Significant Subsidiary Disclosures

31 December 2020
TSB Banking Group plc

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1. Introduction

This document presents the Pillar III Significant Subsidiary Disclosures at 31 December 2020 relating to TSB Banking Group plc (TSB Group), a subsidiary undertaking of Banco de Sabadell Group (Sabadell). TSB Group's risk disclosures presented in this document are included in Sabadell's consolidated Pillar III disclosures.

The purpose of Pillar III is to make certain capital and risk management disclosures available to the market. In compiling this significant subsidiary disclosure, best practice guidelines and interpretations of standards issued by the European Banking Authority (EBA), the Enhanced Disclosure Task Force (EDTF) and national and international trade associations have been considered. The tables, which have been aligned to the standard templates specified by the EBA guidelines published in December 2017, have been labelled in accordance with these guidelines. An analysis of compliance with Capital Requirements Regulation (CRR) in respect of significant subsidiary disclosure is set out in Appendix I.

This document should be considered in conjunction with the TSB Group's 2020 Annual Report and Accounts (ARA), where a number of supporting disclosures are presented.

A detailed overview of the governance arrangements within TSB Group is provided in the Risk Management section within pages 20 to 26 and the Corporate Governance section within pages 27 to 56 of TSB Group's ARA and are not repeated in this document.

TSB Group operates as a United Kingdom (UK) group, authorised and regulated by the Prudential Regulation Authority (PRA). TSB Group also operates within relevant Sabadell policies and its regulatory requirements.

From 1 January 2018, TSB Group has adopted the International Financial Reporting Standard 9 (IFRS 9) transitional arrangements in CRR.

2. Executive summary

TSB Group remains a low risk, well capitalised bank with strong net interest margin and opportunities to grow. Our three-year growth strategy, introduced in November 2019, has helped to navigate the challenges of 2020. Our goal is to restore the Bank's competitiveness through a stronger focus on serving customers more effectively. The strategy is built on three pillars: customer focus; simplification and efficiency, and operational excellence. All three have become even more important in the face of the economic disruption in the UK during 2020.

Like many financial service businesses, the impact of the pandemic is clearly visible in our results for 2020. The statutory result, a loss before tax of £204.6 million, was impacted most significantly by credit impairment charges, which at £164.0 million have increased by £103.5 million compared to 2019. Those charges reflect the UK economic outlook, together with rising unemployment. In addition, income was significantly reduced by supporting customers through the pandemic by waiving interest charges on certain products. Our results are further impacted by a provision for restructuring the Bank and the estimated charges relating to the treatment of some customers in arrears.

Importantly however, this is only part of the story. TSB Group continues to benefit from a relatively low risk balance sheet, with secured lending making up over 92% of all TSB loans. In key areas, the trading performance of the business has improved. Our loan book has grown strongly by £2.2 billion during 2020, as have customer deposits, with an increase of £4.2 billion.

As a result, our balance sheet remains strong as does our capital position, although we note that capital ratios have reduced significantly in 2020 as a result of the business growth referred to above, current year losses and the adoption of new capital regulations. We have also made TSB more efficient. Despite having to invest in new operational measures as a result of the pandemic, our operating costs, measured on a management basis, are down on 2019.

Customer lending exposures grew by £3.6 billion from £35.9 billion to £39.5 billion in 2020 mainly due to growth of £2.8 billion in TSB franchise mortgage lending to £31.7 billion and an increase in lending to SME of £0.6 billion. Customer lending RWAs increase by £2.1 billion to £8.6 billion. The franchise mortgage book RWAs grew by £2.0 billion, of which £1.6 billion was due to the new secured rating system. The new secured rating system was introduced to meet new regulatory expectations. The changes included updating definition of default and exposure at default (EAD), probability of default (PD) and loss given default (LGD) models. These changes are not a reflection of changes in lending performance but are designed to meet the new regulations.

TSB's growth has been particularly significant in lending to SMEs, where 40,000 new business accounts have been opened over the past year, compared to 14,000 in 2019. In our provision of the Bounce Back Loans Scheme (BBLS) loans we have provided over £0.5 billion to over 20,000 SMEs to help them adapt and remain operational during the pandemic. BBL loans are guaranteed by the UK Government and as such have an effective risk weight of 0%.

TSB's capital position has remained above regulatory minimum requirements and internal risk appetite thresholds, with a Common Equity Tier 1 (CET1) capital ratio of 15.3% (2019: 20.8%) (14.8% IFRS 9 fully loaded). In 2020, the CET1 capital ratio decreased by 5.5 percentage points reflecting the statutory loss for the year, lending growth and the effect of the introduction of new capital regulations in 2020 which resulted in an increase in risk weighted assets of £1.6 billion.

TSB Group's leverage ratio of 3.8% (2019: 4.6%) (3.7% IFRS 9 fully loaded) continues to comfortably exceed the CRR minimum of 3%. Under the Bank of England's (BoE) UK leverage ratio framework and in accordance with the PRA policy statement issued in October 2018 and modification issued in May 2020, leverage ratios are calculated on a modified basis to exclude qualifying central bank reserves and COVID-19 lending covered by government guarantee from the exposure measure. While TSB Group is not currently subject to this framework, under this measure TSB Group's modified leverage ratio is 4.3%, in excess of the PRA minimum of 3.25%.

Table 1: Key metrics (KM1 / IFRS 9-FL)

The table below reflects the key metrics and the IFRS 9 transitional capital metrics:

31 December	2020 £000	2019 £000
Available capital (amounts)		
Common Equity Tier 1 (CET1)	**1,630,434**	1,837,943
CET1 as if IFRS 9 or analogous Expected Credit Losses (ECLs) transitional arrangements had not been applied	**1,581,426**	1,823,450
Tier 1 capital	**1,630,434**	1,837,943
Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,581,426**	1,823,450
Total capital	**2,015,339**	2,222,569
Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**2,014,227**	2,216,937
Risk-weighted assets (amounts)		
Total Risk-weighted assets (RWA)	**10,644,263**	8,841,425
Total Risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**10,685,144**	8,853,794
Risk-based capital ratios as a percentage of RWA		
CET1 (as a percentage of risk exposure amount)	**15.3%**	20.8%
CET1 ratio (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**14.8%**	20.6%
Tier 1 capital ratio (as a percentage of risk exposure amount)	**15.3%**	20.8%
Tier 1 capital ratio (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**14.8%**	20.6%
Total capital ratio (as a percentage of risk exposure amount)	**18.9%**	25.1%
Total capital ratio (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**18.9%**	25.0%
Additional CET1 buffer requirements as a percentage of RWA		
Capital conservation buffer requirement	**2.5%**	2.5%
Countercyclical buffer requirement	**0.0%**	1.0%
Bank G-SIB and/or D-SIB additional requirement	**n/a**	n/a
Total CET1 specific buffer requirements	**2.5%**	3.5%
CET1 available after meeting minimum capital requirements(1)	**10.8%**	16.3%
Leverage ratio		
Leverage ratio exposure measure	**42,933,969**	39,889,242
Leverage ratio	**3.8%**	4.6%
Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**3.7%**	4.6%

Footnote

(1) CET1 less Pillar 1 requirement of 4.5%.

Location of risk disclosures

The diagram below summarises the structure of this report and notes the location of the required disclosures on own funds, capital requirements and TSB Group's main Pillar 3 disclosures as appropriate for a Significant Subsidiary Disclosures document.

Own Funds
Pages 8-11

Pillar 1 Capital Requirements
Pages 12-13

Pillar 2 Capital Requirements
Pages 14-15

Pillar 3
Credit Risk Pages 16-34
Leverage Ratio Pages 35-37
Remuneration Pages 38-41

3. Own funds

3.1 Capital adequacy risk

Definition
TSB Group defines capital adequacy risk as the risk associated with the failure to retain sufficient reserves or quality of capital to cover the firm's statutory requirements and operational losses and to support business strategy.

Risk appetite
TSB Group's risk appetite methodology is set out on page 21 of the ARA. TSB Group maintains a strong capital base which meets both its regulatory requirements and supports the growth of the business, including under stressed conditions. The Board approves TSB Group's risk appetite.

Exposure
A capital adequacy exposure arises where TSB Group has insufficient capital to support its strategic objectives and plans, or to meet external stakeholder requirements and expectations. TSB Group's capital management approach is focused on maintaining sufficient capital whilst optimising value for the shareholder.

Measurement
Capital adequacy is measured in accordance with regulatory requirements and TSB Group's Internal Capital Adequacy Assessment Process (ICAAP). Further detail on TSB Group's Pillar 2 capital requirements are available in section 4.3 on page 14.

Mitigation
Compliance with capital adequacy risk appetite is actively managed and monitored through TSB Group's planning, forecasting and stress testing processes. Five-year forecasts of TSB Group's capital position are produced at least annually to inform capital adequacy strategy and form part of the Board approved operating plan. In addition, regular refreshes of planning are produced and reviewed taking into consideration the business and economic conditions at that time. Business plans are tested for capital adequacy using a range of macroeconomic stress scenarios covering adverse economic conditions as well as other potential adverse developments. TSB Group also maintains a Recovery Plan which sets out a range of potential mitigating actions that could be taken in response to stress. The Recovery Plan is reviewed annually and is approved by the Board.

TSB Group can accumulate additional capital through profit retention and, if required, issue eligible capital instruments.

Monitoring
Capital adequacy policies and procedures are subject to independent oversight by the Risk function and Internal Audit. Regular reporting of actual and projected capital ratios against risk appetite is provided to appropriate committees within TSB Group's governance and risk management framework as outlined in pages 20 to 26 of the ARA. These include TSB Executive Committee, the Asset and Liability Committee, Board Risk Committee and the Board.

The regulatory framework within which TSB Group operates continues to be subject to global banking reforms. TSB Group monitors these developments and analyses the potential impacts to ensure that regulatory requirements continue to be met and it operates within risk appetite.

3.2 TSB Group's own funds

TSB Group's own funds as at 31 December 2020 are presented in the table below. This table follows the disclosure format required by the EBA Implementing Technical Standard on Disclosure for Own Funds published in July 2013, however, only items applicable to TSB Group are detailed.

Table 2: Own Funds (OFD2)

31 December	**2020**	2019
	£000	£000
CET1 capital: instruments and reserves		
Capital instruments and related share premium accounts	970,050	970,050
Of which: ordinary shares	5,000	5,000
Retained earnings	1,029,937	1,189,657
Accumulated other comprehensive income (and any other reserves)	(293,373)	(273,761)
CET1 capital before regulatory adjustments	**1,706,614**	1,885,946
CET1 capital: regulatory adjustments		
Prudent value adjustment	(2,345)	(748)
Intangible assets (net of related tax liability) (2)	(38,589)	(20,283)
Fair value reserve relating to gains and losses on cash flow hedges	18,447	4,538
Deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	(102,701)	(46,003)
IFRS 9 transitional adjustments to CET1 Capital	49,008	14,493
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(76,180)**	(48,003)
CET1 capital / Tier 1 capital(1)	**1,630,434**	1,837,943
Tier 2 capital: instruments and provisions		
Capital instruments and related share premium accounts	384,905	384,626
Credit risk adjustments	47,896	8,861
IFRS 9 transitional adjustments to Tier 2 capital	(47,896)	(8,861)
Tier 2 capital	**384,905**	384,626
Total capital	**2,015,339**	2,222,569
Total Risk Weighted Assets	**10,644,263**	8,841,425
Capital Ratios		
Common Equity Tier 1 (as a percentage of total risk exposure amount)	15.3%	20.8%
Tier 1 (as a percentage of total risk exposure amount)	15.3%	20.8%
Total capital (as a percentage of total risk exposure amount)	18.9%	25.1%
Amounts below the threshold for deduction (before risk weighting)		
Direct and indirect holdings 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)	3,349	5,869
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)	42,535	50,130
Applicable caps on the inclusion of provisions in Tier 2		
Credit risk adjustments included in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	86,905	8,861
Cap for inclusion of credit risk adjustments in Tier 2 under internal ratings based approach	47,896	35,000

Footnote

(1) TSB Group does not hold additional Tier 1 capital, hence the CET1 capital and Tier 1 capital have equal values.
(2) Intangible asset deduction is based on the prudential treatment of software assets in EU 2020/2176. The impact of the adjustment is not material for TSB, being a 0.1% impact on CET1% ratio.

From 1 January 2018, TSB Group adopted IFRS 9 transitional arrangements within CRR Article 473a. Further revised guidance was issued in June 2020 regarding the IFRS 9 transitional arrangement in response to COVID-19. At 31 December 2020, these arrangements resulted in an increase of £1.1 million to total capital, comprising of an increase of £49.0 million in CET1 and a reduction of £47.9 million in Tier 2 capital.

3.3 Movements in capital

The movements in CET1 / Tier 1 Capital, Tier 2 Capital and Total Capital in the year are shown below:

Table 3: Movements in capital (OFD3)

	CET1 Capital £000	Tier 2 Capital £000	Total £000
At 31 December 2019	**1,837,943**	**384,626**	**2,222,569**
Profit (loss) attributable to the ordinary shareholder	(159,720)	-	(159,720)
Movement in other comprehensive income (including available for sale)	(19,612)	-	(19,612)
Cash flow hedging reserve regulatory adjustment	13,910	-	13,910
Change in excess of expected losses over impairment allowances	-	-	-
Change in subordinated liabilities	-	279	279
Change in excess of default provision over default expected loss	-	39,035	39,035
Change in intangible fixed assets (1)	(18,306)	-	(18,306)
Movement in prudent valuation adjustment	(1,598)	-	(1,598)
IFRS 9 transitional adjustments	34,515	(39,035)	(4,520)
Movement in deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	(56,698)	-	(56,698)
At 31 December 2020	**1,630,434**	**384,905**	**2,015,339**

	CET1 Capital £000	Tier 2 Capital £000	Total £000
At 31 December 2018	**1,821,180**	**384,348**	**2,205,528**
Profit (loss) attributable to the ordinary shareholder	26,248	-	26,248
Movement in other comprehensive income (including available for sale)	(4,202)	-	(4,202)
Cash flow hedging reserve regulatory adjustment	3,843	-	3,843
Change in excess of expected losses over impairment allowances	-	-	-
Change in subordinated liabilities	-	278	278
Change in excess of default provision over default expected loss	-	2,653	2,653
Change in intangible fixed assets	(1,908)	-	(1,908)
Movement in prudent valuation adjustment	2,178	-	2,178
IFRS 9 transitional adjustments	(1,216)	(2,653)	(3,869)
Movement in deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	(8,180)	-	(8,180)
At 31 December 2019	**1,837,943**	**384,626**	**2,222,569**

Footnote

(1) Intangible asset deduction includes adjustment following publication of regulation 2020/2176 on prudential treatment of software assets.

Tier 1 Capital reduced by £207.5 million during 2020. This was primarily due to the:

- loss of £159.7 million for the year;
- increase in deferred tax asset (that relies on future profits and not from temporary differences) of £56.7 million;
- reduction in other comprehensive income reserve of £19.6 million; and
- movement in regulatory adjustment for intangible fixed assets and higher adjustment for prudent valuation regulatory adjustment.

This reduction was partially offset by the:

- increase in regulatory IFRS 9 transitional adjustment of £34.5 million including revised guidance issued in June 2020 regarding the IFRS 9 transitional arrangement in response to COVID-19; and
- increase in cash flow hedge adjustment.

3.4 Other capital disclosures

Table 4: Reconciliation between statutory and regulatory capital (OFDR)

	2020 Statutory balance £000	2020 Regulatory adjustments £000	2020 Regulatory balance £000	2019 Statutory balance £000	2019 Regulatory adjustments £000	2019 Regulatory balance £000
Own funds	**1,714,987**	-	**1,714,987**	1,874,707	-	1,874,707
Capital	5,000	-	5,000	5,000	-	5,000
Share premium	965,050	-	965,050	965,050	-	965,050
Other reserves	(285,000)	-	(285,000)	(285,000)	-	(285,000)
Retained earnings	1,029,937	-	1,029,937	1,189,657	-	1,189,657
Value adjustments	**(8,373)**	-	**(8,373)**	11,239	-	11,239
Cash flow hedging reserve	(20,049)	-	(20,049)	(2,379)	-	(2,379)
Other value adjustments	11,676	-	11,676	13,618	-	13,618
Total equity	**1,706,614**	-	**1,706,614**	1,885,946	-	1,885,946
Cash flow hedging reserve	-	18,447	18,447	-	4,538	4,538
Intangible assets (1)	-	(38,589)	(38,589)	-	(20,283)	(20,283)
Prudent valuation adjustment	-	(2,345)	(2.345)	-	(748)	(748)
Negative amounts resulting from the calculation of expected loss amounts	-	-	-	-	-	-
Adjustment for deferred tax assets that rely on future profitability and do not arise from temporary differences net of associated tax liabilities	-	(102,701)	(102,701)	-	(46,003)	(46,003)
Other transitional adjustments (IFRS 9)	-	49,008	49,008	-	14,493	14,493
Tier 1 Capital	**1,706,614**	**(76,180)**	**1,630,434**	1,885,946	(48,003)	1,837,943
Subordinated debt	384,905	-	384,905	384,626	-	384,626
Generic funds and provision excess	-	47,896	47,896	-	8,861	8,861
Other transitional adjustments (IFRS 9)	-	(47,896)	(47,896)	-	(8,861)	(8,861)
Tier 2 Capital	**384,905**	**-**	**384,905**	384,626	-	384,626
Total Regulatory Capital	**2,091,519**	**(76,180)**	**2,015,339**	2,270,572	(48,003)	2,222,569

Footnote

(1) Intangible asset deduction includes adjustment following publication of regulation 2020/2176 on prudential treatment of software assets.

The principal features of TSB Group's capital instruments are outlined in Appendix II.

4. Capital requirements

4.1 TSB Group's risk weighted assets and Pillar 1 capital requirements

The risk weighted assets and Pillar 1 capital requirements of TSB Group as at 31 December 2020 are presented in the following table:

Table 5: Overview of RWAs (EU OV1)

	RWAs		Minimum capital requirements (1)
	2020 £000	2019 £000	**2020 £000**
Credit risk (excluding counterparty credit risk - CCR)	**7,584,270**	7,181,081	**606,742**
Of which the standardised approach (2)	1,178,975	1,347,808	94,318
Of which the foundation IRB (FIRB) approach	-	-	-
Of which the advanced IRB (AIRB) approach	6,405,295	5,833,273	512,424
Of which equity IRB under the simple risk-weighted approach or the IMA	-	-	-
Counterparty credit risk (CCR)	**17,452**	48,287	**1,396**
Of which mark to market (2)	17,229	35,755	1,378
Of which original exposure	-	-	-
Of which the standardised approach	-	-	-
Of which internal model method (IMM)	-	-	-
Of which risk exposure amounts for contributions to the default fund of a CCP	178	641	14
Of which CVA	45	11,891	4
Settlement risk	-	-	-
Securitisation exposures in banking book (after cap)	-	-	-
Of which IRB ratings-based approach	-	-	-
Of which IRB Supervisory Formula Approach (SFA)	-	-	-
Of which Internal assessment approach (IAA)	-	-	-
Of which Standardised approach	-	-	-
Market risk	-	-	-
Of which standardised approach	-	-	-
Of which internal model approaches (IMA)	-	-	-
Large exposures	-	-	-
Operational risk	**1,400,392**	1,484,429	**112,031**
Of which Basic Indicator Approach	-	-	-
Of which Standardised Approach	1,400,392	1,484,429	112,031
Of which Advanced Measurement Approach	-	-	-
Amounts below the thresholds for deduction (subject to 250% risk weight) (2)	**50,591**	127,628	**4,047**
Other risk exposure amounts (3)	**1,591,558**	-	127,325
Total	**10,644,263**	8,841,425	**851,541**

Footnotes

(1) Under Pillar 1, firms are required to maintain minimum regulatory capital levels at 8% of RWAs.

(2) In table 6, the standardised credit risk amounts include CCR valued on a mark to market basis and amounts subject to 250% risk weight, which are reported in different sections of table 5.

(3) RWAs reported in 'Other risk exposure amounts' relate to new secured rating system applied to mortgage franchise IRB and associated IFRS 9 transitional adjustment from change in expected loss.

RWAs increased during 2020 by £1,802.8 million.

RWAs measured under the internal rating based (IRB) approach increased by £572.0 million. The increase in mortgage RWAs largely reflected the growth in lending. In addition, £1,591.6 million reported in 'Other risk exposure amounts' related to the deployment of the new secured rating system in compliance with new capital regulation. Unsecured RWA increases reflect increased lending partly offset by a reduction in assets in default.

The expected reduction in RWAs measured under the standardised approach is mainly due to the repayments of institutional exposures and reduced exposures in the closed Whistletree portfolio.

Table 6: Total amount of risk weighted assets and minimum own funds requirements

Exposure classes and risk types	**2020 RWA £000**	**2020 Minimum Capital Requirements £000**	2019 RWA £000	2019 Minimum Capital Requirements £000
Credit risk (standardised approach)	**1,246,795**	**99,743**	1,511,191	120,896
Central governments and central banks	42,219	3,377	112,956	9,037
Institutions	47,137	3,771	141,881	11,351
Corporates	21,991	1,759	17,205	1,376
Retail	97,242	7,779	92,648	7,412
Exposures collateralised with residential or commercial property	438,738	35,099	497,758	39,821
Covered bonds	21,153	1,692	16,630	1,330
Exposures in default status	92,384	7,391	94,238	7,539
Equity exposures	8,373	670	14,673	1,174
Other exposures	477,558	38,205	523,202	41,856
Credit risk (internal ratings-based approach)	**6,405,295**	**512,424**	5,833,273	466,662
Retail	6,405,295	512,424	5,833,273	466,662
i) Mortgages for residential or commercial property	3,664,069	293,126	3,220,002	257,600
ii) Eligible revolving exposures	1,230,518	98,441	1,225,034	98,003
iii) Other retail	1,510,708	120,857	1,388,237	111,059
Contribution to default guarantee fund of a CCP	**178**	**14**	641	51
Operational risk	**1,400,392**	**112,031**	1,484,429	118,754
Operational risk (standardised approach)	1,400,392	112,031	1,484,429	118,754
Credit valuation adjustment risk	**45**	**4**	11,891	951
Other risk exposure amounts	**1,591,558**	**127,325**	-	-
Total minimum own funds requirement	**10,644,263**	**851,541**	8,841,425	707,314

4.2 TSB Group's risk weighted assets movements by key driver

Analysis of movements in IRB credit risk RWAs from 31 December 2019 to 31 December 2020.

Table 7: RWA flow statement of credit risk exposures under IRB (EU CR8)

	RWA £000	**Capital requirements £000**
At 31 December 2019	**5,833,273**	**466,662**
Asset size	903,305	72,264
Asset quality	(442,127)	(35,370)
Model updates [1]	110,844	8,868
Methodology and policy	-	-
Acquisitions and disposals	-	-
Foreign exchange movements	-	-
Other	-	-
At 31 December 2020	**6,405,295**	**512,424**

	RWA £000	**Capital requirements £000**
At 31 December 2018	**6,099,522**	**487,962**
Asset size	713,814	57,105
Asset quality	(1,062,036)	(84,963)
Model updates	83,001	6,640
Methodology and policy	-	-
Acquisitions and disposals	-	-
Foreign exchange movements	-	-
Other	(1,028)	(82)
At 31 December 2019	**5,833,273**	**466,662**

Footnotes

(1) Model update and movement in IRB RWAs doesn't include the RWAs reported in 'Other risk exposure amounts' which relates to new secured rating system applied to mortgage franchise.

During 2020, IRB credit risk RWAs have increased due to the following factors:

- Increased asset size reflects the net effect of the origination of new business with higher risk weights and repayment of mature loans with lower risk weights. The £903.3 million increase in RWAs relates mainly to changes in the mortgage portfolio £770.1 million and £133.2 million in unsecured lending.
- Asset quality refers to the reduction in RWAs of £442.1 million arising from reductions in defaults and arrears.

4.3 TSB Group's Pillar 2 capital requirement

In order to address the requirements of Pillar 2 of the Basel III framework, the PRA has set additional requirements through the Pillar 2a and PRA buffer (Pillar 2b).

Pillar 2a

TSB Group's internal assessment of its capital adequacy process (ICAAP), is a key input to the PRA's Supervisory Review and Evaluation Process (SREP) and determination of Pillar 2a.

TSB Group's ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk and operational risk through the assessment of material risks not covered or not fully captured under Pillar 1. ICAAP is updated at least annually and is subject to review by ALCO, BRC and the Board. The PRA undertakes a regular review of TSB Group's capital adequacy and its approach to capital management. As part of this review, the PRA determines the amount of supplementary capital required under Pillar 2a.

TSB Group's capital requirements, therefore, include Pillar 2a which may be specified by the PRA as a percentage of RWAs and / or as an absolute value and are based on a point in time assessment.

As at 31 December 2020, TSB Group's total Pillar 1 plus Pillar 2a capital requirement was 12.5% of RWAs (8% Pillar 1 plus 4.5% Pillar 2a). At least 56.25% of this requirement is required to be met in the form of CET1, equating to 7.0% of RWAs.

Effective 1 January 2021, TSB Group's total Pillar 1 plus Pillar 2a capital requirement reduced to 11.0% of RWAs (8% Pillar 1 plus 3.0% Pillar 2a based on 31 December RWAs). At least 56.25% is required to be met in the form of CET1, equating to 6.2% of RWAs.

TSB Group is also required to comply with capital conservation buffer (as part of Pillar 2b requirements), countercyclical capital buffer (CCyB) requirements and the PRA buffer (where the regulator considers other buffers to be insufficient).

PRA buffer

As part of the capital planning process, forecast capital positions are subjected to a range of macroeconomic stresses to determine whether TSB Group's own funds are adequate to meet minimum requirements at all times. The PRA uses the output from these stresses to set a PRA buffer for TSB Group.

Capital conservation buffer

The capital conservation buffer is designed to ensure that institutions build up capital buffers that can be drawn upon during times of stress. The fully transitioned buffer of 2.5% of RWAs was effective from 1 January 2019.

Other Systemically Important Institutions buffer (O-SII buffer)

On 1 May 2019 the PRA announced the inaugural Systemic Risk buffers for ring-fenced banks and large building societies – applicable from 1 August 2019. TSB was not allocated a buffer. This was in line with previous Financial Policy Committee (FPC) guidance which had stated that firms with less than £175 billion assets would attract a 0% buffer. In December 2020, as part of the implementation of CRD V, the O-SII buffer replaced the function previously performed by the Systemic Risk Buffer.

Countercyclical capital buffer (CCyB)

The FPC set the UK CCyB rate at 1.0% effective from November 2018. CCyB applies to TSB Group exposures as they are categorised as UK exposures, due to non-UK relevant credit exposure RWAs being less than 2% of total RWAs. On 11th March 2020, as part of the response to mitigate the economic shock from COVID-19 the FPC announced a reduction in the CCyB to 0% with immediate effect. The FPC now expects to hold the 0% until at least Q4 2021. Due to the usual 12-month implementation lag, any subsequent increase is not expected to take effect until Q4 2022 at the earliest. The eventual pace of a return to a standard 2% UK CCyB rate will depend on banks' ability to rebuild capital while continuing to support households and businesses.

4.4 Minimum requirement for own funds and eligible liabilities (MREL)

In June 2018, the BoE published its updated approach to setting an MREL. The BoE's statement of policy set out its approach to the distribution of MREL within groups. As a UK subsidiary of Banco Sabadell, an internal MREL requirement applies to TSB Group. MREL is subject to phased implementation and will be fully implemented from 1 January 2023. During the transitional period from 1 January 2020 until 31 December 2022, the Group is subject to an interim internal MREL, excluding regulatory stress buffers, of 16.2% of RWAs. CET1 capital cannot be used to meet both MREL and capital buffers. During 2020, TSB Group issued £450mn of senior unsecured debt securities that contributes to its internal MREL. TSB Group's MREL ratio of 23.2% comfortably exceeds its interim MREL requirements.

Table 8: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer (BUF1)

	General credit exposures		Trading book exposure		Securitisation exposure		Own funds requirements					
31 December 2020	Exposure value for SA	Exposure value IRB	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own funds requirement weights	Counter-cyclical capital buffer rate
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**%**	**%**
Breakdown by country												
Country: Great Britain	2,381,294	38,183,103	-	-	-	-	605,019	-	-	605,019	100.00%	0.00%
Total	**2,381,294**	**38,183,103**	**-**	**-**	**-**	**-**	**605,019**	**-**	**-**	**605,019**	**100.00%**	**0.00%**

Table 9: Amount of institution-specific countercyclical capital buffer (BUF2)

31 December 2020	**£000**
Total risk exposure amount	10,644,263
Institution specific countercyclical buffer rate %	0.00%
Institution specific countercyclical buffer requirement	0

5. Credit risk

5.1 Overview

Definition
TSB Group defines credit risk as the risk that a borrower, or counterparty, fails to pay the interest or to repay the principal on a loan or other financial instrument as they fall due.

TSB Group adopts decision making processes and systems geared to provide affordable lending. The assessment of a customer's creditworthiness is based on individual needs and circumstances at the time of application. This approach helps customers borrow well and limits the risks associated with non-repayment.

Credit risk appetite is set for responsible and controlled growth and has measures and limits in place to act as a mechanism to prevent TSB Group and its customers from overreaching their ability to manage their borrowing. These measures include loan-to-value thresholds, loan-to-income ratios and credit concentration limits.

TSB Group understands customers circumstances can change, which can impact their ability to repay borrowings and works with its customers to improve their position by offering various treatment strategies and support.

Risk appetite
TSB Group defines risk appetite as the amount and type of risk that it is willing to take in pursuit of strategy. Within each planning cycle, the Board approves TSB Group's risk appetite and strategy. Through clear and consistent communication and monitoring, the Board ensures that senior management stays within risk appetite through risk policies that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the risk profile of TSB Group. For credit risk, TSB maintains a portfolio, focused on UK customers and assets, and prime lending criteria.

Exposures
A range of approaches are available to measure credit risk and to determine the minimum level of capital required.

TSB Group's credit risk exposures are classified into broad categories, as defined under:
- **The retail IRB approach:** Use of internal models to calculate Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD); and
- **The standardised approach:** Portfolios whose associated internal models have yet to roll out or where no model roll out is planned.

The principal source of credit risk within TSB Group arises from loans and advances to retail and business banking customers. TSB Group's retail credit risk exposures include:
- retail exposures secured by real estate collateral - residential mortgages;
- qualifying revolving retail exposures - overdrafts and credit cards;
- other retail exposures - unsecured personal lending; and
- retail SME - lending to sole traders, small employees and small limited companies.

Credit risk arises principally from TSB Group's lending activities through adverse changes in the credit quality of customers and macro-economic disruptions to credit markets. TSB Group also manages credit risk by seeking to avoid geographical concentrations of its credit portfolio in the UK.

Additional sources of credit risk are managed in TSB Group's Treasury function. These include:
- placing surplus funds with financial institutions and sovereign counterparties e.g. the BoE;
- holding securities, e.g. UK gilts, supranational and covered bonds for liquidity management; and
- hedging its interest rate & currency risk. Almost all TSB Group's swaps are cleared through a central counterparty, while the remainder are transacted with high quality financial institutions.

Sections 5.2 – 5.16 provide an overview of TSB Group's credit risk exposures. Tables 12, 13, 14, 15, 16 and 20 disclose TSB Group's credit risk exposures excluding exposures subject to counterparty credit risk.

5.2 Consolidated balance sheet under the regulatory scope of consolidation

The following table shows that the scope of consolidation of the TSB Group's consolidated balance sheet on an accounting basis (as presented on page 60 of TSB Group's ARA) and the consolidated balance sheet on a regulatory basis are the same. The table also provides a mapping of financial statement categories to regulatory risk categories.

Table 10: Differences between accounting and regulatory scopes of consolidation and the mapping of financial statement categories with regulatory risk categories (EU LI1)

			Carrying value of items:				
December 2020 £000	**Carrying values as reported in published financial statements**	**Carrying values under scope of regulatory consolidation**	**Subject to the credit risk framework**	**Subject to the CCR framework**	**Subject to the securitisation framework**	**Subject to the market risk framework**	**Not subject to capital requirements or subject to deduction from capital**
Assets							
Cash, cash balances at central banks and other demand deposits	5,056,521	5,056,521	5,056,521	-	-	-	-
Financial assets held for trading:							
Derivative financial assets	198,320	198,320	-	198,320	-	-	-
Financial assets designated at fair value through profit or loss:							
Equity instruments	21	21	21	-	-	-	-
Financial assets at fair value through other comprehensive income	1,496,860	1,496,860	1,496,860	-	-	-	-
Financial assets designated at amortised cost							
Debt securities	1,123,731	1,123,731	1,123,731	-	-	-	-
Loans to central banks	120,924	120,924	120,924	-	-	-	-
Loans to credit institutions	43,266	43,266	43,266		-	-	-
Loans and advances to customers	33,317,852	33,317,852	33,317,852	-	-	-	-
Reverse repos	-.	-		-	-	-	-
Other advances	220,184	220,184	26,752	193,432	-	-	-
Hedging derivative assets	139,915	139,915	-	139,915	-	-	-
Fair value adjustments for portfolio hedged risk	80,158	80,158	-	-	-	-	80,158
Property, plant and equipment	258,862	258,862	258,862	-	-	-	-
Intangible Assets	49,500	49,500	10,911	-	-	-	38,589
Current tax assets	364	364	364	-	-	-	-
Deferred tax assets	145,236	145,236	42,534	-	-	-	102,702
Other assets	154,880	154,880	154,880	-	-	-	-
Total Assets	**42,406,594**	**42,406,594**	**41,653,478**	**531,667**	-	-	**221,449**
Liabilities							
Financial liabilities held for trading:							
Derivative financial liabilities	302,311	302,311	-	302,311	-	-	-
Financial liabilities at amortised cost:							
Borrowings from central banks	3,065,772	3,065,772	-	-	-	-	3,065,772
Deposits from public administrations	6,510	6,510	-	-	-	-	6,510
Deposits from credit institutions	4,890	4,890	-	-	-	-	4,890
Customer deposits	34,368,753	34,368,753	-	-	-	-	34,368,753
Repurchase agreements	-	-	-	-	-	-	-
Debt securities in issue	1,249,105	1,249,105	-	-	-	-	1,249,105
Subordinated liabilities	841,396	841,396	-	-	-	-	841,396
Other financial liabilities	170,079	170,079	-	-	-	-	170,079
Hedging derivative liabilities	225,249	225,249	-	225,249	-	-	-
Fair value adjustments for portfolio hedged risk	116,957	116,957	-	-	-	-	116,957
Provisions	153,064	153,064	-	-	-	-	153,064
Current tax liabilities	-	-	-	-	-	-	-
Other liabilities	195,894	195,894	-	-	-	-	195,894
Total Liabilities	**40,699,980**	**40,699,980**	-	**527,560**	-	-	**40,172,420**
Shareholder's equity	**1,706,614**	**1,706,614**	-	-	-	-	**1,706,614**
Total equity and liabilities	**42,406,594**	**42,406,594**	-	**527,560**	-	-	**41,879,034**

Table 11: Main sources of differences between regulatory exposure amounts and carrying values in financial statements (EU LI2)

		Items subject to			
31 December 2020	**Total**	**Credit risk framework**	**CCR framework**	**Securitisation framework**	**Market risk framework**
	£000	**£000**	**£000**	**£000**	**£000**
Assets carrying value amount under the scope of regulatory consolidation (as per template EU LI1)	**42,185,145**	**41,653,478**	**531,667**	-	-
Liabilities carrying value amount under the regulatory scope of consolidation (as per template EU LI1)	527,560	-	527,560	-	-
Total net amount under the regulatory scope of consolidation	41,657,585	41,653,478	4,107	-	-
Off-balance-sheet amounts	6,251,535	6,251,535	-	-	-
Removal of accounting values for CCR	(4,107)	-	(4,107)	-	-
Regulatory CCR Exposure	312,385	-	312,385	-	-
Differences due to consideration of provisions	224,088	224,088	-	-	-
Differences due to prudential filters	-	-	-	-	-
Difference in valuation methodologies / regulatory adjustments	1,393,119	1,393,119	-	-	-
Differences due to CCFs	(892,934)	(892,934)	-	-	-
Exposure amounts considered for regulatory purposes	**48,941,671**	**48,629,286**	**312,385**	-	-

5.3 Credit risk exposure: Analysis by exposure class

The net value of exposures as at 31 December 2020 and the 2020 average is set out in the table below:

Table 12: Total and average net amount of exposures (EU CRB-B)

31 December 2020	Net value of exposures at the end of the period £000	Average net exposures over the period £000
Central governments or central banks	-	-
Institutions	-	-
Multilateral development banks	-	-
Corporates	-	-
Of which: Specialised lending	-	-
Of which: SMEs	-	-
Retail	37,223,489	35,066,196
Secured by real estate property	31,731,207	29,803,400
SMEs	-	-
Non-SMEs	31,731,207	29,803,400
Qualifying revolving	4,331,450	4,182,453
Exposures in default	-	-
Other retail	1,160,832	1,080,343
SMEs	-	-
Non-SMEs	1,160,832	1,080,343
Equity	-	-
Total IRB approach	**37,223,489**	**35,066,196**
Central governments or central banks	6,812,814	6,624,833
Regional governments or local authorities	-	-
Public sector entities	247,195	272,056
Multilateral development banks	396,957	381,609
International organisations	-	-
Institutions	57,449	237,250
Corporates	25,057	22,059
Of which: SMEs	18,520	15,341
Retail	733,642	458,764
Of which: SMEs	688,588	406,090
Secured by mortgages on immovable property	1,399,336	1,478,631
Of which: SMEs	27,772	26,334
Exposures in default	92,149	93,745
Items associated with particularly high risk	-	-
Covered bonds	211,531	200,564
Claims on institutions and corporates with a short-term credit assessment	-	-
Collective investments undertakings	-	-
Equity exposures	3,349	3,925
Other exposures	651,226	666,750
Total standardised approach	**10,630,705**	**10,440,186**
Total	**47,854,194**	**45,506,382**

Net exposure value at 31 December 2020 increased by £4,154.7 million to £47,854.2 million compared to December 2019 net exposures of £43,699.5 million.

This was driven mainly by an increase in retail lending, as follows:
- Retail secured lending grew from £28,932.8 million to £31,731.2 million; and
- Retail unsecured balances increased with:
  - personal loan lending increasing by £125.7 million to £1,160.8 million; and
  - qualifying revolving lending increasing by £248.6 million to £4,331.4 million, including growth in off balance sheet credit card balances.

The main movements within exposures under the standardised approach balances were:
- an increase in Bank of England exposures of £955.0 million to £6,812.8 million;
- an increase in 'of which' SME exposures of £589.9 million from £145.0 million to £734.9 million. This strong growth was due to TSB's provision of Bounce Back Loans to help SME's adapt and remain operational during the pandemic; and
- a partly offsetting reduction in institutional exposures and the ongoing and expected repayment of the Whistletree loan portfolio (within Retail, Secured and Default categories of the standardised approach).

5.4 Concentration of exposures: By industry and counterparty types

Net exposures as at 31 December 2020, analysed by major industrial sector and counterparty type, are provided in the table below:

Table 13: Concentration of exposures by industry (EU CRB-D)

31 December 2020 £000	Agriculture, forestry and fishing	Mining and quarrying	Manufacturing	Electricity, gas, steam and air conditioning supply	Water supply	Construction	Wholesale and retail trade	Transport and storage	Accommodation and food service activities	Information and communication	Real estate activities	Professional, scientific and technical activities	Administrative and support service activities	Public administration and defence, compulsory social security	Education	Human health services and social work	Arts, entertainment and recreation	Financial and Insurance activities	Other services	Personal	Total
Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Corporates	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Retail	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	37,223,489	**37,223,489**
Equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Total IRB approach	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**37,223,489**	**37,223,489**
Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	6,812,814	-	-	-	-	-	-	**6,812,814**
Regional governments or local authorities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Public sector entities	-	-	-	-	-	-	-	-	-	-	-	-	-	247,195	-	-	-	-	-	-	**247,195**
Multilateral Development Banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	396,957	-	-	**396,957**
International Organisations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	57,449	-	-	**57,449**
Corporates	-	-	61	-	-	-	2,948	129	2,972	-	13,636	96	-	-	-	4,663	57	-	495	-	**25,057**
Retail	25,123	50	25,588	230	1,634	116,128	132,080	35,505	85,846	20,174	45,020	78,670	32,994	1,147	8,589	29,260	13,477	4,616	30,122	47,389	**733,642**
Secured by mortgages on immovable property	685	162	361	34	-	1,260	2,255	730	2,403	240	17,158	989	228	-	5	758	77	115	342	1,371,534	**1,399,336**
Exposures in default	97	-	6	-	-	166	31	46	77	4	244	1	1	-	-	-	41	47	1,225	90,163	**92,149**
Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Covered bonds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	211,531	-	-	211,531
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Collective investments undertakings (CIU)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Equity exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3,349	-	-	**3,349**
Other exposures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	651,226	-	-	**651,226**
Total standardised approach	**25,905**	**212**	**26,016**	**264**	**1,634**	**117,554**	**137,314**	**36,410**	**91,298**	**20,418**	**76,058**	**79,756**	**33,223**	**7,061,156**	**8,594**	**34,681**	**13,652**	**1,325,290**	**32,184**	**1,509,086**	**10,630,705**
Total	**25,905**	**212**	**26,016**	**264**	**1,634**	**117,554**	**137,314**	**36,410**	**91,298**	**20,418**	**76,058**	**79,756**	**33,223**	**7,061,156**	**8,594**	**34,681**	**13,652**	**1,325,290**	**32,184**	**38,732,575**	**47,854,194**

Exposures at 31 December 2020 are £47,854.2 million, up £4,154.7 million from £43,699.5 million due to increased retail lending, increased SME lending largely from BBLs and an increase in balances held with BoE.

5.5 Credit risk exposure: Geographical breakdown of exposures

TSB's Group's credit risk exposures arising outside of the UK are not deemed material and have been summarised within Other geographical areas where geographical area is based on the location of the ultimate parent company. These relate to institutional exposures of £615.0 million compared to £858.8 million at December 2019.

TSB Group also has £153.9 million (£150.8 million December 2019) of retail secured exposures to customers currently resident overseas but secured on residential properties in the UK.

These exposures are not deemed material in the context of TSB Group's balance sheet and are below the EBA reporting thresholds (of 10% gross exposures or 2% qualifying RWAs) applied for regulatory reporting.

All credit risk exposures as at 31 December 2020 and at 31 December 2019 are therefore categorised as being in the UK.

Table 14: Geographical breakdown of exposures (EU CRB-C)

31 December 2020	UK £000	Other geographical areas £000	Total £000
Central governments or central banks	-	-	-
Institutions	-	-	-
Multilateral development banks	-	-	-
Corporates	-	-	-
Retail	37,223,489	-	**37,223,489**
Equity	-	-	-
Total IRB approach	**37,223,489**	**-**	**37,223,489**
Central governments or central banks	6,782,797	30,017	**6,812,814**
Regional governments or local authorities	-	-	**-**
Public sector entities	68,470	178,725	**247,195**
Multilateral development banks	-	396,957	**396,957**
International organisations	-	-	**-**
Institutions	55,480	1,969	**57,449**
Corporates	25,057	-	**25,057**
Of which: SMEs	18,520	-	**18,520**
Retail	733,642	-	**733,642**
Of which: SMEs	688,588	-	**688,588**
Secured by mortgages on immovable property	1,399,336	-	**1,399,336**
Of which: SMEs	27,772	-	**27,772**
Exposures in default	92,149	-	**92,149**
Items associated with particularly high risk	-	-	**-**
Covered bonds	211,531	-	**211,531**
Claims on institutions and corporates with a short-term credit assessment	-	-	**-**
Collective investments undertakings	-	-	**-**
Equity exposures	-	3,349	**3,349**
Other exposures	647,225	4,001	**651,226**
Total standardised approach	**10,015,687**	**615,018**	**10,630,705**
Total	**47,239,176**	**615,018**	**47,854,194**

5.6 Credit risk exposure: Analysis by maturity

Net on balance sheet credit risk exposures as at 31 December 2020, analysed by residual contractual maturity, are provided in table 15 below:

Table 15: Maturity of exposures (EU CRB-E)

	Net exposure value					
31 December 2020	**On Demand**	**≤ 1 year**	**> 1 year ≤ 5 years**	**> 5 years**	**No stated maturity**	**Total**
	£000	£000	£000	£000	£000	**£000**
Central governments or central banks	-	-	-	-	-	-
Institutions	-	-	-	-	-	-
Corporates	-	-	-	-	-	-
Retail	674,494	247,257	2,247,425	28,169,854	13,199	**31,352,229**
Equity	-	-	-	-	-	-
Total IRB approach	**674,494**	**247,257**	**2,247,425**	**28,169,854**	**13,199**	**31,352,229**
Central governments or central banks	4,910,095	10,700	34,141	1,736,954	120,924	**6,812,814**
Regional governments or local authorities	-	-	-	-	-	**-**
Public sector entities	-	-	17,305	229,890	-	**247,195**
Multilateral Development Banks	-	-	91,499	305,458	-	**396,957**
International Organisations	-	-	-	-	-	**-**
Institutions	1,969	2	43,266	12,212	-	**57,449**
Corporates	2,936	285	1,083	20,709	-	**25,013**
Retail	1,816	6,875	11,911	673,672	-	**694,274**
Secured by mortgages on immovable property	8,218	18,205	114,788	976,491	291	**1,117,993**
Exposures in default	2,119	1,121	7,033	80,323	1,210	**91,806**
Items associated with particularly high risk	-	-	-	-	-	**-**
Covered bonds	-	23,011	175,510	13,010	-	**211,531**
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	**-**
Collective investments undertakings (CIU)	-	-	-	-	-	**-**
Equity exposures	-	-	-	-	21	**21**
Other exposures	-	-	-	-	612,082	**612,082**
Total standardised approach	**4,927,153**	**60,199**	**496,536**	**4,048,719**	**734,528**	**10,267,135**
Total exposures	**5,601,647**	**307,456**	**2,743,961**	**32,218,573**	**747,727**	**41,619,364**

Maturity profile is consistent with previous year. On demand amounts largely relate to exposures with the Bank of England and unsecured lending. The greater than 5 years amounts largely relate to secured retail mortgage lending and gilts.

5.7 Standardised approach: Credit risk exposure and CRM effects

The following table provides a measure of the risk of each portfolio by analysing RWA density.

Table 16: Standardised approach - Credit risk exposure and CRM effects (EU CR4)

31 December 2020	Exposures before CCF and CRM		Exposures post CCF and CRM			
	On-balance-sheet amount	Off-balance-sheet amount	On-balance-sheet amount	Off-balance-sheet amount	RWAs	RWA density
	£000	£000	£000	£000	£000	%
Central governments or central banks	6,812,814	-	7,448,891	171	42,219	1%
Regional government or local authorities	-	-		-	-	-
Public sector entities	247,195	-	161,420	-	-	0%
Multilateral development banks	396,957	-	396,957	-	-	0%
International organisations	-	-	-	-	-	-
Institutions	57,449	-	57,449	-	29,908	52%
Corporates	25,013	44	24,965	9	21,991	88%
Retail	694,274	39,368	147,177	7,813	97,242	63%
Secured by mortgages on immovable property	1,117,993	281,343	1,114,909	140,362	438,738	35%
Exposures in default	91,806	343	91,733	166	92,384	101%
Exposures associated with particularly high risk	-	-	-	-	-	-
Covered bonds	211,531	-	211,531	-	21,153	10%
Institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-	-
Equity	21	3,328	21	3,328	8,373	250%
Other items	612,082	39,144	612,082	27,199	477,558	75%
Total	**10,267,135**	**363,570**	**10,267,135**	**179,048**	**1,229,566**	**12%**

TSB Group does not make use of credit derivatives for regulatory capital purposes. The main sources of CRM relate to Government guarantees on BBLs as evident from movement of exposures between Retail and Central Governments.

5.8 Exposures subject to the Retail IRB approach

Table 17: Portfolios subject to the Retail IRB approach and subject to roll-out for calculating IRB parameters

Regulatory Exposure Portfolio	Internal Portfolio	Internal Estimates Used	Approach	Status
Retail	Residential Mortgages(1)	Probability of default (PD) Loss given default (LGD) Credit conversion factor (CCF)	Retail IRB	Authorised in 06/2014
Retail	Consumer Loans	PD LGD CCF	Retail IRB	Authorised in 10/2014
Retail	Consumer Credit Cards	PD LGD CCF	Retail IRB	Authorised in 06/2015
Retail	Personal Current Accounts	PD LGD CCF	Retail IRB	Authorised in 06/2015
Retail	Retail SME	-	Standardised	Under roll-out plan to IRB

Footnote

(1) TSB Group has developed a new Secured Rating System to meet new regulatory expectations including new definition of default, EAD model, PD model and LGD model. These changes were not a reflection in lending performance but were designed to meet new regulations. TSB Residential Mortgages will be reported using this system during 2021.

Internal rating scales

Probability of default internal rating scales are used within TSB Group in assessing the credit quality of the Retail IRB unsecured lending and mortgage portfolios. One scale exists within the business, Retail Master Scale, which covers all relevant retail portfolios. TSB Group uses a continuous PD scale where customers are allocated to rating scales for the purposes of reporting.

A detailed analysis, by portfolio type and by PD Grade, of credit risk exposures subject to the Retail IRB approach is provided in the sections that follow.

Disclosures provided in the tables below take into account PD floors and LGD floors specified by the regulators in respect of the calculation of regulatory capital requirements.

Table 18: IRB approach – Credit risk exposures by exposure class and PD range (EU CR6)

31 December 2020	PD scale	Original on-balance sheet gross exposure	Off-balance sheet exposures pre CCF	Total	Average CCF	On-balance sheet EAD	Off-balance sheet EAD	EAD post CRM and post-CCF	Average PD	Number of obligors	Average LGD	RWA	RWA density	EL	Value adjustments and provisions
		£000	£000	£000	%	£000	£000	£000	%	000's	%	£000	%	£000	£000
Exposure Class: Retail mortgage (1) (2) (3)	0.00 to <0.15	25,881,622	1,334,276	27,215,898	100.00%	27,109,662	1,398,983	28,508,645	0.35%	213	9.61%	2,027,160	7,11%	11,538	18,309
	0.15 to <0.25	1,872,789	382,930	2,255,719	100.00%	1,961,746	401,535	2,363,281	1.46%	18	12.22%	566,488	23.97%	4,825	4,709
	0.25 to <0.50	986,897	305,398	1,292,295	100.00%	1,033,788	320,246	1,354,034	2.52%	10	13.07%	478,495	35.34%	5,031	3,625
	0.50 to <0.75	228,752	75,450	304,202	100.00%	239,650	79,122	318,772	4.40%	3	12.99%	153,134	48.04%	2,046	1,239
	0.75 to <2.50	256,790	58,703	315,493	100.00%	269,037	61,564	330,601	9.06%	3	11.81%	198,032	59.90%	3,861	2,096
	2.50 to <10.00	153,769	355	154,124	100.00%	160,618	372	160,990	31.84%	2	9.58%	107,017	66.47%	5,784	1,922
	10.00 to <100.00	122,368	196	122,564	100.00%	125,712	206	125,918	72.13%	1	9.76%	45,541	36.17%	10,241	1,530
	100.00 (Default)	109,147	-	109,147	0.00%	108,998	-	108,998	100.00%	1	11.77%	88,202	80.92%	5,769	4,805
	Sub-total	**29,612,134**	**2,157,308**	**31,769,442**	**100.00%**	**31,009,211**	**2,262,028**	**33,271,239**	**1.39%**	**251**	**10.00%**	**3,664,069**	**11.01%**	**49,095**	**38,235**
Exposure Class: Qualifying Revolving Retail Exposures	0.00 to <0.15	43,845	1,665,790	1,709,635	72.90%	52,989	1,214,358	1,267,347	0.08%	1,441	77.84%	57,442	4.53%	923	2,488
	0.15 to <0.25	45,130	648,549	693,679	69.65%	39,762	451,725	491,487	0.20%	480	77.58%	47,708	9.71%	884	2,153
	0.25 to <0.50	83,027	561,393	644,420	74.41%	73,881	417,706	491,587	0.36%	511	79.47%	78,874	16.04%	1,638	3,229
	0.50 to <0.75	62,488	269,978	332,466	122.56%	64,743	330,885	395,628	0.59%	905	79.70%	94,294	23.83%	2,159	4,652
	0.75 to <2.50	214,280	401,554	615,834	83.67%	205,333	335,992	541,325	1.36%	455	81.76%	250,150	46.21%	7,056	18,605
	2.50 to <10.00	170,869	115,708	286,577	109.17%	179,564	126,324	305,888	4.80%	294	82.89%	346,495	113.28%	14,213	32,710
	10.00 to <100.00	64,675	56,030	120,705	71.35%	71,635	39,979	111,614	19.72%	85	82.72%	257,066	230.32%	21,310	29,963
	100.00 (Default)	25,939	13,501	39,440	4.11%	25,837	555	26,392	100.00%	24	83.05%	98,489	373.13%	12,688	17,506
	Sub-total	**710,253**	**3,732,503**	**4,442,756**	**78.17%**	**713,744**	**2,917,524**	**3,631,268**	**2.11%**	**4,195**	**79.43%**	**1,230,518**	**33.89%**	**60,871**	**111,306**
Exposure Class: Retail Loans	0.00 to <0.15	7,280	-	7,280	0.00%	7,424	-	7,424	0.11%	2	83.40%	1,693	22.81%	7	53
	0.15 to <0.25	13,735	-	13,735	0.00%	14,011	-	14,011	0.20%	4	81.88%	4,997	35.66%	24	113
	0.25 to <0.50	57,773	-	57,773	0.00%	58,858	-	58,858	0.36%	13	80.66%	29,884	50.77%	180	582
	0.50 to <0.75	117,276	-	117,276	0.00%	119,090	-	119,090	0.63%	17	84.16%	87,315	73.32%	665	2,263
	0.75 to <2.50	645,577	-	645,577	0.00%	658,201	-	658,201	1.62%	90	87.47%	728,237	110.64%	9,771	22,971
	2.50 to <10.00	357,162	-	357,162	0.00%	366,103	-	366,103	4.40%	39	91.16%	515,291	140.75%	15,337	44,236
	10.00 to <100.00	38,732	-	38,732	0.00%	39,975	-	39,975	31.38%	5	92.18%	75,450	188.74%	12,092	14,627
	100.00 (Default)	16,934	-	16,934	0.00%	16,934	-	16,934	100.00%	2	91.55%	67,841	400.61%	8,231	8,792
	Sub-total	**1,254,469**	**-**	**1,254,469**	**0.00%**	**1,280,596**	**-**	**1,280,596**	**4.47%**	**172**	**88.02%**	**1,510,708**	**117.97%**	**46,307**	**93,637**
Total value (all portfolios)		**31,576,856**	**5,889,811**	**37,466,667**	**87.94%**	**33,003,551**	**5,179,552**	**38,183,103**	**1.56%**	**4,618**	**19.22%**	**6,405,295**	**16.78%**	**156,273**	**243,178**

Footnotes

(1) The Retail mortgages PD model uses a through-the-cycle approach. Whereas the RMS Grades (PD Scale) is based on PiT (point in time) PDs.
(2) IRB EAD includes the impact of additional fees and interest receivable in the event of customer default.
(3) Analysis excludes adjustments in relation to the new secured rating system.

5.9 Model performance

This section provides analysis of TSB Group's IRB PD model performance as at 30 November 2020 for Residential Mortgages, Loans, Cards and PCA. At 31 December 2020 IRB models covered 60.2% of TSB Group's total RWAs, increasing to 75.0% including the adjustment relating to the new mortgage rating system.

Table 19 compares the estimated (weighted and arithmetic average PDs) and actual (average historical annual default rate) PDs by exposure class, along with the number of default and non-default obligors at current and previous year ends. The values are taken from TSB's Group regulatory capital calculation models, including the application of regulatory floors. Both arithmetic and EAD weighted averages have been used throughout.

Table 19: IRB approach – Back testing of PD per exposure class (EU CR9)(1)

30 November 2020	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	End of previous year	End of the year	Default obligors in the year	Of which: new obligors	Average historical annual default rate
			%	%	Number of obligors				%
Retail - Loans	0.00 to <0.15	TSB Group	0.11%	0.11%	1,695	2,139	7	0	0.18%
	0.15 to <0.25		0.20%	0.20%	3,144	3,855	6	0	0.19%
	0.25 to <0.50		0.37%	0.36%	12,289	14,180	48	0	0.47%
	0.50 to <0.75		0.62%	0.61%	12,154	15,077	66	1	0.54%
	0.75 to <2.50		1.60%	1.58%	97,826	89,964	1,358	286	1.14%
	2.50 to <10.00		4.40%	4.51%	33,271	39,239	1,045	22	3.73%
	10.00 to <100.00		28.58%	29.96%	5,803	5,106	1,582	45	31.66%
	100.00 (Default)		100.00%	100.00%	2,866	1,974	3,010	189	97.26%
	Subtotal		**3.91%**	**3.99%**	**169,048**	**171,534**	**7,122**	**543**	**4.14%**
Retail - Cards	0.00 to <0.15	TSB Group	0.08%	0.08%	161,236	244,150	91	0	0.07%
	0.15 to <0.25		0.20%	0.20%	125,727	112,768	172	1	0.15%
	0.25 to <0.50		0.36%	0.35%	131,243	104,152	387	4	0.28%
	0.50 to <0.75		0.61%	0.61%	45,078	46,495	205	4	0.49%
	0.75 to <2.50		1.36%	1.35%	79,868	81,899	966	35	1.21%
	2.50 to <10.00		4.48%	4.86%	54,900	44,847	2,529	26	4.64%
	10.00 to <100.00		18.38%	18.55%	24,263	18,534	3,456	131	18.37%
	100.00 (Default)		100.00%	100.00%	9,000	7,972	9,400	607	97.88%
	Subtotal		**1.97%**	**2.39%**	**631,315**	**660,817**	**17,206**	**808**	**2.73%**
Retail - Personal Current Accounts (PCA)	0.00 to <0.15	TSB Group	0.08%	0.08%	1,188,993	1,209,838	663	2	0.04%
	0.15 to <0.25		0.20%	0.20%	365,444	370,901	497	5	0.10%
	0.25 to <0.50		0.36%	0.36%	417,839	412,444	1,218	6	0.21%
	0.50 to <0.75		0.58%	0.57%	834,157	869,851	5,843	63	0.55%
	0.75 to <2.50		1.42%	1.38%	412,012	377,823	5,052	131	1.06%
	2.50 to <10.00		4.88%	4.94%	256,038	227,090	11,667	1,732	3.90%
	10.00 to <100.00		25.11%	22.95%	73,106	63,504	13,135	1,134	18.67%
	100.00 (Default)		100.00%	100.00%	8,418	17,021	8,504	1,576	89.47%
	Subtotal		**1.85%**	**1.58%**	**3,556,007**	**3,548,472**	**46,579**	**4,649**	**1.71%**
Retail – Mortgages (2)	0.00 to <0.15	TSB Group	0.11%	0.11%	39,259	41,117	5	-	0.02%
	0.15 to <0.25		0.20%	0.20%	51,979	52,627	11	-	0.03%
	0.25 to <0.50		0.35%	0.35%	80,172	83,699	25	-	0.04%
	0.50 to <0.75		0.59%	0.59%	14,997	17,506	10	-	0.09%
	0.75 to <2.50		1.36%	1.36%	39,040	40,326	50	-	0.17%
	2.50 to <10.00		4.24%	4.32%	7,109	9,696	20	-	0.60%
	10.00 to <100.00		38.73%	39.47%	3,645	3,651	487	-	12.42%
	100.00 (Default)		100.00%	100.00%	875	982	835	-	96.70%
	Subtotal		**1.37%**	**1.58%**	**237,076**	**249,604**	**1,443**	**-**	**0.63%**

Several factors impact default rates, including changes in the risk profile of the portfolio, economic factors, movement in individual model parameters and prudence within the models. Models are refreshed through recalibration or replacement as required.

A 'Through the Cycle' (TTC) approach to PD estimation reduces cyclicality in estimates, leading to capital requirements that are less influenced by changes in the economic environment. A Point in Time (PiT) approach for PD leads to capital requirements that are affected directly by changes in economic conditions, increasing during a downturn while decreasing as conditions improve.

Specifically, it is noted that:

- The Mortgage PD model uses a TTC approach(3) and, as a result, the gap between estimated and actual default rates will narrow or widen to reflect the economic environment at the point of measurement.
- The Loans, Cards and PCA PD models use a PiT approach which means that the regulatory PD calculation is calibrated to reflect the cyclicality of defaults. A PD buffer is applied to compensate for any potential underestimation from increasing default rates between calibrations.
- All PDs are calculated using the IRB approach. IFRS 9 considerations have not been taken into account.

Footnote

(1) Back testing is performed separately on retail credit cards and personal current accounts. These are aggregated in regulatory reporting in Qualifying Revolving Retail exposures.
(2) Back testing of retail mortgages does not reflect the new secured system.
(3) At the year-end, TSB Group introduced a new secured rating system to meet regulatory expectations. The changes include:
- the move for definition of default from 180 dpd to 90 dpd and unlikeliness to pay factors,
- the adoption of long run average PDs for mortgages lending which sit between PiT and TTC approaches; and
- the addition of a margin of conservatism (MoC) to PD, EAD and LGD and change in approach to downturn period estimation.

5.10 Impaired lending and provisions

TSB Group's accounting policy in respect of impairment of financial assets is detailed in the notes to the financial statements in TSB Group's ARA on pages 68 to 69.

The following definitions are employed:

- **Impairment of financial assets**
  The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and debt instruments measured at Fair Value through Other Comprehensive Income (FVOCI). At initial recognition, an impairment allowance is required for expected credit losses (ECL) resulting from default events expected within the next 12 months (12-month ECL). In the event of a significant increase in credit risk, allowance is required for ECL resulting from default events expected over the estimated life of the financial instrument (lifetime ECL). IFRS 9 requires the financial asset to be allocated to one of the following three 'stages':

  - **Stage 1:** Financial assets which have not experienced a significant increase in credit risk since they were originated. Recognition of a 12-month ECL is required. Interest income on stage 1 financial assets is calculated on the gross carrying amount of the financial asset;

  - **Stage 2:** Financial assets which have experienced a significant increase in credit risk. For financial assets in stage 2, recognition of a lifetime ECL impairment allowance is required. Interest income on stage 2 financial assets is calculated on the gross carrying amount of the financial asset; and

  - **Stage 3:** Financial assets which have experienced one or more events that have had a detrimental impact on the estimated future cash flows and are credit impaired. Like stage 2, recognition of a lifetime expected ECL impairment allowance is required. However, interest income on stage 3 loans is calculated on the financial asset balance net of the impairment allowance.

  - **Purchased or originated credit impairment (POCI):** Financial assets that are credit impaired at the date of their purchase or origination will be reported in a separate POCI category and will recognise the cumulative change in lifetime expected credit loss since origination as a loss allowance.

- **Past due exposures**: An exposure is past due when a counterparty has failed to make a payment when contractually due.

- **Credit impaired exposures**: Financial assets are considered to be credit impaired and included in stage 3 when there is objective evidence of credit impairment. TSB Group assesses a loan as stage 3 when contractual payments of either principal or interest are past due for more than 90 days, the debtor is assessed as unlikely to pay, or the loan is otherwise considered to be in default.

Impairment provisions are required to be categorised as either general or specific credit risk adjustments as part of the capital requirements calculation process. All TSB Group's impairment provisions (whether individually or collectively assessed) are considered to be specific credit risk adjustments as they are recognised in accordance with IFRS 9.

The CRR gives national supervisors discretion to extend the days past due definition of default to 180 days for secured assets for regulatory reporting[(1)]. The PRA has extended this discretion to UK banks. At the year-end TSB Group introduced a new secured rating system. This included specifically a change in the definition of default from 180 dpd to 90 dpd to meet regulatory expectations of the SSM. The RWA impact of £1,577.4 million of the new secured rating system has been reported in Table 5 within 'Other risk exposure amounts'. This increase in RWAs is not reflective of any reduction in mortgage lending credit performance. RWA impact reflects changes in regulatory requirements.

For TSB Group, in respect of the secured IRB mortgage portfolio, default loans are classified within tables 18,19, 20 and 27, as those that are six months or more in arrears (or where the underlying security is in possession or in cases where the borrower is bankrupt). As explained in the footnote an adjustment to reduce the definition of default to 90 days has been incorporated through the introduction of the new rating system. Whilst this results in a lower volume of customers being classified as impaired when compared to IFRS Stage 3 accounting reporting, it does not impact the level of impairment charge or impairment provision deducted overall from regulatory expected losses for capital purposes.

Footnote

(1) At the year-end TSB Group introduced a new secured rating system to meet regulatory expectations. The changes include:
- the move for definition of default from 180 dpd to 90 dpd, materiality threshold for arrears and appropriate probationary periods
- the addition of a margin of conservatism (MoC) to PD, EAD and LGD and change in approach to downturn period estimation

5.11 Credit quality of exposures by exposure class and instruments

As at 31 December 2020, the total net exposures of TSB Group amounted to £47.9 billion (2019: £43.7 billion). The table below provides an analysis of credit risk adjustments and write-offs:

Table 20: Credit quality of exposures by exposure class and instrument (EU CR1-A)

	Gross Carrying Values of		Specific credit risk adjustment		General credit risk adjustment	Accumulated write-offs (1)	Credit risk adjustment charges of the period (2)	Net values
31 December 2020 £000	**Defaulted Exposures**	**Non-defaulted exposures**	**Defaulted Exposures**	**Non-defaulted exposures**				
Central governments or central banks	-	-	-	-	-	-	-	-
Institutions	-	-	-	-	-	-	-	-
Corporates	-	-	-	-	-	-	-	-
Of which: Specialised lending	-	-	-	-	-	-	-	-
Of which: SMEs	-	-	-	-	-	-	-	-
Retail	165,522	37,301,145	31,103	212,075	-	324,659	156,902	37,223,489
Secured by real estate property	109,147	31,660,295	4,805	33,430	-	-	8,641	31,731,207
SMEs	-	-	-	-	-	-	-	-
Non-SMEs	109,147	31,660,295	4,805	33,430	-	-	8,641	31,731,207
Qualifying revolving	39,441	4,403,316	17,506	93,801	-	186,872	67,727	4,331,450
Other retail	16,934	1,237,534	8,792	84,844	-	137,787	80,534	1,160,832
SMEs	-	-	-	-	-	-	-	-
Non-SMEs	16,934	1,237,534	8,792	84,844	-	137,787	80,534	1,160,832
Equity	-	-	-	-	-	-	-	-
Total IRB approach	**165,522**	**37,301,145**	**31,103**	**212,075**	**-**	**324,659**	**156,902**	**37,223,489**
Central governments or central banks	-	6,812,814	-	-	-	-	-	6,812,814
Regional governments or local authorities	-	-	-	-	-	-	-	-
Public sector entities	-	247,195	-	-	-	-	-	247,195
Multilateral development banks	-	396,957	-	-	-	-	-	396,957
International organisations	-	-	-	-	-	-	-	-
Institutions	-	57,449	-	-	-	-	-	57,449
Corporates	866	26,282	513	1,225	-	-	-	25,410
Of which: SMEs	866	19,559	513	1,039	-	-	-	18,873
Retail	4,502	740,089	1,231	6,447	-	5,129	578	736,913
Of which: SMEs	1,747	694,477	209	5,888	-	5,134	5,,723	690,127
Secured by mortgages on immovable property	91,558	1,401,770	3,033	2,434	-	-	6,540	1,487,861
Of which: SMEs	161	28,345	63	574	-	-	1,870	27,869
Exposures in default	96,926	-	4,777	-	-	-	-	92,149
Items associated with particularly high risk	-	-	-	-	-	-	-	-
Covered bonds	-	211,531	-	-	-	-	-	211,531
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-
Collective investments undertakings	-	-	-	-	-	-	-	-
Equity exposures	-	3,349	-	-	-	-	-	3,349
Other exposures	-	651,226	-	-	-	-	-	651,226
Total standardised approach	**96,926**	**10,548,662**	**4,777**	**10,106**	**-**	**5,129**	**7,118**	**10,630,705**
Total	**262,448**	**47,849,807**	**35,880**	**222,181**	**-**	**329,788**	**164,020**	**47,854,194**
Of which: Loans	248,601	38,317,485	35,424	203,351	-	329,788	162,611	38,327,311
Of which: Debt securities	-	2,620,591	-	-	-	-	-	2,620,591
Of which: Off-balance-sheet exposures	13,847	6,240,269	456	18,830	-	-	1,409	6,234,830

Footnote

(1) Accumulated write-offs reported above reflect the accumulated partial and total amounts of principal and accrued past due interest and fees that have been de-recognised because there is no reasonable expectation of recovery. Write-offs are reported above until the right to recovery is extinguished by expiry of the statute-of-limitations period, forgiveness or other causes, or until recovery. Therefore, where written-off amounts are not yet recovered, and TSB Group continues to have a claim, they continue to be reported above.

(2) Credit risk adjustment charges represent impairment losses reported in the consolidated statement of comprehensive income reported on page 61 of the ARA.

The accumulated amounts written-off to 31 December 2020 was £329.8 million compared to £353.4 million to 31 December 2019. The year on year movement reflects the sale in 2020 of a book of £103 million of charged off unsecured lending balances rather than significant movements in credit quality. Due to the maturity of TSB Group's write-off book, reductions relating to expiry of statute-of-limitations are limited.

Further information on impairment losses on loans is reported with TSB Group's ARA consolidated statement of comprehensive income on page 61 and the notes to the consolidated financial statements on pages 72 and 103.

5.12 Managing impaired exposures and impairment provisions

Provisioning policy
Under IFRS 9, TSB Group's policies and standards in respect of the management of Impairment Provisions consider forward looking ECL for all exposures. These are set out in TSB Group's IFRS 9 provisioning policies. These policies are reviewed and approved on an annual basis.

Adequacy and reporting
All lending assets are assessed for ECL on a monthly basis.

The process for assessing ECL considers information and events that have occurred in the context of current expectations of the future economic environment. IFRS 9 requires that financial assets be allocated to one of three 'stages' as described on page 26.

Assets are reviewed to ensure that the stage allocation remains valid, that cash flow projections remain appropriate (including any potential net proceeds from the realisation of collateral) and that the projected macro-economic outcomes and associated probability weightings used to derive ECL amounts recorded in TSB Group's books and records continue to remain appropriate. In the event that the future expected cash flow has changed from the previous assessment, an adjustment to the level of loss allowance is made as appropriate.

Where credit impaired assets are within a pool of similar assets and are assessed collectively, the relevance of the pool within which the asset has been placed and the assumptions regarding cash flow emanating from the pool are examined.

TSB Group reviews, at least annually, its provision forecast against actual loss experience to identify whether its policies have resulted in over or under provisioning across the economic cycle.

Stress and scenario testing are widely used throughout TSB Group to assess the potential impact on impaired exposures and related provisions.

A robust governance framework has been established to monitor impairment exposures, provisions and the impact of alternative economic scenarios and stress scenarios. Findings and recommendations are reported to regular Portfolio Quality Review meetings, Executive Risk Committees, Audit Committee and the Board.

5.13 Management of customers experiencing financial difficulties

Forbearance

TSB operates a number of schemes to assist borrowers who are experiencing financial difficulties. Forbearance solutions may offer relief in the form of reductions to contractual payments including freezes to interest payments, and for customers who have longer term financial difficulties, term extensions and capitalisation of arrears. TSB applies the European Banking Authority definition of forbearance.

For reporting purposes, TSB Group's definition of a restructured exposure is where terms of lending agreements have been renegotiated by either capitalisation of arrears, interest rate adjustment, payment holidays, interest capitalisation, temporary interest only, lending that would otherwise be past due or impaired but whose terms have been renegotiated. Further details on forbearance are provided on page 89 of the TSB Group's ARA.

TSB supported customers during COVID-19 granting around 114,000 payment holidays relating to £5.9 billion of loans. As these repayment holidays are available to all customers impacted by COVID-19, and are not tailored to individual borrower circumstances, they are not included in the forbearance disclosures.

An analysis of non-performing and forborne exposures is presented in the tables below. The defaulted and impaired exposures reported in the tables 21, 22 and 23 are reported in accordance with Financial Reporting Standards (FINREP) definitions which differ from table 20 which reflects TSB Group's current Common Reporting Standards (COREP) definition. The FINREP definition includes the following:

- balances in probation;
- forborne balances;
- non-performing indicators; and
- past due definition of default of 90 days for secured and unsecured.

At the year-end TSB Group introduced a new secured risk rating model to meet requirements of the SSM which included the regulatory change to 90 days past due definition of default on the mortgage portfolio. This will be required for all UK banks by 2022. This aligns the delinquency requirement to the accounting policy under IFRS 9 for the definition of default.

Table 21: Credit quality of forborne exposures

	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
31 December 2020 £000	**Performing forborne**	**Non-performing forborne**			**On performing forborne exposures**	**On non-performing forborne exposures**		**Of which collateral and financial guarantees received on non-performing exposures with forbearance measures**
			Of which defaulted	**Of which impaired**				
Loans and advances	**130,663**	**170,600**	**76,799**	**170,600**	**1,244**	**25,063**	**248,267**	**134,781**
Central banks	-	-	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-	-
Credit institutions	-	-	-	-	-	-	-	-
Other financial corporations	-	-	-	-	-	-	-	-
Non-financial corporations	2,452	2	-	2	73	1	2,377	-
Households	128,211	170,598	76,799	170,598	1,171	25,062	245,890	134,781
Debt securities	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Loan commitments given	**3,044**	**15,935**	**-**	**15,935**	**-**	**-**	**-**	**-**
Total	**133,707**	**186,535**	**76,799**	**186,535**	**1,244**	**25,063**	**248,267**	**134,781**

Table 22: Credit quality of performing and non-performing exposures by past due days[(1)]

31 December 2020 £000	Gross carrying amount / nominal amount											
	Performing exposures			Non-performing exposures								
	Total	Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days	Total	Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
Loans and advances	**33,491,409**	**33,441,125**	**50,284**	**449,785**	**191,068**	**118,970**	**57,164**	**39,876**	**29,196**	**4,542**	**8,969**	**233,881**
Central banks	120,924	120,924	-	-	-	-	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	69,845	69,845	-	-	-	-	-	-	-	-	-	-
Other financial corporations	194,090	194,090	-	73	-	73	-	-	-	-	-	73
Non-financial corporations	446,954	445,345	1,609	2,259	1,237	592	38	189	202	-	1	850
Of which SMEs	446,954	445,345	1,609	2,259	1,237	592	38	189	202	-	1	850
Households	32,659,596	32,610,921	48,675	447,453	189,831	118,305	57,126	39,687	28,994	4,542	8,968	232,958
Debt securities	**2,620,591**	**2,620,591**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Central banks	-	-	-	-	-	-	-	-	-	-	-	-
General governments	1,734,891	1,734,891	-	-	-	-	-	-	-	-	-	-
Credit institutions	817,230	817,230	-	-	-	-	-	-	-	-	-	-
Other financial corporations	68,470	68,470	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance-sheet exposures	**6,221,575**			**30,242**								**13,526**
Central banks	-			-								-
General governments	-			-								-
Credit institutions	282			-								-
Other financial corporations	116			-								-
Non-financial corporations	18,042			20								6
Households	6,203,135			30,222								13,520
Total	**42,333,575**	**36,061,716**	**50,284**	**480,027**	**191,068**	**118,970**	**57,164**	**39,876**	**29,196**	**4,542**	**8,969**	**247,407**

Footnote

(1) Table reported in accordance with FINREP definitions.

At 31 December 2020, TSB Group's non-performing loans (NPL) ratio was 1.3% compared to 1.2% at 31 December 2019.

TSB Group is not required to make disclosures on foreclosed assets, as TSB Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable to settle indebtedness.

Table 23: Performing and non-performing exposures and related provisions(1)

31 December 2020 £000	Gross carrying amount / nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-offs	Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures			Performing exposures			Non-performing exposures				On performing exposures	On non-performing exposures
	Total	Of which Stage 1	Of which Stage 2	Total	Of which Stage 2	Of which Stage 3	Total	Of which Stage 1	Of which Stage 2	Total	Of which Stage 2	Of which Stage 3			
Loans and advances	**33,491,409**	**30,191,152**	**3,300,257**	**449,785**	**-**	**449,785**	**186,183**	**66,821**	**119,362**	**52,789**	**-**	**52,789**	**-**	**31,054,930**	**372,288**
Central banks	120,924	120,924	-	-	-	-	-	-	-	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	69,845	69,845	-	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	194,090	193,564	526	73	-	73	13	11	2	29	-	29	-	2,939	44
Non-financial corporations	446,954	363,723	83,231	2,258	-	2,258	3,919	2,987	932	758	-	758	-	439,006	1,035
Of which SMEs	446,954	363,723	83,231	2,258	-	2,258	3,919	2,987	932	758	-	758	-	439,006	1,035
Households	32,659,596	29,443,096	3,216,500	447,454	-	447,454	182,251	63,823	118,428	52,002	-	52,002	-	30,612,995	371,209
Debt securities	**2,620,591**	**2,620,591**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
General governments	1,734,891	1,734,891	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	817,230	817,230	-	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	68,470	68,470	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance-sheet exposures	**6,221,575**	**5,856,336**	**365,239**	**30,242**	**-**	**30,242**	**(18,694)**	**(13,047)**	**(5,647)**	**(456)**	**-**	**(456)**	**-**	**-**	**-**
Central banks	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
General governments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	282	282	-	-	-	-	-	-	-	-	-	-	-	-	-
Other financial corporations	116	116	-	-	-	-	(2)	(2)	-	-	-	-	-	-	-
Non-financial corporations	18,042	16,914	1,128	20	-	20	(160)	(120)	(40)	(2)	-	(2)	-	-	-
Households	6,203,135	5,839,024	364,111	30,222	-	30,222	(18,532)	(12,925)	(5,607)	(454)	-	(454)	-	-	-
Total	**42,333,575**	**38,668,079**	**3,665,496**	**480,027**	**-**	**480,027**	**167,489**	**53,774**	**113,715**	**52,333**	**-**	**52,333**	**-**	**31,054,930**	**372,288**

Footnote

(1) Table reported in accordance with FINREP definitions.

5.14 Analysis of past due and impaired loans and advances to customers regardless of impairment status

As at 31 December 2020, past due exposures in respect of loans and advances to customers, regardless of impairment status, amounted to £445.1 million.

Analysis by geography

All past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2020 are categorised as being in the United Kingdom, based on the materiality criteria, outlined on page 21 relating to retail exposures.

Analysis by industry

An analysis of credit quality of exposures by industry is not provided as TSB Group does not have significant impairment provisions in respect of industry sectors other than personal customers. As at 31 December 2020, impairment provisions for non-personal customers are £8.5 million compared to £3.1 million as at 31 December 2019.

5.15 Analysis of impairment provisions in respect of loans and advances to customers

The movement in impairment provisions, from 1 January 2020 to 31 December 2020, in respect of loans and advances to customers is provided below:

Table 24: Changes in the stock of general and specific credit risk adjustments (EU CR2-A)

	Accumulated specific credit risk adjustment £000	Accumulated general credit risk adjustment £000
Opening balance as at 31 December 2019	**165,539**	-
Increases due to origination and acquisition	48,445	-
Decreases due to derecognition	(23,373)	-
Changes due to change in credit risk (net)	110,985	-
Decrease in allowance due to write-offs	(43,640)	-
Other adjustments	163	-
Closing balance as at 31 December 2020	**258,119**	-
Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	(12,094)	-
Amounts written-off directly to the statement of profit or loss	17,409	-

The main increase in provision is due to increases in credit risk of £111.0 million resulting from the expected deterioration in the economic outlook, including a forecast decline in house prices and rise in unemployment.

During 2020, net lending mainly increased in the secured portfolio due to origination. Write-offs decreased in 2020, from £69.0 million in 2019 to £43.6 million in 2020 as TSB assisted customers through relief measures such as payment holidays in response to COVID-19.

The movement in defaulted and impaired loans is provided in the table below:

Table 25: Changes in stock of defaulted and impaired loans and debt securities (EU CR2-B)

	Gross carrying value defaulted exposures £000
Opening balance as at 31 December 2019	**448,817**
Loans and debt securities that have defaulted or impaired since the last reporting period	268,396
Returned to non-defaulted status	(153,984)
Amounts written off	(66,933)
Other changes	(46,511)
Closing balance as at 31 December 2020	**449,785**

Default exposures at 31 December 2020 of £449.8 million are £1.0 million higher than 31 December 2019. Although customer lending increased by £3.6 billion (10.0%) to £39.5 billion, the growth in default exposures was lower, predominantly as a result of fewer defaulting and written off balances during 2020 due to measures to support customer in response to COVID-19.

5.16 Credit risk mitigation

TSB Group uses a range of approaches to mitigate credit risk.

Credit policies and standards

TSB Group's Risk function sets out credit policies and procedures for managing credit risk. These are reviewed at least annually, and any changes are subject to a review and approval process. Policies and procedures are reviewed, as appropriate, to help anticipate future areas of concern and allow TSB Group to take early and proactive mitigating actions.

Portfolio Risk teams define credit strategies, aligned to credit policies and procedures, to actively monitor and manage the credit risk of TSB Group's portfolios, both on and off-balance sheet. Business area processes and procedures provide guidance to operational areas on the management of portfolios where manual intervention is required. This includes documented guidance on lending for, and explicit limitations on, any discretionary powers held by sanctioners and underwriters; ensuring a consistent and controlled approach to making credit decisions. Portfolio and customer performance against TSB Group's policy is regularly assessed in the Portfolio Quality Review.

Retail credit assessment

TSB Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit scorecards and involves a review of an applicant's previous credit history in the form of information held by credit reference agencies. For mortgage and unsecured lending, TSB Group also assesses the affordability of lending to the customer. In addition, TSB Group has in place lending limits such as maximum loan amounts, the level of borrowing to income and the ratio of borrowing to collateral. Certain limits are subject to internal approval while others are hard limits above which TSB Group will reject the application. Credit scorecards and limits are subject to ongoing review and approval in line with TSB Group's governance, to ensure they remain appropriate and effective. TSB Group also has certain criteria applicable to specific products such as for buy-to-let mortgage applications.

TSB Group also provides active support to customers experiencing financial difficulties, including the extension of forbearance measures where appropriate.

Business banking credit assessment

Save for BBL and CBIL exposures, where credit risk is mitigated by government guarantee, credit risk in the Retail SME customer portfolio is subject to individual credit assessments which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities and limit and sector guidelines. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk.

Concentration risk

Concentration risk is the risk of losses arising because of a concentration of exposures due to imperfect diversification. TSB Group manages credit concentration risk in relation to the geographical spread of its secured mortgage portfolio in the UK. TSB Group has also established controls to prevent concentration in wholesale treasury exposures.

Master netting

TSB Group's credit risk exposure on derivative and repo instruments is mainly subject to master netting agreements in accordance with TSB Group's Treasury Risk Counterparty Credit Risk Policy. Although these do not always result in an offset of balance sheet assets and liabilities, as many transactions are settled on a gross basis, they do reduce credit exposures by ensuring amounts due on all instruments covered under the agreement are settled on a net basis in the event of a default. Where master netting is not possible exposure is restricted to high quality financial institutions.

Table 26: Impact of netting and collateral held on exposure values (EU CCR5-A)

31 December 2020	Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held	Net credit exposure
	£000	£000	£000	£000	£000
Derivatives	338,141	718,057	(379,916)	379,929	13
SFT	450,837	437,009	13,828	(2,568)	11,260
Total	**788,978**	**1,155,066**	**(366,088)**	**377,361**	**11,273**

Collateral

The principal collateral types for loans and advances are:

- mortgages over residential and commercial real estate;
- second charges over business assets, including commercial and residential property, inventory and accounts receivables; and
- guarantees received from third parties including government.

It is TSB Group's policy that collateral should be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral is reviewed on a regular basis in accordance with business unit credit standards, which will vary according to the type of lending and collateral involved. For retail residential mortgages, collateral valuation is reviewed quarterly using external house price indices. LGD estimates for the secured IRB portfolio include adjustments to realisable collateral values through the application of recessionary house price movements and forced sale discounts.

Exposures covered by eligible collateral and guarantees

The criteria for recognising eligible collateral, the treatments that apply and the extent to which adjustments are made are set out under the relevant CRR provisions governing the application of credit risk mitigation under the IRB approach (CRR Chapter 3) and the standardised approach (CRR Chapter 2).

Where a credit risk exposure subject to the IRB approach is covered by a form of credit risk mitigation, this can result in an adjustment to the LGD value used in the calculation of the RWA amount.

TSB Group uses the financial collateral comprehensive method for the valuation of treasury exposures. This applies relevant adjustments for volatility to the market value of collateral and maturity mismatches for all collateral types. The regulatory requirements for recognition include a number of considerations including legal certainty of charge, frequency and independence of revaluation and correlation of the value of the underlying asset to the obligor. For counterparty credit risk exposure calculations, TSB Group uses the current exposure method.

TSB Group does not make use of credit derivatives for regulatory capital purposes.

The net carrying value of TSB Group's unsecured and secured exposures is set out in the table below. Secured exposures are those exposures secured by residential property, covered bonds and central governments guarantees. Unsecured exposures include unsecured retail lending, balances with central governments and central banks, balances with institutions and other assets.

Table 27: CRM techniques – Overview (EU CR3)

31 December 2020	Exposures unsecured – Carrying amount [1]	Exposures secured – Carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
	£000	£000	£000	£000	£000
Total loans	12,014,535	33,219,068	32,667,910	551,158	-
Total debt securities	2,323,285	297,306	211,531	85,775	-
Total exposures	**14,337,820**	**33,516,374**	**32,879,441**	**636,933**	**-**
Of which defaulted	35,446	191,123	191,050	73	-

Footnote

(1) Total loans - unsecured exposures includes other assets of £671.5 million.

The exposures secured by financial guarantees for total loans relates to BBLs guaranteed by UK Government to support businesses.

6. Leverage ratio

The following tables present the disclosures required by the EBA Implementing Technical Standards (ITS) on disclosure for leverage ratio. Only rows applicable to TSB Group are presented within tables 28, 29 and 30.

6.1 Leverage ratio exposure

Table 28: Summary reconciliation of accounting assets and leverage ratio exposures (LRSum)

Basel III basis	**2020** **£000**	2019 £000
Total assets as per published financial statements	42,406,594	39,520,902
Adjustments for derivative financial instruments	(442,522)	(325,632)
Adjustment for securities financing transactions (SFTs)	1,089	9,863
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	978,692	772,005
Other regulatory adjustments	(9,884)	(87,896)
Total leverage ratio exposure	**42,933,969**	39,889,242

TSB Group calculates its leverage based on the CRR definition of exposure measure and Tier 1 capital. The leverage ratio measure is defined as the ratio of Tier 1 capital to total exposure. Items deducted from Tier 1 capital are also deducted from the exposure measure to ensure consistency between the capital and exposure components of the ratio. The leverage ratio is intended to complement the risk-based capital requirements with a simple, non-risk based ‘backstop’ measure.

TSB Group’s EBA leverage ratio is 3.8% which comfortably exceeds the CRR minimum of 3.0%.

The leverage ratio has decreased from 4.6% to 3.8% in 2020. Tier 1 capital decreased by £207.5 million, largely due to losses incurred in 2020, and an increase in the deferred tax asset capital and intangible fixed assets deductions. The leverage exposure increased by £3,044.7 million, largely driven by increases in mortgage lending, cash balances at central bank, lending to SMEs and unsecured retail lending.

Under the Bank of England’s UK leverage ratio framework and in accordance with the PRA policy statement issued in October 2018 and modification issued in May 2020, leverage ratios can be calculated on a modified basis to exclude qualifying central bank reserves and COVID-19 lending covered by government guarantee from the exposure measure. While TSB Group is not currently subject to this framework, under this measure TSB Group’s modified leverage ratio is 4.3%, in excess of the PRA minimum of 3.25%.

Table 29: Leverage ratio common disclosure (LRCom)

CRR leverage ratio exposures	**2020** **£000**	2019 £000
On-balance sheet exposures (excluding derivatives and SFTs)		
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	41,958,608	39,088,971
(Asset amounts deducted in determining Tier 1 capital)	(125,188)	(62,496)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**41,833,420**	39,026,475
Derivative exposures		
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	-	44,523
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	77,193	90,462
(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(181,479)	(255,200)
Total derivative exposures	**(104,286)**	(120,215)
Securities financing transaction exposures		
Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	225,054	201,115
(Netted amounts of cash payables and cash receivables of gross SFT assets)	1,089	9,863
Total securities financing transaction exposures	**226,143**	210,978
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	6,254,116	4,959,075
(Adjustments for conversion to credit equivalent amounts)	(5,275,424)	(4,187,070)
Other off-balance sheet exposures	**978,692**	772,005
	42,933,969	39,889,242
Exempted exposures in accordance with Article 429(7) and (14) of Regulation (EU) No 575/2013 (on and off balance sheet)		
Capital and total exposures measure		
Tier 1 capital	1,630,434	1,837,943
Total leverage total exposure measure	42,933,969	39,889,242
Leverage ratio	**3.8%**	4.6%

Table 30: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures) (LRSpl)

CRR leverage ratio exposures	**2020** **£000**	2019 £000
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**41,777,129**	38,833,772
Banking book exposures, of which:	41,777,129	38,833,772
Covered bonds	211,531	166,304
Exposures treated as sovereigns	7,562,008	6,591,954
Institutions	57,449	399,279
Secured by mortgages of immovable properties	30,587,965	28,997,370
Retail exposures	2,441,972	1,787,200
Corporate	25,013	18,813
Exposures in default	226,366	226,521
Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	664,825	646,331

Exempted exposures consist of variation margin pledged of £181.5 million in 2020 and £255.2 million in 2019.

6.2 Management of excessive leverage

The risk of excessive leverage is the risk resulting from an institution's vulnerability to leverage or contingent leverage that may require unintended corrective measures to the business plan, including distressed selling of assets which might result in losses or in valuation adjustments to the remaining assets.

TSB Group monitors the risk of excessive leverage through the leverage ratio which is calculated and reported to Board, Executive Committee (EC) and ALCO on a monthly basis.

The Board approved leverage ratio risk appetite is set above the minimum regulatory requirements. The medium term plan (MTP), updated at least annually, considers compliance with the leverage ratio risk appetite. Where the risk of excessive leverage is identified in the MTP, the business plans are reconsidered to mitigate that risk.

7. Remuneration

As a 'Level 2' firm, under PRA Supervisory Statement 2/17, TSB presents the undernoted remuneration disclosures in accordance with Article 450 of the CRR having applied the proportionality criteria referenced in Article 450 (2).

Ever since TSB was launched onto high streets across Great Britain, the remuneration approach has remained consistent. It is designed to be simple and fair. This underlying principle remains integral to our reward philosophy.

The Remuneration Committee is authorised by the Board to consider and recommend to the Board the remuneration policy framework. Policy is considered regularly by the Remuneration Committee, taking account of changes in regulation and the wider market. In formulating and reviewing policy, independent advice is sought and considered. In particular, the sustainability of the policy and its risk impact are carefully reviewed. The Remuneration Policy is formally reviewed at least annually and, once approved by the Remuneration Committee, is reviewed and approved by the Board. The TSB Remuneration Committee met 6 times during 2020. Further information on the role of the Remuneration Committee including details of its full terms of reference and members are on page 52 of the ARA.

Our remuneration policy

The aim of TSB's remuneration policy as outlined on page 50 of TSB's ARA, is to provide competitive remuneration aligned to the delivery of the strategic goals (as explained in the Chief Executive's statement). It is designed to attract and retain talented individuals and to generate sustainable business performance, while taking into account effective risk management and acceptable conduct. In addition, TSB aims to align the remuneration approach with that of its parent, Sabadell.

TSB's remuneration policy sets out, for management, the Bank's overall approach to remuneration and how it impacts identified employees. That information is readily available internally.

Individual briefing sessions are held for all new Material Risk Takers (MRTs) hosted by Human Resources. At the briefings new MRTs are provided with relevant materials explaining their MRT status and the impact of this status on their remuneration. TSB writes to all MRTs to confirm to them that they have been identified as an MRT. Each MRT is required to confirm that they accept that malus and/ or clawback arrangements could be applied to any future variable remuneration awards made to them.

The remuneration policy applies to all employees of TSB. There are no differences in remuneration policy for different categories of employees at TSB; nor are there regional differences. The remuneration policy was amended in 2020 as follows:

- Variable pay is comprised of the Variable Pay Award which was introduced in 2020 to replace the TSB Award and the one-off transitional 2019 New Award.
- From the start of 2020, TSB no longer uses individual performance ratings and instead has developed and enhanced the performance management process.
- The individual performance rating process for the most senior levels has been replaced with a structured, cascaded individual balanced scorecard.

The Remuneration Review in the TSB's ARA sets out:

- How TSB's remuneration policy continues to meet regulatory requirements (page 51);
- A summary of the key components of TSB's remuneration and its link to performance (page 50); and
- The governance procedure relating to the development of the remuneration policy, information about those who played a significant role in its development and the role of external consultants (page 51 and 52).

The number of identified employees analysed by business area and senior management function is set out in the following table. There has been a decrease in the number of MRTs from 2019.

Table 31: Analysis of identified employees' total remuneration by areas of activity (REM1)

31 December 2020	Management Body Supervisory function	Management Body Management function	Retail Banking	Corporate functions	Independent control functions	All Other	Total
Total Remuneration 2020 £000	988	5,798	2,892	5,891	3,712	-	19,281
No. of identified employees	13	11	10	19	18	-	71
Ratio average variable / fixed remuneration	0%	0%	14%	19%	14%	0%	10%

Our remuneration system

Our remuneration is structured into three main elements: competitive fixed pay, benefits and the Variable Pay Award for all employees.

The key elements of our reward approach are as follows:

- **Salary** provides core remuneration taking into account relevant market benchmarks, complexity of the role and the individual's experience and performance.
- **Market appropriate benefits** principally pension contributions to a defined contribution scheme or, where appropriate, an equivalent cash payment; 4% of salary available to use in our flexible benefits offering; and an employer provided car or alternative cash allowance at certain grades.
- **Variable Pay** is comprised of the Variable Pay Award which was introduced in 2020 to replace the TSB Award and the one-off transitional 2019 New Award. It is based on in-year performance measured against the Primary Corporate Objectives or PCOs (a balanced scorecard with a combination of business measures relating to financial resilience, risk, the customer and employees which focuses on operational excellence, sustainable returns, the customer and making TSB simpler and more efficient). This award will be granted to all employees if affordability thresholds are met, along with appropriate profit and risk management gateways.

  From 2020, TSB no longer uses individual performance ratings and instead has developed and enhanced the performance management process. The focus is on improving performance rather than measuring it and encouraging coaching and development through regular conversations between employees and line managers. Employees who achieve their personal objectives, demonstrate the core behaviours, regularly meet or go beyond the expectations of their role and whose performance is not classified as 'needs improvement', will be eligible for a Variable Pay Award.

  The individual performance rating process for the most senior levels has been replaced with a structured, cascaded individual balanced scorecard. The financial and non-financial metrics in the individual scorecards are taken from the wider set of TSB's Primary Corporate Objectives and Balanced Scorecard, as well as Sabadell Group metrics.

In respect of 2020 performance, TSB will not exceed an annual cap on total variable remuneration of one times salary, calculated in accordance with the PRA's remuneration regulations. Most of TSB's banking competitors operate with an annual cap of two times salary.

The rationale for the fixed elements of remuneration is based on common market practice, the nature of these payments being fixed and not performance related.

For MRTs, the vesting of any 2020 deferred variable remuneration is contingent on three aspects:

- appropriate personal conduct maintained throughout the vesting period;
- application of malus and clawback; and
- maintaining satisfactory liquidity and capital levels during the three years post the formal grant of the deferral. For Sabadell MRTs, the liquidity and capital thresholds will relate to Sabadell levels and for TSB MRTs, the liquidity and capital thresholds will relate to TSB Group thresholds.

The testing of these aspects will determine, subject to the Remuneration Committee's discretion, the extent to which a tranche is released. The award amounts may be reduced, ultimately to zero, depending on the testing outcome and Remuneration Committee discretion.

In respect of variable pay plans, 60% of grants under the PRA Senior Managers Regime will be deferred over seven years with pro-rata release between the third and seventh year based on release underpins. Any shares issued will be subject to a 12 month retention period after the point of release. For MRTs, other than Senior Managers, 40% of grants will be deferred over three or five years, depending on the regulatory status of the employee, with a retention period on the shares of 12 months after the point of release (six months for Risk Managers in accordance with the code). TSB's approach to deferral of total variable remuneration for senior employees ensures that awards are delivered as required by regulations.

Unvested prior year SPA awards that were due to vest in March 2021 will not vest, consistent with SPA awards which were due to vest in March 2020, as performance against the predetermined financial target (cumulative return on equity) was not achieved.

In 2018, the Committee took the decision to delay the payment of the vested but as yet unpaid tranches of the Sabadell Integration Awards (SIA) and other awards due to vest in March 2021, subject to the outcome of both internal and external regulatory investigations into the post migration issues and subsequent consideration by the Committee in light of any findings. This decision continues to apply.

Considerations of risk and conduct

The Remuneration Committee takes risk and conduct issues very seriously. Risk profile and behaviours are a key gateway that must be satisfied for any of the incentive awards to pay. Risk adjustment is a result of several factors:

1. A balance of measures included in individual objectives and business scorecards acts as a framework for adjusting the bonus pool for both performance and risk inherent in TSB's activities.
2. The use of a framework to quantify the risk adjustment of the variable remuneration pool in 2020.
3. The appropriate governance to make informed and robust decisions, including the Remuneration Governance Group (which makes recommendations to the Remuneration Committee on matters as required to ensure that the appropriate standards of risk management and corporate governance are applied), Remuneration Committee oversight and independent access to the Chief Risk Officer (CRO) and Chief Financial Officer (CFO).

Incentive pools and awards may be adjusted, including to zero, in the event of any material breaches. All elements of variable remuneration for MRTs are subject to malus and clawback provisions in line with regulatory requirements.

A Remuneration Governance Group (RGG), as referred to above, was established in 2017 to assist the Remuneration Committee in identifying MRTs across the bank and in considering risk-based adjustments to reward outcomes.

2020 reward outcomes for TSB Group employees are set out in the Remuneration Review on page 51 of TSB Group's ARA.

The Control Functions' heads (CRO and CAO) are members of the Exco and all employees engaged in each discipline have direct reporting lines within that function. The CRO reports to the CEO and has a dotted/indirect reporting line to the Chair of the Board Risk Committee. The CAO reports to the Chair of the Board Audit Committee with a dotted/indirect reporting line to the CEO. The CRO appraisal and remuneration are proposed by the CEO (with input from the Board Risk Committee) and submitted to the Remuneration Committee for approval. The Chief Audit Officer (CAO) appraisal and remuneration are proposed by the Board Audit Committee (with input from the CEO) and submitted to the Remuneration Committee for approval.

The CRO and CAO review and agree all objectives and remuneration decisions for all senior Risk and Audit employees respectively. Senior Risk and Audit employee performance outcomes are decided by the CRO and CAO, subject to final approval by the CEO and the HR Director. The performance outcomes and remuneration of Material Risk Takers are submitted to the Remuneration Committee for approval.

For non-Material Risk Takers staff in the Control Functions, reviews of fixed and variable pay are managed by the line manager with oversight from the HR department, based on external market data, internal relativities and corporate and individual performance, with personal objectives reflecting the delivery of the Risk and Audit annual work cycles. Final approval of reward outcomes for all staff sits with the CEO after review by the HR Director.

Other aspects

Guaranteed bonus payments may only be offered for a period of no more than one year and only in exceptional circumstances to new hires for the first year of service. Any buyout must be in line with the terms in place with the previous employer and have performance conditions attached to it. Guaranteed variable awards are not common practice for MRTs and will be limited to new hires.

Severance payments are made in line with contractual obligations and, in terms of variable remuneration, in line with the relevant scheme rules. For MRTs any variable remuneration which subsists post severance remains subject to the requirements on business performance, deferral and holding post vesting. In addition, malus and clawback provisions continue to apply.

Remuneration for the year ended 31 December 2020

Table 32: Details of remuneration for the year ended 31 December 2020 (REM2)

31 December 2020	Board members	Senior management	Other management	Total
Fixed remuneration £000[1]	**1,998**	**3,800**	**10,762**	**16,560**
Variable remuneration £000	**-**	**-**	**1,732**	**1,732**
Instant payment				
Cash £000			1,064	**1,064**
Shares £000			266	**266**
Number of Banco Sabadell equity shares '000			825	**825**
Deferred payment				
Cash £000			201	**201**
Shares £000			201	**201**
Number of Banco Sabadell equity shares '000			621	**621**
Other types of remuneration	**-**	**-**	**-**	**-**
Remuneration as Directors of the Group £000	**988**	**-**	**-**	**988**
Number of identified employees	15	9	47	**71**
Amount of annual compensation payments £000	-	-	109	**109**
Number of employees with compensation	-	-	2	**2**

Footnote

(1) Payment in lieu of notice is included in fixed remuneration.

Table 33: MRTs with total remuneration of 1 million Euros or above

The following table shows the number of MRTs with total remuneration of EUR 1 million or above arranged by remuneration band for the financial year ended 31 December 2020.

Total remuneration [1] (EUR)	No. of employees
1,000,001 - 1,500,000	1
1,500,001 - 2,000,000	-
2,000,001 - 2,500,000	-
2,500,000 - 3,000,000	-
Total	**1**

Footnote

(1) Total remuneration is the sum of fixed remuneration and variable remuneration.

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Glossary

Capital Requirements Regulation (CRR)	The Capital Requirements Regulation No. 575/2013 is an EU law that aims to decrease the likelihood that banks go insolvent.
Clawback	The recovery of part or all of a remuneration award post vesting.
Central Clearing Counterparty (CCP)	A central clearing counterparty (CCP) is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. For the purposes of the capital framework, a qualifying CCP is a financial institution.
Commercial real estate	Commercial real estate includes office buildings, medical centres, hotels, malls, retail stores, shopping centres, farm land, housing buildings, warehouses, garages, and industrial properties among others.
Common Equity Tier 1 (CET1) capital	The highest quality form of regulatory capital under CRR that comprises common shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
Common Equity Tier 1 ratio	Common Equity Tier 1 Capital as a percentage of risk weighted assets.
Contingent leverage	Contingent leverage represents off-balance sheet items which could convert into on-balance items e.g. unutilised credit limits could be utilised in future.
Contractual maturities	Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.
Counterparty credit risk (CCR)	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and include derivative contracts and repo contracts.
Credit Conversion Factor (CCF)	Credit conversion factors (CCF) are used in determining the exposure at default (EAD) in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn commitments expected to be drawn down at the point of default.
Credit risk	The risk of reductions in earnings and / or value, through financial loss, as a result of the failure of the party with whom the TSB Group has contracted to meet its obligations (both on and off-balance sheet).
Credit risk mitigation (CRM)	A technique used to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantees and credit protection.
Debt securities	Debt securities are assets held by the TSB Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	These are unsubordinated liabilities issued by the TSB Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Enhanced Disclosure Task Force (EDTF)	The Enhanced Disclosure Task Force (EDTF) was established by the Financial Stability Board in May 2012 with the goal for improving the quality, comparability and transparency of risk disclosures. The EDTF issued a report in October 2012 setting out 32 recommendations across seven risk areas.
European Banking Authority (EBA)	The European Banking Authority (EBA) is a regulatory agency of the European Union headquartered in London, United Kingdom. Its activities include conducting stress tests on European banks to increase transparency in the European financial system and identifying weaknesses in banks' capital structures. The EBA was established on 1 January 2011, upon which date it inherited all of the tasks and responsibilities of the Committee of European Banking Supervisors (CEBS).
Expected Loss (EL)	Expected loss represents the anticipated loss, in the event of default, on a credit risk exposure modelled under the internal ratings-based approach. EL is determined by multiplying the associated probability of default, loss given default and exposure at default together and assumes a 12-month time horizon.

Exposure at Default (EAD)	Exposure at default represents the estimated exposure to a customer in the event of default. In determining EAD amounts, consideration is made of the extent to which undrawn commitments may be drawn down at the point of default (see Credit Conversion Factors) and the application of credit risk mitigation (i.e. eligible financial collateral).
Financial Reporting Standards (FINREP)	Financial Reporting Standards framework represents a common standardised reporting framework with the objective to increase comparability of financial information produced by credit institutions for their respective national supervisory authorities.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to an obligor's financial difficulties.
Foreclosed assets	A foreclosed asset is defined as a loan in which the bank has received physical possession of a borrower's assets, regardless of whether formal foreclosure proceedings have taken place or a deed in lieu of foreclosure has been issued.
General Credit Risk Adjustment	Those credit risk adjustments that are freely and fully available, about to timing and amount, to meet losses that are not yet materialised or where no evidence of a loss event has occurred.
Identified Employee	Any employee identified by TSB Group as a 'Material Risk Taker' for 2018 under paragraph 3.1 of the Remuneration Section of the PRA Rulebook.
Impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the expected losses in the lending book. An impairment allowance may be either individual or collective.
Individually / collectively assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Internal Capital Adequacy Assessment Process (ICAAP)	The TSB Group's own assessment, based on CRR requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.
Internal Ratings Based Approach (IRB)	A methodology of estimating the credit risk within a portfolio by utilising internal risk parameters to calculate credit risk regulatory capital requirements.
Leverage Ratio	A non-risk-based leverage ratio is calculated by dividing Tier 1 capital by a defined measure of on and off-balance sheet items. Banks are expected to maintain a leverage ratio in excess of 3%. Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk-based capital requirements with a simple, transparent, non-risk based 'backstop' measure.
Leverage Ratio exposure	The Leverage Ratio exposure measure is the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items. The specific treatments for these four main exposure types are defined by the Basel III leverage ratio framework disclosure requirements.
Lifetime Expected Credit Losses (Lifetime ECL)	The allowance required for Expected Credit Losses resulting from default events expected over the estimated life of the financial instrument, in the event of a significant increase in credit risk.
Loss Given Default (LGD)	Loss given default represents the estimated proportion of an EAD amount that will be lost in the event of default. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.
Material Risk Takers	Employees who have a material impact on TSB Group's risk profile.
Malus	The reduction or cancellation of remuneration awards prior to vesting.
Market risk	The risk that unfavourable market movements (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and / or value.
Minimum capital requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Pillar 1 requirements for credit, market and operational risk.

Model validation	The process of assessing and providing evidence that the TSB Group's models perform as planned and adequately reflect the risk profile of the business, and that there are no material misstatements of the capital requirement.
Multilateral development banks (MBD)	An institution created by a group of countries to provide financing for the purpose of development.
Netting	The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.
Non-performing exposures	Non-performing are those that satisfy either or both of the following criteria: a) material exposures which are more than 90 days past-due; b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.
Non-performing loans (NPL) ratio	The ratio of the amount of non-performing loans in a bank's loan portfolio to the total amount of outstanding loans the bank holds.
Operational risk	The risk of reductions in earnings and / or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people-related or external events.
Original exposure	The exposure value without taking into account value adjustments and provisions, conversion factors and the effect of credit risk mitigation techniques.
Pillar 1	The first pillar of the Basel III framework sets out the quantitative elements – the minimum regulatory capital requirements for credit, operational and market risks.
Pillar 2	The second pillar of the Basel III framework sets out the qualitative expectations that should be met through the supervisory review process. This includes the ICAAP, governance process and the Supervisory Review Process.
Pillar 3	The third pillar of the Basel III framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.
Point-in-Time (PiT)	Estimates of PD (or other measures) made on a point-in-time (PiT) basis generally cover a short time horizon (usually a 12-month period) and are sensitive to changes in the economic cycle. This differs from a through-the-cycle (TTC) basis which uses long run average economic and risk data to reduce such sensitivity.
Probability of Default (PD)	Probability of default represents an estimate of the likelihood that a customer will default on their obligation within a 12-month time horizon.
Public Sector Entity (PSE)	A non-commercial administrative bodies responsible to central governments, regional governments or local authorities; or authorities that exercise the same responsibilities as regional and local authorities; or non-commercial undertakings owned by central governments that have explicit guarantee arrangements; or self-administered bodies governed by law that are under public supervision.
Qualifying Revolving Retail Exposure (QRRE)	Qualifying Revolving Retail Exposures (QRRE) relate to revolving, unsecured retail exposures that, to the extent they are not drawn, are immediately and unconditionally cancellable. Such exposures include credit cards and overdraft facilities.
Regulatory capital	The amount of capital that the TSB Group holds, determined in accordance with rules established by the PRA.
Repurchase agreements or 'repos'	Short-term funding agreements which allow a borrower to sell a financial asset as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.
Residual Maturity	The remaining time in years that a borrower is permitted to take to fully discharge its contractual obligation (principal, interest and fees) under the terms of a loan agreement.
Retail Internal Ratings Based (Retail IRB)	The Retail Internal Ratings Based (Retail IRB) Approach allows internal estimates of PD, LGD and EAD to be used in determining credit risk capital requirements for retail portfolios.

Retail SME	A small or medium sized entity, an exposure to which may be treated as a retail exposure.
Risk appetite	The amount and type of risk that the TSB Group is prepared to seek, accept or tolerate.
Risk weighted assets (RWAs)	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with CRR.
RWA density	RWAs divided by exposure after default (post credit risk mitigation and the application of credit conversion factors).
Securities financing transactions (SFTs)	Securities financing transactions are repurchase and reverse repurchase agreements, buy / sell backs and securities lending. For the lender (seller) of the securities it is usually a way to raise funds to finance the securities positions. For the borrower (buyer) of the securities it is a way to invest short–term funds or to cover short (bond) positions.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.
Specific Credit Risk Adjustment	Those credit risk adjustments that do not meet the criteria to be recognised as GCRAs. Credit risk adjustments recognised via an incurred loss model under IAS 39 are classed as SCRAs.
Standardised Approach	The Standardised Approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by External Credit Rating Agencies to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements.
Stress testing	Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds which are required to be held.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Supervisory Review and Evaluation Process (SREP)	The appropriate supervisor's assessment of the adequacy of certain firms' capital.
Through-The-Cycle (TTC)	See Point-in-time (PiT).
Tier 1 capital	A measure of a bank's financial strength defined by CRR. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A component of regulatory capital defined by CRR, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances.
Total capital ratio	Total capital as a percentage risk weighted assets.
Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
UK Leverage Ratio	A PRA defined modified measure of the leverage ratio which excludes qualifying central bank claims from the exposure measure. The PRA has set the minimum ratio at 3.25%.
Whistletree	Whistletree Loans includes a portfolio of former Northern Rock mortgages and unsecured loans which was acquired with effect from 7 December 2015 and a small portfolio of Airdrie Savings Bank customers which was acquired on 28th April 2017.

Appendix I – CRR Index

Article 13 of the Capital Requirements Regulation (CRR) 575/2013 establishes that EU parent institutions are obliged to comply with the disclosure requirements laid down in Part Eight of the CRR on the basis of their consolidated situation. Similarly, significant subsidiaries shall publish information required by the relevant Articles in Part Eight of that regulation which can be referenced in the disclosure index detailed below:

CRR Ref (575/2013) Part 8	High-Level Summary	Compliance reference
Non-performing and forborne exposures		
431(3)	Comprehensive disclosure of risk profile - non-performing and forborne exposures	Section 5.13 Management of customers experiencing financial difficulties pages 29-31
Own Funds		
437 (1)	Disclosure of the following information relating to Own Funds:	
437 (1)(a)	a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and filters and deductions applied to own funds and the statutory balance sheet	Table 4: Reconciliation between statutory and regulatory capital (OFDR) - page 11
437 (1)(b)	a description of the main features of Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments	Appendix II - Capital instruments main features (OFD1) - page 49
437 (1)(c)	the full terms and conditions of all common Equity Tier 1, Additional Tier 1 and Tier 2 instruments	Appendix II - Capital instruments main features (OFD1) - page 49
437 (1)(d)	Disclosure of the nature and amounts of the following:	
437 (1)(d)(i)	each prudential filter applied pursuant to Articles 32 to 35;	Table 2: Own Funds (OFD2) - page 9
437 (1)(d)(ii)	each deduction made pursuant to Article 36, 56 and 66;	Table 2: Own Funds (OFD2) - page 9
437 (1)(d)(iii)	items not deducted in accordance with Articles 47, 48, 56, 66 and 79;	Table 2: Own Funds (OFD2) - page 9
437 (1) (e)	Description of all restrictions applied to the calculation of own funds and the instruments, prudential filters and deductions to which those restrictions apply	Table 2: Own Funds (OFD2) - page 9
437 (1) (f)	A comprehensive explanation where institutions disclose capital ratios calculated using elements of own funds determined on a different basis	N/A
Capital requirements		
438 (a)	Institutions approach to assessing the adequacy of capital levels	Section 3.1 Capital adequacy risk - page 8
438 (b)	ICAAP result on demand from reporting authorities	Section 4.3 TSB Group's Pillar 2 capital requirement – page 14
438 (c)	Capital requirements for each Standardised credit risk exposure class (excluding CCR)	Table 5: Overview of RWAs (EU OV1) & Table 6: Total amount of risk weighted assets and minimum own funds requirements - pages 12 and 13
438 (d)	Capital requirements for each Internal Ratings Based (IRB) credit risk exposure class	Table 5: Overview of RWAs (EU OV1) & Table 6: Total amount of risk weighted assets and minimum own funds requirements - pages 12 and 13
438 (e)	Capital requirements for Large Exposures, Settlement risk or market risk	Table 5 Overview of RWAs (EU OV1) – page 12
438 (f)	Operational risk capital requirements of which; the basic indicator, standardised and advanced measurement approach	Table 5: Overview of RWAs (EU OV1) & Table 6: Total amount of risk weighted assets and minimum own funds requirements - pages 12 and 13
438 (endnote)	Disclosure of specialised lending exposures and equity exposures in the banking book which fall under the simple risk weight approach	N/A
Capital buffers		
440 (1)(a)	Geographical distribution of credit exposures relevant for calculation of countercyclical capital buffer	Section 4.3 Pillar 2 capital requirement Table 8 (BUF1) Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer – page 14 and 15
440 (1)(b)	Amount of the institution specific counter cyclical capital buffer	Table 9 (BUF2): Amount of institution specific countercyclical capital buffer - page 15

CRR Ref (575/2013) Part 8	High-Level Summary	Compliance reference
Credit risk adjustments		
442 (a)	Definitions of past due and impaired	Section 5.10 Impaired lending and provisions - page 26
442 (b)	Methodology applied to determine general and specific credit risk adjustments	Section 5.10 Impaired lending and provisions and 5.12 Managing impaired exposures and impairment provisions - page 26 and 28
442 (c)	Net exposure and average net exposure by exposure class	Section 5.3 - Credit risk exposure: Analysis by exposure class - Table 12 (EU CRB-B) – page 19
442 (d)	Net exposure by Geography	Section 5.5 Credit risk exposure: Geographical breakdown of exposures – Table 14 (EU CRB-C) - page 21
442 (e)	Net exposure by Industry	Section 5.4 Concentration of exposures: by industry and counterparty types – Table 13 (EU CRB-D) - page 20
442 (f)	Net exposure by residual maturity	Section 5.6 Credit risk exposure: Analysis by maturity – Table 15 (EU CRB-E) – page 22
442 (g)	Defaulted and non-defaulted exposures by exposure classes	Section 5.11 Credit quality of exposures by exposure class and instrument - Table 20 (EU CR1-A) – page 27
442 (g)(i)	A breakdown of impaired, past due, specific and general credit risk adjustments for the period by exposure classes, industry or counterparty type as deemed material	Section 5.14 Analysis of past due and impaired loans and advances to customers regardless of impairment status – page 32
442 (g)(ii)		
442 (g)(iii)		
442 (h)	A breakdown of impaired, past due, specific and general credit risk adjustments for the period by exposure classes, industry or counterparty type as deemed material	Section 5.14 Analysis for past due and impaired loans and advances to customers regardless of impairment status- page 32
442 (i)	Reconciliation of changes in specific and general credit risk adjustments for impaired exposures	Section 5.15 Analysis of impairment provisions in respect of loans and advances to customers - Table 24 (EU CR2-A) – page 32
442 (i)(i)		
442 (i)(ii)		
442 (i)(iii)		
442 (i)(iv)		
442 (i)(v)		
442 (endnote)	Specific credit risk adjustments recorded to income statement to be disclosed separately	Section 5.15 Analysis of impairment provisions in respect of loans and advances to customers - Table 24 (EU CR2-A) – page 32
Remuneration disclosures		
450	Remuneration disclosures	Section 7 pages 38-41. Cross references are also provided to the TSB Group Annual Report and Accounts
Leverage		
451 (1)(a) 451 (1)(b) 451 (1)(c)	Leverage ratio and a breakdown of total exposure measure including reconciliation to financial statements and derecognised fiduciary items	Section 6 Leverage Ratio Table 28 Summary reconciliation of accounting assets and leverage ratio exposure (LRSum) and Table 29 Leverage ratio common disclosure (LRCom) - page 35 and 36
451 (1)(d)	Description of the risk management approach to mitigate excessive leverage	Section 6.2 Management of excessive leverage - page 37
451 (1)(e)	Description of the factors that impacted the leverage ratio during the year	Section 6.1 Leverage ratio exposure - page 35
Use of credit risk mitigation techniques		
453 (a)	Use of off and on balance sheet netting	Section 5.16 Credit risk mitigation - page 33 - Master netting
453 (b)	Management of collateral valuation	Section 5.16 Credit risk mitigation - page 34 - Collateral
453 (c)	Description of the types of collateral used by the institution	Section 5.16 Credit risk mitigation - page 34 - Collateral
453 (d)	Creditworthiness and types of guarantor and credit derivative counterparty	Section 5.16 Exposures covered by eligible collateral and guarantees - page 34
453 (e)	Market or Credit risk concentrations within risk mitigation exposures	Section 5.16 Credit risk mitigation - page 33 - Concentration risk
453 (f)	For exposures under the Standardised or Foundation IRB approach, disclosure of exposure value covered by eligible collateral	Section 5.16 Credit risk mitigation - Table 27 (EU CR3) - page 34
453 (g)	Exposures covered by guarantees or credit derivatives	Section 5.16 Exposures covered by eligible collateral and guarantees - page 34
Transitional period for the impact of the introduction of IFRS 9		
473a (10)	Transitional arrangements for IFRS 9	Table 1 Key Metrics (KM1/IFRS 9-FL) – page 6 Section 3.2 TSB Group's own funds – page 9 Section 3.3 Movements in capital – page 10

Appendix II – Capital instruments' main features (OFD1)

Capital instruments' main features (1)	Share Capital 1	Share Capital 2	Subordinated Liabilities
Issuer	TSB Banking Group plc	TSB Banking Group plc	TSB Banking Group plc
Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement	N/A	N/A	XS1061206337
Governing law(s) of the instrument	English	English	English
Regulatory treatment			
Transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Post-transitional CRR rules	Common Equity Tier 1	Common Equity Tier 1	Tier 2
Eligible at solo/(sub-) consolidated/solo & (sub-) consolidated	Solo and (Sub-) Consolidated	Solo and (Sub-) Consolidated	Solo and (Sub-) Consolidated
Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Ordinary Shares	Subordinated Tier 2 Notes
Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	£1,386.5 million	£200.0 million	£384.9 million
Nominal amount of instrument	£0.5 million	£4.4 million	£385.0 million
Issue price	The nominal value of shares issued was £0.5 million and a minimum premium amount required by the Companies Act 2006 of £769.5 million was transferred to share premium. The balance of £616.5 million was transferred to the Merger Reserve.	£0.4494 per share	£0.9949
Redemption price	N/A	N/A	£1.00
Accounting classification	Shareholders' equity	Shareholders' equity	Liability - amortised cost
Original date of issuance	25 April 2014	19 May 2014	01 May 2014
Perpetual or dated	Perpetual	Perpetual	Dated
Original maturity date	No Maturity	No Maturity	06/05/2026
Issuer call subject to prior supervisory approval	No	No	Yes
Optional call date, contingent call dates, and redemption amount	N/A	N/A	6 May 2021 - the Notes may be redeemed, in whole but not in part, at the option of the Issuer on any Call Date, subject if so required at the relevant time to the Issuer giving prior written notice and receiving permission therefore from the Relevant Regulator. Redemption price £385 million.
Subsequent call dates, if applicable	N/A	N/A	Each subsequent Interest Payment Date after the first call option.
Coupons / dividends			
Fixed or floating dividend/coupon	N/A	N/A	Fixed to floating
Coupon rate and any related index	N/A	N/A	The notes pay interest at a rate of 5.75% per annum, payable semi-annually in arrears until 6 May 2021 at which time the interest rate becomes 3-month LIBOR plus 3.43% per annum payable quarterly in arrears.

Capital instruments' main features	**Share Capital 1**	**Share Capital 2**	**Subordinated Liabilities**
Existence of a dividend stopper	No	No	No
Fully discretionary, partially discretionary or mandatory (in terms of timing	Fully discretionary	Fully discretionary	Mandatory
Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Mandatory
Existence of step up or other incentive to redeem	No	No	No
Noncumulative or cumulative	Non-cumulative	Non-cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
If convertible, conversion trigger (s)	N/A	N/A	N/A
If convertible, fully or partially	N/A	N/A	N/A
If convertible, conversion rate	N/A	N/A	N/A
If convertible, mandatory or optional conversion	N/A	N/A	N/A
If convertible, specify instrument type convertible into	N/A	N/A	N/A
If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A
Write-down features	No	No	No
If write-down, write-down trigger (s)	N/A	N/A	N/A
If write-down, full or partial	N/A	N/A	N/A
If write-down, permanent or temporary	N/A	N/A	N/A
If temporary write-down, description of write-up mechanism	N/A	N/A	N/A
Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Subordinated in right of payment to the claims of depositors, other unsubordinated creditors and the subordinated debt of the issuer.	Subordinated in right of payment to the claims of depositors, other unsubordinated creditors and the subordinated debt of the issuer.	Subordinated in right of payment to the claims of depositors and other unsubordinated creditors of the issuer
Non-compliant transitioned features	No	No	No
If yes, specify non-compliant features	N/A	N/A	N/A

(1) The Group has opted to omit disclosures with regards to original capitalisation of the Group of £50,000 by LBG on the basis of materiality. This capital displays the same capital features as the ordinary shares disclosed in Appendix II.

Contacts

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