

Pillar 3 capital disclosures 2017

Lending for Entrepreneurs, by Entrepreneurs

OakNorth Bank Limited
Registered number: 08595042



OakNorth

Pillar 3 Capital disclosures

For the year ended 31 December 2017

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1 Overview, scope, basis and frequency of disclosures and location

1.1 Overview and scope

OakNorth Bank Limited (herein referred to as “OakNorth”) is a UK registered bank that is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA. OakNorth is focused on servicing entrepreneurs and growth Small and Medium Sized Enterprises (“SMEs”). The strategy includes offering a wide range of loan products to assist UK SMEs in financing their future growth while offering attractive savings products to retail and SME customers.

These disclosures were prepared for the stand-alone entity OakNorth Bank Limited (PRA/FCA reference number 629564).

1.2 Basis

This Pillar 3 report is based upon OakNorth’s Financial Statements for the year ended 31 December 2017. These were prepared in accordance with the requirements of the Capital Requirements Directive and Regulation (CRD IV) which came into force on 1 January 2014.

OakNorth has adopted FRS102 (Financial Reporting Standard applicable in the UK) for preparing its financial statements. OakNorth recognises and measures the financial instruments in accordance with the provisions of IAS39, based on the accounting policy choice permitted under FRS102. In December 2017, the Financial Reporting Council issued amendment¹ to FRS 102 which allowed the accounting policy choice of adopting IFRS 9 effective 01 January 2018 or retaining IAS39 until FRS 102 requirements for the impairment of financial assets have been amended to reflect IFRS 9. OakNorth has currently made an accounting policy choice to continue to apply provisions of IAS39 available under FRS 102.

The report contains information presented for the year ended 31 December 2017, with comparatives for 31 December 2016.

OakNorth uses the Standardised Approach for computing capital requirements for credit risk and market risk and the Basic Indicator Approach for operational risk. The disclosures in this document are based on these approaches.

1.3 Frequency of disclosures

Pillar 3 disclosures are published annually, concurrently with the Annual Report and Accounts in accordance with regulatory guidelines.

1.4 Verification

These disclosures were subject to internal verification and approved by OakNorth’s Board Audit Committee. These disclosures have not been externally audited and do not constitute any part of OakNorth’s financial statements.

¹ Financial Reporting Council: Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland: Triennial review 2017 Incremental improvements and clarifications (December 2017)

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1.5 Location

The Pillar 3 disclosures are available to be provided on request as explained on OakNorth's corporate website (www.oaknorth.com). OakNorth's Annual report and Financial Statements for the year ended 31 December 2017 may be obtained from the UK Companies House website².

2 Risk management framework and policies

2.1 Overview

OakNorth has a comprehensive RMF to ensure that the key risks facing OakNorth are identified, measured, monitored and managed and that appropriate policies, procedures and controls are established such that each risk is mitigated to an acceptable degree.

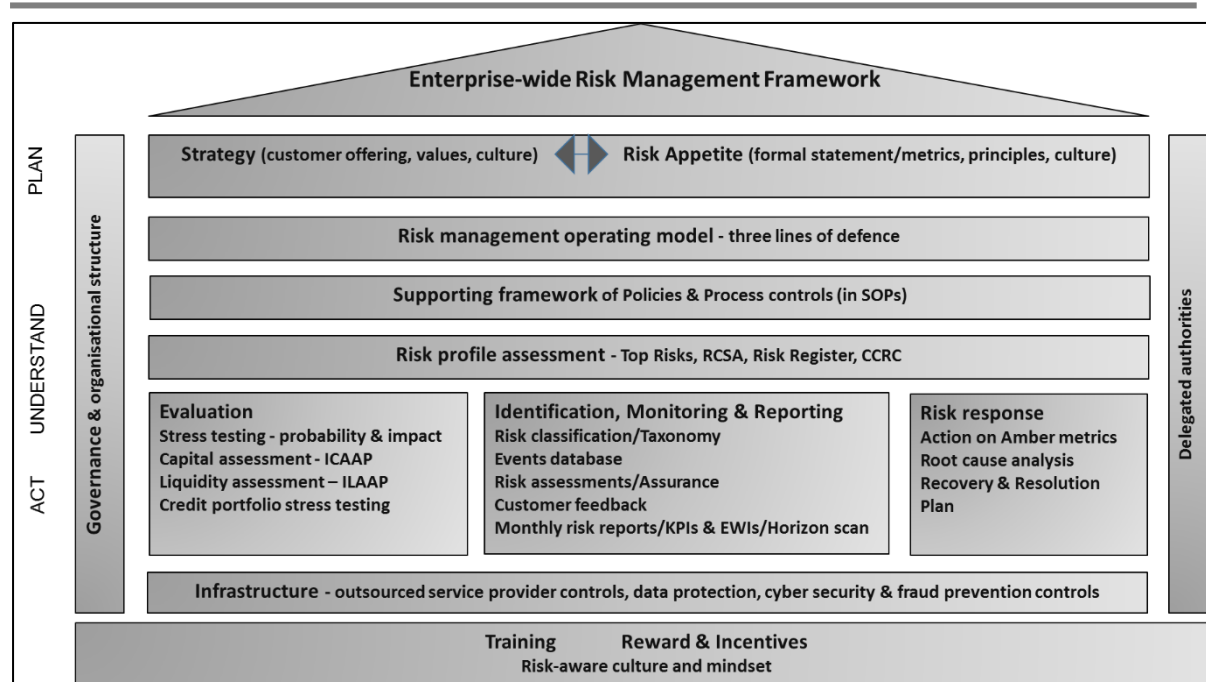
The primary goal of risk management is to ensure that the outcome of risk-taking activity is consistent with OakNorth's strategies and risk appetite, and that OakNorth delivers good outcomes for all stakeholders from its products, whilst achieving an appropriate balance between risk and reward to drive long-term sustainability.

OakNorth's enterprise-wide Risk Management Framework (RMF) is agreed by the Board and provides the foundation for achieving these goals. It is set in compliance with relevant legal and regulatory frameworks including SYSC, CRD IV, MCOB, and codes of conduct such as COCON, the Combined Code on Corporate Governance, and the Lending Code. This framework is subject to constant re-evaluation to ensure that it meets the challenges and requirements of the market in which OakNorth operates, including regulatory standards, industry best practices and emerging issues.

² <https://www.gov.uk/government/organisations/companies-house>

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SOP- Standard Operating Procedures, RCSA- Risk Control Self Assessment, CCRC-Controls and Compliance Review and Certification, ICAAP- Internal Capital Adequacy Assessment Process, ILAAP- Internal Liquidity Adequacy Assessment Process, KPIs- Key Performance Indicators, EWIs- Early Warning Indicators

The Board retains overall accountability for approving the RMF and the Business Strategy, understanding major risks, and ensuring that appropriate limits are set against those risks and that they are adequately controlled and monitored. Through delegated authority from the Board, the Board Risk and Compliance Committee, Board Audit Committee, and the Board Credit Committee provide overall supervision and assurance of the RMF. The Chief Financial Officer, Chief Risk Officer, Head of Credit Risk and Head of Internal Audit all have reporting lines to Board committees, which provide oversight and support to the role holders.

2.2 Principal risks

Given the nature of the activities undertaken, the principal risks that OakNorth faces are business risk, credit risk, capital risk, liquidity risk, interest rate risk, operational risk (including IT systems risk) and conduct, compliance and regulatory risks.

- Business risk: the risks which can affect OakNorth's ability to achieve its strategic objectives. OakNorth's Board defines and reviews the strategy and business plan annually and the performance metrics vs the business plan monthly. The annual strategic review includes (but is not limited to) an analysis of OakNorth's economic and competitive landscape and an assessment of key risks (as detailed below)- which may impact OakNorth's growth and business performance.
- Credit risk: risk of financial loss arising from a borrower or counterparty failing to meet their contractual financial obligations when they are due, to OakNorth.

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- Capital risk: risk that OakNorth has insufficient capital to meet its regulatory requirements and growth objectives.
- Liquidity risk: risk that OakNorth is unable to meet its contractual financial obligations as they fall due and is unable to fund future lending growth opportunities or is able to do so only at significantly higher funding costs.
- Interest rate risk: risk of financial loss arising from re-pricing mismatches in the assets and liabilities positions which have not been hedged.
- Operational risk (including IT risk): risk of direct or indirect impacts resulting from human factors, inadequate or failed internal processes and systems, or external events. This covers a number of areas including:
 - risk of financial loss or loss of reputation due to inadequate internal controls;
 - loss due to internal or external fraud;
 - failure of IT systems causing loss or reduction of service to customers;
 - cyber-attack; and
 - key person reliance.
- Conduct, compliance and regulatory risks: Conduct Risk is defined as the risk that a firm's behaviour results in poor outcomes for customers. Compliance risk is defined as the risk of impairment to the firm's business model, reputation and/or financial condition resulting from failure to meet laws, regulations, standards and policies, and expectations of regulators and society as a whole. For OakNorth, this includes compliance with FCA Handbook and PRA Rulebook, as well as financial crime laws and regulations including those relating to Anti-Money Laundering and Anti-Bribery and Corruption and Anti-Facilitation of Tax Evasion. Regulatory risk is defined as the risk of regulatory sanction, financial loss, or loss to reputation a bank may suffer as a result of failure to comply with all laws and regulations, and the expectations of regulators.
- Reputational risk: Reputation risk is a direct consequence of failing to control adequately all risks facing the organisation impacting on revenue streams, brand value, customer perception and staff motivation.

2.3 Components of the Risk Management Framework

Fundamental to the RMF is defining OakNorth's Risk Appetite- the level of risk that OakNorth is prepared to accept whilst pursuing its business strategy. This is set at the same time as the business strategy and customer offering are developed, and sits alongside the strategy at the top of the logical structure of the RMF. The framework is structured so that its elements support each other.

The components of the framework are as follows:

- Strategy – sets OakNorth's goals over the planning horizon and the methods to achieve them. Includes OakNorth's Values, and describes the target markets, product offering, and customer journey. The strategy is reviewed at least annually.

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- Risk Appetite – sets the quantum of risk OakNorth is willing to accept to achieve its strategic business objectives, with tangible risk metrics in place to identify when action is required. The Risk Appetite is reviewed at least annually.
- Governance – defines the system by which OakNorth is directed, controlled and held accountable
- Delegated authorities – defines the authority delegated by the Board and for which individuals are held accountable
- Risk Management operating model – enables each individual to understand their role in managing risk, set out according to ‘three lines of defence’ principles
- Policies – principles-based policies to address the material risks in a consistent and efficient manner
- Controls – proportionate actions taken by management to mitigate the risks to within OakNorth’s risk appetite
- Risk profile assessment and evaluation – OakNorth uses a number of tools to assess its risk exposure both at a point in time, and how it is expected to evolve in the future
- Identification, monitoring and reporting – the processes needed to provide timely, accurate information to enable management to take high quality decisions
- Risk response – the levers which can be used to manage and mitigate risk, including adding capital or changing risk policy parameters
- Infrastructure – the risk mitigants built into our IT infrastructure, such as the level of resilience provided by our Cloud-based IT platform design
- Training, reward – providing training in risk management, compliance and good conduct, and setting reward and arrangements which incentivise the right behaviours. Ensuring that reward arrangements take account of risk performance

2.4 Risk Appetite

The Board has set a risk appetite based on OakNorth’s strategic risk objectives. It is cascaded top-down, deriving logically from OakNorth’s high-level risk objectives to the low level measures or limits used in day-to-day decision-making by the team, and is defined and measurable. The Board has responsibility for approval, implementation and monitoring of the Risk Appetite.

The strategic objectives which the risk appetite for OakNorth is based on is articulated as follows:

| Risk Category | Strategic Risk Objectives description | Key risk appetite metrics |
|--|---|--|
| Financial (including Capital, Liquidity, | Ensure that OakNorth has sufficient capital, with appropriate buffers, to meet regulatory requirements for its on-going growth projections, even in periods of stress (when new equity may be unavailable). | Capital adequacy buffer, capital resources in place for specified number of days forecast needs, capital ratios tested under stress testing scenarios. |

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| | | |
|-------------------------|---|---|
| Interest rate risk) | <p>Ensure that OakNorth has sufficient funding and liquidity to meet all obligations as they fall due, even in periods of stress.</p> <p>Ensure that OakNorth does not carry any adverse interest rate risk positions.</p> | <p>Total liquidity pool, daily cash balance, funding concentration, liquidity ratios (including LCR and NSFR), liquidity survival period under stress testing.</p> <p>Net Present Value (NPV) calculations, including impact of reference rate floors in loan contracts, under +/- 200 bps parallel shift in the yield curves; Basis Risk assessment.</p> |
| Credit | <p>Build stable earnings and sufficient volume to achieve profitability, at an appropriate risk/reward balance whilst avoiding risk concentrations.</p> | <p>Portfolio maximum probability of default, loss given default; sectoral and single name concentration; Watchlist cases, past due cases, exceptions to credit policy</p> |
| Regulatory & Compliance | <p>Maintain compliance and keep the confidence of our Regulators</p> <p>Be proactive, transparent and forward-looking in understanding, adhering to, and applying regulatory requirements in full. Staff are educated and aware of their personal obligations at all times ensuring any breaches of regulatory or legal requirements are minimised with zero tolerance for any material breaches of any nature.</p> | <p>Material findings reported through compliance assurance tests / internal audit reviews, monitoring of remedial action plans; satisfactory assurance checks on customer due diligence; mandatory staff training; monitoring and reporting of policy exceptions and compliance breaches.</p> |
| Conduct | <p>Maintain integrity and keep the confidence of our customers.</p> <p>Focus on delivery of great outcomes for our customers, meeting their needs and expectations through providing suitable products and a high-quality service.</p> | <p>OakNorth has from the outset established a culture of integrity and openness, delivering good outcomes for customers. This is based on a strong set of company Values which include "Right Ambition", "Say it how it is", and sound Conduct principles. The senior management team works constantly to re-enforce this culture, and we monitor outcomes in various ways including-customer satisfaction scores and surveys for products and marketing material; complaints as % of number of customers; customer net promoter score.</p> |
| Operational | <p>Proactively manage all OakNorth's operational risks to achieve a low level of operational loss.</p> | <p>Operational risk events, fraud attempts, cybercrime event, data protection loss "near miss events", loss of key staff; Satisfactory self-assurance reviews; third-party service provider service level agreement violations; System availability and capacity utilisation.</p> |
| Reputational | <p>Protect OakNorth's reputation through effective systems and controls and high levels of customer service.</p> | <p>Events likely to cause reputational impact with key stakeholders including (but not limited to) customers, regulators, service providers; actual or high likelihood of adverse coverage of OakNorth in the media.</p> |

A number of detailed policies and frameworks, including stress testing framework, approved by the Board and Board committees detail the governance frameworks ensuring that OakNorth's activities are consistent with the risk appetite approved by the Board. These policies cover all areas including (but

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not limited to): Operational risk, Conduct and Customer Experience, Financial Crime, Fraud and Anti-Money Laundering (AML), Compliance Manual, Code of Conduct, Credit Risk Management, Market Risk Management (including liquidity and interest rate risk management), Business Continuity Planning and Stress testing.

A review of the adequacy and effectiveness of the overall risk management framework and compliance management is made annually, in accordance with the Control and Compliance Review and Certification process. The Risk function, as second line of defence, is responsible for providing assurance that those controls are implemented, are being operated satisfactorily, and that risk and control registers are comprehensive. Internal Audit, as third line of defence, conducts reviews in line with the internal audit plan to test the effectiveness of the operational risk framework, including first line controls and the quality of the second line oversight.

2.5 Control framework

The control framework for each principal risk is summarised below:

| Principal risks | Business risk | Credit risk | Capital risk | Liquidity risk | Interest rate risk | Operational risk | Conduct, compliance and regulatory risk |
|------------------------------|--|---|--|---|--|---|--|
| Control documents | Strategic business plan | Credit risk management policy Lending policy Risk Appetite statements | Strategic business plan ICAAP Risk Appetite statements | Strategic business plan ILAAP Funding policy Market Risk Management Policy Risk Appetite statements | Market risk management policy ILAAP Risk Appetite statements | Operational risk policy New Product Approval policy Outsourcing policy IT Security policy Risk register Risk Appetite statements | Conduct & customer experience policy Compliance Manual Financial Crime, Fraud & AML policy Risk Appetite statements |
| Risk reporting | EXCO Reporting on performance vs plan and vs Risk Appetite | Credit and Monitoring pack reporting to the BCC | EXCO & ALCO reporting | EXCO & ALCO reporting | EXCO & ALCO reporting | OPCO & EXCO Operational risk reporting | EXCO reporting |
| Stress testing | ICAAP | ICAAP | ICAAP | ILAAP | ICAAP | ICAAP BCP testing | ICAAP |
| Monitoring committees | EXCO | CRMC | ALCO EXCO | ALCO EXCO | ALCO EXCO | OPCO EXCO | EXCO CRMC |
| Oversight | Board and Board Committees (Risk & Compliance, Credit, Audit, Remuneration and Nomination) and independent assurance by the Internal Audit function | | | | | | |

ALCO: Asset and Liability Committee; EXCO: Executive Committee, OPCO: Operations Committee, CRMC: Credit Risk Management Committee, ICAAP: Internal Capital Adequacy Assessment Process, ILAAP: Individual Liquidity Adequacy Assessment Process; AML: Anti Money Laundering

The reporting and oversight process is designed to ensure the Board Committees are informed and aware of the principal risks and that there are appropriate controls in place for the management of these risks. Reports are produced on each principal risk and the frequency is set according to what is appropriate for the risk type.

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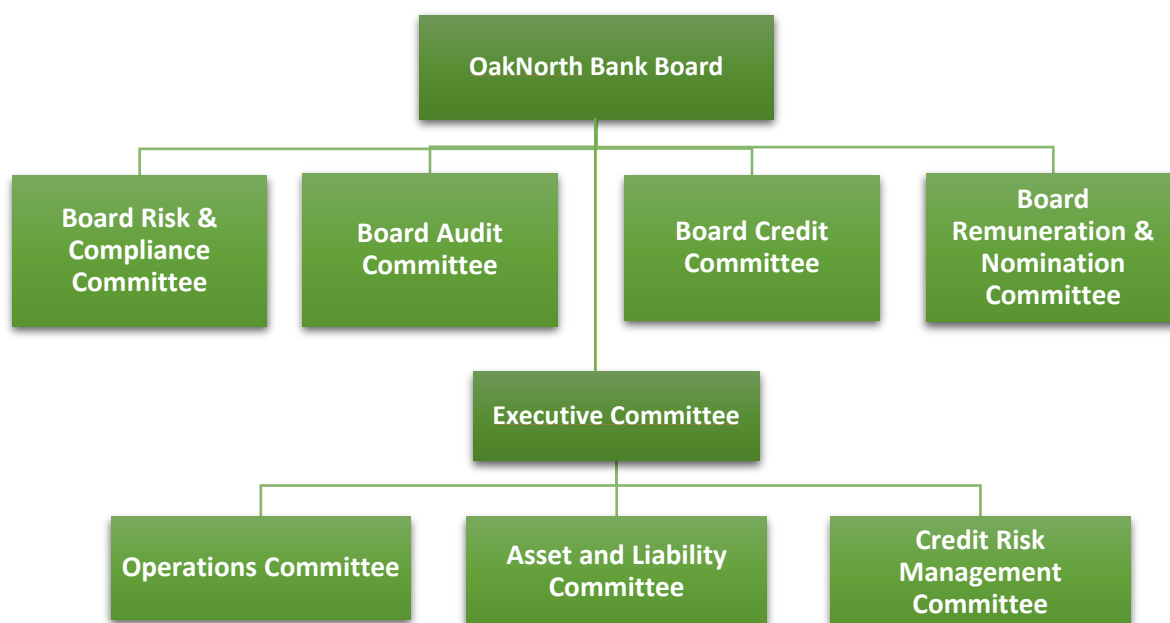
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For each of the Board Committees, the Chair provides an update to the Board with the issues arising from the previous meeting, citing any areas of specific concern and any follow-up actions.

2.6 Risk oversight, monitoring and reporting structure

2.6.1 Committee structure

OakNorth's committee structure is outlined below.



The table below summarised the responsibilities of the various committees:

| Committees | Responsibility |
|------------|---|
| Board | The Board's principal duty is to create and deliver a sustainable business model by setting OakNorth Bank's strategy and overseeing its implementation. It does so with regards to the interests of customers, employees, the environment, communities and suppliers. It seeks to achieve a balance between promoting long term objectives and short term goals, and sets the culture of OakNorth, ensuring that it is focussed on delivering good customer outcomes. It is responsible for maintaining a system of internal control and ensuring that management maintain an effective Risk Management Framework with appropriate oversight processes and for embedding the principle of safety and soundness in the culture of the whole organisation, including whistleblowing. The Board maintains oversight over the effectiveness of each Board Committee through the receipt, review and challenge of regular updates, minutes and management information from each. |

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| | |
|---|---|
| Remuneration & Nomination Committee (REMCO) | The Board Remuneration & Nomination Committee (REMCO) is responsible for ensuring that remuneration arrangements support the strategic aims of OakNorth, comply with best practice and enable the recruitment, motivation and retention of senior executives. The Board Remuneration & Nomination Committee (REMCO) is also responsible for the regular review and approval of OakNorth's succession plan, including the review of role and responsibilities under SM&CR. The plan outlines the "what if" scenario and corresponding actions relating to the departure of each management team member. The Committee reviews succession planning bearing in mind diversity and gender composition. The Committee further ensures compliance with the requirements of regulation (Remuneration Code SYSC 19D) and sees its principles are put in place to expressly discourage any and all inappropriate behaviours. The Committee has delegated authority from the Board for the review and approval of the Remuneration Policy and is responsible for setting remuneration for all executive directors, Non Executive Directors (NEDs), the Chairman and key individuals, including employees captured under the scope of the Certification Regime, including pension rights and any fixed and variable compensation payments. The Committee also recommends and monitors the level and structure of remuneration for senior management. |
| Board Risk & Compliance Committee (BRCC) | The BRCC takes delegated authority from the Board to oversee the Risk Management Framework of OakNorth, with an overall view across the 1 st and 2 nd lines of defence. The Committee ensures that through its control processes and through further delegation of responsibility to the EXCO, all risks (excluding Credit Risk) taken by OakNorth Bank are properly identified, evaluated, mitigated, reported, managed and challenged. This includes fraud and money laundering risk, anti-bribery risk, compliance risk, conduct risk and risk of facilitation of tax evasion. The Committee oversees the Compliance function and approves the annual Compliance Monitoring Plan. |
| Board Audit Committee (BAC) | The Board Audit Committee takes delegated authority from the Board for the review and approval of the Internal Audit Charter and Methodology, the Accounting Policy with a view across the 2 nd and 3 rd lines of defence, and for ensuring that OakNorth Bank values and principles are being adhered to. It monitors the integrity of financial statements and public disclosures; appoints the external auditors and their remuneration; reviews the effectiveness of the internal audit function, and appoints and removes the Head of Internal Audit. |
| Board Credit Committee (BCC) | The Board Credit Committee takes delegated authority from the Board to oversee all Credit Risk related matters for OakNorth and approves all material credit exposures, impairments and write-offs. The Board Credit Committee receives reports from the Credit Risk Management Committee concerning individual credit exposures and the portfolio as a whole, including model performance. The Committee reviews the Watchlist and receives reports concerning the progress on any material recoveries. |
| Executive Committee (EXCO) | The EXCO takes delegated authority from the Board and is responsible for developing OakNorth's strategy and ensuring OakNorth delivers its financial plan and that the agreed strategy is executed across all dimensions. Additionally, the EXCO has responsibility for the Risk Management Framework of OakNorth and for management of all risks and reports its output to the Board. The EXCO is also responsible for the review and approval of policies listed in the EXCO Terms of Reference. |

| Management Committees subsidiary to EXCO | Responsibility |
|--|---|
| Asset & Liability Committee (ALCO) | The Asset & Liability Committee (ALCO) meets monthly to review capital, liquidity and interest rate risk appetite metrics. Additionally, weekly and daily meetings are held as required. It implements OakNorth's Funding Policy & Market risk management |

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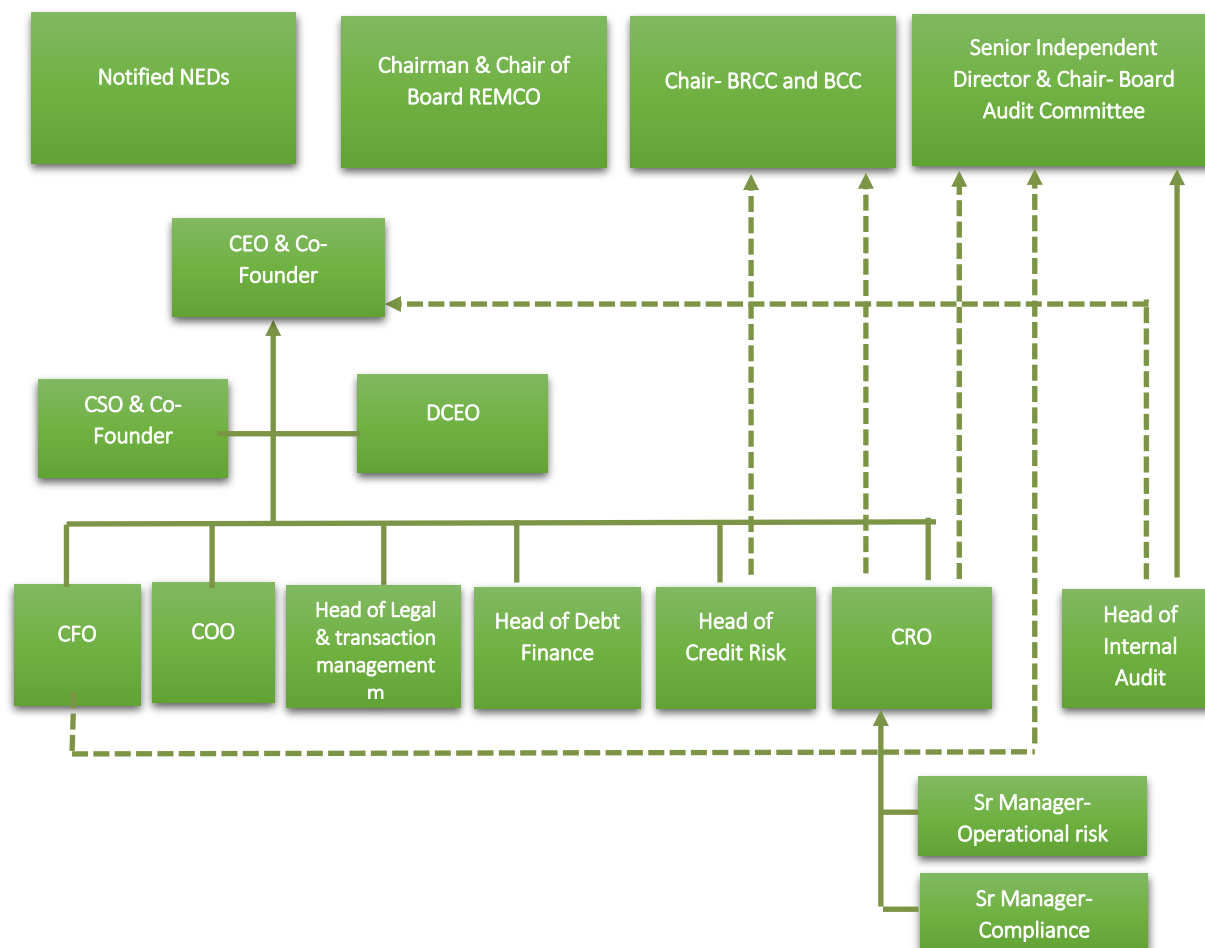
| | |
|---|---|
| | policy, with a focus on active management of liquidity. The ALM activities include specific policies and procedures relating to Liquidity and Funding Risk, Capital Risk, Interest Rate Risk, Credit Risk of counterparties, and Market/Investment Risk. It also monitors regulatory reporting. |
| Credit Risk Management Committee (CRMC) | Operating under mandate from the Board Credit Committee, the purpose of the Credit Risk Management Committee (CRMC) is to oversee, monitor and control credit risk on a day to day basis, and to approve facilities under a delegated authority. It ensures that the RMF is implemented as it relates to Credit Risk and that all credit control processes are fit for purpose and operative so that credit risk is mitigated via: Identification; Evaluation; Mitigation; Reporting; Management and Challenge. |
| Operations Committee (OPCO) | OPCO's main objective is to review the performance of all business operations, business continuity and reach an agreement on actions to address any issues identified. The Committee leads the design and review of Standard Operating Procedures (SOPs) and manages change. The Committee reviews, in depth, any operational issues impacting Product, Operations, IT and Change Management, Finance, Risk, Compliance and People Operations. The Committee's main objective is to promote efficiency, address operational issues in a timely manner, and manage Operational Risk across OakNorth. |

The Board meets once every month, with in person meetings every other month. The Board maintains oversight of the effectiveness of each Board Committee through the receipt, review and challenge of regular standing reports, ad-hoc briefings, minutes and management information from each and will undertake a formal review annually of its own effectiveness, that of its Committees and individual directors.

During 2017, the Board Audit Committee and the Board Risk and Compliance Committee met 7 times.

The Head of Internal Audit is a standing invitee at all committee meetings, and other individuals may be invited to attend all or part of any meeting as and when appropriate and necessary at the invitation of the Committee Chairman.

2.6.2 Reporting structure



The Chief Risk Officer (CRO) reports to the Board in respect of oversight and challenge for the entire RMF, with the exception of credit risk, which is the responsibility of the Head of Credit Risk. The CRO maintains oversight of the reporting of OakNorth’s risk management and performance against the risk appetite statements, and inputs to credit risk decisions as Member (and as alternate Chair) of the Credit Risk Management Committee. Risk reports are provided to the EXCO and Board Risk Committee.

The CRO is also responsible for the direct oversight of the Operational risk and Conduct, Regulatory and Compliance risk management and reporting. Capital, liquidity and interest rate risk is managed by the CFO under report to the ALCO and through to the EXCO and the Board. Business risk is managed collectively by the EXCO and the Board. Credit Risk management and reporting is overseen by the Head of Credit Risk, reporting to the Credit Risk Management Committee and the Board Credit Committee.

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2.7 Additional information on Governance arrangements**2.7.1 Directorships held by members of the Board**

The number of external directorships held by the Executive and Non-Executive Directors who served on the Board as at 31 December 2017 in addition to their roles within OakNorth are:

| Name of Director | Position | Directorships* |
|---------------------|--|----------------|
| Cyrus Ardalan | Chairman | 3 ¹ |
| Navtej S Nandra | Senior Independent Director | 1 |
| Robert Burgess | Independent Non-Executive Director | 4 ² |
| Rishi Khosla | Executive Director Chief Executive Officer and Co-Founder | 2 |
| Joel Perlman | Executive Director Chief Strategy Officer and Co-Founder | 4 |
| Graham Olive | Executive Director Deputy Chief Executive Officer | 1 |
| Cristina Alba Ochoa | Executive Director Chief Financial Officer | - |
| Edward Barry Berk | Notified Non-Executive Director | 2 ³ |
| Gagan Banga | Notified Non-Executive Director | 3 |
| Ajit Kumar Mittal | Notified Non-Executive Director | 2 |

*Note that in line with CRD Article 91(4), one type of directorship for multiple entities within a group is counted as one directorship. The above includes directorships in non-commercial organisations in accordance with the EBA guidelines EBA/GL/2016/11 published in August 2017.

¹ Includes directorship in one non-commercial organisation, ² Includes directorship in one non-commercial organisation, ³ Includes directorship in one non-commercial organisation.

As per the Terms of Reference of the Board, no Board member may hold simultaneously more than either

- 1 x Executive Director and 2 x Non-Executive Director Roles or
- 4 x Non- Executive Director Roles, unless otherwise agreed.

2.7.2 Board recruitment

The Board of Directors has the authority to select and appoint Board members as well as define and approve the Board structure following recommendations from the relevant Board Committees.

The Board Remuneration and Nomination Committee is chaired by the PRA-approved SMF12 holder, currently the Board Chairman. Its membership consists of Non-Executive Directors only, including the Chairman of the Board Risk and Compliance Committee and the Chairman of the Board Audit Committee. It takes delegated authority from the Board of Directors to determine the policy and

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approval process for the Executive Directors and other senior management taking-up external non-executive appointments. It also leads the Board review and approval of the conditions and terms of service agreements of the Executive Directors and, in conjunction with the Non-Executive Directors, the terms of appointment of the Chairman.

The Board reviews annually, following recommendations from the Remuneration and Nomination Committee, the appropriate skills, characteristics and experience required of the Board as a whole and from its individual members. The objective is to have a Board comprising of members with extensive banking experience, and additionally diverse background experience in such areas as business, government, academics and technology.

In evaluating the suitability of individual Board members, the Board, following recommendations from the Board Remuneration and Nomination Committee, takes into account many factors, including a general understanding of OakNorth's business dynamics, social perspective, educational and professional background and personal achievements. Directors must possess experience at policy-making and operational levels in banks or financial institutions that will indicate their ability to make meaningful contributions to the Board's discussion and decision-making in the array of complex issues facing OakNorth. Directors should possess the highest personal and professional ethics, integrity and values. The Committee evaluates each individual with the objective of having a group that best enables the success of OakNorth.

Both the Board and the Board Remuneration and Nomination Committee have the responsibility for identifying suitable candidates in the event of a vacancy being created on the Board on account of retirement, resignation or demise of an existing Board member. Based on recommendations from the Board Remuneration and Nomination Committee, the Board evaluates the candidate(s) and selects the appropriate member.

2.7.3 Board remuneration

The Board Remuneration and Nomination Committee, which comprises exclusively of Non-Executive Directors, has delegated authority from the Board to recommend and review the remuneration of Directors. All Remuneration is set in line with the Remuneration Code (SYSC 19D, as relevant to proportionality level 3 firms). The independent Non-Executive Directors are entitled to yearly fees for attending Board or Committee meetings at the rate that may be agreed upon between the Shareholders and the Board of Directors from time to time. Changes in Board compensation, if any, arise out of the recommendation of the Board Remuneration and Nomination Committee with necessary approvals by the Board, shareholders and PRA and FCA as appropriate.

2.7.4 Board diversity

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OakNorth has a diversity policy approved by the Board of Directors in December 2017. This is available on OakNorth's website. Through the policy OakNorth asserts its commitment to increase diversity at all levels and to provide equal opportunities throughout employment; including in the recruitment, training and promotion of employees. OakNorth is passionate about eliminating discrimination in the workplace, whether on grounds of age, disability, gender or gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex or sexual orientation (the "Protected Characteristics"). All job applicants and employees are treated fairly and assessed solely on merit. The aim of OakNorth is to have a balanced age distribution and no age limit on any career opportunities with gender diversity as a key focus area. A further objective of OakNorth is to attract job, promotion, and training applications from the best possible candidates, regardless of any Protected Characteristics. Company procedures and policies are based on this objective. This commitment applies equally to members of the Board of Directors. All Board of Director appointments are made solely on merit, in the context of the skills, experience, independence and knowledge which the Board of Directors as a whole requires to be effective.

The Board Remuneration and Nomination Committee has delegated authority to decide the Company's diversity targets and to review the diversity policy. Diversity targets will be set for three years at a time.

2.8 Adequacy of risk management arrangements

As detailed in the preceding sections, the Board retains overall accountability for approving the RMF and the Business Strategy, understanding major risks, and ensuring that appropriate limits are set against those risks and that they are adequately controlled and monitored.

The Board considers that, as at 31 December 2017, it had in place an adequate framework of systems and controls with regard to OakNorth's risk profile and business strategy.

3 Capital resources and capital adequacy

3.1 Capital management

OakNorth has a rigorous annual Individual Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment Process (ILAAP) in place. Internal Capital Adequacy Assessment Process ('ICAAP') is a formal capital planning exercise over a 5-year period. The purpose of the ICAAP and ILAAP is to ensure OakNorth's Board can undertake a fully informed assessment of the sufficiency of OakNorth's current and projected capital and liquidity resources given its strategy, risk exposure, risk management framework and exposure to stressed environments. The key risks, stress testing scenarios, and baseline projections that underpin the ICAAP and ILAAP are discussed and challenged in detail across both the executive committee and the Board.

OakNorth manages its capital adequacy through the monitoring of the volume of growth in the loan book on an ongoing basis. The actual and forecast capital adequacy and capital buffer positions are reported to ALCO, EXCO, the Board Risk & Compliance Committee and the Board monthly.

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3.2 Stress testing

Stress testing is a process by which OakNorth's business plans are subjected to severe but plausible adverse impact scenarios to assess the potential impact on the business including projected capital and liquidity positions. The results of stress testing, along with proposed actions, are reported to ALCO, EXCO and to the Board. They are captured in the Individual Liquidity Adequacy Assessment Process (ILAAP) and in the Internal Capital Adequacy Assessment Process (ICAAP). Additional details on Credit risk, Liquidity and Funding risk, Interest rate risk and Operational risk are provided in the subsequent sections of this document.

3.3 Capital resources

The table below shows the composition of OakNorth's regulatory capital position as at 31 December 2016 as per CRD IV.

| | 2017 £'000 | 2016 £'000 |
|---|------------------------------|-----------------------------|
| Regulatory capital | | |
| Share capital | 249,320 | 86,320 |
| Retained earnings/ (losses) | 4,511 | (4,963) |
| Capital contribution | 25 | 4 |
| Available for Sale security reserve | (27) | - |
| Deductions for Intangible assets | (276) | (312) |
| Total Common Equity Tier 1 (CET1) capital | <u>253,553</u> | <u>81,049</u> |
| Total Tier 1 capital | <u>253,553</u> | <u>81,049</u> |
| General provisions | <u>2,357</u> | <u>937</u> |
| Total Tier 2 capital | <u>2,357</u> | <u>937</u> |
| Total regulatory capital | <u><u>255,910</u></u> | <u><u>81,986</u></u> |

Reconciliation to Statutory equity: The CET1 balance is based on the fully paid up Share capital, Retained earnings, AFS security reserve balances and Capital Contribution balances as per the audited financial statements of OakNorth.

Deductions from regulatory capital: Intangible assets are as defined under FRS102 and are deducted from regulatory capital in accordance with the Capital Requirements Regulation (CRR).

Tier 2 items: OakNorth had no Tier 2 instruments in issue and the only item in the Tier 2 capital resources is the impairment allowance for incurred but not reported (IBNR) losses.

3.4 Capital adequacy

| 2017 £'000 | 2016 £'000 |
|---------------|---------------|
|---------------|---------------|

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| | | |
|-----------------------------------|----------------|----------------|
| Risk weighted assets | | |
| Credit risk | 705,788 | 276,142 |
| Market risk | - | - |
| Operational risk | 23,700 | 29,175 |
| Total risk weighted assets | 729,488 | 305,317 |

Capital ratios

| | | |
|------------------------------------|-------|-------|
| Common Equity Tier 1 capital ratio | 34.8% | 26.5% |
| Tier 1 capital ratio | 34.8% | 26.5% |
| Total capital ratio | 35.1% | 26.9% |

As at 31 December 2017, OakNorth's capital base was in excess of the minimum required as per the regulatory requirements, including the capital requirements as per the Individual Capital Guidance (ICG) and the Capital Planning Buffer (CPB).

The total capital requirement (TCR) as set by the PRA, which is defined as the amount and quality of capital a firm is required to maintain to comply with the Pillar 1 and Pillar 2A capital requirements, was 13.02% for OakNorth as of 31 December 2017.

The capital adequacy ratio, buffer over ICG and CPB- are key risk capital risk metrics monitored by the ALCO, EXCO and reported to the Board Risk Committee and the Board on a monthly basis.

3.5 Leverage Ratio

CRD IV requires firms to disclose a non-risk based leverage ratio (LR) and the processes used to manage the risk of excessive leverage. It is calculated as Tier 1 capital divided by total on and off-balance sheet assets adjusted for deductions. The EBA leverage ratio regime comes into force in 2018, according to which a minimum level of 3% based on Tier 1 capital is expected to apply for the LR from 1 January 2018 onwards.

The UK leverage ratio regime requires a minimum leverage ratio of 3.25%. Under the regime, the calculation also excludes assets constituting claims on central banks from the calculation of the total exposure measure. At present, OakNorth has no minimum leverage requirement as it is currently not within the scope of the UK Leverage Ratio Framework as its deposit levels are less than £50 billion.

| | 2017 £'000 | 2016 £'000 |
|---|----------------|---------------|
| Total Common Equity Tier 1 (CET1) capital/ Tier 1 capital for the leverage ratio | 253,553 | 81,049 |

Exposures for the leverage ratio

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| | | |
|---|----------------|----------------|
| Total assets per the financial statements of OakNorth | 768,587 | 291,922 |
| Off balance sheet items* | 66,746 | 21,940 |
| Other adjustments** | 8,073 | 3,631 |
| Leverage ratio exposure | 843,406 | 317,493 |
| Leverage ratio based on 31/12 position (EBA calculation) | 30.1% | 25.5% |
| Leverage ratio based on 31/12 position- UK Leverage ratio framework- excluding claims on central banks | 41.0% | 33.7% |

*Off balance sheet items are stated after application of credit conversion factors

**Other adjustments include deferred fees added back for the purpose of computing loan exposures, excluding IBNR loss impairment allowance (as this is added to tier 2 capital) and intangible assets (as this is deducted from CET1).

As at 31 December 2017, OakNorth's leverage ratio was in excess of the minimum requirements, including the risk appetite limits.

3.6 Minimum capital requirement: Pillar 1

OakNorth's overall capital resources requirement under Pillar 1 are calculated by adding the capital resources requirements for credit risk and operational risk. As at the reporting date, OakNorth did not have any market risk capital requirement and credit valuation adjustment ('CVA'). Pillar 1 capital requirement is computed as 8% of the risk weighted assets.

| | 2017 | 2016 |
|--|----------------|---------------|
| | £'000 | £'000 |
| Capital resources requirement – Pillar 1 | | |
| Credit risk | 56,463 | 22,091 |
| Market risk, Credit valuation adjustment (CVA) | - | - |
| Operational risk | 1,896 | 2,334 |
| Capital resources requirement under Pillar 1 | 58,359 | 24,425 |
| Capital resources | 255,910 | 81,986 |
| Capital resources surplus over Pillar 1 requirement | 197,551 | 57,561 |

4 Credit Risk

Credit Risk is defined as the risk that a borrower or counterparty will fail to meet its obligations in accordance with agreed, contractual terms. This risk arises from OakNorth's lending activities and is the most significant risk faced by OakNorth. Although credit risk arises from OakNorth's loan book, it can also arise from off balance sheet activities. OakNorth does not actively trade in financial instruments, other than for liquidity management purposes.

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4.1 Composition of the minimum capital requirements for credit risk

| Exposures subject to the Standardised Approach | Credit risk exposure | Minimum capital requirement |
|--|----------------------|-----------------------------|
| | 2017 £'000 | 2017 £'000 |
| Central government and central banks | 150,515 | - |
| Regional governments or local authorities | - | - |
| Public sector entities | - | - |
| Multilateral development banks | - | - |
| Institutions (subject to short term credit assessment) | 5,362 | 428 |
| Corporates | 242,196 | 16,218 |
| Of which SME | 1,001 | 61 |
| Retail | 1,347 | 62 |
| Of which SME | 1,347 | 62 |
| Secured by mortgages on immovable property | 304,006 | 17,507 |
| Of which SME | 4,601 | 138 |
| Exposures at default | - | - |
| Items belonging to regulatory high-risk categories | 304,967 | 21,718 |
| Securitisation positions | - | - |
| Other items | 6,629 | 530 |
| Total | 1,015,022 | 56,463 |

All exposures, including undrawn-committed and uncommitted facilities are stated gross before application of any credit conversion factors or credit risk mitigation. As of 31 December 2017, no exposures were specifically impaired. The credit exposures increased significantly in 2017 versus the prior year due to growth in OakNorth's loan book. More details on the business growth and strategy have been provided in OakNorth's Annual report and Financial Statements for the year ended 31 December 2017 which may be obtained from the UK Companies House website³.

| Exposures subject to the Standardised Approach | Credit risk exposure | Minimum capital requirement |
|--|----------------------|-----------------------------|
| | 2016 £'000 | 2016 £'000 |
| Central government and central banks | 51,679 | - |
| Regional governments or local authorities | - | - |
| Public sector entities | - | - |
| Multilateral development banks | - | - |
| Institutions (subject to short term credit assessment) | 9,161 | 693 |
| Corporates | 116,786 | 8,798 |
| Of which SME | 3,606 | 212 |

³ <https://www.gov.uk/government/organisations/companies-house>

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| | | |
|--|----------------|---------------|
| Retail | 758 | 35 |
| Of which SME | 758 | 35 |
| Secured by mortgages on immovable property | 107,432 | 6,740 |
| Of which SME | 1,896 | 50 |
| Exposures at default | - | - |
| Items belonging to regulatory high-risk categories | 51,697 | 5,458 |
| Securitisation positions | - | - |
| Other items | 4,583 | 367 |
| Total | 342,096 | 22,091 |

OakNorth uses the Standardised Approach in determining the appropriate level of capital to be held for regulatory purposes. Under this approach OakNorth is required to set aside capital equal to 8 per cent of its total risk weighted assets to cover its Pillar 1 capital requirements.

SMEs as included in the above tables refer to exposures eligible for SME supporting factor as per the CRR guidelines (exposures upto Eur 1.5 million).

OakNorth did not have any derivative exposures outstanding as at 31 December 2017 (2016: Nil).

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4.2 Maturity bucketing of the exposures

| | Within 1 year | After 1 year but within 5 years | More than 5 years | Undated/ open maturity | Total |
|--|----------------|---------------------------------------|----------------------|------------------------------|------------------|
| | 2017 | 2017 | 2017 | 2017 | 2017 |
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| Central government and central banks | 150,515 | - | - | - | 150,515 |
| Institutions (subject to short term credit assessment) | - | - | - | 5,362 | 5,362 |
| Lending | 216,565 | 597,407 | 38,544 | - | 852,516 |
| Other items | - | - | - | 6,629 | 6,629 |
| Total | 367,080 | 597,407 | 38,544 | 11,991 | 1,015,022 |

| | Within 1 year | After 1 year but within 5 years | More than 5 years | Undated/ open maturity | Total |
|--|----------------|---------------------------------------|----------------------|------------------------------|----------------|
| | 2016 | 2016 | 2016 | 2016 | 2016 |
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| Central government and central banks | 51,679 | - | - | - | 51,679 |
| Institutions (subject to short term credit assessment) | - | - | - | 9,161 | 9,161 |
| Lending | 64,901 | 192,772 | 19,000 | - | 276,673 |
| Other items | - | - | - | 4,583 | 4,583 |
| Total | 116,580 | 192,772 | 19,000 | 13,744 | 342,096 |

4.3 Geographical distribution

All credit risk exposures of OakNorth (i.e the collaterals and business cash flows) are in the UK.

Financial Policy Committee (FPC) in the UK raised the UK Countercyclical Capital Buffer (CCyB) rate 0.5% with binding effect from June 2018 and to 1.0% with binding effect from November 2018. There were no binding requirements as of 31 December 2017.

4.4 Sectoral distribution

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The Sectoral break-down of OakNorth's credit risk exposures as at 31 December 2017 is detailed below:

| Sector | Central government and central banks | Institutions* | Lending | Other items |
|---|--|---------------|----------------|----------------|
| | 2017 £'000 | 2017 £'000 | 2017 £'000 | 2017 £'000 |
| Government and public administration | 150,515 | - | - | - |
| Financial Services | - | 5,362 | 60,061 | - |
| Accommodation and food service activities | - | - | 154,724 | - |
| Administrative and support services activities | - | - | 4,834 | - |
| Construction | - | - | 393,281 | - |
| Education | - | - | - | - |
| Human health and social work activities | - | - | 12,711 | - |
| Information and communication | - | - | - | - |
| Professional, scientific and technical activities | - | - | - | - |
| Real estate activities | - | - | 187,970 | - |
| Wholesale & Retail trade | - | - | 30,334 | - |
| Manufacturing | - | - | 1,431 | - |
| Other Service Activities | - | - | 7,170 | - |
| Other assets | - | - | - | 6,629 |
| Total | 150,515 | 5,362 | 852,516 | 6,629 |

**subject to short term credit assessment*

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| Sector | Central government and central banks | Institutions* | Lending | Other items |
|--|---|---------------|----------------|----------------|
| | 2016 £'000 | 2016 £'000 | 2016 £'000 | 2016 £'000 |
| Government and public administration | 51,679 | - | - | - |
| Financial Services | - | 9,161 | 14,409 | - |
| Accommodation and food service | - | - | 71,611 | - |
| Administrative and support services | - | - | 301 | - |
| Construction | - | - | 38,972 | - |
| Education | - | - | 4,700 | - |
| Human health and social work | - | - | 12,711 | - |
| Information and communication | - | - | 1,151 | - |
| Professional, scientific and technical | - | - | 3,632 | - |
| Real estate | - | - | 109,421 | - |
| Wholesale & Retail trade | - | - | 19,766 | - |
| Other assets | - | - | - | 4,583 |
| Total | 51,679 | 9,161 | 276,673 | 4,583 |

**subject to short term credit assessment*

4.5 Credit Risk: Loans and advances to customers

4.5.1 Overview of the Credit Risk Management Policy and Credit Risk Appetite Statement

A detailed Credit Risk Management Policy (CRMP) has been set, designed to ensure that OakNorth's lending is prudent and is managed in alignment with the overall Board risk appetite and corresponding financial and capital targets for OakNorth. The Board Credit Committee (BCC) is responsible for ensuring that the Credit risk appetite statements are up to date and relevant to OakNorth's operations. Specific credit risk management portfolio oversight and approval of lending decisions within authority is delegated by the Board to the BCC and in turn to the executive Credit Risk Management Committee (CRMC) and Head of Credit Risk (HoCR). The HoCR is responsible for monitoring the appropriate thresholds and limits on the credit risk drivers and ensuring that the day-to-day decision-making process meets the risk appetite limits.

OakNorth has set its detailed guidance and specific Lending Policy metrics. Every approved loan is assigned a risk rating (based on a Probability of Default (PD) and Loss Given Default (LGD)) which drives both pricing and the level of ongoing monitoring which OakNorth adopts.

All Credit proposals are approved by the CRMC with a small number of highest risk proposals requiring BCC sign off and a small number of lower risk proposals being signed off jointly by CEO/HoCR based on

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the amount and/or the internal risk rating of the facility. All credits considered by the BCC are initially recommended by the CRMC.

Concentration risk is managed through the risk appetite framework which also stipulates the various limits to manage exposure concentrations within OakNorth. Credit monitoring is completed by the Credit Risk Portfolio Management team on a regular basis and at least monthly (see section 'Monitoring and Review process' below). OakNorth reviews its credit exposure both at the facility and on a portfolio level. Both the CRMC and BCC also monitor the performance of the overall portfolio at least monthly through the production of management information including: lending volumes, key credit model output performance, rating downgrades, concentration risk (including large exposures), impairments and any material recoveries (if any).

OakNorth seeks to mitigate credit risk through, inter alia, eligible collateral (see section 'Credit risk mitigation' below for details). As on 31 December 2017, 92% of OakNorth's loan facilities were collateralised by security comprising of fixed assets (mainly property) - these exclude any charges on floating assets and guarantees not supported by charge on fixed assets (2016: 87%).

4.5.2 Credit risk mitigation

OakNorth's CRMP also details the credit risk mitigation techniques that are used by OakNorth. OakNorth seeks to mitigate credit risk by taking security as it improves Bank's position in an event of default. This includes debenture/ charge on fixed and floating assets, charge on freehold land or property, guarantees (personal, corporate, intra-group, parent; as well as guarantees issued under various EU or UK Government initiatives such as the Help to Grow program), and cash reserves/deposits. The CRMP details the conditions and the limits applied to the security type.

OakNorth has a policy guidance on the valuation conditions and methods. OakNorth also has a policy in relation to the external valuation firms/quantity surveyors who can be added to OakNorth's valuation panel. Any review of collateral is done in line with the scheduled (minimum annual) review for the credit and frequency as specific to the security type, as applicable.

4.5.3 Monitoring and review process

The monitoring process includes processes for automatically tracking against repayment schedules and escalating any non-payments. Similarly, any over-payment against approved limit will be flagged for immediate review and escalation.

Monitoring is in line with the approved terms and conditions of sanction and any covenants set and OakNorth identifies potential financial difficulty in a customer account via Trigger Events or Early Warning Indicators (for example, financial performance not in line with the projections or breach of covenants). Additionally the business teams are required to escalate any other information/ credit warning signs that they may become aware of outside of the above. Intensive monitoring of customers with potential/ actual financial difficulty takes place via a Watch List process. OakNorth also has a forbearance policy in place.

The credit facilities are subject to periodic (minimum annual) review based upon the risk grading. OakNorth reviews its credit exposure on both a facility basis and on a portfolio basis. The Debt Finance

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team provides the first line inputs and the Portfolio Management/Credit Risk team has the overall responsibility for monitoring the exposures, reporting in to the Head of Credit Risk and Credit Risk Management Committee (CRMC) based on different risk levels. Watch list cases are formally reviewed at least monthly by the CRMC.

4.5.4 Overview of provisioning policy

A provisioning policy is in place to ensure that Bank's financial statements accurately reflect the current value of problem credit assets and level of credit loss, and that defined methodologies and appropriate parameters are in place to calculate provisions. These are aligned with internal and external accounting standards and regulatory requirements which require the assessment of any requirement for impairment at an early stage and frequently thereafter.

The provisioning policy, along with the related credit/underwriting processes and procedures is designed to ensure that the identification, recording, measurement and reporting of provisions enables the Risk Appetite target to be regularly tracked, with any early warning signs of breach of appetite to be quickly identified and remediated.

4.5.4.1 Past due and impaired exposures

The Provisioning policy details the criteria for assessing the performance of the book and identifying past due and impaired exposures. Customers experiencing financial difficulty are identified by the Debt Finance and Credit Risk Portfolio Management teams via Trigger Events or Early Warning Indicators, for example an internal risk rating downgrade within the last 90 days, or breach of covenants. Active monitoring takes place via a Watch account process. To assist in the identification of non-performing or potential problem loans, OakNorth has two categories, namely: Performing Book (or "Good" Book) where the balances are up-to-date, and/or not in Recovery (and may therefore include Balances in Collections, also known as delinquent); and Non Performing Book (or "Bad" book), which includes balances in recovery/ where full repayment has been demanded or there is a "wish to Exit".

Specifically impaired exposures are identified based on impairment triggers under IAS39, and impairment provisions are made where there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event (or events) has an impact on the estimated future cash flows from the asset that can be reliably estimated. Losses expected as a result of future events are not recognised. Evidence of impairment is considered on both on an individual and portfolio level.

As at 31 December 2017, OakNorth had no past due or impaired exposures (2016: Nil).

4.5.4.2 Forbearance

Forbearance is said to occur when, outside of the normal terms of business, a bank seeks to provide support to a borrower struggling to meet its obligations. This may range from ignoring a breach of a loan covenant, to giving the borrower more time to meet its loan obligations, to providing some form

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of active payment relief. Where forbearance is granted, the customer will be included in the Watch Account list. As at 31 December 2017, OakNorth had no exposures in forbearance (2016: Nil).

4.5.4.3 Impairment provisions

The Provisioning policy defines the following impairment provision categories:

- Provisions for incurred but not reported (IBNR) losses: This is calculated as non-defaulted funded balances x Loss Given default (LGD) x probability of default (PD) x Emergence period (EP). Any impairment loss is recognised in the profit and loss account. As OakNorth does not have its own historic loss data, for estimating the PD, OakNorth uses external data to help calibrate internal credit risk models for its own portfolio type, to determine the PDs and also applies LGD to estimate recoverability of security received. OakNorth currently applies an emergence period of 12 months to its portfolio. As at 31 December 2017, OakNorth had total outstanding IBNR provisions of £2,357K (2016: £937K). The provisions are assessed on a quarterly basis considering the trends in the economy as well as competitor banks.
- Individual / Specific Provisions: These are required to be calculated on loans where there is objective evidence of financial difficulty, including missed payments, breach of credit limit or a court judgement, based on criteria as defined under IAS39. The provisioning policy details the calculation of the impairment losses in line with IAS39. OakNorth had no specific provisions outstanding as at 31 December 2017 (2016: nil).

| | IBNR loss provisions | |
|--|----------------------|------------|
| | 2017 | 2016 |
| | £'000 | £'000 |
| Opening balance as at 1 January | 937 | 62 |
| <i>Impairment loss for the year:</i> | | |
| Charge to the income statement | 1,420 | 875 |
| Write-offs net of recoveries | - | - |
| Closing balance as at 31 December | 2,357 | 937 |

4.6 Credit Risk: Treasury assets

4.6.1 Overview and summary

Credit risk also exists with Treasury assets such as investment securities and deposits/balances placed with other banks. The credit risk of Treasury assets is considered to be low. Treasury assets as at 31 December 2017 were held in the form of GILTS and balances at Bank of England reserve account. No assets are held for speculative purposes or actively traded. OakNorth had no derivative exposures as at 31 December 2017 (2016: Nil).

For determining the capital requirements on these exposures (institutional exposures and UK Central Government exposures) OakNorth uses credit ratings provided by the recognised credit rating agencies- Standard & Poor's, Moody's, Fitch and DBRS.

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| <i>Data as on 31 December 2017</i> | CQS 1 | CQS 1 | CQS 2 | CQS 3 | CQS 4 | Total |
|--|----------------|------------|-----------|--------------|------------|----------------|
| Long term rating | AAA | AA+ to AA- | A+ to A- | BBB+ to BBB- | BB+ to BB- | |
| Short term rating | A1 | A1 | A2 | A3 | below A3 | |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Cash and balances at central banks | 148,376 | - | - | - | - | 148,376 |
| UK Government Gilts and Treasury Bills | 2,139 | - | - | - | - | 2,139 |
| Loans & advances to banks | - | 2 | 21 | 5,339 | - | 5,362 |
| Total | 150,515 | 2 | 21 | 5,339 | - | 155,877 |

| <i>Data as on 31 December 2016</i> | CQS 1 | CQS 1 | CQS 2 | CQS 3 | CQS 4 | Total |
|--|---------------|------------|--------------|--------------|------------|---------------|
| Long term rating | AAA | AA+ to AA- | A+ to A- | BBB+ to BBB- | BB+ to BB- | |
| Short term rating | A1 | A1 | A2 | A3 | below A3 | |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Cash and balances at central banks | 51,179 | - | - | - | - | 51,179 |
| UK Government Gilts and Treasury Bills | 500 | - | - | - | - | 500 |
| Loans & advances to banks | - | 0 | 1,000 | 8,161 | - | 9,161 |
| Total | 51,679 | 0 | 1,000 | 8,161 | - | 60,840 |

All loans and advances to Banks have been assessed under short term credit assessment rating.

4.6.2 Impairment of financial assets classified as available for sale

In accordance with IAS39 (as adopted by OakNorth in accordance with the provisions of FRS102), impairment losses on available for sale debt securities are recognised by reclassifying the losses accumulated in the available for sale reserve in equity to the income statement. If in a subsequent period the fair value of an impaired available for sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed.

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As at 31 December 2017, no available for sale debt securities were past due or impaired (2016: nil).

5 Interest Rate Risk in the Banking Book (IRRBB)

Interest rate risk in the banking book is defined as the risk of losses arising from changes in the interest rates associated with OakNorth's banking book exposures. The risk may arise due to the following:

- **Duration or Repricing Risk:** The risk arising from repricing mismatch of assets and liabilities. The majority of OakNorth's assets reprice based on the base rates while most deposit liabilities are fixed rate.
- **Basis Risk:** Unhedged exposure to one interest rate benchmark with exposure to another interest rate benchmark that reprices under different conditions (e.g. Bank of England Base rate and LIBOR).
- **Pipeline Risk:** The uncertainties of occurrence of future transactions.
- **Prepayment Risk:** Borrowers redeeming fixed rate products when interest rates change or prepaying loans for other reasons.

OakNorth's interest rate risk management policy is detailed in OakNorth's Market Risk Management policy, which defines, measures, sets hedging policy statements and details the governance process around the management, monitoring and reporting of the interest rate risks.

The Head of Treasury is responsible for the day-to-day management of the interest rate risk position of OakNorth. The CFO, reporting to the ALCO, takes an oversight role of this function with risk limits and current position against these limits reported monthly.

The two key measures / reports that OakNorth uses for measurement and monitoring of interest rate risk are: sensitivity to 200 basis point (bps) shift in the entire yield curve to measure the interest rate risk in the banking book (IRRBB) and the basis risk exposure report. OakNorth monitors the Net Present Value (NPV) sensitivity to the positive and negative 200 basis points shift in the yield curve including the Bank of England base rate or LIBOR-linked floors embedded within the customer loan agreements.

As at 31 December, the NPV sensitivity to +/-200bps shift was as follows, which indicates a positive effect of the rate floors on OakNorth's interest rate risk:

| | 2017 | 2016 |
|---|------|------|
| | £m | £m |
| NPV Sensitivity to +2% shift (including base/LIBOR rate floors) | 5.8 | 3.3 |
| NPV Sensitivity to -2% shift (including base/LIBOR rate floors) | 17.2 | 4.0 |

As at 31 December 2017, the basis risk exposure due to a 25bps reduction in the Bank of England base rate would reduce the net interest margin by approximately £406K (2016: £131K) on an annualised basis. The impact is mainly driven by the balances held at the Bank of England. The impact on the lending book is low due to the base rate floors embedded within OakNorth's loan agreements.

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As at 31 December 2017, OakNorth did not have any market risk Pillar 1 requirements (2016: nil). OakNorth currently does not take any position with trading intent. OakNorth also did not have any derivatives outstanding for the purposes of hedging its interest rate risk in the banking book.

6 Liquidity risk

This is defined as the risk that OakNorth is unable to meet its contractual financial obligations as they fall due and is unable to fund future lending growth opportunities or is able to do so only at significantly higher funding costs. The most important liquidity risk OakNorth faces is retail funding risk – i.e. the risk that retail funds may be withdrawn from OakNorth at their earliest contractual maturity in the event of a stress occurring.

OakNorth has a detailed Funding policy which sets out the approach to funding the asset book and at the same time limiting the concentration of the funding sources. OakNorth has put in place an Individual Liquidity Adequacy Assessment Process (ILAAP), which informs OakNorth's Board of the ongoing assessment and quantification of OakNorth's liquidity risks by defining OakNorth's ILAAP methodology and prescribed stress tests, how OakNorth mitigates those risks and how much current and future liquidity is required. OakNorth also has a "Liquidity Contingency Plan" (LCP) in place which is designed to ensure that OakNorth can meet its obligations as they fall due even in a stress situation. OakNorth also regularly updates its Recovery plan, which is designed to detail a range of credible options for addressing capital and liquidity challenges under a range of stress scenarios. OakNorth's liquidity position is monitored according to OakNorth's policies set out in Liquidity Risk Management Policy and the Funding Policy.

OakNorth's liquidity position is monitored in accordance with OakNorth's Liquidity Risk Management Policy and in accordance with the Liquidity risk appetite statements as approved by OakNorth's Board.

The Asset and Liability Management Committee (ALCO) is responsible for setting and monitoring the appropriate thresholds and limits on the capital and liquidity risk drivers, the day-to-day decision-making process around early warning triggers and ensuring that OakNorth remains on target and within its capital and liquidity risk appetite. Further oversight is provided by the Risk function. The ALCO also conducts risk appetite appraisals to ensure that the Capital and Liquidity risk appetite statements are up to date and remain relevant to OakNorth's operations.

OakNorth ensures that there is adequate coverage over the internal risk appetite limits for liquidity. OakNorth also ensures that it is in compliance with all regulatory liquidity ratio requirements – LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio).

OakNorth has a "Liquidity Contingency Funding Plan" (LCP) in place which is designed to ensure that OakNorth is able to meet its obligations as they fall due even in a stress situation. To ensure that the LCP works efficiently, clearly defined trigger points have been set, with an escalation process for when these triggers are breached along with the roles and responsibilities of senior management in activating these sources of liquidity if so desired. Testing of the LCP will be carried out to ensure that the proposed actions work as expected.

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As at 31 December 2017, OakNorth held high quality liquid assets of £150.5 million (2016: £51.7 million) of which £1.1 million of GILTS were encumbered (2016: nil).

7 Operational risk

7.1 Operational risk management

Operational risk is defined as the risk of direct or indirect impacts resulting from human factors, inadequate or failed internal processes and systems, or external events. OakNorth aims to mitigate each risk with robust controls and monitoring.

OakNorth has implemented a rigorous Operational Risk policy and risk mitigation processes. Each function, as the first line of defence, ensures that any operational risk in their area is mitigated by clearly defined and documented process documents and undertakes a thorough Risk and Controls Self-Assessment ('RCSA') process. Appropriate risk limits and their thresholds and early warning indicators are set. Reporting of appropriate MI on process effectiveness and any events or near misses is made monthly to the OPCO, EXCO and Board.

The Risk function, as second line of defence, is responsible for providing assurance that those controls are implemented, are being operated satisfactorily, and that risk and control registers are comprehensive. Internal Audit, as third line of defence, conducts reviews in line with the Audit Plan to test the effectiveness of the operational risk framework, including 1st line controls and the quality of the second line oversight.

Conduct, compliance and regulatory risks

Conduct, Compliance and Regulatory Risk is defined in Section 2.2 Principal risks. OakNorth uses the customer outcomes approach to assess conduct and regulatory compliance risk. Staff are provided with a Compliance Manual and appropriate training to provide an overview of the regulatory system under which OakNorth operates, to provide an outline of OakNorth's Compliance policy in each area, and to provide instructions on policies and procedures for compliance.

7.2 Operational risk capital charge computation

The operational risk capital charge for OakNorth under Pillar 1 is calculated using the Basic Indicator Approach, whereby a 15 per cent multiplier is applied to the 3-year historical average net interest and fee income. As OakNorth did not have a full 3-year operating history, in accordance with the guidelines, the charge was determined on the basis of projections submitted to the PRA in the ICAAP. Based on this computation, the capital charge for the period ended 31 December 2017 was £1,896K (2016: £2,334K).

Pillar 3 Capital disclosures

For the year ended 31 December 2017

8 Securitisation exposures

OakNorth had no securitisation exposures as at 31 December 2017 (2016: nil).

9 Asset encumbrance

OakNorth had only £1.1 million nominal value GILTS encumbered, against which a borrowing of £1.0 million borrowing had been made under the BOE Term Funding Scheme.

OakNorth had pre-positioned £171.4 million of eligible loan collateral pool under the scheme, however no drawdowns have been made as of 31 December 2017 and no collateral had been transferred as at the reporting date. There were no assets encumbered as of 31 December 2016.

| | Carrying amount of encumbered assets £000 | Fair value of encumbered assets £000 | Carrying amount of unencumbered assets £000 | Fair value of unencumbered assets £000 |
|---|--|---|--|---|
| Assets of the reporting institution | 1,109 | 1,109 | 767,478 | N/A |
| Loans on demand* | - | - | 153,702 | N/A |
| Equity instruments | - | - | - | - |
| Debt securities | 1,109 | 1,109 | 1,006 | 1,006 |
| Loans and advances other than loans on demand** | - | - | 604,937 | N/A |
| Other assets | - | - | 7,833 | N/A |

*includes £148.3 million balances held at Bank of England and £5.4 million balances held at other banks

**Loans and advances to customers per financial statements

As of 09 February 2018, OakNorth had purchased £75.0 million of GILTS with maturity date of 22 July 2019. As of 22 February 2018, OakNorth had drawn down £147.6 million under the Bank of England's Term Funding Scheme. £159.3 million of OakNorth's gross loan book and £75.0 million of the GILTS had been encumbered against the borrowing.

10 Remuneration disclosures

These are available in a separate document available on request as explained on OakNorth's website (www.oaknorth.com).

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OakNorth Bank



oaknorthbankuk

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