C. Hoare & Co.

Capital and Risk Management
Pillar 3 Disclosures
Year ended 31 March 2018

1. Introduction

This document presents the consolidated Pillar 3 disclosures of C. Hoare & Co. and its subsidiaries, Messrs Hoare Trustees, Mitre Court Property Holding Company, Hoare's Bank Nominees Limited, Hoare's Bank Pension Trustees Limited and C. Hoare & Co. EIG Management Limited ("the Group"), as at 31 March 2018.

C. Hoare & Co. ("the bank") is an unlimited company with share capital, which is incorporated and domiciled in the United Kingdom and has its registered office and principal place of business at 37 Fleet Street, London, EC4P 4DQ. The bank's principal activity, together with its subsidiaries, is the provision of banking and ancillary services to a predominantly high net worth customer base.

On 1 January 2014 the new Capital Requirements Directive (2013/36/EU) (CRD) and Regulation ((575/2013) (CRR), (together referred to as CRD IV)) came into force within the European Union, implementing the Basel III reforms developed by the Basel Committee on Banking Supervision (BCBS). Basel III is part of the Committee's continuous effort to strengthen the regulation, supervision, and risk management of the banking sector.

The Basel framework consists of three 'pillars':

- Pillar 1 sets the minimum regulatory capital requirements for credit, market and operational risk;
- Pillar 2 requires a self assessment of the additional regulatory capital, over and above Pillar 1, required to cover specific risks related to the firm. This process is covered as part of the Internal Capital Adequacy Assessment Process (ICAAP), and is assessed by the Prudential Regulation Authority (PRA) during its Supervisory Review and Evaluation Process (SREP). The PRA sets a firm's Individual Capital Guidance (ICG) based on the review of its ICAAP;
- Pillar 3 complements Pillar 1 and Pillar 2 and aims to encourage market discipline through the disclosure of key information regarding risk exposures and risk management processes.

2. Disclosure Policy

The following sets out a summary of the disclosure policy applied to the Pillar 3 disclosures, including the basis of disclosure, frequency, media, location and verification.

2.1 Basis of Disclosure

This document sets out the consolidated Pillar 3 disclosures of C. Hoare & Co. and its subsidiaries as at 31 March 2018 and has been prepared in accordance with the requirements of Part Eight of the CRR. The purpose of these disclosures is to provide information on the basis of calculating Basel III capital requirements and on the management of risks faced by the bank.

The bank provides certain disclosures as part of the bank's Annual Report and Consolidated Financial Statements. The principal risks affecting the bank are presented in the Strategic Report on pages 3 to 6. Further detail is provided in Note 29 'Financial Risk Management' on pages 65 to 75. Risk management and governance structure is disclosed in the Directors' Report on pages 7 to 12.

The Pillar 3 Disclosures are prepared annually based upon the financial information prepared for the Financial Statements to the 31 March of each year, and is available on the bank's website:
www.hoaresbank.co.uk.

2.2 Verification

The Pillar 3 disclosures were reviewed and approved by the Board on 17 May 2018. These disclosures have not been externally audited; however, some of the information contained within the disclosures also appears in the bank's Annual Report and Consolidated Financial Statements.

3. Scope of Consolidation

The bank is supervised and authorised in the United Kingdom by the PRA and regulated by the Financial Conduct Authority (FCA) (together "the Regulators").

The bank continues to solo consolidate under Article 9 of the CRR (individual consolidation method). Solo consolidation enables the reserves of the solo subsidiaries to be aggregated to the parent when calculating capital resources. Messrs Hoare Trustees is included under solo consolidation and is subject to PRA approval. There are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or the repayment of liabilities within the Group.

4. The Regulatory Capital Framework

The bank's regulatory capital framework is defined by the CRD IV as implemented in the United Kingdom by the PRA, under Policy Statement PS7/13 Strengthening capital standards: implementing CRD IV, feedback and final rules in December 2013. The bank is supervised and authorised in the United Kingdom by the Regulators and submits quarterly capital adequacy returns to the regulator.

The regulatory capital framework is categorised under three pillars.

- Pillar 1, sets out the minimum regulatory capital requirements for credit, market and operational risk. As of 1 January 2015, banks are required to meet a minimum Common Equity Tier 1 (CET 1) ratio of 4.5% of risk weighted assets (RWAs), a minimum Tier 1 ratio of 5.5% of RWAs and a total capital ratio of 8% of RWAs.
- Pillar 2 requires an assessment by firms as set out below:
    - Pillar 2A sets out the additional regulatory capital as determined by the PRA, through the issuance of bank specific Individual ICG, following the Internal ICAAP, as part of the SREP. Pillar 2A was previously met by total regulatory capital, but since 1 January 2015, in accordance with the PRA Supervisory Statement SS5/13, this must now be met with at least 56% CET 1.
    - Pillar 2B is the PRA Buffer where the PRA may impose a firm specific buffer incremental to Pillar 1, Pillar 2A and the CRD IV buffers and replaces the Capital Planning Buffer. This PRA buffer became effective on 1 January 2016 and will be held by firms in the form of CET 1, to absorb losses that may arise under a severe, but plausible stress, in line with CRD IV rules. The PRA buffer will be set taking account of the CRD IV buffers.

CRD IV introduced a number of capital buffers, which are required to be met from CET 1 capital:

- Capital Conservation Buffer (CCoB) is a standard buffer and is calculated as 2.5% of RWAs, designed to provide for losses in times of stress. The CCoB came into effect on 1 January 2016 and is being phased in until 1 January 2019, starting at 0.625% from 2016 and increasing each subsequent year by an additional 0.625% to reach 2.5% by 1 January 2019. Based on the requirements, as at 31 March 2018, the CCoB applicable to the bank was 1.875% of RWAs.
- Countercyclical buffer (CCyB) is designed to require banks to hold additional capital to remove or reduce the build up of systemic risk in times of credit boom. The buffer can be drawn down to absorb losses during periods of stress. The Financial Policy Committee (FPC) is responsible for setting the UK CCyB rate, within a range of 0% - 2.5%, which would be applicable to UK exposures of banks incorporated in the UK. The FPC announced in June 2017 that the UK CCyB would increase from 0% to 0.5%, with effect from 27 June 2018. The FPC confirmed in November 2017, that this rate would increase from 0.5% to 1.0%, with effect from 28 November 2018.
- Systemic buffer is an additional buffer of up to 3% of RWAs for certain banks which are deemed to be 'systemically important', either globally or domestically. This is not applicable to the bank.

- Pillar 3 complements Pillar 1 and Pillar 2 and aims to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess the scope of application of Basel III, capital, risk exposures and risk assessment processes, and hence the capital adequacy of the firm. The disclosures are to be produced in accordance with Part Eight of the CRR within CRD IV which was directly applicable in the UK from 1 January 2014.

5. Regulatory Developments

- The Basel Committee published the final reforms of the Basel II framework in December 2017. The purpose of the reforms is to restore credibility in the calculation of risk weighted assets and to improve comparability between bank's capital ratios. The changes include improving the risk sensitivity of the risk weights under the standardised approach to credit risk; replacement of the operational risk approaches with a single methodology and changes to the exposure measure for the leverage ratio. The Basel Committee has proposed that the final reforms will be implemented on 1 January 2022.
- The European Commission published in November 2016, its draft proposals to make revisions to the existing Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD), including a number of new banking reforms (collectively referred to as 'CRR2'). These proposals are currently under negotiation and include a binding 3% leverage ratio as a Pillar 1 requirement; a binding 100% NSFR and revisions to the Pillar 3 framework. Implementation is expected by 2020 at the earliest.

  The bank monitors and assesses the potential impacts of ongoing regulatory developments.

6. Risk Management

The bank and Group's business is stable and concentrates on the supply of banking and ancillary services to generations of customers. Regular patterns of income and expenditure emerge and are well understood by the bank. This stability enables the Board and management to monitor risks closely and to detect and manage any emerging changes at an early stage.

The bank's approach to risk management is to maintain a balance between risk and potential reward that achieves its strategic objectives without exposing the bank to unacceptably high residual risks.

The bank's risk management objectives and policies are supported by its risk governance structures and risk management framework, including its processes for identifying, assessing, monitoring and mitigating its principal risks in accordance with its risk appetite.

6.1 Risk Appetite Framework

The Board has ultimate responsibility for the management of risk within the bank. It discharges this responsibility with the help of the bank's risk appetite framework, which describes the strategy, governance and protocol in place for the management of risk. The framework has eight elements and is based upon principles established by the bank's regulators:

- The Board sets the bank's strategy and defines risk appetite and risk management strategy
- Roles and responsibilities are defined
- Risk training is undertaken and awareness raised, including common language and definitions
- Risks are identified, measured, monitored and reported on
- Policies and procedures are in place to control and mitigate identified risks, and business continuity planning is undertaken
- Scenario analysis and stress testing is performed, including reverse stress tests and recovery and resolution planning
- Capital adequacy and liquidity risk are assessed
- Regular independent audits and reviews are undertaken

During the course of 2017, a full review of the risk management framework was undertaken. This review resulted in the creation of a new risk taxonomy and the removal of Wealth-specific risks following the sale of the Wealth business earlier in 2017.

The design of the risk management framework was driven by the principles and guidance prescribed by the Committee of Sponsoring Organisations ("COSO"), the International Organisation for Standardisation ("ISO") and the Basel Committee for Banking Supervision ("BCBS").

The key design principles are:

Principle	Description
Protective	Risk management must protect the net asset value and commercial reputation of the Bank whilst maintaining compliance with all applicable regulatory requirements.
Proportionate	Risk management activities must be proportionate to the size of the Bank's operations and relative levels of risk to which the Bank is exposed.
Aligned	Risk management activities must be aligned across the Bank's departments and functions.
Comprehensive	Risk management must consider all current and emerging risks that apply across the Bank's departments and functions, including third party providers.
Embedded	Risk management activities must be core to the Bank's operating model and embedded in day-to-day business activities which are supported by a strong culture of risk awareness from the Board.
Dynamic	Risk management activities must be robust, dynamic and responsive to changes to the Bank's external environment, changes to the Bank's business model and emerging regulations.

The new framework is designed to be flexible, such that new risks can be added as the nature of the business changes. It is expected that the risk framework will continue to evolve through usage and embedding within the business.

6.2 Risk Management Objectives and Policies

The main risk management objectives are:

- reduce the level of uncertainty associated with achieving the bank's strategic objectives
- to ensure significant risks are identified, measured, managed, monitored and reported in a consistent and effective manner across the bank using appropriate risk management methodologies
- to embed a culture of risk awareness and control consciousness in all business activities
- integrate/consolidate all components of risk information to provide a comprehensive picture and understanding of C. Hoare & Co.'s risk exposure to the Management Committee, Audit, Risk & Compliance Committee and the Board whereby performance can be evaluated on a more risk adjusted basis and risk/reward decisions optimised
- articulate and communicate the Board's risk appetite and ensure the bank's risk profile is consistent with it

6.3 Governance Structure

The bank's risk governance structures assign roles and responsibilities to a number of committees and individuals focused on managing the principal risks faced by the bank.

The primary structures from 1 June 2017 are shown below:

Table 1: Governance Structure

Board of Directors	
Remuneration & Nominations Committee	**Audit, Risk & Compliance Committee**
Management Committee	
Banking Committee	**Assets & Liabilities Committee**

Overview of Risk Governance Structure

Board of Directors

The Board of Directors (Board) is the key governance body and is responsible for the overall strategy, performance of the business and ensuring adequate and effective risk management. The Board is ultimately responsible for the Bank's systems and controls and for reviewing the effectiveness of those arrangements. However, such arrangements are designed to mitigate, not eliminate, risk and therefore can provide only reasonable, but not absolute, assurance against fraud, material losses or financial misstatements.

The Board considers that its risk management arrangements, including its risk management systems and controls, are adequate with regard to the Bank's profile and strategy.

In addition to subsidiary boards the Board has established two committees to support the execution of its responsibilities:

- Remuneration & Nominations Committee (RemCo)
- Audit, Risk & Compliance Committee (ARCCo)

The Board has delegated day-to-day executive management of the Bank to the Managing Director (the MD) and has established a Management Committee to assist in the management of the business and delivery against the strategy in an effective and controlled way. The Management Committee has in turn established two sub-committees:

- Banking Committee (BC)
- Asset and Liability Committee (ALCO)

In addition to these structures, there are a number of other committees and working groups which report their activities, as appropriate, to one of the primary structures above.

Group subsidiary companies and boards

Each of the Group's subsidiary companies has its own board of directors. Hoare's Bank Pension Trustees Limited (HBPT) acts as trustee over the Group's defined benefit pension scheme and, in addition to two Partner directors, has three non-Partner directors: two directors nominated by the members of the pension scheme and an external professional pension trustee director.

Most of the Group's subsidiary companies do not undertake any material commercial activities or are dormant. The exception is Messrs Hoare Trustees (MHT), which carries on the business of acting as Executor or Trustee or both Executor and Trustee. MHT's board meets quarterly and the minutes of their meetings are reviewed by the Group board.

Board Declaration on the Adequacy of Risk Management Arrangements

The Board is ultimately responsible for the bank's systems and controls and for reviewing the effectiveness of those arrangements. However, such arrangements are designed to mitigate, not eliminate, risk and therefore can provide only reasonable, but not absolute, assurance against fraud, material losses or financial misstatements.

The Board considers that its risk management arrangements, including its risk management systems and controls, are adequate with regard to the bank's profile and strategy.

Board Approved Risk Statement

The bank's strategic objective is to build long-term relationships with all of our customers and to offer an exceptional and personalised service. Offering multiple banking and ancillary services and expertise under "one roof" enables us to combine the delivery of these services, wherever possible, to make it convenient, consistent and efficient for our customers. The bank seeks to achieve its strategic objective in a manner consistent with the Hoare family's vision to perpetuate a profitable family business.

The bank's strategy is pursued within a defined risk appetite framework approved by the Board, which defines the levels of risk acceptable for a given category of risk, as well as the levels of capital and liquidity the bank should hold in view of its risks. These risk appetite measures are integrated into decision-making, monitoring and reporting processes, with early warning triggers set to provide opportunities to implement management actions before the overall limits are reached.

A comprehensive set of measures are used to monitor the bank's risk profile. The following table provides a selection of some of the most significant measures:

Category	Metric	Measure as at 31 Mar 2018
Capital	Common Equity Tier 1 Ratio	21.52%
	Total Capital Ratio	21.64%
	Leverage Ratio (including profits)	7.5%
Liquidity	Unencumbered assets as a percentage of total assets	96%
	Loan : Deposit Ratio	41%
	High quality liquid assets as a percentage of total assets	38%
Profitability & Growth (for the year ended)	Customer Lending Growth	6.4%
	Deposit Growth	4.7%
	Net Interest Margin	2.03%
	Income Growth (continuing operations)	14%
	Cost Growth (continuing operations)	-4%
	Cost:Income Ratio (continuing operations)	70.1%
	Profit Before Tax (continuing operations)	£28.8m
Credit Risk	Non-performing loans as a percentage of gross lending	35bps
	Provisions (general + specific) / non-performing loans	88%
	Provisions as a percentage of gross total lending	31bps
	Impaired treasury assets as % age of total assets	0bps
Market Risk	Net Interest Income Sensitivity (+/- 200 basis points)	£0.1m
	Treasury assets as a percentage of total deposits	69%

Directorships held by members of the Board

The number of external directorships and partnerships held by the Executive and Non-Executive Directors on the Board, in addition to their roles within the bank are detailed below:

Table 2: Directorships

		Commercial directorships[1]	
Name	**Position**	**Total positions**	**No. separate groups**
Mr A. S. Hoare*	Executive Director	1	1
Miss V. E. Hoare*	Executive Director	0	0
Mr S. M. Hoare*	Executive Director	0	0
Miss A. S. Hoare*	Executive Director	2	2
Mr A.R.Q. Hoare*	Executive Director	0	0
The Lord Macpherson of Earl's Court GCB	Chairman	2	2
Mr D. Green	Chief Executive Officer/Managing Director	1	1
Mr A. J. McIntyre	Non-Executive Director	3	3
Mrs J.E.M Waterous[2]	Non-Executive Director	4	4
Dame Susan Rice[3]	Non-Executive Director	4	4

At 31 March 2018, the Board of Directors included five Directors (those marked with an asterisk in the list above) who are all descendants of the bank's founder. They, and two other Hoare family members, are the bank's only shareholders and each has unlimited liability. They are known as Partners and all work in the business to ensure the continuation of the bank's long-held culture, values and approach to business.

Remuneration & Nominations Committee (RemCo)

The Remuneration & Nominations Committee has two main purposes. The first, in consultation with the Partners, is to oversee the appointment of new Directors to the Board and members of the Management Committee. This includes succession planning, with the aim of achieving an appropriate balance of skills and experience; ensuring that there is a formal, transparent and rigorous process for selection; and overseeing the balance of Partners/Directors and Non-Executive Directors. The second is to set the principles, parameters and governance of remuneration policy across the bank and to consider and approve the remuneration of the Partners, Management Committee and Identified Staff.

Board Recruitment and Diversity Policies

The RemCo periodically reviews the composition of the Board and its Committees in order to identify and recommend for approval candidates to fill Board vacancies, having evaluated the balance of knowledge, skills, diversity and experience of the Board. The Committee may also recommend a target for the representation of the underrepresented gender in the Board and prepare a policy on how to increase the number taking into account the bank's strategy.

While the Board has not set a specific diversity target, it is satisfied with the current level of gender diversity as at 31 March 2018:

- 50% of four Non-Executive Directors are female, and
- 29% of seven family related Shareholders (Partners) are female, of whom,
- 40% of five family related Directors are female.

[1] Table shows the total number of commercial board positions and the number of separate unrelated groups to which those positions relate (see SYSC 4.3A.7 at https://www.handbook.fca.org.uk/handbook/SYSC/4/3A.html)
[2] Mrs J.E.M Waterous was appointed to the Board with effect from 3 July 2017.
[3] Dame Susan Rice was appointed to the Board with effect from 8 January 2018.

Audit, Risk & Compliance Committee (ARCCo)

The ARCCo has two main purposes:

The first is to review the effectiveness and provide independent oversight of the bank's systems of internal controls and financial reporting process, which is achieved through the ongoing review of the quality, independence and effectiveness of the control functions.

In this respect, the Committee performs the following duties:

Financial Reporting	The committee shall monitor the integrity of the financial statements of the company and any other formal announcement relating to its financial performance, reviewing and reporting to the board on significant financial reporting issues and judgements which they contain having regard to matters communicated to it by the auditor.
Narrative Reporting	The committee shall review the content of the annual report and accounts and advise the board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance and financial position.
Internal Controls & Risk Management Systems	The committee shall keep under review the adequacy and effectiveness of the company's internal financial controls and internal control and risk management systems and review and recommend for Board approval the statements to be included in the annual report concerning internal controls and risk management.
Whistleblowing	The committee shall review the adequacy and security of the company's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.
Internal Audit	The committee shall have oversight of all aspects of the internal audit programme, including: approving the appointment or termination of the head of internal audit; reviewing and approving the charter of the internal audit function and ensuring the function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors; and monitoring and reviewing the effectiveness of the company's internal audit function, in the context of the company's overall risk management system.
External Audit	The committee shall have oversight of all aspects of the external audit programme, including: considering and making recommendations to the board, in relation to the appointment, re-appointment and removal of the company's external auditor; overseeing the relationship with the external auditor; meeting regularly with the external auditor; reviewing and approving the annual audit plan and ensuring that it is consistent with the scope of the audit engagement, having regard to the seniority, expertise and experience of the audit team; and reviewing the findings of the audit with the external auditor.

The second purpose of the ARCCo is to provide the Management Committee and the Board with appropriate oversight and challenge on risk management, to embed a culture of risk awareness and control consciousness within the bank, and to ensure the bank's compliance with the legal and regulatory framework governing the activities of the bank and its associated businesses. In this respect, the ARCCo performs the following duties:

Policy reviews	The committee provides appropriate oversight and challenge on the risk appetite framework, statements and metrics, the ICAAP, the ILAAP, and associated stress testing and scenario analysis. The committee also approves or recommends approval of the bank's risk management and compliance policies in accordance with its delegated authorities.
Risk Management	The committee monitors the effectiveness of the bank's risk management framework and ensures that the bank is operating in accordance with its risk appetite. The committee reviews the findings of line management's risk and control self assessments (RCSAs), and challenges these as appropriate.
Compliance	The committee approves the Compliance advisory and monitoring programmes, and checks regularly on their delivery.
Money Laundering	The committee provides oversight of the work of the MLRO.
Data Protection	The committee provides oversight of the work of the Data Protection Officer.
Information Security	The committee provides oversight of the work of the Information Security Officer.
Client Money/Assets	The committee provides oversight of the work of the Client Asset Oversight Officer (CF10a).
Escalation	The committee escalates to the attention of the Board matters of concern, arising either internally or externally, and may advise taking certain actions to mitigate the bank's risks.
Remuneration	The committee advises the RemCo of any relevant risk factors.

Management Committee

The Board has delegated the day-to-day responsibility for running the bank to the Managing Director (MD) who is supported by the Management Committee. The Management Committee recommends and delivers against the bank's strategy in an effective and controlled manner by providing for the general executive management of the business and facilitating cross-functional communication and liaison. The respective Management Committee members are responsible to the Managing Director and Board for managing performance in line with the long-term plan, strategy, budget and risk appetite.

The Management Committee is comprised of:

- Managing Director
- Head of Private Banking
- Chief Finance and Operations Officer
- Head of Human Resources and Business Services
- Head of Treasury
- Head of Compliance and Risk
- Chief Digital and Information Officer

The Management Committee has established sub-committees to support its activities, descriptions of which follow. All decisions of these sub-committees are potentially subject to Management Committee review.

Banking Committee (BC)

The purpose of the Banking Committee is to oversee day-to-day activities of the Banking (or Managers) business, including oversight of its day-to-day deposit and lending activities.

Asset and Liability Committee (ALCO)

The purpose of the Asset and Liability Committee is to oversee the bank's balance sheet, including free capital. It is also responsible for allocating funds within the balance sheet so as to manage liquidity, currency risk, capital adequacy and profitability. The Deposit Committee is a sub-committee of ALCO. The matters of setting of Deposit and Lending rates are reserved for the ALCO.

6.4 Risk Appetite Statements

The objectives of the bank's Risk Appetite Statements are:

- to provide clear boundaries to determine whether an exposure is or is not acceptable
- to provide a benchmark for setting limits and thresholds for specific categories of risk
- to act as a tool for prioritising risk significance
- to ensure strategic decisions are made considering the inherent risks involved and that mitigants and controls are put in place to manage these to within risk appetite

Risk appetite statements are expressed as quantitative measures, hard measures that describe the type and quantum of risk, and qualitative measures, which recognise that not all risk is measurable but can affect achieving strategic objectives. Zero tolerance measures and identifies risks we wish to avoid.

Risk Appetite: Guiding Principles

The bank has approved an overarching Risk Appetite Statement as the guiding principles for setting all other statements and metrics:

Our mission is to perpetuate a profitable family business. We are willing to take risks if they are:

- Consistent with our values and do not jeopardise our reputation.
- Properly understood and not of a size to "bet the bank".

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Risk Appetite: Responsibilities

Risk appetite responsibilities are based on the three lines of defence assurance model, the Board oversees all three lines of defence:

First line of defence – People responsible for day to day risk management and control

Each business unit is responsible for operating within the risk appetite boundaries; ensuring appropriate key risk indicators are identified and thresholds set; regularly monitoring indicators and reporting any issues to the Management Committee, Risk Management Function and /or Compliance.

The Management Committee is responsible for cascading down risk appetite into more meaningful and detailed expressions of limits applicable to each business function.

Second line of defence – Risk oversight, policies and methodology

The Risk Management Function is responsible for developing and maintaining the risk appetite framework and statement for approval by the ARCCo and the Management Committee.

The Risk Management Function is responsible for reporting breaches of risk appetite to the Management Committee, ARCCo and the Board.

The ARCCo is responsible for reviewing and recommending an appropriate risk appetite statement to the Board.

Third line of defence – Independent assurance

Internal Audit provides independent assurance on the effectiveness of risk management and the internal control framework and validates the Risk Appetite Statement.

The ARCCo maintains oversight and monitors the effectiveness of internal control and risk management processes and reports to the Board.

Risk Appetite: Monitoring and Reporting

Performance against risk appetite is monitored through risk appetite indicators for all risk categories plus risk and control self-assessments which establish acceptable levels of residual risk for operational risks. Should risk appetite be exceeded, whether identified by monitoring indicators, risk and control self-assessment or other means, the following actions are taken:

- The Board, ARCCo, Management Committee and relevant sub committees are made aware
- Steps are taken to mitigate/avoid and prevent recurrence, which may include implementing additional controls
- Root cause analysis is undertaken and the costs and benefits of mitigating options are investigated
- Actions taken are clearly recorded

Risk Appetite: Review

The Board will periodically (at least annually) restate or confirm the level of risks that are acceptable as part of the annual strategy to ensure that the boundaries remain aligned with the bank's strategic objectives.

6.5 Risk Assessment

The bank uses a risk register to record risks that have been identified, assessed, evaluated and prioritised as part of the risk and control self-assessment process.

The bank has adopted an enterprise wide risk management approach and all risk categories are recorded in the register.

The inherent risk (the risk evaluation without considering controls) is measured in terms of impact and likelihood to determine the level of control or further mitigation required. An owner is assigned to each risk and control.

6.6 Reputational Risk Assessment

The bank's standing in the eyes of customers, counterparties and the general public is of critical importance. Reputational risk is seen as a consequence of other risk types and so is not defined as an individual risk category within the bank's framework. For example a major fraud (operational risk) that received extensive press coverage might damage the bank's reputation. Therefore an appraisal of potential reputational damage is included in the assessment of all risk types.

6.7 Controls and Mitigants

As part of the risk and controls self-assessment process management will consider whether appropriate controls are in place and the effectiveness of these controls.

Once all controls have been considered the residual risk (the level of risk left after taking into consideration the effect of controls) is evaluated in terms of impact and likelihood of the risk occurring with the controls in place.

6.8 Risk Indicators

Risk appetite indicators are used to monitor and articulate risk appetite. The thresholds are used to identify when corrective actions need to be taken to manage the risk profile of the bank.

In addition to risk appetite indicators key risk indicators are used (KRIs)[4] and set by the business unit; these are used to identify potential risk management and control performance issues. Each business unit is responsible for identifying appropriate KRIs to highlight the current level of risk and provide early warning signals which identify changes in the risk environment, control effectiveness and potential risk issues.

6.9 Assurance

Regular audits of policy and standards of compliance are carried out and standards of performance reviewed, to help identify any opportunities for improvement.

6.10 Reporting

Information is collected from the risk management database and regular reports are submitted to senior management. The Board receive regular reports which include:

- emerging risk issues;
- new or significantly changed key risk exposures;
- breaches of risk appetite;
- control weaknesses and actions to address these;
- breaches of key risk indicator thresholds;
- the operational risk profile; and
- details of operational risk incidents including material loss events, near misses and potential losses.

Business units report to senior management and the Board half-yearly a review of their existing risks and any new or significantly changed risk exposures. The review considers the outcomes of regular risk and control self-assessments and any actions taken to address weaknesses identified.

Any breaches of thresholds or risk appetite are escalated to senior management and actions are established and tracked to resolve issues identified.

6.11 Policies

The following policies govern the bank's approach to risk management and set out the rules, procedures and limits that must be adhered to:

- Risk Management Framework
- Risk Appetite Framework (including Risk Appetite Statements & Metrics)
- Capital Policy/Internal Capital Adequacy Assessment Process (ICAAP)
- Liquidity Policy/Internal Liquidity Adequacy Assessment Process (ILAAP)
- Liquidity Contingency Plan
- Recovery & Resolution Plan

[4] The term KRI encompasses both risk and control indicators

- Large Exposures Policy
- Lending Policy
- Trading Book Policy
- Additionally a further set of policies cover specific operational risks

Internal Capital and Liquidity Adequacy Assessment Processes (ICAAP & ILAAP)

The bank's evaluation of capital and liquidity adequacy is primarily made through the ICAAP and the ILAAP which are the processes by which the firm oversees and regularly assesses:

- The firm's strategies, processes, systems and controls;
- The material risks to the firm's ability to meet its liabilities as they fall due;
- The results of internal stress testing of these risks; and,
- The amounts and types of capital and liquidity resources available and whether they are adequate to cover the nature and level of risks to which the firm is exposed.

The ICAAP and ILAAP processes are owned on behalf of the business by the Finance department. Risk Management facilitates and challenges certain aspects of these processes, in particular with respect to the development of the bank's key risks and the scenarios which underpin the capital and liquidity calculations.

The ICAAP and ILAAP documents are additionally challenged in turn by the Management Committee (and its subcommittees as appropriate) and the ARCCo, eventually leading to challenge and approval by the Board at least once annually or more frequently if circumstances warrant. The ICAAP and ILAAP are subject to regular review by Internal Audit to confirm that the bank is compliant with the regulatory requirements.

The ICAAP/ILAAP processes are integrated elements of the bank's Risk Appetite Framework and as such are embedded in many aspects of the bank's business, risk management and corporate governance activities. The ICAAP and ILAAP lead to an internal assessment of the capital and liquidity that the bank believes appropriate for it to hold to protect it and its customers' deposits from the impact of stress events.

6.12 Key Risks

The following table summarises the bank's Risk Framework. This risk categorisation accounts for the bank's entire risk universe. As such, all of the risks and controls identified in the bank's risk register, as well as any reported errors, incidents, or complaints, are mapped to at least one of the risk categories. In addition, Risk Appetite Statements and Key Risk Indicators are developed for each, which facilitate the management of these risks holistically across the bank.

Key Risk Category	Level 1 Risk	Level 1 Risk Description
Strategic: The risk that the bank fails to achieve its strategic goals or objectives as a result of poor business decisions, or failing to respond proportionately to changes in the external business environment.	Business Model Risk	The risk relating to the loss of revenue or market share due to price, product, promotion or distribution actions of a competitor.
	External Environment Risk	The risk of failing to identify and effectively respond to macroeconomic, regulatory and political change.
	Concentration Risk	The risk of loss arising from a large position in a single asset class, customer base, industry sector, region, industry or product.
	Relationship Management Risk	The risk that the bank fails to constantly develop, manage and maintain high quality relationships with customers throughout their relationship with the bank.
Credit The risk that a customer or counterparty fails to meet its obligations to the bank in accordance with agreed terms and defaults on a debt.	Customer Lending	The risk of financial loss as a result of customers failing to meet their obligations in accordance with agreed contractual terms.
	Counterparty Risk	The risk relating to the failure (or suspected failure leading to a provision) of the ability of a counterparty to repay or service a debt, or the default of the reference obligor of a credit derivative.
	Product	The risk that products offered by the bank are inadequately designed and marketed and do not contribute to profitability targets.
Operational The risk that the bank fails to have robust and well-designed processes, systems and procedures in place to identify and effectively manage the risks that negatively impact the delivery of day to day business operations.	Customer Service Risk	The risk that the bank fails to deliver high quality and consistently reliable services to customers on a day to day basis.
	Outsourcing and Third Party Risk	The risk that the use of a third party service provider to support the bank's operations results in business disruption or causes a negative impact to the bank.
	Information Technology (IT)	The risk that the organisation's technology services are unable to effectively support business processes.
	Business Continuity Management and Disaster Recovery	The risk of failing to have systems, procedures and practices in place to recover and continue business operations during or after a major incident or disaster with minimal impact to customers.
	Facilities Management	The risk that the bank fails to maintain safe and physically secure business premises for staff, contactors and visitors which comply with all requirements set out by current workplace health and safety legislation.
	Change Management Risk	The risk that the bank fails to effectively plan and implement change projects resulting in disruption to the bank's business operations and service delivery to its customers.

Key Risk Category	Level 1 Risk	Level 1 Risk Description
Finance The risk that the bank experiences instability or fails to comply with all statutory financial reporting requirements as a result of failed controls or processes.	Capital Risk	The risk of failing to comply with Basel III regulations regarding the minimum capital requirements needed by the bank for current operations.
	Liquidity Risk	The risk that the bank fails to have sufficient sources of liquidity available to immediately convert into liquid assets to meet short term financial demands without incurring a loss of capital and/or income in the process.
	Market Risk	The risk of losses in, on and off balance sheet positions arising from adverse movements in market prices.
	Finance Operations Risk	The risk of failing to have adequate systems and processes in place to ensure the accurate and timely delivery of finance operations within the bank.
Legal and Compliance The risk that the bank fails to act in accordance with industry laws and regulations, internal policies or prescribed best practices, resulting in legal penalties, financial forfeiture and / or material loss.	Legal Risk	The risk of litigation, adverse court judgments or contractual agreements that turn out to be unenforceable, disruptive or have an adverse effect on the bank's operations.
	Regulatory Compliance Risk	The risk of loss arising from changes in regulations and actions by international or national regulators, which can result in increased competitive pressures and significantly affect the bank's ability to efficiently conduct business.
	Financial Crime	The risk of loss arising due to financial crime, which covers fraud, forgery, alteration of documents, counterfeiting, fictitious information, substitution of information or impersonation, amendment, deletion, unauthorised release of or addition to information or data, corruption and bribery.
	Data Privacy and Security	The risk of failing to embed systems and processes that robustly and effectively manage the availability, usability, integrity, and security of data held by the bank.
People, Conduct and Culture The risk that the bank fails to create and maintain a safe and ethical business environment staffed with personnel who are adequately skilled to deliver the bank's services to a high standard.	People Risk	The risk of non-availability of competent staff to execute key processes necessary for the bank to operate effectively, ethically and within the boundaries of all applicable regulations and legislation.
	Conduct Risk	The risk that the actions of the bank lead to customer detriment or negatively impacts market stability.

6.13 Risk Management by Category of Risk

Under GENPRU 1.2.30, firms must have in place sound, effective and complete processes, strategies and systems:

1) To assess and maintain on an ongoing basis the amounts, types and distribution of financial resources, capital resources and internal capital that it considers adequate to cover:

    a) The nature and level of the risks to which it is or might be exposed;
    b) The risk in the overall financial adequacy rule; and
    c) The risk that the firm might not be able to meet its capital resources requirement (CRR) in the future.

2) That enable it to identify and manage the major sources of risk referred to in (1), including the major sources of risk in each of the following categories where they are relevant to the firm given the nature and scale of its business:

    a) Credit risk
    b) Market risk
    c) Liquidity and funding risk
    d) Operational risk
    e) Insurance risk *
    f) Concentration risk
    g) Residual risk *
    h) Securitisation risk *
    i) Business risk
    j) Interest rate risk
    k) Pension obligation risk
    l) Group risk *

    * The bank does not undertake any business relevant to the risks marked with an asterisk above.

7. Capital position and leverage ratio

7.1 Capital Resources

The bank's policy is to have a strong capital base to provide resilience; maintain customer, creditor and market confidence; and to sustain future development of the business. There have been no material changes to the bank's management of capital during the year. The primary source of new capital for the bank is retained profits. The Board is conscious of the need for retained profits to be sufficient to grow capital in line with business growth and to meet regulatory driven expectations of higher capital ratios across the industry.

The Board is ultimately responsible for capital management. The Board, the Management Committee and the Asset and Liability Committee (ALCO) receive regular reports on the current and forecast level of capital.

The bank measures the amount of capital it holds using the regulatory framework defined by the Capital Requirements Directive and Regulation ("CRD IV") which took effect from 1 January 2014 and was implemented in the UK by the Prudential Regulation Authority ("PRA").

Under CRD IV, the bank's regulatory capital is analysed into two tiers:

- Common Equity Tier 1 capital is the highest form of regulatory capital under CRD IV, which includes the share capital; reserve fund; audited retained profits and losses from previous years; property and heritage asset revaluation reserves; plus any regulatory adjustments.
- Tier 2 capital, which comprises the bank's collective allowance for impairment.

The bank does not have any Tier 1 capital that is not Common Equity Tier 1.

The reserve fund is an apportionment out of the Profit and Loss Account. Under the Articles of Association, the Directors are authorised to set aside such profits as they think proper in the form of a reserve fund. This reserve fund can be applied in any purpose to which the retained profits of the bank may be properly applied.

The revaluation reserves against tangible assets in Common Equity Tier 1 are separated into surpluses arising on the bank's building premises, investment properties and heritage assets.

The bank's heritage assets have been accumulated for over 300 years and comprises of a number of artefacts mostly in the form of paintings, an extensive coin collection and the bank's own ledgers. These artefacts are no longer used in the day to day running of the bank but remain in the bank as part of the bank's museum. They are subject to periodic valuation with any net increase in value forming part of the bank's capital

The bank's capital adequacy and capital resources are managed and monitored in accordance with the regulatory capital requirements of CRD IV and the PRA. The bank is subject to capital requirements as defined under Pillar 1 (minimum capital requirements) and supplemented by additional minimum requirements under Pillar 2 and a number of CRD IV capital buffers. The minimum capital requirement is determined as 8% of total risk weighted assets. The additional minimum requirements are set by the PRA through the issuance of bank specific Individual Capital Guidance ("ICG"), following the Internal Capital Adequacy Assessment Process ("ICAAP"), as part of the supervisory review. The bank assesses the adequacy of its capital through the annual update and more frequently in the event of a material change in capital, of the ICAAP. The ICAAP is the bank's own assessment of its capital needs, and is based on stress testing and scenario analysis of the impact of material risks affecting the bank. The ICAAP is presented at least annually to the ALCO, Audit, Risk and Compliance Committee and the Management Committee for review and challenge, eventually leading to challenge and approval by the Board. The bank has put in place processes and controls to monitor and manage capital adequacy and throughout the year, the bank's regulatory capital remained in excess of the minimum requirements determined by the ICG and CRD IV buffers.

The implementation of CRD IV is subject to transitional arrangements, with the full implementation date being 1 January 2019. The bank continues to monitor these developments and incorporates the impact of forthcoming regulatory changes to the capital forecasts to ensure the bank is able to maintain a strong capital base that exceeds the minimum regulatory requirements.

Regulatory capital buffers

In addition to the bank's own funds requirement set through Pillar 1 and Pillar 2A, since 1 January 2016, new regulatory capital buffers were introduced under CRD IV. These changes converted the existing ICG, expressed as a percentage of the Pillar 1 requirement to a percentage of RWAs but may also include a fixed add-on.

As at 31 March 2018, the bank was required to hold a capital conservation buffer of 1.875% of risk weighted assets. This buffer is applicable for all banks and has been phased in since 2016 at the rate of 0.625% to reach 2.5% at 1 January 2019.

The countercyclical capital buffer for the UK is currently set to zero but will increase to 0.5% on 27 June 2018 and to 1.0% on 28 November 2018.

The bank's regulatory capital, risk-weighted assets and capital ratios at 31 March were as follows:

Table 3: Capital Resources

	2018 £000	*2017* *£000*
Common Equity Tier 1 capital		
Ordinary share capital	**120**	***120***
Reserve Fund	**22,598**	***22,598***
Profit and loss account	**286,617**	***254,111***
Property revaluation reserve	**36,087**	***36,087***
Heritage assets revaluation reserve	**7,035**	***6,788***
Defined benefit pension fund assets	**(8,546)**	***-***
Total Common Equity Tier 1 capital and Total Tier 1 capital	**343,911**	***319,704***
Tier 2 capital		
Collective Impairment Allowance	**2,007**	***320***
Total Tier 2 capital	**2,007**	***320***
Total regulatory capital	**345,918**	***320,024***
Risk Weighted Assets	**1,598,298**	***1,567,896***
Capital ratios (%)		
Total regulatory capital expressed as a percentage of risk weighted assets	**21.64%**	***20.41%***
Common Equity Tier 1 capital expressed as percentage of risk weighted assets	**21.52%**	***20.39%***

The bank's regulatory total capital ratio increased year on year from 20.41% to 21.64%, while the Common Equity Tier 1 ratio increased from 20.39% to 21.52%. The capital ratios remain above the regulatory requirements. The increase during the year was due to higher retained profits.

The table below provides a full reconciliation of the shareholder's funds shown within the Annual Report and Consolidated Financial Statements to the total regulatory capital shown in Table 3, as required under Article 437 (1) (a) of the CRR.

Table 4: Reconciliation of regulatory capital to the shareholders' funds as reported in the audited financial statements.

	2018	*2017*
	£'000	*£'000*
Total shareholder's funds per consolidated balance sheet	**352,457**	*319,704*
Add: Collective Impairment Allowance	**2,007**	*320*
Less: Defined benefit pension fund assets	**(8,546)**	-
Total regulatory capital (Table 3)	**345,918**	*320,024*

Own Funds Disclosures

In accordance with the requirements of the EBA's technical standard on Own Funds Disclosures published in July 2013, see Appendix 1 for the disclosure of the own funds template.

7.2 Capital Requirements

The bank calculates its capital at a consolidated level using the standardised approach to credit risk, market risk and operational risk from the Basel III framework.

Credit risk is the risk of financial loss arising from a borrower or a counterparty failing to meet their contractual financial obligations. The risk arises from loans and advances to customers and banks and from treasury investments. Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads will affect the bank's future cash flows or the fair value of its holdings of financial instruments. The Foreign Exchange Position Risk Requirement (FX PRR) is the amount of regulatory capital required to cover the risk of losses on open foreign currency positions due to movements in foreign exchange rates. The FX PRR is calculated using the standardised approach.

Under CRD IV, the standardised approach uses a standard set of risk weights to credit risk exposures, dependent on a number of factors including the asset class and underlying credit quality.

In accordance with the requirements of Article 317 of the CRR, the standardised calculation of operational risk applies risk percentages to the average annual income over three years by business line. As at 31 March 2018, the capital requirement for operational risk under the standardised approach was £15.0m *(2017: £16.3m).* The capital charge is included in Table 5.

The regulatory minimum of total capital is calculated at the standard rate of 8% of the risk weighted assets.
The table below shows as at 31 March 2018 the Pillar 1 minimum capital requirement and risk weighted assets by exposure class as per Article 112 of the CRR.

Other market risks are not included as a Pillar 1 requirement, since the bank does not hold a trading book for capital purposes under CRD IV. Interest Rate Risk in the banking book is covered as a capital add-on as part of Pillar 2A.

Table 5: Risk weighted assets and Pillar 1 capital requirements by exposure class

Exposure Class	**2018** Risk weighted assets **£'000**	**2018** Capital requirement **£'000**	*2017* *Risk weighted assets* *£'000*	*2017* *Capital requirement* *£'000*
Central governments or central banks	-	-	-	-
Multilateral development banks	-	-	-	-
Institutions	**120,028**	**9,602**	*207,653*	*16,612*
Corporates	**90,010**	**7,201**	*215,975*	*17,278*
Retail	**24,636**	**1,971**	*34,966*	*2,797*
Secured by mortgages on immovable property	**730,572**	**58,446**	*665,854*	*53,268*
Exposures in default	**37,121**	**2,970**	*16,584*	*1,327*
Items associated with particularly high risk	**211,601**	**16,928**	*874*	*70*
Covered bonds	**23,161**	**1,853**	*25,895*	*2,072*
Claims on Institutions and corporates with short-term credit assessment	**73,907**	**5,913**	*98,932*	*7,915*
Other Items[5]	**99,743**	**7,978**	*96,472*	*7,718*
Total credit risk	**1,410,779**	**112,862**	*1,363,205*	*109,057*
Total market risk (FX PRR)	**546**	**44**	*603*	*48*
Total operational risk	**186,973**	**14,958**	*204,088*	*16,327*
Total Pillar 1 capital requirement	**1,598,298**	**127,864**	*1,567,896*	*125,432*

'Items associated with particularly high risk' increased during the year as a result of a reclassification of lending for the purpose of speculative property development. The exposures were previously primarily classified as 'Secured by mortgages on immovable property'.

At 31 March 2018, the bank held excess capital over the Pillar 1 minimum capital requirement of £218m *(2017:£195m).*

[5] Other items include fixed assets, cash and items in the course of collection, sundry debtors and prepayments.

7.3 Leverage Ratio

CRD IV requires firms to calculate and disclose a non-risk based leverage ratio to supplement the risk based capital requirements. The leverage ratio is intended to limit the build up of excessive leverage, in the banking sector, which was considered to be an underlying cause of the global financial crisis.

The leverage ratio is calculated by dividing the Tier 1 capital by the total on and off balance sheet exposures (subject to credit conversion factors).

The Basel Committee has set a minimum leverage ratio of 3% for banks.

The bank's leverage ratio at 31 March 2018 was 7.5% *(2017: 7.3%)* and in excess of the minimum requirement.

The leverage ratio disclosure templates required by the EU Commission Implementing Regulation (EU) No 2016/200 of 15 February 2016, are presented in the following tables. The row numbers identify the lines prescribed in the European Banking Authority (EBA) template. Lines represented are those lines which are applicable and where there is a value.

Table 6a: Summary reconciliation of accounting assets and leverage ratio exposures

	2018	*2017*
	£'000	*£'000*
1 Total assets per published financial statements[6]	**4,447,843**	*4,267,522*
4 Adjustments for derivative financial instruments[7]	**767**	*515*
6 Adjustments for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)[8]	**118,858**	*141,322*
7 Other adjustments[9]	**(8,546)**	-
8 Total leverage ratio exposure	**4,558,922**	*4,409,359*

[6] Total assets as per the balance sheet, less mark to market on derivatives.
[7] The derivatives exposure adjustment is the difference in value between the accounting value of the derivatives recognised as assets and the leverage ratio exposure value as determined by the application of the mark to market method.
[8] The leverage exposure value for off-balance sheet items is determined by applying set credit conversion factors to the nominal value of the items, thereby reducing the exposure measure.
[9] Defined benefit pension fund asset – deducted in determining Tier 1 capital.

Table 6b: Leverage ratio common disclosure

	2018	*2017*
	£'000	*£'000*
On-balance sheet exposures (excluding derivatives and SFTs)		
1 On-balance sheet items (excluding derivatives and SFTs, but including collateral)	**4,447,843**	*4,267,522*
2 (Asset amounts deducted in determining Tier 1 capital)	**(8,546)**	*-*
3 Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**4,439,297**	*4,267,522*
Derivatives exposures		
4 Replacement cost associated with derivatives transactions	**8,422**	*1,751*
5 Add-on amounts for Potential Future Exposure (PFE) associated with derivatives transactions	**11,791**	*11,981*
8 (Exempted central counterparty (CCP) leg of client cleared trade exposures)	**(19,446)**	*(13,217)*
11Total derivative exposures	**767**	*515*
Off-balance sheet exposures		
17 Off-Balance sheet exposures at gross notional amount	**341,579**	*371,845*
18 Adjustments for conversion to credit equivalent amounts	**(222,721)**	*(230,523)*
19 Total Off-balance sheet exposures	**118,858**	*141,322*
Capital and total exposures		
20 Tier 1 Capital	**343,911**	*319,704*
21 Total leverage ratio exposure	**4,558,922**	*4,409,359*
22 Leverage Ratio	**7.5%**	*7.3%*

Table 6c: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

	2018	*2017*
	£'000	*£'000*
EU-1 Total on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures), of which:	**4,439,297**	*4,267,522*
EU-3 Banking book exposures, of which:		
EU-4 Covered bonds	**222,459**	*234,784*
EU-5 Exposures treated as sovereigns	**1,536,858**	*1,084,089*
EU-6 Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**-**	*66,291*
EU-7 Institutions	**395,351**	*499,701*
EU-8 Secured by mortgages of immovable properties	**1,385,342**	*1,286,035*
EU-9 Retail exposures	**32,526**	*48,887*
EU-10 Corporate	**81,518**	*209,559*
EU-11 Exposures in default	**33,804**	*13,826*
EU-12 Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	**751,439**	*824,350*

Table 6d: Disclosure on leverage ratio qualitative items

1 Description of the process used to manage the risk of excessive leverage:

The bank's leverage ratio is calculated and reported on a monthly basis to the ALCO. In addition forecast of the leverage ratio is included in the capital forecasts and the macroeconomic scenarios which are included as part of the annual update of the ICAAP. The bank does not seek to maximise the leverage of its balance sheet and instead seeks to ensure that capital ratios remain in excess of minimum capital requirements in normal circumstances and in stress.

2 Description of the factors that had an impact on the leverage ratio during the period to which the disclosed ratio refers:

The leverage ratio increased in the year from 7.3% to 7.5%, which is primarily driven from a higher increase in Tier 1 capital, as a result of retained earnings.

8. Asset Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against an existing liability and, as a result, is no longer available to the bank to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. An asset is unencumbered if it has not been pledged against an existing liability. The bank's policy is to restrict the encumbrance of its assets. The following exceptions are as follows:

Interest rate swaps are used to hedge the interest rate risk arising on the Bank's fixed interest rate assets. Cash collateral is pledged against the bank's derivative liabilities. As at 31 March 2018, the value of the cash collateral was £161.4m *(2017: £196.1m)*.

During the year £0.5m *(2017: £0.5m)* of assets were charged in favour of Hoare's Bank Pension Trustees Limited, for the benefit of the Hoare's Bank Pension Scheme. These assets would become available to the Pension Scheme in the event of C. Hoare & Co.'s insolvency.

In addition, during the year, £10m *(2017: £10m)* of collateral was charged to Royal Bank of Scotland Plc (RBS) in relation to RBS providing guarantees jointly, with the bank, to Lloyd's of London on behalf of the bank's customers.

A cash ratio deposit of £4.5m *(2017: £3.7m)* was held at the Bank of England on 31 March 2018.

As at 31 March 2018, £Nil *(2017: £3.0m)* of collateral was segregated in a client monies account for the benefit of failing trades on behalf of Wealth Management customers. This arrangement was removed in line with the wind-down of the Wealth-related operations during the year ending 31 March 2017.

The total encumbered assets as at 31 March 2018 was £176.4m *(2017: £214.6m)* and represents 4% *(2017:5%)* of the balance sheet assets.

The disclosure templates for asset encumbrance are shown in Appendix 2 and have been prepared in accordance with the requirements of EBA/PRA. The PRA implemented the EBA's guidelines through the publication of Supervisory Statement SS11/14 CRD IV: Compliance with the European Banking Authority's Guidelines on the disclosure of encumbered and unencumbered assets in December 2014.

There are four disclosure templates and in accordance with the threshold criteria as defined in SS11/14, the bank is not required to report on the fair value of encumbered and unencumbered collateral received (Template B). The templates are shown in Appendix 2.

9. Credit Risk

Credit risk is the risk of financial loss arising from a borrower or a counterparty failing to meet their contractual financial obligations. The risk arises from loans and advances to customers and banks and from treasury investments.

Responsibility for credit risk on customer loans and advances resides with the Lending department, monitored by the Banking Committee. Responsibility for credit risk relating to bank counterparties and treasury investments is managed by the Treasury department and monitored by the ALCO.

Application of the Standardised Approach

Under CRD IV, the standardised approach uses a standard set of risk weights to credit risk exposures, dependent on a number of factors such as the exposure asset class and the credit quality. The standardised approach permits the use of credit risk mitigation against an exposure before the relevant risk weight is applied to the adjusted exposure amount. Where applicable, further reductions to risk weighted assets are made for eligible Small Medium Enterprises (SMEs), for exposure classes; secured by mortgages on immovable property, retail and corporates.

9.1 Treasury Credit Risk

Credit risk arises in the treasury portfolio where the bank has invested in securities or placed cash deposits with other financial institutions. The bank is entirely funded from customer deposits, and exposures in the treasury portfolio are held for liquidity purposes, surplus deposits not required to meet customer lending and derivatives for the purposes of hedging.

The bank has policies in place and sets exposure limits for approved counterparties, taking into consideration the large exposure requirements and where appropriate the use of external credit assessments supplemented with the bank's internal assessment of credit risk. The bank uses market information, such as credit default swap spreads, capital ratios and loan to deposit ratios to monitor the counterparty's credit risk. Limits are also in place for by country, instrument type and residual maturity to mitigate concentration risk within the treasury portfolio.

ALCO reviews the authorised list of bank counterparties at least annually and authorises any amendments to the approved list of counterparties and related credit limits. The committee will also give on-going consideration to changes in external credit ratings and amend counterparty limits as appropriate.

The bank uses the external credit assessments provided by Moody's for calculating the credit risk requirements under the standardised approach to rated counterparties. The risk weight is dependent on the credit rating. The bank uses external credit assessments as part of the determination of risk weightings for exposure classes; Institutions, Claims on institutions and corporates with short term credit assessment and covered bonds. The bank's general policy is to deal with highly rated counterparties in Credit Quality Steps 1 and 2.

The bank subscribes to Moody's and immediately receives notification of any changes to credit rating which is on the approved counterparty list. Where the counterparty is downgraded below the bank's risk appetite, this is escalated to the ALCO for review and decisioning. The counterparty and the related limit is removed from the approved counterparty list or escalated to the Audit, Risk & Compliance committee and the Board for an exemption approval.

The Treasury department is responsible for ensuring compliance with the counterparty credit risk limits with the Finance department providing independent oversight that these limits are maintained. Daily monitoring of exposures are undertaken by the Finance department and in the event of a limit breach, an escalation process is in place to report to the ALCO and to the Board.

In accordance with Article 422 of the CRR, the following tables sets out the disclosure requirements by exposure class; geographic distribution, industrial analysis and residual maturity.

Table 7: Credit Risk Exposure by Exposure Class

Exposure Class	**2018 Exposure Value £'000**	**2018 Average Exposure Value £'000**	*2017 Exposure Value £'000*	*2017 Average Exposure Value £'000*
Central governments or central banks	**1,536,858**	**1,460,925**	*1,084,089*	*1,120,384*
Multilateral development banks	**-**	**16,437**	*66,291*	*66,019*
Institutions	**415,106**	**476,551**	*513,268*	*542,188*
Corporates	**121,154**	**153,935**	*266,032*	*260,521*
Retail	**117,651**	**122,274**	*138,097*	*140,352*
Secured by mortgages on immovable property	**1,583,289**	**1,525,438**	*1,509,913*	*1,434,086*
Exposures in default	**34,923**	**23,094**	*14,265*	*12,444*
Items associated with particularly high risk	**154,206**	**173,107**	*583*	*666*
Covered bonds	**222,459**	**230,993**	*234,784*	*229,976*
Claims on Institutions and Corporates with short-term credit assessment	**513,087**	**581,181**	*725,621*	*644,281*
Other Items	**100,191**	**95,613**	*98,224*	*105,441*
Total credit risk	**4,798,924**	**4,859,548**	*4,651,167*	*4,556,358*

Table 8: Credit Risk Exposure by Geographic distribution

31-Mar-18	**UK**	**Rest of Europe**	**The Americas**	**Other**	**Total**
Exposure Class	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Central governments or central banks	**1,429,950**	**-**	**106,908**	**-**	**1,536,858**
Multilateral development banks	**-**	**-**	**-**	**-**	**-**
Institutions	**229,676**	**125,365**	**34,668**	**25,397**	**415,106**
Corporates	**119,016**	**157**	**1,966**	**15**	**121,154**
Retail	**109,929**	**3,117**	**2,872**	**1,733**	**117,651**
Secured by mortgages on immovable property	**1,438,309**	**75,047**	**55,003**	**14,930**	**1,583,289**
Exposures in default	**33,505**	**223**	**1,191**	**4**	**34,923**
Items associated with particularly high risk	**148,524**	**300**	**4,002**	**1,380**	**154,206**
Covered bonds	**222,459**	**-**	**-**	**-**	**222,459**
Claims on Institutions and Corporates with short-term credit assessment	**354,756**	**62,883**	**57,285**	**38,163**	**513,087**
Other Items	**100,191**	**-**	**-**	**-**	**100,191**
Total credit risk	**4,186,315**	**267,092**	**263,895**	**81,622**	**4,798,924**

31-Mar-17	*UK*	*Rest of Europe*	*The Americas*	*Other*	*Total*
Exposure Class	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
Central governments or central banks	*1,084,089*	*-*	*-*	*-*	*1,084,089*
Multilateral development banks	*-*	*66,291*	*-*	*-*	*66,291*
Institutions	*265,764*	*155,391*	*21,896*	*70,217*	*513,268*
Corporates	*214,152*	*25,824*	*17,430*	*8,626*	*266,032*
Retail	*129,186*	*4,757*	*2,040*	*2,114*	*138,097*
Secured by mortgages on immovable property	*1,400,179*	*60,023*	*41,505*	*8,206*	*1,509,913*
Exposures in default	*13,798*	*210*	*247*	*10*	*14,265*
Items associated with particularly high risk	*-*	*-*	*-*	*583*	*583*
Covered bonds	*234,784*	*-*	*-*	*-*	*234,784*
Claims on Institutions and Corporates with short-term credit assessment	*406,349*	*93,794*	*55,048*	*170,430*	*725,621*
Other Items	*98,224*	*-*	*-*	*-*	*98,224*
Total credit risk	*3,846,525*	*406,290*	*138,166*	*260,186*	*4,651,167*

Table 9: Credit Risk Exposure by Industrial Sector

31-Mar-18	**Sovereign**	**Financial Institutions**	**Individuals**	**Corporates**	**Total**
Exposure Class	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Central governments or central banks	**1,463,600**	**-**	**-**	**73,258**	**1,536,858**
Multilateral development banks	**-**	**-**	**-**	**-**	**-**
Institutions	**-**	**415,106**	**-**	**-**	**415,106**
Corporates	**-**	**6,195**	**54,918**	**60,041**	**121,154**
Retail	**-**	**131**	**94,714**	**22,806**	**117,651**
Secured by mortgages on immovable property	**-**	**11,437**	**838,655**	**733,197**	**1,583,289**
Exposures in default	**-**	**-**	**9,581**	**25,342**	**34,923**
Items associated with particularly high risk	**-**	**380**	**57,524**	**96,302**	**154,206**
Covered bonds	**-**	**222,459**	**-**	**-**	**222,459**
Claims on Institutions and corporates with short-term credit assessment	**-**	**513,087**	**-**	**-**	**513,087**
Total	**1,463,600**	**1,168,795**	**1,055,392**	**1,010,946**	**4,698,733**
Other Items	**-**	**-**	**-**	**-**	**100,191**
Total credit risk	**1,463,600**	**1,168,795**	**1,055,392**	**1,010,946**	**4,798,924**

31-Mar-17	*Sovereign*	*Financial Institutions*	*Individuals*	*Corporates*	*Total*
Exposure Class	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
Central governments or central banks	*1,084,089*	*-*	*-*	*-*	*1,084,089*
Multilateral development banks	*-*	*66,291*	*-*	*-*	*66,291*
Institutions	*-*	*513,268*	*-*	*-*	*513,268*
Corporates	*-*	*25,765*	*29,894*	*210,373*	*266,032*
Retail	*-*	*188*	*95,912*	*41,997*	*138,097*
Secured by mortgages on immovable property	*-*	*721*	*886,725*	*622,467*	*1,509,913*
Exposures in default	*-*	*-*	*11,256*	*3,009*	*14,265*
Items associated with particularly high risk	*-*	*583*	*-*	*-*	*583*
Covered bonds	*-*	*234,784*	*-*	*-*	*234,784*
Claims on Institutions and corporates with short-term credit assessment	*-*	*725,621*	*-*	*-*	*725,621*
Total	*1,084,089*	*1,567,221*	*1,023,787*	*877,846*	*4,552,943*
Other Items	*-*	*-*	*-*	*-*	*98,224*
Total credit risk	*1,084,089*	*1,567,221*	*1,023,787*	*877,846*	*4,651,167*

Table 10: Credit Risk Exposure by Residual Maturity

31-Mar-18	**On demand**	**Less than 3 months**	**3 months to 1 Year**	**1 to 5 years**	**over 5 years**	**Undated**	**Total**
Exposure Class	**£'000**	**£'000**	**£'000**		**£'000**	**£'000**	**£'000**
Central governments or central banks	**1,149,079**	**106,908**	**-**	**-**	**276,302**	**4,569**	**1,536,858**
Multilateral development banks	-	-	-	-	-	-	-
Institutions	**-**	**-**	**370,292**	**34,012**	**10,802**	**-**	**415,106**
Corporates	**89,697**	**4,463**	**326**	**14,821**	**11,847**	**-**	**121,154**
Retail	**115,514**	**-**	**6**	**1,510**	**621**	**-**	**117,651**
Secured by mortgages on immovable property	**694,687**	**87,527**	**81,210**	**595,911**	**123,954**	**-**	**1,583,289**
Exposures in default	**34,923**	**-**	**-**	**-**	**-**	**-**	**34,923**
Items associated with particularly high risk	**123,315**	**1,300**	**17,805**	**10,406**	**-**	**1,380**	**154,206**
Covered bonds	**-**	**37,257**	**1,770**	**55,043**	**128,389**	**-**	**222,459**
Claims on Institutions and corporates with short-term credit assessment	**-**	**-**	**-**	**513,087**	**-**	**-**	**513,087**
Other Items	**-**	**-**	**-**	**-**	**-**	**100,191**	**100,191**
Total credit risk	**2,207,215**	**237,455**	**471,409**	**1,224,790**	**551,915**	**106,140**	**4,798,924**

31-Mar-17	*On demand*	*Less than 3 months*	*3 months to 1 Year*	*1 to 5 years*	*over 5 years*	*Undated*	*Total*
Exposure Class	*£'000*	*£'000*	*£'000*		*£'000*	*£'000*	*£'000*
Central governments or central banks	*777,016*	*-*	*-*	*-*	*303,335*	*3,738*	*1,084,089*
Multilateral development banks	*-*	*-*	*-*	*41,028*	*25,263*	*-*	*66,291*
Institutions	*-*	*-*	*455,621*	*48,077*	*9,570*	*-*	*513,268*
Corporates	*170,100*	*6,317*	*3,776*	*78,740*	*7,098*	*-*	*266,031*
Retail	*135,822*	*481*	*59*	*1,375*	*360*	*-*	*138,097*
Secured by mortgages on immovable property	*909,635*	*14,817*	*106,491*	*382,138*	*96,832*	*-*	*1,509,913*
Exposures in default	*14,265*	*-*	*-*	*-*	*-*	*-*	*14,265*
Items associated with particularly high risk	*-*	*-*	*-*	*-*	*-*	*583*	*583*
Covered bonds	*-*	*15,014*	*-*	*85,234*	*134,537*	*-*	*234,785*
Claims on Institutions and corporates with short-term credit assessment	*-*	*-*	*-*	*725,621*	*-*	*-*	*725,621*
Other Items	*-*	*-*	*-*	*-*	*-*	*98,224*	*98,224*
Total credit risk	*2,006,838*	*36,629*	*565,947*	*1,362,213*	*576,995*	*102,545*	*4,651,167*

Use of External Credit Assessment Institutions (ECAIs)

The bank uses the external credit assessments provided by Moody's for calculating the credit risk requirements under the standardised approach to rated counterparties. External credit assessments have been applied to exposures to rated institutions to determine the relevant "Credit Quality Step" and consequent risk weight. The table below shows the credit risk exposures by Credit Quality Step. For completeness, other exposures, whose risk weightings are defined in the CRR without reference to an ECAI rating, have been included in the table. These exposures are to central governments and banks, multilateral development banks, collective investment undertakings, fixed and other assets and exposures within the lending book.

Table 11: Credit Risk Exposure by Credit Quality Step

31-Mar-18	**Credit Quality Step 1**	**Credit Quality Step 2**	**Credit Quality Step 3**	**Credit Quality Steps 4-6**	**Unrated or risk weight defined in CRR**	**Total**
Exposure Class	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Central governments or central banks	-	-	-	-	**1,536,858**	**1,536,858**
Multilateral development banks	-	-	-	-	-	-
Institutions	**299,042**	**116,064**	-	-	-	**415,106**
Corporates	-	-	-	-	**121,154**	**121,154**
Retail	-	-	-	-	**117,651**	**117,651**
Secured by mortgages on immovable property	-	-	-	-	**1,583,289**	**1,583,289**
Exposures in default	-	-	-	-	**34,923**	**34,923**
Items associated with particularly high risk	-	-	-	-	**154,206**	**154,206**
Covered bonds	**222,459**	-	-	-	-	**222,459**
Claims on institutions and Corporates with short-term credit assessment	**178,051**	**335,013**	**23**	-	-	**513,087**
Other Items	-	-	-	-	**100,191**	**100,191**
Total credit risk	**699,552**	**451,077**	**23**	-	**3,648,272**	**4,798,924**

31-Mar-17	*Credit Quality Step 1*	*Credit Quality Step 2*	*Credit Quality Step 3*	*Credit Quality Steps 4-6*	*Unrated or risk weight defined in CRR*	*Total*
Exposure Class	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
Central governments or central banks	-	-	-	-	*1,084,089*	*1,084,089*
Multilateral development banks	-	-	-	-	*66,291*	*66,291*
Institutions	*142,125*	*371,143*	-	-	-	*513,268*
Corporates	-	-	-	-	*266,032*	*266,032*
Retail	-	-	-	-	*138,097*	*138,097*
Secured by mortgages on immovable property	-	-	-	-	*1,509,913*	*1,509,913*
Exposures in default	-	-	-	-	*14,265*	*14,265*
Items associated with particularly high risk	-	-	-	-	*583*	*583*
Covered bonds	*234,784*	-	-	-	-	*234,784*
Claims on institutions and Corporates with short-term credit assessment	*369,205*	*356,416*	-	-	-	*725,621*
Other Items	-	-	-	-	*98,224*	*98,224*
Total credit risk	*746.114*	*727,559*	-	-	*3,177,494*	*4,651,167*

9.2 Customer Credit Risk

Credit risk arises from loans and advances to customers and is managed in accordance with lending policies and procedures aligned to the bank's risk appetite. The bank seeks to mitigate credit risk by focusing on sectors with specialist expertise. The bank's general policy is to lend to customers with security provided as collateral and primarily includes charges over residential and commercial properties. Unsecured lending is only entered into where the customer's specific circumstances make it prudent to do so. Limits are placed on the aggregate lending to any one customer in accordance with both internal and regulatory guidelines. Lending is monitored closely against individual credit limits. All significant exposures are subject to an annual review.

Interest payments and any capital repayments are generally serviced through a related current account with the bank. These are closely monitored for adequate funds such that past due events such as late payment or missed interest rarely occur.

9.3 Exposures in default

The bank has a low level of exposures in default which is defined as overdraft balances in excess of agreed limits for more than 90 days. This definition only applies to regulatory computations and is disclosed under exposure class, exposures in default.

Exposures in default as at 31 March 2018 were £34.9m (2.1%) *(2017: £14.3m)(2017: 0.9%)* of the total customer loan book of £1,665m *(2017: £1,565m).*

The associated risk weightings range from 100% for real estate property to 150% for wholesale and retail items.

The nature of the bank's lending means that few of the conventional events of default are relevant to the portfolio. The bank reviews extended breaches of advised overdrafts and actual non-performing bad debts. Breaches of overdraft limits are rarely of concern as usually there is more than sufficient collateral to cover the excess. The bank's monitoring and classification policy on non-performing debt is explained in Note 29 of the Financial Statements.

Impaired provisions (also referred to as impairment allowances) are provisions held in the balance sheet as a result of raising a charge against profit for the incurred loss inherent in the lending book. An impairment provision may either be individually or collectively assessed.

The bank regularly assesses whether there is objective evidence that loans or securities are impaired. Loans and securities are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

The bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to identified exposures and a collective loan impairment allowance in respect of losses that have been incurred but have not been identified at the reporting date. In assessing collective impairment the bank uses historical trends of the losses incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than the historical trends suggest.

Impairment losses on loans to banks and the securities portfolio are established when there has been a sustained decrease in value over an extended period, or if it is expected that a fixed income investment will not meet its future cash flow obligations.

The table below shows the reconciliation of changes in provisions for loans and advances to customers.

Table 12: Movements in impaired provisions for loans and advances to customers

	2018	*2017*
	£'000	£'000
Specific allowances for impairment		
Balance at 1 April	**3,939**	*4,628*
Impairment loss for the year		
- Charge for the year	**1,193**	*429*
- Recoveries for the year	**(137)**	*(981)*
Net recovery	**1,056**	*(552)*
Write-offs	**(1,770)**	*(137)*
Balance at 31 March	**3,225**	*3,939*
Collective allowance for impairment		
Balance at 1 April	**320**	*642*
Impairment loss for the year		
- Charge/(recovery) for the year	**1,687**	*(322)*
Balance at 31 March	**2,007**	*320*
Total specific and collective impairment allowances	**5,232**	*4,259*
Non performing debt (NPD)	**5,927**	*4,038*
Other exposures in default	**28,996**	*10,227*
Total exposures in default	**34,923**	*14,265*
Specific provisions to NPD %	**54%**	*98%*
NPD to gross loans and advances	**0.4%**	*0.3%*

The above table shows that the levels of impaired provisions and non performing debts (lending that is assessed as requiring a bad debt provision) are low. Whilst specific provisions as a percentage of non performing debt has decreased, the level of total provisions as a percentage of total gross lending has increased to 0.31% (*2017: 0.27%).*

The bank maintains a watch list of exposures where there is some concern about the performance of the loan, however there has not yet been a credit risk event. These are assessed by the relationship managers and graded high and medium to highlight exposures which require closer management attention because of their relative greater probability of default and potential loss.

The table below is an analysis of the loan book and watch list values as at 31 March 2018.

Table 13: Analysis of the watch list values across the bank's customer lending.

Loan Book Analysis	**2018**	*2017*
	£'000	£'000
Neither on the Watch list nor Non Performing	**1,512,981**	*1,479,236*
Watch List		
High Risk	**73,249**	*16,463*
Medium Risk	**77,770**	*69,651*
Non Performing Debt (NPD) – provision held	**5,927**	*4,038*
- of which are impaired	**(3,225)**	*(3,939)*
Collective allowance for impairment	**(2,007)**	*(320)*
Total Loans and advances to customers	**1,664,695**	*1,565,129*
Watch List		
High Risk	**4.4%**	1.1%
Medium Risk	**4.7%**	4.5%
Non Performing Debt – provision held	**0.4%**	0.3%
Total Watch list & NPD	**9.5%**	5.9%

The proportion of the loan book on the watch list and in Non Performing Debt has increased during the year but remains a small proportion of the total loan portfolio. The primary driver of the increase was concern over the recent performance of the property market, notably in London and the South East, where there has been some softening in prices. The increase in the Collective allowance for impairment was driven by a post model adjustment made by management to reflect these concerns.

9.4 Credit Risk Mitigation

Under the standardised approach the bank is permitted to reduce its exposure balances through credit risk mitigation prior to applying risk weightings and calculating capital requirements. Such mitigation may take the form of liens over cash deposits or charges over investment management portfolios. The bank recognises cash deposits held by the bank as eligible collateral for credit risk mitigation. At 31 March 2018, £5.4m *(2017: £3.9m)* of exposure was covered by cash deposits and, consequently, a risk weight of 0% was applied to these exposures.

9.5 Counterparty Credit Risk (CCR)

The relevant counterparty credit risk for the bank is the risk of loss arising from the default of counterparty to a derivatives trade. The bank uses derivative instruments to hedge its exposure to interest rate risk and foreign exchange risk. Derivatives are not used for trading or speculative purposes.

The bank uses interest rate swaps to hedge fixed rate loans or investments. Following the introduction of the European Market and Infrastructure Regulation (EMIR) the bank clears most of its derivatives through the central clearer (London Clearing House), these positions are subject to daily collateral deposit to or from the clearing house. The few swaps which are not eligible for clearing are traded bilaterally and collateralised daily with the counterparty. In each case the placing of collateral renders any associated credit risk immaterial.

The bank trades forward foreign currency deals to match customer requirements.

The CCR mark to market method is used to calculate the exposure value and is determined by the market value plus an add-on for potential future exposure, prior to being risk weighted under the standardised approach. As at 31 March 2018, the bank's total CCR exposure for derivative contracts was £20.2m *(2017: £13.7m)*. The bank does not include any netting benefits and there is no use of collateral in calculating net derivatives credit exposure. The gross positive fair value of derivative contracts as at 31 March 2018 was £8.4m *(2017: £1.8m)*. Counterparty credit risk represents a small proportion of the bank's total risk weighted assets.

10. Market Risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads will affect the bank's future cash flows or the fair value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on the residual risk taken.

Market risk only arises in the banking book, since the bank does not operate a trading book. Only a small component of the banking book is recorded at fair value and all fixed rate financial instruments are hedged such that the main exposure to market risk is credit and basis risk. The risk to the bank is that it could be required to dispose of certain assets, recorded at amortised costs, at a point in time that would result in losses.

There is a Pillar 1 requirement for holding foreign currencies in the banking book. Interest rate risk in the banking book is treated as a capital add-on as part of Pillar 2A.

10.1 Management of market risk

Interest (basis) rate risk could arise from the mismatch between the bank's lending and deposit rates and is actively managed. The ALCO has set limits to manage basis risk. Advances and deposits which are priced off base rate with margins are closely monitored and evaluated. The sensitivity to interest rate changes in terms of interest cash flows and their effect on fixed interest instruments is computed and reported monthly to the ALCO.

Fixed rate loans are hedged with interest rate swaps of equal size and duration which protect the net interest margin against adverse changes in money market rates. The bank accrues the net interest payment/receipt on interest rate swaps on a quarterly basis and adjusts the estimated fair value of the remaining cash flows accordingly.

10.2 Interest rate risk

The principal market risk to which the bank is exposed is interest rate risk.

Interest rate risk arises on loans, deposits and treasury instruments due to timing differences on re-pricing of assets and liabilities and the shape of the yield curve. Market movements in interest rates affect the net interest income of the bank.

Interest rate risk is managed by the bank's Treasury department principally through monitoring interest rate gaps between assets and liabilities based upon the next interest rate re-fixing dates as against the contractual maturity dates of the instruments. The bank uses interest rate swaps to hedge exposures to interest rate risk, as part of its risk management process.

The bank monitors its exposure to interest rate risk. Consistent with the financial regulator's requirements, the impact of a potential 2.00% shift, both increase and decrease, in the yield curve against the bank's interest bearing assets is computed back to a net present value. This value is monitored and calculated weekly and reported to the ALCO monthly against a Board approved policy limit. The reported interest rate sensitivity as at 31 March 2018 is shown in the table below.

Table 14: Interest Rate Sensitivity

Effect of a change of 2.00% shift in Sterling Market Rates	**2018**	*2017*
	£'000	*£'000*
Net Present Value Sensitivity to:		
Positive shift	**(27)**	*(346)*
Negative shift	**120**	*368*

The interest rate sensitivities set out above are illustrative only and are based on simplified scenarios. The figures represent the effect on net interest income and fixed interest security values arising from a parallel fall or rise in the yield curve and do not take into account the effect of any further actions to mitigate the effect.

Basis risk arises where assets and liabilities re-price with reference to differing short term interest rate benchmarks. The ALCO has set limits to manage basis risk. As at 31 March 2018, approximately 37% *(2017: 41%)* of the bank's assets are LIBOR linked, the interest earned on the majority of the bank's other assets and interest paid on the bank's liabilities is set by the bank. Basis risk is calculated monthly and reported to the ALCO.

10.3 Foreign Currency Risk

Foreign currency balances are driven by the requirements of the bank's customers and do not form a significant part of the balance sheet. In order to limit the bank's exposure to exchange rate risks, limits are placed on the bank's foreign exchange dealers for intraday and end of day positions. The bank's Treasury department is responsible for managing currency risk within intra-day and overnight limits established by ALCO and the Audit, Risk and Compliance Committee.

The foreign exchange dealers have authority to deal in forward foreign exchange contracts within specified limits, either to meet or match customers' requirements or to trade on the bank's behalf. The resulting positions are independently monitored and are reported monthly on a currency by currency basis to the ALCO.

10.4 Equity Risk

The group has a small legacy investment portfolio which is in the process of being wound down under the direction of the ALCO. The investments within this portfolio are monitored monthly. By the end of the year the aggregate value of the investment portfolio had fallen to £0.4m *(2017: £0.5m)* and is not considered material to the balance sheet.

In addition to the legacy portfolio, the group invested in a new equity holding during the year with a value of £1.0m *(2017: £0.0m*). The ongoing monitoring of this investment is performed by a sub-Committee of ALCO.

11. Liquidity and Funding Risk

Liquidity risk is the risk that the bank is unable to meets its liabilities when they come due or is unable to obtain funding other than by paying a premium. The risk arises from mismatches in the timing of cash flows.

Funding risk is the risk that the bank does not have sufficient funding available in the medium and longer term to enable it to fund its customer lending and other longer term and illiquid assets. The risk arises when the funding needed for illiquid asset positions cannot be obtained at the expected terms and when required. The bank does not use wholesale funding. The bank's source of funding is customer deposits in the form of current accounts and savings deposits where a significant proportion of these are repayable on demand.

The bank's Treasury department has responsibility for the day to day liquidity management and continuously monitors deposit activity so to predict expected maturity flows. The ALCO oversees the management of the bank's balance sheet within the Board approved policies.

The bank measures and manages liquidity adequacy in accordance with the liquidity risk appetite set by the Board and maintains a conservative liquidity and funding profile to ensure that it is able to meet its financial obligations under normal and stressed conditions. Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements.

The internal liquidity requirement seeks to ensure that the bank maintains adequate liquid assets to survive a defined stress scenario for a sufficient period as defined by the risk appetite.

Liquidity stress tests are performed semi-annually and reported to the ALCO. Reverse stress testing is also undertaken to identify the scenario or combination of scenarios that would result in liquidity resources being exhausted in which the bank becomes unviable or insolvent. Reverse stress tests are conducted annually as part of the ILAAP.

CRD IV introduced two new liquidity standards, the short term Liquidity Coverage Requirement (LCR) and the longer term Net Stable Funding Requirement (NSFR).

The LCR became the Pillar 1 standard for liquidity in the UK on 1 October 2015, with a minimum standard of 80%, thereafter a 10% increase on 1 January 2017 and 2018, to reach 100% on 1 January 2018. The objective of the LCR is to ensure that banks have sufficient high quality liquid assets (HQLA) that can be converted easily into cash to meet their liquidity needs for a 30 day calendar day liquidity stress scenario. Assets which are eligible for inclusion as HQLA include, for example, balances held at the Central Bank, holdings of securities issued by central banks and multilateral development banks and assets which are able to be lent (repo'd) as security against cash advances (e.g. from the Central Bank). The bank exceeds its regulatory requirements for the LCR ratio.

The bank is a party to the Bank of England reserve facility. This enables the bank to move funds invested in Gilts and other qualifying assets into an on-demand deposit thereby increasing the level of liquidity.

12. Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risk. This definition excludes strategic risk which is captured elsewhere within the bank's risk framework.

The bank has adopted the Standardised Approach to calculating Pillar 1 capital requirements for operational risk. In accordance with the requirements of Article 317 of the CRR, the calculation applies risk percentages to the average annual income over three years by business line.

Operational Risk Management Objectives

The main objectives for operational risk management are:

- To manage operational risk to an acceptable level that reduces the frequency and impact of operational losses in a cost effective way;
- To ensure significant operational risks are identified, measured, assessed, prioritised, managed and treated in a consistent and effective manner across the Bank;
- To ensure appropriate risk management methodologies are used across the business to support the operational risk management process;
- To ensure the Board, management and all staff are responsible and accountable for managing operational risk in line with the roles and responsibilities set out in the risk management framework;
- To ensure compliance with all relevant legislation, regulatory requirements, guidance and codes of practice;
- To ensure the Board and management receive timely, dependable assurance that the Bank is managing the significant operational risks to its business; and
- To ensure the Bank holds sufficient capital to support the operational risks it is exposed to.

Operational Risk Management Policy and Methodology

The bank recognises that operational risk is inherent in all its products, activities, processes and systems and the Board has approved a Risk Management Framework to ensure operational risks are adequately identified, monitored and controlled and any losses resulting from inadequate or failed internal processes, people and systems or from external events are minimised in line with the firm's risk appetite. Proprietary and non-proprietary operational risks are managed in a similar fashion.

Risk Management is responsible for facilitating and embedding the ongoing identification, assessment, monitoring, controlling and mitigation of risks throughout the firm and for maintaining an Operational Risk Policy which describes the roles and responsibilities and the processes, methodologies and tools used for this purpose, including:

- Risk and Control Self-Assessments (RCSAs)
- Key Risks and Emerging Risks
- Key Risk Indicators (KRIs)
- Operational Risk Events and External Loss Data
- Operational Risk Scenario Analysis (for ICAAP)

Risk and Control Self-Assessment (RCSA)

The Risk and Control Self-Assessment (RCSA) is a "bottom-up" process whereby individual business units are asked to describe their processes, the risks inherent in those processes, the controls mitigating those risks, the potential financial impact and likelihood resulting in the rating of the inherent risk, control effectiveness and residual risks, and any planned mitigation or remediation efforts.

Key Risks and Emerging Risks

Key Risks and Emerging Risks is a "top-down" process whereby risk issues identified by senior management are combined with risk issues identified through other methodologies and presented to the Management Committee and Audit, Risk & Compliance Committee for discussion and prioritisation. Every RCSA item is linked to one of the risk categories, such that those categories account for the bank's entire "risk universe" forming an Enterprise Risk Management (ERM) view of the firm's risks.

Key Risk Indicators

Key Risk Indicators (KRIs) are quantitative and qualitative measures that are linked to risks associated with a specific process or control, which are developed by the individual business units and are closely tied to their objectives. KRIs are reviewed regularly and are used for both monitoring and controlling risks and performance. For monitoring purposes, values are tracked over time and significant changes in trends may suggest changes in underlying risk. For controlling, limits or thresholds are placed on the value of the indicators and activities are constrained in order not to breach the limits, where the upper and lower limits define the "risk tolerance" or "risk appetite".

Operational Risk Events and External Loss-Incident Data

Internal data is collected on actual losses, near misses and potential losses. This data is used to:

- identify trends and lessons to be learned
- assess the effectiveness of existing controls
- monitor changes in the risk profile
- identify the need for new or improved controls

External data is collated from the BBA's Global Operational Loss Database. This data is used to:

- identify lessons to be learnt
- ensure that no risks have been overlooked
- provide practical scenarios for risk workshops, training and scenario analysis

The Audit, Risk & Compliance Committee receive regular reports highlighting any material internal or external events. The information is used to review the effectiveness of the risk assessment and risk management processes and decide whether any action, such as improving controls, is required to reduce the incidence of any particular loss types.
Internal and external data are also mapped to the bank's Key Risks in order to inform the development of Operational Risk Scenarios for the ICAAP, as discussed below.

Operational Risk: Scenario Analysis (for ICAAP)

The bank has adopted The Standardised Approach to calculating Pillar 1 capital requirements for Operational Risk.

With respect to Pillar 2A capital requirements, the bank uses scenario analysis to help inform how much operational risk capital should be held against each key risk alone or in combination. The scenarios consider the impact of unlikely, but not impossible events. This enables the bank to gain a better understanding of the risks that it faces under extreme conditions. The scenario inputs and outputs are also used to inform the development of risk appetite statements and KRIs which are monitored and escalated in accordance with aforementioned processes.

The following steps are taken:

Scenario Development

In developing its operational risk scenarios, the bank uses a "top-down" approach involving interviews and workshops with senior management to identify key risks facing their areas and the bank as a whole.
Once the "Key Risks" are identified, they are converted into scenarios using an interactive combination of processes and inputs, including:

- **Senior Management Discussions:** In order to develop each identified risk into scenarios, discussions are held with Senior Management across the bank which consider the potential impacts of each risk over a one year horizon under severe conditions as well as the controls in place to mitigate the risk with a view to quantifying the standalone impact of the risk should it occur.
- **Risk and Control Self-Assessments:** The Risk and Control Self-Assessment (RCSA) process identifies the risks to which the bank is exposed. The most significant of these risks are considered in selecting the bank's ICAAP Scenarios.
- **Internal and External Loss Events:** When estimating the potential impacts, internal loss events associated with a given Key Risk are considered. Where appropriate, external loss events are used to supplement the data and analysis.
- **Industry Guidance:** In addition to its own experiences, the bank also considers the experiences which may have occurred at peer firms, including any guidance which may have been provided by industry groups such as the British Bankers' Association (BBA).
- **Regulatory Guidance:** Individual feedback received by the PRA or FCA as part of the Supervisory Review and Evaluation Process (SREP) and scenarios discussed by the FCA publically in publications such as the FCA Risk Outlook are considered.

Challenge and Adoption

Once developed using the iterative combination of processes and inputs described above, the scenarios, assumptions, and associated calculations are reviewed both on an individual and holistic basis in a series of reviews by the appropriate combination of:

- Senior managers
- Finance, Risk Management, Compliance and Audit
- Management Committee (and relevant subcommittees)
- Audit, Risk & Compliance Committee
- Board

The Board is ultimately responsible for formally approving the scenarios and associated capital and liquidity assessments.

Use and Status

Once approved, the scenarios are monitored and updated as appropriate (at least once annually). New scenarios may also be developed as events warrant. In conjunction with the regular reporting and review of the bank's capital and liquidity adequacy, material changes to scenarios or material new scenarios are escalated to the attention of the Board.

Management Actions

The benefits of management actions (or other mitigants) are assumed to reduce impact associated with particular scenarios but not the frequency (since it is assumed that the management actions occur after the fact). Examples of such after the fact management actions and other mitigants include: exiting businesses/products, headcount reductions, bonus reductions, expense reductions, insurance recoveries, etc.
Management actions are only considered necessary where an impact is deemed to be sufficiently sudden and severe that it would warrant immediate implementation of such actions. Whenever the benefits of specific management actions are taken into account in a particular scenario, the assumptions are documented in the scenario model and the impact benefits are quantified.

Use of Insurance

The bank takes a conservative approach regarding the use of insurance as a mitigant with respect to operational risk scenarios, limiting its consideration to risks such as business continuity incidents where there is high certainty of recovery on a timely basis.

Aggregation and Diversification

Since it is extremely unlikely that all of the operational risks the bank faces would simultaneously occur (i.e. correlation=1) with such high severity, an "aggregation and diversification" assumption has been applied to the operational risk capital figure. In order to recognise that there may be some correlation between its operational risks, the bank's conservative approach to aggregation and diversification is to assume that two of its largest operational risks (as measured by combined revenue and expense impacts) occur in the same year and to provide adequate capital and liquidity to accommodate these risks. This simplified approach to aggregation and diversification of operational risks has been presented and discussed in various industry forums.

13. Other Principal Risks

In addition to the risks identified above, there are a number of other risks to which the bank is exposed as detailed below.

13.1 Concentration Risk

Concentration risk is a form of additional credit risk which can result from high or excessive exposure to certain clients, regions or industry sectors. The bank's activities are concentrated on serving high net worth individuals within the UK and operating primarily in the South of England, where a significant proportion of the bank's lending activities are to residential properties. Whilst this is a somewhat concentrated group, the bank's experience (particularly with respect to lending) is that exposures to this group are lower risk than to the average UK population. The bank mitigates these potential concentration risks by establishing a range of limits and trigger thresholds that are regularly monitored and reported to ALCO. The tables within this document set out the bank's exposure by geography and industrial sector.

13.2 Residual Risk

Residual risk is the risk that credit risk mitigation techniques used by the bank prove less effective than expected. The bank does not generally use such techniques and follows the standardised approach to calculating credit risk. This recognises that the bank has an automatic legal right of set-off under which it may use any credit funds that a customer has with the Bank to offset or repay borrowing. Despite this general rule, on occasion, the bank may take a lien over a cash deposit to ensure a minimum balance is maintained as security and the bank recognises such deposits as collateral eligible for credit risk mitigation. At 31 March 2018, £5.4m *(2017: £3.9m)* of exposures were covered in this way and, consequently, a risk weight of 0% was applied to them. Were the liens to fail or balances to be paid away erroneously, £5.4m *(2017: £3.9m)* of exposure could be at risk. Given the bank has procedures in place to address this risk and has not experienced a failure in respect of this collateral, it is considered highly unlikely that a failure will occur.

13.3 Pension Obligation Risk

The bank has a funding obligation for a defined benefit pension scheme which is closed to new entrants and to future accrual. Pension risk is the risk that the market value of the Scheme's assets, together with any agreed employer contributions, will be insufficient to meet the projected liabilities of the Scheme. Pension risk can adversely impact the bank's capital resources. To mitigate these risks, the Trustees of the Scheme in consultation with the bank, carefully manage the investments of the Scheme to hedge the behaviour of the liabilities and reduce the volatility and downside risk of a Scheme deficit. The bank also undertakes stress testing on the pension scheme liabilities and assets as part of its ICAAP.

14. Remuneration

In compliance with financial services regulatory requirements, the bank is required to make the disclosures set out below. Table 15 sets out the remuneration awards that have been made to Identified Staff. Identified Staff include Senior Management (including the Partners, staff performing a Senior Management Function (as defined by the Regulators) and Non-Executive Directors) and Material Risk Takers (staff whose actions are deemed to have a material impact on the bank's risk profile).

Subsequent paragraphs provide information on decision-making policies for remuneration and links between pay and performance.

Table 15: Remuneration Information – Identified Staff

	Governing Body	Senior Management	Other Material Risk Takers	Totals
Business Area – Private Banking				
Number of Identified Staff	**11**	**7**	**2**	**20**
Fixed Income				
Cash (£m)	**6.4**	**1.6**	**0.3**	**8.3**
Total Fixed	**6.4**	**1.6**	**0.3**	**8.3**
Variable Income				
Cash (£m)	**3.5**	**0.5**	**0.06**	**4.1**
Total Variable	**3.5**	**0.5**	**0.06**	**4.1**

Figures represent amounts paid during the 2017/2018 financial year.

14.1 Decision Making Process for Determining the Remuneration Policy

The bank's RemCo is a sub-committee of the Board, and therefore reports to the Board on a regular basis. The purpose of the RemCo is to set the over-arching principles, parameters and governance of the Remuneration Policy across the bank and to consider and approve the remuneration arrangements of the Partners,[10] the Management Committee and other senior employees. The responsibilities of the RemCo include, but are not limited to:

- Determining the Remuneration Policy of the bank and making recommendations to the Board on the policy and structure of remuneration. This includes proposing total remuneration packages, having given consideration to:
    - overall market positioning of the remuneration package
    - individual remuneration packages (including pension and compensation rights)
    - annual and long term bonus arrangements
    - service contracts
    - termination arrangements
    - the risk implications in respect of the design, implementation and management of remuneration arrangements
    - ensuring that there are formal and transparent procedures for developing the policy around these decisions to the level that the RemCo considers appropriate

[10] At 31 March 2018, the Board includes five Directors who are all descendants of the bank's founder. They and three other Hoare family members, are the bank's only shareholders and each has unlimited liability. They are known as Partners and all work in the business to ensure the continuation of the Bank's long-held culture, values and approach to business.

- Overseeing the remuneration arrangements for those staff carrying out a Senior Management Function (as defined by the Regulators) or individuals whose activities have or could have a material impact on the risk profile of the bank. This includes Risk Management, Internal Audit and Compliance
- Ensuring that no individual is involved in any decision relating to their own remuneration
- Undertaking periodic reviews of the Remuneration Policy in the context of consistent and effective risk management through consultation with the Internal Audit, Compliance and Risk Management functions as required
- Approving the annual recommendations to be included in the bank's budget for pay and employee benefits

The remuneration of non-Hoare family Non-Executive Directors ('NEDs'), including the Chairman is determined by the Partners. The level of remuneration for NEDs is designed to reflect their responsibilities and time commitments. The level of fees paid to NEDs is bench-marked to industry standards and reviewed annually. NEDs do not receive annual variable remuneration payments.

14.2 The Remuneration Policy

The bank's Remuneration Policy reflects the objectives for good corporate governance as well as supporting the business strategy, culture of low risk and future sustainability. The overarching principles of the policy are to:

- Recognise the capabilities and achievements of individual employees, rewarding and incentivising sustained good performance. Whilst pay is performance related, individual targets are not aligned directly to bonus payments
- Encourage behaviour that is consistent with the core values, as captured in the bank's behavioural framework which promotes team working, service excellence and the highest levels of integrity
- Deliver a total remuneration package that is both market competitive and affordable, with consideration given to the impact on capital ratios, liquidity and the continued ability to invest in, and grow, the business
- Ensure remuneration is structured in a way that promotes activity that is within the bank's acceptable risk parameters and is in line with all relevant regulatory requirements
- Provide a total remuneration package that ensures that no employee's subsistence is dependent on an annual bonus payment. Variable remuneration payments are made by the bank on an entirely discretionary basis
- Ensure that total remuneration packages meet the bank's commitment in relation to equal pay and non-discrimination.

14.3 Composition of the RemCo

The RemCo convenes, at a minimum, twice a year and is currently chaired by The Rt. Hon. Lord Macpherson of Earl's Court GCB, the Chairman of the bank. The RemCo's constitution requires that membership will consist of at least three Non-Executive Directors.

The current members are:

- The Rt. Hon Lord Macpherson of Earl's Court GCB – Chairman – Independent Non-Executive Director
- Andrew McIntyre – Independent Non-Executive Director
- Dame Susan Rice – Independent Non-Executive Director
- Johanna Waterous – Independent Non-Executive Director

14.4 The Role of Relevant Stakeholders

The Board is fully engaged with remuneration governance and is instrumental in agreeing the size of the annual bonus pool based on the recommendations made by the RemCo. The final recommendations are ratified at the bank's AGM.

The RemCo may invite any Partner, Management Committee member or senior employee to attend meetings, either regularly, or specifically. Staff in the Internal Audit and Risk Management functions will attend from time to time at the invitation of the Chairman. The RemCo will also be supported by both the Compliance department and the Human Resource (HR) function as and when required.

14.5 Link between Pay and Performance

The bank aims to provide a competitive total remuneration package, starting with a fair and sustainable base salary aligned to the relevant external market and the employee's role and responsibilities. This is then supplemented by discretionary bonus payments, a pension contribution of 20% per annum of base salary (subject to earnings cap) and other core benefits such as death in service cover and a heavily subsidised canteen. All employees may also participate in the flexible benefits offered by the bank which currently include gym membership, medical, dental and travel insurance and childcare vouchers.

While all employees are encouraged to discuss performance on an informal and on-going basis, formal appraisals take place twice a year in April (end of year) and September (interim). The bank has a behavioural competencies framework to supplement the appraisal process. The framework focuses employee attention on the skills and behaviours that are required to drive effective performance and achieve the bank's strategic aims within the prescribed risk appetite. The framework is aligned to the bank's values of empathy, social responsibility, honesty and excellence. The framework also ensures that:

- Employees have a well-defined set of behaviours required for their role and are clear about how they are expected to perform
- Employee behaviour is aligned with business objectives and there is a link between effective individual inputs and organisational performance
- Relevant employees have a risk based objective

The interim and end of year performance appraisals evaluate performance against agreed goals and objectives, including Key Performance Indicators ('KPIs'). Recognition is given to employees meeting both financial and non-financial objectives and to the achievement of all behaviour competencies required by their role. In awarding an overall annual performance rating, the bank places a higher weighting on the values and behaviours demonstrated than on the achievement of financial objectives.

Any bonus payments are made on an entirely discretionary basis. Payments are aligned to the bank's overall economic achievement rather than to individual and/or business line performances.

Appendix 1: Own Funds Disclosure template

Own funds disclosure template		2018 £'000	Regulation (EU) No 575/2013 Article Reference
Common Equity Tier 1 (CET1) capital: instruments and reserves			
1	Capital instruments and the related share premium accounts	120	26 (1), 27, 28, 29
	of which: ordinary share capital	120	EBA list 26 (3)
	of which: Instrument type 2	-	EBA list 26 (3)
	of which: Instrument type 3	-	EBA list 26 (3)
2	Retained earnings	309,215	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	43,122	26 (1)
3a	Funds for general banking risk	-	26 (1) (f)
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	-	486 (2)
5	Minority interests (amount allowed in consolidated CET1)	-	84
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	-	26 (2)
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**352,457**	**Sum of rows 1 to 5a**
Common Equity Tier 1 (CET1) capital: regulatory adjustments			
7	Additional value adjustments (negative amount)	-	34, 105
8	Intangible assets (net of related tax liability) (negative amount)	-	36 (1) (b), 37
9	Empty set in the EU	-	
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	-	36 (1) (c), 38,
11	Fair value reserves related to gains or losses on cash flow hedges	-	33(1) (a)
12	Negative amounts resulting from the calculation of expected loss amounts	-	36 (1) (d), 40, 159
13	Any increase in equity that results from securitised assets (negative amount)	-	32 (1)
14	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	-	33(1) (b)
15	Defined-benefit pension fund assets (negative amount)	(8,546)	36 (1) (e), 41
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	-	36 (1) (f), 42
17	Direct, indirect and synthetic holdings of the CET 1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	36 (1) (g), 44
18	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	36 (1) (h), 43, 45, 46, 49 (2) (3), 79
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	36 (1) (i), 43, 45, 47, 48 (1) (b), 49 (1) to (3), 79
20	Empty set in the EU	-	
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	-	36 (1) (k)
20b	of which: qualifying holdings outside the financial sector (negative amount)	-	36 (1) (k) (i), 89 to 91

20c	of which: securitisation positions (negative amount)	-	244 (1) (b), 258
20d	of which: free deliveries (negative amount)	-	36 (1) (k) (iii), 379 (3)
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	-	36 (1) (c), 38, 48 (1) (a)
22	Amount exceeding the 15% threshold (negative amount)	-	48 (1)
23	of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-	36 (1) (i), 48 (1) (b)
24	Empty set in the EU	-	
25	of which: deferred tax assets arising from temporary differences	-	36 (1) (c), 38, 48 (1) (a)
25a	Losses for the current financial year (negative amount)	-	36 (1) (a)
25b	Foreseeable tax charges relating to CET1 items (negative amount)	-	36 (1) (l)
27	Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	-	36 (1) (j)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	(8,546)	Sum of rows 7 to 20a, 21, 22 and 25a to 27
29	Common Equity Tier 1 (CET1) capital	**343,911**	Row 6 minus row 28
Additional Tier 1 (AT1) capital: instruments			
30	Capital instruments and the related share premium accounts	-	51, 52
31	of which: classified as equity under applicable accounting standards	-	
32	of which: classified as liabilities under applicable accounting standards	-	
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	486 (3)
34	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	-	85, 86
35	of which: instruments issued by subsidiaries subject to phase out	-	486 (3)
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	-	Sum of rows 30, 33 and 34
Additional Tier 1 (AT1) capital: regulatory adjustments			
37	Direct and indirect holdings by an institution of own AT1 instruments (negative amount)	-	52 (1) (b), 56 (a), 57
38	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	56 (b), 58
39	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	56 (c), 59, 60, 79
40	Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	56 (d), 59, 79
41	Empty set in the EU	-	
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	-	56 (e)
43	**Total regulatory adjustments to Additional Tier 1 (AT1) capital**	-	Sum of rows 37 to 42
44	**Additional Tier 1 (AT1) capital**	-	Row 36 minus row 43
45	**Tier 1 capital (T1 = CET1 + AT1)**	**343,911**	Sum of row 29 and row 44

Tier 2 (T2) capital: instruments and provisions			
46	Capital instruments and the related share premium accounts	-	62, 63
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	-	486 (4)
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	-	87, 88
49	of which: instruments issued by subsidiaries subject to phase out	-	486 (4)
50	Credit risk adjustments	2,007	62 (c) & (d)
51	**Tier 2 (T2) capital before regulatory adjustments**	**2,007**	
Tier 2 (T2) capital: regulatory adjustments			
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	-	63 (b) (i), 66 (a), 67
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	66 (b), 68
54	Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	66 (c), 69, 70, 79
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	66 (d), 69, 79
56	Empty set in the EU	-	
57	**Total regulatory adjustments to Tier 2 (T2) capital**	-	Sum of rows 52 to 56
58	**Tier 2 (T2) capital**	**2,007**	Row 51 minus row 57
59	**Total capital (TC = T1 + T2)**	**345,918**	Sum of row 45 and row 58
60	**Total risk weighted assets**	**1,598,298**	
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	21.52%	92 (2) (a)
62	Tier 1 (as a percentage of total risk exposure amount)	21.52%	92 (2) (b)
63	Total capital (as a percentage of total risk exposure amount)	21.64%	92 (2) (c)
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	6.38%	CRD 128, 129, 130, 131, 133
65	of which: capital conservation buffer requirement	1.88%	
66	of which: countercyclical buffer requirement	-	
67	of which: systemic risk buffer requirement	-	
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	-	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	17.02%	CRD 128
69	[non relevant in EU regulation]	-	
70	[non relevant in EU regulation]	-	
71	[non relevant in EU regulation]	-	

Amounts below the thresholds for deduction (before risk weighting)			
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	36 (1) (h), 46, 45 56 (c), 59, 60 66 (c), 69, 70
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	36 (1) (i), 45, 48
74	Empty set in the EU	-	
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	-	36 (1) (c), 38, 48
Applicable caps on the inclusion of provisions in Tier 2			
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	-	62
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	-	62
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	-	62
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	-	62
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)			
80	Current cap on CET1 instruments subject to phase out arrangements	-	484 (3), 486 (2) & (5)
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-	484 (3), 486 (2) & (5)
82	Current cap on AT1 instruments subject to phase out arrangements	-	484 (4), 486 (3) & (5)
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-	484 (4), 486 (3) & (5)
84	Current cap on T2 instruments subject to phase out arrangements	-	484 (5), 486 (4) & (5)
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-	484 (5), 486 (4) & (5)

Appendix 2: Asset Encumbrance

The following tables represent the disclosure of encumbered and unencumbered assets as at 31 March 2018.

F 32.01 ASSETS OF THE REPORTING INSTITUTION (AE-ASS)

		Carrying amount of encumbered assets (£'000)			Fair value of encumbered assets (£'000)		Carrying amount of non-encumbered assets (£'000)			Fair value of non-encumbered assets(£'000)	
			of which: issued by other entities of the group	of which:central bank'seligible		of which:central bank's eligible		of which: issued by other entities of the group	of which:central bank'seligible		of which:central bank's eligible
		010	020	030	040	050	060	070	080	090	100
010	**Assets of the reporting institution**	**176,430**					**4,264,755**		**597,782**		
020	Loans on demand	175,929					1,349,795				
030	Equity instruments						1,382				
040	Debt securities	501					1,126,743		597,782	1,062,620	597,782
050	of which: covered bonds						218,637		218,637	218,637	218,637
060	of which: asset-backed securities										
070	of which: issued by general governments						379,145		379,145	379,145	379,145
080	of which: issued by financial corporations	501					464,838			464,838	
090	of which: issued by non-financial corporations										
100	Loans and advances other than loans on demand						1,678,112				
110	of which: mortgage loans						1,385,342				
120	Other assets						108,723				

Asset Encumbrance ratio 4%

Not to be filled on a consolidated basis template

F 32.04		SOURCES OF ENCUMBRANCE (AE-SOU)				
		Matching liabilities, contingent liabilities or securities lent (£'000)		Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered (£'000)		
			of which: from other entities of the group		of which: collateral received re-used	of which: own debt securities encumbered
		010	020	030	040	050
010	**Carrying amount of selected financial liabilities**	**144,154**		**161,360**		
020	Derivatives	144,154		161,360		
030	of which: Over-The-Counter	144,154		161,360		
040	Deposits					
050	Repurchase agreements					
060	of which: central banks					
070	Collateralised deposits other than repurchase agreements					
080	of which: central banks					
090	Debt securities issued					
100	of which: covered bonds issued					
110	of which: asset-backed securities issued					
120	**Other sources of encumbrance**	**35,070**		**15,070**		
130	Nominal of loan commitments received					
140	Nominal of financial guarantees received	30,000		10,000		
150	Fair value of securities lent with non cash-collateral					
160	Other	5,070		50,070		
170	**TOTAL SOURCES OF ENCUMBRANCE**	**179,224**		**176,430**		

Not to be filled on a consolidated basis template

D - Information on importance of encumbrance

The bank is funded primarily (aside from shareholders' capital) from customer deposits payable on demand or at short notice. As a result, the bank does not use wholesale funding. The bank's policy is to restrict the encumbrance of its assets, and the exceptions to these are cash collateral pledged in derivative transactions due to hedging purposes, cash collateral to RBS in relation to RBS providing guarantees jointly on behalf of the bank's customers, securities pledged in favour of the Hoare's Bank Pension Trustees Limited in the event of the bank's insolvency and a Cash Ratio Deposit held at the Bank of England.