ANNUAL REPORT AND ACCOUNTS

31 DECEMBER 2019

HTB

Hampshire Trust Bank Plc

Company number: 1311315

Non- Executive Directors

Robert Sharpe (Chairman)

James Drummond Smith

Robert East

Astrid Grey

Richard Price

Dominic Slade

Executive Directors

Matthew Wyles (Chief Executive Officer)

Tim Blackwell (Chief Financial Officer)

Secretary & Registered Office

55 Bishopsgate,
London
EC2N 3AS

Independent Auditor

KPMG LLP
15 Canada Square,
Canary Wharf,
London
E14 5GL

1.	**Strategic Report**	4
	Key Highlights	5
	Chairman's Overview	6
	Chief Executive's Report	8
	Financial and Business Review	12
	Impact of IFRS 9	17
2.	**Risk Management**	19
	Risk Management Framework	20
	Principal Risks and Risk Mitigation	25
3.	**Corporate Governance**	30
	Section 172 (1) Statement	31
	Adoption of Wates Principles	32
4.	**Directors' Report**	38
	Statement of Directors' Responsibilities	41
	Independent Auditor's Report	42
5.	**Financial Statements**	49
	Notes to the Financial Statements	55
6.	**Other Useful Information**	105
	Statutory and Amortised Cost Tables	106
	Glossary	107

1. Strategic Report

Key Highlights

Increasing profitability, supporting investment and strong shareholder returns

- Growth in profit before tax of 22% to £13.5m (2018: £11.1m)
- Return on Required Equity (post-tax) 11.4% (2018: 10.7%)

Building our franchises

- Lending assets growth of 31% to £1,180m (2018: £900m)
- Originations growth of 17% to £735m (2018: £626m)
- Deposits growth of 26% to £904m (2018: £721m)
- Total customers grew to 27,000 (2018: 25,600)
- Feefo Platinum Trusted Service Award 2019[1]
- Award-winning Savings Franchise[2]

Delivering strong asset returns and cost effective funding

- Gross Income Margin of 6.2% (2018: 6.8%)[3]
- Blended cost of funds (after hedging) 1.8% (2018: 1.6%)
- Net Interest Margin of 4.4% (2018: 4.9%)
- Net Revenue Margin 4.4% (2018: 5.2%)[3]
- Return on Equity (post-tax) 7.8% (2018: 7.6%)

Investing in our operating platform to support future growth

- Building the team in advance of future growth, employees up 9% to 221 (2018: 202)
- Investment of £3.7m in systems and infrastructure
- Cost to Asset Ratio 2.8% (2018: 3.3%)
- Cost to Income ratio of 60% (2018: 63%)

Maintaining credit quality and low cost of risk

- Total arrears of 29bps on total book (2018: 19bps)[4]
- Cost of Risk of 51bps (2018: 45bps)[3]

Holding conservative levels of capital and liquidity

- Liquidity Coverage Ratio of 242% (2018: 335%)
- CET1 ratio of 17% (2018: 16%)
- Total Capital Ratio of 21% (2018: 20%)
- Leverage ratio of 11% (2018: 12%)
- Risk weighted asset density 64% (2018: 83%)

1. Feefo independently collects reviews from customers. According to Feefo, the Platinum Trusted Award is its most prestigious accolade and is awarded for maintaining an average score of over 4.5 for three consecutive years, while collecting at least 50 reviews. Hampshire Trust Bank's Personal Savings team has over 1,300 reviews.
2. HTB Savings achieved the award for best Business Fixed Account Provider – Business Moneyfacts Awards 2019.
3. Definitions of key ratios are found in the glossary. To provide a clear comparison between 2018 and 2019 KPI:
   - Revenue margin has been defined to exclude Fair Value gains or losses on Loans and Advances to customers.
   - Cost of Risk is defined to include the Fair Value losses on Loans and Advances to customers.
   - Blended cost of funds is calculated excluding Tier 2 and its associated costs.
4. Total book is defined as Loans and Advances to customers at amortised costs and Loans and Advances to customers at FVTPL.

Chairman's Overview

Robert Sharpe
Chairman

"The Bank enjoyed a very successful year despite the negative forces at work in the broader economy. 2019 was, without doubt, a difficult year for the UK, as our politicians struggled with the challenges of Brexit and the consequent failure to achieve a Parliamentary consensus led to an unhelpful prolongation of economic uncertainty."

This uncertainty undermined confidence in a number of the markets in which we operate. Underlying company insolvencies increased to their highest annual level since 2013. The housing market remained subdued as many prospective buyers hesitated to increase their financial commitments.

Despite the headwinds faced by the UK economy, the global markets of 2019 were awash with capital seeking a return which, in turn, led to fierce competition in the credit markets. This structural imbalance in supply and demand was further exacerbated by large pools of surplus liquidity trapped inside the ring-fence banks. As a consequence, margins in mainstream lending classes such as residential mortgages experienced unprecedented compression. Whilst the specialist markets within which we operate were less directly affected, it was, nonetheless, necessary to exercise rigorous margin discipline during the year. We consistently declined to commit capital to opportunities which did not meet our minimum risk / return criteria. The Bank's growth rate was all the more impressive when our success in sustaining margins is taken into account.

Customer expectations continue to evolve rapidly. The financial services sector must adapt and develop to meet these expectations and compete efficiently. Our significant investment in technology and people means that the Bank is well positioned to address the challenges and take advantage of the many opportunities the future will bring.

Our Chief Executive Officer, Matthew Wyles, who took up his role in mid-2018, continued to build the leadership of the Bank during 2019 with new senior hires in Asset Finance, Risk, Operations, Sales, HR, Treasury, Technology and Change functions. We have a small, high calibre work force so the contribution made by each and every employee was key to the delivery of the Bank's strong performance in 2019. On behalf of the Board, I want to thank all our people for what they have achieved.

As Chairman, I am fortunate to lead a talented and diverse Board. My fellow directors' broad palette of experience is invaluable in providing both the constructive challenge and informed support required to achieve the appropriate standards of governance and oversight. I would also like to renew my thanks to our principal shareholder, Alchemy Partners, whose unwavering support continues to be pivotal in driving the success of our business.

The Bank entered 2020 in excellent shape with a clear and a highly effective strategy. We will continue to adhere to the rigorous disciplines which underpin our business model and build the Bank on the solid foundations we have laid.

The key priority for the UK Government of a successful negotiation with the EU has, however, been overtaken with staggering rapidity by the dark shadow of the Covid-19 virus which now presents the most serious threat to the prosperity of the UK since the global financial crisis of 2008.

The Bank is well positioned to weather this coming storm with a strong capital base, a capable management team, a robust, flexible operating platform and committed, supportive shareholders.

Robert Sharpe
Chairman

Chief Executive's Report

Matthew Wyles
Chief Executive

"Hampshire Trust Bank plc delivered a robust performance in 2019 with strong growth in both assets and earnings whilst further investing in risk management, technology and people. Our strategy of delivering consistently high standards of customer service is bearing fruit, not just through our rate of growth but through our ability to sustain margins in a highly competitive environment."

An impressive result from our mortgage business underpinned a 31% rise in our overall lending assets to £1.19bn with post tax profit up 20.8% to £10.8m. The Bank's principal shareholder, Alchemy Partners, subscribed a further £15m of CET1 capital to support this growth and we are very grateful to Alchemy Partners for their support and commitment. Our savings business, which remains our principal funding source, also enjoyed good growth with customer balances rising 26% to £904.2m.

The headline reduction in our net interest margin from 4.9% to 4.4% was principally attributable to the shift in asset mix which occurred during 2019. This change in asset mix resulted in our risk weighted asset density falling significantly from 83% to 64%. Thus the 0.5% reduction in NIM was more than outweighed by the 19% fall in Risk Weighted Asset ("RWA") density with the positive implication that has for underlying return on equity.

We continued to invest in our technology and infrastructure with a focus on strengthening operational resilience, enhancing customer experience whilst improving both productivity and scale-ability. Despite this investment programme, our growth helped to drive down our cost to asset ratio by 16% from 3.3% to 2.8%. Although our lending assets grew by 31%, our permanent headcount rose by only 9%, as we recruited into new front office roles in distribution, risk and underwriting. Our single site operating model in the City of London is relatively expensive but provides access to a uniquely deep and rich pool of skills and capability.

Our business model

Our business model can be summarised as excellence through specialism. Small and highly focused, we concentrate on those segments of our target markets where we can add value and can advantageously deploy our experience, expertise, research and analysis to secure and sustain superior risk adjusted returns. All the business we write must meet our minimum return on equity requirements so that every new pound of capital we deploy is generating the required result. This means we could grow more rapidly than we do, but we prioritise value over volume.

Our lending is principally to small and medium sized UK based enterprises (SME) to support a range of business needs with a bias towards certain types of residential property finance. We do virtually no unsecured lending and we have minimal exposure to commercial real estate.

Our credit philosophy is founded on lending against strong underlying cash-flows and a demonstrable capacity to repay. Selfevidently, this approach is aligned with our commitment to optimising customer outcomes.

The Bank is a regulated UK deposit taker and this is also its principal funding source. We provide savings/cash investment products to both private individuals and SMEs. We do not give advice and we do not sell third party products such as insurance or investments.

The customer

Whilst we serve a broad mix of customers, both business and consumer, our commitment to them is universal and consistent. We are in the business of building strong sustainable franchises in the niche markets where we are positioned and we know that an important component of enduring success is both customer advocacy and loyalty. In some parts of our business, there are, in reality, two customers – the end consumer of our service and their broker or intermediary. For us, both are important and both deserve our undivided attention and energetic, responsive service. We were, therefore, delighted to achieve reaccreditation by the Institute of Customer Service. As part of this process, it was confirmed that our net promoter score of 47.1 compared impressively with the banking sector average of 23.9.

We have no appetite to participate in markets where price is the borrowers' principal criterion and one of our key values, though hardly original, is that we prize relationships, not transactions. For example, in our development finance business, a strong bond of mutual trust and respect between the developer and the Bank is considered essential. Frequently, property developments, no matter how well executed, do not proceed according to plan. The developer has to be confident that his/her project financier will provide advice, support and, on occasions, further funding to achieve an ultimately successful outcome. We are proud that 49% of our new Development Finance lending is to repeat customers.

Finally, in our relentless pursuit of continuous improvement, we regularly survey both new and existing customers in each of our businesses (including intermediaries) and we use their feedback to help drive our change agenda. The significant investment in technology and process design we made during 2019 was directly informed by what our customers told us.

Business performance

As the Chairman has referenced in his statement, 2019 saw intense competition in the mainstream UK mortgage market and the consequent margin compression show no early prospect of abating. It may seem surprising, therefore, to report that our fastest growing business during 2019 was our Specialist Mortgages division.

Specialist Mortgages' distribution is 100% intermediary and so the development of a proposition which resonates with our target intermediary market was essential. Whilst we recognise we still have much to do in developing our offer to the market, our mortgages business still managed to grow its loan book by 81% in twelve months at attractive risk adjusted returns. Whilst price is always a factor, we are building a valuable core of relationships amongst the best mortgage intermediaries in the market who appreciate our attentive service, our solutions based approach to deal structuring and our consistent, logical decisioning process.

During the whole of 2019, in response to the uncertain trading conditions which prevailed, our Development Finance division adopted a defensive strategy which tightened up its lending criteria whilst increasing monitoring and supervision of existing in-flight schemes. Development Finance is a lending class with a high beta to the housing market and our partnership with the British Business Bank was most helpful in assisting us to manage our risk accumulations in this lending class. Notwithstanding a more cautious approach during 2019, we continued to find good quality opportunities and we credit approved 93 new schemes during the year. The division's cost of risk was too high but this was attributable predominantly to discontinued lending on higher value units in London, a market which has not performed well in recent years for a number of reasons.

"Whilst we continue to lend selectively in London, we have confined ourselves to only lending on projects delivering "everyday homes for everyday people" over the course of the last couple of years."

As I reported last year we have also continued to diversify our lending across a much broader geographical footprint and the representative office we opened in Leeds has been pivotal in consolidating our growing presence in the North.

Following my strategic review in 2018, we began the work of repositioning our asset finance business away from the price led, volume "flow" market. I was delighted to secure the services of Paul Bartley as the new Managing Director of that division. Paul has a long and impressive track record and, latterly, was one of the founders of Close Leasing, which he and his colleagues built into a market leading player. Paul has appointed a strong, multi-disciplinary management team and we have a clear, deliverable strategy.

We have scaled back our broker distribution to concentrate on a core of quality firms who share our values and where our innovative, solutions driven approach achieves the best traction. The assignment for asset finance during 2019 was to improve its risk adjusted returns as a priority over mere growth. This we achieved and the division's net revenue rose by 30% with virtually no additional capital utilisation.

Funding our business

Our principal source of funding, in common with many banks of a similar size, is through our deposit taking operations. As our balance sheet grew during 2019, we expanded our deposit base to fund the new assets as we originated them. We continued to manage our liquidity conservatively and total deposits rose by 26% to £904.2m.

We were particularly active in the SME savings market and were delighted to receive a number of awards:

- Moneynet Awards: Best Overall Business Savings Provider 2019
- Moneynet Awards: Best Charity Savings Provider 2019

Business Moneyfacts named us Best Business Fixed Account Provider 2019 for the third year in succession.

Our Savings business performs particularly well in the Bank's customer satisfaction survey programme and these consistently high standards of service were also recognised by Feefo which presented us with their Platinum Trusted Service Award – this is only granted to those businesses which achieve Feefo's Gold standard three years in a row.

As we grow, we will continue to broaden our Savings proposition and the markets which we serve. Accordingly we launched for the first time into the ISA market in September.

Risk management

As the Bank has grown in size and complexity, we continued during 2019 to invest in our risk management both in the first and the second lines of defence.

From a credit risk perspective, we appointed a new, highly experienced Chief Credit Officer and continued with the broader strengthening of our credit underwriting capabilities through the recruitment of additional experienced, specialist credit professionals. We committed significant new investment to credit modelling and in particular, our IFRS9 Expected Credit Loss models were further developed and embedded.

The Bank's maturing Operational Risk Management Framework (ORMF) strengthens our understanding of the risks we run in managing the business. Our regulators, continue to set exacting standards for all UK banks and their focus reflects emerging as well as current threats to the health of the banking system.

These important themes include operational resilience, financial crime / money laundering and climate change. Accordingly, we continued to build and strengthen our risk management capabilities across the organisation ensuring that we appropriately protect the interests of our customers and other key stakeholders.

Operational excellence

As I observed in my introduction, we continued to invest in technology and process re-engineering during 2019. In particular we concentrated our efforts on developing our own bespoke digital applications using our low code platform. This included new enhancements for our front end mortgage origination platform and we launched two new front end solutions for our Development Finance division and for complaints handling.

Our new API (Application Programme Interface) service layer and our use of robotics have significantly improved our agility and enables us to deliver rapid, low cost system integrations as we continuously upgrade our architecture and innovate as we go. APIs also present exciting opportunities for us to access valuable data via Open Banking which will further improve our credit decisioning and enhance customer experience.

In November 2019 we announced an important new partnership with Alfa Systems and we have committed to a rapid implementation of Alfa's market leading, cloud based administration platform in our asset finance division as part of our strategic commitment to scale-ability and operational resilience.

During 2019 we continued to invest in cyber & information security which culminated in the Bank being awarded the Cyber Essentials Plus accreditation. 2020 will see us complete the integration of all our key systems into our new enterprise data warehouse utilising the latest cloud technology to provide a single source of truth. This new architecture delivers multi-dimensional data analysis and integration using internal and external data sources, enabling the Bank to become more 'data driven' through actionable insights.

Conclusion

The Bank's whole workforce worked tremendously hard to deliver our success in 2019 and I am profoundly grateful to each and every one of my colleagues for their commitment and determination. I am fortunate indeed to lead such a dedicated team of professionals.

By March 2020, it became clear that the Covid-19 pandemic would have very serious consequences for the World's economies, not least the UK and we now know that 2020 will involve a much more challenging trading environment than we had originally anticipated. We have swiftly formulated a comprehensive response designed to meet the needs and expectations of all our stakeholders, particularly those of our customers and our people.

Whilst 2020 may prove to be a uniquely difficult year, we are confident that HTB has the necessary resources and capabilities to trade through the coming recession. As a specialist in the financing of SMEs, we will play an important role in helping our clients get back to work when the UK economy finally emerges from the Covid-19 deep freeze. My management team and I will continue to work tirelessly to build a bright and secure future for our customers, our colleagues and our business.

Matthew Wyles
Chief Executive

Financial and Business Review

	2019 £m	2018 £m
Loans and Advances to Banks	**84.6**	**98.2**
Debt securities	**-**	**15.1**
Loans at fair value through profit or loss – *Development Finance*	**126.5**	**166.8**
Loans and advances to customers:	**1,053.4**	**733.2**
Specialist Mortgages	632.4	*347.9*
Development Finance	130.0	*98.4*
Asset Finance	200.3	*202.1*
Wholesale Finance	90.7	*84.8*
Other Assets	**19.4**	**10.9**
Total Assets	**1,283.9**	**1,024.2**
Customer deposits	904.2	720.7
Central Bank Facilities	173.0	135.0
Tier 2 Capital	30.0	30.0
Other Liabilities	25.2	12.7
Total Liabilities	**1,132.4**	**898.4**
Equity	**151.5**	**125.8**
Ratios/KPIs		
Risk weighted assets ("RWA's") (£m)	**757.4**	**687.5**
RWA Density (RWA's as % of Loans)	**64%**	**83%**
Common Equity Tier 1 capital (£m)	**137.5**	**121.7**
Tier 2 Capital (£m)	**30.0**	**30.0**
Common Equity Tier 1 Ratio	**17%**	**16%**
Total Capital Ratio	**21%**	**20%**
Leverage ratio	**11%**	**12%**
LCR	**242%**	**335%**
Loan to deposits ratio	**131%**	**125%**

Liquidity

The Bank had £84.6m (2018: £98.2m) in loans and advances to banks as at 31 December 2019. This represented over 9% of total deposits held (2018: 13%), including high quality liquid assets of £77.5m at 31 December 2019 (2018: £90.9m), all in the form of deposits held in the Bank of England Reserve Account. The liquidity coverage ratio ('LCR') was 242% (2018: 335%), substantially in excess of the minimum set by the PRA of 100%.

Loans to customers

Net loans and advances to customers reached £1,180m as at 31 December 2019 from £900m as at 31 December 2018. The Bank's principal lending activities are as follows:

Specialist Mortgages provides various forms of mortgage loans to professional property developers and landlords via a panel of specialist brokers. Lending comprises buy to let mortgage loans secured on residential properties, bridging finance for property investors in the residential market, semi-commercial loans (where the property is mainly residential housing) and commercial investment mortgages on commercial premises. The business grew 82% from £347.9m in 2018 to £632.5m in 2019, with £335.9m of originations.

Development Finance provides finance mainly for development to well established UK SME house builders and property developers. The business lends throughout England and Wales and is mostly sourced direct from the market. There was a decrease in the loan book of 3% during the year from £265.2m in 2018 to £256.5.m when including loans held at fair value through profit and loss of £126.5m.

During 2018, the Bank opened an office in Leeds to expand its presence in Northern England, diversifying concentration from the South and South-East. As at 31 December 2019, the Northern region accounted for 46% of gross loans.

The loan book continued to experience a steady flow of maturing loans as developments are successfully completed and marketed for sale. Repayments amounted to £185.7m in 2019 (2018: £197.4m) and new business amounted to £222.1m (2018: £242.5m). A key focus of this business is to undertake repeat business which comprised around 49% of business written.

Asset Finance provides small to middle ticket leasing and hire purchase secured on vehicles and business assets for SMEs. Finance is sourced through a network of specialist finance brokers who are serviced by a regionally based team of broker managers. Originations in the year decreased from £129.8m in 2018 to £95.6m in 2019 due to the repositioning of the business and its focus on higher margin products during the year. Despite this decrease in originations, the asset finance book has remained stable with a slight decrease of 1% from £202.1m in 2018 to £200.3m in 2019.

Wholesale Finance, provides wholesale finance to non-bank small finance houses secured on the receivables in their own loan books. The Bank employs an experienced team to undertake this specialised activity which is direct to the customer. Loan books are routinely audited by an in-house team and the loan agreements allow for defaulting underlying customer loans to be replaced with new security paper. The loan book grew 7% from £84.8m in 2018 to £90.7m in 2019 with £67.9m of new business in the year.

Funding

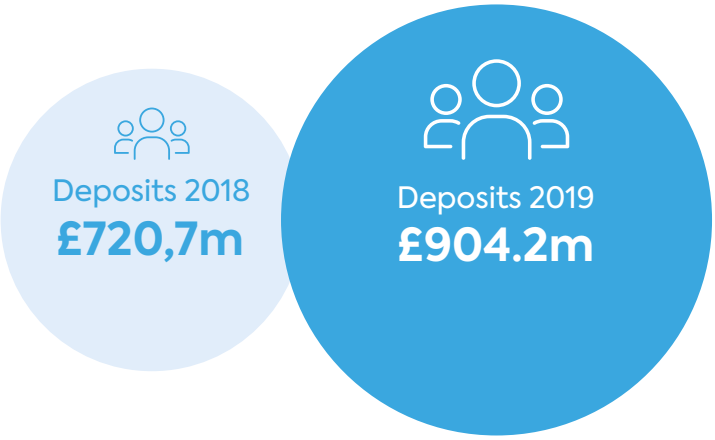
The main funding for the loan books is sourced from deposits and the Bank's loan to deposit ratio at 31 December 2019 was 131% (2018: 125%). The Bank is predominantly funded by deposits which are serviced by our in-house team through an online portal alongside traditional post and telephone methods.

	2019 £'000	2018 £'000
Notice deposits	311,926	207,398
Term deposits	592,245	513,320
Total Customer Deposits	**904,171**	**720,718**

Deposits are sourced direct from the public and SMEs using a combination of on-line marketing and appearance in product best buy tables.

	2019 £'000	2018 £'000
Retail deposits	623,472	543,443
SME deposits	280,699	177,275
Total Customer Deposits	**904,171**	**720,718**

Deposit balances increased from £720.7m in 2018 to £904.2m in 2019. Customer numbers have risen from around 25,600 at the start of the year to over 27,000 at the year end. Qualifying deposits with the Bank are protected under the terms of the Financial Services Compensation Scheme. At 31 December 2019, 90% of deposits with a value of £814.7m were protected under the Scheme.



In addition to Customer Deposits, the Bank continued to use the Bank of England's four year TFS (Term Funding Scheme) with drawn balances of £135m at 31 December 2019 (2018: £135m). For the first time, the Bank drew down balances under the Bank of England's Indexed Long-Term Repo scheme ("ILTR"). Drawings under the ILTR as at 31 December 2019 were £38m (2018: nil).

Capital

The Bank's Common Equity Tier 1 (CET1) Capital comprises ordinary share capital plus share premium, fair value through other comprehensive income reserve and retained earnings, less intangible assets. Regulatory adjustments to CET 1 consist of Prudential Valuation Adjustments and Securitisation positions. During 2019 the bank issued an additional 15m Ordinary shares for cash at par value. As at 1 January 2019, the transition to IFRS 16 impacted retained earnings through the recognition of finance lease liabilities and right-of-use assets. The net impact amounted £108k.

CET1 on a statutory basis as at 31 December 2019 was £137.5m (2018: £121.7m). The statutory CET1 ratio as at 31 December 2019 was 17% (2018: 16%). The CET1 ratio remains above our target minimum and our risk-weighted asset (RWA) density (RWAs divided by customer loans) for the Bank at 31 December 2019 was 64% (2018: 83%). This resulted in a leverage ratio of 11% (2018: 12%).

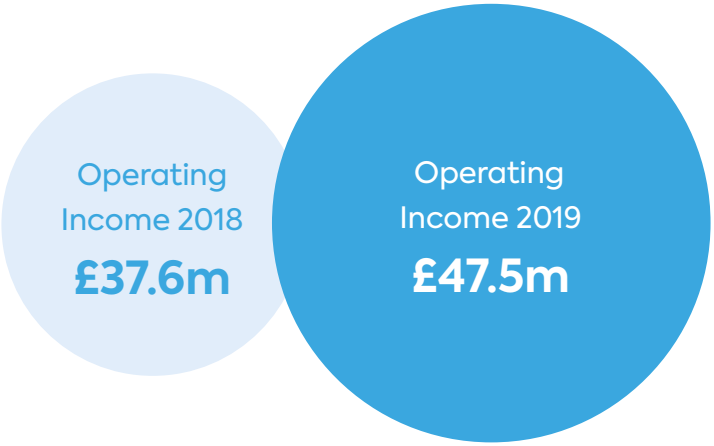
Financial Review

	2019 £'000	2018 £'000
Interest income calculated using the effective interest method	54,388	38,239
Other Interest Income	10,545	12,057
Interest Expense and similar charges	(18,694)	(13,322)
Net interest income	**46,239**	**36,974**
Fees and commissions income	1,500	2,554
Fees and commissions payable	(295)	(166)
Other Income/ Expenses	6	(8)
Net loss on loans at fair value through profit or loss	(1,943)	(1,764)
Operating Income	**45,507**	**37,590**
Impairment losses	(3,375)	(1,742)
Administrative expenses	(28,587)	(24,700)
Profit before Tax	**13,545**	**11,148**
Tax	(2,746)	(2,118)
Profit for the period	**10,799**	**9,030**
Ratios[1]		
Gross Income Margin	**6.2%**	**6.8%**
Blended cost of funds (after hedging)	**1.8%**	**1.6%**
Net Interest Margin	**4.4%**	**4.9%**
Net Revenue Margin	**4.4%**	**5.2%**
Cost to Asset Ratio	**2.8%**	**3.3%**
Cost Income Ratio	**60%**	**63%**
Cost of Risk	**0.51%**	**0.45%**
Return on Required Equity (post tax)	**11.4%**	**10.7%**
Return on Equity (post tax)	**7.8%**	**7.6%**

1. Definitions of key ratios are found in the glossary. To provide a clear comparison between 2018 and 2019 metrics. Net Revenue Margin has been defined to exclude Fair Value losses on Loans and Advances to customers. Cost of Risk is defined to include the Fair Value losses on Loans and Advances to customers as this best represents the underlying asset quality.

Operating income

Operating income, excluding the net loss on loans at fair value, increased by £8.1m to £47.5m (2018: £39.4m). This principally reflects the growth in average lending assets and the effect of the change in lending mix on the Net Revenue Margin generated from those assets. The Net Revenue Margin was 4.4% in 2019 down from 5.2% in 2018 principally driven by the change in lending asset mix, with stronger growth in Specialist Mortgages (81% of overall loan growth) relative to Asset Finance and Wholesale Finance (1% of growth) and Development Finance (1% decline).



Administrative expenses

In 2019, the Bank delivered strong positive jaws with an increase in operating income of 21% compared to an increase in administrative expenses of 16%.

The main expense drivers during the year were:

- People – continued recruitment of skilled resource has been undertaken to strengthen our capabilities, delivery and support future growth.
- Risk and compliance – during the year the Bank continued to strengthen and deepen its risk management capabilities.
- Systems - the impact of the Bank's continuing investment in infrastructure to drive enhanced customer propositions, efficiency and risk management.

Impairments

Credit conditions remained benign during 2019 despite prevailing economic uncertainty surrounding the UK's decision to leave the EU. The Bank's credit appetite remains conservative, with care and diligence continuing to be exercised in loan origination and underwriting.

The cost of risk was 0.51% (2018: 0.45%). Total cost of risk is £5.3m (2018: £3.3m) includes impairment charges of £3.4m on Loans and Advances held at amortised cost with an additional decrease in fair value of loans held at fair value through profit and loss of £1.9m. Fair value of loans is calculated using a discounted cash flow methodology and is sensitive to changes in discount rates and timing of cash flows (refer to note 26). Adverse movements in these estimates can cause losses in the fair value, as seen in 2018 and 2019.

Impact of IFRS 9

The application of IFRS 9 (from 2018), introduced some changes to the measurement and classification in respect of a portion of property development loans within our Development Finance business line. Under IAS 39, these loans were measured at amortised cost. However, with the implementation of IFRS 9 last year, classification was based on both the Bank's business model to hold financial assets in order to collect contractual cash flows and the contractual cash flow characteristics of those financial assets.

Certain property development loans, originated prior to November 2018, have contractual features which introduce exposure to risks or volatility. Thus, they do not give rise on specified dates, to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding. As a result, these loans can no longer be measured at amortised cost, instead they are measured at fair value through profit and loss ("FVTPL"). This means they are measured at fair value with no loan impairment measurement in the Statement of Comprehensive Income.

Amortised Cost basis

For internal governance and business management purposes, the Board and Executives continue to measure and monitor the financial performance of all lending business lines on a consistent classification and measurement basis, this is on an 'Amortised Cost' basis.

For information purposes, the following tables set out the statutory financial statements' presentation of the numbers for 2019 and the amortised cost presentation with the adjustments between the two bases. Further, a table is presented on page 107 that sets out 2019 alongside 2018 on a statutory and amortised cost bases.

This table below shows a summarised income statement and balance sheet setting out the key adjustments to the statutory basis financial statements contained in pages 50 to 54 and the amortised cost.

	2019 (£'000)			2018 (£'000)		
	Statutory	Adjustment[1]	Amortised Cost View	Statutory	Adjustment[1]	Amortised Cost View
Net interest income	46,239	2,846	49,085	36,974	2,101	39,075
Other Net Revenue	(732)	1,253	521	616	(261)	355
Total Revenue	**45,507**	**4,099**	**49,606**	**37,590**	**1,840**	**39,430**
Administrative expenses	(28,587)	-	(28,587)	(24,700)	-	(24,700)
Impairment	(3,375)	(2,829)	(6,204)	(1,742)	(1,103)	(2,845)
Profit Before Taxation	**13,545**	**1,270**	**14,815**	**11,148**	**737**	**11,885**

1. Adjustments in the table relate solely to the fair value of the Development Finance book and the associated imputed tax implications.
   - Net interest income decreases by £2,846k due to the treatment of fees on FVTPL loans under IFRS 9, of which £2,835k is recognised as fees and commission income under the statutory basis and £11k is reversed.
   - Other Net Revenue decreases by £1,253k under the statutory basis due to the £2,835k of fees and commission
   - income mentioned above, offset by a £4,088k fair value loss on loans and advances held at FVTPL.
   - Impairment falls by £2,829k from the amortised cost view due to the release of provisions on loans held at fair value.

	2019 (£'000)			2018 (£'000)		
	Statutory	Adjustment[2]	Amortised Cost View	Statutory	Adjustment[2]	Amortised Cost View
Loans and advances to customers	1,179,895	381	1,180,277	899,996	(889)	899,107
Other assets	104,008	-	104,008	124,177	-	124,177
Total Assets	**1,283,903**	**381**	**1,284,285**	**1,024,173**	**(889)**	**1,023,284**
Customer deposits	904,171	-	904,171	720,718	-	720,718
Other liabilities	228,258	-	228,258	177,705	(226)	177,479
Total Liabilities	**1,132,429**	**-**	**1,132,429**	**898,423**	**(226)**	**898,197**
Shareholders' Equity	**151,474**	**381**	**151,855**	**125,750**	**(663)**	**125,087**

2. Statutory loans and advances are held at £381k lower than the amortised cost view due to a £889k gain on initial application of IFRS 9 less the £1,270 profit before tax adjustment explained above. In addition the application of IFRS 9 creates a deferred tax liability of £94k which reduces the impact on Shareholders Equity from £475k to the £381k fair value adjustment mentioned above.

2. Risk Management

Risk

The Bank's approach to risk

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

Risk Culture

Embedding the right risk culture is fundamental to good risk management. The Board are instrumental in driving good risk management and are visible and actively involved in setting risk appetite. The Board and senior management drive values and behaviours where the customer is at the heart of decision making, and business leaders are held accountable for risk management. The importance of risk management and the need to adhere to risk appetite is built into job descriptions, the setting of objectives and staff performance reviews.

Risk Strategy

The development and implementation of the Bank's Risk Strategy is the responsibility of the Risk and Compliance team led by the Chief Risk Officer, the Executive Management team and ultimately subject to Board approval. Our risk management strategy:

- Identifies the Principal and Emerging Risks the Bank faces and how they are managed
- Defines Risk Appetite
- Confirms that business plans are consistent with Risk Appetite
- Requires the Bank's Risk Profile to be monitored and reported regularly
- Tests the Bank's vulnerabilities to risks under a range of stressed adverse conditions
- Includes a strong control environment
- Allows for robust oversight and assurance
- Encourages strong risk culture and behaviours through its linkage with the remuneration framework

Risk Management Framework

The Risk Management Framework ("RMF") sets parameters within which all the Bank's activities are executed. This ensures we identify, manage, monitor and report the risks to which the Bank is exposed. The RMF is supported by supplemental frameworks, policies, processes and procedures that, together, ensure that risks are managed in a manner appropriate to the size of the Bank and the complexity of its operations. The RMF addresses the legal and regulatory risks the Bank is exposed to, together with the Principal and Emerging Risks. The design and effectiveness of the RMF is overseen and reviewed by the Board Risk Committee.

The structure of the RMF is set out in Figure 1 below.

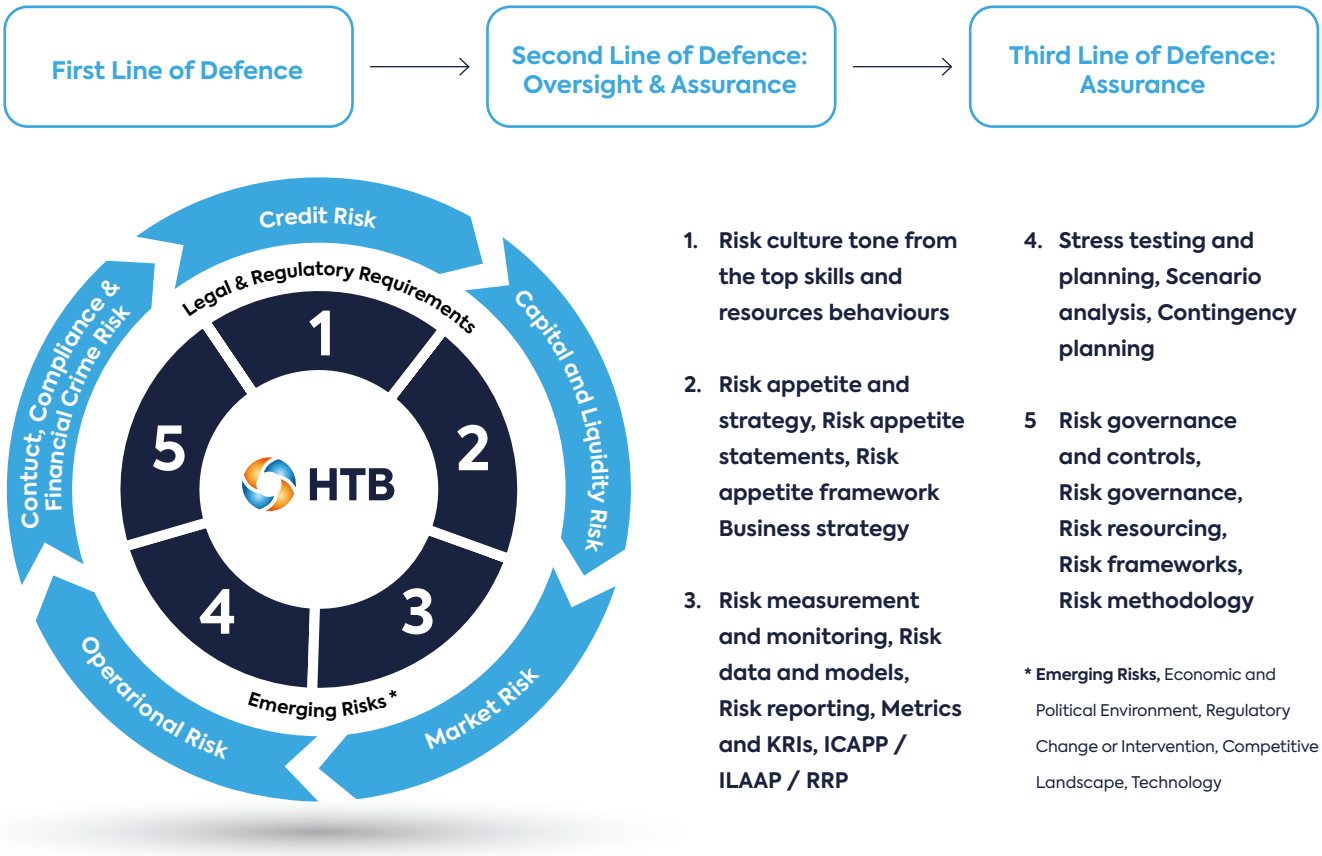


Figure 1 – Risk Management Framework

Risk Appetite Framework

The Risk Appetite Framework ("RAF") is the framework by which we clearly articulate, in a structured and systematic manner, the level and types of risk that we are willing to accept in meeting our business objectives. The RAF:

- Identifies, in both qualitative and quantitative terms, the type and level of risk that the Bank is willing to accept
- Describes the risks that the Bank is willing to take (and those that it will not) in pursuit of its corporate objectives
- Establishes a framework for decision making based on risk appetite statements and metrics
- Enables a view of risks across the whole business

The RAF is structured around the Principal Risks agreed by the Board from time to time with each Principal Risk being supplemented by a suite of more granular Supporting Risks. For each Supporting Risk, the Bank articulates a Risk Appetite Statement with limits that are monitored via the use of specific Risk Appetite Metrics and Key Risk Indicators ("KRIs"). The Risk Appetite metrics are clearly measurable against the Corporate Plan, are actionable and have an assigned limit to monitor performance against the Risk Appetite. The KRIs are outcome driven with negative trends reported monthly to the relevant risk committees.

The structure of the RAF is set out in Figure 2 below.

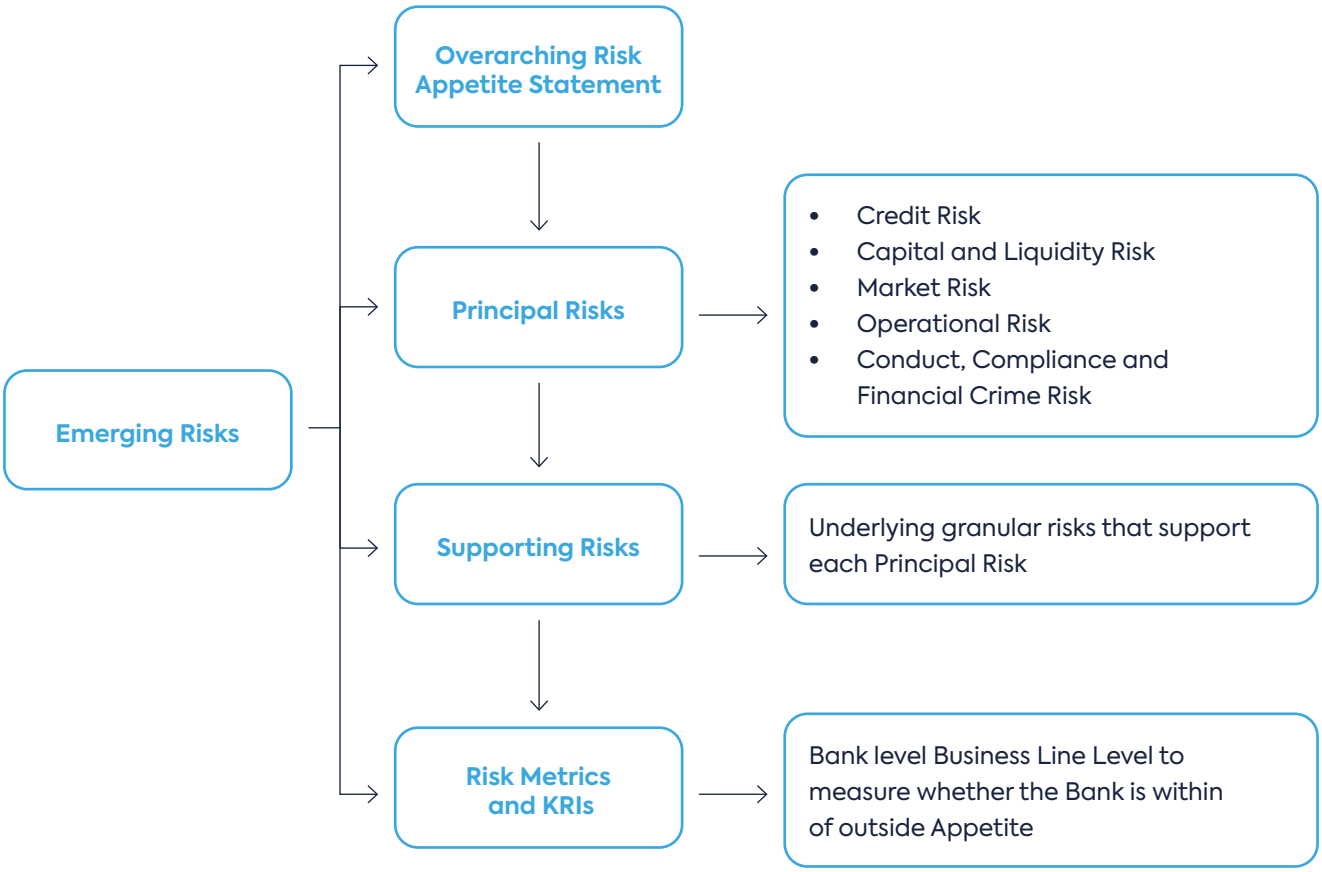


Figure 2 – Structure of the Risk Appetite Framework

Performance against Risk Metrics is regularly reported to the Board and Board Risk Committee via appropriate sub committees.

Risk Governance and Oversight

Risk Governance describes the design of the allocation and delegation of primary accountability, authority and responsibility for risk management across the Bank by the Board. The Board reviews and approves the business strategy, ensuring it is consistent with risk appetite, and that the RMF is appropriate with sufficient governance, often through appropriate sub committees, to ensure risk appetite is being adhered to.

The governance framework is underpinned by a "three lines of defence" model. This ensures a clear delineation of responsibilities between the front line business units' day to day activities (1st line of defence), risk oversight (2nd line of defence) and independent assurance (3rd line of defence).

Front Line Business Units (1st line of defence)

The business lines and central functions have primary responsibility for the day to day management of Principal Risks, and the implementation of approved policies, frameworks, processes and procedures.
They use the Bank's Risk & Control Self Assessment ("RCSA") process to identify and measure risks and ensure that these are managed within agreed Risk Appetite. They will also test key controls, providing regular reporting of testing output.

Risk and Compliance Function (2nd line of defence)
The Risk and Compliance function is independent of the business units and other central functions, and maintains the RMF, supplemental frameworks and Risk Policies. It is deliberately not customer facing. The second line provides independent challenge, oversight and ongoing assurance of the adequacy and effectiveness of risk management within the business units including oversight of the RCSA process. The Risk and Compliance function monitors performance in relation to risk appetite; working with Finance and Treasury on the production of the Internal Capital Adequacy Assessment Process ("ICAAP"), Internal Liquidity Adequacy Assessment Process ("ILAAP"), and the Recovery Plan and Resolution Pack ("RRP").

Internal Audit (3rd line of defence)
Internal Audit operates under the direction of the Board Audit Committee and provides independent assurance to the Board that the first and second lines of defence are discharging their responsibilities effectively. The Bank currently outsources this function to PwC, an independent professional services firm.

Stress Testing

Stress testing is an important risk management tool for the Bank and is used to inform the setting of Risk Appetite limits. Stress testing is also used to inform the Bank's key annual assessments and determination of required buffers, the strategy for capital and liquidity management, and certain documents including the ICAAP, ILAAP, Recovery Plan and Resolution Pack.

The Bank undertakes stress testing to assist the Board in understanding its key risks, and the scenarios and sensitivities that may adversely impact on its financial and/or operational performance. Stress testing supports the setting of Risk Appetite and the Bank's business and capital plans. It does this by:

- Testing the adequacy of the Bank's capital, funding and liquidity to withstand the emergence of risks under both normal and stressed conditions
- Supporting the adequacy of the potential management actions available to mitigate the effect of adverse events
- Supporting the identification of any potential gaps in the Risk Management Framework, not readily apparent from the management of day to day risks

The Board is responsible for reviewing and approving the scenarios that are used for each type of stress testing on at least an annual basis. The scenarios and the results of each stress test are reviewed by an appropriate committee (e.g. ALCO, Credit Committee) before being agreed by ExCo. They will then be reported to Board Risk Committee which will provide further challenge and independent review prior to recommending to the Board for approval.

Stress testing is an ongoing requirement but may be updated, for example, by changes to the Bank's business model, changes in risk appetite, changes in economic conditions or assumptions and changes in regulatory requirements.

The stress scenarios developed as part of the ICAAP are used to size a stress loss buffer which ensures that the Bank can withstand a range of adverse economic scenarios over the term of its planning horizon. The ICAAP incorporates all principal risks that will impact on capital. The CFO and CRO are accountable for the ICAAP.

Similar stress scenarios are developed to support the ILAAP. These scenarios are used to size a liquidity buffer such that the Bank can withstand a range of stressed liquidity scenarios in the short to medium term. The ILAAP incorporates all principal risks that will impact on Liquidity. The CFO is accountable for the ILAAP.

The Bank also performs Reverse Stress Testing ("RST") to help it identify events that could cause its business to become unviable.

The starting point for RST is assumed to be the point at which failure would occur and a logical approach is then taken to work back to identify the potential sequence of events that could occur to lead to that failure. If the tests reveal a risk of failure that is unacceptably high compared to risk appetite, the Board will take action to mitigate that risk.

Key risks

The key risk the Bank faces at the present time relates to the Covid-19 situation

Key Risk	Definition	How we mitigate the risk
Covid-19	The Covid-19 pandemic has very serious consequences for the world economy, and how this will play out is unknown. The situation is fast moving and the Bank has mobilised its operational resilience plans.	• We have stress tested our lending books, and substantially increased our capability and capacity to address the higher level of stress being seen within our customer base • We will be flexible and nimble in supporting our customers in the times ahead • We have reviewed our capital and liquidity plans to ensure we are prepared for an elongated period of disruption to the economy • We continue to work closely with regulatory authorities and respond to the evolving regulatory environment. • We have continued to focus on integrity of data and invest in availability of systems

Principal Risks and Risk Mitigation

The Principal Risks the Bank faces, and how we mitigate the risks, are described below. These should not be regarded as a comprehensive list of all the risk and uncertainties faced by the Bank but rather a summary of the primary risks which have the potential to significantly impact the achievement of strategic objectives.

Principal Risk	Definition	How we mitigate the risk
Credit Risk	The risk that a borrower or counterparty fails to pay the interest or repay the principal on a loan on time. In relation to the Bank's Treasury activities there is a risk that acquired securities or cash placed on deposit with other financial institutions is not repaid in full or in part.	• We evidence affordability (ability to repay from cash flow) • We take security and where appropriate, guarantees, to support our lending • We maintain a diversified portfolio of loans by limiting concentrations by size, asset class, collateral types, geography and sector • We focus on sectors where we have specific expertise • We determine credit decisions using a combination of Due Diligence, reviewing Credit Agency reports, reviewing financial information, credit scores and using the expert opinion of our underwriters • We have a Credit Risk Management Framework that includes detailed lending policies, underwriting manuals and a defined problem debt management process • We undertake regular reviews of our loan portfolios and ongoing assurance testing of our processes • We operate a Treasury policy that only allows for surplus liquidity and swaps to be placed with large banks or invested in High Quality Liquid Assets in line with PRA guidance on Credit Ratings • We monitor lending performance against Risk Appetite regularly

Principal Risk	Definition	How we mitigate the risk
Capital and Liquidity Risk	**Capital** – The risk that the Bank will have insufficient capital to cover unexpected losses, meet regulatory requirements or support growth plans. **Liquidity** – The risk that the Bank is unable to meet its financial obligations as they fall due; smooth out the effect of maturity mismatches; or maintain public confidence.	• We operate a Capital Planning Framework which requires us to maintain appropriate levels of capital in a range of stressed scenarios • We set a prudent Risk Appetite which is approved by the Board and reviewed at least annually • We monitor current and forecast levels of capital and liquidity against our risk appetite and report to Asset and Liability Committee ("ALCO") and the Board regularly • We forecast capital which forms an integral part of the budgeting process • We maintain liquidity buffers based on various stressed liquidity scenarios • We monitor our liquidity position on a daily basis • We meet, as a minimum, all regulatory prescribed coverage and liquidity ratios
Market Risk	The risk that changes in market prices will affect the Bank's income or the value of its holdings of financial instruments.	• We match, wherever possible, the interest rate structure of assets with liabilities or deposits to create a natural hedge • We enter into swap agreements where required to minimise basis and repricing risks within appetite • We capture pipeline risk (where actual movements in assets and liabilities do not match expectations) and Optionality risk (where early terminations can worsen mismatch positions) and report via ALCO
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal and regulatory risk.	• We ensure all staff understand and follow the Operational Risk Management Framework • We have processes and procedures that are clearly documented and understood, and subject to 2nd line oversight and challenge • Senior Management identify and assess operational risks across their businesses and assess the effectiveness of controls that mitigate those risks using a RCSA process • We have a defined Operational Resilience Policy and Framework • We have defined our recovery time objectives for our critical business services where a sustained operational failure would result in customer detriment. • These are linked to the recovery time objectives • We place an emphasis on ensuring that the Bank has an IT infrastructure that meets its security and operational resilience needs which are regularly reviewed • We seek to ensure our systems continue to deliver a secure and reliable service to our customers and staff by identifying cyber security threats and putting in place measures to address those threats • We seek to keep our operating infrastructure up to date and complete regular contingency plan checks to ensure that we can maintain our business under stressed conditions • We operate a change control process through our Investment Committee to ensure that major change programmes are delivered on time and on budget • We monitor the operational risk profile alongside proactive recording and management of events, losses and incidents • We make use of independent expert legal advice where appropriate • New and emerging legislation driven changes are overseen through our horizon scanning process • We seek to maintain an engaged and diverse workforce with the right mix of skills to be able to deliver our strategy • We set a very low risk appetite for breaches of information security whether from internal leakage or external attack

Principal Risk	Definition	How we mitigate the risk
Operational Risk (cont.)		• We closely monitor Climate Change policy, regulatory guidance and industry advances relating to climate change, considering both transition and physical risks. • We assess the impact of these changes/advances on our Business model and risk profile and consider possible impacts on our reporting obligations and our reputation
Conduct, Compliance and Financial Crime Risk	**Conduct** – The risk that the business strategy, the culture, and the manner in which the business is run, creates unfair customer outcomes or detriment to customers, clients and counterparties and/or undermines market integrity. **Compliance** – The risk of legal or regulatory sanctions, material financial loss, or loss of reputation as a result of a failure to comply with applicable regulations, codes of conduct or standards of good practice. **Financial crime** – The risk that the Bank knowingly or unknowingly leaves itself exposed to the risk of being abused by those seeking to obtain or launder funds through illegal means and/or for illegal purposes.	• We operate a Conduct and Compliance Risk Management Framework supported by a number of policies and procedures that set out how we manage these risks and the minimum standards that we • expect. • Our Business lines are primarily responsible for the management of these risks, but with strong oversight from the 2nd Line Compliance function • Senior Management identify and assess conduct, compliance and financial crime risks across their businesses and assess the effectiveness of controls that mitigate those risks using a Risk and Control Self- • Assessment (RCSA) process • New and emerging regulatory driven changes are overseen through our horizon scanning process • We design our products and services so that they consistently deliver fair outcomes for our customers • We complete regular assurance testing of our activities to check that we are operating within our Board approved risk appetite • We operate a programme of staff training and awareness via our regulatory training schedule. • We complete money laundering and financial fraud checks on our customers at application stage and during the customer lifecycle • The Senior Managers and Certification Regime is fully implemented to drive adherence to the Conduct Rules and a culture of accountability and diligence.

Emerging Risks

The Bank has a continuous process for identifying and managing its emerging risks which could have a significant negative impact on its ability to operate or meet its strategic objectives.

Brexit Transition

The Bank acknowledges the continued heightened economic and political risks relating to Brexit transition. As a UK focused Bank, however, we are sheltered from the more direct impacts of the transition, such as access to European markets, but we are exposed to the wider economic impacts. Potential impact could also be increased changes to regulation as the UK regulators work to determine their approach to EU driven policies, as well as through any changes to regulations by the UK government.

Cyber Threat

The frequency of cyberattacks continues to grow and is a global threat particularly within the financial services sector and remains a key area of focus for the Bank. There is an increasing level of sophistication in both criminal and nation state hacking for the purpose of financial crime, destroying or manipulating data, including customer data, and/or disrupting operations. Threats can materialise through malicious emails, distributed denial of service (DDoS) attacks, supply chain and exploitation of system vulnerabilities.

The Bank continue to strengthen the Bank's cyber defences and invest in a multi-layered approach to cyber security.

Climate Change

The Bank recognises that Climate Change is a significant risk and a major challenge for the global economy and society. Extreme weather events and the impacts of transitioning to a low-carbon economy have the potential to disrupt business activities, damage property, and otherwise affect the value of assets, and affect our suppliers and our customers' ability to repay loans.

There has been an increased focus on climate change from the media and our regulators over the last 12 months. As regulatory guidance and expectation on climate change evolves, the Bank will further embed climate risk in its existing risk management framework and support its customers with the transition to a low carbon economy.

Competition

The competitive landscape contains risks from new entrants, increased competition from incumbent lenders and disruptive products/software solutions potentially affecting both lending and deposit taking activities. The effect of this could result in lower lending and deposit volumes, higher customer attrition and/or lower net interest margins. This has increased particularly in the savings space with the launch of savings platforms allowing access to multiple banks.

The Bank continues to monitor the external competitive environment and the impact this has on pricing. The Bank businesses continue to take a disciplined approach to pricing with the aim of maintaining stable margins and an appropriate risk profile.

LIBOR

A fundamental reform of major interest rate benchmarks is being undertaken globally to replace or reform LIBOR with alternative nearly risk-free rates (referred to as 'LIBOR reform'). The Bank has exposure to LIBOR through variable rate lending and through derivatives that have been transacted to mitigate the interest rate risk generated by fixed rate products. There is significant uncertainty over the timing and the methods of how LIBOR will be replaced or reformed as part of this market-wide initiative. It is anticipated that this transition will present significant operational, risk management and accounting impacts across all of its business lines.

The Bank has established a LIBOR transition working group to manage this project. The working group is chaired by the Chief Financial Officer and is a sub-committee of the Asset and Liability Committee (ALCO). The objective of the working group is to manage communication with customers and counterparts about LIBOR reform and to mitigate the operational, conduct, financial and interest rate risk generated by the transition.

3. Corporate Governance

Section 172 (1) statement

The Board is fully aware of its responsibilities to promote the success of the Bank in accordance with s.172 of the Companies Act. We have considered the relevant interests of the various stakeholders as mentioned below in all our Board discussions and decision making during the year ended 31 December 2019.

- ***Customers*** – The Board recognises that building a sustainable and enduring business franchise is dependent on delighting the Bank's customers and delivering for them consistently, transparently and with integrity. Across the Bank's various specialist lending businesses, customers include professional landlords, property developers, SME & Corporate borrowers as well as the intermediaries who introduce borrowers to the Bank. Across the Savings & Deposits business, customers are the Retail, SME & Corporate customers placing deposits with us. The Board seeks to ensure that the key priority of positive customer outcomes is embedded in the way the Bank conducts its business. Specifically, the Board places great emphasis on the development of strong relationships with customers built on trust and that customers benefit from products that are straightforward, fit for purpose and reflect their particular needs. The Board ensures that the Bank listens to its customers by collecting impartial feedback to understand what customers think of our products and service.

- ***Employees*** – Employees are fundamental to the delivery of its strategy as a specialist bank. The Board wants the Bank's employees to have challenging and fulfilling careers in a values orientated culture. During the year, the Board has ensured that employees have been engaged, through a number of fora and channels, to gather their opinions and perceptions of the Bank as an employer. As the Bank continues to build its franchise, the Board is committed to attracting talented people and investing in them.

- ***Regulators*** – The Bank operates in highly regulated markets. The Board has an intense focus on its own responsibilities and those of the relevant Senior Management Function ("SMF") Responsibility Holders. The Board seeks to maintain an open and active dialogue with all of the Bank's regulators. The Board is also focused on ensuring that the Bank embeds high standards of conduct into its product design, service delivery and culture.

- ***Shareholders*** – The Bank's shareholders are critical to the success of the Bank as the providers of capital to underpin the growth and development of the business. A representative of the Bank's shareholder has a seat on the Board and attends all Board meetings, ensuring they are kept up-to-date on the performance of the Bank. The Board maintains a close working relationship with the shareholders' representatives centred on the development and execution of the Bank's strategy.

- ***Community*** – The Board understands the importance of the Bank's wider corporate responsibilities to the wider community in which it operates and to the environment. In 2019, the Bank partnered with XLP, a charity which aims to create positive futures for young people growing up on inner-city estates.

- ***Suppliers*** - As the business continues to grow, the Bank has seen our supplier network expand. As part of our operational resiliency activity, the Board has enhanced our internal controls regarding how we source and manage our supplier relationships. The Board recognises that our suppliers are a key part of the service we provide to our customers and are committed to treating them fairly and have clear policy on payment procedures.

Governance Framework

The Board of Directors is the primary governing body and has ultimate responsibility for establishing the Bank's strategy, corporate objectives and risk appetite. The strategy and risk appetites take into consideration the interests of depositors, borrowers and shareholders. The Board of directors is responsible for the overall governance of the Bank and a robust framework of effective systems of internal control, risk management and compliance.

Adoption of Wates Principles

We welcome the introduction of the Wates Principles which are high level principles issued to help large private companies to report on their corporate governance requirements. During 2019, we complied with all six Wates Principles.

Principle	Explanation of how it is applied
Purpose and Leadership – an effective board develops and promotes the purpose of a company and ensures that its values, strategy and culture align with that purpose.	• Primary role of the Board is to provide leadership and set direction on the Bank's purpose, values, strategy and culture • The Board delegates the day to day responsibility for the implementation of the strategy, development of the culture and the management of the Bank to the Executive Committee, led by the Chief Executive • The Board monitors and challenges delivery by the Executive through appropriate reporting • The Strategic Report provides further details on the Bank's purpose, values and strategy as well as how the Board ensures that the Bank's culture is aligned
Board Composition - effective board composition requires an effective Chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.	• The Board consists of four Independent Non-Executive Directors (including the Chairman), two Shareholder Directors and two Executive Directors • The Board has an appropriate mix of Executive and Non- Executive Directors, who have the requisite skills, knowledge and understanding of the Bank's business itself and of banking more generally • The Nomination and Remuneration Committee is responsible for all senior appointments including all Board Directors and the Bank's senior management • The Bank recognises and values diversity of its Board • The Nomination and Remuneration Committee also considers both senior management and Board succession plans at least annually
Board Responsibilities - the board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.	• The Bank operates within a robust set of governance and risk management frameworks that are appropriate for a regulated UK Bank. The effective operation of these frameworks supports the Board and individual Directors in • maintaining a clear understanding of their accountability and responsibilities • The role & responsibilities of the Board and its various committees are set out in more detail on pages 33 to 36 of this Corporate Governance section • The Board commissioned external consultants to undertake a Board effectiveness review in 2019 • The Board ensures that the systems and controls are operating effectively, and that the quality and integrity of information provided to it is reliable through the assurance actioned within the three lines of defence model • During 2019, the Board met 12 times, further details on key matters discussed in those meetings are provided in pages 34 to 36
Opportunity and Risk - a board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value and establishing oversight for the identification and mitigation of risks	• The Strategic Report (page 5) provides details of how the Bank creates and preserves long term value including future growth opportunities • The Risk Management section of this Report provides detailed information on the framework set by the Board for the management of the Bank's risks • The Board is responsible for the Bank's Risk Management Framework, its development, its ongoing effective operation, periodic review of its appropriateness and any required calibration to it • During 2019, the Board Risk Committee met 11 times, further details on key matters discussed in those meetings are provided in pages 34 to 36

Principle	Explanation of how it is applied
Remuneration - a board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.	• Remuneration policies and practices are designed to support strategy and promote long-term sustainable success, with the role of the Nomination and Remuneration Committee to set and oversee the implementation of the Bank's remuneration processes, including those for the Bank's Executive Directors and other members of its senior management • The Nomination and Remuneration Committee reviews remuneration matters (including remuneration policy), employee benefits and performance related pay structures for the Bank • During 2019, the Nomination and Remuneration Committee met 6 times. Further details on key matters discussed in those meetings are provided in pages 34 to 36
Stakeholder Relationships and Engagement - directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.	• The Bank's key stakeholders include customers, regulators, employees, shareholders and suppliers. • The Section 172(1) statement elsewhere in this Corporate Governance section provides details of how the Board has developed various engagement mechanisms in order to foster effective relationships with all its key stakeholders and to balance their interests in its decision making

Structure of the Board and Board Committees

The Bank's governance structure is designed to ensure the proper running of the Bank in accordance with the legal and regulatory obligations and in line with established principles of good conduct and practice. The Bank is led by a Board comprising an independent Non-Executive Chairman, Non- Executive (Shareholder) Directors, independent Non-Executive Directors and Executive Directors.

The Board approves the strategy and direction of the business, sets the policies and risk appetite, monitors risk management, financial performance and reporting, and ensures that appropriate and effective succession-planning arrangements and remuneration policies are in place. Directors are appointed by the Board. Non-Executive Director appointments can be terminated at any time, without notice or payment of compensation.

Board meetings are held normally eleven times a year. This enables Directors to regularly review corporate strategy, the operations and the results of the business, and to discharge their duties within a framework of prudent and effective controls.

The Board is supported by its Committees, which make recommendations to the Board on those matters delegated to them. These Committees (with the exception of the Executive Committee) comprise only Non-Executive Directors and each is chaired by an independent Non-Executive Director. Matters such as internal and external audit, risk, financial reporting, governance and remuneration policies are delegated to these Committees, in order that the Board can spend a greater proportion of its time on strategic items.

The Committee Chairs report to the Board at the Board meeting following each Committee meeting on the activities of their respective Committees. The Board Chairman undertakes an annual review of performance of each Director. The Board Chairman's performance is evaluated by the Non-Executive Directors taking account of the views of the Executive Directors.

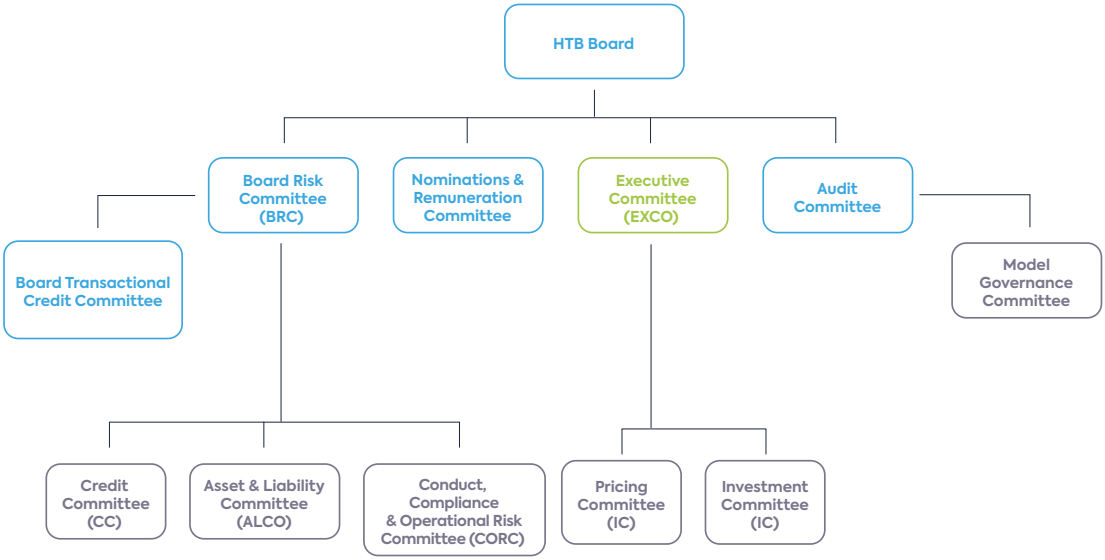
Role of Chairman and Chief Executive Officer

There is a clear division of responsibilities between the Chairman and the Chief Executive Officer. The Chairman has overall responsibility for the leadership of the Board, its effectiveness on all aspects of its role and setting its agenda. The Chief Executive Officer is responsible for the day to day running of the business and is accountable to the Board for its operational and financial performance.

Compliance with the Senior Managers Regime

The PRA defines a set of prescribed responsibilities ("Responsibilities"), which must be allocated to a senior manager performing a Senior Management Function. The Bank maintains a Senior Management Functions (SMF) Responsibilities Map and a list of SMF Responsibilities which are contained within the documents making up this Corporate Governance Framework. The Board and committees have their own detailed terms of references which outline their responsibilities and delegations within the Bank.

The Board operates through a number of Committees covering certain specific matters, illustrated in the chart below.



Membership

Directors

Executive Directors & Senior Management

Executive Directors, Senior Managers & Nominated Staff Members

Board and Committee membership attendance record

Board Member	Board	Risk Co	Audit Co	Nom/Rem Co
Robert Sharpe	12			6
Tim Blackwell	11			
Robert East	11	11	6	6
James Drummond– Smith	11	9	6	6
Astrid Grey	12	11		6
Richard Price	12	10	6	6
Dominic Slade	11			6
Matthew Wyles	12			
Meeting Total	**12**	**11**	**6**	**6**

The key Board committees are:

Audit Committee

The Audit Committee oversees the effectiveness of the Bank's internal control environment, monitors the integrity of the financial statements and risk management systems, involving internal and external auditors in that process, and considers compliance monitoring programmes. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal control is maintained. The Committee recommends the appointment of both internal and external auditors and approves the annual internal and external audit plans. The Committee also oversees the Model Governance Committee which operates under its own terms of reference. The Committee is chaired by an independent Non-executive director and comprises solely Non-Executive directors. The Audit Committee meets at least quarterly. During 2019, the Committee recommended approval to the Board of the 2018 statutory accounts. It also approved the changes to the Bank's Loan loss and impairment policy following the adoption of IFRS 9.

Board Risk Committee ('BRC')

The Board has delegated responsibility for oversight of the Bank's principal risks to the Board Risk Committee. This involves reviewing, challenging and recommending to the Board, the aggregate risk profile of the Bank, including performance against risk appetite for all risk types and ensuring both the risk profile and the risk appetite remain appropriate. This Committee oversees the development, implementation and maintenance of the Bank's Risk Management Framework, compliance with relevant regulations and law, and whistleblowing and proper functioning of controls over the prevention of money laundering, bribery and fraud. It considers and recommends to the Board the ILAAP, ICAAP, Funding Plan, Recovery Plan, Resolution Pack and Capital Management Plan. The Committee also oversee ALCO, Credit Committee and Conduct, Compliance & Operational Risk Committee which operate under their own terms of reference. The Committee is chaired by an independent Non-Executive director and comprises solely Non-Executive directors.

Nomination and Remuneration Committee

The Nomination and Remuneration Committee reviews remuneration matters (including remuneration policy), employee benefits, performance related pay structures for the Bank and leads the process for identifying and making nomination recommendations to the Board. It is also responsible for considering all senior appointments at Executive levels (including Non-Executive directors). It reviews and approves succession plans for all Board and Board Committee positions (including Exco); makes appointments of Committee Approved staff under recommendation from the CEO; sets remuneration & benefits entitlements of Committee-Approved staff; and agrees bonus awards for the Company and Committee-Approved staff. The Committee is chaired by the Chairman of the Bank and comprises solely non-executive directors.

Executive Committee

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

Board Transactional Credit Committee

The Board Transactional Credit Committee is the body charged with approval of transactional credits above limits allocated to the Executive. This includes credit proposals falling outside Board approved policy, credit proposals if advanced resulting in a large exposure above Board approved credit committee mandate and where the Board requests the Board Transactional Credit Committee to review or oversee a material loan in default. The Committee is chaired by the Chairman of the Risk Committee and comprises of Non-Executive directors.

Asset & Liability Committee ('ALCO')

The Asset & Liability Committee (ALCO) is a sub-committee of BRC and has detailed terms of reference. The ALCO meets monthly or more frequently as required. The Committee's key responsibility is to ensure that there is robust ongoing monitoring, challenge, assessment and management of the capital, liquidity and market risks inherent within the Bank's business. It ensures the Bank adheres to its Liquidity and Interest Rate Policy and reviews the Bank's exposure to liquidity and interest rate risks. It also has responsibility for review of certain frameworks and policies and making recommendations to the Board Risk Committee.

4. Directors' Report

Director's Report

The Directors present their report and financial statements for the year ended 31 December 2019.

Principal Activities

Hampshire Trust Bank Plc ("The Bank") is a UK Bank, authorised by the Prudential Regulation Authority (PRA) and regulated by both the PRA and the Financial Conduct Authority (FCA). The Bank provides bank finance to small and medium sized enterprises in the UK secured against property and business assets, including vehicles. It also provides retail savings products to private individuals and SMEs.

Business Review and Future Developments

Information regarding the business review and future developments (pages 12 to 16), key performance indicators (page 12 and 15) and principal risks (pages 24 to 27) is contained in the Strategic report. Results for the year The Bank made a profit before tax on continuing activities of £13.5m (2018: £11.1m), and a profit after tax of £10.8m (2018: £9.0m).

Proposed Dividend

The Directors do not recommend the payment of a final dividend (2018: £nil).

Business relationships

We have appropriately considered the relevant interests of the various stakeholders as mentioned in page 31 in our Board discussions and decision making during the year ended 31 December 2019.

Corporate governance arrangements

At the May 2019 board meeting, it was resolved to adopt the Wates Principles (the new code). There is no obligation on companies to adopt these principles, but the intention is that the Wates Principles provide an approach to corporate governance that offers sufficient flexibility without being too prescriptive.

The Wates Principles are a set of six high level principles of corporate governance. It is a voluntary framework which adopts the "apply and explain" approach. Further details in pages 32 to 33 of the Corporate Governance section.

Financial Instruments

The Bank uses financial instruments to manage certain types of risk, including interest rate risk.
Details of the objectives and risk management of these instruments are contained in pages 24 to 27 of the risk management section.

Employee Share Scheme rights

Details of how rights of shares in employee share schemes are exercised are provided in note 6.5 to the financial statements.

Employees

The Bank is committed to employment policies, which follow best practice, based on equal opportunities for all employees, irrespective of gender, race, colour, age, disability, sexual orientation or marital or civil partner status. The Bank is committed to ensuring that disabled people are afforded equality of opportunity with respect to entering into and continuing employment with the Bank. This includes all stages from recruitment and selection, terms and conditions of employment, access to training and career development. Information on employee involvement and engagement can be found in page 31 of the Corporate Governance section.

Appointment and retirement of Directors

The appointment and retirement of the Directors is governed by the Company's Articles of Association and the Companies Act 2006. The Company's Articles of Association may only be amended by a special resolution passed by shareholders at a general meeting.

Board Composition

The directors who held office during the year were as follows:

Robert Sharpe (Chairman)
Independent Non-Executive Director. Chairman of the Board, and Chairman of the Nomination and Remuneration Committee

Robert East
Independent Non-Executive Director, Chairman of the Board Risk Committee and Chairman of the Board Transactional Committee

James Drummond Smith
Independent Non-Executive Director and Chairman of the Audit Committee

Matthew Wyles
Chief Executive Officer

Timothy Blackwell
Chief Financial Officer

Richard Price
Non-Executive Director

Astrid Grey
Independent Non-Executive Director

Dominic Slade
Non-Executive Director

The Bank maintains liability insurance cover for Directors and Officers as permitted by the Companies Act 2006.

Political and Charitable Donations

The Bank made £205 of charitable donations during the year (2018: £582) and did not make any political donations or incur any political expenditure during the year (2018: £nil).

Remuneration Matters

The Bank adheres to the requirements of the Remuneration Code as defined by the Regulator.
The non-executive directors do not receive variable remuneration. Information on the Bank's Remuneration Code is set out in the Pillar 3 disclosures and will be published on our website www.htb.co.uk.

Going Concern

At the date of this report, the severity and duration of the economic effects arising from the Covid-19 pandemic are highly uncertain. Since 31 December 2019, the Bank has continued to maintain Capital and Liquidity at levels significantly above Regulatory Requirements in response to this uncertainty. Further, despite the wide-ranging actions and measures introduced by the UK Government and the Bank of England (including the introduction of TFSME and the setting of the CCyB at 0%), the Bank has undertaken analysis of forecast Capital and Liquidity levels subject to severe downside scenarios, with downside up to levels similar to the Bank of England Annual Cyclical Scenario, assuming the UK economy enters deep and prolonged recession.

The analysis of liquidity under these scenarios also includes short term stresses similar to our ILAAP to assess the impact on the Bank's liquidity versus our risk appetite and regulatory requirements. The results of this analysis together with the results from our other previous Stress Testing, including our most recent ICAAP and ILAAP, together with the aforementioned actions and measures of UK Government and the bank of England, have provided us with assurance that the Bank is sufficiently capitalised with both current and future sources of liquidity available to it.

Accordingly, the directors conclude that the Bank has adequate resources to continue in operational existence for the period of at least 12 months from the date of approval of the financial statements and, therefore, it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Reappointment of Auditors

The Auditors, KPMG LLP, have indicated their willingness to continue in office and a resolution seeking to reappoint them will be presented at the AGM.

Disclosure of Information to Auditors

The Directors who held office at the date of approval of this Directors' report confirm that so far as each of the Directors are aware, there is no relevant audit information of which the Bank's auditor is unaware and the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

Matthew Wyles
Chief Executive Officer

By order of the board, date: 23.04.2020

Statement of Director's Responsibilities

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law.

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

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

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

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

Independant Auditor's Report

KPMG

Independent auditor's report

to the members of Hampshire Trust Bank PLC

1. Our opinion is unmodified

We have audited the financial statements of Hampshire Trust Bank PLC ("the Company") for the year ended 31 December 2019 which comprise the statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows and the related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of Company's affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

We were first appointed as auditor by the shareholders for the year ended 31 December 2006. The period of total uninterrupted engagement is for the 14 financial years ended 31 December 2019. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality: financial statements as a whole	£680,000 (2018:£520,000) 5% (2018: 4.8%) of profit before tax	
Key audit matters		**vs 2018**
Event driven risk	Going Concern	NEW
Recurring risks	The impact of uncertainties due to Britain exiting the European Union on our audit	◄►
	Expected credit losses on asset finance loans and individual stage 3 portfolios	◄►
	Unobservable inputs into the fair valuation of loans and advances to customers	◄►

2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
Going concern *Refer to page 47 (financial disclosures).*	**Unprecedented levels of uncertainty** The financial statements explain how the Board has formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Company. That judgement is based on an evaluation of the inherent risks to the Company's business model and how those risks might affect the Company's financial resources or ability to continue operations over a period of at least a year from the date of approval of the financial statements. The risk most likely to adversely affect the Company's available financial resources over this period is insufficient regulatory capital to meet minimum regulatory capital levels over the course of the next 12 months and cash reserves to pay liabilities as they fall due. There are also less predictable but realistic second order impacts, such as the impact of Covid-19, which could result in a rapid increase in the level of impairment in loans and advances to customers, or a reduction in incoming cash flows as a result of loan payment holidays. The risk for our audit was whether or not those risks were such that they amounted to a material uncertainty that may have cast significant doubt about the ability to continue as a going concern. Had they been such, then that fact would have been required to have been disclosed.	Our procedures included: — **Our Covid-19 knowledge** – We considered the directors' assessment of Covid-19 related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. — **Sensitivity analysis** – We considered sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively, including payment holidays on loan books. — We challenged the stress testing undertaken by the Directors of the identified critical factors in their financial forecasts. — **Evaluating Directors' intent:** We evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. — **Assessing transparency** – We assessed the completeness and accuracy of the matters covered in the going concern disclosure, including those in the strategic report, by comparing the overall picture against our understanding of the risks. **Our results** We found the going concern disclosure without any material uncertainty to be acceptable (2018: acceptable).

KPMG

2. Key audit matters: including our assessment of risks of material misstatement

	The risk	Our response
The impact of uncertainties due to the UK exiting the European Union on our audit *Refer to page 24*	**Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in *Impairment of loans and advances to customers* below, and related disclosures and the appropriateness of the *Going concern* basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the Company's future prospects and performance. Brexit is one of the most significant economic events for the UK and its effects are subject to unprecedented levels of uncertainty of consequences, with the full range of possible effects unknown.	We developed a standardised, firm-wide approach to the consideration of the uncertainties arising from Brexit, in planning and performing our audits. Our procedures included: — **Our Brexit knowledge** – We considered the directors' assessment of Brexit-related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. — **Sensitivity analysis** – When addressing *Impairment of loans and advances to customers* and other areas that depend on forecasts, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty. — **Assessing transparency** – As well as assessing individual disclosures as part of our procedures *Impairment of loans and advances to customers* we considered all of the Brexit related disclosures together, including those in the Strategic Report, comparing the overall picture against our understanding of the risks. **Our results** As reported under *Impairment of loans and advances to customers* and *Going concern*, we found the resulting estimates and related disclosures in relation to Brexit to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a organisation and this is particularly the case in relation to Brexit.

KPMG

2. Key audit matters: our assessment of risks of material misstatement (cont.)

	The risk	Our response
Impairment of loans and advances to customers (£4.470 million; 2018: £1.872 million) *Refer to pages 58 to 61, and 84 to 86 (accounting policy and financial disclosures).*	**Subjective estimate:** Under IFRS 9, the Company uses forward-looking expected credit loss ('ECL') models. The measurement of the ECLs depends on the change in credit quality of each loan since initial recognition. ECLs are determined relative to the stage of changes in credit quality. ECLs in a 12 month period are recognised on loans where there has been no significant increase in credit risk since the loan was originally recognised (stage 1). A lifetime ECL is recognised where there has been a significant increase in credit risk since initial recognition of the loan (stage 2) or where there is objective evidence of impairment and the loan is considered to be in default, or otherwise credit impaired (stage 3). The Company uses models to determine the level of ECL required to be recognised on each loan. Given the subjectivity inherent in estimating the recoverability of loan balances on a forward-looking basis, the assessment of ECLs becomes highly judgemental. The Company's modelled ECL is concentrated in the Asset Finance division representing c.75% of total ECLs. In particular, there is subjectivity in the following key assumptions and judgements: — The determination of a 'significant increase in credit risk'; — The probability of an account falling into arrears and subsequently defaulting; — Loss given default; and — Forward-looking economic forecasts. The effect of these matters is that, as part of our risk assessment, we determined that impairment of loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality and possibly many times that amount.	Our procedures included: — **Our sector experience**: We critically assessed the assumptions inherent in the model against our understanding of the loan portfolios, their recent performance and industry developments. This included benchmarking certain key assumptions against comparable lenders. — **Our economic expertise**: Our economists evaluated the plausibility of the Company's forward economic guidance and the associated probabilities attached to the alternative scenarios against market data, our own independent assumptions and peer experience. — **Sensitivity analysis**: We evaluate the sensitivity of changes to judgemental assumptions, to critically assess the impact of alternative assumptions and identify those assumptions most significant to the estimate. — **Tests of details**: For a sample of loans and advances we conducted credit file reviews to assess the appropriateness of the stage allocation and associated ECL estimate. Additionally, we engaged our modelling specialists to test the Asset Finance probability of default and loss given default models. — **Assessing transparency**: We critically assessed the adequacy of the disclosures regarding the degree of estimation uncertainty involved in arriving at the valuation and the accounting judgements made in determining the measurement basis and valuation. **Our results** We found the resulting estimate of the expected credit losses to be acceptable (2018: acceptable).

KPMG

2. Key audit matters: our assessment of risks of material misstatement (cont.)

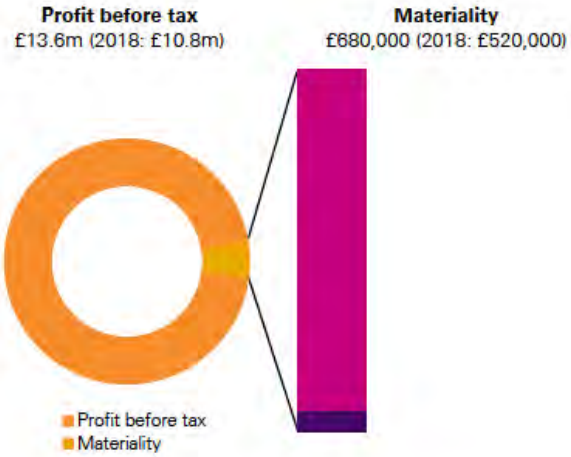
	The risk	Our response
Unobservable inputs into the fair valuation of loans and advances to customers £126.8 million; 2018: £166.8 million *Refer to pages 61 to 62 and 82 to 83 (accounting policy and financial disclosures).*	**Subjective estimate:** The Company holds a portfolio of development finance loans which contain a fee linked to gross development value. In accordance with IFRS 9, these loans are measured at fair value through profit and loss. The Company uses a risk adjusted discounted cash flow model (an income based valuation approach) to estimate the fair value of the loans. The fair value model uses unobservable inputs and as such the loans are classified as level 3 in the fair value hierarchy under IFRS 13. A significant audit risk was identified in respect of the unobservable inputs into the valuation. The key unobservable inputs are the timing of forecast cash flows that are based on estimates of the development completion profile. The effect of these matters is that, as part of our risk assessment, we determined that the unobservable inputs into the fair valuation of loans and advances to customers have a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality and possibly many times that amount.	Our procedures included: — **Methodology choice**: We challenged management on the appropriateness of the methodology used to value the loans, notably the suitability of the model and the discounting rate methodology. — **Independent repricing**: We engaged KPMG specialists to independently rebuild the model and test the observable inputs. — **Historical forecast accuracy**: We assessed the accuracy of historical cash flow forecasts, and challenged instances of divergence between actual cash flows and those forecasted. — **Challenge of key assumptions**: We challenged management on key assumptions around forecast future cash flows and whether they are appropriate. — **Assessing transparency**: We critically assessed the adequacy of the disclosures regarding the degree of estimation uncertainty involved in arriving at the valuation and the accounting judgements made in determining the measurement basis and valuation. **Our results**: We found the resulting estimate of the fair value to be acceptable (2018: acceptable).

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

Materiality for the financial statements as a whole was set at £680,000 (2018: £520,000), determined with reference to a benchmark of profit before tax of which it represents 5% (2018: 4.8%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £34,000 (2018: £26,000), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Company was undertaken to the materiality level specified above and was all performed at the Company's head office in London.



KPMG

4. We have nothing to report on going concern

We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, we are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement in Note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements.

We have nothing to report in these respects.

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

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

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

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

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

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

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

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 35, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

KPMG

Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation, and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Company's licence to operate. We identified the following areas as those most likely to have such an effect: anti-bribery, employment law, regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Company's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any.

Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The identified actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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

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

Simon Ryder
(Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
22 April 2020

KPMG

4. Financial Statements

Statement of Comprehensive Income[1]

	Note	2019 £000	2018 £000
Interest and similar income			
Interest income calculated using the effective interest method	7	54,388	38,239
Other interest income	7	10,545	12,057
Total interest and similar income		**64,933**	**50,296**
Interest expense and similar charges	7	(18,694)	(13,322)
Net Interest Income		**46,239**	**36,974**
Fees and commissions income	8	1,500	2,554
Fees and commissions payable	8	(295)	(166)
Net (loss) on loans and other financial assets at fair value through profit or loss	9	(1,943)	(1,764)
Other Income / (Expenses)	10	6	(8)
Operating Income		**45,507**	**37,590**
Administrative expenses	11	(28,587)	(24,700)
Impairment losses on Loans and Advances to customers	27	(3,375)	(1,742)
Operating profit before tax		**13,545**	**11,148**
Tax (expense)	15	(2,746)	(2,118)
Profit after tax for the year		**10,799**	**9,030**
Other Comprehensive Income / (Expense)	20	50	(50)
Total Comprehensive Income for the year, net of tax		**10,849**	**8,980**

The notes on pages 55 to 105 are an integral part of these financial statements

1. The comparative numbers for 2018 in the Statement of Comprehensive Income and the Statement of Financial Position have not been restated for IFRS 16, as explained in Note 4. As a result they are not directly comparable to 2019.

Statement of Financial Position

	Note	2019 £000	2018 £000
Assets			
Loans and Advances to Banks	17	84,644	98,182
Derivative Assets held for Risk Management	18	1,457	1,708
Financial Assets held at FVOCI	20	-	15,098
Loans and Advances to Customers - FVTPL	21	126,530	166,804
Loans and Advances to Customers – at amortised cost	22	1,053,365	733,192
Property, Plant and Equipment	29	2,077	2,309
Right-of-Use Assets	30	3,463	-
Intangible Assets	31	5,976	4,058
Other Assets	32	6,146	2,822
Deferred tax asset	16	246	-
Total Assets		**1,283,904**	**1,024,173**
Liabilities			
Derivative Liabilities held for Risk Management	18	4,599	836
Central Bank Facilities	24	173,000	135,000
Customer Deposits	25	904,171	720,718
Finance Lease Liability	30	4,525	-
Other Liabilities	33	16,086	11,886
Subordinated Liabilities	34	30,048	29,970
Deferred Tax Liabilities	16	-	13
Total Liabilities		**1,132,429**	**898,423**
Equity			
Share Capital	37	126,288	111,288
Share Premium		196	196
Fair Value through Other Comprehensive Income Reserve		-	(50)
Retained Earnings		24,991	14,316
Total Equity		151,475	125,750
Total Equity and Liabilities		**1,283,904**	**1,024,173**

The notes on pages 55 to 105 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 22nd April 2020 and were signed on its behalf by:

Matthew Wyles
Director

Timothy Blackwell
Director

Company Number: 1311315

Statement of Changes in Equity
For the year ended 31 December 2019

	Share Capital £000	Share Premium £000	Retained Earnings £000	FVTOCI Reserve £000	Total Equity £000
Balance at 1 January 2019	111,288	196	14,316	(50)	125,750
Adjustment on Initial application of IFRS16	-	-	(108)	-	(108)
Restated Balance at 1 January 2019	111,288	196	14,208	(50)	125,642
Comprehensive Income for the year					
Profit for the year/Other Comprehensive Income	-	-	10,799	50	10,849
Total Comprehensive Income for the year	-	-	10,799	50	10,849
Contributions by and distributions to owners					
Equity Settled Share-Based Payment	-	-	(16)	-	(16)
Issue of shares	15,000	-	-	-	15,000
Total contributions by and distributions to owners	15,000	-	(16)	-	14,984
Balance at 31 December 2019	**126,288**	**196**	**24,991**	**-**	**151,475**

Statement of Changes in Equity
For the year ended 31 December 2018

	Share Capital £000	Share Premium £000	Retained Earnings £000	FVTOCI Reserve £000	Total Equity £000
Balance at 1 January 2018	111,288	196	4,156	-	115,640
Adjustment on Initial Application of IFRS 9 for: ECL adjustment, net of tax	-	-	(506)	-	(506)
Loans mandatorily reclassified as FVTPL, net of tax	-	-	1,301	-	1,301
Restated Balance at 1 January 2018	111,288	196	4,951	-	116,435
Comprehensive Income for the year					
Profit for the year/ Other Comprehensive Income	-	-	9,030	(50)	8,980
Total Comprehensive Income for the year	-	-	9,030	(50)	8,980
Contributions by and distributions to owners					
Equity Settled Share-Based Payment	-	-	335	-	335
Issue of shares	-	-	-	-	-
Total contributions by and distributions to owners	-	-	335	-	335
Balance at 31 December 2018	**111,288**	**196**	**14,316**	**(50)**	**125,750**

Statement of Cash flows

	Note	2019 £000	2018 £000
Cashflows from operating activities			
Profit before tax for the year		13,545	11,148
Adjustments for:			
Depreciation and amortisation		2,885	1,409
Foreign Exchange Gains/(Losses)		6	(8)
Increase/(Decrease) in impairment of Loans and Advances		776	(1,582)
Increase/(Decrease) in provisions		2,599	(303)
Equity-settled share based payment transactions		(16)	335
(Increase)/Decrease in Fair Value of Derivative Assets		3,574	82
(Increase)/Decrease in Fair Value of loans and advances designated as hedged items		(3,243)	-
(Increase)/Decrease in Fair Value of Loans and Advances held at FVTPL		4,088	1,682
(Increase)/Decrease in Fair Value of GILT's		61	-
Repayment of the interest accrued on finance lease liabilities		(240)	-
Corporation Tax paid		(2,230)	(2,077)
Changes in:			
(Increase) in Loans and Advances to Customers		(278,881)	(266,849)
Decrease/(Increase) in Other Assets		(3,324)	(964)
Increase in Central Bank Facilities		38,000	115,000
Increase in Customer Deposits		183,827	124,422
Increase in Other Liabilities		3,068	2,032
(Increase) in Encumbered Cash		-	(11)
Decrease/(Increase) in Debt Securities		15,098	(15,098)
Net cash flow from operating activities		**(20,407)**	**(30,782)**
Cash flows from Investing Activities			
Purchase of Property, Plant and Equipment		(280)	(790)
Purchase of Intangible Assets		(3,400)	(1,876)
Net cash flow from Investing Activities		**(3,680)**	**(2,666)**
Cash flows from Financing Activities			
Proceeds from the issuance of subordinated debt		-	30,000
Repayments of the principal portion of finance lease liabilities		(1,078)	-
Proceeds from the issue of share capital		15,000	-
Net decrease in Cash and Cash Equivalents		(10,165)	(3,448)
Cash and cash equivalents at 1 January		94,809	98,257
Cash and Cash Equivalents at 31 December		**84,644**	**94,809**
Cash in hand		-	-
Loans and advances to Banks	17	84,644	94,809
Cash and Cash Equivalents at 31 December		**84,644**	**94,809**

Notes to the financial statements

This section describes the Bank's significant policies and critical accounting estimates that relate to the financial statements and notes as a whole. If an accounting policy or a critical accounting estimate relates to a particular note, the accounting policy and/or critical accounting estimate is contained within the relevant note.

1. Reporting entity

Hampshire Trust Bank Plc (the 'Bank') is domiciled in the United Kingdom, a company limited by shares.

2. Basis of Preparation

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board and as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee (and those part of the Companies Act 2006 as applicable to the companies reporting under IFRS) with some limited modifications such as the temporary 'carve out' from IAS 39.

The Bank is exempt by virtue of Section 400 of the Companies Act 2006 from the requirement to prepare group financial statements. These financial statements present information about the Bank as an individual undertaking and not about its group.

These financial statements are presented in Pounds Sterling (GBP), which is the Bank's functional currency. All amount has been rounded to the nearest thousand except when otherwise stated.

Going concern

At the date of this report, the severity and duration of the economic effects arising from the Covid-19 pandemic are highly uncertain. Since 31 December 2019, the Bank has continued to maintain Capital and Liquidity at levels significantly above Regulatory Requirements in response to this uncertainty. Further, despite the wide-ranging actions and measures introduced by the UK Government and the Bank of England (including the introduction of TFSME and the setting of the CCyB at 0%), the Bank has undertaken analysis of forecast Capital and Liquidity levels subject to severe downside scenarios, with downside up to levels similar to the Bank of England Annual Cyclical Scenario, assuming the UK economy enters deep and prolonged recession. The analysis of liquidity under these scenarios also includes short term stresses similar to our ILAAP to assess the impact on the Bank's liquidity versus our risk appetite and regulatory requirements. The results of this analysis together with the results from our other previous Stress Testing, including our most recent ICAAP and ILAAP, together with the aforementioned actions and measures of UK Government and the bank of England, have provided us with assurance that the Bank is sufficiently capitalised with both current and future sources of liquidity available to it.

Accordingly, the Bank has adequate resources to continue in operational existence for the period of at least 12 months from the date of approval of the financial statements and therefore, it is appropriate to continue to adopt the going concern basis in preparing the accounts.

3. Changes in significant accounting policies

The Bank applied the following standards and amendments to standards from 1 January 2019.

- IFRS 16 Leases.
- Hedge accounting - Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7).

A number of other new standards are also effective from 1 January 2019 but they do not have a material effect on the Bank's financial statements.

3.1. IFRS 16 Leases

The IASB published IFRS 16, the new leases standard with an effective date of 1 January 2019, replacing IAS 17. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single on-balance sheet model that is similar to the current finance lease accounting with the exception of low-value and short-term leases.

The greatest impact of the standard is on lessee accounting because of the requirement for lessees to recognise an asset and corresponding liability in respect of operating leases.

Under the new standard, the Bank recognises new right of use assets and lease liabilities, with the objective to bring added transparency to the balance sheet.

Summary of financial statement impact on application of IFRS 16

Area	Financial statement impact
Statement of financial position	New requirement leads to an increase in recognised asset and liabilities. Overall impact on assets and liabilities as at 1 Jan 19 is summarised in the table below. The Bank will be separately presenting the right of use asset and lease liabilities from other assets and liabilities in the statement of financial position.
Statement of comprehensive income	There is a change in the amount and presentation of expenses related to a lease. Under IAS 17, operating lease expense was presented as part of operating expenses. Applying IFRS 16, the expense is split into financing cost/interest cost and depreciation expense.
Statement of cash flows	Lease payments are split between cash payments for the interest portion of the lease liability and repayments of its principal portion. Repayments of principal is presented within cash flows from financing activities and interest paid is classified as part of cash flows from operating activities.

Transition to IFRS 16	As at 1 January 2019
Right of use asset	4,386,034
Lease liabilities	(5,300,100)
Reversal of accruals	784,342
Deferred tax asset arising on transition	22,053
Equity (difference)	**(107,671)**

Impact on lessee accounting

IFRS 16 has changed how the Bank accounts for leases previously classified as operating leases under IAS 17, which were off balance sheet:

- The Bank has elected not to adjust the comparative periods and elected to apply the modified retrospective/cumulative catch up approach. IFRS 16 offers several practical expedients under the modified retrospective approach.
- The Bank currently has two significant property leases for its office sites in London and Leeds.
- As at 1 Jan 2019, the net impact on transition in retained earnings is a £108k reduction. This will be recouped over future periods by a smaller charge to the income statement than IAS 17. There is an effective gross up of the balance sheet with a new right of use asset and a lease liability.
- The lease liability of £5.3m is measured based on the present value of the lease payments payable over the remaining lease term, discounted at incremental borrowing rate of 5% (estimated market rate for a secured borrowing over a similar lease term).
- The asset of £4.4m is calculated as if IFRS 16 had always been applied from lease inception, depreciating the original right of use asset straight line over the lease term.

- For short-term leases (lease term of 12 months or less) and leases of low-value assets (which includes tablets and personal computers, small items of office furniture and telephones), the Bank has opted to recognise a lease expense as permitted by IFRS 16. This expense is presented within 'Administrative expenses' in the income statement.

The Bank has used the following practical expedients when applying the cumulative catch-up approach to leases previously classified as operating leases applying IAS 17:

- Applied a single discount rate to a portfolio of leases with reasonably similar characteristics.
- Elected not to recognise right-of-use assets and lease liabilities to leases for which the lease term ends within 12 months of the date of initial application.
- Excluded initial direct costs from the measurement of the right-of-use asset at the date of initial application.
- Used hindsight when determining the lease term when the contract contains options to extend or terminate the lease.

Impact on lessor accounting

IFRS 16 does not change substantially how a lessor accounts (bank is the lessor, i.e. leases in the specialist finance division and the sublease of the London office) for leases. Under IFRS 16, a lessor continues to classify leases as either finance leases or operating leases and account for those two types of leases differently. The leases provided as part of speciality finance are classified as finance lease because the rentals cover the purchase price of the asset. The sub lease of the London office is only for 2 years out of the remaining 5-year term in the head lease. Therefore, the sub lease is classified as an operating lease.

3.2. Hedge accounting - Interest rate benchmark reform

During 2019, the Bank adopted the Hedge accounting per IAS 39 for the first time. The Bank has also elected to early adopt the 'Amendments to IFRS 9, IAS 39 and IFRS 7 Interest Rate Benchmark Reform' ("IBOR Reform") issued in September 2019. This results in the following:

- In accordance with the transition provisions, the amendments have been adopted retrospectively to hedging relationships that existed at the start of the reporting period.
- The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform.
- The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness should continue to be recorded in the income statement. Furthermore, the amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present.
- In general, the reliefs end at the earlier of (a) when there is no longer uncertainty arising from IBOR reform over the timing or amount of the IBOR-based cash flows of the relevant item, and (b) when the hedging relationship to which the relief is applied is discontinued.

In summary, the reliefs provided by the amendments that apply to the Bank are:

- In assessing whether the hedge is expected to be highly effective on a forward-looking basis, the Bank has assumed that the GBP LIBOR interest rate on which the cash flows of the interest rate swap that hedges fixed-rate mortgages is not altered by IBOR reform.
- The Bank will not discontinue hedge accounting during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside the required 80–125% range.
- The Bank will cease to apply the amendments to its retrospective and prospective effectiveness assessment of the hedging relationship when the uncertainty arising from interest rate benchmark is no longer present with respect to the timing.
- The Bank has assessed whether the hedged GPB LIBOR risk component is a separately identifiable risk only when it first designates a mortgage as included in its macro hedge and not on an ongoing basis.

4. Use of judgments and estimates

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Bank's accounting policies and the reported amounts of assets, liabilities, income and expenses.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively. The significant estimates and judgements made by management in applying accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the results and financial position, are presented within the notes to the accounts as shown below:

A. Judgements

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the consolidated financial statements is included in the following notes:

- **Notes 6.8**: classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding.
- **Note 6.10:** establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining the methodology for incorporating forward-looking information into the measurement of ECL and selection and approval of models used to measure ECL.

B. Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2019 is included in the following notes:

- **Note 6.1:** the effective interest rate is an estimate of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period.
- **Note 6.6:** estimation of the lease term; determination of the appropriate rate to discount the lease payments; assessment of whether a right-of-use asset is impaired. Estimation of the provision for present value of future costs of restoration of the leased premises.
- **Notes 6.10:** allowance for credit impairment losses on financial assets at amortised cost: determination of inputs into the ECL measurement model, including key assumptions used in estimating recoverable cash flows and incorporation of forward-looking information.
- **Note 6.11:** measurement of the fair value of financial instruments with significant unobservable inputs.
- **Notes 6.15:** estimation of useful lives and related depreciation for PPE and finite intangible assets.

5. Future accounting developments

A number of IFRSs and amendments to IFRSs were in issue at 31 December 2019 that would affect the Bank from 1 January 2020. The amendments to IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policy, Changes in Accounting Estimates and Errors' on the definition of material were issued in October 2018 and are effective for annual periods beginning on or after 1 January 2020 with earlier application permitted.

The amendments are aimed at improving the understanding of the existing requirements rather than to significantly impact current materiality judgements. They provide a new definition of material which shall be used to assess whether information, either individually or in combination with other information, is material in the context of the financial statements.

6. Significant accounting policies

6.1. Interest income and expense

Interest income and expense are recognised in the Statement of Comprehensive Income for all instruments measured at amortised cost using the effective interest rate ("EIR") basis.

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

Interest on impaired financial assets is recognised at the same EIR as applied at the initial recognition of the financial asset but applied to the book value of the financial asset net of any impairment allowance.

6.1.1. Significant judgement & estimates: Effective Interest Rate

In determining the expected life of loans and receivables assets, the Bank uses judgement on the likely redemption profiles. The Bank also forecasts and estimates the likely level of early repayment charges. At regular intervals throughout the year, the expected lives of loans and receivables assets are reassessed for reasonableness. Any variation in the expected life of these assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

Interest income and expenses presented include:

- Interest on financial assets and financial liabilities measured at amortised cost calculated on EIR basis.
- Interest on FVOCI.
- Interest on FVTPL.
- Interest expense on lease liabilities.
- Interest income from Finance Leases and Hire Purchase is recognised over the period of the agreement so as to give a constant rate of return.

6.2. Fee and commission income

Fees and commissions which are not considered integral to the effective interest rate are generally recognised when the service has been provided and the Bank has satisfied its performance obligations per IFRS 15. These fees from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer.

Fees and commission income include customer service fees, wholesale facility fees, placement fees, which are recognised as the related services are performed (at a point in time or over time). Fees and commission income include commitment fees charged for Development Finance loans held at FVTPL.

Fees and commission expense include transaction and service fees, which are expensed as the services are received. None of the fees and commission charged arose from variable consideration and fees charged are generally not refundable unless under exceptional circumstances.

6.3. Net income from other financial instruments at FVTPL

6.3.1. Development Finance ("DF") loans

- Certain DF loans are measured at FVTPL because the contractual cash flows are not SPPI.
- Income from those DF loans will be shown within this line and excludes the interest income on such loans. The related interest income is presented as part of other interest income.

6.3.2. Derivatives

Net income from derivatives relates to non-trading derivatives held for risk management purposes that do not form part of a qualifying hedging arrangement:

- The fair value movement on derivatives held for economic hedging where hedge accounting is not applied are presented in 'Net income from other financial instruments at FVTPL. However, for designated and effective fair value hedge accounting relationships the gains and losses on the hedging instrument are presented in the same line in the profit and loss as the hedged item.

6.4. Employee benefits

The Bank applies IAS 19 Employee benefits in its accounting for components of staff costs.

6.4.1. Short-term employee benefits

Short-term employee benefits are expensed as the related service is provided. A liability is recognised for the amount expected to be paid if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

6.4.2. Defined contribution plans

Obligations for contributions to defined contribution plans are expensed as the related service is provided and recognised as pension costs in the income statement.

6.5. Share based payments

Employees may be entitled to receive remuneration in the form of shares to reward strong long-term business performance and to incentivise growth for the future. These share-based payment transactions are accounted for as equity settled share-based payments in accordance with IFRS 2. This equity is in the 'B' Ordinary Shares of the Bank's parent company, Hoggant Ltd.

The grant date fair value of a share-based payment transaction is recognised as an employee expense, with a corresponding increase in equity over the vesting period of the awards.

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

The amount recognised as an expense in the Income Statement is based on amortising the grant date fair value at a constant rate to the vesting date.

6.5.1. Scheme Details

The Incentive Share scheme, comprising 'B' Ordinary shares issued by Hoggant Ltd (HTB's parent company), was introduced for directors and senior employees of the Bank on 21 May 2014. All shares were issued at a price of £0.01p per share. Holders are entitled to receive a return on the shares acquired in the event of a prescribed exit event.

The Incentive Share scheme is governed by Hoggant's Articles of Association and is deemed by Management to be an equity settled scheme and has been accounted for as such in the financial statements of the Company.

The Bank's long-term incentive share scheme is subject to two conditions. A service and a nonmarket performance condition. Employees must remain in service until the exit event happens (exit being the non-market performance condition). Therefore, there is a variable vesting period. The exit condition influences the length of the estimated vesting period.

6.5.2. Valuation method

The fair values of the shares at the date of grant were valued using the Black-Scholes valuation model. The assumptions used are as follows:

	2019	2018	2017
Expected volatilty	28.9 to 30.2%	29.1% to 30.2%	30.4 to 31.2%
Risk free rate	0.8% to 1.3%	0.9% to 1.3%	0.5 to 0.8%
Dividend yield	0.0%	0.0%	0.0%
Expected life	3 years	3 years	3 years

Although the Black-Scholes equation assumes predictable constant volatility, this is not observed in real markets. In order to estimate the annualised volatility we have assessed the past standard deviation of the stock price of comparable quoted banks over a period commensurate with the expected term.

6.5.3. Significant estimates: Share Based Payments

The fair value of shares in the employee share scheme was determined using a Black Scholes valuation model. The significant inputs into this model were expected term, risk free interest rate, expected dividend yield, equity value at grant date and volatility. Management has estimated the vesting period over which these shares will vest.

6.6. Leases

6.6.1. As a lessee

The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate. The incremental borrowing rate is determined by analysing borrowings from/to external sources adjusted to reflect the terms of the lease and the type of asset leased.

The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases, including leases of IT equipment. The Bank recognises the lease payments with these leases as an expense on a straight-line basis over the lease term. For property leases, the Bank has elected to separate the non-lease and lease component.

6.6.2. As a lessor

At lease inception, the lessor determines whether the lease is a finance lease or an operating lease. To classify each lease, the Bank makes an overall assessment of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease; if not, then it is an operating lease. As part of this assessment, the Bank considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

Assets leased to customers are finance leases per IFRS 16. When assets are leased to customers under finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised within interest income.

The Bank applies the derecognition and impairment requirements in IFRS 9 to the net investment in the lease.

6.6.3. Significant judgement & estimates: Lease term

The Bank has made a judgement on extending the lease term of Leeds office to 2023 and terminating the term of London office to 2023. This will be reassessed at each reporting period.

The discount rate used in the calculation of lease liability, is an estimation. For the property leases, the rate implicit in the Bank's property leases cannot be determined and it is unclear what a market rate for a secured loan provided to a Bank would be. In practice, banks do not enter into mortgage contracts with other lenders, particularly ones which such short terms, therefore, a rate of 5.0% would be an equivalent market rate to borrow a similar amount, on a secured basis, over a similar term, given the Bank's current credit standing.

The Bank also leases computers and equipment in disaster recovery office, however, that is outside the scope of IFRS 16 because the supplier has substantive substitution rights, and the Bank does not have the right to use an asset.

The Bank uses two data centre providers (colocation rack and various other services) where the Bank has the right to direct the use of the asset and obtain all economic benefits relating to the asset i.e. access to physical cabinets and therefore within the scope of IFRS 16. Due to the nature of the rolling contracts, we have taken the exemption of short-term leases on those two data centre agreements.

6.7. Income tax

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided in full using the liability method on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

6.8. Financial assets & liabilities

Loans and advances include:

- loans and advances measured at amortised cost – they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.
- loans and advances mandatorily measured at FVTPL or designated as at FVTPL – these are measured at fair value with changes recognised immediately in profit or loss.
- lease receivables.

6.8.1. Classification

A financial asset is measured at amortised cost if both the following conditions are met and it has not been designated at FVTPL:

- the asset is held within a business model where the objective is to hold the asset to collect its contractual cash flows.
- the contractual terms of the financial asset give rise to cash flows on specified dates that represent payments of solely principal and interest ("SPPI") on the outstanding principal amount.

A debt instrument would be measured at FVOCI only if both of the below conditions are met and it has not been designated as FVTPL:

- the asset is held within a business model where the objective is achieved by both collecting its contractual cash flows and selling the financial asset.
- the contractual terms of the financial asset give rise to cash flows on specified dates that represent payments of solely principal and interest on the outstanding principal amount.

All other financial assets are classified as measured at FVTPL.

6.8.2. Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed, and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile or realising cash flows through the sale of the assets.
- how the performance of the portfolio is evaluated and reported to the Bank's management.
- the risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed.

The Bank's current business model for all financial assets is to hold to collect contractual cash flows.

6.8.3. Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

Significant judgment

In assessing whether the contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows.
- leverage features.
- prepayment and extension terms.
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse loans).
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Bank holds a portfolio of Development Finance loans which have contingent exit fees. As these fees are contingent on the value of the finished development, the Bank deems these loans to fall outside of SPPI and has mandatorily reclassified these assets at FVTPL.

6.8.4. De-recognition

On de-recognition of a financial asset, the difference between the carrying amount of the asset and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in Other Comprehensive Income ("OCI") is recognised in the income statement.

6.9. Modification of financial assets and financial liabilities

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised, and a new financial asset is recognised at fair value plus any eligible transaction costs.

6.10. Impairment

The impairment model in IFRS 9 is an expected loss model, which means that it is not necessary for a loss event to occur before an impairment loss is recognised. The impairment allowance is more forward-looking.

The impairment requirements apply to all financial assets at amortised cost, debt financial assets at FVOCI and loan commitments but not those measured at FVTPL (some Development Finance loans as mentioned above).

IFRS 9 requires assets to be classified into three stages. The Bank applies this three-stage approach to measuring the expected credit loss (ECL) based on credit migration between the stages.

Stage 1	Financial assets determined to have low credit risk at the reporting date, financial assets that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date. For these assets, 12-month expected credit losses (ECL) are recognised and interest revenue is calculated on the gross carrying amount of the asset. 12-month ECL are the expected credit losses that result from default events that are expected within 12 months after the reporting date.
Stage 2	Financial assets that have experienced a significant increase in credit risk since initial recognition but that do not have objective evidence of impairment. Assets that have not subsequently met the Bank's cure methodology or considered to be credit impaired. For these assets, lifetime ECL are recognised, but interest income is still calculated on the gross carrying amount of the asset. Lifetime ECL are the expected credit losses that result from all possible default events over the expected life of the financial asset.
Stage 3	Financial assets that have objective evidence of impairment at the reporting date. For these assets, lifetime ECL are recognised and interest income is calculated on the net carrying amount.

6.10.1. Significant estimates: ECL

Stages 1 and 2 ECLs as defined in the accounting policy are the product of the ECL model. Model governance, including validation, manual overlays, inputs and outputs, is covered by the Model Governance Committee.

Stage 3 impairments are assessed manually. Loans move to stage 3 when a specific event has occurred where there is objective evidence of impairment. In any case, the back-stop position is loans that are in default (90 days+ past due) automatically go into stage 3. When determining specific provisions and recoverability, macro-economic assumptions will also be taken into account.

6.10.2. Measurement of ECL/ECL Model

ECL are a probability-weighted estimate of credit losses. Credit losses are the expected cash shortfalls from what is contractually due over the expected life of the financial instrument, discounted at the original effective interest rate. The impairment model calculates ECL at an individual loan level by multiplying probability of default (PD), loss given default (LGD) and the exposure at default (EAD). These variables are derived from internally developed statistical models adjusted to reflect forward looking information and are discussed below. Management adjustments are made to modelled output to account for situations where known or expected risk factors have not been considered in the modelling process. The recognition and measurement of ECL is highly complex and involves the use of significant judgement and estimation. This includes the formulation and incorporation of multiple forward-looking economic conditions into ECL to meet the measurement objective of IFRS 9.

PD	PD represents the likelihood of a customer defaulting on their loan. The 12-month PD is either taken from a behavioural or application PD model or manually assessed via the 'Watch' process. Application PD models utilise qualitative and quantitative factors that are indicative of the risk of default e.g. arrears status and loan applications scores. This is then extrapolated using historic industry data, where available, or expert judgement to calculate the lifetime PD. The lifetime PD is calculated on a weighted basis across all scenarios. These factors vary for each loan portfolio. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. In monitoring exposures information such as payment records, request for forbearance strategies and forecast changes in economic conditions are considered for Asset Finance and Specialist Mortgages. As the Bank's performance data does not go back far enough to capture a full economic cycle, the proxy series of the quarterly rates of write offs for UK unsecured lending data is used to build an economic response model ('ERM') to incorporate the effects of recession.
EAD	EAD is based on the amount expected to be owed at default over the next 12 months or over the remaining lifetime. EAD represents the expected exposure in the event of a default. EAD is derived from the current exposure and potential changes to the current amount allowed under the terms of the contract, including amortisation, overpayments and early terminations. The EAD of a financial asset is its gross carrying amount. For loan commitments, the EAD includes the amount drawn as well as potential future amounts that may be drawn under the terms of the contract, estimated based on historical observations and forward-looking forecasts.
EAD	LGD is the magnitude of the likely loss in the event of default. This takes into account recoveries either through curing or, where applicable, through auction sale of repossessed collateral and debt sale of the residual shortfall amount. For loans secured by property and property developments, loan to value ('LTV') gross development values ('GDV') ratios are key parameters in determining LGD. LGDs are calculated on a discounted cash flow basis using the financial instrument's origination effective interest rate as the discount factor.

6.10.3. Determining a significant increase in credit risk since initial recognition

The impairment model utilises both relative and absolute criteria to identify increases in credit risk:

- 30 days past due or recent unsatisfied Country Court Judgement/default on the customer's credit file (i.e. including credit events with other organisations).
- Loans moved to watch list. Numerous quantitative and qualitative watch list factors are monitored including changes in bureau behavioural score, formal credit actions (e.g. winding up orders, CCJs, meeting of creditors), adverse changes in financial performance, significant changes in Directors and cost over runs and timing delays experienced by borrowers. Current and forecast adverse changes in the customer's geography and sector are also considered.
- Loans in forbearance less than 90 days in arrears.
- Deterioration of lifetime PD since origination (either doubling or increasing by 5%)

Due to a lack of historic trading data the stage transition criteria were set using industry level data and expert judgement. Going forward the criteria will be refined once Bank specific trading data is available.

6.10.4. Definition of default and credit impaired assets

A financial asset is credit impaired when an event or events that have a detrimental impact on estimated future cash flows have occurred. Loan accounts are classified as in default if any of the following criteria has been met: 90 days past due; or the customer is bankrupt, in administration or liquidation.

6.10.5. Forecast economic data

IFRS 9 requires ECL to reflect a range of possible outcomes and to consider future economic conditions. The Bank incorporates forward looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of ECL. This is achieved by developing a number of potential economic scenarios and modelling ECL for each scenario. The outputs from each scenario are combined using the estimated likelihood of each scenario occurring to derive a probability weighted expected credit loss. The scenarios adopted and probability weighting applied are approved by the Model Governance Committee and then submitted to the Audit Committee as part of year end approval.

To achieve this the model uses five economic forecasts: one base; two upside; and two downside scenarios. All of the scenarios have been sourced from an independent economic consultancy currently Oxford Economics. The upside and downside scenarios are calculated from a range of economic variables that are stressed around the base case. The ECL recognised in the financial statements reflects the effect on expected credit losses of a range of possible outcomes, calculated on a probability-weighted basis, based on the economic scenarios described above. The probabilityweighted amount is typically a higher number than would result from using only the base economic scenario. Credit losses and defaults typically have a non-linear relationship to the many factors which influence credit losses, such that more favourable macroeconomic factors do not reduce expected losses as much as less favourable macroeconomic factors increase expected losses.

6.10.6. Movement between stages

Watch lists are reviewed monthly by the Watch Forum to ensure that the strategies remain appropriate and up to date. Performing assets which have experienced a significant increase in credit risk since initial recognition are reclassified from stage 1 (12 month ECL) to stage 2 (lifetime ECL).

A renegotiated loan is derecognised, and a new agreement is made on a substantially different term. These renegotiated loans are classified as modified loans and can be transferred out of stage 3 if they no longer exhibit evidence of being credit impaired. The decision to move a customer from 'Watch' to 'Performing' status can only be made by an individual/committee with the correct level of authority as per the Bank's Delegated Authorities Policy.

6.10.7. Cure methodology

The credit risk of a financial asset may improve such that it is no longer considered to have experienced a significant increase in credit risk if it meets the Bank's cure methodology. The Bank's cure methodology for all portfolios requires sufficient payments to be made to bring an account back within less than 30 days past due and for such payments to be maintained for consecutive months. To comply with IFRS 9 a customer will remain in default for 90 days even if cured. There is a 3-month probation period for both stage 2 and 3. This also includes accounts that are removed from the watch list.

6.10.8. Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level. Recoveries of amounts previously written off are recognised when cash is received and are included in 'impairment losses on financial instruments' in the statement of comprehensive income and OCI.

6.11. Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between markets participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. When one is available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as "active" if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument on initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value on initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique for which any unobservable inputs are judged to be insignificant in relation to the measurement, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value on initial recognition and the transaction price. Subsequently that difference is recognised in the income statement on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

6.11.1. Significant estimates

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

- Level 1: Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis. The objective of valuation techniques is to determine the fair value of the financial instrument at the reporting date as the price that would have been agreed between active market participants in an arm's length transaction.

The Bank uses widely recognised valuation models to determine the fair value of common and simple financial instruments, such as interest rate swaps, that use only observable market data and require little management and estimation. Observable prices and model inputs are usually available in the market for listed debt securities and simple OTC derivatives such as interest rate swaps. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which are developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market and may be derived from market prices or rates or estimates based on assumptions. Examples of instruments involving significant unobservable inputs include certain loans and advances. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for determination of timing and size of cash flows, probability of counterparty default and selection of appropriate discount rates.

Fair value estimates obtained from models are adjusted for any other factors such as liquidity risk and model uncertainties to the extent the Bank believes a third-party market participant would take them into account in pricing a transaction. Fair values reflect the credit risk of the instrument.

6.12. Loans and advances to banks

Cash and cash equivalents comprise loans and advances to banks and building societies and short term highly liquid debt securities with less than 3 months to maturity. Loans to banks and building societies comprise cash balances and call deposits. All cash ISAs which allow immediate access to capital are also classified as time deposits because they have same level of liquidity as cash.

6.13. Derivatives held for risk management purposes and hedge accounting

The Bank designates certain derivatives as hedging instruments in respect to interest rate risk in fair value hedges. The Bank applies fair value hedge accounting for portfolio hedges of interest rate risk. The hedged items are portfolios that are identified as part of the risk management process. The Bank uses the exemption to continue using IAS 39 hedge accounting. Further, during 2019, the Bank has early adopted the amendments to IAS 39 and IFRS 7 issued by the IASB in September 2019 as part of its project on interest rate benchmark reform ('the amendments').

At the inception of the hedge relationship, the Bank documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Bank documents whether the hedging instrument is effective in offsetting changes in fair values of the hedged item attributable to the hedged risk, which is when the hedging relationships meet all of the following hedge effectiveness requirements:

- there is an economic relationship between the hedged item and the hedging instrument.
- the effect of credit risk does not dominate the value changes that result from that economic relationship.

- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Bank actually hedges and the quantity of the hedging instrument that the Bank actually uses to hedge that quantity of hedged item.

The Bank rebalances a hedging relationship in order to comply with the hedge ratio requirements when necessary. In such cases discontinuation may apply to only part of the hedging relationship. For example, the hedge ratio might be adjusted in such a way that some of the volume of the hedged item is no longer part of a hedging relationship, hence hedge accounting is discontinued only for the volume of the hedged item that is no longer part of the hedging relationship.

If a hedging relationship ceases to meet the hedge effectiveness (80-125%) requirement relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, the Bank adjusts the hedge ratio of the hedging relationship (i.e. rebalances the hedge) so that it meets the qualifying criteria again.

6.13.1. Fair value hedges

The Bank applies fair value hedge accounting for portfolio hedges of interest rate risk. As part of its risk management process, the Bank identifies portfolios whose interest rate risk its wishes to hedge. The portfolio comprise either only assets or only liabilities. The Bank analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur.

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss. The change in fair value of the hedged item attributable to the hedged risk is recognised in profit or loss. If the hedged item would otherwise be measured at cost or amortised cost, then its carrying amount is adjusted accordingly.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively.

Any adjustment up to the point of discontinuation to a hedged item is amortised to income statement on a straight line basis over its remaining life.

On hedge discontinuation, any hedging adjustment made previously to a hedged financial instrument for which the effective interest method is used is amortised to income statement by adjusting the effective interest rate of the hedged item from the date on which amortisation begins. If the hedged item is derecognised, then the adjustment is recognised immediately in profit or loss when the item is derecognised.

6.13.2. EU carve out

Under IFRS it is not possible to hedge ISAs as they are a demand deposit. However, there is a carve out version of IAS39 for EU which does allow for firms to include these as qualifying hedged items. This application relies on the continued availability of the EU carve out to UK entities. The Bank is not aware of any immediate concerns, but the impact of Brexit may lead to eventual changes in the eligibility of UK companies to apply EU-IFRS. New hedge documentation would be required for ensuring that the associated requirements are met including any specific aspects for these hedged items.

6.14. Financial assets at OCI

A debt instrument would be measured at FVOCI only if both of the below conditions are met and it has not been designated as FVTPL:

- the asset is held within a business model where the objective is achieved by both collecting its contractual cash flows and selling the financial asset.
- the contractual terms of the financial asset give rise to cash flows on specified dates that represent payments of solely principal and interest on the outstanding principal amount.

For debt instruments measured at FVOCI, gains and losses are recognised in OCI, except for interest using the effective interest method and ECL. On derecognition, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

6.15. Property, Plant and Equipment

Tangible fixed assets are stated at historical cost, which includes direct and incremental acquisition costs less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of plant and equipment at the following rates:

- Equipment 10% - 33%
- Fixtures and fittings 10% - 33%

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted accordingly with any adjustments made prospectively.

6.15.1. Subsequent costs

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Ongoing repairs and maintenance are expensed as incurred.

6.15.2. Impairment of Property, Plant and Equipment

At each balance sheet date property, plant and equipment are assessed for indications of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying amount of the asset with its recoverable amount which is the higher of the asset's net selling price and its value in use.

The carrying values of fixed assets are written down by the amount of any impairment and this loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to a fixed asset may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the fixed asset's recoverable amount.

The company leases office premises in London and Leeds and these are presented as Right-of-Use assets on a separate line in the statement of financial position.

6.16. Intangibles assets

Purchased software and costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Bank which will generate future economic benefits and where costs can be reliably measured. They are stated at historical cost.

Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is generally between 3 to 7 years. The amortisation periods used are reviewed annually.

6.16.1. Subsequent costs

Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense as incurred. Intangible assets are stated at cost less cumulative amortisation and impairment losses.

6.16.2. Significant estimate: Impairment of Intangibles

Assets are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

6.17. Deposits

Customer deposits are non-derivative financial liabilities with fixed or determinable payments. Deposits are initially measured at fair value minus incremental direct transaction costs. Subsequently, they are measured at their amortised cost using the effective interest rate method.

6.18. Financial liabilities - Central Bank Facilities

Loans and advances over which the Bank transfers its rights to the collateral thereon to the Bank of England under the TFS and ILTR are not derecognised from the Statement of financial position as the Bank retains substantially all the risks and rewards of ownership including all cash flows from the loans and advances and exposure to credit risk.

Financial liabilities are initially measured at fair value and are subsequently measured generally at amortised cost unless it is held for trading. A financial liability will be derecognised when it is discharged or cancelled or expired. Financial liabilities are subsequently measured at amortised cost, interest is accrued over the life of the agreement on an EIR basis.

Drawings under the TFS have a maturity of four years and bear interest at Bank Base Rate. Drawings under the scheme are collateralised using the Bank's loan portfolio and are measured at amortised cost. The volume of funding which can be drawn through central bank facilities is restricted by the volume of assets which the Bank is willing to encumber in the schemes. The Bank has set its risk appetite for asset encumbrance to ensure that the Bank is able to utilise central bank facilities as much as possible, whilst ensuring sufficient availability of 'free' assets, (assets that are unencumbered but that may be encumbered).

Drawings under Indexed Long-term Repo Scheme (ILTR) have a much shorter maturity date and a rate of interest set in auction process. The Bank regularly monitors the level of encumbrance to ensure it is in line with the above approved internal risk appetite limits.

6.19. Subordinated liabilities

Subordinated liabilities are initially measured at fair value minus incremental direct transaction costs. These instruments are subsequently stated at amortised cost using the effective interest rate method. The subordinated Tier 2 notes are eligible for treatment as regulatory capital. The notes pay interest at a rate of 7.25% per annum, payable semi-annually in arrears. The Bank has the option to redeem these notes on 10 May 2023.

6.20. Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably and it is probable that the outflow of the economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.
The unwinding of the discount is recognised as interest expense.

Provision for bank levies is recognised when the condition that triggers the payment of the levy is met. If the levy is subject to a minimum activity threshold, then a provision is recognised when that minimum activity of threshold is reached.

6.21. Financial guarantees and loan commitments

The Bank is the holder of a guarantee offered by the Secretary of State for Business, with the British Business Bank acting as agent.

Financial guarantee contracts held are recognised as an asset equal to the prepayment of the premium paid and the asset is amortised to profit and loss over the period in which benefit of the guarantee is obtained.

6.22. Shareholder's funds

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Where an instrument contains no obligation on the Bank to deliver cash or other financial assets, or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Bank, or where the instrument will or may be settled in the Bank's own equity instruments but includes no obligation to deliver a variable number of the Bank's own equity instruments, then it is treated as an equity instrument. Accordingly, the Bank's share capital is presented as components of equity. Any dividends, interest or other distributions on capital instruments are also recognised in equity. Any related tax is accounted for in accordance with IAS 12.

7. Interest income and expense

See accounting policy in note 6.1.

	2019 £000	2018 £000
Interest and similar income on Loans and Advances to Customers held at amortised cost	53,541	37,446
Interest and similar income on Loans and Advances to Customers held at fair value through profit and loss	10,545	11,953
Interest on Loans and Advances to Banks and Building Societies	680	793
Interest on other financial assets held at fair value	167	104
Total Interest receivable and similar income	**64,933**	**50,296**
Interest on Derivative Financial Instruments	(628)	(487)
Interest on Deposits from Customers, TFS & ILTR	(15,821)	(11,389)
Interest on Subordinated Liabilities	(2,245)	(1,446)
Total Interest expense and similar charges	**(18,694)**	**(13,322)**
Net Interest Income	**46,239**	**36,974**

8. Fees and commission income and expense

See accounting policy in note 6.2.

	2019 £000	2018 £000
Wholesale Facility Fees	356	230
Early Settlement Fees	731	280
Customer Service Fees	163	102
Commitment Fees on Development Finance Loans	250	1,942
Fees and Commission Income	1,500	2,554
Bank Charges	(120)	-
Credit and Identity Searches	(175)	(166)
Fees and Commission Expense	(295)	(166)

Fees and commission income include commitment fees charged for Development Finance loans held at FVTPL. Under IFRS 9 fee income of £250k is recognised upon receipt (2018: £1,942k).

All remaining fee income arose from contractual loan agreements with customers and relates to assets held at amortised cost.

The table below provides a breakdown of fees and commission income and expense in 2019 and 2018.

	2019 £000	Specialist Mortgages £000	Development Finance £000	Asset & Wholesale Finance £000	Savings £000
Wholesale Facility Fees	356	-	-	356	-
Early Settlement Fees	731	-	-	731	-
Option to Purchase Fees	108	-	-	108	-
Other Customer Service Fees	55	19	31	5	-
Commitment Fees	250	-	250	-	-
Fees and Commission Income	**1,500**	**19**	**281**	**1,200**	**-**
Enable guarantee charges	(120)	-	(120)	-	-
Credit and Identity Searches	(175)	(44)	(8)	(103)	(20)
Fees and Commission Expense	**(295)**	**(44)**	**(128)**	**(103)**	**(20)**

	2018 £000	Specialist Mortgages £000	Development Finance £000	Asset & Wholesale Finance £000	Savings £000
Wholesale Facility Fees	230	-	-	230	-
Early Settlement Fees	280	31	-	250	-
Option to Purchase Fees	73	-	-	73	-
Other Customer Service Fees	29	13	10	6	-
Commitment Fees	1,942	-	1,942	-	-
Fees and Commission Income	**2,554**	**44**	**1,952**	**559**	**-**
Bank Charges	-	-	-	-	-
Credit and Identity Searches	(166)	(39)	(7)	(89)	(31)
Fees and Commission Expense	**(166)**	**(39)**	**(7)**	**(89)**	**(31)**

9. Net gain or loss on financial assets at fair value through P&L

See accounting policy in note 6.3. Fair Value gains and losses per the Income Statement

	Note	2019 £000	2018 £000
Derivatives held for risk management excluding the effective portion of derivatives held for hedge accounting purposes			
Interest rate risk	**18/19**	(331)	(82)
Gain/ (Loss) on loans and advances to customers held at FVTPL	**21**	(1,502)	(1,682)
Fair value gain/ (loss) on UK Gilts realised.	**20**	(110)	-
Net (loss)/gain loans & other financial assets at FVTPL		**(1,943)**	**(1,764)**

10. Other income and expenses

	2019 £000	2018 £000
Foreign exchange gains / (loss)	6	(8)
Other Income / (Expense)	**6**	**(8)**

Small foreign exchange gains and losses occasionally arise due to timing difference in the exchange rates when the Bank acquires assets for its finance leasing activity from international suppliers.

All loans to customers and financial institutions are denominated in pounds sterling.

11. Administration Expenses

	Note	2019 £000	2018 £000
Depreciation and amortisation	29/30/31	2,885	1,409
Staff Costs	12	18,825	16,346
Share based payments	13	(16)	335
Operating Lease rentals	30	-	1,164
FSCS costs		28	17
Other Administrative expenses		6,865	5,429
Administrative Expenses		**28,587**	**24,700**

12. Staff numbers and costs

See accounting policy in note 6.4.

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

	2019	2018
Directors	7	6
Lending	111	106
Administrators	75	60
	193	**172**

The analysis includes both full-time and part-time staff including Non-Executive directors.

The aggregate payroll costs of these people were as follows:

	2019 £000	2018 £000
Wages and Salaries	15,249	12,155
Social Security costs	1,922	1,599
Pension costs	925	987
Other staff costs	2,203	2,152
	20,299	**16,893**
Of which capitalised as Intangible Assets	1,474	547
Of which included within Administration Expenses	18,825	16,346

	2019 £000	2018 £000
Directors' Salaries and Bonus	974	894
Directors' Share based payments	(5)	60
	969	954

There were no directors to whom retirement benefits were accruing in respect of qualifying services during the year (2018: nil).

There were no directors in respect of whose qualifying services shares were received or receivable under long term incentive schemes during the year (2018: nil).

The aggregate of emoluments of the highest paid director was £380k (2018: £343k). No pensions were attributable to the highest paid director and no shares were received or receivable by that director in respect of qualifying services under a long term incentive scheme.

Remuneration for Non-Executive directors consisted of salary payments of £320k (2018: £259k).

13. Employee share-based payment transactions

See accounting policy in note 6.5.

Details of shares issued are shown in the table below:

	2019 No. of Shares	2018 No. of Shares
At 1 January	1,422	1,013
Granted	715	525
Forfeited	(114)	(116)
At 31 December	**2,023**	**1,422**

The average fair value of shares issued was £1,925 per share.

The charge to the Consolidated Income Statement was a credit of £16k (2018: £335k debit).

14. Auditor's remuneration

	2019 £000	2018 £000
Audit of financial statements	472	146
Audit-related Assurance Services	-	20
Other non-audit services	58	33
	530	**199**

15. Taxation

See accounting policy in note 6.7.

Recognised in the Statement of Comprehensive Income

	2019 £000	2018 £000
Current tax		
Current tax on profits for the year	**2,984**	**1,809**
Deferred tax:		
Origination and reversal of temporary differences	(230)	329
Adjustments in respect of prior periods	(34)	(11)
Effect of tax rate change on opening balance	26	(9)
Total deferred tax charge/(credit)	(238)	309
Tax on profit/(loss) on ordinary activities	**2,746**	**2,118**

Tax reconciliation

	2019 £000	2018 £000
Profit for the year	13,545	11,148
Tax using the UK corporation tax rate of 19.00% (2018: 19.00%)	2,574	2,118
Effects of:		
Permanent non-deductible expenses	53	43
Impact of rate differences	103	(14)
Adjustment for prior year tax differences	26	(24)
Share based payments charge	(3)	-
Effects of Group Relief/ other reliefs	(7)	(5)
	2,746	**2,118**

In 2019 profit for the year includes profit before tax on continuing activities only of £13,545k (2018: profit before tax on continuing activities £11,148k)

The corporation tax liability at 31 December 2019 is £1,305k (2018: £551k). This is disclosed within other tax and social security in note 33 Other Liabilities.

16. Deferred Tax Asset (Liability)

Deferred tax assets (liabilities) are attributable to the following:

	2019 £000	2018 £000
Accelerated capital allowances	248	36
Short term timing differences	74	52
IFRS16 adjustment	18	-
IFRS 9 Adjustment	(94)	(101)
Deferred Tax Asset / (Liability)	**246**	**(13)**

The movement in deferred tax during the year is as follows:

	2019 £000	2018 £000
Balance brought forward	(13)	495
Adjustments in respect to the prior periods	64	(199)
(Debit) / Credit to the income statement	195	(309)
Deferred Tax Asset/ (Liability)	**246**	**(13)**

A reduction in the UK corporation tax rate from 19% to 17% (effective from 1 April 2020) was substantively enacted on 6 September 2016, and the UK deferred tax asset/ (liability) as at 31 December 2019 has been calculated based on this rate. In the 11 March 2020 Budget it was announced that the UK tax rate will remain at the current 19% and not reduce to 17% from 1 April 2020. This will have a consequential effect on the Bank's future tax charge.

17. Loans and Advances to Banks

See accounting policy in note 6.8.

	2019 £000	2018 £000
Placements with other Banks included in Loans and Advances to Banks		
Repayable on demand	84,644	94,809
Remaining maturity of twelve months or less but over three months*	-	3,373
	84,644	98,182

* Relates to amounts charged to Barclays Bank plc regarding the provision of various banking facilities. Included within loans to Banks and building societies is a balance held in the Bank of England reserve account of £77.5m (2018: £90.9m).

The table below, excluding the Bank of England reserve account, presents an analysis of Loans and Advances to Banks and Building Societies by rating agency designation as at 31 December, based on Moody's long term ratings.

	2019 £000	2018 £000
Aa3	254	477
A1	-	-
A2	6,855	6,830
A3	-	-
	7,109	**7,307**

18. Derivative financial instruments held for risk management

See accounting policy in note 6.13.

The Bank holds derivative financial instruments in the normal course of its banking business for interest rate risk management and margin stabilisation purposes. The fair values and notional amounts of derivative instruments are presented in the following table:

	Notional Fair value £000	Fair value £000	Amount of assets of liabilities £000
At 31 December 2019			
Interest rate swaps:			
Interest rate designated in fair value hedges of loans and advances	1,074,650	1,452	(4,599)
Other risk management derivatives	101,400	5	-
	1,176,050	**1,457**	**(4,599)**
At 31 December 2018			
Interest rate swaps:			
Other risk management derivatives	**842,500**	**1,708**	**(836)**

Gains and losses from derivatives are as follows:

	2019 £000	2018 £000
Net loss on derivatives designated as fair value hedges	(3,147)	-
Fair value adjustments from hedge accounting	3,243	-
Ineffectiveness of fair value hedges	96	-
Movements on other derivative financial instruments	(427)	(82)
Fair Value gains/(loss) on derivative financial instruments	**(331)**	**(82)**

Details of derivatives designated as hedging instruments in qualifying hedging relationships are provided in Note 19. The Bank uses other derivatives, not designated in a qualifying hedging relationship ('other risk management derivatives'), to manage its exposure to interest rate risk. The instruments used principally include interest rate swaps.

For more information about how the Bank manages its market risks, see Note 28.3.

19. Hedge accounting

See accounting policy in note 6.13.

At 31 December 2019 the company held the following interest rate swaps as hedging instruments in fair value hedges of interest risk.

As at 31 December 2019	not more than 3 months £000	over 3 but not more than 6 months £000	over 6 but not more than 1 year £000	over 1 but not more than 3 years £000	over 3 but not more than 5 years £000	over 5 but not more than 10 years £000	Total £000
Nominal value of derivatives held for hedging purposes	-	68,400	223,200	350,600	428,650	3,800	1,074,650
Average fixed interest rate	-	0.71%	0.89%	0.82%	1.06%	0.77%	0.87%

The Bank held swaps as at 31 December 2018, however the Bank didn't apply hedge accounting until 1 Jan 2019.

Amounts recognised in the statement of profit and loss in respect of fair value gains and losses on hedged items and hedged instruments are as follows:

	2019 £000
(Losses)/gains on the hedged items attributable to the hedged risk	3,243
Gains/(losses) on the hedging instruments	(3,147)
Fair value in-effectiveness	3%

The amounts relating to items designated as hedged items at 31 December 2019 were as follows:

	Carrying amount 2019		Accumulated Fair value adjustments on the hedged item included in the carrying amount		Line item in balance sheet	Change in value used for calculating hedge ineffectiveness
	Assets (FV) £000	Liabilities (FV) £000	Assets £000	Liabilities £000		
Loans and advances	596,708		3,617		Loans and advances to customers	3,617
Customer deposits		493,625		374	Customer deposits	374

19. Hedge accounting (continued)

The amounts relating to items designated as hedged instruments at 31 December 2019 were as follows:

As at 31 December 2019	Nominal amount £000	Assets (carrying amount) £000	Liabilities (carrying amount) £000	Line item in balance sheet £000	Change in fair value £000	Ineffective-ness	Line item in profit or loss
Interest rate swap – Hedge of loans and advances							
Assets							
Interest rate risk	491,850	1,452	-	Derivative assets held for risk management	1,452	1%	Net (loss)/gain on loans and other financial assets at Fair value through profit and loss
Liabilities							
Interest rate risk	582,800	-	4,599	Derivative Liabilities held for risk management	4,599	13%	Net (loss)/gain on loans and other financial assets at Fair value through profit and loss

Of the total nominal amounts mentioned above, the entire amount will be directly impacted by the IBOR reform.

20. Financial Assets at FVOCI

See accounting policy in note 6.14.

	2019 £000	2018 £000
UK Gilts	-	15,098
Financial Assets at FVOCI	**-**	**15,098**

The market value of UK Gilts during 2019 increased by £11k (2018: 50k from the date of acquisition). This loss was realised in the period and is recognised through the statement of profit and loss.

The carrying amount of the UK Gilt as at 31 December 2018 is inclusive of £148k of accrued interest and the fair value loss mentioned above.

21. Fair value of loans and advances to customers

See accounting policy in note 6.8.

The following table summarises the carrying values of financial assets presented on the Bank's balance sheet and the fair value of these financial instruments.

	2019 £000	2018 £000
Development Finance	**126,530**	**166,804**

22. Loans and advances to customers at amortised cost:

See accounting policy in note 6.8.

	2019 £000	2019 £000	2018 £000
Development Finance	130,195		98,665
Less: allowance for impairment	(288)		(265)
		129,907	**98,400**
Specialist Mortgages	630,149		348,131
Less: allowance for impairment	(953)		(246)
		629,196	**347,885**
Asset Finance			
Hire Purchase	156,086		165,020
Finance Leases	47,088		38,464
Less: allowance for impairment	(3,216)		(1,361)
	199,958		202,123
Wholesale finance	90,700		84,784
Less: allowance for impairment	(13)		-
	90,687		84,784
		290,645	**286,907**
Fair value adjustments from portfolio hedging		**3,617**	**-**
		1,053,365	**733,192**

Hire Purchase

See accounting policy in note 6.6.

The table below provides an analysis of Hire Purchase receivables.

	2019 £000	2018 £000
Gross investment in hire purchase receivables:		
Less than one year	58,806	57,552
Between one and five years	95,786	107,109
Between five and ten years	1,694	765
	156,286	165,426
Unearned finance income	(200)	(406)
Net investment	156,086	165,020
Less impairment allowance	(2,133)	(719)
	153,953	**164,301**
Net investment in hire purchase receivables:		
Less than one year	58,733	57,415
Between one and five years	95,661	106,842
Between five and ten years	1,692	763
	156,086	**165,020**

Finance Lease Receivables

The table below provides an analysis of finance lease receivables for leases of equipment in which the Bank is the lessor.

	2019 £000	2018 £000
Gross investment in finance lease receivables:		
Less than one year	17,558	13,533
Between one and five years	29,410	25,096
Between five and ten years	274	-
	47,242	38,629
Unearned finance income	(154)	(165)
Net investment in finance leases	47,088	38,464
Less impairment allowance	(1,083)	(642)
	46,005	**37,822**
Net investment in finance lease receivables:		
Less than one year	17,502	13,477
Between one and five years	29,313	24,987
Between five and ten years	273	-
	47,088	**38,464**

23. Funding and liquid assets

Funding is raised from customers depositing money in their savings accounts and central bank facilities. These funds are then used to lend to customers. To ensure the Bank has sufficient cash to repay customers when required, we are required to hold a minimum level of liquid assets. The Bank's Treasury team manage the level of liquid assets and funding to ensure we meet the demands of customers, creditors and regulators.

24. Central Bank Facilities

See accounting policy in note 6.18.

The balances arising from central bank facilities carried in the Bank's accounts are shown below:

	2019 £000	2018 £000
TFS and ILTR	173,000	135,000
Central Bank Facilities	**173,000**	**135,000**

25. Customer Deposits

See accounting policy in note 6.17.

	2019 £000	2018 £000
With agreed maturity dates or periods of notice by remaining maturity:		
On demand	20,768	19,015
Not more than three months	260,750	53,218
More than three months but not more than one year	396,325	448,983
More than one year but not more than five years	225,954	199,502
	903,797	**720,718**
Fair value adjustments for portfolio hedging	374	-
Customer deposits	**904,171**	**720,718**

26. Fair value of financial instruments

See accounting policy in note 6.11.

The following table analyses financial instruments that are both measured at fair value and not measured at fair value at the reporting date, by the level of fair value hierarchy into which the fair value measurement is categorised. The amounts are based on values recognised in the statement of financial position.

At 31 December 2019	Hierarchy level	Amortised Cost £000	Total carrying amount £000	Fair Value £000
Assets				
Loan and Advances to Banks	Level 2	84,644	84,644	84,644
Loans and Advances to Customers - FVTPL	Level 3	-	126,530	126,530
Loans and Advances to Customers – at amortised cost	Level 3	1,053,365	1,053,365	1,052,220
Derivative Financial Instruments	Level 2	-	1,457	1,457
Other Assets	Level 3	4,264	4,264	4,264
Total		**1,142,273**	**1,270,260**	**1,269,115**
Liabilities				
Customer Deposits	Level 3	904,171	904,171	900,762
Central Bank Facilities	Level 3	173,000	173,000	173,000
Subordinated Liabilities	Level 2	-	30,048	30,000
Derivative Financial Instruments	Level 2	-	4,599	4,599
Finance Lease Liability	Level 3	4,525	4,525	4,525
Other Liabilities	Level 3	16,066	16,066	16,066
Share Capital	Level 2	-	126,288	126,288
Share Premium	Level 2	-	196	196
Total Liabilities		**1,097,762**	**1,258,893**	**1,255,436**
At 31 December 2018				
Assets				
Loan and Advances to Banks	Level 2	98,182	98,182	98,182
Financial Assets at FVOCI	Level 3	-	15,098	15,098
Loans and Advances to Customers - FVTPL	Level 3	-	166,804	166,804
Loans and Advances to Customers – at amortised cost	Level 3	733,192	733,192	736,087
Derivative Financial Instruments	Level 2	-	1,708	1,708
Other Assets	Level 3	1,596	1,596	1,596
Total		**832,970**	**1,016,580**	**1,019,475**
Liabilities				
Customer Deposits	Level 3	720,718	720,718	719,901
Central Bank Facilities	Level 3	135,000	135,000	135,000
Subordinated Liabilities	Level 2	-	29,970	30,000
Derivative Financial Instruments	Level 2	-	836	836
Other Liabilities	Level 3	11,886	11,886	11,886
Share Capital	Level 2	-	111,288	111,288
Share Premium	Level 2	-	196	196
Total Liabilities		**867,604**	**1,009,894**	**1,009,107**

Level 3 fair value measurements

i. Reconciliation

The following table shows a reconciliation from the beginning balances to the ending balances for fair value measurements in Level 3 of the fair value hierarchy:

2019	Loans and advances to customers £000
Balance at 1 January	**166,804**
Total gains or losses:	
In profit or loss	9,291
Originations	45,382
Repayments	(94,947)
Balance at 31 December	**126,530**

ii. Unobservable Inputs used in measuring fair value

The only financial instruments where significant unobservable inputs have been used are loans and advances measured at FVTPL. These comprise certain property development loans within the Development Finance business line that do not meet the SPPI criteria.

The valuation technique used for these loans is discounted cash flow and the significant unobservable inputs are the risk-adjusted discount rate and the timing of expected cash flows.

The range of estimates for the discount rate are 0.1% to 4.5% above the contractual interest margin on those loans. A significant increase or decrease in that margin would result in a lower or higher fair value.

An average increase of 1% in the discount rate will result in a drop in fair value of £0.6m.
Significant unobservable inputs include timing of expected cash flows from the sale of completed properties. These cash flows can fluctuate due to changes in construction schedules and consumer demand for the completed units. Projected cash flows are derived from the business line's best estimates. An average delay of 4 months in sales will result in a £263k drop in fair value.

27. Allowance for credit impairment losses on financial assets at amortised cost

i. IFRS 9

The following tables detail the gross carrying value of loans to customers by ECL stage and changes in the loss allowance during the year.

As at 31 December 2019

	Stage 1	Stage 2 Less than 30 days past due	Stage 2 Greater than 30 days past due	Stage 3	Total
	£'000	£'000	£'000	£'000	£'000
Development Finance	121,064	8,961	-	170	130,195
Specialist Mortgages	603,286	21,919	1,437	3,507	630,149
Asset Finance	189,735	8,358	395	4,686	203,174
Wholesale finance	90,693	7	-	-	90,700
Total Exposure	**1,004,778**	**39,245**	**1,832**	**8,363**	**1,054,218**
Off Balance Sheet					
Loan Commitments	203,090	-	-	-	203,090
Total Gross Exposure	**1,207,868**	**39,245**	**1,832**	**8,363**	**1,257,308**
Add FV gains from portfolio hedging	3,487	9	112	8	3,616
Less: allowance for impairment	(1,115)	(124)	(736)	(2,494)	(4,470)
Total Net Exposure	**1,210,239**	**39,130**	**1,208**	**5,877**	**1,256,454**

Gross Carrying Value	2019			
	Stage 1	Stage 2	Stage	3 Total
Development Finance	£'000	£'000	£'000	£'000
Balance at 1 January *	95,786	1,874	1,005	98,665
Transfer to Stage 1	533	(533)	-	-
Transfer to Stage 2	(5,871)	5,871	-	-
Transfer to Stage 3	(623)	-	623	-
Drawdowns/(Repayments)	31,239	1,749	(1,458)	31,530
Balance at 31 December	**121,064**	**8,961**	**170**	**130,195**

	Stage 1	Stage 2	Stage 3	Total
Specialist Mortgages	£'000	£'000	£'000	£'000
Balance at 1 January *	**340,537**	**7,086**	**509**	**348,132**
Transfer to Stage 1	1,041	(1,041)	-	-
Transfer to Stage 2	(11,556)	11,556	-	-
Transfer to Stage 3	(3,720)	(501)	4,221	-
Drawdowns/(Repayments)	276,984	6,256	(1,223)	327,337
Balance at 31 December	**603,286**	**23,356**	**3,507**	**630,149**

	Stage 1	Stage 2	Stage 3	Total
Asset and Wholesale Finance	£'000	£'000	£'000	£'000
Balance at 1 January *	**282,163**	**3,585**	**2,519**	**288,267**
Transfer to Stage 1	1,723	(1,298)	(425)	-
Transfer to Stage 2	(5,646)	5,687	(41)	-
Transfer to Stage 3	(4,166)	(558)	4,724	-
Drawdowns/(Repayments)	6,386	1,369	(835)	6,920
Write Offs	(32)	(25)	(1,256)	(1,313)
Balance at 31 December	**280,428**	**8,760**	**4,686**	**293,874**

	Stage 1	Stage 2	Stage 3	Total
Total	£'000	£'000	£'000	£'000
Balance at 1 January *	718,485	12,545	4,034	735,064
Transfer to Stage 1	3,297	(2,872)	(425)	-
Transfer to Stage 2	(23,073)	23,114	(41)	-
Transfer to Stage 3	(8,509)	(1,059)	9,568	-
Drawdowns/(Repayments)	314,610	9,374	(3,517)	320,467
Write Offs	(32)	(25)	(1,256)	(1,313)
Balance at 31 December	**1,004,778**	**41,077**	**8,363**	**1,054,218**

* The balance at 1 January has been restated from the prior year disclosure and therefore will not be directly comparable to the 2018 closing balance.

Loss allowance	2019			
	Stage 1	Stage 2	Stage 3	Total
Development Finance	£'000	£'000	£'000	£'000
Balance at 1 January	170	5	90	265
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(6)	6	-	-
Transfer to Stage 3	(1)	-	1	-
Drawdowns/(Repayments)	(42)	85	(21)	22
Balance at 31 December	**121**	**96**	**70**	**287**

	Stage 1	Stage 2	Stage 3	Total
Specialist Mortgages	£'000	£'000	£'000	£'000
Balance at 1 January	**91**	**155**	**-**	**246**
Transfer to Stage 1	11	(11)	-	-
Transfer to Stage 2	(5)	5	-	-
Transfer to Stage 3	(1)	(14)	15	-
Drawdowns/(Repayments)	81	313	313	707
Balance at 31 December	**177**	**448**	**328**	**953**

	Stage 1	Stage 2	Stage 3	Total
Asset and Wholesale Finance	£'000	£'000	£'000	£'000
Balance at 1 January	**550**	**297**	**513**	**1,360**
Transfer to Stage 1	114	(114)	-	-
Transfer to Stage 2	(23)	23	-	-
Transfer to Stage 3	(10)	(59)	69	-
Drawdowns/(Repayments)	187	169	2,551	2,907
Write Offs	-	-	(1,038)	(1,038)
Balance at 31 December	**818**	**316**	**2,095**	**3,229**

	Stage 1	Stage 2	Stage 3	Total
Total	£'000	£'000	£'000	£'000
Balance at 1 January	**811**	**457**	**603**	**1,871**
Transfer to Stage 1	125	(125)	-	-
Transfer to Stage 2	(34)	34	-	-
Transfer to Stage 3	(12)	(73)	85	-
Drawdowns/(Repayments)	225	568	2,844	3,637
Write Offs	-	-	(1,038)	(1,038)
Balance at 31 December	**1,115**	**861**	**2,494**	**4,470**

Impairment losses on loans and advances to customers of £3,375k recognised in the income statement comprise movements in the allowance for credit impairment losses of £3,637k as set out in the table above, write offs of £274k and write backs of £536k.

28. Financial Risk

This note presents information about the Bank's exposure to financial risks and the Bank's management of capital. The main areas of financial risk to which the Bank is exposed are:

- Credit risk.
- Liquidity risk.
- Market risk.
- Capital risk.

28.1. Credit Risk

Credit risk is the risk of financial loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, and includes the use of various credit risk rating systems to measure the credit risk of loans and advances to customers and banks at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the exposure to the counterparty at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The Bank uses a range of approaches to mitigate credit risk, including policies, obtaining collateral, using master netting agreements. The Bank's credit risk exposure, which arises solely in the United Kingdom, is set out below.

i. Maximum credit exposure

The maximum credit risk exposure in the event of other parties failing to perform their obligations is presented below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions, their contractual nominal amounts. The maximum exposure to credit risk for financial assets is set out below:

	2019 £000	2018 £000
Loans and Advances to Banks	84,644	98,182
Financial assets at FVOCI	-	15,098
Derivative Financial Instruments	-	872
Loans and Advances to Customers at amortised cost	1,053,365	733,192
Loans and Advances to customers at FVTPL (not subject to impairment requirements)	126,530	166,804
Total on-balance sheet exposure	**1,264,539**	**1,014,148**
Contractual loan commitments	203,090	220,248
Maximum credit exposure	**1,467,629**	**1,234,396**

Contractual loan commitments represent agreements entered into but not advanced at 31 December 2019. However, loan facilities of £147.1m granted by Development Finance are legally drafted as ondemand and are uncommitted.

Quality of credit risk exposures

Internal rating scales

In assessing the credit quality of the loan portfolio the Bank uses an internal rating scale based on a customer's 12 month expected default probability.

	Internal grading
Excellent quality	1
Good quality	2
Satisfactory quality	3
Lower quality	4
Below standard	5

The following table sets out the current stage status of the loan portfolio compared with the internal rating at origination

Internal Rating at Origination	12 month PDrange	Stage 1 £000	Stage 2 £000	Stage 3 £000	2019 Total £000
1	0.0006-0.0045	70,181	4,807	-	74,988
2	0.0045-0.0105	414,574	5,673	4,954	425,201
3	0.0105-0.0240	467,380	29,476	2,301	499,157
4	0.0240-0.0550	52,019	1,097	1,089	54,205
5	>0.0550	624	24	19	667
		1,004,778	**41,077**	**8,363**	**1,054,218**

Internal Rating at Origination	12 month PDrange	Stage 1 £000	Stage 2 £000	Stage 3 £000	2019 Total £000
1	0.0006-0.0045	42,012	-	-	42,012
2	0.0045-0.0105	295,543	2,209	176	297,928
3	0.0105-0.0240	332,129	8,715	2,538	343,382
4	0.0240-0.0550	47,975	1,614	1,262	50,851
5	>0.0550	827	6	58	891
		718,486	12,554	4,034	735,064

The carrying amount and the value of identifiable collateral (mainly residential property) held against loans and advances to corporate customers measured at amortised cost and categorised as stage 3, other than reverse sale and repurchase agreements was £10,686k (2018: £3,588k). For each loan, the value of disclosed collateral is capped at the nominal amount of the loan that it is held against.

Concentrations of credit risk

The Bank monitors concentrations of credit risk by sector, size and by geographical location. An analysis of concentrations of credit risk from loans and advances, investment securities and contractual commitments is shown below.

	Loans and advances to Banks and Building Societies		Loans and advances to Customers		Contractual Commitments	
	2019	2018	2019	2018	2019	2018
	£000	£000	£000	£000	£000	£000
Carrying amount	84,644	98,182	1,179,896	899,966	203,090	220,248
Concentration by sector:						
Corporate		-	315,854	583,417	166,257	184,464
Government	77,534	90,875	-	-	-	
Banks and Building Societies	7,110	7,307	-	-	-	
Retail		-	864,042	316,549	36,833	35,784
	84,644	**98,182**	**1,179,896**	**899,966**	**203,090**	**220,248**
Concentration by location:						
UK	84,644	98,182	1,179,896	899,966	203,090	220,248

Collateral held and other credit enhancements

Collateral held by the Bank includes land, residential and commercial property, and receivables, in the form of finance lease and hire purchase agreements. This collateral exceeds the carrying amount of loans and advances to customers at amortised cost and fair value.

The Bank uses external agents to take physical possession of properties or other assets held as collateral and realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

In addition to the collateral included above, the Bank also holds other types of collateral and credit enhancements such as personal guarantees, second charges and floating charges for which specific values are not generally available.

An analysis by loan-to-value (LTV) ratio of the Bank's Specialist Mortgage lending is presented below. The value of collateral used in determining the LTV ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices.

LTV (Indexed)	Buy-to-let	Other lending	2019 Total
Less than 60%	87,275	33,480	120,755
60% to 65%	53,245	19,133	72,378
65% to 70%	90,296	28,118	118,414
70% to 75%	153,258	34,389	187,647
75% to 80%	91,460	32,341	123,801
80% to 85%	7,155	-	7,155
Over 85%	-	-	-
Grand Total	**482,689**	**147,461**	**630,150**

Forbearance and loan modifications

The Bank maintains a forbearance policy for the servicing and management of customers who are in financial difficulty and require some form of concession to be granted, even if this concession entails a loss for the Bank. The total value of forborne loans amounted to £26.1m as at 31 December 2019 (2018: £38.1m).

At 31 December 2019, the allowance for loan losses held in respect of forborne loans was £2.3m (2018: £103k).

Inputs, assumptions and techniques used for estimating impairment

The Bank incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

The Bank formulates five economic scenarios: a base case, which is the central scenario, and four less likely scenarios, one upside and one downside scenario, and one extreme upside and extreme downside scenario. The central scenario is aligned with information used by the Group for other purposes such as strategic planning and budgeting. External information considered includes economic data from a leading independent economic forecasting consultant. A review is performed at least annually on the design of the scenarios.

The scenario probability weightings applied in measuring ECL are as follows.

	Downside 2	Downside 1	Base	Upside 1	Upside 2
As at 31 December 2019					
Scenario probability weighting	10%	10%	60%	10%	10%
As at 31 December 2018					
Scenario probability weighting	10%	10%	60%	10%	10%

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and has estimated relationships between macro-economic variables and credit risk and credit losses. The key drivers of credit risk identified are unemployment rates, housing price changes and interest rates. The Bank estimates each key driver of credit risk over the active forecast period of 5 years.

The tables below lists the macroeconomic assumptions used in five scenarios over the 5-year forecast period. The assumptions represent the absolute percentage for interest rates and unemployment rates and average house prices.

As at 31 December 2019	Unemployment rate (%)	Annual increase in House prices (%)	LIBOR 3 month (%)
Downside 2 economic assumption			
Average	5.82	79	0.80
Trough	6.55	71	1.70
Downside 1 economic assumption			
Average	5.53	89	0.78
Trough	6.17	83	1.20
Base economic assumption			
Average	3.68	107	1.27
Peak	3.86	114	1.86
Upside 1 economic assumption			
Average	3.32	117	1.97
Peak	3.74	129	2.76
Upside 2 economic assumption			
Average	2.32	124	2.48
Peak	3.58	140	3.45

As at 31 December 2018	Unemployment rate (%)	Annual increase in House prices (%)	LIBOR 3 month (%)
Downside 2 economic assumption			
Average	5.94	80	0.86
Trough	6.63	71	1.7
Downside 1 economic assumption			
Average	5.67	88	1.11
Trough	6.26	83	2.14
Base economic assumption			
Average	3.75	104	1.80
Peak	4.06	112	2.82
Upside 1 economic assumption			
Average	3.46	116	2.19
Peak	4.00	129	3.01
Upside 2 economic assumption			
Average	2.44	123	2.78
Peak	3.84	139	3.95

The base scenario is a recommended base case in which the UK and the EU will remain in a transition period during which trading relationships are expected to remain unchanged throughout 2020. However, it is still possible that at the end of the transition period there may be a hard Brexit-style switch over to WT trading rules as trade deals generally take significantly longer to negotiate than the length of the current transition period in place of 11 months. Should this come to pass, external independent consultants believes that the increased trade friction, coupled with a significant depreciation in the value of the pound sterling would cause GDP to decrease by about 2% vs the current baseline forecast.

Recent data has suggested that labour market momentum has declined in 2019 and a period of stabilisation is expected in the labour market throughout 2020. While the UK unemployment rate edges a little lower after 2020 in the base case scenario, the risks remain skewed towards higher unemployment.

As a result of a reduction in Brexit-related uncertainty, house prices are now expected to grow by 1.7% in 2020. It is expected that housing activity and prices remain subdued in the coming years, reflecting low affordability and continued uncertainty during the transition period. As at 31 December 2019, dueto the uncertainty that remains over trade deal negotiations monetary policy action is expected to be delayed and interest rate rises are now not expected to reach 2% until 2024-Q4.

Sensitivity of ECL to future economic conditions

The ECL are sensitive to judgements and assumptions made regarding formulation of forward-looking scenarios and how such scenarios are incorporated into the calculations. Management performs a sensitivity analysis on the ECL recognised on the Bank's material asset classes.

The table below shows the loss allowance on loans and advances to customers assuming each forward-looking scenario (e.g. base, upside and downside) were weighted 100% instead of applying scenario probability weights across the five scenarios.

As at 31 December 2019	Downside 2	Downside 1	Base	Upside 1	Upside 2
Gross exposure (£'000)	1,054,218	1,054,218	1,054,218	1,054,218	1,054,218
Loss allowance (£'000)	3,793	2,754	1,628	1,358	1,218
Proportion of assets in Stage 2	0.13%	0.11%	0.09%	0.08%	0.07%

As at 31 December 2018	Downside 2	Downside 1	Base	Upside 1	Upside 2
Gross exposure (£'000)	735,064	735,064	735,064	735,064	735,064
Loss allowance (£'000)	3,221	1,982	1,168	1,038	961
Proportion of assets in Stage 2	0.13%	0.11%	0.09%	0.08%	0.08%

28.2. Liquidity risk

Liquidity risk is the risk that the Bank will not be able to meet its financial obligations as they fall due. The Bank measures liquidity risk on a daily basis. Daily liquidity reporting is supplemented by early warning indicators and a Liquidity Contingency Plan. Monthly reporting procedures are in place to update and inform senior management. All liquidity policies and procedures are subject to periodic independent internal oversight.

The table below analyses remaining contractual maturity undiscounted cash flows of non-derivative financial assets and liabilities.

	Carrying value £000	Net inflow/ (outflow) £000	Up to 1 month £000	1 to 3 months £000	3 to 12 month £000 s	1 to 5 years £000	Over 5 Years £000
At 31 December 2019							
Assets							
Loan and advances toBanks	84,644	84,644	84,644	-	-	-	-
Loans and advances to customers	1,179,896	1,555,748	47,651	76,925	224,933	392,235	814,004
Contractual loan commitments	203,090	203,090	37,635	32,095	80,335	53,025	-
Total	**1,467,630**	**1,843,482**	**169,930**	**109,020**	**305,268**	**445,260**	**814,004**
Liabilities							
Deposits	(904,171)	(918,028)	(67,688)	(214,312)	(399,895)	(236,133)	-
Central Bank Facilities	(173,000)	(173,000)	-	-	-	(173,000)	-
Contractual loan commitments	(203,090)	(203,090)	(37,635)	(32,094)	(80,336)	(53,025)	-
Subordinated Debt	(30,000)	(43,051)	-	(1,088)	(1,088)	(40,875)	-
Total	**(1,310,261)**	**(1,337,169)**	**(105,323)**	**(247,494)**	**(481,319)**	**(503,033)**	**-**

	Carrying value £000	Net inflow/ (outflow) £000	Up to 1 month £000	1 to 3 months £000	3 to 12 month £000 s	1 to 5 years £000	Over 5 Years £000
At 31 December 2018							
Assets							
Loan and advances toBanks	98,182	98,182	94,820	-	3,362	-	-
Loans and advances to customers	899,996	1,119,423	52,901	94,549	189,777	355,013	427,183
Financial assets at FVOCI	15,098	15,338	-	15,338	-	-	-
Contractual loan commitments	220,248	220,248	40,652	47,944	65,327	66,325	-
Total	**1,233,524**	**1,453,191**	**188,373**	**157,831**	**258,466**	**421,338**	**427,183**
Liabilities							
Deposits	(720,718)	(738,896)	(38,296)	(30,409)	(464,184)	(206,007)	-
Central Bank Facilities	(135,000)	(135,000)	-	-	-	(135,000)	-
Contractual loan commitments	(220,248)	(220,248)	(40,652)	(47,944)	(65,327)	(66,325)	-
Subordinated Debt	(29,970)	(45,225)	-	(1,087)	(1,088)	(43,050)	-
Total	**(1,105,936)**	**(1,139,369)**	**(78,948)**	**(79,440)**	**(530,599)**	**(450,382)**	**-**

Financial assets pledged as collateral

Financial assets recognised in the statement of financial position that had been pledged as collateral for liabilities at 31 December 2019 are £359.1m.

Financial assets are pledged as collateral as part of sales and repurchases under terms that are usual and customary for such activities.

28.3. Market risk

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

a. Interest rate risk

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

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

ALCO's activities include monitoring changes in the Bank's interest rate exposures, which include the impact of the Bank's outstanding or forecast debt obligations and changes to exposures arising from IBOR reform. ALCO is responsible for setting the overall hedging strategy of the Bank. Central Treasury is responsible for implementing that strategy by putting in place the individual hedge arrangements. Many of those hedge arrangements are designated in hedging relationships for accounting purposes (see note 19).

b. Interest rate sensitivity gap

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

	2019 £000	2018 £000
+200 basis points	(779)	(1,117)
-200 basis points	906	1,273

The table below provides an analysis of the re-pricing periods of assets and liabilities. Mismatches in the re-pricing timing of assets and liabilities creates interest rate risk. Items are allocated to time bands by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

At 31 December 2019	Up to 1 month £000	1 to 3 months £000	3 to 12 months £000	1 to 5 years £000	Noninterest bearing £000	Total £000
Assets						
Loan and advances to Banks	84,644	-	-	-	-	84,644
Loans and advances to customers	374,473	28,200	101,253	675,970	-	1,179,896
Other assets	-	-	-	-	19,364	19,364
Total Assets	459,117	28,200	101,253	675,970	19,364	1,283,904
Liabilities						
Customer Deposits	47,023	214,595	407,972	234,581	-	904,171
Central Bank Facilities	173,000	-	-	-	-	173,000
Subordinated Liabilities	-	-	-	30,048	-	30,048
Non-interest bearing liabilities	-	-	-	-	25,210	25,210
Equity	-	-	-	-	151,475	151,475
Total Liabilities	220,023	214,595	407,972	264,629	176,685	1,283,904
Interest rate sensitivity gap	239,094	(186,395)	(306,719)	411,341	(157,321)	-
Cumulative gap	239,094	52,699	(254,020)	157,321	0	-
Notional value of derivatives	30,050	187.800	175,150	(389,200)	(3,800)	-

At 31 December 2018	Up to 1 month £000	1 to 3 months £000	3 to 12 months £000	1 to 5 years £000	Noninterest bearing £000	Total £000
Assets						
Loan and advances to Banks	98,182	-	-	-	-	98,182
Loans and advances to customers	400,920	23,241	91,864	383,971	-	899,996
Financial Assets at FVOCI	15,098	-	-	-	-	15,098
Other assets	-	-	-	-	10,897	10,897
Total Assets	514,200	23,241	91,864	383,971	10,897	1,024,173
Liabilities						
Customer Deposits	38,503	132,340	354,148	195,727	-	720,718
Central Bank Facilities	-	135,000	-	-	-	135,000
Subordinated Liabilities	-	-	-	29,970	-	29,970
Non-interest bearing liabilities	-	-	-	-	12,735	12,735
Equity	-	-	-	-	125,750	125,750
Total Liabilities	38,503	267,340	354,148	225,697	138,485	1,024,173
Interest rate sensitivity gap	475,697	(244,099)	(262,284)	158,274	(127,558)	-
Cumulative gap	475,697	231,598	(30,686)	127,558	-	-
Notional value of derivatives	(46,000)	15,400	186,000	(155,400)	-	-

c. Derivatives held for risk management purposes and hedge accounting

The Bank holds derivatives for risk management purposes, some of which are designated in hedging relationships (see Note 19). The interest rate have floating legs that are indexed to various IBORs. No derivative instruments have been modified as at the reporting date. The impact of IBOR reform on the Bank's hedge accounting is discussed in Note 3.2

29. Property Plant and Equipment

See accounting policy in note 6.15.

	Equipment £000	Fixtures and fittings £000	Total £000
Cost			
At 1 January 2019	1,374	2,353	3,727
Additions	262	18	280
At 31 December 2019	**1,636**	**2,371**	**4,007**
Depreciation			
At 1 January 2019	762	656	1,418
Charge for year	243	269	512
At 31 December 2019	**1,005**	**925**	**1,930**
Net book value			
At 31 December 2019	**631**	**1,446**	**2,077**
At 31 December 2018	612	1,697	2,309

There were no capitalised borrowing costs related to the acquisition of Property, Plant and Equipment during the year (2018: nil).

No impairment charges were incurred during the year (2018: nil).

30. Finance leases

See accounting policy in note 6.6.

The Bank leases office premises in London and Leeds and these are presented as Right-of-Use assets on a separate line in the statement of financial position. The Net book value and accumulated depreciation charge on right of use assets as at 31 December 2019 is as follows:

Right of use asset – Office premise	2019 £000
Net book value at 1 January 2019	4,386
Net book value at 31 December 2019	3,463
Depreciation at 31 December 2019	2,926

The lease liabilities are secured by the related underlying assets. The undiscounted maturity analysis of lease liabilities at 31 December 2019 is as follows:

	2019 £000	2018 £000
Year 1	1,318	1,323
Year 2	1,318	1,318
Year 3	1,319	1,318
Year 4	660	1,319
Year 5	-	660
	4,615	**5,938**

The discounted lease liability as at 31 December 2019 is £4,525k.
Amounts recognised within the Statement of Comprehensive income in relation to finance leases are as follows:

	2019 £000
Depreciation expense	(904)
Interest expense	(240)
Sublease income	209

31. Intangible Assets

See accounting policy in note 6.16.

	Software £000
Cost	
At 1 January 2019	6,270
Additions	3,400
At 31 December 2019	**9,670**
Amortisation	
At 1 January 2019	2,246
Charge for year	1,448
At 31 December 2019	**3,694**
Net book value	
At 31 December 2019	**5,976**
At 31 December 2018	4,058

32. Other Assets

	2019 £000	2018 £000
Other debtors	4,264	1,596
Prepayments	1,882	1,226
Other Assets	**6,146**	**2,822**

33. Other Liabilities

	2019 £000	2018 £000
Other taxation and social security	1,305	855
Other creditors	4,199	2,484
Accruals	10,582	8,547
Other Liabilities	**16,086**	**11,886**

Accruals include interest accruals on customer deposits amounting to £7.0m (2018: £5.2m).

34. Subordinated Liabilities

See accounting policy in note 6.19.

	2019 £000	2018 £000
Tier 2 notes	30,000	30,000
Deferred acquisition costs	(259)	(336)
Accrued interest	307	306
Subordinated Liabilities	**30,048**	**29,970**

35. Provisions

See accounting policy in note 6.20.

	2019 £000	2018 £000
Remediation Costs	-	-
FSCS Levy	-	-
Provisions for Liabilities	**-**	**-**

FSCS Levy	2019 £000	2018 £000
At 1 January	-	79
Adjustment to provision	-	(13)
Paid during the year	-	(66)
At 31 December	**-**	**-**

The FSCS levy represents the estimated amount payable under the FSCS for the 2018/2019 scheme year, which runs from March 2018 to March 2019, and is calculated with reference to the protected deposits held at 31 December 2017. The Bank, in common with all regulated UK deposit takers, pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it.

The FSCS levy consists of two parts - a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

36. Capital

In order to protect customers as a regulated bank, the Bank is required to hold a minimum level of capital. To date this has been achieved through equity issuances to our investors, Tier 2 notes, and retained earnings. This also provides the investment to build and grow the Bank. This section provides information on the Bank's share capital, retained earnings and other equity balances. It also provides a breakdown of the Bank's regulatory capital position.

36.1. Managing capital risk

Capital risk is the risk that the Bank has insufficient capital resources to meet its capital requirements and to absorb unexpected losses if they were to occur. Causes of inadequate capital could include lending origination volumes far exceeding expectations, suffering a high level of default on loans already made by the Bank, or by having large unexpected development/operating costs for the business (including operational risk events).

Capital is one of the key measures of the Bank and the Board sets capital risk appetite. Capital is actively managed with regulatory ratios being a key factor in the bank's planning processes and stress analysis.

The principal committee at which the Bank's capital is scrutinised and managed is ALCO. The Board and BRC also receive metrics, monthly forecast of capital positions and commentary on capital risk. The Bank refreshes its ICAAP on an annual basis, which includes a 4 year forecast of the Bank's capital position.

The ICAAP is used to inform the future capital strategy and is submitted to the PRA following Board scrutiny and approval. Periodic shorter term forecasts are also undertaken to understand and respond to variations in actual performance against plan.

In order to avoid breaching a regulatory capital measure, a Board approved 'Management Buffer' of additional capital is imposed above the regulatory threshold. Unlike the regulatory limits, the 'Management Buffer' is designed to be utilised in a controlled manner when required.

The Bank monitors its key capital metrics monthly, these include CET1 Ratio, surplus of capital resources over capital requirements and Leverage Ratio, and these allow the Bank to be able to effectively manage its capital resources.

Capital metrics are produced monthly to assess the current and projected capital. Since baseline projections are based upon future capital raises, an additional, stressed projection is also produced, which shows the potential capital position in the event capital raises were to prove impossible.

During 2019, the Bank complied in full with all its externally imposed capital requirements. Note 37 provides information on capital and reserves per the IFRS balance sheet, with a reconciliation to the regulatory definition of capital.

While the Bank has opted to take advantage of the IFRS 9 transitional capital rules in respect of ECLs (as specified in CRR Article 473a), it is not applying these transitional arrangements because IFRS 9 ECLs are lower than IAS 39 loss impairments. This is because most Development Finance loans are measured at fair value in 2018 under IFRS 9 and not at amortised cost (as previously in 2017 under IAS 39).

37. Share Capital

See accounting policy in note 6.22.

Authorised, issued and fully paid.

	Ordinary shares of £1 each	
	2019 £000	2018 £000
In issue at 1 January	111,288	111,288
Issued for cash	15,000	-
In issue at 31 December	**126,288**	**111,288**

During 2019, 15,000,000 Ordinary shares of £1 each were issued for cash at par value (2018: £Nil).

The following shows the regulatory capital resources managed by the Bank:

	2019 £000	2018 £000
Share Capital	126,288	111,288
Share Premium	196	196
Retained Earnings	24,991	14,316
Fair value through other comprehensive income reserve	-	(50)
Intangible Assets	(5,976)	(4,058)
Prudential Valuation Adjustments	(128)	(2)
Securitisation positions	(7,875)	-
Common Equity Tier 1 Capital	**137,496**	**121,690**
Tier 2 Capital	30,000	30,000
Total Capital	**167,496**	**151,690**

38. Related party transactions

Related parties of the Bank include subsidiaries, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members. Key Management Personnel are defined as the Directors.

The compensation of the directors is provided in note 12.

The following Directors directly and indirectly held A and B ordinary shares in Hoggant Limited as at 31 December 2019:

	Class A Shares		Class B Shares	
Director	Number	£ Value	Number	£ Value
Robert East	125,000	125,000	31	0.31
Matthew Wyles	500,000	500,000	375	3.75
Tim Blackwell	200,000	200,000	165	1.65
James Drummond-Smith	30,000	30,000	31	0.31
Robert Sharpe	150,000	150,000	63	0.63

One director and one spouse of a director held deposits with the Bank as at 31 December 2019 amounting to £189k (2018: 1 Director, £103k).

39. Investment in subsidiaries

HTB has the following investments in subsidiaries (amounting to £105 in total):

	Country of incorporation	Class of shares held	Ownership	Principal activity	Registered address
Hampshire Bank Limited	England	A	100%	Dormant	55 Bishopsgate London EC2N 3AS

HTB's subsidiaries are unlisted and have an accounting reference date of 31 December.
None of HTB's subsidiaries are banking institutions.

40. Post balance sheet event

The Bank has evaluated subsequent events between 31 December 2019 and 22 April 2020, the date the financial statements were issued. Covid-19 pandemic will have consequences for the World's economies, not least the UK and we now know that 2020 will involve a challenging trading environment.

The Bank continues to monitor this situation, however at the time of approving these accounts there is still a significant degree of uncertainty as to the impact of Covid-19. Therefore the impact on the Bank's 2020 financial statements cannot be estimated with an appropriate degree of certainty.

As at 31 December 2019, there is no impact to any of the financial information disclosed in these financial statements as it is a non-adjusting event.

41. Ultimate parent company

The Bank is a subsidiary undertaking of Hoggant Limited, which is incorporated in England and Wales and is the largest company in which the results of the Bank are consolidated. The majority of Hoggant Limited's equity is owned by Hoggant L.P. The consolidated financial statements of Hoggant Limited are available on request from 55 Bishopsgate, London EC2N 3AS.

6. Other useful information

Other useful information

Information which may be helpful to shareholders and other users of the Annual Report and Accounts, this information does not form part of the Statutory Accounts.

Statutory and Amortised Cost Tables

	2019 £m Statutory	2019 £m Amortised cost	2018 £m Statutory	2018 £m Amortised cost
Loans and Advances to Banks	84.6	84.6	98.2	98.2
Debt securities	-	-	15.1	15.1
Loans at fair value through profit or loss	126.5	-	166.8	-
Loans and advances to customers:	1,053.5	1,180.4	733.2	899.1
Specialist Mortgages	632.5	632.5	347.9	347.9
Development Finance	130.0	256.9	98.4	264.3
Asset Finance	200.3	200.3	202.1	202.1
Wholesale Finance	90.7	90.7	84.8	84.8
Other Assets	**19.3**	**19.3**	**10.9**	**10.9**
Total Assets	**1,283.9**	**1,284.3**	**1,024.2**	**1,023.3**
Customer deposits	904.2	904.2	720.7	720.7
Central Bank Facilities	173.0	173.0	135.0	135.0
Tier 2 Capital	30.0	30.0	30.0	30.0
Other Liabilities	25.2	25.2	12.7	12.7
Total Liabilities	**1,132.4**	**1,132.4**	**898.4**	**898.4**
Equity	**151.5**	**151.9**	**125.8**	**125.1**
Ratios				
Risk weighted assets ("RWA")	**757.4**	**757.4**	**718.9**	**718.9**
RWA Density (RWA as % of Loans)	**64%**	**68%**	**83%**	**83%**
Common Equity Tier 1 capital	**137.5**	**137.5**	**121.7**	**121.0**
Tier 2 Capital	**30.0**	**30.0**	**30.0**	**30.0**
Common Equity Tier 1 Ratio	**17%**	**17%**	**16%**	**17%**
Total Capital Ratio	**21%**	**21%**	**21%**	**21%**
Leverage ratio	**11%**	**11%**	**12%**	**12%**
LCR	**242%**	**242%**	**335%**	**335%**
Loan to deposits ratio	**131%**	**131%**	**125%**	**125%**

	2019 £'000 Statutory	2019 £'000 Amortised cost	2018 £'000 Statutory	2018 £'000 Amortised cost
Interest income calculated using the effective interest method	54,388	67,779	38,239	52,397
Other Interest Income	10,545	-	12,057	-
Interest Expense and similar charges	(18,694)	(18,694)	(13,322)	(13,322)
Net interest income	**46,239**	**49,085**	**36,974**	**39,075**
Fees and commissions income	1,500	1,250	2,554	611
Fees and commissions payable	(295)	(295)	(166)	(166)
Other Income/ Expenses	6	6	(8)	(8)
Net (loss)/gain on loans and other financial assets at fair value through profit or loss	(1,943)	(441)	(1,764)	(82)
Operating Income	**45,507**	**49,605**	**37,590**	**39,430**
Impairment losses	(3,375)	(6,204)	(1,742)	(2,845)
Administrative expenses	(28,587)	(28,587)	(24,700)	(24,700)
Profit before Tax	**13,545**	**14,814**	**11,148**	**11,885**
Tax	(2,746)	(2,746)	(2,118)	(2,265)
Profit for the period	**10,799**	**12,068**	**9,030**	**9,620**
Ratios				
Gross Income Margin	**6.2%**	**6.6%**	**6.8%**	**7.0%**
Blended cost of funds (after hedging)	**1.8%**	**1.8%**	**1.6%**	**1.6%**
Net Interest Margin	**4.4%**	**4.7%**	**4.9%**	**5.2%**
Net Revenue Margin	**4.4%**	**4.8%**	**5.2%**	**5.2%**
Cost to Asset Ratio	**2.8%**	**2.8%**	**3.3%**	**3.3%**
Cost Income Ratio	**60%**	**58%**	**63%**	**63%**
Cost of Risk	**0.51%**	**0.60%**	**0.45%**	**0.38%**
Return on Required Equity (post tax)	**11.4%**	**12.7%**	**10.7%**	**11.4%**
Return on Equity (post tax)	**7.8%**	**8.7%**	**7.6%**	**8.1%**

Glossary

Average principal employed	Calculated as the average of monthly Loans and Advances to customers held at amortised cost and fair value.
Blended cost of funds (after hedging)	Rate of interest payable on average funding excluding Tier 2 adjusted for interest on interest rate swap liabilities.
Common Equity Tier 1 Ratio (CET1 Ratio)	The Common Equity Tier 1 ratio is calculated as common equity tier 1 capital divided by risk-weighted assets.
Cost of Risk	Cost of risk is calculated as impairment losses on financial assets and net loss or gain on loans held at fair value through profit or loss divided by average principal employed. Cost to Asset Ratio Administrative expenses divided by average principal employed
Cost to Income ratio	Cost to Income Ratio is calculated as administrative expenses divided by operating income excluding net gain or loss on loans held at fair value through profit and loss.
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
Customer Satisfaction Index	This is a measure of customer satisfaction and the quality of customer service. The index is independently compiled by the Institute of Customer Services.
EAD	Exposure at default
ECL	Expected Credit Losses
Gross income margin	Calculated as interest and similar income, fees and commission receivable and Net loss or gain on loans and other financial assets at fair value through profit or loss divided by average principal employed.
IAS	International Accounting Standard
IASB	International Accounting Standard Board
IBOR	Interbank Offered Rate
ICAAP	Internal Capital Adequacy Assessment Process
IFRSs	International Financial Reporting Standards
ILAAP	Individual Liquidity Adequacy Assessment Process
ILTR	Indexed Long-term repo
KMP	Key Management Personnel
Leverage ratio	The leverage ratio is calculated as Common Equity Tier 1 capital divided by the sum of total assets (excluding intangibles).
LGD	Loss given default
LIBOR	London interbank offered rate
Liquidity Coverage Ratio ('LCR')	The ratio of the stock of high-quality liquid assets to expected net cash outflows over the following 30 days. High-quality liquid assets should be unencumbered, liquid in markets during a time of stress, and ideally, central bank eligible.
Loan to Deposit ratio	Calculated as loans and advances to customers divided by customer deposits.
LTI	Long term Incentive
LTV	Loan-to-value ratio
MRT	Material Risk Taker
Net Interest Margin (NIM)	Calculated as net interest income divided by average principal employed.

Net Revenue Margin	Calculated as operating income excluding net loss or gain on loans held at fair value through profit or loss, divided by average principal employed.
Net Promoter Score	This is an index ranging from -100 to 100 that measures the willingness of customers to recommend a company's products or services to others. It is used as a proxy for gauging the customer's overall satisfaction with a company's product or service and the customer's loyalty to the brand.
OCI	Other comprehensive income
PD	Probability of default
PPE	Property, plant and equipment
RAF	Risk Appetite Framework
Return on equity (post-tax)	Return on equity (post-tax) is calculated as profit post tax for the year divided by average equity.
Return on Required Equity	Return on Required Equity is calculated as profit post tax for the year divided by average required equity.
Required Equity	The amount of regulatory equity needed to achieve the required minimum common equity tier 1 ratio.
RFR	Risk-free rate
Risk-weighted asset (RWA)	A measure of a bank's assets adjusted for their associated risk. Risk weightings are established in accordance with the Basel rules as implemented by CRD IV and local regulators.
Risk-weighted asset (RWA) density	The ratio of RWAs to customer loans provides a measure of riskiness of assets.
T1	Tier 1
T2	Tier 2
Total Capital Ratio	Common Equity Tier 1 plus Tier 2 Equity divided by risk weighted assets.
TFS	Term Funding Scheme
TSR	Total Shareholder Return

ANNUAL REPORT 2019

HTB

Hampshire Trust Bank Plc
55 Bishopsgate
London
EC2N 3AS

Company number: 1311315