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.

The group faces a number of risks in the normal course of its 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 12 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 group's Enterprise Risk Management Framework. Information on each of 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.

All disclosures in the Risk Report are unaudited unless otherwise stated.

Enterprise Risk Management

An enterprise-wide framework designed to provide the board and senior management with oversight of the group'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 group, and defines a consistent and measurable approach to identifying, assessing, controlling and mitigating, reviewing and monitoring, and reporting risk – the risk process life cycle.

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

Risk Report continued

Risk Culture and Awareness

An effective risk culture is embedded throughout the group

Maintenance of an effective risk management culture is integral to the group in 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;
- improves the group's control environment; and
- assists in the planning and prioritisation of key projects and initiatives.

While risk management is led centrally, 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 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.

The group risk management function operates independently of the business, providing oversight and advice on the operation of the risk framework, 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 167 to 189.

Risk Culture

Locally embedded
Risks managed in an open, transparent and objective manner.

Independent second line
Providing oversight, advice and assurance.

Open escalation channels
Escalation of risks and concerns encouraged; driving individual accountability.

Risk and reward
Regular evaluations encourage long-term stewardship behaviours.

Risk Governance

Role of the board

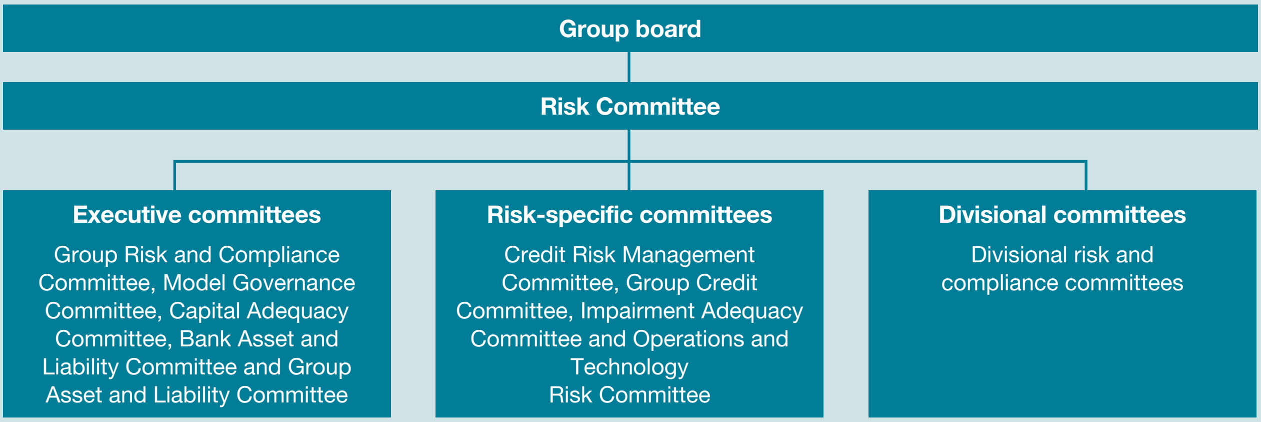
The board retains overall responsibility for overseeing the maintenance of a system of internal control, which ensures that an effective risk management framework and oversight process operate across the group. The risk management framework and associated governance arrangements are designed to ensure 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. On an annual basis, the board reviews the effectiveness of the group's risk management and internal control systems.

Risk management across the group is overseen by the 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 164 to 166.

The group closely monitors its risk profile to ensure that it continues to align with its strategic objectives as documented on pages 20 to 25. The board considers that the group's current risk profile remains consistent with its strategic objectives.

Risk Committee Structure



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 life cycle. They also provide an escalation channel for any risks or concerns, supporting the maintenance of an effective risk culture. During the year the effectiveness of these committees was reviewed and all committees continue to work efficiently and effectively.

Over the past 12 months the group has further enhanced its risk governance framework and specifically the organisation's risk and compliance committees, at both group and divisional level. This has included the continued refinement of committee terms of reference and the evolution of reporting packs and management information suites.

Risk Report continued

Risk Committee overview

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.

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.
Bank Asset and Liability Committee	Provides oversight of the Banking division's risk management and internal controls and its subsidiaries across liquidity, funding and market risk.
Group Asset and Liability Committee	Provides oversight of the company and wider group's risk management and internal controls 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 Banking division'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.

Three lines of defence

The group's risk management approach is underpinned by a strong governance framework founded on a three lines of defence model.

The governance framework is considered appropriate to both the size and strategic intentions of the group. The key principles underlying this approach are that:

- business management owns all the risks assumed throughout the group and is responsible for their day-to-day management to ensure that risk and reward 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.

Three Lines of Defence

		Key features
First line of defence		
The businesses **Group Risk and Compliance Committee (reports to the Risk Committee)** The chief executive delegates to divisional and operating business chief executives the 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, including controls framework and effectiveness; • reporting risks; • committee structure and reporting; and • management and self-assessment of operational resilience capabilities.	• 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 and ongoing self-assessment. • Promotes a culture of customer focus and appropriate behaviours. • Promotes responsibility for ongoing monitoring of positions and management and control of risks and controls effectiveness, including testing, alongside portfolio optimisation.
Second line of defence		
Risk and compliance **Risk Committee (reports to the board)** The Risk Committee delegates day-to-day responsibility for oversight and challenge on risk-related issues to the group chief risk officer.	Risk functions (including compliance) provide support, assurance and independent challenge on: • the design and operation of the risk framework and methodologies; • risk assessment; • risk appetite and strategy; • performance management; • risk reporting; • adequacy of mitigation plans and effectiveness of risk decisions taken by business management; • group risk profile; and • committee governance and challenge.	• Oversees embedding of the risk framework and supporting methodologies, taking an integrated approach to risk and compliance (qualitative and quantitative). • Promotes a strong and effective risk and control culture across the group. • Undertakes compliance monitoring and risk assurance activities. • Supports through developing and advising on risk and compliance strategies. • Facilitates constructive check and challenge. • Oversight of business conduct.
Third line of defence		
Internal audit **Audit Committee (reports to the board)** 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.	• Draws on deep knowledge of the group and its businesses. • Provides independent assurance on the activities of the group, including the risk management framework. • Assesses the appropriateness and effectiveness of internal controls. • Incorporates review of culture and conduct.

Risk Report continued

Internal Control System

Supporting the foundation of a strong risk management structure

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. The controls are designed to ensure the accuracy and reliability of the group'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.

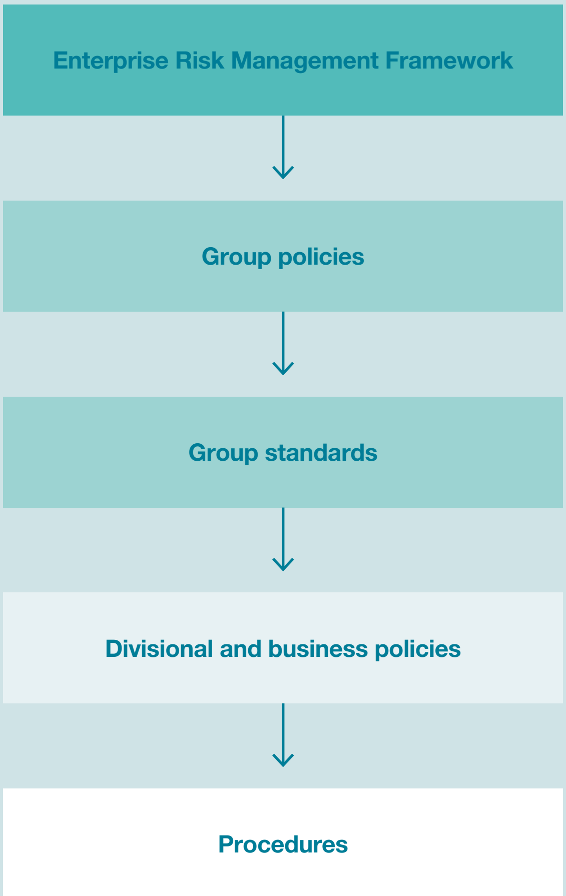
The group policy framework, overseen by the board, is a key component of the group's Enterprise Risk Management Framework, supporting the foundation of a strong risk management structure. Group policies are supported by group standards, and by divisional/business-level policies and procedures which, together, outline the way in which policy is implemented and detail the process controls in place to ensure compliance. The accounting policies form part of this broader policy framework. 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. Simultaneously they facilitate board and executive-level oversight and assurance as to the application of the 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. Monitoring and effectiveness occurs via regular risk management information and commentary; reviews of group-wide risk and control self-assessments and associated mitigation activities; and review of audit reports which focus upon risk management capabilities and the control framework. The board also reviews the effectiveness of both committees on an annual basis. The board has reviewed the group's risk management and internal control framework and the committees' effectiveness, and considers that, overall, the group has in place adequate systems and controls with regard to its profile and strategy.

Group Policy Framework



Risk Appetite

Enabling key risk decisions in delivering the group's strategic objectives

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 via 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 both 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 to align 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.

Stress Testing

Assessing and understanding future levels of risk

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 group'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 and reward optimisation and business resilience planning; and
3. provide a check on the outputs and 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 group's Internal Capital Adequacy Assessment Process ("ICAAP") and Internal Liquidity Adequacy Assessment Process ("ILAAP"), with scenario analysis additionally employed as part of the group's Recovery Plan.

Risk Report continued

Principal and Emerging Risks

Principal Risks

At the core of the Enterprise Risk Management Framework and risk process life cycle sits the group's suite of principal risks.

These are the risks which have been identified as those most material in the delivery of the group's strategic objectives. This suite is subject to ongoing review to ensure that the framework remains aligned to the prevailing risk environment.

The group's activities, business model and strategy remain unchanged; as a result, several of the principal risks faced and the approach to mitigating them remains broadly consistent with prior years. However, reflective of the current environment, legal and regulatory risk has been added as a principal risk and business and strategic risk has been updated (previously business risk). Three risks previously included have been reclassified to non-principal risks to reflect their relative immateriality to the group risk profile. Climate risk remains a cross-cutting risk that could impact across all principal risks.

The table on pages 92 and 93 gives an overview of these principal risks and possible impacts, as well as the outlook pertaining to these. More detailed information on each of these follows on pages 96 to 130 which set out the frameworks in place to manage these risks.

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 could have a significant impact on its future performance.

Climate Risk

Running alongside the suite of principal risks is climate risk, which the group categorises as a cross-cutting risk, as the impacts arising from climate change have the ability to impact across the spectrum of principal risks. In addition, transitional risks from climate change which may have a medium- to longer-term impact on the group's product offering, operations and strategic direction are captured in the group's emerging risks. For further information on the group's climate risk response, see the group Sustainability Report on pages 38 to 65.

Climate risk represents a continued area of focus and the group continues to closely monitor government and regulatory developments in parallel to managing its own carbon footprint and supporting its customers to manage their climate risk impacts. The short-dated tenor of the lending book and strong business model resilience capabilities mitigate current risk exposure while the continued embedding of the climate framework will enable the group to review the evolution of the risk landscape on an ongoing basis.

Emerging Risks

The group's suite of principal risks is accompanied by a portfolio of emerging risks reflecting broader market uncertainties. The group defines an emerging risk as a risk that may potentially become material in the delivery of the group's strategic objectives but the risk and its applicability to the group may not yet be fully understood or assessed. 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 Group Risk and Compliance Committee ("GRCC") and the board.
- Bottom-up: identified at a business level and escalated, where appropriate, via risk updates to the GRCC.

This year, to reflect the evolving nature of risks that accompany the implementation of group strategy, change execution risk has been included as a new emerging risk. Pages 14 to 17 of the Strategic Report provide further information on how the group is adapting to changes in the operating environment. Strategic disruption has also been included as a new emerging risk, a reposition of the previous technological change and new business models risk.

The established framework for monitoring these risks supports the group's organisational readiness to respond. 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 Risk Committee on an ongoing basis, with agreed mitigating actions in place to ensure the group's preparedness should a risk crystallise. Ongoing monitoring also tracks several sub-risks to support identification of key themes and any patterns of deterioration or potential risk crystallisations.

Principal and Emerging Risks

Emerging risks

E1: Economic uncertainty
E2: Geopolitical uncertainty
E3: Legal and regulatory change
E4: Supply chain risk
E5: Medium to long-term transitional climate risks
E6: Strategic disruption
E7: Change execution risk

Risk emergence time frame

- Short term
- Medium term
- Long term

Emerging risks key

- Internal
- External

Risk Report continued

Principal risks

Principal risk	Outlook
Business and Strategic Risk The risk of realising lower than anticipated profits or experiencing a loss rather than a profit due to changing market conditions, pursuing an ineffective strategy or ineffective implementation of strategy. See page 96	• Notwithstanding the continued uncertain macroeconomic environment, the group's business model remains proven and resilient. • The group continues to focus on supporting customers, maintaining underwriting standards and investing in its business. • The group remains prepared for a range of different economic and business scenarios to ensure it has the resources and operational capability to perform effectively.
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, and to operate within board-approved risk appetite and support its strategic goals. See page 97	• Although the continuing macroeconomic uncertainty may impact capital in the short to medium term, the group's capital position is expected to remain well above risk appetite. • Capital requirements for Coronavirus Business Interruption Loans ("CBILS") will increase as these loans refinance without a government guarantee. • The PRA Consultation Paper 16/22 on Basel 3.1 standards was published in November 2022, with changes expected to be implemented or phased in from 2025-2030. As highlighted in the first half results, following initial analysis, it is estimated that if implemented in its current form, it would represent an increase of up to c.10% in the group's RWAs calculated under the standardised approach. This is primarily as a result of the proposed removal of the SME supporting factor and the proposed approach to the classification of Retail SMEs and associated risk weights. The group looks forward to the publication of the final regulatory rules and has sufficient management actions available to address the impact should the proposals remain unchanged.
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. See page 100	• Pressure due to the external macroeconomic environment continues to increase financial pressure on consumers as a result of the higher cost of living. • Consumer Duty sets a higher standard of care for retail customers including the need to act to deliver good customer outcomes and avoid foreseeable harm. Activities introduced as part of the implementation programme will continue to embed and may necessitate further evolution of the conduct risk framework.
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. See page 102	• Uncertainty in the macroeconomic and geopolitical environment leading to high inflation and rising interest rates which could result in higher credit losses in the future. The loan book continues to display resilience due to consistent prudent lending criteria and risk appetite, however the need for proactive monitoring remains. • Target financial institutions remain of appropriate credit quality.
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. See page 119	• Despite ongoing macroeconomic uncertainty which has increased market competitiveness, the Banking division's ability to fund the loan book is expected to be unaffected with continued access to a wide range of funding sources.

Principal risk	Outlook
Legal and Regulatory Risk The risk of non-compliance with laws and regulations which could give rise to fines, litigation, sanctions and the potential for material adverse impact upon the group. See page 121	• The inherent risk arising in financial services as an industry in the jurisdictions in which we operate continues to increase. • Notwithstanding the strong controls in effect limiting residual risk exposure arising from regulatory expectations, external changes may have a follow-on impact to the group's residual exposure. • Legal risks such as complaints in relation to historic commission arrangements may give rise to a potential future obligation to compensate customers.
Non-traded Market Risk The risk to the value of assets or liabilities outside the trading book that arises from changes in market prices such as interest rates, credit spreads and foreign exchange rates. See page 122	• The group expects exposure to interest rate risk and foreign exchange ("FX") risk to remain at similar levels to those seen this year but credit spread risk in the banking book ("CSRBB") is expected to increase as the group restructures its high quality liquid assets ("HQLA") portfolio.
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. See page 125	• Established group-wide operational risk framework and methodology continues to mature, with expectation on best practice increasing. • A changing internal and external environment raises challenges and may impact managing our people. • The group continues to plan and predict resource needs to support its strategy, business change execution and wider technology and information security transformation. • Additionally, financial crime and fraud risks are inherent in doing business, necessitating the requirement to maintain effective systems and controls.
Reputational Risk The risk of detriment to stakeholder perception of the group, leading to impairment of its reputation and future goals, due to any action or inaction of the company, its employees or associated third parties. See page 127	• Established group-wide and employee-level focus on responsibility and sustainability enables an approach in all businesses that aligns to a range of stakeholder expectations, which is supported by group-level oversight.
Traded 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. See page 129	• The impacts of inflation, rising interest rates, supply chain issues and industrial action, coupled with geopolitical uncertainty, are expected to continue to be themes over the next 12 months, and have the potential to keep market liquidity low and suppress market valuations.

Protect Grow Sustain Risk increase Stable Risk decrease

Risk Report continued

Emerging risks

Emerging risk/ uncertainty	Mitigating actions and key developments
Cross-cutting Risks	
Geopolitical uncertainty M	• The group operates predominantly in the UK and Republic of Ireland, covering approximately 98% of the loan book exposure. • 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 minima. • Regular stress testing is undertaken on 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.
Medium to long-term transitional climate risks M	• Transitional climate risks across the medium to long term may potentially impact the group's product offering, operations and strategic direction. • The group continues to mature its climate risk framework, overseen by the Group Climate Committee. • Regular updates are provided to the 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 consideration of climate-related scenario analysis. • The group conducts ongoing reviews and consideration of new green-growth lending opportunities through the Commercial Green Initiatives Working Group to align with its transition roadmap.
Financial Risks	
Economic uncertainty S	• The persistence of macroeconomic uncertainty within the UK and/or globally (for example, from financial volatility or changes to macroeconomic policies) can impact business, customer and broader market confidence. • The group's business model aims to ensure that it is able to trade successfully and support clients in a wide range of economic conditions. By maintaining a strong financial and capital position, the group aims 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 clients when it really matters. • The group focuses on credit quality and returns rather than overall growth or market share and continues to invest in the business for the long term, to support customers and clients through the cycle. • Regular stress testing is undertaken on 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 macroeconomic environment.

S Short-term emergence M Medium-term emergence L Long-term emergence

Emerging risk/ uncertainty	Mitigating actions and key developments
Operational Risks	
Legal and regulatory change S	• The group operates in a developing, complex and demanding regulatory environment. An established horizon scanning and monitoring framework is maintained 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. • The group engages regularly with regulators in the jurisdictions in which it operates, including the PRA and Financial Conduct Authority ("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 as necessary. The extent and nature of this work ranges from simple isolated process changes to large multi-year projects, depending on the complexity and scale of the change.
Supply chain risk M	• The group faces emerging supply chain risk through growing exposure to more complex supply chains and reliance on third-party suppliers for the provision of key services. • 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 life cycle management is implemented. • Ongoing reporting of key risk and performance indicators coupled with periodic supplier reviews from the 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, with risks mitigated through resilience planning and identification of potential alternative solutions where possible. • The group is also continuing to improve its understanding and management of concentration risk across critical third parties and their extended supply chains.
Strategic Risks	
Change execution risk S	• The group faces change execution risk through its projects and investment in delivering change across the group, in line with its strategic objectives and regulatory obligations. • Delivering and successfully embedding change in line with these priorities can lead to delivery pressures for complex projects and initiatives with concurrent demands impacting the operational capability of the group's people and systems. • Regular project updates are provided to senior management to support effective management of any execution risks and ensure transformation is implemented efficiently with strong governance in place.
Strategic disruption M	• Strategic disruption may arise from technological change or new business models that 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. • For example, cloud-delivered solutions reduce barriers to entry and new product time to market, which allows new competitors and start-ups to compete in the marketplace more rapidly. • In addition, the growing prevalence of artificial intelligence in the market represents a potential threat given the current rate of adoption, and is difficult to predict. Notwithstanding, artificial intelligence also introduces an opportunity to rapidly expand the group's product and customer base to enter new markets. • Market developments are closely monitored through horizon scanning to identify and understand emerging dynamics as well as the evolving preferences of the group's customers. The group prides itself on its deep knowledge of its customers and clients and the industries and sectors in which they operate.

Risk Report continued

Principal risks

Business and Strategic Risk

Business and strategic risk is the risk of realising lower than anticipated profits, or experiencing a loss rather than a profit, due to changing market conditions, pursuing an ineffective strategy or ineffective implementation of strategy.

Exposure

The group operates in an environment where it is exposed to an array of independent influencing factors. Its profitability can be impacted by: the broader UK economic climate; front-line sales performance; changes in technology, regulation and customer behaviour; cost movements; and competition from traditional and new players. All of these can vary in both nature and extent across its divisions.

Changes in these factors may affect the Banking division's ability to write loans as it seeks to maintain its desired risk and reward criteria, result in lower new business levels in Close Brothers Asset Management ("CBAM"), impact levels of trading activity at Winterflood, or result in additional investment requirements and higher costs of operation across the group.

Risk Appetite

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

- focusing on specialist markets where the group can build leading market positions based on service, expertise and relationships;
- focusing on credit 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 and prudently managing the group's financial resources;
- consistently supporting our customers and clients through the cycle; and
- acting sustainably and responsibly, considering the interests of all stakeholder groups and growing demand for sustainable products and services.

Measurement

Business and strategic risk is measured through a number of key performance metrics (including those set out on pages 26 and 27) 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 committees, with oversight also exercised via the board, most notably through its 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 and strategic 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 to ensure continued focus on strategic priorities that support the business model and enable the group to 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. This allows the group to continue to support customers at all stages in the financial cycle.

The group also builds and maintains long-term relationships with its clients and intermediaries based on:

- speed and flexibility of services;
- its local presence and personal approach;
- the experience and expertise of its people; and
- an 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 its businesses and product portfolio, which provides resilience against competitive pressure or market weakness in any one of the sectors it operates 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's 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 are 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, which reviews, challenges and finally agrees 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 regular basis.

New growth initiatives and potential acquisitions are assessed against both the group's strategic objectives and its 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 ICAAP and ILAAP 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 formally linked, outputs and analysis from both exercises are used to guide strategic planning.

The annual risk appetite statement review also ensures that the group's risk appetite and supporting key risk indicators are 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, and growth of sustainable products and services). Within credit risk, all 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 such as 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.

Outlook

Notwithstanding the continued uncertain macroeconomic environment and the impact of rising inflation and interest rates on our customers and wider financial market conditions, the group's business model, as outlined on pages 12 to 13, remains resilient. The group continues to focus on supporting customers, maintaining prudent underwriting standards and investing in the business.

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 94 to 95. In addition, further commentary on the market environment and its impact on each division is outlined on pages 66 to 82.

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 CRR and from related additional requirements and guidelines specified by the PRA, and is usually specified in terms of minimum capital ratios which assess the level of regulatory capital and risk weighted assets. The group operates a prudent business model which results in comparatively low levels of leverage and so risk-based capital requirements are, and are likely to remain, the group's binding constraint.

The PRA supervises the group on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the group as a whole. In addition, a number of subsidiaries are regulated for prudential purposes by either the PRA or the FCA. The aim of the capital adequacy regime is to promote safety and soundness in the financial system. It is structured around three "pillars": Pillar 1 on minimum capital requirements; Pillar 2 on the supervisory review process; and Pillar 3 on market discipline. The group's Pillar 1 information is presented in the first table of the "measurement" section. Under Pillar 2, the group completes an annual self-assessment of risks known as the ICAAP. The ICAAP is reviewed by the PRA, which culminates in the PRA setting a Total Capital Requirement ("TCR") that the group and its regulated subsidiaries are required to hold at all times. The TCR is currently set at 9.0%, of which 5.1% needs to be met with CET1 capital. This includes the Pillar 1

Risk Report continued

Principal risks

requirements (4.5% and 8% respectively for CET1 and total capital) and a Pillar 2a component of 1.0%, of which 0.6% needs to be met with CET1 capital. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on the firm's capital, risk exposures and risk assessment process. The group's Pillar 3 disclosures, which are unaudited, can be found on the group's website at www.closebrothers.com/investor-relations/investor-information/results-reports-and-presentations.

Risk Appetite

The group maintains a strong base level and composition of capital, sufficient to:

- support the development and growth of business;
- continue to meet Pillar 1 requirements, TCR, 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.

The group's policy is to be well capitalised and its approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates. Accordingly, 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.

The group has set a management target for the CET1 capital ratio to operate in a range between 12.0% and 13.0% in the medium term, which provides for a significant surplus amount of capital to support the group's strategic objectives whilst respecting the board's risk appetite and ensuring shareholders' equity is commercially deployed.

Measurement

The group maintains a strong capital base to support the development of the business and to ensure the group meets the TCR and additional regulatory buffers at all times. As a result, the group maintains capital adequacy ratios above minimum regulatory requirements, which are currently set at a minimum CET1 capital ratio of 9.5% and a minimum total capital ratio of 13.4%. The minimum capital requirements are inclusive of the capital conservation buffer (currently 2.5% for both CET1 capital and total capital) and the countercyclical buffer (currently 1.9% effective rate for the group, for both CET1 capital and total capital) and exclusive of any applicable PRA buffer.

Analysis of the composition of regulatory capital and Pillar 1 RWAs and a table showing the movement in CET1 capital during the year are shown on the following pages. A comprehensive analysis of the composition of regulatory capital and RWAs is provided in the group's Pillar 3 disclosures.

The CET1 capital ratio reduced from 14.6% to 13.3%, mainly driven by loan book growth in the year, a decrease in the IFRS 9 transitional arrangements and deduction of dividends paid and foreseen, partly offset by capital generation through profit and a decrease in risk weighted assets associated with derivatives and CVA. The impact of Novitas on the CET1 capital ratio was c.115bps, and consists of impact on retained earnings (c.85bps) and IFRS 9 transitional arrangements (c.40bps), offset by a reduction in loan book RWAs (c.10bps).

CET1 capital decreased to £1,310.8 million (31 July 2022: £1,396.7 million) primarily due to a decrease in the transitional IFRS 9 add-back to capital, the regulatory deduction of dividends paid and foreseen and an increase in the intangible assets deducted from capital. This was partially offset by capital generation through profit.

RWAs, calculated using the standardised approaches, increased to £9,847.6 million (31 July 2022: £9,591.3 million) driven mainly by growth in the Commercial and Property business loan book, offset by a decrease in RWAs associated with derivatives and CVA following changes to the derivatives calculation to recognise netting agreements and to implement the standardised approach to counterparty credit risk.

Composition of regulatory capital and Pillar 1 RWAs

	31 July 2023 £ million	31 July 2022 £ million
CET1 capital		
Shareholders' equity per balance sheet	**1,644.9**	1,657.5
Regulatory adjustments to equity		
Intangible assets, net of associated deferred tax liabilities	**(262.8)**	(250.7)
Foreseeable dividend[1]	**(67.0)**	(65.6)
Cash flow hedging reserve	**(34.4)**	(21.7)
Pension asset, net of associated deferred tax liabilities	**(1.0)**	(5.3)
Prudent valuation adjustment	**(0.4)**	(0.5)
Insufficient coverage for non-performing exposures[2]	**(0.4)**	–
IFRS 9 transitional arrangements[3]	**31.9**	83.0
CET1 capital[4]	**1,310.8**	1,396.7
Tier 2 capital – subordinated debt	**200.0**	200.0
Total regulatory capital[4] – audited	**1,510.8**	1,596.7
RWAs		
Credit and counterparty credit risk	**8,655.4**	8,389.0
Operational risk[5]	**1,084.0**	1,085.8
Market risk[5]	**108.2**	116.5
	9,847.6	9,591.3
CET1 capital ratio[4]	**13.3%**	14.6%
Total capital ratio[4]	**15.3%**	16.6%

1. Under CRR Article 26, a deduction has been recognised at 31 July 2023 and 31 July 2022 for a foreseeable dividend, being the proposed final dividend as set out in note 8 to the financial statements.
2. In line with CRR, effective on 1 January 2022, the CET1 capital includes a regulatory deduction where there is insufficient coverage for non-performing exposures, amounting to £0.4 million at 31 July 2023 (31 July 2022: £0.0 million).
3. The group has elected to apply IFRS 9 transitional arrangements for 31 July 2023, which allow the capital impact of expected credit losses to be phased in over the transitional period.
4. Shown after applying IFRS 9 transitional arrangements and the CRR transitional and qualifying own funds arrangements in force at the time. Without their application, at 31 July 2023 the CET1 capital ratio would be 13.0% and total capital ratio 15.1% (31 July 2022: CET1 capital ratio 13.8% and total capital ratio 15.9%).
5. Operational and market risk include an adjustment at 8% in order to determine notional RWAs.

Movement in CET1 capital during the year

	2023 £ million	2022 £ million
CET1 capital at 1 August	**1,396.7**	1,439.3
Profit in the period attributable to shareholders	**81.1**	165.2
Dividends paid and foreseen	**(100.5)**	(98.4)
IFRS 9 transitional arrangements	**(51.1)**	(34.8)
Change in software assets treatment[1]	**–**	(50.2)
Increase in intangible assets, net of associated deferred tax liabilities	**(12.1)**	(19.7)
Other movements in reserves recognised for CET1 capital	**(7.3)**	0.1
Other movements in adjustments from CET1 capital	**4.0**	(4.8)
CET1 capital at 31 July	**1,310.8**	1,396.7

1. Upon implementation of CRR, effective 1 January 2022, the CET1 ratio no longer included the benefit related to software assets which were previously exempt from the deduction requirements for intangible assets from CET1.

Risk Report continued

Principal risks

Mitigation (audited)

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 instrument.

Monitoring

Both actual and forecast capital adequacy are reported monthly 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 CAC 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 group 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 CAC also monitors actual, forecast and stressed capital metrics using an IRB approach in order to prepare for anticipated future transition to this approach.

Outlook

Although the continuing macroeconomic uncertainty may impact capital in the short to medium term, the group's capital position is expected to remain well above risk appetite.

Capital requirements for CBILS loans will increase as these loans refinance without a government guarantee.

Changes in requirements as a result of IFRS 9 transitional effects and changes in capital buffer structures are captured in the group's capital planning process.

The PRA Consultation Paper 16/22 on Basel 3.1 standards was published in November 2022, with changes expected to be implemented or phased in from 2025-2030. As highlighted in the Half Year 2023 results, following initial analysis, the group estimates that if implemented in its current form, it would represent an increase of up to c.10% in the group's RWAs calculated under the standardised approach. This is primarily as a result of the proposed removal of the SME supporting factor and the proposed approach to the classification of Retail SMEs and associated risk weights. The group looks forward to the publication of the final regulatory rules and has sufficient management actions available to address the impact should the proposals remain unchanged.

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 either directly or via its distributors, 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 and which is aimed at enhancing consumer protection and maintaining market integrity given the current macroeconomic environment. Failure to evidence delivery of good customer outcomes may lead to reputational harm, legal or regulatory sanctions and/or customer redress.

Risk Appetite

The group recognises the importance of delivering good customer outcomes and seeks to reasonably avoid customer detriment or foreseeable harm resulting from inappropriate judgements or behaviours in the execution of business activities. To support this, it strives to maintain a culture aligned to its values 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 to ensure good customer outcomes.

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 several areas where harm could occur, whether 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 ("RCC"). Performance against the key risk indicators is reported to the GRCC and the 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 all individuals across the organisation to feel responsible for managing conduct risks within their business area and/or function.
- The group provides support to colleagues to enable them to improve the conduct of their business or function, including group-wide 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 expectations of employees and key controls to ensure conduct risk is managed within the agreed risk appetite, including for essential areas such as dealing with clients, dealing with markets, complaint handling, vulnerable customers, and conflicts of interest. Mandatory staff training on key conduct areas is provided on a regular basis.
- All products are subject to a robust risk-based product development and review process.

Monitoring

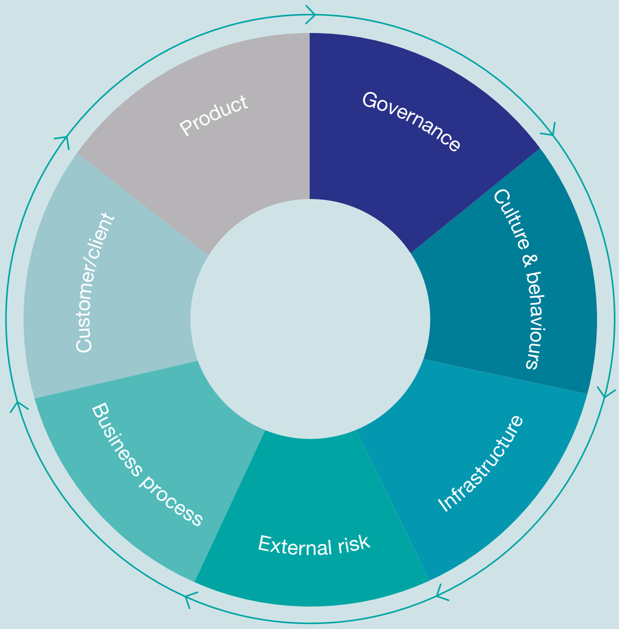
Risk identification and timely management action are undertaken by management and employees as the first line of defence. The risk and compliance functions provide support, review and independent challenge to ensure conduct risk reporting is robust, remains fit for purpose, and agreed management actions appropriately mitigate the identified risks.

The compliance monitoring function undertakes regular reviews of key areas, such as complaint handling and vulnerable customer processes, to confirm customers are experiencing good outcomes. Group internal audit provides 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 GRCC and the Risk Committee.

Over the past year, conduct risk reporting has continued to mature to provide increased transparency and visibility to monitor conduct risk. Reporting on, and monitoring of, conduct risk will continuously evolve with the introduction of new regulatory requirements per the FCA's Consumer Duty for retail customers for in-scope businesses, and in light of the ever-changing regulatory landscape.

Conduct Risk Framework



Risk Report continued

Principal risks

Outlook

Conduct risk increased in the year as the macroeconomic environment continues to increase financial pressure on consumers as a result of the higher cost of living, caused by rising inflation and interest rates which remain volatile due to various factors. Whilst there have been some improvements, the medium to long-term outlook remains uncertain. This may widen or increase the number of individuals and businesses requiring credit. As a result, support for customers in financial difficulty, including vulnerable customers, is expected to increase.

To enhance consumer protection, in addition to various publications and "Dear CEO" letters to support retail customers facing rising costs or financial difficulty, the FCA has outlined new requirements under Consumer Duty. This introduces a new Principle 12 that requires firms to act to deliver good outcomes for retail customers, as well as cross-cutting rules which require firms to act in good faith, avoid causing foreseeable harm and enable and support retail customers to pursue their financial objectives. 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 customers.

Implementation activities for Consumer Duty were successfully delivered ahead of the FCA's implementation deadline of 31 July 2023, including enhancements to the Conduct Risk Framework to incorporate additional mechanisms for monitoring the delivery of good customer outcomes going forward.

Whilst these activities continue to embed, the group is focused on maintaining its culture of tailoring its approach to supporting customers to drive good customer outcomes and implementing Consumer Duty changes for books of business not open to new customers. Further details on Consumer Duty can be found on page 25.

Credit risk

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

The Banking division applies consistent and prudent lending criteria to mitigate credit risk. Its lending activities are predominantly secured across a diverse range of asset classes. Details of average tenor and loan size by business can be found on page 4 of the Strategic Report. This ensures concentration risk is controlled in both the loan book and associated collateral. Credit risk appetites are set around unsecured and structurally protected lending to ensure portfolios remain predominantly secured. At 31 July 2023, secured lending accounts for 90.4% (31 July 2022: 89.6%) of the loan book.

The group has established limits for all financial counterparties with whom it places deposits, enters into derivative contracts or whose debt securities are held, and the credit quality of the counterparties is monitored. While these amounts may be material, the counterparties are all regulated institutions with investment grade credit ratings assigned by international credit rating agencies and are monitored in accordance with the regulatory large exposures framework.

The group's principal credit risk exposure is to the loan book, which is the focus of the credit risk part of the risk report.

Managing Credit Risk

Exposure

As a lender to businesses and individuals, the group is exposed to credit losses if customers are unable to repay loans and outstanding interest and fees. At 31 July 2023, loans and advances to customers was £9.6 billion (31 July 2022: £9.1 billion).

Further details on loans and advances to customers and debt securities held are in notes 10 and 11 on pages 224 to 229 of the financial statements. Further commentary on the credit quality of the loan book is outlined on pages 106 to 118.

Risk appetite

The group seeks to maintain the discipline of its lending criteria, both to preserve its business model and to maintain an acceptable return that appropriately balances risk and reward. This is underpinned by a strong customer focus and credit culture that extend 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 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 against agreed measures, and covers both credit concentration and portfolio performance measures.

The measures supporting the group CRAS are based on the following key principles:

1. To lend within familiar asset classes, in well-known and understood markets.
2. To operate as a predominantly secured, or structurally protected, lender against identifiable and accessible assets, and maintain conservative loan-to-value ("LTV") ratios across the Banking division's portfolios.
3. To maintain a diversified loan portfolio (by business, asset class and UK geography), as well as a short average tenor and low average loan size.
4. To rely on local underwriting expertise, with authority delegated from the Risk Committee, with ongoing central oversight.
5. To maintain rigorous and timely collections and arrears management processes.
6. To operate strong control and governance within the 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 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. Performance is also monitored monthly via divisional RCCs. Material breaches are escalated via established governance channels.

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

Credit Risk Governance Framework

Risk Report continued
Principal risks

Measurement

A consistent, accurate and consolidated central credit reporting framework is in place and represents a key tool for effective credit risk management and measurement by the central group credit risk team. The framework 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 ensuring that asset portfolios are grown responsibly and profitably.

A centralised dataset incorporates:

- the use of common data definitions within Credit Risk Management Information ("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 credit risk appetite; and
- identification, monitoring and control of material credit risks against a clear and communicated CRAS.

Mitigation (audited)

Credit assessment and lending criteria

The Banking division's general approach to credit mitigation is based on the provision of affordable lending on a secured or structurally protected basis, against assets that are known and understood. 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, the businesses adhere to a set of common lending principles resulting in stable portfolio credit quality and consistently low loss rates through the cycle.

The common lending principles are as follows:

1. Predominantly secured lender: 97.9% of loan book secured or structurally protected.
2. Short average tenor: portfolio residual maturity of 16 months.
3. Small average loan size and low single-name concentration risk with balance for the top 10 facility limits representing less than 6% of book.
4. Further diversification by sector, asset class and UK geography.
5. Local underwriting expertise with central oversight: focus on assets that are known and understood, with continued investments in people and systems.

Exposure to credit losses is minimised by applying these strict lending criteria when testing the credit quality of the borrower and maintaining consistent and conservative LTV 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

Across the various businesses, credit risk employees are specialists in their area and can support loan book growth in a manner that is consistent with both risk strategy and appetite. This local distribution allows the formation of strong relationships with customers and intermediaries based on a deep understanding of their needs and the markets in which they operate. Consistent underwriting discipline and lending against assets that are known and understood benefits customers through the cycle and allows maintenance of a track record of strong margins and profitability.

Governance Framework and Oversight

Lending is underpinned by a strong control and governance framework both within the 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 Risk Committee, with lending businesses approving lower-risk exposures locally subject to compliance with credit policy and risk appetite.

Local risk directors assure the quality of underwriting decisions for all facilities within the business' delegated sanctioning authority level via a quality assurance programme. This programme 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 biannually with consolidated summaries presented to the 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 customers.

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

Monitoring

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

Documented policy includes business-specific definitions for identifying customers in, or likely to experience, financial difficulty. There are accompanying courses of action outlined that protect the group's 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.

The 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, the CRMC, the Model Governance Committee ("MGC") and the Risk Committee) overlaid with a third-line formed by the group internal audit function.

First line of defence: Credit risk management

Banking businesses have primary responsibility for ensuring that a robust risk and control environment is established as part of day-to-day operations, and that 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.

Second line of defence: 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 officer, are responsible for setting and communicating credit risk strategy, identifying exceptions and ensuring local compliance. Similarly, the risk heads in the Asset Management and Securities divisions, 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 central group credit risk team provides a further layer of oversight and approval, supported by credit committees, and the CRMC, MGC, GRCC and Risk Committee. 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.

Third line of defence: Internal audit

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

Banking Overview

The Commercial business is a combination of several specialist, predominantly secured, lending businesses. The nature of assets financed varies across the businesses. The majority of the loan book comprises loans of less than £2.5 million. Credit quality is assessed predominantly on an individual loan-by-loan basis. During and after the pandemic, the Commercial business has provided additional support to customers using the CBILS, Coronavirus Large Business Interruption Loan Scheme ("CLBILS"), and Recovery Loan Scheme ("RLS") products, which benefit from UK government guarantees. Collection and recovery activity is executed promptly by experts with relevant experience in specialised assets. This approach allows remedial action to be implemented at the appropriate time to minimise potential loss.

The Retail business is predominantly high-volume secured or structurally protected lending. The majority of the loan book comprises loans less than £20,000 and includes both regulated and unregulated agreements. Credit issues are identified via largely automated monitoring and tracking processes. Collections processes and actions, focused on good and fair customer outcomes, are designed and implemented to restore customers to a performing status, with recovery methods applied to minimise potential loss.

The Property business is predominantly a low-volume, specialised lending portfolio with credit quality assessed on an individual loan-by-loan basis. The majority of the loan book comprises residential development loans of less than £10 million. All loans are regularly reviewed to ensure that they are performing satisfactorily, with Residential Development facilities monitored monthly by independently appointed project monitoring surveyors ("PMSs") to certify build payments and the residual cost to complete. This ensures the thorough supervision of all live developments and facilitates the monthly checking of on-site progress against original build plan.

In the Commercial and Property businesses, performing loans with elevated levels of credit risk may be placed on watch lists depending on the perceived severity of the credit risk.

Risk Report continued

Principal risks

Outlook

Credit losses increased in the year to 31 July 2023, primarily reflecting the impact of updated assumptions in relation to expected case failure, time to recover and recovery rates for the Novitas portfolio, but also the underlying impacts of ongoing market uncertainty, which continue to be monitored closely.

Relative to 31 July 2022, 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, the rising cost of living and inflation. In addition, the long-term effects of the pandemic and subsequent cessation of various government support schemes could have an impact on both consumers and businesses. The impact of this on our customers, including potential lagging factors, continues to be closely monitored. These factors could result in higher credit losses in the future.

Risk appetite has remained consistent with the Banking division's prudent, through-the-cycle underwriting standards.

Forborne balances have increased year-on-year. They remain lower than peaks observed during the pandemic; however, they are above pre-pandemic levels.

Further details on loans and advances to customers and debt securities held are in notes 10 and 11 to the financial statements on pages 224 to 229.

Credit Risk Highlights (audited)

	31 July 2023 £ million	31 July 2022 £ million
Gross loans and advances to customers		
Property business	**1,744.8**	1,510.2
Retail business	**3,091.2**	3,133.9
Commercial business	**4,799.6**	4,500.4
Of which Novitas:	*244.0*	*272.7*
Excluding Novitas:	*4,555.6*	*4,227.7*
Total gross loans and advances to customers	**9,635.6**	9,144.5
Impairment provisions		
Property business	**41.7**	36.7
Retail business	**89.4**	69.9
Commercial business	**249.5**	179.0
Of which Novitas:	*184.1*	*113.3*
Excluding Novitas:	*65.4*	*65.7*
Total impairment provision	**380.6**	285.6
Provision coverage ratio		
Property business	**2.4%**	2.4%
Retail business	**2.9%**	2.2%
Commercial business	**5.2%**	4.0%
Novitas only:	*75.5%*	*41.5%*
Excluding Novitas:	*1.4%*	*1.6%*
Total impairment coverage ratio	**3.9%**	3.1%
Part- and non-performing loans		
Loans in Stage 2	**1,062.0**	1,158.9
Of which Novitas:	*1.3*	*96.0*
Loans in Stage 3	**583.4**	358.6
Of which Novitas:	*241.7*	*75.4*
Stage 2 coverage	**3.0%**	6.8%
Excluding Novitas:	*3.0%*	*2.6%*
Stage 3 coverage	**49.8%**	43.8%
Excluding Novitas:	*31.2%*	*36.4%*

Stage allocation of loans and advances to customers has been applied in line with the definitions set out on page 213 of the notes to the financial statements.

During the year the staging profile of loans and advances to customers deteriorated as a result of Novitas migrations into Stage 3. At 31 July 2023, 82.9% (31 July 2022: 83.4%) of gross loans and advances to customers were Stage 1. Stage 2 loans and advances to customers decreased to 11.0% (31 July 2022: 12.7%) as transfers into Stage 3 have offset migrations into Stage 2 associated with a significant increase in credit risk. The remaining 6.1% (31 July 2022: 3.9%) of loans and advances to customers was deemed to be credit-impaired and was classified as Stage 3.

Overall impairment provisions increased to £380.6 million (31 July 2022: £285.6 million), following regular reviews of staging and provision coverage for individual loans and portfolios. The movement in impairment provisions was driven by Novitas, which reflects the latest case failure, time to recover and recovery rate assumptions used. Excluding Novitas, impairment provisions increased across the remainder of the Banking division to £196.5 million (31 July 2022: £172.3 million), reflecting the impact of external pressures resulting from deterioration in the macroeconomic environment.

As a result, there has been an increase in provision coverage to 3.9% (31 July 2022: 3.1%).

Provision Coverage Analysis by Business (audited)

In Commercial, the impairment coverage ratio increased to 5.2% (31 July 2022: 4.0%), reflecting the impacts of updated Novitas assumptions. The significant increase in credit provisions against the Novitas loan book reflects the latest assumptions on case failure, time to recover and recovery rates.

Excluding Novitas, the Commercial provision coverage ratio decreased to 1.4% (31 July 2022: 1.6%) as additional provisions to take into account weaker macroeconomic variables and outlook were offset by write-offs on Stage 3 balances.

In Retail, the provision coverage ratio increased to 2.9% (31 July 2022: 2.2%), reflecting the uncertain macroeconomic outlook and increased arrears and forbearance levels in Motor Finance business as a result of continued cost of living pressures on customers.

In Property, the provision coverage ratio was stable at 2.4% (31 July 2022: 2.4%), with write-offs on well-provided single names offset by deteriorating macroeconomic conditions and strong levels of new business.

See note 10 to the financial statements for full staging tables and analysis, and pages 110 to 113 for additional detail on changes to macroeconomic forecasts that have impacted provisions during this financial year.

Measuring Credit Risk Across Our Businesses

In order to effectively assess credit risk across the Banking division, a number of judgements and estimates are used. These are based on historical experience and reasonable expectations of future events and are reviewed on an ongoing basis.

In particular, the calculation of the group's expected credit loss provision under IFRS 9 requires the group to make a number of judgements, assumptions and estimates, which have a material impact on the accounts. This assessment, which requires judgement, is unbiased and probability-weighted and uses historical, current and forward-looking information. The most significant judgements and estimates are set out below.

While the impact of climate change represents a source of uncertainty, the group does not consider climate-related risks to be a critical accounting judgement or estimate at 31 July 2023. Climate risk continues to be a key area of focus for the group and the Banking division continues to assess the sensitivity of assets and customers to climate-related risks as part of regular credit monitoring. Transitional climate risks are considered to be largely mitigated by short average loan book tenors (16 months), conservatively secured and diversified portfolios, and the rigorous underwriting, monitoring and control processes that are in place.

Use of Judgements (audited)

In the application of the group's accounting policies, which are described in note 1 to the financial statements, judgements that are considered by the board to have the most significant effect on the amounts in the financial statements are as follows.

Significant increase in credit risk

Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk since initial recognition. Typically, the group assesses whether a significant increase in credit risk has occurred based on a quantitative and qualitative assessment, with a "30 days past due" backstop.

Due to the diverse nature of the group's lending businesses, the specific indicators of a significant increase in credit risk vary by business and may include some or all of the following factors:

- quantitative assessment: the lifetime probability of default ("PD") has increased by more than an agreed threshold relative to the equivalent at origination. Thresholds are based on a fixed number of risk grade movements which are bespoke to each business to ensure that the increased risk since origination is appropriately captured;

Risk Report continued

Principal risks

- qualitative assessment: events or observed behaviour indicate credit deterioration. This includes a wide range of information that is reasonably available, including individual credit assessments of the financial performance of borrowers as appropriate during routine reviews, plus forbearance and watch list information; or
- backstop criteria: the “30 days past due” backstop is met.

Definition of default

The definition of default is an important building block for expected credit loss models and is considered a key judgement. A default is considered to have occurred if any unlikeliness to pay criterion is met or when a financial asset meets a “90 days past due” backstop. While some criteria are factual (e.g. administration, insolvency or bankruptcy), others require a judgemental assessment of whether the borrower has financial difficulties which are expected to have a detrimental impact on their ability to meet contractual obligations. A change in the definition of default may have a material impact on the expected credit loss provision.

Use of Estimates (audited)

Expected credit loss provisions are a key source of estimation uncertainty which, depending on a wide range of factors, could result in a material adjustment to the carrying amounts of assets and liabilities in the next financial year.

The accuracy of expected credit loss provisions can be impacted by unpredictable effects or unanticipated changes to modelled estimates. In addition, forecasting errors could also occur due to macroeconomic scenarios or weightings differing from actual outcomes observed. Regular model monitoring, validations and provision adequacy reviews are key mechanisms to manage estimation uncertainty across model estimates. Provisions relating to Novitas loans are also sensitive to specific estimation uncertainty associated with case failure rates, expected recovery rates and time to recover periods. Further detail on these most significant estimates is set out in the following section.

Modelled estimates

The calculation of expected credit losses (“ECL”) for loans and advances to customers, either on a 12-month or lifetime basis, is based on the PD, the exposure at default (“EAD”) and the loss given default (“LGD”), and includes forward-looking macroeconomic information where appropriate.

PD, EAD and LGD parameters are projected over the remaining life of each exposure. ECL is calculated for each future quarter by multiplying the three parameters and is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the effective interest rate.

IFRS 9 risk parameters are estimated using historical data wherever possible, and in the absence of sufficient loss history an expert judgement approach is considered for some parameters.

Probability of default

PD estimates represent the likelihood of a borrower defaulting on their financial obligation. Bespoke model-based approaches to estimate PDs are employed across the Commercial, Retail and Property businesses. The framework applied typically includes an economic response model to quantify the impact of macroeconomic forecasts and a risk ranking mechanism (e.g. a scorecard) to quantify obligor-level likelihood of default. Risk characteristics that feed into the PD model framework include current and past information related to borrowers, transaction and payment profiles, and future economic forecasts. Statistical techniques, based on evidence observed in historical data, and business knowledge are used to determine which characteristics are predictive of default behaviour.

Exposure at default

EAD represents the amounts expected to be owed at the time of default and is estimated using an amortising schedule for the large majority of exposures, or a credit conversion factor, depending on the nature of lending.

Loss given default

LGD represents an expectation of the extent of loss on a defaulted exposure after taking into account cash recoveries, including the value of collateral held and other credit risk mitigants. LGD methodologies vary by the nature of assets financed and can include estimates for the likelihood of collateral recovery and a separate calculation for the likely loss on recovery. For some businesses, LGDs are estimated using liquidation curves based on historical cash flows. Recoveries are adjusted to account for the impact of discounting using the effective interest rate.

Novitas loans

Since 31 July 2022, there has been an increase in the expected credit loss provision in Novitas. The two assumptions requiring the most significant judgement relate to expected recovery rates and time to recover periods in Novitas. During 2021 and 2022, expected case failure rates were considered a significant judgement. Due to the migration of loans to Stage 3, as explained on page 109, expected case failure rates are no longer considered to be a significant judgement, while time to recovery periods have become a significant judgement.

Case failure rates represent a forward-looking probability assessment of successful case outcomes through court proceedings or out-of-court settlements. Recovery rates represent the level of interest and capital that is covered by an insurance policy and expected to be recoverable once a case fails. Time to recover periods represent management’s view on timing using weighted probabilities.

Novitas provides funding to individuals who wish to pursue legal cases. The majority of the Novitas portfolio, and therefore provision, relates to civil litigation cases.

To protect customers in the event that their case fails, it was a condition of the Novitas loan agreements that an individual purchased an After the Event ("ATE") insurance policy which covered the loan.

As previously announced, following a strategic review, in July 2021 the group decided to cease permanently the approval of lending to new customers across all of the products offered by Novitas and withdraw from the legal services financing market. Since that time, the Novitas loan book has been in run-off, and the business has continued to work with solicitors and insurers, with a focus on supporting existing customers and managing the existing book to ensure good customer outcomes, where it is within Novitas' ability to do so.

In the first half of the financial year under review, management reviewed and updated its assumptions for expected case failure rates, expected time to recover periods and expected recovery rates to reflect experienced credit performance and ongoing dialogue with customers' insurers. This included initiating formal legal action against one of the ATE insurers regarding the potential recoverability of funds in relation to failed cases and considering its position in respect of other insurers. As a result, a number of updates were made to the expected credit loss provision calculation, resulting in an increase of £70.8 million to £184.1 million (31 July 2022: £113.3 million). The increase to the expected credit loss provision is net of write-offs previously provided for and does not include write-offs and costs taken directly to the income statement.

Based on the current position, the majority of loans in the portfolio have been assessed as credit-impaired and have been migrated to Stage 3, with expected case failure rates increased accordingly. Expected credit losses for the portfolio have been calculated by comparing the gross loan balance to expected cash flows discounted at the original effective interest rate, over an appropriate time to recovery period. In line with IFRS 9, a proportion of the expected credit loss is expected to unwind, over the estimated time to recover period, to interest income, which reflects the requirement to recognise interest income on Stage 3 loans on a net basis.

Since 31 July 2022, a material increase in the expected case failure rate assumptions and decrease in the expected recovery rate assumptions have been recognised and the recoverability of interest on relevant loans has been reassessed.

Further detail on the impairment provision is included in note 10 to the financial statements.

Given that the majority of the Novitas portfolio is in Stage 3, the key sources of estimation uncertainty for the portfolio's expected credit loss provision are time to recover periods and recovery rates. On this basis, management have assessed and completed sensitivity analysis when compared to the expected credit loss provision for Novitas of £184.1 million (31 July 2022: £113.3 million). At 31 July 2023, a 10% absolute deterioration or improvement in recovery rates would increase or decrease the ECL provision by £11.0 million. Separately, a 12-month improvement in the time to recover period will reduce the ECL provision by £12.1 million, while a 12-month delay in the time to recover period will increase the ECL provision by £10.0 million.

Forward-looking information

Determining expected credit losses under IFRS 9 requires the incorporation of forward-looking macroeconomic information that is reasonable, supportable and includes assumptions linked to economic variables that impact losses in each portfolio. The introduction of macroeconomic information introduces additional volatility to provisions.

In order to calculate forward-looking provisions, economic scenarios are sourced from Moody's Analytics. These scenarios cover a range of plausible economic conditions that are then used to project potential credit outcomes for each portfolio. An overview of these scenarios using key macroeconomic indicators is provided on pages 110 to 113. Ongoing benchmarking of the scenarios to other economic providers is carried out monthly to provide management with comfort on Moody's Analytics scenario paths.

Five different projected economic scenarios are currently considered to cover a range of possible outcomes. These include a baseline scenario, which reflects the best view of future economic events. In addition, one upside scenario and three downside scenario paths are defined relative to the baseline. Management assigns the scenarios a probability weighting to reflect the likelihood of specific scenarios, and therefore loss outcomes, materialising, using a combination of quantitative analysis and expert judgement.

The impact of forward-looking information varies across the group's lending businesses because of the differing sensitivity of each portfolio to specific macroeconomic variables. This is reflected through the development of bespoke macroeconomic models that recognise the specific response of each business to the macroeconomic environment.

The modelled impact of macroeconomic scenarios and their respective weightings is reviewed by business experts in relation to stage allocation and coverage ratios at the individual and portfolio level, incorporating management's experience and knowledge of customers, the sectors in which they operate, and the assets financed.

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Principal risks

This includes assessment of the reaction of the ECL in the context of the prevailing and forecast economic conditions, for example where currently higher interest rates and inflationary conditions exist compared to recent periods.

Economic forecasts have evolved over the course of 2023 and reflect the continued economic challenges and uncertainty. Forecasts deployed in IFRS 9 macroeconomic models are updated on a monthly basis. At 31 July 2023, the latest baseline scenario forecasts GDP growth of 0.5% in calendar year 2023 and an average base rate of 4.9% across calendar year 2023. CPI is forecast to be 5.2% in calendar year 2023 in the baseline scenario, with 1.5% forecast in the protracted downside scenario over the same period.

At 31 July 2022, the scenario weightings were: 30% strong upside, 32.5% baseline, 20% mild downside, 10.5% moderate downside and 7% protracted downside. As economic forecasts are considered to appropriately recognise deterioration in the macroeconomic environment, no change has been made to the weightings ascribed to the scenarios since 31 July 2022.

Given the current economic uncertainty, further analysis has been undertaken to assess the appropriateness of the five scenarios used. This included benchmarking the baseline scenario to consensus economic views, as well as consideration of an additional forecast related to stagflation, which could be considered as an alternative downside scenario.

Compared to the scenarios in use in the expected credit losses calculation, the stagflation scenario includes a longer period of higher interest rates coupled with a shallower but extended impact on GDP. Due to the relatively short tenor of the portfolios, the stagflation scenario is considered to be of less relevance than those deployed. This is supported by the fact that, due to the higher severity of recessionary factors in the existing scenarios, using the stagflation scenario instead of the moderate or protracted downside scenario would result in lower expected credit losses.

The final scenarios deployed reflect overall deterioration in the UK economic outlook relative to 31 July 2022, and factor in recent developments including dampened GDP growth for 2024 and 2025 and a Bank of England base rate peak in late 2023 following persistent high levels of inflation. Under the baseline scenario, UK headline CPI inflation continues to fall from its peak owing to sustained base rate increases and eased supply chain pressures. House price outlook includes contraction across all scenarios; however, house prices return to growth sooner than previously anticipated. Unemployment rate forecasts have marginally improved compared to 31 July 2022.

Scenario Forecasts and Weights

	Baseline		Upside (strong)		Downside (mild)		Downside (moderate)		Downside (protracted)	
	2023	2024	2023	2024	2023	2024	2023	2024	2023	2024
At 31 July 2023										
UK GDP growth	**0.5%**	**0.3%**	**1.3%**	**3.0%**	**(0.2)%**	**(2.3)%**	**(0.6)%**	**(4.8)%**	**(0.8)%**	**(6.2)%**
UK unemployment	**4.1%**	**4.4%**	**3.9%**	**3.9%**	**4.2%**	**4.8%**	**4.4%**	**6.5%**	**4.5%**	**7.7%**
UK HPI growth	**(6.3)%**	**(1.4)%**	**(0.4)%**	**8.3%**	**(9.1)%**	**(6.9)%**	**(10.8)%**	**(13.2)%**	**(12.6)%**	**(20.1)%**
BoE base rate	**4.9%**	**5.5%**	**4.9%**	**5.7%**	**4.8%**	**4.8%**	**4.7%**	**4.2%**	**4.5%**	**3.6%**
Consumer Price Index	**5.2%**	**2.2%**	**4.8%**	**2.2%**	**3.8%**	**1.2%**	**3.0%**	**(0.3)%**	**1.5%**	**(2.3)%**
Weighting	**32.5%**		**30%**		**20%**		**10.5%**		**7%**	

	Baseline		Upside (strong)		Downside (mild)		Downside (moderate)		Downside (protracted)	
	2022	2023	2022	2023	2022	2023	2022	2023	2022	2023
At 31 July 2022										
UK GDP growth	3.4%	0.8%	4.1%	2.9%	2.7%	(1.8)%	2.4%	(4.4)%	2.1%	(5.9)%
UK unemployment	3.8%	4.1%	3.6%	3.6%	4.0%	4.6%	4.1%	6.2%	4.2%	7.4%
UK HPI growth	4.3%	2.6%	10.9%	12.7%	1.1%	(3.1)%	(0.5)%	(9.1)%	(2.4)%	(15.9)%
BoE base rate	1.1%	1.8%	1.1%	1.7%	1.3%	1.0%	1.4%	1.1%	1.5%	1.2%
Consumer Price Index	10.7%	2.8%	10.3%	2.8%	12.3%	0.4%	14.2%	0.2%	17.1%	(2.2)%
Weighting	32.5%		30%		20%		10.5%		7%	

Notes:
UK GDP growth: National Accounts Annual Real Gross Domestic Product, Seasonally Adjusted – year-on-year change (%).
UK unemployment: ONS Labour Force Survey, Seasonally Adjusted – Average (%).
UK HPI growth: Average nominal house prices, Land Registry, Seasonally Adjusted – Q4-to-Q4 change (%).
BoE base rate: Bank of England base rate – Average (%).
Consumer Price Index: ONS, All items, annual inflation – Q4-to-Q4 change (%).

	Five-year average (calendar years 2023 to 2027)				
	Baseline	**Upside (strong)**	**Downside (mild)**	**Downside (moderate)**	**Downside (protracted)**
At 31 July 2023					
UK GDP growth	**0.9%**	**1.7%**	**0.5%**	**0.0%**	**(0.1)%**
UK unemployment	**4.4%**	**3.9%**	**4.6%**	**6.4%**	**7.3%**
UK HPI growth	**0.5%**	**2.1%**	**(1.1)%**	**(2.9)%**	**(5.4)%**
BoE base rate	**3.8%**	**3.8%**	**3.5%**	**2.8%**	**2.3%**
Consumer Price Index	**2.6%**	**2.6%**	**2.1%**	**1.6%**	**0.7%**
Weighting	**32.5%**	**30%**	**20%**	**10.5%**	**7%**

	Five-year average (calendar years 2022 to 2026)				
	Baseline	Upside (strong)	Downside (mild)	Downside (moderate)	Downside (protracted)
At 31 July 2022					
UK GDP growth	1.2%	1.7%	0.8%	0.2%	(0.1)%
UK unemployment	4.4%	3.8%	4.6%	6.4%	7.2%
UK HPI growth	0.1%	1.8%	(1.3)%	(2.5)%	(4.6)%
BoE base rate	2.0%	2.0%	1.5%	0.9%	0.6%
Consumer Price Index	3.8%	3.8%	3.7%	3.6%	3.4%
Weighting	32.5%	30%	20%	10.5%	7%

Notes:
UK GDP growth: National Accounts Annual Real Gross Domestic Product, Seasonally Adjusted – CAGR (%).
UK unemployment: ONS Labour Force Survey, Seasonally Adjusted – Average (%).
UK HPI growth: Average nominal house prices, Land Registry, Seasonally Adjusted – CAGR (%).
BoE base rate: Bank of England base rate – Average (%).
Consumer Price Index: ONS, All items, annual inflation – CAGR (%).

The forecasts represent an economic view at 31 July 2023, after which the economic uncertainty has continued. These trends, including the risk of further interest rate rises, and their impact on scenarios and weightings, are subject to ongoing monitoring by management.

The tables on pages 110 to 111 show economic assumptions within each scenario, and the weighting applied to each at 31 July 2023. The metrics shown are key UK economic indicators, chosen to describe the economic scenarios. These are the main metrics used to set scenario paths, which then influence a wide range of additional metrics that are used in expected credit loss models. The first tables show the forecasts of the key metrics for the scenarios utilised for calendar years 2022 and 2023. The subsequent tables show averages and peak-to-trough ranges for the same key metrics over the five-year period from 2023 to 2027.

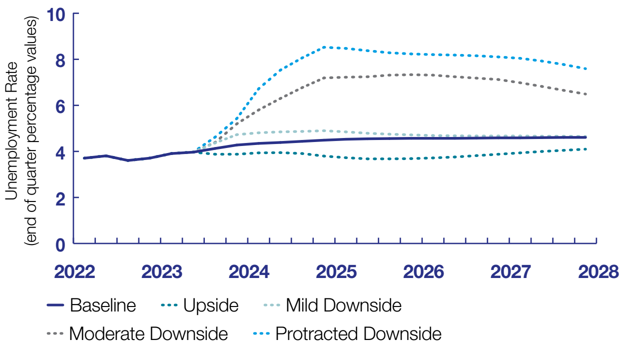
These periods have been included as they demonstrate the short, medium and long-term outlooks for the key macroeconomic indicators which form the basis of the scenario forecasts. The portfolio has an average residual maturity of 16 months, with c.98% of loan value having a maturity of five years or less.

The following charts on page 112 represent the quarterly forecast data included in the above tables incorporating actual metrics up to 31 July 2023. The dark blue line shows the baseline scenario, while the other lines represent the various upside and downside scenarios.

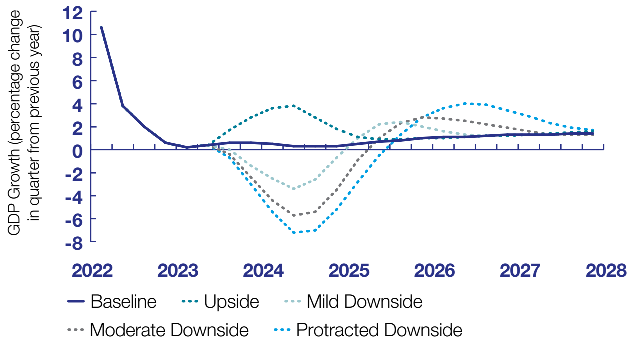
The tables on page 113 provide a summary for the five-year period (calendar years 2023 to 2027) of the peak-to-trough range of values of the key UK economic variables used within the economic scenarios at 31 July 2023 and 31 July 2022.

Risk Report continued
Principal risks

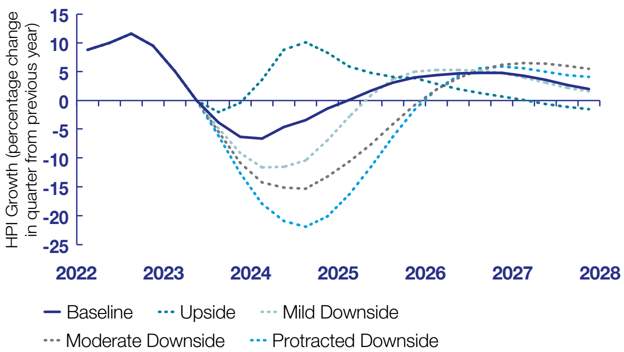
Unemployment Rate (%)



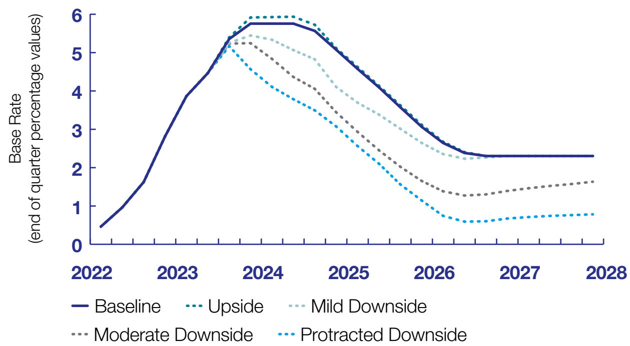
Real Gross Domestic Product (Annual % Change)



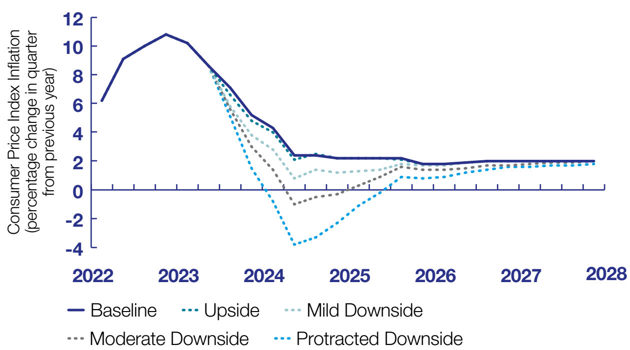
House Price Index – Current Prices (Annual % Change)



Bank of England Base Rate (%)



Consumer Price Index (Annual % Change)



	Five-year period (calendar year 2023 to 2027)									
	Baseline		Upside (strong)		Downside (mild)		Downside (moderate)		Downside (protracted)	
	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough
At 31 July 2023										
UK GDP growth	**4.6%**	**0.1%**	**8.7%**	**0.1%**	**2.5%**	**(3.0)%**	**0.3%**	**(5.9)%**	**0.3%**	**(8.1)%**
UK unemployment	**4.6%**	**3.9%**	**4.1%**	**3.7%**	**4.9%**	**3.9%**	**7.3%**	**3.9%**	**8.5%**	**3.9%**
UK HPI growth	**2.6%**	**(7.8)%**	**12.9%**	**(3.1)%**	**(0.5)%**	**(15.4)%**	**(0.5)%**	**(24.0)%**	**(0.5)%**	**(32.1)%**
BoE base rate	**5.8%**	**2.3%**	**5.9%**	**2.3%**	**5.4%**	**2.2%**	**5.2%**	**1.3%**	**5.2%**	**0.6%**
Consumer Price Index	**10.2%**	**1.8%**	**10.2%**	**1.8%**	**10.2%**	**0.8%**	**10.2%**	**(1.0)%**	**10.2%**	**(3.8)%**
Weighting	**32.5%**		**30%**		**20%**		**10.5%**		**7%**	

	Five-year period (calendar year 2022 to 2026)									
	Baseline		Upside (strong)		Downside (mild)		Downside (moderate)		Downside (protracted)	
	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough
At 31 July 2022										
UK GDP growth	6.3%	0.4%	9.0%	0.4%	4.1%	(2.6)%	1.0%	(5.1)%	0.8%	(6.9)%
UK unemployment	4.8%	3.7%	4.2%	3.5%	4.8%	3.7%	7.4%	3.7%	8.4%	3.7%
UK HPI growth	2.0%	(5.0)%	16.7%	(1.1)%	2.0%	(11.7)%	2.0%	(17.9)%	2.0%	(26.0)%
BoE base rate	2.5%	0.5%	2.5%	0.5%	2.5%	0.1%	2.4%	0.1%	2.6%	0.1%
Consumer Price Index	10.7%	2.0%	10.3%	2.0%	12.3%	0.4%	14.2%	0.1%	17.1%	(2.2)%
Weighting	32.5%		30%		20%		10.5%		7%	

Notes:
UK GDP growth: Maximum and minimum quarterly GDP as a percentage change from start of period (%).
UK unemployment: Maximum and minimum unemployment rate (%).
UK HPI growth: Maximum and minimum average nominal house price as a percentage change from start of period (%).
BoE base rate: Maximum and minimum Bank of England base rate (%).
Consumer Price Index: Maximum and minimum inflation rate over the five-year period (%).

Scenario sensitivity analysis

The expected credit loss provision is sensitive to judgements and estimations made with regard to the selection and weighting of multiple economic scenarios. As a result, management has assessed and considered the sensitivity of the provision as follows:

- For the majority of the portfolios, the modelled expected credit loss provision has been recalculated under the upside strong and downside protracted scenarios described above, applying a 100% weighting to each scenario in turn. The change in provision requirement is driven by the movement in risk metrics under each scenario and resulting impact on stage allocation.
- Expected credit losses based on a simplified approach, which do not utilise a macroeconomic model and require expert judgement, are excluded from the sensitivity analysis.
- In addition to the above, key considerations for the sensitivity analysis are set out below, by segment:
  - In Commercial, the sensitivity analysis excludes Novitas, which is subject to a separate approach, as it is deemed more sensitive to credit factors than macroeconomic factors.
  - In Retail, the sensitivity analysis does not apply further stress to the expected credit loss provision on loans and advances to customers in Stage 3, because the measurement of expected credit losses is considered more sensitive to credit factors specific to the borrower than macroeconomic scenarios.
  - In Property, the sensitivity analysis excludes individually assessed provisions, and certain sub-portfolios which are deemed more sensitive to credit factors than the macroeconomic scenarios.

Based on the above analysis, at 31 July 2023, application of 100% weighting to the upside strong scenario would decrease the expected credit loss by £18.1 million whilst application of 100% weighting to the downside protracted scenario would increase the expected credit loss by £32.7 million, driven by the aforementioned changes in risk metrics and stage allocation of the portfolios.

When performing sensitivity analysis there is a high degree of estimation uncertainty. On this basis, 100% weighted expected credit loss provisions presented for the upside and downside scenarios should not be taken to represent the lower or upper range of possible and actual expected credit loss outcomes. The recalculated expected credit loss provision for each of the scenarios should be read in the context of the sensitivity analysis as a whole and in

Risk Report continued
Principal risks

conjunction with the disclosures provided in note 10 to the financial statements. The modelled impact presented is based on gross loans and advances to customers at 31 July 2023; it does not incorporate future changes relating to performance, growth or credit risk. In addition, given the change in the macroeconomic conditions, underlying modelled provisions and methodology, and refined approach to adjustments, comparison between the sensitivity results at 31 July 2023 and 31 July 2022 is not appropriate.

The economic environment remains uncertain and future impairment charges may be subject to further volatility, including from changes to macroeconomic variable forecasts impacted by geopolitical tensions and sustained cost of living pressures.

Use of Adjustments (audited)

Limitations in the group's expected credit loss models or input data may be identified through ongoing model monitoring and validation of models. In certain circumstances, management make appropriate adjustments to model-calculated expected credit losses. These adjustments are based on management judgements or quantitative back-testing to ensure expected credit loss provisions adequately reflect all known information. These adjustments are generally determined by considering the attributes or risks of a financial asset which are not captured by existing expected credit loss model outputs. Management adjustments are actively monitored, reviewed and incorporated into future model developments where applicable.

Macroeconomic forecasts continue to react to a range of external factors including the ongoing conflict in Ukraine, government attempts to address cost of living and inflationary pressures, and long-term impacts of the pandemic. In response, our use of adjustments has evolved. In particular, adjustments have been applied in the second half of the year in response to improvements in macroeconomic forecasts that resulted in releases in modelled provisions. A number of these releases were considered premature or counterintuitive by management and adjustments have been made as a result. These adjustments recognise the ongoing uncertainty associated with the current environment.

The approach to adjustments continues to reflect the use of expert management judgement which incorporates management's experience and knowledge of customers, the areas in which they operate, and the underlying assets financed.

The need for adjustments will continue to be monitored as new information emerges which might not be recognised in existing models.

At 31 July 2023, £17.0 million (31 July 2022: £(2.8) million) of the expected credit loss provision was attributable to adjustments.

Other Credit Risk Tables (audited)

Segmental credit risk

The table on page 115 sets out loans and advances to customers, trade receivables and undrawn facilities by the group's internal credit risk grading and illustrates the allocation of these per IFRS 9 staging category for comparative purposes. The analysis of lending has been prepared based on the following risk categories:

- Low risk: The credit risk profile of the borrower is considered acceptable with the borrower considered likely to meet obligations as they fall due. Standard monitoring is in place.
- Medium risk: Evidence of deterioration in the credit risk profile of the borrower exists which requires increased monitoring. Potential concerns over their ability to meet obligations as they fall due may exist.
- High risk: Evidence of significant deterioration in the credit risk profile of the borrower exists which requires enhanced management. Full repayment may not be achieved, with potential for loss identified.

Low risk loans and advances to customers represent 87% (31 July 2022: 88%) of the overall portfolio, reflective of a prudent and consistent approach to credit risk management. 80% (31 July 2022: 80%) of total advances are classified as low risk Stage 1, driven by the strong quality of the portfolio. Low risk Stage 2 represents 7% (31 July 2022: 8%) of loans and advances to customers, largely comprising early arrears cases, or agreements which have triggered a significant increase in credit risk indicator, or the "30 days past due" backstop. Low risk Stage 3 loans and advances to customers primarily relate to agreements which have triggered the "90 days past due" backstop but where full repayment is expected.

Medium risk loans account for 7% (31 July 2022: 8%) of total loans and advances to customers, of which the majority is in Stage 2. Medium risk Stage 1 remained stable at 3% (31 July 2022: 3%). Medium risk Stage 2 represents 3% (31 July 2022: 4%) of the overall portfolio. Loans and advances to customers reflected as medium risk Stage 3 primarily relate to agreements that have triggered the "90 days past due" backstop in addition to other significant increases in credit risk triggers.

High risk loans account for 6% (31 July 2022: 4%) of total loans and advances to customers, with the majority corresponding to Stage 3. This increase reflects the significant migration of Novitas accounts into Stage 3 following updates to assumptions for expected case failure rates, expected time to recover periods and expected recovery rates.

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
At 31 July 2023				
Gross loans and advances to customers				
Low risk	**7,702.4**	**693.9**	**23.2**	**8,419.5**
Medium risk	**278.7**	**313.1**	**48.8**	**640.6**
High risk	**9.1**	**55.0**	**511.4**	**575.5**
Total	**7,990.2**	**1,062.0**	**583.4**	**9,635.6**
Undrawn commitments				
Low risk	**1,202.3**	**21.5**	**0.1**	**1,223.9**
Medium risk	**–**	**2.7**	**–**	**2.7**
High risk	**–**	**–**	**1.9**	**1.9**
Total	**1,202.3**	**24.2**	**2.0**	**1,228.5**
Trade receivables[1]				
Low risk	**10.0**	**–**	**–**	**10.0**
Medium risk	**–**	**0.6**	**–**	**0.6**
High risk	**–**	**–**	**0.7**	**0.7**
Total	**10.0**	**0.6**	**0.7**	**11.3**

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
At 31 July 2022				
Gross loans and advances to customers				
Low risk	7,356.7	706.9	21.4	8,085.0
Medium risk	259.3	401.9	47.3	708.5
High risk	11.0	50.1	289.9	351.0
Total	7,627.0	1,158.9	358.6	9,144.5
Undrawn commitments				
Low risk	1,205.9	10.7	–	1,216.6
Medium risk	0.4	3.8	–	4.2
High risk	–	2.4	0.2	2.6
Total	1,206.3	16.9	0.2	1,223.4
Trade receivables[1]				
Low risk	8.6	–	–	8.6
Medium risk	–	0.4	–	0.4
High risk	–	–	0.8	0.8
Total	8.6	0.4	0.8	9.8

1. Lifetime expected credit losses are recognised for all trade receivables under the IFRS 9 simplified approach. The figures presented are on a net basis after deducting for expected credit losses of £2.0 million (31 July 2022: £3.2 million) relating to predominantly Stage 3 receivables.

Risk Report continued
Principal risks

Forbearance

Forbearance occurs when a customer is experiencing difficulty in meeting their financial commitments and a concession is granted, by changing the terms of the financial arrangement, which would not otherwise be considered. This arrangement can be temporary or permanent, depending on the customer's circumstances. The Banking division reports on forborne exposures as either performing or non-performing in line with regulatory requirements. A forbearance policy is maintained to ensure the necessary processes are in place to enable consistently fair treatment of all customers and that each is managed based on their individual circumstances. The arrangements agreed with customers will aim to create a sustainable and affordable financial position, thereby reducing the likelihood of suffering a credit loss. The forbearance policy is periodically reviewed to ensure it remains effective.

The Banking division offers a range of concessions to support customers which vary depending on the product and the customer's status. Such concessions include an extension outside terms (for example, a higher LTV or overpayments) and refinancing, which may incorporate an extension of the loan tenor and capitalisation of arrears. Furthermore, other forms of forbearance such as moratorium, covenant waivers and rate concessions are also offered.

Loans are classified as forborne at the time a customer in financial difficulty is granted a concession and the loan will remain treated and recorded as forborne until the following exit conditions are met:

1. the loan is considered as performing and there is no past-due amount according to the amended contractual terms;
2. a minimum two-year probation period has passed from the date the forborne exposure was considered as performing, during which time regular and timely payments have been made; and
3. none of the customer's exposures with Close Brothers are more than 30 days past due at the end of the probation period.

At 31 July 2023, the gross carrying amount of exposures with forbearance measures was £214.6 million (31 July 2022: £208.9 million). The key driver of this increase has been movement of high-value individual exposures in Property and higher volumes of business-as-usual forbearance in our Motor Finance business resulting from enduring cost of living pressures on customers.

The reduction in volumes across all segments is driven by the continued run-off of Covid-19-related concessions, lower volumes in Premium Finance related to short loan tenors and general resilience across all portfolios.

As the number of customers supported via Covid-19-related concessions has continued to reduce (noting no new Covid-19 forbearance arrangements have been offered in the period), the low outstanding volumes have been consolidated into the single forbearance total in the tables on pages 116 to 117.

An analysis of forborne loans is shown in the table below:

	Gross loans and advances to customers £ million	Forborne loans £ million	Forborne loans as a percentage of gross loans and advances to customers %	Provision on forborne loans £ million	Number of customers supported
At 31 July 2023	**9,635.6**	**214.6**	**2.2%**	**56.1**	**6,996**
At 31 July 2022	9,144.5	208.9	2.3%	44.3	11,043

The following is a breakdown of forborne loans by segment:

	31 July 2023 £ million	31 July 2022 £ million
Commercial	**38.0**	62.3
Retail	**28.8**	23.0
Property	**147.8**	123.6
Total	**214.6**	208.9

The following is a breakdown of the number of customers supported by segment:

	31 July 2023 Number of customers supported	31 July 2022 Number of customers supported
Commercial	**243**	518
Retail	**6,700**	10,467
Property	**53**	58
Total	**6,996**	11,043

The following is a breakdown of forborne loans by concession type:

	31 July 2023 £ million	31 July 2022 £ million
Extension outside terms	**105.8**	113.0
Refinancing	**10.4**	3.0
Moratorium	**66.1**	69.9
Other modifications	**32.3**	23.0
Total	**214.6**	208.9

Government lending schemes

Over the pandemic period, following accreditation, customers were offered facilities under the UK government-introduced CBILS, the CLBILS and the Bounce Back Loan Scheme ("BBLS"), thereby enabling the Banking division to maximise its support to small businesses. At 31 July 2023, there are 4,364 (31 July 2022: 5,445) remaining facilities, with a residual balance of £456.3 million (31 July 2022: £747.5 million) following repayments across the Property, Asset Finance & Leasing and Invoice & Speciality Finance businesses.

The Banking division also received accreditation to offer products under the RLS, and schemes in the Republic of Ireland. Applications for facilities under phase 2 of the RLS closed in June 2022 and recently facilities have been offered under the new RLS phase 3. At 31 July 2023, there are 943 (31 July 2022: 560) live facilities, with balances of £276.2 million (31 July 2022: £166.1 million), and a further 58 (31 July 2022: 73) approved facilities with limits of £14.3 million (31 July 2022: £15.6 million).

The Banking division maintains a regular reporting cycle of these facilities to monitor performance. To date, a number of claims have been made and payments received under the government guarantee.

Collateral held

The group mitigates credit risk through holding collateral against loans and advances to customers. The group has internal policies on the acceptability of specific collateral types, the requirements for ensuring effective enforceability and monitoring of collateral in-life. Internal policies define, amongst other things, legal documentation requirements, the nature of assets accepted, LTV and age at origination, and exposure maturity and in-life inspection requirements. An asset valuation is undertaken as part of the loan origination process.

The principal types of collateral held by the group against loans and advances to customers in the Property and Commercial businesses include residential and commercial property and charges over business assets such as equipment, inventory and accounts receivable. Within Retail, the group holds collateral primarily in the form of vehicles in Motor Finance and refundable insurance premiums in Premium Finance, where an additional layer of protection may exist through broker recourse.

The Banking division's collateral policies have not materially changed during the reporting period. There has been an increase in the proportion of exposures in higher LTV bands as exposures backed by government lending schemes have run-off and been replaced by more normalised LTV profiles.

Unsecured and structurally protected populations have reduced year-on-year, consistent with limited appetite for growth in unsecured lending and lower new business volumes in structurally protected portfolios.

Analysis of gross loans and advances to customers by LTV ratio is provided on page 118. The value of collateral used in determining the LTV ratio is based upon data captured at loan origination or, where available, a more recent valuation.

Risk Report continued
Principal risks

	Commercial £ million	Retail £ million	Property £ million	Total £ million
LTV[1]				
60% or lower	**1,021.0**	**150.3**	**1,083.9**	**2,255.2**
>60% to 70%	**588.6**	**152.4**	**475.3**	**1,216.3**
>70% to 80%	**468.7**	**336.3**	**84.0**	**889.0**
>80% to 90%	**777.9**	**1,067.5**	**12.3**	**1,857.7**
>90% to 100%	**1,285.2**	**505.0**	**14.1**	**1,804.3**
Greater than 100%	**226.5**	**387.7**	**74.7**	**688.9**
Structurally protected[2]	**265.5**	**452.0**	**–**	**717.5**
Unsecured	**166.2**	**40.0**	**0.5**	**206.7**
At 31 July 2023	**4,799.6**	**3,091.2**	**1,744.8**	**9,635.6**

	Commercial £ million	Retail £ million	Property £ million	Total £ million
LTV[1]				
60% or lower	1,238.2	179.5	1,011.4	2,429.1
>60% to 70%	471.6	179.5	367.3	1,018.4
>70% to 80%	375.5	374.9	49.8	800.2
>80% to 90%	692.7	1,108.0	4.5	1,805.2
>90% to 100%	1,052.6	477.6	–	1,530.2
Greater than 100%	213.3	318.9	77.2	609.4
Structurally protected[2]	291.7	452.8	–	744.5
Unsecured	164.8	42.7	–	207.5
At 31 July 2022	4,500.4	3,133.9	1,510.2	9,144.5

Gross loans and advances to customers which are credit-impaired split by LTV ratio:

	Commercial £ million	Retail £ million	Property £ million	Total £ million
LTV				
60% or lower	**48.7**	**1.7**	**31.7**	**82.1**
>60% to 70%	**4.6**	**2.3**	**15.9**	**22.8**
>70% to 80%	**4.2**	**6.9**	**23.9**	**35.0**
>80% to 90%	**8.9**	**19.3**	**9.1**	**37.3**
>90% to 100%	**19.2**	**22.2**	**13.6**	**55.0**
Greater than 100%	**4.7**	**15.7**	**74.7**	**95.1**
Structurally protected[2]	**229.5**	**5.0**	**–**	**234.5**
Unsecured	**19.6**	**1.5**	**0.5**	**21.6**
At 31 July 2023	**339.4**	**74.6**	**169.4**	**583.4**

	Commercial £ million	Retail £ million	Property £ million	Total £ million
LTV				
60% or lower	42.5	1.7	9.2	53.4
>60% to 70%	0.7	2.4	14.2	17.3
>70% to 80%	2.7	7.0	19.1	28.8
>80% to 90%	16.4	17.9	4.4	38.7
>90% to 100%	10.1	19.1	–	29.2
Greater than 100%	4.8	11.9	77.1	93.8
Structurally protected[2]	56.5	4.1	–	60.6
Unsecured	35.4	1.4	–	36.8
At 31 July 2022	169.1	65.5	124.0	358.6

1. Government lending scheme facilities totalling £732.4 million (31 July 2022: £913.5 million) are allocated to a low LTV category reflecting the nature of the government guarantee and resultant level of lending risk.
2. Exposures are considered structurally protected when, in management's judgement, they have characteristics which mitigate the credit risk of the exposure to a significant extent, in spite of not representing tangible security. The increase in credit-impaired structurally protected gross loans and advances is a result of updates to Novitas assumptions which are detailed on pages 108 to 109.

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 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 legal entity basis with each of the group's divisions responsible for ensuring it maintains sufficient liquidity for its own purposes. The group's divisions operate independently of each other with no liquidity reliance.

The company has relatively few 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 its committed borrowing facilities.

The Banking division's funding profile comprises a broad range of channels. Its diversified approach to funding includes secured funding, unsecured funding, retail deposits and non-retail deposits. Funding risk exposure primarily arises if the Banking division is unable to obtain the necessary funding to support its asset positions for the expected maturity. 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 the bank's ability to originate new assets and potentially leading to negative market or customer perception.

The Banking division's ILAAP covers potential event drivers from a range of stress testing scenarios, including idiosyncratic examples. This ensures liquidity management remains a source of strength and features a robust and prudent approach to assessing and maintaining liquidity requirements. The Banking division's ILAAP is combined with Internal Capital Adequacy and Risk Assessments ("ICARA") from Winterflood and CBAM, alongside the company considerations, to form the group ILAAP.

Funding and liquidity risk in Winterflood is driven by four primary sources: long trading book risk positions; overnight and intraday settlements; margin requirements; and multi-day client orders. Winterflood maintains risk appetites sufficient to ensure continued compliance with the rules under the Investment Firm Prudential Regulation ("IFPR").

For CBAM, funding and liquidity risks are managed through the division's cash flow forecasting, ensuring that sufficient liquidity is maintained to cover the next three months of outflows. CBAM also has specific requirements under ICARA in relation to liquidity which are monitored against.

Further detail on the group's funding and liquidity exposure is provided on pages 70 and 71 of the Financial Overview and page 250 of the financial statements.

Risk Appetite

The group adopts a conservative approach to funding and liquidity risk and seeks to maintain a 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 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 metrics 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") and Group Asset and Liability Committee ("GALCO"). 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 assets ratio.

Funding is measured and monitored in accordance with 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. The NSFR was implemented by the PRA on 1 January 2022. The four-quarter average ratio to 31 July 2023 was 126.0% (point in time ratio at 31 July 2022: 118.3%), comfortably in excess of the binding minimum requirement of 100%.

Risk Report continued

Principal risks

Liquidity is managed in accordance with regulatory requirements and the ILAAP which is approved by the board. The group's LCR is significantly above the regulatory requirement. This is because the nature of the funding model means that it holds higher inflows compared to outflows within the 30-day period and significantly more HQLA than is required under regulatory metrics. The group's 12-month average LCR to 31 July 2023 was 1,143% (31 July 2022: 924%).

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 Banking division remains within risk appetite and identifies potential areas of vulnerability. The outcomes of these scenarios are formally reported to the ALCO, GRCC and board.

Mitigation (audited)

This 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 Term Funding Scheme ("TFSME"), that was introduced to support lending in the then prevailing low interest rate environment. Total available funding is kept well in excess of the loan book funding requirement to ensure funding is available when needed.

The following tables analyse the contractual maturities of the group's on-balance sheet financial liabilities on an undiscounted cash flow basis.

	On demand £ million	**In less than three months £ million**	**In more than three months but not more than six months £ million**	**In more than six months but not more than one year £ million**	**In more than one year but not more than five years £ million**	**In more than five years £ million**	**Total £ million**
At 31 July 2023							
Deposits by banks	**10.3**	**43.7**	**89.7**	**–**	**–**	**–**	**143.7**
Deposits by customers	**175.1**	**1,838.3**	**1,972.9**	**1,869.6**	**2,140.6**	**–**	**7,996.5**
Loans and overdrafts from banks	**31.8**	**25.2**	**7.6**	**243.8**	**383.2**	**–**	**691.6**
Debt securities in issue	**–**	**46.7**	**132.3**	**168.1**	**1,705.1**	**416.3**	**2,468.5**
Subordinated loan capital	**–**	**2.0**	**–**	**2.0**	**16.0**	**213.0**	**233.0**
Total	**217.2**	**1,955.9**	**2,202.5**	**2,283.5**	**4,244.9**	**629.3**	**11,533.3**

	On demand £ million	In less than three months £ million	In more than three months but not more than six months £ million	In more than six months but not more than one year £ million	In more than one year but not more than five years £ million	In more than five years £ million	Total £ million
At 31 July 2022							
Deposits by banks	6.0	51.9	98.9	4.1	–	–	160.9
Deposits by customers	120.9	1,645.1	2,046.5	1,600.1	1,427.2	–	6,839.8
Loans and overdrafts from banks	12.0	12.0	1.9	3.7	610.5	–	640.1
Debt securities in issue	–	30.3	256.2	619.5	890.7	444.2	2,240.9
Subordinated loan capital	–	2.0	–	2.0	15.0	218.0	237.0
Total	138.9	1,741.3	2,403.5	2,229.4	2,943.4	662.2	10,118.7

Growth in the balance sheet over the current year has been funded through longer-term customer deposits with maturities between one and five years, supporting and maintaining the principles of "borrow long, lend short".

Monitoring

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

The Banking division operates a three lines of defence model with the treasury function responsible for the measurement and management of the bank's funding and liquidity position and asset and liability management 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.

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 because of market volatility and uncertainty.

Legal and regulatory risk

Legal and regulatory risk is the risk of non-compliance with laws and regulations which could give rise to fines, litigation, sanctions and the potential for material adverse impact upon the group.

Exposure

The group is subject to the laws and regulations of the various jurisdictions in which it operates. This exposure includes risks of breaching financial services regulations and laws, as well as action resulting from contractual breach and litigation.

Risk appetite

The group has minimal appetite for legal and regulatory risk, seeking to operate to high ethical standards and expecting its staff to operate in accordance with the laws, regulations and voluntary codes which impact the group and its activities.

The group seeks to avoid knowingly operating in a manner which is contrary to the provisions of the regulatory system and has no tolerance for knowingly transacting business outside the scope of its regulatory permissions or relevant legislation.

The group will respond in an appropriate, risk-based and proportionate manner to any changes to the legal and regulatory environment, as well as changes driven by any strategic initiatives.

Measurement

The group monitors and manages its legal, regulatory and compliance risks through regular engagement and interaction across the organisation, and the implementation of appropriate policies, standards and procedures. This includes reliance on a formal horizon scanning capability to identify changes, as well as regular management information which enables oversight and challenge via RCCs.

Mitigation

The group's Enterprise Risk Management Framework, including its suite of policies and standards and the associated three lines of defence operating model, sets common control objectives across risk disciplines. This consistent approach to setting and embedding control expectations acts to mitigate the likelihood and impact of events which could give rise to legal and regulatory risk.

Dedicated specialist legal and compliance teams with relevant knowledge and experience provide advice, support and challenge to the group's businesses, enabling alignment with legal and regulatory requirements. These teams further have the ability to consult with external experts on technical or otherwise complex matters as appropriate.

Internal change and investment processes consider regulatory and legal inputs, such that sufficient funding can be allocated to deliver system and process changes in line with evolving regulatory and legal expectations.

Monitoring

In line with the group's three lines of defence model, businesses monitor their alignment with standards on an ongoing basis. Relevant management information, including the output of quality assurance activities, is reviewed by the RCCs.

An independent compliance monitoring team undertakes assurance to assess compliance with key regulations and the effectiveness of associated controls. Reports are provided to management and any remedial actions identified are tracked to completion.

Legal and compliance teams monitor for external developments through both structured horizon scanning activity and engagement in industry forums.

Risk Report continued

Principal risks

Outlook

Legal and regulatory risk is inherently elevated in financial services as an industry. The UK government's current proposals to reform UK financial services regulation and potential divergence between the UK and EU regulatory regimes could affect and provide further challenges for the group.

The inherent risk exposure for the group continues to increase across the jurisdictions in which it operates. The nature and scale of any risk exposure related to the introduction of Consumer Duty by the FCA remains to be seen as it embeds across industry. Separately, the group's retail lending offerings in the Republic of Ireland operate in an environment with increasing regulatory activity – the Central Bank of Ireland continues to embed further regulatory expectations with respect to operational resilience and customer outcomes.

The group operates strong controls which limit residual risk exposure arising from regulatory expectations, however the external drivers increasing inherent risk may have a follow-on impact to the group's residual exposure.

The group faces legal risks that could result in substantial monetary damages or fines. Specifically, the group has received a number of complaints, some of which are with the Financial Ombudsman Service, and is subject to a number of claims through the courts regarding historic commission arrangements with intermediaries on its Motor Finance products. This follows the FCA's Motor Market Review in 2019. Depending on the outcome of the courts' rulings and/or regulatory findings on the matter, these complaints and claims may give rise to a potential future obligation to compensate customers. It is not currently possible to estimate the financial impact (if any) or scope of these or any future related claims.

Non-traded market risk

Non-traded market risk is the risk to the value of assets or liabilities outside the trading book that arises from changes in market prices such as interest rates, credit spreads and foreign exchange rates.

Exposure

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

IRRBB is predominantly incurred in the Banking division as a result of its lending and funding activities and from funding activities for the group holding company. Interest rate risk in the other divisions is immaterial.

CSRBB arises from the HQLA portfolio held in the Banking division.

FX risk is incurred across the group and arises from:

- managing the funding requirements of the Banking division 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.

Risk Appetite

The group has a restricted 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 use interest rate swaps to secure the margin on its loans and advances to customers.

The group has a limited appetite for credit spread risk which occurs due to its holdings of HQLA assets, which primarily comprise highly rated UK and European supranational debt, sovereign debt, agency bonds and UK covered bonds.

The group has a restricted appetite for foreign exchange risk. It avoids large open positions and sets individual currency limits to mitigate the risk.

Measurement

Interest rate risk

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 reference interest rate for assets and liabilities.

IRRBB is assessed and measured by applying key behavioural and modelling assumptions including, but not limited to, those related to fixed rate loans subject to prepayment risk, the behaviour of non-maturity assets and liabilities, the treatment of own equity and the expectation of embedded interest rate options. This assessment is performed across a range of regulatory prescribed and internal interest rate shock scenarios 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, 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 any risk to capital.

No material exposure exists in the other parts of the group, and accordingly the analysis below relates to the Banking division and company.

EaR impact (audited)

The table below sets out the assessed impact on net interest income over a 12-month period from interest rate changes. The results shown are for an instantaneous and parallel change in interest rates at 31 July 2023:

	31 July 2023 £ million	31 July 2022 £ million
0.5% increase	**4.5**	4.3
2.5% increase	**22.6**	22.3
0.5% decrease	**(4.5)**	(1.0)
2.5% decrease	**(22.8)**	16.7

The group also monitors any potential earning exposure from basis mismatches between its lending and funding activities on a monthly cadence. To provide a clearer assessment of the group's exposure to interest rate changes, this has been excluded from the EaR numbers disclosed for the current year and the prior year comparatives. The prior year comparatives have also been restated to include EaR risk within the company as compared to Bank only in prior years.

The group's EaR at 31 July 2023 reflects its policy to ensure exposure to interest rate shocks is managed within the group's risk appetites. The EaR measure is a combination of the group's repricing profile, which is positively correlated to rising rates, and its optionality risk, which is negligible in the current higher rate environment.

EV impact (audited)

The following table sets out the assessed impact on our base case EV, which measures the impact on equity value of an instantaneous and parallel change in interest rates at 31 July 2023:

	31 July 2023 £ million	31 July 2022 £ million
0.5% increase	**4.4**	1.5
2.5% increase	**21.5**	8.4
0.5% decrease	**(4.4)**	(1.2)
2.5% decrease	**(21.9)**	3.3

The group's EV at 31 July 2023 reflects its policy to ensure exposure to interest rate shocks is managed within the group's risk appetites. In a rising rate environment, the distance to the interest rate floors increases and so the benefit of the floors on the group's lending decreases. This explains the movement seen for the parallel rate up and down 2.5% scenarios. The EV measure is a combination of our repricing profile, which is positively correlated to rising rates, offset partially by embedded optionality to cover interest rate floors within the bank's lending and borrowing activities. The prior year comparatives have been restated to include EV risk within the company as compared to Bank only in prior years.

Credit spread risk

Treasury holds assets for the purpose of liquidity management; all treasury assets at 31 July 2023 were LCR Level 1. Derivatives are used to mitigate interest rate risk exposure from treasury assets.

Credit spread sensitivity is measured by comparing the impact of a one basis point change in credit spread on the value of the Banking division's liquidity portfolio. CSRBB is assessed by calculating potential changes in value of the liquidity portfolio, based on historic stresses to credit spreads. The group has started the process of restructuring its liquidity portfolio, as shown in the following table, so its current exposure to credit spread risk is modest.

The table below sets out the total exposure to each asset class within the Banking division's liquidity portfolio at 31 July 2023:

	31 July 2023 £ million	31 July 2022 £ million
Cash and balances at central banks	**1,937.0**	1,254.7
Sovereign and central bank debt (LCR Level 1)	**186.1**	415.4
Covered bonds (LCR Level 1)	**106.3**	–
Supranational bonds (LCR Level 1)	**–**	–
Certificates of deposit	**–**	185.0
Total treasury liquid asset holdings	**2,229.4**	1,855.1

At 31 July 2022, sovereign and central bank debt holdings included encumbered UK government debt of £216.9 million. The Banking division did not hold any encumbered assets in its liquidity portfolio at 31 July 2023.

Risk Report continued

Principal risks

Foreign exchange risk (audited)

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 each Banking business 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.

The group's largest FX exposure is from its euro lending and funding activities. A change in the euro exchange rate would increase the group's equity by the following amounts:

	2023 £ million	2022 £ million
20% strengthening of sterling against the euro	**0.3**	(1.7)

The bank seeks to match its assets and liabilities by currency; any remaining gaps are hedged using exchange rate derivative contracts. Details of these derivatives are disclosed in note 13.

The group also has exposures which arise from share trading settled in foreign currency in Winterflood and foreign currency equity investments. The group has policies and processes in place to manage foreign currency risk, and as such the impact of any reasonably expected exchange rate fluctuations would not be material.

Mitigation (audited)

The group maintains a limited 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 Group Asset and Liability Committee ("GALCO") and ALCO are respectively responsible for approving any changes to hedging strategies before implementation for the company and Bank.

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

All marketable securities are "hold to collect and sell" and have their interest rate exposure hedged with vanilla interest rate swaps.

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

Monitoring

The GALCO monitors the non-traded market risk exposure across the group's balance sheet. ALCO monitors the non-traded market risk exposure for the Banking division. Treasury is responsible for day-to-day management of all non-traded market risks. Day-to-day oversight is exercised via a combination of daily reporting by the treasury finance team, and divisional RCC review and challenge. Further independent oversight is provided via the second line of defence through the asset liability management risk team ("ALM Risk"), with monthly reporting into ALCO and GALCO.

Banking 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 businesses through their respective RCCs.

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

Outlook

The group expects exposure to IRRBB and FX risk to remain at similar levels to those seen this year but CSRBB is expected to increase as the group restructures its HQLA portfolio.

Operational risk

Operational risk is 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 the group operates are considered within a maturing framework for resilient delivery of important business services.

Risk Appetite

The group manages its 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, controls are implemented in a manner that reduces the likelihood of higher-impact risk events crystallising. Further, the group monitors aggregate loss trends and seeks 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 the Risk Committee. The population of KRIs is reviewed annually in line with the scheduled review of the group's 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 to 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;
- investment decisions that prioritise risk benefits via key systems, third-party relationships, processes and teams;
- 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 its risk profile; and
- planning and rehearsing strategic and operational responses to severe but plausible stress scenarios.

Key Operational Risks

Risk Report continued

Principal 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 while ensuring transparency regarding the level of model risk incurred. A model risk framework is embedded across the group to manage and mitigate this risk through the model life cycle.

This framework 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. As part of the model risk framework, 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 KRIs which form part of the group risk appetite. Ongoing evolution of the model risk framework is aligned to external regulatory requirements, best industry practice and the firm's ongoing advanced internal-rating-based ("AIRB") application.

Resilience Focus

Resilience supports successful outcomes over time for the group's customers and other stakeholders.

Resilience minimises the impact of operational disruptions to business services. In particular, the group has considered the regulatory objectives in this area, focusing on potential intolerable harm caused by severe but plausible events.

This goal is aligned to the foundations for the group's long-term success, and in particular to its strategy of providing exceptional service to its customers. The priority is to improve the experience of and minimise harm to customers in the event of operational disruption.

The group has an established multi-year programme to implement and maintains a sustainable approach to resilience.

Data Risk Focus

Growing maturity across a discipline which underpins the group's approach to information.

The group views data risk holistically through the life cycle from acquisition to usage and eventual disposal. Development of a data governance methodology to identify, assess, treat and report risk and issues across our critical data elements continues.

Data governance forums monitor the group's position within the established risk governance framework, with data ownership and accountability as key focus areas.

Data risk interlinks with the group's approach to operational risk in key areas such as data protection, model management, end user computing management and information security. Complementary frameworks allow a linked language and shared approach in policies, standards and controls.

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. The group acknowledges the challenge of preventing all incidents as the capabilities and tactics of malicious actors advance; the group focuses its 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 approach, with an emphasis on delivering controls against identified external and internal threats.

The cyber risk management life cycle is aligned to the group's broader approach to operational risk management. The group has strategic partnerships with external experts, participates in industry forums 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 Risk Committee has oversight of the group's cyber risk profile, supported by detailed oversight from the Operations and Technology Risk Committee ("OTRC").

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 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 which is responsible for maintaining the framework, tool sets and reporting necessary for effective operational risk management. Operational risk managers are aligned to businesses, with an additional 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 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 Risk Committee. In the last year, these have covered third-party risk, cyber risk and operational resilience more broadly. 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.

Outlook

The operational risk profile has broadly remained stable compared to the prior period. Key drivers remain market-wide people risks relating to recruitment and retention, industry-wide security, cyber threats and some continued supply chain impacts arising from the Russia/Ukraine conflict and the potential for increasing trends in attempted external fraud coinciding with increasing cost of living pressures. The group is investing in data and tooling capability to support greater management insights and coupled with continued investments across its businesses, it continues to deliver and focus on improved control maturity.

Reputational risk

Reputational risk is the risk of detriment to stakeholder perception of the group, leading to impairment of its reputation 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 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 ethical attributes. The group has no tolerance for behaviours that contradict these attributes in a manner that could harm it, and avoids engaging with third parties, markets or products that would inhibit the group'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.

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

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.

Risk Report continued

Principal risks

Core Drivers of Reputational Risk

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 life cycle;
- 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 implementation 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 group, reinforcing its commitment to favourable client outcomes. Regular engagement with 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 group appropriately addresses its sustainable and responsible priorities and expectations of wider stakeholder groups.

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.

Traded market risk

Traded market risk is 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.

Exposure

Traded market risk in the group only arises in Winterflood, 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 and FX forwards.

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 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 group's risk appetite. The framework incorporates:

- market risk appetite being managed via trading book exposure 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 FX exposures against agreed limits; and
- minimal exposure to derivatives (limited to hedging of interest rate exposures and FX positions resulting from positions in foreign securities).

Mitigation (audited)

The management of traded market risk is fully embedded within 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 the front office controls team. This training includes market risk considerations as well as details on order entry controls;
- the maintenance of risk mandates for all traders, detailing the group'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 GRCC and Risk Committee where needed;
- the maintenance of a group Market Risk Policy and a specific Traded Market Risk Standard at Winterflood, outlining minimum governance requirements and escalation. Implementation of these requirements is achieved through documented front office procedures;
- order entry controls in place across the trading floor limiting, amongst other trading variables, the executable value per order (these are documented in a front office procedure); and
- daily total value traded caps to limit the amount the business can trade through a single broker.

Monitoring

Building on the use of real-time limit monitoring, 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 management information 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, management information dashboards are utilised alongside daily reporting to help manage market risk on a daily and intraday basis.

Risk Report continued

Principal risks

Outlook

Several themes have driven markets over the past 12 months: inflation, rising interest rates, supply chain issues, industrial action and the knock-on impacts these factors have had on the economy. These factors, coupled with ongoing geopolitical uncertainty, will continue to be themes over the next 12 months, with the potential to keep market liquidity low and suppress market valuations if recessionary fears play out further.

In a rising interest rate environment seeking to combat high inflation, following an extended period of low interest rates, and where the government, institutions and households may be servicing increased levels of debt, the probability of another credit event impacting financial markets is elevated. It is therefore important to ensure disciplined allocation of capital within the trading book in line with our prudent approach, and that robust reporting and control frameworks are embedded to help manage exposures and the potential for losses.

Trading Financial Instruments: Equity Shares and Debt Securities (Audited)

The group's trading activities relate to Winterflood. The following table shows the group's trading book exposure to market risk:

	Highest exposure £ million	**Lowest exposure £ million**	**Average exposure £ million**	**Exposure at 31 July 2023 £ million**
For the year ended 31 July 2023				
Equity shares				
Long	**68.3**	**21.8**	**28.3**	**27.8**
Short	**20.1**	**4.7**	**7.7**	**6.4**
Net position			**20.6**	**21.4**
Debt securities				
Long	**37.4**	**10.6**	**15.8**	**15.2**
Short	**11.8**	**3.6**	**6.4**	**3.5**
Net position			**9.4**	**11.7**

	Highest exposure £ million	Lowest exposure £ million	Average exposure £ million	Exposure at 31 July 2022 £ million
For the year ended 31 July 2022				
Equity shares				
Long	54.0	25.3	32.6	27.1
Short	28.9	5.3	10.0	7.9
Net position			22.6	19.2
Debt securities				
Long	23.8	14.2	19.5	12.4
Short	16.1	7.2	11.5	7.5
Net position			8.0	4.9

With respect to the long and short positions on debt securities, £11.0 million and £0.3 million (2022: £8.0 million and £1.7 million) were due to mature within one year respectively.

The average exposure has been calculated on a daily basis. The highest and lowest exposure columns reflect the absolute maximum and minimum long and short debt and equity exposures across the relevant period (rather than the maximum and minimum net position).

Based upon the 31 July 2023 trading book exposure given above, a hypothetical fall of 10% in equity prices would result in a £2.1 million decrease (31 July 2022: £1.9 million decrease) in the group's income and net assets. A hypothetical 10% fall across the fixed income desk would result in a £1.2 million decrease (31 July 2022: £0.5 million decrease) in the group's income and net assets. However, the group's trading activity is mainly market-making, in which positions are managed throughout the day on a continuous basis. Accordingly, the sensitivity referred to above is purely hypothetical.