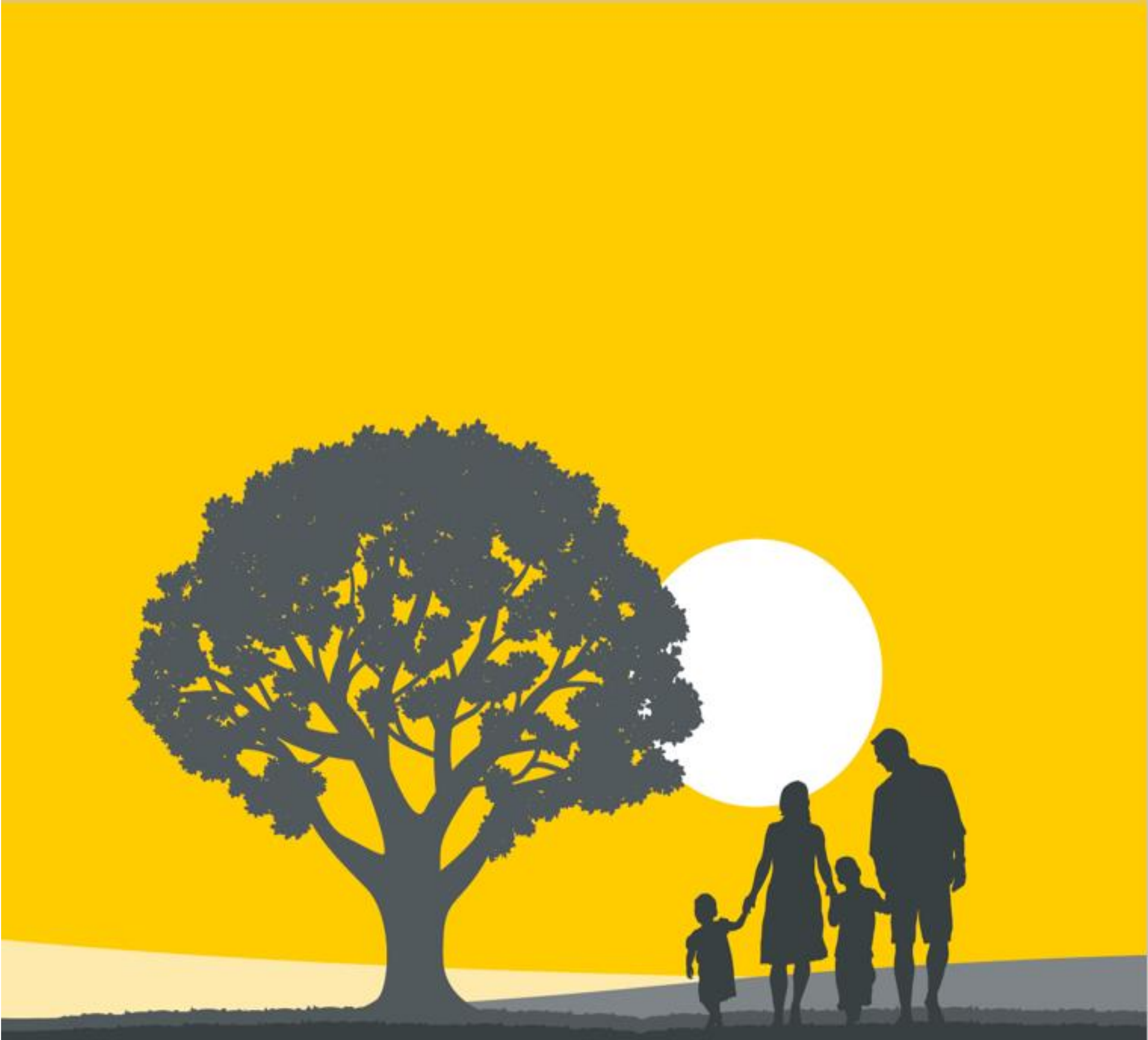


HODGE

BANK

Pillar 3 Disclosures

Year ended 31 October 2019

Our Mission

We make life better for our customers, colleagues and communities by providing specialist residential lending, commercial and savings solutions in a manner that is fair, friendly and personal.

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 current strategy is based on a continuing involvement in (a) residential and lifetime mortgages through its later life lending and buy-to-let activities, both of which it believes will enable it to achieve its strategic objectives (b) commercial property, primarily through the Bank's commercial lending business.

Our Business

We are a privately-owned bank that provides specialist mortgages including buy-to-let, later-life lending and commercial products.

Specialist mortgages

Hodge'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 portfolio buy-to-let mortgages, and personal customers through our later-life mortgages.

Buy-to-let

During the year we launched our portfolio buy-to-let mortgage, aimed at those portfolio landlords who want a single lender relationship, flexibility to move properties in and out of their portfolio and the ability to grow.

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. Over the past two years we have developed our later life lending proposition through the addition of our Retirement Mortgage (a hybrid lifetime mortgage) and 55+ Mortgage (a standard residential mortgage) to our product range.

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, serially-active 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 the Bank of England's Term Funding Scheme ('TFS'), which provides a cost-effective source of funding in the form of central bank reserves to support additional lending to the real economy.

Contents

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 2019 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. Portfolio buy-to-let mortgages are aimed at 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 document has been prepared in accordance with the Capital Requirements Directive and the Capital Requirements Regulations (CRR) which is the legislative package for implementing the Basel III framework within the EU. This came in to effect from 1 January 2014 and was enforced in the UK, together with local implementing rules and guidance, by the Prudential Regulatory Authority ("PRA").

CRDIV 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.

All numerical disclosures within this document have been prepared as at 31 October 2019, which is the Bank's most recent financial year-end. Pillar 3 disclosures are issued on an annual basis, based on year-end financial information, and will be made available concurrently with the audited financial statements, as required by the CRR.

1.3 Summary of Key Regulatory Metrics

	31 October 2019	31 October 2018
Total capital (£m)	156.6	168.0
Total risk-weighted assets (RWA) (£m)	681.9	754.6
Common Equity Tier 1 ratio (%)	23.0%	22.3%
Basel III leverage ratio (%)	11.2%	11.9%
LCR ratio (%)	516.9%	236.9%

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 Regulatory Changes

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). These guidelines apply from 31 December 2017. 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.

1.6 New Financial Reporting Standards

IFRS 9 – Financial Instruments

On 1 November 2018, the Bank adopted the requirements of IFRS 9 as issued in July 2014. The new standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'. To reflect the difference between IFRS 9 and IAS 39, consequential amendments were also made to other standards including IFRS 7 'Financial Instruments: Disclosures' and IAS 1 'Presentation of Financial Statements'. The Bank adopted these consequential amendments, along with IFRS 9, on 1 November 2018.

IFRS 9 introduces new requirements for the classification, measurement and impairment of financial assets and liabilities. IFRS 9 also replaces the incurred loss model implemented under IAS 39 with an expected credit loss (ECL) model which results in earlier recognition of credit losses. The model applies to all financial assets not held at FVTPL, together with financial guarantee contracts and loan commitments.

The Bank has adjusted the opening balance of retained earnings to reflect the application of the new requirements of IFRS 9. In accordance with the transition requirements, comparative information was not restated.

The Bank has elected to take advantage of the IFRS 9 transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year-period. The phase-in factors will allow for a 95% add back to CET1 capital and risk weighted assets in the financial year ended 31 October 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year. Where such relief is taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

	31 October 2019 (£m)
Common Equity Tier 1 Capital ('fully loaded')	154.2
Common Equity Tier 1 Capital (with transitional relief)	156.6

IFRS 15 Revenue from Contracts with Customers

On 1 November 2018, the Bank adopted the requirements of IFRS 15. The new standard replaces IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

The Bank assessed its non-interest revenue streams that fall under the scope of IFRS 15 and determined that the impact on the amount or timing of revenue to be recognised as a result of the adoption of IFRS 15 is immaterial. As such, there is no adjustment to the opening balance of retained earnings or related tax balance.

For further information in relation to IFRS 9 and IFRS 15, please review the Financial Statements for the year ended 31 October 2019.

2. Scope of Pillar 3 Disclosures

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.

3. Risk Management Objectives and Policies

3.1 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 Hodge:

- 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.

3.2 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 who replaced PWC in December 2019. Internal audit reports 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:

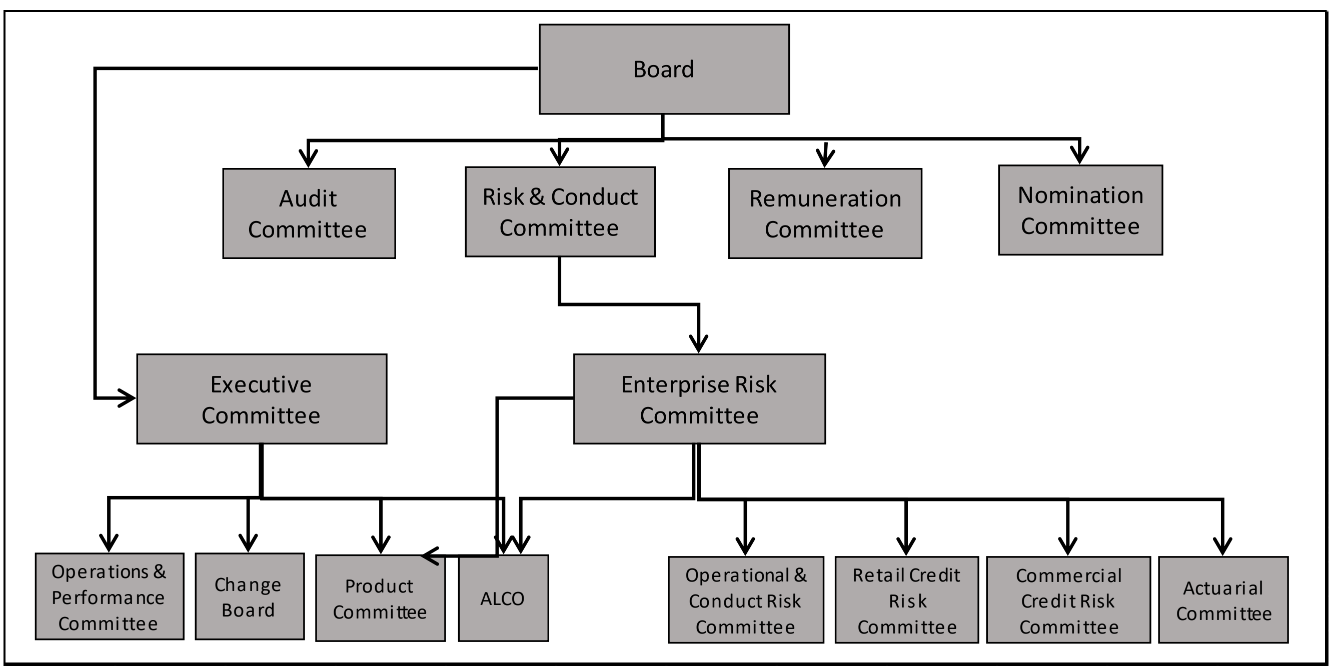
- Conducts independent testing and verification of the efficacy of the Bank's business model, controls, policies, processes and business line compliance; and
- Provides assurance that the risk management process is functioning as designed.

3.3 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 six 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 is 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 market risks, asset/liability matching, and liquidity and capital 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 Managing Director of Mortgages. 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.

3.4 Principal 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 borrowers at origination and lending against a security of 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 (ALCO). 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 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 (ALCO) 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 multi-lateral 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 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. An ICAAP is undertaken annually which assesses the Bank's exposure to property price risk. The risk is managed by setting and monitoring maximum loan to value at inception of the loan.

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. Lapse risk is the risk that a high rate of mortgage lapse results in financial losses for the Bank. The exposure to lapse 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. Additional oversight in this area is provided by an external technical adviser, to help to mitigate potential conflicts of interest and to assist the Board with decision-making on technical actuarial matters.

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 lending division has a geographic concentration in Wales, the West and London, though this has reduced appreciably 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 relative 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 a company's financial condition that arises from a funding deficit within its defined benefit pension plan. A deficit may arise 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.

IBOR Reform Risk

In July 2017, the UK Financial Conduct Authority (FCA) announced a transition away from LIBOR as the key interest rate index used in calculating floating or adjustable rates for loans, bonds, derivatives and other financial contracts. The FCA's intention is that, at the end of 2021, it will no longer seek to persuade, or compel, banks to submit rates for calculation of LIBOR. The Bank is currently assessing the impact of this change on its financial instruments which use LIBOR as their benchmark interest rate, this work will continue through 2020 as the impact on markets becomes clearer.

4. Key Regulatory Metrics

As at 31 October 2019, and throughout the period to 31 October 2019, the Bank maintained its capital resources, leverage ratio, liquidity coverage ratio and net stable funding ratio at a level above the minimum requirements.

The following table provides a summary of the key regulatory metrics for the Bank as at 31 October 2019:

Key metrics	31 October 2019	31 October 2018
Available capital (amounts)		
Common Equity Tier 1 (CET1) (£m)	156.6	168.0
Tier 1 (£m)	156.6	168.0
Tier 2 (£m)	-	-
Total capital (£m)	**156.6**	**168.0**
Risk weighted assets (amounts)		
Total risk-weighted assets (RWA) (£m)	681.9	754.6
Risk-based capital ratios as a percentage of RWA		
Common Equity Tier 1 ratio (%)	23.0%	22.3%
Tier 1 ratio (%)	23.0%	22.3%
Total capital ratio (%)	**23.0%**	**22.3%**
Additional CET1 buffer requirements as a percentage of RWA		
Capital conservation buffer requirement (%)	2.50%	1.88%
Countercyclical buffer requirement (%)	1.00%	0.50%
Total of bank CET1 specific buffer requirements (%)	**3.50%**	**2.38%**
Basel III leverage ratio		
Total Basel III leverage ratio exposure measure (£m)	1,393.2	1,412.2
Basel III leverage ratio (%)	**11.2%**	**11.9%**
Liquidity Coverage Ratio		
Total HQLA after haircuts (£m)	346.4	245.2
Total net cash outflow (£m)	67.0	103.5
LCR ratio (%)	**516.9%**	**236.9%**

5. 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 years ended 31 October 2019 and 31 October 2018.

Composition of regulatory capital (£m)	31 October 2019	31 October 2018
CET1 capital		
Share capital	105.0	105.0
Retained earnings	66.6	72.8
Accumulated other comprehensive income	(11.4)	(6.0)
CET1 capital before regulatory adjustments	**160.2**	**171.8**
Regulatory adjustment to CET1:		
Intangible assets (1)	(5.6)	(3.1)
IFRS 9 transitional adjustment (2)	2.4	
Prudent valuation adjustment (3)	(0.4)	(0.7)
CET1 and Tier 1 capital (T1)	**156.6**	**168.0**
Tier 2 capital (T2)	**-**	**-**
Total regulatory capital (TC = T1 + T2)	**156.6**	**168.0**
Total risk-weighted assets	**681.9**	**754.6**
Common Equity Tier 1 (as a percentage of RWA)	23.0%	22.3%
Tier 1 (as a percentage of RWA)	23.0%	22.3%
Total capital (as a percentage of RWA)	**23.0%**	**22.3%**
Institution specific buffer requirement	**3.50%**	**2.38%**
Of which: capital conservation buffer requirement	2.50%	1.88%
Of which: bank specific countercyclical buffer requirement	1.00%	0.50%
Amounts below threshold for deduction		
Deferred tax assets arising from temporary differences (4)	6.6	6.5

Tier 1 Capital

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

(1) An adjustment is required to be made 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 under the regulatory rules.

(2) Article 473a provides a framework for the transitional adoption of the IFRS 9 standards into the Bank's own funds calculation. As at 31 October 2019 year end the Bank can recognise transitional relief of 95% of the IFRS 9 provision.

(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.

The following table shows the movement in CET1 capital during the year:

£m	2019	2018
CET1 capital at 1 November	**168.0**	**149.3**
Disposal of subsidiary	-	16.0
(Loss)/profit for the year	(5.6)	5.5
Impact on adoption of IFRS 9	(3.4)	-
IFRS 9 transitional relief	2.4	-
Movement in other reserves	(2.7)	(1.1)
Movement due to other regulatory adjustments	(2.1)	(1.7)
CET1 Capital at 31 October	**156.6**	**168.0**

Tier 2 Capital

The Bank currently has no Tier 2 instruments.

6. Capital Adequacy

6.1 Capital Management

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

Pillar 1

The Pillar 1 capital requirements set out the minimum capital requirement that the Bank must adhere to.

The Pillar 1 capital requirement consists of the following components:

- *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 has adopted the standardised approach to determine its Pillar 1 credit risk capital. This involves the application of standard rules 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, reviewed by the Risk and Conduct Committee and is reported to the PRA 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, additional re-forecasts are reviewed by the Board to take into account the effects 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 consider the capital required to support future growth.

6.2 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 needs. 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 April 2019. In addition to the ICAAP stress testing, enterprise-wide stress testing on capital, liquidity, operational risk and reverse stress testing is performed.

6.3 Pillar 1 Capital Requirement

The table below sets out the Pillar 1 capital requirements. 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 31 October 2019 £m	Exposure Value	RWAs	Pillar 1 Capital
Government and central banks	343.7	-	-
Multi-lateral development banks	13.1	-	-
Financial institutions	91.2	3.7	0.3
Mortgages on residential/commercial real estate	770.2	487.1	38.9
Covered bonds	41.7	4.2	0.3
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**

As at 31 October 2018 £m	Exposure Value	RWAs	Pillar 1 Capital
Government and central banks	234.4	-	-
Multi-lateral development banks	12.4	-	-
Financial institutions	114.7	14.1	1.2
Corporate	25.8	20.1	1.6
Mortgages on residential/commercial real estate	840.3	528.2	42.3
Covered bonds	40.9	4.1	0.3
Exposures in default	20.7	29.2	2.3
Other items	114.1	124.0	9.9
Total credit risk	**1,403.3**	**719.7**	**57.6**
Operational risk – basic indicator approach	-	29.9	2.4
CVA – standardised approach	**-**	5.0	0.4
Total	**1,403.3**	**754.6**	**60.4**

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 8.1.

The following tables break down the Bank's risk exposure by asset class and risk weighting.

Overview of RWA £m	31 October 2019	
	RWA	Pillar 1
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**

Overview of RWA £m	31 October 2018	
	RWA	Pillar 1
Credit risk (excluding counterparty risk)		
Standardised approach	699.4	56.0
Counterparty credit risk (CCR)		
Standardised approach	4.0	0.3
Credit valuation adjustment (CVA)		
Standardised approach	5.0	0.4
Market risk		
Standardised approach	-	-
Operational risk		
Basic indicator approach	29.9	2.4
Amounts below thresholds for deduction (250% risk weight)		
Deferred tax asset	16.3	1.3
Total	**754.6**	**60.4**

Counterparty credit risk adjustment

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

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

6.4 Summary of risk weightings applied to the exposure value to calculate the RWA

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
Multi-lateral development banks	13.1	-	-	-	-	-	-	-	-	13.1
Financial institutions	79.5	-	7.2	-	4.5	-	-	-	-	91.2
Mortgages on residential/ commercial real estate	-	-	-	463.8	-	0.3	269.3	36.8	-	770.2
Covered bonds	-	41.7	-	-	-	-	-	-	-	41.7
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

As at 31 October 2018 £m	Risk Weightings									Exposure Value
	0%	10%	20%	35%	50%	75%	100%	150%	250%	
Government and central banks	234.4	-	-	-	-	-	-	-	-	234.4
Multi-lateral development banks	12.4	-	-	-	-	-	-	-	-	12.4
Financial institutions	81.7	-	17.3	-	12.0	-	3.7	-	-	114.7
Corporate	-	-	2.3	-	9.0	-	11.2	3.3	-	25.8
Mortgages on residential/ commercial real estate	-	-	-	504.6	-	-	304.2	31.5	-	840.3
Covered bonds	-	40.9	-	-	-	-	-	-	-	40.9
Exposures in default	-	-	-	-	-	-	3.5	17.2	-	20.7
Other items	-	-	-	-	-	-	107.5	-	6.6	114.1
Total	328.5	40.9	19.6	504.6	21.0	-	430.1	52.0	6.6	1,403.3

7. Regulatory Capital 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. The buffer has been phased in from 1 January 2016 at the rate of 0.625% per annum to reach 2.5% by 1 January 2019. Hence as at 31 October 2019, the buffer was 2.5% of RWA. The table below shows the CCoB requirement:

£m	31 October 2019	31 October 2018
Total RWA	681.9	754.6
Institution specific CCoB rate (%)	2.5	1.88
Institution specific CCoB requirement	**17.0**	**14.2**

Countercyclical Capital Buffer ("CCyB")

In June 2018, the UK Financial Policy Committee ("FPC") increased the UK CCyB rate from 0.5% of a banks' UK exposures to 1% from November 2018. Hence as at 31 October 2019, the buffer was 1% of RWA.

The table below shows from the CCyB requirement:

£m	31 October 2019	31 October 2018
Total RWA	681.9	754.6
Institution specific CCyB rate (%)	1.0	0.5
Institution specific CCyB requirement	**6.8**	**3.8**

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 shows the geographical distribution of credit exposures relevant for the calculation of the CCyB requirement:

	Exposure values	RWA	CCyB rate	CCyB amount
	£m	£m	%	£m
2019				
United Kingdom	1,393.5	681.9	1.00	6.8
2018				
United Kingdom	1,403.3	754.6	0.5	3.8

8. 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.

8.1 Summary of the Bank's Credit Risk Exposures

The exposures are summarised as follows at 31 October 2019:

£m	Exposures		
	On-Balance Sheet	Off-Balance Sheet	Total
Credit Risk – Standardised Approach			
Government and central banks	343.7	-	343.7
Multi-lateral development banks	13.1	-	13.1
Financial institutions	91.2	-	91.2
Mortgages on residential/commercial real estate	750.6	19.6	770.2
Covered bonds	41.7	-	41.7
Exposures in default	19.6	-	19.6
Other items (1)	114.0	-	114.0
Total	**1,373.9**	**19.6**	**1,393.5**

The exposures are summarised as follows at 31 October 2018:

£m	Exposures		
	On-Balance Sheet	Off-Balance Sheet	Total
Credit Risk – Standardised Approach			
Government and central banks	234.4	-	234.4
Multi-lateral development banks	12.4	-	12.4
Financial institutions	114.7	-	114.7
Corporate	24.6	1.2	25.8
Mortgages on residential/commercial real estate	805.3	35.0	840.3
Covered bonds	40.9	-	40.9
Exposures in default	20.7	-	20.7
Other items (1)	114.1	-	114.1
Total	**1,367.1**	**36.2**	**1,403.3**

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

8.2 Credit Risk by Geographic Distribution

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

£m	UK	Europe	USA	Other	Total
Credit Risk – Standardised Approach					
Government and central banks	340.7	3.0	-	-	343.7
Multi-lateral development banks	-	13.1	-	-	13.1
Financial institutions	88.1	1.9	1.2	-	91.2
Mortgages on residential/commercial real estate	770.2	-	-	-	770.2
Covered bonds	37.4	4.3	-	-	41.7
Exposures in default	19.6	-	-	-	19.6
Other items	114.0	-	-	-	114.0
Total	**1,370.0**	**22.3**	**1.2**	**-**	**1,393.5**

The geographic distribution of these exposures as at 31 October 2018 is shown below:

£m	UK	Europe	USA	Other	Total
Credit Risk – Standardised Approach					
Government and central banks	231.3	3.1	-	-	234.4
Multi-lateral development banks	-	12.4	-	-	12.4
Financial institutions	108.6	2.2	2.2	1.7	114.7
Corporate	23.2	1.6	1.0	-	25.8
Mortgages on residential/commercial real estate	840.3	-	-	-	840.3
Covered bonds	40.9	-	-	-	40.9
Exposures in default	20.7	-	-	-	20.7
Other items	114.1	-	-	-	114.1
Total	**1,379.1**	**19.3**	**3.2**	**1.7**	**1,403.3**

8.3 Credit Risk by Residual Maturity

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	Undated	Total
Credit Risk – Standardised Approach					
Government and central banks	329.9	6.1	7.7	-	343.7
Multi-lateral development banks	-	10.2	2.9	-	13.1
Financial institutions	85.6	5.6	-	-	91.2
Mortgages on residential/commercial real estate	107.2	221.1	441.9	-	770.2
Covered bonds	4.5	30.5	6.7	-	41.7
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**

The residual maturity of the exposures as at 31 October 2018 is shown below:

£m	Within 1 year	After 1 year but within 5 years	More than 5 years	Undated	Total
Credit Risk – Standardised Approach					
Government and central banks	155.8	68.5	10.1	-	234.4
Multi-lateral development banks	1.0	8.3	3.1	-	12.4
Financial institutions	104.3	4.9	5.5	-	114.7
Corporate	3.3	7.2	15.3	-	25.8
Mortgages on residential/commercial real estate	81.2	241.3	517.8	-	840.3
Covered bonds	5.6	23.4	11.9	-	40.9
Exposures in default	20.7	-	-	-	20.7
Other items	-	-	-	114.1	114.1
Total	**371.9**	**353.6**	**563.7**	**114.1**	**1,403.3**

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

8.4 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 exactly.

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 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.

8.5 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 Mortgage, 55+ Mortgage and 55+ Retirement Interest Only (RIO) Mortgage.

Therefore, the Bank's credit risk for roll-up equity release mortgages, and the capital element of the Retirement Mortgage, 55+ Mortgage and 55+ RIO Mortgage, 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 mortgages and the 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 Mortgage, 55+ Mortgage and 55+ RIO Mortgage.

The maximum amount that the Bank will lend to borrowers of roll-up equity release mortgages is age-related. For borrowers of the Retirement Mortgage, 55+ Mortgage and 55+ RIO Mortgage, the maximum amount the Bank will lend is linked to the customers' ability to service the loan requested. These measures minimise the extent to which the Bank is exposed to loss risk.

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.

8.6 Non-performing loans and impairment

The Bank monitors credit risk by regularly reviewing loans and advances to customers for impairment. IFRS9 stipulates that the impairment of loans and advances to customers is calculated using a forward-looking Expected Credit Loss (ECL) models. 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 shows 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.

The following table provides an analysis of loans and advances to customers by reportable segment and the year-end stage classification:

For more information regarding the Banks IFRS 9 policy and methodology for calculating ECL provision please review the Financial Statements for the year ended 31 October 2019.

8.7 Impairment Provisions on Loans and Advances to Customers

The table below summarises the bad debt provisions held against financial assets classified at Amortised Cost on the Bank's Balance Sheet:

£m	Commercial Loans	Buy to Let	Residential
2019			
Stage 1	286.7	21.3	176.6
Stage 2	14.3	-	1.9
Stage 3	25.7	-	-
Gross Loans and Advances 31 October 2019	326.7	21.3	178.5
Stage 1	(2.1)	(0.3)	-
Stage 2	(0.1)	-	(0.1)
Stage 3	(7.3)	-	-
Loss allowance 31 October 2019	(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

The total IFRS 9 provision is £9.9m for the financial year end 2019. Prior to IFRS 9, under IAS 39 impairment of loans and advances to customers was based on an incurred loss model. Loans were regularly reviewed to determine if there was any objective evidence of impairment.

Under IAS39, loans were categorised as follows:

- *Individual impairment* - where specific circumstances indicated that a loss was likely to be incurred.
- *Collective impairment* - impairment allowances were calculated for each portfolio on a collective basis, given the homogenous nature of the assets in the portfolio.

2018 £m	Specific	Collective
At 1 November 2017	6.2	0.2
Utilised on redemption	(1.7)	-
Amounts written back during the year	(1.3)	(0.1)
Charge for loan impairment	0.4	-
At 31 October 2018	3.6	0.1

2018 £m	Commercial Lending	Residential Lending	Residential Lending Fair Value
Of which neither past due or impaired	324.6	208.0	269.9
Impaired assets	12.8	-	-
Past due	16.9	-	-
Loan book	**354.3**	**208.0**	**269.9**
Charge for loan impairment	(3.7)	-	-
Loan fee deferral	(2.3)	-	-
Total loans and advances to customers net of impairment	348.3	208.0	269.9

8.8 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. Any change therein is recognised in the Income Statement within other income. The property will be sold when the customer dies or moves into long term care, at which point the Bank will recognise any gains or losses in the Income Statement.

8.9 Treasury Credit Risk

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

All of the bank's exposures within the treasury asset portfolio are rated by major credit rating agencies. The Bank uses this to identify specific provisions within CRR to calculate the capital requirements determined by the credit rating, counterparty and asset class of each of each assets.

The table below provides a summary of the External Credit Assessment Institutions credit assessments 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 31 October 2019, analysed by credit rating, are summarised in the tables below:

Central governments or central banks

Rating – S&P / Fitch	31 October 2019	31 October 2018
AAA to AA-	343.7	204.9
Total	**343.7**	**204.9**

Financial institutions

Rating – S&P / Fitch	31 October 2019	31 October 2018
AAA to AA-	79.5	15.7
A+ to A-	11.7	91.6
BBB to BBB-	-	4.2
BB+ to BB-	-	2.6
Unrated	-	0.6
Total	**91.2**	**114.7**

Multi-lateral development banks

Rating	31 October 2019	31 October 2018
AAA to AA-	13.1	12.4
Total	**13.1**	**12.4**

Corporates

Rating	31 October 2019	31 October 2018
AAA to AA-	-	1.9
A+ to A-	**-**	11.4
BBB+ to BBB-	-	6.7
BB+ to BB-	-	1.1
Unrated	-	4.7
Total	**-**	**25.8**

The Bank disposed of its corporate bond portfolio during the year ended 31 October 2019.

Covered bonds

Rating	31 October 2019	31 October 2018
AAA to AA-	41.7	40.9
Total	**41.7**	**40.9**

Derivatives

The Bank uses financial derivatives to manage interest rate risk. A collateral asset is held by the corresponding counterparties as collateral against derivatives in a net liability position. 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 reproduced daily (minimum) and for some derivatives intraday. In the event of default, the collateral asset would be offset against the corresponding derivative liability, and vice versa.

The following table shows the exposure to counterparty credit risk for derivative contracts as at 31 October 2019 and 31 October 2018:

£m	31 October 2019	31 October 2018
Negative fair value (inclusive of potential future exposure)	(80.4)	(107.8)
Add: collateral held in the form of treasury bills	-	29.5
Add: cash collateral held by financial institutions	79.5	82.6
Net derivative exposure	**(0.9)**	**4.3**

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

8.10 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 at c. 4 years on average. 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.

9. 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 into account 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 to a 200-basis point shift in the yield curve are as follows:

£m	31 October 2019	31 October 2018
+200 basis points increase	2.0	0.3
-200 basis points decrease (floored at zero)	(0.6)	(2.9)

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 year-end, to determine how the net interest income may change on an annualised basis for one year, as follows:

£m	31 October 2019	31 October 2018
+100 basis points increase	0.7	2.1
-100 basis points decrease (floored at zero)	(1.8)	(1.2)

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 two stress scenarios, of the underlying Balance Sheet items. The results also include the impact of derivative transactions.

10. Leverage Ratio

The leverage ratio is a capital ratio not affected by risk weightings. It is calculated as Tier 1 capital divided by an adjusted Balance Sheet exposure.

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.

Summary comparison of accounting assets against leverage ratio exposures

£m	31 October 2019	31 October 2018
Total assets as per published financial statements	**1,378.7**	**1,363.4**
Adjustment for derivative financial instruments	4.2	5.6
Adjustment for off-Balance Sheet items (conversion to credit equivalent amounts of off-Balance Sheet exposures)	19.6	46.3
Other adjustments	(9.3)	(3.1)
Total leverage exposure	**1,393.2**	**1,412.2**

Leverage ratio common disclosure

£m	31 October 2019	31 October 2018
Total assets as per published financial statements	**1,378.7**	1,363.4
Asset amounts deducted in determining Tier 1 Capital	(9.3)	(3.1)
Total on-Balance Sheet exposures	**1,369.4**	**1,360.3**
Derivative exposures		
Replacement cost associated with all derivative transactions (i.e. net of eligible cash variation margin)	4.2	5.6
Total derivative exposures	**4.2**	**5.6**
Other off-Balance Sheet exposures		
Off-Balance Sheet exposures at gross notional amount	179.7	193.7
Adjustment for conversion to credit equivalent amounts	(160.1)	(147.4)
Total other off-Balance Sheet exposures	**19.6**	**46.3**
Capital and total exposures		
Tier 1 capital	**156.6**	**168.0**
Total leverage ratio exposure	**1,393.2**	**1,412.2**
Leverage ratio		
Basel III leverage ratio	**11.2%**	**11.9%**

Breakdown of on-Balance Sheet exposures (excluding derivative and exempted exposures)

£m	31 October 2019	31 October 2018
Total assets as per published financial statements	**1,378.7**	**1,363.4**
Asset amounts deducted in determining Tier 1 Capital	(9.3)	(3.1)
Total on-Balance Sheet exposures	**1,369.4**	**1,360.3**
Of which		
Exposures treated as sovereigns	356.8	246.8
Institutions	87.1	110.7
Secured mortgages of immovable property	750.2	804.1
Corporate	-	23.0
Covered bonds	41.7	40.9
Exposures in default	19.6	20.7
Other exposures	114.0	114.1
Total	**1,369.4**	**1,360.3**

11. 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 material 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. A sample of the assets held is 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

Liquidity 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

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

Liquidity Coverage Ratio £m	31 October 2019	
	Total unweighted value	Total weighted value
High-quality liquid assets		
Total HQLA		346.4
Cash outflows		
Retail deposits and deposits from small business customers, of which:		
Stable deposits	(262.0)	(13.1)
Less stable deposits	(94.3)	(15.0)
Unsecured wholesale funding, of which:		
Non-operational deposits	(24.4)	(7.6)
Secured wholesale funding	-	-
Additional requirements, of which:		
Outflows related to derivative exposures and other collateral requirements	(19.4)	(19.4)
Other contractual funding obligations	**(71.1)**	**(18.5)**
Other contingent funding obligations	-	-
Total cash outflows		**73.6**
Cash inflows		
Other cash inflows	23.4	6.6
Total cash inflows		**6.6**
Total HQLA		**346.4**
Total net cash outflows		**67.0**
Liquidity Coverage Ratio (%)		**516.9%**

12. 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 31 October 2019 is 217.6%. This is in excess of the minimum level of 100% proposed by the Basel Committee on Banking Supervision and European Commission.

13. 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.

31 October 2019 £m	Carrying amount encumbered assets	Carrying amount unencumbered assets
Assets of the reporting institution		
Treasury bills	-	81.2
Debt securities	51.0	6.0
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**

31 October 2018 £m	Carrying amount encumbered assets	Carrying amount unencumbered assets
Assets of the reporting institution		
Treasury bills	56.2	25.0
Debt securities	19.4	68.1
Loans and advances to credit institutions	82.6	13.6
Loans and advances to customers	139.6	688.3
Other assets	-	270.6
Total	**297.8**	**1,065.6**

Information on the importance of encumbrance

The Bank encumbers assets by positioning loans as collateral to support access to the Bank of England's Term Funding Scheme (TFS) and in relation to derivative transactions.

14. 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 evaluation system based on job descriptions which assess the knowledge and skills required for the job, the level of thinking and problem solving involved and the degree of accountability or decision making required. Salaries are reviewed annually 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 or termination 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.

Short term	The annual cash bonus is a performance-based remuneration plan designed to reward achievement of agreed budgets and short-term objectives. This includes financial and non-financial results and measures. For all our colleagues, subject to the rules of the scheme, we have introduced the non-contractual Annual Reward Plan that will recognise and pay out against performance with a value of anything from 0% to 12% and a further 5% for exceptional performers. This scheme runs for the duration of our accounting year 2019/20.
Long-term incentive plan (LTIP)	We have introduced a non-contractual reward scheme for a group of our strategic leaders that will recognise long-term performance against the 2023 plan. 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, including risk management oversight and customer experience. The purpose of the LTIP 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 LTIP 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 31 October 2019, in addition to the two executive directors, 28 (2018: 24) other members of staff, including those in control functions, are designated as being MRTs. Remuneration for the year ended 31 October 2019 for the staff subject to the remuneration code was:

£m	31 October 2019	31 October 2018
Fixed	2.7	2.3
Variable	0.4	0.3
Total remuneration	**3.1**	**2.6**

No special payments were made to MRTs during either the year ended 31 October 2019, or the year ended 31 October 2018.

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

£m	31 October 2019				
	Financial Statements	Regulatory Exposure	Credit Risk Framework	Counterparty Risk Framework	Market Risk Framework
Assets					
Cash balances held at central banks	321.9	321.9	321.9	-	-
Treasury bills	25.1	25.1	25.1	-	-
Debt securities	57.0	57.0	57.0	-	-
Advances to credit institutions	86.1	86.1	86.1	-	-
Loans and advances to customers	766.9	783.3	783.3	-	-
Intangible assets (1)	5.8	-	-	-	-
Property, plant & equipment	1.9	1.9	1.9	-	-
Investment properties	97.3	97.3	97.3	-	-
Deferred tax assets	6.6	6.6	6.6	-	-
Derivative financial instruments (2)	-	4.2	-	4.2	-
Other assets	10.1	10.1	10.1	-	-
Total assets	1,378.7	1,393.5	1,389.3	4.2	-
Liabilities					
Deposit from banks	72.5	-	-	-	-
Deposits from customers	1,042.8	-	-	-	-
Derivative financial instruments	80.4	-	-	-	-
Other liabilities	6.1	-	-	-	-
Accruals and deferred income	-	-	-	-	-
Other provisions	-	-	-	-	-
Pension liabilities	16.6	-	-	-	-
Total liabilities	1,218.4	-	-	-	-
Share capital and reserves					
Called-up share capital	105.0	-	-	-	-
Other Reserves	55.3	-	-	-	-
Total equity	**160.3**	-	-	-	-
Total equity and liabilities	1,378.7	-	-	-	-

(1) The intangible asset has a 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
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
LTIP	Long-Term Incentive 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