Close Brothers Group plc

Pillar 3 disclosures for the year ended 31 July 2011

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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 and are based on data as at 31 July 2011 with comparative figures for 31 July 2010 where relevant.

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 27 of the group’s annual report. There are no differences between the basis of consolidation of the group for accounting and regulatory purposes except where the group’s associates are accounted for on an equity basis for accounting purposes and consolidated in proportion to the participation of the group for 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.

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

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 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

Close Brothers Limited (“CBL”), the group’s regulated banking subsidiary 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) as at 31 July 2011. CBL publishes its Pillar 3 disclosures on the group’s website.

2. Risk management objectives and policies

The board has overall responsibility for the group's risk management framework, regulatory compliance and internal control and for ensuring that they work effectively. The risk management framework and associated governance arrangements are designed to ensure that there is a clear organisational 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.

Identification, measurement and management of risk are strategic priorities for the group. Governance has been strengthened by the establishment of the Board Risk Committee to lead the management of risk across the group. This is supported by risk and compliance committees at group level and in the divisions with responsibility for risk management, internal control and regulatory compliance.

A key priority of the risk and control framework is to allow business opportunities to be captured while maintaining an appropriate balance of risk and reward. The group's risk management framework is designed to ensure that the risks to which the group is or may become exposed are identified and that those which the group chooses to take are managed, controlled and, where appropriate, mitigated so that the group is not subject to unexpected loss.

The group reviews and revises its risk appetite as part of the strategy setting process and identifies its material risks through this process. This aligns risk taking with the achievement of strategic objectives.

The key principles underlying risk management in the group are:

- Business management own all the risks assumed throughout the group and are responsible for ensuring that these are managed 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, not simply to maximise short-term profits;
- Risk functions are independent of the businesses but partner closely with and provide support and challenge to the businesses;
- Risk management across the group is 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.

The risk management framework is based on the concept of "three lines of defence". Business management are responsible for ensuring that all key risks have been identified, assessed and evaluated and that, where necessary, appropriate controls have been put in place to manage and mitigate them within their defined risk appetites. Risk functions provide oversight of this and group internal audit ensures that the first and second lines of defence are working effectively. More detail on the risk and control framework can be found in the Annual Report Corporate Governance section.

1st Line of defence	2nd Line of defence	3rd Line of defence
Group Risk & Compliance Committee	**Board Risk Committee**	**Audit Committee**
Reports to the board via the Risk Committee	Reports to the board	Reports to the board
Chief executive delegates to divisional and operating business heads day-to-day responsibility for risk management, regulatory compliance and internal control in running their divisions or businesses.	Risk Committee delegates to the Chief Risk Officer day-to-day responsibility for oversight and challenge on risk related issues.	Audit Committee mandates the head of Group Internal Audit with day-to-day responsibility for independent assurance.
Business management has day-to-day ownership, responsibility and accountability for risks: • Identifying and assessing risks; • Managing and controlling risks; • Mitigating risks; • Reporting risks	Risk functions provide support and independent challenge on: • Risk framework; • Risk assessment; • Risk appetite and strategy; • Performance management; • Risk reporting; • Adequacy of mitigation plans	Internal Audit provides independent assurance on: • First and second lines of defence; • Appropriateness / effectiveness of internal controls; • Effectiveness of policy implementation
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 • Ongoing monitoring of positions and management of risks • Portfolio optimisation	Key features: • Overarching “risk oversight unit” takes an integrated view of risk (qualitative and quantitative) • Risk management separate from risk control but work together • Supports through developing and advising on risk strategies • Creates constructive tension through challenge – “critical friend”	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

The Board Risk Committee's primary responsibilities are to:

- Develop, review and recommend risk appetite to the Board in the context of both the group's strategy and the economic, market and regulatory environment;
- Monitor the risk profile in relation to current and future strategy and ensure that it is consistent with the risk appetite;
- Consider, evaluate, monitor and challenge the appropriateness and effectiveness of the risk management framework and the oversight arrangements in relation to the business undertaken and risk profile;
- Review and challenge reports and recommendations regarding current risk exposures and overall risk strategy and discuss mitigation, providing advice as appropriate;
- Consider and assess the implications of proposed regulatory and legal changes that are material to the risk profile, risk appetite and management of risk;
- Oversee and challenge the design and execution of stress and scenario testing;
- Provide the advice, oversight and challenge necessary to embed and maintain a supportive risk culture; and
- Agree recommended actions, as appropriate, and ensure that these are owned and followed through to completion.

In addition the committee:

- Provides input and advice to the Remuneration Committee on the alignment of reward structures to the group's risk appetite; and
- Considers and approves the appointment and dismissal of the group Chief Risk Officer.

Risk oversight is further provided by specialist risk committees at both group and divisional or business level. The risk and compliance committees are required to establish their own Terms of Reference, which may include, but are not limited to the following responsibilities:

- Help to develop, review and recommend risk appetite;
- Monitor the risk profile in relation to current and future strategy and ensure that it is consistent with the risk appetite;
- Consider, evaluate, monitor and challenge the appropriateness and effectiveness of the risk management framework;
- Review and challenge reports and recommendations regarding current risk exposures and overall risk strategy;
- Consider and assess the implications of material regulatory and legal changes;
- Oversee and challenge of the stress and scenario testing;
- Provide the advice, oversight and challenge necessary to embed and maintain a supportive risk culture; and
- Agree recommended actions arising from internal business reviews, internal and external audits and ensure that these are owned and followed through to completion.

2. Risk management objectives and policies continued

Risk assessment

The principal risks and uncertainties facing the group at 31 July 2011 are listed below together with a description of the risk, how it impacts or could impact the group's businesses and the measures taken to mitigate and manage the particular risk or uncertainty. The list below should not be regarded as a comprehensive list of the risks and uncertainties faced by the group but rather a summary of those which the group currently faces and believes have the potential to have a significant impact on its financial performance and future prospects.

Key risk and uncertainty	Group exposure	Risk mitigation and management
Economic environment Demand for the group's products and services are sensitive to global economic conditions particularly those within the UK. Underlying economic conditions influence the levels of competition the group's businesses face and their ability to trade profitably.	Underlying economic conditions could impact the group in a number of different ways. Specific examples of impact on performance include but are not limited to: • Lower demand for the group's products and services in the Banking and Asset Management divisions; • Reduced retail and/or institutional securities trading activity leading to lower trading volumes in the Securities division; • Failure of a material institution where group or client funds are deposited and/or invested; • High bad debt charges within the Banking division due to customers inability to repay loans and reductions in asset values held as security for those loans; and • Asset write downs as a result of lower present values of future cash flows due to reduced economic activity.	The group's businesses typically trade in specialist areas where they have developed significant market knowledge and expertise. Across the divisions, the group aims to be "there when it matters" and to build long-term relationships with its customers adding resilience to trading performance in difficult economic conditions. The group's activities are diversified both across its divisions and within the divisions themselves with the result that adverse conditions for one area of the business should not necessarily impact the whole group. The Banking business model is based on conservative loan to value ratios, relatively short-term loan duration and is predominantly secured on accessible and identifiable assets. The Securities division's primary activity is to be a market-maker in short-dated exchange traded products, thereby providing liquidity to the markets within conservative trading limits, rather than proprietary trading. The Asset Management model focuses on managing, protecting and enhancing the wealth of private and corporate clients.

2. Risk management objectives and policies continued

Key risk and uncertainty	Group exposure	Risk mitigation and management
Credit risk 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 in a timely manner.	The group's Banking division advances loans to a range of corporates, SMEs and individuals. Failure to recover the amounts lent or the interest and fees associated with those loans could result in a significant bad debt charge. The group places surplus funding with other financial institutions. At 31 July 2011 the group placed deposits at, and held CDs and FRNs issued by, financial institutions. The group also enters into derivative contracts in order to hedge interest rate and foreign currency exposures with counterparties creating an exposure throughout the life of those contracts. As part of the acquisition of the structured deposit book from Dunbar Bank plc, taken on as part of the group's strategy of diversifying its funding sources, the group acquired equity derivatives with counterparties that hedge the embedded derivatives in the structured deposits. As such, the group is at risk of financial loss if one of its financial counterparties defaults or fails.	The group's lending businesses have a dual approach to mitigate credit risk: • Robust processes that facilitate the assessment of the credit quality and covenant of the underlying borrower; and • Lending on a predominantly secured basis with significant emphasis on the quality of the underlying security to minimise any loss should the customer not be able to repay. These are supplemented by timely and rigorous collections and arrears management processes. Much of the Banking division's lending is short term and average loan size is small with the result that few individual loans have the capacity to materially impact the group's earnings. The Banking division has enhanced its management of credit by creating a central team to oversee the management of risk at both the transaction and portfolio level. The Banking division monitors the credit quality of the counterparties with whom the group places deposits, enters into derivative contracts or whose debt securities are held, within approved limits. Interest rate and foreign currency derivatives are solely held to hedge the interest rate and foreign currency exposures. Similarly, the equity derivatives are only held to hedge the embedded derivatives in the structured deposits. The Securities division exposure 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. The Asset Management division maintains and monitors an approved list of banks and custodians for client money and assets which it controls.

2. Risk management objectives and policies continued

Key risk and uncertainty	Group exposure	Risk mitigation and management
Funding and liquidity risks Funding: The risk of loss caused by the inability to raise funds at an acceptable price or to access markets in a timely manner. Liquidity: The risk that liabilities cannot be met when they fall due or can only be met at an uneconomic price.	The group requires access to funding in order to support its client lending in particular within the Banking division but also trading and growth initiatives within the Securities and Asset Management divisions. The vast majority of the funding requirements for the group relate to the Banking division. Following the credit crisis of 2008, access to credit markets has become more uncertain. Inability to source sufficient funding could constrain growth and in extreme circumstances require the Banking division to reduce lending levels. The group also requires liquidity to ensure that it is able to meet its obligations as they become due in all circumstances.	The group's total funding at 31 July 2011 remained significantly in excess of its customer loans and advances. The excess is invested in assets such as FRNs, short-term CDs and gilts or placed on deposit at the Bank of England. In addition the group has diversified sources of funding and is confident that it will be able to access sufficient funding to support its operations. The group manages its liquidity to ensure liabilities are met as they fall due. The Banking division has historically maintained longer maturity funding, aiming to "borrow long and lend short".
Regulation, legislation and tax The group operates in a highly regulated environment. Changes in regulation and legislation or the basis of tax, particularly in the UK, could materially impact the group's performance.	The impact on the group's businesses caused by changes in regulation, legislation or the tax system is potentially material. Significant changes to the regulatory and legislative environment are currently being introduced. These include: • Changes to the types and levels of liquidity banks are required to hold; • Amendments to the regulatory capital regime including changes to the level and type of capital required ("Basel III"); • Required enhancement to risk management and governance processes; and • Revisions to the FSA remuneration code. Although many of the proposed changes are aimed primarily at larger institutions, the impact on the group's business model and earnings is potentially significant.	The group monitors regulatory and legal developments and engages in dialogue with regulatory authorities on a regular basis and continues to maintain a conservative model with a strong, well capitalised and funded balance sheet and believes it is well placed to react to regulatory change. The group has a central tax function which liaises regularly with the tax authorities and has developed a group tax policy to ensure a consistent approach is taken to tax issues across the group.

2. Risk management objectives and policies continued

Key risk and uncertainty	Group exposure	Risk mitigation and management
Operational risk The risk of loss or other material adverse impact resulting from inadequate or failed internal processes, people and systems or from external events.	In common with any financial services group, operational risk is inherent to the group. The group's success is closely aligned to the abilities and experience of its employees. The ability of the group to attract and retain key personnel is critical to the group's prospects in the medium and long-term. The group's activities are highly reliant on their IT infrastructure in their daily operations. Failure to respond to new technology, develop existing systems and ensure a robust infrastructure could have a material effect either competitively or operationally on the group's earnings and reputation. The group is also exposed to process and control failures that could give rise to losses, including those from internal or external fraud.	The group has continued to improve its operational risk management framework to ensure that operational risks are assessed, mitigated and reported in a consistent and timely manner across the group. A new central human resources department leads enhancements to the performance management framework and reviews the reward and incentive schemes regularly to ensure that the group is successful in attracting and retaining the calibre of employees necessary to meet its objectives. Each of the businesses continually invests in its IT platforms to ensure they remain up-to-date and fit for purpose for the markets in which they operate. Additionally, business continuity plans enable the businesses to respond in a timely manner to a disaster event. The group undertakes a regular review of its risk and control environment which facilitates an assessment of the ongoing effectiveness of its processes and controls, including those related to fraud prevention.

2. Risk management objectives and policies continued

Key risk and uncertainty	Group exposure	Risk mitigation and management
Strategic risk The risk of reduction in earnings or value from the pursuit of a defective or inappropriate strategy; an inability to successfully implement a determined strategy; or that changes to the operating environment occur that invalidate strategies.	The group devotes substantial management resources to the development and execution of strategic plans supported by substantial expenditure to generate growth in customer business. If these strategic plans are not delivered as anticipated, the group's earnings could grow more slowly or decline.	The group monitors key performance and risk indicators and has various policies and practices to mitigate strategic risk, including subscribing to sound corporate governance practices, which require that activities, processes and decisions are based on carefully considered principles. The group regularly reinforces these policies and practices through transparent communication, accurate reporting, continuous group culture and values assessment, regulatory compliance review, and risk management practices. This is supported by more formal strategy and budgetary reviews.

2. Risk management objectives and policies continued

Key risk and uncertainty	Group Exposure	Risk mitigation and management
Market risk The risk that a change in the value of an underlying market variable, such as interest or foreign exchange rates, will give rise to an adverse movement in the value of the group's assets.	The group's securities businesses are exposed to market movements deriving from trading in equity and fixed income securities. Interest income is a substantial proportion of the group's revenues. Movements in interest rates have the potential to affect the group's earnings. While the majority of the group's activities are located in the UK and transacted in sterling, the group is subject to foreign exchange exposure. The group has currency assets and liabilities, principally lending and FRNs as well as borrowings and customer deposits, arising from a range of currency services offered by the Banking division. In addition the group has a small number of overseas subsidiaries and currency denominated investments.	The securities businesses are market-makers and as a result typically have lower market risk exposure than businesses which trade speculatively. Position limits are set annually for each product, sector and individual stock with real time monitoring and oversight by senior management. The Banking division does not trade in money market instruments although they are held for liquidity purposes. 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 Banking division's risk and compliance committees 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. A sensitivity analysis on interest rate exposures is shown on page 109 of the annual report. The foreign exchange exposures arising from the Banking division's 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 does not hedge its currency exposure to its overseas subsidiaries and currency investments since it is relatively modest. A sensitivity analysis on foreign currency exposures is shown on page 110 of the annual report.

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3. Capital resources

The table below summarises the composition of regulatory capital as at 31 July 2011, 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.

	2011 £ million	2010 £ million
Core tier 1 capital		
Called up ordinary share capital	**37.6**	37.4
Share premium account	**283.0**	275.9
Retained earnings and other reserves	**448.9**	490.6
Non-controlling interests	**1.9**	2.5
Deductions from tier 1 capital		
Intangible assets	**(133.1)**	(107.5)
Goodwill in associates	**(12.2)**	(51.9)
Investment in own shares	**(37.6)**	(43.7)
Core tier 1 capital after deductions	**588.5**	603.3
Tier 2 capital before deductions		
Subordinated debt	**75.0**	75.0
Unrealised gains on available for sale equity shares	**7.0**	7.6
Tier 2 capital after deductions	**82.0**	82.6
Total tier 1 and tier 2 after deductions	**670.5**	685.9
Deductions from total of tier 1 and tier 2		
Investments that are not qualifying holdings	**(1.3)**	(1.8)
Other regulatory adjustments	**(0.1)**	(0.3)
Total regulatory capital	**669.1**	683.8

The following table shows a reconciliation between equity and core tier 1 capital after deductions:

	2011 £ million	2010 £ million
Equity	**728.3**	754.4
Regulatory deductions from equity:		
Intangible assets	**(133.1)**	(107.5)
Goodwill in associates	**(12.2)**	(51.9)
Other reserves not recognised for core tier 1 capital:		
Cash flow hedging reserve	**3.0**	3.6
Available for sale movements reserve	**2.5**	4.7
Core tier 1 capital after deductions	**588.5**	603.3

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

All the subordinated loan capital has been issued by CBL and is denominated in sterling. The subordinated loans have over five years until the final maturity date and the option for prepayment is solely at CBL's discretion therefore the full subordinated loan capital total of £75m has been included as lower Tier 2 capital.

3. Capital resources continued

There has been no change from 31 July 2010 and the terms are as follows:

Final maturity date	Prepayment date	Initial interest rate	**2011 £ 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 been to be well capitalised. The group's 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. In addition to maintaining a strong capital base to support the development of the business it is also important to ensure the group meets regulatory capital requirements at all times, and therefore maintains capital adequacy ratios comfortably above minimum regulatory requirements.

Internal capital adequacy assessment process ("ICAAP")

The group and CBL are required carry out internal capital adequacy assessments. An annual group-wide process has been developed and 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 and CBL to determine the level of capital required against each major source of risk and an analysis of a severe stress test 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 before approval by both the group risk and compliance committee and by the board.

4. 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 risk weighted exposure amounts for each of the following standardised exposure classes in accordance with FSA rules.

	2011 £ million	2010 £ million
Credit risk - standardised approach		
Central governments or central banks	**-**	-
Regional governments or local authorities	**-**	-
Administrative bodies and non-commercial undertakings	**0.1**	0.1
Institutions	**2.6**	10.8
Corporates	**60.4**	50.8
Retail	**127.4**	102.3
Secured by mortgages on residential real estate	**0.1**	-
Secured by mortgages on commercial real estate[1]	**37.6**	34.4
Past due items	**13.2**	16.9
Items belonging to regulatory high risk categories	**1.5**	1.5
Short-term claims on institutions and corporates	**15.4**	15.7
Collective investment undertakings	**-**	0.6
Other items	**16.4**	16.0
	274.7	249.1
Operational risk	**66.5**	77.8
Counterparty credit risk	**6.4**	9.4
Market risk - trading book		
Interest rate PRR[2]	**1.6**	3.1
Equity PRR[2]	**4.4**	4.1
Market risk - non trading book		
Foreign currency PRR[2]	**5.8**	3.7
Total Pillar 1 capital requirement	**359.4**	347.2

[1] Previously classified as "secured on real estate property". In 2011 FSA changed this classification to "secured by mortgages" split between residential and commercial real estate. As a result, it has been necessary to map the majority of the group's real estate lending to this classification, despite not being secured by mortgages.
[2] Position Risk Requirement

As at 31 July 2011, to reflect improvements in the operational risk framework, the group migrated to the Standardised Approaches in calculating operational risk. The 2010 comparative is calculated using the Basic Indicator Approach.

5. 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 securities financing transactions, namely a repurchase agreement in the Banking division and stock borrowing and lending in the Securities division. Additionally, the 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.

The table on page 13 shows that counterparty credit risk amounts to less than 2% (2010: less than 3%) of the overall capital requirement. Consequently, on the grounds of materiality, no further detail is provided on this risk.

6. 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 in a timely manner. The following tables analyse regulatory credit risk exposures at 31 July 2011:

	2011 £ million	Average exposure in 2011 £ million
Standardised approach		
Central governments or central banks	**821.5**	904.1
Regional governments or local authorities	**0.1**	0.1
Administrative bodies and non-commercial undertakings	**0.4**	0.2
Institutions[1]	**157.5**	269.8
Corporates[1]	**1,114.3**	1,018.3
Retail	**2,182.7**	2,125.3
Secured by mortgages on residential real estate	**0.8**	2.6
Secured by mortgages on commercial real estate[2]	**770.9**	722.7
Past due items	**133.2**	140.2
Items belonging to regulatory high risk categories	**12.5**	12.0
Short-term claims on institutions and corporates[3]	**588.6**	599.8
Collective investment undertakings	**0.2**	5.5
Other items	**198.1**	211.3
	5,980.8	6,011.9

[1] Excluding those assessed as short-term claims on institutions and corporates.
[2] Previously classified as "secured on real estate property". In 2011 FSA changed this classification to "secured by mortgages" split between residential and commercial real estate. As a result, it has been necessary to map the majority of the group's real estate lending to this classification, despite not being secured by mortgages.
[3] Where a short-term credit assessment is available from Moody's (defined on page 18).

The retail exposure class consists of loans to individuals and small and medium sized entities with similar characteristics. Past due items follows the regulatory definition as disclosed on page 16 and is net of any provisions made against such items. Short term claims on institutions are defined as exposures where a short term credit rating is available and the remaining maturity is less than twelve months.

6. Credit risk continued

Geographic distribution of exposures by regulatory exposure asset class at 31 July 2011:

	British Isles £ million	Europe £ million	Rest of world £ million	**Total £ million**
Standardised approach				
Central governments or central banks	821.4	0.1	-	**821.5**
Regional governments or local authorities	0.1	-	-	**0.1**
Administrative bodies and non-commercial undertakings	0.4	-	-	**0.4**
Institutions[1]	105.7	7.0	44.8	**157.5**
Corporates[1]	1,039.9	39.7	34.7	**1,114.3**
Retail	2,090.4	92.3	-	**2,182.7**
Secured by mortgages on residential real estate	0.8	-	-	**0.8**
Secured by mortgages on commercial real estate[2]	754.8	16.1	-	**770.9**
Past due items[3]	131.5	1.7	-	**133.2**
Items belonging to regulatory high risk categories	12.5	-	-	**12.5**
Short-term claims on institutions and corporates[4]	381.5	197.7	9.4	**588.6**
Collective investment undertakings	0.2	-	-	**0.2**
Other items	193.3	4.8	-	**198.1**
	5,532.5	**359.4**	**88.9**	**5,980.8**

[1]Excluding those assessed as short-term claims on institutions and corporates.
[2] Previously classified as "secured on real estate property". In 2011 FSA changed this classification to "secured by mortgages" split between residential and commercial real estate. As a result, it has been necessary to map the majority of the group's real estate lending to this classification, despite not being secured by mortgages.
[3]Shown net of value adjustments and provisions.
[4]Where a short term credit assessment is available from Moody's (defined on page 18).

Residual maturity breakdown of regulatory exposure asset classes on a contractual basis at 31 July 2011:

	< 3 months £ million	3 months to 1 year £ million	1 to 5 years £ million	> 5 years £ million	**Total £ million**
Central governments or central banks	594.6	129.1	97.8	-	**821.5**
Regional governments or local authorities	-	-	0.1	-	**0.1**
Administrative bodies and non-commercial undertakings	-	0.1	0.3	-	**0.4**
Institutions[1]	-	-	157.3	0.2	**157.5**
Corporates	644.6	130.4	277.0	62.3	**1,114.3**
Retail	599.3	606.5	968.4	8.5	**2,182.7**
Secured by mortgages on residential real estate	0.8	-	-	-	**0.8**
Secured by mortgages on commercial real estate[2]	294.5	321.9	154.5	-	**770.9**
Items belonging to regulatory high risk categories	-	-	12.5	-	**12.5**
Short-term claims on institutions and corporates[3]	216.0	370.9	1.7	-	**588.6**
Collective investment undertakings	-	-	-	0.2	**0.2**
Other items	100.2	28.1	67.8	2.0	**198.1**
	2,450.0	**1,587.0**	**1,737.4**	**73.2**	**5,847.6**

[1]Excluding those assessed as short-term claims on institutions and corporates.
[2] Previously classified as "secured on real estate property". In 2011 FSA changed this classification to "secured by mortgages" split between residential and commercial real estate. As a result, it has been necessary to map the majority of the group's real estate lending to this classification, despite not being secured by mortgages.
[3]Where a short-term credit assessment is available from Moody's (defined on page 18)

Past due items have been excluded from the above table.

6. Credit risk continued

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 held to maturity, available for sale or loans and receivables is impaired.

(a) Loans and advances to customers

Treatment

Impairment provisions are made if there is objective evidence regarding a significant loan or a portfolio of loans ("loan") that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows.

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"). 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 EIR 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 overleaf are the accounting values shown in note 34 of the group's annual report, where further relevant information can be found.

Analysis of impairment provisions

Impaired loans and advances to customers are analysed according to whether the impairment provisions are individually or collectively assessed.

Individually assessed provisions are determined on a case by case basis, taking into account the financial condition of the customer and an estimate of potential recovery from the realisation of security. Typically this methodology is applied by the Property business and by the invoice finance business within Commercial.

Collectively assessed provisions are considered on a portfolio basis, to reflect the homogeneous nature of the assets. A percentage of the portfolio is impaired by evaluating the ageing of missed payments combined with the historical recovery rates for that particular portfolio. Broadly this methodology is applied by the Retail businesses and the asset finance business within Commercial.

The above outlines the group's approach towards provisioning and differs from FSA's definition of general/collective provisions. The group does not have any general/collective provisions as defined by the FSA.

6. Credit risk continued

(b) 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 EIR of the instrument at initial recognition.

(c) 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.

The following tables analyse impaired exposures as treated for accounting purposes and past due exposures as treated for regulatory purposes at 31 July 2011.

Gross impaired loans, past due loans, impairment provisions and charges for impairment provisions by counterparty type[1] at 31 July 2011:

	Gross impaired loans 2011 £ million	Gross past due loans 2011 £ million	Impairment provisions 2011 £ million	Charges for impairment provisions during the period to 2011 £ million
Corporates	205.9	158.2	62.8	35.3
Retail	108.2	55.2	30.9	29.9
Total	**314.1**	**213.4**	**93.7**	**65.2**

[1] Counterparty type analysis is based on mapping all relevant loans to either Corporates or Retail, as classified by the FSA

Geographical analysis of gross impaired, gross past due exposures and impairment provisions at 31 July 2011:

	Gross impaired loans 2011 £ million	Gross past due loans 2011 £ million	Impairment provisions 2011 £ million	Charges for impairment provisions during the period to 2011 £ million
British Isles	309.3	209.6	89.3	61.1
Europe	4.8	3.8	4.4	4.1
Rest of World	-	-	-	-
Total	**314.1**	**213.4**	**93.7**	**65.2**

Impairment provisions:

	£ million
Opening balance at 1 August 2010	87.1
Charge for the year	65.2
Amounts written off net of recoveries	(58.6)
Closing balance at 31 July 2011	**93.7**

7. 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 FSA 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.

The tables below shows the exposure amounts associated with the credit quality steps and the relevant risk weightings as at 31 July 2011:

Institutions[1]

Credit quality step	Risk weight	Exposure
1	20%	157.5
2	50%	-
3	50%	-
4	100%	-
5	100%	-
6	150%	-
Total		**157.5**

Short-term claims on institutions and corporates[2]

Credit quality step	Risk weight	Exposure
1	20%	494.0
2	50%	-
3	100%	94.6
4	150%	-
5	150%	-
6	150%	-
Total		**588.6**

Corporates (rated exposures only)

Credit quality step	Risk weight	Exposure
1	20%	-
2	50%	21.9
3	100%	-
4	100%	-
5	150%	-
6	150%	-
Total		**21.9**

[1]Excluding those assessed as short-term claims on institutions and corporates.
[2]Where a short-term credit assessment is available from Moody's.

8. Non-trading book exposures in equities

At 31 July 2011, the group had £19.2 million of equity investments in the non-trading book, of which £14.4 million were classified as available for sale and £4.8 million as held at fair value through profit or loss under the fair value option. Listed investments amounted to £9.6 million with the remainder being unlisted. Under regulatory rules one investment of £1.3 million was required to be deducted from capital. The capital requirement for the remainder amounted to £1.8 million, with £9.5 million of equity investments being classified as high risk for regulatory purposes. Cumulative gains from sales in the period were immaterial.

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 the fair value option

These are equity shares fair valued where the resulting gains and losses are included in the income statement. Listed investments are valued at bid price. Unlisted investments comprise those made in various private equity limited liability partnerships. These partnerships themselves typically invest in unquoted companies via equity and loans and value each investment semi-annually in compliance with the International Private Equity and Venture Capital Valuation Guidelines, such valuations being externally audited annually.

Movements in equity shares in the year to 31 July 2011 were as follows:

	Available for sale £ million	Fair value through profit or loss £ million
At 1 August 2010	22.7	5.7
Additions	-	0.5
Disposals	(10.9)	(4.5)
Currency translation differences	0.6	-
Increase/(decrease) in carrying value of:		
Equity shares classified as available for sale	2.0	-
Unlisted equity shares held at fair value	-	3.1
At 31 July 2011	**14.4**	**4.8**

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. Interest rate risk is regularly measured and reviewed throughout the year.

The sensitivities below are based upon reasonably possible changes in interest rate scenarios, including parallel shifts in the yield curve. This analysis shows the group's interest rate sensitivity on a contractual basis. At 31 July 2011 a 1% 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:

	2011 **£ million**
1.0% increase	**2.7**
0.5% decrease	**(1.4)**

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 immaterial.

10. Securitisation

The group has securitised £495.0 million (31 July 2010: £nil) of its insurance premium receivables in return for debt securities in issue of £350.0 million (31 July 2010: £nil). 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 on its consolidated balance sheet. As a result, the group does not apply BIPRU 9 in calculating risk weighted assets on its securitised loans, and no further disclosures are required.

11. Remuneration

The Remuneration Committee (the "Remco")

Remco Membership

The membership of the Remco is comprised of three non-executive directors. They are Bruce Carnegie-Brown, Ray Greenshields and Douglas Paterson.

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;

- 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 provisions regarding disclosure of remuneration are fulfilled; and

- Seek advice from group risk to ensure remuneration structures and annual bonuses are appropriately aligned to the group's risk appetite.

Advice

During the year under review the Remco consulted and took advice from PricewaterhouseCoopers, Slaughter and May, the chief executive, the group head of human resources and group head of reward.

Where appropriate the Remco receives input and information from the chairman of the board, chief executive, finance director, group head of human resources, group head of reward, group chief risk officer and the company secretary although this never relates to their own remuneration.

Remuneration Policy

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 longer term strategic objectives;
- Align the interests of employees with those of all key stakeholders in particular our shareholders, clients and regulators; and

- Support good risk management procedures and a positive treating customers fairly culture.

Remuneration Schemes for Code Staff

Remuneration Code staff (“Code Staff”) comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm’s risk profile. The remuneration of Code Staff is subject to specific requirements within the FSA Remuneration Code.

Base Salary

The base salary is designed to reflect an employee’s role, skills and knowledge. This may take into account base salaries at comparator companies and specific factors relating to individual performance.

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 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.

The overall bonus pool amounts are set using a combination of financial and non-financial measures. The key financial measure is the adjusted operating profit. They also include income and productivity measures. Non-financial measures include headcount, any necessary adjustment for risk, and macro measures such as business strategy as well as considering the phase in the business cycle and the macro-economic environment.

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:

- 33.3% of the award is subject to absolute total shareholder return (“TSR”) growth;
- 33.3% of the award is subject to adjusted earnings per share (“EPS”) growth; and
- 33.3% of the award is subject to a balanced scorecard of strategic goals.

Targets for the LTIP award are:

Absolute TSR:

Absolute TSR growth over three years	Vesting % of TSR element
20% p.a. or greater	100%
Between 20% p.a. and 10% p.a.	Straight-line between these points
10% p.a.	25%
Less than 10% p.a.	0%

EPS:

Adjusted EPS growth over three years	Vesting % of EPS element
RPI + 10% p.a. or greater	100%
Between RPI + 10% p.a. and RPI + 3% p.a.	Straight-line between these points
RPI + 3% p.a.	25%
Less than RPI + 3% p.a.	0%

Strategic goals

The board has agreed a number of long-term business improvement goals focusing on:

- Strategic priorities;
- People;
- Capital and balance sheet management;
- Risk, compliance and controls; and
- Financial key performance indicators.

Share Match Plan ("SMP")

In addition to the elements outlined above, members of the Group Executive Committee ("Exco") (all of whom are Code Staff) can choose to invest up to 100% of base salary from their total annual bonus into Close Brothers Group plc shares ("Invested Shares"). The Invested Shares have a deferral period of three years, have an additional six month holding period and are subject to the malus provisions. They can choose to invest from any element of their bonus.

Invested shares are matched with free Matching Shares for every invested share, subject to performance conditions over the three year period. The Remuneration Committee has determined the maximum matching ratio for the 2011 award to be two Matching Shares for each Invested Share. The Matched Shares are subject to the same performance conditions and malus provisions as the LTIP. At all times the participants in the SMP will still be subject to the minimum deferral and shares requirements of the Remuneration Code.

Structure of awards – Code Staff

The structure of the awards for Code Staff employees are determined in line with the requirements of the FSA Remuneration Code. The rules take into account the proportionality of certain entities which are permitted to disapply certain rules of the Code.

Where the Code Staff member is treated as a Tier 2[1] employee for the purposes of the FSA Remuneration Code and variable remuneration is greater than £500,000, the variable remuneration breakdown is as follows:

Element	Award Type	Total % breakdown
Total Variable Remuneration [2]		100
Deferred Remuneration (60%)		
• 50% in deferred shares	LTIP [3] and Deferred Annual Bonus ("DAB")	30
• 50% in deferred cash	Deferred Cash Bonus Plan ("DCBP")	30
Non-deferred Remuneration (40%)		
• 50% in non-deferred shares	Non-deferred Shares Plan ("NDSP")	20
• 50% in cash	Cash Bonus	20

Where the variable remuneration is less than £500,000, the structure is the same as that shown above, but the deferred element decreases to 40%.

[1]As defined in FSA's PS10/21 Implementing CRD requirements on the disclosure of remuneration
[2]Variable Remuneration for the purposes of calculating the structure of awards outlined consists of the discretionary annual bonus and 60% of the face value of the LTIP award.
[3]The majority of Tier 2 Code Staff are eligible to receive an LTIP award. As outlined above this is a deferred share based award with vesting subject to performance against pre-set performance targets. For the purposes of the Remuneration Code we have valued these awards at 60% of face value. Where the LTIP alone does not satisfy the deferred shares requirement the balance of the deferred shares requirement is satisfied by a mandatory deferral of a proportion of the bonus into the DAB.

Details of Award Types for Code Staff

Award Type	Deferral Period?	Additional holding period?	Subject to performance conditions?	Subject to malus provisions?
Immediate Cash Bonus	No	No	No	No
NDSP	No – immediate vesting	Yes – 6 months	No	No
DCBP	Yes – vests 1/3rd per year over 3 years	No	No	Yes
DAB	Yes – vests 1/3rd per year over 3 years	Yes – 6 months	No	Yes
LTIP	Yes – vests after 3 years subject to performance conditions	Yes – 6 months	Yes – 1/3rd EPS, 1/3rd TSR, 1/3rd Strategic Goals	Yes

Risk Management

The remuneration policy approved by the Remco in January 2011 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 heads 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.

Link between reward and performance - FY2011

The group achieved a sound performance for the year with continued strong performance in the Banking division. The Banking division has actively taken advantage of favourable business conditions and delivered a strong performance. In the Securities division, Winterflood has had a slower performance reflecting challenging market conditions in the three months to 31st July 2011, whilst Close Brothers Seydler continued to benefit from good capital markets activity. The Asset Management division continues to invest in its private clients business and delivered a small loss as expected. The group recognises the need to invest in Asset Management to attract, retain and motivate key individuals during this period of significant change.

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

2011 Aggregate Remuneration[1] in respect of Code Staff by business (£ million)

Banking	Winterflood	Group	Asset Management
7.0	14.5	8.2	4.5

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

2011 Aggregate Remuneration in respect of Code Staff split into fixed and variable remuneration

	Senior Management	Other Code Staff
Number of Code Staff	33	6
Fixed Remuneration (£m)[1]	8.8	1.1
Variable Remuneration (£m)[2]	23.6	0.7

[1]Fixed Remuneration consists of base salary, company pension contributions and any other fixed allowances.
[2]Variable Remuneration consists of the discretionary annual bonus, 60% of the face value of the LTIP award and 60% of the SMP match value.