

PROUDLY  
DIFFERENT.

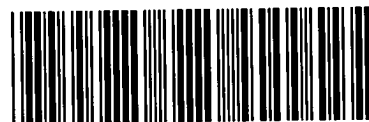
Shawbrook Group plc  
Annual Report & Accounts 2017



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Annual Report & Accounts 2017

**Proudly different.**

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## Contents

### Strategic report

The Strategic report provides readers with a holistic picture of Shawbrook's business model, strategy, 2017 performance and future prospects.

03	The difference in being different
04	Basis of preparation
07	Our Business
09	Chairman's Statement
10	Chief Executive Officer's statement
11	Our strategy
12	Our business model
14	Business review
21	Risk management report
36	Corporate social responsibility

### Corporate Governance Report

In this section we set out our commitment to the highest standards of corporate governance in line with UK best practice, our approach to remuneration and Directors Responsibilities.

38	Corporate Governance Report
39	Board of Directors
68	Directors' Remuneration Report
74	Directors' Report
78	Statement of Directors' Responsibilities
79	Independent Auditor's Report

### Financial Statements

The financial statements comprise of the statutory financial statements and notes to the accounts for 2017.

86	Consolidated statement of profit and loss and other comprehensive income
87	Consolidated and Company statements of financial position
88	Consolidated statement of changes in equity
89	Company statement of changes in equity
90	Consolidated and Company statement of cash flows
91	Notes to the financial statements
155	Glossary

## THE DIFFERENCE IN BEING DIFFERENT

**Shawbrook is a growing UK specialist bank. Our approach to lending and savings is founded on the simple and good old-fashioned quality of good sense.**

What sets us apart is the deep relationships we develop with our customers and business partners. We take the time to get to know them; we learn more about their specific needs and this allows us to identify and tailor the products that will help them to maximise their opportunities.

Our chosen target markets are selected carefully and are ones that are poorly served by the mainstream banks. We are determined to support our customers and business partners by being highly engaged, straightforward, agile and easy to do business with.

Drawing on a deep understanding of our clients' businesses and our specialist knowledge, we offer a clear proposition and certainty in the markets in which we operate.

We use our experience and judgement to make decisions that balance risk, return and customer needs.

**Shawbrook – Proudly different.**

## Basis of preparation

The statutory results have been prepared in accordance with International Financial Reporting Standards (IFRS). Where appropriate, certain aspects of the results are presented to reflect the Board's view of the Group's underlying performance without distortions caused by non-recurring items that are not reflective of the Group's ongoing business activities.

Underlying results should be considered in addition to, and not as a substitute for, the Group's statutory results, and the Group's presentation of underlying results should not be construed as an indication that future results will be unaffected by exceptional items. Underlying results have limitations as analytical tools, and they should not be considered in isolation or as substitutes for analysis of the Group's results as reported on a statutory basis. Limitations may include, but are not limited to, the following:

- > they may not reflect every cash expenditure, future requirements for capital expenditure or contractual commitments; and
- > they may not reflect the impact of earnings or charges resulting from matters the Directors consider not to be indicative of ongoing operations.

Because of these limitations, underlying results are not intended as an alternative to the Group's statutory results or as an indicator of the Group's operating performance. The Group compensates for these limitations by using underlying results, along with other comparative tools, together with statutory results, to assist in the evaluation of operating performance.

The following items have been excluded from underlying results:

- > Costs of £13.2 million include expenses incurred during the year in relation to the offer from Marlin BidCo for the entire share capital of Shawbrook Group plc.
- > IFRS 2 charges amounting to £5.9 million were recognised in 2017 in respect of share-based awards made to employees that vested on Marlin BidCo gaining control of Shawbrook Group plc. IFRS 2 charges recognised in 2016 amounting to £2.2 million related to share-based awards to Steve Pateman, Chief executive Officer, which were fully satisfied by Special Opportunities Fund (Guernsey) LP. This was the result of a one-off award for compensation against forfeited long-term incentives at a previous employer.
- > Corporate activity costs of £0.4 million in 2017 relate to the cost of the incremental deposits raised to prefund the acquisition of a c.£190 million portfolio of property loans at the end of Q3 2017, which completed at the end of November 2017. In 2016 the costs of £1 million related to the cost of the incremental deposits raised to prefund the acquisition of the c.£300 million portfolio of property loans at the end of 2015, which completed in H2 2016. In both instances, during the period between acquisition and completion, the portfolio was funded by the vendor due to the length of the transition period, and reimbursed by Shawbrook, thus resulting in Shawbrook paying to fund the portfolio twice.

International Organisation of Securities Commissions regulation does not permit adjustment for items that are reasonably likely to occur in the foreseeable future, or activities that affected the entity's recent past, when considering underlying results as in their experience there are rarely circumstances where an explanation is sufficiently robust to result in restructuring costs or impairment losses being described as non-recurring. In addition, European Securities and Markets Authority regulation states that items which affected past periods and will affect future periods – such as restructuring costs or impairment losses – will rarely be considered as non-recurring, infrequent or unusual.

# Shawbrook Group plc – 2017 Annual Report and Accounts

## Profit and loss

	2017 (£m)	2016 (£m)
Interest income, net fee and operating lease income	314.7	292.7
Interest expense and similar charges	(76.0)	(83.1)
<b>Net operating income</b>	<b>238.7</b>	<b>209.6</b>
Costs and provisions for liabilities and charges	(128.9)	(97.1)
Impairment losses on financial assets	(23.3)	(24.3)
<b>Statutory profit before taxation</b>	<b>86.5</b>	<b>88.2</b>
Income tax charge	(25.3)	(23.4)
<b>Statutory profit after taxation, attributable to owners</b>	<b>61.2</b>	<b>64.8</b>

## Underlying adjustments

Project Marlin costs	13.2	-
IFRS 2 charge	5.9	2.2
Corporate activity costs	0.4	1.0
<b>Underlying profit before taxation</b>	<b>106.0</b>	<b>91.4</b>
Income tax on an underlying basis	(26.8)	(24.3)
<b>Underlying profit after taxation, attributable to owners</b>	<b>79.2</b>	<b>67.1</b>

## Comparison of statutory KPIs to underlying KPIs<sup>1</sup>

	2017		2016	
	Statutory	Underlying	Statutory	Underlying
Gross asset yield (%)	7.1	7.1	7.8	7.8
Liability yield (%)	(1.7)	(1.7)	(2.2)	(2.2)
Net interest margin (%)	5.4	5.4	5.6	5.6
Management expenses ratio (%)	(2.9)	(2.5)	(2.6)	(2.5)
Cost of risk (%)	(0.53)	(0.53)	(0.64)	(0.64)
Return on lending assets before tax (%)	2.0	2.4	2.3	2.4
Return on lending assets after tax (%)	1.4	1.8	1.7	1.8
Return on tangible equity (%)	15.1	19.5	18.8	19.4
Cost to income ratio (%)	54.0	45.9	46.3	45.1
Average principal employed (£m)	4,424.9	4,424.9	3,769.3	3,769.3
Customer Loans (£m)	4,880.4	4,880.4	4,088.5	4,088.5

<sup>1</sup> Refer to the Glossary on page 155 for KPI definitions and calculations.

## How we've done 2017 key highlights

### How we have delivered against our strategic pillars

Achieve strong risk-adjusted returns

5.4%  
Stable NIM<sup>1</sup> throughout 2017

Maintain excellent credit quality

53bps  
Cost of risk

Progressively increase originations

20%  
Increase in loan book to £4.9bn

Maintain conservative foundations

12.9%  
CET1 ratio

19.1%  
Total Capital Ratio

Enhance customer focus

89%  
Customer satisfaction  
(\* As conducted in our 2017 Charterhouse survey))

<sup>1</sup> Refer to the Glossary on page 155 for definitions

## Our Business

### What we do

Shawbrook is a specialist UK lending and savings bank focused on Property Finance, Business Finance and Consumer Lending and savings. We differentiate ourselves by concentrating on markets where our specialist knowledge, judgement and personalised approach to underwriting offers us a competitive advantage. This supports attractive, stable returns and sustainable growth, and also benefits businesses and consumers in parts of the market which continue to be poorly served by mainstream banks.

## Our divisions

### Property Finance

The Property Finance division has a well diversified product range with both residential and commercial mortgage offerings.

**£3.2bn**

Customer loans

### Business Finance

The Business Finance division offers an extensive product range, enabling it to provide a comprehensive suite of services to address the needs of the UK SME market.

**£1.1bn**

Customer loans

### Consumer

The Consumer division offers a broad range of lending and savings products enabling it to provide unsecured loans to consumers for a variety of purposes in addition to a range of savings products.

**£0.6bn**

Customer loans

## Our people and community

671

Employees  
(period average)

52

Charities  
supported

58% M 42% F

Gender split

## Our five strategic pillars

- Achieve strong risk adjusted returns
- Maintain excellent credit quality
- Progressively increase originaations
- Maintain conservative foundations
- Enhance customer focus

## Our differentiated approach

The Shawbrook way  
A customer led approach...

Specialists

Thoughtful decision making through judgement

Driven by customer needs

Innovative and tailored products

Focus on quality

## Our values

**We are Expert** - We are quietly confident and enabling.

**We are Driven** - We are ambitious and passionate.

**We are Practical** - We are down to earth and pragmatic.

**We act with Integrity** - We are thoughtful and responsible.



## Chairman's statement

Iain Cornish

I am delighted to introduce this year's Annual Report & Accounts, in what has been another successful year for the Group in 2017, with continued growth across the business.

The Group has achieved a strong performance, with underlying profit before tax of £106 million and an underlying return on tangible equity of 19.5%. We are confident that our clear and consistent strategy and the disciplined implementation of our business model will ensure we continue to support our clients and generate good returns even in a more uncertain environment.

### Accelerating our strategy

Clearly a significant event in 2017 has been the Board's decision ultimately to accept a bid from the Marlin consortium (a private equity consortium of Pollen Street Capital and BC Partners). Throughout the offer process the Board considered the interests of the independent shareholders and other stakeholders at every phase, and notwithstanding the significant time consumed by this, the Executive management team did a tremendous job in continuing to keep focussed on the progression of the business.

### Commitment to strong Governance

The Board's responsibility to provide strong and effective governance remains paramount. Throughout 2017 we aligned to the provisions included within UK Corporate Governance Code (the 'Code') as detailed within the Corporate Governance Report. We remain committed to strong governance standards and we have worked closely with our new shareholder to ensure that the Board can operate independently and continue to protect the interests of all stakeholders.

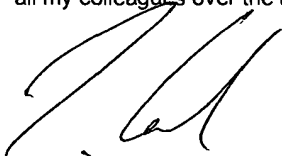
During 2017, the Board welcomed the appointment of Andrew Didham, Independent Non-Executive Director and Chairman of the Audit Committee, Cédric Dubourdieu, Non-Executive Director and Dylan Minto as Chief Financial Officer. I believe the Board is well placed to provide effective oversight of the Group in the delivery of its strategy.

### Our communities

We remain committed to investing in the communities we are a part of, whether that is within Shawbrook through development of our people; our local communities through volunteering and fundraising; or the broader UK economy through lending to businesses, landlords, house builders or personal customers. We are also committed to strong corporate responsibility.

### Outlook

I am highly confident in the capability of the Group, with an Executive Management team with strength and depth, and the excellence of colleagues throughout the business to continue delivering growth and value into the future. During the year I took the decision that with the change in ownership it was an appropriate time to step down. Finally, I would like to express my gratitude to all my colleagues over the last three years for the continual support they have given to me and to the Group.



Iain Cornish  
Chairman

## Chief Executive Officer's statement

Steve Pateman

### OPPORTUNITY

2017 was another year of considerable progress for Shawbrook and one of great change with the company accepting a bid from the Marlin Consortium valuing the company at c.£850m in July and de-listing its securities in August.

The change in ownership creates a stable and supportive shareholder base upon which to build a medium term plan to develop our existing business recognising the opportunities and challenges that will arise from the pace of technological change and how this impacts both our traditional distribution and servicing methodologies as well as the ongoing changes within the banking market as the mainstream banks refine their risk appetite, capital planning in preparation for Basel 4 and distribution leaving many business and personal customers looking for banking providers that have a more accommodating risk appetite.

Shawbrook was created to serve customer markets with an adjacent risk profile to the mainstream providers but to do so with thoughtful and considered underwriting rather than rely purely on scorecards, models and algorithms, all of which have a part to play in an effective risk management model; our approach to risk management was once again a core strength with our underlying cost of risk at 0.53% on a customer loan book which grew 20% to £4.9bn.

Our markets continued to be challenging reflecting the impact of high liquidity on both competitive pricing and risk appetite; by maintaining an appropriate discipline we were able to hold our NIM at 5.4% offsetting margin compression by improving funding costs.

Our Property business grew 27% to £3.2bn albeit adversely impacted in the final quarter by changes to our underwriting criteria in second charge mortgages; Consumer grew 33% to £0.6bn as our Personal and Retail Finance franchises gathered momentum whilst maintaining origination levels in our maturing Home Improvement and Holiday Ownership businesses. Business Finance held flat at £1.1bn and remained a highly competitive market whilst the Regional Business Centres continued to establish themselves, Specialist Asset Finance had a record year and was offset by a high level of redemption in Wholesale Finance where pricing has moved outside our return criteria.

We continued to bring new products to the market with the launch of the Motor Flexiloan in Consumer in partnership with the RAC, expansion of our first charge mortgage business into more complex mortgage products and the introduction of further specialist asset classes in Asset Finance, agriculture and renewables. Our Jersey business continued to grow and in December we completed the acquisition of the Royal Bank of Scotland International offshore portfolio in partnership with Investec. We have now staffed and opened seven Regional Business Centres and these will also house our growing Development Finance business which from a standing start in 2017 now has committed facilities of c.£110m. We also successfully adapted our buy-to-let business to the revised underwriting regulatory standards introduced in September.

Profitability was impacted by the one-off costs incurred on the change in ownership and on an underlying basis was up 16%; whilst the outlook for the economy is challenging reflecting the uncertainty around how the UK will exit the European Union and we would expect price and risk competition to remain intense, we believe that our product diversity will allow us to maintain our levels of organic growth and there will continue to be modest inorganic opportunities. Accordingly, we took the opportunity in December to strengthen our capital base with the successful issue of £125m of Additional Tier 1 securities.

Our strong income growth has allowed us to continue to invest in the franchise with headcount increasing to 671 (2016: 569). Our underlying cost to income ratio increased to 45.9% as we invested for the future and continue to plan to reduce this further to 35% by 2020, notwithstanding the investment required to maintain and enhance our IT architecture. The strong disciplines applied to capital allocation, underwriting and investment allowed us to deliver a RoTE of 19.5%, however we are carrying surplus levels of capital to support growth with a Total Capital Ratio of 19.1% and continue to target RoTE in the range of 22-25%.

I would like to close by thanking my colleagues for their contribution to the business over the last 12 months, to the Board for their continued support and to Iain Cornish whose counsel I will miss when he passes on the role of Chairman to his successor. Iain has guided the Group through a challenging period following the Initial Public Offering in April 2015 and it is appropriate to thank him for his contribution to the significant progress we have made in building the banking business we have today.



Steve Pateman  
Chief Executive Officer

## Our strategy

### Our five strategic pillars

### How we will achieve these

Achieve strong risk adjusted returns

- > Continue to identify specialist lending sectors
- > Achieve strong returns whilst maintaining high quality underwriting standards

Maintain excellent credit quality

- > Ensure that the loan book is sustainable over the long term when markets may not be so benign

Progressively increase originations

- > Increase organic originations
- > Continue to identify and carefully enter adjacent specialist markets
- > Further increase diversification

Maintain conservative foundations



- > Conservative approach to risk management
- > Prudently positioned capital, funding and liquidity

Enhance customer focus

- > The SME Champion – we meet the needs of poorly served markets
- > Consumer specialists – we serve sectors where our products and high degree of choice differentiate our offer
- > Exploit leading edge technology to enhance customer experience and drive efficiencies

**Our business model**  
A unique model  
for a 'proudly  
different bank'...

**We differentiate ourselves  
by concentrating on markets  
where our specialist knowledge  
and personalised approach  
to underwriting, offers us a  
competitive advantage.**

This supports attractive, stable returns and sustainable growth, and also benefits businesses and consumers in parts of the market which continue to be poorly served by mainstream banks. Fundamental to our success is a relationship focus which puts the interests of our customers and business partners at the heart of everything we do, built on a culture which stresses the use of our experience and judgement to make decisions that balance risk, return and customer needs.

## 1. The Shawbrook way. A customer led approach...



We use our expertise and judgement to make individual decisions that balance risk and return with customer needs.

## 2. where we leverage our key differentiators...

Our ability to serve markets where there is a structural supply and demand imbalance.

- |   |   |
|---|---|
| ■ Our people  | ■ Diversification across core asset classes and new markets |
| ■ Unique expertise  | ■ Specialist underwriting                                   |
| ■ Deep relationships with customers and business partners | ■ Thoughtful innovation                                     |

## Strategic report

## Corporate governance

## Financial statements

### 3. across our carefully selected markets...



Property Finance



Business Finance



Consumer Finance

### 4. to our customers...



SMEs



Landlords



Homeowners



Consumers



Savers

### 5. through direct and indirect channels...

Established distribution channels with wide reach through business partners, intermediaries and directly to customers.



Business partners / Customers

### 6. to create value for all our stakeholders.

**89%**

customer satisfaction<sup>1</sup>

Our customers

**84%**

partner satisfaction<sup>2</sup>

Our partners

**50+**

charities supported

Our communities

**Underpinned by exemplary risk management, strong governance and our pragmatic culture**

### How we create value



Customer deposits



Existing loan book OR Originations



Lend to poorly served customers



Interest charged



**Strong Returns**

<sup>1</sup> Charterhouse customer survey, Q4 2017.

<sup>2</sup> Property Finance partner surveys, Q2 2017 – Partner satisfaction regarding product proposition.

## Business review

### Property Finance

We provide finance to the specialist residential investment and commercial property market, to professional property investors and SME owner occupier together with a range of first and second charge and complex mortgages for personal customers.

#### Activity

The Property Finance Division has a well diversified product range with both residential and commercial mortgage offerings. Within these broad markets, we actively specialise in the following areas:

- > **Residential:** serving homeowners primarily through second-charge mortgages and specialist first-charge mortgages.
- > **Commercial:** serving property professionals in both residential and commercial investment markets through the provision of traditional mortgages and also through both short-term lending, and development finance to established SME house builders and well established SME owner occupiers.

The Division's products are distributed, in the main, through the mortgage intermediary market, leveraging long established relationships and a highly regarded brand.

#### Differentiation

The Property Finance division is our most mature business, built on foundations of strong, longstanding relationships with mortgage brokers and intermediaries, working hand in hand to deliver exceptional service and positive outcomes for our customers.

We have continued to develop our product range and innovate our approach so we can offer our customers more choice and a timely and well considered response. For example, during 2017, we introduced a new 'lending into retirement' mortgage proposition as well as a Complex first mortgage product whilst developing our award winning Electronic Application In Principle (EAIP) system, and expanding our distribution in both residential and commercial mortgages to leverage the broader Network distribution. Our Development Finance business agreed facilities of c.£110 million from a standing start.

Our specialist knowledge and deep sector expertise allow us to continue to provide thoughtful judgement and a personal service whilst utilising technology to support process improvements and response times. We operate selectively within extensive markets and our specialist approach continues to resonate with customers. Each loan is manually underwritten, allowing our teams to provide pragmatic and good sense solutions. As with all our divisions, we continue to maintain a sensible and clearly defined risk appetite which, allied to our robust underwriting processes, positions us appropriately through the cycle. The breadth of our product range, combined with the exceptional service levels delivered by our teams, continue to receive industry accolades. We received a total of 13 awards during 2017.

#### Residential

Our residential proposition remains predominantly focused on the second-charge mortgage market. We provide a wide range of secured loans, principally to prime borrowers for a variety of purposes including home improvements, loan consolidation and large consumer purchases.

During 2017, our second charge mortgage proposition has continued to evolve and we launched a broader suite of products and pricing points in December 2017. This new proposition provides the broker community and our customers with a clearer understanding of our risk appetite and has allowed us to become more competitive in the pricing options we are able to offer.

Whilst remaining committed to maintaining our prominent position in the second-charge mortgage market, we have made progress with our plans to diversify into specialist segments of the first-charge market. In 2017, we launched a range of 'lending into retirement' products and started to write complex first charge mortgages; we continue to explore other segments where our pragmatic approach can deliver good outcomes for carefully identified customer segments and would expect to launch further first charge propositions in 2018.

## Commercial

Our activity in the commercial markets remains focused on providing financing to property professionals for investment, refurbishment or redevelopment and to SMEs for owner-occupied property. Specialist buy-to-let (BTL) mortgages remain a significant part of our activity and we have seen strong growth during the year.

We have progressed with our ambition to develop a capability within the development finance market, and we have continued to build a dedicated and experienced team. Our early engagement in the market has reaffirmed our confidence in our product design and capability to offer a selective service to professional SME house builders, many of whom we have existing relationships with. Allied to the distribution reach we have with our intermediary partners, we have adopted a controlled entry into this market, validating our principles regarding risk appetite and customer service delivery. We will continue to expand this throughout 2018 and leverage the presence and profile of our Regional Business Centres (RBCs) network across the UK.

## Outlook

Whilst the BTL market is forecast to contract further in 2018 as a result of the cumulative effect of tax changes on investors, there will continue to be a positive shift towards the professional segment, in which we specialise, and this asset class remains an attractive one for long term investors underpinned by favourable supply/demand dynamics in UK housing; we would thus expect to be able to grow our share and flow whilst also looking at options to participate in the wider BTL market.

We have taken steps to improve the breadth and depth of our second charge portfolio of products and having undertaken a soft launch of our complex first charge products, would expect to expand this range in 2018 whilst building out options to respond to the impact of technology on the distribution of residential mortgages.

Development Finance offers significant opportunity as the Government seek to encourage supply of new housing and where smaller house builders continue to find it hard to access attractively priced and sensibly structured funding support; we have built a small business from scratch in a market that has annual flow of up to £3bn and are confident that by utilising the Group's RBC presence, we can scale this business towards a £1bn portfolio over the medium-term through a combination of organic growth and strategic partnerships.

## Business Finance

### Activity

Business Finance's primary focus is on providing debt based financing solutions to support SME businesses through a combination of asset finance, working capital finance, commercial mortgages and growth capital; finance is predominantly secured over a pool of assets.

Business Finance operates through:

- > **Regional Business Centres:** we have seven RBCs which provide our full suite of debt financing solutions to local SME's.
- > **Structured Finance:** provides finance to companies that in turn provide a mix of consumer and SME funding; finance is secured over a pool of portfolio receivables.
- > **Specialist Asset Finance:** leasing and hire purchase finance solutions in specialist UK SME market segments including marine and aviation, healthcare, taxis, technology, agriculture and renewables.
- > **Shawbrook International Limited:** provides a range of consumer, property and SME financing solutions in Jersey.

### Differentiation

Business Finance provides a range of debt based financing solutions targeted on the SME market working with companies whose risk profile or product needs sit outside the appetite or capabilities of the mainstream banking providers.

Whilst our focus remains predominantly on providing finance secured over fixed soft and hard assets, pools of receivables, or commercial property, we can provide unsecured working capital where there is evidence of sustainable earnings and growth capital to support expansion of an existing business helping to grow future earnings. The combination of our sector expertise and regional presence provide the foundation for thoughtful underwriting helping to provide solutions that meet the needs of our customers.

We believe that there is significant potential to develop our Business Finance proposition and we were pleased to appoint Ian Cowie as Managing Director, Business Finance in April; Ian brings considerable experience from his time with Royal Bank of Scotland where he led many of their corporate, commercial and asset financing businesses. Whilst competition and strong level of liquidity have challenged historic margins and risk appetite, there remains room for a specialist proposition and this was reflected in the maintenance of our NIM at 7%

### Regional Business Centres (RBCs)

In 2017, the Group developed the Regional Business Centre model establishing a network of seven centres in, Maidstone, Dorking, Bristol, Birmingham, Manchester, Leeds and Glasgow bringing together our existing field based sales teams in Asset and Invoice Finance. These new centres provide the foundations for a national network of teams providing advice, execution and in-life management for complex non-standard asset, working capital, property and growth finance solutions. New business is originated through direct channels, particularly as regional teams begin to integrate with local professional communities, and also through commission based intermediaries via broker managers based in each RBC.

The RBC network is at the heart of the Business Finance division, giving us a physical footprint across the UK, allowing us to work with businesses, brokers and advisors in their own communities. Investing in a physical presence and recruiting more specialists to supplement our existing teams are a clear sign of our commitment to this market.

### Specialist Asset Finance (SAF)

A portfolio of asset finance businesses offering solutions tailored to the specific dynamics of a number of niche and specialist markets, including agriculture, marine and aviation, healthcare, taxi, technology and paper professionals. Origination is both direct and via specialist brokers.

Across SAF, the balance of old and new businesses has delivered a real advantage. Technology is a new specialist sector for us but we have already delivered some significant and exciting transactions, which has given us real credibility in this market; similarly, with agriculture; our more established sectors including marine and aviation, healthcare and taxi have performed impressively, showing year on year growth of 32% and delivering some landmark transactions.



## **Structured Finance (SF)**

A London based team offering access to wholesale funding through both Block Discounting and Wholesale Finance facilities. Clients vary from early-stage fintech platform funders through to established regional specialist lending businesses. Origination is direct.

The SF business has faced significant pressures in its market throughout 2017, driven largely by aggressive pricing from a number of new and established providers, but across Wholesale and Block we have continued to attract and retain a high quality franchise with attractive risk and reward characteristics which is testament to the expertise within the team. Under new leadership, the team is now focussed on broadening its proposition whilst delivering the highest levels of service that has helped to set Shawbrook apart in this market.

## **Shawbrook International Limited (SIL)**

Shawbrook International houses the expansion of the complete Shawbrook proposition into the Channel Islands, where there is demand for our approach and portfolio of solutions. Able to draw upon the scale, expertise and capabilities of the wider Group, SIL is able to offer personal loans, asset finance, development finance and motor finance. SIL have also recently launched a partnership with Jersey Post which extends the reach and profile of the Group on the island. Deal flow is currently driven by brokers and intermediaries, but continued to focus on building the brand on the island is helping to establish SIL's direct proposition.

As SIL approaches its first anniversary, it is now looking to extend its reach into Guernsey after making significant progress in Jersey. The acquisition of the offshore asset finance loan book from Lombard, in partnership with Investec, was a significant event at the end of 2017 that gives SIL a step up in scale and presence.

## **Investing in a safe and sustainable model**

With the appointment of a new Director of Risk, our approach to risk and the way we now recognise, understand, manage and mitigate risks across the business has moved on considerably during the year. Adopting a risk based approach to client management, delivering a programme of continuous improvement in detecting and managing problem loans and generating enhanced risk management information and reporting gives us real confidence in our ability to deliver our products in the right way.

We have also completed the design and started the roll out of a new operating model to ensure greater customer focus, connectivity, consistency and operational efficiency across the Division. The RBCs are now responsible for the full life cycle of their customers, as is already the case in our SAF and SF businesses, and by being a more connected business we're concerned less about individual product lines and more about finding the right solution for each individual customer. Progress towards rolling out and embedding the new operating model and will continue throughout Q1 2018.

A new Business Finance induction programme is the most recent example of how we are working hard to support individuals as they develop their careers within Shawbrook, alongside initiatives to improve operational knowledge and to equip teams with the tools they need to succeed. Whether that's through core systems training, the investment in risk factor or the trial of Artesian and LinkedIn to support our originators.

## **Financials and KPIs**

Financial performance reflects the transitional nature of 2017 as the more immature areas of the business took time to establish themselves against the backdrop of increased liquidity and competition in the market, which particularly impacted the Wholesale and Block Finance businesses. Despite significant competitive pressures, our loan book and yield remained steady at £1.1bn and 8.2% respectively.

## **Outlook**

The foundations are now in place to effectively manage and grow Business Finance in 2018. Growth will come from a combination of developing the RBC's and their product portfolio, adding to and building on our specialist asset financing activities and creating a broader proposition in Wholesale and Block Finance.

## Consumer

The Consumer division has an extensive product range whilst allowing us to provide unsecured loans for a variety of purposes, in addition to a range of savings products for consumer and SME's. We distribute our products directly to customers and through strategic partners and intermediaries, using efficient systems, combined with human oversight to underwriting and the latest technology to give fast and fair credit decisions with transparent pricing.

Consumer Lending operates through relationships with major home improvement firms, in store and online retailers, carefully selected holiday ownership companies, loan broker partners, affinity partners and through our direct to consumer channel. Savings products are available directly to personal and business customers and through partners. The division is managed in four lending businesses; Home Improvement/Holiday Ownership (HIL/HOL), Personal Loans, Retail Finance and Motor Finance, alongside the Savings business.

### Differentiation

Shawbrook has a specialist and deep understanding of the consumer market, both in lending and savings. Our key differentiator remains our commitment to offer fair and transparent products and pricing to all customers.

The division's lending proposition has significant potential to grow as we develop and provide innovative solutions to our partners and customers enabling a seamless process for the provision of credit. Our advanced risk management and scoring techniques combined with our expert judgement allow us to make sensible lending decisions whilst providing the best possible outcome for our partners and customers.

In Savings, we maintain consistently competitive rates across our broad range of simple and straight forward retail deposit offerings, providing exceptional levels of service from our UK call centre. Our Savings franchise is not an advised service, and has no sales incentives. Our deposit book is fully administered in-house, which offers the advantage of rapid execution of decisions on pricing and service.

### Home Improvement/Holiday Ownership (HIL/HOL)

The HIL/HOL business provides unsecured financing for Home Improvement and Holiday Ownership purposes. We distribute our products through carefully selected partners, working closely with them to understand their needs and key customer demographics to ensure alignment with our own target markets. We continue to develop innovative solutions to enhance end customers' experiences and deliver a seamless and timely service.

During 2017, the business had to adapt to a number of changes in the market with headwinds primarily coming from suppliers who have found trading conditions increasingly difficult and an increased level of regulatory focus on certain areas of this market. Despite this, originations remained stable resulting in a modest increase in the loan book. In addition, we entered the USA holiday ownership market with our HOL proposition and have now started writing business for customers purchasing their property share across the Atlantic.

### Personal Loans

The Personal Loans market in the UK continues to be dominated by low representative teaser rates which are subsidised, in many cases, by a group of customers being offered much higher rates than those advertised. The Group's Personal Loans offering is built on the principles of fairness and transparency, providing a risk based pricing solution to consumers who may be unable to obtain the super prime loss leading rates available in the mainstream Personal Loans market.

Our Personal Loans are primarily distributed through broker and affinity partnerships and through our direct to consumer proposition. The market in which we operate is continuing to evolve rapidly through innovation and digitisation and we continue to be at the forefront of this evolution, building a strong presence with key digital partners such as ClearScore, Totally Money and Credit Matcher. All of our digital partners maintain a focus on working with customers to ensure they receive fair and transparent outcomes, in line with our own ethos. This has enabled us to achieve significant growth whilst remaining true to our strategy of putting the customer first and avoiding the misleading teaser rate market.

## Retail Finance

The Retail Finance business provides point of sale consumer finance in partnership with recognised retail brands both in store and online. We distribute our products directly through retailers as well as through a number of carefully selected intermediaries.

Throughout 2017, we have actively pursued our diversification strategy by deepening in our core markets and expanding into strategic areas such as motoring, online estate agencies, technology and furniture. In addition, we have been bold and innovative with new propositions such as financing for IVF which allows customers to fund their treatment and, if it is unfortunately unsuccessful, the loan is cancelled with no detriment to the customer. As a result, we have achieved significant growth in originations, supported by a reduction in application referral rates as we continue to roll out and embed our bespoke risk framework and systems.

## Motor Finance

In Q4 2017, we launched our inaugural Motor Finance proposition, the Flexiloan in collaboration with our affinity partner, RAC. As with all of our products, the Flexiloan was developed with the customer at the forefront of our mind. We recognise that every one of our customers is different and we therefore created a product which gives customers flexible options to ensure that the finance they acquire suits their own individual needs. Given this product is not only new to the Group, but unique in the Motor Finance market, we are actively pursuing a slow growth strategy which will enable us to obtain feedback on the proposition itself, the customer journey and the behaviour of the portfolio as it seasons and adapt elements where necessary.

## Savings

The Savings business provides a wide range of cash savings solutions, primarily targeting affluent UK consumers. The broad product range, which includes notice, fixed rate, cash ISAs and easy access products, has driven sustainable deposit growth by meeting a wider range of customer savings needs. During 2017, we have diversified and expanded our proposition through less traditional channels, partnering with highly regarded brands to enhance the offerings available to their customers and increase our customer base, thus reducing our reliance on best buy tables. These developments have contributed to an increase in our addressable market. Whilst the business attracts deposits from all customer demographics, a significant proportion of the customer deposit base continues to be sourced from affluent customers, with a wide range of savings needs and high average balances.

Our exceptional levels of customer service and satisfaction combined with a wide product range have translated into deeper relationships with our customers and our fair and transparent pricing across both existing and new customer segments has driven continued strong fixed rate retention performance.

Whilst we continue to generate new deposits predominantly through our direct online offering, we have continued to build our relationships with affinity partners and identify additional partners such as Hargreaves Lansdown who work alongside us to provide our offerings to their customer base. We will continue to identify and support new partners and relationships throughout 2018 to broaden our proposition and provide customers with optionality for their savings.

The transition towards a fully digitised savings business that is supporting the progressive growth of the balance sheet continued throughout 2017, with the launch of our first ever online only proposition in August 2017, which enabled record inflows in that month. In the early part of 2018, we are investing in our Savings platforms to ensure our capabilities provide customers with the level of service they expect from such a well known and well established brand.

## Outlook

The Consumer Credit market is subject to increasing regulatory focus as the levels of unsecured debt rise and the macroeconomic environment remains challenging. As the Bank Rate continues its upward trajectory, affordability may be squeezed and consumer confidence may fall.

The propositions we have developed at Shawbrook and the increased investment in our risk management systems and underwriting processes position us well to continue to grow in a controlled and sustainable manner, whilst providing customers with fair and transparent outcomes.

We continue to identify new partners who share our ethos and customer focus, allowing us to expand our distribution channels and increase our addressable market for each of our propositions. To support these new partnerships and growth opportunities, we will continue to enhance our decision making capabilities and will further develop our broker channel by gaining, maintaining and deepening relationships, building on the progress we made in 2017. We will look to enhance customer level pricing, credit risk and automated decision making, thus optimising acceptance rates and further improving customer journeys.

## TESTIMONIALS

### Property Finance Testimonial

*"In today's market you need a back that can keep up with the demands placed on its customers. Shawbrook understands these demands and removes a lot of the refinancing on a scale that the high street cannot match. Their continuing growth and support makes them the obvious choice for investors"*

**Geoff Knight, Joy International**

### RBC Customer – Business Finance Testimonial

*"The ongoing relationship is important to us. Since inception, the Shawbrook team has been actively engaged in what we are looking to achieve, providing a service that is supportive and pragmatic as well as flexible. With the transaction with Shawbrook completed, all of the constituent parts are now in place to deliver our next phase of strong commercial growth"*

**Graham Stott, Group Finance Director of Dudson Limited**

### SIL Customer – Business Finance Testimonial

*"The service was first class and we were able to get the equipment quickly and on competitive terms. I would have no hesitation in recommending Shawbrook."*

**Nick Mourant, Owner, Meleches Farms**

### Consumer Testimonial

*"Thank you superstars. This was the best experience ever. I honestly thought it was going to be a nightmare. It was so easy, so quick and everyone I spoke to were helpful. Cant rate them highly enough."*

**Anon, Trustpilot online review 13 November 2017**

## Risk management report

The Group seeks to manage the risks inherent in its business activities and operations through close and disciplined risk management which quantifies the risks taken, manages and mitigates them as far as possible and prices appropriately for the residual level of risk carried in order to produce an appropriate commercial return through the cycle.

The Group's approach to risk management continues to evolve and has benefited from further investment during 2017 in areas such as technology and information risk, credit grading in support of preparation for the introduction of IFRS9 and the Bank's key operating divisions to support the Group's growth plans. The Bank's Risk Management Framework was further enhanced in 2017 to reflect increased focus on the first line of defence in support of growth in digital channels, information risk, third party relationships and the maturity of the Group's conduct and compliance capabilities.

This enterprise wide Risk Management Framework is underpinned by the following key elements:

### Risk Strategy

The Risk Strategy sets out the risk management objectives which support the achievement of the Group's commercial goals and the operation of business activities which seek to deliver those aims. The Risk Strategy sets out which risks are to be acquired or incurred and how they will be managed by the organisation.

The strategic risk management objectives are to:
Identify material risks arising in the day to day activities and operations of the Group
Quantify the risks attaching to the execution of the Group's business plans
Set an appropriate Risk Appetite with calibrated measures and tolerance levels
Optimise the risk/reward characteristics of business written
Set minimum standards in relation to the acquisition, incurrence and management of risk
Secure and organise the required level and capability of risk infrastructure and resources
Undertake remedial action where any weaknesses are identified
Scan the external horizon for emerging risks

### Risk Appetite

The level of risk that the Group is willing to tolerate in operating the various elements of its business are defined in a Risk Appetite Statement, which is agreed by the Board and reviewed on a regular basis. This articulates qualitative and quantitative measures of risk which are cascaded across various areas of the Group's operations, calibrated by reference to the Group's absolute capacity for risk absorption, limit of appetite and target thresholds. During 2017 the Group commenced a full review of the Group Risk Appetite Framework incorporating greater alignment to the Group Risk management framework, enhancements in risk measurement and to reflect changes in the ownership of the Bank. The review includes a full annual review of the divisional and functional risk appetite statements.

### Risk Management Framework

All of the Group's business and support service activities, including those outsourced to third party providers or originated via brokers and other business intermediaries are executed within the parameters of a single comprehensive Risk Management Framework (RMF). This sets out minimum requirements and ensures consistent standards and processes are set across the organisation. Risks are identified, measured, managed, monitored, reported and controlled using the RMF. The design and effectiveness of the framework is overseen and reviewed by the Risk Committee. The key elements of the framework are set out later in this report.

### Governance

All the Group's risk activities are subject to detailed and comprehensive governance arrangements which set out how risk based authority is delegated from the Board to Executive management and the various Risk Management Committees and individuals. These bodies and senior officers are accountable and responsible for ensuring that the day to day risks are appropriately managed within the agreed Risk Appetite and in accordance with the requirements of the RMF. Escalation and reporting requirements are set out in risk policies and by the Risk Appetite thresholds.

## Risk management report (continued)

### Culture

The Group is led by an experienced Executive management team with a combination of significant underwriting expertise and institutional and regulatory banking experience at various major financial institutions and specialist lenders. This heritage provides the platform for a set of values and behaviours where the client is at the heart of the decision making process and business areas are held fully accountable for risk performance. At the individual level this process begins with the induction program and job descriptions; it is carried into the setting of individual objectives and performance reviews and ultimately reflected in the compensation and reward structure.

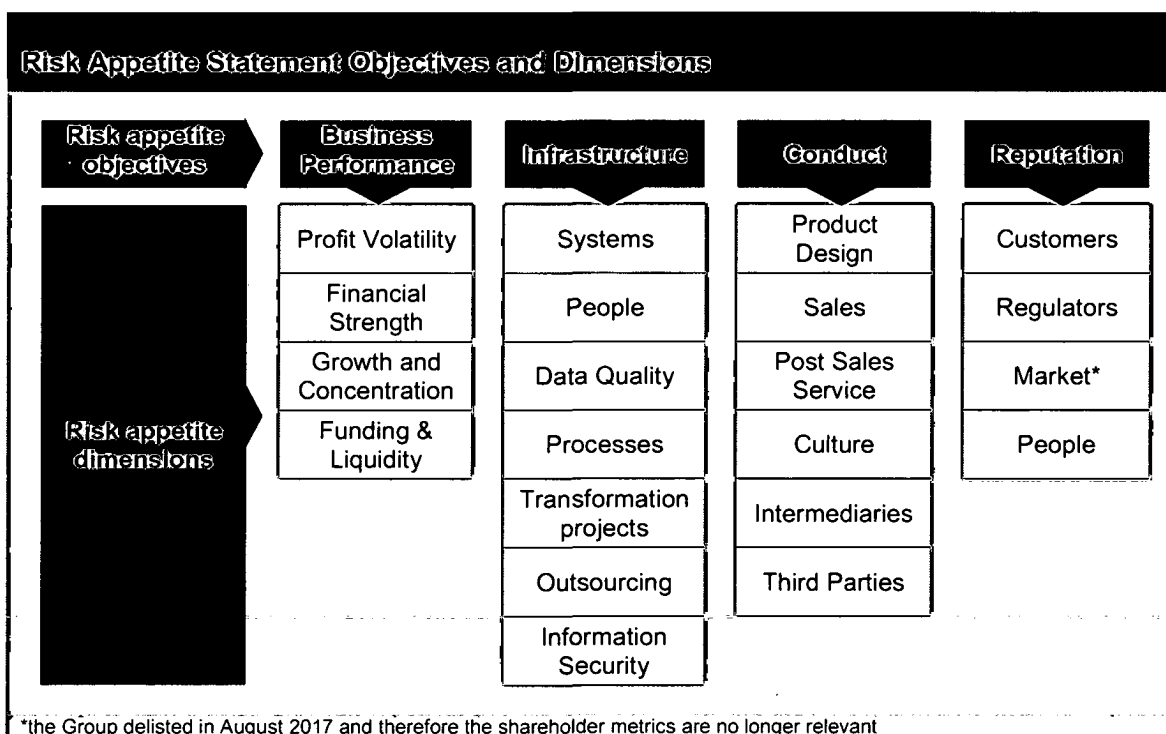
### Risk appetite statement

The Risk Appetite Statement (RAS) is a detailed and granular expression of the level of risk the Group is willing to accept in relation to the pursuit of its business strategy. The RAS is not static and will evolve to both reflect and support the Group's business objectives, the operating environment and risk outlook.

Whilst the RAS provides an aggregated measure of risk temperature and performance, it is not just a reporting tool. Just as importantly, it also provides a framework which is used dynamically to inform strategic and operational management decisions, as well as supporting the business planning process.

The RAS is reviewed periodically by the Risk Committee and agreed with the Board on an annual basis as a minimum. A dashboard with the status of each metric is monitored monthly. Executive management and the Board exercise their judgement as to the appropriate action required in relation to any threshold trigger breach, dependent on the scenario at the time.

The RAS identifies four groups of risk appetite objectives which are further subdivided into 21 appetite dimensions as set out diagrammatically below. A suite of qualitative statements and quantitative measures have been set for each dimension, with hard risk limits calibrated by reference to absolute capacity, maximum risk tolerance and a threshold trigger level.



## Risk management report (continued)

### Risk Management Framework (RMF)

Responsibility for risk management sits at all levels across the Group from the Board and Executive Committee down through the Group's divisions, Central Functions, and in turn to each Divisional Head and their business managers and risk officers.

In 2017 the Group continued to invest in enhancing the design and build of its integrated risk management model to support its strategic and commercial objectives.

The Group's RMF describes the various activities, techniques and tools which are mandated to support the identification, measurement, control, management, monitoring, reporting and challenge of risk across the Group. It is designed to provide an integrated, comprehensive, consistent and scalable structure which is capable of being communicated to and clearly understood by all our employees and is described in the sections below.

The RMF also incorporates the organisational arrangements for managing risk with specific responsibilities distributed to certain functions. This ensures that there is clear accountability, responsibility and engagement at appropriate levels within the organisation which can provide robust review and challenge as well as be challenged. Operationally, the RMF is organised around the key risk categories.

### Risk Governance

Risk Governance describes the architecture through which the Board allocates and delegates primary accountability, responsibility and authority for risk management across the organisation.

Responsibility for risk oversight is delegated from the Board to the Risk Committee and Audit Committee. The ultimate responsibility for risk remains with the Board.

Accountability, Responsibility and Authority for risk management is delegated to the Chief Executive Officer and Chief Risk Officer, who in turn allocates responsibility for oversight and certain approvals across a number of Management Committees.

Authority and responsibility for material operational risk management, decision making and risk assurance is vested in the Chief Risk Officer and the Risk function. Lesser levels of authority are cascaded to the senior management within the support functions and Business Divisions.

Board / Risk Committee				Audit Committee Third Line
Over-sight Risk Category	First Line	Second Line		
Credit Risk	Credit Management in Business Areas & Treasury	Credit Risk	ERMC	Internal Audit
Liquidity and Market Risk	Treasury	Market & Liquidity Risk & Finance	ALCo	
Operational Risk	All Business Divisions and functional areas	Operational Risk	ERMC	
Conduct, Legal and Compliance Risk	All Business Divisions and functional areas	Compliance	ERMC	
Strategic Risk	Exec Directors & Executive management team	Finance	ExCo	
Systems and Change Risk	IT / Change Management	Operational Risk	ERMC	

These bodies and senior officers are accountable and responsible for ensuring that the risks are appropriately managed within the agreed Risk Appetite and in accordance with the requirements of the RMF.

Individuals are encouraged to adopt an open and independent culture of challenge which is essential to ensuring risk issues are fully surfaced and debated with views and decisions recorded. Risk Governance and culture is reinforced by the provisions of the Senior Managers and Certification Regime.

Formal risk escalation and reporting requirements are set out in Risk Policies, individual Committee terms of reference and the approved Risk Appetite thresholds and limits.

## Risk management report (continued)

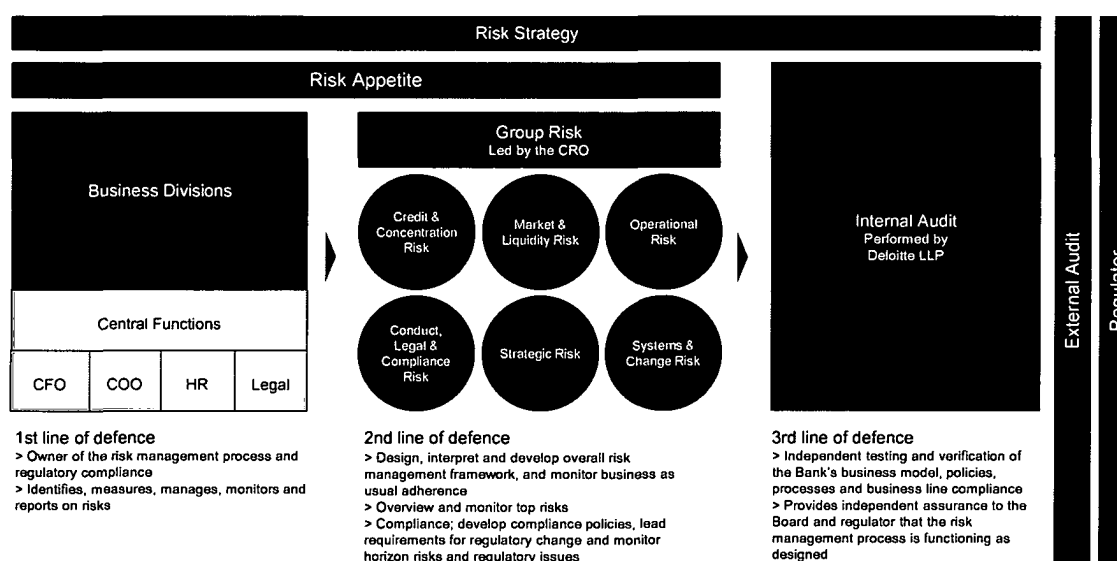
### Committee Structure and Risk Responsibilities

An abbreviated Board and Management Committee structure is set out in the Corporate Governance report at pages 43 to 44. The monitoring and controlling of risk is a fundamental part of the management process within the Group. The Board oversees the management of the Key Risk Categories across the organisation.

During 2017 the Group made a number of changes to enhance its risk governance. These included the re-positioning of the Group Product Committee to focus on the approval of new products, changes to existing products and the annual review of its existing products. Responsibility for pricing transferred to the Executive Committee. The Chief Risk Officer implemented three additional working groups below the Enterprise Risk Management Committee including a Complaints Working Group, Intermediary and Broker Working Group and a Collections and Recoveries Working Group, to increase oversight in these areas.

### Three Lines of Defence model

The Group's RMF is underpinned by the "Three Lines of Defence" model which is summarised in the diagram below.



### First Line of Defence

Responsibility for risk management resides in the front line business Divisions and Central Functions, and line management is directly accountable for identifying and managing the risks that arise in their business or functional area. They are required to establish effective controls in line with Group Risk Policy and act within the Risk Appetite parameters set and approved by the Board. The First Line of Defence comprises each of the three Lending Divisions. The First Line of Defence also includes the Finance Function led by the Chief Finance Officer, Operations led by the Chief Operating Officer and Human Resources (HR) led by the Group HR Director, although they are not customer facing themselves, they provide support and back-up to the customer facing divisions and have insight into many operational factors that could ultimately impact on Group's exposure to market, liquidity, credit, regulatory, legal, conduct, compliance and operational risk.

Each division and functional area operates to set risk policies to ensure that activities remain within the Board's stated risk appetite for that area of the Group. The risk policies are approved by the appropriate Committee in accordance with their terms of reference and reviewed annually with any material changes requiring approval at Committee level.

The First Line of Defence has its own operational process and procedures manuals to demonstrate and document how it conforms to the approved policies and controls. Likewise it develops Quality Control programmes to monitor and measure adherence to and effectiveness of procedures. All employees within a customer facing unit are considered First Line of Defence. Each employee is aware of the risks to the Group of their particular activity and the Divisional and Function heads are responsible for ensuring there is a "risk aware" culture within the First Line of Defence. For certain key policies, Divisional staff complete regular on-line training programs to ensure knowledge is refreshed and current.

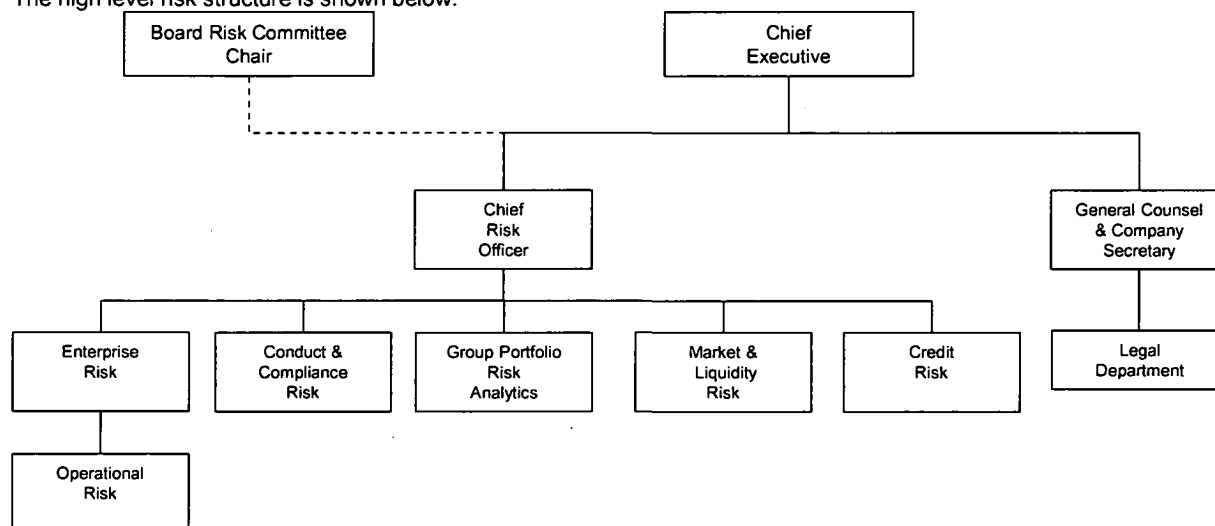


## Risk management report (continued)

### Second Line of Defence

The Second Line of Defence comprises the Group's central and independent risk management and compliance function led by the Chief Risk Officer, who reports to the Chairman of the Risk Committee and to the Chief Executive Officer. It also includes the General Counsel & Company Secretary who reports to the Chief Executive Officer. During 2017 the role of Money Laundering Reporting Officer transferred to the reporting line of the Chief Compliance Officer from the General Counsel & Company Secretary.

The high level risk structure is shown below:



The Second Line of Defence is necessarily and deliberately not customer facing and has no responsibility for any business targets or performance. It is primarily responsible for:

- The design and build of the various components of the Group's RMF and embedding these, together with the Risk Strategy and Risk Appetite, across the organisation;
- Independent monitoring of the Group's activities against the Board's Risk Appetite and limits, and provision of monthly analysis and reporting on the risk portfolio to the Executive Committee and the Board;
- Issuing and maintaining the suite of Group Risk Policies;
- Undertaking physical reviews of risk management, controls and capability in the First Line units and providing Risk Assurance reports to the Executive Committee and the Board on all aspects of risk performance and compliance with the RMF;
- Providing advice and support to the First Line of Defence in relation to risk management activities;
- Credit Approvals between Divisional Authority and the threshold for Credit Approval Committee; and
- Undertaking stress testing exercises and working with Finance and Treasury on the production of the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), Recovery Plan and Resolution Pack.

## Risk management report (continued)

### Third Line of Defence

The Third Line of Defence, Internal Audit (currently outsourced to Deloitte LLP) provides independent assurance on the activities of the Group and the effectiveness of the Group's Risk Management Framework and internal controls directly to the Board and Audit Committee. Internal Audit reports directly to the Chairman of the Audit Committee as well as the Chief Executive Officer and is independent of the First and Second Lines of Defence.

The Third Line of Defence has access to the activities and records of both the First and Second Lines of Defence. It can inspect and review adherence to policy and controls in the First Line, the monitoring of activity in the Second Line and the setting of policy and controls in the Second Line. The Third Line of Defence does not independently establish policy or controls itself, outside of those necessary to implement its recommendations with respect to the other two Lines of Defence. The Third Line may in some cases use as a starting point the reports and reviews compiled by the Second Line but is not restricted to them or necessarily influenced by their findings.

The Third Line of Defence's scope of work is agreed with the Audit Committee to provide an independent assessment of the governance, risk management and internal control frameworks operated by the Group and to note the extent to which the Group is operating within its Risk Appetite. It does this by reviewing aspects of the control environment, key processes and specific risks and includes review of the operation of the Second Line of Defence.

The Group's engagement of Deloitte LLP to carry out the functions of the Third Line of Defence provides the Group with access to specialist capabilities beyond its current scale and provides insight into best practice.

### Risk policies and Controls

The RMF is enacted through a comprehensive suite of control documents and risk policies, setting out the minimum requirements and standards in relation to the acquisition and management of risk assets as well as the control of risks embedded in the Group's operations, activities and markets.

The Group's High Level Control Documents and Risk Policies are owned and managed by the Group Risk function, headed by the Chief Risk Officer and approved by the Board or, where delegated, the appropriate Risk Committee. The suite of Policies is grouped according to importance and key risk categories.

Group-level Risk Policies are supplemented as required by Divisional Risk processes and procedures, where more specific and tailored criteria are detailed. Divisional processes and procedures are required to be compliant with Group Policy and dispensations or waivers are required where gaps are identified. These process and procedure manuals provide staff at all levels with day to day direction and guidance in the execution of their duties.

The effectiveness of and compliance with the risk policy framework is evaluated on a continuous basis through the monthly reporting requirements (including risk policy exceptions reporting). Additionally a quarterly Control Self Certification process supplemented by a program of audits, thematic risk assurance reviews and quality control testing is undertaken by each of the three lines of defence.

### Asset Class Policies

The Group's Lending Policies are contained in 13 Asset Class Policies. These have been arranged to operate on a Group wide basis rather than based upon Divisional products. This is considered to provide a more stable, consistent risk standard and control across the Group's portfolio of loan assets. Asset Classes can also be aligned more readily with Risk Weightings, Probability of Default, Loss Given Default and Expected Loss metrics which facilitates risk reporting, risk adjusted profitability analysis and modelling for stress testing and capital adequacy purposes.

Asset Class Policies are structured on the basis of Policy Rules which must be adhered to and Guidelines where an element of controlled discretion is permitted. All planned exceptions to Policy Rules require approval at the Group Risk level and both planned and unplanned exceptions to Policy Rules are reported monthly to the relevant risk management Committee.

## Risk management report (continued)

### Key risk categories

The key risk categories faced by the Group are as follows:

Risk Category	Definition
<b>Credit Risk (including concentration and single name risk)</b>	<ul style="list-style-type: none"> <li>The risk that a borrowing client or treasury counterparty fails to repay some or all of the capital or interest advanced to them. This category also includes credit concentration risk which is the risk of exposure to particular groups of customers or sectors or geographies that uncontrolled may lead to additional losses that the shareholder or the market may not expect.</li> </ul>
<b>Liquidity and Market Risk</b>	<ul style="list-style-type: none"> <li>Liquidity risk is the risk that the group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost.</li> <li>Market risk is the risk of financial loss through un-hedged or mismatched asset and liability positions that are sensitive to changes in interest rates or currencies.</li> </ul>
<b>Operational Risk</b>	<ul style="list-style-type: none"> <li>Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and system failures, or from external events including strategy and reputational risks.</li> </ul>
<b>Conduct, Legal and Compliance Risk</b>	<ul style="list-style-type: none"> <li>Conduct risk is the risk that the Group's behaviour will result in poor customer outcomes and that our people fail to behave with integrity.</li> <li>Legal and Compliance risk is the risk of regulatory enforcement and sanction, material financial loss, or loss to reputation the Group may suffer as a result of its failure to identify and comply with applicable laws, regulations, codes of conduct and standards of good practice.</li> </ul>
<b>Strategic Risk</b>	<ul style="list-style-type: none"> <li>Risk that the Group is unable to meet its objectives through the inappropriate selection or implementation of strategic plans. This includes the ability to generate lending volumes inside risk appetite.</li> </ul>
<b>Systems and Change Risk</b>	<ul style="list-style-type: none"> <li>Systems and change risk is the risk that transition changes in the business will be improperly implemented.</li> </ul>

A more detailed summary of each principal risk is contained in the following sections.

### Credit Risk

This risk has two main components:

- Customer risk (from core lending activity); and
- Treasury credit risk (from treasury activity).

The Group's Treasury credit risk exposure is limited to short term deposits placed with leading UK banks.

### Credit Risk Approval Process

The Group operates a hierarchy of lending authorities based principally upon the size of the aggregated credit risk exposure to counterparties, group of connected counterparties or, where applicable, a portfolio of lending assets that are subject to a single transaction. In addition to maximum amounts of credit exposure, sole lending mandates may stipulate sub-limits and / or further conditions and criteria.

## Risk management report (continued)

The Group implemented a number of changes to its hierarchy of lending mandates during 2017. Each Division has a maximum authority level allocated, with exposures above these levels requiring approval from an approver in the Second Line of Defence or the Credit Approval Committee. In each Lending Division, at least one signatory to the loan must be a segregated first line of defence credit approver who has no responsibility for, or remuneration arrangements linked to, sales targets, on-going sales origination or relationship responsibility with the borrower.

The maximum Divisional mandate for Business Finance regions, Business Finance specialist sectors and commercial property in the Property division is £1.25m. The maximum Divisional mandate for secured lending in the Property division is £100k and £75k in Consumer. Exposures beyond these limits up to £5m may be approved by an approver in the second line of defence and exposures up to the Group single name concentration limit of £25m must be approved by the Credit Approval Committee. In addition, where transactions involve financing portfolios of lending assets in excess of £15m or where an individual loan is required in excess of £25m Board approval is also required.

Lending is advanced subject to Group lending approval policy and specific credit criteria. When evaluating the credit quality and covenant of the borrower, significant emphasis is placed on the nature of the underlying collateral. This process also includes the review of the Board's appetite for concentration risk.

### Credit Monitoring

Approval and on-going monitoring control is exercised both within the businesses and through oversight by the Group Credit Risk function. This applies to both individual transactions as well as at the portfolio level by way of monthly credit information reporting, measurement against Risk Appetite limits and testing via risk quality assurance reviews.

The Divisions operate timely collections and arrears management processes. The Group further invested in 2017 in developing its operational arrangements and capabilities for non-performing loan management to ensure that the Group is capable of operating in a more challenging environment where interest rates are rising and there is lower demand and liquidity in property markets.

### Liquidity and Market Risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost.

Market risk is the risk associated with adverse changes in the fair value of positions held by the Group as a result of movement in market factors such as interest rates, currencies, volatility and credit spreads.

The Group has, therefore, developed comprehensive funding and liquidity policies to ensure that it maintains sufficient liquid assets to be able to meet all its financial obligations and maintain public confidence.

The Group's Treasury function is responsible for the day to day management of the Group's liquidity and wholesale funding. The Board sets limits over the level, composition, and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk personnel independent of Treasury. Additionally, a series of liquidity stress tests are performed weekly by Risk and formally reported to the Asset and Liabilities Committee and the Board to ensure that the Group maintains adequate liquidity for business purposes even under stressed conditions.

The Group reports its liquidity position against its Liquidity Coverage Ratio, Net Stable Funding Ratio and other key regulatory ratios for regulatory purposes.

A liquid asset buffer of government Treasury Bills acquired under the Funding for Lending Scheme, and reserves with the Bank of England, are maintained as a source of high quality liquid assets that can be called upon to create sufficient liquidity in order to meet liabilities on demand.

## Risk management report (continued)

### Operational Risk

The Risk Committee received regular reports across the spectrum of operational risks and information security. These reports cover incidents that have arisen to allow the Committee to assess management's response and proposed remedial actions. Although a number of incidents were raised during the course of 2017, none of these was material in nature and the Committee was satisfied that the action taken was appropriate and that the control of operational incidents continued to improve. A test of the Group's Cyber Incident Response Plan was undertaken to assess the adequacy of the Group's internal control framework to respond to this threat and a maturity assessment of the Group's strategy to manage increasing levels of cyber risk in the market place was completed. The operational risk reports were developed throughout 2017 to include more focus on forward looking risks which permits a more strategic discussion at Risk Committee level.

### Conduct, Legal and Compliance Risk

The Group continually reviews its risk management approach to reflect the regulatory and legal environment in which the Bank operates.

The Group has no appetite for knowingly behaving inappropriately, resulting in unfair outcomes for its customers. During 2017 the Group appointed a Chief Compliance Officer to further develop its Risk Appetite for Conduct Risk and to introduce and embed measures across the conduct risk lifecycle, which includes product design, sales or after sales processes and culture. It also embedded revisions to annual product reviews and risk appetite to support the management of brokers, intermediaries and outsource partners. These measures are reported to the Board monthly and provide the basis for demonstrating that the Group is operating within its risk appetite. Where the Group identifies potential unintended outcomes for customers the Group uses its risk management process to proactively escalate, agreeing appropriate actions and communicating clearly with its customers to ensure a fair outcome is achieved. The Group also implemented three additional working groups to oversee complaints, Intermediaries and Brokers and Collections.

### Strategic Risk

Strategic risk focusses on large, long-term risks that could become a material issue for the delivery of the Group's goals and objectives. Management of strategic risk is primarily the responsibility of Executive management. The management of strategic risk is intrinsically linked to the corporate planning and stress testing processes and is further supported by the regular provision of consolidated business performance and risk reporting to the Executive Committee and the Board. The Board received and approved a number of reports during 2017 including the Strategy Update and the inception of the 2017 annual review of risk appetite. It has also been engaged actively in the formation of the Group's ICAAP and ILAAP which are critical tools to managing strategic risk.

### Systems and Change Risk

Customer expectations for service availability are rising with the rapid pace of new technologies leading to a significantly lower tolerance for service disruption. The Group recognises that in order to continue to be recognised for very high levels of customer satisfaction it needs to continually monitor systems risk and ensure that change is delivered with minimum disruption to customers. During 2017 the Group reviewed its approach to managing change with a 'build the bank' and 'run the bank' focus across Change and Technology in line with its target operating model.

### Top and emerging risks

The Group's top and emerging risks are identified through the process outlined in the 'Risk Management Framework' section and are considered regularly by management and subsequently by the Risk Committee. The Group sees seven themes as its top and emerging risks:

- Geopolitical Risk;
- Economic and Competitive Environment;
- Pace of Regulatory Change;
- Intermediary and Outsourcing;
- Pace, Scale of Change and Management Stretch;
- Credit Impairment; and
- Information Risk.

## Risk management report (continued)

Key: ↔ No Change      ↓ Risk Decreased      ↑ Risk Increased

These themes, together with the Group's strategy to mitigate the risk and the direction of each theme, are considered further in the following sections:

Risk	Mitigation	Change
<p><b>Geopolitical Risk</b></p> <p>The Group's financial position continues to improve with increasing profitability and strong capital ratios. However, increasing Geopolitical risk presents a risk to the business, its financials and earnings volatility following an unprecedented political event.</p> <p>The UK has experienced a number of political events during 2017 including the UK government losing its majority in a snap election, increasing global populist trends, terrorist attacks and a weakening of Sterling. These risks have the potential to have an impact on the Group and the impact could be wide reaching affecting other risks such as economic, regulatory, business change, outsourcing, organisational and business change, regulation and conduct risk.</p>	<p>The Group monitors the environment and its chosen markets on a regular basis and continues to prioritise RoTE over volume.</p> <p>The Group operates in specialist areas where management and staff have significant expertise and a deep understanding of customer needs to drive a long term relationship with its customers through the cycle.</p> <p>The Group undertakes a comprehensive assessment of its Risk Appetite and stress tests its lending and deposit portfolios to ensure that it can meet its objectives in severe but plausible economic conditions.</p> <p>The Group regularly reviews its key outsource partners to establish Early Warning Indicators and to formalise exit plans.</p>	<p>↑</p> <p>The UK economic outlook is expected to remain favourable in the short term but with increasing risks to the downside driven by weak productivity that may increase the potential for volatility for the Group and its customers.</p> <p>Developments regarding the UK's withdrawal from the EU, and in particular the reaction of households, businesses and asset prices to them, remain a significant influence on, and source of uncertainty about, the economic outlook.</p>

## Economic & Competitive Environment

A reversal in UK economic conditions, particularly in England where the majority of the Group's operations are based, could affect the Group's performance in a number of ways including:

- lower demand for the Group's products and services;
- changes in funding costs resulting from ongoing political uncertainty accompanied by a loss of confidence;
- rising competition compressing Group margins below sustainable levels; and
- higher impairments through increased defaults and/or reductions in collateral values.

The Group uses its expertise and deep understanding of its customers' needs to drive customer service and long-term relationships with its customers through the cycle.

The Group monitors its chosen markets on a regular basis and regularly reviews adjacent markets where it has expertise, and also reviews opportunities for inorganic growth. The Group operates in specialist areas where management and staff have significant expertise and a deep understanding of customer needs that delivers superior service. As a result, all loans are written thorough, bespoke underwriting to SMEs and consumers based on their ability to repay and, in the main, sufficient security.

The Group undertakes a comprehensive assessment of its risk appetite to ensure that it can meet its objectives in severe but plausible economic conditions.

The Group completes comprehensive stress testing of its lending and deposit portfolios to test resilience to severe but plausible economic conditions.

The Group also establishes a prudent balance sheet strategy with robust levels of capital and liquidity and a prudent funding structure. The Group maintains risk appetite and pricing discipline.



The UK economy remains resilient with near-term momentum and following eight years of consecutive growth. However, the Board expects there to be a period of uncertainty with increased risks to the downside as Brexit negotiations continue.

## Pace of Regulatory Change

The prudential and conduct regulatory regimes are subject to change and could lead to increases in the level and quality of capital that the Group needs to hold to meet regulatory requirements.

The Financial Policy Committee (FPC) in June 2017 announced the restoration of the countercyclical buffer (CCyB) to 0.5% with effect from June 2018. The FPC also confirmed on 28 November 2017 that the CCyB will increase from 0.5% to 1% with effect from November 2018 to lock in surplus capital in the PRA buffer to add resiliency to the market prior to Brexit.

The Prudential Regulation Committee has indicated that it will set additional PRA buffers in light of the 2017 stress test results to reflect the judgement that, following recent rapid growth, the loss rate on consumer credit may be understated where they are based on benign recent conditions.

The FCA has undertaken a number of thematic reviews during 2017 including high cost consumer credit, a thematic

The regulatory environment continues to evolve and change. The Group actively engages with regulators, industry bodies and advisors to actively engage in consultation processes.

The Bank undertakes forward capital planning and sensitivity analysis using its ICAAP to ensure that the Bank has a long runway to respond to any changes in capital requirements.



UK financial services businesses remain subject to significant scrutiny and the current level of risk is elevated when compared to last year.

The Group adopts the Standardised Approach to its assessment of credit risk regulatory capital. The Basel Committee on Banking Supervision announced changes to the risk weightings under the Standardised Approach in December 2017 that will lead to an increase in capital requirements over the period of the strategic plan.

The Group has completed its preparations to support adoption from 1 January 2018.

The Group also remains on track to ensure it has a fully resourced plan to support General Data Protection Regulation compliance by 25 May

<p>review of consumer credit and has set out its plans for 2018.</p>		<p>2018 including all necessary changes.</p>
<p>Intermediary &amp; Outsourcing</p>		<p>The Bank completed an Additional Tier 1 Issue of £125m in December 2017.</p>
<p>The Group is a specialist lending and savings bank for SMEs and consumers. The specialist nature of some of its lending through intermediaries and brokers could mean that some customers find themselves with an increased risk of an unfavourable outcome. For the Group this could also lead to increased conduct related redress, additional fraud or credit risk impairments.</p>	<p>The Group works with carefully selected intermediary and broker partners who take on the role of advising SMEs and consumers. The Group recognises that it is ultimately accountable for the lending it originates through its partners and continually undertakes reviews of their performance.</p> <p>The Group continually reviews its risk management approach to intermediaries, brokers and outsource partners to reflect the regulatory environment in which the Group operates.</p>	<p>↑</p> <p>The Group continued to invest in its monitoring controls to manage its exposure to intermediaries, brokers and outsource partners during 2017 and believes that it continues to improve its risk profile.</p> <p>The Group's continued to invest in its relationship with Target Servicing Limited and is expected to further improve its outsourcing risk profile. The Group continues to explore other third party relationships through which to deliver its objectives.</p>
<p>Pace, Scale of Change &amp; Management Stretch</p>		<p>↔</p>
<p>The scale and pace of change could create delivery challenges and could lead to disruption of the Group's plans and in the delivery of its objectives.</p>	<p>The Group understands the need to manage change without disrupting the Group's operating environment and impacting customer service. These operational risks are managed through a strong focus on change governance and programme management disciplines and are led by a dedicated Executive member. The risks are further mitigated by the Group's strengthening of the Executive management team.</p> <p>The Group has a formal Operations Committee that is set up to prioritise change and provide effective oversight of the change portfolio to ensure that requirements are delivered within budget and on time.</p>	<p>The Group continues to invest in its change management processes to increase the pace and scale of change without impacting on the Group's operations and customer service. During 2017 this has focussed on the embedding of the new target operating model and the implementation of the Chief Operating Office.</p> <p>However, the Group has a strong appetite for change and the risk of an impact on its operations remains.</p>
<p>Credit Impairment</p>		<p>↔</p>
<p>At 31 December 2017 the Group had customer loans (including operating leases and net of impairment provisions) of £4.9 billion, and is exposed to credit impairment if customers are unable to repay loans and any outstanding interest and fees.</p> <p>In addition the Group has exposure to a small number of counterparties with whom it places surplus funding.</p>	<p>The Group recognises that it will experience credit impairment in connection with its lending activities, but manages its exposure by:</p> <ul style="list-style-type: none"> <li>• undertaking a prudent assessment of through the cycle losses in pricing, forecasting and stress testing;</li> <li>• maintaining consistent and conservative loan to value ratios and avoiding material weakening of credit quality to drive volumes;</li> <li>• lending predominantly on a secured basis against identifiable and accessible assets;</li> <li>• operating strong controls and governance with effective</li> </ul>	<p>Underlying Group credit impairment has remained low, reflecting favourable market conditions in the UK and the Group's approach to lending.</p> <p>The Group's counterparty exposure has remained broadly unchanged with the majority of surplus funding placed with the Bank of England and balances with UK clearing banks.</p> <p>The Group believes that the potential for additional credit impairment has increased with uncertainty over the outlook of the Brexit negotiations and the outlook for the UK economy given recent forecasts of productivity and</p>



	<ul style="list-style-type: none"> <li>oversight by a centralised Group credit team; and</li> <li>maintaining a prudent Treasury counterparty policy with surplus funding placed with the Bank of England and UK clearing banks.</li> </ul>	<p>increasing consumer debt. The Group has completed its assessment of the impact of IFRS9 and will make use of the transition arrangements.</p> <p>The Group considers that its borrowers exposure to Carillion is minimal and has improved over 2017.</p>
<p><b>Information Risk</b></p> <p>The pace of technological development is changing the way in which SMEs and consumers want to engage with the Group, leading to a number of risks:</p> <ul style="list-style-type: none"> <li>increasing customer demand could exceed the Group's ability to provide highly reliable and widely available systems and services;</li> <li>the evolving nature and scale of criminal activity could increase the likelihood and severity of attacks on the Group's systems; and</li> <li>franchise value and customer trust could be significantly eroded by a sustained hack of the Group's systems leading to a diversion of funds or the theft of customer data.</li> </ul>	<p>The Group continually reviews its control environment for information security to reflect the evolving nature of the threats to which the Group is exposed.</p> <p>The Group's strategy for mitigating information security risk is comprehensive, including: a documented cyber strategy, ongoing threat assessments, regular penetration testing, the wide deployment of detective controls and a programme of education and training.</p>	<p>↑</p> <p>The Group continues to invest in its capabilities to reduce its exposure to a cyber-attack and has further developed its risk appetite and controls with respect to information security. However, the risk of information security breaches, threats from cyber-crime and the impact of new technology on the Group's businesses remain.</p>

### ICAAP, ILAAP and Stress Testing

The ICAAP, ILAAP and associated stress testing exercises represent important elements of the Group's on-going risk management processes. The results of the risk assessment contained in these documents is embedded in the strategic planning process and risk appetite to ensure that sufficient capital and liquidity are available to support the Group's growth plans as well as cover its regulatory requirements at all times and under varying circumstances.

The ICAAP and ILAAP are reviewed at least annually, and more often in the event of a material change in capital or liquidity. On-going stress testing and scenario analysis outputs are used to inform the formal assessments and determination of required buffers, the strategy and planning for capital and liquidity management as well as the setting of Risk Appetite limits.

The Board and Executive management have engaged in a number of exercises which have considered and developed stress test scenarios. The output analysis enables management to evaluate the Group's capital and funding resilience in the face of severe but plausible risk shocks. In addition to the UK variant test on capital prescribed by the Regulator, the stress tests have included a range of Group wide, multi-risk category stress tests, generic and idiosyncratic financial shocks as well as operational risk scenario analyses. Stress testing is an integral part of the adequacy assessment processes for liquidity and capital, and the setting of tolerances under the annual review of Group Risk appetite.

The Group also performed reverse stress tests to help Executive management understand the full continuum of adverse impact and therefore the level of stress at which the Group would breach its individual capital and liquidity guidance requirements as set by the Regulator under the ICAAP and ILAAP processes.

## **Recovery Plan and Resolution Pack**

The Group has prepared a Recovery Plan and Resolution Pack (RP&RP) in accordance with PRA Supervisory Statements SS18/13 and SS19/13. The Group is planning to update its RP&RP in 2018 to reflect the change in ownership.

The plan represents the Group's 'Living Will' and examines in detail:

- The consequences of severe levels of stress (i.e. beyond those in the ICAAP) impacting the Group at a future date;
- The state of preparedness and contingency plan to respond to and manage through such a set of circumstances; and
- The options available to Executive management to withstand and recover from such an environment.

This plan is prepared annually, or more frequently in the event of a material change in the Group's status, capital or liquidity position. The Board of Directors and Executive management are fully engaged in considering the scenarios and options available for remedial actions to be undertaken.

The Board considers that the Group's business model, its supportive owners and the diversified nature of its business markets provides it with the flexibility to consider selective business or portfolio disposals, loan book run off, equity raising or a combination of these actions. The Group would invoke the Recovery Plan and a Resolution Pack in the event they are required.

## Risk management report (continued)

### Group Viability Statement

The Directors have assessed the outlook for the Group over a longer period than the twelve months required by the 'Going Concern' statement in line with good governance practice and reporting.

The assessment relied on:

- The Board approved Strategic Update in December 2017 that outlines the business plans and financial projections from 31 December 2017 to 31 December 2021;
- The completion of an issuance of £125m of Additional Tier 1 in December 2017;
- The Internal Capital Adequacy Assessment Process ('ICAAP');
- The Internal Liquidity Adequacy Assessment Process ('ILAAP');
- A review and evaluation of its top and emerging risks (as reported upon earlier in this section);
- Consideration of the effect of a moving regulatory landscape on the Pillar 2A, Pillar 2B and the CRD IV Combined Buffer requirements, together with the effect of the Group's Capital Contingency Plan to restore the capital position in scenarios of capital headwinds; and
- The effect of the implementation of the IFRS 9 'Financial Instruments', taking into account the phase-in arrangements published in the amended EU regulation No (EU) 575/2013.

The Group is not large enough to participate in the annual Bank of England concurrent stress testing programme but has, as part of its ICAAP, performed a variety of equivalent stress tests and reverse stress tests of its business. These include two market wide stress tests and five Group specific (idiosyncratic) stress tests. The stress tests were derived through discussions with Executive management and the Board, after considering the Group's top risks. The Group also considered its funding and liquidity adequacy in the context of the reverse stress testing. The risk of the UK leaving the EU has been considered and the Board believe this risk was captured within its stress testing scenarios, and will keep this risk under review.

The stress tests enable the Group to assess the impact of a number of severe but plausible scenarios on its business model. In the case of reverse stress testing, the Board is able to assess scenarios and circumstances that would render its business model unviable, thereby identifying business vulnerabilities and ensuring the development of early warning indicators and potential mitigating actions.

The Board aims to build a sustainable lending and savings bank for SMEs and consumers over the medium to long term. The Board monitors a four year strategic plan that provides a robust planning tool against which strategic decisions are made. Whilst the Board has no reason to believe that the Group will not be viable for a four year period, given the inherent uncertainty involved, the Board concluded that a three-year period is an appropriate length of time to perform a viability assessment with a greater level of certainty.

Based on the results of the above mentioned assessments, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over a period of at least three years.

## Corporate Social Responsibility Report

During 2017, we continued to develop our Corporate Social Responsibility (CSR) programme to better reflect how we operate as a company and how we position ourselves in the communities we operate in. This year, we launched our CSR programme internally, promoting our functions, accomplishments and aims for the future whilst also encouraging new ideas and ways we can further improve.

Our CSR programme builds on what we have already. The Shawbrook approach to CSR addresses both how we deal with our employees and our customers, and how we manage our ethical and environmental responsibilities.

Our approach to CSR and sustainability builds and focuses on four main stakeholder areas:

- **Environment**
- **Marketplace**
- **Workplace and**
- **Community**

### Environment

At Shawbrook, we are committed to creating a strong business that is not achieved at the expense of the environment. Our CSR programme defines our thinking around responsibilities and processes in relation to waste, energy, water and travel at our offices across the UK. We are dedicated to ensuring we operate and work sustainably, building a responsible business whilst also making sure this is reflected in our suppliers, business partners, contractors and members of the wider community.

**Our Emissions:** We are committed to reducing our Greenhouse Gas emissions. To support this, in 2017 we introduced a Car Share network to encourage colleagues to share their journey to and from work and between our offices. At the end of 2017 this provided colleagues with a saving of over 87,000 miles annually which equate to 25+ tons of Co2 avoided<sup>1</sup>. In 2018, we are looking to implement new ways to expand our Car Share network by offering further incentives. The use of alternative forms of transport is another way we have reduced our impact on the environment. We provide a shuttle bus service at our head office covering various locations for employees, reducing the use of personal vehicles. This year, we also launched our Cycle2Work scheme. To support this, we have now introduced more bike racks to our offices, further reducing our impact on the environment and promoting a healthier journey to work.

**Print and Paper solutions:** We have made progress in implementing an alternative printing solution, our aim is to become a Hybrid Mail Solution run bank to further reduce print and mail distribution costs and our carbon footprint.

**Recycling:** As well as using recycled paper for our printing and hand towels, we have recycling facilities located in all our offices in support of our commitment to reduce the waste we send to landfill. We are continuously looking for new ways to recycle. This year, we have introduced new recycling facilities to encourage the appropriate disposal of batteries and the re-use of plastic bags.

**Office plants:** Air quality and employee satisfaction are important to us. As part of our 2017 CSR programme launch we introduced desk plants to all employees to boost positive wellbeing and to help improve air quality in our offices.

### Marketplace

At Shawbrook, we strive to work with suppliers who subscribe to operate on and promote similar principles that match our traditional values and culture of respect, care and thoughtful judgement.

**Awareness:** A key aim for our Marketplace quadrant is to enhance awareness and understanding of key policies and processes associated with our suppliers and our supply chain. Shawbrook relies on an extensive number of external suppliers and expects all suppliers and staff to behave ethically at all times during the sourcing and supply of goods and services. By promoting our procurement policy and creating communications regarding our suppliers and best practice when choosing a supplier, we can ensure we build equitable working relationships.

**My Shawbrook Idea:** Our initiative 'My Shawbrook Idea' encourages us to start to think about how we can improve and communicate with one another with ideas for best practice. It allows us to listen to our workforce and capture every small process improvement, cost reduction, efficiency gain and helps to prevent every avoidable waste, re-work, or complaint.

**Sourcing:** We are continually working with the business to source the right companies and opportunities to source locally. As we further roll out our regional business centres, there will be more opportunity to work with national companies with local presence to also offer consistency across all our Shawbrook sites.

<sup>1</sup> Assuming that each car share persists for 200 working days. This figure was calculated using [www.carbonfootprint.com/calculator](http://www.carbonfootprint.com/calculator)

## Corporate Social Responsibility Report (continued)

### Workplace

At Shawbrook, we are committed to ensuring we remain a great place to work. We work hard to create a business where we can attract, retain and reward talented, hardworking individuals and help them to develop in their careers through valuable experience and development and training programmes. We promote a diverse and inclusive workplace and one in which our people think and feel engaged in our approach and are supported to be their best at work.

**Training and development:** We have devoted considerable investment to ensuring that all colleagues are supported in their training requirements, enabling them to be the best they can be. Each department is allocated a training champion to ensure that we can meet the appropriate training needs of each individual. The Shawbrook Learning Bank launched last year plays a significant part in our training needs and we are continuously uploading new modules to complete.

**New innovative systems:** In November 2017, we launched our new HR Hub system, simplifying the way our employees seek support and guidance from HR. It allows colleagues to access their payslips, highlights rewards schemes such as our Bupa Rewards System and encourages learning and development.

**Diversity and inclusion:** Last year we signed up to the Treasury's (HMT) Women in Finance Charter and we are keen to create and encourage a sustainable, diverse and inclusive culture in all areas of our business. We have recently set up our Shawbrook Inclusion Community which hosts various events to build on our diversity and inclusion and encourages our colleagues to engage in discussions and contribute their feedback.

**Health and wellbeing:** The health and wellbeing of our staff is important to us. Following feedback from our people steering group, we increased all staff holidays by two days and withdrew our policy regarding dress code, ensuring we all feel comfortable and happy at work. Our community intranet page promotes various articles and tips on how employees can improve their health and wellbeing both at work and at home. To encourage healthier eating at work, our fruit box initiative was trailed in our HQ, providing fruit in all our communal areas. Due to its success, we are looking to expand this across all our offices.

**Flexible working:** We want to ensure that our people are happy. Our aim is to support anyone at Shawbrook who is a working carer and help them to get their work and life balance at a level that is right for them. In 2017, we launched our 'Guarding our Guardians' network providing a platform to support our working carers. Run by the CSR team, the network recognises the importance of flexibility and hosts numerous events for colleagues to get involved with and discuss key topics important to them.

### Community

We are committed to supporting our communities and local causes that are close to the hearts of our people. Dedication to our community is embedded in our core values, and we recognise the importance of investing time and support to non-profit organisations, aspiring to make a difference.

**Corporate charities:** We are delighted to support our three corporate charities, Contact the Elderly, Little Havens and Future First, a wide variety of causes, helping young people and elders to improve their quality of life. This year we donated to over 50 causes. In 2018, we'd like to further our support to these charities by gifting our time to volunteer and assist in any way we can.

**Staff donations:** We want to ensure that the charities we support are charities that also matter to our staff. Each month we host a charity day to encourage donations and awareness for a cause nominated by a member of our team. This year, we raised over £5,000 from our charity collections.

**Gift Matching:** Our pledge is to support colleagues and their families that gift their time and fundraise for charities they want to help. In 2017, we're proud to say that we have been able to contribute over £42,000 to staff nominated causes.

**Making a difference:** Engaging with local communities is important to us. In order to encourage our employees to support their local communities and charities we have now launched our 'Making a Difference Days'. This allows every colleague up to one volunteer day per year so they can gift their time to a cause they're keen to support.

The Strategic report was approved by the Board and signed on its behalf by the Chief Executive Officer.



Steve Pateman  
Chief Executive Officer  
7 March 2018

## Corporate governance report

### Chairman's introduction

I am pleased to present our Corporate Governance Report for 2017. This report sets out our approach to governance and the work of the Board in 2017. It includes reports from the Nomination Committee, the Audit Committee, Risk Committee and Remuneration Committee.

This report also explains how the Group applies the principles of corporate governance; aligning our structure and arrangements with best practice in the sector.

We recognise that effective governance is key to the successful delivery of the Group's strategy and that it continually needs to evolve to meet the requirements of a growing bank operating in a heavily regulated and uncertain environment.

Following the change of ownership of the Group, the commitment to retaining Board and Committee independence was formalised by the adoption of a Framework Agreement and Memorandum of Understanding governing the ongoing interactions between the Board, Executive management and the Shareholder. These have formalised governance arrangements to ensure that appropriate challenge and independence remains, so supporting the interests of investors, customers, employees, the regulators and other key stakeholders. An externally facilitated Board effectiveness review will be undertaken in 2018 to further ensure the effectiveness of the framework. Full details of the Group's governance arrangements are also set out in this report.

In addition to its ongoing oversight activities, the key issues on which the Board focused time during 2017 included:

- considering the interests of the independent shareholders and other stakeholders during the change of ownership of the Group;
- consideration of the Group strategy and formulation of a Group plan to 2021;
- the evolution of the target operating model and infrastructure required to support the future development of the Group;
- deep dives into each of the business divisions, considering both current performance and future opportunities and plans;
- the people strategy for the business;
- cyber resilience, information security and data management;
- capital and liquidity adequacy, including consideration of the ICAAP and ILAAP documents, both with specific sessions held to ensure the Board had sufficient opportunity to consider the key elements;
- oversight of loan portfolio acquisitions including the acquisition a portfolio of assets, from RBS; and
- continuing to review how the Group delivers good customer outcomes across all of its activities.

Andrew Didham joined the Board in February 2017, taking over from Roger Lovering as Chair of the Audit Committee. Dylan Minto was also appointed to the Board as Chief Financial Officer in February 2017, after holding the position on an interim basis for a number of months. Cédric Dubourdieu, a Partner at BC Partners LLP, joined the Board as a shareholder representative in September 2017 following the change in ownership of the Group. I believe the addition of Andrew, Dylan and Cédric means the Board has the appropriate mix of skills and experience to fulfill its responsibilities effectively.

In January 2018, Stephen Johnson decided to step down from the Board. Stephen was an integral part of the Group since inception and the Board thanks him for his significant contribution during that his time

Having led the Board since shortly after the Initial Public Offering in April 2015, I believe now is an appropriate time for me to stand down as Chairman. I believe I leave with the Group in a strong position well placed for the future, and I wish my successor every success and will take all steps to ensure a smooth handover.

I thank the Board and my colleagues throughout the Group for their support over the last three years and wish them well.

Profiles of all the Directors are set out on pages 39 to 42

**Iain Cornish**  
Chairman  
7 March 2018

## Corporate governance report (continued)

### Board of Directors

Role	Iain Cornish Chairman and Independent Non- Executive Director	Steve Pateman Chief Executive Officer	Dylan Minto Chief Financial Officer
	Appointed to the Board in July 2015	Appointed to the Board in January 2016	Appointed to the Board in February 2017
Skills and experience	Iain was a founding member of the PRA Board at its formation in 2013. He holds a degree in Business, Economics and Statistics from Southampton University.	Steve joined Shawbrook from Santander UK, where he was Executive Director and Head of UK Banking, running the bank's Corporate, Commercial, Business and Retail Banking operations as well as Wealth Management. He joined Santander in 2008 with responsibility for building an SME franchise. He is a Fellow of the Chartered Institute of Bankers in Scotland.	Dylan joined Shawbrook in 2013 from KPMG where he spent 11 years in their Financial Services practice advising large UK and European banks. Dylan was appointed permanent CFO in February 2017 having been Interim CFO from June 2016. He is a Fellow of the ICAEW and holds a dual BA Honours degree in German and Business Studies from Sheffield University.
External appointments/ directorships	Iain is currently Senior Independent Director of both Arrow Global Group PLC and St James's Place plc. Iain also serves as a Trustee of Macmillan Cancer Support.	Steve is currently a member of the Financial Capability Board for the Money Advice Service and was recently appointed Vice President of the Council of the Chartered Institute of Bankers Scotland. He also provides informal advisor services to Arora Group.	None.

# Shawbrook Group plc – 2017 Annual Report and Accounts

**Robin Ashton**  
Senior Independent  
Director

**Andrew Didham**  
Independent Non-  
Executive Director

**David Gagie**  
Independent Non-  
Executive Director

Appointed to the Board in March 2015 (Appointed to the Board of Shawbrook Bank Limited in December 2011)

Appointed to the Board in February 2017

Appointed to the Board in January 2016

Robin has extensive experience of retail financial services both in the UK and internationally. He is a chartered accountant and holds a Bachelor of Arts (Hons) degree in Economics and Law from Durham University.

Andrew has extensive financial services experience. He is a qualified accountant, having enjoyed a successful career at KPMG, becoming a partner in 1990, and subsequently as Group Finance Director of Rothschild.

David has global experience in consumer lending, banking, credit card payments and risk management. Whilst a Senior Advisor at the Financial Conduct Authority and member of the Payments Systems Regulator Executive he focused on regulatory conduct issues relating to retail banking, consumer credit and payments.

Robin has been a Non-Executive Director of Leeds Building Society since April 2011 and Chairman since March 2013.

Andrew is currently an Executive Vice-Chairman for Rothschild and also a Non-Executive Director of Charles Stanley PLC and is Non-Executive Chairman of its principal operating company Charles Stanley & Co Ltd. He is also Non-Executive Director of Jardine Lloyd Thompson Group plc.

David is a Non-Executive Director of Lowell GFKL Group and serves as a Chairman on some of the subsidiaries within the Group. He is also a Non-Executive Director of Populus Consulting Ltd and MWS Technology Ltd.



<b>Sally-Ann Hibberd</b> Independent Non-Executive Director	<b>Paul Lawrence</b> Independent Non-Executive Director	<b>Roger Lovering</b> Independent Non-Executive Director	<b>Lindsey McMurray</b> Non-Executive Director
Appointed to the Board in November 2015	Appointed to the Board in August 2015	Appointed to the Board in March 2015 (Appointed to the Board of Shawbrook Bank Limited in January 2013)	Appointed to the Board in April 2010 (Appointed to the Board of Shawbrook Bank Limited in January 2011)
Sally-Ann has a broad financial services background having worked in Life Assurance, Asset Management, Retail Banking, Bancassurance and General Insurance. Her particular strengths are in Operations, Technology and Business Transformation.	Paul has extensive experience in financial services having had a successful career within HSBC Group. Paul has particular strengths in managing risk and internal audit across a number of business lines. Paul previously served as a member on the IIA Committee for Internal Audit Guidance for Financial Services.	Roger has over 25 years of experience in the consumer finance industry, focusing on lending to individuals. He has extensive knowledge of secured and unsecured lending, both fixed and revolving term via credit cards. Roger is a member of ICAEW and has a degree in Accountancy and Financial Analysis from Warwick University.	Lindsey has over 20 years of experience as a private equity investor with a particular focus on the financial services sector. She holds a first class Honours degree in Accounting and Finance from Strathclyde University.
Sally-Ann is currently a Non-Executive Director of Equiniti Group plc and sits on the Governing Body of Loughborough University.	Paul is currently an independent consultant to HSBC in the formation of their UK Ring Fence Bank.	Roger is a Non-Executive Director of Caswell Consultancy Limited, Logical Glue Limited and Amigo Holdings Limited. He is also a Non-Executive of Oodle Finance Services Limited.	Lindsey is managing partner of private equity fund manager Pollen Street Capital, an affiliate of Marlin Bidco Limited of which she is also a Director. She is also currently an Executive Director of Pollen Street Capital Limited and a Director of Freedom Acquisitions Limited, Honeycomb Holdings Limited, Honeycomb Finance plc and Cashflows Europe Limited.

# Shawbrook Group plc – 2017 Annual Report and Accounts

**Cédric Dubourdieu**  
Non-Executive Director

**Daniel Rushbrook**  
General Counsel and  
Company Secretary

Appointed to the  
Board in September 2017

Appointed Company  
Secretary in March 2015  
(appointed Company  
Secretary to Shawbrook  
Bank Limited in March  
2011)

Cédric has close to 20 years of private equity experience, having led a number of investments in a variety of sectors across Europe. He holds a degree from Ecole Polytechnique, Paris.

Daniel has over 20 years' legal experience. He has experience in private practice having worked for both Linklaters LLP and Macfarlanes LLP. Daniel became the first in-house lawyer for Commercial First Mortgages Limited, later joining its Board as Legal Director in 2005. In 2011 Daniel transferred to Shawbrook becoming General Counsel and Company Secretary. Daniel holds a first class law degree from Oxford University and a Masters law degree from the University of Pennsylvania.

Cédric is a Managing Partner of private equity firm BC Partners and sits on BC Partners' investment committee. BC Partners is an affiliate of Marlin Bidco of which Cédric is also a Director. Cédric currently serves on the Boards of MCS, Nille and Allflex.

None

Stephen Johnson resigned as a Director on 23 January 2018.

## Corporate governance report (continued)

### Leadership structure

Below, an overview of the delegations in place from the Board to its Committees is provided. Overleaf, the Executive and Risk Governance structure has been included, it has delegated authorities from the Chief Executive Officer and members of the Executive management team. All authorities have documented through terms of reference. Board Committee terms of reference can be found on the website: <https://investors.shawbrook.co.uk/>.

#### The Board

The primary role of the Board is to provide leadership to the Group, to set the Group's long-term strategic objectives and to develop robust corporate governance and risk management practices. The Board delegates specific powers to some committees, details of which are set out below.

#### Nomination Committee

- > Recommends Board appointments
- > Oversees appointments under the Senior Managers and Certification Regime.
- > Succession planning

#### Audit Committee

- > Oversees financial reporting
- > Monitors internal control
- > Monitors internal and external auditors

#### Disclosure Committee

- > Monitors disclosure controls
- > Reviews and advises on the scope and content of the disclosure

#### Remuneration Committee

- > Monitors the level and structure of remuneration for executive management.
- > Approves annual performance objectives
- > Ensure incentives are aligned with prudent risk taking

#### Risk Committee

- > Reviews the design and implementation of risk management
- > Reviews the Group's ICAAP
- > Monitors the risk framework

#### Executive Committee

The Executive Committee is responsible for developing the business and delivering against a Board approved strategy, putting in place effective monitoring, control mechanisms and setting out a framework for reporting to the Board.

#### Operations Committee

- > Provides operational oversight
- > Assures quality and performance management

#### Group Product Committee

- > Approves the Product Approval and Management policy
- > Carries out annual reviews of all products across the Group
- > Reports to ERM as necessary

#### Asset and Liability Committee

- > Identifies, manages and controls balance sheet risks;
- > Oversees and monitors Liquidity control frameworks;
- > Oversees and monitors of Capital control frameworks;
- > Recommends Liquidity, Funding, Market and Counterparty Risk policy for approval; and
- > Recommends Liquidity and Market Risk Appetite Statements and limits for approval and monitoring.

## Corporate governance report (continued)

### Enterprise Risk Management Committee

- > Oversees the design and implementation of the Risk Management Framework; and conduct of business issues including fair outcomes for customers
- > Oversees regulatory reporting requirements and the Financial Crime and Anti-Money Laundering (AML) regime
- > Defines detailed risk appetite limit and statements and recommends to Board Risk Committee material risk appetite limits and statements
- > Oversees working groups which ensure risks and trends are appropriately managed. In 2017 the ERMCM formed three new working groups covering Complaints, Broker & Intermediary Management and Collections & Recoveries.

### Model Management Group

- > Ensures that the Group has in place, and operates effective, appropriate and robust procedures and business processes for managing the Group's models and model risk policy.
- > Accountable for the overall model maintenance and governance across the Group
- > Approves/ratifies the model inventory

### Impairment Committee

- > Oversees impairment forecasts and budgets
- > Monitors impairment from lending portfolios

### Credit Approval Committee

- > Considers and approves individual credit proposals submitted by the business units of the Group which fall outside their permitted delegated lending authority

### Policy Review Group

- > Ensures that the Group has in place, and operates effective and appropriate policies
- > Maintains policies and governance across the Group
- > Oversees the Group Policy Inventory including the annual refresh of the Group risk policies

## Corporate governance report (continued)

### The Board

The Board has responsibility for ensuring that the Group is managed effectively and in the best interests of its shareholder, investors, customers, employees and other stakeholders (including regulators) and its principal banking subsidiary, Shawbrook Bank Limited. A Framework Agreement has been established containing a formal schedule of matters reserved for the Board and those matters requiring a recommendation for shareholder approval. This document, alongside the Memorandum of Understanding, ensures the Board retains its independence when making significant decisions. The Board delegates specific powers for some matters to Board Committees, with the outputs from each Committee meeting reported to the Board regularly, thus ensuring the Board maintains the necessary oversight. More detail on the Committees and their work is described in the separate Committee Reports at pages 51 to 73.

### Roles and responsibilities

#### Chairman (Iain Cornish)

Leads the Board, ensuring its effectiveness in all aspects of its role as well as being responsible for its governance. Sets the tone for the Group and ensures effective relationships between management, the Board and the Shareholder are strong.

##### Key responsibilities:

- > Ensure effective communication with the Shareholder and other key stakeholders.
- > Promote effective flow of information between Board Directors.
- > Provide entrepreneurial leadership.
- > Ensure effective communication between Executive Directors and Non-Executive Directors.
- > Chair Board and Nomination Committee meetings.

#### Chief Executive Officer (Steve Pateman)

Responsible for the day to day management of the Group's operations, recommending the Group's strategy to the Board and the implementation of the agreed strategy. Accountable to the Board for the Group's operational and financial performance. Supported in decision making by the Executive management team. The Chief Executive Officer chairs the Executive Committee, which meets three times a month to provide oversight and scrutiny of the Group's business and consider matters that need to be escalated to the Board.

##### Key responsibilities:

- > Maintain a good working relationship with the Chairman and all Directors.
- > Assess the principal risks of the Group.
- > Lead relationships with government, authorities, regulators and stakeholders.
- > Ensure effective internal controls and management information systems are in place.
- > Responsibility for the performance of the Group's obligations under the Senior Manager and Certification Regime.

#### Senior Independent Director (Robin Ashton)

Provides a sounding board for the Chairman and serves as an intermediary for the other Directors when necessary. Available to the Shareholder if they have concerns, which the normal channels of Chairman, Chief Executive Officer or other Executive Directors have failed to resolve, or for which such contact is inappropriate.

##### Key responsibilities:

- > Leads the planning for the succession of the Chairman of the Board.
- > Meet with other Non-Executive Directors to appraise the Chairman's performance.
- > Provide feedback to the Chairman, Shareholder and Executive Directors on the Independent Non-Executive Directors' views.

#### Non-Executive Director's

Provide constructive challenge to management, and bring experience and objectivity to the Board's discussions and decision making. Monitor the delivery of the Group's strategy against the governance, risk and control framework established by the Board. Led by the Senior Independent Director, the Non-Executive Directors are also responsible for evaluating the performance of the Chairman.

## Corporate governance report (continued)

### Further responsibilities:

- > Scrutinise management performance.
- > Ensure the integrity of financial information and ensure that the financial controls and systems of risk management are effective.
- > Seek independent professional advice if needed.

### Company Secretary (Daniel Rushbrook)

All Directors have access to the services of the Company Secretary in relation to the discharge of their duties. Responsible for working with the Chairman to develop Board and Committee agendas and to ensure that all Board procedures are complied with. Advises the Board on corporate governance, legal, regulatory and compliance matters and developments.

### Additional duties:

- > Ensure the Group's governance framework is maintained.
- > Organise Directors' training and induction.
- > Oversee Board and Committee administration and record keeping.

### Division of responsibilities

There is a clear division of responsibility at the head of the Group. The roles of the Chairman and the Chief Executive Officer are separate, clearly defined in writing and have been agreed by the Board.

### Board Committees

The Board has a number of Committees: Audit, Risk, Nomination and Remuneration. The written terms of reference of the Committees, including their objectives and the authority delegated to them by the Board, are available upon request from the Company Secretary or via the Group's website at [investors.shawbrook.co.uk](http://investors.shawbrook.co.uk). All Committees have access to independent expert advice and the services of the Company Secretary. Each Committee Chairman reports on activities throughout the year, highlighting anything which needs to be brought to the wider Board's attention. The terms of reference of each Committee are reviewed annually to ensure that the Committees are operating effectively and any changes considered necessary are recommended to the Board and the Shareholder for approval.

The Board has a Disclosure Committee, which is responsible for monitoring, evaluating and enhancing disclosure controls and procedures within the Group. In particular, responsibilities set out in its terms of reference include the identification of inside information and maintenance of insider lists, the design, implementation and evaluation of disclosure procedures and the resolution of any questions concerning the materiality of certain information. The Disclosure Committee also ensures the Group makes timely and accurate disclosure of all information where disclosure is required to meet legal and regulatory obligations.

The Board delegates daily management responsibility for the Group to the Chief Executive Officer and the Executive management team, who meets three times a month. The Executive Committee is responsible for developing the business and delivering against a strategy approved by the Board and ensuring effective monitoring and control mechanisms. There are also a number of executive sub-committees (a table showing the governance structure is set out on page 43) which assist the Executive Committee in discharging its responsibilities.

### Composition, Board Balance and Time commitment

The Board currently consists of 11 members, namely the Chairman, six Independent Non-Executive Directors, two Executive Directors and two Non-Independent Non-Executive Directors. Biographical details of all Directors are given on pages 39 to 42.

The Non-Executive Directors have strong and relevant experience across all aspects of banking, including relevant skills in financial management, regulatory, credit assessment and pricing, liability management, technology, operational and conduct matters. To ensure the Board continues to have an appropriate balance of skills, these skill sets are reviewed annually through the completion of a skills matrix which is considered by the Nomination Committee and the Board.

The Board considers that the balance of skills and experience is appropriate to the requirements of the Group's business and that the balance between Executive and Non-Executive Directors allows it to exercise objectivity in decision making and proper control. Each member of the Board has had access to all information relating to the Group, the advice and services of the Company Secretary (who is responsible for ensuring that governance procedures are followed) and, as required, external advice at the expense of the Group.

The Board keeps under review the structure, size and composition of the Board (and undertakes an evaluation to ensure it retains an appropriate balance of skills, knowledge and experience). The Board also reviews the membership of the various Board committees and the expected time commitment.

## Corporate governance report (continued)

The terms of appointment of the Non-Executive Directors specify the amount of time they are expected to devote to the Group's business. They are currently required to commit to at least four days per month which is calculated based on the time required to prepare for and attend Board and Committee meetings, meetings with the Shareholder and training.

### Meetings and attendance

The Board holds meetings at regular intervals, at which standing items such as the Group's financial and business performance, risk, compliance, IT, human resources and strategic matters are reviewed and discussed. There is a comprehensive Board pack and agenda which is circulated beforehand so that Directors have the opportunity to consider the issues to be discussed. Detailed minutes and any actions arising out of discussions are documented.

Regular meetings are scheduled up to a year in advance, and if any Director is unable to attend then they may provide comments on the papers to the Chairman before the meeting. Meetings are structured so that appropriate time is devoted to all agenda items. In addition to these regular, scheduled meetings, ad hoc Board meetings are held outside the published cycle where circumstances require; including but not limited to approval of appointments to the Board, any material transactions or the approval of regulatory submissions.

In 2017, there were 42 Board meetings. 10 Board meetings were scheduled and there were 11 ad-hoc meetings to discuss matters ranging from acquisitions to the Additional Tier 1 (AT1) issuance. 21 further Board meetings were held to discuss the change in ownership of the Group. As a result of her involvement with Marlin Bidco Limited, Lindsey McMurray did not attend the first three scheduled Board meetings of the year, nor any of the Board meetings to discuss the change in ownership of the Group.

The Board held a strategy workshop with the Executive management team in October 2017 to discuss the Group's strategic plan.

Attendance at the scheduled Board meetings is shown below:

Director	Date appointed or resigned in the year	Meetings attended/ meetings eligible to attend as a Director
Iain Cornish		10/10
Robin Ashton		10/10
Cédric Dubourdieu	Appointed 5 September 2017	4/4
Andrew Didham	Appointed 1 February 2017	10/10
David Gagie		9/10
Sally-Ann Hibberd		10/10
Stephen Johnson	Resigned 23 January 2018	9/10
Paul Lawrence		10/10
Roger Lovering		9/10
Lindsey McMurray		7/10
Dylan Minto	Appointed 6 February 2017	9/9
Steve Pateman		10/10

Throughout the relevant period, the Chairman has held a number of meetings with Non-Executive Directors, without the Executive Directors being present. The Senior Independent Director has held meetings with Non-Executive Directors, without the Chairman being present.

## Corporate governance report (continued)

### Independence

The Board has reviewed the independence of each of the Non-Executive Directors who have served on the Board throughout the financial year and concluded that Robin Ashton, Andrew Didham, David Gagie, Roger Lovering, Paul Lawrence and Sally-Ann Hibberd are independent. Lindsey McMurray and Cédric Dubourdieu, who represent the Group's Shareholder, are not considered independent. During the relevant period, the Board has operated with due regard to the UK Corporate Governance Code (the "Code") requirement that at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent.

The Non-Executive Directors are considered to be of sufficient calibre and experience to bring significant influence to bear on the decision making process. The Board has considered the Independence of Roger Lovering who is a Non-Executive Director of Amigo Loans, which has a wholesale facility from the Group; Andrew Didham who is a Non-Executive Director of Jardine Lloyd Thompson Group plc who are the Group's insurance broker; and Sally-Ann Hibberd who is a Non-Executive Director of Equiniti Group plc, which was the Group's share registrar during and up to the delisting of the Company. The Board concluded that these outside interests do not affect their independence. This is based on observations of the way the above Directors have discharged their duties as members of the Board Committees and their contribution to and challenge in Board meetings.

### Conflicts of interest

All Directors have a duty to avoid situations that may give rise to a conflict of interest (in accordance with s175 of Companies Act 2006). Formal procedures are in place to deal with any conflict of interest. Directors are responsible for notifying the Chairman and the Company Secretary as soon as they become aware of any actual or potential conflict of interest for discussion by the Board, who will take into account the circumstances of the conflict when deciding whether to permit potential conflict or to impose conditions on the Director in the interests of the Group. Any actual or potential conflicts of interest are recorded in a central register and Directors are also required, on an annual basis, to confirm that they are not aware of any circumstances which may affect their fitness and propriety and therefore their ability to continue to serve on the Board. In addition, Directors are required to seek the Board's approval of any new appointments or changes in commitments.

### Induction, training and professional development

On appointment, all new Directors receive a comprehensive and tailored induction, having regard to any previous experience they may have as a Director of a publically listed company. The Group also provides additional induction materials and training for those Directors who are also Committee Chairman. The content of our Director induction programmes are tailored and scheduled, with input from the new Director. The induction information is delivered in a variety of formats; including face to face meetings with the Chairman, Board Directors and Executive management, and input from external advisers as appropriate. This is supplemented by the provision of key governance documents as reading material, including policies, procedures, Board and Committee minutes, the Board meeting schedule, the Group structure chart and copies of the Code, the FCA Handbook, regulatory codes/requirements and information on Directors' duties and responsibilities under the Companies Act 2006 and other relevant legislation.

Tailored training is made available to all newly appointed Directors, ensuring any previous experience they may have as a Director of a financial services company or otherwise is considered. An ongoing programme of training is available to all members of the Board which includes professional external training, internal on-line training and bespoke Board training on relevant topics such as regulatory and governance developments, changes to the Companies Act 2006 or accounting requirements. Directors are also encouraged to devote an element of their time to self-development, including attendance at relevant external seminars and events. This is in addition to any guidance that may be given from time to time by the Company Secretary.

The Chairman is responsible for reviewing the training needs of each Director, and for ensuring that Directors continually update their skills and knowledge of the Group. All Directors are advised of changes in relevant legislation, regulations and evolving risks, with the assistance of the Group's advisers where appropriate. During 2017, scheduled training was provided to the Board on Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), IFRS 9 requirements, the FCA's regulation of conduct, Data Management, Credit Grading Systems and Corporate Governance developments.

The Board receives detailed reports from Executive management on the performance of the Group at its meetings and other information as necessary. Regular updates are provided on relevant legal, corporate governance and financial reporting developments. The Board frequently reviews the actual and forecast performance of the business compared against the annual plan, as well as other Key Performance Indicators.



## Corporate governance report (continued)

### Internal Board Evaluation

The Board carried out an internal evaluation of the performance of the Board during 2017, in accordance with the guidance set out in the Code. Further to the change of ownership the Board thought it important to assess the performance and effectiveness of the Board across the year. Each Director was provided with a questionnaire and the results were presented to the Board for consideration on 5 December 2017. Areas for the evaluation included, composition of the Board and associated governance processes, workings of the Audit and Risk Committee and behaviours and activities of Directors. The result of the evaluation indicated that the Directors consider the Board to be performing effectively.

### Internal control

The Board has overall responsibility for the Group's system of internal control and for monitoring its effectiveness. The Audit Committee and Risk Committee have been in operation throughout the relevant period and oversee the Group's system of internal control. Material risk or control matters are reported by the Audit Committee and Risk Committee to the Board. The Board monitors the ongoing process by which 'top risks' affecting the Group are identified, measured, managed, monitored, reported and challenged. This process is consistent with both the Group Risk Management Framework and with internal control and related financial and business reporting guidance issued by the Financial Reporting Council in September 2014, and has been in place for the relevant period under review and up to the date of approval of the Annual Report & Accounts. The key elements of the Group's system of internal control include regular meetings of the Executive Management and Risk Committees, together with annual budgeting, and monthly financial and operational reporting for all businesses within the Group. Conduct and compliance are monitored by management, the Group Risk function, Internal Audit and, to the extent it considers necessary to support its audit report, the External Auditor.

The Board assesses the effectiveness of the Group's system of internal controls (including financial, operational and compliance controls and risk management systems) on the basis of:

- > established procedures, including those already described, which are in place to manage perceived risks;
- > reports by management to the Audit Committee and Risk Committee on the adequacy and effectiveness of the Group's system of internal control and significant control issues;
- > under the direction of the Chief Risk Officer, the continuous Group wide process for formally identifying, evaluating and managing the significant risks to the achievement of the Group's objectives; and
- > reports from the Audit Committee on the results of internal audit reviews and work undertaken by other departments.

The Group's system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve the Group's objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss. In assessing what constitutes reasonable assurance, the Board considers the materiality of financial and non-financial risks and the relationship between the cost of, and benefit from, the system of internal control. During 2017, the Group continued to invest in its risk management capability to ensure that it remained relevant, appropriate and scalable to support the Group's objectives over the duration of the strategic plan, and continued to embed improvements into the Group's Risk Management Framework.

Lines of responsibility and delegated authorities are clearly defined. The Group's policies and procedures are regularly updated and distributed throughout the Group. The Audit Committee and Risk Committee receive reports on a regular basis on compliance with the Group's policies and procedures.

Shawbrook Bank Limited (the main operating subsidiary of the Group) is subject to regulation by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) and as such undertakes an ICAAP and ILAAP on a regular basis. These processes benefited from ongoing improvements in risk assessment during 2017 including, in the case of the ICAAP, an update to reflect the latest guidance from the PRA on approaches to the calculation of Pillar 2 capital. The ICAAP and ILAAP are reviewed by the Board at least annually. The process involves an assessment of all the risks that the Group faces in its operating environment, the likelihood of those risks crystallising and their potential materiality and the effectiveness of the control framework in mitigating each risk. This includes a thorough evaluation of how the Group would be impacted by severe, but plausible, periods of stress in its stress testing programme.

The purpose of the process is to establish the level and quality of capital resources that the business should maintain, both under current market conditions and under a range of stressed scenarios, in order to ensure that financial resources are sufficient to successfully manage the effects of any risks that may crystallise.

## Corporate governance report (continued)

### Cyber resilience

The Group recognises the importance of cyber resilience. The Board oversees the Group's cyber resilience approach and the level of investment into cyber security, providing robust challenge and scrutiny to ensure that the Group is adequately mitigating the threats it faces. The Board recognises that specialist knowledge is required in this area and therefore seeks relevant advice from third parties where appropriate. The cyber resilience strategy is routinely monitored by the Risk Committee and reviewed by the Board on an annual basis. The review takes into account the latest cyber threat intelligence assessment, the specialist nature of cyber threats and any outsourcing risks faced by the Group in this area. This ensures that the strategy remains fit for purpose to combat the potential cyber threats the Group may face.

### Relationship with the Marlin Consortium

Following the change of ownership, the Group remains committed to maintaining a constructive relationship with the Shareholder whilst not compromising its independence. As previously mentioned on page 10 the Company is now 100% owned by Marlin Bidco Limited.

The Chief Executive Officer and the Chief Financial Officer meet with the Shareholder and their representatives on a regular basis outside of regular Board and Committee meetings. The Shareholder has the opportunity to meet with the Chairman and/or other Non-Executive Directors on request.

The Group recognises the potential impact of the change of ownership on governance and independence arrangements. To ensure that the governance arrangements with the Shareholder are clearly established, the Group has entered into a Framework Agreement and Memorandum of Understanding which outlines the responsibilities each party has to one another. The Framework Agreement ensures that information flows are clear, that the independent judgement of the Board is not impacted and that the Board retains its oversight of the business in respect of strategy, performance, risk appetite and assessment of the control framework and governance arrangements. The Memorandum of Understanding ensures that the independence of the Board is protected, particularly in relation to the appointment of Independent Non-Executive Directors to the Board and its Committees. It ensures that there will always be a majority of Independent Non-Executive Directors in line with good governance practice and the Code. As set out in the Framework Agreement the Marlin Consortium has used the right to appoint two Directors to the Board, both of whom are considered Non-Independent Non-Executive Directors.

The Group recognises the importance of ensuring effective communication with all of its stakeholders. This report, together with a wide range of other information, including the half-yearly financial report and regulatory announcements are made available on the Investor section of the Group's website at [investors.shawbrook.co.uk](http://investors.shawbrook.co.uk).

## Corporate governance report (continued)

### Report of the Nomination Committee

I am pleased to present the report of the Nomination Committee.

During 2017 the Committee focused on a wide range of governance, succession and development matters. This has included working with the Group Human Resources Director to oversee an externally facilitated executive assessment which provided a thorough evaluation for our Executive management. We remain committed to the continued development of key personnel within the business and ensuring a pipeline of executive talent to enable us to deal with any future requirements at Board and senior management levels. We will continue to keep succession planning and talent development under close review as part of our annual agenda.

During the year, the Committee recommended the appointment of Andrew Didham as Chairman of the Board Audit Committee and Cédric Dubourdieu as a Non-Executive Director. Both Andrew and Cédric, who joined following the acquisition of the Group, underwent a fitness and propriety assessments before joining the Board. Both Directors also undertook a thorough induction process to assist with his familiarisation of the Group. Dylan Minto was appointed Chief Financial Officer, following a comprehensive recruitment process involving external candidates. The Committee agreed that Dylan, who held the interim position for eight months, was the strongest candidate. This evidences the Committee's focus on Executive management as well as Board level talent development and succession planning. The Committee also recommended the appointment of a new Money Laundering Reporting Officer.

As highlighted within my Chairman's introduction, I have taken the decision to step down from the Board. Following a comprehensive search, a candidate has been identified and regulatory approval is awaited. The Committee is confident that the chosen candidate, will bring a vast wealth of expertise and experience to the Board and will continue to lead the Group with integrity. I will take all steps to ensure a smooth succession.

Diversity and inclusion remains a strategic priority for the Group. The Committee and Board recognise the importance of diversity in enabling Board effectiveness and improving the quality of decision making, and are committed to increasing the diversity of the Board. This commitment is reflected in us signing the Government's Women in Finance Charter, an initiative by HM Treasury which seeks to increase the representation of women in financial services, particularly at senior levels. We have set our own targets in line with the Charter to achieve a third of women on our Board and 40% in senior management positions by 2020. Our approach to diversity is described on page 53.

Looking ahead, the Board plans to undertake an externally facilitated Board effectiveness review in 2018 which will build on the progress since the last external review in 2016. The review will look at the Board's membership, the focus of its work, its delegation to Committees and to its Executive management and its culture and the effectiveness of arrangements between the Board and shareholders.

Further information on the activities of the Committee is provided in the following report.

**Iain Cornish**

Chairman of the Nomination Committee

7 March 2018

## Corporate governance report (continued)

### Role of the Nomination Committee

The Nomination Committee's principal function is to keep the Board's governance, composition, skills, experience knowledge and independence and succession plans under review and to make appropriate recommendations as to appointments to the Board.

As part of the identification and nomination process, the Committee carries out a formal selection process for Executive and Non-Executive Directors is undertaken and subsequently recommends to the Board any new appointments. As set out in the Framework Agreement, Shareholder approval is then sought. The Committee also has oversight of the recruitment for anyone designated as a Senior Manager under the Senior Managers and Certification Regime.

### Membership, composition and meetings

The Nomination Committee is chaired by Iain Cornish (the Chairman of the Group) and its membership comprises three Non-Executive Directors, a majority of whom are Independent Non-Executive Directors in line with provision B.2.1 of the Code.

Meetings are held at least four times per year. The Nomination Committee met on nine occasions during 2017 to discuss proposed appointments, succession and development and to evaluate the balance of skills, experience, independence and knowledge on the Board. Meeting attendance during 2017 is set out below.

Member	Meetings attended/ Meetings eligible to attend as a member
Iain Cornish	4*/9
Robin Ashton	9/9
Paul Lawrence	8**/9

\* Iain Cornish did not attend meetings relating to his succession planning. In line with provision B.2.1 of the Code, Robin Ashton, as the Senior Independent Director chaired those meetings.

\*\*Paul Lawrence did not attend one meeting given it was considering his appointment to the Remuneration Committee.

At the invitation of the Chairman of the Nomination Committee, on occasion, other attendees included the Chief Executive Officer, Human Resources Director.

At the beginning of 2018, Lindsey McMurray and Cédric Dubourdieu joined the Committee.

### Appointments

The Committee ensures that a diverse pool of candidates is considered for any vacancy which arises and any appointments are made based on merit, having regard to the skills, competencies and experience of the candidate.

During the year, a key focus for the Committee was the succession of the Chairman. The appointment process for the future Chairman involved Ridgeway Partners, who were appointed to support the search. Ridgeway Partners confirmed on appointment, that they have no other connection with the Group. The specification for the role was agreed by the Committee, with input from the Chief Executive Officer, Committee members and the institutional directors. Key attributes for the position included extensive banking and previous Chairman experience in addition to regulatory credibility.

Ridgeway Partners provided a shortlist of candidates who were compared against the role profile and candidate brief. Candidates were interviewed by members of the Nomination Committee.

The Committee also carried out relevant reviews and evaluations in respect of all other appointments. For Andrew Didham, Dylan Minto and Cédric Dubourdieu this included skills and fitness and propriety assessments after which the Committee recommended their appointments. All underwent a well planned induction programme.

## Corporate governance report (continued)

### Diversity

The Group is committed to improving diversity in its membership and whilst new appointments continue to be based on skill, experience and knowledge, careful consideration is given to diversity. The Group actively supports the Women in Finance Charter, committing to increasing the representation of women across the business, particularly in relation to senior management.

When searching for candidates for Board appointments, the Nomination Committee takes into account a number of factors, including the benefits of diversity, including gender diversity, and the balance of the composition of the Board. The overriding requirement is to ensure that recommendations for appointments are made on merit against objective criteria, and that the best candidates are put forward for Board appointments.

### Succession planning

The Committee is responsible for ensuring that appropriate succession and development plans are in place for appointments to the Board. We are satisfied that the succession planning structure in place is appropriate for the size and nature of the Group. Succession planning arrangements will be kept under regular review in the future.

### Executive and Non-Executive Director Induction

All new Directors are required to take part in an induction process. This includes comprehensive training in line with the Senior Managers and Certification Regime as prescribed by the PRA and FCA. In addition, Directors are required to undertake training in the regulatory and compliance frameworks, and are also required to gain an understanding of relevant legal requirements such as the Market Abuse Directive and Money Laundering legislation. Inductions also include sessions with the Chairman, Directors, Executive management and external advisors to gain insight into the organisation. Training is tailored to the requirements of each Director's role.

Cédric, Dylan and Andrew received induction's tailored to their knowledge and experience, this included:

- > understanding the role of sub-committees and governance structures;
- > gaining an overview of Board Director duties, responsibilities and protocols;
- > reviewing past Board packs, Committee packs and minutes;
- > gaining an understanding of current issues relevant to the Board;
- > understanding the strategic implementation of the Board's policies in relation to corporate governance across the Group and amongst the management team;
- > receiving a full briefing on UK Conduct Standards, Senior Managers Regime and Prudential Regulation;
- > receiving a full briefing on the UK Corporate Governance Code;
- > meeting with divisional heads to consider, in depth, the key challenges facing their businesses;
- > meeting key external Group advisers; and
- > holding discussions with the Chairman and Company Secretary.

In line with provision B.4 of the Code, in addition to providing an induction when Directors join the Board, care is taken to ensure they update and refresh their skills and knowledge.

### Election of Directors

Having reviewed the findings of the Board effectiveness process, the Nomination Committee is satisfied that the Board continues to be effective and has recommended to the Board that each of the Directors should stand for re-election (in line with provision B.7.1 of the Code) at the 2018 Annual General Meeting.

### Primary areas of focus during the year

During the relevant period the Nomination Committee considered the following principal items:

- > the appointment of a new Chairman;
- > a review of the current structure, size and composition of the Board;
- > the time commitment expected of Non-Executive Directors leadership and succession planning;
- > the proposed election and re-election of Directors at the forthcoming Annual General Meeting;
- > the appointment of a new Non-Executive Director;
- > the appointment of a new Chief Financial Officer;
- > responsibilities under the Senior Managers and Certification Regime;
- > Board effectiveness, and
- > the implementation of the Group's Diversity Policy.

## Corporate governance report (continued)

### Report of the Audit Committee

I am pleased to present my report as Chairman of the Audit Committee, a role which I assumed on 1 February 2017, having succeeded Roger Lovering, who remains a Committee member. As a Committee, we possess recent and relevant financial experience in line with good governance practice across the sector and included within the Code

We have continued to focus on the issues relevant to the Group's financial reporting, considering emerging trends, and overseeing the Group's internal control framework to ensure it remains robust and fit for purpose.

In the year, the Committee also undertook a formal competitive tender process of the External Auditor, which saw KPMG LLP reappointed.

The Committee's annual work plan is framed around the Group's financial reporting cycle which ensures that the Committee considers all matters delegated to it by the Board and covers a review and challenge of the significant accounting estimates and judgments, which are set out in a table in Note 1.8 of the financial statements. We also received reports from the Internal Audit function, which included cyber, responsible lending, conduct risk, financial crime and divisional deep dives.

The roll out of the IFRS 9 implementation programme was a key focus of the Committee with the bulk of the testing and implementation taking place in 2017. During the year the Committee received regular reports on the progress of this project, and has challenged Executive management to ensure its implementation runs smoothly. Progress has been made in developing our Expected Credit Loss (ECL) models, including our Credit Grading Framework. The IFRS 9 programme sponsored jointly by the Chief Financial Officer and Chief Risk Officer and managed by a single steering committee, will be implemented in mid-2018.

**Andrew Didham**  
Chairman of the Audit Committee

7 March 2018

## Corporate governance report (continued)

### Accountability

#### Role of the Audit Committee

The Audit Committee is responsible on behalf of the Board, for, amongst other things:

#### Financial reporting process

- > the significant areas of judgement and their application to the results of the Group;
- > reviewing the Group's Annual Report & Accounts and the Group's Interim Report to ensure that, taken as a whole, based on the information supplied to it and challenged by the Committee and on its judgement is fair, balanced and understandable and advising the Board to that effect;
- > monitoring the integrity of the Annual Report & Accounts and the Interim Report and reviewing the critical accounting policies, disclosure obligations and changes in accounting requirements;
- > reviewing and challenging the going concern and viability assessment undertaken by Executive management, further details of which can be found on page 35; and
- > reviewing the Group's Pillar 3 disclosures to ensure compliance with prescribed requirements.

#### Internal controls and risk management

- > considering the process used to evaluate the effectiveness of internal controls, financial reporting and risk management;
- > considering the extent of the work undertaken by the finance function and ensuring the finance teams have adequate resources to ensure that the control environment continues to operate effectively;
- > continuously considering any findings of internal investigations into control weaknesses, fraud or misconduct and management's responses to any deficiencies identified; and
- > risk management consideration and monitoring is carried out in partnership with the Risk Committee.

#### External audit

- > making recommendations to the Board in relation to the appointment, re-appointment and removal of the External Auditor and approving the auditor's remuneration and terms of engagement; and
- > reviewing the findings of the External Audit and the level of challenge produced by the External Auditor and considering management's responsiveness to the findings and recommendations.

#### Internal audit

- > monitoring the activity, role and effectiveness of the Internal Audit function and their audit programme;
- > approving the audit plan and budget and monitoring the progress against it at regular intervals, confirming that appropriate resource and capability is in place to execute the plan effectively; and
- > considering the internal audit reports, including thematic and routine reviews on prudential and regulatory compliance.

#### Whistleblowing

- > continuously considering the Group's whistleblowing policies and procedures, including the protection of whistleblowers.

#### Membership and meetings

The Audit Committee comprises seven members. In line with provision C.3.1 of the Code, the majority of the Committee are Independent Non-Executive Directors and have recent and relevant financial experience.

The Committee meets as required, and met formally six times last year.

## Corporate governance report (continued)

The attendance of Directors eligible to attend during the period is shown below.

Member	Meetings attended/ meetings eligible to attend as a member
Andrew Didham	6/6
Roger Lovering	5/6
Robin Ashton	6/6
David Gagie	6/6
Paul Lawrence	6/6

The Company Secretary acts as secretary to the Committee. Other individuals attend at the request of the Committee Chairman.

During the year, the External Auditor, Chairman of the Board, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Internal Audit and other senior managers as appropriate (where provision of clarification and explanation on reports is required) attended the meetings of the Committee. The Committee also met with the external and internal auditors without Executive management on regular occasions in 2017.

The Board is satisfied that Andrew Didham has recent and relevant financial experience, as referred to in the Code. The Committee also believes it has the competence as a whole, relevant to the sector in which the Group operates. Biographical details can be found on pages 39 to 42.

Lindsey McMurray and Cédric Dubourdieu joined the Committee on 27 February 2018.

A full copy of the terms of reference for the Audit Committee can be obtained by request to the Company Secretary or via the Group's website at [investors.shawbrook.co.uk](http://investors.shawbrook.co.uk).

### Significant areas of judgement

During 2017, the following significant issues and accounting judgements were considered by the Committee in relation to the 2017 Annual Report & Accounts:

### Significant financial and reporting issue

### How the Committee addressed the issue

#### Impairment of loans and advances

The Committee received presentations from Executive management explaining the provisioning methodology across the Group's lending operations ahead of both the interim and full year results. The Committee considered and challenged the provisioning methodology applied by management, including the inputs to the statistical loan loss models prepared by the Group Risk function. The Committee also considered the calibration of model parameters in the light of economic indicators, including house price movements and underlying book performance.

The Committee also considered the movements in arrears balances, impairment coverage ratios and non-performing loan ratios throughout the year and concluded that these were appropriately monitored during the year.

The Committee concluded that the impairment provisions, including management's judgements, were appropriate. The disclosures relating to impairment provisions are set out in Note 14 to the financial statements.



## Corporate governance report (continued)

### Effective interest rate

Interest earned on loans and receivables is recognised using the Effective Interest Rate (EIR) method. The EIR methodology of accounting uses a discounted cash flow model to spread interest and fee income and expenses attributable to loan assets, including costs and other premium and discounts, over the estimated life of the asset. EIR is calculated on the initial recognition of loan lending through a discounted cash flow model that incorporates fees, costs and other premiums or discounts. There have been no changes to the EIR accounting policies during the year.

The Committee considered and challenged the EIR methodology applied by Executive management, including expected future customer behaviours, redemption profiles and changes to existing redemption profiles and concluded that the EIR methodology was appropriate as at 31 December 2017. The disclosures relating to EIR are set out in Note 3 to the financial statements.

### Impairment assessment of goodwill

The Committee considered and challenged the annual assessment of the carrying value of goodwill. Following the review and challenge of the Group's value in use calculations and key assumptions, the Committee agreed with management's conclusion that the Group's carrying value of goodwill as at 31 December 2017 was reasonably stated.

### Conduct risk

The Group's Consumer Lending division is exposed to risk under s. 75 of the Consumer Credit Act (CCA), in relation to any misrepresentations or breaches of contract by suppliers of goods and services to customers where the purchase of those goods and services is financed by the Group. While the Group would have recourse to the supplier in the event of such liability, if the supplier becomes insolvent then that recourse would have limited value.

The Committee considered the increase in exposures to insolvent suppliers, specifically in the case of the Group's exposure to s.75 of the CCA relating to solar panels and in 2017, the Group's Consumer Lending division has seen an increase in the number of customer complaints which relate either to the quality of the panels or to representations allegedly made by suppliers as to the expected financial performance of the panels.

The Committee concluded that the provisioning against conduct risk exposures was appropriate as at 31 December 2017. The disclosures relating to conduct risks are set out in Note 23 and 35 of the financial statements.

### IFRS 9

The Committee received regular updates through the year on management's progress in preparation for the introduction of IFRS 9 which will require provisioning methodology to take into account future expected losses. The Committee has noted the considerable progress made during the year while also recognising the extent of the review still required to successfully implement this significant accounting change. As the group enters the 2018 financial year, the Committee will continue to monitor progress closely. Further disclosure around the Group's progress is outlined in Note 1.10.1 of the financial Statements.

In addition to the matters described above, the Committee considered issues relating to the acquisition of the Group, IFRS 9 implementation process and the acquisition of loan books and a Jersey based portfolio of loans and products closely aligned to the Group's current Business Finance offering. The Committee was regularly updated on the progress of the IFRS 9 programme against the programme plan. Areas of focus include the review and interpretation and of technical accounting opinions, policy setting and operational changes required in the Finance function to implement IFRS 9.

## Corporate governance report (continued)

### Financial reporting process

During the year, the Audit Committee reviewed and discussed the financial disclosures made in the Annual Report & Accounts, half-yearly financial report and other trading statements made by the Group up to the point of delisting, together with any related management letters, letters of representation and reports from the External Auditors. Significant financial reporting issues and judgments were considered together with any significant accounting policies and changes proposed to them.

### Going concern and long-term viability

The Committee reviewed a detailed paper presented by management setting out the assumptions underlying the going concern statement. The paper covered the capital position of the Group, embedding of the Group's Risk Management Framework and governance, and the work performed on the Group's ICAAP and ILAAP. Based on the work performed, the Committee concluded that the Group will have adequate resources to continue in operational existence for the period of assessment of 12 months from the date of signing the accounts. The Committee reported accordingly to the Board, which also considered Going Concern in detail.

In order to support the Board's approval of the statement on page 35 as to the longer term viability of the Group, the Committee reviewed papers from management setting out the intended approach to the disclosures and providing details in support of the statement based in particular on the Group's medium term plan and the results of stress testing.

### Internal controls and risk management

The Audit Committee annually assesses the Risk Management Framework and principal risks and uncertainties on a financial control basis. Details of the risk management systems in place and principal risks and uncertainties are provided within the Risk management report on pages 21 to 35. The Group's system of internal control has been designed to manage risk and whilst risk cannot be eliminated, the system assists with the provision of reasonable assurance against material misstatement or loss.

The Audit Committee receives reports on a regular basis on compliance with the Group's policies and procedures and the effectiveness of the Group's systems and controls.

The Risk and Internal Audit functions review the extent to which the system of internal control is effective; is adequate to manage the Group's principal risks; safeguards the Group's assets; and, in conjunction with the Company Secretary and the Group's Legal and Compliance functions, ensures compliance with legal and regulatory requirements. It provides independent and objective assurance on risks and controls to the Audit Committee and Executive management.

### Internal Audit

The Internal Audit function as the third line of defence is outsourced to Deloitte LLP providing assurance to the Group that the specialist nature of the Group's activities can be fully assessed. The role of the Internal Audit function and the scope of its work continue to evolve to take into account of changes within the business and emerging best practice.

The work of Internal Audit is focused on areas of greatest risk to the Group, as determined by a structured risk assessment process involving Executive management. The output from the process is summarised in an annual audit plan, which is approved by the Audit Committee.

On behalf of the Board, the Committee through discharging its responsibilities under its terms of reference undertakes regular reviews of the effectiveness of the Group's systems of internal control as detailed in the section above. The Group has outsourced the Internal Audit function to Deloitte LLP since June 2013. The Committee is satisfied that in 2017 this continued to be the most appropriate way of managing the delivery of internal audit services.

The terms of reference of the Internal Audit function are set out in the Internal Audit Charter. The Audit Committee approves the annual audit plan and audit methodology for Internal Audit and monitors progress against the plan during the year. The Internal Audit Partner agrees the programme of work and reports directly to the Committee on the outcomes. Special reviews are carried out as required and requested by the Committee.

Internal Audit carried out a significant number of audits during 2017 of varying size and complexity. Thematic audits focused on, amongst other things, responsible lending, watchlist management, ICAAP and treasury management. Internal Audit reports are circulated to the Audit Committee members prior to each scheduled meeting and the Committee monitors progress against actions identified in these reports.

The Committee monitors and reviews Internal Audit's effectiveness annually, using feedback from the Board, senior management and regular attendees. Additionally, the Committee ensures that there are sufficient resources available to Internal Audit to complete its remit. Internal Audit has unrestricted access to all Group documentation, premises, functions and employees as required to enable it to perform its functions. The appointment and removal of Internal Audit staff is the responsibility of the Audit Committee.

## Corporate governance report (continued)

### External Audit

The Audit Committee oversees the relationship with the External Auditor and considers the External Auditor's engagement (including remuneration), their effectiveness, their continued independence and their objectivity. The Committee also considers audit and audit strategy (including the planned levels of materiality). The External Auditor attends the Committee meetings as appropriate and meets at least annually with the Committee without Executive management. The Chairman of the Committee also meets privately with the External Auditor before each Committee meeting.

During the year, the Committee received regular detailed reports from the External Auditor including formal written reports dealing with the audit objectives; and reports on: the Auditors' qualifications, expertise and resources; the effectiveness of the audit process; procedures and policies for maintaining independence; and compliance with the ethical standards issued by the Auditing Practices Board. The External Auditor's management letter is reviewed, as is management's response to issues raised and progress is monitored against actions identified in these reports. The Committee monitors the provision of non-audit services by the External Auditor throughout the year.

The audit carried out by KPMG in respect of the Group's 2016 financial statements were subject to an in depth review by the Financial Reporting Council (FRC). The Committee reviewed the findings and discussed them with KPMG, matters raised were included in the planning for the year-end audit for 2017.

### External Audit independence and objectivity

The Committee is responsible for reviewing the independence of the Group's External Auditor, KPMG LLP and making a recommendation to the Board on their engagement. KPMG LLP has a policy of partner rotation which complies with regulatory standards, and the audit partner changed from John Ellacott to Simon Ryder in June 2017, in line with this requirement. The Committee monitors the latest ethical guidance regarding rotation of audit partners.

Maintaining an independent relationship with the Group's Auditor is a critical part of assessing the effectiveness of the audit process. The Committee has a formal policy on the use of the Auditor for non-audit services and ensures that work is only awarded when, by virtue of the Auditor's knowledge, skills or experience are a decisive factor and when the Auditors are clearly to be preferred over alternative suppliers.

The Committee receives and reviews each year an analysis of all non-audit work and reviews the level of audit and non-audit fees paid to KPMG LLP and also ensures that significant assignments are not awarded without first being subject to the scrutiny of the Committee. The fees paid to KPMG for audit and non-audit services are set out in Note 7 of the financial statements.

### Non-Audit Services Policy

The key principles of the policy on non-audit services are:

- (i) Prohibited services include services remunerated on a success fee or participation in activities normally undertaken by management.
- (ii) The Committee approved a list of permitted audit related reviews of the Group's interim results or any other review of its accounts for regulatory purposes. (Details of the services provided by the External Auditor can be found in Note 7 of the financial statements).
- (iii) The Committee maintains a list of prohibited services which is aligned to the 'blacklist' of services set out in the EU Audit regulations and directives.
- (iv) Pre-approved services up to £100,000 require approval by the Chief Financial Officer/Chief Executive Officer or the Chairman of the Audit Committee. All services that are not pre-approved, or are discretionary or exceed the monetary threshold of £100,000 should be referred to the Audit Committee for approval.

The Committee reviewed payment for non-audit services and confirms that no prohibited services were provided by the External Auditor and it is satisfied that the policy on the supply of non-audit services could not lead to audit objectivity and independence being compromised.

During the year the Committee assessed the effectiveness of the External Auditor. The review included seeking the views of Audit Committee members and Executive management. The review concluded that the external audit process was effective.

The Committee is satisfied with the performance of the External Auditor in 2017 and the policies and procedures in place to maintain their objectivity and independence, and has recommended that they be re-appointed at the forthcoming Annual General Meeting.

## Corporate governance report (continued)

### Audit tender

The Group appointed KPMG Audit Plc as external auditor from 2011 to 2014, and KPMG LLP thereafter. The Group did not carry out a formal tender process following the Initial Public Offering in 2015, seeking to keep the audit tender under review whilst stability was created across the Group. Further to the acquisition of the Group in August 2017, and the recent increased regulation the Committee made the decision to tender the External Audit in the final quarter of 2017.

The Audit tender process was overseen by the Committee with the support from a selection panel comprising of the Audit Committee Chairman, the Risk Committee Chairman, an Independent Non-Executive Director, the Chief Financial Officer and the Head of External Reporting.

The Board resolved to re-appoint KPMG LLP as external auditor for the Group on 21 November 2017. The Group confirms it has complied with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

An outline of the process which was followed is provided below:

Stage 1 Issue of formal tender	Stage 2 Provision of information to audit firms	Stage 3 Meetings with key individuals and submissions of final proposals	Stage 4 Presentation to the Selection Committee and outcome
<ul style="list-style-type: none"> <li>An invitation to tender was issued to firms along with a deadline to submit their intent to tender.</li> <li>The firms also submitted a non-disclosure agreement and a declaration of independence.</li> <li>Two firms responded to the invitation to tender.</li> </ul>	<ul style="list-style-type: none"> <li>The Group issued both firms with all the relevant information to provide them with an overview of the Group's business, history and audit requirements.</li> <li>Firms were provided with the opportunity to ask questions and clarification on the Group to support their understanding of the business.</li> </ul>	<ul style="list-style-type: none"> <li>Firms met with key members of the Finance, Legal and Compliance, Executive management and Non-Executive Directors.</li> <li>These meetings took place over a number of weeks and allowed the Group to undertake an informal evaluation of the firms and enhance their understanding of the Group.</li> </ul>	<ul style="list-style-type: none"> <li>Both firms were asked to submit and present their final proposals to the selection committee and were then provided with an opportunity to present to the selection committee across a two hour slot.</li> <li>Following the presentations the selection committee made a recommendation to the Committee and the Board.</li> <li>After careful consideration the Board accepted the recommendation to re-appoint KPMG as external auditors for the Group.</li> </ul>

### Whistleblowing

A formalised whistleblowing policy and procedure for staff to raise issues regarding possible improprieties in matters of financial reporting or other matters has been established and was reviewed during the year. The Committee is responsible for monitoring the effectiveness of the Group's whistleblowing procedures and any notifications made. The Committee is charged with ensuring that appropriate arrangements are in place for employees to be able to raise matters of possible impropriety in confidence and performing suitable subsequent follow up action. An alternative reporting channel also exists whereby perceived wrong doing may be reported via telephone to an external third party.

The Audit Committee has access to the services of the Company Secretarial function and is authorised to obtain independent professional advice if it considers it necessary.

## Corporate governance report (continued)

### Governance

The Committee has undertaken an internal review of its own performance in the year. The review considered the effectiveness of the Committee against its terms of reference and Code requirements for Audit Committees.

### Fair, balanced and understandable

The Committee considered on behalf of the Board whether the 2017 Annual Report & Accounts taken as a whole is fair, balanced and understandable, and whether the disclosures are appropriate. The Committee is satisfied that the 2017 Annual Report & Accounts meets this requirement, and in particular, that appropriate disclosure has been made with respect to any developments in the year. In justifying this statement, the Committee has considered the robust procedures around the preparation, review and challenge of the Report and the consistency of the narrative sections with the financial statements. The Annual Report & Accounts is drafted by executive management with overall governance and co-ordination provided by the Annual Report & Accounts Working Group comprising a team of cross functional senior management.

Assurances are sought by the Audit Committee on each section of the Annual Report in advance of final sign-off by the Audit Committee and ultimately the Board.

Following its review, the Committee is satisfied that the Annual Report is fair, balanced and understandable, and provides the information necessary for the Shareholder and other stakeholders to assess the Group's position and performance, business model and strategy and has advised the Board accordingly.

### Andrew Didham

Chairman of the Audit Committee

7 March 2018

## Corporate governance report (continued)

### Risk Committee Report

I am pleased to present the report of the Risk Committee. The Risk Committee's key role is to provide oversight of and advice to the Board on the current risk exposures and future risk strategy of the Group, including the development and implementation of the Group's Risk Management Framework and for ensuring compliance with the Group's approved risk appetite.

The Risk Committee had a full agenda in 2017 which involved balancing standing areas of risk management whilst ensuring key risks which have emerged during the course of the year are appropriately addressed.

We have continued to evolve and embed risk frameworks, which included the continued oversight of the stress and scenario testing undertaken to provide comfort on the Group's ability to mitigate potential risks, including those considered in relation to the ICAAP and ILAAP before making a recommendation to Board.

Proposals were also approved to implement a Group Policy Framework under which policies, processes and procedures are governed thereby strengthening the overarching Risk Management Framework.

We undertook an externally facilitated Risk Culture Survey of the Group, the outcomes of which will be worked through to ensure we are well placed to continue embedding an appropriate risk culture in 2018.

The Risk Committee keeps under review those risks on the horizon that could have a material impact on the Group in the future. I believe we are now well positioned to monitor the environment in which the Group operates whilst reviewing inherent and emerging risks and in the face of a changing economic outlook and developments in the regulatory environment.

**Paul Lawrence**  
Chairman of the Risk Committee  
7 March 2018

## Corporate governance report (continued)

### Committee membership

The Risk Committee comprises six members, all of whom are Independent Non-Executive Directors of the Group.

The Committee meets as required, but holds at least four meetings a year. The Committee had six scheduled meetings last year, and two additional meetings.

The attendance of Directors, at the scheduled meetings is shown below:

Member	Meetings attended/ meetings eligible to attend as a member
Paul Lawrence	6/6
Robin Ashton	6/6
David Gagie	6/6
Sally-Ann Hibberd	6/6
Roger Lovering	5/6
Andrew Didham	6/6

During the year, the members of the Committee were Andrew Didham, Paul Lawrence, Robin Ashton, David Gagie, Sally-Ann Hibberd and Roger Lovering, who (with the exception of Sally-Ann Hibberd) also served on the Audit Committee throughout the reporting period. Andrew Didham was appointed to the Committee on 1 February 2017.

At the beginning of 2018, Lindsey McMurray and Cédric Dubourdieu joined the Committee..

The Company Secretary acts as secretary to the Committee. Other individuals attend at the request of the Risk Committee Chairman and during the year the External Auditors, Chairman of the Board, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, staff from the Internal Audit function and other senior managers as appropriate would usually attend meetings to report to the Committee and provide clarification and explanations where appropriate.

### Role of the Risk Committee

The purpose of the Committee is to assist the Board in its oversight of risk within the Group, with particular focus on the Group's risk appetite, risk culture, risk profile and the effectiveness of the Group's Risk Management Framework. As well as reviewing the Group's risk assessment processes and methodology it identifies and manages new risks, alongside advising on proposed transactions and reviewing reports on any material breaches of risk limits. The Committee is also responsible for monitoring and reviewing the effectiveness of the risk function and the capital adequacy requirements of the Group's relevant subsidiaries on an ongoing basis.

Over the course of 2017, the Committee considered a wide range of risks facing the Group both standing and emerging, across all areas of risk management in addition to risk appetite, conduct and culture. Below is an outline of these risks with a summary of the material factors considered by the Committee including the conclusions which were ultimately reached.

## Corporate governance report (continued)

Significant risks	Board Risk Committee review
<b>Enterprise risk management</b>	<ul style="list-style-type: none"> <li>&gt; The Committee reviewed and recommended for the Board's approval the 2018 Risk Plan which included the key areas of focus for the Risk function.</li> <li>&gt; The Committee received regular summaries of the enterprise risk profile of the Group through the Chief Risk Officer's report.</li> <li>&gt; The Committee reviewed the effectiveness of the Risk Management Framework throughout the year through the Chief Risk Officer's report.</li> <li>&gt; The Committee received updates on the three lines of defence system and risk culture through the Chief Risk Officer's report and challenged the effectiveness of the first lines of defence across the divisions.</li> </ul>
<b>Board risk appetite</b>	<ul style="list-style-type: none"> <li>&gt; The Committee received regular updates on the evolving risk appetite framework, including the provision of a monthly risk appetite dashboard which accompanies the Chief Risk Officers report at each meeting.</li> <li>&gt; The Committee reviewed the appropriateness of the risk appetite framework and statements to ensure alignment with enhancements in risk measurements and reflect ownership changes.</li> </ul>
<b>Credit risk</b>	<ul style="list-style-type: none"> <li>&gt; The Committee received regular updates on the Group's preparations for IFRS 9.</li> </ul>
<b>Operational risk</b>	<ul style="list-style-type: none"> <li>&gt; The Committee reviewed updates on the implementation of the improved product management and annual review process and product approval policy.</li> <li>&gt; The Committee received updates on a wide range of operational risks across the year, including information security.</li> <li>&gt; The Committee received updates the testing of the Cyber Incident Response Plan.</li> </ul>
<b>Conduct, legal and compliance risk</b>	<ul style="list-style-type: none"> <li>&gt; The Committee reviewed the Group's Annual Compliance Monitoring Plan and updates on performance.</li> <li>&gt; The Committee received updates on various conduct risk and legal liability risk matters, including training on the new conduct risk framework introduced by the regulator.</li> </ul>
<b>Liquidity and market risk</b>	<ul style="list-style-type: none"> <li>&gt; The Committee reviewed and recommended to the Board approval of the Internal Liquidity Adequacy Assessment Process (ILAAP).</li> <li>&gt; The Committee reviewed and recommended to the Board approval of the Contingent Liquidity Plan (CLP).</li> </ul>
<b>Stress testing and capital</b>	<ul style="list-style-type: none"> <li>&gt; The Committee reviewed the Group's Internal Capital Adequacy Assessment Process (ICAAP) in June 2017 and was actively engaged in the oversight of the macroeconomic stress testing, the development of idiosyncratic stress tests and reverse stress testing.</li> <li>&gt; The Committee received the Capital Contingency Plan (CCP) during the year.</li> </ul>
<b>Recovery and resolution plan</b>	<ul style="list-style-type: none"> <li>&gt; The Committee reviewed the Group's updated Recovery Plan and Resolution Pack during the year.</li> </ul>



## Corporate governance report (continued)

### Primary areas of focus during the year

- > ICAAP – The Committee was actively engaged in the development of the Group's ICAAP. Activities included workshops to review and approve recommendations of the Group's assessment of Pillar 2A risks and review and approval of the macroeconomic scenarios used to assess the Group's risks over a three to five- year period. The Committee was also involved in reviewing risks in the Group's business model in the assessment of idiosyncratic scenarios and reverse stress testing.
- > ILAAP – The Group undertook a comprehensive review of the ILAAP in 2017 with the Committee involved throughout. This included workshops to enhance the stress testing framework, Group liquidity risks and ensure liquidity adequacy.
- > Risk Management Framework ('RMF') – The Committee continued to challenge the embedding of the framework with a particular focus on first line of defence and review of enhancements to the design to ensure that it fully supports the business.
- > Group's Risk Appetite Framework – The Group undertook a review of the Risk Appetite Framework aligning it to the wider RMF and allowing for further refinement of the Risk Appetite Statements.
- > Regulatory and legislative change – continually assessed and monitored.
- > Review of internal controls and risk management systems.
- > Regular review of strategic, operational and credit risk events technology and information risk.
- > Risk Conduct and Culture – The Committee have continued to develop and monitor training to ensure the appropriate risk culture and conduct is embedded and further strengthened across the Group. This included carrying out a review of the results of a Risk Culture survey which was completed by staff.
- > Recovery and Resolution Plan – continued monitoring of the preparedness and contingency plan to respond to and manage levels of severe stress.

**Other matters considered in detail by the Committee in 2017**

- Implementation of Mortgage Credit Directive
- Credit Grading for IFRS 9
- Contingent Liabilities
- Risk Culture Survey

During 2017, the Group has continued its strategy to embed RMF across the business, with a particular focus on first line defence and risk culture. The RMF has provided the Group with tools to ensure that minimum standards and requirements are met when identifying, assessing, monitoring and reporting risk. Throughout the year the Committee has monitored first line defence across the divisions further to ensure that the new RMF has been suitably embedded and that a culture of risk has been established. Across the year there have been events which have driven the Committee to undertake focussed reviews into responsible lending in the Property and Business Finance divisions, to ensure that the risks are being managed adequately and that first and second line risk roles across the Group are defined appropriately.

Further to an FCA audit on the implementation of the Mortgage Conduct of Business Rules (MCOB) the Group has focused on ensuring that the procedures, policies and process in place for responsible lending are appropriate. This has included a review of affordability processes in all division with a particular focus on lending for second charge mortgages. The Risk Committee and the Audit Committee have jointly worked to ensure that training, procedures and policies adequately enhanced and align with FCA expectations.

The implementation of IFRS 9 has provided the Committee a chance to review the credit grading system which had recently been rolled out to all lending portfolios in the Group. This system will assist with the compliance with IFRS 9 and is providing enhanced credit management information, for reporting to the Committee and Board.

During 2017, an emerging risk arose around contingent liabilities, certain suppliers of goods and services to customers of the Group's Consumer Lending division, where such suppliers have gone into liquidation. The Committee has kept this under review across the year alongside the Audit Committee ensuring that the risks and responsibilities of the Group are being monitored and managed appropriately.

The Group undertook a Risk culture survey during the year, providing valuable feedback and comfort to the Committee surrounding on employees views and approach to risk. The survey was completed by 60% of participants and provided a good view of how risk is perceived across all divisions and central functions. Areas which have been highlighted for improvement will be further reviewed and monitored into 2018.

## Corporate governance report (continued)

### Priorities for 2018

The Group will continue to embed risk culture during 2018 with a key priority being to focus on divisional risk management within the Group. During 2018 the Group will complete an update on many of the items delivered in 2017 and deliver/support management and effectiveness of Risk.

The key projects which the Group Risk function are accountable for delivering in 2018 include:

- > delivery of customer aggregation methodology;
- > delivery of Basel 4 regulations into the approach for calculating Pillar 1 capital and phasing of capital floors;
- > embedding IFRS 9 compliance;
- > delivery of operational risk capital assessment enhancement including the introduction of an ICAAP modelling tool;
- > development of credit risk authorisation workflow; and
- > delivery and embedding of regulatory change projects, including Capital Requirements Directive and Regulation.

### Paul Lawrence

Chairman of the Risk Committee

7 March 2018

## Corporate governance report (continued)

### Directors' Remuneration Report

On behalf of the Board, as Chairman of the Remuneration Committee, I am pleased to present our 2017 Directors' Remuneration Report.

This year has been one of significant change at Shawbrook the change in ownership in the summer and delisting of securities which led to a number of activities for the Remuneration Committee. Set out below are the key areas of focus for the Committee during the year and going forward into 2018

The Board welcomed the appointment of Dylan Minto as Chief Financial Officer in February 2017. His remuneration arrangements are in line with the remuneration policy are set out on the following pages.

Stephen Johnson stepped down as Deputy Chief Executive Officer an Executive Director of the Company on 23 January 2018. His termination arrangements will also be determined in line with the Bank's remuneration policy and disclosed in next year's report.

Following the change in ownership, the Committee reviewed outstanding employee share awards and determined the most appropriate treatment in line with the plan rules. We determined that awards granted under the Deferred Share Bonus Plan (DSBP) would vest in full and, based on an assessment of performance to date, the Performance Share Plan (PSP) awards would also vest in full subject to time pro-rating. In addition, all employees who held options under the Sharesave (SAYE) plan were able to exercise these options using their accumulated savings.

In reviewing annual bonus outcomes, the Committee undertook a rounded assessment of the Bank's performance throughout the year. Having due regard to the impact of the change in ownership, the Committee recognised the Bank's underlying financial growth and strong performance in risk management, customer and employee engagement during the year. On that basis, the Committee approved an annual bonus pool outcome of 80% of maximum, before overlaying an assessment of individual performance to determine the individual outcomes for Executive Directors.

As we look ahead to 2018 the key priority for the Committee will be finalising its review of the long term incentive framework to ensure senior leaders of the Bank are rewarded for the delivery of our strategy under our new ownership structure.

**Robin Ashton**  
Chairman of the Remuneration Committee  
7 March 2018

## Corporate governance report (continued)

### Remuneration Governance

#### Role of the Remuneration Committee

The Remuneration Committee's principal function is to determine, for onward recommendation to the Board, the terms and conditions of employment, remuneration and benefits of each of the Chairman of the Board, Executive Directors, members of the Executive management, and all other Material Risk Takers. The Remuneration Committee exercises independent judgement on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.

#### Membership, composition and meetings

The Remuneration Committee is chaired by Robin Ashton (the Senior Independent Director) and, during the year, its membership comprised of four Independent Non-Executive Directors, one of whom is the Chairman of the Board. The Committee is mindful of the provisions relating to remuneration within the Code and have continued to adhere to good governance practice during 2017.

Meetings are held at least four times per year. The Remuneration Committee met on eight occasions during 2017. In addition to cyclical agenda items, the Committee discussed the settlement of the share schemes following the change in ownership, the development of a new long-term incentive framework and changes to the remuneration policy in light of the takeover. Meeting attendance during 2017 is set out below.

Member	Date joined or stepped down in the year	Meetings attended/ Meetings eligible to attend as a member
Robin Ashton		8/8
Sally-Ann Hibberd		8/8
Paul Lawrence	Appointed on 29 March 2017	5/5
Iain Cornish		6/8

On 27 February 2018, Lindsey McMurray and Cédric Dubourdieu joined as members of the Committee.

At the invitation of the Chairman of the Remuneration Committee, on occasion, other attendees included the Chief Executive Officer, Human Resources Director and Lindsey McMurray. No individual was present for discussions relating to their own remuneration.

Deloitte LLP provided independent advice to the Committee on all executive remuneration matters. Deloitte LLP is a member of the Remuneration Consultants Group and is a signatory to its Code of Conduct. The Committee is satisfied that the advice received from Deloitte LLP was objective and independent.

#### GUIDING REWARD PRINCIPLES

The Group seeks to reward its employees fairly for their contribution and motivate them to deliver the best outcomes for all stakeholders. This is underpinned by the following principles:

- Reward structures will be developed in alignment with the Group's strategy, ensuring they meet appropriate regulatory requirements.
- Remuneration will be determined within the Group's stated risk appetite defined as maintaining a balanced strategy to reward our employees for appropriate conduct and performance. Safeguarding the right outcomes for customers is at the heart of this.
- There will be an appropriate mix of long term and short-term variable pay arrangements in place, which will assist in driving the long term security, soundness and success of the Group.
- The long-term and short term variable pay plans will be subject to appropriate performance measures, ensuring the right balance between these elements of the reward package.
- Remuneration outcomes will be determined with reference to total reward principles. For example, when making bonus decisions, the Group will take into account an employee's total aggregate remuneration.
- Eligibility for, and payment of, any remuneration will be communicated in a clear and transparent way and in a timely manner.
- Reward structures will be designed to avoid any conflicts of interest.

## Corporate governance report (continued)

### Directors' Remuneration Policy

Following the change in ownership and delisting of securities, Shawbrook is no longer required to produce a Directors' Remuneration Report in accordance with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended). However, for transparency the Board has produced the table below which summarises the key components of the Group's reward package and how these apply to the Executive Directors.

Element	Purpose	Operation
<b>Salary</b>	To provide a competitive level of base pay to attract and retain talent.	<p>Base salaries are set with reference to the size and scope of the role, the external market as well as skills and experience of the individual.</p> <p>Salaries are normally reviewed on an annual basis, with increases typically in line with those awarded to the wider workforce.</p>
<b>Pension</b>	To provide a competitive post-retirement benefit.	<p>Executive Directors may participate in the Group's Personal Pension Plan or receive a cash allowance in lieu of pension contributions.</p> <p>Currently, the Chief Executive Officer receives a pension allowance of 35% of salary with other Executive Directors receiving an allowance of 15% of salary per annum.</p>
<b>Benefits</b>	To provide a suite of competitive benefits to support the wellbeing of employees.	<p>Executive Directors receive a range of benefits, including but not limited to private medical cover, life assurance and permanent health insurance.</p> <p>Additional benefits may be provided as reasonably required.</p>
<b>Annual Bonus</b>	<p>To incentivise and reward the achievement of short term financial and non-financial objectives which are closely linked to the Bank's strategy.</p> <p>Deferral encourages long-term focus and risk alignment.</p>	<p>Annual bonus awards are determined with reference to financial, non-financial and individual performance measures. The Committee considers the overall performance of the Group and the outcome of the independent risk adjustment process before finalising individual award levels.</p> <p>The normal maximum opportunity will be 100% of salary per annum.</p> <p>Awards over a threshold level (set by the Remuneration Committee each year) are subject to deferral. Deferred awards will normally be released in equal tranches after one, two and three years, subject to continued employment.</p> <p>Annual bonus awards are subject to the Group's malus and clawback provisions.</p>
<b>Long Term Incentives</b>	To incentivise and reward the delivery of the Group's long term strategy and growth over a sustained period.	As a result of the change in ownership, the Remuneration Committee is reviewing the long-term incentive framework to ensure it is fit-for-purpose and continues to incentivise and reward the delivery of the Group's long term strategy and growth over a sustained period.

## Non-Executive Director reward

The Chairman of the Board and Non-Executive Directors are entitled to an annual fee, with additional fees payable to the Senior Independent Director, the Chairman and members of the respective sub-committees of the Board. Fee levels are normally reviewed annually.

Reasonable expenses incurred in the performance of non-executive duties may also be reimbursed or paid directly by the Company, as appropriate.

## Directors' Remuneration in 2017

The tables below set out the remuneration received by Executive and Non-Executive Directors during 2017.

<b>Executive Directors</b>				
	<b>2017</b>		<b>2016</b>	
	<b>All Executive Directors</b>	<b>Highest paid Executive Director</b>	<b>All Executive Directors</b>	<b>Highest paid Executive Director</b>
Salary (£000)	1,185	625	1,098	625
Taxable benefits (£000)	5	2	5	2
Pension (£000)	303	219	261	219
Annual bonus (£000)	881	500	677	482
<b>Subtotal (£000)</b>	<b>2,374</b>	<b>1,346</b>	<b>2,041</b>	<b>1,328</b>
Shares vesting on completion of change of ownership (£000)	1,782	875	-	-
Recruitment award	-	-	2,184	2,184
<b>Total (£000)</b>	<b>4,156</b>	<b>2,221</b>	<b>4,225</b>	<b>3,512</b>
<b>Non-Executive Directors</b>				
	<b>2017</b>		<b>2016</b>	
Fees (£000)	686		646	

## Corporate governance report (continued)

### Notes to the tables

**Pension:** All three Executive Directors received their pension contributions during 2017 by way of a cash allowance.

**Annual bonus:** Executive Directors were eligible to participate in the annual bonus in 2017, with a maximum opportunity of 100% of salary. The bonus pool outcome for the Bank was determined through a rounded assessment of performance that included a review of the following key performance measures:

### Financial

- Profit before tax
- Return of tangible equity
- Cost to income ratio

### Non-financial

- Risk Management
- Customer and employee

The Committee carefully reviewed performance against all of the above measures, also taking into consideration the outcomes of the Chief Risk Officer's independent report as part of their considerations. In particular, the Committee recognised the Bank's underlying financial growth and strong performance in risk management, customer and employee engagement during the year, as well as the impact of the change in ownership. As a result, it approved an annual bonus pool outcome of 80% of maximum.

Individual performance was also assessed to determine the individual awards for each Executive Director; the aggregate values of which are included in the emoluments table above. In line with policy, 50% of any amount in excess of £100,000 will be subject to deferral in cash and released in three equal tranches after one, two and three years. However, in line with its review of the long-term incentive framework, the Committee determined that for selected senior leaders across the Group, the 2017 award should be fully deferred into a nil cost option award over Marlin Bidco Limited securities that become exercisable at the time of an exit event.

**Share related benefits:** In 2017, three Executive Directors (including the highest paid director) received shares in satisfaction of long-term incentive awards granted under the Performance Share Plan (PSP) vesting due to the transaction. At the time of the transaction, the Committee reviewed the performance to date for all outstanding PSP awards and determined that all awards should vest in full subject to time pro-rating. The aggregate value received from these long-term awards is reflected in the emoluments table above based on a share price of £3.40.

In addition, three Executive Directors (including the highest paid director) exercised nil-cost options granted under the Deferred Share Bonus Plan and one Executive Director, who was not the highest paid director, exercised options granted under the SAYE.

**Recruitment award:** This amount, as fully disclosed on page 94 of the Annual Report and Account 2016, related to the remuneration forfeited by the highest paid director on leaving prior employment.

**Payments for loss of office:** No payments for loss of office were made to Directors during 2017.



## Corporate governance report (continued)

### Directors' Remuneration in 2018

The Committee has determined that for 2018 the remuneration policy will be implemented as follows for Executive Directors.

**Executive Director salaries:** The Remuneration Committee reviewed Executive Director salaries on an individual basis, in line with the normal annual salary review, and determined that no increases would be awarded at this time.

Pension and benefits will continue to operate in line with the remuneration policy.

**Annual bonus:** The normal maximum annual bonus opportunity for Executive Directors will be 100% of salary. When determining the annual bonus outcomes for 2018, the Committee will give consideration to performance based on a range of key financial and non-financial measures, as outlined below, as well as the individual's overall performance and the outcome of the Chief Risk Officer's independent report.

<b>Financial measures</b>	<ul style="list-style-type: none"> <li>• Profit before tax</li> <li>• Return on tangible equity</li> <li>• Cost to income ratio</li> <li>• Cost of risk</li> </ul>
<b>Non-financial measures</b>	<ul style="list-style-type: none"> <li>• Risk management</li> <li>• Stakeholder engagement (including Customer and employee)</li> </ul>

**Long-term incentive:** The Company is intending to implement a new long term incentive framework in 2018; to incentivise and selected members of the senior management team for the delivery of the Group's long term strategy. These arrangements will be subject to malus and clawback provisions.

### Non-Executive Director fees

	Fee from 1 January 2018
Chairman fee*	£190,000
Non-Executive Director base fee**	£65,000
Senior Independent Director fee	£10,000
Audit and Risk Committee Chairman fee	£20,000
Remuneration Committee Chairman fee	£5,000
Audit and Risk Committee membership fee	£5,000
Remuneration and Nomination Committee membership fee	£2,500

\* The Committee intends to review the Chairman fee in line with the appointment of the new Chairman.

\*\* Each Director appointed to the Board by the Shareholder is paid a fee of £50k per annum as set out and agreed within the Framework Agreement.

**Robin Ashton**  
Chairman of Remuneration Committee  
7 March 2018

## Directors' Report

### Corporate Governance Statement

The Strategic report and Corporate Governance report found on pages 6 to 78 and, together with this report fulfils section 414C of the Companies Act 2006 by including, by cross reference, details of the Group's position on the business model and strategy, financial risk management objectives and policies, business overview, future prospects and Corporate Social Responsibility activities during 2017.

The Directors consider that the Annual Report & Accounts for the year ended 31 December 2017 taken as a whole are fair, balanced and understandable and provide the information necessary for the shareholder and other stakeholders to assess the Group's position and performance, business model and strategy.

During the period, the Directors have ensured the group has given due regard to the provisions and principles set out in the Code. Following the delisting of the Company in August 2017, the Listing Rules and some areas of the Disclosure and Transparency Rules no longer apply to the Group.

### Results for the year

Results for the Group (including reconciliation of statutory results to underlying results) are laid out on pages 86 to 154.

### Dividends

The Directors are not recommending a final dividend (2016: 2.7p per share) in respect of the year ended 31 December 2017.

### Directors

The names and biographical details of the current Directors are shown on pages 39 to 42. Particulars of their interests in shares are detailed in the Directors' Remuneration Report on pages 68 to 73. Changes to the composition of the Board since 1 January 2017 up to the date of this report are shown in the table below:

Name	Joined the Board
Andrew Didham	1 February 2017
Dylan Minto	6 February 2017
Cédric Dubourdieu	5 September 2017
Name	Left the Board
Stephen Johnson	23 January 2018

The Company Secretary during the year was Daniel Rushbrook.

### Appointment and retirement of Directors

The Group's Articles of Association sets out the rules for the appointment and replacement of Directors. In accordance with the recommendations of the Code, all Directors shall retire from office and may offer themselves for re-appointment at the Annual General Meeting. The Directors' powers are conferred on them by UK legislation and by the Group's Articles of Association.

Changes to the Group's Articles of Association must be approved by shareholders passing a special resolution and must comply with the provisions of the Companies Act 2006.

### Directors' interests

The Directors' interests in the share capital of the Group during the course of 2017 are set out on in Note 33 of the financial statements.

### Directors' indemnities

The Group's Articles of Association provide that, subject to the provisions of the Companies Act 2006, the Group may indemnify any director or former director of the Group or any associated Group against any liability and may purchase and maintain for any director or former director of the Group or any associated Group insurance against any liability.

The Directors of the Group have entered into individual deeds of indemnity with the Group which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds were in force from 1 April 2015 or from the date of appointment for those Directors appointed after 1 April 2015 and are in force as at the date of this Directors' Report. The deeds remain in force for the duration of a Director's period of office and thereafter in respect of any claims made in accordance with the indemnity in respect of the matters arising during the Director's period of office.

## Directors' Report (continued)

The Group has maintained appropriate Directors' and Officers' liability insurance in place throughout 2017.

### Share capital

Shawbrook Group plc is a public company limited by shares.

Details of the Group's issued share capital, together with details of the movements in the Group's issued share capital during the year, are shown in Note 27 of the financial statements.

The Group's share capital comprises one class of ordinary share with a nominal value of 0.01p each. At 31 December 2017, 253,086,879 ordinary shares were in issue. 3,086,879 ordinary shares were issued under a block listing in August 2017 of which 2,586,879 were allotted for the satisfaction of Shawbrook Group Employee Share Schemes further to the terms of the change in ownership of the Group. On 31 August 2017 all shares in Shawbrook Group Limited were transferred to Marlin Bidco Limited.

### Restrictions on the transfer of shares

According to the articles of association and prevailing legislation there are no specific restrictions on the transfer of shares of the Group.

### Rights attaching to shares

On a show of hands, each member has the right to one vote at general meetings of the Group. On a poll, each member would be entitled to one vote for every share held. The shares carry no rights to fixed income. No person has any special rights of control over the Group's share capital and all shares are fully paid.

### New issues of share capital

Under section 551 of the Companies Act 2006, the Directors may allot equity securities only with the express authorisation of shareholders which may be given in general meeting, but which cannot last more than five years. Under section 561 of the Companies Act, the Board may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Shareholder authority for the Group to allot shares up to an aggregate nominal amount of £835,000 for any purposes was granted at the 2017 Annual General Meeting. Shares were allotted under this authority to satisfy Shawbrook Employee Share Schemes as detailed in the Share Capital paragraph above.

### Purchase of own shares

Under section 701 of the Companies Act 2006 a Group may make a market purchase of its own shares if the purchase has first been authorised by a resolution of the Group.

The Directors were granted the authority at the 2017 AGM to repurchase up to a maximum of 2,505,000 ordinary shares. No shares were purchased pursuant to this authority during the year.

### Capital redemption reserve

During 2017, the Group cancelled the capital redemption reserve as part of a court-confirmed reduction of capital. The entire balance of the capital redemption reserve was cancelled and credited to the Company's retained earnings. Following the cancellation of the capital redemption reserve, the Company created additional distributable reserves of £183.1m. Further details can be found in Note 1.7 of the financial statements.

### Significant Shareholder disclosure

Following the change in ownership of the Group, the Company is now 100% owned by Marlin Bidco Limited.

## Directors' Report (continued)

### Acceptance of Bid from Marlin Consortium

On 31 March 2017, Marlin Bidco Limited, a company owned jointly by funds managed and/or advised by Pollen Street Capital Limited and funds advised by BC Partners LLP, announced an offer to acquire the entire issued and to be issued ordinary share capital of the Group not already directly or indirectly owned by the Marlin Consortium or its concert parties (as subsequently revised on 5 June 2017, the "Offer"). The Offer was declared unconditional in all respects on 7 July 2017 and, on 24 August 2017, the listing of the Group's ordinary shares on the London Stock Exchange was cancelled. Throughout the change of ownership, the Marlin Consortium stated its support for the management team and strategy, while offering its support for continued growth and continued use of its highly disciplined approach to lending.

### Relationship with the Shareholder

Further information on the relationship with the Marlin Consortium can be found on page 50.

### Post-balance sheet events

Details of any Post-balance sheet events can be found in Note 38 of the financial statements.

### Business activities

The Group's business activities, together with the factors likely to affect its future development and performance and its summarised financial position are set out on pages 6 to 37 of the Strategic report.

### Branches, future developments and financial risk management objectives and policies

The Group operates in the United Kingdom and has a branch in Jersey. Information about future developments, internal control and financial risk management systems in relation to financial reporting and financial risk management objectives and policies in relation to the use of financial instruments can be found in the following sections of the Annual Report which are incorporated into this report by reference:

Further information on future developments of the Group please refer to the Strategic Report (pages 6 to 37).

Further information on Internal control and financial risk management systems in relation to financial reporting of the Group please refer to the Corporate Governance report (page 58).

Further information on Financial risk management objectives and policies in relation to the use of financial instruments of the Group please refer to the Risk management report (pages 21 to 35) and Note 31 of the financial statements.

### Research and development activities

During the ordinary course of business the Group develops new products and services within the business units.

### Employees

The Group is committed to being an equal opportunities employer and opposes all forms of discrimination. Applications from people with disabilities will be considered fairly and if existing employees become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled employees.

The Group regularly provides employees with information of concern to them, which incorporates the Group's current performance and its future aims and strategies. During the change in ownership, as required by the Takeover Code, employees were kept up to date with developments through circulations from the Chief Executive Officer and Group Company Secretary. The Group conducts an Annual Employee Survey and uses the results of this survey to improve performance in areas that are important to staff. A monthly newsletter providing business updates and background information on the Group is circulated to all staff.

### Employee share schemes

Full details of the Group's employee share schemes are set out in Note 10 of the financial statements. There are no Employee Share Schemes currently in place.

### Slavery and human trafficking

In the financial year ended 31 December 2017, the Group took the following steps to ensure slavery and human trafficking did not occur within the organisation or supply chain:

- > identifying and addressing risks: the Group has updated its processes for evaluating prospective suppliers and reviewing existing suppliers to understand its suppliers' self-assessment of slavery and human trafficking issues;
- > developing policy: the Group has and continues to update its compliance policies to include consideration of slavery and human trafficking issues (as applicable); and
- > training: the Group has made available training to those of its staff who deal most with its suppliers. Development of an intranet resources page is also underway which staff will be able to access to learn about modern slavery and human trafficking.

## Directors' Report (continued)

### Political and charitable donations

The Group did not make any political donations during the year (2016: £nil). For further information on Charitable Donations made by the Group can be found on page 37 as part of the Corporate Social Responsibility report.

### Going concern

The financial statements are prepared on a going concern basis, the Directors are satisfied that the Group has the resources to continue in business for the 12 months from the reporting date. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including the current state of the balance sheet, future projections of profitability, cash flows and capital resources and the longer term strategy of the business. The Group's capital and liquidity plans, including stress tests, have been reviewed by the Directors.

The Group's forecasts and projections show that it will be able to operate at adequate levels of both liquidity and capital for the 12 months from the reporting date, including a range of stressed scenarios, the availability of alternative sources of capital if required and appropriate management actions.

After making due enquiries, the Directors believe that the Group has sufficient resources to continue its activities for the 12 months from the reporting date and to continue its expansion, and the Group has sufficient capital to enable it to continue to meet its regulatory capital requirements as set out by the PRA.

### Fair, balanced and understandable

Details of the governance procedures which have been embedded to support this can be found in the Audit Committee Report at page 61.

### Disclosure of information to the auditor

The Directors confirm that:

1. so far as each of the Directors is aware, there is no relevant audit information of which the auditor is unaware; and
2. the Directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

### Auditor and Audit Tender

Resolutions to reappoint KPMG LLP as the Group's auditor and to give the directors the authority to determine the auditor's remuneration will be proposed at the Annual General Meeting.

Details of the Audit tender which was carried out during 2017 can be found in the report of the Audit Committee on page 60.

### Annual General Meeting

Shawbrook Group plc's third Annual General Meeting will be held on 29 March 2018.

By order of the Board



**Steve Pateman**  
Chief Executive Officer

7 March 2018

## Statement of Directors' responsibilities in respect of the Annual Report & Accounts

The Directors are responsible for preparing the Annual Report & Accounts and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Parent Company financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Parent Company and of their profit or loss for that period. In preparing each of the Group and Parent Company financial statements, the Directors are required to:

- > select suitable accounting policies and then apply them consistently;
- > make judgements and estimates that are reasonable, relevant and reliable;
- > state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- > assess the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- > use the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### Responsibility statement of the directors in respect of the annual financial report

The Directors as at the date of this statement whose names and functions are set out on pages 39 to 42 confirm that to the best of their knowledge:

- > the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and
- > the Strategic Report and Directors' Report includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

This responsibility statement was approved by the Board of Directors and is signed on its behalf by:



**Daniel Rushbrook**  
Company Secretary

7 March 2018



# Independent auditor's report

## to the members of Shawbrook Group PLC

### 1. Our opinion is unmodified

We have audited the financial statements of Shawbrook Group Plc ("the Company") for the year ended 31 December 2017 which comprise the *Consolidated statement of profit and loss and other comprehensive income, Consolidated and Company statements of financial position, Consolidated statement of changes in equity, Company statement of changes in equity, Consolidated and Company statement of cash flows, and the related notes, including the accounting policies.*

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were appointed as auditor by the directors in June 2011. The period of total uninterrupted engagement is for the 7 financial years ended 31 December 2017. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

#### Overview

<b>Materiality:</b>	£5.1m (2016: £4.2m)
group financial statements as a whole	4.8% (2016: 4.8%) of normalised profit before tax (2016: profit before tax)

<b>Coverage</b>	100% (2016: 100%) of group profit before tax
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#### Risks of material misstatement vs 2016

<b>Recurring risks</b>	Impairment provisioning	◀▶
	Effective interest rate accounting	◀▶
	Valuation of goodwill	◀▶
	Recoverability of parent company's investment in subsidiaries	◀▶

<b>Event driven</b>	<b>New:</b> Provisions for conduct related matters	▲
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## 2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

Our assessment of the Group's significant risks was the starting point for our audit. This considered both internal and external risks to the Group's business model and how these have been mitigated.

*The internal factors considered were:*

**Control environment** – we considered the Group's control environment and in particular whether its systems were processing transactions completely and faithfully, and included appropriate controls designed to prevent fraud;

**Capital and liquidity** – we considered the strength of the Group's capital and liquidity position, the diversification of assets, the flexibility and composition of its balance sheet and the management of its cost base; and

**Business activity** – we assessed the risk in relation to new and one-off transactions including newly acquired loan portfolios and the Group's delisting, as well as the impact of portfolio seasoning on loan impairment and redemption behaviour.

*The external factors considered were:*

**Economic changes** – we consider the audit risk in relation to loan impairment and goodwill to have been affected by the impact on the economy of the result of the EU referendum, which introduces unpredictability of forecasting in comparison to the previously benign market.

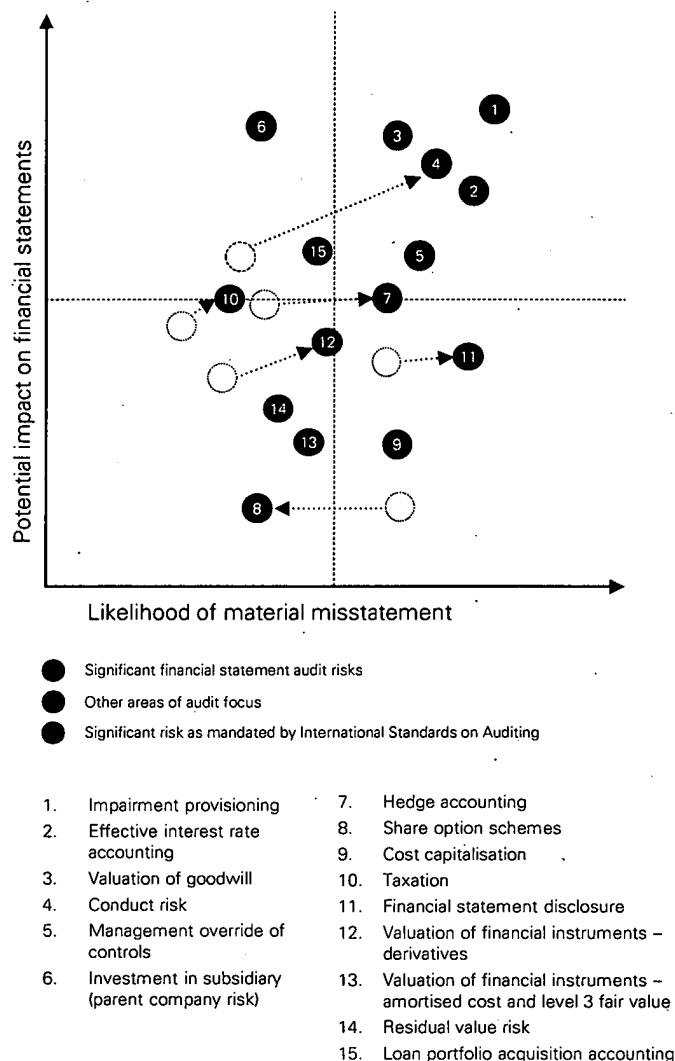
**Political and regulatory changes** – the regulatory and tax changes in the buy-to-let market, together with greater competition in this market, have introduced increased uncertainty over the expected remaining lives of current buy-to-let lending.

**Market developments** – increasing levels of competition in the market, and the advancement of technological solutions, including the upcoming changes from Open Banking.

Our assessment of key risks continued from our initial planning throughout our interim and final audits and was regularly updated through ongoing conversations with management, the Board and Audit Committee. This consideration includes conversations not only with the Group, and ongoing knowledge gained through reading pertinent information, but also reflected the views of the Prudential Regulatory Authority, market analysts, specialists within our firm, and peer comparisons.

Consistent with 2016, we are of the view that loan impairment, recognition of revenue in relation to effective interest rate accounting and the valuation of goodwill carry the greatest significance. One new key audit matter has been included this year in relation to conduct related provisions. As described on pages 56 to 57 these are areas that have been focused on by the Group's Audit Committee.

We have identified investment in subsidiary as a key audit matter for the parent company's separate accounts albeit we do not consider this to be a significant risk.



We summarise on the following pages the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.



	The risk	Our response
<b>Impairment provisioning</b> (£31.6 million; 2016: £24.4 million)  <i>Refer to page 56 (Audit Committee Report), note 14 of the financial statements.</i>	<b>Subjective estimate</b>  The calculation of certain impairment provisions for the Group is inherently judgemental. Individual and collective impairment provisions (identified and unidentified) may not reflect recent developments in credit quality, arrears experience, or emerging macro-economic risks. The most significant areas are:  <i>Individual provisions</i>  For the modelled individual provisions (consumer finance and second charge mortgages) the key judgements are the probabilities of default (PDs). These judgements are particularly subjective because the Group has limited historical experience to support the assumptions made due to the relatively unseasoned nature of its loan portfolios underwritten during a relatively benign economic period.  Business Finance and Commercial loans are monitored and placed on a watch list if they are considered to exhibit evidence of impairment. Provisioning judgements are then made for these loans based on the individual circumstances of each case and expectations of future cash flows. These individually assessed provisions are particularly judgemental for these portfolios where the nature of collateral and exit strategy selected can significantly impact the timing and value of cash flows.  <i>Collective provisions</i>  The key judgements in the collective provisioning model are the emergence period, probability of default and loss given default. The emergence period is the most difficult judgement to estimate due to the difficulty of obtaining historical data.  Alongside the above, another area of focus is post modelling adjustments and management overlays as they have the potential to be significant, judgemental and may be difficult to corroborate.	Our procedures included:  <ul style="list-style-type: none"> <li>— <b>Control testing:</b> We tested the design, implementation and operating effectiveness of key controls over the monitoring and reporting of loans and advances to customers;</li> <li>— <b>Sensitivity analysis:</b> We assessed and challenged the reasonableness of the Group's key assumptions, being the propensity to default, loss given default and emergence periods, performing stress tests;</li> <li>— <b>Assessing transparency:</b> Considering the adequacy of the Group's disclosures in respect of the sensitivity of impairment provisions to these assumptions.</li> </ul> For loans assessed for individual provisions:  <ul style="list-style-type: none"> <li>— <b>Our credit experience:</b> We examined a risk based sample of business finance and commercial mortgage exposures including impaired and unimpaired loans and formed our own judgement, based on the individual facts and circumstances, as to whether impairment was required. This included an assessment of the supporting evidence for collateral valuations;</li> <li>— <b>Independent re-performance:</b> We re-performed a sample of calculations of impairment and agreed the key data inputs to source documentation; and</li> <li>— <b>Our sector experience:</b> We challenged and assessed the reasonableness of the key judgemental areas of the calculation, being forecast sale value of the collateral through benchmarking and back-testing to historical experience.</li> </ul> For loans assessed collectively for impairment:  <ul style="list-style-type: none"> <li>— <b>Our sector experience:</b> We critically assessed the assumptions inherent in the model against our understanding of the different loan portfolios across the Group, their recent performance and industry developments; and</li> <li>— <b>Management overlay:</b> We critically assessed the rationale for quantum of overlay maintained with reference to our own knowledge of the industry and findings from our audit of the models.</li> </ul> <b>Our results</b>  <ul style="list-style-type: none"> <li>— We found the resulting estimate for impairment provisioning to be acceptable.</li> </ul>

	The risk	Our response
<b>Valuation of goodwill</b> (£44.8 million; 2016: £44.8 million)  <i>Refer to page 57 (Audit Committee Report), note 17 of the financial statements.</i>	<b>Forecast-based valuation</b>  The carrying value of goodwill is tested for impairment on the occurrence of an impairment trigger or otherwise annually.  The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash flows and selecting an appropriate discount rate.  £34.7 million of the total goodwill balance relates to Business Finance, being the area of most significant judgement in light of the size of the balance and weaker than expected financial performance in the year.	Our procedures included:  <ul style="list-style-type: none"> <li>— <b>Our sector experience:</b> Evaluating assumptions used, in particular those relating to forecast revenue growth, discount rate and incremental capital requirements in Business Finance;</li> <li>— <b>Benchmarking assumptions:</b> Comparing the Group's assumptions to external comparable data in relation to key inputs such as projected economic growth and discount rates;</li> <li>— <b>Sensitivity analysis:</b> Performing breakeven analysis on the assumptions noted above using our data analytic capabilities; and</li> <li>— <b>Assessing transparency:</b> Assessing whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill.</li> </ul> <b>Our results</b>  <ul style="list-style-type: none"> <li>— We found the resulting estimate of the carrying value of goodwill to be acceptable.</li> </ul>
<b>Provisions for conduct related matters</b> (£2.5 million; 2016: £nil)  <i>Refer to page 57 (Audit Committee Report), notes 23 and 35 of the financial statements.</i>	<b>Estimation of exposure</b>  Certain of the Group's lending activities give rise to ongoing exposure under Section 75 Consumer Credit Act.  During the year, the Group saw an increase in customer complaints relating to its solar lending product, where the original supplier is no longer solvent.  The application of accounting standards to determine the amount, if any, to be provided as a liability and the associated disclosure, is inherently subjective.	Our procedures included:  <ul style="list-style-type: none"> <li>— <b>Enquiry of management:</b> We enquired of the Directors and key members of legal, risk and compliance to obtain their view on the status of all significant litigation and regulatory matters and the completeness of their assessment in respect of these provisions;</li> <li>— <b>Independent evaluation:</b> inspecting internal papers and regulatory correspondence we challenged the timing of the recognition of provisions where there is potential exposure but it is not clear whether an obligation exists or where the Group have determined a reliable estimate is not possible. We independently evaluated the provision estimated including a re-performance of management's calculations; and</li> <li>— <b>Assessing transparency:</b> Assessing whether the group's disclosures detailing significant conduct related matters adequately disclose the potential liabilities of the Group.</li> </ul> <b>Our results</b>  <ul style="list-style-type: none"> <li>— We found the liability recognised, and the associated disclosure, to be acceptable.</li> </ul>

	The risk	Our response
<p><b>Effective interest rate accounting ('EIR')</b></p> <p>Interest paid by customers £307.1 million (2016: £279.0 million);</p> <p><i>Refer to page 57 (Audit Committee Report ), note 3 of the financial statements.</i></p>	<p><b>Subjective estimate</b></p> <p>Interest and fees, including early redemption charges, earned on loans are recognised using the effective interest rate method which spreads directly attributable cash flows over the expected lives of the loans. The Group apply judgement in deciding which cash flows are spread on an EIR basis and assessing the redemption profiles used to spread those cash flows. The most critical element of judgement in this area is the estimation of the redemption profiles of the loans, informed by past customer behaviour of when loans have been paid off.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> <li>— <b>Methodology choice:</b> We tested the accuracy of data inputs from the mortgage systems into the effective interest rate models and the consistency of methodology and application across the Group's loan portfolios;</li> <li>— <b>Independent re-performance:</b> We evaluated the mathematical accuracy of models through re-performance of the model calculations;</li> <li>— <b>Sensitivity analysis:</b> We assessed and challenged the reasonableness of the models' key assumptions, expected lives and forecast future cash flows, by comparing these to historical trends within the Group and performing stress tests; and</li> <li>— <b>Assessing transparency:</b> Considering the adequacy of the Group's disclosures in respect of the sensitivity of the revenue to these assumptions.</li> </ul> <p><b>Our results</b></p> <ul style="list-style-type: none"> <li>— We found the amount of interest paid by customers recognised in the year to be acceptable.</li> </ul>
<p><b>Parent company risk: Recoverability of parent company's investment in subsidiaries</b></p> <p>(£409.5m; 2016: £277.0m)</p> <p><i>Refer to note 20 of the financial statements.</i></p>	<p><b>Impairment assessment</b></p> <p>The carrying amount of the parent company's investments in subsidiaries represents 84% (2016: 78%) of the company's total assets. Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the parent company financial statements, this is considered to be the area that had the greatest effect on our overall parent company audit.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> <li>— <b>Tests of detail:</b> Comparing the carrying amount of 100% of investments with the relevant subsidiaries' financial statements to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making.</li> </ul> <p><b>Our results:</b></p> <ul style="list-style-type: none"> <li>— We found the Group's assessment of the recoverability of the investment in subsidiaries to be acceptable.</li> </ul>

### 3. Our application of materiality and an overview of the scope of our audit

#### Materiality

Materiality for the group financial statements as a whole was set at £5.1m (2016: £4.2m), determined with reference to a benchmark of group profit before tax, normalised to exclude this year's costs in relation to the acquisition of the Group as disclosed in note 6 and the accelerated IFRS2 charge totalling £19.1m (of which it represents 4.8% (2016: 4.8%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.3m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Materiality for the parent company financial statements as a whole was set at £5.1m (2016: £4.2m), determined with reference to a benchmark of company net assets, of which it represents 1.2% (2016: 1.5%).

#### Team structure

The Group team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality level set out above.

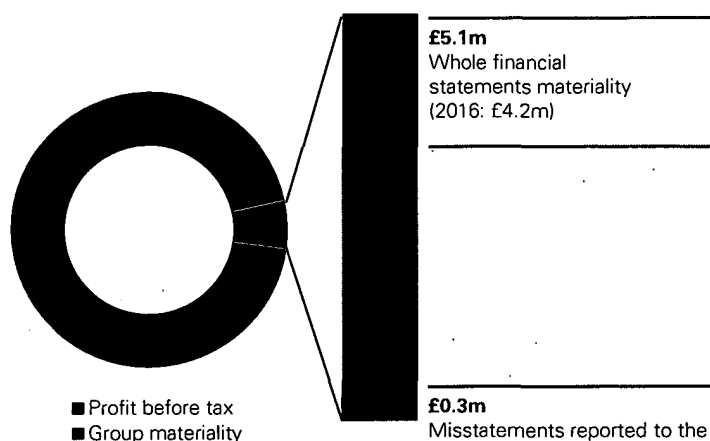
#### Scope – disclosure of IFRS 9 effect

The Group is adopting IFRS 9 Financial Instruments from 1 January 2018 and has included an estimate of the financial impact of the change in accounting standard in accordance with IAS 8 Changes in Accounting Estimates and Errors as set out in note 1.10. This disclosure notes that the estimate has been prepared under an interim control environment with models that continue to undergo validation. While further testing of the financial impact will be performed as part of our 2018 year end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. Specifically we have:

- considered key classification and measurement decisions, including business model assessments and solely payment of principal and interest outcomes;
- considered the appropriateness of key technical decisions, judgements, assumptions and elections made in determining the estimate;
- involved credit risk modelling and economic specialists in the consideration of credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios, for a sample of models used in determining the estimate;
- considered interim controls and governance processes related to the calculation and approval of the estimated transitional impact.

Profit before tax  
£86.5m (2016: £88.2m)

Group Materiality  
£5.1m (2016: £4.2m)



### 4. We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

### 5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information in the Annual Report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

### 6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

## 7. Respective responsibilities

### Directors' responsibilities

As explained more fully in their statement set out on page 78, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

### Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

### Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the group's regulatory and legal correspondence.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related annual accounts items.

In addition we considered the impact of laws and regulations in the specific areas of regulatory capital and liquidity, conduct, money laundering, and financial crime and certain aspects of company legislation recognising the regulated nature of the Group's activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory and legal correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related annual accounts items. Further detail in respect of conduct related matters is set out in the key audit matter disclosures in section 2 of this report.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations (irregularities), as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

## 8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.



**Simon Ryder (Senior Statutory Auditor)**  
**for and on behalf of KPMG LLP, Statutory Auditor**

*Chartered Accountants*

15 Canada Square

London

E14 5GL

7 March 2018

## Consolidated statement of profit and loss and other comprehensive income

For the year ended 31 December 2017

	Notes	2017 £m	Restated <sup>1</sup> 2016 £m
Interest and similar income	3	313.3	284.4
Interest expense and similar charges	4	(76.0)	(83.1)
<b>Net interest income</b>		<b>237.3</b>	<b>201.3</b>
Operating lease rentals		12.3	13.5
Other income		-	0.1
Depreciation on operating leases	16	(10.6)	(11.3)
<b>Net income from operating leases</b>		<b>1.7</b>	<b>2.3</b>
Fee and commission income	5	12.3	11.2
Fee and commission expense		(12.8)	(5.7)
<b>Net fee and commission (expense)/income</b>		<b>(0.5)</b>	<b>5.5</b>
Fair value gains on financial instruments	15	0.2	0.5
<b>Net operating income</b>		<b>238.7</b>	<b>209.6</b>
Administrative expenses	6	(126.8)	(96.0)
Impairment losses on loans and advances to customers	14	(23.3)	(24.3)
Provisions for liabilities and charges	23	(2.1)	(1.1)
<b>Total operating expenses</b>		<b>(152.2)</b>	<b>(121.4)</b>
<b>Profit before taxation</b>		<b>86.5</b>	<b>88.2</b>
Income tax charge	12	(25.3)	(23.4)
<b>Profit after taxation, being total comprehensive income, attributable to owners</b>		<b>61.2</b>	<b>64.8</b>

The notes on pages 91 – 155 are an integral part of these financial statements.

<sup>1</sup> Refer to Note 1.8 for details of the reclassification.

# Consolidated and Company statement of financial position

As at 31 December 2017

	Notes	Group 2017 £m	Company 2017 £m	Group 2016 £m	Company 2016 £m
<b>Assets</b>					
Cash and balances at central banks		752.5	-	429.9	-
Loans and advances to banks		28.8	-	24.1	-
Loans and advances to customers	13	4,844.3	-	4,050.4	-
Derivative financial assets	15	1.8	-	5.2	-
Property, plant and equipment	16	39.6	-	42.6	-
Intangible assets	17	65.7	-	59.9	-
Deferred tax assets	18	15.7	-	17.9	-
Other assets	19	10.3	1.5	16.6	2.2
Investment in subsidiaries	20	-	409.5	-	277.0
Subordinated debt receivable	26	-	76.1	-	76.1
<b>Total assets</b>		<b>5,758.7</b>	<b>487.1</b>	<b>4,646.6</b>	<b>355.3</b>
<b>Liabilities</b>					
Customer deposits	21	4,376.2	-	3,943.5	-
Amounts due to banks	22	607.3	-	147.7	-
Provisions for liabilities and charges	23	2.8	-	1.3	-
Derivative financial liabilities	15	3.4	-	0.4	-
Current tax liabilities		7.7	-	14.2	-
Other liabilities	24	62.8	0.4	27.0	-
Subordinated debt liability	26	75.4	75.4	75.3	75.3
<b>Total liabilities</b>		<b>5,135.6</b>	<b>75.8</b>	<b>4,209.4</b>	<b>75.3</b>
<b>Equity</b>					
Share capital	27	2.5	2.5	2.5	2.5
Capital securities	28	124.0	124.0	-	-
Share premium account		87.3	87.3	87.3	87.3
Capital redemption reserve <sup>1</sup>		-	-	183.1	183.1
Retained earnings		409.3	197.5	164.3	7.1
<b>Total equity</b>		<b>623.1</b>	<b>411.3</b>	<b>437.2</b>	<b>280.0</b>
<b>Total equity and liabilities</b>		<b>5,758.7</b>	<b>487.1</b>	<b>4,646.6</b>	<b>355.3</b>

The notes on pages 91 – 155 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 7 March 2018 and were signed on its behalf by:

  
**Steve Pateman**  
 Chief Executive Officer

  
**Dylan Minto**  
 Chief Financial Officer

Registered number 07240248

<sup>1</sup> Refer to Note 1.7 for details of the cancellation of the capital redemption reserve.

# Consolidated statement of changes in equity

For the year ended 31 December 2017

	Share capital £m	Capital securities £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
Balance as at 1 January 2016	2.5	-	87.3	183.1	94.7	367.6
<i>Total comprehensive income for the year</i>						
Profit for the year	-	-	-	-	64.8	64.8
Total comprehensive income for the year	-	-	-	-	64.8	64.8
Share-based payments	-	-	-	-	4.8	4.8
Balance as at 31 December 2016	2.5	-	87.3	183.1	164.3	437.2
<b>Balance as at 1 January 2017</b>	<b>2.5</b>	<b>-</b>	<b>87.3</b>	<b>183.1</b>	<b>164.3</b>	<b>437.2</b>
<i>Total comprehensive income for the year</i>						
Profit for the year	-	-	-	-	61.2	61.2
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>61.2</b>	<b>61.2</b>
<i>Transactions with owners recorded directly in equity</i>						
Dividend paid	-	-	-	-	(6.8)	(6.8)
<b>Total contributions by and distributions to owners</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(6.8)</b>	<b>(6.8)</b>
Cancellation of capital redemption reserve <sup>1</sup>	-	-	-	(183.1)	183.1	-
<i>Transactions with non-controlling entities</i>						
Issue of capital securities	-	125.0	-	-	-	125.0
Cost of issuance of capital securities	-	(1.0)	-	-	-	(1.0)
<b>Total contributions by non-controlling entities</b>	<b>-</b>	<b>124.0</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>124.0</b>
Share-based payments	-	-	-	-	7.5	7.5
<b>Balance as at 31 December 2017</b>	<b>2.5</b>	<b>124.0</b>	<b>87.3</b>	<b>-</b>	<b>409.3</b>	<b>623.1</b>

The notes on pages 91 – 155 are an integral part of these financial statements.

<sup>1</sup> Refer to Note 1.7 for details of the cancellation of the capital redemption reserve.



# Company statement of changes in equity

For the year ended 31 December 2017

	Share capital £m	Capital securities £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
Balance as at 1 January 2016	2.5	-	87.3	183.1	3.2	276.1
<i>Total comprehensive income for the year</i>						
Loss for the year	-	-	-	-	(0.9)	(0.9)
Total comprehensive income for the year	-	-	-	-	(0.9)	(0.9)
Share-based payments	-	-	-	-	4.8	4.8
Balance as at 31 December 2016	2.5	-	87.3	183.1	7.1	280.0
<b>Balance as at 1 January 2017</b>	<b>2.5</b>	<b>-</b>	<b>87.3</b>	<b>183.1</b>	<b>7.1</b>	<b>280.0</b>
<i>Total comprehensive income for the year</i>						
Profit for the year	-	-	-	-	6.6	6.6
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6.6</b>	<b>6.6</b>
<i>Transactions with owners recorded directly in equity</i>						
Dividend paid	-	-	-	-	(6.8)	(6.8)
<b>Total contributions by and distributions to owners</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(6.8)</b>	<b>(6.8)</b>
Cancellation of capital redemption reserve <sup>1</sup>	-	-	-	(183.1)	183.1	-
<i>Transactions with non-controlling entities</i>						
Issue of capital securities	-	125.0	-	-	-	125.0
Cost of issuance of capital securities	-	(1.0)	-	-	-	(1.0)
<b>Total contributions by non-controlling entities</b>	<b>-</b>	<b>124.0</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>124.0</b>
Share-based payments	-	-	-	-	7.5	7.5
<b>Balance as at 31 December 2017</b>	<b>2.5</b>	<b>124.0</b>	<b>87.3</b>	<b>-</b>	<b>197.5</b>	<b>411.3</b>

The notes on pages 91 – 155 are an integral part of these financial statements.

<sup>1</sup> Refer to Note 1.7 for details of the cancellation of the capital redemption reserve.

# Consolidated and Company statement of cash flows

For the year ended 31 December 2017

	Notes	Group 2017 £m	Company 2017 £m	Group 2016 £m	Company 2016 £m
<b>Cash flows from operating activities</b>					
Profit/(loss) for the year before taxation		86.5	6.6	88.2	(0.9)
Adjustments for non-cash items	29	54.5	6.5	51.8	6.5
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>141.0</b>	<b>13.1</b>	<b>140.0</b>	<b>5.6</b>
<b>Increase/decrease in operating assets and liabilities</b>					
Increase in mandatory balances with central banks		(0.3)	-	(1.7)	-
Increase in loans and advances to customers		(817.2)	-	(755.6)	-
Increase in operating lease assets		(8.6)	-	(7.5)	-
Decrease/(increase) in derivatives		6.4	-	(2.0)	-
Decrease/(increase) in other assets		6.3	0.7	(8.7)	2.0
Increase in subordinated debt receivable		-	-	-	(1.1)
Increase in customer deposits		432.7	-	757.1	-
Increase in provisions for liabilities and charges		1.5	-	0.4	-
Increase/(decrease) in other liabilities		35.8	0.4	(296.8)	(1.4)
<b>Net change in operating assets and liabilities</b>		<b>(343.4)</b>	<b>1.1</b>	<b>(314.8)</b>	<b>(0.5)</b>
Tax (paid)/received		(29.6)	-	(20.4)	0.1
<b>Net cash flow (used by)/generated from operating activities</b>		<b>(232.0)</b>	<b>14.2</b>	<b>(195.2)</b>	<b>5.2</b>
<b>Cash flows from investing activities</b>					
Purchase of property, plant and equipment	16	(1.6)	-	(0.2)	-
Sale of property, plant and equipment		-	-	0.2	-
Purchase of intangible assets	17	(9.8)	-	(7.9)	-
Investment in subsidiaries net of cash and cash equivalents acquired		-	(125.0)	-	-
<b>Net cash used by investing activities</b>		<b>(11.4)</b>	<b>(125.0)</b>	<b>(7.9)</b>	<b>-</b>
<b>Cash flows from financing activities</b>					
Increase in amounts due to banks		459.6	-	107.8	-
Payment of subordinated debt interest		(6.4)	(6.4)	(5.2)	(5.2)
Net proceeds from the issue of capital securities		124.0	124.0	-	-
Dividends paid to Shareholders		(6.8)	(6.8)	-	-
<b>Net cash generated from/(used by) financing activities</b>		<b>570.4</b>	<b>110.8</b>	<b>102.6</b>	<b>(5.2)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>327.0</b>	<b>-</b>	<b>(100.5)</b>	<b>-</b>
Cash and cash equivalents at 1 January		450.0	-	550.5	-
<b>Cash and cash equivalents at 31 December</b>		<b>777.0</b>	<b>-</b>	<b>450.0</b>	<b>-</b>

The notes on pages 91 – 155 are an integral part of these financial statements.

## Notes to the financial statements

For the year ended 31 December 2017

### 1. Basis of preparation

#### 1.1 Reporting entity

Shawbrook Group plc is domiciled in the UK. The Company's registered office is at Lutea House, Warley Hill Business Park, The Drive, Great Warley, Brentwood, Essex, CM13 3BE. The consolidated financial statements of Shawbrook Group plc, for the year ended 31 December 2017, comprise the results of the Company and its subsidiaries (together referred to as the Group and individually as Group entities).

#### 1.2 Basis of accounting

The Group's financial statements have been prepared on a historical cost basis and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The financial statements are drawn up in accordance with the Companies Act 2006. No individual statement of profit and loss or related notes are presented for the Company as permitted by section 408 (4) of the Companies Act 2006.

#### 1.3 Functional and presentation currency

The consolidated financial statements are presented in Pounds Sterling, which is the Company and its subsidiaries' functional currency.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the statement of financial position reporting date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the statement of profit and loss. Non-monetary items (which are assets and liabilities which do not attach to a right to receive or an obligation to pay a fixed or determinable number of units of currency) denominated in foreign currencies are translated at the exchange rate at the date of the transaction.

#### 1.4 Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Group has the resources to continue in business for at least 12 months following the year end. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including the current state of the statement of financial position, future projections of profitability, cash flows and capital resources and the longer-term strategy of the business. The Group's capital and liquidity plans, including stress tests, have been reviewed by the Directors.

The Group's forecasts and projections suggest that it will be able to operate at adequate levels of both liquidity and capital for at least 12 months following the year end, including in a range of stressed scenarios, assuming the availability of alternative sources of capital if required and appropriate management actions.

After making due enquiries, the Directors believe that the Group has sufficient resources to continue its activities for at least 12 months following the year end, and the Group has sufficient capital to enable it to continue to meet its regulatory capital requirements as set out by the Prudential Regulation Authority (PRA).

#### 1.5 Basis of consolidation

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Entities are regarded as subsidiaries where the Group has the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to affect those returns. Intercompany transactions and balances are eliminated upon consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that power over an investee, exposure or rights to variable returns and the ability to affect these returns ceases. Accounting policies are applied consistently across the Group.

These financial statements consolidate the results of the subsidiary companies set out in Note 32.

**Basis of preparation (continued)****1.6 Critical accounting estimates and judgements**

The preparation of financial statements in conformity with IFRS adopted in the EU requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on Management's best knowledge of the amount, actual results may ultimately differ from those estimates.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed within the notes to the financial statements which the estimate or judgement relates to as follows:

Area of significant judgement or estimate	Note reference
Effective interest rate	3
Impairment of loans and advances	14
Impairment assessment of goodwill	17
Customer remediation and conduct issues	23

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

**1.7 Other reserves****Capital redemption reserve**

This is a statutory, non-distributable reserve into which amounts are transferred following the redemption or purchase of a company's own shares. The provisions relating to the capital redemption reserve are set out in section 733 of the Companies Act 2006. During 2017, the Company cancelled the capital redemption reserve as part of a court confirmed reduction of capital. The entire balance of the capital redemption reserve was cancelled and credited to the Company's retained earnings. Following the cancellation of the capital redemption reserve, the Company created additional distributable reserves of £183.1m.

**1.8 Reclassification of fee income**

£4.2 million of fee income has been reclassified from fee and commission income to interest and similar income in order to accurately reflect the nature of the revenue. The reclassification has no effect on either the net operating income, profit before tax or the net assets of the Group.

**1.9 Adoption of new and revised standards and interpretations**

Minor amendments to IAS 12 'Income Taxes' and IAS 7 'Statement of Cash Flows' were adopted with effect from 1 January 2017. The adoption of these amendments had no significant impact for the Group. In all other respects, the accounting policies adopted are consistent with those of the previous financial year.

**1.10 New and revised standards and interpretations not yet adopted**

A number of new standards have been issued by the International Accounting Standards Board (IASB) and endorsed for use in the EU but are not effective for this financial year. The Group has not early adopted any of the new standards in preparing these consolidated financial statements.

The new standards considered to be the most relevant to the Group are as follows:

**1.10.1 IFRS 9 'Financial Instruments'**

IFRS 9 contains new requirements for the classification and measurement, impairment and hedge accounting of financial assets and liabilities.

In July 2014, the IASB issued the final version of IFRS 9 'Financial Instruments'. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. It replaces IAS 39 'Financial Instruments: Recognition and Measurement'.

## Basis of preparation (continued)

In October 2017, the IASB issued 'Prepayment Features with Negative Compensation' (Amendments to IFRS 9). The amendments are effective for annual periods beginning on or after 1 January 2019, with early adoption permitted. The Group is not an early adopter of the amendments to IFRS 9.

The Group will apply IFRS 9 as issued in July 2014 initially on 1 January 2018. Based on assessments undertaken to date, the total estimated adjustment (net of tax) of the adoption of IFRS 9 on the opening balance of the Group's equity at 1 January 2018 is a reduction of approximately £12.1 million, representing:

- a reduction of approximately £16.4 million related to impairment requirements (see 1.10.1.2); and
- an increase of approximately £4.3 million related to deferred tax impacts.

The above assessment is preliminary because not all transition work has been finalised. The actual impact of adopting IFRS 9 on 1 January 2018 may change because:

- IFRS 9 will require the Group to revise its accounting processes and internal controls and these changes are not yet complete;
- although parallel runs were carried out in the second half of 2017, the new systems and associated controls in place have not been operational for a more extended period;
- the Group has not finalised the testing and assessment of controls over its new IT systems and changes to its governance framework;
- the Group is refining and finalising its models for expected credit loss (ECL) calculations and further validations will continue into 2018; and
- the new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Group finalises its first financial statements that include the date of initial application.

### 1.10.1.1 Classification and measurement – financial assets

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 includes three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). It eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are SPPI on the principal amount outstanding.

The Group assessed the objective of the business model in which the financial assets are held at a portfolio level and concluded that, for all portfolios reviewed, Management's strategy focusses on earning contractual interest revenue from the portfolios, rather than holding the portfolios for trading. For portfolios that have been sold in the past, Management concluded that the sale of the portfolios were for the purposes of managing credit risk. All financial assets will be classified as amortised cost, except derivatives which will be FVTPL.

For the purposes of assessing whether contractual cash flows are SPPI, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a reasonable profit margin. The Group considered the contractual terms on a portfolio basis and concluded that the contractual cash flows of the portfolios are SPPI.

## Basis of preparation (continued)

### Impact assessment:

The Group has considered the changes in the classification and measurement criteria and has concluded that there are no significant changes in the classification and measurement of the financial assets and estimated that, on the adoption of IFRS 9 at 1 January 2018, the impact of these changes is immaterial.

### 1.10.1.2 Impairment

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward looking ECL model. Under IFRS 9 the measurement of the ECLs depends on the staging of the financial assets. Entities are required to recognise a 12-month ECL on initial recognition (Stage 1) and a lifetime ECL where there has been a significant increase in credit risk (Stage 2). Where there is objective evidence of impairment and the financial asset is considered to be in default, or otherwise credit impaired, then it is in Stage 3.

### Key accounting judgements relating to impairment

#### Inputs into measurement of the ECLs

The following are the key inputs into the measurement of ECLs:

- Probability of default (PD);
- Loss given default (LGD); and
- Exposure at default (EAD).

#### *Probability of default*

The Group has developed a credit grading system for all its asset classes and has aligned these to a common master grading scale that has been aligned to the Standard and Poor grading scale. The Group operates both a model based PD for its high volume portfolios such as Consumer Lending and Secured and has developed and implemented a 'slotting approach' for the low volume and high value obligors in Development Finance, Business Finance and large ticket Commercial property cases. Both processes deliver a measure of a point-in-time measure of default.

For the model based portfolios the measure of PD is based on information available to the Group from credit reference agencies and internal product performance data. For the slotted portfolios, the measure of PD relates to attributes relating to financial strength, political and legal environment, asset/transaction characteristics, strength of sponsor and security.

For each asset class, the Group has a proprietary approach to extrapolate its best estimate of the point-in-time PD from 12 months to behavioural maturity, using economic response models that have been developed specifically to forecast the sensitivity of PD to key macroeconomic variables. The Group has used three scenarios to support its assessment of ECL. For its assessment of day one impact this includes a central view that has been used for the 2018 budget, an alternative downside base case and an alternative upside base case. These alternative base cases have been chosen to deliver a non-linearity in the final ECL number.

#### *Loss given default*

For Property portfolios, the LGD is generally broken down into two parts. These include the Group's estimate of the probability of possession given default, combined with the loss given possession. The Group has continued to focus on the proportion of accounts that have not cured over an emergence period, rather than the proportion of accounts that enter possession. The LGD is based on the Group's estimate of a shortfall, based on the difference between the property value after the impact of a market value decline and sale costs, and the loan balance with the addition of unpaid interest and fees.

For Asset Finance, the LGD is based on the experience of losses on repossessed assets. The LGD on Block and Wholesale portfolios is based on experience of losses supported by key judgements.

For the Consumer portfolio, the Group uses an estimate of the probability of charge-off, defined as six or more payments in arrears, combined with an estimate of the expected write-off based on established contractual forward flow arrangements for the sale of charge-off debt.

In all cases the LGD or its components are tested against recent experience to ensure that they remain current.

## Basis of preparation (continued)

### *Exposure at default*

EAD is designed to address increases in utilisation of committed limits and unpaid interest and fees that the Group would ordinarily expect to observe to the point of default, or through to the point of realisation of the collateral.

ECL is measured on either a 12-month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition, or whether the asset meets the definition of default.

### **Significant increase in credit risk (movement from Stage 1 to Stage 2)**

The Group has identified a series of quantitative, qualitative and backstop criteria that will be used to determine if an account has demonstrated a significant increase in credit risk, and therefore should move from Stage 1 to Stage 2:

- quantitative measures consider the increase in an account's remaining lifetime PD at the reporting date compared to the expected residual lifetime PD when the account was originated. The Group will segment its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency;
- qualitative measures include the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms; and
- IFRS 9 includes a rebuttable presumption that 30 days past due is an indicator of a significant increase in credit risk. The Group considers 30 days past due to be an appropriate backstop measure and will not rebut this presumption.

### **Default (movement to Stage 3)**

The Group has identified a series of quantitative and qualitative criteria that will be used to determine if an account meets the definition of default, and therefore should move to Stage 3:

- when the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security (if any is held);
- when the borrower is more than 90 days past due on any material credit obligation to the Group; and
- when a material credit obligation to the Group has gone past maturity or there is a degree of doubt that the exit strategy for the obligation is likely.

In assessing whether a borrower is in default, the Group will consider indicators that are:

- qualitative: e.g. breaches of covenant;
- quantitative: e.g. overdue status and non-payment of another obligation of the same issuer to the Group; and
- based on data developed internally and obtained from external sources.

The definition of default is aligned with the definition of 'credit impaired' and the regulatory definition of default.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

### **Forward looking information**

The Group incorporates forward looking information into the assessment of significant increase in credit risk and the calculation of ECLs. The Group has identified the most significant macroeconomic factors including house price inflation, unemployment rate and bank base rate.

These variables and their associated impact on PD, EAD and LGD have been factored into the ECL models. The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and will therefore source economic scenarios from a third party source to form the basis of the economic scenarios used.

The ECL model will require considerable judgement over how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis. The Group will consider three forward looking scenarios on a probability-weighted approach.

## Basis of preparation (continued)

### Impact assessment

The most significant impact on the Group's financial statements from the implementation of IFRS 9 is expected to result from the new impairment requirements. Impairment losses will increase and become more volatile for financial instruments in the scope of the IFRS 9 impairment model.

The Group has estimated that, on the adoption of IFRS 9 at 1 January 2018, the impact of the increase in loss allowances (before tax) will be approximately £16.4 million.

### 1.10.1.3 Classification – financial liabilities

The classification of financial liabilities under IFRS 9 largely retains the existing requirements in IAS 39 except for the presentation of changes in fair value due to own credit risk under other comprehensive income for liabilities designated at FVTPL. The impact for the Group is immaterial.

### 1.10.1.4 Hedge accounting

When initially applying IFRS 9, the Group may choose to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in Chapter 6 of IFRS 9.

The Group has elected to continue to apply IAS 39. However, the Group will provide the expanded disclosures on hedge accounting introduced by IFRS 9's amendments to IFRS 7 'Financial Instruments: Disclosures' because the accounting policy election does not provide an exemption from these new disclosure requirements.

### 1.10.1.5 Disclosures

IFRS 9 will require extensive new disclosures, in particular about credit risk, ECLs and hedge accounting.

### 1.10.1.6 Impact on capital planning

The Group's regulator has issued guidelines on transition requirements for the implementation of IFRS 9. The guidelines allow a choice of two approaches regarding recognition of the impact of adoption of the standard on regulatory capital:

1. phasing in the full impact on a phased basis using transitional factors published in the amended regulation EU No 575/2013; or
2. recognising the full impact on the day of adoption.

The Group has decided to adopt the first approach.

The principal impact on the Group's regulatory capital of the implementation of IFRS 9 will arise from the new impairment requirements.

Under current regulatory requirements, impairment provisions are dealt with under the standardised approach. The capital requirement is calculated based on the gross exposures net of specific provisions – i.e. net exposure. IFRS 9 is expected to increase the loss allowances associated with individual assets, and therefore the resulting net exposure and the capital requirement will fall. However, this reduction in the capital requirement will be offset by a scalar that has been published by the EU in its amended regulation EU No 575/2013 that aims to ensure that firms do not benefit from this impact.

The Group's assessment indicates that the impact on capital resources of the implementation of IFRS 9 for the standardised portfolios will be a reduction in Common Equity Tier 1 (CET1) capital and total capital of approximately £12.1 million before adjustments for phasing in, and a reduction in CET1 capital and total capital is negligible as at 1 January 2018 after adjustments for phasing in.

### 1.10.1.7 Transition

The Group will record an adjustment to its opening 1 January 2018 retained earnings to reflect the application of the new requirements of IFRS 9 and will not restate comparative periods. The Group estimates the transition to IFRS 9 will reduce Shareholders' equity by approximately £12.1 million after deferred tax as at 1 January 2018.

The impact on the Group's CET1 capital ratio will reflect the recently published capital transitional arrangements. This adjustment arises from the increase in the Group's statement of financial position loan loss allowances as a result of the application of IFRS 9 requirements.



## Basis of preparation (continued)

The Group continues to refine, monitor and validate certain elements of the impairment models and related controls ahead of full reporting of IFRS 9 impacts later in 2018.

### 1.10.2 IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 establishes the principles to apply when reporting information about the nature, amount, timing and uncertainty of revenue and cash flows from a contract with a customer. The standard introduces a five step revenue recognition model to be applied to all contracts with customers to determine whether, how much, and when revenue is recognised.

The new standard is effective from 1 January 2018, and replaces IAS 11 'Construction Contracts', IAS 18 'Revenue', IFRIC 13 'Customer Loyalty Programmes', IFRIC 15 'Agreements for the Construction of Real Estate', IFRIC 18 'Transfers of Assets from Customers' and SIC 31 'Revenue – Barter Transactions Involving Advertising Services'. It applies to contracts with customers but does not apply to insurance contracts, financial instruments or lease contracts, which fall under the scope of other IFRSs. It also does not apply if two companies in the same line of business exchange non-monetary assets to facilitate sales to other parties.

Assessments performed to date by the Group indicate adoption of IFRS 15 will not have a material impact on the Group due to the nature of the products and services provided to clients. Assessments are ongoing to determine the impact that IFRS 15 adoption will have on a continuing basis.

Early adoption of IFRS 15 is permitted, however the Group does not intend to adopt the standard until the date it becomes effective.

### 1.10.3 IFRS 16 'Leases'

IFRS 16 introduces a single lessee accounting model that requires a lessee to recognise all leases (subject to certain exemptions) on-balance sheet. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items. Lessor accounting is largely unchanged.

The new standard is effective from 1 January 2019 and replaces IAS 17 'Leases', IFRIC 4 'Determining whether an Arrangement Contains a Lease', SIC-15 'Operating Leases – Incentives' and SIC-27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. It applies to all leasing arrangements.

The Group is considering the potential impact on its consolidated financial statements. Initial assessments indicate IFRS 16 will not have a material impact as the Group is mainly a lessor of assets. Further assessments will be made to evaluate the impact that IFRS 16 adoption will have on a continuing basis. The Group has not yet decided whether it will use the optional exemptions.

Early adoption of IFRS 16 is permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied, however the Group does not intend to adopt the standard until the date it becomes effective.

### 1.10.4 IFRS 2 amendment 'Classification and Measurement of Share-based Payment Transactions'

In June 2016 amendments to IFRS 2 were issued in relation to the classification and measurement of share-based payment transactions. The amendments specifically relate to: effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; classification of a share-based payment transaction with net settlement features for withholding tax obligations; accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

The amendments are effective from 1 January 2018.

## 2. Operating segments

### Accounting policy

The Group determines operating segments according to similar economic characteristics and the nature of its products and services in accordance with IFRS 8 'Operating Segments'. Management reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources.

Segment performance is evaluated based on the underlying profit or loss and is measured consistently with underlying profit or loss in the consolidated financial statements. Segment results are regularly reviewed and reported to the Board of Directors to allocate resources to segments and to assess their performance. Operating segments are reported in a manner consistent with the internal reporting provided to the Board. The Group Executive Committee has been determined to be the Chief Operating Decision Maker for the Group.

The Group has four reportable operating segments as described below which are based on the Group's three lending divisions plus a central segment which represents the savings business, central functions and shared central costs.

The following summary describes the operations in each of the Group's reportable segments:

- > **Property Finance:** Provides mortgages for investors, businesses and personal customers. It serves professional landlords and property traders in residential and commercial asset classes across long-term and shorter-term finance. It lends to trading businesses to fund the acquisition and refinancing of business premises. The division serves the needs of personal customers through the provision of loans secured by second charge on the main residence and increasingly through specialist areas of first charge lending.
- > **Business Finance:** Provides the following propositions:
  - the Regional Business Centres provides finance solutions to established businesses in UK SME markets, principally through a direct product offering. The Centres primarily provide leasing finance for business critical assets operated by established UK SME businesses, and working capital solutions in the form of invoice discounting and asset-based lending;
  - the Structured Finance proposition includes lending to SME finance companies with security against receivables within their portfolios. The Structured Finance product set provides wholesale finance and block discounting to smaller UK financial institutions to allow customers to release cash and grow their businesses. Loans are secured against receivables within the customers' portfolios, with the security given by the ultimate borrower taking the form of a hard asset or a pool of loan receivables;
  - the Specialist Asset Finance proposition includes leasing and hire purchase finance solutions in specialist UK SME market segments such as marine and aviation, healthcare and taxis; and
  - Shawbrook International Limited provides finance solutions to consumers and SMEs in Jersey, with a growing range of products designed to address a breadth of needs in the Jersey market.
- > **Consumer Lending:** Provides unsecured loans for a variety of purposes, primarily focused on home improvements, holiday ownership, personal loans and certain retailers.
- > **Central:** As well as common costs, Central includes the Group's Treasury function and Consumer Savings business which are responsible for raising finance on behalf of the lending segments.

## Operating segments (continued)

Information regarding the results of each reportable segment and their reconciliation to the total results of the Group is included below. Performance is measured based on the product contribution as included in the internal management reports. All revenue for each operating segment is earned from external customers.

The underlying basis is the basis on which financial information is presented to the Chief Operating Decision Maker, which excludes certain items included in the statutory results. The table below includes a reconciliation between the statutory results and the underlying basis.

Current taxes, deferred taxes and certain financial assets and liabilities are not allocated to segments as they are managed on a Group basis.

	Property Finance £m	Business Finance £m	Consumer Lending £m	Central £m	Total £m
<b>Year ended 31 December 2017</b>					
Interest and similar income	178.4	76.5	51.8	6.6	313.3
Interest expense and similar charges	(41.1)	(13.2)	(8.2)	(13.5)	(76.0)
<b>Net interest income/(expense)</b>	<b>137.3</b>	<b>63.3</b>	<b>43.6</b>	<b>(6.9)</b>	<b>237.3</b>
Operating lease rentals	-	12.3	-	-	12.3
Depreciation on operating leases	-	(10.6)	-	-	(10.6)
<b>Net income from operating leases</b>	<b>-</b>	<b>1.7</b>	<b>-</b>	<b>-</b>	<b>1.7</b>
Fee and commission income	0.4	11.2	0.7	-	12.3
Fee and commission expense	(3.3)	(0.7)	(8.5)	(0.3)	(12.8)
<b>Net fee and commission (expense)/income</b>	<b>(2.9)</b>	<b>10.5</b>	<b>(7.8)</b>	<b>(0.3)</b>	<b>(0.5)</b>
Fair value gains/(losses) on financial instruments	0.1	-	0.5	(0.4)	0.2
<b>Net operating income/(expense)</b>	<b>134.5</b>	<b>75.5</b>	<b>36.3</b>	<b>(7.6)</b>	<b>238.7</b>
Administrative expenses	(17.1)	(16.7)	(13.0)	(80.0)	(126.8)
Impairment losses on loans and advances to customers	(2.4)	(8.5)	(12.4)	-	(23.3)
Provisions for liabilities and charges	-	-	(2.5)	0.4	(2.1)
<b>Total operating expenses</b>	<b>(19.5)</b>	<b>(25.2)</b>	<b>(27.9)</b>	<b>(79.6)</b>	<b>(152.2)</b>
<b>Statutory profit/(loss) before taxation</b>	<b>115.0</b>	<b>50.3</b>	<b>8.4</b>	<b>(87.2)</b>	<b>86.5</b>
Underlying adjustments	0.4	-	-	19.1	19.5
<b>Profit/(loss) before taxation on an underlying basis</b>	<b>115.4</b>	<b>50.3</b>	<b>8.4</b>	<b>(68.1)</b>	<b>106.0</b>
Income tax charge on an underlying basis					(26.8)
<b>Profit after taxation on an underlying basis</b>					<b>79.2</b>
Assets	3,187.0	1,076.0	617.4	878.3	5,758.7
Liabilities	-	-	-	(5,135.6)	(5,135.6)
<b>Net assets/(liabilities)</b>	<b>3,187.0</b>	<b>1,076.0</b>	<b>617.4</b>	<b>(4,257.3)</b>	<b>623.1</b>

# Operating segments (continued)

Restated <sup>1</sup>	Property Finance	Business Finance <sup>1</sup>	Consumer Lending	Central	Total <sup>1</sup>
Year ended 31 December 2016	£m	£m	£m	£m	£m
Interest and similar income	154.9	79.3	44.7	5.5	284.4
Interest expense and similar charges	(52.8)	(21.2)	(9.9)	0.8	(83.1)
Net interest income	102.1	58.1	34.8	6.3	201.3
Operating lease rentals	-	13.5	-	-	13.5
Other income	-	0.1	-	-	0.1
Depreciation on operating leases	-	(11.3)	-	-	(11.3)
Net income from operating leases	-	2.3	-	-	2.3
Fee and commission income	0.4	10.5	0.3	-	11.2
Fee and commission expense	(2.7)	(0.6)	(2.0)	(0.4)	(5.7)
Net fee and commission income/(expense)	(2.3)	9.9	(1.7)	(0.4)	5.5
Fair value gains on financial instruments	-	-	-	0.5	0.5
Net operating income	99.8	70.3	33.1	6.4	209.6
Administrative expenses	(15.2)	(16.3)	(10.8)	(53.7)	(96.0)
Impairment losses on loans and advances to customers	(2.1)	(14.5)	(7.7)	-	(24.3)
Provisions for liabilities and charges	-	-	-	(1.1)	(1.1)
Total operating expenses	(17.3)	(30.8)	(18.5)	(54.8)	(121.4)
Statutory profit/(loss) before taxation	82.5	39.5	14.6	(48.4)	88.2
Underlying adjustments	-	-	-	3.2	3.2
Profit/(loss) before taxation on an underlying basis	82.5	39.5	14.6	(45.2)	91.4
Income tax charge on an underlying basis	-	-	-	-	(24.3)
Profit after taxation on an underlying basis	-	-	-	-	67.1
Assets	2,519.1	1,104.4	465.0	558.1	4,646.6
Liabilities	-	-	-	(4,209.4)	(4,209.4)
Net assets/(liabilities)	2,519.1	1,104.4	465.0	(3,651.3)	437.2

<sup>1</sup> Refer to Note 1.8 for details of the reclassification.

### 3. Interest and similar income

#### Accounting policy

Revenue represents income derived from loans and advances to customers, operating lease rentals and fees and commissions receivable.

Interest income and expense are recognised in the statement of profit and loss for all instruments measured at amortised cost using the effective interest rate method (EIRM).

The EIRM is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate (EIR) is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the EIR, the Group takes into account all contractual terms of the financial instrument, for example prepayment options, but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the EIR, transaction costs and all other premiums or discounts.

Income from finance lease and instalment credit agreements is recognised over the period of the leases so as to give a constant rate of return on the net investment in the leases.

Fees and commissions which are not considered integral to the EIR are recognised on an accruals basis when the service has been provided or received.

#### Critical accounting estimates and judgements

##### Effective interest rate

IAS 39 'Financial Instruments: Recognition and Measurement' requires interest earned from loans and advances to be measured under the EIRM. Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. Management reviews the expected lives on a segmental basis, whereby products of a similar nature are grouped into cohorts that exhibit homogenous behavioural attributes.

The key assumptions applied by Management in the EIR methodology are the behavioural life of the assets and the quantum of future early settlement fee income. The expected life behaviours are subjected to changes in internal and external factors and may result in adjustments to the carrying value of loans which must be recognised in the statement of profit and loss. The EIR behavioural models are based on market trends and experience. The actual behaviour of the portfolios are compared to the modelled behaviour on a quarterly basis and the modelled behaviours are adjusted if the modelled behaviour materially deviates from actual behaviour, with adjustments recognised in the statement of profit and loss.

Management continues to perform sensitivity analyses on the EIR models applied. A decrease in the redemption curve of a loan by 10% would result in a net decrease in the statement of profit and loss of £2.6 million. The movement in the sensitivity can be attributed to Property Finance and Consumer Lending. Property Finance is expected to show an income of £1.4 million mainly due to income received from early settlement fees. Consumer Lending is expected to show an expense of £3.7 million mainly attributable to the acceleration of the amortisation of broker fees.

	2017	Restated <sup>1</sup> 2016
	£m	£m
Interest paid by customers	307.1	279.0
Interest received from derivative financial instruments	4.4	3.7
Interest on loans and advances to banks	1.8	1.7
<b>Interest and similar income</b>	<b>313.3</b>	<b>284.4</b>

<sup>1</sup> Refer to Note 1.8 for details of the reclassification.

The interest income recognised during the year on loans impaired was £2.7 million (2016: £2.1 million). The Group did not capitalise any interest during the year.

#### 4. Interest expense and similar charges

	2017 £m	2016 £m
Interest paid to depositors	67.3	73.0
Interest on amounts due to banks	1.8	1.2
Interest on subordinated debt liability	6.5	6.5
Other interest	0.4	2.4
<b>Interest expense and similar charges</b>	<b>76.0</b>	<b>83.1</b>

#### 5. Fee and commission income

	2017 £m	Restated <sup>1</sup> 2016 £m
Fee income on loans and advances to customers	10.4	9.0
Credit facility related fees	1.9	2.2
<b>Fee and commission income</b>	<b>12.3</b>	<b>11.2</b>

<sup>1</sup> Refer to Note 1.8 for details of the reclassification.

#### 6. Administrative expenses

##### Accounting policy

##### Payroll costs

Staff costs include salaries and social security costs and are recognised over the period in which the payments relate. Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period of service that employees are required to work to qualify for the payment.

The accounting policies for employee share-based payments are set out in Note 10.

##### Leases

If a lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of ownership of the asset, the lease is recorded as an operating lease. Operating lease payments are charged to the statement of profit and loss on a straight-line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the statement of profit and loss in the period in which termination is made.

	Notes	2017 £m	2016 £m
Payroll costs	8	66.1	54.1
Depreciation (excluding operating lease assets)	16	2.6	2.2
Amortisation of intangible assets	17	4.0	2.7
Operating lease rentals - land and buildings		1.6	1.8
Other administrative expenses <sup>1</sup>		52.5	35.2
<b>Administrative expenses</b>		<b>126.8</b>	<b>96.0</b>

<sup>1</sup> Other administrative expenses include £13.2m (2016: £nil) legal and consultancy costs relating to the Marlin Bidco Limited acquisition of the Company.

## 7. Auditor's remuneration

	2017 £000	2016 £000
Audit of these financial statements	100	100
Amounts receivable by the Company's Auditor and their associates in respect of other services:		
Audit of the financial statements of subsidiaries of the Company	466	423
Tax compliance services	-	28
Other tax advisory services	4	101
Audit related assurance services	135	133
All other assurance services	129	39
All other services	58	106
<b>Total Auditor's remuneration</b>	<b>892</b>	<b>930</b>

## 8. Employees

The average number of persons employed by the Group (including Directors) during the year was as follows:

	2017 No.	2016 No.
Property Finance	143	122
Business Finance	133	139
Consumer Lending	43	44
Central	352	264
<b>Average number of employees on a full-time equivalent basis</b>	<b>671</b>	<b>569</b>

The aggregate payroll costs of these persons were as follows:

	2017 £m	2016 £m
Wages and salaries	58.0	46.9
Social security costs	5.6	5.0
Pension costs	2.5	2.2
<b>Total payroll costs</b>	<b>66.1</b>	<b>54.1</b>

## 9. Employee retirement obligations

### Accounting policy

The Group does not operate a defined benefit pension scheme. Pension contributions are paid to staff members' and Directors' group personal pension arrangements. The costs of the Group's contributions to such arrangements are recognised as an employee benefit expense when they are due.

The Group made contributions of £2.5 million (2016: £2.2 million) during the year.

## 10. Employee share-based payment transactions

### Accounting policy

Where the Group engages in share-based payment transactions in respect of services received from certain of its employees, these are accounted for as equity-settled share-based payments in accordance with IFRS 2 'Share-based Payment'. The equity is in the ordinary £0.01 shares.

The grant date fair value of a share-based payment transaction is recognised as an employee expense, with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards. In the absence of market prices, the fair value of the equity at the date of the grant is estimated using an appropriate valuation technique.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related services and non-market vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

For share-based payment awards with market performance conditions or non-vesting conditions the grant date fair value of the award is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

Taxation on the amount recognised as an expense is charged to the statement of profit and loss. Tax benefits of equity-settled share-based payment transactions that exceed the tax effected cumulative remuneration expenses are considered to relate to an equity item and are recognised directly in equity.

Expected volatility is determined by reviewing the share price volatility for the expected life of each option/scheme up to the date of the grant.

Cancellations of share-based payments during the vesting period are accounted for as accelerated vesting. The share-based payment is recognised immediately at the amount that would have been recognised for services received over the remainder of the vesting period, as if the service and the non-market performance conditions were met for the cancelled awards.

### Critical accounting estimates and judgements

Critical accounting estimates and judgements have been discussed below within the various categories of share-based payments.

The employee share-based payment charge comprises:

	2017 £m	2016 £m
Save-as-you-earn schemes (SAYE)	0.8	0.1
Performance share plan (PSP) – 2015	1.4	1.6
Performance share plan (PSP) – 2016	1.7	3.1
Performance share plan (PSP) – 2017	2.4	-
Deferred share bonus plan (DSBP) – 2017	1.2	-
<b>Share-based payments</b>	<b>7.5</b>	<b>4.8</b>



## Employee share-based payment transactions (continued)

Movements in the number of share-based awards are as follows:

No. of shares	DSBP 2017	SAYE 2016	SAYE 2015	PSP 2017	PSP 2016	PSP 2015	Total
At 1 January 2017	-	1,298,794	160,095	-	1,792,612	1,277,471	4,528,972
Granted	301,615	-	-	1,547,183	-	-	1,848,798
Vested	(301,615)	(245,361)	(123,108)	(269,706)	(1,089,905)	(962,750)	(2,992,445)
Lapsed	-	(1,053,433)	(36,987)	(1,277,477)	(702,707)	(314,721)	(3,385,325)
At 31 December 2017	-	-	-	-	-	-	-

### Accelerated vesting of the schemes

Subsequent to the acquisition of the Group by Marlin Bidco Limited, there was an issue of 2,586,879 £0.01 shares and the vesting of all share option schemes was accelerated. The acceleration of the share options is recognised as if the service and the non-market performance conditions of all schemes were met. Subsequent to vesting, all shares were repurchased by Marlin Bidco Limited at the offer price of £3.40. The total acceleration charge of £5.9m is included in the total charge of £7.5m.

Prior to the acquisition, the following schemes were granted (and subsequently accelerated):

### Deferred share bonus plan (DSBP) – 2017 plan

During March 2017, 301,615 awards were granted to selected members of Senior Management of which the share price at grant date was £3.14. The scheme was deemed to be an equity-settled scheme and has been accounted for as such in the financial statements of both the Company and its subsidiary, Shawbrook Bank Limited. Each award was structured as a nil cost option with no performance conditions attached, although the individuals were subject to continued employment until March 2020.

### Save-as-you-earn schemes (SAYE) – 2015 and 2016

In October 2015, the SAYE scheme was introduced for all employees. The scheme provided employees with the opportunity to take part in a tax efficient savings scheme and to acquire Shawbrook Group plc shares at a discount to market value. The shares subject to this option had no restrictions, save those restrictions applying as a matter of law, regulation and the Company's dealing code. The SAYE scheme was governed by the Company's Articles of Association. The scheme was deemed by Management to be an equity-settled scheme and has been accounted for as such in the financial statements of both the Company and its subsidiary, Shawbrook Bank Limited. The fair value of the call options was calculated as £0.71. The awards generally required employees to remain in employment over the vesting period but were not subject to performance conditions after the grant date. The awards vested over a period of three years.

In October 2016, a further SAYE scheme was introduced for all employees. The scheme's terms and conditions were the same as those of the 2015 scheme. The fair value of the call options for this scheme was calculated as £0.66. The awards vested over a period of three years.

The call options were valued using the Black-Scholes valuation model. The assumptions used were as follows:

Assumptions	2016 Scheme	2015 Scheme
Share price at grant date	£2.48	£3.10
Expected volatility	30.80%	25.90%
Dividend yield	3.31%	2.08%
Risk-free rate of return	0.19%	0.74%
Weighted average contractual life (years) at grant date	3.17	3.17
Exercise price	£1.87	£2.60

## Employee share-based payment transactions (continued)

### Performance Share Plan (PSP) – 2017 plan

During 2017, 1,547,183 share awards were granted to a set of individuals. These individuals were entitled to acquire ordinary shares in Shawbrook Group plc, subject to performance conditions. The scheme was deemed to be an equity-settled scheme and has been accounted for as such in the financial statements of both the Company and its subsidiary, Shawbrook Bank Limited.

The performance conditions for the 2017 tranche related to the growth in total Shareholder return (TSR) over the vesting period for 20% of each award, the customer and employee performance condition at the date of vesting for 20% of each award, the risk performance over the vesting period for 20% of each award and the annual compound growth in the earnings per share (EPS) over the vesting period for 40% of each award. The outcome of the performance conditions, as assessed by the Remuneration Committee, determined the vesting outcome of the awards and the shares available for exercise.

The performance condition relating to the TSR element was measured in relation to the ranking of the Group's TSR within a comparator group of companies selected by the Remuneration Committee.

The fair value of the shares in the EPS, customer and employee performance condition and risk performance elements of the awards was based on the share price at the date of the grant. The fair value of these awards was £2.94.

The fair value of the shares in the TSR award was calculated using a Monte Carlo model. Set out below is a summary of the key data and assumptions used to calculate the fair value of the TSR award:

<b>Assumptions</b>	
Share price at grant date	£3.14
Expected volatility	35% p.a.
Dividend yield	2.50% p.a.
Risk-free rate of return	0.16% p.a.

The fair value of the shares in the TSR award was £1.89.

### Performance Share Plan (PSP) – 2016 plan

During 2016, 2,181,165 share awards were granted to a set of individuals. These individuals were entitled to acquire ordinary shares in Shawbrook Group plc, subject to performance conditions. The scheme was deemed to be an equity-settled scheme and has been accounted for as such in the financial statements of both the Company and its subsidiary, Shawbrook Bank Limited. This amount included a number of options related to new hires as discussed below in 'New hires – 2016'.

The performance conditions for the 2016 tranche related to the growth in TSR over the vesting period for 20% of each award, the net promotor score at the date of vesting for 20% of each award, the risk performance over the vesting period for 20% of each award and the annual compound growth in the EPS over the vesting period for 40% of each award. The outcome of the performance conditions, as assessed by the Remuneration Committee, determined the vesting outcome of the awards and the shares available for exercise.

The performance condition relating to the TSR element was measured in relation to the ranking of the Group's TSR within a comparator group of companies selected by the Remuneration Committee.

The fair value of the shares in the EPS, net promotor score and risk performance elements of the awards was based on the share price at the date of the grant discounted for any expected dividends over the vesting period. The dividend adjusted fair value of these awards was £2.63.

## Employee share-based payment transactions (continued)

The fair value of the shares in the TSR award was calculated using a Monte Carlo model with 100,000 simulations. Set out below is a summary of the key data and assumptions used to calculate the fair value of the TSR award:

Assumptions	
Share price at grant date	£2.87
Expected volatility	30% p.a.
Dividend yield	2.83% p.a.
Risk-free rate of return	0.51% p.a.

The fair value of the shares in the TSR award was £1.46.

### Performance Share Plan (PSP) – 2015 plan

During 2015, a number of share awards were granted to a set of individuals other than Directors. These individuals were entitled to receive an award to acquire a specific number of ordinary shares in Shawbrook Group plc, subject to performance conditions. The scheme was deemed to be an equity-settled scheme and has been accounted for as such in the financial statements of both the Company and its subsidiary, Shawbrook Bank Limited. The share awards were subject to performance conditions, namely the Group earning a defined underlying profit before tax in 2017, and subject to the Group maintaining its threshold capital and liquidity requirements.

The fair value of the shares was based on the share price at the dates of the grant discounted for any expected dividends over the vesting period. The weighted average fair value of the shares issued was £3.25.

### New hires – 2016

During 2016, a number of senior hires were, under the terms of their employment with the Group, granted options over shares of £0.01 in the Company, in accordance with the 'Performance Share Plan - 2016 plan' discussed above, in order to compensate them for forfeited awards from previous employment. A total of 897,403 options were granted that vested over the following two years.

## 11. Directors' remuneration

	2017	2016
	£000	£000
Directors' emoluments	5,285.3	3,328.9
Contributions to money purchase scheme	-	13.0
<b>Directors' remuneration</b>	<b>5,285.3</b>	<b>3,341.9</b>

Included in the current year Directors' emoluments is £nil (2016: £1.1 million) relating to new hires (refer to Note 10 for more information) and £nil (2016: £228,000) relating to termination payments.

## 12. Taxation

### Accounting policy

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the statement of profit and loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the statement of financial position reporting date, and any adjustment to tax payable in respect of previous years.

	2017 £m	2016 £m
<b>Recognised in the statement of profit and loss</b>		
<b>Current tax:</b>		
Current year	24.2	27.4
Adjustment in respect of prior years	(1.1)	(0.2)
<b>Total current tax</b>	<b>23.1</b>	<b>27.2</b>
<b>Deferred tax:</b>		
Origination and reversal of temporary differences	1.3	(4.0)
Adjustment in respect of prior years	0.9	0.2
<b>Total deferred tax</b>	<b>2.2</b>	<b>(3.8)</b>
<b>Total tax charge</b>	<b>25.3</b>	<b>23.4</b>

	2017 £m	2016 £m
<b>Tax reconciliation</b>		
<b>Profit before tax</b>	<b>86.5</b>	<b>88.2</b>
Implied tax charge thereon at 19.25% (2016: 20%)	16.7	17.6
<b>Adjustments:</b>		
Banking surcharge	4.9	5.4
Prior year adjustment	(0.2)	-
Disallowable expenses and other permanent differences	3.9	0.4
<b>Total tax charge</b>	<b>25.3</b>	<b>23.4</b>

Reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and further reductions to 17% (effective 1 April 2020) were substantively enacted on 16 March 2016. This will reduce the Company's future current tax charge accordingly.

The deferred tax asset at 31 December 2017 has been calculated based on an aggregation of a rate of 18% substantively enacted at the statement of financial position reporting date and the additional 8% of tax suffered in relation to the banking surcharge that will unwind over the remaining life of the underlying assets with which they are associated.

### 13. Loans and advances to customers

#### Accounting policy

##### Loans and advances

The Group's loans and advances to banks and customers are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the EIRM, less any provision for impairment.

##### Assets acquired in exchange for loans

Included within loans and advances to customers are assets acquired in exchange for loans, instalment credit and finance lease receivables as part of an orderly realisation. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the lease (net of impairment allowance) at the date of exchange. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the statement of profit and loss. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write-down, is also recognised in the statement of profit and loss, together with any realised gains or losses on disposal.

Loans and advances to customers include those classified as loans and advances, finance leases and instalment credit advances as summarised below:

	2017 £m	2016 £m
Loan receivables	4,418.7	3,639.5
Finance lease receivables	79.8	93.6
Instalment credit receivables	348.0	316.9
Fair value adjustments for hedged risk	(2.2)	0.4
<b>Total loans and advances to customers</b>	<b>4,844.3</b>	<b>4,050.4</b>

At 31 December 2017, loans and advances to customers of £1,081.7 million (2016: £695.2 million) were positioned with the Bank of England for use as collateral under its funding schemes.

	2017 £m	2016 £m
<b>Loan receivables</b>		
Gross loan receivables	4,438.4	3,653.1
Less: allowances for impairment losses	(19.7)	(13.6)
<b>Net loan receivables</b>	<b>4,418.7</b>	<b>3,639.5</b>

The Group provides finance lease and instalment credit agreements to customers for a variety of assets including plant and machinery, taxis, aviation and marine vessels. These assets provide security against the gross receivables. Included within instalment credit receivables are block discounting facilities of £106.6 million (2016: £107.5 million).

**Loans and advances to customers (continued)**

	2017 £m	2016 £m
<b>Finance lease receivables</b>		
<b>Gross amounts receivable</b>		
within one year	47.0	59.5
in the second to fifth year inclusive	49.5	55.2
after five years	3.0	1.5
	99.5	116.2
Less: unearned finance income	(10.6)	(14.1)
Less: allowances for impairment losses	(9.1)	(8.5)
<b>Net investment in finance lease receivables</b>	<b>79.8</b>	<b>93.6</b>
<b>Amounts falling due</b>		
within one year	37.5	47.1
in the second to fifth year inclusive	39.7	45.2
after five years	2.6	1.3
<b>Net investment in finance lease receivables</b>	<b>79.8</b>	<b>93.6</b>
	2017 £m	2016 £m
<b>Instalment credit receivables</b>		
<b>Gross amounts receivable</b>		
within one year	162.5	165.9
in the second to fifth year inclusive	204.9	182.6
after five years	18.1	6.6
	385.5	355.1
Less: unearned finance income	(34.7)	(35.9)
Less: allowances for impairment losses	(2.8)	(2.3)
<b>Net investment in instalment credit receivables</b>	<b>348.0</b>	<b>316.9</b>
<b>Amounts falling due</b>		
within one year	143.3	143.3
in the second to fifth year inclusive	186.8	167.3
after five years	17.9	6.3
<b>Net investment in instalment credit receivables</b>	<b>348.0</b>	<b>316.9</b>
	2017 £m	2016 £m
<b>Cost of equipment acquired during the year</b>		
Finance leases	40.1	43.9
Instalment credit	161.5	128.7
<b>Total cost of equipment acquired during the year</b>	<b>201.6</b>	<b>172.6</b>

## 14. Impairment provisions on loans and advances to customers

### Accounting policy

On an ongoing basis, the Group assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include, but are not limited to, the following:

- > delinquency in contractual payments of principal or interest;
- > cash flow difficulties experienced by the borrower;
- > initiation of bankruptcy proceedings;
- > the customer being granted a concession that would otherwise not be considered; and
- > observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio.

If there is objective evidence that an impairment loss on an individual financial asset has occurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original EIR. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit and loss. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR determined under the contract.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Objective evidence of impairment of a portfolio of receivables exists if objective data indicates a decrease in expected future cash flows from a collection of receivables and the decrease can be measured reliably but cannot be identified with the individual receivables in the portfolio in which case a collective provision is applied.

When a loan or receivable is not economic to recover, it is written off against the related provision for loan impairments. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised directly in the statement of profit and loss through the impairment line as post write-off recoveries. If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of reversal is recognised in statement of profit and loss.

The Group operates a forbearance policy in situations where it becomes aware that an individual customer is experiencing financial hardship. Repayment options are discussed with the customer that are appropriate to the customer's specific situation. The Group seeks to ensure that any forbearance results in a fair customer outcome and will not repossess an asset unless all other reasonable attempts to resolve the position have failed. Further information is provided in Note 31.1.1.

**Impairment provisions on loans and advances to customers (continued)****Critical accounting estimates and judgements**

Individual impairment losses on loans and advances are calculated based on an assessment of the expected cash flows and the underlying collateral. For individual provisions, statistical models are used for consumer and second charge loans, whilst provisions for first charge loans, asset finance and business finance are assessed on a loan-by-loan basis. Where models are used for individual provisions, score cards are used to calculate PDs based on the recent performance of the portfolios. LGDs are calculated taking into account the valuations of available collateral, and the experienced forced sale discounts when collateral has been realised. These factors are applied to all the aged portfolios of debt at each statement of financial position reporting date to derive the individual impairment requirement.

For the purpose of collective impairment, financial assets are grouped on the basis of similar risk characteristics. For some portfolios, the collective impairment requirement is based on the forecast cost of risk, being the annualised percentage loss per monetary unit of loan across the loan portfolios. These loss rates are multiplied by emergence periods, currently six months for all portfolios (2016: six months), for each class of loan to calculate the amount of loss which is incurred at the statement of financial position reporting date but not yet individually identified.

The key assumptions, being the emergence periods, forced sale discount on the Residential portfolio, cost of risk and PD of the Residential and Consumer portfolios, are monitored regularly to ensure the impairment allowance is entirely reflective of the current portfolio. The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes. For example, for loans and advances:

- > change of one month in the emergence period across all portfolios, would change the collective provision by £1.5 million (2016: £0.9 million);
- > a change in the cost of risk rate of 10 basis points, would change the collective provision by £2.2 million (2016: £1.7 million);
- > an increase in the forced sale discount on the Residential portfolio of 5%, would increase the individual provisions by £0.8 million (2016: £0.5 million); and
- > an increase in the PD on the Residential and an increase in the cost of risk on the Consumer portfolios of 10%, would increase the individual provisions by £2.4 million (2016: £1.1 million).

The movement in the allowances for losses in respect of loans, finance leases and instalment credit agreements during the year was as follows:

	2017 £m	2016 £m
<b>At 1 January</b>	<b>24.4</b>	<b>13.5</b>
Charge for impairment losses	23.3	24.3
Amounts written off in the year	(18.6)	(15.2)
Amounts recovered in the year	2.5	1.8
<b>At 31 December</b>	<b>31.6</b>	<b>24.4</b>
<b>Analysis of impairment type:</b>		
Loan receivables	19.7	13.6
Finance lease receivables	9.1	8.5
Instalment credit receivables	2.8	2.3
<b>At 31 December</b>	<b>31.6</b>	<b>24.4</b>



## 15. Derivative financial instruments

### Accounting policy

#### *Derivatives and hedge accounting*

The Group's derivative activities are entered into for the purposes of matching or eliminating risk from potential movements in interest rates and foreign exchange in the Group's assets and liabilities. Derivatives which are not designated as hedging instruments in qualifying hedge relationships are used to manage the Bank's exposure to interest rate and foreign exchange risk.

The Group uses interest rate swaps and options to hedge its interest rate risks. Such derivative financial instruments are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value.

Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models (at a benchmark interest rate, typically over-night indexed swap or its equivalent) and option pricing models.

Derivatives are measured as assets where their fair value is positive and liabilities where their fair value is negative. The Group applies the exemption under IFRS 9 'Financial Instruments' to continue to apply the hedge accounting rules as per IAS 39 'Financial Instruments: Recognition and Measurement', and as such all hedge relationships must be clearly and formally documented at inception and the derivative must be expected to be highly effective at mitigating the hedged risk.

The Group undertakes transactions denominated in foreign currencies; consequently, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts.

#### *Fair value hedge*

The change in the fair value of a hedging instrument is recognised in the statement of profit and loss. The change in the fair value of the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged item and is also recognised in the statement of profit and loss. Where hedging gains/losses are recognised in the statement of profit and loss they are recognised on the same line as the hedged item. The Group discontinues hedge accounting only when the relationship (or a part thereof) ceases to meet the qualifying criteria. This includes when the hedging instrument is sold or expires. The fair value adjustment to the carrying amount of the hedged item, for which the EIR method is used, arising from the hedged risk is amortised to the statement of profit and loss commencing no later than the date when hedge accounting is discontinued.

#### *Unobservable valuation differences on initial recognition*

The transaction price in the market in which derivative transactions are undertaken may be different from the fair value of the derivative transaction. On initial recognition, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability).

## Derivative financial instruments (continued)

### Derivatives held for risk management

The Group uses derivatives to reduce exposure to market risks, and not for trading purposes. The Group uses the International Swaps and Derivatives Association Master Agreement to document these transactions in conjunction with a Credit Support Annex. The following table, prepared under IAS 39, analyses derivatives held for risk management purposes by type of instrument:

	Notional Amount £m	Fair Value £m
<b>Interest rate swaps:</b>		
Assets	389.0	1.8
Liabilities	189.0	(0.3)
<b>Interest rate options:</b>		
Liabilities	500.0	(2.8)
<b>Foreign exchange swaps:</b>		
Liabilities	33.3	(0.3)
<b>At 31 December 2017</b>	<b>1,111.3</b>	<b>(1.6)</b>
<b>Interest rate swaps:</b>		
Assets	485.0	5.2
Liabilities	39.0	(0.4)
<b>Foreign exchange swaps:</b>		
Liabilities	16.4	-
<b>At 31 December 2016</b>	<b>540.4</b>	<b>4.8</b>

Gains and losses from derivatives and hedge accounting are as follows:

	2017 £m	2016 £m
Fair value gain on financial instruments	3.9	2.0
Fair value loss on hedged risk	(3.7)	(1.5)
<b>Fair value gain on financial instruments</b>	<b>0.2</b>	<b>0.5</b>

It is the Group's policy to enter into master netting and margining agreements with all derivative counterparties. In general, under master netting agreements the amounts owed by each counterparty that are due on a single day in respect of all transactions outstanding under the agreement are aggregated into a single net amount payable by one party to the other. In certain circumstances, for example when a credit event such as a default occurs, all outstanding transactions under the agreement are aggregated into a single net amount payable by one party to the other and the agreements terminated.

# Derivative financial instruments (continued)

Under margining agreements where the Group has a net asset position valued at current market values, in respect of its derivatives with a counterparty, then that counterparty will place collateral, usually cash, with the Group in order to cover the position. Similarly, the Group will place collateral, usually cash, with the counterparty where it has a net liability position.

The Group's property loan portfolio includes loans whose interest rate terms are referenced to the three-month LIBOR index, but with a minimum reference rate of 0.75%. On 29 March 2017, the Group sold interest rate options with a nominal value of £500 million into the wholesale market in order to hedge the Group's interest rate position against possible increases in the reference rate.

The table below illustrates the amounts that are covered by enforceable netting arrangements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and those that are subject to collateral arrangements only (e.g. loans and advances).

	Amounts subject to enforceable netting arrangements					Amount not subject to enforceable netting arrangements £m
	Effect of offsetting on statement of financial position			Related amounts not offset		
	Gross amount £m	Amount offset %	Net amount reported on statement of financial position £m	Cash collateral £m	Net amount £m	
At 31 December 2017						
Derivative financial instruments - assets	1.8	-	1.8	1.8	-	-
Derivative financial instruments - liabilities	(3.4)	-	(3.4)	(3.4)	-	-
<b>Total financial instruments</b>	<b>(1.6)</b>	<b>-</b>	<b>(1.6)</b>	<b>(1.6)</b>	<b>-</b>	<b>-</b>
At 31 December 2016						
Derivative financial instruments - assets	5.2	-	5.2	5.2	-	-
Derivative financial instruments - liabilities	(0.4)	-	(0.4)	(0.4)	-	-
<b>Total financial instruments</b>	<b>4.8</b>	<b>-</b>	<b>4.8</b>	<b>4.8</b>	<b>-</b>	<b>-</b>

Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however, this amount is limited to the net statement of financial position exposure in order not to include any over-collateralisation.

Details of derivatives designated as hedging instruments in qualifying hedging relationships are provided under 'Hedge accounting' below.

## Derivative financial instruments (continued)

### Hedge accounting

#### Fair value hedges of interest rate risk and foreign currency risk

The Group uses interest rate swaps and cross currency swaps to hedge its exposure to changes in the fair values of fixed rate loans and advances to customers in respect of a benchmark interest rate (mainly three-month LIBOR) and foreign currency risks (mainly Euro and US Dollar). Interest rate swaps are matched to specific issuances of fixed rate loans.

The Group's approach to managing market risk, including interest rate risk and foreign currency risk, is discussed in Note 31. The Group hedges interest rate risk only to the extent of benchmark interest rates. The benchmark interest rate is a component of interest rate risk that is observable in the relevant environments. Hedge accounting is applied where economic hedge relationships meet the hedge accounting criteria.

The Group does not apply a credit valuation adjustment or debit valuation adjustment as the Group's portfolio is fully collateralised. The Group does not apply funding fair value adjustment to its derivative exposures as it deems the adjustment to be immaterial.

When fair value hedge accounting is applied by the Group, the Group assesses whether the derivative designated in each hedge relationship is expected to be and has been highly effective in offsetting the changes in fair value of the hedged item using linear regression.

Under the Group policy, in order to conclude that a hedge relationship is effective, all of the following criteria should be met:

- > There is a formal designation and written documentation at the inception of the hedge.
- > The effectiveness of the hedging relationship can be measured reliably. This requires the fair value of the hedging instrument, and the fair value of the hedged item with respect to the risk being hedged, to be reliably measurable.
- > The hedge is expected to be highly effective in achieving fair value offsets in accordance with the original documented risk management strategy.
- > The hedge is assessed and determined to be highly effective if changes in the fair value of the hedging instrument, and changes in the fair value or expected cash flows of the hedged item attributable to the hedged risk, offset within the range of 80-125%.

In these hedge relationships, the main sources of ineffectiveness relates to the modelled prepayment behaviour and the assumptions that are used in modelling this behaviour. There were no other sources of ineffectiveness in these hedge relationships.

Fair value gains on derivatives held in qualifying fair value hedging relationships and the hedging gain or loss on the hedged items are included in net interest income.

At 31 December 2017, the Group held the following interest rate swaps as hedging instruments in fair value hedges:

	Maturity				
	Less than 1 month	1-3 months	3 months - 1 year	1-5 years	More than 5 years
<b>At 31 December 2017</b>					
<b>Interest rate risk:</b>					
Nominal amount (£m)	-	-	307.0	740.0	31.0
Average fixed interest rate	-	-	1.17%	1.16%	0.94%

# Derivative financial instruments (continued)

## Fair value hedges

The amounts relating to items designated as hedging instruments and hedge ineffectiveness were as follows:

	Nominal amount	Carrying amount		Statement of financial position line item	Change in fair value used for calculating hedge ineffectiveness	Ineffectiveness recognised in statement of profit and loss	Statement of profit and loss line item
	£m	Assets	Liabilities		£m	£m	
<b>At 31 December 2017</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>		<b>£m</b>	<b>£m</b>	
<b>Interest rate risk:</b>							
Interest rate swaps	389.0	1.8	-	Derivative financial assets	-	-	-
Interest rate swaps	189.0	-	(0.3)	Derivative financial liabilities	(0.7)	0.1	Fair value gains on financial instruments
Interest rate options	500.0	-	(2.8)	Derivative financial liabilities	4.6	0.1	Fair value gains on financial instruments

The amounts relating to items designated as hedged items were as follows:

	Carrying amount		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Statement of financial position line item	Change in value used for calculating hedge ineffectiveness	Accumulated amount of fair value hedge adjustments
	Assets	Liabilities	Assets	Liabilities		£m	£m
<b>At 31 December 2017</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>		<b>£m</b>	<b>£m</b>
Loans and advances to customers	1,227.1	-	4.1	-	Loans and advances to customers	(3.7)	(3.7)
Customer deposits	-	407.0	-	(1.9)	Customer deposits	-	0.5

## 16. Property, plant and equipment

### Accounting policy

#### *Operating leases*

Included within property, plant and equipment are assets leased to customers under operating leases. The net book value of operating leases represents the original cost of the equipment less cumulative depreciation. Rentals are recognised on a straight-line basis over the lease term. Depreciation is recognised on a straight-line basis to a residual value over the life of the associated agreement.

#### *Depreciation*

Tangible fixed assets are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Depreciation is charged to the statement of profit and loss on a straight-line basis over the estimated useful lives of each part of an item of plant and equipment as follows:

- > office equipment            3/5 years
- > fixtures and fittings        10 years
- > motor vehicles              4 years
- > freehold property          50 years
- > leasehold costs            life of the lease
- > operating leases<sup>1</sup>        life of the lease

<sup>1</sup> Operating leases are assets leased to customers.

Depreciation methods, useful lives and residual values are reviewed at each statement of financial position reporting date.

#### *Assets acquired in exchange for operating leases*

Included within property, plant and equipment are assets acquired in exchange for operating leases as part of an orderly realisation. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the lease (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the statement of profit and loss. Any subsequent increase in the fair value less costs to sell, to the extent it does not exceed the cumulative write-down, is also recognised in the statement of profit and loss, together with any realised gains or losses on disposal.

#### *Residual values*

The residual values of assets under operating leases are reviewed by Management for impairment, taking into account the nature and condition of the assets. Where the residual value of the assets exceeds the estimated recoverable amount, the assets are impaired and the impairment charged to the statement of profit and loss.

**Property, plant and equipment (continued)**

	<b>Freehold property £m</b>	<b>Leasehold property £m</b>	<b>Fixtures, fittings &amp; equipment £m</b>	<b>Assets on operating leases £m</b>	<b>Total £m</b>
<b>Cost</b>					
At 1 January 2016	0.2	0.1	10.2	67.3	77.8
Additions	-	-	0.2	11.1	11.3
Disposals	(0.2)	-	-	(11.2)	(11.4)
Transfer to finance leases	-	-	-	(10.6)	(10.6)
<b>At 31 December 2016</b>	<b>-</b>	<b>0.1</b>	<b>10.4</b>	<b>56.6</b>	<b>67.1</b>
Additions	-	<b>0.7</b>	<b>0.9</b>	<b>11.7</b>	<b>13.3</b>
Disposals	-	-	<b>(0.1)</b>	<b>(7.8)</b>	<b>(7.9)</b>
Transfer to finance leases	-	-	-	<b>(8.7)</b>	<b>(8.7)</b>
<b>At 31 December 2017</b>	<b>-</b>	<b>0.8</b>	<b>11.2</b>	<b>51.8</b>	<b>63.8</b>
<b>Depreciation</b>					
At 1 January 2016	-	0.1	3.7	25.4	29.2
Depreciation charge for the year	-	-	2.2	11.3	13.5
Disposals	-	-	-	(9.9)	(9.9)
Transfer to finance leases	-	-	-	(8.3)	(8.3)
<b>At 31 December 2016</b>	<b>-</b>	<b>0.1</b>	<b>5.9</b>	<b>18.5</b>	<b>24.5</b>
Depreciation charge for the year	-	<b>0.4</b>	<b>2.2</b>	<b>10.6</b>	<b>13.2</b>
Disposals	-	-	<b>(0.1)</b>	<b>(6.3)</b>	<b>(6.4)</b>
Transfer to finance leases	-	-	-	<b>(7.1)</b>	<b>(7.1)</b>
<b>At 31 December 2017</b>	<b>-</b>	<b>0.5</b>	<b>8.0</b>	<b>15.7</b>	<b>24.2</b>
<b>Net book value</b>					
At 31 December 2016	-	-	4.5	38.1	42.6
<b>At 31 December 2017</b>	<b>-</b>	<b>0.3</b>	<b>3.2</b>	<b>36.1</b>	<b>39.6</b>

## 17. Intangible assets

### Accounting policy

#### Goodwill

Goodwill may arise on the acquisition of subsidiaries and represents the excess of the aggregate of the fair value of consideration transferred and the fair value of any non-controlling interest over the fair value of identifiable net assets at the date of acquisition. Goodwill is stated at cost less any accumulated impairment losses.

Goodwill is not amortised but is tested annually for impairment and additionally whenever there is an indication that impairment may exist. For the purpose of impairment testing, goodwill is allocated to cash generating units (CGUs). A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. An impairment loss is recognised if the carrying amount of a CGU exceeds its recoverable amount. Recoverable amount is the greater of the CGUs value in use and fair value less costs to sell. Value in use is based on estimated future cash flows less a residual value, discounted at a risk-adjusted discount rate appropriate to the CGU. Where impairment is required, the amount is recognised in the statement of profit and loss and cannot subsequently be reversed.

#### Computer software

Computer software acquired by the Group is stated at cost less accumulated amortisation and any accumulated impairment losses.

Internally developed computer software is recognised as an asset only when the Group is able to demonstrate that the following conditions have been met: expenditure can be reliably measured, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group has the intention and ability to complete development and subsequently use or sell the asset. If these conditions are not met, expenditure is recognised in the statement of profit and loss as incurred. Capitalised costs include all costs directly attributable to developing the computer software. Internally developed computer software is stated at capitalised cost less accumulated amortisation and any accumulated impairment losses.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in the statement of profit and loss as incurred.

Computer software is amortised on a straight-line basis over its estimated useful life from the date it is available for use. The estimated useful life of computer software is between three and seven years. Amortisation is recognised in the statement of profit and loss. The amortisation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

### Critical accounting estimates and judgements

The review of goodwill for impairment reflects Management's best estimate of future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to judgement and uncertainty as follows:

- > the future cash flows of the CGUs are sensitive to projected cash flows based on the forecasts and assumptions regarding the projected periods and the long-term pattern of sustainable cash flows thereafter.
- > the rates used to discount future expected cash flows can have a significant effect on their valuations and are based on the price-to-book ratio method which incorporates inputs reflecting a number of variables. These variables are subject to uncertainty and require the exercise of significant judgement.



# Intangible assets (continued)

The factors and inputs are described in more detail below.

	Goodwill £m	Computer software £m	Total £m
At 1 January 2016	44.8	9.9	54.7
Additions	-	7.9	7.9
Amortisation	-	(2.7)	(2.7)
At 31 December 2016	44.8	15.1	59.9
At 1 January 2017	44.8	15.1	59.9
Additions	-	9.8	9.8
Amortisation	-	(4.0)	(4.0)
At 31 December 2017	44.8	20.9	65.7

Total cost of computer software amounted to £29.1 million (2016: £19.3 million) while accumulated amortisation amounted to £8.2 million (2016: £4.2 million). Additions of £9.8 million included £8.5 million of internally generated assets.

## Impairment testing for CGUs containing goodwill

For the purposes of impairment testing, goodwill is allocated to the Group's CGUs as follows:

	2017 £m	2016 £m
Property Finance	9.0	9.0
Business Finance	34.7	34.7
Consumer Lending	1.1	1.1
At 31 December	44.8	44.8

No impairment losses were recognised in 2017 (2016: £nil) because the recoverable amounts of the CGUs were higher than their carrying values.

The recoverable amounts of the CGUs were calculated based on their value in use, determined by discounting the future cash flows (post-tax profits) to be generated from the continuing use of the CGU. Forecast cash flows were reduced by any earnings retained to support the growth in the underlying CGUs loan books through higher regulatory capital requirements. Forecast post-tax profits were based on expectations of future outcomes taking into account past experience and adjusted for anticipated revenue growth.

The key assumptions used in the calculation of value in use were as follows:

	Post-tax	Pre-tax <sup>1</sup>
<b>Discount rate:</b>		
Property Finance	12.0%	16.6%
Business Finance	12.5%	16.3%
Consumer Lending	13.0%	16.8%
<b>Cash flow period (Years)</b>	4	4
<b>Terminal value growth rate</b>	2.0%	2.0%

<sup>1</sup> Management applies post-tax discount rates to post-tax cash flows when testing the CGU for impairment. The pre-tax discount rate is disclosed in accordance with IAS 36.

**Intangible assets (continued)**

The post-tax discount rate is an estimate of the return that investors would require if they were to choose an investment that would generate cash flows of amount, timing and risk profile equivalent to those that the entity expects to derive from the asset. Subsequent to the Group's delisting from the stock exchange, calculation of the discount rate based on the capital asset pricing model used in 2016 was no longer appropriate. As such, the price-to-book ratio method was adopted as an alternative method incorporating target return on equity, growth rate and price-to-book ratio. The discount rate for each CGU was adjusted to reflect the risks inherent to the individual CGU.

Four years of cash flows were included in the discounted cash flow model based on a Board approved plan. A terminal value growth rate was then applied into perpetuity to extrapolate cash flows beyond the cash flow period. The terminal value growth rate was estimated by Management taking into account rates disclosed by comparable institutions. Sensitivity analysis on the cash flows identified that a decrease of the cash flows of 20.0% will not result in any impairment of the goodwill balance. The key assumptions described above may change in response to changes in economic and market conditions. However, the value in use of all CGUs was significantly greater than their carrying values and sensitivity analysis identified that an increase of 3.0% in each of the individual CGU discount rates will not result in any impairment of the goodwill balance.

**18. Deferred tax****Accounting policy**

Deferred tax is provided in full using the liability method on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the statement of financial position reporting date. A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets are attributable as follows:

	2017 £m	2016 £m
Accelerated tax depreciation	13.6	14.9
Share-based payments	-	1.1
Bad debt provision	2.0	1.8
Other	0.1	0.1
<b>Deferred tax assets</b>	<b>15.7</b>	<b>17.9</b>
<b>At 1 January</b>	<b>17.9</b>	<b>14.1</b>
Current period movement - recognised in income	(0.4)	1.8
Prior year adjustment	(0.9)	(0.2)
Share-based payments	(1.1)	0.9
Bad debt provision	0.2	1.3
<b>At 31 December</b>	<b>15.7</b>	<b>17.9</b>

The Group had a deferred tax asset of £15.7 million at 31 December 2017 (2016: £17.9 million) resulting primarily from decelerated capital allowances. The business plan projects profits in future years sufficient to recognise the £15.7 million deferred tax asset. The tax assets will unwind over the remaining life of the underlying leased assets with which they are associated. A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and further reductions to 17% (effective 1 April 2020) were substantively enacted on 16 March 2016. The deferred tax asset at 31 December 2017 has been calculated based on an aggregation of a rate of 18% substantively enacted at the statement of financial position reporting date and the additional 8% of tax suffered in relation to the banking surcharge that will unwind over the remaining life of the underlying assets with which they are associated.

## 19. Other assets

	2017 £m	2016 £m
Other debtors	0.5	1.9
Prepayments	9.8	14.7
<b>Total other assets</b>	<b>10.3</b>	<b>16.6</b>

## 20. Investment in subsidiaries

	Company 2017 £m	Company 2016 £m
<b>At 1 January</b>	<b>277.0</b>	<b>272.2</b>
Issue of capital securities in Shawbrook Bank Limited	125.0	-
Share-based payments	7.5	4.8
<b>At 31 December</b>	<b>409.5</b>	<b>277.0</b>

## 21. Customer deposits

	2017 £m	2016 £m
Instant access	878.2	636.6
Term deposits and notice accounts	3,496.0	3,301.9
Fair value adjustments for hedged risk	2.0	5.0
<b>Total customer deposits</b>	<b>4,376.2</b>	<b>3,943.5</b>

## 22. Amounts due to banks

Total amounts due to banks of £607.3 million at 31 December 2017 (2016: £147.7 million) includes £nil (2016: £24.8 million) which are monies arising from the sale and repurchase of Treasury Bills drawn under the Bank of England's Funding for Lending Scheme (FLS). Also included is £605.0 million (2016: £118.0 million) of deposits received from the Bank of England under the Term Funding Scheme (TFS) which fall due for repayment in 2020 and 2021. The TFS deposits are collateralised by loan assets of £902.2 million (2016: £160.8 million).

**23. Provisions for liabilities and charges**

	2017 £m	2016 £m
<b>At 1 January</b>	<b>1.3</b>	<b>0.9</b>
Provisions utilised	(0.6)	(0.7)
Provisions made during the year	2.1	1.1
<b>At 31 December</b>	<b>2.8</b>	<b>1.3</b>

**Financial Services Compensation Scheme (FSCS)**

In common with all regulated UK deposit takers, the Group pays levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

The FSCS meets these current claims by way of loans received from HM Treasury. The terms of these loans were interest only for the first three years, and the FSCS seeks to recover the interest cost, together with ongoing management expenses, via annual management levies on members, including the Group, over this period. The loan for the compensation levy has been repaid in full.

The Group's FSCS provision reflects market participation up to the reporting date. The above provision includes the estimated management expense levy for the scheme year 2016/17. This amount was calculated on the basis of the Group's current share of protected deposits taking into account the FSCS's estimate of total management expense levies for the scheme year.

**Critical accounting estimates and judgements***Customer remediation and conduct issues*

Provisions have been made in respect of various potential customer claims and represent Management's best estimate of the likely costs. A provision of £2.5 million relates to potential instances of misrepresentation or breaches of contract by suppliers where the suppliers have become insolvent (and therefore the Group having limited recourse to those suppliers). The provision is calculated using Management's estimate of complaints volumes, referral levels to the Financial Ombudsman Service, claim rates upheld internally and by the Financial Ombudsman Service, redress payments and complaint handling costs.

**24. Other liabilities**

	2017 £m	2016 £m
Other creditors	46.2	12.8
Accruals	16.6	14.2
<b>Total other liabilities</b>	<b>62.8</b>	<b>27.0</b>

Included in other creditors are amounts relating to sundry creditors, deferred incomes and other taxes.

Other creditors have increased to £46.2 million in 2017 (2016: £12.8 million). This is primarily due to amounts owing to a bank in relation to the purchase of a loan book.

## 25. Operating leases

### Accounting policy

Operating lease income is recognised in the statement of profit and loss on a straight-line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the statement of profit and loss in the period in which termination is made.

### Leases as lessee

Non-cancellable operating lease rentals on land and buildings are payable as follows:

	2017 £m	2016 £m
<b>Leases as lessee</b>		
Less than 1 year	2.0	1.5
Between 1 and 5 years	5.8	3.4
More than 5 years	1.8	-
<b>Total leases as lessee</b>	<b>9.6</b>	<b>4.9</b>

### Leases as lessor

Operating lease rentals receivable from agreements classified as property, plant and equipment, as disclosed in Note 16, are receivable as follows:

	2017 £m	2016 £m
<b>Leases as lessor</b>		
Less than 1 year	8.6	10.4
Between 1 and 5 years	16.7	16.0
More than 5 years	1.5	1.0
<b>Total leases as lessor</b>	<b>26.8</b>	<b>27.4</b>

## 26. Subordinated debt

### Accounting policy

The subordinated debt is a non-derivative financial liability with fixed or determinable payments. The subordinated debt is recognised initially at fair value and subsequently measured at amortised cost. Interest costs arising are capitalised in accordance with agreed terms and incorporated into the total debt payable and recognised on an EIR basis.

### Subordinated debt liability:

In 2015, the Group issued £75.0 million fixed rate reset callable subordinated notes due 2025 with an initial semi-annual coupon of 8.5%. The notes were listed for trading on the London Stock Exchange on 28 October 2015. Fees of £1.0 million were incurred on issuance.

	2017 £m	2016 £m
<b>At 1 January</b>	<b>75.3</b>	<b>74.0</b>
Interest expense	6.5	6.5
Repayment of interest	(6.4)	(5.2)
<b>At 31 December</b>	<b>75.4</b>	<b>75.3</b>

### Subordinated debt receivable:

Following the issue of subordinated debt to the market, subordinated debt was issued from the Bank to the Group on consistent terms with the listed loan notes. The subordinated debt ranks behind any claims against the Group from all depositors and creditors.

## 27. Share capital

Ordinary shares of £0.01 each: issued and fully paid

	2017 No.	2016 No.
<b>Ordinary £0.01 shares</b>	<b>253,086,879</b>	<b>250,500,000</b>

	2017 No.	2017 £	2016 No.	2016 £
<b>On issue at 1 January</b>	<b>250,500,000</b>	<b>2,505,000</b>	<b>250,500,000</b>	<b>2,505,000</b>
<b>Issued during the year</b>	<b>2,586,879</b>	<b>25,869</b>	<b>-</b>	<b>-</b>
<b>On issue at 31 December</b>	<b>253,086,879</b>	<b>2,530,869</b>	<b>250,500,000</b>	<b>2,505,000</b>

Each ordinary share of £0.01 has full voting, dividend and capital distribution rights, including on a winding up, but does not have any rights of redemption. Par value is £0.01 per share. Ordinary shares were removed from the Official List and trading cancelled on the London Stock Exchange on 24 August 2017.

## 28. Capital securities

### Accounting policy

In accordance with IAS 32 'Financial instruments: Presentation', the capital securities are classified as equity instruments based on the characteristics associated with its redemption and interest payments discussed fully below. No embedded derivative features were identified. Accordingly, the capital securities have been included in equity at the fair value of the proceeds received less any costs directly attributable to their issue, net of tax relief thereon. Any interest paid on the capital securities, net of tax relief thereon, is a distribution to holders of equity instruments and is recognised directly in equity on the payment date.

	2017 £m	2016 £m
Issue of capital securities	125.0	-
Cost of issuance of capital securities	(1.0)	-
<b>Capital securities</b>	<b>124.0</b>	<b>-</b>

During the year the Company issued £125.0 million Fixed Rate Reset Perpetual Additional Tier 1 Write Down Capital Securities which were listed on the Irish Stock Exchange on 8 December 2017.

The capital securities are perpetual securities in respect of which there is no fixed redemption date. The capital securities may only be redeemed or repurchased by the Company for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA. The capital securities bear interest on their principal amount at an initial rate of 7.875% per annum until the first reset date of 8 December 2022. The reset rate of interest will be determined on the first reset date and on each fifth anniversary thereafter. Interest is payable on the capital securities semi-annually in arrears commencing 8 June 2018 and is non-cumulative. Interest is fully discretionary and the Company may elect to cancel (in whole or in part) the interest otherwise scheduled to be paid.

There are a number of additional terms relating to events such as acquisition and wind up, however there are no circumstances in which the Group has an unavoidable obligation to issue a variable number of its own shares.

## Capital Securities (continued)

In the event of the Group's CET1 capital ratio falling below 7.00%, a 'Trigger Event', an 'Automatic Write Down' shall occur on the next business day, resulting in the irrevocable and automatic reduction of the full principal amount of the capital securities to zero and the cancellation of all accrued and unpaid interest and any other amounts arising under or in connection with the capital securities.

Following the listing of the capital securities to the market, capital securities were issued from Shawbrook Bank Limited to Shawbrook Group plc on consistent terms as the listed capital securities.

## 29. Notes to the cash flow statement

### Accounting policy

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash and balances at central banks, loans and advances to banks and building societies and short-term highly liquid debt securities with less than three months to maturity from the date of acquisition. Loans to banks and building societies comprise cash balances and call deposits.

		Group 2017 £m	Company 2017 £m	Group 2016 £m	Company 2016 £m
<b>Non-cash items in the cash flow statement</b>	Notes				
Capitalisation of subordinated debt interest	26	6.5	6.5	6.5	6.5
Depreciation	16	13.2	-	13.5	-
Amortisation of intangible assets	17	4.0	-	2.7	-
Provisions against loans and advances to customers	14	23.3	-	24.3	-
Amortisation of share scheme fair value	10	7.5	-	4.8	-
<b>Total non-cash items</b>		<b>54.5</b>	<b>6.5</b>	<b>51.8</b>	<b>6.5</b>

	Group 2017 £m	Company 2017 £m	Group 2016 £m	Company 2016 £m
<b>Cash and cash equivalents</b>				
Cash and balances at central banks	752.5	-	429.9	-
Loans and advances to banks	28.8	-	24.1	-
Less: mandatory deposits with central banks	(4.3)	-	(4.0)	-
<b>Cash and cash equivalents</b>	<b>777.0</b>	<b>-</b>	<b>450.0</b>	<b>-</b>

Mandatory deposits are not available for use in the Group or Bank's day-to-day business and are non-interest bearing.

### 30. Financial instruments

#### Accounting policy

Financial assets and financial liabilities are recognised in the Group statement of financial position when the Group becomes a party to the contract provisions of the instrument.

Recognised financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at FVTPL) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the financial asset or financial liabilities at FVTPL are recognised immediately in the statement of profit and loss.

If the transaction price differs from the fair value at initial recognition, the Group will account for such differences as follows:

- > if fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in the statement of profit and loss on initial recognition (i.e. day 1 profit or loss);
- > in all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability).

After initial recognition, the deferred gain or loss will be released to the statement of profit and loss on a rational basis, only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

#### Financial assets

All financial assets are recognised and derecognised on a trade date where the purchase or sale of a financial asset is under contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as FVTPL. Transaction costs directly attributable to the acquisition of financial assets classified as FVTPL are recognised immediately in the statement of profit and loss.

The Group classifies its financial assets in the following two categories:

- > FVTPL; and
- > loan receivables.

#### Derivative financial instruments

The Group enters into a variety of derivative financial instruments some of which are held for trading while others are held to manage its exposure to interest rate risk and foreign exchange risk. Derivatives held include foreign exchange forward contracts, interest rate swaps and cross currency interest rate swaps. Further details of derivative financial instruments are disclosed in Note 15.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each statement of financial position reporting date. The resulting gain or loss is recognised in the statement of profit and loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in the statement of profit and loss depends on the nature of the hedge relationship. A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months.

The Group has not classified any assets or liabilities as held to maturity or as available for sale.

#### Loan receivables

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances to banks and building societies are classified as loans and receivables. Loans and advances to customers include finance leases and instalment credit advances.



Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses. In cases where there is a modification of a financial asset (i.e. the contractual terms governing the cash flows of the financial asset are renegotiated or modified), the Group assesses whether this modification results in derecognition. A modification results in derecognition when it gives rise to substantially different terms such as:

- > Qualitative factors, such as contractual cash flows after modification are no longer payments of principal and interest, for example a change in the currency or change of counterparty, extensive change in interest rates, maturity, covenants. If these do not clearly indicate a substantial modification then;
- > A quantitative assessment is performed to compare the present value of the remaining contractual cash flows under the original terms with the contractual cash flows under the revised terms discounted using the original EIR. If the difference in present value is greater than 10% then the Group deems the arrangement is substantially different leading to derecognition.

The net investment in finance leases and instalment credit agreements represents the future lease rentals and instalments receivable less profit and costs allocated to future periods. Income is recognised throughout the life of the agreement to provide a constant rate of return on the net investment in each lease or instalment credit agreement. Where an agreement is classified as an operating lease at inception, but is subsequently reclassified as a finance lease following a change to the agreement or an extension beyond the primary term, then the agreement is accounted for as a finance lease.

## *Financial liabilities*

Customer deposits and amounts due to banks are non-derivative financial liabilities with fixed or determinable payments. Deposits and amounts due to banks are recognised initially at fair value and are subsequently measured at amortised cost using the EIRM.

## *Derecognition of financial assets and liabilities*

Derecognition is the point at which an asset or liability is removed from the statement of financial position. The Group's policy is to derecognise financial assets when the contractual rights to the cash flows from the financial asset have expired or when all the risks and rewards of ownership have been transferred.

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled, or expired.

If the terms of the financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised. If the net present value of the cash flows from the original financial asset is substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and the new financial asset is recognised at fair value.

The impairment loss before an unexpected restructuring is measured as follows:

- > if the expected restructuring will not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original EIR of the existing financial asset; and
- > if the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is then discounted from the expected date of derecognition to the reporting date using the original EIR of the existing financial asset.

## Financial instruments (continued)

### *Fair value of financial assets and liabilities*

The Group measures fair values in accordance with IFRS 13 'Fair Value Measurement', which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Group also uses a fair value hierarchy that categorises into three levels the inputs to valuation techniques used to measure fair value which gives highest priority to quoted prices.

**Level 1:** Quoted prices in active markets for identical assets or liabilities, for identical assets or liabilities that the entity can access at the measurement date;

**Level 2:** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). A Level 2 input must be observable for substantially the full term of the instrument. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads. Assets and liabilities classified as Level 2 have been valued using models whose inputs are observable in an active market; and

**Level 3:** Inputs for the asset or liabilities that are not based on observable market data (unobservable inputs).

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. The Group holds financial assets and liabilities for which quoted prices are not available, such as over-the-counter derivatives (interest rate swaps, options and foreign currency derivatives). For these financial instruments, the Group uses valuation techniques to estimate fair value. The valuation techniques used include discounted cash flow models and Black-Scholes option pricing. These valuation techniques use as their basis independently sourced market parameters, such as interest rate yield curves, option volatilities and currency rates.

The Group uses generally accepted valuation models to determine the fair value of simple and liquid financial instruments, such as interest rate and currency swaps, which involve minimum judgement. The use of observable market prices and model inputs when available reduces the need for Management judgement and estimation, as well as the uncertainty related with the estimated fair value. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on general conditions and specific events in the financial markets.

The consideration of factors such as the scale and frequency of trading activity, the availability of prices and the size of bid/offer spreads assists in the assessment of whether a market is active. If, in the opinion of Management, a significant proportion of an instrument's carrying amount is driven by unobservable inputs, the instrument in its entirety is classified as valued at Level 3 of the fair value hierarchy. Level 3 in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

The Group does not adjust fair value estimates derived from models for any factors such as credit risk, liquidity risk or model uncertainties. For measuring derivatives that might change classification from being an asset to a liability or vice versa fair values do not take into consideration either the credit valuation adjustment or the debit valuation adjustment as it is deemed to be immaterial.

### **Cash and balances at central banks**

Fair value approximates to carrying value as cash and balances at central banks have minimal credit losses and are either short-term in nature or re-price frequently.

### **Loans and advances to banks, customer deposits, amounts due to banks and derivatives**

Fair value is estimated by using discounted cash flows applying either market rates where practicable or rates offered with similar characteristics by other financial institutions. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Fair values of derivatives are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flows.

## Financial instruments (continued)

### Loans and advances to customers

Fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the statement of financial position reporting date, and adjusted for future credit losses if considered material.

### Subordinated debt

Fair values are based on quoted prices where available or by discounting cash flows using market rates.

### Fair value hierarchy

The table below analyses the Group's financial instruments measured at amortised cost into a fair value hierarchy:

	2017 Level 3 £m	2017 Level 2 £m	2017 Level 1 £m	2016 Level 3 £m	2016 Level 2 £m	2016 Level 1 £m
<b>Financial assets</b>						
Cash and balances at central banks	-	-	752.5	-	-	429.9
Loans and advances to banks	-	28.8	-	-	24.1	-
Loans and advances to customers	4,844.3	-	-	4,050.4	-	-
<b>Financial liabilities</b>						
Customer deposits	-	4,376.2	-	-	3,943.5	-
Amounts due to banks	-	607.3	-	-	147.7	-
Subordinated debt liability	-	75.4	-	-	75.3	-

There were no transfers of assets or liabilities between the levels of the fair value hierarchy during the year (2016: £nil).

The table below analyses the Group's financial instruments measured at fair value into a fair value hierarchy:

	2017 Level 3 £m	2017 Level 2 £m	2017 Level 1 £m	2016 Level 3 £m	2016 Level 2 £m	2016 Level 1 £m
<b>Financial assets</b>						
Derivative financial instruments	-	1.8	-	-	5.2	-
<b>Financial liabilities</b>						
Derivative financial instruments	-	(3.4)	-	-	(0.4)	-

## Financial instruments (continued)

The fair values of all financial assets and financial liabilities by class together with their carrying amounts shown in the statement of financial position are shown in the following table:

	Loans and receivables £m	Other liabilities at amortised cost £m	Total carrying amount £m	Fair value £m
<b>At 31 December 2017</b>				
Cash and balances at central banks	752.5	-	752.5	752.5
Loans and advances to banks	28.8	-	28.8	28.8
Loans and advances to customers	4,844.3	-	4,844.3	5,045.9
<b>Total financial assets</b>	<b>5,625.6</b>	<b>-</b>	<b>5,625.6</b>	<b>5,827.2</b>
Customer deposits	-	4,376.2	4,376.2	4,369.3
Amounts due to banks	-	607.3	607.3	594.5
Subordinated debt liability	-	75.4	75.4	81.0
<b>Total financial liabilities</b>	<b>-</b>	<b>5,058.9</b>	<b>5,058.9</b>	<b>5,044.8</b>
<b>At 31 December 2016</b>				
Cash and balances at central banks	429.9	-	429.9	429.9
Loans and advances to banks	24.1	-	24.1	24.1
Loans and advances to customers	4,050.4	-	4,050.4	4,100.5
<b>Total financial assets</b>	<b>4,504.4</b>	<b>-</b>	<b>4,504.4</b>	<b>4,554.5</b>
Customer deposits	-	3,943.5	3,943.5	3,963.8
Amounts due to banks	-	147.7	147.7	147.7
Subordinated debt liability	-	75.3	75.3	76.0
<b>Total financial liabilities</b>	<b>-</b>	<b>4,166.5</b>	<b>4,166.5</b>	<b>4,187.5</b>

## 31. Risk management

The main areas of risk that the business is exposed to are:

- > credit risk (see 31.1);
- > liquidity risk (see 31.2);
- > market risk (see 31.3);
- > capital risk and management (see 31.4);
- > operational risk; and
- > conduct risk.

### 31.1 Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group. These risks are managed by the Board Risk Committee and the Asset and Liability Committee. This risk has two main components:

- > customer risk (individual and business lending) (see 31.1.1); and
- > treasury risk (see 31.1.2).

## Risk management (continued)

The Group's maximum exposure to credit risk is the carrying value of its financial assets, without taking account of any underlying collateral, and contractual commitments, which represent agreements entered into but not advanced as at 31 December 2017.

	2017 £m	2016 £m
<b>Assets</b>		
Cash and balances at central banks	752.5	429.9
Loans and advances to banks	28.8	24.1
Loans and advances to customers	4,844.3	4,050.4
Derivative financial assets	1.8	5.2
	<b>5,627.4</b>	<b>4,509.6</b>
Contractual commitments	623.0	459.2
<b>Maximum exposure to credit risk</b>	<b>6,250.4</b>	<b>4,968.8</b>

The contractual commitments are a combination of loan commitments and committed undrawn facilities.

The amount of collateral held at 31 December 2017 is £4,250.9 million (2016: £3,603.0 million) of which £3,197.8 million (2016: £2,524.3 million) is in the form of residential and commercial property and £1,053.1 million (2016: £1,078.7 million) is secured on other assets and debt receivables. Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis.

### Credit quality of assets

#### Loans and receivables

During the year the Group developed and implemented a credit grading scorecard. The credit scoring scale is used to determine an individual internal credit score based on the point-in-time PDs of the individual agreements. The point-in-time PD is an internal parameter used within the Group's advanced internal risk based capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Exposures are categorised as follows:

- > **Low risk:** where assets are not past due and have a point-in-time PD less than or equal to 0.38%;
- > **Medium risk:** where assets are not past due and have a point-in-time PD greater than 0.38% and less than or equal to 1.76%;
- > **High risk:** where assets are not past due and have a point-in-time PD greater than 1.76%.

The credit grading scorecard cannot retrospectively be applied to the FY 2016 results, and therefore the FY 2017 results are not directly comparable to the FY 2016 results.

**Risk management (continued)**

The credit quality of assets that are neither past due nor impaired are as follows:

At 31 December 2017	Property Finance		Business Finance		Consumer Lending		Total	
	£m	%	£m	%	£m	%	£m	%
Low risk	1,700.7	54.6	119.9	11.8	125.3	20.5	1,945.9	41.0
Medium risk	1,270.8	40.8	421.5	41.5	411.4	67.3	2,103.7	44.4
Higher risk	143.3	4.6	474.3	46.7	74.6	12.2	692.2	14.6
<b>Total neither past due nor impaired</b>	<b>3,114.8</b>	<b>100.0</b>	<b>1,015.7</b>	<b>100.0</b>	<b>611.3</b>	<b>100.0</b>	<b>4,741.8</b>	<b>100.0</b>

In 2016 the Group defined three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures. These were based on the following criteria:

- > **Property Finance:** For the residential mortgage portfolio, a risk rating scale is applied to the individual loans and weighs the propensity of non-performance and write-offs. The provisioning methodology within the residential portfolio was amended during the year to utilise credit scoring to drive loan level PDs. The combined propensity scores are scaled into low risk, medium risk and higher risk. In the Commercial Mortgages portfolio loans are classified as low risk, medium risk and higher risk on a case by case basis based on the circumstances of every case.
- > **Business Finance:** Loans are classified as low risk, medium risk and higher risk on a case by case basis. Classification is based on Management's review of the individual circumstances of every case.
- > **Consumer Lending:** Any loans that are 90 days or more past due are deemed to be impaired. Loans that are neither past due nor impaired are considered by Management to be low risk.

At 31 December 2016	Property Finance		Business Finance		Consumer Lending		Total	
	£m	%	£m	%	£m	%	£m	%
Low risk	2,397.5	98.1	986.5	95.1	460.8	100.0	3,844.8	97.5
Medium risk	38.5	1.6	50.3	4.9	-	-	88.8	2.3
Higher risk	7.9	0.3	0.1	-	-	-	8.0	0.2
<b>Total neither past due nor impaired</b>	<b>2,443.9</b>	<b>100.0</b>	<b>1,036.9</b>	<b>100.0</b>	<b>460.8</b>	<b>100.0</b>	<b>3,941.6</b>	<b>100.0</b>

**31.1.1 Customer risk**

The Group maintains a forbearance policy for the servicing and management of customers who are in financial difficulty and require some form of concession to be granted, even if this concession entails a loss for the Group. A concession may be either of the following:

- > a modification of the previous terms and conditions of an agreement, which the borrower is considered unable to comply with due to its financial difficulties, to allow for sufficient debt service ability, that would not have been granted had the borrower not been in financial difficulties; or
- > a total or partial refinancing of an agreement that would not have been granted had the borrower not been in financial difficulties.

Forbearance in relation to an exposure can be temporary or permanent depending on the circumstances, progress on financial rehabilitation and the detail of the concession(s) agreed. A forbearance classification can be discontinued when all of the following conditions have been met:

- > the exposure is considered as performing, including, if it has been reclassified from the non-performing category, after an analysis of the financial condition of the borrower shows it no longer meets the conditions to be considered as non-performing;
- > regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period; and
- > none of the exposures to the debtor is more than 30 days past due at the end of the probation period.

## Risk management (continued)

Details of the forbearance arrangements in place are set out in the tables below:

<b>Forbearance at 31 December 2017</b>	<b>Number</b>	<b>Capital balances £m</b>	<b>Provisions £m</b>	<b>Coverage %</b>
Property Finance	239	16.2	1.0	6.2%
Business Finance	361	35.8	5.3	14.8%
Consumer Lending	830	5.3	2.8	52.8%
<b>Total</b>	<b>1,430</b>	<b>57.3</b>	<b>9.1</b>	<b>15.9%</b>

<b>Forbearance at 31 December 2016</b>	<b>Number</b>	<b>Capital balances £m</b>	<b>Provisions £m</b>	<b>Coverage %</b>
Property Finance	191	13.6	0.7	5.1%
Business Finance	237	30.1	3.3	11.0%
Consumer Lending	273	1.8	0.6	33.3%
<b>Total</b>	<b>701</b>	<b>45.5</b>	<b>4.6</b>	<b>10.1%</b>

There were seven property repossessions during the year (2016: six). The total carrying value of these assets was £1.1 million (2016: £2.1 million). Of the seven repossessions, four were disposed of by 31 December 2017 and the remaining three are currently on the market.

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 tables below:

<b>Type of impairment assessment</b>	<b>Description</b>
Individual impairment	Where specific circumstances indicate that a loss is likely to be incurred.
Collective impairment	Impairment allowances are calculated for each portfolio on a collective basis, given the homogenous nature of the assets in the portfolio.

<b>Risk categorisation</b>	<b>Description</b>
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.
Past due but not impaired	Loans past due but not impaired consist predominantly of loans in Property Finance and Business Finance that are past due and individually assessed as not being impaired. This definition also includes unsecured loans in the Consumer Lending division that are past due by not more than 90 days.
Impaired assets	Loans that are in arrears or where there is objective evidence of impairment and where the carrying amount of the loan exceeds the expected recoverable amount. This definition also includes unsecured loans in the Consumer Lending division that are more than 90 days in arrears and carry identified impairment.

The Group enters into agreements with customers and where appropriate takes security. Loan receivables include amounts secured against property (commercial and residential), or against other assets such as asset backed loans and invoice receivables. Finance lease and instalment credit is secured on a variety of assets including, but not limited to, plant and machinery.

## Risk management (continued)

The profile of the loan receivable book is shown below:

	2017 £m	2016 £m
Loan receivables	4,418.7	3,639.5
Finance lease receivables	79.8	93.6
Instalment credit receivables	348.0	316.9
Fair value adjustments for hedged risk	(2.2)	0.4
<b>Total loans and advances to customers</b>	<b>4,844.3</b>	<b>4,050.4</b>

	2017 £m	2016 £m
<b>Loan receivables</b>		
Neither past due nor impaired	4,329.4	3,548.7
<b>Past due but not impaired:</b>		
Up to 30 days	12.8	18.3
30-60 days	40.1	40.2
60-90 days	10.4	15.5
Over 90 days	18.4	15.8
<b>Total past due but not impaired</b>	<b>81.7</b>	<b>89.8</b>
<b>Impaired assets</b>	<b>27.3</b>	<b>14.6</b>
	<b>4,438.4</b>	<b>3,653.1</b>
Less: allowances for impairment losses	(19.7)	(13.6)
<b>Net loan receivables</b>	<b>4,418.7</b>	<b>3,639.5</b>
Fair value adjustments for hedged risk	(2.2)	0.4
	<b>4,416.5</b>	<b>3,639.9</b>

The Group enters into agreements with customers and where appropriate takes security. The security for loans to customers is in the form of a first or second charge over property and debt receivables. Finance leases and instalment credit are secured on the underlying assets which can be repossessed in the event of a default. The security profile of loans and advances to customers is shown below:

	2017 £m	2016 £m
Secured on commercial and residential property	3,197.6	2,524.3
Secured on debt receivables	456.6	545.4
Secured by finance lease and instalment credit assets	439.7	421.3
Secured on other assets	68.3	49.3
<b>Total secured receivables</b>	<b>4,162.2</b>	<b>3,540.3</b>
Unsecured	715.9	534.5
<b>Gross loans and advances to customers</b>	<b>4,878.1</b>	<b>4,074.8</b>



## Risk management (continued)

Collateral held in relation to secured loans is capped, after taking into account the first charge balance, at the amount outstanding on an individual loan basis.

	2017 £m	2016 £m
<b>Finance lease receivables</b>		
Neither past due nor impaired	72.0	82.3
<b>Past due but not impaired:</b>		
Up to 30 days	2.9	4.6
30-60 days	1.9	1.1
60-90 days	0.9	0.4
Over 90 days	0.9	2.3
<b>Total past due but not impaired</b>	<b>6.6</b>	<b>8.4</b>
<b>Impaired assets</b>	<b>10.3</b>	<b>11.4</b>
	<b>88.9</b>	<b>102.1</b>
Less: allowances for impairment losses	(9.1)	(8.5)
<b>Net finance lease receivables</b>	<b>79.8</b>	<b>93.6</b>

	2017 £m	2016 £m
<b>Instalment credit receivables</b>		
Neither past due nor impaired	340.4	310.6
<b>Past due but not impaired:</b>		
Up to 30 days	4.9	3.6
30-60 days	2.2	0.9
60-90 days	0.3	0.6
Over 90 days	0.9	1.3
<b>Total past due but not impaired</b>	<b>8.3</b>	<b>6.4</b>
<b>Impaired assets</b>	<b>2.1</b>	<b>2.2</b>
	<b>350.8</b>	<b>319.2</b>
Less: allowances for impairment losses	(2.8)	(2.3)
<b>Net instalment credit receivables</b>	<b>348.0</b>	<b>316.9</b>

**Risk management (continued)**

	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
<b>31 December 2017</b>				
Neither past due nor impaired	3,114.8	1,015.7	611.3	4,741.8
Past due but not impaired:				
Up to 30 days	9.2	10.4	1.0	20.6
30-60 days	32.8	4.0	7.4	44.2
60-90 days	7.8	1.2	2.6	11.6
Over 90 days	18.1	2.1	-	20.2
<b>Total past due but not impaired</b>	<b>67.9</b>	<b>17.7</b>	<b>11.0</b>	<b>96.6</b>
<b>Impaired assets</b>	<b>13.3</b>	<b>21.5</b>	<b>4.9</b>	<b>39.7</b>
	<b>3,196.0</b>	<b>1,054.9</b>	<b>627.2</b>	<b>4,878.1</b>
Fair value adjustments for hedged risk	(2.7)	-	0.5	(2.2)
Less: allowances for impairment losses	(6.3)	(15.0)	(10.3)	(31.6)
<b>Net loans and advances to customers</b>	<b>3,187.0</b>	<b>1,039.9</b>	<b>617.4</b>	<b>4,844.3</b>
	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
<b>31 December 2016</b>				
Neither past due nor impaired	2,443.9	1,036.9	460.8	3,941.6
Past due but not impaired:				
Up to 30 days	13.8	12.0	0.7	26.5
30-60 days	33.6	4.3	4.3	42.2
60-90 days	10.7	4.2	1.6	16.5
Over 90 days	12.2	7.2	-	19.4
<b>Total past due but not impaired</b>	<b>70.3</b>	<b>27.7</b>	<b>6.6</b>	<b>104.6</b>
<b>Impaired assets</b>	<b>10.1</b>	<b>14.1</b>	<b>4.0</b>	<b>28.2</b>
	<b>2,524.3</b>	<b>1,078.7</b>	<b>471.4</b>	<b>4,074.4</b>
Fair value adjustments for hedged risk	-	-	0.4	0.4
Less: allowances for impairment losses	(5.2)	(12.4)	(6.8)	(24.4)
<b>Net loans and advances to customers</b>	<b>2,519.1</b>	<b>1,066.3</b>	<b>465.0</b>	<b>4,050.4</b>

## Risk management (continued)

The Group's lending portfolio is geographically diversified across the UK as shown below:

<b>31 December 2017</b>	<b>Property Finance £m</b>	<b>Business Finance £m</b>	<b>Consumer Lending £m</b>	<b>Total £m</b>
East Anglia	99.0	75.3	25.6	199.9
East Midlands	100.5	34.7	48.6	183.8
Greater London	1,233.8	169.8	64.9	1,468.5
Guernsey/Jersey/Isle of Man	18.6	47.0	0.1	65.7
North East	45.5	16.4	29.9	91.8
North West	264.5	159.9	75.4	499.8
Northern Ireland	13.6	2.8	1.7	18.1
Scotland	183.0	71.0	76.9	330.9
South East	648.3	169.3	109.9	927.5
South West	239.5	89.7	48.3	377.5
Wales	69.4	84.8	24.4	178.6
West Midlands	125.0	74.8	62.0	261.8
Yorkshire/Humberside	155.3	59.4	59.5	274.2
<b>Gross loans and advances to customers</b>	<b>3,196.0</b>	<b>1,054.9</b>	<b>627.2</b>	<b>4,878.1</b>

<b>31 December 2016</b>	<b>Property Finance £m</b>	<b>Business Finance £m</b>	<b>Consumer Lending £m</b>	<b>Total £m</b>
East Anglia	84.3	71.1	21.1	176.5
East Midlands	75.2	26.9	36.8	138.9
Greater London	911.6	214.7	48.3	1,174.6
Guernsey/Jersey/Isle of Man	6.1	0.6	0.1	6.8
North East	38.5	11.3	23.7	73.5
North West	221.0	151.8	55.9	428.7
Northern Ireland	10.6	3.7	0.8	15.1
Scotland	157.5	96.9	60.9	315.3
South East	539.8	191.6	80.1	811.5
South West	198.3	107.5	36.8	342.6
Wales	57.1	70.1	17.9	145.1
West Midlands	104.1	64.1	47.2	215.4
Yorkshire/Humberside	120.2	68.4	41.8	230.4
<b>Gross loans and advances to customers</b>	<b>2,524.3</b>	<b>1,078.7</b>	<b>471.4</b>	<b>4,074.4</b>

## Risk management (continued)

The Group's lending portfolio falls into the following concentrations by loan size:

31 December 2017	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
0 - £50k	246.1	164.6	627.0	1,037.7
£50k - £100k	369.2	79.7	0.2	449.1
£100k - £250k	784.9	113.3	-	898.2
£250k - £500k	657.0	80.3	-	737.3
£500k - £1 million	478.1	106.1	-	584.2
£1 million - £2.5 million	379.2	153.7	-	532.9
£2.5 million - £5 million	167.1	80.2	-	247.3
£5 million - £10 million	61.8	77.4	-	139.2
£10 million - £25 million	52.6	199.6	-	252.2
<b>Gross loans and advances to customers</b>	<b>3,196.0</b>	<b>1,054.9</b>	<b>627.2</b>	<b>4,878.1</b>

31 December 2016	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
0 - £50k	249.6	170.3	471.3	891.2
£50k - £100k	312.6	80.2	0.1	392.9
£100k - £250k	622.5	106.3	-	728.8
£250k - £500k	495.8	93.2	-	589.0
£500k - £1 million	371.8	100.0	-	471.8
£1 million - £2.5 million	283.2	118.6	-	401.8
£2.5 million - £5 million	110.1	81.2	-	191.3
£5 million - £10 million	67.2	91.2	-	158.4
£10 million - £25 million	11.5	237.7	-	249.2
<b>Gross loans and advances to customers</b>	<b>2,524.3</b>	<b>1,078.7</b>	<b>471.4</b>	<b>4,074.4</b>

### 31.1.2 Treasury risk

Treasury risk arises from the wholesale investments made by the Group's Treasury function, which is responsible for managing this aspect of credit risk in line with the Board approved risk appetite and wholesale credit policies. The credit quality of loans and advances to banks is assessed by rating agency designation as at 31 December 2017, based on Moody's long-term ratings.

	2017 £m	2016 £m
<b>Loans and advances to banks</b>		
Aa3	12.2	-
A1	2.5	15.6
A2	-	1.1
A3	14.1	7.4
<b>Total credit risk</b>	<b>28.8</b>	<b>24.1</b>

The Group only lends to UK high street banks. Deposits are placed either overnight or for a short-term with a duration of less than three months. No collateral or other credit enhancements are held against loans and advances to banks.

## Risk management (continued)

The Group's exposure to the Bank of England is set out below:

	2017	2016
Cash and balances at central banks	£m	£m
Aa1	-	429.9
Aa2	752.5	-

Credit risk derived from derivative transactions is mitigated by collateralising the exposures. Such collateral is subject to the standard industry Credit Support Annex and is paid or received on a regular basis. At 31 December 2017, cash collateral of £3.9 million had been received by the Group (2016: £4.8 million).

### 31.2 Liquidity risk

#### Accounting policy

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost.

The Group has, therefore, developed comprehensive funding and liquidity policies to ensure that it maintains sufficient liquid assets to be able to meet all its financial obligations and maintain public confidence.

The Group's Treasury function is responsible for the day-to-day management of the Group's liquidity and wholesale funding. The Board sets limits over the level, composition, and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk function personnel independent of the Treasury function. Additionally, a combined liquidity stress test is performed daily and a series of other liquidity stress tests are performed monthly by the Risk function and formally reported to the Asset and Liability Committee and the Board to ensure that the Group maintains adequate liquidity for business purposes even under stressed conditions.

The Group reports its liquidity position against its liquidity coverage ratio, net stable funding ratio and other key regulatory ratios for regulatory purposes

#### Funding for Lending Scheme (FLS)

The Group is a participant in the FLS which enables it to borrow highly liquid UK Treasury bills in exchange for eligible collateral. The Treasury bills issued are for an original maturity of nine months and if delivered back prior to their maturity date can be exchanged for further nine-month bills. Costs of borrowing are charged directly to the statement of profit and loss.

The Treasury bills are not recorded on the Group's statement of financial position as ownership remains with the Bank of England. The risks and rewards of the collateral provided remains with the Group and continue to be recognised in the Group's financial statements.

#### Term Funding Scheme (TFS)

The TFS was announced by the Bank of England on 4 August 2016 and became effective from 19 September 2016. The TFS is designed to reinforce the transmission of reductions in the Bank of England's official interest rate (Bank Rate) to those interest rates actually faced by households and businesses by providing term funding to banks at rates close to Bank Rate. It is a monetary policy tool of the Monetary Policy Committee and will be operated as part of the Asset Purchase Facility.

The TFS allows participants to borrow central bank reserves in exchange for eligible collateral. The Group had drawn £605.0 million as at 31 December 2017 (2016: £118.0 million). This is included within 'Amounts due to banks' on the statement of financial position as detailed in Note 22.

# Risk management (continued)

The table below analyses the Group's contractual undiscounted cash flows of its financial assets and liabilities:

At 31 December 2017	Carrying amount £m	Gross nominal inflow/ (outflow) £m	Less than 1 month £m	1-3 months £m	3 months to 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m
<b>Financial assets</b>								
Cash and balances at central banks	752.5	752.5	748.2	-	-	-	-	4.3
Loans and advances to banks	28.8	28.8	28.8	-	-	-	-	-
Loans and advances to customers	4,844.3	4,989.8	211.8	218.7	646.3	690.8	1,222.7	1,999.5
	5,625.6	5,771.1	988.8	218.7	646.3	690.8	1,222.7	2,003.8
<b>Financial liabilities</b>								
Customer deposits	(4,376.2)	(4,448.7)	(1,026.3)	(317.1)	(1,818.7)	(837.3)	(440.1)	(9.2)
Amounts due to banks	(607.3)	(612.4)	(2.4)	-	-	-	(610.0)	-
Subordinated debt liability	(75.4)	(127.1)	-	-	(7.5)	(6.4)	(19.1)	(94.1)
	(5,058.9)	(5,188.2)	(1,028.7)	(317.1)	(1,826.2)	(843.7)	(1,069.2)	(103.3)

At 31 December 2016	Carrying amount £m	Gross nominal inflow/ (outflow) £m	Less than 1 month £m	1-3 months £m	3 months to 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m
<b>Financial assets</b>								
Cash and balances at central banks	429.9	429.9	425.9	-	-	-	-	4.0
Loans and advances to banks	24.1	24.1	24.1	-	-	-	-	-
Loans and advances to customers	4,050.4	4,174.9	115.4	137.6	561.0	649.9	1,213.3	1,497.7
	4,504.4	4,628.9	565.4	137.6	561.0	649.9	1,213.3	1,501.7
<b>Financial liabilities</b>								
Customer deposits	(3,943.5)	(3,887.9)	(791.9)	(250.3)	(1,705.4)	(634.1)	(506.2)	-
Amounts due to banks	(147.7)	(148.9)	(5.3)	(0.1)	(24.6)	(0.3)	(118.6)	-
Subordinated debt liability	(75.3)	(133.5)	-	-	(7.5)	(6.4)	(19.1)	(100.5)
	(4,166.5)	(4,170.3)	(797.2)	(250.4)	(1,737.5)	(640.8)	(643.9)	(100.5)

**Risk management (continued)**

The following table sets out the components of the Group's liquidity reserve:

	2017 Carrying amount £m	2016 Carrying amount £m
Cash and balances at central banks	752.5	429.9
Less: mandatory deposits with central banks	(4.3)	(4.0)
Loans and advances to banks	28.8	24.1
Debt securities	100.9	213.8
<b>Total liquidity reserve</b>	<b>877.9</b>	<b>663.8</b>

The total liquidity reserve includes £100.9 million (2016: £213.8 million) of securities issued by the Bank of England through FLS participation which are not recognised on the statement of financial position.

The average liquidity reserve throughout the year was £708.4 million (2016: £745.1 million).

**Asset encumbrance**

The Group's assets can be used to support collateral requirements for central bank operations or third party repurchase transactions. 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'. These comprise assets that are readily available to secure funding or meet collateral requirements, and assets that are not subject to any restrictions but are not readily available for use. The table below sets out the availability of the Group's assets to support future funding:

	Encumbered (pledged as collateral) £m	Unencumbered (available as collateral) £m	Unencumbered other £m	Total £m
<b>Asset encumbrance 2017</b>				
Cash and balances at central banks	4.3	-	748.2	752.5
Loans and advances to banks	-	28.8	-	28.8
Loans and advances to customers	1,081.7	3,762.6	-	4,844.3
Derivative financial assets	-	-	1.8	1.8
Property, plant and equipment	-	36.1	3.5	39.6
Non-financial assets	-	-	91.7	91.7
<b>Total assets</b>	<b>1,086.0</b>	<b>3,827.5</b>	<b>845.2</b>	<b>5,758.7</b>

	Encumbered (pledged as collateral) £m	Unencumbered (available as collateral) £m	Unencumbered other £m	Total £m
<b>Asset encumbrance 2016</b>				
Cash and balances at central banks	4.0	-	425.9	429.9
Loans and advances to banks	-	24.1	-	24.1
Loans and advances to customers	695.2	3,355.2	-	4,050.4
Derivative financial assets	-	-	5.2	5.2
Property, plant and equipment	-	38.1	4.5	42.6
Non-financial assets	-	-	94.4	94.4
<b>Total assets</b>	<b>699.2</b>	<b>3,417.4</b>	<b>530.0</b>	<b>4,646.6</b>

**Risk management (continued)****Liquidity risk – stress testing**

Stress testing is a major component of liquidity risk management and the Group has developed a range of scenarios covering a range of market wide and firm specific factors. A comprehensive stress testing exercise is conducted at least annually and the methodology is incorporated into the Group's statement of financial position risk management model to ensure that stress tests are run on a regular basis. The output of stress testing is circulated to the Board and to the Asset and Liability Committee who use the results to decide whether to amend the Group's risk appetite and liquidity limits.

**31.3 Market risk**

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities change as a result of changes in market prices, the principal element being interest rate risk.

The Group's objective is to manage and control market risk exposures while maintaining a market profile consistent with the Group's risk appetite.

The Group's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's treasury policies. The Asset and Liability Committee approves the Group's treasury policies and receives regular reports on all aspects of market risk exposure, including interest rate risk.

The Group has minimal foreign currency exposure and does not engage in any treasury trading operations.

**Interest rate risk**

Interest rate risk is the risk of loss arising from adverse movements in market interest rates. Interest rate risk arises from the loan and savings products that the Group offers. This risk is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures.

**Basis risk**

Basis risk is the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics (for example, LIBOR and the Bank of England base rate). This is monitored closely and regularly reported to the Asset and Liability Committee. This risk is managed by matching and where appropriate and necessary, through the use of derivatives, with established risk limits and other control procedures.

The Group's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.

**Foreign exchange risk**

Foreign exchange risk is the risk that the value of, or net income arising from, assets and liabilities changes as a result of movements in exchange rates. The Group has low levels of foreign exchange risk which is managed by natural hedging and appropriate financial instruments including derivatives. The table below sets out the Group's exposure to foreign exchange risk:

<b>Assets and liabilities in foreign currencies at Sterling carrying values</b>	<b>Euros</b>	<b>US</b>	<b>Australian</b>
<b>2017</b>	<b>£m</b>	<b>Dollars</b>	<b>Dollars</b>
		<b>£m</b>	<b>£m</b>
Loans and advances to banks	1.9	(0.8)	(0.1)
Loans and advances to customers	24.4	7.7	0.1
<b>Net position</b>	<b>26.3</b>	<b>6.9</b>	<b>-</b>

<b>Assets and liabilities in foreign currencies at Sterling carrying values</b>	<b>Euros</b>	<b>US</b>	<b>Australian</b>
<b>2016</b>	<b>£m</b>	<b>Dollars</b>	<b>Dollars</b>
		<b>£m</b>	<b>£m</b>
Loans and advances to banks	0.4	(0.9)	-
Loans and advances to customers	12.9	6.6	-
<b>Net position</b>	<b>13.3</b>	<b>5.7</b>	<b>-</b>



## Risk management (continued)

### Foreign exchange sensitivity

The Group estimates that a 5% movement in exchange rates would have no greater impact on the 2017 profit than an increase or decrease of £1.7 million.

### Interest rate sensitivity gap

The Group considers a parallel 200 basis points (bps) movement to be appropriate for scenario testing given the current economic outlook and industry expectations. The Group estimates that a +/- 200 bps movement in interest rates paid/received would have impacted the economic value of equity as follows:

+200 bps – £10.5 million negative (2016: £9.5 million positive)

-200 bps – £41.0 million positive (2016: £12.1 million positive)

In addition, the effect of the same two interest rate shocks are applied to the statement of financial position at year end, to determine how net interest income may change on an annualised basis for one year, as follows:

+200 bps – £20.8 million positive (2016: £20.0 million positive)

-200 bps – £4.0 million positive (2016: £1.9 million positive)

In preparing the sensitivity analyses above, the Group makes certain assumptions consistent with expected and contractual re-pricing behaviour as well as behavioural repayment profiles, under the two interest scenarios, of the underlying statement of financial position items. The results also include the impact of hedge transactions.

The following table summarises the re-pricing periods for the Group's assets and liabilities at 31 December 2017. Items are allocated to time bands by reference to the earlier of the next contractual interest rate change and the maturity date.

	Within 3 months £m	3 months but less than 6 months £m	6 months but less than 1 year £m	1 year but less than 5 years £m	More than 5 years £m	Non- interest bearing £m	Total £m
<b>31 December 2017</b>							
<b>Assets</b>							
Cash and balances at central banks	748.2	-	-	-	-	4.3	752.5
Loans and advances to banks	28.8	-	-	-	-	-	28.8
Loans and advances to customers	2,495.5	210.1	363.6	1,533.5	296.4	(54.8)	4,844.3
Derivative financial assets	-	-	-	-	-	1.8	1.8
Property, plant and equipment	3.6	2.1	4.1	22.2	4.8	2.8	39.6
Other non-financial assets	-	-	-	-	-	91.7	91.7
<b>Total assets</b>	<b>3,276.1</b>	<b>212.2</b>	<b>367.7</b>	<b>1,555.7</b>	<b>301.2</b>	<b>45.8</b>	<b>5,758.7</b>
<b>Equity and liabilities</b>							
Customer deposits	1,412.4	787.7	955.6	1,212.6	7.9	-	4,376.2
Amounts due to banks	607.3	-	-	-	-	-	607.3
Derivative financial liabilities	-	-	-	-	-	3.4	3.4
Other non-financial liabilities	-	-	-	-	-	73.3	73.3
Subordinated debt liability	-	-	-	-	75.4	-	75.4
Total equity	-	-	-	-	-	623.1	623.1
<b>Total equity and liabilities</b>	<b>2,019.7</b>	<b>787.7</b>	<b>955.6</b>	<b>1,212.6</b>	<b>83.3</b>	<b>699.8</b>	<b>5,758.7</b>
<b>Notional values of derivatives</b>	<b>578.0</b>	<b>(25.0)</b>	<b>(282.0)</b>	<b>(240.0)</b>	<b>(31.0)</b>	<b>-</b>	<b>-</b>
<b>Interest rate sensitivity gap</b>	<b>1,834.4</b>	<b>(600.5)</b>	<b>(869.9)</b>	<b>103.1</b>	<b>186.9</b>	<b>(654.0)</b>	<b>-</b>
<b>Cumulative gap</b>	<b>1,834.4</b>	<b>1,233.9</b>	<b>364.0</b>	<b>467.1</b>	<b>654.0</b>	<b>-</b>	<b>-</b>

## Risk management (continued)

The following table summarises the re-pricing periods for the Group's assets and liabilities at 31 December 2016. Items are allocated to time bands by reference to the earlier of the next contractual interest rate change and the maturity date.

31 December 2016	Within 3 months £m	3 months but less than 6 months £m	6 months but less than 1 year £m	1 year but less than 5 years £m	More than 5 years £m	Non-interest bearing £m	Total £m
<b>Assets</b>							
Cash and balances at central banks	425.9	-	-	-	-	4.0	429.9
Loans and advances to banks	24.1	-	-	-	-	-	24.1
Loans and advances to customers	2,812.3	117.8	201.1	714.1	254.9	(49.8)	4,050.4
Derivative financial assets	-	-	-	-	-	5.2	5.2
Property, plant and equipment	2.9	2.9	5.3	23.1	4.2	4.2	42.6
Other non-financial assets	-	-	-	-	-	94.4	94.4
<b>Total assets</b>	<b>3,265.2</b>	<b>120.7</b>	<b>206.4</b>	<b>737.2</b>	<b>259.1</b>	<b>58.0</b>	<b>4,646.6</b>
<b>Equity and liabilities</b>							
Customer deposits	1,191.2	954.8	630.7	1,166.8	-	-	3,943.5
Amounts due to banks	123.3	-	24.4	-	-	-	147.7
Derivative financial liabilities	-	-	-	-	-	0.4	0.4
Other non-financial liabilities	-	-	-	-	-	42.5	42.5
Subordinated debt liability	-	-	-	-	75.3	-	75.3
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>437.2</b>	<b>437.2</b>
<b>Total equity and liabilities</b>	<b>1,314.5</b>	<b>954.8</b>	<b>655.1</b>	<b>1,166.8</b>	<b>75.3</b>	<b>480.1</b>	<b>4,646.6</b>
Notional values of derivatives	524.0	-	(340.0)	(145.0)	(39.0)	-	-
Interest rate sensitivity gap	2,474.7	(834.1)	(788.7)	(574.6)	144.8	(422.1)	-
Cumulative gap	2,474.7	1,640.6	851.9	277.3	422.1	-	-

### 31.4 Capital risk and management

Capital risk is the risk that the Group has insufficient capital to cover regulatory requirements and/or to support its own growth plans. Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due, or can do so only at excessive cost.

The Group's objective in managing Group capital is to maintain appropriate levels of capital to support the Group's business strategy and meet regulatory requirements.

#### Policies and processes for managing the Group's capital

The Group's approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates.

The Group's principal objectives when managing capital are to:

- > address the expectation of the Shareholders and optimise business activities to ensure return on capital targets are achieved through efficient capital management;
- > ensure that the Group and Bank hold sufficient risk capital. Risk capital caters for unexpected losses that may arise, protects shareholders and depositors and thereby supports the sustainability of the Group and Bank through the business cycles; and
- > comply with capital supervisory requirements and related regulations.

## Risk management (continued)

The PRA supervises the Group on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. In addition, a number of subsidiaries are regulated for prudential purposes by either the PRA or the Financial Conduct Authority. The aim of the capital adequacy regime is to promote safety and soundness in the financial system and embed the requirements of Pillar 3 on market discipline. Under Pillar 2, the Group completes an annual self-assessment of risks known as the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP is reviewed by the PRA which culminates in the PRA setting 'Individual Capital Guidance' (ICG) on the level of capital the Group and its regulated subsidiaries are required to hold. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that firm's capital, risk exposures and risk assessment process. The Group's Pillar 3 disclosures can be found on the Group's website.

The Group maintains a strong capital base with the aim of supporting the development of the business and to ensure it meets the Pillar 1 capital requirements and ICG at all times. As a result, the Group maintains capital adequacy ratios above minimum regulatory requirements. The Group's individual regulated entities complied with all of the externally imposed capital requirements to which they are subject for the years ended 2017 and 2016.

### Regulation

Capital Requirements Directive IV (CRD IV) requires the Group to hold CET1 capital to account for capital conservation, countercyclical and systemic risk buffers. A capital conservation buffer of 0.625% was introduced on 1 January 2016 and will increase each year to 2019 in line with regulations. The Bank's capital conservation buffer is currently set at 1.25%.

CRD IV also introduced a new leverage ratio requirement. The leverage calculation determines a ratio based on the relationship between Tier 1 capital and total consolidated exposure, being the sum of on-balance sheet exposures, derivative exposures, securities financing transaction exposures and off-balance sheet exposures. This leverage ratio is a risk-based measure that is designed to act as a supplement to risk-based capital requirements.

Minimum Requirements for Eligible Liabilities (MREL) are applicable from 1 January 2016 and will be phased in fully by 1 January 2020. Prior to 31 December 2019, MREL will be equal to an institution's minimum regulatory capital requirements. The Bank of England has provided MREL guidance to the Group, as well as guidance on the transitional arrangements until 1 January 2020.

The CET1 capital ratio for the Group was 12.9% as at 31 December 2017 (31 December 2016: 13.3%), compared with a regulatory minimum of 4.5%. The Total Tier 1 capital ratio for the Group was 16.6% as at 31 December 2017 (31 December 2016: 13.3%), compared with a regulatory minimum of 6.0%.

The leverage ratio for the Group (based on the Basel III definition of January 2014, and the CRD IV definition of October 2014) is 9.4% (2016: 7.8%), compared to the minimum requirement of 3.0%. The Group is not required to comply with the PRA leverage ratio framework until its retail deposits exceed the £50 billion threshold; however, the Group maintains a prudent risk appetite for leverage.

The Bank has a Pillar 2A requirement of 2.50% of risk-weighted assets.

# Risk management (continued)

The following shows the regulatory capital resources managed by the Group and Bank:

	Group 2017 £m	Bank 2017 £m	Group 2016 £m	Bank 2016 £m
Share capital	2.5	175.5	2.5	175.5
Share premium account	87.3	81.0	87.3	81.0
Capital redemption reserve	-	16.7	183.1	9.2
Merger reserve	-	1.6	-	1.6
Retained earnings	409.3	201.2	164.3	145.8
Intangible assets	(65.7)	(44.6)	(59.9)	(38.8)
Foreseeable dividend <sup>1</sup>	-	-	(6.7)	(6.7)
<b>Common Equity Tier 1 capital</b>	<b>433.4</b>	<b>431.4</b>	<b>370.6</b>	<b>367.6</b>
Capital securities	124.0	125.0	-	-
<b>Additional Tier 1 capital</b>	<b>124.0</b>	<b>125.0</b>	<b>-</b>	<b>-</b>
<b>Total Tier 1 capital</b>	<b>557.4</b>	<b>556.4</b>	<b>370.6</b>	<b>367.6</b>
Subordinated debt liability <sup>2</sup>	74.2	75.0	75.3	76.1
Collective impairment allowance	11.1	11.0	8.7	8.7
<b>Tier 2 capital</b>	<b>85.3</b>	<b>86.0</b>	<b>84.0</b>	<b>84.8</b>
<b>Total regulatory capital</b>	<b>642.7</b>	<b>642.4</b>	<b>454.6</b>	<b>452.4</b>

<sup>1</sup> As required by Article 26(2) of the Capital Requirements Regulation, a deduction was made for foreseeable dividends from the 2016 profit.

<sup>2</sup> Excludes capitalised interest of £1.2 million for Group (2016: £nil) and £1.1 million for Bank (2016: £nil). Accrued interest is payable semi-annually and is therefore excluded from capital reserves.

	Group 2017 £m	Bank 2017 £m	Group 2016 £m	Bank 2016 £m
<b>Risk-weighted assets<sup>1</sup></b>				
Property Finance	1,529.1	1,529.1	1,107.1	1,107.1
Business Finance	967.2	945.3	1,019.7	1,019.7
Consumer Lending	489.8	489.8	372.9	372.9
Other	71.6	66.7	66.9	66.9
Operational risk	304.0	304.5	212.0	212.0
<b>Total risk-weighted assets</b>	<b>3,361.7</b>	<b>3,335.4</b>	<b>2,778.6</b>	<b>2,778.6</b>

<sup>1</sup> Risk-weighted assets are not covered by the External Auditor's opinion.

## Risk management (continued)

The regulatory capital reconciles to the total capital in the Group's consolidated statement of financial position as follows:

	<b>Group 2017 £m</b>	<b>Bank 2017 £m</b>	<b>Group 2016 £m</b>	<b>Bank 2016 £m</b>
<b>Total regulatory capital</b>	<b>642.7</b>	<b>642.4</b>	<b>454.6</b>	<b>452.4</b>
Subordinated debt liability <sup>1</sup>	(74.2)	(75.0)	(75.3)	(76.1)
Collective impairment allowance	(11.1)	(11.0)	(8.7)	(8.7)
Intangible assets	65.7	44.6	59.9	38.8
Foreseeable dividend <sup>2</sup>	-	-	6.7	6.7
<b>Total equity</b>	<b>623.1</b>	<b>601.0</b>	<b>437.2</b>	<b>413.1</b>

<sup>1</sup> Excludes capitalised interest of £1.2 million for Group (2016: £nil) and £1.1 million for Bank (2016: £nil). Accrued interest is payable semi-annually and is therefore excluded from capital reserves.

<sup>2</sup> As required by Article 26(2) of the Capital Requirements Regulation, a deduction was made for foreseeable dividends from the 2016 profit.

The key capital ratios for the Group are presented below<sup>1</sup>:

	<b>Group 2017</b>	<b>Bank 2017</b>	<b>Group 2016</b>	<b>Bank 2016</b>
Common Equity Tier 1 capital ratio	12.9%	12.9%	13.3%	13.2%
Total Tier 1 capital ratio	16.6%	16.7%	13.3%	13.2%
Total capital ratio	19.1%	19.3%	16.4%	16.3%
Leverage ratio	9.4%	9.5%	7.8%	7.7%

<sup>1</sup> The Group's capital ratios are not covered by the External Auditor's opinion.

The following table shows the movement in Total Tier 1 capital during the year:

	<b>Group 2017 £m</b>	<b>Bank 2017 £m</b>	<b>Group 2016 £m</b>	<b>Bank 2016 £m</b>
<b>Total Tier 1 capital at 1 January</b>	<b>370.6</b>	<b>367.6</b>	<b>312.9</b>	<b>308.6</b>
<b>Movement in Common Equity Tier 1 capital:</b>				
(Decrease)/increase in capital redemption reserve	(183.1)	7.5	-	4.8
<b>Movement in retained earnings:</b>				
Profit for the year	61.2	74.9	64.8	66.1
Dividend paid	(6.8)	(19.5)	-	-
Cancellation of capital redemption reserve	183.1	-	-	-
Share-based payments	7.5	-	4.8	-
Increase in intangible assets	(5.8)	(5.8)	(5.2)	(5.2)
Decrease/(increase) in foreseeable dividend <sup>1</sup>	6.7	6.7	(6.7)	(6.7)
<b>Movement in Additional Tier 1 capital:</b>				
Increase in capital securities	124.0	125.0	-	-
<b>Total Tier 1 capital at 31 December</b>	<b>557.4</b>	<b>556.4</b>	<b>370.6</b>	<b>367.6</b>

<sup>1</sup> As required by Article 26(2) of the Capital Requirements Regulation, a deduction was made for foreseeable dividends from the 2016 profit.

# Risk management (continued)

	Group 2017 £m	Bank 2017 £m	Group 2016 £m	Bank 2016 £m
<b>Leverage ratio<sup>1</sup></b>				
<b>Total Tier 1 capital</b>	<b>557.4</b>	<b>556.4</b>	<b>370.6</b>	<b>367.6</b>
Exposure measure:				
Total regulatory statement of financial position assets (excluding derivatives)	5,756.9	5,699.6	4,641.4	4,619.8
Exposure value for securities financing transactions	-	-	0.6	0.6
Off-balance sheet items	224.7	224.7	171.6	171.6
Exposure value for derivatives	2.2	2.2	1.3	1.3
Other regulatory adjustments	(65.7)	(44.6)	(59.9)	(38.8)
<b>Total exposures</b>	<b>5,918.1</b>	<b>5,881.9</b>	<b>4,755.0</b>	<b>4,754.5</b>
<b>Leverage ratio</b>	<b>9.4%</b>	<b>9.5%</b>	<b>7.8%</b>	<b>7.7%</b>

<sup>1</sup> The Group's leverage ratio is not covered by the External Auditor's opinion.

Exposure values associated with derivatives and securities financing transactions have been reported in compliance with CRD IV rules. For purposes of the leverage ratio, the derivative measure is calculated as the replacement cost for the current exposure plus an add-on for future exposure and is not reduced for any collateral received or grossed up for collateral provided.

Off-balance sheet exposure comprises pipeline and committed facilities balances which have a credit conversion factor of medium risk attached to them.

Other regulatory adjustments comprise net replacement costs of derivatives and securities financing transactions to the leverage ratio exposure.

## 32. Subsidiary companies

### Accounting policy

#### Subsidiaries

Subsidiaries are entities controlled by the Group. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The Company has the following subsidiary companies whose results are included in these consolidated financial statements:

	Country of incorporation	Class of shares held	Ownership %	Principal activity
Shawbrook Bank Limited	England and Wales	Ordinary	100%	Banking
and its subsidiaries:				
Shawbrook International Limited	Jersey	Ordinary	100%	Banking
Shawbrook Buildings and Protection Limited	England and Wales	Ordinary	100%	FCA authorised introducer of insurance
Singers Corporate Asset Finance Limited	England and Wales	Ordinary	100%	Dormant
Singers Healthcare Finance Limited	England and Wales	Ordinary	100%	Dormant
Coachlease Limited	England and Wales	Ordinary	100%	Dormant
Hermes Group Limited	England and Wales	Ordinary	100%	Dormant
Singer & Friedlander Commercial Finance Limited	Scotland	Ordinary	100%	Dormant
Link Loans Limited	England and Wales	Ordinary	100%	Non-trading
Centric Group Holdings Limited	England and Wales	Ordinary	100%	Dormant
and its subsidiaries:				
Centric Group Finance 2 Limited	England and Wales	Ordinary	100%	Dormant
Centric Group Finance Limited	England and Wales	Ordinary	100%	Dormant
and its subsidiaries:				
Centric Commercial Finance Limited	England and Wales	Ordinary	100%	Dormant
Centric SPV 1 Limited	England and Wales	Ordinary	100%	Dormant
Centric SPV 2 Limited	England and Wales	Ordinary	100%	Dormant
Resource Partners SPV Limited	England and Wales	Ordinary	100%	Dormant

All entities have the same registered address as the Company, except the following:

- > Shawbrook International Limited – 1st Floor Kensington Chambers, Kensington Place, St Helier, JE4 0ZE, Jersey; and
- > Singer & Friedlander Commercial Finance Limited – 8 Nelson Mandela Place, Glasgow, Scotland, G2 1BT.

### 33. Related party transactions

Related parties of the Group include Directors, key management personnel, or their close family members, and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Directors, key management personnel or their close family members.

#### Company

Movement in amounts owed by Group companies:

	2017 £m	2016 £m
<b>Balance at 1 January</b>	<b>1.7</b>	<b>2.6</b>
Issue of capital securities	125.0	-
Investment in subsidiaries	(125.0)	-
Dividend received from Shawbrook Bank Limited	19.5	-
Professional fees and other costs	(17.8)	0.3
Transfer of funds	(2.4)	(1.2)
<b>Balance at 31 December</b>	<b>1.0</b>	<b>1.7</b>

In 2015, Shawbrook Group plc entered into a £75.0 million subordinated debt with its subsidiary Shawbrook Bank Limited. The terms and conditions mirror the subordinated debt listed by the Company on the London Stock Exchange on 28 October 2015 (see Note 26).

During 2017, Shawbrook Bank Limited issued £125.0 million Fixed Rate Reset Perpetual Additional Tier 1 Write Down Capital Securities. Following listing of the capital securities on the Irish Stock Exchange on 8 December 2017, Shawbrook Bank Limited issued the capital securities to Shawbrook Group plc on consistent terms as the listed capital securities (see Note 28).

Pollen Street Capital Limited is a private equity firm who, in conjunction with BC Partners LLP, are the ultimate controlling entities of the Company (see Note 36). Both Pollen Street Capital Limited and BC Partners LLP hold equal shareholdings in Marlin Bidco, the Parent of Shawbrook Group plc.

During 2017, the Group extended a €20.0 million revolving credit facility to Capitalflow (Asset Finance) DAC, which is 100% owned by PSC Nominee 3 Limited, a Pollen Street Capital Limited company. As of 31 December 2017, the balance outstanding was £5.8 million.

During 2017, the Group extended a senior revolving facility to 1st Stop Funding Limited, whose ultimate parent is 1st Stop Holdings Limited. 1st Stop Holdings Limited is 100% owned by PSC Nominee 3 Limited, a Pollen Street Capital Limited company. The balance outstanding at 31 December 2017 was £20.0 million (2016: £21.0 million).

#### Transactions with Directors

The Directors of the Group declared and sold shares as part of the acquisition of the Group by Marlin Bidco which totalled 4,447,746 shares of four Directors and two closely associated persons. Lindsey McMurray and Cédric Durbourdieu are Directors of Marlin Bidco Limited the Group's 100% Shareholder.

#### Transactions with key management personnel

Key management personnel are defined as the Executive Management team of Shawbrook Group plc excluding the Executive and Non-Executive Directors. The total remuneration which included short-term benefits and employer pension contributions totalled £5.0 million (2016: £2.4 million). Six members of the Executive Management team and two persons closely associated also declared and sold shares as part of the acquisition of the Group by Marlin Bidco which totalled 2,098,741 shares.

### 34. Capital commitments

The Group had capital commitments totalling £nil at 31 December 2017 (2016: £0.3 million).



### 35. Contingent liabilities and guarantees

#### Accounting policies

##### *Financial guarantee contracts*

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received, or the present value of the fee receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

##### *Contingent liabilities*

Contingent liabilities, which includes contingent liabilities related to legal proceedings or regulatory matters, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Group. Alternatively, they are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed, unless the probability of settlement is remote.

#### Financial guarantee contracts

In 2015, the Group entered into a financial guarantee contract to an amount of £2.5 million. This contract is a continuous obligation which may be terminated by the Group on giving three months written notice. The contract is fully collateralised through a first fixed charge over a blocked deposit account to an amount of £2.5 million.

#### Contingent liabilities

Part of the Group's business is regulated by the Consumer Credit Act (CCA), which contains very detailed and highly technical requirements. The Group continues to commission external reviews of its compliance with the CCA and other consumer regulations. The Group has identified some areas of potential non-compliance, although these are not considered to be material. While the Group considers that no material present obligation in relation to non-compliance with the CCA and other consumer regulations is likely, there is a risk that the eventual outcome may differ.

The Group's Consumer Lending division is exposed to risk under Section 75 CCA, in relation to any misrepresentations or breaches of contract by suppliers of goods and services to customers where the purchase of those goods and services is financed by the Group. While the Group would have recourse to the supplier in the event of such liability, if the supplier becomes insolvent then that recourse would have limited value.

In 2017, the Group's Consumer Lending division has seen an increase in the number of customer complaints relating to the provision of solar panels by certain suppliers. These complaints relate either to the quality of the panels or to representations allegedly made by suppliers as to the expected financial performance of the panels and the Group investigates each complaint on its individual merits.

### 36. Ultimate parent company

The Company was acquired by Marlin Bidco Limited on 31 August 2017 and was removed from the Official List and trading cancelled on the London Stock Exchange on 24 August 2017. Marlin Bidco Limited is a company jointly owned by PSCM Pooling LP and Marlinbass Limited which are investment vehicles of Pollen Street Capital Limited and BC Partners LLP respectively.

The largest company in which the results of the Group are consolidated is that headed by Shawbrook Group plc, incorporated in England and Wales. No other financial statements include the results of the Group.

## 37. Country-by-country reporting

The Capital Requirements (country-by-country reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of CRD IV.

The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the financial institution's income and locations of its operations.

Shawbrook Group plc and its subsidiaries are all UK or Channel Island registered entities, the activities of which are disclosed in Note 32.

The Group's net operating income, profit before taxation, income tax charge, tax paid and number of full-time equivalent employees were:

	2017	2016
Net operating income (£m)	238.7	209.6
Profit before tax (£m)	86.5	88.2
Income tax charge (£m)	25.3	23.4
Tax paid (£m)	29.6	20.4
Average number of employees on a full-time equivalent basis	671	569

The Group did not receive any public subsidies.

## 38. Post-balance sheet events

On 23 February 2018, the Group received confirmation of an interim payment of £4.95 million relating to the Group's insurance claim in respect of the controls breach identified in the Business Finance division in H1 2016, which will be paid subject to verification of the quantum of the claimed losses. The Group's insurers confirmed that the Group's insurance claim is covered in principle under the policy, but insurers are still considering certain aspects of the Group's claim before the final settlement amount can be determined.

There have been no other significant events between 31 December 2017 and the date of approval of the financial statements which would require a change to, or additional disclosure in, the financial statements.

## Glossary

<b>Average principal employed</b>	Calculated as the average of monthly closing loans and advances to customers, net of impairment provision, from the Group's financial reporting and management information systems, including operating leases, which are classified as property, plant and equipment in the Group's financial statements.
<b>Basel III</b>	Global regulatory standard on bank capital adequacy, stress testing and market and liquidity proposed by the Basel Committee on Banking Supervision in 2010. It aims to strengthen regulation, supervision and risk management in the banking sector.
<b>Basis point (bps)</b>	One hundredth of a percent (0.01%). 100 basis points is 1%. It is used in quoting interest rates or yields on securities.
<b>Board</b>	The Board of Directors of Shawbrook Group plc.
<b>Buy-to-let (BTL) mortgages</b>	BTL mortgages are those mortgages offered to customers purchasing residential property as a rental investment.
<b>Capital Requirements Regulation (CRR)</b>	The European Union has implemented the Basel III capital proposals through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), collectively known as CRD IV. CRD IV was implemented on 1 January 2014.
<b>CCA</b>	Consumer Credit Act.
<b>CGU</b>	Cash generating unit.
<b>Code</b>	The FRC's UK Corporate Governance Code (2016 edition).
<b>Common Equity Tier 1 (CET1) Capital</b>	The highest quality form of capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
<b>Common Equity Tier 1 (CET1) capital ratio</b>	The CET 1 capital ratio is calculated as CET1 capital divided by risk-weighted assets.
<b>Cost of risk</b>	Cost of risk is calculated as impairment losses on financial assets divided by average principal employed.
<b>Cost to income ratio</b>	Cost to income ratio is calculated as administrative expenses plus provisions for liabilities and charges, divided by net operating income.
<b>CRD</b>	Capital Requirements Directive.
<b>CRD IV</b>	In June 2013, the European Commission published legislation for a CRD and CRR which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in.
<b>CSR</b>	Corporate Social Responsibility.
<b>Customer deposits</b>	Monies deposited by individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Group's statement of financial position.

<b>Customer loans</b>	Loans and advances to customers, net of impairment provision and including operating leases, which are classified as property, plant and equipment in the Group's financial statements.
<b>Deferred tax assets</b>	Income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry forward of tax losses and unused tax credits.
<b>ECL</b>	Expected credit loss.
<b>Effective Interest Rate (EIR) Effective Interest Rate Method (EIRM)</b>	The EIRM calculates the amortised cost of a financial asset or financial liability, and allocates the interest income over the relevant period. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or financial liability. Calculation of the EIR takes into account all contractual terms of the financial instrument but includes all amounts received or paid that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts.
<b>Encumbrance</b>	The use of assets to secure liabilities, such as by way of a lien or charge.
<b>EPS</b>	Earnings per share.
<b>Exposure at default</b>	An estimate of the amount expected to be owed by a customer at the time of a customer's default.
<b>Fair value</b>	The amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.
<b>Financial Services Compensation Scheme (FSCS)</b>	The FSCS is the UK's independent statutory compensation fund for customers of authorised financial service firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on the authorised firms.
<b>Forbearance</b>	Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties. Forbearance options are determined by assessing the customer's personal circumstances.
<b>FRC</b>	Financial Reporting Council.
<b>Full-time employee</b>	A full-time employee is one that works a standard five-day week. The hours worked by part-time employees are measured against this standard and accumulated along with the number of full-time employees and counted as full-time equivalents.
<b>Funding for Lending Scheme (FLS)</b>	The Bank of England launched the FLS in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to businesses by lowering interest rates and increasing access to credit.
<b>FVOCI</b>	Fair value through other comprehensive income.
<b>FVTPL</b>	Fair value through profit or loss.
<b>Gross asset yield</b>	Gross asset yield is calculated as the sum of interest and similar income, net income from operating leases, net fee and commission income and fair value gains/(losses) on financial instruments divided by average principal employed.
<b>Group</b>	The Company and its subsidiaries.
<b>HIL</b>	Home Improvement Loan.
<b>HOL</b>	Holiday Ownership Loan.

<b>IAS</b>	International Accounting Standard.
<b>IASB</b>	International Accounting Standards Board.
<b>ICG</b>	Individual Capital Guidance.
<b>IFRS</b>	International Financial Reporting Standards.
<b>Impaired assets</b>	Loans that are in arrears or where there is objective evidence of impairment and where the carrying amount of the loan exceeds the expected recoverable amount. This definition also includes unsecured loans in the Consumer Lending division that are more than 90 days in arrears and carry identified impairment that is calculated on a collective basis.
<b>Impairment allowance</b>	The impairment allowance includes allowances against loans that have been individually impaired and those that are subject to collective impairment.
<b>Instalment credit agreement</b>	An instalment credit agreement is an agreement similar in nature to a hire purchase agreement or otherwise known as a rent-to-own agreement.
<b>Interest rate risk</b>	The risk of a reduction in the present value of the current statement of financial position or earnings as a result of adverse movement in interest rates.
<b>Internal Capital Adequacy Assessment Process (ICAAP)</b>	The Group's own assessment, based on Basel III requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.
<b>Internal Liquidity Adequacy Assessment Process (ILAAP)</b>	The Group's own assessment of its overall liquidity adequacy and in particular the level of liquidity resources it requires to meet its liabilities as they fall due even under stressed conditions, in accordance with the PRA's liquidity rules under PS11/15.
<b>Leverage ratio</b>	The leverage ratio is calculated Common Equity Tier 1 capital divided by the sum of total assets (excluding intangible assets and include adjustments for certain off-balance sheet items such as pipeline and undrawn collateral).
<b>Liability yield</b>	Liability yield is calculated as interest expense and similar charges divided by average principal employed.
<b>LIBOR (London Inter-Bank Offered Rate)</b>	The interest rate participating banks offer to other banks for loans on the London market.
<b>Loss given default</b>	The estimated loss that will arise if a customer defaults. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.
<b>Management expenses ratio</b>	Management expenses ratio is calculated as administrative expenses plus provisions for liabilities and charges, divided by average principal employed.
<b>MREL</b>	Minimum Requirements for Eligible Liabilities.
<b>Neither past due nor impaired</b>	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.
<b>Net interest income</b>	The difference between interest received on assets and interest paid on liabilities.
<b>Net interest margin (NIM)</b>	Calculated as net operating income divided by average principal employed.
<b>Net stable funding ratio</b>	The ratio of available stable funding required to support the assets and activities over the medium term as set out by the Basel III requirements and implemented by the European Banking Authority and the PRA.

<b>Past due</b>	A loan is considered past due when the borrower has failed to make a payment under the terms of the loan agreement. This may also include loans past maturity where an outstanding balance exists.
<b>Past due but not impaired</b>	Loans past due but not impaired consist predominantly of loans in Property Finance and Business Finance that are impaired. This definition also included unsecured loans in the Consumer Lending Division that are past due but not more than 90 days.
<b>PD</b>	Probability of default.
<b>Pillar 1</b>	The part of the Basel framework that sets out the rules that govern the calculation of Minimum capital requirements for credit, market and operational risks.
<b>PRA</b>	Prudential Regulation Authority.
<b>RAS</b>	Risk Appetite Statement.
<b>RBC</b>	Regional Business Centres.
<b>Recovery Plan and Resolution Pack</b>	The Bank Recovery and Resolution Directive establishes a common approach to the recovery and resolution of banks and investment firms. The Group's recovery plan enables the Board and Senior Management to manage a crisis which may threaten the capital and/or liquidity adequacy of the Bank, or its ultimate viability. The objective of the plan is to put in place measures (recovery options) to restore capital, liquidity or profitability so that the Bank can operate sustainably and viably. The Group's resolution pack lays out the information required to support effective resolution planning. The requirements for the Recovery Plan and Resolution Pack are set out in supervisory statement SS18/13 and SS19/13 respectively.
<b>Repurchase agreements or 'Repos'</b>	An agreement where one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective, such agreements are repurchase agreements (repos) and from the buyer's perspective they are reverse repurchase agreements (reverse repos).
<b>Return on lending assets</b>	Return on lending assets before tax is calculated as profit/(loss) before taxation divided by average principal employed.
<b>Return on tangible equity (RoTE)</b>	Return on tangible equity is calculated as profit for the year attributable to owners divided by average tangible equity. Average tangible equity is calculated as total equity less intangible assets at the beginning of a period plus total equity less intangible assets at the end of the period, divided by two.
<b>Risk-weighted assets</b>	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules and are used to assess capital requirements and adequacy under Pillar 1.
<b>RMF</b>	Risk Management Framework.
<b>SAF</b>	Structured Asset Finance.
<b>Secured lending</b>	Lending on which the borrower uses collateral such as equity in their home.
<b>SF</b>	Structured Finance.
<b>SIL</b>	Shawbrook International Limited.
<b>SME</b>	Small to medium enterprises.
<b>SPPI</b>	Solely payments of principal and interest.

<b>Standardised approach</b>	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ratings of obligators (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines.
<b>Stress testing</b>	Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital or liquidity resources which are required to be held.
<b>Term Funding Scheme (TFS)</b>	The Bank of England launched the TFS in 2016 to allow banks and building societies to borrow from the Bank of England at rates close to Bank base rate. This is designed to increase lending to businesses by lowering interest rates and increasing access to credit.
<b>Tier 1 capital</b>	A measure of banks financial strength defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.
<b>Tier 1 capital ratio</b>	Tier 1 capital as a percentage of risk-weighted assets.
<b>Tier 2 capital</b>	A further component of regulatory capital defined by the PRA. It comprises eligible collective assessed impairment allowances under CRD IV.
<b>Total capital ratio</b>	The total capital ratio is calculated as total regulatory capital divided by risk-weighted assets.
<b>TSR</b>	Total Shareholder return.
<b>Unencumbered assets</b>	Assets that are readily available to secure funding or to meet collateral requirements, and assets that are not subject to any restrictions but are not readily available for use.