TSL Servicing Limited

ICAAP Pillar III statement December 2018

Contents

1. Executive Summary

IFPRU 2.2 states, "A firm must, at all times, maintain overall financial resources and internal capital, including own funds and liquidity resources which are adequate both as to amount and quality to ensure there is no significant risk that its liabilities cannot be met as they fall due".

Following receipt of additional regulatory permissions in 2015, TSL was reclassified as an IFPRU £125k Limited Licence firm and as such, the Group is required to meet the requirements of the FCA's capital adequacy framework. This framework consists of three pillars:

- Pillar I: Sets out the minimum capital requirements for credit, market and operational risks;
- Pillar II: Requires that regulated firms take a view on whether a firm should hold additional capital against risks not covered by Pillar I; and
- **Pillar III: Complements Pillars I and II, and requires firms to publish details of their risks, risk management processes and capital position.**

Overall conclusion

The Board of TSL considers that its oversight of its ICAAP statement and risk framework is robust and is pleased to confirm:

- Financial resources sufficiently exceed the FCA's capital requirements for TSL of £9.46m
- As at 31/03/18, TSL's own funds were £28.17m, providing a surplus of £18.71m against FCA requirements and a capital ratio of 23.8%
- TSL's Board assessment of its overall risk capital requirement is marginally lower than FCA requirements at £9.2m, providing a surplus of £18.97m (£3.5m in 2016) against our own funds position as at 31/03/18
- TSL has a culture of risk awareness that enables the proactive identification, control and mitigation of risk. In completing its ICAAP, the TSL Board has considered whether any additional capital should be held, but has concluded that its risk mitigation activities are sufficiently robust and therefore no additional capital is required
- The ICAAP has been reviewed and challenged by Management and Group Risk committees and the Board of TSL, with final review and approval occurring on 23/05/2018.

2. Basis of Disclosure

IFPRU 2.2.12 requires that the processes, strategies and systems described by the overall Pillar 2 (ICAAP) rule must be comprehensive and proportionate to the nature, scale and complexity of the firm's activities. TSL has completed its ICAAP on a proportionate basis (as set out in IFPRU 2.3.33) as its "activities are simple and predominantly not credit related".

Within its ICAAP submission TSL has assessed its capital requirements against its five-year business plan (2015 -2019). The assessment included appropriate stress testing of its requirements against severe, but plausible, risk scenarios. The disclosures in this document reflect that ICAAP submission and cover the qualitative requirements of Pillar III reporting

These disclosures provide information on the risk structure that underpins the calculation of capital requirements and on the holistic management of risks faced by TSL. It should be noted that whilst only TSL was included in the ICAAP reporting, the Risk Management framework and governance described in this document applies across Target Group.

2.1 Frequency of disclosure
Pillar III disclosures will be made on an annual basis as soon as practicable after the publication of the Group's annual report.

2.2 Location of disclosure
Pillar III disclosures will be published on the Target Group Ltd website (https://www.Targetgroup.com), and will also be available on request by writing to Target's company secretary at:

Target Group
Imperial Way
Newport
NP10 8UH

2.3 Verification of disclosure
Disclosures will only be subject to external verification to the extent they are equivalent to those taken from the audited annual financial statements. These disclosures provide information about risk management generally, they do not constitute financial statements.

3. Background

3.1 Summary of TSL business model
TSL's core business model is built around its loan and investments administration capability. For nearly 40 years Target has helped its clients operate more efficiently and manage their risk. Firstly, as a software company and latterly as a broader service provider with many of the UK's leading finance companies, using Target software and services to manage their portfolios.

In early 2015 TSL was granted additional regulatory permissions that enabled it to build on its structured products administration services and move to originating structured products through its brand Hartmoor Financial (Hartmoor). Hartmoor launched its first structured deposits in January 2016, and withdrew from the market at the end of that year and therefore this work represented only a small proportion of the TSL business model. However, because of the additional permissions required, TSL became an IFPRU 125k limited licence firm and is therefore included within the ICAAP process.

3.2 Ownership framework
TSL operates as part of the Target Group, with Tech Mahindra considered the ultimate controlling party, through Tech Mahindra Fintech Holdings Limited.

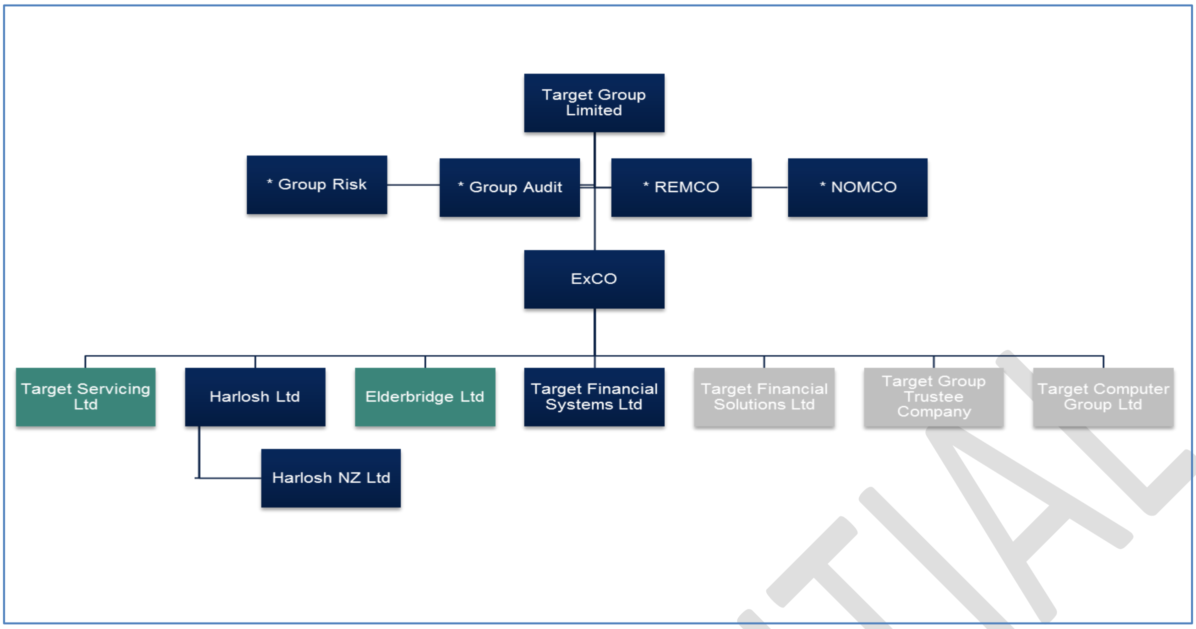
4. Governance and Risk Framework
TSL's risk appetite statement underpins its day-to-day decision making:

"*TSL aims to increase its enterprise value by offering innovative technology based servicing, software and product propositions, within the constraints of its financial resources and without compromising customer outcomes, its reputation or its brand.*

It only pursues opportunities that are well understood, that support the vision and strategy of the group and where risks can be effectively managed".

TSL has established a robust governance framework that supports this risk appetite and facilitates effective, risk based decision making. Risk decisioning is aligned to the overall group strategy and approach established by the Board. The schematics below set out TSL's governance arrangements.

4.1 Governance structure



The directors of TSL have ultimate responsibility for ensuring that the business is managed and controlled effectively. The Board is comprised off:

- Vivek Agarwal - Non-Executive Chairman
- Andrew Doman - Non-Executive Director
- Patrick Byrne - Non-Executive Director
- Ian Larkin - CEO
- Iestyn Evans - CFO
- Terence Baxter – Risk and Compliance Director

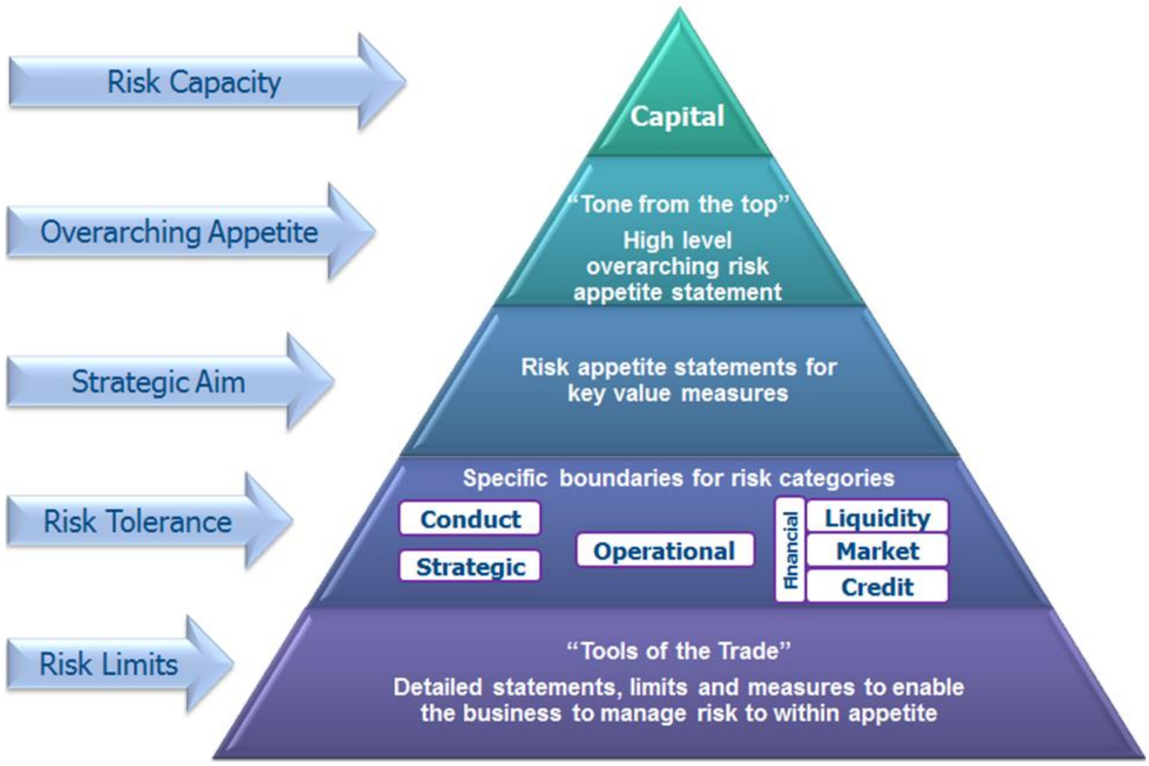
In practice, day-to-day management is delegated by the Board to the CEO and the EXCO. Control processes are built into the risk management framework and the key committees:

Target Group Risk Governance Model

* These are examples of various business level forums and meetings that form part of the risk identification process in the first line.

4.2 Risk Management Framework

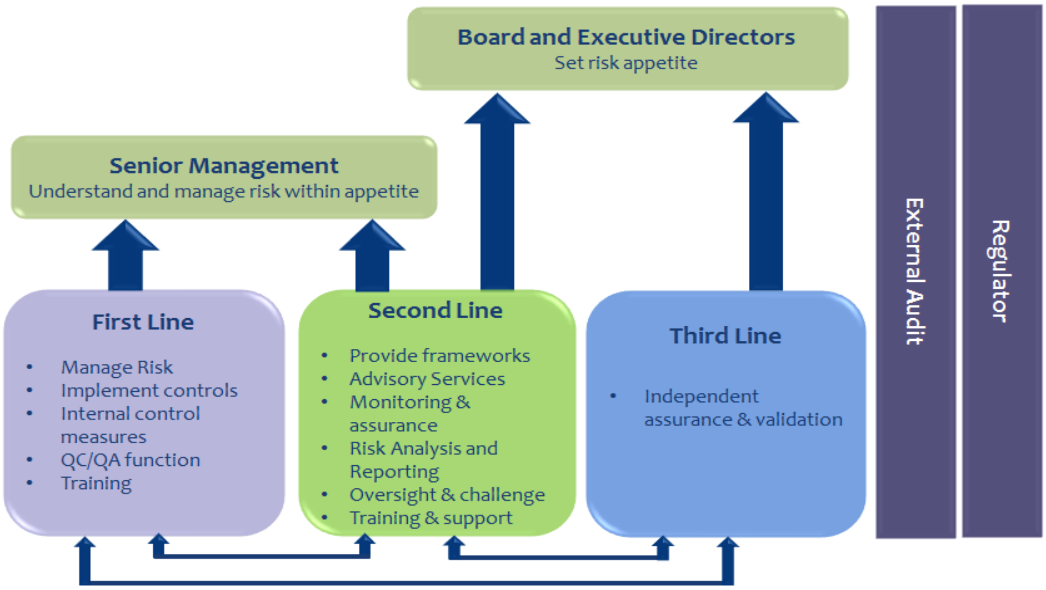
TSL's Board set the overall strategy for TSL and monitors adherence to this strategy through the various governance forums that exist.



TSL benefits from being a core part of Target Group's Risk management framework, which is at the heart of its business activities. All colleagues are responsible for helping to manage the risk in the organisation. As illustrated in the diagram below the risk framework is designed to identify, assess, monitor and manage risks within the business. The outputs of this activity are reviewed on a regular basis by the Risk governance committee structure.

Risk management is a continuous and developing activity with TSL. It is integral to our culture and led by senior management. Responsibility for risk at board, divisional and business level is assigned to ensure clear reporting lines and defined areas of responsibility.

The risk management arrangements at TSL are based on the '**Three lines of defence'** model as follows:



As part of its 3LoD model, TSL benefits from a group wide second line Risk & Compliance function with c50 FTE and an Internal Audit function of 3 FTE. The Internal Audit function is supplemented by an external co-sourcing arrangement with Ernst & Young (EY).

TSL's external auditors are KPMG.

4.3 Risk language

To support the identification and oversight of risk, a language model has been developed that defines the major risk category types. These risk categories (shown in the diagram below) have been defined and mandated by TSL, and each of which is supported by separate policies and guidance notes. Each category reflects a risk to the organisation which can then be reported against, tracked and aggregated, as appropriate. This language can then support varying business priorities. For example, in Dec 2016 the board agreed 4 key objectives within the Balanced Business Scorecard for the business; Client, People, Internal process and Financial. The Risks associated with these are already covered in the Risk language and Risk metrics are in place to support the chosen business focus.

Strategic Risk	
External & Reg Environment	Governance
Reputational	Target Strategy
Culture	

Financial Risk	
Revenue	Operating Expense
Liquidity/Capital Risk	

Operational & Conduct			
Information Security and Data Protection	Servicing & Arrears	Workflow & Resource Planning	Client Money and Assets
Business resilience & Physical Assets	Customer Outcomes	Client Management	People
Technology Capability and Availability	Financial Control	Supplier / Third Parties	Business process and event reporting
Change	Financial Crime	Health/Safety	

4.4 Risk identification

The Risk team uses a combination of multiple first line fora/committees alongside a process of Risk Control Self-Assessment (RCSA) within the business to identify and escalate risk. Once identified the risk will be escalated for review and action though the appropriate monthly Divisional Risk Committee to the Management Risk Committee (MRC). Group Risk Committee (GRC) meets at least 6 times a year (bi-monthly) to provide oversight and challenge at board level to the actions and decisions taken at MRC. In addition, The MRC papers include a summary of risks under review and horizon scanning for future risk. The Risk team provide advice, guidance and challenge to the 1st line to help them identify assess and manage risk.

4.5 Risk measurement

The Risk team use an agreed matrix to quantify risk and create a RAG status to aid reporting and prioritisation.

Impact and Likelihood Risk Rating Criteria						
Consequences What is the severity/financial impact (If the risk event actually occurs)?		Likelihood (Probability) How likely is the failure to occur Rare 1	Unlikely 2	Possible 3	Likely 4	Almost Certain 5
Very High	5	Medium Low [12]	Medium High [19]	High [22]	Very High [24]	Very High [25]
High	4	Medium Low [11]	Medium High [17]	Medium High [18]	High [21]	Very High [23]
Medium - High	3	Low [5]	Medium Low [10]	Medium High [15]	Medium High [16]	High [20]
Medium - Low	2	Low [4]	Medium Low [8]	Medium Low [9]	Medium High [13]	Medium High [14]
Low	1	Low [1]	Low [2]	Low [3]	Medium Low [6]	Medium Low [7]

4.6 Risk mitigation

Once a risk is identified, the business line provides details of any mitigating factors/controls in place against each risk. The business line in conjunction with the Risk function then assess and agree an action plan to deliver the appropriate mitigating actions. Where Risks are outside appetite a summary of the risk and action plan is escalated through the Risk committee framework. All red and amber risks have either an action to mitigate the risk or information to explain why no further action is planned.

4.7 Risk training

Risk training is conducted at induction and is part of the annual program of Computer Based Training (CBT) for all relevant employees. Refresher training is provided by the Risk Team through bespoke ad hoc delivery where required or requested. Training emphasises the collegiate responsibility for managing risk and provides information to help colleagues escalate risks to their line management and, where appropriate, into the RCSA process.

5 Financial and capital positions

The Group's objectives when managing capital are i) to comply with the regulatory capital requirements set by the FCA and EBA; ii) to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and iii) to maintain a strong capital base to support the development of its business.

6. Risk Capital assessment

Summary

Based on our financial modelling and assessment of relevant risk mitigation activities, the TSL Board has confirmed the following.

Pillar I	**£8.93m**
Pillar II	**£0.2m**
Total TSL Board view of risk assessed capital requirement	**£9.13m**
FCA Capital requirements calculation based on FOR 8% of £86.9m (25%*27.8*12.5)	£9.46m
2017 own funds	**£28.17m**

6.1 Pillar 1 Capital

Pillar 1 within ICAAP includes:

- Credit risk
- Operational risk
- Market risk

6.1.1 Credit risk
Due to its business model, TSL is not subject to any material credit risk within its activities.

The Group considers the credit risk on liquid funds to be *de minimis*, as the counterparties are UK licensed banks. The Group takes what it considers to be a conservative approach to cash management and selection of banking counterparties.

6.1.2 Market Risk
TSL has no material exposure to market risk due to its diversified business model. (Interest rate risk capital is modelled under Pillar 2). Historically Hartmoor introduced some market risk through its hedging strategy for new product launches, but this risk ceased when the Hartmoor business was closed.

6.1.3 Operational risk
TSL defines "operational risk", as a "risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events".

TSL has a range of controls to mitigate risk:

- Focused and well-structured governance arrangements as set out in section 3, including Board and risk committees
- Documented policies, procedures and processes which identify and address operational risk issues
- Appropriate oversight arrangements within all three lines of defence, including risk self- assessments, compliance monitoring, internal audit.

Key elements of the above controls are also regularly audited by our clients or their professional advisers. The most significant operational risks that TSL is exposed are:

6.1.3.1 Business continuity (BCP) and disaster recovery (DR)
TSL has a detailed BCP and DR plan that is regularly tested and risk monitored. Disaster recovery planning & BCP is tested annually, with the most recent tests being completed in Q3 2017. The position is regularly monitored and in Q4 2017 Target identified a need for a refresh of plans to physically move staff to the recovery sites. This refresh was completed in April 2018.

TSL's BCP/DR planning is designed to enable the business to continue to operate via its workplace recovery site, albeit with reduced capacity, within 4 hours of a full BCP/DR being invoked.

TSL has DR/BCP insurance in place.

6.1.3.2 Cybercrime and data loss
TSL has established a control framework that is focused on keeping data secure and keeping intruders out.

In 2017 and 2018 Target has designed and delivered an extensive programme to ensure that it is both internally compliant with GDPR and provides a compliant service for its clients. The programme delivered in late May 2018, in line with ICO requirements. Further, over the last 12 months Target has enhanced its cyber defences, to support the delivery of web portals and to increase the frequency of penetration testing.

6.1.3.3 Failure to adhere to regulatory requirements
Due to its business model and the regulatory landscape, TSL is exposed to the risk of delivering poor outcome for customers and therefore failing to comply with a regulatory requirement. This is an area of focus

for TSL with a programme of continuous improvement in place to enhance the control environment around regulation.

6.1.3.4 Key person risk

In common with other growing organisations, TSL is exposed to the risk of key person dependency TSL has developed a flexible recruitment model, succession planning and management systems for both short term and longer-term key person risk. These mitigants are tried and tested but the residual risk continues that additional urgent contractor recruitment might be necessary for up to 6 months.

6.1.3.5 Financial Crime risk, including fraud

TSL has extensive procedures both to protect against financial crime and internal fraud. Due to the nature of its business model and the extensive controls in place, external fraud is considered low risk.

6.1.3.6 Loss of client

TSL's revenue is primarily derived from the services it provides to its clients. TSL has therefore invested heavily in its infrastructure to ensure that it minimises the risk of client departure due to operational failures. The success of this strategy is evidenced by the rolling renewal of key clients and the risk of loss of major client risk is deemed to be low.

6.1.3.7 Operational (non-regulatory) process failure or error

In any operation, there will always be the risk of error or failure with the consequential adverse impact on customers. In addition to significant experience in running operations Target has in place control frameworks to mitigate the risk of Operational failure and appropriate oversight arrangements to identify and escalate risk as necessary. In addition, Target assesses the potential capital risk of each identified operational risk.

6.2 Pillar 2 Capital assessment

IFPRU sets out specific risks that should be included within a firm's Pillar 2 calculation as well as placing an obligation to identify any additional risk capital required, not included in Pillar 1.

6.2.1 Counterparty/legal risk

TSL is part of the Target Group and regularly provides services to other group companies and receives revenue as a result. TSL performs these services at "arms-length" and generally under agreed contractual terms. TSL has established controls to avoid potential contagion risk from these contracts which have proved robust in mitigating this risk.

6.2.2 Business strategy risk

Business strategy risk is the risk that the business may not be able to carry out its business plan and desired strategy, either due to internal or external factors.

As set out in section 3, TSL has a defined business strategy that has been approved by the Board and is regularly reviewed. Its strategy is also sufficiently diverse that changes in one market e.g. lending, can be offset through its other markets i.e. Investments and Insurance. See also risk 6.2.6.

6.2.3 Interest rate risk

Due to TSL's business model, an interest rate rise has both a negative and positive impact. Negatively it will impact the cost of our variable rate funding. Conversely, an increase in interest rates may be revenue generating for TSL, as it is likely that our arrears services will need to increase. We have chosen however not to include any positive impact in our risk scenarios.

6.2.4 Liquidity risk

TSL's clients are blue chip and financial institutions on multi period contracts; this generates a strong recurring revenue profile and gives increased certainty of income streams. As a result, TSL has access to sufficient liquidity to meet both current and forecast trading requirements.

6.2.5 Insurance risk

TSL has a comprehensive programme of insurance which is reviewed annually by its broker and is deemed appropriate for the size and scale of its existing and proposed business model. Interim reviews and updates are also built into our annual programme with our insurers.

6.2.6 Group contagion risk

TSL is part of the wider Target group and as such we have assessed the potential impact on TSL of revenue and other failures within other parts of the group. Any such shocks are unlikely to directly impact TSL over and above existing allowances made in the ICAAP assessment (revenue risk for example is already covered) but there will be a significant draw on management time to address these issues. To cover this an assessment of potential cost impact is included in the ICAAP process.

6.2.7 Risks set out in IFPRU 2.2.7

IFPRU 2.2.7 (2) prescribes risks which if relevant, based on the nature and scale of its business, should be included in a firm's ICAAP. The table below sets out our rationale for excluding certain of these risks from our assessment.

Required Pillar 2 risks for IFPRU	Relevant for inclusion in TSL ICAAP assessment Y/N	Rationale
Concentration risk	No	TSL's business model is predicated on providing services to a number of clients. Our activities are spread across different business segments e.g. Lending, Investments and Insurance and the range of services provided range from full BPO to IP only. Consequently, there is no material exposure to specific market segments.
Residual risk	No	There is no credit risk beyond the items discussed in Section 6.1.1
Securitisation risk	No	TSL is not an investor, originator or sponsor of securitisation activity. Its services in relation to securitisation are limited to assisting portfolio owners securitise through our administration services.
Pension risk	No	The Group does not have a defined benefit pension scheme. Contributions to the defined contribution employee pension scheme are made as the Group's liability arises. Accordingly, the Group has assessed that no capital is necessary.

7 Approach to stress testing

To help assess how much capital it should hold, TSL has reviewed the key risks it is exposed to and considered severe and plausible scenarios that could result in the risk crystallising. The risk assessment was informed by the existing risk documentation within the business considered from both a "ground up" and "top down" view of risk.

In developing the various scenarios, we have considered both the financial impact and the extent to which the risks are mitigated by the controls in place and management action.

8 Adoption and use of the ICAAP in TSL

8.1 TSL Business review and challenge

The risk scenarios, prepared by the Risk function in conjunction with business leaders, are presented to TSL EXCO for challenge and approval.

8.2 Risk committees

Papers are presented to the various risk committees for debate and challenge. In addition, each individual operational risk has an estimate maximum crystallisation cost which allows an overall sensitivity analysis on capital impact to be prepared.

8.3 Board approval

Where potential material changes of capital are identified through the BAU process (see section 8.4 Use test) these are escalated to the appropriate risk committee and where necessary to the TSL Board which will review relevant scenario and assumptions and approve any necessary changes. This is evidenced by the review of the impact of Brexit and the capital impact assessment carried out on our individual Operational risk assessments.

8.4 Use test

While the need to create ICAAP is a relatively new process within TSL driven following receipt of additional permissions in early 2015, the fundamental risk management processes that underpin it have been in place for significantly longer. TSL views the ICAAP as a living document which is reviewed and updated at regular intervals, as well as in response to any significant changes in circumstances affecting its business model.

9 Remuneration Code Disclosure

TSL is covered by the Target Group Remuneration Committee which is responsible for the framework for the fair remuneration of the “Material Risk Takers” (as defined in accordance with the FCA’s Remuneration Code (“the Code”)) as well as their performance management. The policy is determined with due regard to the interests of the Group and the shareholders. The Committee makes recommendations to the Board. No individual plays a part in any discussion about his or her own remuneration.

TSL sits within *proportionality level 3* under the rules laid out in *the General guidance on proportionality: The IFPRU Remuneration Code (SYSC 19A) section 3.4 Table 2* and has applied the rules as appropriate to this tier.

The Remuneration Committee (see section 4.1) meets at least twice per year and is governed by formal Terms of Reference approved by the Board. The Committee shall consist of the Group Chairman, two Non-Executive Directors and the Chief Executive Officer. The Human Resources Director will act as adviser to the meeting.