Hampshire Trust Bank

PILLAR 3 DISCLOSURES

31 DECEMBER 2016

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1. Introduction

1.1 OVERVIEW

This document provides the Pillar 3 disclosures required of Hampshire Trust Bank plc (referred to in this document as 'the Bank') as at 31st December 2016. The Bank is authorised by the Prudential Regulation Authority ('PRA') and regulated by the PRA and the Financial Conduct Authority ('FCA').

1.2 BACKGROUND

The Basel III framework, which was implemented in Europe through the Capital Requirements Directive IV ('CRD IV'), came into effect on 1 January 2014. CRD IV defines the level of capital that banks must hold, having regard to the risk profile of each bank. CRD IV also made changes on corporate governance, including remuneration, and introduced standardised regulatory reporting within the EU.

The Basel framework consists of three 'pillars':

- **Pillar 1:** defines the minimum capital requirements that banks are required to hold for credit, market and operational risks.
- **Pillar 2:** this builds on Pillar 1 and requires each bank to perform an 'Internal Capital Adequacy Assessment Process' ('ICAAP') to assess its own risk profile, and determine the level of additional capital required over and above Pillar 1 requirements, having regard to those risks. The amount of any additional capital requirement is also assessed by the PRA during its Supervisory Review and Evaluation Process ('SREP') and is used to determine the overall capital resources required by the Bank.
- **Pillar 3:** aims to improve market discipline by requiring banks to publish information on their principal risks, capital structure and risk management.

1.3 BASIS OF DISCLOSURE

The purpose of these disclosures is to provide information on the management of risks faced by the Bank and the basis of calculating capital requirements under CRD IV.

The disclosures in this report have been prepared as at 31 December 2016. They should be read in conjunction with the Bank's 2016 Annual Report and Accounts ('the Annual Report and Accounts'), approved by the Board on 30 March 2017.

The Bank uses the Standardised Approach for credit risk, capital management and market risk. This approach uses standard risk weighting percentages set by the PRA. The Basic Indicator Approach is used for operational risk.

The disclosures have not been, and are not required to be, subject to independent external audit and do not constitute any part of the Bank's financial statements.

The disclosures are published on the Bank's website.

1.4 SCOPE

The monitoring and controlling of risk is a fundamental part of the management process. All senior management are involved in the development of risk management policies and in monitoring their application.

This document outlines the capital required under Pillar 1 and in accordance with Pillar 2, details specific risks which the Bank faces, and how these risks are managed.

This document is applicable only to Hampshire Trust Bank plc, which is a subsidiary of Hoggant Limited.

1.5 SUMMARY OF KEY RATIOS

The key ratios for the Bank under CRD IV are:

	2016	2015
Common Equity Tier 1 (CET1) Ratio	16%	33%
Risk weighted assets (£000)	430,807	157,455
Leverage ratio	11%	57%

1.6 REGULATORY DEVELOPMENTS AFFECTING THE BANK

1.6.1 BASEL IV

The Basel Committee on Banking Supervision (BCBS) is proposing to revise the standardised approach to credit, market and operational risk, in addition to a revised leverage ratio and new standards regarding the management and supervision of interest rate risk in the banking book. This has collectively been termed "Basel IV". These revisions, as they currently stand, are likely to have a significant impact on banks' risk weighted assets and hence capital requirements.

The Basel Committee were due to meet in January 2017 to finalise its standards for the calculation of capital requirements for credit risk and operational risk. However this has been postponed as the Group of Central Bank Governors and Heads of Supervision (GHOS) needs more time to review the package of proposals. Any future impact on the Bank is therefore uncertain, although the Bank's capital position and ongoing profit generation gives us confidence that we can absorb any changes.

1.6.2 IFRS 9

The key change introduced by IFRS 9 is the replacement of loan impairment recognition with expected loss from incurred loss. The Bank commenced the implementation of IFRS 9 in 2016 with delivery of an expected loss model planned for in 2017. Following a parallel run with IAS39 during 2017, the Bank will be ready to apply the standard from 1 January 2018.

1.6.3 OTHER

Total loss absorbing capital (TLAC) and Minimum requirement for eligible liabilities (MREL) regulations continue to be developed and transitional arrangements are likely to be incremental up to 2022. The Bank is in the lowest resolution risk level category where MREL requirements are set to equal the level of Pillar 1 and Pillar 2 requirements, therefore no additional capital would be required. Developments in this area are being monitored closely, however.

2. Risk Management

2.1 OVERVIEW

Effective management of risk plays a key role in the successful execution of the Bank's business strategy as encapsulated within our overarching risk appetite statement – ***"to run a sustainable, safe and sound business that conducts its activities in a prudent and reputable manner taking into account the interests of our customers and key stakeholders"***.

Embedding the right risk culture is fundamental to good risk management and in recognition of that the Bank has invested significantly in people, processes and training over the course of the last 12 months supported by the continued development and enhancement of frameworks, policies, tools and data to support risk aware decision making in all areas.

The Board alongside Executive management and the Risk function have developed risk appetite and risk management frameworks that are explicitly linked to business strategy. In developing such frameworks care has been taken to ensure that our risk appetite is capable of being understood and articulated at all levels of the Bank. From Board to business level, our aim is to ensure that decisions are made with risk considerations at the forefront with all staff encouraged to highlight and address risk issues promptly.

With an eye to future growth, and in support of the flow of regulatory change, the Bank has bolstered its compliance, operational and data management capabilities via continued people recruitment alongside ongoing investment in data capture and reporting systems. The Bank is also well advanced in preparing for the regulatory change in credit loss calculation with the formal implementation of the new accounting standard, IFRS 9 with effect from 1st January 2018. A major project which has industry wide implications in terms of the understanding and management of credit risk.

The last twelve months has seen a significant change of pace on the risk management front with investment decisions designed to ensure the Bank is well positioned for future growth whilst retaining the ability to react quickly to changes in the external environment.

2.2. RISK APPETITE STATEMENTS (RAS)

In support of the above, the Board and Executive management have developed a number of Risk Appetite Statements ('RAS') that give expression to the levels of risk the Bank is willing to take in delivering against strategic plans.

The RAS reflect those risks considered critical to delivery (designated as Principal Risks), with review of appetite and relevant risks undertaken formally on an annual basis as an integral part of the budgetary cycle and medium-term strategy review process. That annual review combines a top-down view of the Bank's overall risk profile with a bottom-up view from the business and Executive supported by relevant data and risk and control self-assessments. Where internal or external circumstances alter significantly an interim review of risk appetite can be instigated by the Board or Executive ensuring that the Bank maintains the ability to react dynamically to changing circumstances.

We will maintain stakeholder confidence – by operating the business in such a way that we deliver against our key objectives, financial and non-financial, and remain within our risk appetite.

We will maintain adequate capital resources – we will maintain a sufficient level of capital to effectively support the business under normal market conditions and a range of stressed scenarios taking into account any emerging economic or business model issues as well as changes to regulatory guidance.

We will maintain adequate liquidity – we will hold sufficient quantity and quality of liquidity to ensure that all liabilities will be met as they fall due under normal market conditions and under a range of stress scenarios and regulatory guidance.

We will protect our reputation – we will be a safe haven for retail and business savers and be seen as an organisation that treats our customers and employees fairly. We have no appetite for material negative or adverse reputational events however caused.

We will limit the potential for credit loss – by being aware of and managing key concentrations, lending in markets where we can demonstrate expertise, to credit worthy borrowers, backed by satisfactory security (or, where assets cannot be readily valued, proven affordability alongside personal recourse) and consistent with risk adjusted return objectives.

We will effectively manage our operational risks – we have a low tolerance for operational risk failures (including IT system failures) and will ensure that our staff are properly trained, procedures are thoroughly documented and supervisory controls and reporting methodologies are in place to manage and minimise the impact of adverse operational risk events that disrupt customer service and/or impact internal service standards.

We will demonstrate high standards of conduct and compliance – we have a low tolerance for material conduct or compliance related adverse events, or breaches of a regulatory or legal nature, and will operate the business in such a way as to minimise the potential for such adverse events to occur.

2.3 THE FRAMEWORK

HOW WE MANAGE OUR RISKS

The Bank has established an Enterprise Risk Management Framework (ERMF) which provides guidance for cohesive and consistent risk management activity across the whole business. The overarching aim of the ERMF is to ensure that all types of risk are identified and managed in a consistent manner across the Bank. The ERMF sets a standard approach for the management of each Principal risk and comprises consideration of the following key components:

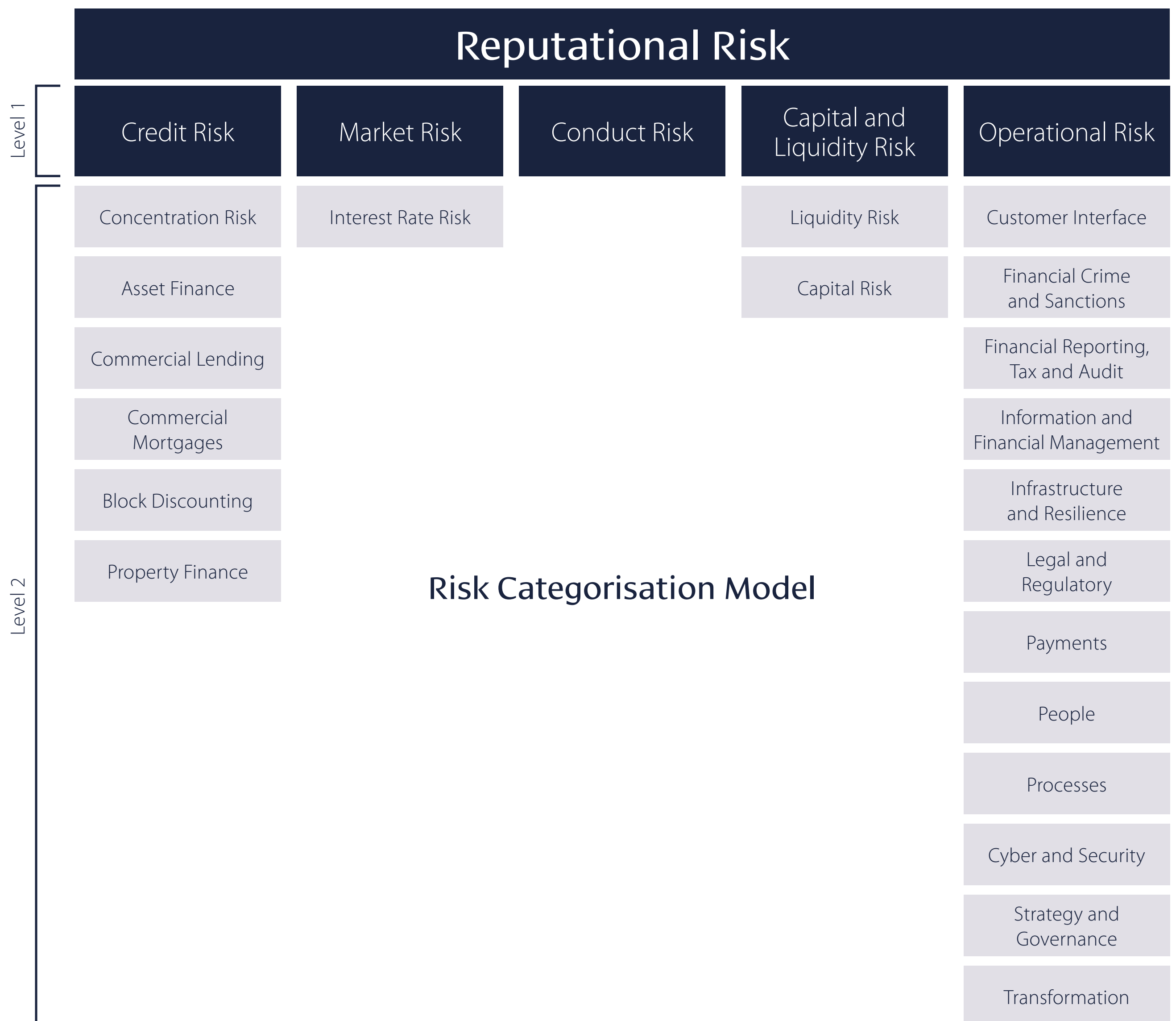
- Risk Culture;
- Risk Governance and Control;
- Risk Strategy and Appetite;
- Risk Measurement and Reporting; and
- Stress Testing and Contingency Planning.

The ERMF is enacted through a range of policies and control frameworks, setting out risk appetite both in qualitative and quantitative terms in respect of each of the principal risks identified. Adherence to policy is monitored by Management through a variety of formal governance processes. Performance is measured for, and reported to, Executive management and the Board Risk Committee, with any material risks or risk appetite deviation reported to the Board on a monthly basis.

We use stress testing as the primary means to understand how risk behaves under stressed conditions, and the implication for capital and liquidity resources.

HOW WE IDENTIFY AND CATEGORISE OUR RISKS

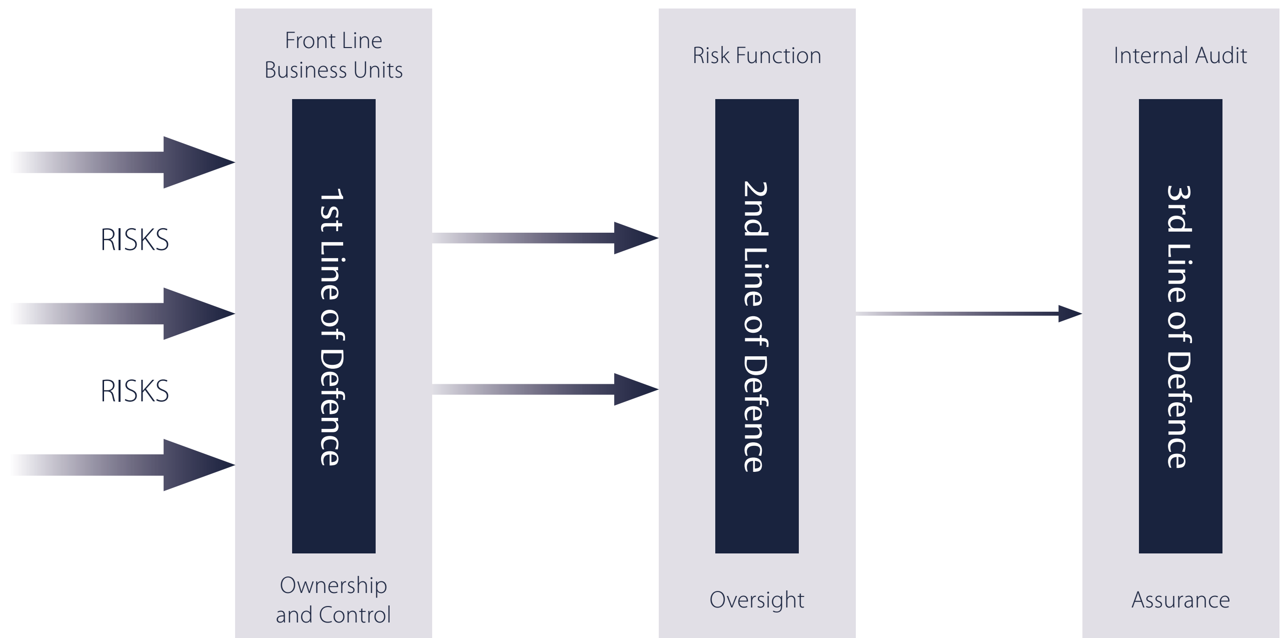
We use the following risk categorisation model as our primary reference point and reflect that categorisation in the matters reviewed under Board and related Committees terms of reference. Qualitative and/or quantitative statements of Risk Appetite exist for each Level 1 Principal Risk and Level 2 risk category. Further sub categories and metrics have been developed to ensure the Bank has a detailed understanding of the individual components of each risk category.



Risk Categorisation Model

HOW WE CONTROL OUR RISKS

Risk oversight is performed by the Board and the Board Risk Committee. Effective risk management is enhanced by a three lines of defence model:



FRONT LINE BUSINESS UNITS

The first line of defence (the business lines and related operational functions) own primary responsibility for the day to day management of our principal risks and the implementation of approved policies, frameworks and related methodologies.

RISK FUNCTION

The second line of defence (Risk and Compliance) provides independent challenge, oversight and ongoing assurance of the adequacy and effectiveness of risk management within the business.

AUDIT

The third line of defence provides impartial assurance of our risk control and oversight activities and acts under the direction of the Audit Committee. Risk oversight is performed by the Board and Board Risk Committee.

Internal Audit is outsourced and provided by PwC, an independent third party firm of accountants and business advisers. The work of Internal Audit is designed to provide independent assurance to the Board (via the Board Audit Committee) of the adequacy and effectiveness of control systems operating within the first and second lines in identifying and managing risk.

External audit, undertaken by KPMG, also provide independent assurance to the Board and Board Audit Committee on financial controls and the integrity of the financial statements. KPMG's report is to the shareholders.

Risk Governance – is provided by the hierarchy of Board and subordinate forums, Executive and business committees, policies, mandates and supporting processes and procedures

Risk Reporting – risks are transparently measured, monitored, managed and regularly reported via approved governance structures with all risks (including exceptions and breaches of appetite) reported to the Board Risk Committee via Executive management committees.

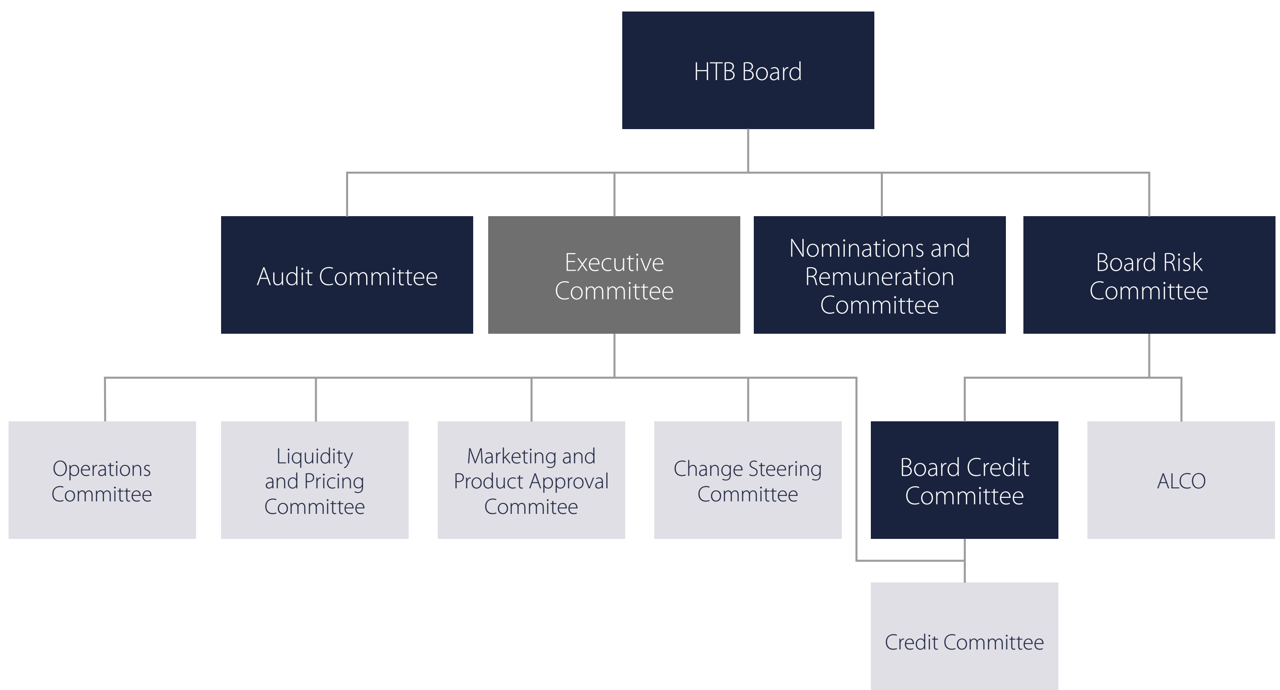
Risk Stress Testing – the stress testing framework is designed to assess the resilience of the corporate plan projections to 1) changes in key operating assumptions, 2) prescribed stress scenarios and, 3) reverse stress testing. Stress testing helps inform considerations around risk capacity and risk appetite as well as the construction of suitable stress capital and liquidity buffers under the ICAAP and Internal Liquidity Adequacy Assessment process ("ILAAP"). Recovery and Resolution planning considerations and early warning indicators are similarly derived from stress test outputs and consequent risk indicators.

Recovery and Resolution Plans – The Recovery Plan represents a 'menu of options' for the Bank to deal with firm-specific or market-wide stress which can be rolled out quickly as part of a credible and executable plan. The recovery plan is enacted if certain key triggers are breached, or events happen in the market which are likely to affect the Bank detrimentally (e.g. failure of a counterparty). Orderly wind-up of the Bank is considered to be a viable recovery plan option for a small institution.

The Resolution Plan provides the data required, if it was necessary, to close down the Bank. In preparing and planning for such extreme events, the Board ensures that it has taken these severe risks, however remote, into account in its planning and considered the mitigating actions available.

2.4 COMMITTEE STRUCTURE

The responsibility for managing the principal risks ultimately rests with the Bank's Board of Directors. The Bank's committee structure as at 31 December 2016 with regard to risk management is outlined below:



Set out below are the details of the Board and principal committees which enable high level controls to be exercised over the Bank's activities.

2.4.1 THE BOARD

The Board is the primary governing body and has ultimate responsibility for setting the Bank's strategy, corporate objectives and risk appetite. The strategy and risk appetites take into consideration the interests of depositors, borrowers and shareholders.

The Board defines and approves the level of risk which the Bank is willing to accept. It is responsible for maintaining an appropriate control environment to manage the principal risks and for ensuring the capital and liquidity resources are adequate to achieve the Bank's objectives without taking undue risk. The Board also maintains a close oversight of current and future activities, through a combination of monthly board reports including financial results, operational reports, budgets and forecasts and reviews of the main risks set out in the ICAAP and ILAAP reports.

2.4.2 BOARD AUDIT COMMITTEE

The Audit Committee oversees the effectiveness of the Bank's internal control environment, monitors the financial integrity of the financial statements and risk management systems, involving internal and external auditors in that process, and considers compliance monitoring programmes. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal control is maintained. The Committee is chaired by an independent non-executive director and comprises solely of non-executive directors.

2.4.3 BOARD RISK COMMITTEE ('BRC')

The Board has delegated responsibility for oversight of the Bank's principal risks to the Board Risk Committee. This involves reviewing the aggregate risk profile of the Bank, including performance against risk appetite for all risk types and ensuring both the risk profile and the risk appetite remain appropriate. This committee oversees the development, implementation and maintenance of the Bank's Risk Management Framework, compliance with relevant regulations and law, and whistleblowing and proper functioning of controls over the prevention of money laundering, bribery and fraud.

2.4.4 NOMINATION AND REMUNERATION COMMITTEE

The Nomination and Remuneration Committee reviews remuneration matters (including remuneration policy), employee benefits and performance related pay structures for the Bank. It is also responsible for considering all senior appointments both at Board and Executive levels (including Non-Executive Directors).

2.4.5 EXECUTIVE COMMITTEE

The Executive Committee takes day-to-day responsibility for the running of the business. The Executive Committee implements the strategy and financial plan which is approved at the Board and ensures the performance of the business is conducted in accordance with the Board's instructions. It also reviews prudential and regulatory matters of the Bank.

2.4.6 BOARD CREDIT COMMITTEE

This committee meets when required to consider:

- Credit proposals that fall outside Board approved policy;
- Credit proposals if the advance would result in a large exposure above Board approved Credit Committee mandate; and
- When the Board requests the Committee to review/oversee a material loan in default.

2.4.7 CREDIT COMMITTEE

The Credit Committee is the body charged with the transactional credit responsibility for the Bank. It operates within policy parameters approved by the Board in carrying out the approval and monitoring of the credit business of the Bank. The Credit Committee is a deal specific review forum and is also responsible for making provisions for loan losses.

2.4.8 ASSET AND LIABILITY COMMITTEE ('ALCO')

The Board Risk Committee has delegated responsibility for overseeing the Bank's exposure to capital, liquidity, interest rate and market risk to the ALCO.

The ALCO meets monthly and ensures that the overall policies and objectives for asset and liability management, including interest rate, liquidity and market risk, are adhered to by the Bank. It also has responsibility for ensuring that the policies that are implemented are adequate to meet prudential and regulatory targets.

2.4.9 MARKETING AND PRODUCT APPROVAL COMMITTEE

The Marketing and Product Approval Committee ('MAPAC') is the forum through which the Bank reviews and controls the processes around its products, its marketing communications and its branding. Specifically, it is responsible for ensuring that these comply with applicable laws, regulations and codes of practice that apply to the Bank's business. The committee meets monthly.

2.4.10 LIQUIDITY AND PRICING COMMITTEE ('LPC')

The purpose of the LPC is to guide Treasury in the ongoing management of liquidity and the setting and co-ordinating of pricing for all of the Bank's savings products.

2.4.11 CHANGE STEERING COMMITTEE

The Change Steering Committee is specifically responsible for overseeing the efficient and effective design and implementation of operational projects. It is the forum for setting priorities, resolving issues and ensuring operational projects are properly supporting business needs.

2.4.12 OPERATIONS COMMITTEE

The Operations Committee is focused on the operational environment of the Bank. The aim of the Committee is to monitor and measure performance of operational areas; identify and pro-actively manage and resolve current and potential issues, problem areas and risks; and improve communication and understanding of operational risk and controls across the Bank.

3. Credit Risk

3.1 CREDIT RISK OVERVIEW

Credit risk is the risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan on time.

The controlled management of credit risk is critical to the Bank's overall strategy. The Bank has therefore embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

Lending under asset finance, property finance and commercial mortgages, is undertaken within detailed limits and guidelines set out in Lending and Credit policies. These include maximum advances and Loan to Value ("LTV") percentages for each type of lending. These are monitored by management with the aid of monthly detailed portfolio performance reports.

Money market investments are made with eligible counterparties approved by the Board. The ALCO reviews the list of counterparty exposures at least monthly and sets limits for each institution based on its credit rating.

3.2 MANAGEMENT OF CREDIT RISK

Credit risks associated with lending are managed via a combination of consistent, conservative and prudent underwriting processes (as detailed in the Bank's lending and credit policies), supported by a robust governance and control environment. The Bank will take necessary steps if specific issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to economic or sector-specific weaknesses.

The Bank also seeks to mitigate credit risk by focusing on business sectors where it has specific expertise and through limiting concentrated exposures on larger loans or certain sectors which can represent higher risk. The Bank also seeks to obtain security cover, and where appropriate, personal guarantees from borrowers.

Each business area has its own lending policy and dedicated resources which assess credit risk, supported by senior credit risk management who have oversight of lending activities. A tiered credit approval mandate framework is in place for each business line encompassing first line, second line and Credit Committee mandate thresholds linked to business type and debt quantum. Compliance is monitored via second line monthly assurance review and reporting.

3.2.1 PROPERTY FINANCE

This business provides development and bridging finance to well established UK house builders. Property Finance lending operates within conservative loan to value ratios, with a rigorous and cost focused approach to assessing development values. Lending is focused primarily in liquid residential markets and multi dwelling developments which offer granular security. An assessment is made of the quality of the developer, with a focus on clients with an established track record. There is also a vigorous monitoring process, which involves an external monitoring surveyor who visits client sites on a regular basis before further drawdowns of facilities, supplemented by regular site visits from the property finance team and surveyors.

3.2.2 ASSET FINANCE

Hire Purchase and Leasing

This comprises small ticket leasing and hire purchase secured on vehicles and business assets. The lending is spread across a diverse customer base and secured against a range of asset types. A rigorous assessment of the resale value of assets are made, with deposits typically required of between 10% and 20%. Loans are only made to established SMEs with a history of stable earnings and evidence of sufficient cash flow to meet repayments. Personal guarantees are often taken from the principals of the business, whose credit profile is also assessed. Lending to individuals requires the borrower to have a clean credit history and demonstrate that the payments are affordable.

Block Discounting

Block Discounting lending is spread across non -bank small finance companies and secured against instalment credit agreements for a diverse range of asset types. The Bank may provide finance to the customer based on their credit position, however there will also be a review carried out on the end user contracts to ensure that they provide good security. Other factors will also be considered to ensure that credit risk is reduced, customer track record (management experience, profitability, arrears etc.), low risk concentrations through diversified portfolios, sufficient security levels and effective auditing to avoid fraud.

All customers will have pre-audits carried out by the in-house audit team of the Bank. These will be carried out prior to any approval of facilities, and will continue to occur quarterly once a facility has been approved. This measure will ensure that any changes in customer business performance are alerted to the Bank.

3.2.3 COMMERCIAL MORTGAGES ('CM')

Commercial Mortgages launched in Q2 2016, providing finance to professional landlords secured on residential properties, short term finance to experienced property investors and loans on semi-commercial and commercial properties in England and Wales. Lending is focussed to specialist experienced investors and owner operators in both sectors (residential & commercial). The business model concentrates on a twin approach to the market to optimise transaction flows and returns using a broker/direct approach (all brokers are FCA regulated or NACFB members).

CM classify the majority of its customers as SME as their annual turnover will be below €50m. Any with a higher turnover would be classified as corporate customers, but such situations are exceptional.

CM lending mitigates risk by ensuring that borrowers have experience in managing property investments (or operating commercial assets if owner operator), and that their financial conduct meets the Bank's strict criteria. Emphasis is placed on the track record of borrowers, and particular value to those who have a successful track record with either the Bank's management or other lenders.

3.2.4 COMMERCIAL FINANCE

The Bank exited the asset backed lending market during 2016 as the opportunity to reach scale within acceptable risk appetite became unattainable. This is a discontinued activity. As at 31 December 2016, there was one remaining loan on the portfolio.

3.3 CREDIT RISK EXPOSURES

3.3.1 CREDIT RISK EXPOSURE BY SECTOR

The Bank monitors concentrations of credit risk by sector, size and by geographical location. An analysis of concentrations of credit risk from loans and advances, investment securities, financial guarantees and contractual commitments as at 31 December 2016 is shown below.

	Loans and advances to Banks and Building Societies		Loans and advances to Customers		Financial Guarantees and Contractual Commitments	
	2016	2015	2016	2015	2016	2015
	£000	£000	£000	£000	£000	£000
Carrying amount	136,317	60,684	463,605	177,613	162,268	116,911
Concentration by sector						
Corporate		-	309,863	108,674	162,268	116,911
Government	128,740	30,099		-		-
Banks and Building Societies	7,577	30,585		-		-
Retail	-	-	153,742	68,939	-	-
	136,317	**60,684**	**463,605**	**177,613**	**162,268**	**116,911**
Concentration by location						
UK	136,317	60,684	463,605	177,613	162,268	116,911

3.3.2 GEOGRAPHIC DISTRIBUTION OF CREDIT RISK EXPOSURE

Credit risk for the three main lending businesses as at 31 December 2016 is analysed by geography in the table below:

	Asset Finance	Commercial Mortgages	Property Finance	Exposure Value
	£000	£000	£000	£000
Exposure Category				
East Midlands	11,830	1,639	293	13,762
East of England	25,686	6,137	8,174	39,997
Greater London	2,822	2,858	59,865	65,545
London	7,659	49,878	53,077	110,614
North East	1,968	102	0	2,070
North West	16,235	6,302	2,540	25,077
Northern Ireland	278	0	0	278
Scotland	3,954	0	0	3,954
South East	26,465	20,225	50,630	97,320
South West	16,187	1,878	20,376	38,441
Wales	16,025	716	0	16,741
West Midlands	13,387	1,258	3,654	18,299
Yorkshire and Humberside	11,246	10,308	8,980	30,534
Total	**153,742**	**101,301**	**207,589**	**462,632**

3.3.3 NON-PERFORMING LOANS & PROVISIONING

A consistent approach to provisioning applies to all lending activities within the Bank. Collective provision reflects the estimated amount of losses incurred on a collective basis, but which have yet to be individually identified. Specific provisions are raised against non-performing or defaulted agreements.

In the case of residential development and commercial finance lending, specific impairment provisions will be raised against watch list or default loans where there is a reasonable expectation of an actual or potential loss. The distinction between a watch list classification and default classification is determined by Credit Committee based on the specific circumstances of a loan. The provision is determined by comparing outstanding loan balance against the stressed value of security.

Specific provisions for Hire Purchase and Leasing under Asset Finance are initially raised when a loan is over 2 months in arrears and is incrementally increased at each further month in arrears until it is fully provided at over 4 months in arrears. Asset values are initially attributed on a desktop basis and adjusted on inspection post recovery.

The following table shows the impairments for 2016:

	2016	2015
	£000	£000
Individual allowance for impairment		
Balance at 1 January	4	24
Charge for the year	2,244	63
Write offs	(363)	(83)
Balance at 31 December	1,885	4
Collective allowance for impairment		
Balance at 1 January	101	16
Charge for the year	362	85
Balance at 31 December	463	101

The Bank maintains a forbearance policy for the servicing and management of any customers entering into arrears across its lending products. As at 31 December 2016, 15 accounts amounting to £10.8m (2015: £nil) had forbearance arrangements in place.

3.3.4 SUMMARY CREDIT RISK EXPOSURE

The Bank uses the Standardised Approach in determining the level of capital necessary for regulatory purposes. Under the Standardised Approach the level of capital required against a given level of exposure to credit risk is calculated as:

Credit risk capital requirement = Exposure value x Risk weighting* x 8%.

* The risk weighting applied will vary depending on whether the asset is retail or wholesale. For retail assets, variables such as loan to value and security will impact the risk weighting. Wholesale assets are dependent on counterparty, duration and credit rating.

The table below shows the total exposure by regulatory exposure class as at 31 December 2016.

	Exposure Value	RWAs	Pillar 1 Capital
	£000	£000	£000
Exposure Category			
Loans and advances to zero risk weighted counterparties	128,831	0	0
Loans and advances to financial institutions (1)	9,088	2,181	174
Loans and advances to customers	463,988	422,717	33,818
Fixed and other assets	5,977	5,909	472
Total	**607,884**	**430,807**	**34,464**

(1) Includes £1,210k gross credit equivalent exposure for swaps counterparties and accrued interest receivable of £392k.

3.3.5 TREASURY COUNTERPARTY CREDIT RISK

Counterparty credit risk arises from wholesale placements made by the Bank's Treasury function. The Treasury function is responsible for managing this aspect of credit risk in line with Board approved risk appetite and counterparty credit policies. Wholesale counterparty limits are reviewed monthly by the ALCO based on counterparty credit ratings to ensure that limits remain within the defined Risk Appetite. Counterparty credit risk is analysed by its contractual maturity profile in the table below as at 31 December 2016 (based on Moody's long term ratings):

	Under 3 Months £000	3 Months to 1 Year £000	Total £000
Exposure Category			
A1 Rated UK Banks	6,772	612	7,384
A3 Rated UK Banks	102	0	102
Total	**6,874**	**612**	**7,486**

4. Liquidity Risk

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

In order to mitigate this risk firms are required to maintain sufficient liquidity resources to ensure that all liabilities can be met, as they become due.

The regulatory liquidity regime requires that a firm's liquidity resources contain an adequate 'buffer' of unencumbered High Quality Liquid Assets (HQLA) which can be utilised in a period of liquidity stress. This buffer of HQLA should, at least, meet net expected outflows over a 30-day stressed period. Holding sufficient liquid assets to match these outflows will result in a firm having a Liquidity Coverage Ratio that exceeds the regulatory minimum requirement of 100%. In addition, the Bank holds sufficient liquidity (HQLA and cash placed with other institutions), to survive a range of stress scenarios.

The liquidity risk management strategy of the Bank is documented via the Internal Liquidity Adequacy Assessment Process (ILAAP) which records and defines the Bank's approach to management of liquidity risk and compliance with the Overall Liquidity Adequacy Rule (OLAR). The Bank's Treasury function is responsible for the day to day management of the Bank's liquidity and funding. The Board has responsibility for setting and approving the liquidity risk management strategy and risk appetite; it then sets liquidity limits which reflect that risk appetite, ensuring that a robust liquid asset buffer is maintained under normal and stressed conditions.

4.1 LIQUIDITY RISK DRIVERS

This section provides an overview of the Bank's key liquidity risk drivers.

Deposit funding risk

The Bank has limits in place to ensure that it is not over-reliant on short term deposit funding and that the deposits are well diversified by products and withdrawal terms. Deposit amounts are managed on a tranche basis to limit concentration and re-pricing exposures. In addition, the Bank limits the proportion of the deposit base that can be used for lending purposes.

Intraday Liquidity Risk

Intra-day risk arises because, whist the Bank is not a direct participant in the payment system, it is a clearing customer of correspondent banks, which facilitate payments being made. The Bank currently has access to two banks' payment systems, both of which have been tested throughout the year. This is done to ensure the Bank can continue to operate without interruption in the event of failure of one of its systems.

Loan commitments

The Bank needs to maintain liquidity to cover outstanding loan offers. Although certain offers may not be legally binding, the failure to adhere to an expression of intent to finance a loan contract brings reputational risk, therefore liquidity is held for such offers.

Liquidity contingency plan

As a regulated firm, the Bank is required to maintain a Liquidity Contingency Plan ('LCP'). The Bank maintains preventative and curative contingency funding plans to manage in times of liquidity stress.

4.2 LIQUIDITY COVERAGE RATIO

The Liquidity Coverage Ratio ('LCR') aims to improve the resilience of banks to liquidity risks over a 30 day period. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets that can be converted easily and immediately into cash to meet their liquidity needs for a 30 calendar day liquidity stress scenario.

The LCR is calculated by dividing the level of the Bank's liquid assets by the total expected net cash outflows over the next 30 days in a stressed environment.

$$\text{LCR} = \frac{\text{Stock of High Quality Liquid Assets}}{\text{Net Outflows over a 30 day period}}$$

The detailed rules and definitions for the calculation of the LCR are set out in the European Commission Delegated Act, of 10th October 2014.

All banks within the European Economic Area were required to have a minimum LCR of 60% by 1st October 2015, although UK banks were required by the PRA to have a minimum LCR of 80% by this date, rising to 90% by 1st January 2017, then to 100% by 1st January 2018.

As at 31st December 2016 the Bank's Liquidity Coverage Ratio was 816%.

5. Operational Risk

The Bank has adopted the Basic Indicator Approach to operational risk, and thus will hold, as a minimum, capital against the risk equal to 15% of the projected three year average net operating income (net interest income plus fees and commissions). As at December 2016 this was £1.2m.

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. These could arise from information technology, information security, project outsourcing, tax, legal, fraud and compliance risks.

The first line of defence is responsible for the management of operational risk in accordance with stated policies, governance, agreed processes and controls. The second line of defence provides oversight and challenge supplemented by a programme of regular assurance testing. The third line of defence (via internal audit) provides an independent overview of key operational risk controls and frameworks via an agreed programme of audits.

The Bank has established an Operational Risk management framework, underpinned by clear policies which are geared to ensuring the Bank operates within a low risk appetite for operational risk failures. Monitoring and reporting of the overall risk profile is undertaken via a number of key operationally focused committees and second line functions ultimately reporting into Executive Committee and Board Risk Committee.

The Bank has placed additional emphasis on operational risk during the course of 2016:- via the recruitment of an experienced Chief Operating Officer; by separating IT core infrastructure and Change Management functions to allocate responsibilities more effectively; through further investment and training in dedicated operational risk management systems, principal of which is 'Magique' – a software application which captures and rates all relevant operational risks and controls across the Bank. Magique is the central repository for all loss incidents and near misses linked to operational risks. The tool is in roll out across the business and will further embed in business as usual processes over the course of 2017.

Strategy Risk and Regulatory Risk are treated as Level 2 risks within Operational Risk. In addition operational risk is assessed (inherent, residual and target) for its potential impact on:

- Customer Experience
- Brand and Reputation
- Financial
- Employee / Business Disruption
- Legal and Regulatory

6. Market Risk

Market risk is the risk that changes in market prices will affect the Bank's income or the value of its holdings of financial instruments. The Bank does not engage in any trading operations. The Bank's exposure to foreign currency risk is limited and overseen by ALCO on a monthly basis.

The Bank's Treasury function is responsible for managing the Bank's exposure to all aspects of market risk within the operational limits set out in the Bank's Treasury policies. BRC approves the Bank's Treasury policies and ALCO receives regular reports on all aspects of market risk exposure, including interest rate risk.

6.1 INTEREST RATE RISK

Interest rate risk is the potential adverse impact on the Bank's future cash flows from changes in interest rates and arises from the differing interest rate risk characteristics of the Bank's assets and liabilities. In particular, fixed rate products expose the Bank to the risk that a change in interest rates could cause either a reduction in interest income or an increase in interest expense relative to variable rate interest flows.

The Bank manages and controls interest rate risk through its hedging strategy. Interest rate exposure is overseen by ALCO on a monthly basis and it operates within pre-agreed limits.

Derivatives are only used to limit the extent to which the Bank will be affected by changes in interest rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Bank are interest rate swaps. The Bank's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.

6.2 BASIS RATE RISK

Basis rate 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 Bank of England Base Rate). This risk is monitored closely and regularly reported to ALCO.

6.3 INTEREST RATE SENSITIVITY

The Bank considers a 200 basis points movement to be appropriate for scenario testing given the current economic outlook and industry expectations. The change in equity as a result, based on the present value of future cash flows discounted using the London Interbank Offered Rate ("LIBOR"), would be as follows:

	2016 £000	2015 £000
+200 basis points	4,502	1,486
-200 basis points	(2,369)	(1,570)

6.4 REFINANCING RISK

This is the risk that the Bank may face higher cost of funds and margin compression when rolling over shorter term deposits that are matched against longer term assets. Management have analysed the impact on the Bank of a potential increase in cost of funds margins based on forecast lending and have concluded that any refinancing risk associated with not match funding longer dated assets will be borne and capital provided.

7. Other Key Risks

7.1 STRATEGIC RISK

Strategic risk is the risk to earnings or capital arising from changes to the business environment, from adverse business decisions, from improper implementation of business decisions, or from lack of responsiveness to changes in the business environment. Furthermore the risk that the Bank may need to raise additional capital due to changes in business cycles or deteriorating economic conditions, or highly competitive business conditions, is managed through the ICAAP. The Bank mitigates this risk by monitoring the market, pricing, lending parameters and exposure limits.

7.2 CONDUCT RISK

Conduct risk is the risk that the business strategy, the culture, and the manner in which the business is run, is not focussed on the customer. The Bank extends the definition of 'customer' to include both retail and SME commercial customers (but excludes intermediaries and other third parties) across all business segments, including both regulated and non-regulated activities, thereby applying its conduct risk policies to all lending and deposit-taking activities.

Customer detriment could affect the Bank's reputation, lead to loss of market share due to damage to the Bank's brand, may lead to customer redress payments and could lead to regulatory action and censure.

HTB mitigates conduct risk principally via staff training and awareness, ongoing education via the compliance function with support provided via monthly monitoring, reporting and escalation of relevant metrics (particularly customer complaints) through Executive management and ultimately to Board Risk Committee. Customer surveys are seen as a valuable source of conduct and wider performance information with the Bank intent on utilising such information increasingly in 2017 to supplement the above.

Each customer-facing area is responsible for implementing controls designed to manage and report on conduct risk, which includes understanding how customer detriment may occur, how it is identified and how it is prevented going forward.

7.3 REPUTATIONAL RISK

Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion. Management has considered how this might arise and what the impact could be. The consequences would adversely impact the future prospects of the Bank and could expose the Bank to litigation and financial loss.

Reputational risk is inherent across the Bank. Senior Management manages this risk in the following ways:

- Management of the Bank's reputation through marketing and external communications;
- By ensuring compliance with all regulatory requirements; and
- Through the risk management framework which has reputational risk as a key consideration.

7.4 FINANCIAL CRIME AND SANCTIONS RISK

Financial Crime and Sanctions risk is the risk that the Bank knowingly or unknowingly leaves itself exposed to the risk of being abused by those seeking to utilise the financial system to obtain or launder funds through illegal means and / or for illegal purposes.

Financial Crime risk sits within Operational Risk and therefore the first line of defence is responsible for the management of financial crime risk in accordance with stated policies, with the second line providing oversight and challenge. The Money Laundering Reporting Officer is responsible for oversight of the Bank's compliance with Anti-Money Laundering (AML) obligations and acts as the focal point for the Bank's AML activities.

HTB has implemented a number of critical operational controls such as a dedicated customer and company screening solution, a register of all Politically Exposed Persons and a refined training programme. The Bank is committed to enhancing controls by completing an enterprise-wide financial crime risk assessment to allow resources to be focused on the areas of highest financial crime risk.

8. Capital Adequacy

At 31 December 2016 and throughout the financial year, the Bank complied with the capital requirements that were in force as set out by European and UK legislation, and enforced by the PRA.

8.1 CAPITAL RESOURCES

The Bank's capital resources as at 31 December 2016 are broken down as follows:

	2016	2015
	£000	£000
Common Equity Tier 1 (CET1)		
Share Capital	78,288	58,288
Share Premium	196	196
Retained Earnings	(4,412)	(6,908)
	74,072	51,576
Regulatory adjustments to CET1:		
Intangible Assets	(1,845)	(1,376)
Total Common Equity Tier 1 (CET1) capital	**72,227**	**49,106**
Tier 2		
Collective impairment allowance	463	101
Total regulatory capital	**72,690**	**49,207**

8.2 LEVERAGE RATIO

The leverage ratio, introduced by CRD IV, is a non-risk based measure that is designed to act as a supplement to risk based capital requirements. The ratio measures the relationship between the capital resources of the organisation and its total assets. The purpose of monitoring and managing this metric is to enable regulators to constrain the build-up of excessive leverage.

The Bank's leverage ratio at 31 December 2016 was 11%.

9. Capital Risk and Management

The Board is ultimately responsible for capital management. The Board and Executive Committee monitor the capital position of the Bank on a monthly basis. The ICAAP is central to the capital management framework and is used to inform the Board of the ongoing assessment and quantification of the Bank's risks, how the Bank mitigates those risks and capital adequacy of the Bank.

The ICAAP is embedded in the risk management framework for the Bank and is subject to ongoing updates and revisions when necessary. However, at a minimum, the ICAAP is updated annually as part of the business planning process. The ICAAP is a process that brings together the management framework (i.e. the policies, procedures, strategies and systems that the Bank has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar I plus" approach to determine the level of capital the Bank needs to hold. This method takes the Pillar I capital formula calculations (standardised approach for credit, market and operational risk) as a starting point, and then considers whether each of the calculations deliver a sufficient capital sum adequate to cover management's anticipated risks. Where the Board considered that the Pillar I calculations did not reflect the risk, an additional capital add-on in Pillar II is applied, as per the Individual Capital Guidance ('ICG') issued by the PRA.

At all times the Bank's capital position must be aligned with the capital adequacy limits approved by the Board in the risk appetite statement, which is to maintain a robust capital and liquidity management under "normal" and "stressed" conditions. With regard to capital management this means:

- Maintaining a level of capital equal to the minimum that is set by the PRA in the ICG.
- All capital mainly comprises Core tier 1 capital. Any change to this policy must be agreed by the Board.

Throughout the year the Bank has complied with ICG requirements.

The Bank's Pillar 1 capital resources requirement is calculated by adding the capital resources requirements for credit risk, and operational risk.

The following table shows the Bank's capital resources requirement and capital resources surplus under Pillar 1 as at 31 December 2016.

	2016 £000	2015 £000
Capital resources requirement – Pillar 1		
Credit risk	34,464	12,596
Operational risk	1,189	1,189
Capital resources Pillar 1 requirement	35,653	13,785
Capital resources (see table in 8.1)	72,227	49,106
Capital resources surplus over Pillar 1 requirement	**36,574**	35,321

10. Remuneration

This remuneration disclosure is a requirement under Article 450 of the CRR.

"Remuneration policies and practices for categories of staff whose professional activities have a material impact on the company's risk profile (Material Risk Takers ("MRTs")). MRTs include staff who hold Significant Management Functions ("SFs") as designated by the regulatory authorities."

10.1 DECISION MAKING PROCESS

The Nomination and Remuneration Committee (the 'Nom/RemCo'), on an annual basis, formally review and (where applicable) update the Bank's Remuneration Policy and submit this to the Board for approval. Nom/RemCo also has oversight of the remuneration of the senior management team.

The Bank maintains a record of staff whose activities have a material impact on the Bank's risk profile and takes reasonable steps to ensure they understand the implications of the code.

The Nom/RemCo recognises the need to be competitive within the UK banking market, however the Nom/RemCo's policy is to set remuneration levels which are aligned within the overall Bank stated risk appetite. We ensure that the executive directors, senior management and employees are fairly and responsibly rewarded in return for high levels of individual and business performance within an appropriate risk management framework.

10.2 REMUNERATION STRUCTURE

Fixed Pay

Employees are paid fixed base salaries, and benefits such as holiday allowance, pension scheme, life assurance, private medical insurance, permanent health insurance and may access staff loans. These elements are set at a level so as to ensure that there is not an excessive dependence on variable remuneration.

Annual bonus

The annual cash bonus is performance based and designed to drive and reward medium term results. It considers financial results and non-financial metrics at Bank and individual level. Nomco/Remco approves the bonus amount, and any proposed payment.

Long term incentive plans ("LTIP")

Some senior staff from time to time may be offered "B" Shares on the Bank's parent company, Hoggant Ltd. These are issued at par and granted over a vesting period of five years.

10.3 LINK BETWEEN PAY AND PERFORMANCE

Nomco/Remco has approved remuneration principles which support a clear link between pay and performance. The principles include:

- striking an appropriate balance between risk taking and reward;
- rewarding the achievement of the overall business objectives and values of the Bank;
- encouraging and supporting the Bank's culture of excellent customer service; and
- guarding against risk taking over and above the Bank's risk appetite.

10.4 REMUNERATION STATISTICS

In relation to 2016 the Bank paid the following remuneration:-

	£000
Total value of remuneration awards for the current fiscal year	
Fixed remuneration	8,547
Variable remuneration	1,725
Total remuneration	**10,272**

	Number	Amount £000
Senior management whose actions have a material impact on the risk profile of the Bank (during 2016, including Non-Executive Directors)	24	
Salaries		2,822
Pensions		139
Social security costs		279
Cash variable remuneration		761
Variable remuneration in the form of "B" shares		422
Total remuneration		**4,423**

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