Provident Financial plc

Pillar III disclosures – April 2010

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Contents

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1. Introduction

1.1 Background

The Provident Financial consolidated group (the group) comprises two principal trading operations:

- The Consumer Credit Division (CCD) providing home credit and unsecured direct repayment loans to the non-standard UK consumer credit market; and

- Vanquis Bank which provides credit cards to the non-standard UK consumer credit market.

Vanquis Bank holds a banking licence and is therefore regulated by the Financial Services Authority (FSA). In its supervisory role, the FSA sets requirements relating to capital adequacy, liquidity management and large exposures. Vanquis Bank does not currently take deposits.

CCD operates under a number of consumer credit licences granted by the Office of Fair Trading but is not regulated by the FSA. However, the group, incorporating both CCD and Vanquis Bank, is the subject of consolidated supervision by the FSA by virtue of Provident Financial plc being the parent company of Vanquis Bank. The FSA sets requirements for the consolidated group in respect of capital adequacy and large exposures but not in respect of liquidity.

1.2 BASEL II

The BASEL II regulatory framework is a revision to the existing BASEL I regulatory framework. The aim of BASEL II is to make regulatory capital requirements more risk sensitive and representative of risk management controls and procedures in place within firms.

The BASEL II framework has been implemented in the European Union via the Capital Requirements Directive (CRD). The group and Vanquis Bank adopted the CRD with effect from 1 January 2008. The CRD comprises three Pillars:

- Pillar I is the calculation of minimum regulatory capital requirements firms are required to keep for credit, market and operational risk;

- Pillar II requires an Internal Capital Adequacy Assessment Process (ICAAP) by firms to assess whether additional regulatory capital over and above Pillar I should be held based on the risks faced by a firm and the risk management processes in place. This is followed by a supervisory review process prior to the FSA setting a firm's Individual Capital Guidance (ICG); and

- Pillar III complements Pillars I and II and aims to encourage market discipline by developing a set of disclosure requirements which allows market participants to assess key pieces of information on a firm's capital, risk exposures and risk management processes.

1. Introduction (continued)

1.3 Pillar III disclosure policy

The group's Pillar III disclosure policy is as follows:

Frequency of disclosures

Pillar III disclosures will be made on an annual basis using the group's year end date of 31 December. The disclosures will be published by 30 April each year. More frequent disclosures will be made if there is a material change in the nature of the group's risk profile during any particular year.

Media and location of Pillar III disclosures

The Pillar III disclosures will be published on the group's corporate website www.providentfinancial.com.

Board approval

The group's Pillar III disclosure policies were approved by the Board of Directors (the Board) on 19 June 2008.

1.4 Basis of Pillar III disclosures

The Pillar III disclosures have been prepared for the group as a whole in accordance with the rules laid out in the FSA handbook BIPRU Chapter 11. The disclosures provide information on the capital adequacy and risk management processes of the group.

The results of all subsidiary undertakings have been included in the Pillar III disclosures. The ability of Vanquis Bank Limited to pay dividends to Provident Financial plc is restricted by regulatory capital requirements. There are no other current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities between Provident Financial plc and its subsidiary undertakings.

The Pillar III disclosures were approved for publication on 26 April 2010.

2. Risk management objectives and policies

2.1 Risk management objectives

The risk management objective of the Board is to maintain an effective internal control and risk management framework to prudently manage the risks that arise from the group's operations and maintain a sufficient level of regulatory capital in excess of the ICG set by the FSA.

2.2 ICAAP

In accordance with the CRD, the group is required to conduct an ICAAP on an annual basis or more frequently if there is a material change in the nature, trading status or risk profile of the group. The ICAAP allows the Board to assess whether the group's risk management objective is being met.

The key output of the ICAAP is a document which:

- Considers the adequacy of the group's internal control and risk management framework;

- Assesses the risks faced by the group and, in light of the internal control and risk management framework in place, ascertains the level of regulatory capital that should be held to cover those risks over a five year period in line with the group's corporate planning cycle; and

- Undertakes stress testing of the calculated regulatory capital requirement to ensure that the group would maintain adequate regulatory capital under severely stressed conditions.

The group has operated to interim capital guidance set by the FSA since 1 January 2008 whilst the group's ICAAP was being considered by the FSA. In September 2009, the FSA set final ICG for the group, which is not materially different from the interim capital guidance set by the FSA.

The ICAAP has now been embedded into the group's risk management framework. In achieving this, the group's risk registers have been updated to ensure each of the group's risks is allocated into the FSA risk categories. In addition, estimates are made of the level of regulatory capital, if any, that should be held against each risk and then, after aggregating these amounts, this total is compared to the group's regulatory capital requirement as set by the FSA and the group's actual level of regulatory capital. On an annual basis, or more frequently if required, the group's ICAAP document is updated and approved by the Board.

Sections 2.3 and 2.4 of this report set out:

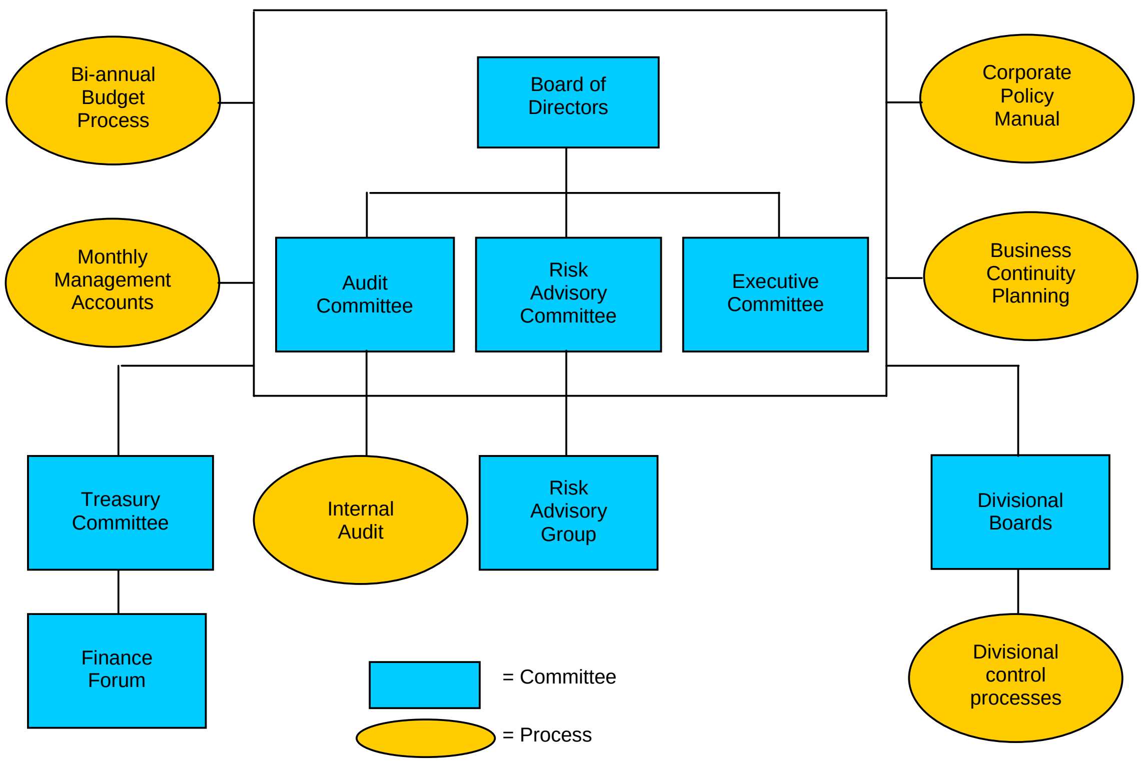
- The key features of the group's internal control and risk management framework that are assessed as part of the ICAAP; and

- The key risks faced by the group which are considered within the ICAAP to assess the overall level of regulatory capital required to be held by the group after taking account of the adequacy of the group's internal control and risk management framework.

2. Risk management objectives and policies (continued)

2.3 Internal control and risk management framework

The overall group internal control and risk management framework is the responsibility of the Board. Certain responsibilities in respect of internal control and risk management are delegated to various sub-committees who report directly to the Board. The Board and its committees are supported by various policies, procedures and reporting mechanisms as set out in the following chart:



The group's risk appetite is defined by the policies, controls and approval limits determined within the internal control and risk management framework. This ensures that the group has an effective system of internal control and risk management to manage the group prudently within its regulatory capital requirements and to mitigate the potential for material financial loss to the business. Taking each of the above control mechanisms in turn:

Board of Directors

The Board is responsible for the group's overall system of internal control and for reviewing its effectiveness. The Board comprises three Executive Directors, three Non-Executive Directors and a Non-Executive Chairman and now meets nine times a year including an annual three day planning conference. The Board delegates authority to a number of formal sub-committees including the Audit Committee, the Risk Advisory Committee and the Executive Committee.

2. Risk management objectives and policies (continued)

Audit Committee

The Audit Committee comprises the Non-Executive Directors. The Executive Directors, Head of Audit & Risk, Group Financial Controller and the external audit partner from PricewaterhouseCoopers normally attend all meetings by invitation. The Audit Committee meets three times a year and is responsible for monitoring group-wide internal financial controls, appointment and appraisal of the external auditors, agreeing the internal audit plan each year, reviewing the reports produced by internal audit and reviewing the group's whistle-blowing policy. The Audit Committee also reviews the financial statements, interim reports and preliminary announcements of the group including any significant accounting judgements made in preparing them.

Internal audit

The group operates an in-house internal audit function led by the Head of Audit & Risk.

An annual programme of work is established and approved by the Audit Committee which targets and reports on higher risk areas as identified by the group's key risk registers. Board and Audit Committee papers include a summary of the results and recommendations from each internal audit review and a follow-up of previously reported recommendations.

Risk Advisory Committee (RAC)

The group's risk management framework is managed by the RAC on behalf of the Board. The RAC comprises the three Non-Executive Directors and the Finance Director. The remaining Executive Directors, Head of Audit & Risk and Group Financial Controller normally attend by invitation. The RAC keeps the group's risk registers under review, considers the most important risks facing the group, including credit and operational risk, and is responsible for approving the group's annual Documented Risk Assessment (DRA) and approving the group's ICAAP document prior to submission to the Board. The RAC meets three times a year and delegates a number of responsibilities to the Risk Advisory Group (RAG).

Risk Advisory Group (RAG)

The RAG comprises the Executive Directors, the Company Secretary, the Head of Audit & Risk and the Group Financial Controller. The divisional Heads of Risk normally attend by invitation. The RAG formally meets four times a year and considers the extent and nature of the risks facing the group, the extent and categories of risk which are acceptable to bear, the likelihood of the risk materialising, the group's ability to mitigate any risk, and the costs of operating particular controls relative to the benefits obtained. It also reviews the risk registers prepared by the divisional risk committees twice a year, challenging and making changes where appropriate. In addition, it has primary responsibility for producing the DRA and the ICAAP document. It submits a schedule of key risks, divisional key risk registers, the DRA and the ICAAP document to the RAC for review and approval.

Executive Committee

The Executive Committee comprises the three Executive Directors and is chaired by the Chief Executive. The committee normally meets at least once a week, and more frequently as required, and deals with matters relating to the general running of the group. These matters include monitoring the weekly performance of the group's businesses, approving capital expenditure projects and long term contracts subject to certain limits, approving treasury related transactions and annually reviewing corporate and accounting policies.

2. Risk management objectives and policies (continued)

Treasury Committee

The Treasury Committee is chaired by the Finance Director and comprises the key heads of finance, treasury, tax and legal within the group. The Treasury Committee manages the treasury activities of the group and meets at least six times a year. The Treasury Committee is not a formal sub-committee of the Board but it regularly reports to the Board on compliance with treasury policies and other treasury matters. The Treasury Committee is also responsible for monitoring the group's capital adequacy and liquidity positions.

Finance Forum

The Finance Forum is chaired by the Finance Director and comprises the key heads of finance, treasury, tax and legal within the group. The role of the Finance Forum is to monitor and discuss accounting and internal control issues, trading performance, tax and investor relations matters. The Finance Forum meets at least six times a year in conjunction with the Treasury Committee.

Divisional Boards

The group has two divisional Boards; CCD and Vanquis Bank, both of which report to the group Chief Executive. Each divisional Board is responsible for the day-to-day operations of their division. The divisional Boards have implemented various controls to mitigate the risks specific to their business.

Divisional control processes

The divisions have a number of important controls to manage risk.

<u>CCD</u>

In addition to the control from the divisional Board and those group-wide controls set out above, the most significant divisional controls within CCD are as follows:

- *Project Governance* – A governance framework to oversee significant business projects undertaken by CCD.
- *Risk Committee* – Reports to the CCD Board and into the group RAG and is responsible for the management and reporting of risk within CCD and for updating the divisional risk register on at least a quarterly basis.
- *Risk management function* – Supports the Risk Committee in the identification and management of risks.
- *Credit Committee* – Implements credit policy and monitors credit performance.
- *Field risk* – Responsible for the detection of fraud in the field operations of CCD.
- *Compliance function* – Responsible for assessing compliance with laws and regulations within CCD.
- *Hierarchy of field structure* – Well-established hierarchical structure to manage and control the field workforce of CCD.

<u>Vanquis Bank</u>

As a regulated entity with a banking license, Vanquis Bank replicates a number of the internal control and risk management processes typically only held at a group level in many organisations. In addition to the group-wide controls set out above, the most significant controls within Vanquis Bank are as follows:

2. Risk management objectives and policies (continued)

- *Project Governance* – An Executive sign-off committee to oversee project justification and execution.
- *Audit Committee* – Chaired by an independent Non-Executive Director, the Vanquis Bank Audit Committee is separate from the group Audit Committee.
- *Risk Committee* – Reports to the Vanquis Bank Board and into the Group RAG and is responsible for the management and reporting of risk within Vanquis Bank and for updating the divisional risk register on at least a quarterly basis. Chaired by an independent Non-Executive Director.
- *Treasury Committee* – Responsible for the day-to-day monitoring of liquidity and capital within Vanquis Bank.
- *Risk management function* – Supports the Risk Committee in the identification and management of risks.
- *Credit Committee* – Implements credit policy and monitors credit performance.
- *Risk identification and controls self assessment framework* – Ongoing self assessment of control effectiveness against identified risks facing each business area within Vanquis Bank.
- *TCF Committee* – Responsible for embedding TCF within Vanquis Bank.
- *Compliance function* – Responsible for assessing compliance with laws and regulations within Vanquis Bank.
- *In-house reviews* – A specific Vanquis Bank internal audit function which supplements the work of group internal audit.
- *Early warning bulletin* – A pre-determined process to escalate potential business issues throughout Vanquis Bank.

Biannual budget process

Each division produces a formal budget in November each year covering the current year out-turn, the budget for the following year and the forecast for the four subsequent years. The budgets are fully aligned to the group's strategy. Each division presents its budget to the Executive Directors before the budgets are consolidated and submitted to the Board for approval at the December Board meeting. A formal budget update is performed in May of the following year which is again approved by the Board.

Monthly management accounts

Monthly management accounts are prepared comparing actual trading results by division to budget and the prior year. Capital adequacy, funding and economic trends are also reported monthly. A rolling forecast of the full year out-turn is produced as part of the management accounts pack. Management accounts are distributed to the Executive Directors and senior members of the management team on a monthly basis and are distributed to the Board for each Board meeting.

Corporate policy manual

The group has a corporate policy manual setting out authority levels within the group. The corporate policy manual is distributed to each divisional Board and each divisional Board is required to confirm compliance with these policies on a biannual basis and outline any areas of non-compliance during the year.

Business continuity planning

Each division is responsible for preparing, maintaining and testing its own business continuity plans and ensuring that their plans are fit for purpose within the framework and strategy agreed by the RAG.

2. Risk management objectives and policies (continued)

2.4 Key risks faced by the group

In the course of its business, the group is exposed to a wide range of risks. For the purposes of undertaking the ICAAP, the group's risks are categorised into the FSA's GENPRU 1.2.30 risk classes as follows:

Pillar I risks:

- Credit risk;
- Operational risk; and
- Market risk.

Pillar II risks:

- Tax risk;
- Liquidity risk;
- Interest rate risk;
- Foreign exchange risk;
- Business risk;
- Reputational risk;
- Regulatory risk;
- Concentration risk; and
- Pension risk.

The definition of these risks and the associated controls and procedures in place to mitigate the risks are as follows:

2.4.1 Credit risk

Credit risk is the risk that the group will suffer loss in the event of a default by a customer or bank counterparty. A default occurs when the customer or bank fails to honour repayments as they fall due. Customer defaults in the non-standard credit market are typically higher than in more mainstream markets. In addition, the current economic climate has led to increased impairment levels in the credit market generally.

CCD

Credit risk management for CCD is the responsibility of the CCD Credit Committee. The CCD Credit Committee comprises the CCD Board and the Head of Credit Management and is responsible for approving product criteria and pricing. All changes to lending policy must be approved by the CCD Credit Committee, which meets at least every two months.

Credit Risk is managed using a combination of lending policy criteria, credit scoring (including behavioural scoring), policy rules, individual lending approval limits, central underwriting, and a home visit to make a decision on applications for credit.

2. Risk management objectives and policies (continued)

The home credit business is uniquely placed to manage impairment through challenging economic conditions. The loans offered by home credit are short-term, typically a contractual period of around a year, with an average value of between £300 and £500. The loans are underwritten in the home by an agent with emphasis placed on any previous lending experience with the customer and the home credit agent's assessment of the credit risk based on a completed application form and the home visit. Once a loan has been made, the agent visits the customer weekly to collect payment. The agent is well placed to identify signs of strain on a customer's income and can moderate lending accordingly. Equally, the regular contact and professional relationship that the agent has with the customer allows them to manage customers' repayments effectively even when the household budget is tight. This can be in the form of taking part payments, occasionally allowing missed payments or restructuring the debt in order to maximise cash collections.

Agents are paid commission for what they collect and not for what they lend so their primary focus is on ensuring loans are affordable at the point of issue and then on collecting cash. Affordability is reassessed by the agent each time an existing customer is re-served, or not as the case may be. This normally takes place within 12 months of the previous loan because of the short-term nature of the product.

The underwriting of direct repayment loans is also performed in the home. The emphasis is placed on employment and residential history, credit bureau reports, bank statements, salary slips, disposable income calculations, and the home visit. Average loan sizes are typically £1,800 repayable monthly via direct debit over a two-year period.

Behavioural scoring is used in home credit to support further lending decisions. An assessment of the credit risk of the customer is determined, based on the performance of the customer over the past 30 weeks. This risk assessment is used to set a lending limit for each customer (which could be zero). The home credit agent will combine their knowledge of the customer with the information from the behavioural scoring system.

Arrears management within CCD is a combination of central letters, central telephony, and field activity undertaken by field management. This will often involve a home visit to discuss the customer's reasons for non-payment and to agree a resolution.

Weekly and monthly monitoring is undertaken by two departments: Credit Management and Portfolio Analysis & Forecasting. Monitoring occurs at both the product portfolio level and at field management level. Any significant departures from expected performance, together with the reason for departure, are reported to the CCD Credit Committee for it to determine the appropriate action.

Vanquis Bank

Oversight of Vanquis Bank credit risk is managed by the Vanquis Bank Credit Committee. The Vanquis Bank Credit Committee comprises the Managing Director, Commercial Director and the Directors of Finance, Credit and Operations and meets at least quarterly. The Committee manages all credit risks of Vanquis Bank, specifically to ensure that the approach to lending is within sound risk and financial parameters and that key metrics are reviewed to ensure compliance to policy.

2. Risk management objectives and policies (continued)

A customer's risk profile and credit line is evaluated at the point of application and at various times during the agreement. Credit lines can go up as well as down according to the point in time risk assessment. Initial credit limits are low, typically £250.

Vanquis Bank has developed a set of scorecards and policy rules to assess an individual's default risk and their ability to manage a specific credit line. The scorecards have been developed using the actual payment performance history of customers, and are a reflection of the applicant's likely default risk.

For applications from new customers, the scorecards incorporate data from the applicant, such as income and employment, and data from external credit bureaus. The credit bureau reports a history of the applicant's payment performance with other lenders' credit products. This data is combined to provide an overall assessment of risk.

For existing customers, the scorecards also incorporate data on actual payment performance and product utilisation and take data from an external credit bureau each month to refresh customers' payment performance position with other lenders. As a result, the customer's latest performance across all their UK lending is incorporated into credit line management decisions each month.

Arrears management is a combination of central letters, inbound and outbound telephony and outsourced Debt Collection Agency activities. Vanquis Bank attempts to make contact with the customer to discuss the reasons for non-payment and specific strategies are employed to support the customer in recovering to a good standing.

Daily and monthly monitoring of portfolio KPIs is undertaken. Any significant departures from expected performance, together with the reason for departure, are reported to the divisional Board and the Vanquis Bank Credit Committee to take the appropriate action.

Bank counterparties

Counterparty credit risk arises as a result of cash deposits placed with banks and the use of derivative financial instruments with banks and other financial institutions which are used to hedge interest rate risk (see also 2.4.6) and foreign exchange risk (see also 2.4.7).

Counterparty credit risk is managed by the group's Treasury Committee and is governed by a Board approved counterparty policy which ensures that the group's cash deposits and derivative financial instruments are only made with high quality counterparties with the level of permitted exposure to a counterparty firmly linked to the strength of its credit rating. In addition, there is a maximum exposure limit for all institutions, regardless of credit rating. This is linked to the group's regulatory capital base and is in line with the group's regulatory reporting requirements on large exposures to the FSA.

2. Risk management objectives and policies (continued)

2.4.2 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems.

The group manages operational risk as part of the risk management process which is overseen by the RAC. Each division has the responsibility for putting in place appropriate controls to mitigate operational and other risks. Both CCD and Vanquis Bank operate their own risk functions whose responsibility it is to monitor operational risks at a divisional level, monitor the controls in place to mitigate those risks and determine the likelihood, value and impact of the risks. Regular reporting of all risks, including operational risk, is presented to the divisional boards and to the RAG on a quarterly basis by means of updated risk registers.

The principal operational risks and the key controls in place to mitigate those risks are as follows:

- **IT systems** - Like any other financial services organisation, the group's divisions rely on the effective and efficient use of IT systems. IT is managed on a divisional basis by experienced management teams with the use of third party contractors and consultants where necessary.

  The group has disaster recovery procedures and policies in place which are designed to allow the group to continue trading in the event of such a disaster. These policies and procedures are tested on a regular basis.

  Significant changes to IT systems are managed by dedicated project teams in each division. This ensures that specialist resource is utilised to plan, test and deliver new systems enabling other resources to continue with business as usual activities.

- **Health and safety** - The health and safety of employees and agents is a key concern for the group. As a result, the group invests a considerable amount of time ensuring staff are safety conscious. It also assists agents to ensure that they are safety aware. Induction sessions and regular updates are provided on safety awareness and safety awareness weeks form part of the annual calendar.

- **Fraud** - The group can be the subject of fraud by customers, employees and agents. Both CCD and Vanquis Bank operate specialist departments to identify, investigate and report on fraudulent activity. Fraud reports are presented to the divisional boards and the group Audit Committee.

- **Recruiting and retaining highly skilled management and staff** - The group is dependant on the Executive Directors and the senior management team to deliver the group's strategy. The group maintains effective recruitment, retention and succession planning strategies and monitors remuneration and incentive structures to ensure that they are appropriate and competitive. The group also ensures that there are training and development opportunities and effective staff communication throughout the business.

In addition to the above mitigating controls, the group also maintains a range of insurance policies to cover eventualities such as business interruption, loss of IT systems and crime.

2. Risk management objectives and policies (continued)

2.4.3 Market risk

Market risk under Pillar I is the risk of loss due to adverse market movements caused by active trading positions taken in interest rates, foreign exchange markets, bonds and equities.

The group's policies do not permit it to undertake trading positions and accordingly, the group is not therefore subject to market risk under Pillar I.

2.4.4 Tax risk

Tax risk is the risk of loss arising from changes in tax legislation or practice.

The group has a board approved tax strategy. The group's overall tax risks are managed by an in-house tax team who are responsible for managing the group's tax affairs. In addition, advice from external professional advisors is sought for all material transactions and, where possible, tax treatments are agreed in advance with any relevant authorities.

The group's in-house tax team works closely with external advisors on key corporate and indirect tax matters, including the self-employed status of agents.

2.4.5 Liquidity risk

Liquidity risk is the risk that the group will have insufficient liquid resources available to fulfil its operational plans and/or meet its financial obligations as they fall due.

Liquidity risk is managed daily by the group's centralised treasury department through monitoring of expected cash flows in accordance with a Board approved group funding and liquidity policy. This process is monitored regularly by the Treasury Committee.

The group's funding and liquidity policy is designed to ensure that the group is able to continue to fund the growth of the business through its existing borrowing facilities. The group therefore maintains committed borrowing facilities in excess of expected borrowing requirements to ensure a significant and continuing headroom above forecast requirements at all times for at least the following 12 months. In determining the forecast borrowing requirement, attention is paid to the currently undrawn credit lines granted by Vanquis Bank.

The group is less exposed than mainstream lenders to liquidity risk as the loans issued by the home credit business, the group's largest business, are of a short-term duration (typically of around one year) whereas the group's borrowing facilities typically extend over a number of years.

As at 31 December 2009, the group's committed borrowing facilities had a weighted average maturity of 3.5 years (2008: 3.0 years) and the headroom on these facilities amounted to £331.0m (2008: £251.2m).

2. Risk management objectives and policies (continued)

2.4.6 Interest rate risk

Interest rate risk is the risk that a change in external interest rates leads to an increase in the group's cost of borrowing.

The group's interest cost is a relatively small part of the group's cost base, representing only 7.8% of total costs in the year ended 31 December 2009.

The group's exposure to movements in interest rates is monitored by the Treasury Committee and is governed by a Board approved interest rate hedging policy, which forms part of the group's treasury policies.

The group seeks to limit the net exposure to changes in sterling interest rates. This is achieved through a combination of issuing fixed rate debt and by the use of derivative financial instruments such as interest rate swaps.

2.4.7 Foreign exchange risk

Foreign exchange risk is the risk that a change in foreign currency exchange rates leads to a reduction in profits or equity.

The group's exposure to movements in foreign exchange rates is monitored by the Treasury Committee and is governed by a Board approved currency risk management policy which forms part of the group's treasury policies.

The group's exposures to foreign exchange risk arise solely from: (i) the issuance of US dollar loan notes, which are fully hedged into sterling through the use of cross-currency swaps; and (ii) the Home Credit operations in the Republic of Ireland, which are hedged by matching euro denominated net assets with euro denominated borrowings as closely as possible.

2.4.8 Business risk

Business risk is the risk of loss arising from the failure of the group's strategy or management actions over the planning horizon.

The group has developed a clear strategy to grow the business by focusing on being the leading lender to the c.10 million people in the UK who make up the non-standard market. To deliver the strategy the group aims to grow its existing businesses in a controlled manner by developing new distribution channels; developing or acquiring new products and services to meet the changing needs of customers; and enhancing business processes to ensure that the group remains efficient and competitive.

The business risk associated with failure to deliver the group strategy is mitigated by a number of actions:

- The Board has an annual off-site planning conference to discuss strategy, performance and business opportunities.
- The group has a Director of Corporate Strategy whose role is to develop corporate strategy, identify strategic opportunities and monitor the strategy and performance of direct, indirect and potential competitors and partners.

2. Risk management objectives and policies (continued)

- New products or processes are supported by a detailed business plan and are thoroughly tested and assessed prior to formal roll-out.
- Customer surveys performed by third parties are used regularly to assess customer demographics, attitudes and needs.
- There is wide ranging monitoring of competitor product offers, pricing levels and strategic and operational actions.
- There is a programme management function and process that oversees and controls major change efforts in the business to ensure that they align with strategic priorities.
- A management accounts and budgeting process is in place to monitor actual performance against targets, including strategic and operational reporting.

2.4.9 Reputational risk

Reputational risk is the risk that an event or circumstance could adversely impact the group's reputation. Operating as it does in the non-standard market leads to greater scrutiny of the group's activities and any adverse publicity from the activities of legislators, pressure group and the media could potentially have a detrimental impact on the group's sales and collections activities.

Reputational risk is managed in a number of ways. At group level there is a dedicated team and established procedures for dealing with media issues. In addition, a pro-active communication programme to foster a better understanding of the group's products is co-ordinated at group level and is targeted at key opinion formers.

Both divisions regularly conduct customer satisfaction surveys to ensure that customer's needs are being met and that customers are satisfied with the service they are receiving. Customer satisfaction in the home credit business is 94% (2008: 95%) and in Vanquis Bank is 86% (2008: 86%).

Continued investment in a group co-ordinated community programme helps to foster good relations with customers and the areas in which they live.

2.4.10 Regulatory risk

Regulatory risk is the risk of loss arising from a breach of existing regulation or regulatory changes in the markets within which the group operates. The current volatile economic environment has resulted in a greater focus on regulation, and in particular, there has been an increase in the level of scrutiny placed upon lenders in the non-standard markets.

The group's operations are subject to various forms of regulation originating from Europe, the UK and the Republic of Ireland. These regulations are subject to continual modification which could adversely affect the group's operations if they are not effectively anticipated and responded to. Changes to legislation could include the introduction of interest rate caps, changes to regulations on doorstep lending, more stringent consumer credit legislation or changes in the employment status of CCD's self-employed agents.

In order to effectively manage the risk associated with changing regulation, the group has a central in-house legal team which, working closely with the CCD and Vanquis Bank compliance functions, seeks to ensure that the group's operations are compliant with current legislation and manages the implementation of future changes to legislation. Expert third party legal advice is taken where necessary. In addition, both directly and through its trade body, the Consumer Credit Association, the group aims to maintain a constructive level of dialogue with its regulators to ensure that its businesses are fully understood.

2. Risk management objectives and policies (continued)

2.4.11 Concentration risk

Concentration risk is the risk arising from the lack of diversification in the group's business either geographical, demographic or by product.

The group's operations are concentrated wholly in the UK and Republic of Ireland in the non-standard consumer credit market which may indicate concentration risk. However, the group's customer base is well diversified throughout the UK and the Republic of Ireland and is not concentrated in a particular region. In addition, the group offers a number of different products within CCD in addition to the Vanquis Bank credit card to ensure that there is not an over reliance on a particular product.

2.4.12 Pension risk

Pension risk is the risk that there may be insufficient assets to meet the liabilities of the group's defined benefit pension scheme.

The group operates a defined benefit pension scheme based on final salary. There is a risk that the liabilities within the scheme materially exceed the assets in the scheme due to changes in corporate bond yields, inflation, equity and bond returns and mortality rates.

In order to mitigate the pension risk, the defined benefit pension scheme was substantially closed to new members joining the group after 1 January 2003. All new employees joining the group after 1 January 2003 are invited to join a stakeholder pension plan into which the group typically contributes between 5.1% and 10.6% of members' pensionable earnings, provided the employee contributes, through a salary sacrifice arrangement, a minimum of between 3.0% and 8.0%. The group has no investment or mortality risk in respect of the stakeholder pension plan. In addition, during 2006, new pension arrangements were incorporated into the group's defined benefit scheme which gave active members the choice of (i) paying higher contributions into the scheme and retaining final salary benefits or (ii) paying reduced contributions and joining the 'cash balance' section of the scheme. The aim of the new arrangements is to reduce the group's exposure to improving mortality rates. The scheme's investment strategy is to maintain a balance of assets between equities and bonds in order to reduce the risk of volatility in investment returns.

As at 31 December 2009 the group had a pension asset, calculated in accordance with IAS 19 'Employee benefits', of £19.9m (2008: £50.9m) on its balance sheet. The group, in conjunction with its advisors, continues to monitor investment strategy carefully.

3. Capital adequacy

3.1 Controls

The group prudently manages its regulatory capital to ensure that it is always maintained at a sufficient level in excess of the ICG set by the FSA. The key controls in achieving this objective are:

- Monitoring the level of regulatory capital against the ICG on a monthly basis as part of the group's management accounts;
- Producing a rolling forecast, as part of the management accounts, projecting regulatory capital against the ICG for the remainder of the financial year;
- As part of the budget and budget update process, forecasting regulatory capital for the following five years and comparing this to the group's ICG;
- Assessing the impact that strategic projects could have upon regulatory capital;
- Submitting regulatory capital reports to the FSA periodically; and
- Assessing the appropriateness of the ICG as part of the group's ICAAP process, including stress and scenario testing, and reporting to the FSA if it is no longer considered to be appropriate.

3.2 Composition of regulatory capital resources

The group's regulatory capital resources comprise tier 1 and lower tier 2 capital. The table below sets out the composition of the group's regulatory capital resources as at 31 December 2009:

	Note	2009 £m	2008 £m
Core tier 1 capital:			
Called-up share capital		27.9	27.3
Share premium account		142.4	134.6
Retained earnings and other reserves	1	113.3	107.1
		283.6	269.0
Deductions from tier 1 capital:			
Intangible assets	2	(21.6)	(20.2)
Investment in own shares	3	(16.9)	(16.0)
		(38.5)	(36.2)
Total tier 1 capital after deductions		245.1	232.8
Tier 2 capital:			
Lower tier 2 capital - Subordinated loan notes	4	6.0	100.0
Total regulatory capital resources		251.1	332.8

1. Retained earnings and other reserves for regulatory capital purposes represent the group's equity reserves, adjusted to exclude the group's pension asset, net of deferred tax, and fair value movements in respect of derivative financial instruments, net of deferred tax. The group's retained earnings and other reserves included in tier 1 regulatory capital can be reconciled to the amounts disclosed in the 2009 and 2008 financial statements as follows:

3. Capital adequacy (continued)

	2009	2008
	£m	£m
Retained earnings	111.1	132.3
Other reserves:		
Profit retained by subsidiary	0.8	0.8
Capital redemption reserve	3.6	3.6
Hedging reserve	(12.6)	(12.0)
Share-based payment reserve	12.1	7.3
Retained earnings and other reserves included in the financial statements	115.0	132.0
Regulatory capital adjustments:		
Pension asset	(19.9)	(50.9)
Deferred tax on pension asset	5.6	14.3
Fair value of derivative financial instruments	17.4	16.6
Deferred tax on fair value of derivative financial instruments	(4.8)	(4.6)
Other	-	(0.3)
Retained earnings and other reserves included in tier 1 regulatory capital	113.3	107.1

2. Intangible assets comprise goodwill and capitalised software and software development costs. These are required to be deducted from capital for regulatory capital purposes.

3. The investment in own shares represents shares in Provident Financial plc which have been purchased to satisfy grants and awards made under the group's share incentive schemes. These are required to be deducted from capital for regulatory capital purposes.

4. The group's lower tier 2 capital represents subordinated loan notes which are repayable on 15 June 2015 and accrue interest at 7.125%. The company has the option to redeem the loan notes at par on 15 June 2010. On 23 October 2009, the group repurchased £94.0m of the £100.0m subordinated loan notes prior to their call date at a price of 97.5p in the £ following a tender offer. The group no longer required this lower tier 2 regulatory capital following confirmation of its ICG by the FSA. The subordinated loan notes are hybrid instruments which have attributes of both debt and equity which, subject to certain criteria, allow the loan notes to qualify as eligible lower tier 2 capital. The criteria include the need for the loan notes to be long-term in nature, subordinated to all other borrowings and liabilities upon winding up of the company and not contain financial ratio covenants which may trigger early redemption by the note holders. There are two further restrictions on the recognition of the subordinated loan notes as eligible lower tier 2 regulatory capital:

   (i) Lower tier 2 regulatory capital cannot exceed 50% of tier 1 capital; and
   (ii) When the loan notes have more than 5 years until maturity, they are fully eligible, subject to (i) above, as lower tier 2 regulatory capital. However, when they have less than 5 years until maturity, the amount eligible for recognition as lower tier 2 regulatory capital reduces by 20% per annum for each year below 5 years.

   As at 31 December 2009 and 31 December 2008, the subordinated loan notes were not in excess of 50% of tier 1 capital and had over 5 years until maturity. Accordingly, the full amount of the loan notes was eligible as lower tier 2 capital.

3. Capital adequacy (continued)

3.3 Pillar I minimum capital requirement

In calculating the Pillar I minimum capital requirement, the group has adopted the standardised approach to credit risk and the alternative standardised approach to operational risk.

An analysis of the Pillar I minimum capital requirement as at 31 December 2009 is as follows:

	2009	2008
	£m	£m
Credit risk:		
Retail – not past due	58.3	55.4
Retail – past due	14.3	12.1
Other	5.6	4.4
Total credit risk	78.2	71.9
Operational risk	6.8	6.4
Counterparty risk	0.4	0.7
Foreign currency risk	0.2	0.4
Pillar I minimum capital requirement as at 31 December	85.6	79.4

3.4 Capital adequacy ratio

The ICG set by the FSA is expressed as a percentage of the minimum regulatory capital required under Pillar I of the CRD.

As at 31 December 2009, the group's total regulatory capital resources of £251.1m (2008: £332.8m) represented 293% (2008: 419%) of the Pillar I minimum capital requirement. This was comfortably in excess of the ICG set by the FSA.

4. Credit risk

4.1 Accounting policy for customer receivables

All customer receivables are initially recognised at the amount loaned to the customer plus directly attributable incremental issue costs. After initial recognition, customer receivables are subsequently measured at amortised cost. Amortised cost is the amount of the customer receivable at initial recognition less customer repayments, plus revenue earned calculated using the effective interest rate, less any deduction for impairment.

The group assesses whether there is objective evidence that customer receivables have been impaired at each balance sheet date. The principal criteria for determining whether there is objective evidence of impairment is delinquency in contractual payments.

Within the weekly home credit business of CCD, objective evidence of impairment is based on the payment performance of loans in the previous 12 weeks as this is considered to be the most appropriate indicator of credit quality in the short-term cash loans business. Loans are deemed to be impaired when the cumulative amount of two or more contractual weekly payments have been missed in the previous 12-week period since only at this point do the expected future cash flows from loans deteriorate. Accordingly, loans with one missed weekly payment over the previous 12-week period are not deemed to be impaired. The amount of impairment loss is calculated on a portfolio basis by reference to arrears stages and is measured as the difference between the carrying value of the loans and the present value of estimated future cash flows discounted at the original effective interest rate. Subsequent cash flows are regularly compared to estimated cash flows to ensure that the estimates are sufficiently accurate for impairment provisioning purposes.

Within the monthly Vanquis Bank credit card business and the monthly unsecured direct repayment loans business of CCD, customer balances are deemed to be impaired as soon as customers miss one monthly contractual payment. Impairment is calculated as the difference between the carrying value of receivables and the present value of estimated future cash flows discounted at the original effective interest rate. Estimated future cash flows are based on the historical performance of customer balances falling into different arrears stages and are regularly reassessed.

At the closed Yes Car Credit (YCC) business, customer accounts are deemed to be impaired as soon as one monthly contractual payment has been missed. Impairment is calculated as the difference between the carrying value of the receivable and the present value of estimated future cash flows, discounted at the original effective interest rate. Estimated future cash flows on impaired loans include the expected proceeds from the disposal of the motor vehicle upon which finance was originally provided. The collect-out of the residual receivables book of YCC was completed in October 2009.

4. Credit risk (continued)

4.2 Analysis of credit risk exposures

The group's maximum exposure to credit risk on customer receivables is the carrying value of customers receivables recorded in the group's balance sheet.

All customer receivables are classed as retail exposures. Vanquis Bank exposures are revolving retail exposures.

Exposures analysed by business division are as follows:

	2009	2008
	£m	£m
CCD	883.8	852.1
Vanquis Bank	255.5	205.4
YCC	-	5.8
Total	1,139.3	1,063.3

The average exposure in the year to 31 December 2009 was £1,012.7m (31 December 2008: £909.8m).

Exposures analysed by geographical area are as follows:

	2009	2008
	£m	£m
UK	1,088.8	1,011.7
Republic of Ireland	50.5	51.6
Total	1,139.3	1,063.3

The group's exposures are well dispersed across the United Kingdom (UK) and Republic of Ireland (ROI).

The following table shows the residual maturity of exposures by business on a contractual basis:

	2009			2008		
	Due within one year	Due within one to two years	Total	Due within one year	Due within one to two years	Total
	£m	£m	£m	£m	£m	£m
CCD	796.9	86.9	883.8	768.4	83.7	852.1
Vanquis Bank	255.5	-	255.5	205.4	-	205.4
YCC	-	-	-	5.8	-	5.8
Total	1,052.4	86.9	1,139.3	979.6	83.7	1,063.3

4. Credit risk (continued)

4.3 Credit quality of customer receivables

In the home credit business of CCD, past due but not impaired balances relate to loans which are contractually overdue. However, contractually overdue loans are not deemed to be impaired unless the customer has missed two or more cumulative weekly payments in the previous 12-week period, since only at this point do the expected future cash flows from loans deteriorate.

Within Vanquis Bank, YCC and the unsecured direct repayment loans business of CCD, customer balances are deemed to be impaired as soon as customers miss one contractual monthly payment. Therefore, within Vanquis Bank, YCC and the unsecured direct repayment loans business of CCD, there are no accounts/balances which are past due but not impaired.

The credit quality of customer receivables is as follows:

	2009	2008
	£m	£m
Neither past due nor impaired	545.4	504.7
Past due but not impaired	129.5	113.8
Impaired	464.4	444.8
Total	1,139.3	1,063.3

The credit quality of customer receivables analysed by business division is as follows:

	2009				2008			
	CCD	Vanquis Bank	YCC	Total	CCD	Vanquis Bank	YCC	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Neither past due nor impaired	333.7	211.7	-	545.4	328.7	170.8	5.2	504.7
Past due but not impaired	129.5	-	-	129.5	113.8	-	-	113.8
Impaired	420.6	43.8	-	464.4	409.6	34.6	0.6	444.8
Total	883.8	255.5	-	1,139.3	852.1	205.4	5.8	1,063.3

The credit quality of customer receivables analysed by geographical area is as follows:

	2009			2008		
	UK	ROI	Total	UK	ROI	Total
	£m	£m	£m	£m	£m	£m
Neither past due nor impaired	526.8	18.6	545.4	485.3	19.4	504.7
Past due but not impaired	121.9	7.6	129.5	106.8	7.0	113.8
Impaired	440.1	24.3	464.4	419.6	25.2	444.8
Total	1,088.8	50.5	1,139.3	1,011.7	51.6	1,063.3

4. Credit risk (continued)

4.4 Movement in impairment provisions

The impairment charge/(credit) to the income statement in respect of customer receivables analysed by business division is as follows:

	2009	2008
	£m	£m
CCD	223.4	197.9
Vanquis Bank	61.7	38.2
YCC	(1.7)	1.6
Total	283.4	237.7

The movement in the impairment allowance account within Vanquis Bank in the year is as follows:

	2009	2008
	£m	£m
At 1 January	26.4	19.9
Charge for the year	61.7	38.2
Amounts written off during the year	(57.2)	(40.9)
Amounts recovered during the year	9.1	9.2
At 31 December	40.0	26.4

For CCD and YCC, impairment charges are deducted directly from the carrying value of receivables without the use of an impairment allowance account. Accordingly, it is not possible to disclose movements in an impairment allowance account for CCD and YCC.

5. Counterparty credit risk

Details of the group's counterparty credit risk and the controls in place to mitigate the risk are set out in section 2.4.1 on page 10.

5.1 Counterparty exposure limits

The counterparty credit limits that are applied to banks and similar institutions are based on:

- Credit rating limits; and
- An assessment of excess risk.

The group uses credit ratings as an independent measure of an institution's capacity for timely payment of debt. The group relies principally on two UK rating agencies; Moodys and Fitch Ratings. Rating limits are determined by reference to the lower of the long-term rating granted to an institution by Moodys and Fitch Ratings. In each case the institution must also have the highest short-term credit rating of P-1 to be acceptable.

Excess risk is considered by the Board on a case by case basis. It is normally only applicable for institutions with whom the group has a strong lending relationship to offset the exposure.

It is the group's policy that exposures maturing in less than one year do not exceed 5% of the group's regulatory capital, and that exposures maturing in more than one year do not exceed 10% of the group's regulatory capital.

5.2 Exposures to counterparties

The group measures exposure value on counterparty credit exposures under the CCR mark-to-market method. This exposure value is derived by adding the gross positive fair value of the contract (replacement cost) to the contract's potential credit exposure, which is derived by applying a multiple based on the contract's residual maturity to the notional value of the contract.

The group uses derivative financial instruments to hedge the interest rate risk and foreign exchange rate risk on its borrowings. The group does not enter into speculative transactions or positions.

The contractual/notional amounts and the fair value of derivative financial instruments are set out below:

			2009			2008
	Contractual /notional amount	Fair value of assets	Fair value of liabilities	Contractual/ notional amount	Fair value of assets	Fair value of liabilities
	£m	£m	£m	£m	£m	£m
Interest rate swaps	1,361.0	-	(24.6)	1,488.5	-	(20.0)
Cross-currency swaps	164.8	12.5	(4.4)	164.8	28.9	(0.1)
Foreign exchange contracts	3.0	-	(0.1)	5.5	-	(0.7)
Total	1,528.8	12.5	(29.1)	1,658.8	28.9	(20.8)

5. Counterparty credit risk (continued)

Due to the high-quality nature of the group's counterparties, the group does not secure collateral and does not establish credit reserves. The group does not provide collateral to counterparties and there is no requirement to provide collateral in the event of a downgrade in the group's own credit rating (currently BBB+ with Fitch Ratings) or any other circumstances. The group has no wrong-way risk exposures or credit derivative hedges.

6. Interest rate risk

Details of the group's interest rate risk and the controls in place to mitigate the risk are set out in section 2.4.6 on page 13.

The group measures its interest rate exposure by quantifying the impact of an immediate and sustained movement of 200bp in LIBOR rates upon its forecast profit.

In calculating this exposure, the group assumes that it will not re-price its receivables portfolio during the next 18 months to mitigate the impact upon forecast borrowing costs. This period is considered to represent an appropriate balance between the contractual duration of the receivables portfolios and the achievement of a high level of certainty over near-term forecast borrowing costs. In practice, it is possible for Vanquis Bank to re-price its receivables at 30 days' notice and for all new CCD loans to be issued at re-priced levels immediately.

The level of fixed and floating rate receivables and borrowings beyond the next 18 months are forecast to be matched, resulting in a neutral interest rate position.

The level of interest rate exposure calculated on the basis set out above as at 31 December 2009 is as follows:

	2009	2008
	£m	£m
Sterling	0.1	1.3
Euro	0.2	0.6
Total	0.3	1.9