Cambridge & Counties Bank Limited

Capital Requirements Directive
Pillar 3 Disclosures
31 December 2016

Cambridge & Counties Bank
Growing business together

Contents

1. Introduction

1.1. Purpose

This document comprises Cambridge & Counties Bank's (or 'the Bank') Pillar 3 disclosures on capital and risk management at 31 December 2016. It has two principal purposes:

- It provides information on the policies and approach taken by Cambridge & Counties Bank to risk management and the maintenance of its capital resources. It also includes details of:
  - The governance structure of the Bank, including Board and Committees; and
  - Information quantifying the Bank's assets and capital resources.
- To meet the regulatory disclosure requirements under the Capital requirements Regulation (EU) No 575/2013 ("CRR"), Part 8 and the rules of the Prudential Regulation Authority ("PRA").

1.2. Business Overview

Cambridge & Counties Bank is a UK bank that specialises in providing lending and deposit products for Small and Medium Enterprises (SMEs).

Established in June 2012, Cambridge & Counties Bank has a unique ownership structure being owned jointly by Trinity Hall, a college of the University of Cambridge, and Cambridgeshire County Council as trustees for the Cambridgeshire Local Government Pension Fund.

The Bank is authorised by the Prudential Regulation Authority, regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is registered under the Financial Services Compensation Scheme.

- Lending

Our commercial loans are secured on property. We lend to owner occupied businesses to invest in their own commercial premises, as well as to experienced commercial and residential property investors.

We also provide finance for businesses to acquire essential assets such as equipment, plant, machinery or vehicles using hire purchase or finance lease facilities.

- Deposits

Our lending is primarily funded by the acquisition of UK savings balances. We offer a range of business deposit accounts that are available to all types of businesses as well as a number of broader organisations such as charities, clubs, societies and associations.

- Our Distribution Network

Cambridge & Counties Bank provides lending products via a network of Business Development Managers who deal via business introducers as well as directly with customers. We deliver our range of savings accounts via the internet, post and business introducers.

- Financial performance

Full details on the Bank's financial results are reported in its statutory accounts which are published on its website (www.ccbank.co.uk). For the year ended 31 December 2016 the Bank had operating income of £28.7m and reported pre-tax profit of £18.1m. Total capital at 31 December 2016 was £57.2m. The Bank employed an average of 105 FTE employees during the year.

1.3. Legislative Framework

Cambridge & Counties Bank is subject to the European Union Capital Requirements Directive (CRD) and Capital Requirements Regulations (CRR) implemented on 1 January 2014. The CRR and CRD, commonly known as CRD IV, provide consistent capital adequacy standards for financial services companies and an associated supervisory framework across the European Union and are enforced in the UK by the Prudential Regulation Authority (PRA). The legislation sets out the rules that determine the amounts of capital financial institutions must hold in order to provide security for members and depositors.

The CRD regulations split the Bank's capital resources and reporting requirements into 3 pillars:

- Pillar 1
  Pillar 1 capital is the Bank's minimum regulatory capital requirement relating to credit, market and operational risk.

  The Bank has followed the Standardised Approach when calculating the minimum capital requirements for credit risk (which includes counterparty credit risk). The Bank has no Pillar 1 capital requirement for market risk as it does not operate a trading book. Any market related activity or derivative usage is solely for the purpose of hedging known exposures. The Bank uses the Basic Indicator Approach (BIA) for operational risks.

- Pillar 2
  To calculate its Pillar 2 capital requirements the Board has performed a detailed assessment of the risks facing the Bank including the impact of a severe economic downturn. It has calculated the amount of capital that it considers necessary to cover these risks within its Internal Capital Adequacy Assessment Process (ICAAP). The Bank's ICAAP is reviewed and assessed by the PRA during its annual Supervisory Review and Evaluation Process

- Pillar 3
  Pillar 3 sets out the disclosures that banks' are required to make in order to promote market discipline through the external disclosure of its risk management and risk exposures. The Bank is required to publish a Pillar 3 report annually.

In December 2016 the European Banking Authority (EBA) published its final guidelines on regulatory disclosure requirements following an update of the Pillar 3 requirements by the Basel Committee in January 2015. These guidelines apply from 31 December 2017. The Bank have implemented the EBA guidelines in terms of the tables and qualitative data being disclosed in this report. The table below sets out where each table is presented.

EBA Template	Description	Location in document
-	Own Funds	Appendix 1
-	Leverage ratio	Appendix 1
1	EU LI – Differences between accounting and regulatory scopes of consolidation and the mapping of financial statement categories with regulatory risk categories	Appendix 1
2	EU LI2 – main sources of differences between regulatory exposure amounts and carrying values in financial statements	Appendix 1
3	EU LI3 – outline of the differences in the scope of consolidation	CCB is a solo entity – therefore this template is not applicable
4	EU OV1 – Overview of RWAs	Section 5.2
5	EU CR10 – IRB	CCB uses the standardised approach – this template is therefore not applicable
6	EU INS1	CCB is not an insurance undertaking – this template is therefore not applicable
7	EU CRB-B – total and average net amount of exposures	Appendix 1
8	EU CRB-C – geographical breakdown of exposures	Appendix 1
9	EU CRB-D – concentration of exposures by industry or counterparty types	Appendix 2
10	EU CRB-E - Maturity of exposures	Appendix 2
11	EU CR1-A – Credit quality of exposures by exposure class and instrument	Appendix 2
12	EU CR1-B – Credit quality of exposure by industry or counterparty types	Appendix 2

EBA Template	Description	Location in document
13	EU CR1-C- Credit Quality of exposures by geography	Appendix 2
14	EU Cr1-D- Ageing of past-due exposures	Appendix 2
15	EU CR1 – E – Non-performing and forborne exposures	Appendix 2
16	EU CR2-A- Changes in the stock of specific credit risk	Appendix 2
17	EU CR2-B- Changes in the stock of defaulted and impaired loans and debt securities	Appendix 2
18	EU CR3-CRM techniques – Overview	Appendix 2
19	EU CR4 – Standardised approach – Credit risk exposure and CRM effects	Appendix 2
20	EU CR5 – Standardised approach	Section 6.1
21-24	IRB approach	Not applicable as CCB does not use the IRB approach
25	EU CCR1 – Analysis of CCR exposure by approach	Appendix 3
26	EU CCR2 - CVA capital charge	Appendix 3
27	EU CCR8Exposures to CCPs	Appendix 3
28	EU CCR3 – Standardised approach – CCR exposure by regulatory portfolio and risk	Section 7
29-30	IRB / IMM templates	Not applicable as CCB does not use TRB/IMM approach
31	EU CCR-5A – Impact of netting and collateral held on exposure values	Appendix 3
32	EU CCR5-B- Composition of collateral for exposures to CCR	Section 7
33	EU CCR6 – Credit derivatives exposures	Section 7
34-38	Market risk templates	Not applicable as CCB does not have a trading book and therefore no market risk

1.4. Scope of Application

All the figures, governance, objectives and policies included within this document are as at 31 December 2016 (unless stated otherwise) and have been prepared to meet the disclosure requirements of CRD IV.

The Pillar 3 report is based upon the Bank's annual report and financial statements for the year ended 31 December 2016. Pillar 3 disclosures are issued on an annual basis in conjunction with the publication of the annual report and financial statements in accordance with regulatory guidelines.

These disclosures have been reviewed by the Risk and Compliance Committee members and the Internal Audit function and approved by the Board. The disclosures are not subject to external audit; however, some of the information within the disclosures also appears in the audited 2016 financial statements. The processes for preparing this disclosure are laid out in the Bank's Pillar 3 policy.

Cambridge & Counties Bank Limited is not part of a Group of companies. This report therefore relates to just Cambridge & Counties Bank Limited. The Bank is regulated by the PRA, with its registration no. 579415. The registered office of the Bank is Charnwood Court, 5B New Walk, Leicester, LE1 6TE.

1.5. Directors

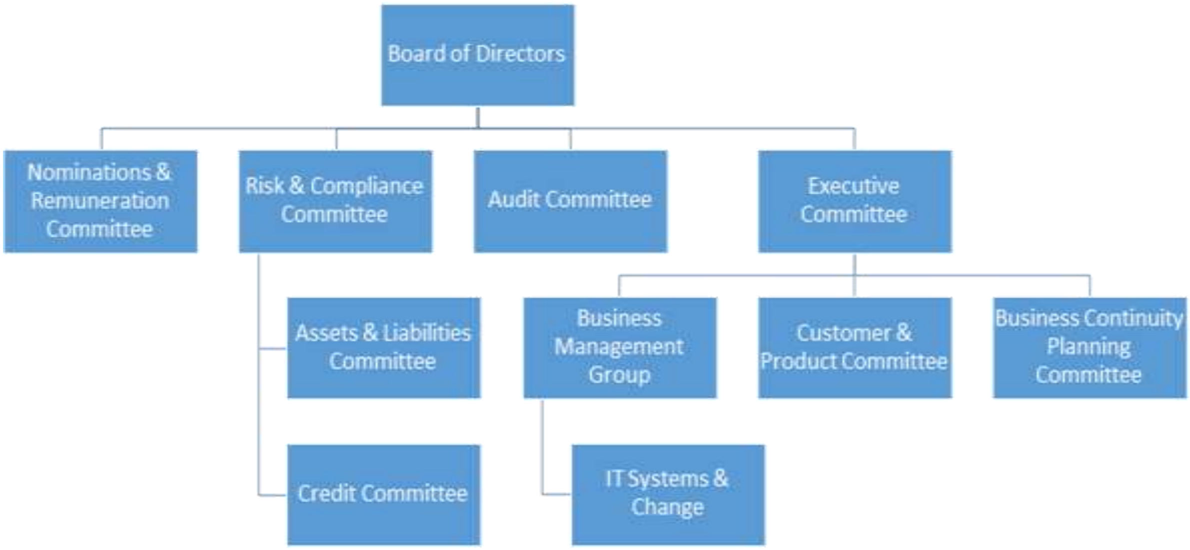
Cambridge & Counties Bank has 4 Executive and 5 Non-Executive Directors. A summary of their experience and confirmation of any other directorships is disclosed on the Bank's website (www.ccbank.co.uk).

Our recruitment policy for selection of all staff, including Directors, can also be found on the Bank's website (www.ccbank.co.uk). This policy covers both recruitment and diversity.

2. Governance and Committees

Authority for managing the Bank's risks ultimately rests with the Bank's Board of Directors. All the powers of the Bank are vested in and exercised by the Board; but some are delegated through job specifications and to various committees. The Board considers the delegation of powers on an on-going basis.

The Board comprises of four Executive Directors and five Non-Executive Directors and sets the Bank's corporate objectives, strategy and risk appetite. The Board ensures that the Bank has sufficient liquidity and capital resources and closely monitors financial results, budgets and forecasts as well as providing oversight of current and future activities. The Board meets every month. The Board's risk and governance structure is outlined below.



A summary of the four Board Committees is set out below. Full terms of reference for each of these committees are included in appendix 4.

- The Remuneration and Nominations Committee has been established by the Board to oversee the appointment, remuneration and other benefits of all Directors and Executive Management and to make recommendations as appropriate to the Board concerning such matters.

- The principle objectives of the Risk and Compliance Committee are to identify, control and manage the risks inherent in the Bank (including conduct / compliance risk) ensuring that these risks are fully documented for approval, and to recommend to the Board an appetite of risk statement.

- The Audit Committee is responsible for managing all issues regarding the internal and external audits of the Bank. This includes recommending to the Board the renewing of the appointment of the current auditors or instigating processes to effect a change in the auditing arrangements. The Audit Committee is responsible for considering and recommending for approval by the Board the non-Audit Services Policy. The Audit Committee also review and assess the effectiveness of the Bank's control environment.

- The Executive Committee has been established by the Board to manage the activities of the Bank on an on-going basis, within the framework of the Business Plan and subject to the overall control of the Board. The Executive Committee delegates some of its responsibilities to a sub-committee, the Business Management Group.

3. Risk Management Objectives and Policies

The Bank regards the monitoring and controlling of risk as a fundamental part of the management process and accordingly involves its most senior people in developing risk policy and in monitoring its application. The Board has ultimate responsibility for setting the Bank's risk appetite, agreeing a risk management policy and developing a risk management framework. The Board believes that the policies and risk management processes are adequate with regard to the Bank's profile and strategy.

A detailed analysis of key risks has been considered as part of the assessments of liquidity and capital adequacy and is documented in the Individual Liquidity Adequacy Assessment Process ("ILAAP") and the Internal Capital Adequacy Assessment Process ("ICAAP"), which are approved by the Board.

The Board has delegated the management of the systems of internal control to senior management who have adopted a "Three Lines of Defence" approach to the operational management of the Bank. This approach ensures that staff are aware of their responsibilities and that an effective segregation of duties is in place across the Bank.

Line	Business Function	Description
First line of defence	Operational management	The Bank's managers are in the best position to assess and manage the risk exposures within their departments and teams. Operational oversight is provided by the Executive Committee.
Second line of defence	Risk and compliance functions	Responsible for the quantification, analysis and reporting of all risks. These functions are operationally independent from the business managers, and can therefore uphold the principles and policies of the Bank. They provide oversight of the first line functions and can independently report to Risk and Compliance and/or Audit Committees any policy breaches or control issues.
Third line of defence	Internal audit	Internal audit is entirely independent of the operational functions of the Bank, and reports directly to the Audit Committee. The function is outsourced to Deloitte LLP to ensure further independence. Their role is to assess the Bank's control environment and provide the Audit Committee with an independent view of the effectiveness of the Bank's systems and controls.

The internal control systems can only provide reasonable and not absolute assurance against material misstatement or loss.

The Director of Risk and Compliance assesses the principal risks; challenges the operational managers and provides assurance to the Board that the Bank is managing its risks and operating within its appetite for risk. Risk reports are provided to the Board via the Risk and Compliance Committee. The Bank's Risk and Compliance function operates independently and reports to the Bank's Chief Risk Officer who is an Executive Director.

3.1. Risk Oversight, Monitoring and Management

Oversight and direction from the Board remains central to the risk management process. The Board ensures, through its sub-committees, that appropriate policies, procedures and processes are implemented across the business to control and monitor the risk exposures which arise from the Bank's operations.

Regular management information presented to the Board ensures that the management of risk is aligned to the Board's risk appetite and that unacceptable risk exposures are identified and, where possible, mitigated.

In addition to the on-going assessment of known risk exposures, the quarterly updating of the risk register combined with a forward looking assessment from the Risk and Compliance Committee ensures that new risks are adequately captured and monitored.

The Board is ultimately responsible for the risk management process and defines, through its risk appetite statements, the acceptable levels of risk exposure that should be taken in the delivery of the Bank's strategic objectives. As noted above, the Board's oversight of risk is supported by the structure of sub-committees. Each of the sub-committees provides a forum for the direction and challenge of the Bank's management, whilst monitoring business performance and risk exposures.

In order for Cambridge & Counties Bank to fulfil its strategic plan, in line with the objectives of the Bank's shareholders, the Board of Directors is committed to maintaining a sound risk management culture within the Bank. To this end, they have established a definition of the Bank's risk appetite to limit the total level of the Bank's risk exposure. The risk appetite is a set of statements that are used to ensure that the management and staff of the Bank understand the level of risk that is acceptable to the Board.

As well as limiting the total level of risk exposure taken on by the business, the Bank's risk appetite is a way of articulating the Board's level of risk tolerance to our key external stakeholders and regulators. The Bank's risk appetite is kept under review and is subject to a formal re-approval at least annually. The latest update to the risk appetite statement was completed in September 2016.

3.2. Risk Appetite Introduction

The Bank is committed to maintaining a sound risk management culture that underpins the safe delivery of its strategic objectives. This is supported by qualitative and quantitative policies and Risk Appetite Statements for each of the major risk categories faced by the Bank; these are detailed below. For each of the risk appetite statements there are a range of defined key risk and early warning indicators (KRIs and EWIs) that facilitate an assessment of the risk and performance against appetite. It should be noted that a breach in any single KRI / EWI does not necessarily indicate that the overall Risk Appetite has been breached.

The major risks to which the Bank is exposed are as follows:

- Strategic Risk
- Capital Risk
- Credit Risk
- Liquidity Risk
- Funding Risk
- Conduct, Compliance and Regulatory Risks
- Operational Risk
- Market Risk (including Interest Rate Risk in the Banking Book)
- Treasury Counterparty Risk

3.3. Risk Appetite Statements

The Risk Appetite statements below describe each risk and articulates the Bank's appetite. The Bank's full risk appetite statement is set out in Appendix 5.

Risk	Definition	Appetite
Strategic Risk	The risk that it fails to execute its strategic plan due to either internal or external factors.	• The Bank has little appetite for significant variance from the strategic plan or budget, without Board approval. The Bank seeks to meet all promises to shareholders in terms of delivering strategy, budgets and published targets. • The Bank only has an appetite for strategic risk where it supports its business model, sustainable growth, operational efficiency, high quality lending and a conservative approach to funding and liquidity.
Capital Risk	The risk that it fails to hold enough capital resources to meet its regulatory capital requirements.	• The Bank's Board will not accept a level of capital resources that is less than the regulatory capital requirement in either normal or stressed scenarios. • The Bank will maintain a conservative level of tier one capital based on a percentage of risk weighted assets
Credit Risk	The risk of a reduction in earnings, and/or value, as a result of the failure of a counterparty failing to meet, in a timely manner, a commitment that they have entered into with the Bank.	• The Bank has no appetite for arrears or bad debt that would create material volatility in earnings. • The Bank has no appetite for unplanned material concentrations within its lending portfolios. • The Bank has no appetite for unsecured lending.
Funding Risk	The risk that it is unable to raise funds at an acceptable price or to access markets in a timely manner.	• The Bank's funding Risk Appetite is defined as ensuring that the Bank has access to sufficient and diverse financial resources (in terms of source, type and tenor) to fund the Bank and maintain a sound level of liquidity
Liquidity Risk	The risk that it is unable to meet its short to medium term commitments as they fall due or that they can only be met at an uneconomic price.	• At all times the Bank requires that it has sufficient liquid assets to meet its liabilities when they fall due.
Conduct, Compliance and Regulatory Risk	Conduct risk is the risk that its customers suffer loss or detriment due to failures in product design, sales marketing processes and operational delivery or failures in the behaviour or ethics of its staff or its third party distributors / suppliers. Compliance and Regulatory Risk is the risk that non-compliance with laws or regulation could give rise to fines, litigation, sanctions and the potential for material adverse impact on the Bank.	• The Bank has zero tolerance for any material breach of laws or regulations. The Bank defines "material" as being of a significance that would expose the Bank or its management to legal or regulatory sanction. • The Bank has zero tolerance for any consciously unfair treatment of customers. Any accidental unfair treatment will be remediated as soon as the Bank becomes aware and root cause analysis undertaken to prevent recurrence. • The Bank seeks at all times to protect its good name in the management of the Bank and its customer relationships. • The Bank has zero tolerance for any consciously unethical behaviour by its staff. Again, any unconsciously unethical behaviour will be remediated and subject to root cause analysis to prevent recurrence.

Risk	Definition	Appetite
Operational Risk	The risk that failures arising from inadequate or failed internal processes, people and systems or from external events that may cause monetary loss, service disruption or customer detriment	• The Bank accepts that operational risk cannot be fully eliminated and applies a cost/benefit approach to limit its exposure with a focus on protecting its earnings, information assets, customer service, legal and regulatory compliance, and reputation. • The Bank has a minimal appetite for failures caused by inadequate systems, processes or procedures that could materially impact its ability to service customers
Market Risk, including Interest Rate Risk in the Banking Book (IRRBB)	The risk that changes in market rates negatively impact the earnings or market value of the Bank's assets or liabilities.	Market Risk can take many forms, but the Bank's only significant exposure relates to IRRBB. The limit of the Bank's appetite for IRRBB is 2% of total available capital. The Bank monitors its exposure to changes in interest rates based on two measures: • Repricing risk exposure – the exposure to timing mismatches between when assets and liabilities re-price; and • Basis Risk exposure – the exposure to assets and liabilities being linked to different interest rate bases (Bank Base Rate, LIBOR etc.), which do not move in parallel with each other
Treasury Counterparty Risk	The risk of wholesale Treasury counterparties being unable or unwilling to meet a commitment that they have entered into with the Bank.	• The Bank has a zero tolerance for losses relating to the failure of treasury counterparties.

3.4. Embedding of Risk Appetites within the Business

- Strategic Planning

  The Bank's risk appetite is a key input into strategic and financial planning decisions. Risk appetite tolerances are also considered and factored into the stress testing work that is undertaken relating to the Bank's capital and liquidity requirements (in the ICAAP and ILAAP processes respectively).

- Risk Limits

  The Bank's risk appetite statements are linked to the day-to-day running of the business through individual Key Risk Indicators and Early Warning indicators which are managed through policies and protocols under the oversight of the Board and its sub-committees.

- Management Information

  In order to monitor the Bank's performance against stated risk appetites, the Board and its sub-committees receive regular management information containing key current and forecast metrics linked to the risk appetite statements.

4. Remuneration

As a Bank with less than £15bn of assets, the Bank is classified as a "Tier 3" firm for the purposes of the disclosure of remuneration under the Capital Requirements Regulations (CRR). In compliance with the requirements, as laid out in the PRA Supervisory Statement LSS8/13 'Remuneration standards: the application of proportionality', the Bank has taken note of the regulator's guidance on materiality and proportionality.

The period covered by this declaration is from 1 January 2016 through to 31 December 2016.

The following disclosures meet the requirements for a Tier 3 firm:

- The Bank's Nominations and Remuneration Committee is responsible for designing and implementing the reward structure of the Bank. The committee ensures that effective risk management is a key component of remuneration and incentive structures. Membership is restricted to Non-Executive Directors only.
- The committee's terms of reference describe the committee's responsibilities. The committee's terms of reference are set out in Appendix 4.
- The Nominations and Remuneration Committee meets annually to distribute the variable remuneration from an aggregated pool of reserves.
- The Board of Cambridge & Counties Bank is committed to adhering to the Financial Services Remuneration Code, thus ensuring that the Bank has risk-focused remuneration policies, which are consistent with and promote effective risk management and does not expose the Bank to excessive risk. This is done in a manner which is appropriate to the Bank's size, internal organisation and the nature, scope and the complexity of its activities.
- Cambridge & Counties Bank ensures that its remuneration policies, practices and procedures are clear and documented. To record those policies, practices and procedures, and assess its compliance with the Code, the Bank's Remuneration Policy is reviewed annually to take account of any changes to policies, practices and procedures and is approved by the Nominations and Remuneration Committee.
- The Bank's remuneration policy is structured in such a way as to ensure that there is a clear link between pay and performance. Performance measures are related to both financial performance and the achievement of defined risk management objectives.
- The table below sets out the remuneration of the Bank's Executive and Non-Executive Directors. These members of staff have been classified as 'Code Staff' as they have a material impact on the profit of the Bank.

	Total remuneration £'000	Number of beneficiaries No.
2016	1,116	9
2015	850	9

5. Capital Resources

The Bank manages its capital under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV) framework which came into force on 1 January 2014. The framework is enforced in the UK by the PRA. The PRA sets and monitors capital requirements for the Bank.

The PRA's approach to the measurement of capital adequacy is primarily based on monitoring the relationship of the capital resources requirement to available capital resources. The regulator sets Individual Capital Guidance (ICG) for each bank in excess of the minimum resources requirement of 8%. A key input to the ICG-setting process is the Bank's ICAAP.

The Bank's policy is to maintain a strong capital base to maintain investor and market confidence and to sustain the future development of the business. The Board manages its capital levels for both current and future activities and documents its risk appetite and capital requirements during stress scenarios as part of the ICAAP. The ICAAP is used by the Board, management and shareholders to understand the levels of capital required to be held and to assess the reliance of the Bank against failure.

The Bank submitted its latest ICAAP to the PRA in January 2017. The Bank presents regular reports on the current and forecast level of capital, as well as the results of the stress scenarios to ALCO, Risk and Compliance Committee and the Board. The key assumptions and risk drivers used to create the ICAAP are regularly monitored and reported and any material deviation from the forecast and risk profile of the Bank would mean the ICAAP would need to be reviewed.

The Bank has complied with all externally imposed capital requirements. The Bank has elected to use the standardised approach for credit risk. Under CRD IV the Bank must set aside capital equal to 8% of its total risk weighted assets to cover its 'Pillar 1' capital requirements. The Bank must also set aside additional 'Pillar 2' capital to provide for additional risks.

As at 31 December 2016, the Bank's capital base was made up of £56.7m of Tier 1 capital and £1.5m of Tier 2 capital. The Bank's regulatory capital consists of the following elements:

Tier 1 capital

- Tier 1 capital includes ordinary share capital, perpetual subordinated convertible loan notes, retained earnings, reserves, and deductions for intangible assets which are included in equity but treated differently for capital adequacy purposes.

Tier 2 capital

- Tier 2 capital includes provisions for loan losses that are presently unidentified on an individual basis.

The total assets of the Bank at 31 December 2016 were £745,767k. The eligible capital resources at 31 December 2016 totalled £58,227k. The tables below set out the Bank's capital resources at 31 December 2016, reconciles these resources to the Bank's reported regulatory capital and shows the Bank's capital ratios as at 31 December 2016.

£'000	31 December 2016	31 December 2015
Tier 1		
Ordinary share capital	23,955	22,955
Retained earnings	20,283	6,422
Available for sale reserve	106	11
Deductions: Intangible assets	(509)	(681)
Total common equity Tier 1 capital	43,835	28,707
Perpetual subordinated contingent convertible loan notes	12,900	11,900
Total Tier 1 capital	56,735	40,607
Tier 2		
Subordinated debt	-	400
Preference share capital	-	-
Add: Collective impairment allowance	1,492	1,047
Total Tier 2 capital	**1,492**	**1,447**
Total regulatory capital	**58,227**	**42,054**

£'000	31 December 2016	31 December 2015
Equity as per statement of financial position	57,244	41,288
Regulatory adjustments		
Add subordinated debt	-	400
Add collective impairment allowance	1,492	1047
Less intangible assets	(509)	(681)
Total regulatory capital	**58,227**	**42,054**

%	31 December 2016	31 December 2015
Common equity tier 1 capital ratio	10.6	10.5
Tier 1 capital ratio	13.7	14.8
Tier 2 capital ratio	0.4	0.6
Total capital ratio	**14.0**	**15.4**

- The 2016 capital ratios assume the verification of 2016 profits and reserves as at 31 December 2016 and operational risk charges as at 30 December 2016.
- The subordinated debt was repaid in full in August 2016, and is therefore only included in the comparatives
- Trinity Hall and Cambridgeshire County Council subscribed for a further 500k ordinary share capital each in September 2016
- Cambridgeshire County Council subscribed for a further 1m convertible loan notes in January 2016

The Bank's Own Funds are disclosed in the regulatory CRR format in appendix 1.

5.1. Operational Risk Capital

Operational risk is defined in section 3 of this report. The Bank identifies, assesses and monitors its operational risks via an agreed framework and methodology which is reviewed on a regular basis by the Risk and Compliance Committee. The Bank calculates its operational risk capital requirement using the Basic Indicator Approach as set out in the table below.

£'000	2014	2015	2016
Net interest income	8,490	17,526	26,682
Other income	309	1,016	1,997
Relevant indicator	8,799	18,542	28,679
3 year average			18,673
Basic indicator approach percentage			15%
Operational risk capital requirement			2,801

The Bank's operational risk capital requirement at 31 December 2016 was £2.8m (based on the average net income for 2014-2016).

5.2. Risk Weighted Exposure Amounts and Operational Risk Capital

The assets of the Bank are analysed by risk category and given weightings according to the level of risk entailed. The Bank's credit risk consists of counterparty credit risk and all other credit risk (this principally arises from its loans and advances to customers).

The Bank's minimum capital requirements are calculated by applying credit risk weightings to the risk weighted assets. The credit risk weighting are determined by the "Standardised Approach" as set out in the CRR. The Bank uses Moody's Investors Service as its nominated External Credit Assessment Institution (ECAI) for all standardised counterparty credit risk exposure classes.

<u>Overview of RWA</u>

Overview of RWA (OV1) £'000 31 December			Risk Weighted Assets* 2016	Risk Weighted Assets* 2015	Minimum Capital Requirements 2016
	1	Credit risk (excluding CCR)	390,505	263,398	31,240
Article 438(c)(d)	2	Of which standardised approach (SA)	390,505	263,398	31,240
Article 107 Article 438(c)(d	6	Counterparty credit risk (CCR)	3,087	2,180	251
	9	Of which SA-CCR	3,087	2,180	251
Article 438(f)	23	Operational risk	35,013	19,275	2,801
	24	Of which Basic Indicator Approach	35,013	19,275	2,801
Article 437(2), Article 48 and Article 60	27	Amounts below the thresholds for deduction (subject to 250% risk weight)	551	653	44
	28	Floor adjustment	-	-	-
	29	Total	428,605	284,853	34,292

*after the application of SME factor where appropriate

The minimum capital requirement has increased by over 60% over the past twelve months principally reflecting the growth in loans and advances to customers.

The tables below shows the Bank's exposures at 31 December 2016 by exposure class, net of provisions.

Credit risk exposure and capital requirement

Credit Risk Exposure 31 December 2016	Exposure Value £'000	Minimum Pillar 1 Capital Requirement (8% x risk weight) £'000
Government and central banks	141,154	0
Institutions	14,754	237
Secured by mortgages on commercial real-estate	290,366	20,694
Secured by mortgages on residential property	266,945	5,680
Other loans	25,613	2,434
Past due items	6,585	527
Other items	998	107
Balance sheet Exposure	746,415	29,679
Derivative – potential future exposure add-on	150	6
Off balance sheet commitments	72,986	1,802
Off balance sheet treasury bills	2,000	0
Total Exposure	**821,551**	**31,487**
Operational risk capital requirement		2,801
Credit Value Adjustment		4
Total Pillar 1 capital requirement		**34,292**

- Past due items are defined as any account which is three or more months in arrears.
- Other loans includes asset finance, unsecured and certain light refurbishment loans.
- Collective provision is included in the other items.
-Treasury bills relate to drawings under the Funding for Lending Scheme. The Bank has placed appropriate collateral with the Bank of England.

Credit risk exposure by type

Credit Risk Exposure 31 December 2016		Exposure Value £'000
Government and central banks		
	Repayable on demand	127,905
	Marketable securities	13,249
Banks and building societies		
	Repayable on demand	14,754
	Derivatives	150
Loans and advances to customers		589,509
Other		998
Off balance sheet commitments		74,986
Total Exposure		**821,551**

Credit risk exposure – on and off balance sheet reconciliation

The difference between the total credit risk exposures shown above of £821,551k and the total assets per the 2016 financial statements of £745,767k can be explained as follows;

31 December 2016	£'000
Total credit risk exposure (per table above)	821,551
Less:	
Off balance sheet customer loans and advances commitments	(72,986)
Off balance sheet treasury bills	(2,000)
Derivative potential future exposure add-on	(150)
Verified general provision	(1,492)
Add:	
Collateral deposits adjustments to loans	335
Verified intangible assets	509
Total assets per balance sheet	**745,767**

5.3. Leverage Ratio

The CRD IV framework requires firms to calculate a non-risk based leverage ratio that is a supplementary measure to the risk-based capital requirements. The ratio is defined Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Bank's ratio is significantly higher than the regulatory requirement of 3%.

Further analysis of the Bank's leverage ratio calculation and disclosures set out by the EBA and Basel Committee can be found in appendix 1.

Leverage Ratio	Regulatory Minimum	2016 £'000	2015* £'000
Total Tier 1 Capital		**56,735**	**36,707**
Exposures			
Balance sheet exposure (inc. Derivative PFE exposure)		746,565	521,617
Off balance sheet commitments		74,986	61,153
Total Exposures		**821,551**	**582,770**
Leverage Ratio	3.0%	**6.91%**	**6.30%**

Assumes capital and reserves have been verified as at 31 December.
*the 2015 ratio is as reported in the 2015 Pillar 3 report and reports uses a quarter end average.

6. Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's receivables from customers. The risk of financial loss from the Bank's exposures to other financial institutions and investment securities is reported as counterparty credit risk and is reported in section 7.

The Bank's credit risk appetite is set out in its Risk Appetite Statement in appendix 5. The Bank's credit risk arises as a result of its lending activities. The Bank lends to customers secured on property or, in the case of hire purchase agreements and finance leases, business essential assets. The Bank's risk appetite is reviewed at least annually and approved by the Board.

Credit risks associated with lending are managed through the use of detailed lending policies which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Bank seeks to mitigate credit risk by focusing on business sectors where it has specific expertise and through limiting concentrated exposures on larger loans, certain sectors and other factors that can represent higher risk. The Bank also seek to obtain security cover and, where appropriate, personal guarantees from borrowers. Credit risk is principally assessed through the manual underwriting of all transactions.

The Bank's lending policy is fully explained to customers as part of the application process. As part of the underwriting process the Bank undertakes an independent valuation of the property being proposed as security. The Bank has a series of loan to value policy limits which are applied against all loan applications. During the underwriting process the Bank's Credit and Business Development teams keep the customer fully informed of the progress of their application. If the application is unsuccessful the Bank ensures that the customer is provided with a full explanation of the Bank's rationale for declining the loan request.

The Bank has separately managed credit, risk and compliance functions and it outsources its internal audit function to Deloitte LLP. The Risk and Compliance Committee has oversight responsibility for credit risk. The Bank's management receive a daily report with details of the Bank's credit exposures. The report includes details on the pipeline of applications, loans drawn down, accounts in arrears, lending by sector, geography and loan to value ratio. The Board and the Risk and Compliance Committee members receive a monthly Risk MI report with full details of the Bank's credit risk exposures and how this compares to its risk appetite.

6.1. Credit Risk - Exposure Values

The Bank's maximum exposure to credit risk after provisions for impairment is as follows:

£'000	2016	2015
Cash and balances at central banks	127,905	62,121
Loans and advances to banks	14,754	10,740
Debt securities	13,249	27,229
Loans and advances to customers	590,860	417,410
Total on balance sheet**	**746,768**	**517,500**
Off-balance sheet treasury bills	2,000	10,000
Commitments to lend*	72,986	66,875
Gross credit risk exposure	**821,754**	**594,375**
Less allowance for impairment losses	(2,508)	(1,147)
Net credit risk exposure	**819,246**	**593,228**

*Commitments to lend represent agreements entered into but not advanced as at 31 December.
**excludes other debtors, prepayments and fixed assets, PFE charge and is gross of cash collateral deposits

The above table represents the maximum credit risk exposure to the Bank at 31 December 2016 and 2015 without taking account of any underlying security. At 31 December 2016 the value of securities held as collateral is £992m (2015: £737m) of which £992m (2015: £735m) is in the form of property and £0.4m (2015: £2m) is in the form of cash deposits.

The following table breaks down the Bank's credit risk exposure by asset class and risk weighting. The assets of the Bank are analysed by risk category and given weightings according to the level of risk entailed. Credit risk weightings are determined by the "Standardised Approach" as set out in the CRR. The Bank uses Moody's Investors Service as its nominated External Credit Assessment Institution (ECAI) for the bank's exposure class.

Standardised Approach - Exposures by asset classes and risk weights (template 20: EU CR5) 31 December 2016 £'000							
	Exposure class	Risk weighting				Total credit	Of which
		35%	100%	150%	250%	exposure	unrated
7	Corporates		41,560			41,560	41,560
9	Secured by mortgages on immovable property	295,659	302,236			597,895	597,895
10	Exposures in default		6,585			6,585	6,585
11	Higher-risk categories			16,455		16,455	16,455
16	Other assets*		778		220	998	998
17	Total	295,659	351,159	16,455	220	663,493	663,493

*principally fixed assets and deferred tax

6.2. Credit risk – Security

The Bank enters into loan agreements with customers and takes security in the form of a charge over property in the case of real estate loans or business essential assets in respect of hire purchase and finance lease transactions. The security profile of the loans receivable book is shown below:

	2016		2015	
	£m	%	£m	%
Secured on property	581	98	416	100
Secured on other assets	10	2	1	-
Unsecured	-	-	-	-
Total	591	100	417	100

In addition to security over property the Bank may also take additional security in the form of Director Guarantees and cash deposits.

There has been no change in the Bank's credit risk mitigation techniques or type of lending activities in 2016. The Bank continues to focus on lending to SME customers secured on property or, in the case of finance leases and hire purchase agreements, business essential assets.

6.3 Credit Risk – Maturity Profile

The table below analyses the Bank's contractual undiscounted cash flows of its financial assets. The table reflects both counterparty credit risk and all other credit risk.

At 31 December 2016 £'000	Total	Contractual cash flows Less than 3 months	3 months to 1 year	Greater than 1 year
Assets				
Cash and balances at central banks	127,905	127,905		
Loans and advances to banks	14,754	14,754		
Loans and advances to customers	588,352	11,406	46,972	529,974
Debt securities	13,249	-	10,100	3,149
Total	**744,260**	**154,065**	**57,072**	**533,123**

At 31 December 2015 £'000	Total	Contractual cash flows Less than 3 months	3 months to 1 year	Greater than 1 year
Assets				
Cash and balances at central banks	62,121	62,121		
Loans and advances to banks	10,740	10,740		
Loans and advances to customers	416,263	8,823	23,013	384,427
Debt securities	27,229	10,394	6,776	10,059
Derivatives	15			15
Total	**516,368**	**92,078**	**29,789**	**394,501**

The main change in the maturity of the Bank's cash flows over the past twelve months has been the increase in cash and balances at Central Banks. This increase reflects increased cash deposits held at the Bank of England. The Bank's liquidity increased in 2016 as a result of the growth in these balances.

6.4 Credit Risk – Geographical Breakdown

All of the Bank's property loans are secured on UK property. The table below outlines the Bank's credit exposure at 31 December on a regional basis.

Region	2016	2015
East Anglia	5%	6%
East Midlands	19%	22%
Greater London	3%	4%
North East	4%	5%
North West	22%	21%
Scotland	5%	3%
South East	5%	4%
South West	7%	5%
Wales	4%	5%
West Midlands	7%	7%
Yorkshire/Humberside	19%	18%
Total	**100%**	**100%**

7. Counter Party Credit Risk / Liquid Assets

The Bank's counterparty credit risk appetite is set out in its Risk Appetite which is set out in appendix 5. The Bank's counterparty risk arises principally as a result of its Nostro accounts (held with Royal Bank of Scotland and Barclays), its Bank of England reserve account and its interest rate risk derivatives with Royal Bank of Scotland.

The selection of counterparties and the approval of limits is governed by the Bank's Counterparty Policy and involves consideration of background credit rating information as well as up to date credit reports and other market intelligence. ALCO reviews counterparty limits on a monthly basis and recommends changes to the Risk and Compliance Committee for approval. No exposure can be held with counterparties which do not have a pre-approved limit.

Credit risk weightings for treasury counterparties are determined by the "Standardised Approach" using credit quality steps as set out in the CRR.

The credit ratings and counterparties of the Bank's liquid asset exposures as at 31 December 2016 (on balance sheet) were as follows:

£'000	2016	2015
Cash and balances at central banks	127,905	62,121
Deposits at other banks		
- Rated* A or above	14,746	10,715
- Unrated	8	175
UK Government Gilts	13,249	16,835
European Investment Bank bonds	-	10,394
Derivatives held for risk management purposes		
Rated* A or above	(183)	(14)

*Ratings based on Moody's long term rating

The Bank uses two UK clearing banks with a Moody's credit rating of single-A or above for deposits, clearing services and derivatives – Royal Bank of Scotland and Barclays. The unrated deposit relates to an exposure with Kaupthing Singer and Friedlander (KSF). KSF was a financial services provider which the UK government put into administration on 8 October 2008 in response to the failure of its parent as a result of the financial crisis of 2007/8. This exposure arose as a result of Cambridge & Counties Bank acquiring the assets of Pensions Bank in June 2012. Pensions Bank had a £1m money market deposit with KSF at the time it was put into administration, together with a provision of £150k. The provision was utilised in 2016.

The table below sets out the Bank's counterparty credit risk exposures by regulatory portfolio and risk weight.

Counterparty Credit Risk exposures by regulatory portfolio and risk weights (template 28: EU CCR3) 31 December 2016 £'000							
	Exposure Class	Risk Weight				Total	Of which unrated
		0%	20%	50%	100%		
1	Central governments or central banks	143,154				143,154	-
6	Institutions		14,746	150	8	14,904	8
11	**Total**	**143,154**	**14,746**	**150**	**8**	**14,904**	**8**

The Bank has interest rate derivatives with a nominal value of £40m at 31 December 2016 (2015: £16.5m). The net fair value of these swaps totalled -£183k at 31 December 2016 (2015: -£14k). The Bank's derivatives are interest rate swaps to hedge its exposure to changes in the fair value of its fixed rate debt securities and a proportion of its fixed rate deposit balances. The effectiveness of the Bank's hedging is monitored on a monthly basis. Derivative financial instruments are recognised at fair value on the Bank's balance sheet.

The fair value of derivatives designated as fair value hedges are as follows:

Fair value hedges of interest rate risk £'000	2016		2015	
	Assets	Liabilities	Assets	Liabilities
Instrument type: Interest rate	0	183	15	29
Total	**0**	**183**	**15**	**29**

Credit derivatives exposures (template 33: CCR6) 31 December 2016 £'000	A	B	C
	Credit derivative hedges		Other credit derivatives
	Protection bought	Protection sold	
Notionals			
Other credit derivatives	40,000	-	-
Total notionals	**40,000**	**-**	**-**
Fair values			
Positive fair value (asset)	-	-	-
Negative fair value (liability)	183	-	-

The Bank has not had to post any collateral in respect of derivative transactions in 2016 (2015: nil).

8. Credit Quality - Impairment and Provisions

Loans and advances to customers are reviewed regularly to determine whether there is any objective evidence of impairment and assets are categorised as detailed in the table below:

Type of impairment assessment	Description
Individual impairment	Where specific circumstances indicate that a loss is likely to be incurred
Collective impairment	Impairment allowances are calculated on a collective basis, given the homogenous nature of the assets in the portfolio
Neither past due nor impaired	Loans that are not in arrears and have not been subject to forbearance solutions.
Past due but not impaired	Loans that are in arrears or where there is objective evidence of impairment, but the asset does not meet the definition of an impaired asset as the expected recoverable amount exceeds the carrying amount
Impaired assets	Loans that are in arrears or where there is objective evidence of impairment and where the carrying value of the loan exceeds the expected recoverable amount.

The table below provides information on the payment due status of loans and advances to customers at 31 December. All of our residential and commercial loans and advances are secured on UK based assets.

£'000	2016	2015
Neither past due nor impaired	575,100	411,311
Past due but not impaired:		
Up to 1 payment missed	6,911	2,538
Up to 3 payments missed	733	567
Over 3 payments missed	-	-
Impaired	8,116	2,994
Total	590,860	417,410
Less allowances for impairment losses	(2,508)	(1,147)
Total loans and advances to customers	588,352	416,263

Impairment provisions against loans and advances to customers are based on a period end appraisal of recoverability of all advances.

Specific provisions are made against exposures which have been identified as bad or doubtful to reduce the carrying amount, including interest in arrears. The Bank estimates the ultimate net realisable value of the loan to determine the amount of the provision. Provisions are utilised in part or in full when the extent of loss has been confirmed and there is no longer any realistic prospect of recovery.

A collective provision is made against those loans that are not identified as individually impaired. The losses are provided for as a percentage of the loan book. This percentage is based on management experience, economic and market conditions.

Impairment provisions against customer loans and advances at 31 December 2016 have been made up as follows:

£'000	Individual provisions	Collective provisions	Total provisions
Balance as at 1 January 2016	100	1,047	1,147
Impairment loss for the year:			
Charge to income statement	986	445	1,431
Write-offs net of recoveries	-	-	-
Provisions released	(70)	-	(70)
Balance as at 31 December 2016	**1,016**	**1,492**	**2,508**

Impairment provisions against customer loans and advances at 31 December 2015 have been made up as follows:

£'000	Individual provisions	Collective provisions	Total provisions
Balance as at 1 January 2015	113	595	708
Impairment loss for the year:			
Charge to income statement	81	452	533
Write-offs net of recoveries	-	-	-
Provisions released	(94)	-	(94)
Balance as at 31 December 2015	**100**	**1,047**	**1,147**

All of the Bank's customer loans and advances are UK based. The majority (over 98%) of the Bank's lending is secured on property.

The Bank classifies a loan as being in default once it is 3 or more payments behind (typically 90 days). The value of loans in default has increased over the past 12 months reflecting a small number of customers who have got into financial difficulty. The increase remains relatively small compared to the growth in total lending balances and is to be expected as the loan book matures. Overall Management continue to believe that the Bank has a high quality loan book.

Further disclosures on the Banks credit quality are included in appendix 2.

9. Interest Rate Risk in the Banking Book (IRRBB)

The Bank's exposure and risk appetite in respect to Interest Rate Risk in the Banking Book is set out in appendix 5.

To assess the impact of rate change the Bank's assets and liabilities are allocated to time bands by reference to the earlier of the next contractual interest rate change and the maturity date. The interest rate sensitivity exposure of the Bank at 31 December 2016 was:

	Within 3 months	More than 3 but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5	More than 5 years	Non-interest bearing	Total
Assets							
Cash and balances at central banks	127,891					14	127,905
Loans and advances							
to banks	14,754						14,754
to customers	575,315	1,411	7,849	8,903	247	(5,373)	588,352
Debt securities			10,000	3,000		249	13,249
Other assets						1,507	1,507
Total assets	**717,960**	**1,411**	**17,849**	**11,903**	**247**	**(3,603)**	**745,767**
Liabilities							
Customer accounts	(582,233)	(12,450)	(40,658)	(46,212)		(3,119)	(684,672)
Other liabilities						(3,851)	(3,851)
Total equity		(12,900)				(44,344)	(57,244)
Total liabilities	**(582,233)**	**(25,350)**	**(40,658)**	**(46,212)**		**(51,314)**	**(745,767)**
Off-balance sheet items							
Notional value of derivatives	40,000		(10,000)	(30,000)			-
Interest rate sensitivity gap	175,727	(23,939)	(32,809)	(64,309)	247	(54,917)	-
Cumulative gap	**175,727**	**151,788**	**118,979**	**54,670**	**54,917**	**-**	**-**

The Bank considers a 200 basis points ("bps") movement to be appropriate for scenario testing given the current economic outlook and industry expectations.

The Bank estimates that a +/-200bps movement in interest rates paid/received would have impacted the overall balance sheet values as follows:

+200bps: £463k (2015: £162k)

-200 bps: -£490k (2015: -£170k)

This calculation assumes that the change occurred at the balance sheet date and had been applied to risk exposures existing at that date.

10. Asset Encumbrance

The Bank can use its assets to support collateral requirements for central bank operations, third party repurchase transactions and its interest rate derivatives. Assets that have been set aside for such purposes are classified as 'encumbered assets' and cannot be used for other purposes. All other assets are defined as 'unencumbered assets'. The Bank reviews all its assets against the criteria of being able to finance them in a secured form (encumbrance) but certain asset types lend themselves more readily to encumbrance. The typical characteristics that support encumbrance are an ability to pledge those assets to another counterparty or entity through operation of law without necessarily requiring prior notification, homogeneity as well as predictable and measurable cash flows. The Bank considers all its liquid assets and customer loans and advances, with the exception of its cash deposits at other banks and its small portfolio of unsecured customer loans, are available to be encumbered.

As at 31 December 2016 the Bank had no encumbered assets although it had pre-positioned assets with the Bank of England as part of its Funding for Lending Scheme (FLS) membership which may at a future date become encumbered. The Bank has not been required to post any collateral in respect of its interest rate derivatives.

The Bank is a participant in the FLS which enables it to borrow highly liquid UK Treasury bills in exchange for eligible collateral. The Treasury bills are not recorded on the Bank's balance sheet as ownership remains with the Bank of England. As at 31 December 2016 the Bank had drawn £2m (2015: £10m) of Treasury bills under FLS. During the year Treasury bill drawings under the FLS scheme peaked at £60.5m. These Treasury bills are held off balance sheet and as at 31 December 2016 they had not been monetised. The Bank has pre-positioned, with the Bank of England, loan assets totalling £157m as collateral.

The following tables show the appropriate disclosures in respect of the Bank's encumbered and unencumbered assets during 2016. The tables show the median balance sheet values for the past 12 month basis as prescribed in the regulatory requirements.

- **Template A - Overview of encumbered and unencumbered assets**

Template A 2016 Rolling 12 month median £'000		Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
			of which notionally eligible EHQLA and HQLA		of which notionally eligible EHQLA and HQLA		of which EHQLA and HQLA		of which EHQLA and HQLA
		010	030	040	050	060	080	090	100
010	**Assets of the reporting institution**	-	-			-	-		
030	Equity instruments	-	-			-	-		
040	Debt securities	-	-	-	-	-	-	-	-
050	of which: covered bonds	-	-	-	-	-	-	-	-
060	of which: asset-backed securities	-	-	-	-	-	-	-	-
070	of which: issued by general governments	-	-	-	-	19,923	19,923	19,923	19,923
080	of which: issued by financial corporations	-	-	-	-	-	-	-	-
090	of which: issued by non-financial corporations	-	-	-	-	-	-	-	-
120	Other assets	-	-			583,848	78,749		
121	of which: Central bank Reserve Account	-	-			78,749	78,749		
122	of which: Deposits at other Banks	-	-			13,026	-		
123	of which: Loans and advances to Customers	-	-			490,568	-		

- Template B - The Bank meets the criteria set by the PRA to waive the requirement to report Table B- Characteristics of received collateral. The Bank's Table B return would have in any case have been a nil return in 2016 as we have not encumbered any assets during the period.

- Template C – Encumbered assets/collateral received and associated liabilities

Template C 2016 Rolling 12 month median £'000	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	-	-

2016 Rolling 12 month median £'000	Fair value of encumbered collateral received or own debt securities issued	Fair value of non-encumbered collateral received or own debt securities issued available for encumbrance
Collateral received by the reporting institution	-	-

- Template D - Disclosures required to meet the requirements of Template D – "Accompanying narrative information on the impact of the business model on assets encumbrance and the importance of encumbrance to the institution's business model" have been included in the above narrative.

11. Other Disclosure Requirements

The Bank has:

- no exposures to securitisation positions
- no trading book
- not been identified as having any global or domestic systemic importance
- all of its credit exposures in the UK. It has no countercyclical capital buffer.

12. Conclusion / Contacts

This Pillar 3 disclosure document has been prepared in accordance with the requirements of the CRD, CRR and the PRA, as appropriate to the size and complexity of Cambridge & Counties Bank. If a user of these disclosures requires further information please contact:

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Appendix 1

Additional Disclosures

Own Funds, Leverage Ratio and Reconciling differences between regulatory reported values and financial statements

Own funds disclosure

Own Funds – Regulatory disclosure template 31 December 2016 £'000		
Common Equity Tier 1 (CET1) capital: instruments and reserves		
1	Capital instruments and the related share premium accounts	
	of which: Ordinary share capital	23,955
2	Retained Earnings	20,283
3	Accumulated other comprehensive income	106
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**44,344**
Common Equity Tier 1 (CET1) capital: regulatory adjustments		
8	Intangible assets	(509)
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**(509)**
29	**Common Equity Tier 1 (CET1) capital**	**43,835**
Additional Tier 1 (AT1) capital: instruments		
30	Capital instruments and the related share premium accounts	
31	of which: classified as equity under applicable accounting standards	12,900
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	**12,900**
Additional Tier 1 (AT1) capital: regulatory adjustments		-
44	**Additional Tier 1 (AT1) capital**	**12,900**
45	**Tier 1 capital (T1 = CET1 + AT1)**	**56,735**
Tier 2 (T2) capital: instruments and provisions		
50	**Credit risk adjustments**	1,492
51	**Tier 2 (T2) capital before regulatory adjustments**	**1,492**
Tier 2 (T2) capital: regulatory adjustments		
57	**Total regulatory adjustments to Tier 2 (T2) capital**	-
58	**Tier 2 (T2) capital**	**1,492**
59	**Total capital (TC = T1 + T2)**	**58,227**
60	**Total risk weighted assets**	**428,605**
Capital ratios and buffers		
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	10.60%
62	Tier 1 (as a percentage of total risk exposure amount)	13.72%
63	Total capital (as a percentage of total risk exposure amount)	14.08%
64	Institution specific buffer requirement	14,922
65	of which: capital conservation buffer	17.9%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	63.9%

Capital ratios assumed profits were verified at 31 December 2016, with operational risk requirement based on 30 December 2016.

Leverage ratio regulatory disclosures

Table LRSum : Summary reconciliation of accounting assets and leverage ratio exposures		Applicable amount
1	Total assets as per published financial statements	745,767
4	Adjustments for derivative financial instruments	150
6	Adjustment for off-balance sheet items	74,986
7	Other Adjustments	648
8	**Leverage ratio total exposure measure**	**821,551**

Table LRCom: Leverage ratio common disclosure	On-balance sheet exposures	CRR leverage ratio exposures
1	On-balance sheet items	746,924
2	Asset amounts deducted in determining Tier 1 capital	(509)
3	Total on-balance sheet exposures	**746,415**
	Derivative exposures	
5	Add-on amounts for PFE associated with all derivative transactions	150
11	Total derivative exposures	**150**
	SFT exposures	
16	Total securities financing transaction exposures	-
	Other off-balance sheet exposures	
17	Off-balance sheet exposures at gross notional amount	74,986
19	Other off-balance sheet exposures	**74,986**
	Capital and total exposure measure	
20	Tier 1 capital	56,735
21	Leverage ratio total exposure measure	821,551
	Leverage Ratio	
22	Leverage ratio	6.91%

Table LRSpl: Split-up of on balance sheet exposures		CRR leverage ratio exposures
EU-1	Total on-balance sheet exposures, of which:	746,415
EU-5	Exposures treated as sovereigns	141,154
EU-7	Institutions	14,754
EU-8	Secured by mortgages on immovable properties	543,223
EU-10	Corporate	39,701
EU-11	Exposures in default	6,585
EU-12	Other exposures	998

High risk loans are split between Corporates and Secured by mortgages on immovable properties

Reconciling differences between regulatory reported values and financial statements

Linkages between financial statements and regulatory exposures (LI1) 31 December 2016 £'000	A Carrying values as reported in published financial accounts	C Carrying values of items subject to credit risk framework	D Carrying values of items subject to counterparty credit risk framework	G Carrying values of items not subject to capital requirements or subject to deduction from capital
Cash and balances at central banks	127,905	-	127,905	-
Loans and advances to banks	14,754	-	14,754	-
Debt securities	13,249	-	13,249	-
Loans and advances to customers*	588,352	588,352	-	-
Other assets and prepayments	449	449	-	-
Property, plant and equipment	329	329	-	-
Intangible assets	509	-	-	509
Deferred taxation	220	220	-	-
Total assets	745,767	589,350	155,908	509
Customers' accounts	684,672	-	-	684,672
Derivative financial liabilities	183	-	-	183
Other liabilities and accruals	3,668	-	-	3,668
Total liabilities	688,523	-	-	688,523

*net of collective and specific provisions

Main sources of differences between regulatory exposure amounts and carrying values in financial statements (LI2) 31 December 2016 £'000			Items subject to	
		A Total	B Items subject to credit risk framework	C Items subject to counterparty risk framework
1	Assets carrying value amount under the scope of regulatory consolidation*	746,750	590,842	155,908
2	Liabilities carrying value amount under the regulatory scope of consolidation	(335)	(335)	-
3	Total net amount under the regulatory scope of consolidation	746,415	590,507	155,908
4	Off balance sheet amounts	74,986	72,986	2,000
9	PFE - derivatives	150	-	150
10	Exposure amount considered for regulatory purposes	821,551	663,493	158,058

The Bank has no assets subject to Market risk or securitisation frameworks
*gross of collective provisions and excluding intangible assets

The following processes and interpretations have been followed to calculate the above carrying values:

- Cash and balances at central banks

These represent amounts with an initial maturity of less than 3 months and their carrying value is considered to be the fair value.

- Loans and advances to banks

These represent amounts with a maturity of less than 3 months, where adjustments to fair value in respect of the credit rating of the counterparty are not considered necessary. The carrying value of the asset is considered to be the fair value after taking into account any provisions.

– Debt securities

Where securities are actively traded in a recognised market, with available and quoted prices, these have been used to value these instruments.

- Loans and advances to customers

The majority of the Bank's lending is via products with a variable interest rate which it considers equivalent to a current market product rate. Therefore the Bank considers the discounted future cash flows of these mortgages to be equal to the carrying value.

– Customers' accounts

The fair value of fixed rate customers' accounts have been determined by discounting estimated future cash flows based on market interest rates on equivalent deposits. Customers' accounts at variable rates are at current market rates and therefore the Bank regards the fair value to be equal to the carrying value.

– Derivatives

The fair values of derivative assets and liabilities are calculated based on the present value of future interest cash flows, discounted at the market rate of interest at the balance sheet date.

Total and average net amount of exposures (template 7 EU CRB-B) 31 December 2016 £'000		A Net value of exposures at the end of the period	B Average net exposures over The period
16	Central governments or central banks	141,154	115,252
21	Institutions	14,904	12,822
22	Corporates	31,226	27,092
23	*Of which: SMEs*	30,997	26,884
26	Secured by mortgages on immovable property	536,991	457,803
27	*Of which: SMEs*	536,991	457,803
28	Exposures in default	6,585	3,366
29	Items associated with particularly high risk	14,707	13,981
34	Other Exposures	998	1,031
	Off-balance sheet - lending commitments and FLS t-bills	74,986	70,931
35	Total standardised approach	821,551	702,278
36	Total	821,551	702,278

The above table includes off-balance sheet exposures in respect of the Bank's lending commitments which give rise to a credit risk exposure and the value of the PFE on the Bank's derivative portfolio.

All of the above exposures are in the UK and therefore template 8 EU CRB-C geographical exposures is not shown separately.

Appendix 2

Additional Credit Risk Disclosures

The following table splits the Bank's loans and advances to customer by industry sector.

Concentration of exposures by industry or counterparty type (template 9 EU CRB-D)
31 December 2016 £'000

		A	B	C	D	E	F	G	H	I	J	L	M	N	O	P	Q	R	S	U
		Agriculture, forestry and fishing	Mining and quarrying	Manufacturing	Electricity, gas, steam and air Condition supply	Water supply	Construction	Wholesale and retail trade	Transport and storage	Accommodation and food service activities	Information and communication	Real estate activities	Professional, scientific and technical activities	Administrative and support service activities	Public administration and defence, Compulsory social security	Education	Human health services and social work activities	Arts, entertainment and recreation	Other services	Total
13	Corporates	13		3,448		1,014	2,811	2,798		480		18,445	150			12	109	285	11,995	41,560
15	Secured by mortgages on immovable property	7,909		9,825		1,315	4,243	27,742		12,111		509,130	2,726			1,918	4,621		16,355	597,895
16	Exposures in default			843				158				5,339					245			6,585
17	Items associated with particularly high risk						2945					11,790					1,720			16,455
23	Total standardised approach	7,922	-	14,116	-	2,329	9,999	30,698	-	12,591	-	544,708	2,876	-	-	1,930	6,695	285	28,350	662,495
24	Total	7,922	-	14,116	-	2,329	9,999	30,698	-	12,591	-	544,704	2,876	-	-	1,930	6,695	285	28,350	662,495

The following table shows the maturity of the Bank's assets. There has been no significant change over the past 12 months.

Maturity of exposures (template 10 EU CRB-E) 31 December 2016 £'000		A	B	C	D	E	F
		Net exposure value					
		On demand	<=1 year	>1 year <= 5 years	>5 years	No stated maturity	Total
7	Central governments or central banks	127,905	10,100	3,149	-	-	141,154
12	Institutions	14,746	-	-	-	8	14,754
13	Corporates	-	6,676	6,407	18,143		31,226
15	Secured by mortgages on immovable property	-	35,024	105,072	396,895	-	536,991
16	Exposures in default	-	6,585				6,585
17	Items associated with particularly high risk	-	10,026	4,681			14,707
22	Other exposures	-	282	265	451		998
23	**Total standardised approach**	**142,651**	**68,693**	**119,574**	**415,489**	**8**	**746,415**
24	**Total**	**142,651**	**68,693**	**119,574**	**415,489**	**8**	**746,415**

- **Loan impairments, provisions and credit mitigation**

The Bank has recorded strong growth in its lending balances since it started trading in 2012. Loans and advances to customers increased by 41% in 2016. General credit risk adjustments have grown in line with balances. Specific credit risk adjustments increased to £1m at31 December 2016 reflecting a small number of cases where the customers have got into financial difficulty. This increase was expected as the book grows and loans mature.

The following tables show further analysis on the split of the Bank's lending and the breakdown of loans in arrears and default and the balance of provisions.

Credit quality of exposures by exposure calcs and instrument types (template 11 EU CR1 A) 31 December 2016 £'000								
		A	B	C	D	E	F	G
		Gross carrying values of		Specific credit risk adjustment	General credit Risk adjustments	Accumulated write-offs	Credit risk Adjustment charges from the prior period	Net values
		Defaulted exposures	Non-defaulted exposures					(a+b-c-d-e)
22	Corporates	-	41,560	-	112	-	85	41,448
23	Of which: SMEs	-	41,446	-	112	-	-	41,334
26	Secured by mortgages on immovable property	-	597,909	14	1,342	-	1,010	596,553
27	Of which: SMEs	-	597,909	14	1,342	-	1,010	596,553
28	Exposures in default	7,587	-	1,002	-	-	19	6,585
29	Items associated with particularly high risk	-	16,455	-	38	-	33	16,418
34	Other exposures	-	998	-	-	-	-	998
35	**Total standardised approach**	**7,587**	**656,922**	**1,016**	**1,492**	**-**	**1,147**	**662,001**
36	**Total**	**7,587**	**656,922**	**1,016**	**1,492**	**-**	**1,147**	**662,001**
37	Of which: Loans	7,587	582,938	1,016	1,492	-	1,147	589,016
39	Of which: Off-balance-sheet exposures	-	72,986	-	-	-	-	72,986

Credit quality of exposures by industry or counterparty type (template 12 EU CR1-B) 31 December 2016 £'000		A	B	C	D	E	F	G
		Gross carrying values of		Specific credit risk adjustment	General credit risk adjustment	Accumulated write-offs	Credit risk adjustment charges	Net values
		Defaulted exposures	Non-defaulted exposures					(a+ b-c-d-e)
1	Agriculture, forestry and fishing		7,922	-	20	-	6	7,902
2	Mining and quarrying	-	-	-	-	-	-	-
3	Manufacturing	863	13,273	20	19	-	26	14,097
4	Electricity, gas, steam and air conditioning supply	-	-	-	-	-	-	-
5	Water supply	-	2,329	-	-	-	-	2,329
6	Construction	-	9,999	-	21	-	6	9,978
7	Wholesale and retail trade	158	30,540	-	46	-	14	30,652
8	Transport and storage	-	-	-		-	-	-
9	Accommodation and food service activities	-	12,591	-	27	-	8	12,564
10	Information and communication	-	-	-	-	-	-	-
11	Real estate activities	6,291	539,379	966	1,296	-	1,322	543,408
12	Professional, scientific and technical activities	-	2,876	-	6	-	2	2,870
13	Administrative and support service activities	-	-	-	-	-	-	-
14	Public administration and defence compulsory social security	-	-	-	-	-	-	-
15	Education	-	1,930	-	1	-	-	1,929
16	Human health services and social work activities	275	6,450	30	10	-	33	6,685
17	Arts, entertainment and recreation	-	285	-	1	-	-	284
18	Other services	-	28,350	-	45	-	14	28,305
19	Total	**7,587**	**655,924**	**1,016**	**1,492**	**-**	**1,431**	**661,003**

Credit Quality of Exposures by geography (template 13 EU CR1-C) 31 December 2016 £'000								
		A	B	C	D	E	F	G
		Gross carrying values of		Specific credit risk adjustment	General credit risk adjustment	Accumulated write-offs	Credit risk adjustment charges	Net values (a+b-c-d-e)
		Defaulted exposures	Non-defaulted exposures					
11	Total	7,587	583,936	1,016	1,492	-	-	589,015

Ageing of past-due exposures (template 14 EU CR1-D) 31 December 2016 £'000							
		A	B	C	D	E	F
		Gross carrying values					
		< 30 days	> 30 days < 60 days	> 60 days < 90 days	> 90 days < 180 days	>180 days < 1 year	> 1 year
1	Loans	7,040	1,235	735	4,720	1,753	277
2	Debt Securities	-	-	-	-	-	-
3	Total exposures	7,040	1,235	735	4,720	1,753	277

Non-performing and forborne exposures (template 15 EU CR1-E) 31 December 2016 £'000														
		A	B	C	D	E	F	G	H	I	J	K	L	M
		Gross carrying amount of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
			Of which performing but past due > 30 days and < = 90 days	Of which performing forborne	Of which non-performing				On performing exposures		On non-performing exposures		On non-performing exposures	Of which forborne exposures
						Of which defaulted	Of which impaired	Of which forborne		Of which forborne		Of which forborne		
010	Debt securities	13,249	-	-	-	-	-	-	-	-	-	-	-	-
020	Loans and advances	590,860	310	2,348	8,116	6,750	1,366	-	-	-	1,016	-	-	-
030	Off-balance-sheet exposures	72,896	-	-	-	-	-	-	-	-	-	-	-	-

Accumulated provision reflects the specific provisions.

Changes in stock of general and specific credit risk adjustments (template 16 EU CR2A) 31 December 2016 £'000		A	B
		Accumulated specific credit risk adjustment	Accumulated general credit risk adjustment
1	Opening Balance	100	1,047
2	Increases due to amounts set aside for estimated loan losses during the period	986	445
3	Decreases due to amounts reversed for estimated loan losses during the period	(70)	-
4	Decreases due to amounts taken against accumulated credit risk adjustments	-	-
5	Transfers between credit risk adjustments	-	-
6	Impact of exchange rate differences	-	-
7	Business combinations, including acquisitions and disposals of subsidiaries	-	-
8	Other adjustments	-	-
9	Closing balance	**1,016**	**1,492**
10	Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	-	-
11	Specific credit risk adjustments directly recorded to the statement of profit or loss	-	-

Changes in stock of defaulted loans and debt securities (template 17 EU CR2 B) 31 December 2016 £'000		Gross carrying value defaulted exposures
1	Opening balance Defaulted loans and debt securities at 31 December 2015	147
2	Loans and debt securities that have defaulted since 31 December 2015	7,587
3	Returned to non-defaulted status	(147)
4	Amounts written off	-
5	Other charges	-
6	Closing balance Defaulted loans and debt securities at 31 December 2016	**7,587**

There has been no change in the Bank's use of credit mitigation techniques in 2016. The Bank uses collateral deposits from SME customers in a small number of cases as a credit mitigation method. These cash deposit totalled £0.4m at 31 December 2016 (2015: £2.3m). With the exception of these deposits, credit conversion factors are applied to the Bank's total on balance sheet exposure.

Credit risk mitigation techniques overview (template 18 EU CR3) 31 December 2016 £'000		A	B	C	D	E
		Exposures unsecured: carrying amount	Exposures to be secured	Exposures secured by collateral	Exposures secured by financial guarantees	Exposures secured by credit derivatives
1	Loans				-	-
	To non-financial customers	1,112	72,986	589,395	-	-
3	Total exposure	**1,112**	**72,986**	**589,395**	**-**	**-**
4	Of which defaulted	-	-	6,585	-	-

Exposures to be secured represents loan commitments
Exposures unsecured includes £998k of assets represents fixed assets and other debtors
Loan values are net of specific provisions

Credit risk exposure and credit risk mitigation (CRM) effects (template EU 19 CR4) 31 December 2016 £'000							
		A	B	C	D	E	F
	Asset Classes	Exposures before CCF and CRM		Exposures post CCF and CRM		RWA and RWA density	
		On balance sheet amount	Off balance sheet amount	On balance sheet amount	Off balance sheet amount	RWA	RWA density
7	Corporates	31,226	10,334	31,226	10,334	29,175	70%
9	Secured by mortgages on immovable property	536,991	60,904	536,991	60,904	330,045	55%
10	Exposures in default	6,585	-	6,585	-	6,585	100%
11	Higher-risk categories	14,707	1,748	14,707	1,748	23,372	142%
16	Other assets*	998	-	998	-	1,328	133%
17	**Total**	**590,507**	**72,986**	**590,507**	**72,986**	**390,505**	**59%**

*other assets includes the Bank's fixed assets

Appendix 3

Counterparty Risk

Analysis of Counterparty Credit Risk (CCR) exposure by approach (template 25 EU CCR1)
31 December 2016 £'000

		A	B	C	D	E	F
		Replacement cost	Potential future exposure	EEPE	Alpha used for computing regulatory EAD	EAD post-CRM	RWA
1	SA-CCR (for derivatives	-	150		1.4	155	75
2	Internal Model Method (for derivatives and SFTs)			-	-	-	-
3	Simple Approach for credit risk mitigation (for SFTs)					-	-
4	Comprehensive Approach for credit risk mitigation (for SFTs)					-	-
5	VaR for SFTs					-	-
6	Total						75

Credit Valuation Adjustment (CVA) Charge (template 26 EU CCR2)
31 December 2016 £'000

		A	B
		EAD post-CRM	RWA
1	Total portfolios subject to the Advanced method	-	-
2	(i) VaR component (including 3*multiplier		-
3	(ii) Stressed VaR component (including the 3* multiplier)		-
4	All portfolios subject to the Standardised method	150	75
EU4	Based on original exposure method	-	-
5	Total subject to the CVA capital charge	150	75

The Bank's credit Valuation Adjustment capital charge has not changed significantly over the past twelve months.

The Bank has no exposure to counterparty credit risk to central counterparties as defined in template 27 EU CCR8 (exposures due to operations, margins, contributions to default funds) and has therefore not reproduced this table.

Impact of netting and collateral for exposures to CCR (template 31: EU CCR5A)
31 December 2016 £'000

	A	B	C	D	E
	Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held	Net credit exposure
Total	-	-	-	-	-

Composition of collateral for CCR exposure (template 32: EU CCR5B)
31 December 2016 £'000

	A	B	C	D	E	F
	Collateral used in derivative transactions				Collateral used in SFTs	
	Fair value of collateral received		Fair value of posted collateral			
	Segregated	Unsegregated	Segregated	Unsegregated	Fair value of collateral received	Fair value of posted collateral
Total	-	-	-	-	-	-

The Bank has not posted or received any collateral in respect of its derivative transactions

Appendix 4

Board Committees Terms of Reference

Audit Committee

The Audit Committee has been established by the Board to provide an independent interface with the external auditors, to direct the work of the Internal Audit and to provide oversight of the Bank's control environment.

Membership and Meetings

The Committee shall be appointed by the Board. All members of the Committee must be non-executive directors of the Bank. A quorum shall be a minimum of two members.

The Committee will hold meetings as required, but normally quarterly. Meetings may be held in person, by telephone, fax or email as the Committee may decide.

Responsibilities

The Committee will:

a) Consider and recommend for approval by the Board the following policies:

   a) Non-Audit Services Policy

External Audit

b) Hold annual meetings with the External Auditors

c) Consider the appointment (and on an annual basis the re-appointment) of the External Auditors to the Company and review their performance.

d) Following the detailed review of (c) above make a recommendation to the Board to either
   a. Renew the appointment of the current auditors of
   b. Instigate such processes as are necessary to effect a change in the auditing arrangements

e) Recommend the audit fee and terms of engagement to the Board.

f) Consider and approve the Bank's policy in relation to non-audit services.

g) Consider objectivity/independence and obtain confirmation from auditor.

h) Review and approve audit plan and scope of audit work

i) Review the draft annual accounts and audit report and recommend approval to the Board of Directors.

j) Review any management points identified by the auditors.

Internal Audit

k) Establish an overall work programme for the Internal Audit function.
l) Review and approve the audit plan and scope of audit work

m) Review and discuss all reports produced by Internal Audit.

n) Consider the appointment (and on an annual basis the re-appointment) of the Internal Auditors to the Company and review their performance.

o) Following the review detailed in (n) above make a recommendation to the Board to either
   a. Renew the appointment of the current auditors or
   b. Instigate such processes as are necessary to effect a change in the auditing arrangements

Control Environment

p) Review and assess the effectiveness of the Bank's control environment

The Committee shall make recommendations to the Board as appropriate on the above.

<u>Delegated Authority</u>

The Committee is authorised by the Board to handle any activity within its Terms of Reference. It is authorised to seek any information it requires from any employee and all employees are directed to co-operate with any request made by the Committee.

The Committee is authorised by the Board to obtain external legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

<u>Limitations on Authority</u>

The Committee shall have no authority to commit the Company to unbudgeted expenditure or new areas of activity other than where delegated to do so by the Board.

<u>Reporting</u>

The Committee will maintain Minutes and these will be copied to the Board.

<u>Review</u>

The Terms of Reference for the Committee will be reviewed annually.

Nominations and Remuneration Committee

The Nominations and Remuneration Committee has been established by the Board to oversee the appointment, remuneration and other benefits of all Directors and Executive Management and to make recommendations as appropriate to the Board concerning such matters.

<u>Membership and Meetings</u>

The Committee shall be appointed by the Board. All members of the Committee shall be non-executive directors of the Bank. The Chief Executive Officer may attend meetings, or parts of meetings, as required. A quorum will be a minimum of two members.

The Committee will hold meetings at least annually but as required. Meetings may be held in person, by telephone, fax or email as the Committee may decide.

<u>Responsibilities</u>

The Committee will:

a) Review the structure, size and composition required of the Board.

b) Consider the appointment of new Executive and Non-Executive Directors.

c) Prepare all new Directors and Executive Management contracts and/or remuneration arrangements.

d) Review all Directors and Executive Management's remuneration arrangements.

e) Oversee and implement the operation of the Annual Bonus Scheme and any discretionary bonus payments.

f) Review annually all staff remuneration levels together with the Chief Executive Officer.

g) Ensure all responsibilities are undertaken with due consideration given to the Bank's Strategic plan, its Business Plan, Board approved policies and conduct risks, specifically those associated with remuneration.

h) Consider the Remuneration policy for recommendation to the Board for approval.

The Committee shall make recommendations to the Board as appropriate on the above.

<u>Limitations on Authority</u>

The Committee shall have no authority to commit the Company to unbudgeted expenditure or new areas of activity other than where delegated to do so by the Board.

<u>Delegated Authority</u>

The Committee is authorised by the Board to handle any activity within its Terms of Reference. It is authorised to seek any information it requires from any employee and all employees are directed to co-operate with any request made by the Committee.

The Committee is authorised by the Board to obtain external legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

<u>Reporting</u>

The Committee shall maintain Minutes and these will be copied to the Board.

<u>Review</u>

The Terms of Reference for the Committee will be reviewed annually.

Risk and Compliance Committee

The Risk and Compliance Committee has been established by the Board to determine a structure for risk management to operate effectively and ensure that the Company operates within the overall risk appetite approved by the Board, in order to achieve its business/corporate objectives. The committee will also provide oversight of the Bank's Risk and Compliance function.

<u>Membership and Meetings</u>

The Committee shall be appointed by the Board and shall comprise of Non-Executive Directors – John McGuire (Chairman), Simon Moore, Paul ffolkes Davis, Chris Malyon and Ian Smith. A quorum shall be three members of whom a minimum of two are not members of the Credit Committee.

The Committee will normally hold meetings monthly and report to the Board at each Board meeting.

Responsibilities

The principle objectives of the Committee are to identify, control and manage the risks inherent in the Company (including conduct / compliance risk) ensuring that these risks are fully documented for approval, and to recommend to the Board an appetite of risk statement.

Other responsibilities will include:

a) To review the Risk Register.

b) To Approve the Terms of Reference and responsibilities of the Credit Committee and the Assets and Liabilities Committee (ALCO) and receiving minutes from these Committees.

c) Consider and recommend for approval by the Board the following policies:

- Anti-Bribery and and Corruption
- Anti-Fraud
- Anti-Money Laundering and Counter Terrorist Finance
- Complaint Handling
- Conduct Risk
- Counterparty
- Customer Acceptance and Identification Procedures
- Foreign Exchange
- Interest Rate Risk in the Banking Book
- IT and Data Protection
- Lending
- Liquidity
- Pillar 3
- Risk Management
- Trading

d) To approve any recommendations made by ALCO for amendments to the authorised list of counterparties and limits, to initiate any changes to this list and instruct ALCO to act accordingly.

e) To assess and sanction lending recommendations made by the Credit Committee that fall outside its delegated lending authority.

f) In order to consider these risks, to understand the strategies and business/corporate objectives, and the key factors used to measure performance.

g) To ensure that the Risk Management systems, including people and processes, are appropriately resourced.

h) To review risk related Management Information to understand and manage the overall risk position of the bank, making recommendations to the board as appropriate.

i) To ensure that the Company has a culture that promotes openness and challenge.

j) To ensure that the Company has a culture that embeds the principles of good customer outcomes and Treating Customers Fairly (TCF), and to provide oversight and Conduct Risk and TCF related Management Information to the Board.

k) To consider whether the Board is fulfilling its risk oversight obligations and to recommend any training needs, either for individuals or for the whole Board.

l) To consider any emerging or inter-related risks that may impact the Company and any training requirements as a result.

m) To ensure there is a satisfactory relationship with and between other areas of the business e.g. Strategy, Risk, Controls, Compliance, Remuneration and Resources.

n) Establish the overall work programme of the Compliance function

o) Review and discuss all reports produced by the Compliance function.

<u>Delegated Authority</u>

The Committee is authorised by the Board to handle any activity within its Terms of Reference. It is authorised to seek any information it requires from any employee and all employees are directed to co-operate with any request made by the Committee.

The Committee is authorised by the Board to obtain external legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

<u>Limitations on Authority</u>

The Committee has no authority to commit the Company to unbudgeted expenditure or new areas of activity other than where delegated to do so by the Board.

<u>Reporting Procedures</u>

The Committee shall maintain Minutes and theses will be copied to the Board.

<u>Review</u>

The Terms of Reference for the Committee will be reviewed annually.

Executive Committee

The Executive Committee is an Executive Committee established by the Board to manage the activities of the Company on an on-going basis, within the framework of the Business Plan and subject to the overall control of the Board.

<u>Membership and Meetings</u>

The Committee will consist of: the Chief Executive Officer (Chairman), the Chief Risk Officer, the Chief Financial Officer, the Chief Customer Officer. A quorum will be a minimum of two members, at least one of whom are the Chief Executive Officer or the Chief Finance Officer. The Committee will hold meetings as required, but normally at least monthly.

Where, because of staff holidays, absences through sickness, other unforeseen absences or emergencies a quorum of the Committee cannot be convened as required, then the Committee may itself co-opt additional members to remedy the position on a temporary basis. A majority of the Committee must approve the temporary appointments and the matter must be reported to the Board. The temporary appointments will be limited to such number of additional members as is required to make the Committee quorate, and shall continue for only so long as the situation which gave rise to the lack of quorum persists. On the temporary appointment terminating, the matter will be reported to the Board.

Regular attendance of business Directors who are members of the Business Management Group will be arranged as necessary on non-voting terms.

<u>Responsibilities</u>

The Committee will be responsible for:
Implementation of the strategic objectives of the Bank in accordance with the Business Plan and compliance with the Company's Budget

a) All day to day operational issues of the Bank which are delegated to the Business Management Group.
b) Reviewing draft Board papers prior to finalisation and submission to the Board
c) Creating, developing and recommending the ICAAP for Board approval
d) Approving the Terms of Reference and responsibilities of the Business Management Committee, the Product Committee and the Marketing Committee, and receive Minutes from these committees.
e) Ensuring all responsibilities are undertaken with due consideration given to the Bank's Strategic plan, its Business Plan, Board approved policies and good customer outcomes.
f) Formulation of the following policies for recommendation to the Board for approval:

   - Anti-Bribery and Corruption
   - Anti-Fraud
   - Anti-Money Laundering and Counter-Terrorist Finance
   - Board Governance and Control
   - Complaint Handling
   - Conduct Risk including Treating Customers Fairly
   - Conflict of Interest including Gifts and Hospitality
   - Corporate and Social Responsibility
   - Customer Acceptance and Identification Procedures
   - Data Retention
   - Environment and Sustainability
   - Expenditure Policy
   - Freedom of Information Act Policy
   - IT and Data Protection
   - Risk Management
   - Recruitment and Selection
   - Remuneration
   - Staff Rules and Regulations
   - Tax Risk
   - Whistleblowing

<u>Delegated Authority</u>

The Committee is authorised by the Board to handle any activity within its Terms of Reference. It is authorised to seek any information it requires from any employee and all employees are directed to co-operate with any request made by the Committee.
The Committee is authorised by the Board to obtain external legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

<u>Limitations on Authority</u>

The Committee shall have no authority to commit the Company to unbudgeted expenditure or new areas of activity other than where delegated to do so by the Board.

<u>Reporting</u>

The Committee shall provide Minutes of its own and sub committees and these shall be copied to the Board, together with a verbal report to each Board meeting as required.

<u>Review</u>

The Terms of Reference for the Committee will be reviewed annually.

Appendix 5

Risk Appetite Statements

The types of risk, to which the Bank is exposed are as follows:

- Strategic Risk
- Capital Risk
- Credit Risk
- Liquidity Risk
- Funding Risk
- Conduct Compliance and Regulatory Risk
- Operational Risk
- Market Risk, including Interest Rate Risk in the Banking Book (IRRBB)
- Treasury Counterparty Risk

The Risk Appetite statements below describe each risk, articulate the Bank's appetite and set out how performance against Risk Appetite is assessed and reported.

Strategic Risk

Strategic Risk for the Bank is the risk that it fails to execute its strategic plan due to either internal or external factors.

- the Bank has little appetite for significant variance from the strategic plan or budget, without Board approval. The Bank seeks to meet all promises to shareholders in terms of delivering strategy, budgets and published targets.
- the Bank only has an appetite for strategic risk where it supports its business model, sustainable growth, operational efficiency, high quality lending and a conservative approach to funding and liquidity.

Regular financial and balance sheet MI is presented to the Board to enable it to monitor actual performance against budgeted performance. In addition, any planned or inadvertent deviation from the agreed strategic plan is discussed by the Board.

Capital Risk

Capital Risk for the Bank is the risk that it fails to hold enough capital resources to meet its regulatory capital requirements.

- the Bank's Board will not accept a level of capital resources that is less than the regulatory capital requirement in either normal or stressed scenarios.
- the Bank will maintain a conservative level of tier one capital based on a percentage of risk weighted assets

On a monthly basis, both the Bank's capital adequacy position and a rolling 12 month forecast are produced and reported to ALCO and Risk & Compliance Committee members. Furthermore, an Early Warning Indicator (EWI) system is in place to highlight any potential future issues and prompt remedial action.

Credit Risk

Credit Risk for the Bank is the risk of a reduction in earnings, and/or value, as a result of a counterparty failing to meet, in a timely manner, a commitment that they have entered into with the Bank.

- the Bank has no appetite for arrears or bad debt that would create material volatility in earnings.
- the Bank has no appetite for unplanned material concentrations within its lending portfolios.
- the Bank has no appetite for unsecured lending.

The Bank's primary aim is to lend money to small and medium sized enterprises. It recognises that some losses are inevitable through the full range of the economic cycle, but desires low overall losses and stable earnings in line with its strategic risk appetite.
The Bank has implemented portfolio level protocols across its major business lines, setting out limits and EWIs on credit risk and portfolio concentrations. Key Risk Indicators (KRIs) relating to the lending book are produced and reported on a daily basis. Furthermore, risk positions are reported monthly to Credit Committee and Risk & Compliance Committee members.

Funding Risk

Funding Risk for the Bank is the risk that it is unable to raise funds at an acceptable price or to access markets in a timely manner.

- the Bank's funding Risk Appetite is defined as ensuring that the Bank has access to sufficient and diverse financial resources (in terms of source, type and tenor) to fund the Bank and maintain a sound level of liquidity.

At all times the Bank requires that it has sufficient liquid assets to meet its liabilities as and when they fall due. To ensure that this is the case over the longer term, the Bank seeks to ensure that there are no significant spikes of refinancing risk exposure, that there is a long maturity profile of liabilities and that excessive concentrations of depositor types, deposit tenors and deposit maturity dates are avoided. Risk exposures are monitored daily and reported monthly to both ALCO and Risk & Compliance Committee members. The Bank monitors funding risk using a range of sources and metrics including the ratio of deposits to loans.

Liquidity Risk

Liquidity Risk for the Bank is the risk that it is unable to meet its short to medium term commitments as they fall due or that they can only be met at an uneconomic price.

- At all times the Bank requires that it has sufficient liquid assets to meet its liabilities when they fall due.

To ensure that this is the case over the short to medium term, the Bank seeks to attract liquidity from a diverse range of sources and monitors day to day liquidity against indicators including:

- The CRD IV Liquidity Coverage Ratio; and
- The Survival Days measure.

Risk exposures are monitored daily and reported monthly to ALCO and Risk & Compliance Committee members.

Conduct, Compliance & Regulatory Risk

Conduct Risk for the Bank is the risk that its customers suffer loss or detriment due to failures in product design, sales marketing processes and operational delivery or failures in the behaviour or ethics of its staff or its third party distributors / suppliers.
Compliance & Regulatory Risk is the risk that non-compliance with laws or regulation could give rise to fines, litigation, sanctions and the potential for material adverse impact on the Bank.

- the Bank has zero tolerance for any material breach of laws or regulations. The Bank defines "material" as being of a significance that would expose the Bank or its management to legal or regulatory sanction.
- the Bank has zero tolerance for any consciously unfair treatment of customers. Any accidental unfair treatment will be remediated as soon as the Bank becomes aware and root cause analysis undertaken to prevent recurrence.
- the Bank seeks at all times to protect its good name in the management of the Bank and its customer relationships.
- the Bank has zero tolerance for any consciously unethical behaviour by its staff. Again, any unconsciously unethical behaviour will be remediated and subject to root cause analysis to prevent recurrence.

Oversight of Conduct, Compliance & Regulatory Risk is provided by a number of bodies including: Audit Committee, Risk & Compliance Committee, Executive Committee, Product Committee and the Compliance Team. Regular MI is provided to both Risk & Compliance Committee and Audit Committee.

Operational Risk

Operational Risk for the Bank is the risk that failures arising from inadequate or failed internal processes, people and systems or from external events that may cause monetary loss, service disruption or customer detriment.

- the Bank accepts that operational risk cannot be fully eliminated and applies a cost/benefit approach to limit its exposure with a focus on protecting its earnings, information assets, customer service, legal and regulatory compliance, and reputation.
- the Bank has a minimal appetite for failures caused by inadequate systems, processes or procedures that could materially impact its ability to service customers

The Bank has a low tolerance for operational losses; however, the Bank recognises that some operational losses are inevitable. Both losses and near misses are reported to Risk & Compliance Committee.

The Bank continues to invest in data and IT security. The Bank have adopted the UK Government's recommended Cyber Essentials security framework and have achieved the Cyber Essentials Plus accreditation demonstrating we have the appropriate controls in place to meet regulatory requirements and mitigate the risk posed by cyber criminals. An IT Security Specialist, Ken Munro of Pentest Partners, was appointed as Special Advisor to the Board in 2015 to advise on matters of Cyber Threat and Data Security to ensure that the Bank remains well prepared to face these significant risks. All staff have received training and attended presentations during 2016 to ensure they remain aware of the threat of cyber attacks and the detective and preventative measures they can employ.

Market Risk, (this includes Interest Rate Risk in the Banking Book (IRRBB))

Market Risk for the Bank is the risk that changes in market rates negatively impact the earnings or market value of the Bank's assets or liabilities.

Market Risk can take many forms, but the Bank's only significant exposure relates to IRRBB.
The Bank monitors its exposure to changes in interest rates based on two measures:

- Repricing risk exposure – the exposure to timing mismatches between when assets and liabilities re-price; and
- Basis Risk exposure – the exposure to assets and liabilities being linked to different interest rate bases (Bank Base Rate, LIBOR etc.), which do not move in parallel with each other.

All risk limits are monitored regularly and reported monthly to both ALCO and Risk & Compliance Committee members.

Treasury Counterparty Risk

Treasury Counterparty Risk for the Bank is the risk of wholesale Treasury counterparties being unable or unwilling to meet a commitment that they have entered into with the Bank.

- The Bank has a zero tolerance for losses relating to the failure of treasury counterparties.

As such, the Bank will only invest in institutions that meet minimum credit quality criteria. In addition, no limit for an individual counterparty or group of related counterparties, will exceed 100% of the Bank's capital except for limits to zero risk-weighted Central Banks and Sovereigns.

The risk exposure limits are monitored daily and performance against these is reported monthly to both ALCO and Risk & Compliance Committee members.

Embedding of Risk Appetites within the Business

- ### Strategic Planning

The Bank's risk appetite is a key input into strategic and financial planning decisions. Risk appetite tolerances are also tested in the stress testing work undertaken relating to the adequacy firm's capital and liquidity requirements. This allows the Bank to compare its appetite for risk with its capacity to take risk.

- ### Risk Limits

The Bank's risk appetite statements, both overarching and supporting, are linked to the day-to-day running of the business through individual Key Risk and Early Warning Indicators, which are managed through policies and protocols under the oversight of the Board and its sub-committees.

- ### Management Information

In order to monitor the Bank's performance against stated risk appetites, the Board and its sub-committees receive regular management information containing key current and forecast metrics linked to the risk appetite statements.