Close Brothers Group plc

Pillar 3 disclosures for the year ended 31 July 2017

Contents

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1. Overview

Background

The aim of the capital adequacy regime is to promote safety and soundness in the financial system. It is structured around three 'pillars': Pillar 1 on minimum capital requirements; Pillar 2 on the supervisory review process; and Pillar 3 on market discipline. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess key pieces of information on that firm's capital, risk exposures and risk assessment process. The disclosures contained in this document cover the qualitative and quantitative disclosure requirements of Pillar 3, set out in the EU's Capital Requirements Regulation ("CRR"), and are based on data at 31 July 2017 with comparative figures for 31 July 2016 where relevant. Within this document are references to the Close Brothers Group plc's Annual Report which can be found at: www.closebrothers.com/investor-relations/investor-information/results-reports-and-presentations.

Scope

The Prudential Regulation Authority ("PRA") supervises Close Brothers Group plc ("CBG" or "the group") on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the group as a whole. In addition, a number of subsidiaries are regulated for prudential purposes by either the PRA or the Financial Conduct Authority. The main subsidiary institutions which are subject to the CRR are Close Brothers Limited ("CBL"), Winterflood Securities Limited and Close Asset Management Limited. Details of the group's principal subsidiaries are included in note 29 of the group's Annual Report. There are no differences between the basis of consolidation of the group for accounting and regulatory purposes. Other than restrictions due to regulatory capital requirements for regulated entities, there are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities when due between the group and its subsidiaries.

Pillar 3 policy

Disclosures will be issued as a minimum on an annual basis and are published on the group's website. These disclosures are not subject to audit except where they are equivalent to those prepared under accounting requirements for inclusion in the group's Annual Report. These disclosures are ratified by the Group Risk and Compliance Committee ("GRCC") and approved by the CBG board ("the board").

The Pillar 3 disclosures have been prepared purely for explaining the basis on which the group has prepared and disclosed certain capital requirements and information about the management of certain risks and for no other purpose. They do not constitute any form of financial statement and must not be relied upon in making any judgement about the group.

Solo-consolidation

CBL, the group's regulated banking subsidiary, makes use of the provisions laid down in CRR Article 9 and reports to the PRA on a solo-consolidated basis. This solo-consolidated group includes CBL and its major UK trading subsidiaries as at 31 July 2017.

Regulatory developments during the year

During the period, the European Banking Authority ("EBA") issued new guidance which mandates the risk weighting of property development loans at 150% and applies to the majority of our property lending. There have been no new requirements during the year that impact the disclosures included.

Future regulatory developments

As the regulatory landscape continues to evolve, forthcoming changes such as the ongoing Basel consultation on risk weightings and implementation of IFRS9 have the potential to increase capital requirements across the industry. Our strong capital position and ongoing profit generation gives us the ability to absorb any changes and we remain focused on ensuring we maintain appropriate capital flexibility going forward. New disclosures, including Liquidity Coverage Ratio ("LCR") reporting, are due to come in to force 31 December 2017 and will initially be mandatory for large banks.

2. Risk management objectives and policies

Risk and Control Framework

The board has overall responsibility for maintaining a system of internal control to ensure that an effective risk management and oversight process operates across the group. The risk management framework and associated governance arrangements are designed to ensure that there is a clear organisation structure with well defined, transparent and consistent lines of responsibility and effective processes to identify, manage, monitor and report the risks to which the group is, or might become, exposed. The board has a well defined risk appetite with risk appetite measures which are integrated into decision-making, monitoring and reporting processes, with early warning trigger levels set to drive the required corrective action before overall tolerance levels are reached. The risk framework, through key committees, including the Risk Committee and Audit Committee, is the mechanism that ensures the board receives comprehensive risk information in a timely manner.

Identification, measurement and management of risk are fundamental to the success of the group. Over the past 12 months the group has continued to strengthen its risk management framework and further develop the organisation's risk committees, at both a group and business level, and these continue to work efficiently and effectively.

The group's risk and control framework is designed to allow the capture of business opportunities while maintaining an appropriate balance of risk and reward within the group's agreed risk appetite. It further ensures that the risks to which the group is, or may become, exposed are appropriately identified, and that those which the group chooses to take are managed, controlled and, where necessary, mitigated, so that the group is not subject to material unexpected loss.

The group reviews and adjusts its risk appetite annually as part of the strategy setting process. This aligns risk-taking with the achievement of strategic objectives. Adherence to appetite is monitored by the group's risk committees.

Throughout the year the Risk Committee undertakes a robust assessment of the principal risks facing the group, and reviews reports from the risk function on the processes that support the management and mitigation of those risks. A summary of the group's principal risks and uncertainties is provided on page 5.

On an ongoing basis the Risk Committee, along with the Audit Committee, also reviews the adequacy and effectiveness of the group's risk management and internal control arrangements in relation to the group's strategy and risk profile for the financial year. This covers all material controls, including financial, operational and compliance controls. On the basis of its own review, the board considers that it has in place adequate systems and controls with regard to the group's profile and strategy.

The risk management framework is based on the concept of "three lines of defence", as set out in the table on the following page, and the key principles underlying risk management in the group are:

- Business management own all the risks assumed throughout the group and are responsible for their management on a day-to-day basis to ensure that risk and return are balanced;
- The board and business management promote a culture in which risks are identified, assessed and reported in an open, transparent and objective manner;
- The overriding priority is to protect the group's long-term viability and produce sustainable medium to long-term revenue streams;
- Risk functions are independent of the businesses and provide oversight of and advice on the management of risk across the group;
- Risk management activities across the group are proportionate to the scale and complexity of the group's individual businesses;
- Risk mitigation and control activities are commensurate with the degree of risk; and
- Risk management and control supports decision making.

2. Risk management objectives and policies continued

First line of defence	Second line of defence	Third line of defence
The Businesses Group Risk and Compliance Committee (Reports to the Risk Committee) Chief executive delegates to divisional and operating business heads day-to-day responsibility for risk management, regulatory compliance, internal control and conduct in running their divisions or businesses. Business management has day-to-day ownership, responsibility and accountability for risks: • identifying and assessing risks; • managing and controlling risks; • measuring risk (key risk indicators/early warning indicators); • mitigating risks; • reporting risks; and • committee structure and reporting. **Key Features** • Promotes a strong risk culture and focus on sustainable risk-adjusted returns; • Implements the risk framework; • Promotes a culture of adhering to limits and managing risk exposures; • Promotes a culture of customer focus and appropriate behaviours; • Ongoing monitoring of positions and management and control of risks; • Portfolio optimisation; and • Self-assessment.	**Risk and Compliance** Risk Committee (Reports to the board) Risk Committee delegates to the group chief risk officer day-to-day responsibility for oversight and challenge on risk related issues. Risk functions (including compliance) provide support and independent challenge on: • the design and operation of the risk framework; • risk assessment; • risk appetite and strategy; • performance management; • risk reporting; • adequacy of mitigation plans; • group risk profile; and • committee governance and challenge. **Key Features** • Overarching "risk oversight unit" takes an integrated view of risk (qualitative and quantitative); • Supports through developing and advising on risk strategies; • Facilitates constructive check and challenge – "critical friend"/"trusted adviser"; and • Oversight of business conduct.	**Internal Audit** Audit Committee (Reports to the board) Audit Committee mandates the head of group internal audit with day-to-day responsibility for independent assurance. Internal audit provides independent assurance on: • first and second line of defence; • appropriateness/effectiveness of internal controls; and • effectiveness of policy implementation. **Key Features** • Draws on deep knowledge of the group and its businesses; • Independent assurance on the activities of the firm including the risk management framework; • Assesses the appropriateness and effectiveness of internal controls; and • Incorporates review of culture and conduct.

2. Risk management objectives and policies continued

Committee roles and responsibilities

The Risk Committee's key roles and responsibilities are to:

- oversee the maintenance and development of a supportive culture in relation to the management of risk;
- review and set risk appetite, which is the level of risk the group is willing to take in pursuit of its strategic objectives;
- monitor the group's risk profile against the prescribed appetite;
- review the effectiveness of the risk framework to ensure that key risks are identified and appropriately managed; and
- provide input from a risk perspective into the alignment of remuneration with performance against risk appetite (through the Remuneration Committee).

Membership and meetings

The Risk Committee comprises each of the independent non-executive directors. Six scheduled meetings were held during the year.

Full details of attendance by the non-executive directors at these meetings during the year are set out on page 56 of the Annual Report.

In addition to the members of the Risk Committee, standing invitations are extended to the group chairman, the executive directors, the chief risk officer, the head of compliance and the head of internal audit. All attend our Risk Committee meetings as a matter of course and have supported and informed the Risk Committee's discussions.

Other executives, subject matter experts, risk team members and external advisers are invited to attend the Risk Committee from time to time as required, to present and advise on reports commissioned.

Principal risks and uncertainties

The group faces a number of risks in the normal course of business providing lending, deposit taking, wealth management services and securities trading.
As set out in the strategy section on the previous pages, the protection of our established business model is a key strategic objective. As a result the management of the risks we face is central to everything we do. The key elements to the way we manage risk are as follows:

- Adhering to our established and proven business model outlined on pages 10 to 13 of the Annual Report;
- Implementing an integrated risk management approach based on the concept of "three lines of defence"; and
- Setting and operating within clearly defined risk appetites monitored with defined metrics and set limits.

Further details on our approach to risk management are set out on pages 59 and 60 of the Annual Report. Risk management is overseen by the Board Risk Committee and its key areas of focus over the last year are set out on pages 62 and 63 of the Annual Report. We believe the key risks facing the group now are how current economic uncertainty, including that arising from the departure of the UK from the EU, will impact our customers and in particular their ability to repay loans, the regulatory landscape and how it may impact some or all of our businesses, the competitive environment and maintaining operational resilience particularly given growing cyber threats.

The following pages set out the principal risks and uncertainties which may impact the group's ability to deliver its strategy, how we seek to mitigate these risks and the change in the perceived level of risk over the year. While we constantly monitor emerging risks, the group's activities, business model and strategy are unchanged as set out on the previous pages. As a result the principal risks and uncertainties the group faces and our approach to mitigating them remain broadly unchanged. The consistency of both our business model and risk management approach has underpinned the group's track record of trading successfully and supporting our clients in all market conditions.

2. Risk management objectives and policies continued

The summary below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties faced by the group but rather those which the group currently believes may have a significant impact on its performance and future prospects.

Key: ━ No change ↘ Risk decreased ↗ Risk increased

Risk/uncertainty	Mitigation	Change
Credit losses As a lender to small businesses and individuals, the group is exposed to credit losses if customers are unable to repay loans and outstanding interest and fees. At 31 July 2017 the group had loans and advances to customers amounting to £6.9 billion. The group also has exposure to counterparties with which it places deposits or trades, and also has a small number of derivative contracts to hedge interest rate and foreign exchange exposures.	We seek to minimise our exposure to credit losses from our lending by: • Applying strict lending criteria when testing the credit quality and covenant of the borrower; • Maintaining consistent and conservative loan to value ratios with low average loan size and short-term tenors; • Lending on a predominantly secured basis against identifiable and accessible assets; • Maintaining rigorous and timely collections and arrears management processes; and • Operating strong control and governance both within our lending businesses and with oversight by a central credit risk team. Our exposures to counterparties are mitigated by: • Conservative management of our liquidity requirements and surplus funding with £0.8 billion placed with the Bank of England; • Continuous monitoring of the credit quality of our counterparties within approved set limits; and • Winterflood's trading relating to exchange traded cash securities and being settled on a delivery versus payment basis. Counterparty exposure and settlement failure monitoring controls are also in place.	↗ Bad debts have remained low during the year to 31 July 2017 and our other counterparty exposures are broadly unchanged with the majority of our liquidity requirements and surplus funding placed with the Bank of England. However, we are monitoring the uncertainty over Brexit combined with rising consumer debt levels and potential increases in interest rates closely. This uncertainty, combined with the low level of current credit losses, increases the risk of higher credit losses. Further commentary on the credit quality of our loan book is outlined on pages 26 to 31 of the Annual Report. Further details on loans and advances to customers and debt securities held are in notes 10 and 11 on pages 120 and 121 of the Annual Report. Our approach to credit risk management and monitoring is outlined in more detail in note 27 on page 142 of the Annual Report.

2. Risk management objectives and policies continued

Risk	Mitigation	Change
Economic environment Any downturn in economic conditions may impact the group's performance through: • Lower demand for the group's products and services; • Lower investor risk appetite as a result of financial markets instability; • Higher credit losses as a result of customers inability to service debt and lower asset values on which loans are secured; and • Increased volatility in funding markets.	The group's business model aims to ensure that we are able to trade successfully and support our clients in all economic conditions. By maintaining a strong financial position we aim to be able to absorb short-term economic downturns, continuing to lend when others pull back and hence build long-term relationships by supporting our clients when it really matters. We test the robustness of our financial position by carrying out regular stress testing on our performance and financial position in the event of adverse economic conditions.	Economic uncertainty remains elevated in our view. While the performance of the UK economy has been resilient following the 2016 referendum, the current period of uncertainty is likely to continue reflecting both the outcome of Brexit negotiations and wider global events. Further commentary on the attributes and resilience of the group's business model is shown on pages 10 to 13 of the Annual Report.
Legal and regulatory Changes to the existing legal, regulatory and tax environments and failure to comply with existing requirements may materially impact the group. Failing to treat customers fairly, to safeguard client assets or to provide advice and products which are in clients' best interests has the potential to damage our reputation and may lead to legal or regulatory sanctions including litigation and customer redress. This applies to current, past and future business. Similarly changes to regulation and taxation can impact our financial performance, capital and liquidity and the markets in which we operate.	The group seeks to manage these risks by: • Providing straightforward and transparent products and services to our clients; • Governance and control processes to review and approve new products and services; • Maintaining a prudent capital position with headroom to minimum capital requirements; • Investing in training for all staff including anti-money laundering, bribery and corruption, conduct risk, data protection and information security. Additional tailored training for relevant employees is provided in key areas such as complaint handling; • Continuous monitoring of key legal, regulatory and tax developments to anticipate their potential impact; and • Maintaining constructive and positive relationships and dialogue with regulatory bodies and tax authorities.	Financial services businesses remain the subject of significant regulatory scrutiny. Minimum capital requirements are increasing as regulatory buffers are phased in while global consultations over capital levels continue. There has also been growing regulatory focus on consumer borrowing, particularly around motor finance, and also on the Asset Management industry. For further details on this and our response please see page 22 of the Annual Report. Further information on our approach to conduct risk can be found in the Sustainability Report on page 39 of the Annual Report.

2. Risk management objectives and policies continued

Risk	Mitigation	Change
Competition The group operates in highly competitive markets and we expect to see continued high levels of competition particularly within our asset and motor finance businesses in the Banking division. Elevated levels of competition may impact demand for the group's products and services.	The group has a long track record of trading successfully in all types of competitive environment. We value our clients and build long-term relationships offering a differentiated proposition based on: • Speed and flexibility of service; • Local presence; • Experienced and expert people; and • Tailored, client driven product offerings. This differentiated proposition combined with the consistent application of our business model helps build long-term relationships and generate high levels of repeat business.	– We continue to experience high levels of competition across each of our businesses, particularly in certain areas of the Banking division. Our approach remains unchanged as we focus on supporting our clients, maintaining underwriting standards and investing in our business. Further commentary on the market environment of the Banking division is outlined on page 26 of the Annual Report. Our business model is set out on pages 10 to 13 of the Annual Report.
Technology and operational resilience Providing robust, contemporary and secure IT services is fundamental to enabling the group to: • Provide a high quality customer experience across our businesses; • Respond to new technology; • Protect client and company data; and • Counter the evolving cyber threat. Failure to keep up with changing customer expectations or provide reliable, secure IT services has the potential to impact group performance.	The group continues to invest in its IT services. Currently there are major investment projects across a number of our businesses to enhance our customer offering. Asset Management has recently successfully completed the conversion of our clients on to a single technology platform to enhance the customer experience and increase operating efficiency. The group has strong governance in place to oversee its major projects. We also continue to invest in strengthening our cyber capabilities including the appointment of a new chief information security officer. We conducted a test scenario with the senior executive team during the year. We have in place, and regularly test, operational resilience capabilities, including crisis management, business continuity and disaster recovery plans.	– Operational resilience remains a key area of focus for the group, particularly as the rate of technology-driven disruption, including the impact and severity of cyber attacks, within the financial services industry continues to increase. We continue to invest and upgrade our IT infrastructure to improve our customer proposition, simplify our technology architecture and enhance resilience to cyber attacks. For further information on our response to cyber threats see page 63 of the Annual Report.

2. Risk management objectives and policies continued

Risk	Mitigation	Change
Employees The quality and expertise of our employees is critical to the success of the group. The loss of key individuals or teams may have an adverse impact on the group's operations and ability to deliver its strategy.	The group seeks to attract, retain and develop staff by: • Operating remuneration structures which are competitive and recognise and reward performance; • Implementing succession planning for key roles; • Improving our talent pipeline via our graduate and school leavers programmes, and training academy in asset finance; • Investing in training and development for all staff; and • Delivering leadership development programmes to develop current and future leaders for the group.	– Our highly skilled people are likely to be targeted but we are confident we are able to retain key employees. Further detail on the employee survey and our investment in our people is outlined in the Sustainability Report on pages 36 to 39 of the Annual Report.
Funding and liquidity The Banking division's access to funding remains key to support our lending activities and the liquidity requirements of the group.	Our funding approach is conservative based on the principle of "borrow long, lend short". The average maturity of funding allocated to the loan book was 21 months at 31 July 2017. This compares to our weighted average loan maturity of 14 months. Our funding is well diversified both by source and channel, and by type and tenor. Liquidity in our Banking division is assessed on a daily basis to ensure adequate liquidity is held and remains readily accessible in stressed conditions. At 31 July 2017 the group's funding position was strong with total available funding equal to 127% of the loan book. This provides a prudent level of liquidity to support our lending activities.	– While economic uncertainty has the potential to impact funding markets, overall the group remains well funded and continues to have good access to a wide range of funding sources. We have further diversified our funding during the year. The diversity of funding combined with relatively long tenor when compared to the average duration of our lending means we are well placed. Further commentary on funding and liquidity is provided on pages 24 and 25 of the Annual Report. Further financial analysis of our funding is shown in note 18 on page 127 of the Annual Report.

2. Risk management objectives and policies continued

Market risk Market volatility impacting equity and fixed income exposures, and/or changes in interest and exchange rates have the potential to impact the group's performance.	Our policy is to minimise interest rate risk by matching fixed and variable interest rate assets and liabilities using swaps where appropriate. The group's capital and reserves are not hedged. Similarly foreign exchange exposures are generally hedged using foreign exchange forwards or currency swaps with exposures monitored daily against approved limits. Winterflood is a market maker providing liquidity to its clients. Our trading is predominantly short-term with most transactions settling within three days. Trading positions are monitored on a real time basis and both individual and trading book limits are set to control exposure. Trading exposures on foreign securities are also hedged and monitored against limits.	The group's approach and the underlying risks are unchanged. Further detail on the group's exposure to market risk is outlined in note 27 on pages 145 to 147 of the Annual Report. The sensitivity analysis on interest rate exposures shown in note 27 on page 145 of the Annual Report demonstrates the limited level of exposure to interest rate and foreign exchange movements.

Information on number of directorships

Information on the number of directorships held by members of the management body, and information on the recruitment and diversity policy with regards to selection of members of the management body are shown in the group's Annual Report on pages 46, 47 and 55. In addition, Mike Biggs is a director of UK Insurance Limited and Churchill Insurance Company Limited. Geoffrey Howe is a director of Gateway Electronic Components Limited. Oliver Corbett is a director of HIG Finance Limited, Hyperion Development UK Limited, Howden UK Group Limited, Windsor Services Ltd and HIG Finance 2 Limited, Hyperion & Partners Limited, Hyperion Development S.à r.l., Hyperion Euro Growth S.à r.l. and Hyperion Refinance S.à r.l.

3. Key regulatory metrics

The table below summarises the key regulatory metrics as at 31 July 2017:

Key Metrics	**31 July 2017 £ million**	31 July 2016 £ million
Regulatory capital		
Common equity tier 1 ("CET1") capital	**990.6**	901.4
Tier 1 capital	**990.6**	901.4
Total capital[1]	**1,196.2**	925.4
Total risk weighted assets ("RWAs")	**7,859.0**	6,682.5
Regulatory capital as a percentage of RWAs		
CET1 capital ratio	**12.6%**	13.5%
Tier 1 capital ratio	**12.6%**	13.5%
Total capital ratio[1]	**15.2%**	13.8%

1 Total capital and total capital ratio are shown on a CRR transitional basis. On a fully loaded basis, the total capital is £1,165.6m, with a total capital ratio of 14.8% at 31 July 2017 (31 July 2016: total capital £901.4m and total capital ratio 13.5%).

4. Capital resources

The table below summarises the composition of regulatory capital. The group's individual regulated entities and the group as a whole complied with all of the externally imposed capital requirements to which they are subject for the years ended 31 July 2017 and 31 July 2016.

	31 July 2017 £ million	31 July 2016 £ million
CET1 capital		
Called up share capital	**38.0**	37.7
Share premium account	**307.8**	284.0
Retained earnings	**906.6**	797.5
Other reserves recognised for CET1 capital	**21.4**	21.8
Deductions from CET1 capital		
Intangible assets, net of associated deferred tax liabilities	**(186.3)**	(145.3)
Foreseeable dividend[1]	**(59.8)**	(56.1)
Investment in own shares	**(34.1)**	(37.2)
Pension asset, net of associated deferred tax liabilities	**(2.8)**	(0.9)
Prudent valuation adjustment	**(0.2)**	(0.1)
CET1 capital	**990.6**	901.4
Tier 2 capital – Subordinated debt[2]	**205.6**	24.0
Total capital[3]	**1,196.2**	925.4

1 Under the Regulatory Technical Standards on own funds, a deduction has been recognised at 31 July 2017 and 31 July 2016 for a foreseeable dividend being the proposed final dividend as set out in note 8 of the group's Annual Report.
2 Shown after applying the CRR's transitional and qualifying own funds arrangements.
3 Total capital is shown on a CRR transitional basis (see Section 3 "Key regulatory metrics").

The following table shows a reconciliation between equity and CET1 capital after deductions:

	31 July 2017 £ million	31 July 2016 £ million
Equity	**1,236.0**	1,096.9
Regulatory deductions from equity:		
Intangible assets, net of associated deferred tax liabilities	**(186.3)**	(145.3)
Foreseeable dividend[1]	**(59.8)**	(56.1)
Pension asset, net of associated deferred tax liabilities	**(2.8)**	(0.9)
Prudent valuation adjustment	**(0.2)**	(0.1)
Other reserves not recognised for CET1 capital:		
Cash flow hedging reserve	**3.2**	6.7
Non-controlling interests	**0.5**	0.2
CET1 capital	**990.6**	901.4

1 Under the Regulatory Technical Standards on own funds, a deduction has been recognised at 31 July 2017 and 31 July 2016 for a foreseeable dividend being the proposed final dividend as set out in note 8 of the group's Annual Report.

4. Capital resources continued

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

	31 July 2017 £ million
CET1 capital at 31 July 2016	**901.4**
Profit in the period attributable to shareholders	**191.2**
Shares issued in the period	**24.1**
Dividends paid and foreseen	**(89.3)**
Increase in intangible assets, net of associated deferred tax liabilities	**(41.0)**
Other movements in retained reserves	**3.5**
Increase in share-based payments reserve	**2.4**
Decrease in exchange movements reserve	**(0.4)**
Increase in available for sale movements reserve	**0.7**
Increase in pension assets, net of associated deferred tax liabilities	**(1.9)**
Increase in prudent valuation adjustment	**(0.1)**
CET1 capital at 31 July 2017	**990.6**

Intangible assets include goodwill, capitalised software and intangible assets arising on acquisition. All the subordinated debt capital is denominated in sterling. Further detail on subordinated debt is provided in Appendix 2. A reconciliation of regulatory capital to the balance sheet is shown in Appendices 1 and 3.

5. Capital adequacy

The group's policy is to be well capitalised and its approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates. The group maintains a strong capital base to support the development of the business and to ensure the group meets the Pillar 1 capital requirements and Individual Capital Guidance ("ICG") at all times. During the year, we received updated ICG from the PRA, confirming our total Pillar 2 add-on at 1.9%, of which 56% or 1.1% needs to be met with CET1 capital. As a result, the group maintains capital adequacy ratios above minimum regulatory requirements, which are currently set at a minimum CET1 capital ratio of 6.8% and a minimum total capital ratio of 11.2%, both inclusive of ICG and the capital conservation buffer (currently 1.25% for both CET1 capital and total capital).

Internal capital adequacy assessment process ("ICAAP")

The group undertakes a group-wide internal capital adequacy assessment annually which is an integral part of the group's risk management processes. The main output from the process is an assessment of all material risks faced by the group, determination of the level of capital required to be held against each major source of risk and an analysis of a number of severe stress tests over a three-year time horizon, which is the group's standard business planning timescale. Management at all levels within the group are involved in carrying out risk assessments for their business units, having input into stress testing and scenario analysis and where necessary approving inputs into the process. The ICAAP is subject to detailed review and challenge by both the GRCC and by the Risk Committee, before approval by the board.

5. Capital adequacy continued

Capital requirement

The group's Pillar 1 capital requirement is set out in the table below. The Pillar 1 requirement in respect of credit risk is based on 8% of the RWAs for each of the following standardised exposure classes.

	2017 £ million	2016 £ million
Credit risk - standardised approach		
Central governments or central banks	**10.7**	11.6
Regional governments or local authorities	**0.1**	0.1
Public sector entities	**0.1**	0.1
Institutions	**7.6**	8.0
Corporates	**120.2**	113.8
Retail	**195.8**	183.0
Secured by mortgages on immovable property[1]	**22.0**	108.2
Exposures in default	**7.2**	11.9
Items associated with particular high risk[1]	**161.6**	0.2
Other items	**28.6**	25.5
	553.9	462.4
Operational risk - standardised approach[2]	**64.5**	62.8
Counterparty credit risk	**3.5**	3.7
Market risk - trading book		
Interest rate PRR[3]	**0.7**	0.8
Equity PRR[3]	**5.0**	4.1
Market risk - non-trading book		
Foreign currency PRR[3]	**1.1**	0.8
Total Pillar 1 capital requirement	**628.7**	534.6

1 Movement relates to exposure reclassification following EBA guidance on property risk weighting.
2 The Standardised Approach is used for Securities, Asset Management and non-lending income in the Banking division. The Alternative Standardised Approach is applied to the loan book and securities exposures in the Banking division. Further details on operational risk can be found in section 2 'Risk Management Objectives and Policies'.
3 Position Risk Requirement.

The increase of £94.1 million in the capital requirements during the year results from growth in credit and counterparty risk associated with the loan book and EBA guidance which mandates 150% risk weighting for property development loans. Notional RWAs for operational risk also increased reflecting increased performance over recent years.

6. Regulatory capital buffers

The following regulatory capital buffers apply to CBG:

Capital conservation buffer ("CCB")

The CCB applies to banks and has been developed to ensure capital buffers are available which can be drawn upon during periods of stress if required. The buffer is being phased in from 2016 at the rate of 0.625% p.a. to reach 2.5% in 2019. As of 31 July 2017, the buffer was 1.25% of RWAs.

Countercyclical capital buffer ("CCyB")

On 27 June 2017, the UK Financial Policy Committee ("FPC") increased the UK CCyB rate from 0.0% to 0.5% of banks' UK exposures, with an effective date of 27 June 2018. The FPC further stated that it expects to increase the rate to 1% at its November meeting.

The table below shows the geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer as at 31 July 2017:

Breakdown by country[1]	General credit exposures *Exposure value* £ million	Trading book exposures *Sum of long and short trading book positions* £ million	Own funds requirements *Of which: General credit exposures* £ million	*Of which: Trading book exposures* £ million	*Total* £ million	Own funds requirement weighting	CCyB rate %
United Kingdom	6,370.7	45.1	477.5	3.6	481.1	0.90	0%
Ireland	665.5	-	40.2	-	40.2	0.08	0%
Jersey	74.4	-	4.8	-	4.8	0.01	0%
British Virgin Islands	36.4	-	4.1	-	4.1	0.01	0%
Germany	37.5	-	2.5	-	2.5	0.00	0%
Guernsey	28.3	-	1.9	-	1.9	0.00	0%
Isle of Man	24.9	-	2.6	-	2.6	0.00	0%
Monaco	6.0	-	0.5	-	0.5	0.00	0%
Malta	5.5	-	0.4	-	0.4	0.00	0%
Cayman Islands	4.6	-	0.4	-	0.4	0.00	0%
Poland	3.5	-	0.3	-	0.3	0.00	0%
Others[2]	2.2	1.1	0.2	0.1	0.3	0.00	0-2%
Total	**7,259.5**	**46.2**	**535.4**	**3.7**	**539.1**	**1.00**	

The table below shows the amount of institution-specific CCyB as at 31 July 2017:

	2017 £ million
Total risk exposure amount[3]	**7,859.0**
Institution-specific CCyB rate (%)	**0.0%**
Institution-specific CCyB requirement	**-**

1 Exposures are classified by the domicile of the counterparty.
2 Included in 'others' are immaterial trading book exposures to Norway and Sweden, to which 1.5% and 2% CCyB applies respectively.
3 'Total Risk Exposure Amount' is equivalent to RWAs (see Section 3 "Key Regulatory Metrics").
4 The two tables above follow the templates set out in the relevant EU Delegated Act, except certain columns have been omitted that are not relevant. In accordance with the Delegated Act and CRR requirements, exposures to central governments or central banks, regional governments or local authorities, public sector entities and institutions are excluded.

7. Counterparty credit risk

Counterparty credit risk is the risk of loss as a result of a counterparty to a transaction defaulting before the final settlement of the transaction's cash flows.

Counterparty credit risk derives from derivative exposures, including the regulatory credit valuation adjustment, and from exposures arising in the Securities division trading in the cash markets with regulated counterparties on a delivery versus payment basis such that any credit exposure is limited to price movements in the underlying securities. It also includes exposures resulting from free deliveries in the Securities division.

The table in Section 5 "Capital adequacy" shows that counterparty credit risk amounts to less than 1% (2016: less than 1%) of the overall capital requirement. Consequently, on the grounds of materiality, no further detail is provided on this risk.

8. Credit risk

Credit risk is the risk of a reduction in earnings and/or value, as a result of the failure of a counterparty or associated party with whom the group has contracted to meet its obligations as they fall due. Credit risk across the group arises mainly through the lending and treasury activities of the Banking division. The following tables analyse regulatory credit risk exposures:

	2017 £ million	2016 £ million	Average exposure in 2017 £ million
Central governments or central banks	**902.3**	905.4	859.6
Regional governments or local authorities	**3.8**	5.1	4.2
Public sector entities	**5.8**	7.2	6.2
Institutions	**280.1**	330.8	284.2
Corporates	**1,626.5**	1,557.0	1,622.7
Retail	**3,581.4**	3,379.4	3,473.5
Secured by mortgages on immovable property	**283.4**	1,420.9	529.5
Exposures in default	**64.0**	110.0	71.6
Items associated with particular high risk	**1,346.4**	1.7	1,034.8
Collective investment undertakings	**-**	0.1	0.0
Other items	**357.8**	318.5	344.9
	8,451.5	8,036.1	8,231.2

The exposures are before applying risk weightings and include undrawn commitments after the application of the applicable credit conversion factors. The retail exposure class consists of loans to individuals and small and medium sized entities with similar characteristics.

As at 31 July 2017, the group's exposure to SMEs is £4,183 million (excluding undrawn commitments) (2016: £4,054 million).

8. Credit risk continued

Geographic distribution of exposures[1] by regulatory exposure asset class at 31 July 2017:

	United Kingdom[2] £ million	Europe £ million	Rest of world £ million	**Total £ million**
Central governments or central banks	858.7	43.6	-	**902.3**
Regional governments or local authorities	3.8	-	-	**3.8**
Public sector entities	5.8	-	-	**5.8**
Institutions	237.7	39.5	2.9	**280.1**
Corporates	1,473.9	147.7	4.9	**1,626.5**
Retail	3,020.0	561.4	-	**3,581.4**
Secured by mortgages on immovable property	273.2	3.5	6.7	**283.4**
Exposure in default	61.7	2.3	-	**64.0**
Items associated with particular high risk	1,314.9	-	31.5	**1,346.4**
Collective investment undertakings	-	-	-	**-**
Other items	354.6	3.2	-	**357.8**
Total	**7,604.3**	**801.2**	**46.0**	**8,451.5**

1 Exposures are classified by the domicile of the counterparty.
2 Includes Channel Islands and Isle of Man.

Residual maturity breakdown of regulatory exposure asset classes on a contractual basis at 31 July 2017:

	Less than three months £ million	Three months to one year £ million	One to five years £ million	More than five years £ million	**Total £ million**
Central governments or central banks	811.7	12.4	30.7	47.5	**902.3**
Regional governments or local authorities	0.9	1.0	1.5	0.4	**3.8**
Public sector entities	1.4	2.1	2.3	-	**5.8**
Institutions	99.8	180.3	-	-	**280.1**
Corporates	645.5	275.1	643.0	62.9	**1,626.5**
Retail	754.7	1,070.9	1,743.9	11.9	**3,581.4**
Secured by mortgages on immovable property	42.2	132.3	108.9	-	**283.4**
Items associated with particular high risk	539.5	595.5	211.4	-	**1,346.4**
Collective investment undertakings	-	-	-	-	**-**
Other items	239.8	33.5	82.1	2.4	**357.8**
Total	**3,135.5**	**2,303.1**	**2,823.8**	**125.1**	**8,387.5**
Exposures in default					64.0
					8,451.5

Impairment of financial assets

The group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available for sale or loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset. Details on forbearance are shown on page 142 of the Annual Report.

8. Credit risk continued

(a) Loans and advances to customers

Treatment

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics.

For loans and receivables, the amount of the loss is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the original effective interest rate. As the loan amortises over its life, the impairment loss may amortise. All impairment losses are reviewed at least at each reporting date. If subsequently the amount of the loss decreases as a result of a new event, the relevant element of the outstanding impairment loss is reversed. Interest on impaired financial assets is recognised at the original effective interest rate applied to the carrying amount as reduced by an allowance for impairment.

For loans that are not considered individually significant, the group adopts a formulaic approach which allocates a loss rate dependent on the overdue period. Loss rates are based on the discounted expected future cash flows and are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Differences in accounting and regulatory treatment

For accounting purposes, a financial asset is treated as past due when a counterparty has failed to make a payment when contractually due and an impairment provision is made where there is objective evidence of impairment. In contrast, under regulatory rules, a financial asset is treated as past due when the payment is ninety days past the contractual due date. Value adjustments and provisions required under regulatory rules are calculated on the same basis as impairment provisions, and so all provisions for impaired loans and advances are referred to as impairment provisions. The impairment provisions shown below are the accounting values shown in note 27 of the group's Annual Report, where further relevant information can be found.

Analysis of impairment provisions

For accounting purposes, impaired loans and advances to customers are analysed according to whether the impairment provisions are individually or collectively assessed, as described in more detail in note 27 of the group's Annual Report. However, for regulatory purposes the group does not have any general or collective provisions as defined under the CRR.

(b) Financial instruments classified as available for sale

When a decline in the fair value of a financial asset classified as available for sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the consolidated income statement. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available for sale equity instruments are not reversed through the consolidated income statement, but those on available for sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

Analysis of impaired and past due loans

The tables below analyse impaired loans as treated for accounting purposes and past due loans as treated for regulatory purposes at 31 July 2017.

8. Credit risk continued

Counterparty type[1] analysis of gross impaired and past due loans, and impairment provisions at 31 July 2017:

	Gross impaired loans 2017 £ million	Gross past due loans 2017 £ million	Impairment provisions 2017 £ million	Charges for impairment provisions during the period to 2017 £ million
Corporates	67.0	88.6	29.4	8.5
Retail	68.8	51.8	23.0	31.7
Total	**135.8**	**140.4**	**52.4**	**40.2**

1 Counterparty type analysis is based on mapping all relevant loans to either Corporates or Retail.

Geographical analysis of gross impaired and past due loans, and impairment provisions at 31 July 2017:

	Gross impaired loans 2017 £ million	Gross past due loan 2017 £ million	Impairment provisions 2017 £ million	Charges for impairment provisions during the period to 2017 £ million
United Kingdom[1]	125.7	130.1	50.6	39.1
Europe	3.7	3.9	1.7	1.0
Rest of World	6.4	6.4	0.1	0.1
Total	**135.8**	**140.4**	**52.4**	**40.2**

1 Includes Channel Islands and Isle of Man.

Impairment provisions on loans and advances to customers:

	£ million
At 1 August 2016	**59.7**
Charge for the year	**40.2**
Amounts written off net of recoveries	**(47.5)**
As 31 July 2017	**52.4**

9. Credit risk: standardised approach

The group uses external credit assessments provided by Moody's Investors Service ("Moody's") to determine the risk weight of rated counterparties in each standardised credit risk exposure class. Moody's is recognised by the PRA as an eligible external credit assessment institution for the purposes of calculating credit risk requirements under the standardised approach. The external ratings of Moody's are mapped to the prescribed credit quality step assessment scale that in turn produces standard risk weightings. Exposures to central governments and central banks that have obtained a 0% risk weight from using external credit assessments are omitted from the tables below.

9. Credit risk: standardised approach continued

The tables below show the exposure amounts associated with the credit quality steps and the relevant risk weightings as at 31 July 2017 (only credit quality steps with exposures are shown):

Institutions

Credit quality step	Moody's rating	Risk weight	Exposure £ million
1	Aaa to Aa3	20%	**50.1**
2	A1 to A3	50% / 20%[1]	**225.6**
3	Baa1 to Baa3	50% / 20%[1]	**4.4**
Total			**280.1**

1 20% risk weight applies where residual maturity is three months or less.

Corporate

Credit quality step	Moody's rating	Risk weight	Exposure £ million
3	Baa1 to Baa3	100%	**0.4**
Total			**0.4**

10. Credit risk mitigation

In the normal course of business cash collateral (margin) is posted by the counterparty to collateralise the mark to market exposure on a derivative portfolio. This covers £35.4 million of exposures within the institutions exposure class.

As explained in Section 2 "Risk management objectives and policies" and in note 27 of the group's Annual Report, the majority of the Banking division's lending is secured. The security taken does not result in any reduction in RWAs under the standardised approach to credit risk. The group does not make use of on-balance sheet netting.

11. Non-trading book exposures in equities

At 31 July 2017, the group had £0.8 million of equity investments in the non-trading book, all of which were classified as available for sale. All equity investments are unlisted. The capital requirement amounted to £0.1 million, with £0.5 million of equity investments being classified as high risk for regulatory purposes. Cumulative realised gains from sales in the period were £0.1 million.

The accounting policies for classifying equity investments are outlined below.

Equity investments classified as available for sale

These are recognised at fair value plus any directly attributable purchase costs, with changes being accounted for through equity. If such an asset is sold or there is objective evidence that they are impaired, the cumulative gains and losses recognised in equity are recycled through the income statement.

Equity investments designated at inception under fair value option

These are equity shares fair valued where the resulting gains and losses are included in the income statement.

11. Non-trading book exposures in equities continued

Movements in equity shares in the year to 31 July 2017 were as follows:

	Available for sale £ million	Fair value through profit or loss £ million	Total £ million
At 31 July 2016	2.0	0.1	2.1
Disposals	(1.3)	(0.1)	(1.4)
Currency translation differences	0.1	-	0.1
At 31 July 2017	**0.8**	**-**	**0.8**

12. Interest rate risk in the non-trading book

The group's exposure to interest rate risk arises in the Banking division and the remainder of this section relates to the Banking division accordingly. Interest rate risk in the group's other divisions is considered to be immaterial. The group has a simple and transparent balance sheet and a low appetite for interest rate risk which is limited to that required to operate efficiently.

The group's policy is to match repricing characteristics of assets and liabilities naturally where possible or by using interest rate swaps where necessary to secure the margin on its loans and advances to customers. These interest rate swaps are disclosed in note 13 of the Annual Report.

The Asset and Liability Committee ("ALCO") monitors the interest rate risk exposure across the balance sheet.

There are three main sources of interest rate risk recognised, which could adversely impact future income or the value of the balance sheet:

- Repricing risk – occurs when assets and liabilities reprice at different times;
- Embedded optionality risk – occurs as a result of special conditions attached to contract terms embedded in some loans; and
- Basis risk – occurs where there is a mismatch in the interest rate reference rate for assets and liabilities.

The table below sets out the assessed impact on our base case earnings at risk ("EaR") due to a parallel shift in interest rates as at 31 July 2017:

	2017 £ million
0.5% increase	**(8.7)**
0.5% decrease	**6.2**

The table below sets out the assessed impact on our base case economic value of equity ("EVE") due to a shift in interest rates as at 31 July 2017:

	2017 £ million
0.5% increase	**0.2**
0.5% decrease	**(0.1)**

The above analysis is calculated in sterling as the group's exposure to foreign exchange risk is immaterial. More information on the group's foreign currency risk is disclosed in note 27 of the Annual Report.

13. Leverage

The leverage ratio is a transparent, comparable measure not affected by risk weightings. It is calculated as tier 1 capital divided by adjusted balance sheet exposure. The level of leverage is actively monitored and regularly assessed alongside capital and capital ratios, as described in Section 5 "Capital adequacy". The following three tables follow the formats that are prescribed by the EBA.

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

	CRR leverage ratio exposure 2017 £ million
Total assets as per published financial statements	**9,285.2**
Adjustments for derivative financial instruments	**34.9**
Adjustments for Securities Financing Transactions ("SFTs")	**8.2**
Adjustments for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**129.3**
Other adjustments	**(189.1)**
Total leverage exposure	**9,268.5**

Table LRCom: Leverage ratio common disclosure:

	CRR leverage ratio exposure 2017 £ million
On-balance sheet exposures (excluding derivatives and SFTs):	
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	**9,258.2**
Asset amounts deducted in determining Tier 1 capital	**(189.1)**
Total on-balance sheet exposures (excluding derivatives and SFTs)	**9,069.1**
Derivative exposures:	
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**35.8**
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**26.1**
Total derivative exposures	**61.9**
Securities financing transaction exposures:	
Counterparty credit risk exposure for SFT assets	**8.2**
Total securities financing transaction exposures	**8.2**
Other off-balance sheet exposures:	
Off-balance sheet exposures at gross notional amount	**1,097.5**
Adjustments for conversion to credit equivalent amounts	**(968.2)**
Other off-balance sheet exposures	**129.3**
Capital and total exposures:	
Tier 1 capital	**990.6**
Total leverage ratio exposure	**9,268.5**
Leverage ratio	**10.7%**

1 The table above follows the template set out in the relevant EU guidance, except certain irrelevant rows have been omitted.
2 There is no difference in the leverage ratio on a transitional versus fully loaded basis.

13. Leverage continued

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

	CRR Leverage Ratio Exposure 2017 £ million
Total on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures), of which:	**9,069.1**
Trading book exposures	**643.4**
Banking book exposures, of which:	**8,425.7**
Exposures treated as sovereigns	**902.3**
Exposures to regional governments, local authorities and public sector entities not treated as sovereigns	**9.6**
Institutions	**280.1**
Secured by mortgages of immovable properties	**283.3**
Retail exposures	**3,571.5**
Corporate	**1,619.8**
Exposures in default	**64.0**
Exposures associated with a particularly high risk	**1,337.3**
Other exposures (e.g. equity, securitisation, and other non-credit obligation assets)	**357.8**

14. Securitisation

The group has securitised without recourse and restrictions £1,486.3 million (31 July 2016: £1,443.9 million) of its insurance premium and motor loan receivables in return for asset-backed securities in issue of £899.6 million (31 July 2016: £1,015.9 million) which includes £157.3 million (31 July 2016: £168.1 million) asset-backed securities in issue retained for liquidity purposes. As the group has retained exposure to substantially all the credit risk and rewards of the residual benefit of the underlying assets it continues to recognise these assets in loans and advances to customers in its consolidated balance sheet. As a result, CRR Article 243 does not apply when calculating risk weighted assets on the securitised loans, and no further disclosures are required.

15. Asset encumbrance

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn.

The Pillar 3 asset encumbrance disclosure templates, shown below, have been compiled in accordance with PRA and EBA regulatory reporting requirements, specifically the PRA's supervisory statement SS11/14 ("CRD IV: Compliance with the EBA's Guidelines on the disclosure of encumbered and unencumbered assets"). In accordance with the threshold criteria under SS11/14, the group is not required to report Template B on the fair value of encumbered and unencumbered collateral received. Also, the values disclosed will differ from the group's disclosures contained in the group's Annual Report as the data are presented as a median calculation rather than point in time.

15. Asset encumbrance continued

Template A: Encumbered and unencumbered assets (median value):

	Carrying amount of encumbered assets 2017 £ million	Fair value of encumbered assets 2017 £ million	Carrying amount of unencumbered assets 2017 £ million	Fair value of unencumbered assets 2017 £ million
Assets of the reporting institution	2,234	-	6,738	-
Equity instruments	4	4	27	27
Debt securities	-	-	-	-
Other assets	7	-	1,199	-

Template C: Encumbered Assets, Collateral Received and Associated Liabilities (median value):

	Matching liabilities, contingent liabilities or securities lent 2017 £ million	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered 2017 £ million
Carrying amount of selected financial liabilities	1,283	1,816

1 Asset encumbrance figures are calculated on a quarterly basis

Information on importance of encumbrance

As an integral aspect of its business, the group engages in activities that result in certain assets being encumbered. The main activity relates to securitisation which is explained in Section 14 "Securitisation" above, which includes comparatives, and from accessing the Bank of England's Funding for Lending and Term Funding Schemes (of which more information is set out in note 27 of the group's Annual Report). The group also pledges assets for repurchase agreements and securities borrowing agreements, mainly in our Securities division.

ALCO monitors the level of encumbrance to ensure it remains within approved risk appetite limits which are based on loan book and balance sheet encumbrance levels. Further information on asset encumbrance can be found in note 27 of the group's Annual Report under the section "Assets pledged and received as collateral" and "Financial assets: Loans and advances to customers".

16. Remuneration

Remuneration Committee ("RemCo") Membership

The membership of the RemCo is comprised of four non-executive directors. They are Bridget Macaskill, Oliver Corbett, Geoffrey Howe and Lesley Jones. The Committee met seven times during the year.

RemCo Responsibilities

The RemCo's main responsibilities are to:

- Review and determine the total remuneration packages of executive directors and other senior executives in consultation with the chairman and chief executive and within the terms of the agreed policy;
- Approve the design and targets of any performance related pay schemes operated by the group;
- Review the design of all employee share incentive plans;
- Ensure that contractual terms on termination and any payments made are fair to the individual and the group, that failure is not rewarded and that a duty to mitigate loss is fully recognised;

16. Remuneration continued

- Review any major changes in employee benefits structures throughout the group;
- Select, appoint and determine terms of reference for independent remuneration consultants to advise the RemCo on remuneration policy and levels of remuneration;
- Ensure that the remuneration structures in the group are compliant with the rules and requirements of regulators and all relevant legislation;
- Ensure that provisions regarding disclosure of remuneration are fulfilled; and
- Seek advice from group control functions to ensure remuneration structures and annual bonuses are appropriately aligned to the group's risk appetite.

Advice

During the year under review and up to the date of this report the RemCo consulted and took advice from PricewaterhouseCoopers ("PwC"), the chairman of the board, the group chief executive, the group head of human resources, the head of reward and HR operations, the group chief risk officer and the company secretary. Where the committee seeks advice from employees this never relates to their own remuneration.

Remuneration Philosophy

The reward structure aims to:

- Attract, motivate and retain high calibre employees across the group;
- Reward good performance;
- Promote the achievement of the group's annual plans and its long-term strategic objectives;
- Align the interests of employees with those of all key stakeholders, in particular our shareholders, clients and regulators; and
- Support effective risk management and promote a positive client conduct culture.

Our Approach to Remuneration

The remuneration structures within the group are designed to support the group's key attributes across our businesses, which are expertise, service and relationships. In order to attract the calibre of employees who can support these attributes, compensation must be competitive and designed to encourage the right behaviours. Although the risk profile of the business is short-term in nature, we seek to promote prudence, strong client relationships and sustained performance over the medium to long term with a remuneration structure for executives and senior employees which includes levels of deferral of the annual bonus and a Long Term Incentive Plan subject to performance measures applicable over a three year period.

All our businesses have a "pay for performance" culture. Performance management is integral to our annual compensation review processes and assessment of performance for discretionary bonus awards takes into account a broad range of performance measures, both financial and non-financial. These include an assessment of risk management behaviour which ensures that negative behaviours are penalised, resulting in lower or no variable compensation, regardless of financial performance. Our review process to determine annual awards includes input from the group control functions (risk, compliance and internal audit) to ensure awards have been adjusted to take into account positive or negative issues from a risk and compliance perspective.

The Committee believes the remuneration policies aim to balance the requirements of all key stakeholders, including clients, shareholders, regulators and employees. The shareholder "share" of adjusted operating profit, calculated as the dividend and retained earnings as a percentage of adjusted operating profit before bonus and after tax, has increased over the last three years from 64% to 70% for the 2017 financial year. The ratio of total compensation to adjusted operating income for the 2017 financial year is 38%.

The Committee believes that the group's good performance over the past three years shows that the group's remuneration policies provide an effective incentive for executives and employees while striking a balance between risk and reward for the business as a whole.

16. Remuneration continued

Remuneration Schemes for Code Staff

Remuneration Code Staff (also known as Material Risk Takers) comprises categories of staff whose professional activities have a material impact on the firm's risk profile ("Code Staff"). The remuneration of Code Staff is subject to specific requirements within the Remuneration Code.

New Remuneration Policy

During 2017 we have undertaken an extensive review of our Directors' Remuneration Policy to ensure that this remains appropriate and aligned to our distinctive business model and the interests of our shareholders.

We believe that the existing Remuneration Policy, approved by our shareholders in 2014, but largely unchanged since 2009, has worked well to date in incentivising strong business and financial performance and in aligning the interests of Executive Directors with Close Brothers' shareholders. This has been reflected in increased returns to shareholders and strong performance over the last several years. However, the review this year identified that looking forward; the scheme for the next three years could be improved to increase alignment with our model, market best practice and shareholder interests.

The new Policy therefore maintains those elements that work well for our business and are also seen favourably by our shareholders, with a number of amendments aimed at increasing alignment with our business model, simplifying our arrangements and bringing our structures into line with evolving best practice. The key changes to our Policy and populations to which they apply are summarised in the table below:

Change to remuneration policy	Executive Directors	Senior Management	Code Staff
Simplification of long-term variable remuneration by moving to a single long-term plan	✓	✓	✓
Changes to the performance measures on the annual bonus and long-term incentive award	✓	✓	✓
Introduction of a two-year post-vesting holding period on the LTIP	✓	✓[1]	-
Changes to the approach to deferral on the annual bonus	✓	-	-

1 Only applicable to Group ExCo members.

The new Remuneration Policy is subject to approval at the shareholder AGM on 16 November 2017, for further details please refer to the Directors Remuneration Report within the group's 2017 Annual Report.

Base Salary

The base salary is designed to attract and retain high calibre employees and reflect an employee's role, skills and knowledge. These are set annually based on the individual's role and experience, pay for the broader employee population and external factors, where applicable.

Discretionary Bonus Scheme

The majority of employees in the group have the potential to receive a performance related element of pay as part of their overall compensation package. This element is based on a combination of the overall assessment of the performance of the business and individual performance. Employees have individual objectives against which their personal performance is rated. These objectives cover both financial and non-financial measures, including risk management objectives appropriate to their role. In addition to the

16. Remuneration continued

assessment of performance against these objectives (conducted by an individual's line manager as part of their overall performance review) the group chief risk officer reports independently to the RemCo on behalf of group risk, compliance and internal audit to ensure that any concerns highlighted by the control functions during the year are appropriately addressed in individual remuneration proposals.

A portion of any discretionary bonus above certain thresholds and for certain individuals is deferred. For the performance year 2018 onwards the Executive Directors' bonuses will be deferred at a fixed rate. The deferral is generally into Close Brothers Group plc shares but in certain areas, where it is appropriate for the business based on the risk profile of that business, this may be deferred in cash. The deferred awards for Code Staff are subject to forfeiture and malus provisions. The malus provisions mean that the awards may be subject to forfeiture or may be reduced after grant in certain adverse circumstances. The deferred awards for Executive Directors are subject to clawback provisions which mean that the awards already paid out may be subject to repayment in certain circumstances.

The aggregate level of bonuses is determined by reference to group and divisional metrics, including financial and non-financial metrics, such as risk and strategic considerations.

Long Term Incentive Plan ("LTIP") Award

The LTIP is delivered through an annual award of nil cost options (or conditional shares or restricted shares) with a face value of up to 200% of base salary. The RemCo decides annually the actual size of individual awards. The shares vest after three years subject to the following performance targets for the 2017 awards:

- 35% of the award is subject to average Return on Equity (RoE);
- 35% of the award is subject to adjusted earnings per share ("EPS") growth; and
- 30% of the award is subject to risk management objectives.

The LTIP awards are subject to forfeiture and malus provisions. In addition, LTIP awards for Executive Directors are subject to clawback provisions.

Targets for the LTIP awards for 2017 are:

RoE:

Average RoE over three years	Vesting % of RoE element
20% p.a. or greater	100%
Between 20% p.a. and 12% p.a.	Straight-line between these points
12% p.a.	25%
Less than 12% p.a.	0%

Adjusted EPS:

Adjusted EPS growth over three years	Vesting % of EPS element
30% or greater	100%
Between 10% and 30%	Straight-line between these points
10%	25%
Less 10%	0%

16. Remuneration continued

Risk Management Objectives

There are two objectives, with equal weighting of each:

- Capital and balance sheet management; and
- Risk, compliance and controls.

Risk Management

The remuneration policy approved by the RemCo is designed to promote sound and effective risk management and to ensure that risk taking within the group does not exceed the group's risk tolerance. The RemCo also approves changes to compensation structures for groups of individuals and mandates the involvement of group risk in determining new structures to ensure that they are appropriately aligned to the risk profile of the business in which they operate.

The group chief risk officer, group head of compliance, internal audit, and the divisional heads of risk and compliance are closely involved in the remuneration process to ensure that remuneration practices support this. The group chief risk officer reports independently to the RemCo to ensure that remuneration decisions and practices support these objectives. Risk and compliance provide input into, and independent review of, the remuneration policies of the company.

Recovery and Withholding

As outlined in the sections above, variable remuneration for Code Staff is subject to malus, and variable remuneration for Executive Directors is subject to both malus and clawback.

The cash bonus for Executive Directors is subject to clawback for a period of three years from award.

The deferred bonuses for Code Staff and Executive Directors are subject to malus prior to vesting. In addition, the deferred bonuses for Executive Directors are subject to clawback for the period of three years from the date of grant.

The LTIP for Code Staff and Executive Directors is subject to malus for the three year period to the point of vesting. In addition, LTIP for Executive Directors is subject to clawback for four years from the date of grant.

The Invested SMP shares for Code Staff and Executive Directors are subject to malus until vesting and in addition, Invested SMP shares for Executive Directors are subject to clawback for three years from the date of grant. The Matched SMP shares are subject to malus until vesting and, for Executive Directors, to clawback for four years from the date of grant.

The events which may trigger malus are as follows:

- The employees' employment has been terminated for misconduct or the employee has been issued with a formal disciplinary warning for misconduct under the firm's disciplinary policy; or
- The firm suffers a material loss where the employee has operated outside of the risk parameters or risk profile applicable to their position and as such, the Committee considers a material failure in risk management has occurred; or
- The level of the award is not sustainable when assessing the overall financial viability of the firm.

In the event that one of these is triggered, the Committee may, at its discretion, defer and/or reduce, in whole or in part any unvested award.

16. Remuneration continued

The events which may trigger clawback for Executive Directors are as follows:

- Discovery of a material mis-statement resulting in an adjustment in the audited consolidated accounts of the company, or the audited accounts of any material subsidiary. This would also be for a period that was wholly or partly before the end of the period over which the performance target applicable to an award was assessed;
- The assessment of any performance target or condition in respect of an award was based on material error, or materially inaccurate or misleading information;
- The discovery that any information used to determine the bonus and number of shares subject to an award was based on material error, or materially inaccurate or misleading information; and
- Action or conduct of a plan participant which, in the reasonable opinion of the board, amounts to fraud or gross misconduct.

In the event that one of these is triggered, the Committee may require the Executive Director to repay all or part of a relevant award, and any associated dividend equivalents.

Link between reward and performance - financial year 2017

The group's financial results have been good this year, and over the past three years. Adjusted operating profit has increased 13% in the year to £264.8 million, and it has grown 32% or 10% per annum compounded over the last three financial years. Notwithstanding the increase in the tax rate, Return on Equity remains strong at 17.9% compared to 17.9% in 2014. Dividend growth was 5% this year, with dividend cover remaining at 2.2 times up from 2.1 times in 2014.

These factors were taken into consideration in determining bonus payments for the Code staff for the financial year.

2017 Aggregate Remuneration1 in respect of Code Staff by business

Banking £ million	Securities £ million	Asset Management £ million	Group £ million
14.3	12.1	9.1	9.9

1 Aggregate Remuneration consists of fixed and variable remuneration as outlined below.

2017 Aggregate Remuneration in respect of Code Staff split into fixed and variable remuneration

	Senior Management	Other Code Staff
Number of Code Staff	35	45
Fixed Remuneration (£ million)[1]	10.9	6.9
Variable Remuneration (£ million)[2]	21.2	6.4

1 Fixed Remuneration consists of base salary, company pension contributions and any other fixed allowances.

2 Variable Remuneration consists of the discretionary annual bonus and 60% of the face value of the LTIP award (60% being a reasonable estimate based on historic and expected future levels of vesting as this award is subject to performance conditions) consists of fixed and variable remuneration as outlined below.

Appendix 1: EBA regulatory capital balance sheet reconciliation

	Balance sheet extract 31 July 2017 £ million	Balance sheet components 31 July 2017 £ million	Ref[1]
Assets			
Intangible assets	191.7		
of which: deduction from common equity tier 1 capital		191.7	A
Deferred tax asset	47.4		
of which: deferred tax liability - intangible assets		(5.4)	B
of which: deferred tax liability - pension related		(0.8)	C
Prepayments, accrued income and other assets	158.7		
of which: defined-benefit pension fund assets		3.6	D
Total Assets	**9,285.2**		
Liabilities			
Subordinated loan capital	220.7		
of which: Tier 2 capital issued by Close Brothers Group plc		175.0	E
of which: Tier 2 capital issued by Close Brothers Limited		30.6	F
Total liabilities	**8,049.2**		
Equity			
Called up share capital	38.0		
of which: amount eligible for common equity tier 1 capital		38.0	G
Share premium account	307.8		
of which: amount eligible for common equity tier 1 capital		307.8	H
Retained earnings	906.6	906.6	I
Exchange movements reserve	(1.5)	(1.5)	J
Cash flow hedging reserve	(3.2)	(3.2)	K
Available for sale movements reserve	0.7	0.7	L
Share-based payments reserve[1]	(11.9)	22.2	M
of which: holdings of own capital instruments		(34.1)	N
Total equity	**1,236.0**		
Total liabilities and equity	**9,285.2**		
Non balance sheet items			
Foreseeable dividend		(59.8)	O
Prudent valuation adjustment		(0.2)	P

1 Consists of £34.1 million relating to holdings of own capital instruments, which is shown separately in Section 4 “Capital Resources” and Appendix 3, and £22.2 million relating to a share based payments reserve as described in Note 25 of the group’s Annual Report.
2 The letters in the “Ref” column in the table above are referenced to the capital table in Appendix 3 to show how the group’s regulatory capital is derived from the group’s balance sheet.

Appendix 2: EBA Capital instruments' key features

Capital Instruments main features template

1	Issuer	CBL	CBL	CBG[1]
2	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	None	None	XS1548943221
3	Governing law(s) of the instrument	English	English	English
	Regulatory treatment			
4	Transitional CRR rules	Tier 2 capital	Tier 2 capital	Tier 2 capital
5	Post-transitional CRR rules	Ineligible	Ineligible	Eligible
6	Eligible at solo/(sub-) consolidated/ solo&(sub-) consolidated	Solo and consolidated	Solo and consolidated	Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Subordinated debt	Subordinated debt	Subordinated debt
8	Amount recognised in regulatory capital (Currency in million, as of most recent reporting date)	£10.2 million	£20.4 million	£175 million
9	Nominal amount of instrument	£15 million	£30 million	£175 million
9a	Issue price	Par	Par	Par
9b	Redemption price	Par	Par	Par
10	Accounting classification	Amortised cost	Amortised cost	Amortised cost
11	Original date of issuance	02/03/01	01/03/01	24/01/17
12	Perpetual or dated	Dated	Dated	Dated
13	Original maturity date	02/03/26	01/03/26	24/01/27
14	Issuer call subject to prior supervisory approval	Yes	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	02/03/21 Tax event call	01/03/21 Tax event call	24/01/22 Tax event or capital disqualification event
16	Subsequent call dates, if applicable	At any time	At any time	N/A
	Coupons / dividends			
17	Fixed or floating dividend/coupon	Fixed and then floating after optional call date	Fixed and then floating after optional call date	Fixed then floating after reset date
18	Coupon rate and any related index	7.42%	7.62%	4.25%
19	Existence of a dividend stopper	No	No	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Mandatory	Mandatory	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Mandatory	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	Yes	Yes	No
22	Noncumulative or cumulative	Cumulative	Cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible	Convertible

Appendix 2: EBA Capital instruments' key features continued

24	If convertible, conversion trigger(s)	N/A	N/A	Non viability via UK Banking Act HM Treasury, PRA, FCA and BoE
25	If convertible, fully or partially	N/A	N/A	Both - fully or partially
26	If convertible, conversion rate	N/A	N/A	N/A
27	If convertible, mandatory or optional conversion	N/A	N/A	Mandatory
28	If convertible, specify instrument type convertible into	N/A	N/A	Equity
29	If convertible, specify issuer of instrument it converts into	N/A	N/A	CBG
30	Write-down features	N/A	N/A	Yes
31	If write-down, write-down trigger(s)	N/A	N/A	Non viability via UK Banking Act HM Treasury, PRA, FCA and BoE
32	If write-down, full or partial	N/A	N/A	Both - full or partial
33	If write-down, permanent or temporary	N/A	N/A	Permanent
34	If temporary write-down, description of write-up mechanism	N/A	N/A	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Outstanding Senior unsecured	Outstanding Senior unsecured	Outstanding Senior unsecured
36	Non-compliant transitioned features	Yes	Yes	N/A
37	If yes, specify non-compliant features	Step up reset rate	Step up reset rate	N/A

1 In parallel to the £175 million subordinated debt issue by CBG, CBL entered into a £175 million subordinated debt agreement with CBG on a like-for-like basis.

Appendix 3: EBA Transitional own funds disclosure

	Transitional Own Funds Disclosure template[1]	31 July 2017 £ million	Ref [2]
	"CET1" capital: instruments and reserves		
1	Capital instruments and the related share premium accounts	**345.8**	G+H
	of which: ordinary shares	**345.8**	
2	Retained earnings	**906.6**	I
3	Accumulated other comprehensive income and other reserves	**18.2**	J+K+L+M
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(59.8)**	O
6	CET1 capital before regulatory adjustments	**1,210.8**	
	"CET1" capital: regulatory adjustments		
7	Additional value adjustments	**(0.2)**	P
8	Intangible assets (net of related tax liability)	**(186.3)**	A+B
11	Fair value reserves related to gains or losses on cash flow hedges	**3.2**	K
15	Defined-benefit pension fund assets	**(2.8)**	C+D
16	Direct and indirect holdings of own CET 1 capital instruments	**(34.1)**	N
28	Total regulatory adjustments to common equity tier 1 capital	**(220.2)**	
29	**"CET1" capital**	**990.6**	
45	**Tier 1 capital**	**990.6**	
	Tier 2 capital: instruments and provisions		
46	Capital instruments and the related share premium accounts	**175.0**	E
48	Qualifying own funds instruments included in consolidated tier 2 capital issued by subsidiaries and held by third parties	**30.6**	F
49	of which: instruments issued by subsidiaries subject to phase out	**30.6**	
51	Tier 2 capital before regulatory adjustments	**205.6**	
58	**Tier 2 capital**	**205.6**	
59	**Total capital**	**1,196.2**	
60	**Total RWAs**	**7,859.0**	
	Capital ratios and buffers		
61	CET1 ratio	**12.6%**	
62	Tier 1 ratio	**12.6%**	
63	Total capital ratio	**15.2%**	
64	Institution specific buffer requirement	**1.25%**	
65	of which: capital conservation buffer requirement	**1.25%**	
68	CET1 available to meet buffers	**5.2%**	
	Amounts below the thresholds for deduction (before risk weighting)		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability)	**53.6**	
	Capital instruments subject to phase-out arrangements		
84	Current cap on tier 2 capital instruments subject to phase out arrangements	**37.5**	
85	Amount excluded from tier 2 capital due to cap (excess over cap after redemptions and maturities)	**7.5**	

1 The table above follows the template set out in the relevant EU Delegated Act, except certain rows have been omitted that are not relevant.

2 References identify balance sheet components in Appendix 1 used in the calculation of regulatory capital.

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