Risk Report

Protecting our established business model is a key strategic objective. Effective management of the risks we face is central to everything we do.

Our Approach to Risk
The group faces a number of risks in the normal course of business providing lending, deposit taking, wealth management services and securities trading. To manage these effectively, a consistent approach is adopted based on a set of overarching principles, namely:
- adhering to our established and proven business model, as outlined on pages 10 to 13;
- implementing an integrated risk management approach based on the concept of "three lines of defence"; and
- setting and operating within clearly defined risk appetites, monitored with defined metrics and limits.

This Risk Report provides a summary of our approach to risk management, covering each of the key aspects of the firm's Enterprise Risk Management Framework. Information on the group's principal risks, including an overview of the frameworks in place to manage them, is also included, together with an overview of current emerging risks and uncertainties.

Role of the Board
The board retains overall responsibility for overseeing the maintenance of a system of internal control which ensures that an effective risk management framework and oversight process operates across the group. The risk management framework and associated governance arrangements are designed to ensure a clear organisational structure with distinct, transparent and consistent lines of responsibility and effective processes to identify, manage, monitor and report the risks to which the group is, or may become, exposed.

Risk management across the group is overseen by the Board Risk Committee. The Committee is responsible for reviewing risk appetite, monitoring the group's risk profile against this and reviewing the day-to-day effectiveness of the risk management framework. In addition, the Committee is responsible for overseeing the maintenance and development of an appropriate and supportive risk culture and for providing risk input into the alignment of remuneration with performance against risk appetite. The Committee's key areas of focus over the last financial year are set out on pages 117 to 119.

The group closely monitors its risk profile to ensure that it continues to align with its strategic objectives as documented on pages 24 to 33. The board considers that the group's current risk profile remains consistent with its strategic objectives.

Risk Appetite
Risk appetite forms a key component of the group's risk management framework and refers to the sources and levels of risk that the group is willing to assume in order to achieve its strategic objectives and business plan. It is managed through an established framework that facilitates ongoing communication between the board and management with respect to the group's evolving risk profile. This enables key decisions concerning the allocation of group resources to be made on an informed basis.

Risk appetite is set on a top-down basis by the board with consideration to business requests and executive recommendation. Appetite measures, both qualitative and quantitative, are applied to inform decision-making, and monitoring and reporting processes. Early-warning triggers are also employed to drive required corrective action before overall tolerance levels are reached.

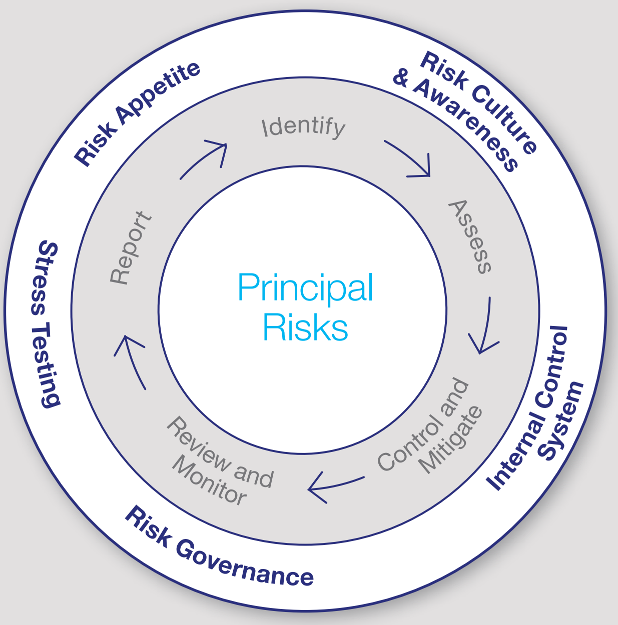
The group conducts a formal review of its risk appetites annually, as part of the strategy-setting process. This aligns risk-taking with the achievement of strategic objectives. Adherence is monitored through the group's risk committees on an ongoing basis with interim updates to individual risk appetites considered as appropriate through the year.

Enterprise Risk Management
The group employs an Enterprise Risk Management Framework to provide the board and senior management with oversight of the organisation's financial position as well as the risks that might adversely affect it.

The framework details the core risk management components and structures used across the firm, and defines a consistent and measurable approach to identifying, assessing, controlling and mitigating, reviewing and monitoring, and reporting risk – the risk process lifecycle. This sets out the activities, tools, techniques and organisational arrangements that ensure all principal risks facing the group are identified and understood; and that appropriate responses are in place to protect the group and prevent detriment to its customers and colleagues. This enables the group to meet its goals and enhances its ability to respond to new opportunities.

The framework is purposely designed to allow the capture of business opportunities whilst maintaining an appropriate balance of risk and reward within the group's agreed risk appetite.

Enterprise Risk Management Framework



Stress Testing

Stress testing represents another core component of the risk management framework and is employed, alongside scenario analysis, to support assessment and understanding of the risks to which the group might be exposed in the future. As such, it provides valuable insight to the board and senior management, playing an important role in the formulation and pursuit of the firm's strategic objectives.

Stress testing activity within the group is designed to meet three principal objectives:

1. Inform capital and liquidity planning – including liquidity and funding risk assessment, contingency planning and recovery and resolution planning;
2. Support ongoing risk and portfolio management – including risk appetite calibration, strategic decisioning and planning, risk/reward optimisation and business resilience planning; and
3. Provide a check on the outputs/accuracy of risk models – including the identification of non-linear effects when aggregating risks.

To support these objectives, stress testing is designed to cover the group's most material risks, with activity conducted at various levels, ranging from extensive group-wide scenario analysis to simple portfolio sensitivity analysis.

Stress testing also represents a critical component of both the firm's Internal Capital Adequacy Assessment ("ICAA") and Internal Liquidity Adequacy Assessment ("ILAA") processes, with scenario analysis additionally employed as part of the group's Recovery Plan.

Risk Governance

The group's risk management approach is underpinned by a strong governance framework that it considers appropriate to both the size and strategic intentions of its businesses.

The framework is founded on a "three lines of defence" model, as set out below:

The key principles underlying this approach are that:

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

Aligned to these core principles, the governance framework operates through various delegations of authority from the board downwards. These cover both individual authorities as well as authorities exercised via the group's risk committee structure.

Three Lines of Defence

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

Risk Report continued

Risk Committee Structure

Group Board

Board Risk Committee

Executive Committees
- Group Risk and Compliance Committee
- Model Governance Committee
- Capital Adequacy Committee
- Asset and Liability Committee

Risk-Specific Committees
- Credit Risk Management Committee
- Group Credit Committee
- Impairment Adequacy Committee
- Operations and Technology Risk Committee

Divisional Committees
- Divisional Risk and Compliance Committees

Risk Committee Overview

Group Risk and Compliance Committee	Provides oversight of the group's risk profile, alignment to risk appetite and effectiveness of the risk management and compliance framework.
Model Governance Committee	Provides oversight of the group's exposure to model risk through the review, approval and monitoring of all high materiality models.
Capital Adequacy Committee	Monitors group and bank capital adequacy, incorporating capital planning, stress testing, governance, processes and controls.
Asset and Liability Committee	Provides oversight of risk management and internal control for the bank and its subsidiaries across liquidity, funding and market risk.
Credit Risk Management Committee	Monitors the group's credit risk profile, examining current performance and key portfolio trends, ensuring compliance with risk appetite.
Group Credit Committee	Reviews material credit transactions and exposures from a credit, reputational, funding structure and business risk perspective.
Impairment Adequacy Committee	Governs the bank's impairment process, reviewing the financial position relating to impairment and ensuring adequate coverage is held across the portfolio.
Operations and Technology Risk Committee	Monitors and oversees group-wide operational resilience, including technology, security, supplier and operational risk appetite, examining industry, regulatory and technical risks.
Divisional Risk and Compliance Committees	Provide oversight of risk profile, alignment to risk appetite and effectiveness of the risk management and compliance framework at a divisional or business level.

Together, these committees facilitate an effective flow of key risk information, as well as functioning to support appropriate risk management at each stage of the risk process lifecycle. They also provide an escalation channel for any risks or concerns, supporting the maintenance of an effective risk culture.

Over the past 12 months the group has further enhanced its risk governance framework and specifically the organisation's risk and compliance committees, both at a group and divisional level. This has included the continued refinement of committee Terms of References and the evolution of reporting packs and MI suites. All committees continue to work efficiently and effectively.

Internal Control System

Aligned to the risk governance framework, oversight across the group is supported by the maintenance of a range of internal controls. These cover risk and financial management and reporting and control processes and are designed to ensure the accuracy and reliability of the firm's financial information and reporting.

The main features of these controls include consistently applied accounting policies, clearly defined lines of responsibility and processes for the review and oversight of disclosures within the Annual Report. These controls are overseen by the Audit Committee.

The accounting policies form part of a broader policy framework, overseen by the board, that supports the foundation of a strong risk management structure. Group policies are supported by group standards, divisional/business-level policies and procedures which, together, outline the way in which policy is implemented and detail the process controls in place to ensure compliance. Policies and standards relating to the group's principal risks are fully covered within the framework, and include specific documents relating to financial crime compliance (e.g. anti-money laundering/anti-bribery and corruption) and whistleblowing.

This structure establishes a link between group strategy and day-to-day operations in a manner consistent with agreed risk appetite, while simultaneously facilitating board and executive-level oversight and assurance as to the application of said strategy via conformance with underlying policy and standard requirements.

Review of Effectiveness of Risk Management and Internal Control Systems

Throughout the year, the board, assisted by the Risk Committee and the Audit Committee, monitors the group's risk management and internal control systems and reviews their effectiveness. This covers all material controls, including financial, operational and compliance controls. The board also reviews the effectiveness of both committees on an annual basis. Based on its assessment throughout the year, and its review of the committees' effectiveness, the board considers that, overall, the group has in place adequate systems and controls with regard to its profile and strategy.

Risk Culture and Awareness

Maintenance of an effective risk management culture is integral to the group meeting its regulatory conduct requirements and assisting the accomplishment of key strategic goals.

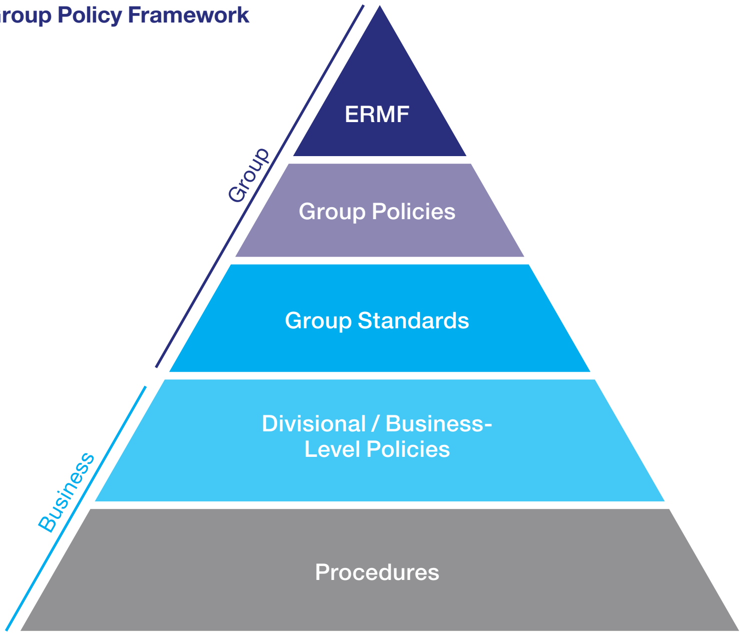
The risk culture:

- supports the group and its directors in meeting their legal and regulatory obligations, particularly with respect to the identification and management of risks and the need for a robust control environment;
- underpins the group's purpose, strategy, cultural attributes and divisional values;
- provides enhanced awareness of risk in business operations by highlighting strengths and weaknesses and their materiality to the business and, in turn, facilitating informed decision-making;
- optimises business performance by facilitating challenge of ineffective controls and improving the allocation of resources;
- ensures allocation of capital for operational risk is proportionate for the risks identified;
- improves the group's control environment; and
- assists in the planning and prioritisation of key projects and initiatives.

While risk management is led by the centre, it is embedded locally within our businesses. Managers actively promote a culture in which risks are identified, assessed, managed and reported in an open, transparent and objective manner, and where appropriate staff conduct is viewed as critical.

All members of staff are responsible for risk identification and reporting within their area of responsibility and are encouraged to escalate risks and concerns where necessary, either through line or business management or by following the provisions of the Group Whistleblowing Policy.

Group Policy Framework



Risk Culture

Group Risk Management operates independently of the business, providing oversight and advice on the operation of the risk framework, and assurance that agreed processes operate effectively and that a risk and conduct culture is embedded within the business.

The relationship between risk and reward is also a key priority with all staff evaluated against both agreed objectives (the what) and desired behaviours (the how). This encourages long-term, stewardship behaviours together with a strong and appropriate risk and conduct culture.

For further information on our approach to remuneration for the group's directors see pages 123 to 143.

Risk Report continued

Principal Risks

The following pages set out the principal risks that may impact the group's ability to deliver its strategy, the frameworks in place to mitigate them, and relevant key developments, both over the last year and anticipated for the next financial year.

While we constantly monitor our portfolio for emerging risks, the group's activities, business model and strategy remain unchanged. As a result, the principal risks that the group faces and our approach to mitigating them remain broadly consistent with prior years. This consistency has underpinned the group's track record of trading successfully and supporting our clients over many years.

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

Principal Risks and Direction of Outlook

Key: (=) No change (↘) Risk decreased (↗) Risk increased

Principal Risk	Change/Outlook
Business Risk The risk of realising lower than anticipated profits or experiencing a loss rather than a profit.	=
Capital Risk The risk that the group has insufficient regulatory capital (including equity and other loss absorbing debt instruments) to operate effectively, including meeting minimum regulatory requirements, operating within board approved risk appetite and supporting its strategic goals.	=
Conduct Risk The risk that the group's behaviours, or those of its colleagues, whether intentional or unintentional, result in poor outcomes for customers or the markets in which it operates. It is rooted in the importance of delivering good customer outcomes at every stage of the customer journey.	↗
Credit Risk The risk of a reduction in earnings and / or value due to the failure of a counterparty or associated party, with whom the group has contracted or is exposed as part of its operations, to meet its obligations in a timely manner.	↗
Funding and Liquidity Risk Funding risk is the risk of loss caused by the inability to raise funds at an acceptable price or to access markets in a timely manner. Liquidity risk is defined as the risk that liabilities cannot be met when they fall due or can only be met at an uneconomic price.	=
Market Risk The risk that a change in the value of an underlying market variable will give rise to an adverse movement in the value of the group's assets. To support the management of market risk, the group distinguishes between traded market risk and non-traded market risk, as set out in the sections that follow.	Traded Market Risk = Non-Traded Market Risk ↘
Operational Risk The risk of loss or adverse impact resulting from inadequate or failed internal processes, people and systems or from external events. This includes the risk of loss resulting from fraud/financial crime, cyber attacks and information security breaches.	↗
Reputational Risk The risk of detriment to stakeholder perception of the firm, leading to impairment of the business and its future goals, due to any action or inaction of the company, its employees or associated third parties.	=

Note: While defined benefit pension obligation risk, intra group risk and tax risk are also classified internally as principal risks, none are deemed sufficiently material to impact the group's ability to deliver its strategy. The group's defined benefit pension scheme was closed to new entrants in 1996 and to future accrual in 2012. For further information see Note 25 on pages 187 and 188.

Business risk

Business risk is defined as the risk of realising lower than anticipated profits or experiencing a loss rather than a profit.

Exposure

The group operates in an environment where it is exposed to an array of independent factors. Its profitability is impacted by the broader UK economic climate, changes in technology, regulation and customer behaviour, cost movements and competition from traditional and new players, varying in both nature and extent across its divisions.

Changes in these factors may affect the bank's ability to write loans at its desired risk and return criteria, result in lower new business volumes in Asset Management, impact levels of trading activity at Winterflood or result in additional investment requirements and higher costs of operation.

Risk appetite

The group seeks to address business risk through the execution of a sustainable business model based on:

- focusing on specialist markets where we can build leading market positions based on service, expertise and relationships;
- focusing on quality and returns rather than overall loan book growth or market share;
- investing in the business for the long term;
- maintaining a strong balance sheet;
- consistently supporting our customers and clients through the cycle; and
- acting sustainably and responsibly, considering the needs of all stakeholder groups and increasing demand for sustainable products and services.

Measurement

Business risk is measured through a number of key performance metrics (including those set out on page 33) and risk indicators at a business, divisional and group level which provide transparency on progress and execution against strategy. These indicators are typically reported monthly via relevant risk and finance committees, with oversight also exercised via the board, most notably through their review of key financial metrics and underlying performance trends.

Alongside these measures, the status of key group initiatives and projects is also tracked and discussed, noting the importance of their successful delivery to the group's strategic trajectory.

Mitigation

To support the management of its core strategy, and help mitigate potential business risk, the group maintains a comprehensive framework covering both the design and approval of strategy, and the ongoing monitoring of its implementation.

The group's core strategic pillars are regularly reviewed and updated to ensure we continue to focus on strategic priorities that support our business model and adapt to changes and expectations in the external operating environment.

The group's long track record of successful growth and profitability is supported by a consistent and disciplined approach to pricing and credit quality, both in competitive markets and through periods of heightened risk. This allows the group to continue to support customers at all stages in the financial cycle.

We also build and maintain long-term relationships with our clients and intermediaries based on:
- speed and flexibility of services;
- our local presence and personal approach;
- the experience and expertise of our people; and
- our offering of tailored and client-driven product solutions.

This differentiated and consistent approach results in strong customer relationships and high levels of repeat business.

The group is further protected by the diversity of our businesses and product portfolio, which provides resilience against competitive pressure or market weakness in any one of the sectors we operate in.

Monitoring

On an ongoing basis, strategy is formulated and managed at an individual business level through local Executive Committees with top-down oversight maintained through the Group Executive Committee. Outputs also feed into the group's annual budgeting and planning process which typically operates on a three-year time horizon. The group's budget and plan is subject to review and challenge, initially at a business level, and subsequently by the group's Executive Committee ahead of final submission to the board who review, challenge and agree the group's budget for the following year.

The ongoing strategic planning process is supplemented by an annual board strategy day, which takes a thematic approach to the review and challenge of group and business-level strategic priorities. In addition, a deep dive on strategy for each business is presented to the board for discussion on a biennial basis.

New growth initiatives and potential acquisitions are assessed against both the group's strategic objectives and Model Fit Assessment Framework, to ensure consistency with the group's strategic priorities and the key attributes of its business model.

Capital and liquidity adequacy planning conducted as part of both the annual ICAA and ILAA processes is also used to assess the resilience of the group's current strategy and business model in the event of different stress scenarios. Although not intrinsically linked, outputs and analysis from both exercises are used to guide strategic planning.

The annual risk appetite statement review also ensures that risk appetite, and supporting key risk indicators, is fully aligned with the financial and strategic plan. Agreed appetite is communicated throughout the group through the review and approval of divisional risk appetite statements and business-level key risk indicators.

The group also conducts monitoring focused on the external environment (for example, key market indices, growth of sustainable products and services). Within credit risk, all of the banking businesses monitor agreed external early warning indicators (for example, movement in housing indices) with a view to supporting the early identification of negative trends, and enhancing the group's ability to respond appropriately, minimising potential impact on performance.

In addition to business-level monitoring, emerging risks are also monitored and debated on an ongoing basis at all levels of the group and across all functions. These include developments in areas concerning technology, regulation and sustainability, which have the potential to present both opportunities and threats. Within the risk function specifically, reporting capabilities continue to be enhanced to further support the group's ability to identify, and more importantly, respond effectively, to changes in the external environment and in customer behaviours with a view to mitigating any potential impact on business performance.

Change/Outlook =

Notwithstanding the continued uncertain macroeconomic environment our business model as outlined on pages 10 to 13 remains proven and resilient. We continue to focus on supporting our customers, maintaining underwriting standards and investing in our business.

As the pressures resulting from Covid-19 have receded these have been replaced with other macroeconomic and geopolitical tensions. Accordingly, the group remains prepared for a range of different economic and business scenarios to ensure it has the resources and operational capability to continue to perform effectively through this period of uncertainty.

For further details on emerging risks and uncertainties see pages 90 to 92. In addition, further commentary on the market environment and its impact on each of our divisions is outlined on pages 65 to 73.

Capital risk

Capital risk is the risk that the group has insufficient regulatory capital (including equity and other loss-absorbing debt instruments) to operate effectively, including meeting minimum regulatory requirements, operating within board-approved risk appetite and supporting its strategic goals.

Exposure

The group's exposure to capital risk principally arises from its requirement to meet minimum regulatory requirements set out in the Capital Requirements Directive and from related additional requirements and guidelines specified by the Prudential Regulation Authority ("PRA"), and is usually specified in terms of minimum capital ratios which assess the level of regulatory capital and risk weighted assets.

Risk Report continued

Risk appetite
The group looks to maintain a strong base level and composition of capital, sufficient to:
- support the development and growth of business;
- continue to meet Pillar 1 requirements, Individual Capital Guidance, additional Capital Requirements Directive buffers and leverage ratio requirements; and
- be able to withstand a severe but plausible stress scenario with satisfactory capital and leverage ratios.

A prudent capital position is a core part of the group's business model, allowing it to grow and invest in the business, support paying dividends to shareholders and meet regulatory requirements.

Capital triggers and limits are maintained within the risk appetite framework and are approved by the board at least annually.

Measurement
Capital risk is measured using CET1, Tier 1 and total capital ratios, and leverage ratios, determined in line with regulatory capital adequacy requirements. These ratios, and associated metrics, are actively monitored, and reported quarterly to the regulator. They are also disclosed annually in the group's Pillar 3 disclosures as well as in the Annual Report – see pages 184 to 186.

Mitigation
The group retains a range of capital risk mitigants, the most notable being its strong capital generating capacity, as evidenced by its track record of sustained profitability. It also maintains access to capital markets and in recent years has successfully renewed and increased its Tier 2 capital instruments.

Monitoring
Both actual and forecast capital adequacy is reported through the group's governance framework with oversight from the Capital Adequacy Committee ("CAC"). Annually, as part of the ICAAP, the group also undertakes its own assessment of its capital requirements against its principal risks (Pillar 2a) together with an assessment of how capital adequacy could be impacted in a range of stress scenarios (Pillar 2b). Under both assessments, the group ensures that it maintains sufficient levels of capital adequacy.

The group's finance team is responsible for measuring and monitoring the capital position and reporting to the board on a regular basis, with any changes to the capital structure of the group reserved for the CBG Board. On a monthly basis, the group's latest and forecast capital positions are reported to the CAC, whose membership consists of finance, business and risk executives and senior management. The committee also monitors actual, forecast and stressed capital metrics under an Internal Ratings Based approach in order to prepare for anticipated future transition to this approach.

Change/Outlook =
Continuing economic uncertainty may impact capital in the short to medium term due to lower than expected profits. RWA density is expected gradually to increase as Coronovirus Business Interruption Loans ("CBILS") are refinanced. Capital is expected to be adversely impacted as IFRS9 transitional effects reduce. The group's capital requirements are forecast to increase by 1.4 percentage points as UK and Irish countercyclical capital buffers are introduced. These factors are embedded in the group's capital planning process and distance to risk appetite remains substantial.

Conduct risk
Conduct risk is the risk that the group's behaviours, or those of its colleagues, whether intentional or unintentional, result in poor outcomes for customers or the markets in which it operates. It is rooted in the importance of delivering good customer outcomes at every stage of the customer journey.

Exposure
The group is exposed to conduct risk in its provision of products and services to customers and through other business activities that enable delivery. The group faces a significant volume of regulatory change, which is expected to continue over the near term, aimed at enhancing consumer protection and maintaining market integrity given the current economic conditions. Failure to deliver good customer outcomes may lead to reputational harm, legal or regulatory sanctions or customer redress.

Risk appetite
The group recognises the importance of delivering good customer outcomes and seeks to avoid customer detriment resulting from inappropriate judgements or behaviours in the execution of our business activities. To support this, it strives to maintain a culture which places the customer at the heart of the business model and remains dedicated to addressing customer dissatisfaction or detriment in a timely and fair manner.

The group is committed to maintaining the integrity of the markets in which it operates, avoiding any abusive or anti-competitive behaviour.

Measurement
Conduct risk is measured through a number of business activities which form part of the Conduct Risk Framework. These activities span seven areas where harm could occur, be it intentional or unintentional.

In addition, a number of quantitative and qualitative key risk indicators are determined at an individual business level, with reporting to and oversight via the relevant divisional Risk and Compliance Committee. Performance against the key risk indicators is reported to the Group Risk and Compliance Committee and the Board Risk Committee as needed.

Mitigation
The following controls and procedures are in place to help mitigate conduct risk:
- The group takes steps to proactively identify conduct risks and encourages individuals across the organisation to feel responsible for managing the conduct of their business and/or function.
- The group provides support to colleagues to enable them to improve the conduct of their business or function, including training and specialist training where required.
- The group's remuneration strategy is designed to incentivise good behaviours and due consideration is given to individual conduct as part of any remuneration.
- Policies and standards set out employee expectations around key areas including dealing with clients, dealing with markets, complaint handling, vulnerable customers, and conflicts of interest. Mandatory staff training on these topics is provided on a regular basis.
- All products are subject to a robust risk-based product development and review process.

Monitoring
Risk identification and management action are undertaken by management and employees as the first line of defence. Risk and compliance provide support, review and challenge, to ensure conduct risk reporting is robust and remains fit for purpose. Compliance monitoring undertake regular reviews of key areas, such as complaint handling and vulnerable customer processes to confirm customers are experiencing good outcomes. Group internal audit provide independent assurance on the control effectiveness of key areas using a risk-based approach.

All Risk and Compliance Committees are required to review conduct risk reporting and outputs and consider any required action. Where appropriate, issues may be escalated to both the Group Risk and Compliance Committee and the Board Risk Committee.

Over the past 18 months, conduct risk reporting has been enhanced in some of our businesses to provide increased transparency and visibility to monitor conduct risk. Reporting on, and monitoring of, conduct risk is expected to further evolve with the introduction of new regulatory requirements for the Financial Conduct Authority's ("FCA") Consumer Duty for retail customers for our in-scope businesses of Motor Finance, Premium Finance, Asset Finance and Savings.

Conduct Risk Framework

Change/Outlook
Conduct risk has increased in the last 12 months.

The economic environment is increasing pressure on consumers as result of the higher cost of living. This may widen the number of individuals and businesses requiring credit in an environment of rising interest rates. As a result, support for customers in financial difficulty, including vulnerable customers, is expected to increase. This comes at a time when the FCA has outlined new requirements under Consumer Duty, which introduces Principle 12 and requires firms to act to deliver good outcomes for retail customers. It sets a higher standard than the existing Principle 6 (a firm must pay due regard to the interests of its customers and treat them fairly) and Principle 7 (a firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading) for retail businesses. Implementation activities for Consumer Duty are underway and will be incorporated into the Conduct Risk Framework. In the meantime, the group is focused on tailoring its approach to supporting customers to drive good customer outcomes.

Credit risk

Credit risk is defined as the risk of a reduction in earnings and/or value due to the failure of a counterparty or associated party, with whom the group has contracted or is exposed as part of its operations, to meet its obligations in a timely manner.

Exposure

Credit risk across the group arises predominantly through the lending activities of the bank. As a lender to businesses and individuals, the bank is exposed to credit losses if customers are unable to repay loans and outstanding interest and fees. At 31 July 2022 the group had loans and advances to customers amounting to £9.1 billion.

The group also has exposure to counterparties with which it places deposits or trades, and also has in place a small number of derivative contracts to hedge interest rate and foreign exchange exposures.

Further details on loans and advances to customers and debt securities held are in notes 11 and 12 on pages 172 to 176 of the financial statements. Further commentary on the credit quality of our loan book is outlined on pages 195 to 202.

Risk appetite

The group seeks to maintain the discipline of its lending criteria both to preserve its business model and maintain an acceptable return that appropriately balances risk and reward. This is underpinned by a strong customer focus and credit culture that extends across people, structures, policies and principles. This in turn provides an environment for long-term sustainable growth and low, predictable loan losses.

To support this approach, the group maintains a credit risk appetite framework in order to define and align credit risk strategy with its overall appetite for risk and business strategies as defined by the board.

The group Credit Risk Appetite Statement ("CRAS") outlines the specific level of credit risk that the group is willing to assume, utilising defined quantitative limits and triggers, and covers both credit concentration and portfolio performance measures.

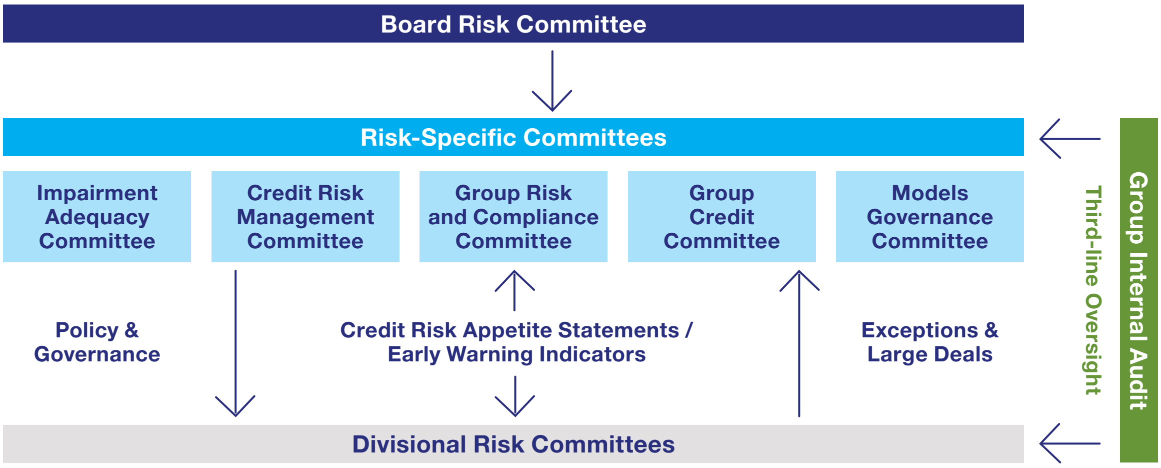
All are based on the following key principles:
1. To lend within asset classes we are familiar with, and in markets we know and understand.
2. To operate as a predominantly secured, or structurally protected, lender against identifiable and accessible assets, and maintain conservative loan to values ("LTVs") across our portfolios.
3. To maintain a diversified loan portfolio (by business, asset class and geography), as well as a short average tenor and low average loan size.
4. To rely on local underwriting expertise, with delegated authority cascaded from the chief risk officer, with ongoing central oversight.
5. To maintain rigorous and timely collections and arrears management processes.
6. To operate strong control and governance within our lending businesses overseen by a central group credit risk team.

Ultimate responsibility for the approval and governance of the Group CRAS lies with the board, on recommendation from the Group Risk and Compliance Committee ("GRCC"), with support from the Credit Risk Management Committee ("CRMC"). Performance is monitored against agreed appetites on a monthly basis.

The CRAS is embedded into business unit credit risk management through a hierarchy of local triggers and limits, which are approved by the CRMC (or the chief credit risk officer depending on materiality) and include formal caps and triggers against which performance is similarly monitored monthly via local Risk and Compliance Committees ("RCCs"). Material breaches are escalated via established governance channels.

Risk Report continued

Credit Risk Governance Framework



CRAS metrics are closely aligned with the bank's overall strategy to facilitate monitoring of the composition and quality of new lending to ensure it remains within defined appetite.

Measurement

Consistent, accurate and consolidated Credit Risk Management Information ("CRMI") represents a key tool for effective credit risk management and measurement. CRMI facilitates the identification, measurement, monitoring and control of all material credit risks within the lending portfolios, setting clear credit risk appetite within which all lending is originated and ensures that asset portfolios are grown responsibly and profitably.

A central repository facilitates:
- the use of common data definitions for CRMI across all business units;
- consistent and controlled extraction and housing of credit data from the bank's core business systems;
- dynamic credit risk management to improve strategic policy decision-making;
- oversight and control of the profile of the lending book to manage to credit risk appetite;
- identification, monitoring and control of material credit risks against a clear and communicated credit risk appetite statement.

Mitigation

Credit assessment/lending criteria

Our general approach to credit mitigation is based on the provision of affordable lending on a secured or structural protected basis, against assets that we know and understand. These assets are typically easily realisable with strong secondary markets and predictable values, and spread across a broad range of classes within established sectors.

Whilst diverse, our businesses adhere to a set of common lending principles resulting in stable portfolio credit quality and consistently low loss rates through the cycle.

The bank's common lending principles are as follows:
1. Predominantly secured lender: 97.7% of loan book secured or structurally protected.
2. Short average tenor: portfolio residual maturity of 17 months.
3. Low average loan size: approximately 42% of loan book has a value of less than £50k.
4. Diversified portfolio: by sector, asset class and UK geography. Low single-name concentration risk with the top 10 facilities representing less than 5% of book.
5. Local underwriting expertise with central oversight: focus on assets "we know and understand", with continued investments in people and systems.

We seek to minimise our exposure to credit losses by applying these strict lending criteria when testing the credit quality and covenant of the borrower and maintaining consistent and conservative loan to value ratios with low average loan size and short-term tenors. All lending criteria and assessment procedures are thoroughly documented in robust credit policies and standards, at both a bank and business level.

Expertise

We also employ credit risk staff across our various businesses who are specialists in their area and can support book growth in a manner that is consistent with both risk strategy and appetite. This local distribution allows us to form strong relationships with our customers and intermediaries based on a deep understanding of their needs and the markets in which they operate. Consistent underwriting disciplines and lending against assets that we know and understand benefits customers through the cycle and allows us to maintain our track record of strong margins and profitability.

Governance framework and oversight

Our lending is underpinned by a strong control and governance framework both within our lending businesses and through oversight via a central group credit risk team.

Credit underwriting is undertaken either centrally or through regional office networks, depending on the nature of the business and the size and complexity of the transaction. Underwriting authority is delegated from the Board Risk Committee, with lending businesses approving lower-risk exposures locally subject to compliance with credit policy and risk appetite.

Local risk directors assure quality of underwriting decisions for all facilities within the business's delegated sanctioning authority level via a quality assurance programme which samples new business underwritten, with a particular focus on lending hotspots; for example, long-tenor agreements, new asset classes, or high LTVs. Outputs are reported at least quarterly with consolidated summaries presented at CRMC.

These underwriting approaches are reinforced by timely collections and arrears management, working in conjunction with the customer to ensure the best possible outcome for both customer and the group.

The local model is supported by central oversight and control. An independent central credit risk function provides ongoing monitoring of material credit risks through regular reviews of appetite and policy.

Counterparty risk mitigation
Exposures to counterparties with whom we trade or place deposits are mitigated by continuous monitoring of the credit quality of our counterparties within approved set limits and Winterflood's trading relating to exchange traded cash securities being settled on a delivery versus payment basis. Counterparty exposure and settlement failure monitoring controls are also in place.

Monitoring
High-level requirements are outlined in standards documents covering the identification, monitoring and management of problem lending, with detailed credit policy and guidance formalised within local credit policies, including guidelines on the identification and treatment of vulnerable customers.

This includes the documentation of internal policy and process for monitoring, recording and approving problem credits at all levels of exposure, business-specific definitions of criteria for identifying problem cases and requirements for outlining the courses of action available to protect our position, taking account of the terms/covenants of facilities, security enforcement options, legal remedies and third-party intervention (for example, brokers).

This process is owned by the risk directors, ensuring that prompt action is taken to review the financial conditions of customers when warning signs indicate deterioration in financial health, credit quality, covenant compliance or asset strength/coverage. Where possible, credit limits are amended where there is evidence of delinquency or deteriorating financial condition/capacity to repay.

Our credit risk framework aligns with the broader "three lines of defence" approach, with a governance structure flowing from local first line business teams, up to second line risk directors (and key oversight committees such as Credit Committees, divisional RCCs, CRMC, Model Governance Committee ("MGC") and the BRC) overlaid with a third line group internal audit function.

First line credit risk management
Lending businesses have primary responsibility for ensuring that a robust risk and control environment is established as part of day-to-day operations, and good quality credit applications are brought forward for consideration. They are also responsible for ensuring that their activities are compliant with the rules and guidance set out in local credit policies and processes. Each business unit has its own formalised credit risk appetite and policy documents, approved by divisional RCCs. This risk culture is facilitated by local profit and loss ownership, ensuring a long-term approach is taken, with an understanding of how loans will be repaid.

Credit risk oversight and control
The second line of defence has three tiers: business-aligned risk directors and their teams, the central group credit risk team, and oversight committees. The risk directors in the bank, who report to the chief credit risk officer, are responsible for setting and communicating credit risk strategy, identifying exceptions and ensuring local compliance. Similarly, the risk heads in Close Brothers Asset Management and Winterflood Securities, and the asset and liability management risk lead, ensure that their respective operations are performed in line with the group financial institution and non-banking financial institution credit risk standards and also report up through their divisional RCCs. The group credit risk team provides a further layer of oversight and approval, supported by credit committees, CRMC, MGC, GRCC and the BRC. Together, the second line of defence provides a clear tactical and strategic understanding of credit risk, proposing enhancements to the credit risk framework for ongoing effective management and control.

The third line of defence is the group internal audit function. They use both a risk-based approach and a rolling programme of reviews to ensure that the first and second lines of defence are working effectively.

Change/Outlook ↗
Credit losses have increased in the year to 31 July 2022, reflecting the impacts of ongoing market uncertainty, which we continue to monitor closely. While direct Covid-19 impacts have receded, the overall credit risk outlook reflects a heightened level of uncertainty in the macroeconomic environment in the short- to medium-term due to a combination of evolving factors. These include the ongoing conflict in Ukraine, supply chain disruption, the rising cost of living, and inflation. In addition, the cessation of various government support schemes could have an impact on both consumers and businesses and the impact of this on our customers will be closely monitored. These factors could result in higher credit losses in the future.

Bad debt levels are broadly consistent year-on-year, with these new challenges offsetting earlier improvements in the macroeconomic outlook as we emerged from the pandemic. Risk appetite has remained consistent with our prudent, through-the-cycle underwriting standards.

Forbearance levels have further decreased from those observed at the peak of the pandemic; however, they remain above historical, pre-pandemic levels.

Assumptions relating to the Novitas business provisions have been updated. Other counterparty exposures are broadly unchanged, with the majority of our liquidity requirements and surplus funding placed with the Bank of England.

Further commentary on the credit quality of our loan book is outlined on pages 195 to 202. Further details on loans and advances to customers and debt securities held are in Notes 11 and 12 on pages 172 to 176 of the financial statements. Our approach to credit risk management and monitoring is outlined in more detail in note 28 on pages 195 to 202.

Risk Report continued

Funding and liquidity risk

Funding risk is defined as the risk of loss caused by the inability to raise funds at an acceptable price or to access markets in a timely manner.

Liquidity risk is defined as the risk that liabilities cannot be met when they fall due or can only be met at an uneconomic price.

Exposure

Funding and liquidity are managed on a separate legal entity basis with each division responsible for ensuring it maintains sufficient liquidity for its own purposes. The group's divisions operate independently of each other with no facilities or other funding arrangements in place between them, and there is no liquidity reliance between the different divisions.

Close Brothers Group plc has relatively few material cash requirements and all requirements are known in advance; for example, external dividends. It meets its cash requirements through deposits placed with the Banking division and the group's committed borrowing facilities.

The Banking division's funding profile benefits from a broad array of liabilities, comparable with those of much larger banks. Its diversified approach to funding includes using secured funding, unsecured funding, retail deposits and non-retail deposits. Funding risk exposure primarily arises if it is unable to obtain the necessary funding to support its asset positions for the maturity expected to be required. Unsustainable or undiversified funding bases, such as an over-reliance on short-term deposits, can increase the level of risk and can lead to a deviation from the funding plan. In turn this can increase the costs of raising new funds, reducing our ability to originate new assets and potentially leading to negative market or customer perception.

The Banking division's Internal Liquidity Adequacy Assessment Process ("ILAAP") covers potential event drivers of a range of stress testing scenarios, including idiosyncratic examples, to ensure liquidity management remains a source of strength with a robust and prudent approach to assessing and maintaining liquidity requirements in place.

Funding and liquidity risk in Winterflood Securities is driven from four primary sources: long trading book risk positions; overnight and intraday normal and failed settlement; margin requirements; and multiday client orders. Winterflood maintains risk appetite sufficient to ensure continued compliance with Individual Liquidity Guidance ("ILG") set by the regulator.

For Close Brothers Asset Management, cash requirements, such as payroll and dividends to the group, are known in advance. Funding and liquidity risks are considered through the division's cash flow forecasting, ensuring that sufficient liquidity is maintained to cover the next three months of outflows.

Further detail on the group's funding and liquidity exposure is provided on page 64 of the Financial Overview and page 204 of the financial statements.

Risk appetite

The group adopts a conservative approach to funding and liquidity risk and seeks to maintain a distinctive funding and liquidity position characterised by preserving a simple and transparent balance sheet, sustaining a diverse range of funding sources and holding a prudent level of high quality liquidity. As such, the weighted average maturity of its funding is longer than the weighted average maturity of its lending portfolio.

These objectives form the basis for the Group Funding and Liquidity Risk Appetite Statement, approved annually by the board, which outlines the specific levels of funding and liquidity risk that the group is willing to assume. Given the materiality of the Banking division, this is primarily focused on the levels of risk assumed within the bank.

Measurement

A variety of metrics are used to measure the Banking division's funding and liquidity position to ensure compliance with both external regulatory requirements and internal risk appetite. These cover both the short and long-term view of liquidity and funding and have limits and early-warning indicators in place that are approved via the Asset and Liability Committee ("ALCO"). These metrics include term funding as a percentage of loan book, weighted average tenor of loan book versus weighted average tenor of funding, available cash balance with the Bank of England and liquid to total asset ratio.

The primary measurement tool for funding is the Banking division's funding plan which seeks to ensure that the bank maintains a balanced and prudent approach to its funding risk that is in line with risk appetite. The funding plan is supplemented by metrics that highlight any funding concentration risks, funding ratios and levels of encumbrance.

Liquidity is managed in accordance with the ILAAP which is approved by the board. In addition to regulatory metrics, the banking division also uses a suite of internally developed liquidity stress scenarios to monitor its potential liquidity exposure daily and determine its high quality liquid asset requirements. This ensures that the bank remains within risk appetite and identifies potential areas of vulnerability. The outcomes of these scenarios are formally reported to the ALCO, GRCC and the board.

Mitigation

Our funding approach is based on the principles of "borrow long, lend short" and ensuring a diverse range of sources and channels of funding. In the Banking division, retail and corporate customer funding is supported by wholesale funding programmes including unsecured medium-term notes and securitisation programmes.

The bank has also drawn against the Bank of England's TFSME scheme, that was introduced to support lending in the prevailing low interest rate environment. This approach provides resilience and flexibility. Total available funding is kept well in excess of the loan book funding requirement to ensure funding is available when needed.

A strong liquidity position is maintained to ensure that we remain comfortably within both internal risk appetites and regulatory requirements. Liquidity risk is assessed on a daily basis to ensure adequate liquidity is held and remains readily accessible in stressed conditions.

Funding and liquidity risks are reviewed at each meeting of the ALCO.

Monitoring

Liquidity is measured and monitored on a daily basis with monthly reports forming standing items for discussion at both the ALCO and GRCC, with the Board Risk Committee maintaining overall oversight. Any liquidity and funding issues are escalated as required to the ALCO, and then onwards to the GRCC and the Board Risk Committee.

The bank operates a three lines of defence model, with Treasury responsible for the measurement and management of the bank's funding and liquidity position and Asset and Liability Management ("ALM") risk providing independent review and challenge. ALCO provides oversight of funding and liquidity and supports the relevant senior managers in discharging their senior management function responsibilities.

Change/Outlook =

Economic uncertainty has continued over the last 12 months, increasing market competitiveness. Despite the challenges this has presented, the Banking division's ability to fund the loan book has been largely unaffected and it continues to retain access to a wide range of funding sources and products. Similarly, elevated levels of liquidity have continued to be maintained despite market volatility and uncertainty.

The Banking division successfully issued a new £200 million securitisation transaction in April 2022 and has continued to enhance its current retail product range. For example, this year saw the launch of a new version of our Personal Fixed Rate Bond product which has greatly increased operational efficiencies and allowed us to scale up our level of fixed funding. ISAs continue to feature heavily in our range and represent a key product for growth.

Market risk

Market risk is defined as the risk that a change in the value of an underlying market variable will give rise to an adverse movement in the value of the group's assets.

Market volatility impacting equity and fixed income exposures, and/or changes in interest and exchange rates, has the potential to impact the group's performance.

To support the management of market risk, the group distinguishes between traded market risk and non-traded market risk, as set out in the sections that follow.

Traded market risk

Exposure

Traded market risk in the group only arises in Winterflood Securities, whose core business is to provide liquidity and interact with the market on a principal basis, holding positions in financial instruments as a result of its client facilitation activity.

Winterflood operates as a market maker in equities, exchange-traded products, investment trusts and sovereign and corporate bonds, operating across three primary markets: the United Kingdom, North America and Europe. For hedging purposes, a number of derivatives are also traded, although these are limited to listed futures in UK equity and fixed income markets.

See page 203 for details of the group's trading book exposure to market price risk.

Risk appetite

Winterflood's strategic objectives and business plan are centred on its ability to continue transacting in the markets in which it operates, in the manner it has historically. The group sets its risk appetite accordingly, acknowledging that an acceptable level of traded market risk must be incurred for the business to operate effectively.

Winterflood seeks to always ensure sufficient levels of capital and liquidity are maintained to cover its traded market risk exposure.

Measurement

Traded market risk is measured against a set of defined risk limits set at overall global, desk and individual stock levels, on both an intraday and end-of-day basis. These limits are monitored via a combination of internally developed, and external, industry leading systems on an intraday and overnight basis against a limit framework aligned to the company risk appetite. The framework incorporates:

- Market risk appetite being managed via trading book exposures limits. These are set using gross cash positions and the sterling value of a basis point ("SV01") for products with interest rate exposure.
- Adoption of a real-time limit monitoring system, along with end-of-day summary reports to track equity, fixed income and foreign exchange ("FX") book cash exposure risk against agreed limits.
- Minimal exposure to derivatives (limited to hedging of interest rate exposures and FX positions resulting from trades in foreign currencies).

Mitigation

The management of traded market risk is fully embedded under Winterflood's training and governance framework. Key attributes include:

- An established training programme for junior dealers, requiring their supervision by a senior dealer until deemed competent to trade on their own.
- The provision of training to all new joiners and newly certified staff by front office controls. This includes market risk considerations as well as detail regarding order entry controls.
- The maintenance of risk mandates for all traders, detailing the firm's market-making strategy, controls frameworks and policies and procedures.
- Oversight of all risk issues, including traded market risk, via the Winterflood Risk and Compliance Committee. Management information and key risk indicators are reported to the committee on a monthly basis with escalation to the Group Risk and Compliance Committee and Board Risk Committee in case of need.
- The maintenance of a Group Market Risk Policy and specific Traded Market Risk Standard, outlining minimum governance requirements and escalation.
- Order entry controls in place across the trading floor, limiting, amongst other trading variables, the amount of capital that can be committed per order (these are documented in a front office procedure).
- Daily total value traded caps to limit the amount the business can trade through a single broker.
- Minimal exposure to derivatives (limited to conservative hedging of FX positions resulting from trades in foreign currencies).

Monitoring

Building on the use of real-time limit monitoring (see above), the monitoring of traded market risk is embedded across all three lines of defence. Top-down visibility is exercised via the Winterflood Risk and Compliance Committee which retains regular oversight of core traded market risk MI and key risk indicators, as well as stress testing outputs and policies and standards.

The Winterflood risk team works in conjunction with the front office controls team to ensure the management of traded market risk is correctly aligned to documented controls. To support this, MI dashboards are utilised alongside daily reporting to help manage market risk on a daily and intraday basis.

Change/Outlook =

While the impacts of Covid-19 have largely fallen away, in recent months China's economy has been impacted by further lockdowns which has had an onward impact to global markets and supply chains. This has been coupled with a rising interest rate environment, driven by inflation, and a backdrop of global political uncertainty, driving higher volatility into what is now a bear market.

The Investment Firms Prudential Regime ("IFPR") has been introduced in the past 12 months, changing the way the company calculates capital. From a market risk perspective this has had very little impact in the calculations we perform for the regulator or those we conduct internally. Over the next 12 months it was expected that the introduction of the Fundamental Review of the Trading Book ("FRTB") may change the firm's calculation of regulatory capital; however, the implementation of this regulation has been delayed.

Non-traded market risk

Exposure

The group's non-traded market risk exposure consists of interest rate risk in the banking book ("IRRBB") and foreign exchange risk.

Interest rate risk is predominantly incurred in the Banking division as a result of the bank's lending and funding activities.

Foreign exchange risk is incurred across the group and arises from:

- managing the funding requirements of the bank's lending subsidiaries through deposit gathering and wholesale funding and managing the associated FX risks;
- conducting foreign exchange payment services on behalf of the group; and
- non-sterling investments.

Further detail on the group's exposure to non-traded market risk is outlined in note 28 on pages 202 and 203 of the financial statements.

Risk appetite

The group has a simple and transparent balance sheet and a low appetite for interest rate risk which is limited to that required to operate efficiently. The group's policy is to match repricing characteristics of assets and liabilities naturally where possible or by using interest rate swaps to secure the margin on its loans and advances to customers.

Risk Report continued

The group also has a low appetite for foreign exchange risk, avoiding large open positions and applying individual currency limits to mitigate risk.

The group does not use financial instruments for speculation although it retains a limited risk appetite to take advantage of profit opportunities that may arise in the normal course of business.

Measurement

The group recognises three main sources of IRRBB which could adversely impact future income or the value of the balance sheet:

- repricing risk – the risk presented by assets and liabilities that reprice at different times and rates;
- embedded optionality risk – the risk presented by contract terms embedded into certain assets and liabilities; and
- basis risk – the risk presented by a mismatch in the interest rate reference rate for assets and liabilities.

IRRBB is assessed and measured by applying key behavioural and modelling assumptions including, but not limited to, fixed rate loans subject to prepayment risk, behaviour of non-maturity assets, treatment of own equity and the expectation of interest rate options. This is performed across a range of regulatory prescribed and internal interest rate shocks approved by the bank's ALCO.

Two measures are used for measuring IRRBB, namely Earnings at Risk ("EaR") and Economic Value ("EV"):

- EaR measures short-term impacts to earnings, including basis risk, highlighting any earnings sensitivity should rates change unexpectedly.
- EV measures longer-term earnings sensitivity due to rate changes, highlighting the potential future sensitivity of earnings, and ultimately risk to capital.

The group is exposed to transaction, translation and structural foreign exchange risk. Transaction risk is measured daily within Treasury based on net cash flows and contracted future exposures. Translation risk is monitored within local business units monthly, translating non-UK profits regularly to mitigate fluctuations in foreign exchange rates. Structural risk is assessed at least annually as part of the group's ICAAP and is deemed to be immaterial.

Mitigation

As noted above, the group maintains a low appetite for interest rate risk with simple hedging strategies in place to mitigate risk. The Banking division's treasury is responsible for hedging the non-traded interest rate risk. Any residual risk which cannot be naturally matched is hedged utilising vanilla derivative transactions to remain within prescribed risk limits. The ALCO is responsible for approving any changes to hedging strategies before implementation.

Derivative transactions can only be undertaken with approved counterparties and within the respective credit risk limits assigned to those counterparties.

Foreign exchange exposures are generally hedged using foreign exchange forwards or currency swaps with exposures monitored daily against approved limits.

Monitoring

ALCO is responsible for monitoring the non-traded market risk of the current and future risk profile within defined limits. Treasury are responsible for day-to-day management of all non-traded market risks. Day-to-day oversight of non-traded market risk is exercised via a combination of daily reporting by bank finance and review and challenge through local RCCs. Further independent oversight is provided via the second line of defence through ALM risk, with monthly reporting into the ALCO.

Local businesses have operational processes and controls in place to monitor their exposure to IRRBB and ensure it remains within approved local risk appetites. Any exceptions are reported to ALM risk on the same working day. Residual IRRBB that is not transferred into treasury for central management through the Banking division's funding transference process is monitored by the local business through their RCC.

ALM risk is responsible for maintaining processes and controls to monitor the divisional position and report exposures to ALCO, and subsequently GRCC and Board Risk Committee. An ALM system is deployed as the primary source for IRRBB reporting and risk measurement.

Change/Outlook

In recent years, the Banking division's exposure to IRRBB has been driven by embedded optionality with some variable rate lending businesses utilising contracts with floors. With rates now rising, this embedded optionality risk is decreasing, with repricing risk now the biggest driver of EaR. The Banking division currently has positive sensitivity under both up and down rate scenarios for the group's EaR as shown in note 28 on page 202.

Operational risk

Operational risk is defined as the risk of loss or adverse impact resulting from inadequate or failed internal processes, people and systems or from external events. This includes the risk of loss resulting from fraud/financial crime, cyber attacks and information security breaches.

Exposure

The group is exposed to various operational risks through its day-to-day operations, all of which have the potential to result in financial loss or adverse impact.

Losses typically crystallise as a result of inadequate or failed internal processes, people, models and systems, or as a result of external factors.

Impacts to the business, customers, third parties and the markets in which we operate are considered within a maturing framework for resilient delivery of important business services.

Legal and regulatory risks are also considered as part of operational risk. Failure to comply with existing legal or regulatory requirements, or to adapt to changes in these requirements in a timely fashion, may have negative consequences for the group. Similarly, changes to regulation can impact our financial performance, capital, liquidity and the markets in which we operate.

Risk appetite

We manage our exposure to operational risk through a balanced consideration of investment case and risk, accepting that it is not proportionate or feasible to fully eliminate operational risk.

In line with the group's conservative approach to risk management, we implement controls in a manner that reduces the likelihood of higher-impact risk events crystallising. Further, we monitor aggregate loss trends and seek to limit aggregate losses arising in any given year.

The group has limited appetite for operational risks with significant residual exposure and as such requires a near-term mitigation strategy for any such identified risks.

Measurement

Operational risk is measured through Key Risk Indicators ("KRIs"), observed impact of risk incidents, risk and control self-assessment and scenario analysis.

Each key risk within operational risk has a set of defined KRIs. These are regularly monitored via local, divisional and group committees with exceptions reported to both the GRCC and Board Risk Committee. The population of KRIs is reviewed annually in line with the scheduled review of the firm's risk appetite.

Operational risk incidents are identified and recorded in a common system. This facilitates root cause analysis, enables thematic and trend analysis, and enables the consistent delivery of management information into risk committees.

Risk and control self-assessments are completed by risk owners on a regular basis. This enables the consistent identification and assessment of key risks and controls. Where a risk owner self-assesses elevated levels of residual risk, additional management action is considered.

Scenario analysis is utilised to identify and consider potential low frequency/high impact events. Complementary approaches to desktop scenario analysis and scenario testing are deployed to test the efficacy of risk and control self-assessments, evaluate the resilience of important business services and drive Pillar 2a operational risk capital calculations.

Mitigation

The group seeks to maintain its operational resilience through effective management of operational risks, including by:
- sustaining robust operational risk management processes, governance and management information;
- identifying key systems, third party relationships, processes and staff, informing investment decisions;
- investing in technology to provide reliable and contemporary customer service offerings and effective model outputs;
- attracting, retaining and developing high quality staff through the operation of competitive remuneration and benefit structures and an inclusive environment that embraces diversity and recognises behaviours aligned to our cultural attributes;
- investing in cyber security including expertise, tools and staff engagement;
- maintaining focus on personal data protection;
- adopting fraud prevention and detection capabilities aligned with our risk profile; and
- planning and rehearsing strategic and operational responses to severe but plausible stress scenarios.

Key Operational Risks

Operational Risk Areas of Focus

Model Risk Focus:

Robust model risk framework embedded across the group to reduce the risk of potential adverse outcomes arising from the use of models.

The group uses models for a range of different purposes, including provisioning, stress testing, credit approval, risk management and financial reporting. In doing so, it seeks to minimise the occurrence of financial loss, lost income or reputational damage as a result while ensuring transparency regarding the level of model risk incurred.

A model risk framework is embedded across the group to manage and mitigate risk through the model lifecycle. This is underpinned by a Group Model Risk Policy and various supporting standards and procedures outlining clear roles and responsibilities in terms of model risk management. A dedicated model risk management team is also in place, responsible for the independent validation of all models, the identification of potential limitations and assumptions and the proposal of approval recommendations, including the use of expert judgement to adjust model outputs or identify appropriate post-model adjustments. The MGC provides oversight of the group's exposure to model risk through the review, approval and monitoring of material models used within the group, alongside regular reporting on a set of defined key risk indicators which form part of the Group Risk Appetite. Ongoing evolution of the model risk framework is aligned to the firm's ongoing advanced internal rating based ("AIRB") application.

Cyber Risk Focus:

The group recognises the importance of protecting information and systems from the ever-growing cyber threat faced by the financial services industry.

The group uses an industry standard framework to anchor its cyber risk management, continually assessing and developing its maturity. We acknowledge the challenge of preventing all incidents as the capabilities and tactics of malicious actors advance and focus efforts across a spectrum of controls to mitigate occurrence and potential impacts.

A group chief information security officer maintains a dedicated team and sets the policy for the group's posture, with an emphasis on delivering controls against identified external and internal threats.

The cyber risk management lifecycle is aligned to the group's broader approach to operational risk management. The group has strategic partnerships with external experts, participates in industry fora and utilises the three lines of defence model to manage cyber risk. This is underpinned by supporting standards and baselines which set the terms for the management of cyber risk. The Board Risk Committee has oversight of the group's cyber risk profile, supported by detailed oversight by the Operations and Technology Risk Committee.

Risk Report continued

Legal and regulatory risks are mitigated by:

- responding in an appropriate, risk-based and proportionate manner to any changes to the legal and regulatory environment as well as those driven by strategic initiatives;
- implementing appropriate and proportionate policies, standards and procedures designed to capture relevant regulatory and legal requirements;
- providing clear advice on legal and regulatory requirements, including in relation to the scope of regulatory permissions and perimeter guidance;
- delivering relevant training to all staff, including anti-money laundering, anti-bribery and corruption, conduct risk, data protection and information security. This is augmented by tailored training to relevant employees in key areas;
- deploying a risk-based monitoring programme designed to assess the extent to which compliant practices are embedded within the business;
- maintaining, where possible, constructive and positive relationships and dialogue with regulatory bodies and authorities; and
- maintaining a prudent capital position with headroom above minimum capital requirements.

Monitoring

The board delegates authority to the GRCC to manage the group's operational risk framework on a day-to-day basis and provide oversight of its exposure. The committee is supported by the Operations and Technology Risk Committee ("OTRC") which is responsible for oversight of technology, information security, third party and certain other resilience-related risks. Regular management information is presented to and discussed by these committees.

The risk function has a dedicated operational risk team that is responsible for maintaining the framework, toolsets and reporting necessary for effective operational risk management. Operational risk managers are aligned to businesses with a technical second line of defence team providing specialist oversight of technology, information security, data and resilience-related risks. Monitoring of all operational risk types is conducted via divisional RCCs with escalation to the GRCC and Board Risk Committee as appropriate.

In addition to the delivery of standardised management information across all operational risks, periodic deep dives are also conducted on key focus areas and reviewed by the GRCC and Board Risk Committee. In the last year, these have covered third party risk, cyber and more broadly operational resilience. Further independent assurance is obtained through reviews conducted by the compliance monitoring team, specialist external partners (e.g. regarding cyber risk management), and group internal audit.

Change/Outlook

Operational risks arising from Covid-19 subsided during the year following a global vaccine rollout. Ways of working have stabilised with associated control environment considerations having embedded. Investments in operational and cyber resilience continue to deliver improved control maturity. Notwithstanding these improvements, the overall operational risk profile has increased. Drivers include market-wide people risks relating to recruitment and retention, industry-wide information security, cyber threats and supply chain impacts arising from the Russian / Ukrainian conflict and expected increasing trends in attempted external fraud coinciding with increasing cost of living pressures.

Reputational risk

Reputational risk is defined as the risk of detriment to stakeholder perception of the firm, leading to impairment of the business and its future goals, due to any action or inaction of the company, its employees or associated third parties.

Exposure

Protection and effective stewardship of the group's reputation are fundamental to its long-term success.

Detrimental stakeholder perception could lead to impairment of the group's current business and future goals. The group remains exposed to potential reputational risk in the course of its usual activities, such as through employee, supplier or intermediary conduct, the provision of products and services, crystallisation of another risk type, or as a result of changes outside of its influence.

Risk appetite

The group has a strong reputation which it has built over many years and considers it a valuable asset, managing it accordingly through consistent focus on a set of cultural and responsible attributes. The group has no tolerance for behaviours that contradict these attributes in a manner that could harm the organisation, and avoids engaging with third parties, markets or products that would inhibit the firm's adherence to them.

The group seeks to operate in a responsible manner that has client outcomes at the heart of everything that it does. Protection of the group's reputation is firmly embedded in its business-as-usual activities, and the group, as part of its overall strategy, adopts a prudent approach to risk taking.

Core Drivers of Reputational Risk

Drivers
1. Employee conduct
2. Supplier and intermediary conduct
3. Products and services
4. Changes in business/societal conduct
5. Crystallisation of another risk type

Reputational Risk

Impact Areas
1. Customers and clients
2. Intermediaries
3. Employees
4. Suppliers
5. Regulators and government
6. Communities and the environment
7. Investors

The group also recognises that its reputation is linked to broader responsibilities to help address social, economic and environmental challenges, and maintains appropriate sustainable objectives that the group sets itself as a business.

Measurement

The group recognises five core drivers of reputational risk and considers potential impact across seven areas as shown in the diagram.

Risk identification and subsequent management action are embedded within business-as-usual activities.

Additionally, the group actively monitors for changes in the business, legal, regulatory and social environment in which it operates to ensure the timely identification, assessment and mitigation of any potential reputation concerns that may arise following changes in the expectations of key stakeholders.

Mitigation

Reputational risk management is embedded through the organisation, including via:

- focus on employee conduct, with cultural attributes embedded throughout the group;
- supplier and intermediary conduct management through the relationship lifecycle;
- new product approval and existing product review processes for business products and services;
- a proactive approach to environmental, social and governance matters;
- embedding of reputational risk management within the management frameworks of other risk types; and
- proactive communication and engagement with investors, analysts and other market participants.

In addition, the group maintains policies and standards that serve to protect the group's reputation, most notably those covering anti-bribery, conflicts of interest, dignity at work and high-risk client policies. These are regularly reviewed and updated with staff receiving annual training to reinforce understanding of their obligations.

The group crisis management team supports management of cases where there is a potential risk of reputational impact on the group on an exceptional basis. A communications plan also forms part of the group's recovery plan, which sets out core principles to ensure fair and transparent communication, to control the risk of misinformation and minimise any negative reaction to the implantation of recovery options.

Monitoring

Reputational risk is considered across all three lines of defence as part of oversight and assurance activities.

Adherence to the group's cultural framework is monitored through the culture dashboard, which is reported to the board on a quarterly basis and includes key metrics in relation to culture across the group and each of its divisions. Customer forums are also in place across the firm, reinforcing the organisation's commitment to favourable client outcomes. Regular engagement with our investors also enables open communication with this stakeholder group.

A series of sustainability forums and committees operate at a divisional and group level to ensure that the organisation appropriately addresses its sustainable and responsible priorities and expectations of wider stakeholder groups.

Change/Outlook =

The group's focus on acting responsibly and sustainably enables it to respond and adapt to a range of stakeholder expectations with regard to sustainable practices and address heightened public interest in businesses taking a proactive, responsible approach to their operations, products and services. Internal oversight of matters relating to employees, the environment, wider society and community impact at both an operational and strategic level ensure the group gives due considerations to the reputational impact of its actions.

Risk Report continued

Emerging Risks and Uncertainties

In addition to day-to-day management of its principal risks, the group utilises an established framework to monitor its portfolio for emerging risks, consider broader market uncertainties, and support its organisational readiness to respond.

This incorporates input and insight from both a top-down and bottom-up perspective:

- **Top-down:** identified by directors and executives at a group level via the GRCC and the board.
- **Bottom-up:** identified at a business level and escalated, where appropriate, via risk updates into the GRCC.

Additionally, active monitoring of the correlation impacts across emerging risks, uncertainties and principal risks is undertaken.

Group-level emerging risks are monitored by the GRCC and Board Risk Committee on an ongoing basis, with agreed actions tracked to ensure the group's preparedness should a risk crystallise.

Emerging risks and uncertainties currently tracked by the group include:

Emerging Risk/Uncertainty	Mitigating Actions and Key Developments	Outlook
Economic uncertainty	The group's business model aims to ensure that we are able to trade successfully and support our clients in a wide range of economic conditions. By maintaining a strong financial and capital position, we aim to be able to absorb short-term economic downturns, respond to any change in activity or market demand, and in so doing, build long-term relationships by supporting our clients when it really matters. The group focuses on quality and returns rather than overall growth or market share and continues to invest in the business for the long term, to support our customers and clients through the cycle. We test the robustness of our financial position by carrying out regular stress testing on our performance and financial position in the event of adverse economic conditions. The group adopts a prudent and conservative approach and regularly reviews its risk appetite to ensure it remains appropriate in the prevailing economic environment.	There remains significant ongoing uncertainty regarding the future economic trajectory in both the UK and across global markets more generally. Notwithstanding the resilience of our model, we are continuing to plan for a range of different economic and business scenarios to ensure we have the resources and capability to continue to perform effectively. Further commentary on the attributes and resilience of the group's diversified business model is shown on pages 10 to 13 with commentary on the market environment and its impact on each of our divisions outlined on pages 65 to 73.
Geopolitical uncertainty	The group operates predominantly in the UK and Republic of Ireland, with approximately 99% of our loan book exposure to the UK, Republic of Ireland and Channel Islands. Monitoring is in place to track changes in the geopolitical landscape that could have an impact on the group and its operations, its customers and its supply chain, either directly or indirectly. The group has a strong financial position and maintains capital and liquidity levels well in excess of regulatory minimums. Further information on the group's financial performance during the year can be found on pages 61 to 73 Regular stress testing is undertaken on our performance and financial position in the event of various adverse conditions to test the robustness and resilience of the group. The group adopts a prudent and conservative approach and regularly reviews its risk appetite to ensure it remains appropriate in the prevailing geopolitical and economic environment.	The geopolitical environment remains uncertain, with conflict in Ukraine, possible Brexit-related changes to the Northern Ireland protocol and the potential for a Scottish independence referendum amongst others. Going forward, we will continue to closely monitor changes in the geopolitical landscape and regularly test the financial and operational resilience of the group under an evolving range of scenarios.

Emerging Risk/Uncertainty	Mitigating Actions and Key Developments	Outlook
Financial loss or disruption resulting from the impacts of climate change	Since 2019 the group has been working to embed an appropriate and regulatory-compliant climate risk framework, overseen by a Climate Risk Steering Committee and supporting working groups for credit risk, scenarios, disclosures and sustainability. Regular updates are provided to the Board Risk Committee, which retains oversight responsibility, while senior management responsibility is assigned to the group chief risk officer. Monitoring is in place to continually identify and assess climate risks and opportunities, supported by annual climate-related scenario analysis. For further detail, see the firm's inaugural Task Force on Climate-related Financial Disclosures ("TCFD") Report on pages 42 to 59.	Climate risk represents an area of continued focus, both within the group and across the industry more broadly. We continue to closely monitor government and regulatory developments as well as emerging best practice. The short-dated tenor of our lending book and strong business model resilience capabilities mitigate current risk exposure while the continued embedding of our climate framework will enable us to review the evolution of the risk landscape on an ongoing basis.
Legal and regulatory change	The group maintains an established horizon scanning and monitoring framework to identify regulatory and legal changes that could materially impact its operations, including legislative and regulatory reform, changes in regulatory practice and case law developments. We engage regularly with regulators in the jurisdictions in which we operate, including the PRA and FCA in the UK, as well as industry bodies and external advisers, to understand relevant changes. High-level gap and impact analyses are undertaken to assess new compliance requirements and identify any changes required to the group's systems and controls, processes and procedures, with programmes of work initiated to address any identified issues. The extent and nature of this work ranges from simple isolated remedial activity to large multi-year projects, depending on the complexity and scale of the change.	A sustained increase in legal and regulatory change has been experienced in recent years and this is expected to continue in the short to medium term, including the possibility of regulatory and legal divergence between the UK and EU. Increasing regulatory focus on consumer and small business customer outcomes is seen from the group's regulators in the UK, the Republic of Ireland and other jurisdictions in which the group operates.
Evolving working practices	The group continues to assess the appropriateness of its work patterns on an ongoing basis through consideration of four key principles: customer and client outcomes; risk appetite; culture and collaboration; and employee choice. Ways of working are risk assessed quarterly, enabling the identification and mitigation of any risks arising. All roles are assessed to ensure flexibility can be offered where appropriate in response to competitive pressure for talent attraction and retention. Market developments continue to be monitored for further shifts in working patterns which could impact employee and candidate expectations. We remain focused on maintaining our company culture and ensuring optimisation of the workspace and in-office activities to support collaboration and inclusion.	Management continues to monitor market expectations regarding work patterns to ensure levels of flexibility can be offered to compete effectively in a tight labour market.

Risk Report continued

Emerging Risk/Uncertainty	Mitigating Actions and Key Developments	Outlook
Technological change and new business models	Technological change and new business models have the potential to impact the group's market position and future profitability. While regulation remains a barrier to entry for many potential new competitors, consumer expectations continue to evolve, challenging existing capabilities and traditional approaches. Competitors are adapting in response, while new financial technology companies continue to develop alternative business models. Notwithstanding, the group prides itself on its deep knowledge of its customers and clients and the industries/sectors in which they operate. Market developments are closely monitored to identify and understand emerging dynamics as well as the evolving preferences of our customers.	The group is continuing to invest in strategic data capabilities as part of our business and technology strategies. Data governance remains a key focus as part of this as we look to further manage and exploit our data assets. Our businesses, particularly within Retail, also continue to prioritise digital channels and messaging to enhance the customer journey and associated experience. The technology function is actively planning to benefit from cloud arrangements which match the agility and scalability of any potential competitor or new entrant. The group is also focused on upskilling current staff and strategic third party provider partnerships to support the digital transformation of our businesses.
Supply chain risk	The group's third party management framework ensures a risk-based approach is adopted with regard to the identification, classification and management of the many potential business impacts that can result from failures in the supply chain. Through the identification of inherent risks at the outset of all third party engagements, appropriate due diligence is completed prior to onboarding, suitably robust contracts are put in place and effective lifecycle management is implemented. Ongoing reporting of key risk and performance indicators coupled with periodic supplier reviews from our third party monitoring team help to manage supply chain risk. Oversight of all material suppliers is retained via the GRCC while continuity of service is a key focus for all critical relationships through resilience and substitutability planning. The group is also continuing to build out its understanding of supply chain concentration risk across material third and fourth parties.	While Covid-19 continues to impact supply chains globally, this has been further aggravated by the conflict in Ukraine and the general inflationary economic environment in key markets. Direct impacts have thus far proved relatively moderate across the sector and less so for the group given its relatively low level of reliance on offshore service provision, although close monitoring and management is ongoing in more sensitive goods and services categories. Notwithstanding, continued improvement to the group's third party management framework is likely to be required to keep pace with the evolving regulatory landscape over the short to medium term, noting this remains an area of heightened regulatory focus, particularly with respect to material suppliers.
Future pandemics and ability to respond	Capabilities delivered through the group's focus on operational resilience are primary mitigants against plausible and controllable impacts of a future pandemic. The group's ability to respond to pandemic-induced disruption was tested through Covid-19. The resilience of the group's workforce, suppliers and systems is tested on a risk-based cycle, considering severe but plausible disruptions. This approach to ongoing testing enables maintenance of suitable readiness should another pandemic emerge in the future.	Pandemics of a nature that cause material societal impact are inherently low-likelihood, high-impact events. It is unlikely that another pandemic will emerge in any given year, although it is probable that at some future point another one will emerge.