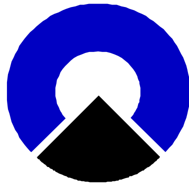

Close Brothers Group plc

Pillar 3 disclosures for the year ended 31 July 2009

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Should you have any queries please e-mail pillar3@cbgplc.com

1. Overview

Background

The aim of Basel II and the EU Capital Requirements Directive (referred collectively as Basel II) is to promote safety and soundness in the financial system. They are both 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 aims to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on a 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 and are based on data as at 31 July 2009.

Scope

The Financial Services Authority ("FSA") 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 directly regulated by the FSA or overseas regulators. Details of the group's principal subsidiaries are included in note 26 of the group's annual report. There are no differences between the basis of consolidation of the group for accounting and regulatory purposes and, therefore, all of the group's subsidiaries are included in these Pillar 3 disclosures.

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.

The group has not applied for any IRB (Internal Ratings Based) waivers and consequently no specific Pillar 3 IRB disclosures are included in this document.

Policy

This is the second time that disclosures under Pillar 3 have been published. Comparative figures for 2008 have only been included for the overall capital position and the summary of the group's capital requirement. Disclosures will be issued as a minimum on an annual basis and will be published on the group's website as soon as practicable after the publication of the group's annual report. 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.

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

CBG's banking subsidiary, Close Brothers Limited ("CBL"), makes use of the provisions laid down in the FSA handbook BIPRU Chapter 2.1 and reports to the FSA on a solo-consolidated basis. This solo-consolidated group includes CBL and its subsidiaries other than its debt collection subsidiary (Close Credit Management) and the offshore banks in Guernsey, Isle of Man and Cayman. CBL publish their Pillar 3 disclosures on the group's website.

2. Risk management objectives and policies

Objectives of the group's risk management framework

Risk management is the process of identifying the principal risks, including regulatory compliance risks, to the group achieving its strategic objectives, establishing appropriate controls to manage those risks and ensuring that appropriate monitoring and reporting systems are in place. The group's risk management process balances cost against risk within the constraints of the group's risk appetite and is consistent with the prudent management required of a large financial organisation.

The group's risk management framework

The group has adopted a "three lines of defence" model to manage its principal business risks:

- Line one is risk management: primary responsibility for strategy, performance and risk management lies with the board, the chief executive and the heads of each division and operating business.
- Line two is risk oversight: risk oversight is provided by the Group Risk and Compliance Committee ("GRCC") and the head of group risk working with counterparts in the divisions and operating businesses and with group compliance. This is supplemented by a range of risk related committees at divisional and operating business levels.
- Line three is independent assurance: independent assurance on the effectiveness of the risk management systems is provided by group internal audit reporting to the Audit Committee (Click here for the Audit Committee terms of reference).

There are clear reporting lines and defined areas of responsibility at board, divisional and business level. This structure is designed to ensure, amongst other things, that key issues and developments are escalated on a timely basis.

The CBG board ("the board") has overall responsibility for ensuring the adequacy of the group's risk management arrangements with the chief executive charged with day to day responsibility for the group-wide management of risk. The GRCC is a committee established by the chief executive to assist him in the discharge of that responsibility comprising the executives of the group board supported by the heads of group risk, group compliance, group internal audit and the general counsel. It meets monthly and is responsible for:

- recommending for board approval the group's risk appetite;
- the development of the group's risk management strategy, approach and policy;
- the development of the group's risk management and regulatory compliance policies and procedures; and
- receiving regular reports on significant risk management, regulatory compliance and internal control issues and for monitoring their analysis and resolution.

The head of group risk and general counsel report to the chief executive. The head of group compliance reports to the general counsel. The head of group internal audit reports functionally to the Audit Committee through the chairman of that committee and to the finance director. Risk oversight is further provided by a number of specialist risk committees at divisional or business level.

The principal such risk committees are as follows:

Division	**Committee**	**Objective**
Banking	Credit committees	Loan underwriting in accordance with centrally established limits of authority.
	Treasury committee	Establishment of policies in respect of interest rate, foreign exchange and liquidity management and counterparty risk for the treasury activities of the group.
Asset management	Risk and compliance committee	Establishment of divisional level risk and regulatory compliance policies and oversight of compliance with those policies.
	New product committees	Business level committees responsible for: approval of new products; review of existing products.
	Investment review committee	Review of investment performance and associated risk.
	Client acceptance committees	Business level committees responsible for approval of new clients. May require divisional and/or CBG approval.
Securities	New client committee	Business level committees responsible for approval of new clients. May require divisional and /or CBG approval.
	Business acceptance committee	Business level committee responsible for approval of new corporate clients and transactions. May require CBG approval.
	Board	Oversight of market and counterparty risk.

Risk assessment

The board considers that the principal risks and uncertainties facing the group have the potential to have a significant detrimental impact on its financial performance and future prospects and are described in the 2009 Annual Report under Principal Risks and Uncertainties. These risks and the uncertain economic conditions are considered to fall within the following risk categories and types as described in the 2009 Internal capital adequacy assessment process ("ICAAP").

Risk category	Risk type
Non-financial	Reputational Strategic Operational Regulatory compliance
Financial	Economic Conditions Credit/Counterparty risk Market Liquidity

The group's exposures under each of these risks are reviewed and reassessed on a bottom-up and top-down basis by senior executives at operating business, divisional and CBG levels at least annually in an exercise coordinated by the group risk function. The group uses a probability and impact scoring system linked to the group's risk appetite to assess the significance of individual risks and the adequacy of risk controls. These risk assessments are reviewed and approved by the board responsible for the management of those risks with the board approving the CBG risk assessment. A high level summary of those risk assessments is set out below:

Reputational Risk

The board considers a loss of reputation to be the most significant risk to a business operating in the financial services sector. The group believes that the risk to its reputation would arise as a result of a failure to manage the group's other risks and places the highest importance on risk management at all levels of the organisation. It also strives to demonstrate the highest level of integrity in all its activities and dedicates significant senior management time and other resources to ensure all employees are aware of the need to display the highest ethical standards in their day to day work.

Strategic Risk

Strategic risk results from external factors and inadequate senior management processes that could lead to a significant failure of the effectiveness of the strategy of the group as a whole, or of its divisions and businesses. This risk is mitigated by the group having a well established structure for agreeing strategy, risk appetite, planning and budgets. Detailed monthly group management accounts are produced and variances and trends are closely monitored. Divisional heads report to the group board each month on the performance of, and key issues affecting, their division. Detailed budgets and three year plans, which are based upon group strategy, are stress tested to take account of potential adverse conditions and are subject to rigorous challenge at divisional and board level to ensure that the group has adequate capital to meet its business and regulatory needs.

Operational Risk

In common with any large financial services group operational risk, which is defined as the risk of loss or other material adverse impact resulting from failed internal processes, people and systems, or from external events, is inherent in the group's operations on an on-going basis.

The group has implemented an operational risk management framework designed to ensure that operational risks are assessed, mitigated and reported in a consistent manner across the group. The group has adopted a formal approach to operational risk event reporting which involves the identification of an event, assessment of its materiality, analysis of the cause, establishment of remedial action required and escalation to divisional or group level risk committees for monitoring of implementation. The group is also exposed to fraud risk both internal and external and has continued to review and enhance its anti-fraud controls.

Regulatory Compliance Risk

Regulatory compliance risk is the risk of loss or other material adverse impact resulting from failure to comply with laws, regulations, codes of conduct or standards of good practice governing the financial services sectors in which we operate. The group operates in a highly regulated environment. The regulatory environment is expected to change significantly in the near future in response to the banking crisis of late 2008. The uncertainty over the exact details of these changes, the potential for increased capital requirements and the costs associated with compliance with changes to the regulatory environment all have the potential to impact on the group's earnings.

The group monitors regulatory developments and engages in dialogue with regulatory authorities on a regular basis and continues to maintain a conservative model with a strong, well capitalised balance sheet and believes it is well placed to react to regulatory change.

Each of the group's regulated businesses has a dedicated compliance officer who is responsible for supporting the business in meeting its regulatory compliance objectives and for executing risk-based monitoring programmes to confirm compliance. The activities of these compliance professionals are co-ordinated and overseen on a group wide basis by the head of group compliance to whom they report.

Economic Conditions

The group engages in a diversified range of activities within the financial services industry, with the majority of transactions undertaken within the UK. As such the group has an exposure to global economic conditions generally and to economic conditions in the UK in particular. Economic conditions deteriorated significantly during the latter part of 2008 and in 2009 and the outlook remains significantly uncertain. The impact of poor economic conditions on the group's customers and markets has the potential to adversely impact the group's financial performance and prospects, as well as increasing other risks. Specific examples of how a weakened economy could affect the group include but are not limited to:

- Reduced demand for the group's products in both the Banking and Asset Management divisions.
- Failure of an institution where the group's or client funds have been invested.
- Increasing bad debt charges within the Banking division as a result of the inability of customers to repay loans and decreasing values of underlying securities.
- Lower trading volumes in our market-making businesses.

- Write downs to group assets as present values of future cash flows reduce due to reductions in economic activity.

The group has historically operated a conservative business model and has traded profitably in the 2009 financial year despite worsening economic conditions. While there is limited visibility on future economic conditions, the group's risk management, internal control systems and overall business model are designed so as to enable it to continue to trade profitably through downturns in the economic cycle.

Credit Risk

Credit risk is the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion. The group has loans and advances to, and has purchased debt securities from, a number of financial institutions. A failure of one or more of these institutions could have a material impact on the group's financial position.

The credit quality of the counterparties with whom the group places deposits or whose debt securities the group holds is monitored by the Treasury Committee. The Committee establishes maximum individual counterparty limits which are monitored on a daily basis. When assessing the suitability of counterparties, the Committee has regard to, inter alia, the following factors:

- Stability of the underlying economy of the country in which the institution is domiciled.
- The scale of the institution and the level of support it is expected to attract in the event of financial difficulties.
- The credit rating of the entity. Only "AA" rated entities are considered suitable as new counterparties. The Committee reviews the ongoing suitability of any counterparty which is subsequently downgraded.

The Banking division's lending activities give rise to credit risk. This credit risk is controlled by a number of local credit committees within centrally set limits of authority. Transactions above those limits are considered by a group level credit committee.

The group adheres to strict lending criteria and places significant emphasis on the quality of any security provided. In addition, the loan book is diversified, short term and the majority of lending is secured. Because the group's loan book is spread over a large number of counterparties with a low average loan size, there are very few individual loans with the capacity to have a material impact on the group's earnings.

Exposure within the Securities division is limited as the businesses trade 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. Counterparty exposure and settlement failure monitoring controls are in place.

Market Risk

Market risk is the risk of loss that arises from adverse movements in equity, bond, interest rate, foreign exchange or other traded markets and arises primarily in our Securities division.The group's securities businesses are exposed to market movements deriving from trading in equity and fixed income securities. Senior management is closely involved in risk management processes which are also monitored at group level. There are controls, supplemented by cash limits, on individual large or slow moving equity or fixed income positions. Real time controls on the size and risk profile of trading books and of individual books within these are maintained. Treasury operations do not trade actively in money market instruments although they are held for liquidity purposes.

Interest income is a substantial proportion of the group's revenues. Movements in interest rates

have the potential to materially affect the group's earnings. The group's policy is to match fixed and variable interest rate liabilities and assets utilising interest rate swaps where necessary. Interest rate mismatch policies are established by the Treasury Committee with compliance monitored daily. Returns from the group's capital and reserves are necessarily subject to interest rate fluctuations and as a matter of policy are not hedged.

The majority of the group's activities are located in the British Isles and are transacted in sterling. The group does however have material currency assets and liabilities primarily due to a range of currency services offered by the Banking division. These currency assets and liabilities are principally certificates of deposit, floating rate notes and lending as well as borrowings and customer deposits. The foreign exchange exposures arising from these assets and liabilities are managed by matching assets and liabilities by currency and the limited use of foreign currency swaps. Exposures are monitored daily against centrally authorised limits. The group does not take speculative proprietary positions in foreign currency. The group also has a number of overseas subsidiaries, a US dollar investment in its associate Mako and two seed capital investments within currency denominated funds. The exposure from these investments is relatively modest and is not currently hedged.

Liquidity Risk

Liquidity risk is the risk of not being able to meet liabilities as they fall due and arises mainly in our Banking division.

The group requires cash resources to support client lending, trading activities and investments. The liquidity of the group is managed so as to ensure that the group is always able to meet its liabilities as they fall due. However, in the event of a sudden loss of confidence in the group's liquidity position causing a rapid withdrawal of customer deposits, the group's ability to continue to pursue its business objectives could be placed at risk.

Each of our operations is responsible for its own liquidity within specified guidelines. Each is capitalised at a level required to meet its business and regulatory needs and, where necessary, has appropriate borrowing facilities from the group or external lenders. The liquidity of each division is reviewed at its monthly board meeting and the overall funding position is reported to the group board each month.

The group's policy has been to finance customer loans and advances by capital and reserves, longer-term deposits and committed facilities with only limited financing from shorter-term deposits. This policy is kept under review by the Treasury Committee which monitors compliance on a daily basis. This policy, the average duration of the group's borrowings (24 months versus twelve months for the loan book) and the group's success in raising term retail funds since 31 July 2008 all lead the group to believe it is in a strong position with respect to liquidity risk.

<u>Risk monitoring and reporting</u>

There is regular reporting at operating business and divisional level of risk and performance information. Summary information is reported to the GRCC, the Audit Committee and the board. At all levels of reporting if past or forecast business performance appears to have moved or is likely to move outside of agreed parameters or there is a breach or near breach of policy limits, the relevant board or committee will ensure that the most appropriate course of action is implemented.

3. Capital resources

The table below summarises the composition of regulatory capital as at 31 July 2009, at which point the group's individual entities and the group complied with all of the externally imposed capital requirements to which they are subject.

	Notes	At 31 July 2009 £ million	At 31 July 2008 £ million
Core tier 1 capital			
Called up ordinary share capital		37.4	37.3
Share premium account		274.5	274.1
Retained earnings and other reserves	1	477.8	448.0
Minority interests		4.3	5.0
Deductions from tier 1 capital			
Intangible assets	2	(107.6)	(134.4)
Goodwill in associates		(49.0)	(49.7)
Investment in own shares		(50.9)	(33.1)
Securitisation positions	3	-	(3.3)
Unrealised losses on available for sale equity shares		(4.6)	-
Core tier 1 capital after deductions		581.9	543.9
Tier 2 capital			
Subordinated debt	4	75.0	75.0
Unrealised gains on available for sale equity shares		-	4.2
General/Collective provision		-	2.2
		75.0	81.4
Deductions from tier 2 capital			
Securitisation positions		-	(3.3)
Tier 2 capital after deductions		75.0	78.1
Total tier 1 and tier 2 after deductions		656.9	622.0
Deductions from total of tier 1 and tier 2			
Investments that are not qualifying holdings		(4.8)	(6.5)
Other regulatory adjustments	3	(0.5)	(1.9)
Total regulatory capital		651.6	613.6

Notes:

1. Retained earnings and other reserves exclude unrealised gains or losses on cash flow hedges and consist of the profit and loss account reserve (excluding earnings unverified by 31 July 2009), the share-based awards reserve and the exchange movements reserve.

2. Intangible assets include goodwill, capitalised software and intangible assets arising on acquisition.

3. For Pillar 3 reporting purposes 50% of the securitisation positions are required to be deducted from tier 1 capital and 50% from tier 2 capital. In the 2008 Annual Report the whole of this deduction has been deducted from the total of tier 1 and tier 2 as part of 'Other regulatory adjustments'. For year ended 31 July 2009 there are no securitisation positions, 'Other regulatory adjustments' relate to deductions for free deliveries in the Securities division.

4. All the subordinated loan capital has been issued by CBG's banking subsidiary CBL and is denominated in sterling. If CBL opts not to prepay at the prepayment date, the interest rate is reset to a margin over the yield on five year UK Treasury securities. There has been no change from 31 July 2008 and the terms are as follows:

Final maturity date	Prepayment date	Initial interest rate	2009 £ million
2020	2015	7.39%	30.0
2026	2021	7.42%	15.0
2026	2021	7.62%	30.0
			75.0

4. Capital adequacy

The group's policy has always been to be well capitalised and soundly financed. Our approach to capital management is driven by strategy and organisational requirements, while also taking into account the regulatory and commercial environments in which we operate. We maintain a strong capital base to support the development of the business and to ensure we meet regulatory capital requirements at all times. We would therefore expect to have capital adequacy ratios in excess of minimum regulatory requirements even before taking account of the need to fund our non regulated activities and small acquisitions.

The board considers both the overall group and each division's capital position and requirements on a regular basis and after taking into account each division's regulatory and operational requirements, excess capital is transferred to the parent company every six months by way of dividend to permit the strategic allocation of capital.

Internal capital adequacy assessment process ("ICAAP")

The introduction of Basel II has resulted in a formal requirement for the group, CBL and the offshore banks in Guernsey and the Isle of Man to each carry out internal capital adequacy assessments. A group-wide process has been developed to undertake this requirement and is now an integral part of the group's risk management processes. The board considers that given the group's risk profile an annual process is sufficient. The output from the process is a report for each entity required to carry out an ICAAP which addresses all material risks faced by the entity to determine the level of capital required against each major source of risk over a three-year time horizon which is the group's standard business planning timescale.

The group ICAAP was coordinated by the head of group risk reporting to the ICAAP committee consisting of the executive directors of CBG, the heads of group risk, finance, compliance and the CBL finance director. Management at all levels within the group are involved by 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 was subject to detailed review and approval by both the ICAAP Committee and by the board.

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 risk weighted exposure amounts for each of the following standardised exposure classes.

	At 31 July 2009 £ million	At 31 July 2008 £ million
Credit risk - standardised approach		
Central governments or central banks	0.0	0.0
Regional governments or local authorities	0.0	0.0
Administrative bodies and non-commercial undertakings	0.5	0.9
Institutions	11.3	13.8
Corporates	33.4	31.6
Retail	84.7	73.5
Secured on real estate property	33.2	33.8
Past due items	13.5	4.8
Items belonging to regulatory high risk categories	2.5	2.6
Short term claims on institutions and corporates	27.3	26.3
Collective investment undertakings	0.6	1.4
Other items	15.7	13.5
	222.7	202.2
Operational risk – basic indicator approach	72.3	82.0
Credit risk- trading book		
Counterparty risk capital component	4.5	2.6
Market risk - trading book		
Interest rate PRR*	2.0	2.0
Equity PRR*	2.7	4.3
Market risk - non trading book		
Foreign currency PRR*	3.5	4.6
Total Pillar 1 capital requirement	**307.7**	**297.7**

* Position Risk Requirement.

5. Counterparty credit risk

Counterparty credit risk is the risk of loss as a result of a party to a transaction defaulting before the final settlement of the transaction's cash flows. Credit risk in our trading book is limited as our Securities businesses trade 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. This can be seen from the table in Section 4 where counterparty credit risk amounts to less than 2% (2008: less than 1%) of the overall capital requirement. Consequently, on the grounds of materiality, no further detail is provided on this risk.

6. Credit risk and dilution risk

Credit risk is the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion. The following tables analyse regulatory credit risk exposures at 31 July 2009.

Analysis of exposures by regulatory exposure asset class

	Exposure at 31 July 2009 £ million	Average exposure for period to 31 July 2009 £ million
Standardised approach		
Central governments or central banks	287.7	144.7
Regional governments or local authorities	0.7	0.8
Administrative bodies and non-commercial undertakings	6.4	7.3
Institutions	696.5	913.1
Corporates	528.8	525.9
Retail	1,561.8	1,485.5
Secured on real estate property	517.0	496.6
Past due items	132.3	123.8
Items belonging to regulatory high risk categories	20.4	22.0
Short term claims on institutions	1,702.4	1,693.8
Collective investment undertakings	7.6	8.0
Other items	197.4	191.2
	5,659.0	**5,612.7**

The retail exposure class consists of loans to individuals and small and medium sized entities, which consist of a significant number of loans with similar characteristics, such that the risk of loss associated with such lending are reduced. Past due items above follows the regulatory definition as disclosed on page 15 and is net of any provisions made against such items. Short term claims on institutions consists of exposures where a short term credit rating is held and the remaining maturity is less than twelve months.

Geographic distribution of exposures by regulatory exposure asset class at 31 July 2009

	British Isles £ million	Europe £ million	Rest of world £ million	**Total £ million**
Standardised approach				
Central governments or central banks	287.7	0.0	0.0	**287.7**
Regional governments or local authorities	0.7	0.0	0.0	**0.7**
Administrative bodies and non-commercial undertakings	6.4	0.0	0.0	**6.4**
Institutions	306.1	245.5	144.9	**696.5**
Corporates	468.6	31.4	28.8	**528.8**
Retail	1,488.5	72.0	1.3	**1,561.8**
Secured on real estate property	504.2	12.8	0.0	**517.0**
Past due items	131.3	0.8	0.2	**132.3**
Items belonging to regulatory high risk categories	20.4	0.0	0.0	**20.4**
Short term claims on institutions	1,044.0	575.0	83.4	**1,702.4**
Collective investment undertakings	7.6	0.0	0.0	**7.6**
Other items	190.8	3.6	3.0	**197.4**
	4,456.3	**941.1**	**261.6**	**5,659.0**

Residual maturity breakdown of regulatory exposure asset classes on a contractual basis at 31 July 2009

	< 3 months £ million	3 months - 1 year £ million	1-5 years £ million	> 5 years £ million	**Total £ million**
Central governments or central banks	1.7	0.0	286.0	0.0	**287.7**
Regional governments or local authorities	0.4	0.2	0.1	0.0	**0.7**
Administrative bodies and non-commercial undertakings	1.8	3.7	0.9	0.0	**6.4**
Institutions	0.0	0.0	694.9	1.6	**696.5**
Corporates	244.4	93.6	182.6	8.2	**528.8**
Retail	569.9	434.5	554.8	2.6	**1,561.8**
Secured on real estate property	84.2	336.2	96.6	0.0	**517.0**
Items belonging to regulatory high risk categories	0.1	0.0	20.3	0.0	**20.4**
Short term claims on institutions	783.9	918.5	0.0	0.0	**1,702.4**
Collective investment undertakings	0.0	7.6	0.0	0.0	**7.6**
Other items	160.9	8.2	26.1	2.2	**197.4**
	1,847.3	**1,802.5**	**1,862.3**	**14.6**	**5,526.7**

The period greater than one year in institutions consists mainly of marketable securities. Past due items have been excluded from the above table.

Impairment of financial assets

Loans and advances to customers

Impairment provisions are made if there is objective evidence of impairment as a result of one or more events that occurred after initial recognition of a significant loan or a portfolio of loans ("a loan") that have an impact on future cash flows which can be reliably estimated.

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 (EIR). 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 EIR applied to the carrying amount as reduced by an allowance for impairment.

For portfolios of loans where the loans 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.

For accounting purposes, a financial asset is treated as past due when a counterparty has failed to make a payment when contractually due. In contrast, under regulatory rules, a financial asset is treated as past due when the payment is ninety days past the contractual due date.

Financial instruments classified as “held to maturity”

If there is objective evidence that a “held to maturity” asset is impaired, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows discounted at the financial asset’s effective interest rate.

Financial instruments classified as available for sale

If there is objective evidence that an available for sale asset is impaired, the cumulative gains and losses recognised in equity are recycled to the income statement.

The following tables analyse impaired and past due exposures at 31 July 2009.

Impaired and past due exposures; value adjustments and provisions; charges for value by counterparty type

	Impaired loans 31 July 2009 £ million	Past due loans 31 July 2009 £ million	Value adjustments and provisions 31 July 2009 £ million	Charges for value adjustments during the period to 31 July 2009 £ million
Corporates	122.3	113.9	38.4	25.1
Retail	22.5	76.4	32.8	34.8
Total	**144.8**	**190.3**	**71.2**	**59.9**

Value adjustments are individually assessed balance sheet impairments while provisions are defined as collectively assessed balance sheet impairments.

Geographical analysis of impaired and past due exposures; value adjustments and provisions at 31 July 2009

	British Isles £ million	Europe £ million	Rest of world £ million	**Total £ million**
Impaired loans	142.3	2.5	0.0	**144.8**
Past due loans	187.1	3.2	0.0	**190.3**
Value adjustments and provisions	68.8	2.4	0.0	**71.2**

Impairment losses

	£ million
Opening balance at 1 August 2008	
Individual provision	48.1
General/Collective provision	2.2
Total	50.3
Charge for the year	59.9
Amounts written off net of recoveries	(39.0)
Closing balance at 31 July 2009	
Individual provision	71.2
General/Collective provision	0.0
Total	**71.2**

7. Credit risk: standardised approach

The group uses external credit assessments provided by Moody's to determine the risk weight of rated counterparties in each standardised credit risk exposure class. Moody's is recognised by the FSA as an eligible external credit assessment institution (ECAI) for the purposes of calculating credit risk requirements under the standardised approach. The external ratings of each ECAI are mapped to the prescribed quality assessment scale that in turn produces standard risk weightings. Credit risk mitigation was not used.

The table below shows the exposure amounts associated with the credit quality steps and the relevant risk weightings as at 31 July 2009:

Institutions original effective maturity of more than three months

Credit quality step	Risk weight	Exposure
1	20%	689.5
2	50%	7.0
3	50%	0.0
4	100%	0.0
5	100%	0.0
6	150%	0.0
Total		**696.5**

Short term claims on institutions

Credit quality step	Risk weight	Exposure
1	20%	1,699.4
2	50%	3.0
3	100%	0.0
4	150%	0.0
5	150%	0.0
6	150%	0.0
Total		**1,702.4**

Corporates (rated exposures only)

Credit quality step	Risk weight	Exposure
1	20%	25.1
2	50%	0.0
3	100%	0.0
4	100%	0.0
5	150%	0.0
6	150%	0.0
Total		**25.1**

8. Non-trading book exposures in equities

At 31 July 2009, the group had £38.0 million of equity investments in the non-trading book, of which £25.4 million were classified as available for sale and £12.6 million as held at fair value through profit or loss under the fair value option. Listed investments amounted to £14.3 million with the remainder being unlisted. Under regulatory rules one investment of £4.8 million was required to be deducted from capital. The capital requirement for the remainder amounted to £3.3 million, with £12.7 million of equity investments being classified as high risk for regulatory purposes. Cumulative gains from sales in the period were immaterial.

Equity investments held as available for sale

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

Equity investments designated at fair value through profit or loss

These are equity shares classified thus because they are managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, with results being reported to the company's board. Resulting gains and losses are included in the income statement.

Methods of valuation

Listed investments are valued at bid price. Unlisted investments comprise investments in various funds (valued at net asset value) and in the limited liability partnerships that the group's private equity operations manage. These partnerships value their investments semi-annually in compliance with the International Private Equity and Venture Capital Valuation Guidelines, their valuations being externally audited annually. Valuations are typically based on an appropriate multiple of earnings before interest and tax ("EBIT") adjusted, if necessary, to what considered sustainable levels are based on forecast indicators.

Movements in the year to 31 July 2009 were as follows:

	Equity shares	
	Available for sale £ million	Fair value through profit and loss £ million
At 1 August 2008	33.0	16.2
Additions	0.1	3.3
Disposals	-	(1.0)
Currency translation differences	(0.7)	-
Disposals of subsidiary undertakings	(0.6)	(0.4)
Increase/(decrease) in carrying value of:		
Equity shares classified as available for sale	(6.4)	-
Listed equity shares held at fair value	–	-
Unlisted equity shares held at fair value	–	(5.5)
At 31 July 2009	**25.4**	**12.6**

9. Interest rate risk in the non-trading book

The group's exposure to interest rate fluctuations relates primarily to the returns from its capital and reserves which, as a matter of policy, are not hedged. The group's policy is to match fixed and variable interest rate liabilities and assets utilising interest rate swaps where necessary to secure the margin on its loans and advances to customers.

The sensitivities below are based upon reasonably possible changes in interest rate scenarios, including parallel shifts in the yield curve. At 31 July 2009 a 2% increase and 0.5% decrease in interest rates compared to actual rates would increase (decrease) the group's annual net interest income by the following amounts, prior to mitigation:

	2009 £ million
2.0% increase	5.1
0.5% decrease	(1.3)

The above analysis is calculated in sterling as, apart from currency investments in subsidiaries and associates where the policy decision has been taken not to hedge such exposures, the group's exposure to foreign exchange risk is minimal.

10. Securitisation

At 31 July 2008 the group had securitised £172 million of its loans and advances to customers with Cruise Limited ("Cruise") in return for non-refundable finance of £165 million. This securitisation facility expired during the year and was not renewed.