Risk Report

Effective management of the risks we face is central to everything we do.

The group faces a number of risks in the normal course of its business providing lending, deposit taking, wealth management services and securities trading. To manage these effectively, a consistent approach is adopted based on a set of overarching principles, namely:

- adhering to our established and proven business model, as outlined on pages 14 to 15;
- implementing an integrated risk management approach based on the concept of three lines of defence; and
- setting and operating within clearly defined risk appetites, monitored with defined metrics and limits.

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

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

Enterprise Risk Management

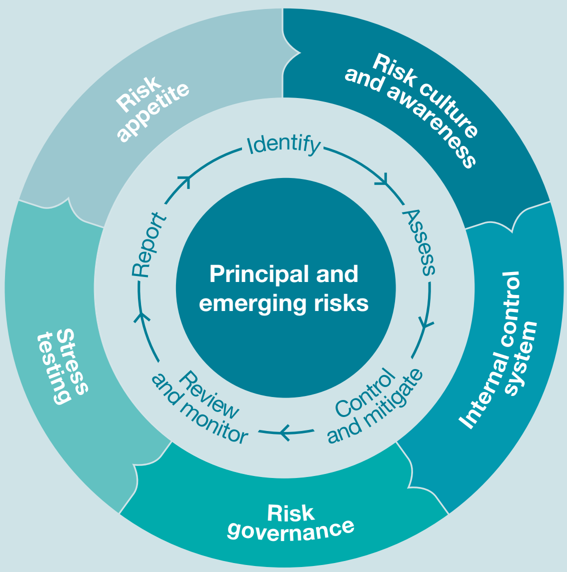
An enterprise-wide framework designed to provide the board and senior management with oversight of the group's financial position as well as the risks that might adversely affect it

The framework details the core risk management components and structures used across the group, and defines a consistent and measurable approach to identifying, assessing, controlling and mitigating, reviewing and monitoring, and reporting risk – the risk process life cycle.

This sets out the activities, tools, techniques and organisational arrangements designed to identify the principal and emerging risks facing the group; and that appropriate responses are in place to mitigate these risks and prevent detriment to its customers and colleagues. This is an enabler for the group to meet its goals and enhance its ability to respond to new opportunities.

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

Enterprise Risk Management Framework



Risk Culture and Awareness

An effective risk culture is embedded throughout the group

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

The risk culture:

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

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

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

The group risk management function operates independently of the business, providing oversight and advice on the operation of the risk framework, assurance that agreed processes operate effectively and that a risk and conduct culture is embedded within the business.

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

For further information on our approach to remuneration for the group's directors see pages 150 to 175.

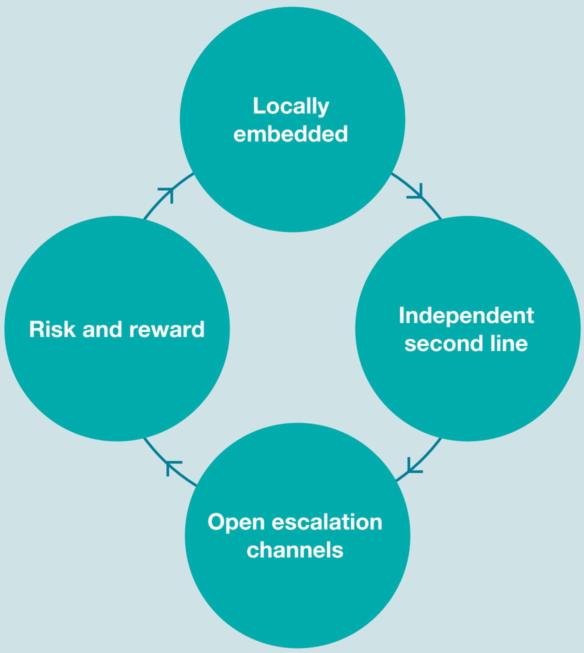
Risk Culture

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

Independent second line
Providing oversight, advice and assurance.

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

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



Risk governance

Role of the Board

The board retains overall responsibility for overseeing the maintenance of a system of internal control, to ensure that an effective risk management framework and oversight process operate across the group. The risk management framework and associated governance arrangements are designed to ensure a clear organisational structure with distinct, transparent and consistent lines of responsibility and effective processes to identify, manage, monitor and report the risks to which the group is, or may become, exposed. On an annual basis, the board reviews the effectiveness of the group's risk management and internal control systems. Further details on the board review of risk management and internal controls is provided on pages 128 and 129.

Risk management across the group is overseen by the Risk Committee. The committee is responsible for reviewing risk appetite, monitoring the group's risk profile against this and reviewing the day-to-day effectiveness of the risk management framework. In addition, the committee is responsible for overseeing the maintenance and development of an appropriate and supportive risk culture and for providing risk input into the alignment of remuneration with performance against risk appetite.

The committee's key areas of focus over the last financial year are set out on pages 147 to 149.

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

Risk Committee Structure

The board

Risk Committee

Executive committees

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

Risk-specific committees

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

Divisional committees

- Divisional risk and compliance committees

Together, these committees facilitate an effective flow of key risk information, as well as functioning to support appropriate risk management at each stage of the risk process life cycle. They also provide an escalation channel for any risks or concerns, supporting the maintenance of an effective risk culture. The group's risk governance framework is designed to enable the group to respond to changes in the risk and the broader regulatory environment in a considered and effective manner, with oversight from the board. During the year the effectiveness of these committees was reviewed to ensure they remain fit for purpose and all committees continue to work efficiently and effectively. During 2024, further enhancements have been made to the risk reporting packs and management information to support strengthened risk evaluation and management.

Risk Committee Overview

Aligned to these core principles, the governance framework operates through various delegations of authority from the board downwards, with a number of committees focused on risk management. The delegations of authority cover both individual authorities as well as authorities exercised via the group's risk committee structure.

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

Three Lines of Defence

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

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

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

Three Lines of Defence

First line of defence

The businesses

Group Risk and Compliance Committee (reports to the Risk Committee)

The chief executive delegates to divisional and operating business chief executives the day-to-day responsibility for risk management, regulatory compliance, internal control and conduct in running their divisions or businesses.

Business management has day-to-day ownership, responsibility and accountability for:

- identifying and assessing risks;
- managing and controlling risks;
- measuring risk (key risk indicators/early warning indicators);
- mitigating risks, including controls framework and effectiveness;
- reporting risks;
- committee structure and reporting; and
- management and self-assessment of operational resilience capabilities.

Key features

- Promotes a strong risk culture and focus on sustainable risk-adjusted returns.
- Implements the risk framework.
- Promotes a culture of adhering to limits and managing risk exposures and ongoing self-assessment.
- Promotes a culture of focus on good customer outcomes.
- Promotes responsibility for ongoing monitoring of positions and management and control of risks and controls effectiveness, including testing of controls, alongside portfolio optimisation.

Second line of defence

Risk and compliance

Risk Committee (reports to the board)

The Risk Committee delegates day-to-day responsibility for oversight and challenge on risk-related issues to the group chief risk officer.

Risk functions (including compliance) provide support, assurance and independent challenge on:

- the design and operation of the risk framework and methodologies;
- risk assessment;
- risk appetite and strategy;
- risk reporting;
- adequacy of mitigation plans and effectiveness of risk decisions taken by business management;
- group risk profile; and
- committee governance and challenge.

Key features

- Oversees embedding of the risk framework and supporting methodologies, taking an integrated approach to risk and compliance (qualitative and quantitative).
- Promotes a strong and effective risk and control culture across the group.
- Undertakes compliance monitoring and risk assurance activities.
- Supports through developing and advising on risk and compliance strategies.
- Facilitates constructive check and challenge.
- Oversight of business conduct and customer outcomes.

Third line of defence

Internal audit

Audit Committee (reports to the board)

The Audit Committee mandates the group head of internal audit with day-to-day responsibility for independent assurance.

Internal audit provides independent assurance on:

- first and second lines of defence;
- appropriateness/effectiveness of internal controls; and
- effectiveness of policy implementation.

Key features

- Draws on deep knowledge of the group and its businesses.
- Provides independent assurance on the activities of the group, including the risk management framework.
- Assesses the appropriateness and effectiveness of internal controls.
- Incorporates review of culture, conduct and customer outcomes.

Risk Management and Internal Controls

Supporting the foundation of a strong risk management structure

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

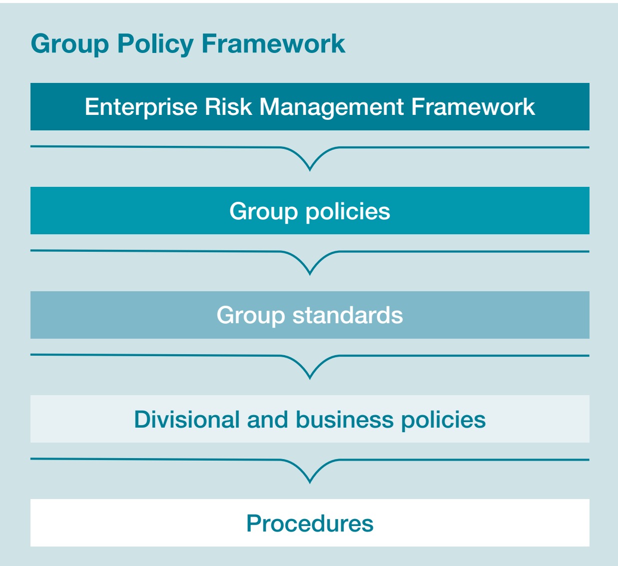
The main features of these controls with respect to financial reporting include consistently applied accounting policies, clearly defined lines of responsibility and processes for the review and oversight of disclosures within the Annual Report. These controls are overseen by the Audit Committee.

The group policy framework, overseen by the board, is a key component of the group's Enterprise Risk Management Framework, supporting the foundation of a strong risk management structure. Group policies are supported by group standards, and by divisional/business-level policies and procedures which, together, outline the way in which policy is implemented and detail the process controls in place to ensure compliance. The accounting policies form part of this broader policy framework, alongside policies and standards relating to the group's principal risks.

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

Review of effectiveness of risk management and internal control systems

Throughout the year, the board, assisted by the Risk Committee and the Audit Committee, actively monitors the group's risk management and internal control systems and reviews their effectiveness to ensure the maintenance of an effective risk management and internal control framework. A review of the effectiveness has been performed, covering all material controls, including financial, operational and compliance controls. Further detail on the board review of the risk management and internal controls is provided on page 129.



Risk Appetite

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

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

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

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

Stress Testing

Assessing and understanding future levels of risk

Stress testing represents another core component of the risk management framework and is employed, alongside scenario analysis, to support assessment and understanding of the risks to which the group might be exposed in the future. As such, it provides valuable insight to the board and senior management, playing an important role in the formulation and pursuit of the group's strategic objectives. All stress testing activities are overseen by the Scenario Planning Forum, who consider the various risks impacting the business and recommend actions required to enhance the group's stress testing ability.

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

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

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

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

Principal and emerging risks

Principal Risks

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

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

The group's activities, business model and strategy remain unchanged; as a result, following review and challenge, it has been determined that at present the principal risks themselves remain broadly consistent with those detailed in our prior year's report, although the underlying risk drivers may have changed and our approach to mitigating these has evolved in step with them.

The table on pages 82 and 83 gives an overview of these principal risks and possible impacts, as well as the outlook pertaining to these. More detailed information on each of these follows on pages 85 to 116 which set out the frameworks in place to manage these risks.

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

Climate Risk

Running alongside the suite of principal risks is climate risk, which the group categorises as a cross-cutting risk, as the impacts arising from climate change have the ability to impact across the spectrum of principal risks. In addition, transitional risks from climate change which may have a medium to longer-term impact on the group's product offering, operations and strategic direction are captured in the group's emerging risks. For further information on the group's climate risk response, see the group Sustainability Report on pages 33 to 54.

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

Emerging Risks

The group's suite of principal risks is accompanied by a portfolio of emerging risks reflecting broader market uncertainties. The group defines an emerging risk as a risk that may potentially become material in the delivery of the group's strategic objectives but the risk and its applicability to the group may not yet be fully understood or assessed. This incorporates input and insight from both a top-down and bottom-up perspective:

Top-down: identified by directors and executives at a group level via the Group Risk and Compliance Committee ("GRCC") and the board.

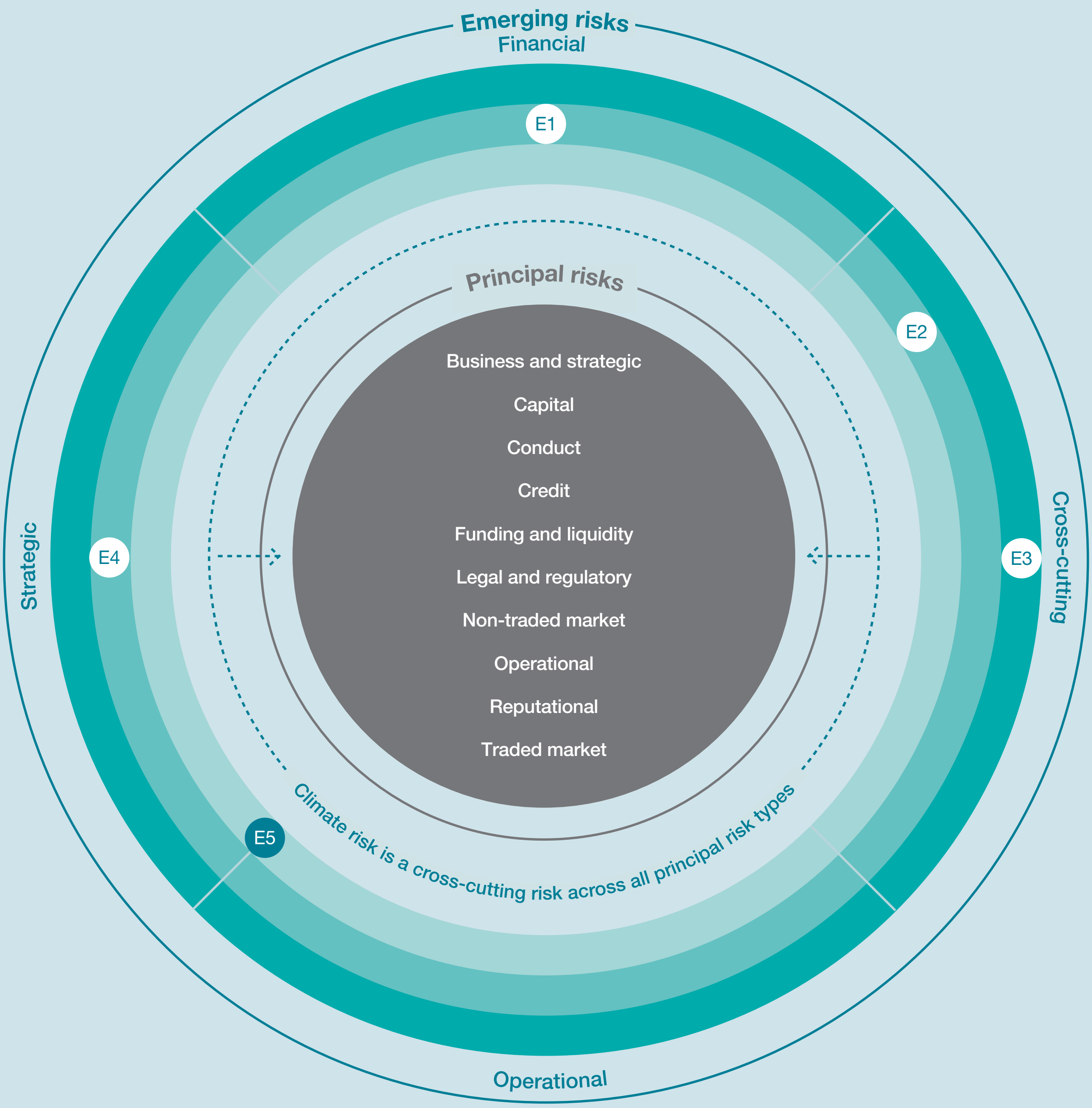
Bottom-up: identified at a business level and escalated, where appropriate, via risk updates to the GRCC.

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

Emerging risks are considered on both an internal and external basis with careful consideration given to likely emergence periods. Additionally, active monitoring of the correlation impacts across emerging risks, uncertainties and principal risks is undertaken.

During the year, to reflect the evolving nature of risks that accompany the implementation of group strategy, supply chain risk and legal and regulatory change risk have been removed as emerging risks and will continue to be monitored under business as usual cadence. In line with changes to the Corporate Governance Code, published by the Financial Reporting Council ("FRC") in 2024, the group continues to progress a programme of work to enhance the risk and controls management framework and monitoring of existing and horizon emerging risks.

Principal and Emerging Risks



Emerging risks

E1: Economic uncertainty
E2: Geopolitical uncertainty
E3: Medium to long-term transitional climate risks
E4: Strategic disruption
E5: Change execution risk

Risk emergence time frame

- Short term
- Medium term
- Long term

Emerging risks key

- Internal
- External

Principal risk	Outlook
Business and Strategic Risk The risk of realising lower than anticipated profits or experiencing a loss rather than a profit due to failure to adapt to changing market conditions, pursuing an ineffective strategy or ineffective implementation of strategy. *See page 85.*	• Whilst in the continued uncertain macroeconomic environment the group's business model remains proven and resilient, there is uncertainty in relation to the FCA's review of historical motor finance commission arrangements. • We continue to focus on supporting our customers, maintaining underwriting standards and investing to support future income generation, maintain operational resilience and generate operational efficiency and cost savings. • A number of management actions are in train and actively progressing to leave the group well placed to navigate the current uncertainty, as referenced in the H1 2024 announcement. • We continue to be encouraged by the strength of demand in our Banking business and see good growth prospects for the group, as we focus on resuming our track record of earnings growth and attractive returns. • The group remains prepared for a range of different economic and business scenarios to help ensure it has the resources and operational capability to perform effectively.
Capital Risk The risk that the group has insufficient regulatory capital (including equity and other loss-absorbing debt instruments) to operate effectively, including meeting minimum regulatory requirements, and to operate within board-approved risk appetite and support its strategic goals. *See page 86.*	• The FCA's review of historical motor finance commission arrangements may result in the need to raise a customer redress provision. • The PRA Policy Statement PS9/24 ("Implementation of the Basel 3.1 standards near-final part 2") could have an impact on the group's capital ratio.
Conduct Risk The risk that the group's behaviours, or those of its colleagues, whether intentional or unintentional, result in poor outcomes for customers or the markets in which it operates. It is rooted in the importance of delivering good customer outcomes at every stage of the customer journey. *See page 89.*	• As Consumer Duty continues to be embedded within the businesses, the group will continue to keep abreast of regulatory guidance and developments to enable adherence to regulatory expectations in relation to the delivery of good customer outcomes. • The external macroeconomic environment continues to increase financial pressure on consumers.
Credit Risk The risk of a reduction in earnings and/or value due to the failure of a counterparty or associated party, with whom the group has contracted or is exposed as part of its operations, to meet its obligations in a timely manner. *See page 90.*	• Notwithstanding signs of resilience in the economy over the last 12 months, uncertainty has remained for both individuals and SMEs. This could result in higher credit losses in the future. • The loan book continues to display resilience resulting from the application of consistent prudent lending criteria and risk appetite.

Protect Grow Sustain Risk increase Stable Risk decrease

Principal risk	Outlook
Funding and Liquidity Risk Funding risk is the risk of loss caused by the inability to raise funds at an acceptable price or to access markets in a timely manner or any decrease in the stability of the current funding base. Liquidity risk is defined as the risk that the group, or any of its entities, do not have sufficient liquid assets to meet liabilities as they come due during normal and disrupted markets. *See page 104.*	• The group has a long-standing approach based on the principle of "borrow long, lend short" and the group continues to benefit from the diverse funding mix and prudent maturity profile. • Consistent with the funding plan, growth in retail deposits is expected to continue.
Legal and Regulatory Risk The risk of non-compliance with laws and regulations which could give rise to fines, litigation, sanctions and/or direct claims by customers and the potential for material adverse impact upon the group. *See page 106.*	• The inherent risk arising in financial services as an industry in the jurisdictions in which we operate continues to increase. • Notwithstanding the strong controls in effect limiting residual risk exposure arising from regulatory expectations, external changes may have a follow-on impact to the group's residual exposure. • Legal risks such as the approach from the Financial Ombudsman Service ("FOS") relating to motor commissions, and uncertainty of: the outcome of the FCA's review of historical motor finance commission arrangements; position of the courts in relation to litigation and the Judicial Review of FOS (issued by Barclays); and the increase of activity from claim management companies, is likely to increase costs to the business and may give rise to potential future obligations to compensate customers.
Non-traded Market Risk Is the current or prospective risk to the group's capital or earnings, arising from changes in interest rates, credit spreads and foreign exchange rates applied to the group's non-trading book. *See page 107.*	• The group expects exposure to interest rate risk, credit spread risk and foreign exchange ("FX") risk to remain broadly stable.
Operational Risk Operational risk is the risk of loss or customer harm resulting from inadequate or failed internal processes, people and systems or external events. This includes the risk of being unable to recover systems quickly and maintain critical services. *See page 109.*	• In addition to the continuing investment required to sustain the group's systems and processes, an accelerating pace of external technology and market changes is increasing the imperative for the group to evolve and adapt its processes, risks and controls and the associated necessary staff capabilities. • Possible outcomes of the FCA's review of historical motor finance commission arrangements could strain operations and technology capacity, notwithstanding advance preparatory work. • Allocation of capital investment funding and change delivery capacity continue to be areas of management focus, to enable safe delivery of change programmes that enable the group's strategy and associated technology transformation.
Reputational Risk The risk of detriment to stakeholder perception of the group, leading to impairment of its reputation and future goals, due to any action or inaction of the company, its employees or associated third parties. *See page 113.*	• Established group-wide and employee-level focus on responsibility and sustainability enables an approach in all businesses that aligns to a range of stakeholder expectations, which is supported by group-level oversight. • Increased media attention, including in relation to the FCA's review of historical motor finance commission arrangements, may lead to an adverse perception of the group.
Traded Market Risk The risk that a change in the value of an underlying market variable will give rise to an adverse movement in the value of the group's trading assets and liabilities. *See page 115.*	• The external macroeconomic environment may continue to impact market volumes and suppress some market valuations.

Emerging risk/uncertainty	Mitigating actions and key developments
Cross-cutting Risks	
M **Geopolitical uncertainty** The risk that UK or global political events result in disruption to the business or negatively impact business performance or prospects.	• The group operates predominantly in the UK and Republic of Ireland, covering approximately 98% of the loan book exposure. Nevertheless, monitoring is in place to track changes in the geopolitical landscape that could impact the group's operations, customers and supply chain. • The group has a strong financial position, maintaining capital and liquidity levels in excess of regulatory minima. • Regular stress testing is undertaken on performance and financial position in the event of various adverse conditions to test the robustness and resilience of the group. • Risk appetite is regularly reviewed to ensure it remains appropriate in the prevailing geopolitical and macroeconomic environment.
L **Medium to long-term transitional climate risks** The risk that the move to a low carbon economy impacts demand for the group's products and services.	• Transitional climate risks across the medium to long term may potentially impact the group's product offering, operations and strategic direction. Monitoring is in place to continually identify and assess climate risks and opportunities, supported by annual consideration of climate-related scenario analysis. • Regular updates are provided to the Group Climate Committee and Risk Committee, which retains oversight responsibility, while senior management responsibility is assigned to the group chief risk officer. • The group continues to evolve its intermediate green lending ambitions, aligning to its wider net zero commitments under NZBA.
Financial Risks	
M **Economic uncertainty** The risk that changes in the external macroeconomic environment or consumer sentiment negatively impact on the group's performance or prospects.	• Persisting national or international macroeconomic uncertainty (for example, from financial volatility or changes to macroeconomic policies) can impact business, customer and broader market confidence. • The group's business model aims to enable it to trade successfully and support clients in a wide range of economic conditions. By maintaining a strong financial and capital position, the group aims to be able to absorb short-term economic downturns, respond to any change in activity or market demand, and in so doing build long-term relationships by supporting clients when it really matters. • The group focuses on credit quality and returns rather than overall growth or market share and continues to invest in the business for the long term, to support customers and clients through the cycle. • Risk appetite is regularly reviewed to ensure it remains appropriate in the prevailing macroeconomic environment. Regular stress testing is undertaken on performance and financial position in the event of various adverse conditions to test the robustness and resilience of the group.
Strategic Risks	
S **Change execution risk** Strategic, reputation, regulatory or financial risk as a result of failure to execute, embed and deliver the outcomes of change successfully.	• The group faces the risk that poorly executed change, or failure to deliver the outcomes and benefits of change, results in the failure to deliver good customer outcomes or meet strategic objectives and regulatory obligations. • Various large, complex projects and initiatives executed concurrently can place high demand on the group's operational capacity, increasing potential failure in achieving the required outcomes. The execution of a large portfolio of change could place demand on key subject matter experts and cause disruption and uncertainty to colleagues across the business. • Regular portfolio and project updates are provided to senior management, supporting oversight and governance of execution risks and ensuring appropriate resources are deployed to promote successful delivery.
M **Strategic disruption** The risk that changes in competition, technology, competitor business models or client expectations negatively impact on demand for the group's products and services.	• Strategic disruption may arise from technological change or new business models that may impact the group's market position and future profitability. • While regulation remains a barrier to entry for many potential competitors, consumer expectations continue to evolve, challenging existing capabilities and traditional approaches. • Competitors are adapting in response, while new financial technology companies develop alternative business models. For example, cloud-delivered solutions reduce barriers to entry and new product time to market, allowing new competitors and start-ups to compete in the marketplace more rapidly. • The growing prevalence of AI increases the effectiveness and efficiency in delivering customer-centric products and services for those competitors unable to deploy solutions at scale. The group acknowledges the benefits of investment in technology platforms and will consider the exploitation of new capabilities such as cloud and AI solutions where possible within capacity and financial constraints. • Market developments are closely monitored through horizon scanning to identify emerging dynamics as well as evolving preferences of the group's customers. The group prides itself on its knowledge of its customers, clients and the industries and sectors in which they operate.

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

Business and strategic risk

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

Exposure

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

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

Risk Appetite

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

- focusing on specialist markets where the group can build leading market positions based on service, expertise and relationships;
- focusing on credit quality and returns rather than loan book growth or market share;
- investing in the business for the long term;
- maintaining a strong balance sheet and prudently managing the group's financial resources;
- consistently supporting our customers and clients; and
- acting sustainably and responsibly, considering the interests of all stakeholders and growing demand for sustainable products and services.

Measurement

Business and strategic risk is measured through a number of key performance metrics (including those set out on pages 26 and 27) and risk indicators at a business, divisional and group level which provide transparency on progress and execution against strategy. These indicators are typically reported monthly via relevant committees, with oversight via the board, most notably through its review of key financial metrics and underlying performance trends.

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

Mitigation

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

The group's strategic pillars are regularly reviewed to ensure continued focus on strategic priorities that support the business model and enable the group to adapt to changes and expectations in the operating environment. Whilst these pillars remain unchanged, the group's strategic priority in the short term is to further strengthen the capital position, while protecting our business franchise.

Notwithstanding the current focus on optimising risk weighted assets, in part through selective loan book growth, the group's long track record of successful growth and profitability is supported by a consistent and disciplined approach to pricing and credit quality. This allows the group to support customers throughout the financial cycle.

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

- speed and flexibility of services;
- its local presence and personal approach;
- the experience and expertise of its people; and
- an offering of tailored and client-driven product solutions.

This differentiated and consistent approach combining our focus on credit quality and relationships with our clients results in strong customer engagement and high levels of repeat business.

The group is further protected by the diversity of its businesses and products, which provides resilience against competitive pressure or market weakness in any of the sectors it operates in.

Monitoring

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

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

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

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

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

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

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

Outlook

Whilst in the continued uncertain macroeconomic environment our business model remains proven and resilient, there is significant uncertainty in relation to the FCA's review of historical motor finance commission arrangements.

We continue to focus on supporting our customers, maintaining underwriting standards and investing to support future income generation, maintain operational resilience and generate operational efficiency and cost savings.

A number of management actions are in train and actively progressing to leave the group well placed to navigate the current uncertainty.

We continue to be encouraged by the strength of demand in our Banking business and see good growth prospects for the group, as we focus on resuming our track record of earnings growth and attractive returns.

The group remains prepared for a range of different economic and business scenarios to help ensure it has the resources and operational capability to perform effectively.

For further details on emerging risks and uncertainties see page 84. In addition, further commentary on the market environment and its impact on each division is outlined on pages 57 to 73.

Capital risk

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

Exposure

The group's exposure to capital risk principally arises from its requirement to meet minimum regulatory requirements set out in the Capital Requirements Regulation ("CRR") and PRA requirements and guidelines and is usually specified in terms of minimum capital ratios which assess the level of regulatory capital and RWAs. The group operates a prudent business model which results in comparatively low levels of leverage and so risk-based capital requirements are, and are likely to remain, the group's binding constraint.

The PRA supervises the group on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the group as a whole. In addition, a number of subsidiaries are regulated for prudential purposes by either the PRA or the FCA. The group's Pillar 1 information is presented in the first table of the "Measurement" section. Under Pillar 2, the group completes an annual self-assessment of risks known as the ICAAP. The ICAAP is reviewed by the PRA, which culminates in the PRA setting a Total Capital Requirement ("TCR") that the group and its regulated subsidiaries are required to hold at all times.

During the 2024 financial year the PRA reset the group's Pillar 2a requirements from 1% of RWAs to 1.3%. The TCR is now set at 9.3%, of which 5.2% needs to be met with Common Equity Tier 1 ("CET1") capital. This includes the Pillar 1 requirements (4.5% and 8% respectively for CET1 and total capital) and a Pillar 2a component of 1.3%, of which 0.7% needs to be met with CET1 capital.

There are no planned increases to the UK countercyclical buffer ("CCyB") at this time, and the rate remains at 2%. During the 2024 financial year, a planned increase of 1% to the Ireland CCyB rate has come into effect, with an applicable rate of 1.5% in effect from 7 June 2024. This change had a minimal impact on the group's CCyB, which remains at 1.9%.

Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on the firm's capital, risk exposures and risk assessment process. The group's Pillar 3 disclosures, which are unaudited, can be found on the group's website at www.closebrothers.com/investor-relations/investor-information/results-reports-and-presentations.

Risk Appetite

The group maintains a strong base level and composition of capital, sufficient to support the development and growth of the business, continue to meet Pillar 1 requirements, TCR, additional Capital Requirements Directive ("CRD") buffers and leverage ratio requirements, and be able to withstand a severe but plausible stress scenario with satisfactory capital and leverage ratios.

The group's policy is to be well capitalised and its approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates. Accordingly, a prudent capital position is a core part of the group's business model, allowing it to grow and invest in the business, support paying dividends to shareholders and meet regulatory requirements.

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

The group has set a management target for the CET1 capital ratio to operate in a range between 12.0% and 13.0% in the medium term, which provides for a significant surplus amount of capital to support the group's capital risk policy. Given the capital headwinds the group is facing, actions are being taken to build and preserve capital strength.

Measurement

The group maintains a strong capital base to support the development of the business and to ensure the group meets the TCR and additional regulatory buffers at all times. As a result, the group maintains capital adequacy ratios above minimum regulatory requirements, which are currently set at a minimum CET1 capital ratio of 9.7% and a minimum total capital ratio of 13.7%. The minimum CET1 capital requirements are inclusive of the capital conservation buffer (2.5% of RWAs) and the CCyB (currently 1.9% of RWAs), and exclusive of any applicable PRA buffer.

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

The CET1 capital ratio reduced from 13.3% to 12.8%, mainly driven by growth in loan book (-c.100 bps), a decrease in IFRS 9 transitional arrangements (-c.20 bps), the Bluestone acquisition (-c.20 bps) and AT1 coupon (-c.10 bps). This was partly offset by profits for the current financial year (c.90 bps).

CET1 capital increased by 5% to £1,374.8 million (31 July 2023: £1,310.8 million) mainly driven by £100.4 million of profits, partly offset by the dividend paid and foreseen related to AT1 coupon of £15.0 million and a decrease in the transitional IFRS 9 add-back to capital of £19.7 million.

Tier 1 capital increased 20% to £1,574.8 million (31 July 2023: £1,310.8 million), driven by the issuance of the group's inaugural AT1 in a £200 million transaction to optimise the capital structure and provide further flexibility to grow the business. The transaction strengthened the regulatory capital position and was in line with the group's strategy and capital management framework.

Total capital increased 17% to £1,774.8 million (31 July 2023: £1,510.8 million), primarily reflecting the AT1 issuance.

RWAs increased 9% to £10.7 billion (31 July 2023: £9.8 billion), driven by loan book growth (c.£790 million) primarily in Commercial and Property, and the acquisition of Bluestone Motor Finance (Ireland) DAC (c.£120 million), and a decrease in operational risk RWAs (c.£40 million) reflecting a reduction in average income in Winterflood, partly offset by loan book growth.

As a result, CET1, tier 1 and total capital ratios were 12.8% (31 July 2023: 13.3%), 14.7% (31 July 2023: 13.3%) and 16.6% (31 July 2023: 15.3%), respectively.

Composition of regulatory capital and Pillar 1 RWAs (unaudited)

	31 July 2024 £ million	31 July 2023 £ million
CET1 capital		
Shareholders' equity per balance sheet	**1,842.5**	1,644.9
Regulatory adjustments to CET1 capital		
Contingent convertible securities recognised as AT1 capital[1]	**(197.6)**	–
Intangible assets, net of associated deferred tax liabilities	**(264.0)**	(262.8)
Foreseeable dividend[2]	**(3.8)**	(67.0)
Cash flow hedging reserve	**(13.0)**	(34.4)
Pension asset, net of associated deferred tax liabilities	**(0.6)**	(1.0)
Prudent valuation adjustment	**(0.8)**	(0.4)
Insufficient coverage for non-performing exposures[3]	**–**	(0.4)
IFRS 9 transitional arrangements[4]	**12.1**	31.9
CET1 capital[5]	**1,374.8**	1,310.8
Additional Tier 1 capital	**200.0**	–
Total Tier 1 capital[5]	**1,574.8**	1,310.8
Tier 2 capital – subordinated debt	**200.0**	200.0
Total regulatory capital[5]	**1,774.8**	1,510.8
RWAs		
Credit and counterparty credit risk	**9,548.4**	8,655.4
Operational risk[5]	**1,044.5**	1,084.0
Market risk[5]	**108.3**	108.2
	10,701.2	9,847.6
CET1 capital ratio[5]	**12.8%**	13.3%
Tier 1 capital ratio[5]	**14.7%**	13.3%
Total capital ratio[5]	**16.6%**	15.3%

1. The contingent convertible securities are classified as an equity instrument for accounting but treated as AT1 for regulatory capital purposes, note 20 to the financial statements.
2. Under CRR Article 26, a deduction for a foreseeable dividend and charges has been recognised at 31 July 2024 and 31 July 2023. The deduction at 31 July 2024 reflects charges for the coupon on the group's contingent convertible securities.
3. In line with the amendment to Own Funds Part of the PRA Rulebook confirmed in PS 14/23, CET1 capital at 31 July 2024 no longer includes a regulatory deduction for insufficient coverage for non-performing exposures as this is no longer applicable (31 July 2023: £0.4 million).
4. The group has elected to apply IFRS 9 transitional arrangements for 31 July 2024, which allow the capital impact of expected credit losses to be phased in over the transitional period.
5. Shown after applying IFRS 9 transitional arrangements and the CRR transitional and qualifying own funds arrangements in force at the time. Without their application, at 31 July 2024 the CET1 capital ratio would be 12.7%, tier 1 capital ratio 14.6% and total capital ratio 16.5% (31 July 2023: CET1 capital ratio 13.0% and total capital ratio 15.1%).

Movement in CET1 capital during the year (unaudited)

	2024 £ million	2023 £ million
CET1 capital at 1 August	**1,310.8**	1,396.7
Profit in the period attributable to shareholders	**100.4**	81.1
Dividends paid and foreseen	**(15.0)**	(100.5)
IFRS 9 transitional arrangements	**(19.7)**	(51.1)
Increase in intangible assets, net of associated deferred tax liabilities	**(1.2)**	(12.1)
Other movements in reserves recognised for CET1 capital	**(0.8)**	(7.3)
Other movements in adjustments from CET1 capital	**0.3**	4.0
CET1 capital at 31 July	**1,374.8**	1,310.8

Mitigation

The group has a range of capital risk mitigants available including the cancellation of dividends, RWA optimisation activities and efficiency savings which support the strong organic capital-generating capacity of the group. In February 2024, the group announced that it will not pay any dividends on its ordinary shares for the current financial year.

In addition, the group has a strong track record of access to capital markets including issuance of £200 million Additional Tier 1 capital in November 2023, noting that currently there is an opportunity to optimise the group's capital position further through the issuance of Tier 2.

Monitoring

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

The CAC is responsible for the management of capital risk and for the allocation of capital across the group, which includes the setting of the group's capital strategy and the setting and monitoring of a comprehensive capital risk appetite framework. These are managed through a series of group policies, standards and methodology documents and supported by capital reporting and planning control frameworks. The CAC, whose membership consists of finance, business and risk executives, is responsible for measuring and monitoring the actual and forecast capital position on a monthly basis. Key capital metrics are reported to the board on a regular basis, with any changes to the capital structure of the group reserved for the group board. The CAC also monitors actual, forecast and stressed capital metrics using an IRB approach in order to prepare for anticipated future transition to this approach.

Outlook ↑

With respect to the FCA's review of discretionary commission arrangements in the motor finance market prior to the 2021 ban on these models, on 30 July 2024, the FCA announced that it now aims to set out next steps by the end of May 2025, rather than by September 2024 as previously expected. Therefore, there remains significant uncertainty for the industry and the group regarding any potential remedial action as a result of the review. There are a range of possible outcomes and we remain focused on further strengthening the group's capital position, with the priority of protecting and sustaining our valuable franchise.

As previously announced, we are implementing management actions which include selective loan book growth initiatives, potential risk transfer through securitisation, a continued review of our business portfolios, capital retention opportunities and identified cost savings, which, combined with the decision not to pay a dividend in the 2024 financial year, have the potential to strengthen the group's available CET1 capital by approximately £400 million by the end of the 2025 financial year.

Following a comprehensive strategic review, the group announced that it entered into an agreement to sell CBAM to Oaktree on 19 September 2024. The transaction is expected to increase the group's CET1 capital ratio by approximately 100 basis points on a pro forma basis.

Nevertheless, there remains considerable uncertainty regarding the specifics of any potential redress scheme, if required, as well as its timing. Subject to the execution of management actions and capital generation, we have the potential to increase the group's CET1 capital ratio to be between 14% and 15% at the end of the 2025 financial year (excluding any potential redress or provision related to the FCA's review of historical motor finance commission arrangements).

The PRA Policy Statement PS 9/24 Implementation of the Basel 3.1 standards near-final part 2 was published on 12 September 2024, with an implementation date of 1 January 2026, six months later than previously anticipated. The majority of rules applicable to the group remain unchanged, including the proposed removal of the small and medium-sized enterprises ("SME") supporting factor, new conversion factor for cancellable facilities and new market risk rules. As a result, we continue to expect implementation to result in an increase of up to c.10% in the group's RWAs calculated under the standardised approach. However, the PRA has proposed to apply an SME lending adjustment as part of Pillar 2a, to ensure that the removal of the SME support factor under Pillar 1 does not result in an increase in overall capital requirements for SME lending. Whilst this adjustment is subject to PRA confirmation and a resulting restatement of the group's TCR, we would reasonably expect the UK implementation of Basel 3.1 to have a less significant impact on the group's overall capital headroom position than initially anticipated.

Conduct risk

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

Exposure
The group is exposed to conduct risk in its provision of products and services to customers either directly or via its distributors, and through other business activities that enable delivery. The regulatory change agenda continues at pace and is expected in the near term to continue to enhance consumer protection given the macroeconomic environment. Regulatory expectations, including with respect to retail customer savings and borrowing, wealth advisory, and trading activities continue to evolve, with impact on the group's businesses in each of these markets. Failure to evidence delivery of good customer outcomes may lead to reputational harm, legal or regulatory sanctions and/or customer redress.

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

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

Measurement
Conduct risk is measured throughout the Enterprise Risk Management Framework by management information and risk indicators. A number of quantitative and qualitative key risk indicators are determined at an individual business level, with reporting to and oversight via the relevant divisional Risk and Compliance Committee ("RCC"). Performance against the key risk indicators is reported to the GRCC and the Risk Committee.

Customer outcome monitoring metrics are key contributors to conduct risk monitoring. Customer outcome monitoring metrics are designed to identify potential or actual poor customer outcomes. Where potential or actual customer harm is identified via outcome monitoring, businesses are required to consider and deploy, where appropriate, remedial actions.

For businesses with products in scope of the FCA's Consumer Duty, indicators feed into the local and group reporting (RCCs/GRCC) and into the quarterly Customer Outcomes Report which is shared with the board.
The aforementioned report supports the annual assessment of customer outcomes where the board is required to review and approve an assessment of whether the firm is delivering good customer outcomes.

Mitigation
The following controls and procedures are in place to help mitigate conduct risk:

- The group takes steps to proactively identify conduct risks and encourages all individuals across the organisation to feel responsible for managing conduct risks within their business area and/or function.
- The group provides support to colleagues to enable them to improve the conduct of their business or function, including group-wide and specialist training where required.
- The group's remuneration strategy is designed to incentivise good behaviours and due consideration is given to individual conduct as part of any remuneration.
- Policies and standards set out expectations of employees and key controls to ensure conduct risk is managed within the agreed risk appetite, including for essential areas such as dealing with clients, dealing with markets, complaint handling, vulnerable customers and conflicts of interest. Mandatory staff training on key conduct areas is provided on a regular basis.
- All products are subject to a robust risk-based product development and review process.

Implementation activities for Consumer Duty continued with further embedding and enhancements to processes introduced in 2023 for open book products and completion of work in relation to closed book products in 2024.
The board has actively engaged with the Consumer Duty journey of each division in the light of each unique market and considers the distinct conduct risks that present across the business lines. The board has oversight of each regulated entity and their own annual assessment of customer outcomes.

On an ongoing basis, the board actively oversees Consumer Duty, including through engagement with regular management information to identify risks to these outcomes, and through monitoring the status of work to improve outcomes where necessary.

Conduct Risk Framework

Monitoring

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

The compliance monitoring function undertakes regular reviews of key areas, such as complaint handling, vulnerable customer processes and customer communications, to confirm customers are experiencing good outcomes. Group internal audit provides independent assurance on the adequacy, completeness and control effectiveness of key areas using a risk-based approach. Compliance monitoring and audit findings assist with early detection of potential conduct risk or poor customer outcomes in order that appropriate action plans can be put in place.

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

Conduct risk reporting has continued to mature, providing increased transparency and visibility aiding management's monitoring of conduct risk. With the introduction of the enhanced regulatory requirements of the FCA's Consumer Duty for retail customers, reporting has been evolved and enhanced. Metrics will continue to be evaluated with the introduction of new regulatory requirements.

Outlook

Conduct risk remains elevated as the macroeconomic environment continues to place financial pressure on customers as a result of the cost of living and interest rates. Whilst there has been moderation in inflation within the past financial year, the medium to long-term outlook remains uncertain. This may increase the stresses on individuals and businesses requiring credit. As a result, the importance of appropriate support for customers in financial difficulty, including vulnerable customers, is expected to remain elevated. The group is focused on maintaining its culture which enables tailoring its approach to supporting customers to drive good customer outcomes.

The group's regulators continue to evolve market-wide expectations for firms to deliver good customer outcomes. The group continues to engage with its regulators in an open and cooperative manner, including with respect to this evolving agenda. Where it becomes evident that good customer outcomes may not have been achieved, the group has moved to understand where any shortcomings may have arisen and to address those, such as through the recent Past Business Review of forbearance practices and associated redress relating to the group's motor finance lending.

Credit risk

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

The Banking division applies consistent and prudent lending criteria to mitigate credit risk. Its lending activities are predominantly secured across a diverse range of asset classes. This ensures concentration risk is controlled in both the loan book and associated collateral. Credit risk appetites are set around unsecured and structurally protected lending to ensure portfolios remain predominantly secured. At 31 July 2024, secured lending accounts for 90.0% (31 July 2023: 90.4%) of the loan book.

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

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

Managing Credit Risk

Exposure

As a lender to businesses and individuals, the group is exposed to credit losses if customers are unable to repay loans and outstanding interest and fees. At 31 July 2024, gross loans and advances to customers was £10.3 billion (31 July 2023: £9.6 billion).

Further details on loans and advances to customers and debt securities held are in notes 10 and 11 to the Financial Statements. Further commentary on the credit quality of the loan book is outlined on pages 93 to 103.

Risk appetite

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

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

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

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

- To lend within familiar asset classes, in well-known and understood markets.
- To operate as a predominantly secured, or structurally protected, lender against identifiable and accessible assets, and maintain conservative loan-to-value ("LTV") ratios across the Banking division's portfolios.
- To maintain a diversified loan portfolio (by business, asset class and UK geography), as well as a short average tenor and low average loan size.
- To rely on local underwriting expertise, with authority delegated from the Risk Committee, and ongoing central oversight.
- To maintain rigorous and timely collections and arrears management processes.
- To operate strong control and governance within the lending businesses, overseen by a central group credit risk team.

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

The CRAS is embedded into business unit credit risk management through a hierarchy of local triggers and limits, which are approved by the chief credit officer ("CCO") and noted at CRMC. Performance is also monitored monthly via divisional RCCs. Material breaches are escalated via established governance channels.

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

Credit Risk Governance Framework

Measurement

A consolidated central credit reporting framework is in place and facilitates effective credit risk management and measurement by the central group credit risk team. The framework enables the identification, measurement, monitoring and control of all material credit risks within the lending portfolios, setting clear credit risk appetite within which all lending is originated and ensuring that asset portfolios are grown responsibly and profitably.

A centralised framework incorporates:

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

Mitigation (Audited)

Credit assessment and lending criteria

The Banking division's general approach to credit mitigation is based on the provision of affordable lending on a secured or structurally protected basis, against assets that are known and understood. These assets are typically easily realisable with strong secondary markets and predictable values, and spread across a broad range of classes within established sectors.

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

The common lending principles are as follows:

- Predominantly secured lending: 97.6% of loan book secured or structurally protected.
- Short average tenor: portfolio residual maturity of 15 months.
- Small average loan size and low single-name concentration risk: balance for the top 10 facility limits represents less than 6% of book.
- Further diversification by sector, asset class and UK geography.
- Local underwriting expertise with central oversight: focus on assets that are known and understood.

All lending criteria and assessment procedures are thoroughly documented in robust credit policies and standards, at both a bank and business level.

Expertise

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

Governance Framework and Oversight

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

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

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

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

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

Monitoring

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

Documented policy includes business-specific definitions for identifying customers in, or likely to experience, financial difficulty. There are accompanying courses of action outlined that protect the group's position, taking account of the terms/covenants of facilities, security enforcement options, legal remedies and third-party intervention (for example, brokers).

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

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

First line of defence: Credit risk management

Banking businesses have primary responsibility for ensuring that a robust risk and control environment is established as part of day-to-day operations, and that good-quality credit applications are brought forward for consideration.

They are also responsible for ensuring that their activities are compliant with the rules and guidance set out in local credit policies and processes. Each business unit has its own formalised credit risk appetite and policy documents, approved by divisional RCCs. This risk culture is facilitated by local profit and loss ownership, ensuring a long-term approach is taken, with an understanding of how loans will be repaid.

Second line of defence: Risk oversight and control

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

Third line of defence: Internal audit

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

Banking Overview

The Commercial business is a combination of several specialist, predominantly secured, lending businesses.

The nature of assets financed varies across the businesses. The majority of the loan book comprises loans of less than £2.5 million. Credit quality is assessed predominantly on an individual loan-by-loan basis. During and after the Covid-19 pandemic, the Commercial business has provided additional support to customers using the CBILS, Coronavirus Large Business Interruption Loan Scheme ("CLBILS") and RLS products, which benefit from UK government guarantees. Collection and recovery activity is executed promptly by experts with relevant experience in specialised assets. This approach allows remedial action to be implemented at the appropriate time to minimise potential loss and support good and fair customer outcomes.

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

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

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

Outlook

Expected credit losses increased in the year to 31 July 2024, primarily resulting from loan book growth across all divisions, Novitas Stage 3 interest accrual plus changes to time to recover assumptions, increases to existing impaired accounts and migrations into Stage 3. This increase is set against a backdrop of ongoing market uncertainty, which continues to be monitored closely.

The market backdrop has been mixed this year. The economy has proved resilient, with a general improvement in macroeconomic indicators, low unemployment and strong wage growth. Nevertheless, uncertainty has persisted for both individuals and SMEs.

Notwithstanding the reduction in the Bank of England base rate in August 2024 and the improvement in some economic indicators, headwinds remain, with interest rates at higher levels, inflation proving more persistent than expected and cost of living pressures continuing, all of which could result in higher credit losses in the future.

The change in government seen in July 2024 is expected to lead to changes in policy which could have an impact on the UK's economic outlook.

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

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

Further details on loans and advances to customers and debt securities held are in notes 10 and 11 to the Financial Statements.

Credit Risk Highlights (Audited)[1]

	31 July 2024 £ million	31 July 2023 £ million
Gross loans and advances to customers		
Property business	**2,015.4**	1,744.8
Retail business	**3,136.8**	3,091.2
Commercial business	**5,112.6**	4,799.6
Of which Novitas:	*283.1*	*244.0*
Excluding Novitas:	*4,829.5*	*4,555.6*
Total gross loans and advances to customers	**10,264.8**	9,635.6
Impairment provisions		
Property business	**60.2**	41.7
Retail business	**94.9**	89.4
Commercial business	**290.7**	249.5
Of which Novitas:	*220.7*	*184.1*
Excluding Novitas:	*70.0*	*65.4*
Total impairment provision	**445.8**	380.6
Provision coverage ratio		
Property business	**3.0%**	2.4%
Retail business	**3.0%**	2.9%
Commercial business	**5.7%**	5.2%
Novitas only:	*78.0%*	*75.5%*
Excluding Novitas:	*1.4%*	*1.4%*
Total impairment coverage ratio	**4.3%**	3.9%
Part and non-performing loans		
Loans in Stage 2	**1,128.8**	1,062.0
Of which Novitas:	*1.0*	*1.3*
Loans in Stage 3	**725.5**	583.4
Of which Novitas:	*282.1*	*241.7*
Stage 2 coverage	**2.8%**	3.0%
Excluding Novitas:	*2.7%*	*3.0%*
Stage 3 coverage	**49.9%**	49.8%
Excluding Novitas:	*32.2%*	*31.2%*

1. The credit risk highlights table relates to assets held at amortised cost, which excludes £11.8 million of loans held at fair value through profit and loss ("FVTPL") under IFRS 9.

Disclosures are provided for loans and advances to customers held at amortised cost under IFRS 9. This excludes £11.8 million of loans and advances to customers measured at fair value through profit or loss which are managed on a consistent basis as detailed on pages 90 to 92, but do not attract an ECL under IFRS 9. Stage allocation of loans and advances to customers has been applied in line with the definitions set out in note 1 to the Financial Statements.

During the year the staging profile of loans and advances to customers deteriorated, primarily as a result of stage migrations in Asset Finance, Motor Finance and Property Finance offsetting strong Stage 1 loan book growth in the Leasing and Property Finance businesses.

At 31 July 2024, 81.9% (31 July 2023: 82.9%) of gross loans and advances to customers were Stage 1. Stage 2 loans and advances to customers remained stable at 11.0% (31 July 2023: 11.0%). The remaining 7.1% (31 July 2023: 6.1%) of loans and advances to customers were deemed to be credit-impaired and were classified as Stage 3.

Overall impairment provisions increased to £445.8 million (31 July 2023: £380.6 million), following regular reviews of staging and provision coverage for individual loans and portfolios. The movement in impairment provisions was mainly driven by Novitas Stage 3 interest accrual in line with the requirement under IFRS 9 to recognise interest on a net basis, plus changes to time to recover assumptions.

Excluding Novitas, impairment provisions increased across the Banking division to £225.1 million (31 July 2023: £196.5 million), reflecting overall loan book growth, increases to existing impaired accounts and migrations into Stage 3. These factors are set against the backdrop of persistent external pressures resulting from uncertainty in the macroeconomic environment.

As a result, there has been an increase in provision coverage to 4.3% (31 July 2023: 3.9%).

Provision Coverage Analysis by Business (Audited)

In Commercial, the impairment coverage ratio increased to 5.7% (31 July 2023: 5.2%), reflecting the impacts of Novitas Stage 3 interest accrual in line with the requirement under IFRS 9 to recognise interest on a net basis.

Excluding Novitas, the Commercial provision coverage ratio remained stable at 1.4% (31 July 2023: 1.4%) as strong Stage 1 new business levels offset the impacts of migrations into Stages 2 and 3 during the financial year.

In Retail, the provision coverage ratio increased to 3.0% (31 July 2023: 2.9%), reflecting resilient portfolio performance in light of sustained macroeconomic uncertainty and heightened levels of arrears and forbearance in the Motor Finance business as a result of persistent cost of living pressures on customers.

In Property, the provision coverage ratio increased to 3.0% (31 July 2023: 2.4%), as a result of migrations to Stage 3 and increased individual provisions for some existing impaired accounts during the financial year.

See note 10 to the Financial Statements for full staging tables and analysis, and pages 97 to 99 for additional detail on changes to macroeconomic forecasts that have impacted provisions during this financial year.

Measuring Credit Risk Across Our Businesses

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

In particular, the calculation of the group's expected credit loss provision under IFRS 9 requires the group to make a number of judgements, assumptions and estimates, which have a material impact on the accounts.

This assessment, which requires judgement, is unbiased and probability-weighted and uses historical, current and forward-looking information. The most significant judgements and estimates are set out below.

While the impact of climate change represents a source of uncertainty, the group does not consider climate-related risks to be a critical accounting judgement or estimate at 31 July 2024. Climate risk continues to be a key area of focus for the group and the Banking division continues to assess the sensitivity of assets and customers to climate-related risks as part of regular credit monitoring. Transitional climate risks are considered to be largely mitigated by short average loan book tenors (15 months), conservatively secured and diversified portfolios, and the rigorous underwriting, monitoring and control processes that are in place.

Use of Judgements (Audited)

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

Significant increase in credit risk

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

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

- quantitative assessment: the lifetime probability of default ("PD") has increased by more than an agreed threshold relative to the equivalent at origination. Thresholds are based on a fixed number of risk grade movements which are bespoke to each business to ensure that the increased risk since origination is appropriately captured;
- qualitative assessment: events or observed behaviour indicate credit deterioration. This includes a wide range of information that is reasonably available, including individual credit assessments of the financial performance of borrowers as appropriate during routine reviews, plus forbearance and watch list information; or
- backstop criteria: the "30 days past due" backstop is met.

Definition of default

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

Use of Estimates (Audited)

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

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

Modelled estimates

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

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

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

Probability of default

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

Exposure at default

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

Loss given default

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

Novitas loans

Novitas provided funding to individuals who wished to pursue legal cases. The majority of the Novitas portfolio, and therefore provision, relates to civil litigation cases. To protect customers in the event that their case failed, it was a condition of the Novitas loan agreements that an individual purchased an After the Event ("ATE") insurance policy which covered the loan.

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

In the financial year under review, management has maintained its assumptions for expected case failure rates, and expected recovery rates which continue to appropriately reflect experienced credit performance and ongoing dialogue with customers' insurers. Within the 2024 financial year impairment charge for Novitas of £6.4 million, an adjustment has been made for extended time to recovery assumptions from insurers. This reflects management's latest assessment of negotiations with customers' insurers and the current timeline of litigation proceedings.

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

Since 31 July 2023, expected credit loss provisions have increased by £36.6 million to £220.7 million (31 July 2023: £184.1 million). This increase is a primarily a result of interest accrual on civil litigation accounts, for which a full loss provision is applied, and the update to the time to recover assumption.

Given that the majority of the Novitas portfolio is in Stage 3, the key sources of estimation uncertainty for the portfolio's expected credit loss provision are time to recover periods and recovery rates for the civil litigation portfolio. On this basis, management assessed and completed sensitivity analysis when compared to the expected credit loss provision for Novitas of £220.7 million (31 July 2023: £184.1 million).

At 31 July 2024, a 10% absolute deterioration or improvement in recovery rates would increase or decrease the ECL provision by £13.4 million. Separately, a 12-month improvement in the time to recover period will reduce the ECL provision by £13.4 million, while a 12-month delay in the time to recover period will increase the ECL provision by £11.0 million.

Further detail on the impairment provision is included in note 10 to the Financial Statements.

Forward-looking information

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

In order to calculate forward-looking provisions, economic scenarios are sourced from Moody's Analytics. These cover a range of plausible economic paths that are used in conjunction with PD, EAD and LGD parameters for each portfolio to assess expected credit loss provisions across a range of conditions. An overview of these scenarios using key macroeconomic indicators is provided on pages 97 to 99. Ongoing benchmarking of the scenarios to other economic providers is carried out monthly to provide management with comfort on Moody's Analytics scenario paths.

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

The impact of forward-looking information varies across the group's lending businesses because of the differing sensitivity of each portfolio to specific macroeconomic variables.

This is reflected through the development of bespoke macroeconomic models that recognise the specific response of each business to the macroeconomic environment.

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

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

Economic forecasts have evolved over the course of 2024 and reflect the mixed external backdrop observed in the year. Forecasts deployed in IFRS 9 macroeconomic models are updated on a monthly basis. At 31 July 2024, the latest baseline scenario forecasts gross domestic product ("GDP") growth of 1.0% in calendar year 2024 and an average base rate of 5.1% across calendar year 2024. Consumer Price Index ("CPI") inflation is forecast to be 2.5% in calendar year 2024 in the baseline scenario, with 0.7% forecast in the protracted downside scenario over the same period.

At 31 July 2024, the scenario weightings were: 30% strong upside, 32.5% baseline, 20% mild downside, 10.5% moderate downside and 7% protracted downside. As economic forecasts are considered to appropriately recognise developments in the macroeconomic environment, no change has been made to the weightings ascribed to the scenarios since 31 July 2023.

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

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

The final scenarios deployed reflect general improvement in the UK economic outlook relative to 31 July 2023. Under the baseline scenario, UK headline CPI inflation is expected to stabilise at current levels as a result of sustained base rate increases in 2022 and 2023 and eased supply chain pressures. Aligned to recent reductions in inflation, the Bank of England base rate is forecast to gradually reduce in all scenarios. House price outlook has improved across all scenarios, recognising more resilient housing market performance than previously anticipated. Unemployment rate forecasts have marginally deteriorated compared to 31 July 2023.

The tables on pages 97 to 98 show economic assumptions within each scenario, and the weighting applied to each at 31 July 2024. The metrics shown are key UK economic indicators, chosen to describe the economic scenarios. These are the main metrics used to set scenario paths, which then influence a wide range of additional metrics that are used in expected credit loss models. The first tables show the forecasts of the key metrics for the scenarios utilised for calendar years 2024 and 2025. The subsequent tables show averages and peak-to-trough ranges for the same key metrics over the five-year period from 2024 to 2028.

Scenario forecasts and weights

	Baseline		**Upside (strong)**		**Downside (mild)**		**Downside (moderate)**		**Downside (protracted)**	
	2024	2025	**2024**	2025	**2024**	2025	**2024**	2025	**2024**	2025
At 31 July 2024										
UK GDP growth	**1.0%**	1.2%	**1.8%**	3.9%	**0.3%**	(1.4)%	**(0.1)%**	(3.9)%	**(0.3)%**	(5.4)%
UK unemployment	**4.4%**	4.5%	**4.2%**	4.0%	**4.5%**	4.9%	**4.7%**	6.6%	**4.8%**	7.8%
UK HPI growth	**0.7%**	3.2%	**7.1%**	13.3%	**(2.3)%**	(2.6)%	**(4.1)%**	(9.2)%	**(6.0)%**	(16.4)%
BoE base rate	**5.1%**	4.2%	**5.2%**	4.4%	**5.0%**	3.5%	**5.0%**	2.9%	**4.8%**	2.3%
Consumer Price Index	**2.5%**	2.1%	**2.6%**	2.2%	**1.6%**	0.4%	**1.1%**	(0.5)%	**0.7%**	(1.0)%
Weighting	**32.5%**		**30%**		**20%**		**10.5%**		**7%**	

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

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

	Five-year average (calendar years 2024 to 2028)				
	Baseline	**Upside (strong)**	**Downside (mild)**	**Downside (moderate)**	**Downside (protracted)**
At 31 July 2024					
UK GDP growth	**1.5%**	**2.3%**	**1.1%**	**0.6%**	**0.4%**
UK unemployment	**4.6%**	**4.0%**	**4.8%**	**6.6%**	**7.4%**
UK HPI growth	**2.5%**	**4.2%**	**0.9%**	**(1.0)%**	**(3.5)%**
BoE base rate	**3.5%**	**3.6%**	**3.2%**	**2.5%**	**2.0%**
Consumer Price Index	**2.1%**	**2.2%**	**1.5%**	**1.2%**	**0.8%**
Weighting	**32.5%**	**30%**	**20%**	**10.5%**	**7%**

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

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

The forecasts represent an economic view at 31 July 2024, after which there have been further economic developments, including the Bank of England base rate cut to 5.0%. These developments, including the potential for further rate reductions, and their impact on scenarios and weightings, are subject to ongoing monitoring by management.

These periods have been included as they demonstrate the short, medium and long-term outlooks for the key macroeconomic indicators which form the basis of the scenario forecasts. The portfolio has an average residual maturity of 15 months, with 99% of loan value having a maturity of five years or less.

The following charts on pages 98 to 99 represent the quarterly forecast data included in the above tables incorporating actual metrics up to 31 July 2024. The dark blue line shows the baseline scenario, while the other lines represent the various upside and downside scenarios.

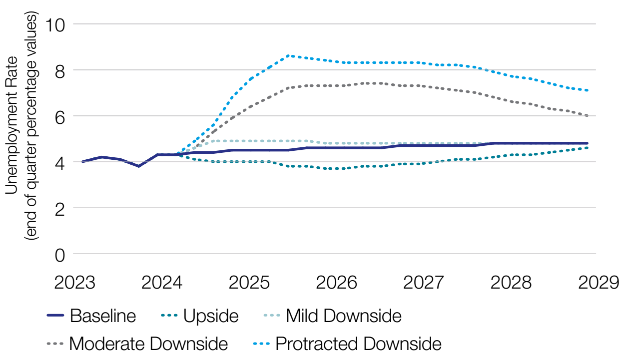
The tables below provide a summary for the five-year period (calendar years 2024 to 2028) of the peak-to-trough range of values of the key UK economic variables used within the economic scenarios at 31 July 2024 and 31 July 2023.

	Five-year period (calendar year 2024 to 2028)									
	Baseline		**Upside (strong)**		**Downside (mild)**		**Downside (moderate)**		**Downside (protracted)**	
	Peak	**Trough**	**Peak**	**Trough**	**Peak**	**Trough**	**Peak**	**Trough**	**Peak**	**Trough**
At 31 July 2024										
UK GDP growth	**7.7%**	**0.7%**	**11.8%**	**0.7%**	**5.5%**	**(1.4)%**	**2.8%**	**(4.2)%**	**2.2%**	**(6.3)%**
UK unemployment	**4.8%**	**4.3%**	**4.3%**	**3.7%**	**4.9%**	**4.3%**	**7.4%**	**4.3%**	**8.6%**	**4.3%**
UK HPI growth	**13.3%**	**0.7%**	**27.2%**	**0.7%**	**4.4%**	**(5.7)%**	**0.9%**	**(14.2)%**	**0.9%**	**(23.4)%**
BoE base rate	**5.3%**	**2.5%**	**5.3%**	**2.5%**	**5.3%**	**2.1%**	**5.3%**	**1.1%**	**5.3%**	**0.6%**
Consumer Price Index	**3.6%**	**2.0%**	**3.6%**	**2.0%**	**3.6%**	**(0.4)%**	**3.6%**	**(1.1)%**	**3.6%**	**(2.0)%**
Weighting	**32.5%**		**30%**		**20%**		**10.5%**		**7%**	

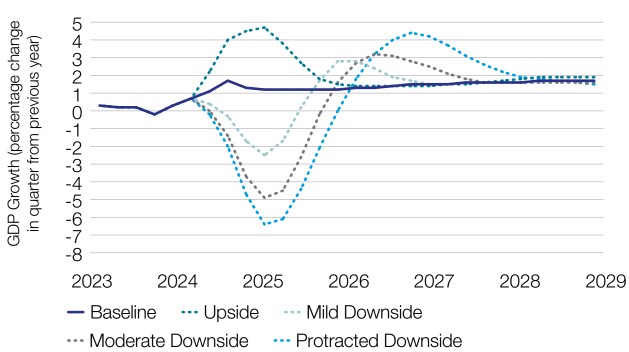
	Five-year period (calendar year 2023 to 2027)									
	Baseline		Upside (strong)		Downside (mild)		Downside (moderate)		Downside (protracted)	
	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough
At 31 July 2023										
UK GDP growth	4.6%	0.1%	8.7%	0.1%	2.5%	(3.0)%	0.3%	(5.9)%	0.3%	(8.1)%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

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

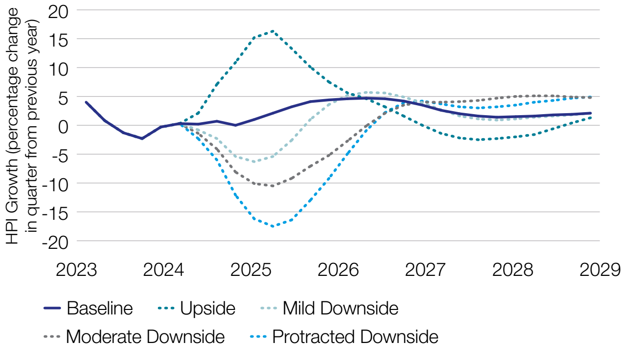
Unemployment Rate (%)



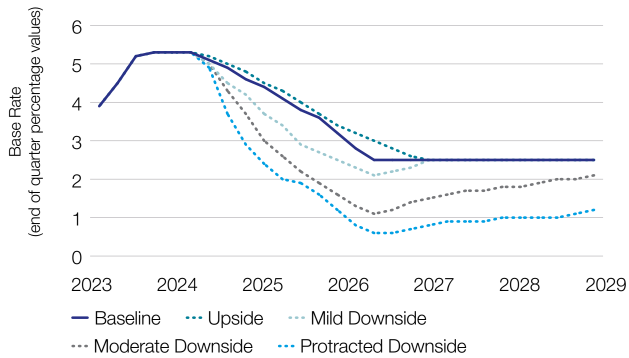
Real Gross Domestic Product (Annual % Change)



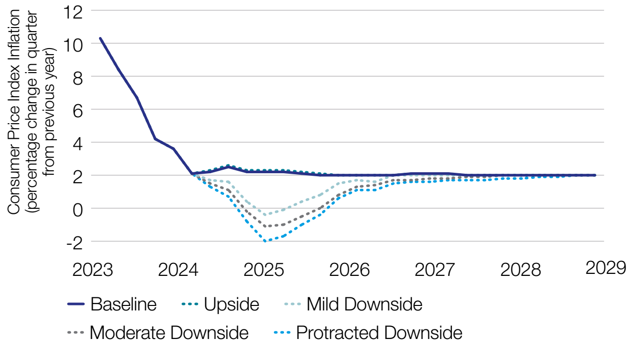
House Price Index – Current Prices (Annual % Change)



Bank of England Base Rate (%)



Consumer Price Index (Annual % Change)



Scenario Sensitivity Analysis

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

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

Based on the above analysis, at 31 July 2024, application of 100% weighting to the upside strong scenario would decrease the expected credit loss by £21.3 million whilst application of 100% weighting to the downside protracted scenario would increase the expected credit loss by £40.1 million, driven by the aforementioned changes in risk metrics and stage allocation of the portfolios.

When performing sensitivity analysis there is a high degree of estimation uncertainty. On this basis, 100% weighted expected credit loss provisions presented for the upside and downside scenarios should not be taken to represent the lower or upper range of possible and actual expected credit loss outcomes. The recalculated expected credit loss provision for each of the scenarios should be read in the context of the sensitivity analysis as a whole and in conjunction with the disclosures provided in note 10 to the Financial Statements. The modelled impact presented is based on gross loans and advances to customers at 31 July 2024; it does not incorporate future changes relating to performance, growth or credit risk. In addition, given the change in the macroeconomic conditions, underlying modelled provisions and methodology, and refined approach to adjustments, comparison between the sensitivity results at 31 July 2024 and 31 July 2023 is not appropriate.

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

Use of Adjustments (Audited)

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

Macroeconomic forecasts continue to react to a range of external factors including the recent change in government, the ongoing conflict in Ukraine, policies aimed at addressing cost of living and inflationary pressures, and long-term impacts of the Covid-19 pandemic. In response, our use of adjustments has evolved.

In particular, adjustments were applied in the previous financial year in response to improvements in macroeconomic forecasts that resulted in releases in modelled provisions. A number of these releases were considered premature or counterintuitive by management and adjustments were made as a result. Portfolio performance has been closely monitored during the financial year under review, over which modelled provisions have increased and external forecasts have remained broadly stable. As a result, adjustments have gradually reduced in recognition of the portfolio and models appropriately reacting to changes in the external environment.

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

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

At 31 July 2024, £(1.5) million (31 July 2023: £17.0 million) of the expected credit loss provision was attributable to adjustments, which reflects a combination of positive and negative adjustments depending on the adjustment purpose or model requirement. Adjustments include £2.4 million held to reflect ongoing economic uncertainty.

Other Credit Risk Tables (Audited)

Segmental credit risk

The table on page 101 sets out loans and advances to customers, trade receivables and undrawn facilities by the group's internal credit risk grading and illustrates the allocation of these per IFRS 9 staging category for comparative purposes. The analysis of lending has been prepared based on the following risk categories:

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

Low risk loans and advances to customers have reduced to 84% of the overall portfolio (31 July 2023: 87%), reflective of stage deterioration and the impacts of macroeconomic pressures during the financial year.

77% (31 July 2023: 80%) of total advances were classified as low risk Stage 1. Low risk Stage 2 represented 7% (31 July 2023: 7%) of loans and advances to customers, largely comprising early arrears cases, or agreements which have triggered a significant increase in credit risk indicator, or the "30 days past due" backstop. Low risk Stage 3 loans and advances to customers primarily related to agreements which have triggered the "90 days past due" backstop but where full repayment is expected.

Medium risk loans account for 8% (31 July 2023: 7%) of total loans and advances to customers, of which the majority were spread across Stages 1 and 2. Medium risk Stage 1 increased to 5% (31 July 2023: 3%). Medium risk Stage 2 represented 4% (31 July 2023: 3%) of the overall portfolio. Loans and advances to customers reflected as medium risk Stage 3 primarily related to agreements that have triggered the "90 days past due" backstop in addition to other significant increases in credit risk triggers.

High risk loans accounted for 8% (31 July 2023: 6%) of total loans and advances to customers, with the majority corresponding to Stage 3. This increase primarily reflected the impacts of stage migrations and Novitas Stage 3 interest accrual over the course of the financial year.

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
At 31 July 2024				
Gross loans and advances to customers[1]				
Low risk	**7,943.3**	**679.6**	**15.4**	**8,638.3**
Medium risk	**474.6**	**360.6**	**16.2**	**851.4**
High risk	**4.4**	**88.6**	**693.9**	**786.9**
Total	**8,422.3**	**1,128.8**	**725.5**	**10,276.6**
Undrawn commitments				
Low risk	**1,025.1**	**18.3**	**–**	**1,043.4**
Medium risk	**–**	**1.2**	**–**	**1.2**
High risk	**–**	**–**	**3.1**	**3.1**
Total	**1,025.1**	**19.5**	**3.1**	**1,047.7**
Gross trade receivables[2]				
Low risk	**11.8**	**–**	**–**	**11.8**
Medium risk	**–**	**1.5**	**–**	**1.5**
High risk	**–**	**–**	**3.2**	**3.2**
Total	**11.8**	**1.5**	**3.2**	**16.5**

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
At 31 July 2023				
Gross loans and advances to customers				
Low risk	7,702.4	693.9	23.2	8,419.5
Medium risk	278.7	313.1	48.8	640.6
High risk	9.1	55.0	511.4	575.5
Total	7,990.2	1,062.0	583.4	9,635.6
Undrawn commitments				
Low risk	1,202.3	21.5	0.1	1,223.9
Medium risk	–	2.7	–	2.7
High risk	–	–	1.9	1.9
Total	1,202.3	24.2	2.0	1,228.5
Gross trade receivables[2]				
Low risk	10.1	–	–	10.1
Medium risk	–	0.7	–	0.7
High risk	–	–	2.5	2.5
Total	10.1	0.7	2.5	13.3

1. Gross loans and advances to customers include £11.8 million of loans and advances held at FVTPL, presented as Stage 1 Low risk based on management judgement.
2. Lifetime expected credit losses are recognised for all trade receivables under the IFRS 9 simplified approach. The figures presented are on a gross basis before deducting for expected credit losses of £2.7 million (31 July 2023: £2.0 million) relating to predominantly Stage 3 receivables.

Forbearance

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

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

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

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

At 31 July 2024, the gross carrying amount of exposures with forbearance measures was £363.8 million (31 July 2023: £214.6 million). The key driver of this increase has been higher forbearance in our Asset Finance and Leasing, Motor Finance and Property Finance businesses reflecting continued macroeconomic challenges and enduring cost of living pressures on customers.

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

	31 July 2024	31 July 2023
Gross loans and advances to customers (£ million)	**10,276.6**	9,635.6
Forborne loans (£ million)	**363.8**	214.6
Forborne loans as a percentage of gross loans and advances to customers (%)	**3.5%**	2.2%
Provision on forborne loans (£ million)	**89.4**	56.1
Number of customers supported	**13,166**	6,996

The following is a breakdown of forborne loans by segment:

	31 July 2024 £ million	31 July 2023 £ million
Commercial business	**118.5**	38.0
Retail business	**42.8**	28.8
Property business	**202.5**	147.8
Total	**363.8**	214.6

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

	31 July 2024 Number of customers supported	31 July 2023 Number of customers supported
Commercial business	**839**	243
Retail business	**12,275**	6,700
Property business	**52**	53
Total	**13,166**	6,996

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

	31 July 2024 £ million	31 July 2023 £ million[1]
Extension outside terms	**101.7**	52.6
Refinancing	**28.0**	10.4
Moratorium	**147.0**	66.1
Deferring collections/recoveries activity	**85.1**	82.9
Other modifications	**2.0**	2.6
Total	**363.8**	214.6

1. Comparatives have been updated to present deferring collections/recoveries activity category in a separate line based on categorisation as at 31 July 2024.

Government lending schemes

Over the pandemic period, following accreditation, customers were offered facilities under the UK government-introduced CBILS, the CLBILS and the Bounce Back Loan Scheme ("BBLS"), thereby enabling the Banking division to maximise its support to small businesses. At 31 July 2024, there are 2,887 (31 July 2023: 4,364) remaining facilities, with residual balance of £202.3 million (31 July 2023: £456.3 million) following further repayments across the Commercial businesses.

The Banking division also received accreditation to offer products under the various Recovery Loan Schemes ("RLS"), the recent Growth Guarantee Scheme ("GGS") and schemes in the Republic of Ireland. At 31 July 2024, there are 1,321 (31 July 2023: 943) live facilities, with balances of £340.7 million (31 July 2023: £276.2 million), and a further 73 (31 July 2023: 58) approved facilities with limits of £17.7 million (31 July 2023: £14.3 million).

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

Collateral held

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

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

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

Analysis of gross loans and advances to customers by LTV ratio is provided on page 103. The value of collateral used in determining the LTV ratio is based upon data captured at loan origination or, where available, a more recent valuation.

	Commercial £ million	Retail £ million	Property £ million	Total £ million
LTV[1]				
60% or lower	**828.3**	**143.4**	**1,100.1**	**2,071.8**
>60% to 70%	**552.7**	**150.1**	**667.1**	**1,369.9**
>70% to 80%	**575.3**	**332.7**	**56.2**	**964.2**
>80% to 90%	**848.5**	**1,056.9**	**56.5**	**1,961.9**
>90% to 100%	**1,451.4**	**550.3**	**27.3**	**2,029.0**
Greater than 100%	**326.0**	**419.9**	**107.6**	**853.5**
Structurally protected[2]	**329.3**	**445.8**	**–**	**775.1**
Unsecured	**212.9**	**37.7**	**0.6**	**251.2**
Total at 31 July 2024[3]	**5,124.4**	**3,136.8**	**2,015.4**	**10,276.6**

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

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

	Commercial £ million	Retail £ million	Property £ million	Total £ million
LTV				
60% or lower	**39.2**	**1.8**	**12.3**	**53.3**
>60% to 70%	**5.6**	**2.5**	**11.3**	**19.4**
>70% to 80%	**5.8**	**8.2**	**24.6**	**38.6**
>80% to 90%	**13.9**	**23.2**	**52.1**	**89.2**
>90% to 100%	**35.2**	**28.1**	**27.3**	**90.6**
Greater than 100%	**12.6**	**19.4**	**107.1**	**139.1**
Structurally protected[2]	**274.4**	**5.4**	**–**	**279.8**
Unsecured	**13.5**	**1.4**	**0.6**	**15.5**
Total at 31 July 2024	**400.2**	**90.0**	**235.3**	**725.5**

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

1. Government lending scheme facilities totalling £543.0 million (31 July 2023: £732.4 million) are allocated to a low LTV category reflecting the nature of the government guarantee and resultant level of lending risk.
2. Exposures are considered structurally protected when, in management's judgement, they have characteristics which mitigate the credit risk of the exposure to a significant extent, in spite of not representing tangible security.
3. Total gross loans and advances to customers includes £11.8 million of loans and advances held at FVTPL.

Funding and liquidity risk

Funding risk is the risk of loss caused by the inability to raise funds at an acceptable price or to access markets in a timely manner or any decrease in the stability of the current funding base.

Liquidity risk is the risk that the group or any of its entities do not have sufficient liquid assets to meet liabilities as they come due during normal and disrupted markets.

Exposure

Funding and liquidity are managed on a legal entity basis with each of the group's divisions (Banking, CBAM and Winterflood) responsible for ensuring it maintains sufficient liquidity for its own purposes. The group's divisions operate independently of each other with no liquidity reliance between them.

The company has relatively few cash requirements and all requirements are known in advance, for example external dividends. It meets its cash requirements through deposits placed with the Banking division and its committed borrowing facilities.

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

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

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

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

Further detail on the group's funding and liquidity exposure is provided on pages 61 and 62 of the Financial Overview and Note 26 "Financial Risk Management".

Risk Appetite

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

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

Measurement

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

Funding is measured and monitored in accordance with the Banking division's funding plan, which seeks to ensure that the bank maintains a balanced and prudent approach to its funding risk that is in line with risk appetite. The funding plan is supplemented by metrics that highlight any funding concentration risks, funding ratios and levels of encumbrance. The Net Stable Funding Ratio ("NSFR") was implemented by the PRA on 1 January 2022. The four-quarter average ratio to 31 July 2024 was 134.4% (31 July 2023: 126.0%), comfortably in excess of the binding minimum requirement of 100%.

Liquidity is managed in accordance with regulatory requirements and the ILAAP which is approved by the board. The group's liquidity coverage ratio ("LCR") is significantly above the regulatory requirement. This is because the nature of the funding model means that it holds higher inflows compared to outflows within the 30-day period and significantly more high quality liquid assets ("HQLA") than is required under regulatory metrics. The group's 12-month average LCR to 31 July 2024 was 1,034% (31 July 2023: 1,143%).

In addition to regulatory metrics, the Banking division also uses a suite of internally developed liquidity stress scenarios to monitor its potential liquidity exposure daily and determine its HQLA requirements. This ensures that the Banking division remains within risk appetite and identifies potential areas of vulnerability. The outcomes of these scenarios are formally reported to the ALCO, GRCC and board.

Mitigation (Audited)

This funding approach is based on the principles of "borrow long, lend short" and ensuring a diverse range of sources and channels of funding. Economic uncertainty has continued over the last 12 months, increasing market competitiveness. Despite the challenges this has presented, the Banking division's ability to fund the loan book has been largely unaffected. The Banking division has actively sought to grow the retail deposit base and optimise the funding mix in light of market conditions. These deposits continue to remain diverse in terms of source, type and tenor, ensuring flexibility and greater optionality. Retail and corporate customer funding is supported by wholesale funding programmes including unsecured medium-term notes and securitisation programmes. The bank has also drawn against the Bank of England's Term Funding Scheme ("TFSME"), that was introduced to support lending in the then prevailing low interest rate environment. Two repayments of the TFSME have been made this year totalling £490 million, with £110 million remaining to be repaid in the coming year. Despite movements in the Banking division's funding base, the balance sheet and subsequent funding plan continues to remain well within internal risk appetites and total available funding is kept well in excess of the loan book funding requirement to ensure funding is available when needed as shown by the NSFR metrics.

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

	On demand £ million	**In less than three months £ million**	**In more than three months but not more than six months £ million**	**In more than six months but not more than one year £ million**	**In more than one year but not more than five years £ million**	**In more than five years £ million**	**Total £ million**
At 31 July 2024							
Deposits by banks	**0.9**	**53.2**	**86.1**	**–**	**–**	**–**	**140.2**
Deposits by customers	**708.9**	**2,309.5**	**1,502.1**	**2,008.7**	**2,474.8**	**–**	**9,004.0**
Loans and overdrafts from banks	**46.7**	**9.9**	**1.4**	**2.7**	**111.7**	**–**	**172.4**
Debt securities in issue	**–**	**40.0**	**119.3**	**195.4**	**1,541.7**	**409.8**	**2,306.2**
Subordinated loan capital	**–**	**2.0**	**–**	**2.0**	**16.0**	**209.0**	**229.0**
Total	**756.5**	**2,414.6**	**1,708.9**	**2,208.8**	**4,144.2**	**618.8**	**11,851.8**

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

Monitoring

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

The Banking division operates a three lines of defence model with the treasury function responsible for the measurement and management of the bank's funding and liquidity position and asset and liability management risk providing independent review and challenge. ALCO provides oversight of funding and liquidity and supports the relevant senior managers in discharging their senior management function responsibilities.

Outlook

In January 2024, the FCA announced a review of historical motor finance commission arrangements. The immediate market reaction to the announcement was limited, largely comprising of a number of enquiries from savers and a small value of deposits being withdrawn, notice given, or renewed but on a shorter duration than previously. Further to this, the Banking division expects to lose a number of rate-sensitive corporate customers over the course of the coming year. The expected attrition from this segment has been replaced with retail deposits, reflecting the strength of the retail deposit franchise. The Banking division continues to access wholesale funding, for example, in November 2023 our wholesale funding portfolio was further enhanced by the AT1 transaction. During the 2025 financial year, focus will be on renewing and increasing securitisation programmes. The funding model continues to provide robust support, and the strength of our "borrow long, lend short" business model provides significant funding resilience, resulting in a stable funding base.

Legal and regulatory risk

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

Exposure

The group is subject to the laws and regulations of the various jurisdictions in which it operates. This exposure includes risks of breaching financial services regulations and laws, as well as action resulting from contractual breach and litigation (including direct customer claims based on regulatory breaches).

Failure to comply with existing legal or regulatory requirements, or to adapt to changes in a timely fashion in the course of the provision of products and services, may result in legal and regulatory risk.

Changes could also affect our financial performance, capital liquidity and access to markets in which we operate.

With an increased regulatory focus on protecting customers, any failure to implement and/or adapt to these changes quickly may expose the group to reputational harm, legal or regulatory sanctions and/or customer redress requirements.

Risk Appetite

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

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

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

Measurement

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

Mitigation

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

Clear accountability and ownership for meeting regulatory requirements is overseen by business heads, thus driving oversight and action.

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

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

Monitoring

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

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

Legal and compliance teams monitor for external developments through both structured horizon scanning activity, regular external updates on relevant issues and engagement in industry forums.

Outlook

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

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

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

The group faces legal risks that could result in substantial monetary damages or fines. Specifically, the group has received a number of complaints, some of which are with the Financial Ombudsman Service, and is subject to a number of claims through the courts regarding historical commission arrangements with intermediaries on its Motor Finance products. This inflow of complaints commenced following the FCA's 2021 changes to its Handbook rules after its consideration of historical motor finance commission arrangements and has increased following the January 2024 publication of three FOS decisions (against Barclays, Lloyds and BMW Financial Services) on this topic, and the FCA's simultaneous announcement of a review of this sector. There are currently cases considering some of the issues involved in historic motor commission claims (i.e. prior to the FCA's 2021 Handbook rule changes) before the superior courts. The group is a party to one of these court cases, but they will be of general application. Given the significance of these cases, they may ultimately be determined by an Appeal Court.

Depending on the final outcome of the courts' rulings and/or the outcome of the FCA's review work, there may be a potential future obligation to compensate customers with historic claims. It is not currently possible to estimate the financial impact (if any) or scope of these or any future related claims as it is not currently possible to assess whether the group's conduct pre 2021 may be considered by one of these decision-makers to have been in breach of the relevant FCA Handbook rules at that time and/or general legal requirements. The group considers that it has been compliant with the relevant Handbook rules and general legal requirements at all times.

Non-traded market risk

Non-traded market risk is the current or prospective risk to the group's capital or earnings arising from changes in interest rates, credit spreads and foreign exchange rates applied to the group's non-trading book.

Exposure

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

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

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

Foreign exchange risk is incurred across the group and arises from foreign currency loan commitments; translating foreign currency assets, liabilities and profits; and non-sterling investments.

Risk Appetite

The group has a restricted appetite for interest rate risk which is limited to that required to operate efficiently. The group's policy is to match repricing characteristics of assets and liabilities naturally. Where this is not possible, vanilla interest rate swaps are used to hedge the risk within prescribed limits.

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

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

Measurement

Interest rate risk

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

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

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

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

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

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

EaR impact (audited)

The table below sets out the assessed impact on group net interest income over a 12-month period from interest rate changes. The results shown are for an instantaneous and parallel change in interest rates at 31 July 2024:

	31 July 2024 £ million	31 July 2023 £ million
0.5% increase	**0.1**	4.5
2.5% increase	**0.5**	22.6
0.5% decrease	**(0.1)**	(4.5)
2.5% decrease	**(0.8)**	(22.8)

The group also monitors any potential earning exposure from basis mismatches between its lending and funding activities on a monthly cadence. To provide a clearer assessment of the group's exposure to interest rate changes, basis risk is excluded from the EaR numbers.

The group's EaR at 31 July 2024 reflects its policy to ensure exposure to interest rate shocks is managed within the group's risk appetites. The EaR measure is a combination of the group's repricing profile and the embedded optionality risk, which is negligible in the current interest rate environment.

The decrease in EaR reflects the bank's strategy to manage and minimise interest rate risk, to that required to operate efficiently.

EV impact (audited)

The table below sets out the assessed impact on group EV, which measures the potential change in the balance sheet value following an instantaneous and parallel change in interest rates at 31 July 2024:

	31 July 2024 £ million	31 July 2023 £ million
0.5% increase	**3.5**	4.4
2.5% increase	**17.2**	21.5
0.5% decrease	**(3.5)**	(4.4)
2.5% decrease	**(14.4)**	(21.9)

The group's EV at 31 July 2024 reflects its policy to ensure exposure to interest rate shocks is managed within the group's risk appetites. The EV measure is a combination of our repricing profile and the embedded optionality to cover interest rate floors within the bank's lending and borrowing activities.

Credit spread risk in the banking book

The group's HQLA portfolio is held for the purpose of liquidity management. The table below sets out the total exposure to each asset class held within the HQLA portfolio by the Banking division.

Credit spread risk arises on the bonds held in the HQLA portfolio and specifically to the change in the value of a bond relating to a change in a bond's credit spread, which is the difference between a bond's total interest rate and the corresponding risk-free interest rate, and represents the perceived creditworthiness of that bond.

In the HQLA portfolio, each bond's interest rate exposure is hedged, leaving the residual credit spread, which is monitored, assessed and measured. Measurement techniques include a historical stress methodology that is consistent with PRA requirements. The historical stress estimate is monitored against an internal risk appetite limit. Credit spread risk is only realised if the bond is sold and the swap hedging the interest rate risk is cancelled before maturity.

	31 July 2024 £ million	31 July 2023 £ million
Cash and balances at central banks	**1,584.0**	1,937.0
Sovereign and central bank debt (LCR Level 1)	**383.7**	186.1
Covered bonds (LCR Level 1)	**187.7**	106.3
Supranational bonds (LCR Level 1)	**145.5**	–
Total treasury liquid asset holdings	**2,300.9**	2,229.4

At 31 July 2024, the Banking division did not hold any encumbered assets in its HQLA portfolio or any encumbered UK government debt in its sovereign and central bank debt holdings.

Foreign exchange risk (audited)

The group recognises three categories of FX risk:

1. transaction risk: the risk relating to foreign currency loan commitments;
2. translation risk: the risk relating to converting foreign currency balances and profits into sterling;
3. structural FX risk: the risk relating to the potential impact on capital ratios relating to non-GBP exposures.

Transaction risk is measured daily within treasury based on net cash flows and contracted future exposures. Treasury's strategy is to hedge the FX risk as soon as it arrives, and to have zero FX transaction exposure each day at close of business.

Translation risk is monitored within each business monthly, translating non-UK profits regularly to mitigate fluctuations in foreign exchange rates. The group's largest FX exposure is from its euro lending and funding activities. A change in the euro exchange rate would increase the group's equity by the following amounts:

	31 July 2024 £ million	31 July 2023 £ million
15% strengthening of sterling against the euro	**0.5**	0.3

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

Structural FX risk is assessed at least annually as part of the group's ICAAP and is deemed to be immaterial.

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

Mitigation (Audited)

The group maintains a limited appetite for interest rate risk with simple hedging strategies in place to mitigate risk. The Banking division's treasury is responsible for hedging the non-traded interest rate risk. Any residual risk which cannot be naturally matched is hedged utilising vanilla derivative transactions to remain within prescribed risk limits. The Group Asset and Liability Committee ("GALCO") and ALCO are respectively responsible for approving any changes to hedging strategies before implementation for the company and bank.

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

All marketable securities are "hold to collect and sell" and have their interest rate exposure hedged on a back-to-back basis with vanilla interest rate swaps. The exception to this is the £250 million group bond held in company, which is hedged as part of the portfolio mix.

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

Monitoring

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

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

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

Outlook

The group expects exposure to interest rate risk, credit spread risk and foreign exchange risk to remain broadly stable.

Operational risk

Operational risk is the risk of loss or customer harm resulting from inadequate or failed processes, people and systems or external events. This includes the risk of being unable to recover systems quickly and maintain critical services.

Exposure

Operational risks arise from day-to-day business activities, many of which have the potential to result in direct or indirect financial loss or adverse impact, including impact to the group's financial performance, levels of customer care or reputation.

The group strives to deliver operational efficiency in the implementation of its objectives and accepts that a level of loss may arise from operational failure. Implementing key controls and monitoring ensures that risks are managed, and losses remain within acceptable limits.

Impacts to the business, customers, third parties and the markets in which the group operates are considered within a maturing framework for resilient delivery of our important business services and setting of impact tolerances. Ongoing work will further enhance stress testing requirements.

Operational risk is a core component of the Enterprise Risk Management Framework and is embedded in day-to-day business activities. Requirements and responsibilities are set out in the Operational Risk Policy and supporting standards and procedures as part of the framework to identify, assess, mitigate, monitor and report the operational risks, events and issues that could impact the achievement of business objectives or impact core business processes.

Businesses are responsible for the day-to-day management of operational risk, with oversight from the risk and compliance function, and independent assurance activities undertaken by group internal audit.

The group's exposure to operational risk is impacted through the need to engage with innovative, dynamic third parties; delivery of new products and services; and effective use of reliable data in a changing external environment, to support delivery of the group's strategic objectives.

Alongside ongoing risk and control monitoring, operational risk oversight is aligned across the following risk categories:

IT resilience risk

The group's ability to adapt to disruptions, while maintaining continuous operations on critical processes and safeguarding technology in the face of severe but plausible adverse events, operational disruptions or incremental changes. The group recognises the significant regulatory focus on resilience with increased reliance on remote working, use of third parties, cloud solutions and automated digital solutions.

How this risk is managed

The group has invested to respond to new regulations and standards and develops technology and implements change with resilience inbuilt as a principle. The priority is to improve the experience of, and minimise harm to, customers in the event of operational disruption and we remain on track to meet our regulatory commitments.

A multi-year programme of work continues to maintain, enhance and embed a sustainable approach to resilience through continuous monitoring, alongside disaster recovery testing, to minimise the impacts on our customers and key stakeholders. Additionally, the group tests critical business recovery and contingency plans.

Financial crime and fraud risk

The risk that the group's products and services are used to facilitate financial crime and fraud against the group, its customers and third parties. If the group does not take measures to minimise the impact of financial crime and fraud risk, or adhere with the relevant laws and regulations, it risks financial loss, regulatory fines and reputational damage.

The group has an established control framework to both prevent and mitigate the financial crime fraud risks, including risk appetite statements, policies, standards and procedures that are consistent with the group's purpose and designed to safeguard the interest of customers.

Whilst external environmental drivers may now be easing cost of living causal factors, the opportunism and sophistication of individuals and groups, and the technology to support financial crime and fraud, is increasing.

How this risk is managed

The group has established a framework of systems and controls to prevent and detect financial crime and fraud. The framework is continuously evolving and enhancing its controls to prevent its products and services being used to facilitate financial crime and fraud and it takes advantage of new technologies to combat emerging threats.

Third-party risk

The risks associated with ensuring that the group's outsourced and offshoring arrangements are controlled effectively, including the risk of failure which may impact customer service; the potential cessation of specific activities; the risk of personally identifiable information or group sensitive data being exposed or exploited; and the risk of financial, reputational and regulatory censure should the third party enter into any illegal or unethical activities.

In line with the group's increased strategic appetite for material outsourcing to provide greater agility to meet strategic goals, most notably the outsourcing of our technology services to a third party in the last 12 months, our risk frameworks are evolving to maintain effective risk management.

How this risk is managed

The group continues to enhance its third-party risk and controls framework, and oversight approach, with ongoing performance management and due diligence undertaken, to ensure that supplier relationships are controlled effectively.

Workplace risk (property, physical and personal security risk)

The risk to the safety and protection of colleagues, customers and physical assets arising from unauthorised access to buildings, theft, robbery, intimidation, blackmail, sabotage, terrorism and other physical security risks.

How this risk is managed

Physical and personal security standards are managed by the group's Property and Workplace team. Controls are in place to protect physical assets, as well as the security of colleagues and customers.

Cyber and information security risk

The risks arising from inadequate internal and external information and cyber security, where failures impact the confidentiality, integrity and availability of electronic data.

How this risk is managed

The group uses an industry-standard framework to anchor its cyber risk management, continually assessing and developing its maturity. The group maintains robust cyber and information security standards and policies, and controls are in place and operating, with periodic assurance completed. This includes threat intelligence, education and awareness, partnerships with strategic partners and effective deployment across the three lines of defence model to manage and undertake assurance of controls within the group and our third parties.

Data management

Poor-quality data can lead to loss, customer disruption, potential misrepresentation in regulatory reporting, non-compliance with General Data Protection Regulations ("GDPR") and unnecessary rework.

Quality data underpins decision-making at all levels of the organisation.

The group views data risk holistically through the life cycle from acquisition to usage and eventual disposal.

Ongoing development and enhancement of the group's data strategy, methodology, framework and governance to identify, assess, treat and report risk and issues across our critical data elements continues.

How this risk is managed

The group has a maturing data management framework governing the creation, storage, distribution, usage and retirement of data, aligned with data management industry standards and GDPR requirements. Our current focus is on enhancing and maturing our data governance frameworks.

Change risk

The risks associated with a failure to execute and deliver business and technology change that could result in an inability to meet our strategic objectives, including failing to meet our customer, regulator, colleague or shareholder expectations, as a group and within individual businesses.

How this risk is managed

The group has processes and procedures which cover all levels of change management to ensure appropriate prioritisation, oversight and decision-making across the investment portfolio.

This approach ensures that the risks are managed effectively, and that investment and capacity are prioritised to minimise the overall risks to the group in line with risk appetite.

Model risk

The group has adopted the PRA's SS1/23 definition of a model, defined as "a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into output". Model input data could be quantitative and/or qualitative, or expert judgement-based, and model outputs are quantitative or qualitative.

The use of models invariably presents an element of model risk, and the group has adopted the European Directive 2013/36/EU (Article 3(1)(11)) definition of model risk i.e. "the potential loss an institution may incur, as a consequence of decisions that could be principally based on the output of internal models, due to errors in the development, implementation or use of such models." Model risk increases with greater model complexity, higher uncertainty around inputs and assumptions, broader use, and larger potential impact. If left unmitigated, model risk may lead to poor decision-making, misreporting or a failure to identify risks.

How this risk is managed

The group has a robust model risk framework embedded across the group and deploys a risk-based approach to classify each model according to materiality. This is underpinned by a Model Risk Policy and various supporting standards and procedures.

The group has adopted a three lines of defence approach to the management of model risk, with the first line formed by model owners and model developers focusing on the build, maintenance and monitoring of models. The second line of defence is composed of two teams: the group model risk management and the risk operations and governance teams. The former is responsible for the model risk policy and associated standards along with the independent validation exercises across the group. The latter teams are responsible for the management of the model inventory (master source of the group's model management information) and the aggregate model risk reporting (based on governance status and performance of models). Finally, the third line of defence is formed by our internal audit function performing independent audits.

The Model Governance Committee is the primary model approval authority and body responsible for overseeing the framework used to manage model risk.

People risk

People risk is defined as the risk of not having sufficiently skilled, capable and engaged colleagues, who are clear on their responsibilities and accountabilities and who behave in an ethical way. This could lead to inappropriate decision-making that is detrimental to customers, colleagues, other key stakeholders or shareholders and could ultimately lead to regulatory sanction.

How this risk is managed

The group has a range of key risk indicator ("KRI") metrics in place which help to measure and report people risk. Operational controls are designed to mitigate the risks associated throughout each element of the colleague life cycle. Group-wide systems provide tools and online guidance to all colleagues to support them in discharging their accountabilities and creating a culture in which everyone can thrive. Periodic employee engagement surveys are completed.

Risk Appetite

The group is prepared to tolerate a level of operational risk exposure within agreed thresholds and limits but has limited appetite for operational risks with significant residual exposure and as such requires a near-term mitigation strategy for any such identified risks.

A level of resilience risk from internal and external events is tolerated; however, immediate steps are taken to minimise customer disruption through recovery within pre-defined parameters and timelines. In line with the group's conservative approach to risk management, controls are implemented in a manner that reduces the likelihood of higher-impact risk events crystallising. Further, the group monitors aggregate loss trends and seeks to limit aggregate losses arising in any given year.

Measurement

Operational risk is measured through key risk indicators, observed impact of risk events, periodic risk and control self-assessments and scenario analysis.

Material operational risk events are identified, reviewed and escalated in line with criteria set out in the Enterprise Risk Management Framework and a supporting suite of standards and policies and use of common systems.

Each key risk within operational risk has a set of defined KRIs which are regularly monitored via local, divisional and group committees with exceptions reported to GRCC and the Risk Committee.

Lessons are learned and root cause analysis is undertaken, with appropriate management action plans implemented. Losses may result from both internal and external events and are categorised using risk categories defined as part of the taxonomy deployed within our risk management tool.

Mapping to the Basel II categories is disclosed to support industry data and trends analysis. Due to the nature of risk events, losses and recoveries can take time to crystallise and therefore may be restated for prior or subsequent financial years.

External fraud continues to be volumes of facility misuse, driven by economic pressures rationalising fraudulent behaviour. Cifas data indicates an increase of 55% across asset finance sectors in the last Fraudscape report.

The table below outlines the operational risk losses by Basel category.

The table below outlines the operational risk losses by Basel category:

	% of total volume		% of total losses	
Operational risk losses by Basel category[1, 2, 3]	**2024**	2023	**2024**	2023
Business disruption and system failures	**1%**	1%	**1%**	1%
Clients, products and business practices	**6%**	4%	**23%**	11%
Execution, delivery and process management	**21%**	16%	**28%**	27%
External fraud	**72%**	78%	**48%**	61%
Internal fraud	**0%**	0%	**0%**	0%
Employment practices and workplace safety	**0%**	0%	**0%**	0%
Damage to physical assets	**0%**	0%	**0%**	0%

1. Losses greater than or equal to gross £5,000, excluding unexpected losses (e.g. remediation).
2. Historical loss amounts can change due to the dynamic and ongoing reporting of recoveries.
3. Percentages have been rounded where appropriate.

Mitigation

The group seeks to deliver its strategic objectives and maintain operational resilience, and accepts a level of loss may arise from operational failure. Key to this is continued management of operational risks and key controls, monitoring and governance, with appropriate escalation and oversight to manage operational risks and losses within acceptable limits.

We operate controls over the group's most significant operational risks ensuring there are near-term mitigation strategies where risks are greatest and ensure these are sufficient to prevent material disruption of our service to customers and/or our businesses.

Monitoring

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

The Risk function has a dedicated operational risk team which is responsible for maintaining the framework, tool sets and reporting necessary for effective operational risk management. The group has identified, assessed and monitored all key operational and resilience risks, including undertaking a biannual assessment of control effectiveness, monitoring key risk indicator trends and escalating events, in accordance with policy and standard requirements.
In the second line, operational risk managers are aligned to businesses, with an additional technical second line of defence team providing specialist oversight of technology, information security, data, resilience and third-party risks. Monitoring of all operational risk domains is conducted via divisional RCCs with escalation to the GRCC and Risk Committee as appropriate.

The delivery of a standardised framework and management information across all operating risks is complemented by periodic thematic reviews conducted on key focus areas and reviewed by the GRCC and Risk Committee. In the last year these have included change execution, including technology services material outsourcing, the Asset transformation programme, third party risk, operational resilience, and fraud. Further independent assurance is obtained through reviews conducted by the compliance monitoring team and specialist external partners (e.g. cyber risk management) and group internal audit.

Additionally, the group has an embedded Whistleblowing Policy which sets out the high level framework for meeting regulatory requirements in relation to the handling of reportable concerns by whistleblowers. The policy and supporting standard sets out the process to raising aspects of concerns by all employees, past and current, across the group.

Furthermore, the Risk function performs a level of oversight of the group's business planning process, including analysis of industry trends or forward-looking threats that could lead to material impact on our ability to deliver on the strategic objectives or result in a significant impact on assessment of operational risk capital.

Stress Testing

The group develops and maintains a suite of operational risk scenarios using internal and external data. These scenarios provide insights into the stresses the business could be subject to given plausible but severe circumstances. Scenarios cover material operational risks across key risk domains and are developed by businesses and senior management across the group with the process facilitated by the Risk function, GRCC and the Risk Committee, as part of the ICAAP process, and support the setting of operational risk Pillar 2a capital. Management actions are agreed and monitored and linked with business resilience and continuity testing where appropriate.

Outlook

Established group-wide operational risk frameworks and methodologies are embedded, with enhancements planned as part of a multi-year investment in process, risk and controls transformation.

In addition to the continuing investment required to sustain the group's systems and processes, an accelerating pace of external technology and market changes are increasing the imperative for the group to evolve and adapt its processes, risks and controls and the associated necessary staff capabilities.

Possible outcomes of the FCA's review of historical motor finance commission arrangements could strain operations and technology capacity, notwithstanding advance preparatory work.

Allocation of capital investment funding and change delivery capacity continue to be areas of management focus, to enable safe delivery of change programmes.

Changing internal and external environment raises challenges and impacts managing our people. The group continues to plan and predict resource needs to support its strategy, change execution and wider technology and information transformation, however continued management strain is anticipated.

Financial crime and fraud risks are inherent in doing business in financial services, necessitating the requirement to maintain effective systems and controls.

Reputational risk

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

Exposure

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

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

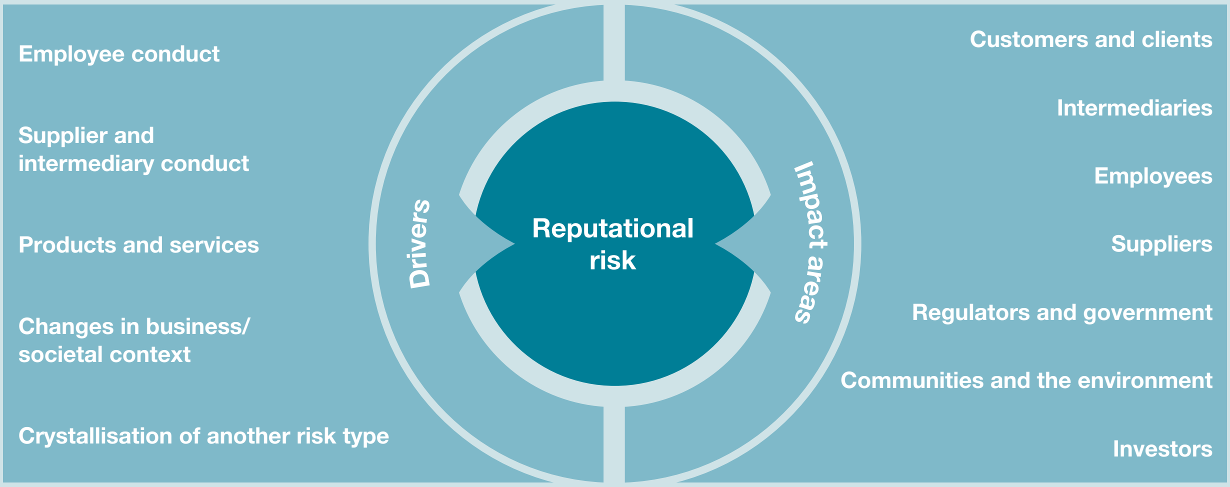
Risk Appetite

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

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

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

Core Drivers of Reputational Risk



Measurement

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

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

Mitigation

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

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

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

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

Monitoring

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

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

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

Outlook

Established group-wide and employee-level focus on responsibility and sustainability enables an approach in all businesses that aligns to a range of stakeholder expectations, which is supported by group-level oversight.

Increased media attention, including in relation to the FCA's review of historical motor finance commission arrangements, may lead to an adverse perception of the group.

Traded market risk

Traded market risk is the risk that a change in the value of an underlying market variable will give rise to an adverse movement in the value of the group's trading assets and trading liabilities.

Exposure

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

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

Risk Appetite

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

Winterflood maintains sufficient levels of capital and liquidity to cover its traded market risk exposure.

Measurement

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

- market risk appetite being managed via trading book exposure limits. The limits are set on gross cash positions, also the sterling value of a basis point ("SV01") for products with interest rate exposure;
- adoption of a real-time limit monitoring system, along with end-of-day summary reports to track equity, fixed income and FX exposures against agreed limits; and
- minimal exposure to derivatives (limited to hedging of interest rate exposures and hedging of FX positions resulting from positions in securities settling in foreign currency).

Mitigation (Audited)

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

- the provision of training to all new joiners and newly certified staff by the Business and Trading Controls team. This training includes certain market risk considerations as well as details on order entry controls;
- the maintenance of risk mandates for all traders, detailing the business' market-making strategy, controls frameworks and policies and procedures;
- oversight of all risk issues, including traded market risk, via Winterflood's RCC. Management information and key risk indicators are reported to the committee on a monthly basis with escalation to the GRCC and Risk Committee where needed;
- the maintenance of a group Market Risk Policy and a specific Traded Market Risk Standard at Winterflood, outlining minimum governance requirements and escalation. Implementation of these requirements is achieved through documented front office procedures and risk procedures; and
- order entry controls in place across the trading floor limiting, amongst other trading variables, the executable value per order (these are documented in a front office procedure).

Monitoring

Building on the use of real-time limit monitoring, the monitoring of traded market risk is embedded across all three lines of defence. Top-down visibility is exercised via Winterflood's RCC, which retains oversight of core traded market risk management information and key risk indicators, as well as stress testing outputs, policies and standards.

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

Outlook

Several themes have driven markets over the past 12 months: inflation, high interest rates, supply chain issues, industrial action, geopolitical uncertainty and the knock-on impacts these factors have had on the economy. These factors, coupled with a new administration in the UK and a potential new administration in the US, will continue to be themes over the next 12 months, with the potential to keep market liquidity low and suppress some market valuations.

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

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

	Highest exposure £ million	Lowest exposure £ million	Average exposure £ million	Exposure at 31 July 2024 £ million
For the year ended 31 July 2024				
Equity shares				
Long	**54.9**	**19.0**	**26.0**	**25.8**
Short	**35.1**	**3.8**	**7.2**	**9.3**
Net position			**18.8**	**16.5**
Debt securities				
Long	**31.9**	**4.7**	**12.9**	**16.0**
Short	**12.5**	**1.9**	**4.4**	**5.5**
Net position			**8.5**	**10.5**

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

With respect to the long and short positions on debt securities, £11.1 million and £0.1 million (2023: £11.0 million and £0.3 million) were due to mature within one year respectively.

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

Based upon the 31 July 2024 trading book exposure given above, a hypothetical fall of 10% in equity prices would result in a £1.7 million decrease (31 July 2023: £2.1 million decrease) in the group's income and net assets. A hypothetical 10% fall across the fixed income desk would result in a £1.1 million decrease (31 July 2023: £1.2 million decrease) in the group's income and net assets.