Interest rate risk is the risk that arises when there is a mismatch between the maturity dates of interest rate sensitive assets, liabilities and off-Balance Sheet items. This risk is managed through the appropriate use of financial instruments, mainly derivatives within the established risk limits set by the Board.

Derivatives are only used to limit the extent to which the Bank will be affected by changes in interest rates or other indices which affect the fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Bank are interest rate exchange contracts, commonly known as interest rate swaps. The Bank's forecasts and plans take account of the risk in interest rate changes and are prepared and stressed accordingly.

Basis Risk
Basis risk is the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics. An example is the relationship between London Interbank Offered Rate (LIBOR) and the Bank of England Base Rate (Bank Rate). This is monitored closely and regularly reported to ALCo. The Bank's policy is to maintain basis risk at a controlled level within limits set by the Board.

With regards to the industry and regulatory transition away from LIBOR to alternative benchmark rates by the end of 2021, the Bank is progressing with its plans to manage this transition and is engaged with regulators and the Bank of England's Working Group on Sterling Risk Free Reference Rates.

Interest Rate Sensitivity Gap
Interest rate risk exposures are measured monthly and reported to ALCo and the Board. The net present value sensitivity of the interest rate risk exposures for each of the supervisory prescribed interest rate shock scenarios are as follows:

£m	EVE	
	30 September 2020	31 October 2019
+200 basis points increase	(2.8)	2.0
-200 basis points decrease (floored at zero)	0.0	(0.6)
Steepener (Short term rates down and long-term rates up)	(5.0)	(1.5)
Flattener (Short term rates up and long-term rates down)	3.6	(1.3)
Short rate up	3.1	(0.2)
Short rate down	(0.8)	(0.2)
Maximum	(5.0)	(1.5)

The movement in sensitivity of the Bank's Balance Sheet to interest rate movements has been caused by changes to the interest rate environment and changes to the Bank's Balance Sheet.

In addition, the effect of a 100-basis point shift in the yield curve is applied to the Balance Sheet at the period-end, to determine how the net interest income may change on an annualised basis for one year, as follows:

£m	NII	
	30 September 2020	31 October 2019
+100 basis points increase	4.3	0.7
-100 basis points decrease (floored at zero)	(0.1)	(1.8)

The movement in sensitivity of the Bank's Balance Sheet to interest rate movements has been caused by changes to the interest rate environment and changes to the Bank's Balance Sheet.

In preparing the sensitivities above, the Bank makes certain assumptions regarding the expected and contractual re-pricing behaviour as well as behavioural repayment profiles, under the stress scenarios, of the underlying Balance Sheet items. The results also include the impact of derivative transactions.

09 Leverage Ratio

9. Leverage Ratio

The leverage ratio is a non-risk-based measure that supplements the risk-based capital requirements. It is calculated as Tier 1 capital divided by an adjusted Balance Sheet exposure. The ratio does not distinguish between the credit quality of loans and acts as a primary constraint to excessive lending in proportion to the capital base. Under European regulation the minimum leverage ratio is 3%.

The PRA's UK leverage ratio framework, which has not been reflected in European regulation, allows institutions within its scope to exclude Bank of England assets from their leverage calculations; however, as a result the PRA expects the minimum ratio to be 3.25%. A Counter-Cyclical Leverage Ratio Buffer (CCLB) applies under these regulations; institutions are required to hold 35% of their firm CCyB as a CCLB.

The Bank is not within scope of the UK leverage framework as retail deposits do not exceed £50bn; however, the Bank's ratio of 10.7% is well above the minimum requirements.

The Bank manages leverage in its balance sheet within the established risk limits set by the Board. This is monitored and reported regularly to ALCo.

The table below provides a summary comparison of accounting assets against leverage ratio exposure:

£m	30 September 2020	31 October 2019
Total assets as per published financial statements	**1,409.2**	**1,378.7**
Adjustment for derivative financial instruments	2.8	4.2
Adjustment for off-Balance Sheet items (conversion to credit equivalent amounts of off-Balance Sheet exposures)	15.7	19.6
Other adjustments	(4.2)	(9.3)
Total leverage exposure	**1,423.5**	**1,393.2**

The following table provides a summary of the leverage ratio:

£m	30 September 2020	31 October 2019
Total assets as per published financial statements	**1,409.2**	**1,378.7**
Asset amounts deducted in determining Tier 1 Capital	(4.2)	(9.3)
Total on-Balance Sheet exposures	**1,405.0**	**1,369.4**
Derivative exposures		
Replacement cost associated with all derivative transactions (i.e. net of eligible cash variation margin)	2.8	4.2
Total derivative exposures	**2.8**	**4.2**
Other off-Balance Sheet exposures		
Off-Balance Sheet exposures at gross notional amount	86.1	179.7
Adjustment for conversion to credit equivalent amounts	(70.4)	(160.1)
Total other off-Balance Sheet exposures	**15.7**	**19.6**
Capital and total exposures		
Tier 1 capital	**136.4**	**156.6**
Total leverage ratio exposure	**1,423.5**	**1,393.2**
Basel III leverage ratio	**9.6%**	**11.2%**
UK Leverage Ratio Framework (1)	**10.7%**	**14.6%**

(1) The UK position shows the Leverage ratio with £147.9m of Bank of England assets (2019: £321.9m) excluded from the Leverage Exposure measure as per the UK leverage ratio framework.

The table below provides a breakdown of on balance sheet exposures that are included in the leverage ratio exposure:

£m	30 September 2020	31 October 2019
Total assets as per published financial statements	**1,409.2**	**1,378.7**
Asset amounts deducted in determining Tier 1 Capital	(4.2)	(9.3)
Total on-Balance Sheet exposures	**1,405.0**	**1,369.4**
Of which:		
Government and central banks	196.5	343.7
Multi-lateral development banks	17.4	13.1
Financial institutions	106.3	87.1
Covered bonds	33.3	41.7
Mortgages on residential/commercial real estate	897.9	713.4
Items associated with particularly high risk	26.9	36.8
Exposures in default	7.5	19.6
Other items	119.2	114.0
Total	**1,405.0**	**1,369.4**

10 Liquidity Metrics

10. Liquidity Metrics

10.1 Liquidity Coverage Ratio

The Liquidity Coverage Ratio (LCR) refers to the amount of highly liquid assets a firm must hold to meet liquidity outflows during a 30-calendar day stress event. The aim of the LCR is to ensure that the Bank can survive a 30-calendar day stress event by identifying the quantum of unencumbered, high quality liquid assets held to offset the net cash outflows the Bank could encounter in this stress event.

Approach to management of high-quality liquid assets
The Bank maintains a portfolio of unencumbered high-quality liquid assets (HQLA) meeting the eligibility criteria specified by the LCR regulations. Assets pledged as collateral for secured funding transactions or derivative credit risk mitigation purposes are specifically excluded from the Bank's HQLA portfolio.

The Treasury Credit Risk Management Policy contains a series of risk limits intended to limit exposures to individual counterparties and classes of assets, thereby ensuring diversification of risk to minimise credit or concentration risks.

The Bank maintains lines with counterparty banks providing the ability to monetise liquid assets through secured funding transactions. In addition, the Bank has access to the Bank of England Discount Window Facility, allowing monetising of eligible assets held in collateral pools. Assets held are tested through repurchase agreements on at least an annual basis.

The major portion of cash resources are held in the Bank's Bank of England reserve account. Other, smaller, balances are held with relationship banks. Exposures to individual counterparties (excluding the Bank of England) are limited as per the Liquidity Risk Management Policy to avoid excessive deposits held with any one firm.

Liquidity outflows
Outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities mainly savings accounts and off-Balance Sheet commitments by the rates at which they are expected to run off or be drawn down as indicated by the regulations.

Liquidity inflows
Inflows are assessed over a 30-calendar day period and comprise contractual inflows from exposures that are not past due.

Liquidity Coverage Ratio £m	30 September 2020	
	Total unweighted value	Total weighted value
High-quality liquid assets		
Total HQLA		196.4
Cash outflows		
Retail deposits and deposits from small business customers, of which:		
Stable deposits	254.2	12.7
Less stable deposits	109.2	16.8
Unsecured wholesale funding, of which:		
Non-operational deposits	31.2	8.5
Additional requirements, of which:		
Outflows related to derivative exposures and other collateral requirements	20.2	20.2
Other contractual funding obligations	**56.7**	**19.3**
Total cash outflows		**77.5**
Cash inflows		
Other cash inflows	5.6	5.6
Total cash inflows		**5.6**
Total HQLA		**196.4**
Total net cash outflows		**71.9**
Liquidity Coverage Ratio (%)		**272.9%**

10.2 Net Stable Funding Ratio

The Bank's Net Stable Funding Ratio (NSFR) aims to promote resilience over a longer time horizon by creating incentives for banks to fund their activities with more stable sources of funding on an ongoing basis. Based on current interpretations of regulatory requirements and guidance, the NSFR as at 30 September 2020 is 154.6%. This is in excess of the minimum level of 100% proposed by the Basel Committee on Banking Supervision and European Commission.

11 Asset Encumbrance

11. Asset Encumbrance

Asset encumbrance is the process by which assets are pledged to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn. The table below shows the split of the Bank's encumbered and unencumbered assets at 30 September 2020:

30 September 2020 £m	Carrying amount encumbered assets	Carrying amount unencumbered assets
Government bonds	14.6	34.0
Debt securities	32.8	17.9
Loans and advances to credit institutions	86.1	166.7
Loans and advances to customers	68.6	863.3
Other assets	-	125.2
Total	**202.1**	**1,207.1**

The breakdown at 31 October 2019 is:

31 October 2019 £m	Carrying amount encumbered assets	Carrying amount unencumbered assets
Government bonds	13.3	11.8
Debt securities	37.7	75.4
Loans and advances to credit institutions	79.5	6.6
Loans and advances to customers	57.9	709.0
Other assets	-	387.5
Total	**188.4**	**1,190.3**

Information on the importance of encumbrance
The Bank encumbers assets by positioning loans and HQLA's as collateral to support access to the Bank of England's Term Funding Scheme (both TFS & TFSME) and in relation to derivative transactions.

The increase in encumbered assets during the period is related to the introduction of the TFSME scheme during the year.

The table below shows the encumbered assets and the value of the matching liabilities at 30 September 2020:

Carrying Amount £m	30 September 2020	31 October 2019
Encumbered Assets	202.1	188.4
Matching Liabilities	169.7	149.3

12 Remuneration

12. Remuneration

As a Bank with less than £15bn of assets, the Bank is classified as a "Tier 3" firm for the purposes of the disclosure of remuneration under the Capital Requirements Regulations (CRR). In compliance with the requirements, the Bank has taken note of the regulator's guidance on materiality and proportionality.

The remuneration policy of the Bank is managed by the Remuneration Committee. All members of the Remuneration Committee are non-executive.

The function of the Remuneration Committee is to consider remuneration policy and specifically to determine the remuneration and other terms of service of executive directors and senior managers. The executive directors decide fees payable to non-executive directors.

The policy provides a framework to attract, retain and motivate employees to achieve the objectives of the Bank within its risk appetite and risk management framework. Remuneration may comprise of base salary, overtime (for certain employees), variable remuneration and car allowance (for senior employees). Benefits may include holiday allowance, company car (for sales roles only), pension scheme, life assurance, private medical insurance and permanent health insurance.

Fixed Remuneration
Base salary is designed to align to the value an individual provides to the Bank, including the skills and competencies required and the contribution to the Bank, in the context of the external market for staff. This is achieved through a job assessment system based on internal and external benchmarking and job descriptions which consider the knowledge and skills required for the role, the level of thinking and problem solving involved and the degree of accountability or decision making required. A pay review takes place annually and is approved by the Committee. Non-executive directors are only entitled to fees, which are set by executive directors.

The Bank does not offer share options or shares and, as a matter of principle, does not enter into supplementary arrangements, unless exceptional circumstances dictate.

The Remuneration Committee approves all retention payments which are not contractual.

Variable Remuneration
Variable remuneration awards are non-contractual discretionary benefits based on company and individual performance. Both short and long-term incentives are in place.

The Remuneration Committee may, at its discretion, award bonuses to individuals/categories of employees, without reference to specific qualifying financial criteria, if it feels that performance warrants a bonus.

Annual Reward Plan (ARP)	In line with the Bank's Reward Strategy, the Bank's employees deserve to be rewarded and recognised fairly, responsibly and competitively in return for their contribution to the Bank's success. The ARP is a non-contractual performance-based remuneration plan designed to reward achievement of both financial and non-financial objectives. The ARP that will recognise and pay out against performance with a value of anything from 0% to 12%, with the same reward allocated to all employees (subject to the scheme rules). The % awarded is determined by the Remuneration Committee after consideration of gateway conditions and a balanced scorecard. A broad range of performance themes feature, including risk management, customer experience, profitability and the successful implementation of the Bank's transformation initiatives.
Executive Reward Plan (ERP)	We intend to introduce a non-contractual reward scheme for a group of our strategic leaders that will recognise long-term performance over a three-year period to 30 September 2023. This reviews performance against the delivery of the plan in September 2023 with deferred payments built in and complete remuneration committee discretion for any vested payments. A broad range of performance themes feature, similar to those outlined in the ARP section above, but with a longer-term focus. The purpose of the ERP is to align the interests of senior employees with the long-term interests of the Bank. The Board has a strategy to achieve strong yet sustainable growth. It also recognises that the achievement of that strategy is heavily dependent on senior employees within the Bank and rewards them for the part they play in achieving that strategy. Whilst senior employees may have specific business unit responsibilities, the Board wishes to foster a "single entity" culture, such that overall performance of the combined entity is the driving factor. It believes that the provision of an ERP scheme achieves this aim.

The Code and European regulatory technical standards require the Bank to identify Material Risk Takers (MRTs), being those staff, whose activities have a material impact on the firm's risk profile.

The Board has determined that, as at 30 September 2020, in addition to the two executive directors, 27 (2019: 28) other members of staff, including those in control functions, are designated as being MRTs. Remuneration for the period ended 30 September 2020 for the staff subject to the remuneration code was:

£m	30 September 2020	31 October 2019
Fixed	2.8	2.7
Variable	-	0.4
Total remuneration	**2.8**	**3.1**

There was 3 special payments, for a combined value of £0.1m, made to MRTs during the period ended 30 September 2020. No special payments were made for the year ended 31 October 2019.

Appendix 1: Main sources of differences between regulatory exposure amounts and carrying amounts in the Financial Statements

£m	Financial Statements	Regulatory Exposure	30 September 2020 Credit Risk Framework	Counterparty Risk Framework	Market Risk Framework
Assets					
Cash balances held at central banks	147.9	147.9	147.9	-	-
Treasury bills	48.6	48.6	48.6	-	-
Debt securities	50.7	50.7	50.7	-	-
Advances to credit institutions	105.2	105.2	105.2	-	-
Loans and advances to customers	930.8	948.0	948.0	-	-
Intangible assets (1)	7.3	-	-	-	-
Property, plant & equipment	1.9	1.9	1.9	-	-
Investment properties	97.4	97.4	97.4	-	-
Deferred tax assets	9.5	9.5	9.5	-	-
Derivative financial instruments (2)	-	2.8	-	2.8	-
Other assets	9.9	11.5	11.5	-	-
Total assets	**1,409.2**	**1,423.5**	**1,420.7**	**2.8**	**-**
Liabilities					
Deposit from banks	87.5	-	-	-	-
Deposits from customers	1,071.4	-	-	-	-
Derivative financial instruments	82.0	-	-	-	-
Other liabilities	6.3	-	-	-	-
Accruals and deferred income	-	-	-	-	-
Other provisions	-	-	-	-	-
Pension liabilities	21.0	-	-	-	-
Total liabilities	**1,268.2**	**-**	**-**	**-**	**-**
Share capital and reserves					
Called-up share capital	105.0	-	-	-	-
Other Reserves	36.0	-	-	-	-
Total equity	**141.0**	**-**	**-**	**-**	**-**
Total equity and liabilities	**1,409.2**	**-**	**-**	**-**	**-**

(1) The intangible asset has an exposure value of £nil from a regulatory perspective. The Bank deducts the intangible asset in calculating the Bank's Common Equity Tier 1 capital, as set out in CRDIV.
(2) The derivative regulatory adjustment relates to the CCR adjustment which is made to address the risk of loss as a result of a default of a counterparty before the final settlement of the cash flows.

Appendix 2: Glossary of terms used

ALCo	Assets and Liabilities Committee
ARP	Annual Reward Plan
CCR	Counterparty Credit Risk
CCoB	Capital Conservation Buffer
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1
CRDIV	Capital Requirements Directive and Regulation
CRR	Capital Requirements Regulation
CVA	Credit Valuation Adjustment
EBA	European Banking Authority
FPC	Financial Policy Committee
FRS 101	Financial Reporting Standard 101 Reduced Disclosure Framework
HQLA	High Quality Liquid Assets
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
IRB	Internal Ratings Basis
LCR	Liquidity Coverage Ratio
LIBOR	London Interbank Offered Rate
ERP	Executive Reward Plan
MRT	Material Risk Taker
NSFR	Net Stable Funding Ratio
PRA	Prudential Regulation Authority
RICS	Royal Institution of Chartered Surveyors
RWA	Risk Weighted Asset
SREP	Supervisory Review and Evaluation Process
TFS	Term Funding Scheme

HODGE

Registered Office

One Central Square
Cardiff
CF10 1FS