Julian Hodge Bank Limited

Annual report and financial statements
30 September 2020
Registered number
00743437

Officers and professional advisers

Directors	Graeme Hughes	Chairman A.C.I.B., M.B.A.
	Alison Halsey	Senior Independent Director B.A. (Hons), F.C.A
	David Landen	Chief Executive Officer F.C.C.A., BSc.
	Matthew Burton	Group Retail Director and Deputy CEO F.C.A., B.Sc.
	Richard Jones	Interim Chief Financial Officer ACA
	Alun Bowen	Non-Executive Director F.C.A., M.A.
	Helen Molyneux	Non-Executive Director LLD (Hons), LLB (Hons).
	John Barbour	Non-Executive Director BSc, M.B.A.
	Aileen Wallace	Non-Executive Director M.C.B.I C.I.R.M. A.M.B.C.S.
	Iain Laing	Non-Executive Director BEng
Bank secretary	Kirsty Williams	LLB (Hons).
Registered office	One Central Square Cardiff CF10 1FS	
Auditor	Ernst & Young LLP Bristol	
Principal bankers	Lloyds Bank Plc London	

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Chairman's Statement

I was deeply honoured to be appointed to Chair Julian Hodge Bank Limited (the 'Bank') on the 1st of May this year, having previously been the Senior Independent Director for a number of months, at a time of unprecedented change both globally and within the Bank itself. I would like to say a huge thank you to Adrian Piper for all of his years of leadership and support to the Bank, and for his personal guidance and help to me in achieving a smooth handover.

We were disappointed to see our previous CEO resign at the turn of the year but that created the opportunity for our CFO, David Landen, to step into the role initially as interim CEO, ably supported by Matthew Burton as interim CFO.

They assumed their roles just as the biggest global challenge in a generation, COVID-19, started to dramatically impact on everyone's lives. It is well documented just how much of an economic shock was created across the world, with many markets effectively closing and many businesses having to rapidly rethink their operating model.

The Bank was no exception, with our financial position adversely affected both by the loss of new business income, as the UK housing market was effectively shut down for several months, as well as the increased loss provisioning on aspects of some of our loans.

Whilst this was incredibly disappointing and frustrating as we had seen encouraging growth in our retail mortgage business prior to the crisis, we have seen our business volumes return to those record levels in recent weeks and so there are promising signs that the recovery is underway.

However, recovery is fragile as I write this, and we have yet to see the outcome of the Brexit trade negotiations.

The Commercial team have been focussing on managing our existing client relationships and, whilst inevitably there will be some stresses in some of those loans, the strength of those relationships together with the insight of the team is minimising the longer-term impact.

The operational response was excellent, with the whole business able to work from home with immediate effect which preserved service levels and ensured the safety and security of all colleagues. The Board was extremely impressed with the management response and grateful to all of the leadership team for such a tremendous achievement.

Throughout we have maintained a close eye on preserving our capital position and we have seen this improve as a result of the actions taken.

Corporate strategy

Looking to the future, our strategy remains rooted in the traditional values of the Bank established some fifty years ago by Sir Julian Hodge.

The Bank will deliver its strategy through using our trusted expertise built up in the specialist areas we understand best, showing genuine empathy with customers and partners alike, and showing bold flexibility to respond to the needs of people in this ever-changing world.

Our longer-term strategy remains to optimise the allocation of capital across the business so as to increase the return both in terms of Return on Capital Employed ('ROCE') and in absolute terms.

These strategic priorities were reaffirmed by the Board at our June Strategy day, with a primary goal of building a fast moving, innovative and agile business capable of responding quickly to market initiatives as well as creating new opportunities ourselves.

This will see the Bank growing its retail mortgage business in highly specialised areas where the changing demographic nature of the UK mortgage market is not being adequately met by the mainstream lenders. To facilitate this growth, we will be expanding our savings capability and product range to add further support to our existing customers as well as attracting new savers using both traditional and digital channels.

Our Commercial business will remain a critically important aspect of the Bank, with the objective of maximising the capital supporting this business area through a number of important, manageable, long term relationships, where our expertise can be fully utilised.

Chairman's Statement (continued)

A key enabler will be our investment in technology, especially utilising open architecture to meet more customer needs and to enable effective partnerships across our product range. This commitment was most evident throughout the COVID-19 crisis where the decision was made to continue the investment in technology at pace so as to enable a fast recovery at the right time.

Financial performance

Despite 2020 being a year which was challenging as a result of the economic environment caused by COVID-19, the Bank increased its loans and advances to customers by 21.3%. The Bank has changed its reporting period from 31 October to 30 September as Hodge staff had previously been operating under pressure to complete the financial statements in the lead up to the December holiday season. Hence the 2020 period below is comparing a 11-month period with 12-month periods:-

Five Year Summary

	2020 11-months	2019 1 year	2018 1 year	2017 1 year	Restated 2016 1 year
	£m	£m	£m	£m	£m
Net operating income	20.9	28.0	26.2	18.6	18.3
Operating (loss)/profit	(8.6)	6.5	14.3	10.2	3.6
(Loss)/profit before taxation	(21.1)	(7.8)	6.3	10.5	23.1
Total assets	1,409.2	1,378.7	1,363.4	1,267.4	1,324.0
Loans and advances to customers	930.8	766.9	827.9	757.9	706.9
Customer deposits	1,071.4	1,042.8	994.6	947.7	991.7
Shareholder's funds	141.0	160.3	171.7	167.3	153.5

The Banks's performance at a net operating income decreased during the year as the Bank continued with its planned growth in residential mortgages and reduction in commercial lending balances. This is in line with expectation as the Bank continues to change its asset mix to improve capital efficacy.

Net operating income was also impacted by reduced reversionary asset sales due to the disruption caused by COVID-19 compared with the prior year. This reduced net operating income by £3.7 million.

The operating profit level has deteriorated partly due to the planned increase in overheads due to substantial investment in people and systems to enable us to carry out our plans to grow the business over the coming years. We continue to make significant investment in our business, particularly within the digital arena, recognising that any successful financial services business must invest to stay relevant and to meet the aspirations and expectations of its customers.

The operating loss was further impacted by a large increase in commercial loan impairments, partly as a result of COVID-19, but the Bank also recognised an additional loss, on final settlement, of £3.5 million in relation to a badly performing loan. Further progress has been made in 2020 to resolve commercial lending exposures in default, with gross default balances decreasing by £10.0m.

The Bank recognised a £4.1 million loss on its macro hedge accounting portfolio as part of its transition away from LIBOR, this was offset by a £4.2 million gain on disposal of the underlying hedged items of government bonds and debt securities.

The overall result is a loss after tax of £15.9m, is partly driven by the operating loss but also due to adverse fair value movements of £16.7 million. The fair value loss is mainly due to a revised valuation methodology for lifetime mortgages and reversions implemented in the period. The Bank now uses a discount rate that more closely reflects active market pricing within the mark to model valuation.

Our Shareholder's funds were further depleted due to actuarial losses of £4.4m on the defined benefit pension scheme.

Chairman's Statement (continued)

Our business

We are a privately owned bank seeking to use finance for good, opening up possibilities in the moments that matter for people and business.

We continue to offer a full range of later life products assisting our customers prior to, at and post-retirement. We have been in this market since 1965. Our unrivalled expertise enables us to develop solutions for customers based on a clear understanding of their needs.

Alongside our later life proposition, we operate in other specialist residential mortgage markets offering portfolio buy-to-let and holiday-let products. In addition, through our commercial lending business, we offer real estate finance to developers and investors.

We use our considerable experience to ensure that we have ample liquidity and capital to safeguard our customers' savings and to meet all regulatory requirements.

Specialist mortgages

The Bank's specialist mortgage business combines our expertise in both residential and later-life lending.

We work closely in partnership with our trusted network of intermediaries, serving professional landlords through our buy-to-let mortgages, and personal customers through our later-life mortgages.

Our range of later-life mortgages include retirement interest only mortgages, either with or without a fixed-term end date. These products are available to those over 50, a growing market that we are committed to serving.

2020 has been a year of focus on improving our service delivery, affirming our commitment to place our customers at the heart of everything we do. We have invested in enhancing the intermediary experience providing an online transactional portal that provides real time case management and account support. We continue to value and respond to feedback from the broker community, delivering a range of product updates and service enhancements throughout the year. We work closely with them to ensure the products we offer deliver for our customers whilst providing flexibility in a notoriously rigid market. This is essential as we look to evolve our product offering.

We have also focussed investment in our teams, strengthening our expertise and capability to serve and respond to the market. This continues to pay dividends in the feedback we receive from brokers.

Commercial lending

Our core purpose is to support experienced, serially active investors and developers of real estate assets, predominantly in residential or residential-led mixed use schemes. This means that we impact positively on the communities into which we lend, by helping our clients deliver much needed new homes for sale or rent, as well as regenerating areas and providing ancillary support facilities. We are a long term funding partner for our clients as they grow their own businesses.

Our financial period to 30 September has been the proverbial 'period of two halves' with our markets very active and loan volumes strong in Q4 2019 and Q1 2020 as political and Brexit related uncertainties started to ease, before COVID-19 emerged to impact the UK, both economically and socially in a material way.

Whilst the immediate impact of COVID-19 was an effective hiatus in our markets, as clients and businesses took stock of the sudden and dramatic change in the environment, it has been encouraging to see a notable resurgence in confidence and activity through the traditionally quieter summer months. Our new enquiry levels have been particularly strong of late which is indicative of investors and developers having the confidence and motivation to plan and progress new investments and building projects. Whether this is a sustainable trend, a release of pent up demand from earlier in the year, or a temporary reaction to the currently buoyant housing market activity and price levels, time will tell.

Chairman's Statement (continued)

However, what is certain is that there remains a sizeable cohort of businesses in the UK that have been severely affected by COVID-19 and which will take a considerable period of time to recover from its impact. This will affect the level of business activity in general, as well as future demand for the property space our clients develop and provide, in particular. Allied to this, it is plausible that widespread and sustained homeworking across the economy could represent structural change to working practices, rather than being a temporary phenomenon, with consequent longer-term implications for the type, location, nature and size of business and residential property demand.

More positively, our priority growth areas in development finance and residential investment have proved attractive to our target market and both have shown good traction since their initial launches last year. We are growing our lending volumes and client numbers in these areas, whilst continuing to service our clients who focus on wider commercial real estate projects such as offices, retail, leisure or industrial.

Our clients remain central to everything we do and we are continuing to invest time, effort and money in improving the efficiency of our systems, process and people as we strive for excellent client experience across all areas of our business.

Savings
Customer savings are, and will remain to be, the most important part of our funding base.
Throughout 2020 we have continued investing in our digital offering, using technology to create better experiences for our customers. Alongside investment in the journey, we will continue to grow our savings product offerings.

During the next twelve months we aim to expand the range of products and services that can be arranged online, giving customers even more control over how they engage with us.

Our customers tell us they appreciate the value of human touch. The level of interaction varies between the human touch at every stage of a journey through to reassurance that any queries can be answered by a person. Our team of experts support those customers as and when required.

We continue to manage over £1bn of our customers' savings balances providing competitive interest rates and an efficient personalised service. As we have grown our digital offering to include on-line account servicing this has attracted more new customers and resulted in an increased proportion of our savings balances being raised through this channel. We expect this trend to continue.

The Bank is also a participant in the Bank of England's Term Funding Scheme ('TFS'), which provides a cost-effective source of funding in the form of central bank reserves to support additional lending to the real economy. The TFS balance represents 7.3% of the overall funding from deposits with banks and customers at 30 September 2020.

Governance and the Board
This year also saw a number of changes in the composition of the Board. I have already spoken of the changes at CEO and CFO level, but we also welcomed a number of non-executive directors which continued the strengthening of the governance of the Bank.

Iain Laing joined as Chair of the Risk and Conduct Committee for the Bank, taking over from Alun Bowen pending his retirement later this year. Iain brings considerable industry wide expertise in all aspects of risk and so I am confident he will build on the legacy that Alun will leave behind. The Board is extremely grateful to Alun for his considerable contribution to the Bank and he will be enormously missed.

Aileen Wallace also joined the Board this year and she brings a strong customer and innovation lens to the Bank. Aileen will be chairing the newly created Change and Innovation Committee to oversee the transformation of the Bank's infrastructure and to ensure the strategic alignment of the investment programme.

Chairman's Statement (continued)

I am also delighted to welcome Alison Halsey as our Senior Independent Director. Alison brings a wealth of experience from the finance world as well as from other industries and, as an accountant by profession, replaces the expertise we lose in Alun's planned retirement.

I am delighted to confirm that David Landen was appointed to the CEO role on a permanent basis with the full support of the Board following a very impressive performance leading the business throughout the crisis and beyond.

Alongside this the Board valued the contribution made by Matthew Burton as interim CFO and so have appointed him to the role of Deputy CEO and Retail Director to lead the very important growth of that business area. I would also like to welcome Richard Jones to the Board as Matt's replacement as the new interim CFO.

Finally, the Board would like to put on record our thanks to all colleagues across the Bank who have responded so effectively, flexibly and pragmatically to the extreme changes caused by the COVID-19 crisis. In common with most businesses across the sector we utilised the government's job retention scheme for some colleagues, particularly those in our new business sections where markets effectively shut down, and in doing so continued to pay full salaries and packages as well as looking to rotate colleagues to ensure that they kept a close connection with the business.

Graeme Hughes
Chairman
11 December 2020

Strategic Report

Principal activities
The Bank is principally engaged in the business of banking.

The Bank is an Authorised Institution under the Financial Services and Markets Act 2000.

Business review, future developments and key performance indicators
A review of business, future developments and key performance indicators is included in the Chairman's Statement on pages 1 to 5. The key performance indicators are considered to be net operating income and operating profit.

Results and dividends
The loss for the year after taxation amounted to £15.9m (2019: loss after taxation of £5.7m). No dividend was paid during the year (2019: £nil) leaving a deficit for the year of £15.9m (2019: deficit of £5.7m) to be taken to reserves.

S172 Statement by the Directors
The Companies Act 2006 requires the directors of the Bank to act in the way he or she considers, in good faith, would be most likely to promote the success of the Bank for the benefit of its stakeholders as a whole. In doing so, s172 requires a director to have regard, amongst other matters, to the:
• likely consequences of any decisions in the long-term;
• interests of the Bank's employees;
• need to foster the Bank's business relationships with suppliers, customers and others;
• impact of the Bank's operations on the community and environment;
• desirability of the Bank maintaining a reputation for high standards of business conduct; and
• interests of the Bank's Shareholder.

In discharging its s172 duties, the Board has regard to the factors set out above. The Board also has regard to other factors which it considers relevant to the decisions it makes. The Board acknowledges that not every decision it makes will necessarily result in a positive outcome for all of the Bank's stakeholders. By considering the Bank's purpose, vision and values together with its strategic priorities and having a process in place for decision-making, the Board does, however, aim to make sure that its decisions are consistent.

The Board delegates authority for the day-to-day running of the business to the CEO and, through him, to the Executive Committee to set, approve and oversee the execution of the Bank's strategy and related policies. The Board reviews matters relating to financial and operational performance, business strategy, key risks, stakeholder-related matters, compliance and legal and regulatory matters, over the course of the financial year. This is supported through the consideration of reports and presentations provided at board meetings and reviewing aspects of the Bank's strategy at least twice a year. A high-level summary of the Bank's strategy can be found in the Chairman's Statement on page 1.

The Bank has a number of key stakeholder groups with whom it actively engages. Listening to, understanding and engaging with these stakeholder groups is an important role for the Board in setting strategy and decision-making. The Bank recognises its obligations and requirements to be a well-controlled financial services business, compliant with regulation and delivering good customer outcomes. The Regulators are consulted and kept closely informed in relation to key decisions made by the Board, as appropriate. A summary of how the Board engages with customers, employees, suppliers, the community and the Shareholder is provided below.

Our Customers
As a customer-centric business the Bank uses a range of methods to involve and engage with our customers. The Board values feedback from customers to ensure the Bank is providing them with what they want and need.

The Bank has an established customer forum and continues to work closely with our broker network to ensure the products we design are needed and add value. A variety of customer surveys are also carried out on a regular basis to gather feedback from customers as and when they have an interaction with the Bank.

Strategic Report (continued)

2020 has been a year of progress, during which we focused on ensuring we put the customer at the heart of everything we do. We launched the new holiday lets product, engaging with the broker community in its development.

We continue to make significant investment in technology to improve our operational and digital capability which is vital in delivering our promises to our customers. This ongoing investment brings efficiency and scalability to our operations, whilst delivering great service to our customers.

In the prior year we launched a portal for mortgage advisers which provides a seamless online service to support our network of advisers and enables efficient processing of mortgage applications; additional functionality has been built within the portal in 2020. In addition, in 2020 the Bank has worked with a third party to build a new mortgage servicing platform which provides the Bank with the functionality to service both interest only and capital and interest products in-house for the first time. The new mortgage servicing system is due to go live by the end of 2020 and should assist the Bank in improving the level of service it provides to its customers.

Our Employees

In 2017, the Bank formed the Colleague Alliance, to provide a link between colleagues and the Board and to champion the values that drive our culture.

We continue to invest in our people, with leadership support and mentoring across the business. This commitment will enhance strategic leadership as well as strengthening capability at multiple levels throughout the organisation. We have taken steps to drive colleague engagement through reward and recognition schemes aligned with our desire to delight our customers and we have made enhancements to our internal communication so that all our colleagues are aware of the business's direction. The directors recognise the importance of communication with employees and they make it their policy to be accessible to them.

In March, the impact of the COVID-19 pandemic on new business volumes demanded swift and immediate action to protect and secure our colleagues and their families. The government's job retention scheme was used to ensure that, at a time when new business levels were seriously curtailed as a result of the pandemic, staffing levels were appropriately managed. Staffing levels were regularly reviewed to ensure that the business was able to cope with slowly increasing work levels and the use of the scheme reviewed regularly to ensure its appropriateness.

The Board took the decision to continue to pay furloughed employees their full pay, as it was considered vitally important to support our colleagues and their families during a difficult and stressful time. One of the impacts of the COVID-19 pandemic, which became clear at an early stage, was that bearing in mind the Bank's performance and the economic outlook, it was highly unlikely that the performance targets set by the Board would be met to enable payments to be made under the Bank's Incentive Scheme. The Board informed employees of the situation as early as possible in order to manage expectations.

Our people are central to the value we deliver for our customers and the key to creating a strong experience for our customers. We remain committed to building a culture where people thrive through rewarding talent and performance.

The Bank has an equal opportunities employment policy, and it is the Board's policy to employ disabled persons whenever suitable vacancies arise and to provide for such employees the appropriate level of training and career progression within the Bank.

Last year, the Board completed the important task of shaping and agreeing a reward strategy for the Bank that sets out our guiding principles and direction for the Bank's reward policies, practices and offerings. The Bank's strategy remains to show how much we value colleagues, to provide flexibility and opportunity for all, and to offer an upper quartile package.

Strategic Report (continued)

During the year, we introduced our new flexible benefits package for all employees. Having conducted a survey of our colleagues, considering the type of benefits that would work for everyone, and identified a range of benefits which would support our colleagues at the various stages of their lives, including the ability to buy additional holidays and health plans.

In addition to the new flexible benefits package, the business adopted a new parental leave benefits policy, which equalised the benefits for maternity and paternity leave and increased the length of paid leave to bring the business into the top quartile of local employers.

The Board has committed to conduct a gender pay audit in 2020/21 and to publish the results.

Our Suppliers
Our suppliers play an important role in the operation of the Bank's business to enable the delivery of an effective and efficient business model. The Bank launched a new procurement system in 2020 which improves the management of the relationship with our suppliers.

During 2020 several material contracts were presented to the Board for approval, covering both new relationships and contract renewals. In approving these contracts, the Board considered the strategic value of the relationships as well as looking at the customer impact, risk exposure, legal and compliance considerations and financial implications. The Bank has a framework in place which provides a consistent and proportionate approach to the procurement and management of suppliers to ensure that it can effectively engage, manage and terminate, where appropriate, supplier relationships.

Our Community
Throughout 2020 we have continued to make a difference to the lives of others through our corporate social responsibility commitment. The Bank has a focus on the wider community, supporting four charity partners during the year: Re-engage, Care & Repair Cymru, Maggies and Hourglass. Additionally, colleagues are able to take up to four days off work per year to support good causes with the Bank's 'Four to do More' initiative.

Our Shareholder
A Shareholder Engagement Policy has been agreed and adopted by the Board, detailing the Shareholders' expectations of the Bank and those matters that require shareholder approval or shareholder consultation, to support appropriate governance and oversight.

The Board provides updates to and engages with the shareholders of the Bank regularly to obtain a clear understanding of their views and requirements.

Corporate Governance
A comprehensive corporate governance framework is vital in supporting executive management in its execution of strategy and in driving long-term sustainable performance. It helps ensure that the Shareholder's investment in the Bank is protected, while at the same time recognising the interests of our wider stakeholders.

The Board's agenda during 2020 was focused on overseeing and supporting executive management to deliver on the Bank's strategic objectives. It is during periods of significant change, which the Bank is currently undergoing, that leadership and good governance are more important than ever.

The Bank's Board comprises three executive and seven non-executive directors. The roles of Chairman and Chief Executive are separate to ensure that neither can exercise unfettered powers of decision-making on matters of material importance.

The Board has sought to ensure that directors are properly briefed on issues arising at board meetings by:
- Distributing papers sufficiently in advance of meetings;
- Considering the adequacy of the information provided before making decisions; and
- Deferring decisions when directors have concerns about the quality of information.

The Board is ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. The system of control is designed to manage rather than eliminate risks which are inherent in the Bank's business and can provide only reasonable and not absolute assurance against material misstatement or loss.

Strategic Report (continued)

The Bank's system of internal financial control includes appropriate levels of authorisation, segregation of duties and limits for each aspect of the business. There are established procedures and information systems for regular budgeting and reporting of financial information. Financial reports are presented at every board meeting detailing the results and other performance data.

The Bank changed its internal auditors, following a tender process, from PwC to Deloitte on an outsourced basis. The primary purpose of this function is to review the effectiveness of controls and procedures established to manage risk. An audit programme is agreed annually in advance with the Audit Committee and the Head of Internal Audit attends each meeting to present a summary of audit reports completed during the period and to provide any explanations required by the Committee.

Governance framework

Nestor Advisors were engaged to undertake a review of the Board in 2019, including governance and individual director development, specifically to:

- Identify improvements to the Board structure, functioning, ability to work as a team, and capacity to challenge;
- Develop shared views on further enhancing board effectiveness;
- Enhance comfort among board members regarding fulfilment of their collective role;
- Bolster confidence of shareholders, regulators and stakeholders in Board governance practices.

Following the review, which had the full participation of the Board, Nestor Advisors provided feedback on their findings, drawing attention to the strength and collegiality of the Board. In addition, Nestor Advisors presented recommendations, including at a high-level to:

- Continue to enhance the strategic capability of the Board, without undermining collegiality;
- Strengthen the Board's oversight capability, without cancelling its proximity to the business, and;
- Streamline support functions.

As a result of the recommendations the CEO and the Board have initiated several changes to further strengthen the Board and this continued in 2020 with a number of appointments and changes.

The following is a summary of the framework for corporate governance adopted by the Bank.

The Board

The Board has ultimate responsibility for the proper stewardship of the Bank in all its undertakings. It meets regularly throughout the year to discharge its responsibilities for all important aspects of the Bank's affairs, including monitoring performance, considering major strategic issues, approving budgets and business plans and reviewing operational performance. The Board holds regular discussions with the Bank's shareholder to ensure a clear understanding of their views and requirements. A shareholder's covenant has been agreed detailing the shareholder's expectations of the Bank.

The Chair is responsible for the leadership and operation of the Board, setting the agenda and the tone of board discussions as well as having responsibility for assessing the effectiveness of the Board and its directors.

A board control manual has been adopted and was updated during the year which describes the high-level policy and decision-making arrangements within the Bank. The manual includes a schedule of matters reserved to the Board together with those items delegated to directors and board and executive committees.

Details of the members of the Board are set out below.

Graeme Hughes – Chairman

Graeme joined the Board in 2019 and was appointed Chair in May 2020. Graeme has spent the vast majority of his career with the Nationwide Building Society, most recently becoming Group Distribution Director, responsible for all sales and service activities across 720 branches and 10,000 staff. Earlier roles have seen him leading group strategy and planning, as well as human resources and external affairs.

Strategic Report (continued)

Alison Halsey – Senior Independent Director
Alison joined the Board of the Bank as the Senior Independent Director in November 2020, and is also a non-executive director of Hodge Life Assurance Company. With 30 years of experience at KPMG, Alison headed up KPMG's UK Financial Services practice before becoming a Global Lead Partner, a position she held for 10 years. Prior to that, she was an Audit Partner for 10 years.

A skilled non-executive director, Alison also sits on the Boards of Credit Suisse International and Aon in a variety of non-executive roles.

Alun Bowen - Non-Executive Director
Alun joined the Board in 2013, he was Chair of the Risk and Conduct Committee until 31 July.

Alun enjoyed a long career at KPMG. He became the Managing Partner of KPMG in Kazakhstan in 2008 and before that was the firm's Senior Partner in Wales, specialising in the banking, insurance and retail financial services sectors. Between 2001 and 2005, he also headed KPMG's practice advising global companies on sustainability.

Alun is Chair of the Audit Committee of PAO Severstal and Transport for Wales and is a Fellow of the Institute of Chartered Accountants in England & Wales. Alun has also been Chair of Business in the Community in Wales, a member of the Council of the Prince's Trust Cymru and the BT Wales Advisory board.

John Barbour - Non-Executive Director
John joined the Board in March 2017 and is also Chair of the Audit Committee.

John was previously Managing Director of Treasury at ICBC Standard Bank, the London-based financial markets and commodities bank, owned by China-based ICBC and South African-based Standard Bank. He has spent his entire career in treasury and financial markets-related roles, having previously worked at Investec and Bank of New York.

Helen Molyneux - Non-Executive Director
Helen joined the Board in June 2015 and is Chair of the Remuneration Committee.

Until November 2016, Helen was the CEO of NewLaw Legal, a business she established from scratch, which now employs over 400 people. She is now a non-executive director of the EUI board of the Admiral Insurance Group.

In 2011 Helen was named Welsh Woman of the Year and in 2013 the Law Society's Business Woman of the Year. She was a member of the Silk Commission on Devolution in Wales and previously chair of the Institute of Welsh Affairs. In 2016 she was awarded an honorary doctorate by the University of South Wales in recognition of her services to the legal profession.

Iain Laing – Non-Executive Director
Iain joined the Board in July 2020, and is the Chair of the Risk and Conduct Committee. He is also the Chief Risk Officer of Monzo Bank. Prior to joining Monzo Bank, Iain was the Chief Risk Officer and a member of the Executive Committees of both TSB Bank and Nationwide Building Society, and Chief Credit Officer of Santander UK Retail throughout the 2007 to 2010 financial crisis.

Aileen Wallace – Non-Executive Director
Aileen is an experienced executive turned advisor and non-executive director with more than 30 years' experience in senior financial services and digital services roles at Virgin Money (formerly CYBG Plc), Co-operative Bank, Cognizant and a pre-seed Fintech. A Chartered Banker, her expertise is in business transformation, technology and customer innovation and corporate governance in highly regulated environments. Aileen is currently a non-executive director at Target Group.

David Landen – Chief Executive Officer
David was appointed Chief Executive Officer in September 2020, stepping up from CFO and Deputy CEO. David joined the Bank in 2002 and has held a variety of finance and treasury roles during his time with the organisation. He was appointed to the Board as CFO in 2011. An accountancy graduate from Cardiff University, he is a fellow of the Association of Chartered Certified Accountants.

Strategic Report (continued)

Matthew Burton – Group Retail Director and Deputy CEO
Matthew joined the Board in April 2020 on his appointment as Interim CFO. He has since been appointed as Group Retail Director and Deputy CEO. Matthew joined Hodge in 2015 as the Group Head of Finance, before taking up the role of Managing director of Mortgages in February 2019. Matthew has a 14-year career in finance, having held roles at Future plc, Zodiac Aerospace and BDO LLP.

Richard Jones – Interim Chief Financial Officer
Richard joined Hodge in October 2020 as Interim CFO. He has a 30 year career in finance working as a Senior Interim finance professional in a variety of financial services businesses.

Board Committees
The Board has established the following standing committees:

Audit Committee: John Barbour (Chair), Alison Halsey, Helen Molyneux, Alun Bowen, Aileen Wallace and Iain Laing

All members of the Audit Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Audit Committee is to review the work of the Internal Audit function, to consider the adequacy of internal control systems, to oversee the relationship with the external auditors, to review the statutory accounts including the key estimates and judgements used in the statutory accounts and to consider compliance issues. The Committee meets at least eight times a year.

Remuneration Committee: Helen Molyneux (Chair), Alison Halsey, Graeme Hughes and Iain Laing

All members of the Remuneration Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Remuneration Committee is to consider remuneration policy and specifically to determine the remuneration and other terms of service of executive directors and senior managers. The executive directors decide fees payable to non-executive directors. The Committee meets at least twice per year.

Change and Innovation Committee: Aileen Wallace (Chair) and Helen Molyneux

All members of the Innovation and Change Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Committee is to oversee the end-to-end digital delivery of the Bank's product and services. It monitors investment and management of risk associated with the delivery of change associated with the Bank's strategic initiatives.

The Committee was set up during the year and only one meeting took place.

Risk and Conduct Committee: Iain Laing (Chair), Graeme Hughes, Alison Halsey, John Barbour, Helen Molyneux, Alun Bowen and Aileen Wallace.

All members of the Risk and Conduct Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Risk and Conduct Committee is to oversee the management of risk and the conduct of business on behalf of the Board to ensure that significant risks are identified, understood, assessed and managed and that good customer outcomes are achieved. It is responsible for the second line of defence of the business, ensuring that the level of assurance available to the Board is sufficient and appropriate. The Committee meets at least eight times a year.

Strategic Report (continued)

Nomination & Governance Committee: Graeme Hughes (Chair), Alison Halsey, Helen Molyneux, John Barbour and Aileen Wallace.

All members of the Nomination & Governance Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Committee is to recommend the appointment of directors to the Board and board committees and to ensure that the Bank has an appropriate succession plan for executive and senior management positions. It also is responsible for ensuring that the Company's diversity and inclusion policy is being delivered. The Committee meets at least twice per year.

Board and Committee Membership and Attendance

Name	Board		Audit Committee		Risk & Conduct Committee		Remuneration Committee		Nomination & Governance Committee		Change and Innovation Committee	
	(a)	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	(a)	(b)
Graeme Hughes	11	11			9	9	6	6	7	5		
Adrian Piper	11	8			9	6			7	4		
Alison Halsey												
John Barbour	11	11	8	8	9	9			7	6		
Helen Molyneux	11	11	8	7	9	9	6	6	7	7	1	1
Alun Bowen	11	11	8	7	9	9						
Aileen Wallace	11	4	8	3	9	5			7	3	1	1
Iain Laing	11	4	8	2	9	5	6	3				
David Landen	11	11										
Matthew Burton	11	8										
Steve Pateman	11	3										
Richard Jones												

(a) Number of meetings held **(b)** Number of meetings attended

<u>Notes</u>
Steve Pateman resigned on 16/03/2020
Matthew Burton joined the Board on 09/04/2020
Aileen Wallace joined the Board on 24/04/2020
Adrian Piper retired from the Board on 30/04/2020
Iain Laing joined the Board on 30/07/2020
Richard Jones joined the Board on 9/10/2020
Alison Halsey joined the Board on 05/11/2020

Risk appetite
On an annual basis, in the context of the Board's review of its strategy, the Board establishes a risk appetite with appropriate key risk indicators and risk limits for executive management to operate within. The Board monitors adherence to the risk appetite on a regular basis.

Risk management
In the normal course of its business, the Bank is exposed to credit risk, house price risk, liquidity risk, interest rate risk, conduct risk, operational risk and pension risk. As a result of recent events, the risks from the COVID-19 pandemic are likely to impact all of our principal risk categories in varying degrees of severity.

Credit risk is the risk that a counterparty will be unable or unwilling to meet a commitment that it has entered into with the Bank. The Bank manages its credit risk through the Retail Credit Committee, Commercial Credit Committee and the Assets and Liabilities Committee. Regular credit exposure reports are produced which include information on credit and property underwriting, large exposures, asset concentrations, industry exposure and levels of bad debt provisioning.

Strategic Report (continued)

House price risk is the risk that arises when there is an adverse mismatch between actual house prices and those implicit in the costing of the Bank's lending into retirement products, such that the ultimate realisation of the property would not yield the expected return to the Bank and could, in certain circumstances, result in a capital loss. The Bank mitigates house price risk by setting and monitoring maximum loan to value at inception of the loan.

Liquidity risk is the risk that the Bank will encounter difficulty in realising assets or otherwise raising funds to meet commitments as they fall due. The Bank manages its liquidity risk through its Assets and Liabilities Committee, and monitors its liquidity position on a daily basis and has adopted a policy to ensure that it has adequate resources to enable it to conduct its normal business activities without interruption. The maturity analysis of assets and liabilities is disclosed in the notes to the financial statements.

The customer deposit base represents a stable source of funding due to the number and range of depositors. Liquidity is further managed through dealings in the money markets.

Interest rate risk is the risk that arises when there is an imbalance between the maturity dates of rate sensitive assets, liabilities and off-Balance Sheet items. The Bank manages its interest rate risk through its Assets and Liabilities Committee. The Bank's policy is to maintain interest rate risk at a controlled level within limits set by the Board.

The table in note 27 shows an estimate of the interest rate sensitivity gap as at 30 September 2020. Assets and liabilities are included in the table at the earliest date at which the applicable interest rate can change.

The Bank enters into derivative transactions, normally interest rate swaps. The purpose of such transactions is to manage the interest rate and other risks arising from the Bank's operations and other resultant positions. The Bank's interest rate risk management policy defines the type of derivative transactions that can be undertaken. Further information is provided in note 22 to the financial statements.

In July 2017, the Financial Conduct Authority announced a transition away from LIBOR. The Bank set-up a LIBOR working group in 2020 to assess the impact and manage this change and has made progress during the year to transition away from LIBOR. We will be transitioning our remaining LIBOR linked derivatives by the end of 2021.

Conduct risk is the risk that the Bank's behaviour results in poor outcomes for customers. The Bank is exposed to this risk by virtue of the markets in which it chooses to operate. The Executive Risk Committee has overall responsibility for implementing and monitoring principles, frameworks, policies and limits. The Committee is responsible for managing risk decisions and monitoring risk levels which it reports to the Board.

Operational risk is the risk of economic loss from control failures or external events, which result in unexpected or indirect loss to the Bank. The evaluation of the various risks and the setting of policy is carried out through the Bank's Executive Risk Committee which reports to the Risk and Conduct Committee, which ensures adherence to the Bank's risk management policy and framework. The Assets and Liabilities Committee covers liquidity risk and credit risk for treasury counterparties. Strategic risk is monitored through the Board.

Pension risk - the Bank is also exposed to pension risk through its defined benefit scheme. Further information is provided in note 24.

Pandemic risk, whilst not a principal risk category we consider the risk of economic loss as a result of the COVID-19 pandemic. The Bank runs a variety of stress test scenarios as part of its ICAAP, including stress tests which are more severe than that observed during the COVID-19 pandemic to date. The Bank also has a Recovery Plan which is reviewed annually by the Board and documents the plans in place and actions to be taken to recover from a severe stress event.

David Landen
Director
11 December 2020

Directors' Report

The directors present their report together with the audited financial statements for 11-month period ended 30 September 2020. Certain disclosures are provided in the Chairman's Statement, Strategic Report and the financial statements and are incorporated here by cross-reference. Specifically, these incorporate the following disclosures:

Business review and future developments	Page 1
Results and dividends	Page 6
Risk management policies	Page 12
Financial instruments	Note 27

Directors and their interests

The directors who held office during the period are listed below:

Graeme Hughes*	Chairman
Adrian Piper * (Retired 30 April 2020)	
Alun Bowen *	
Helen Molyneux *	
David Gulland * (Resigned 1 November 2019)	
John Barbour *	
Aileen Wallace * (Joined 24 April 2020)	
Iain Laing * (Joined 30 July 2020)	
Stephen Pateman (Resigned 16 March 2020)	
David Landen	Chief Executive Officer
Matthew Burton (Joined 9 April 2020)	Deputy CEO and Retail Director

* All non-executive directors are deemed to be independent by the Board.

During the year, there were no contracts entered into by the Bank in which the directors had a material interest.

Change in year end

During the year the Bank changed its year end from 31 October to 30 September.

Political contributions

The Bank made no political contributions during the year.

Post Balance Sheet events

There were no post Balance Sheet events to disclose.

Disclosure of information to the auditor

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Bank's auditor is unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Qualifying third-party indemnity provisions

The Bank has granted an indemnity to one or more of its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies' Act 2006. Such qualifying party indemnity provisions remain in force as at the date of approving the Directors' Report.

Re-appointment of auditors

A resolution for the re-appointment of EY as the auditor of the Bank and to provide the Audit Committee with the authorisation to determine the auditors remuneration is to be proposed at the forthcoming Annual General Meeting of The Carlyle Trust Limited.

Directors' Report (continued)

Going concern

The Board has considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance, including consideration of projections incorporating the impact of the COVID-19 pandemic or an adverse Brexit outcome on the Bank's capital and funding position. As part of this assessment the Board considered:

- The impact on Bank's profits from an expected reduction in income from residential and commercial lending combined with increased credit impairment charges;
- The sufficiency of the Bank's capital base, which is expected to be sufficient to weather even a severe COVID-19 or Brexit related downturn; and,
- The adequacy of the Bank's liquidity.

The Bank's forecasts and projections include scenario testing undertaken in accordance with the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment Process (ILAAP), which are required by the Prudential Regulation Authority to demonstrate appropriate levels of capital and liquidity respectively under stressed conditions.

The directors confirm that they are satisfied that the Company will continue in business for a period of at least 12 months from the date of signing the financial statements. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

Directors' Responsibilities Statement

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 UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) including Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

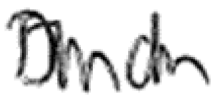
Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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 the financial statements comply with the Companies Act 2006. They 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.

By order of the Board



David Landen
Director
11 December 2020

Independent Auditor's Report to the Member of Julian Hodge Bank Limited

Opinion

We have audited the financial statements of Julian Hodge Bank Limited for the period ended 30 September 2020 which comprise the Income Statement, Statement of Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity and the related notes 1 to 30 (except for the sections of note 29 which are marked as unaudited), including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 30 September 2020 and of its loss for the period then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; 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 under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	• The risk that inappropriate actuarial assumptions are used in the valuation of equity release mortgages and reversion assets. • The risk of incomplete and inaccurate IFRS 9 Expected Credit Loss ('ECL') provision. • The risk of incorrect valuation of derivatives.
Materiality	• Overall materiality of £2.4m which represents 1.7% of equity.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included 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. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
The risk that inappropriate actuarial assumptions are used in the valuation of equity release mortgages and reversion assets (Loans and advances - equity release mortgages): £131.4m, (2019: £144.7m), Investment properties - reversion assets: £97.4m, (2019: £97.3m). The valuation of the equity release mortgages, and reversion assets is highly judgemental as it relies upon a number of assumptions with high estimation uncertainty, including those in respect of the No Negative Equity Guarantee (NNEG), voluntary early redemption, discount rate, policyholder mortality/longevity and expenses. The increased uncertainty in property valuation as a result of COVID-19 presents an increased risk on the valuation of lifetime mortgages and reversion asset valuations. Inappropriate assumptions may lead to a material misstatement in the financial statements. The equity release mortgages are disclosed as loans and advances to customers in note 13 of the financial statements, with the principal assumptions and sensitivity analysis of changes to key assumptions disclosed in note 27.	We performed a walkthrough to understand the assumption setting process and tested the controls within the process. Utilising our actuarial specialists, we assessed and challenged the assumptions used within the valuation of equity release mortgages and reversion assets to ensure that they are in line with peer companies, internal experience analysis and the requirements of financial reporting and regulatory standards. The key assumptions we focused our audit work on were as follows: <u>No Negative Equity Guarantee</u> We considered each of the assumptions used within the NNEG calculation, considering a combination of historic and projected future house price movements, the potential variability in house price growth and the allowance made for property dilapidation within the portfolio. We also considered the appropriateness of the assumptions in view of the current uncertainty in the UK property market due to the COVID-19 pandemic. <u>Voluntary early redemption</u> We compared the voluntary early redemption assumptions in the valuation with observed experience in the portfolio and with those used by peer companies in the sector.	Overall, we consider the assumptions that are used in the valuation of the equity release mortgages and reversion assets to be within a reasonable range, with the majority of assumptions towards the middle of the range except for expense assumptions which are at the optimistic end of the range.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

The reversion assets are disclosed as investment properties in note 17 of the financial statements, with the principal assumptions and sensitivity analysis of changes to key assumptions disclosed in note 17.	We paid particular attention to the implications for experience in light of the increased competition in the market over the last 3-4 years and the relevance of historic data to future VER assumption setting in light of these changes. <u>Discount rate</u> We tested whether the discount rates used in the valuation of the lifetime mortgages and reversion assets were consistent with the discount rates used by other companies in the sector, relative liquidity levels and customer rates available in the market. <u>Policyholder mortality/ longevity</u> We assessed the mortality assumptions by considering management's experience analysis and comparing the assumption adopted by management for future improvements with those used by other companies in the sector, allowing for particular factors around the profile of the Company's business compared to the industry experience. We also considered the appropriateness of the assumptions in view of the COVID-19 pandemic. <u>Expenses</u> We tested current and forecast expense levels to evaluate if the unit costs and inflation assumptions used within the valuation were reasonable. We tested the allocation of expenses between Hodge Life Assurance Company Limited and Julian Hodge Bank Limited.	

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

The risk of incomplete and inaccurate IFRS 9 Expected Credit Loss ('ECL') provisions includes the following aspects: 1. The risk of incomplete identification of loan assets held at amortised cost with significant increases in credit risk (Stage 2) or credit impairment (Stage 3) on a timely basis, including due to incorrect application of the internal risk and scorecard ratings applied in the commercial loan book (gross loan balance for commercial loans): £299.9m (2019: £326.7m). Additionally, there is a risk that inappropriate management overlays are applied to IFRS 9 credit staging. 2. The ECL PD, LGD, EAD models are inaccurate because the historical default data and risk attributes used to build and run the models are inaccurate or non-representative of the portfolio (for Stage 1 or 2 assets). The external data used to calculate the PD and LGD is provided by an external credit rating agency. There is a risk that the data used is not representative of Hodge's portfolio, and a risk that there are errors in the application of the external data.	We performed a walkthrough to understand the IFRS 9 estimated credit loss process including any changes as a result of COVID-19 and tested the controls for the assignment of risk ratings which are used to determine the staging of the loans. As part of walkthrough we gained an understanding of the rationale for the inputs into each scorecard file tested. We reviewed management's methodology for identifying loans with significant increases in credit risk in prior year and we have verified that the treatment is consistent and still appropriate for FY20. We tested the model scorecard ratings and a sample of internal risk ratings to ensure the inputs to the staging calculation were appropriate including assessment of the data on payment holidays, receivable aging, credit scores and known litigation or issues. We reperformed the staging assessment, to verify the accuracy of the staging formulas within the estimated credit loss model. We also reviewed the resilience exercise performed by management over the entire commercial portfolio to identify any increase in credit risk as a result of COVID-19 including treatment of customers which have taken payment holidays and tested the appropriateness and accuracy of overlays made on the risk rating of customers for a sample of commercial loans.	The controls within the process were tested and were found to be operating effectively. We conclude that exposures are correctly classified with Stage 2 and Stage 3 in line with staging criteria and that the management overlays applied to the credit staging are reasonable. We have concluded that the ECL PD, LGD and EAD models are appropriate. We concluded that although the range of economic scenarios used by management is narrower than other companies, the economic assumptions used in the IFRS 9 ECL model and the weightings applied to the economic scenarios are reasonable. For the sample of Stage 3 property loans collateral selected for testing, the valuation of the collateral was determined to be within an acceptable range. Overall, we conclude that IFRS 9 ECL provision is within a reasonable range.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

3. Inappropriate economic assumptions applied (including weighting of multiple economic scenarios) in modelled IFRS 9 credit impairment provision. We regard that assumptions set by management represent an area of increased opportunity for management override, due to the judgement involved in the estimation. In the current year, this will include additional uncertainty from COVID-19 and Brexit transitional arrangements. The economic assumptions and weighting of economic scenarios determined by management are key inputs to the IFRS 9 model and can significantly affect the final expected credit loss provision.	We evaluated management's assessment of the appropriateness of the model data for the Hodge portfolio. We involved our IFRS 9 Modelling Specialist team to test the model, which included benchmarking the ECL coverage against peers and back testing the model. We engaged our EY Economics specialists to assess the economic assumptions and scenario weightings set by management, including the impact of COVID-19. We performed benchmarking to those used by other market participants, including assessing the updates to scenario weightings as compared to prior year.	
4. The risk that inappropriate property/collateral valuations are applied in the calculation of the IFRS 9 Expected Credit Loss ('ECL') provision (Stage 3 credit impairment provision on loans and advances to customers): £4.8m (2019: £7.3m)). The assessment of the expected credit loss provision is inherently judgemental, with the valuation of the collateral a key input to the calculation of the provision. The increased uncertainty in property valuation as a result of COVID-19 presents an increased risk on the valuation of underlying properties/ collaterals used in the calculation of the IFRS 9 expected credit losses ('ECL') provision. The loan impairment is disclosed in note 14 and 28 respectively of the financial statements.	For a sample of Stage 3 loans we utilised our property valuation specialists to perform an independent valuation of the collateral used within the ECL provision calculation. The sample we tested in our audit covered £9.2m, 73% (2019: £20.8m, 97%) of the collateral value for the Stage 3 loans.	

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

The risk of incorrect valuation of derivatives: £82.0m (2019: £80.4m). The Company holds a significant number of derivative financial instruments, which it uses to manage interest rate risk. The valuation of these derivatives is determined through the application of valuation techniques which often involve the exercise of judgement and the use of assumptions and estimates. Due to the significance of the financial instruments and the related estimation uncertainty this is considered a key audit matter. The financial statement value is the counterparty valuation, which is assessed for reasonableness by management. The fair value of these derivative financial instruments is disclosed in note 22 of the financial statements.	Utilising our derivative valuation specialists, we independently valued a sample of derivative financial instruments. We compared our independent valuation to management's valuation and considered whether management's value was within an acceptable range. The sample selected covered £74.5m (2019: £70.9m) of the total population.	The valuation of the sample selected was determined to be within an acceptable range.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

An overview of the scope of our audit

Tailoring the scope
Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed.

Our application of materiality
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality
The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Company to be £2.4m (2019: £2.6m), which is 1.7% (2019: 1.6%) of equity. We believe equity to be the most appropriate basis as the key stakeholders (including the principal shareholder and the PRA) are focused on the financial strength and solvency position of the business, which is represented in the financial statements by equity.

During the course of our audit, we reassessed and confirmed that the final materiality was in line with initial materiality.

Performance materiality
The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2018: 75%) of our planning materiality, namely £1.8m (2019: £2.0m). We have set performance materiality at this percentage because our prior year audit experience indicates a lower risk of misstatements, both corrected and uncorrected.

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.1m (2019: £0.1m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information
The other information comprises the information included in the annual report, other than the financial statements and our Auditor's Report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements;

Matters on which we are required to report by exception
In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- Adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- The financial statements to be audited 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.

Responsibilities of directors
As explained more fully in the Directors' Responsibilities Statement set out on page 15, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for 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 the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
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 error, and to issue an Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant are the regulations, license conditions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').
- We understood how the Company is complying with those frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Executive Risk Committees held; and gained an understanding of the Company's approach to governance, demonstrated by the Board's approval of the Company's governance framework and the Board's review of the Company's Risk Management Framework ('RMF') and internal control processes.
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur by considering the entity level controls that the Company has established to address risks identified by the Company, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making enquiry of those charged with governance, senior management and internal audit for their awareness of any non-compliance of laws or regulations, inquiring about the policies that have been established to prevent non-compliance with laws and regulations by officers and employees, inquiring about the Company's methods of enforcing and monitoring compliance with such policies and inspecting significant correspondence with the FCA and PRA.
- The Company operates in the banking industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.
- A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our Auditor's Report.

Other matters we are required to address

- We were appointed by the Company on 22 April 2016 to audit the financial statements for the year ending 31 October 2016 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 5 years, covering the years ending 31 October 2016 to 30 September 2020.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Independent Auditor's Report to the Member of Julian Hodge Bank Limited (continued)

Use of our report

This report is made solely to the Company's member, 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.

Ernst & Young LLP

Andy Blackmore (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Bristol
11 December 2020

Notes:
1. The maintenance and integrity of the Company's web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income Statement
For the 11-month period ended 30 September 2020

	Notes	11-months ended 30 September	Year ended 31 October
		2020	2019
		£m	£m
Interest receivable and similar income	4	38.4	48.3
Interest payable and similar charges	5	(22.8)	(28.1)
Net interest income		**15.6**	**20.2**
Fees and commissions receivable		1.8	0.7
Fees and commissions payable		-	(0.1)
Net fee and commission income		**1.8**	**0.6**
Investment income		3.5	7.2
Net operating income		**20.9**	**28.0**
Administrative expenses	6	(22.3)	(16.4)
Depreciation and amortisation		(1.8)	(1.2)
Impairment losses on loans and advances to customers	14	(5.4)	(3.9)
Operating (loss)/ profit		**(8.6)**	**6.5**
Gains arising from the derecognition of financial assets managed at amortised cost	10/11	4.2	3.1
Other fair value losses	7	(16.7)	(12.8)
Loss on disposal of loans and advances to customers held at fair value		-	(4.6)
Loss before taxation	**8**	**(21.1)**	**(7.8)**
Tax credit on profit	9	5.2	2.1
Loss for the financial period		**(15.9)**	**(5.7)**

Statement of Other Comprehensive Income
For the 11-month period ended 30 September 2020

	Notes	11-months ended 30 September	Year ended 31 October
		£m	£m
Loss for the financial period		**(15.9)**	**(5.7)**
Re-measurement of defined benefit pension plan	24	(4.4)	(3.3)
Deferred tax thereon	18	0.7	0.6
Movement of pension scheme reimbursement asset	19	0.4	0.5
Deferred tax thereon	18	(0.1)	(0.1)
Total other comprehensive income		**(3.4)**	**(2.3)**
Total comprehensive income for the year		**(19.3)**	**(8.0)**

The results for the 11-month period ended 30 September 2020 relate entirely to continuing operations.

The notes on pages 30 to 79 form part of these financial statements of the Bank.

Balance Sheet

As at 30 September 2020

	Notes	30 September 2020 £m	31 October 2019 £m
Assets			
Cash and balances held at central banks		147.9	321.9
Government bonds	10	48.6	25.1
Debt securities	11	50.7	57.0
Loans and advances to credit institutions	12	105.2	86.1
Loans and advances to customers	13	930.8	766.9
Intangible assets	15	7.3	5.8
Property, plant & equipment	16	1.9	1.9
Investment properties	17	97.4	97.3
Deferred tax assets	18	9.5	6.6
Other assets	19	9.9	10.1
Total assets		**1,409.2**	**1,378.7**

	Notes	30 September 2020 £m	31 October 2019 £m
Liabilities			
Deposit from banks	20	87.5	72.5
Deposits from customers	21	1,071.4	1,042.8
Derivative financial instruments	22	82.0	80.4
Other liabilities	23	6.3	6.1
Pension liabilities	24	21.0	16.6
Total liabilities		**1,268.2**	**1,218.4**
Share capital and reserves			
Share capital	25	105.0	105.0
Other reserves		36.0	55.3
Total equity		**141.0**	**160.3**
Total equity and liabilities		**1,409.2**	**1,378.7**

These financial statements of the Bank were approved by the Board of directors on 11 December 2020 and were signed on its behalf by:

David Landen
Director

Statement of Changes in Equity
For the 11-month period ended 30 September 2020

	Called up share capital	Retained earnings	Pension reserve	Total
	£m	£m	£m	£m
2020				
At beginning of period	105.0	66.7	(11.4)	160.3
Loss for the financial year	-	(16.3)	0.4	(15.9)
Other comprehensive income	-	-	(3.4)	(3.4)
At end of financial period	**105.0**	**50.4**	**(14.4)**	**141.0**

	Called up share capital	Retained earnings	Pension reserve	Total
	£m	£m	£m	£m
2019				
At beginning of year	105.0	72.0	(8.7)	168.3
Loss for the financial year	-	(5.3)	(0.4)	(5.7)
Other comprehensive income	-	-	(2.3)	(2.3)
At end of year	**105.0**	**66.7**	**(11.4)**	**160.3**

Notes to the Financial Statements

1 Accounting policies

Basis of preparation
The financial statements of the Bank are prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ("FRS 101").

The Bank is a privately-owned company incorporated and registered in England and Wales.

In preparing these financial statements, the Bank applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ("adopted IFRSs"), but makes amendments where necessary in order to comply with Companies Act 2006, applicable to companies reporting under IFRS (Schedule 2 of The Large and Medium-sized Companies and Banks (Accounts and Reports) Regulations 2008) and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

The immediate parent undertaking of the Bank is Hodge Limited. The parent undertaking of the smallest group of undertakings for which group accounts are drawn up and of which the Bank is a member is Hodge Limited. The ultimate parent undertaking and controller is The Carlyle Trust (Jersey) Limited (incorporated in Jersey). Within the meaning of the Companies Act 2006, The Carlyle Trust Limited is the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Bank is a member. The accounts of Hodge Limited and The Carlyle Trust Limited can be obtained from: The Registrar of Companies, Companies House, Crown Way, Cardiff, CF14 3UZ.

In these financial statements, the Bank has applied the exemptions available under FRS 101 in respect of the following disclosures:
- A Cash Flow Statement and related notes;
- Reconciliation between carrying amounts of investment properties at the beginning and at the end of the period;
- Disclosures in respect of transactions with members of a group;
- Disclosures in respect of the compensation of key management personnel and related parties.

The Bank proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

The financial statements have been prepared on a going concern basis. The Board has considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance, including consideration of projections incorporating the impact of the COVID-19 pandemic or an adverse Brexit outcome on the Bank's capital and funding position. As part of this assessment the Board considered:
- The impact on Bank's profits from an expected reduction in income from residential and commercial lending combined with increased credit impairment charges;
- The sufficiency of the Bank's capital base, which is expected to be sufficient to weather even a severe COVID-19 or Brexit related downturn; and,
- The adequacy of the Bank's liquidity.

The Bank's forecasts and projections include scenario testing undertaken in accordance with the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment Process (ILAAP), which are required by the Prudential Regulation Authority to demonstrate appropriate levels of capital and liquidity respectively under stressed conditions.

The directors confirm that they are satisfied that the Company will continue in business for a period of at least 12 months from the date of signing the financial statements. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

1 Accounting policies (continued)

Standards and interpretations effective for the Company in these financial statements:
The Company has considered a number of amendments to published International Financial Reporting Standards and interpretations effective for the 11-month period ended 30 September 2020. They are either not relevant to the Bank or do not have a significant impact on the Bank's financial statements.

Standards and interpretations effective for the Company in future periods:
None of the standards issued by the IASB but not yet effective, are expected to have a material impact on the Bank's financial statements in future periods.

Summary of Significant Accounting Policies

Measurement convention
The Bank prepares its accounts under the historical cost convention, except for certain financial assets and liabilities held at fair value.

Interest receivable and interest payable
Interest income and expense are recognised in the Income Statement for all instruments measured at amortised cost using the effective interest rate method. The Bank estimates future cash flows considering all contractual terms of the financial instrument. 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. The net incremental transactional income/costs are amortised over the period to the contractual maturity date for commercial loans and to the end of the minimum term for residential and buy-to-let portfolios. An allowance is made for prepayments for the residential portfolios, but no adjustment is made for the commercial and portfolio buy-to-let portfolios.

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any loss allowance. For credit-impaired financial assets i.e. Stage 3, a credit-adjusted effective interest rate is calculated using estimated future cash flows including loss allowance. The Bank does not currently hold any purchased or originated credit-impaired financial assets.

If the status of the asset subsequently recovers, the amount by which the provision has increased due to suspended interest is recognised as a reversal of impairment loss allowance rather than interest income. The reversal of impairment loss allowance will not be recognised until the reversal of the impairment is fulfilled.

Revenue Recognition
Investment income
Investment income consists of realised gains on financial assets and liabilities held at fair value through profit and loss ('FVTPL').

Realised gains and losses on financial assets and liabilities held at fair value represent the difference between the proceeds received, net of transaction costs, and the original cost.

Fees and commissions
Fee and commission income primarily relate to fees for originating and servicing mortgages on behalf of third-parties. Fee income is recognised when performance obligations attached to the fee or commission have been satisfied.

1 Accounting policies (continued)

Financial instruments

Recognition
Financial assets and liabilities are recognised when the Bank becomes a party to the contractual provisions of the instrument. Purchases and sales of financial assets are recognised on the date in which they are settled.

Financial assets
The Bank has classified its financial assets as follows:

- Amortised cost: Cash and balances held with central bank, Residential, Portfolio buy-to-let and Commercial loans, Loans and advances to credit institutions, Government bonds, Debt securities and Other assets. These assets are held within a business model whose objective is to hold assets to collect contractual cash flows and the contractual terms of the loans are solely payments of principal and interest on the principal amount outstanding.
- FVTPL: Lifetime mortgages including Retirement and Equity release mortgages are classified as FVTPL due to the existence of an embedded derivative in the form of a 'No negative equity guarantee' ('NNEG') which forms part of the terms and conditions applicable to these products. To classify financial assets the Bank performs two assessments to evaluate the business model in which financial assets are managed and their cash flow characteristics.

The 'business model assessment' is performed at a portfolio level and determines whether the Bank's objective is to generate cash flows from collecting contractual cash flows, or by both collecting contractual cash flows and selling financial assets.

The assessment of cash flow characteristics determines whether the contractual cash flows of the financial asset are solely payments of principal and interest on the principal amount outstanding ('SPPI'). The SPPI test is performed at an instrument level based on the contractual terms of the instrument at initial recognition. For the purposes of the SPPI test, principal is defined as the fair value of the financial asset at initial recognition. Interest is defined as consideration for the time value of money and credit risk associated with the principal amount outstanding and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a reasonable profit margin.

A financial asset is classified as measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- It is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- Its contractual terms give rise on specified dates to cash flows that are SPPI.

The Bank does not hold any financial instruments that are classified and measured at fair value through other comprehensive income, accordingly all financial assets not classified as measured at amortised cost are classified as FVTPL.

On initial recognition, the Bank may irrevocably designate a financial asset as FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial liabilities
The Bank has classified its financial liabilities as follows:

- Amortised cost: Deposits from customers and Other liabilities.
- FVTPL: Derivatives.

1 Accounting policies (continued)

De-recognition of financial assets and financial liabilities

(i) Financial assets
Financial assets are de-recognised when:

- The rights to receive cash flows from the asset have expired;
- The Bank has transferred its rights to receive cash flows or has assumed an obligation to pay the received cash flows in full without material delay; and either
- The Bank has transferred substantially all the risks and rewards of the asset; or
- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset but has transferred control of the asset.

Where an existing financial asset is replaced by another to the same customer on substantially different terms, or the terms of an existing facility are substantially modified, such an exchange or modification is treated as a de-recognition of the original asset and the recognition of a new asset.

(ii) Financial liabilities
Financial liabilities are de-recognised when the obligation is discharged, cancelled or has expired.

Fair value of financial instruments
On initial recognition, the best evidence of the fair value of a financial instrument is normally 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, the Bank accounts for such differences as follows:

- If fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in the Income Statement on initial recognition (i.e. day 1 profit or loss);
- In all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability). Subsequently, the deferred gain or loss will be released to 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.

The Bank uses a fair value hierarchy that categorises financial instruments into three different levels as detailed in note 27. Levels are reviewed at each reporting date and this determines whether transfers between levels are required.

Equity release and retirement mortgages
On initial recognition, the fair value of equity release and retirement mortgages is calculated by discounting the future expected cash flows at swap rates together with an allowance for illiquidity. The illiquidity spread is informed by examining the pricing of new originations amongst other market participants, creating a market consistent discount rate for the asset.

For equity release mortgages, if the difference between the fair value at transaction date and the transaction price is a gain, it is not recognised but deferred. This difference will be a short lived effect and is deferred over one year and recognised uniformly over this period into the Income Statement. If the difference between the fair value and the transaction price is a loss upon initial recognition, it is expensed to the Income Statement.

On subsequent measurement, the value of lifetime mortgages is calculated by projecting the cash flows expected to be generated by the portfolio on redemption, allowing for credit losses caused by the no-negative equity guarantee using a variant of the Black Scholes option pricing method. These cash flows are then discounted at the swap yield plus a margin to reflect the illiquidity of lifetime mortgage assets, as described above. An allowance for possible early redemption of the lifetime mortgages has been determined by reference to historic rates of lapse within the portfolio.

1 Accounting policies (continued)

Embedded derivatives
The NNEG is an embedded derivative. The Company does not separate the NNEG embedded derivative from the host instrument. The fair value of lifetime mortgages takes into account an explicit provision in respect of the NNEG. Further details are disclosed in note 27(d).

Measurement of Expected Credit Loss (ECL)
Impairment of financial assets is calculated using a forward looking ECL model. The Bank records an allowance for ECLs ('loss allowance') for all financial assets not held at FVTPL.

Measurement of ECLs depends on the 'stage' of the financial asset, based on changes in credit risk occurring since initial recognition, as described below:

- Stage 1: when a financial asset is first recognised it is assigned to Stage 1 and a 12-month ECL is recognised. If there is no significant increase in credit risk from initial recognition the financial asset remains in Stage 1.
- Stage 2: if there is a significant increase in credit risk from initial recognition a financial asset it is moved to Stage 2 and a lifetime ECL is recognised.
- Stage 3: when there is objective evidence of impairment and the financial asset is considered to be in default, it is moved to Stage 3 and a lifetime ECL is recognised.

A 12-month ECL is defined as the portion of lifetime ECL that will result if a default occurs in the 12-months after the reporting date, weighted by the probability of that default occurring.

A lifetime ECL is defined as ECLs that result from all possible default events over the expected behavioural life of a financial instrument.

For loan commitments, where the loan commitment relates to the undrawn component of a facility, it is assigned to the same stage as the drawn component of the facility. For pipeline loans, the loan commitment is assigned to Stage 1.

If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an assessment is made to consider whether there has been a significant increase in the credit risk of the financial instrument.

Significant increase in credit risk
The Bank applies a series of quantitative, qualitative and backstop criteria to determine if there has been a significant increase in credit risk:

- Quantitative criteria: this is based on a doubling of the probability of default plus 45bps since origination for the commercial and portfolio buy-to-Let exposures and a deterioration in a customer's credit score of greater than or equal to 160 points for residential mortgages.
- Qualitative criteria: this includes the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms.
- Backstop criteria: IFRS 9 includes a backstop that 30-days past due is an indicator of a significant increase in credit risk. The Bank considers 30-days past due to be an appropriate backstop measure and does not rebut this presumption. The granting of a short-term payment holiday of up to 60-days during the Covid-19 outbreak does not by itself represent a significant increase in credit risk.

Definition of default and credit-impaired assets
The Bank's definition of default is fully aligned with the definition of credit-impaired. The Bank applies both a qualitative and quantitative criterion to determine if an account meets the definition of default. These criteria include:

- When the borrower is more than 90-days past due; and
- Qualitative factors to comply with the internal rating systems risk grading approach adopted by the Bank.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

1 Accounting policies (continued)

Presentation of loss allowances in the Balance Sheet
Loss allowances for financial assets measured at amortised cost are presented as a deduction from the gross carrying amount of the financial asset.

Write-offs
Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery.

Hedge accounting
The Bank has elected to continue to apply the hedge accounting requirements of IAS 39. All derivatives entered into by the Bank are for the purposes of providing an economic hedge. Where the criteria set out in IAS 39 are met, the Bank uses hedge accounting and designates the hedging derivative as hedging fair value risks.

At inception of the hedge relationship, the Bank formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the risk management objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship at inception and on an ongoing basis.

At each hedge effectiveness assessment date, a hedge relationship must be expected to be highly effective on a prospective basis and demonstrate that it was effective (retrospective effectiveness) for the designated period in order to qualify for hedge accounting. A formal assessment is undertaken by comparing the hedging instrument's effectiveness in offsetting the changes in fair value or cash flows attributable to the hedged risk in the hedged item, both at inception and at each quarter end on an ongoing basis. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated were offset by the hedging instrument in a range of 80% to 125% and were expected to achieve such offset in future periods.

Hedge ineffectiveness is recognised in the Income Statement in other fair value gains and losses. For situations where the hedged item is a forecast transaction, the Bank also assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the Income Statement.

Derivatives are introduced into the portfolio at inception and therefore this prevents a large gain or loss on the hedged item as the derivative is introduced into the fair value macro hedge portfolio. Any gain or loss is amortised over the period to the date of maturity of the derivative. If a derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying hedged item is sold or repaid, the unamortised fair value adjustment is recognised in the Income Statement.

1 Accounting policies (continued)

Intangible assets
Where software costs are capitalised, they are amortised using the straight-line method over their estimated useful lives which is three to five years. The amortisation periods used are reviewed annually. Costs associated with maintaining software are expensed as they are incurred. Amortisation is charged to its own line in the Income Statement.

Intangible assets have finite lives and are assessed for indicators of impairment at each Balance Sheet date.

An intangible asset is impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated recoverable value of the asset has been reduced. The recoverable amount of the intangible assets is deemed to be its value in use. If there is objective evidence of impairment, an impairment loss is recognised in the Income Statement.

Property, plant and equipment
Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is provided on a straight-line basis over the anticipated useful lives as follows:
- *Fixtures, fittings and equipment* *3-10 years*

Investment properties – reversionary interests in properties
Reversionary interests in properties are included in the financial statements initially at cost and subsequently at fair value, with any change therein recognised in the Income Statement within other fair value gains and losses on investments.

The current market value of the underlying property is taken as the last formal valuation of the property on a vacant possession basis, modified by the change in the quarterly Nationwide Regional House Price Index, adjusted down by an annual underperformance assumption.

A further deduction is made from the value to reflect the expected sale expenses and a delay factor between death and sale of the property.

Investment properties are derecognised either when they have been disposed of, or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on derecognition are recognised in the Income Statement in the year of disposal within investment income.

Government Grants
The Bank received a grant in the form of the Coronavirus Job Retention Scheme during the year. The income associated with this grant has been netted against the related expense within administrative expenses.

1 Accounting policies (continued)

Taxation including deferred tax
Corporation tax on profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the Balance Sheet date. Where group relief is received or surrendered from or to a group company, the corresponding liability or asset is settled in full.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements of the Bank. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised, or liability settled based on the tax rates and laws enacted or substantively enacted at the Balance Sheet date.

Corporation tax is charged directly to the Income Statement.

Employee benefits
i) Pensions
The Bank operates a defined benefit pension scheme for members of staff. The Bank and a fellow subsidiary of Hodge Limited participates in The Carlyle (1972) Pension and Life Assurance Scheme, a defined benefits scheme operated by The Carlyle Trust Limited. The assets of the scheme are held separately from those of the Bank.

The Bank's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in the current and prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds using the projected unit method. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or liability respectively in the Bank's accounts at the Balance Sheet date.

ii) Reimbursement asset on pension deficit
The Bank has recognised a reimbursement asset in respect of its pension scheme deficit which relates to retired employees that were contracted to the Bank's ultimate parent, The Carlyle Trust Limited (note 24). The movement in the reimbursement asset each year is recognised in the Income Statement to the extent that the reimbursement relates to a charge or a gain in the Bank's Income Statement. The calculation of the reimbursement asset is based on the split of scheme members by employer.

2 Judgement in applying accounting policies and critical accounting estimates

The Bank has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements of the Bank. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgement and estimates are made are as follows:

Judgements

Fair values of financial instruments

The Bank uses widely recognised valuation models for determining the fair value of common and simple financial instruments, such as interest rate swaps that use only observable market data. Further analysis can be found in note 27.

The availability of observable market prices and model inputs reduces the need for management judgement 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.

Where observable market data is unavailable, unobservable inputs are used in the actuarial valuation models to value equity release and retirement mortgages held at FVTPL. The key judgements and assumptions used, and the related sensitivities are outlined in note 27.

Estimates and assumptions

Impairment losses on loans and advances to customers

IFRS 9 has a single impairment model that applies to all financial instruments in its scope. Under this model, an entity must recognise either a 12-month or lifetime expected credit loss. ECLs are the present value of all cash shortfalls over the expected life of the financial instrument. The key assumptions used, and the related sensitives, are outlined in note 28.

Value of reversionary investment properties

There is significant judgement applied in setting the assumptions used in calculating the fair value of reversionary interests in property. Further information on the following assumptions is provided in note 17.

- Property prices
- Mortality or entry into long term care
- Expense assumption
- Discount rate.

Pension scheme assumptions

Estimation uncertainty surrounds the measurement of the pension scheme liabilities. The assumptions used as part of the valuation include the rate of salary increase, the discount rate applied to scheme liabilities and inflation. The key assumptions used are disclosed in note 24.

Value of equity release and retirement mortgages including the value of the NNEG

There is significant judgement applied in setting the assumptions used in calculating the fair value of lifetime mortgages and the liability arising from the no-negative equity guarantee. Further information on the following assumptions is provided in note 27(d).

- Mortality or entry into long term care
- Lapses
- Expense assumption
- Discount rate
- Property prices.

Change in accounting estimates

There is significant judgement in the methodologies and assumptions applied in estimating the fair value of lifetime mortgages and reversions. The methodologies and assumptions contain unobservable inputs resulting in the fair value being classified as a Level 3 estimate within the IFRS 13 fair value hierarchy. Changes have been made during the period to the methodology used to discount the anticipated cash flows associated with the reversion and lifetime mortgage portfolios. The change in methodology results in a valuation approach that is more consistent with the approach used by many other financial institutions that hold these types of assets. The impact of these changes is disclosed within note 27 and are recognised prospectively as a change in accounting estimate.

3 Segmental information

The Board is the Bank's chief operating decision-maker (CODM). Management has determined the operating segments based on information reviewed by the Board for the purposes of allocating resources and assessing performance.

11-month period ended 30 September 2020	Commercial	Residential	Portfolio Buy-to-Let	Other	Total
	£m	£m	£m	£m	£m
Interest receivable and similar income	15.7	18.0	1.8	2.9	38.4
Interest payable and similar charges	(6.1)	(14.9)	(1.0)	(0.8)	(22.8)
Fees and commissions receivable	0.3	1.3	-	0.2	1.8
Fees and commissions payable	-	-	-	-	-
Investment income	-	3.5	-	-	3.5
Administrative expenses	(5.4)	(11.6)	(1.2)	(4.1)	(22.3)
Depreciation and amortisation	-	(0.6)	-	(1.2)	(1.8)
Impairment losses on loans and advances to customers	(5.4)	0.1	(0.1)	-	(5.4)
Operating (loss)	**(0.9)**	**(4.2)**	**(0.5)**	**(3.0)**	**(8.6)**

Year ended 31 October 2019	Commercial	Residential	Portfolio Buy-to-Let	Other	Total
	£m	£m	£m	£m	£m
Interest receivable and similar income	19.7	22.4	0.1	6.1	48.3
Interest payable and similar charges	(8.0)	(19.5)	(0.1)	(0.5)	(28.1)
Fees and commissions receivable	-	-	-	0.7	0.7
Fees and commissions payable	-	(0.1)	-	-	(0.1)
Investment income	-	7.5	-	(0.3)	7.2
Administrative expenses	(4.6)	(8.0)	(0.2)	(3.6)	(16.4)
Depreciation and amortisation	(0.2)	(0.2)	-	(0.8)	(1.2)
Impairment losses on loans and advances to customers	(3.5)	(0.1)	(0.3)	-	(3.9)
Operating profit	**3.4**	**2.0**	**(0.5)**	**1.6**	**6.5**

Total assets by business segments	2020	2019
	£m	£m
Commercial	290.5	315.2
Residential	671.2	524.4
Portfolio Buy-to-Let	63.1	20.9
Other	384.4	518.2
	1,409.2	**1,378.7**

4 Interest receivable and similar income

	11-months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Interest income calculated using EIR method		
Loans and advances to customers	36.1	42.4
Loans and advances to credit institutions	1.0	2.2
Interest on government bonds & debt securities	1.3	3.7
	38.4	**48.3**

5 Interest payable and similar charges

	11-months ended 30 September 2020 £m	Year ended 31 October 2019 £m
On customer accounts	14.5	16.0
On defined benefit pension scheme	0.3	0.4
On term funding scheme	0.2	0.5
On derivative financial instruments	7.8	11.2
	22.8	**28.1**

6 Administrative expenses

	11-months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Staff costs		
Wages and salaries	10.6	8.0
Social security	1.2	1.0
Pension costs (note 24)	3.0	1.8
	14.8	**10.8**
Other administrative expenses	7.5	5.6
	22.3	**16.4**

During the year the Bank received £0.3m from the Coronavirus Job Retention Scheme. The grant income has been netted against the staff costs disclosed above.

Directors and employees

The average number of employees of the Bank during the period was as follows:

	11-months ended 30 September 2020	Year ended 31 October 2019
Provision of finance and banking	277	169
	277	**169**

6 Administrative expenses (continued)

Staff costs include remuneration in respect of directors as follows:

	11-months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Fees	0.3	0.3
Aggregate emoluments as executives	0.4	0.5
	0.7	**0.8**

The emoluments of the highest paid director, excluding pension contributions, were as follows:

	11-months ended 30 September 2020 £000	Year ended 31 October 2019 £000
Aggregate emoluments	189	228
	189	**228**

The pension accrued for the highest paid director was £36,817 *(2019: £24,186)*.
Retirement benefits are accruing to three *(2019: one)* directors in the defined benefit scheme.

7 Other fair value losses

	11-months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Movement in fair value of derivatives (note 22)	(4.6)	(27.9)
Movement in fair value of equity release and retirement mortgages	(9.6)	14.7
Reversal of unrealised gains on disposal of investment properties	(2.9)	(5.9)
Movement in fair value of investment properties (note 17)	4.6	6.8
Movement in fair value of government bonds (note 10)	-	(0.7)
Movement in fair value of hedged items attributable to hedged risk	(4.2)	0.2
	(16.7)	**(12.8)**

8 Loss on ordinary activities before taxation

	11-months ended 30 September 2020 £000	Year ended 31 October 2019 £000
Loss on ordinary activities before taxation is stated after charging:		
Remuneration of the auditor and its associates		
Audit of these financial statements of the Bank	177	121
Audit of pension scheme	11	11
Impairment provision expense (note 14)	5,435	3,861
Amortisation (note 15)	1,308	801
Depreciation (note 16)	452	491

9 Tax on profit

	11-months ended 30 September 2020		Year ended 31 October 2019	
	£m	£m	£m	£m
Analysis of charge in the financial period				
UK corporation tax				
Current tax on income for the year	(2.4)		(2.5)	
Prior period adjustment	(0.5)		(0.8)	
Total current tax		**(2.9)**		**(3.3)**
Deferred tax				
Origination/reversal of timing differences:				
Current period	(1.6)		0.8	
Prior period adjustment	0.1		0.4	
Effect of tax rate change on opening balance	(0.8)		-	
Total deferred tax (note 18)		**(2.3)**		**1.2**
Tax on profit on ordinary activities		**(5.2)**		**(2.1)**

The total tax charge for the period is lower than *(2019: lower than)* the blended rate of corporation tax in the UK. The differences are explained below.

	11-months ended 30 September 2020	Year ended 31 October 2019
	£m	£m
Total tax reconciliation		
Loss on ordinary activities before tax	(21.1)	(7.8)
Current tax at 19.00% (2019: 19.00%)	**(4.0)**	**(1.5)**
Index linked gilt RPI movement	-	(0.2)
Rate differences	(0.8)	-
Adjustments in respect of previous years	(0.4)	(0.4)
Total tax credit (see above)	**(5.2)**	**(2.1)**

In the current period the substantively enacted tax rate applicable from 1 April 2020 was increased from 17% to 19%. The closing deferred tax assets and liabilities have been calculated at 19% and accordingly a rate change adjustment has arisen as the opening deferred tax had been calculated taking into account the previously enacted rate of 17%.

10 Government bonds

	11-months ended 30 September	Year ended 31 October
	2020	2019
	£m	£m
Government bonds – at amortised cost	48.6	21.9
Fair value adjustment – hedge accounting	-	3.2
	48.6	**25.1**

The movement in government bonds is summarised as follows:

	11-months ended 30 September	Year ended 31 October
	2020	2019
	£m	£m
At start of period	25.1	81.0
Additions	74.2	5.5
Redemptions and interest received	(39.8)	(8.0)
Disposals due to restructuring exercise	(7.6)	(53.5)
(Loss)/gain from hedge accounting – Income Statement	(3.3)	0.8
Loss from changes in fair value – Income Statement	-	(0.7)
At end of financial period	**48.6**	**25.1**

Of this amount, £12.0m (2019: £10.7m) has been pledged as collateral under the Term Funding Scheme ('TFS') and £2.6m (2019: £2.6m) under repurchase agreements. Collateral pledged is restricted.

During the year, the Bank performed a one-off restructuring exercise as part of its transition away from LIBOR which resulted in the disposal of government bonds held at amortised cost. The carrying value at the date of disposal amounted to £7.6m, the proceeds received amounted to £11.1m, resulting in a profit on disposal of £3.5m. The government bonds disposed formed part of the macro-hedge relationship, a loss of £3.3m was realised in the Income Statement reflecting the hedge adjustment attributable to the disposed assets. The Bank holds the government bonds for liquidity purposes and intends to hold the remaining portfolio to maturity. The disposal is viewed as a one-off restructuring exercise and therefore the business model assessment for the remaining assets remains unchanged.

11 Debt securities

	2020 £m	2019 £m
Debt securities – at amortised cost	50.7	56.4
Fair value adjustment – hedge accounting	-	0.6
	50.7	**57.0**

The movement in debt securities is summarised as follows:

	2020 £m	2019 £m
At start of period	57.0	84.4
Additions	5.5	10.9
Redemptions and interest received	(5.8)	(10.1)
Disposals due to restructuring exercise	(5.4)	(28.1)
Loss from hedge accounting - Income Statement	(0.6)	(0.1)
At end of financial period	**50.7**	**57.0**

Of this amount £32.8m (2019: £37.7m) has been pledged as collateral under the TFS. Collateral pledged is restricted.

During the year, the Bank performed a one-off restructuring exercise as part of its transition away from LIBOR which resulted in the disposal of debt securities held at amortised cost. The carrying value at the date of disposal amounted to £5.4m, the proceeds received amounted to £6.1m, resulting in a profit on disposal of £0.7m. The debt securities disposed formed part of the macro-hedge relationship, a loss of £0.6m was realised in the Income Statement reflecting the hedge adjustment attributable to the disposed assets. The Bank holds the debt securities for liquidity purposes and intends to hold the remaining portfolio to maturity. The disposal is viewed as a one-off restructuring exercise and therefore the business model assessment for the remaining assets remains unchanged.

12 Loans and advances to credit institutions

	2020 £m	2019 £m
Repayable on demand	19.1	6.7
Collateral held by swap counterparties	86.1	79.4
	105.2	**86.1**

The collateral is pledged against the market value of derivative instruments and comprises interest-bearing cash deposits (note 22). Collateral that has been pledged and held is not restricted and is returned at the end of the contract. There are no provisions held in respect of loans and advances to credit institutions (2019: £nil).

13 Loans and advances to customers

	2020 £m	2019 £m
Loans and advances – classified at amortised cost		
Commercial	290.5	315.2
Residential	347.0	178.8
Buy-to-Let	63.1	20.9
	700.6	**514.9**
Amounts owed from parent and fellow subsidiaries	3.1	3.3
Fair value adjustment for hedged risk	0.3	0.4
Loans and advances (equity release and retirement) – classified as FVTPL - see note 27	226.8	248.3
	930.8	**766.9**

Of this amount £68.6m (2019: £57.9m) has been pledged as collateral under the TFS. Collateral that has been pledged is restricted.

The amounts owed from parent is a loan due from The Carlyle Trust Limited and accrues a market rate of interest.

	2020 £m	2019 £m
Loans and advances to customers at amortised cost		
Gross balances	709.3	526.4
Less: Provision for impairment	(7.9)	(9.8)
Less: Loan fee deferral	(0.8)	(1.7)
Net balance	**700.6**	**514.9**

14 Impairment provisions on loans and advances to customers

IFRS 9	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m
2020				
At start of period	2.4	0.1	7.3	9.8
Utilised in the period	-	-	(7.3)	(7.3)
Income Statement				
Charge for loan impairment	(0.9)	1.5	4.8	5.4
At 30 September 2020	**1.5**	**1.6**	**4.8**	**7.9**

IFRS 9	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m
2019				
At start of period	2.0	0.3	3.6	5.9
Income Statement				
Charge for loan impairment	0.4	(0.2)	3.7	3.9
At 31 October 2019	**2.4**	**0.1**	**7.3**	**9.8**

The impact of modifications to contractual cash flows that has not resulted in derecognition is immaterial in the year.

For further details on loans and advances to customers refer to note 28.

15 Intangible assets

	Computer software	
	2020	2019
	£m	£m
Cost:		
At start of period	7.4	3.9
Disposals	(0.1)	-
Additions	2.8	3.5
At end of financial period	**10.1**	**7.4**
Amortisation:		
At start of period	(1.6)	(0.8)
Disposals	0.1	-
Amortisation	(1.3)	(0.8)
At end of financial period	**(2.8)**	**(1.6)**
Net book value:		
At end of financial period	**7.3**	**5.8**

£2.3m (2019: £1.3m) of expenditure relating to intangible projects was expensed during the year as it did not meet the development criteria of IAS 38 and has therefore been expensed as incurred.

16 Property, plant and equipment

	Fixtures, fittings and equipment	
	2020	2019
	£m	£m
Cost:		
At start of period	3.0	2.9
Additions	0.5	0.2
Disposals	-	(0.1)
At 30 September 2020	**3.5**	**3.0**
Depreciation:		
At start of period	(1.1)	(0.7)
Depreciation	(0.5)	(0.5)
Disposals	-	0.1
At 30 September 2020	**(1.6)**	**(1.1)**
Net book value:		
At 30 September 2020	**1.9**	**1.9**
At 31 October 2019	1.9	2.2

17 Investment properties

	Reversionary Interests £m
At start of period	97.3
Disposals	(4.5)
Fair value adjustments	4.6
At 30 September 2020	**97.4**

The historical cost of the reversionary interest in properties is £41.3m at 30 September 2020 (2019: £42.9m).

Reversionary interests are categorised as Level 3 in the fair value hierarchy. There were no transfers into or out of Level 3 in the year.

Reversionary interests - principal assumptions

All gains and losses arising from reversionary interests are largely dependent on the longevity of the tenant. Principal assumptions underlying the calculation of reversionary interests include the following:

Mortality or entry into long term care

This is based on the expected death or entry into long term care of the tenant or the last remaining tenant in relation to a joint contract. Mortality assumptions have been derived by reference to the PCMA00/PCFA00 mortality tables and include an allowance for mortality improvements.

Expenses

Assumptions for future policy expense levels are based on the Bank's recent expense analyses. Expenses are modelled as an amount per policy per annum that incorporates an annual inflation rate allowance of 4.09% (2019: 4.01%).

Discount rate

The discount rate applied to the reversion cash flows comprises two parts: a risk-free yield curve and an allowance for illiquidity. The risk-free yield curve is the GBP curve published by EIOPA. The average discount rate for the portfolio (assumed to be the 10-year point on the yield curve based on the average duration of our business) at 30 September 2020 was 2.27% (31 October 2019: 1.71%).

Property prices

The value of a property is based on the value at the last survey increased to the current valuation date using the Nationwide Regional House Price Index, this is then adjusted down by an annual underperformance assumption. No future property price inflation is assumed beyond the valuation date.

Sensitivity analysis

Changes to unobservable inputs used in the valuation technique could give rise to significant changes in the fair value of the assets. The Bank has estimated the net decrease in profit before tax for the period arising from changes to these inputs as follows:

	Reversionary Interests			
	Delay in mortality or entry into long term care - 10% £m	Discount rate +1% £m	Expenses +10% £m	Property prices -10% £m
At 30 September 2020	(1.1)	(2.1)	(0.2)	(8.7)
At 31 October 2019	(0.9)	(2.4)	(0.2)	(9.1)

The sensitivity factors are applied via actuarial models. The analysis has been prepared for a change in each variable with other assumptions remaining constant. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear and larger or smaller impacts cannot be interpolated or extrapolated from these results.

18 Deferred tax

	2020 £m	2019 £m
At start of period	6.6	7.3
Credit/(charge) to the Income Statement	2.3	(1.2)
Credit to the Statement of Other Comprehensive Income	0.6	0.5
At end of financial period	**9.5**	**6.6**

Deferred tax assets and liabilities are attributable to the following items:

	2020 £m	2019 £m
Accelerated capital allowances	(0.3)	(0.2)
Other timing differences	4.2	4.6
Timing differences on reimbursement asset	(0.6)	(0.5)
Defined benefit pension scheme	4.0	2.7
Tax losses	2.2	-
At end of financial period	**9.5**	**6.6**

19 Other assets

	2020 £m	2019 £m
Prepayments and accrued income	2.3	1.5
Pension reimbursement asset	3.3	2.9
Corporation tax debtor	1.2	2.4
Group relief debtor	2.9	3.0
Other assets	0.2	0.3
At end of financial period	**9.9**	**10.1**

20 Deposits from banks

	2020 £m	2019 £m
Repurchase agreement	2.5	2.5
Term Funding Scheme	85.0	70.0
	87.5	**72.5**

21 Deposits from customers

	2020 £m	2019 £m
Deposit from customers	1,066.6	1,036.1
Amounts owed to parent and fellow subsidiaries	4.4	5.9
Fair value adjustment for hedged risk	0.4	0.8
	1,071.4	**1,042.8**

The amounts owed to parent and fellow subsidiaries are deposit accounts which accrue a market rate of interest.

22 Derivative financial instruments

Interest rate swaps are used by the Bank for hedging purposes. These are commitments to exchange one set of cash flows for another. No exchange of principal takes place.

	Contract/notional amount		Fair value	
	2020	2019	2020	2019
	£m	£m	£m	£m
Derivative liabilities held for hedging purposes and designated fair value hedges:				
Interest rate swaps	264.8	308.2	81.9	78.8
RPI index linked interest rate swaps	-	55.0	-	(1.8)
Derivatives held in fair value hedges	152.7	293.7	0.1	3.4
Total recognised derivative liabilities	**417.5**	**656.9**	**82.0**	**80.4**

The following table describes the types of derivatives used, the related risks and the activities against which the derivative financial instruments are used to hedge.

Type of Hedge	Risk	Activity
Interest rate swap	Sensitivity to changes in interest rates	Fixed rate savings products, Fixed rate residential mortgages, Fixed rate debt securities, Fixed rate government bonds and Fixed rate commercial loans.

At 30 September 2020, the fixed interest rates vary from 0.2% to 5.4% (2019: 0.5% to 5.4%), the floating rates are both LIBOR and SONIA. Gains and losses recognised on interest rate swap contracts are credited to the Income Statement.

	2020	2019
	£m	£m
Movement in fair value of interest rate swaps	(4.6)	(27.9)
	(4.6)	**(27.9)**

The Bank agreed to exit a number of interest rate swaps during the year which were held at fair value of £0.7m (2019: £(51.8)m), £nil (2019: £nil) profit or loss was incurred on disposal.

In addition, the Bank agreed to exit a number of interest rate swaps held within the macro hedge accounting portfolio as part of its transition away from LIBOR. The fair value of these swaps at the date of disposal was £(3.9)m, £nil profit or loss was incurred on disposal.

The amounts relating to items designated as hedged items were as follows:

	2020		2019	
	Book Value £m	Hedged Fair Value £m	Book Value £m	Hedged Fair Value £m
Government bonds	48.6	-	21.9	3.2
Debt securities	50.7	-	56.4	0.6
Loans advances to customers	702.3	0.4	514.9	0.4
Deposits from customers	(1,066.6)	(0.4)	(1,036.1)	(0.8)
		-		**3.4**

At 30 September 2020, there was a hedge ineffectiveness of £nil (2019: £nil).

22 Derivative financial instruments (continued)

Offsetting
In accordance with IAS32 Financial Instruments; the Bank reports derivative financial instruments on a net basis as there is a legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. A table is provided below which demonstrates the amounts which have been offset in the Balance Sheet:

	Amounts subject to netting arrangements		
	Gross amounts	Amounts offset	Net amounts reported on Balance Sheet
	£m	£m	£m
2020			
Derivative financial assets	1.0	(1.0)	-
Impact on total assets	**1.0**	**(1.0)**	**-**
Derivative financial (liabilities)	(83.0)	1.0	(82.0)
Impact on total (liabilities)	**(83.0)**	**1.0**	**(82.0)**
2019			
Derivative financial assets	2.5	(2.5)	-
Impact on total assets	**2.5**	**(2.5)**	**-**
Derivative financial (liabilities)	(82.9)	2.5	(80.4)
Impact on total (liabilities)	**(82.9)**	**2.5**	**(80.4)**

The collateral pledged against the market value of derivative instruments comprises interest bearing cash deposits, which are included in loans and advances to credit institutions (note 12).

23 Other liabilities

	2020	2019
	£m	£m
Due within one year:		
Amounts owed in relation to mortgages administered for third parties	2.3	0.9
Other creditors	-	0.4
Other taxation and social security	0.1	-
Accruals	1.1	1.3
Amounts owed to fellow subsidiaries	2.8	3.5
	6.3	6.1

The amounts owed to fellow subsidiaries are repayable on demand and accrue no interest.

24 Pension scheme

The Carlyle Trust Limited group operates a defined benefit pension scheme for certain directors and employees, The Carlyle (1972) Pension and Life Assurance Scheme.

The assets of the scheme are administered by the Trustees and are held in a fund that is separate and independent of other group funds. The scheme was established with effect from 1972 and is fully approved under Chapter I Part XIV of the Income and Corporation Taxes Act 1988.

The scheme is subject to the funding legislation outlined in the Pensions Act 2004. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, sets out the framework for funding defined benefit occupational pension schemes in the UK.

The scheme typically exposes the Bank to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the Balance Sheet and may give rise to increased charges in future periods. The Bank has not changed its processes used to manage its risks from previous periods.

The weighted average duration of the defined pension obligation is 24 years (2019: 23 years).

Pension costs are assessed in accordance with the advice of a qualified, independent actuary using the projected unit method. The assumptions which have the most significant effect on the calculation are the long-term average investment return expected in future and the rate of future increases to benefits, both before and after retirement.

The benefit basis changed to a career average revalued earnings ("CARE") basis, from a final salary basis, with effect from 1 April 2005.

The calculations are based upon an assessment of the scheme's liabilities as at 30 September 2020. These have been based upon the results of the 1 April 2019 formal triennial valuation projected forward with allowance for benefit accrual and expected investment return. The next triennial valuation will be carried out on 1 April 2022.

The Bank's total expense for the year amounted to £3.4m (2019: £3.0m). Both the Bank's fellow subsidiary Hodge Life Assurance Company Limited and the Bank's parent company, The Carlyle Trust Limited, reimbursed the Bank £0.2m (2019: £0.6m) for their share of the employer contribution expense. The Bank has agreed that it will aim to eliminate the pension scheme deficit over the next 10 years and additional contributions of £0.9m (2019: £1.0m) were paid into the scheme in the 11-month period ended 30 September 2020. Funding levels are monitored on an annual basis and the Bank has agreed to increase the contribution rate to 23.3% from 1 April 2019.

The IAS 19 valuation as at 30 September 2020 has been produced by a qualified independent actuary and is based on the results of the valuation as at 1 April 2019.

24 Pension scheme (continued)

Scheme assets and liabilities

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

	2020	2019
	£m	£m
Fair value of plan assets	30.3	27.3
Present value of defined benefit obligations	(51.3)	(43.9)
Deficit	**(21.0)**	**(16.6)**

Movements in fair value of plan assets

	2020	2019
	£m	£m
Market value of assets at the beginning of the year	27.3	24.2
Interest income	0.5	0.7
Actuarial (loss)/ gain	(0.4)	0.6
Member contributions	0.4	0.3
Employer contributions	3.3	2.4
Benefits paid	(0.8)	(0.9)
Market value of assets at the end of the period	**30.3**	**27.3**

Movements in present value of defined benefit obligations

	2020	2019
	£m	£m
Present value of scheme liabilities at start of the period	43.9	37.0
Interest cost	0.8	1.1
Current service cost	3.0	1.8
Member contributions	0.4	0.3
Actuarial loss on defined benefit obligation of which:		
due to experience	-	(1.9)
due to demographic assumptions	0.9	0.4
due to financial assumptions	3.1	5.4
Benefits paid	(0.8)	(0.9)
Past service cost	-	0.7
Present value of scheme liabilities at end of the period	**51.3**	**43.9**

24 Pension scheme (continued)

Expense recognised in the Income Statement

	2020	2019
	£m	£m
Current service cost – staff costs	3.0	1.8
Net interest expense – other finance costs	0.3	0.4
Past service cost	-	0.7
Other admin costs	0.1	0.1
	3.4	**3.0**

The total amount recognised in the Statement of Other Comprehensive Income in respect of actuarial gains and losses is a loss of £4.4m (2019: loss of £3.3m) before tax.

Cumulative losses reported in the Statement of Other Comprehensive Income since the date of transition to FRS 101 are losses of £14.4m (2019: losses of £11.4m) after deferred tax.

Plan assets
The fair value of the plan assets and the return on those assets was as follows:

	Fair Value	
	2020	2019
	£m	£m
Quoted equity investments	5.5	4.4
Diversified growth funds	18.5	17.8
Private investments	2.4	2.5
Bonds	1.8	1.6
Cash	2.1	1.0
Total market value of assets	**30.3**	**27.3**

The actual return on assets was £0.1m (2019: £1.3m)

Future contributions
The Bank expects to contribute approximately £2.8m (2019: £3.9m) to its defined benefit plan in the next financial year.

24 Pension scheme (continued)

Major assumptions
The major assumptions underpinning the defined benefit obligation are:

	2020	2019
	%	%
Rate of increase in salaries	2.9	4.0
Rate of increase – RPI capped at 5.0% per annum	2.8	2.9
Rate of CARE revaluation	1.9	2.0
Discount rate applied to scheme liabilities	1.6	2.0
RPI inflation assumption	2.9	3.0

The assumptions relating to longevity underlying the pension liabilities at the Balance Sheet date are based on standard actuarial mortality tables and include an allowance for future improvements in longevity. The life expectancy of scheme members is as follows:

	2020	2019
Current pensioners age 65 – male	86.8	86.6
Current pensioners age 65 – female	89.1	88.9
Future pensioners age 65 (current age 45) - males	87.8	87.6
Future pensioners age 65 (current age 45) - females	90.2	90.0

Sensitivities
The Bank has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension scheme liability. The sensitivity of the defined pension obligation to changes in the weighted principal assumptions is:

Impact on present value of obligation:	Change in assumption	Change in deficit £m
Discount rate	0.1%	1.3
Rate of inflation (RPI or CPI)	0.1%	0.9
Life expectancy	1 year	1.7

The sensitivity analyses above have been determined based on a method that extrapolates the impact on the defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period. The sensitivity analyses are based on a change in a significant assumption, keeping all other assumptions constant. The sensitivity analyses may not be representative of an actual change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation of one another.

History of the scheme Balance Sheet position

	2020	2019	2018	2017	2016
	£m	£m	£m	£m	£m
Fair value of plan assets	30.3	27.3	24.2	24.2	25.7
Present value of funded defined benefit obligations	(51.3)	(43.9)	(37.0)	(37.2)	(39.2)
Deficit	**(21.0)**	**(16.6)**	**(12.8)**	**(13.0)**	**(13.5)**

24 Pension schemes (continued)

History of experience gains and losses

	2020	2019	2018	2017	2016
Difference between the expected and actual return on scheme assets:					
Amount	**£(0.4)m**	£0.6m	£(1.4)m	£0.1m	£0.5m
Percentage of year-end scheme assets	**1.3%**	2.2%	(5.6)%	0.0%	1.5%
Experience gains and losses on scheme liabilities:					
Amount	**£(0.0)**	£1.9m	£(0.0)m	£(0.0)m	£(0.4)m
Percentage of year-end present value of scheme liabilities	**0.0%**	(4.4)%	0.0%	0.0%	1.0%
Total amount recognised in statement of comprehensive income:					
Gain/(losses) before tax	**(4.4)m**	£(3.3)m	£0.6m	£0.4m	£(9.1)m
Percentage of year-end present value of scheme liabilities	**8.5%**	7.5%	1.6%	1.1%	23.0%

25 Called up share capital

	2020	2019
	£m	£m
Authorised, allotted, called-up and fully paid:		
105,000,000 ordinary shares of £1 each	105.0	105.0
	105.0	**105.0**

26 Financial commitments and contingent assets/liabilities

	2020	2019
	£m	£m
Loan Commitments		
Expiring in less than one year	37.3	26.0
Expiring in more than one year	19.4	45.1
	56.7	**71.1**

Capital commitments

The Bank had contracted capital commitments amounting to £nil at 30 September 2020 (2019: £nil).

27 Financial instruments

a) Categories of financial assets and liabilities

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost.

The accounting policies note describes how the classes of financial instruments are measured and how income and expenses including fair value gains and losses, are recognised. The following tables analyse the financial assets and liabilities in the Balance Sheet by the class of financial instrument to which they are assigned and by the measurement basis and include both non-financial assets and liabilities in order to reconcile the disclosures to Balance Sheet totals.

As at 30 September 2020	At amortised cost	FVTPL	Total
	£m	£m	£m
Assets			
Cash and balances held at central banks	147.9	-	147.9
Government bonds	48.6	-	48.6
Debt securities	50.7	-	50.7
Loans and advances to credit institutions	105.2	-	105.2
Loans and advances to customers	704.0	226.8	930.8
Other assets	9.9	-	9.9
Total financial assets	**1066.3**	**226.8**	**1,293.1**
Total non-financial assets			116.1
Total assets			**1,409.2**
Liabilities			
Deposit from banks	87.5	-	87.5
Deposit from customers	1,071.4	-	1,071.4
Derivative financial instruments	-	82.0	82.0
Other liabilities	6.3	-	6.3
Total financial liabilities	**1,165.2**	**82.0**	**1,247.2**
Total non-financial liabilities			21.0
Share capital and other reserves			141.0
Total reserves and liabilities			**1,409.2**

27 Financial instruments (continued)

a) Categories of financial assets and liabilities (continued)

As at 31 October 2019	At amortised cost	FVTPL	Total
	£m	£m	£m
Assets			
Cash and balances held at central banks	321.9	-	321.9
Government bonds	25.1	-	25.1
Debt securities	57.0	-	57.0
Loans and advances to credit institutions	86.1	-	86.1
Loans and advances to customers	518.6	248.3	766.9
Other assets	10.1	-	10.1
Total financial assets	**1,018.8**	**248.3**	**1,267.1**
Total non-financial assets			111.6
Total assets			**1,378.7**
Liabilities			
Deposit from banks	72.5	-	72.5
Deposit from customers	1,042.8	-	1,042.8
Derivative financial instruments	-	80.4	80.4
Other liabilities	6.1	-	6.1
Total financial liabilities	**1,121.4**	**80.4**	**1,201.8**
Total non-financial liabilities			16.6
Share capital and other reserves			160.3
Total reserves and liabilities			**1,378.7**

b) Fair value estimation

The table below summarises the fair value of the Bank's financial assets and liabilities. The different levels have been defined as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Valuation techniques for which all significant inputs are based on observable market data.
- Level 3: Valuation techniques for which significant inputs are not based on observable market data.

27 Financial instruments (continued)

Where applicable, 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 take place with sufficient frequency and volume to provide pricing information on an on-going basis. For all other financial instruments, the Bank determines fair value using other valuation techniques.

The fair value of financial assets and liabilities carried at amortised cost approximate to their carrying value on the Balance Sheet.

The following table presents the Bank's financial assets and liabilities that are measured at fair value on the face of the Balance Sheet and the disaggregation by fair value hierarchy and product type:

As at 30 September 2020	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets at fair value through profit or loss				
Loans and advances to customers	-	-	226.8	226.8
Total financial assets at FVTPL	**-**	**-**	**226.8**	**226.8**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	-	82.0	-	82.0
Total financial liabilities at FVTPL	**-**	**82.0**	**-**	**82.0**

As at 31 October 2019	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets at fair value through profit or loss				
Loans and advances to customers	-	-	248.3	248.3
Total financial assets at FVTPL	**-**	**-**	**248.3**	**248.3**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	-	80.4	-	80.4
Total financial liabilities at FVTPL	**-**	**80.4**	**-**	**80.4**

c) Level 1 and 2 assets and liabilities measured at fair value

Derivative financial instruments:
Derivative products (interest rate swaps) use a valuation technique with observable market inputs, their fair value is based on counterparty valuations. Those valuations are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

The fair value of financial instruments that are not traded in an active market (for example, over the counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

Transfers
There were no transfers between Levels 1 and 2 during the year.

27 Financial instruments (continued)

d) Level 3 assets and liabilities measured at fair value

Loans and advances to customers – equity release and retirement mortgages:
Loans and advances to customers include £226.8m (2019: £248.3m) of assets which have been classed as FVTPL and include equity release and retirement mortgages.

	Fair Value		Book Value	
	2020	2019	2020	2019
	£m	£m	£m	£m
Loans and advances (equity release and retirement mortgages) – classified as FVTPL	226.8	248.3	178.3	197.1
	226.8	**248.3**	**178.3**	**197.1**

Reconciliation of the opening and closing recorded amount of Level 3 loans secured by equity release and retirement mortgages:

	2020	2019
	£m	£m
At start of period	248.3	375.1
Disposal of equity release portfolio to a third party	-	(122.0)
Disposal of equity release portfolio to a fellow group company	-	(10.3)
Total (losses)/gains in the Income Statement	(3.7)	27.5
Loans advanced	2.2	7.7
Redemptions	(20.0)	(29.7)
At end of financial period	**226.8**	**248.3**

The £3.7m decrease (2019:£27.5m increase) in fair value is predominantly driven by the changes in methodology which are discussed below. The 15-year point on the EIOPA yield curve used for discounting the future mortgage cash flows has fallen by 39bps from 0.78% to 0.39% (2019: fallen 84bps from 1.62% to 0.78%). This is partially offset by smaller relative reductions in past and assumed future HPI.

27 Financial instruments (continued)

Equity release and retirement mortgages - principal assumptions

Principal assumptions in the calculation of equity release and retirement mortgages include:

Mortality or entry into long term care
This is based on the expected death or entry into long term care of the customer or the last remaining customer for a joint contract. Mortality assumptions have been derived by reference to PCMA00/PCFA00. This table is adjusted from 2000 by calendar year for mortality improvements based on the CMI 2018 mortality projection model. The mortality tables are further adjusted to reflect recent mortality experience by multiplying the mortality rates by a percentage factor.

Lapses
Due to limited market information, these assumptions have been derived from the Bank's own experience on this product.

Expenses
Assumptions for future policy expense levels are based on the Bank's recent experience analyses. Expenses are modelled as an amount per policy per annum that incorporate an annual inflation rate allowance of 4.09% (2019: 4.01%).

Discount rate
The discount rate applied to the mortgage cash flows comprises two parts: a risk-free yield curve and an allowance for illiquidity. The risk-free yield curve is based on the GBP curve published by EIOPA. The average discount rate for each mortgage (assumed to be the 15-year point on the yield curve) depends on the loan to value of the mortgage. For low LTV business the average discount rate was 2.24% due to a 185bps allowance for illiquidity. For high LTV business the average discount rate was 3.39% due to a 300bps allowance for illiquidity (31 October 2019: 1.78% across all business).

No-negative equity guarantee
The fair value of loans secured by mortgages takes into account an explicit provision in respect of the no-negative equity guarantee, calculated using a variant of the Black Scholes option pricing model. The key assumptions used to derive the value of the no-negative equity guarantee include property growth, volatility and credit risk. Property price is based on the last survey valuation adjusted by the Nationwide Regional House Price Index with an annual underperformance assumption. The future property price is based on Future HPI with an annual underperformance assumption.

The property growth and volatility assumed at 30 September 2020 was 3.09% (31 October 2019: 3.08%) and 13.0% (31 October 2019: 13.0%) respectively. The value of the no-negative equity guarantee as at 30 September 2020 was £7.9m (31 October 2019: £6.7m).

27 Financial instruments (continued)

Sensitivity analysis

Changes to unobservable inputs used in the valuation technique could give rise to significant changes in the fair value of the assets. The Bank has estimated the net decrease in profit before tax for the period arising from changes to these inputs as follows:

	Interest rates +100 BP	Maintenance expenses +10%	Property inflation -100bps	Property prices -10%	Lapses +10%	Delay in mortality +10%
	£m	£m	£m	£m	£m	£m
30 September 2020	**(13.4)**	**(0.4)**	**(3.2)**	**(3.9)**	**(3.9)**	**(1.3)**
31 October 2019	(19.1)	(0.2)	(3.8)	(2.1)	(5.1)	(2.2)

The sensitivity factors are applied via actuarial models. The analysis has been prepared for a change in each variable with other assumptions remaining constant. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear and larger or smaller impacts cannot be interpolated or extrapolated from these results. These sensitivities are chosen as they are all key components of the fair value calculation.

The sensitivity factors take into consideration that the Bank's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs. In addition, swaps taken out will mitigate some of these sensitivities to movements in rates disclosed above.

e) Maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and liabilities into relevant maturity grouping based on the remaining period to the contractual maturity date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. As such, the Bank uses past performance of each asset and liability class along with management judgement to forecast likely cash flow requirements.

As at 30 September 2020	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash and balances held at central banks	147.9	-	-	-	-	147.9
Government bonds	12.1	6.0	-	-	30.5	48.6
Debt securities	1.1	3.0	-	41.4	5.2	50.7
Loans and advances to credit institutions	105.2	-	-	-	-	105.2
Loans and advances to customers	77.6	39.2	36.1	277.0	500.9	930.8
Other assets	9.9	-	-	-	-	9.9
Total financial assets	**353.8**	**52.4**	**36.1**	**314.2**	**536.6**	**1,293.1**
Liabilities						
Deposit from banks	2.5	-	-	85.0	-	87.5
Deposit from customers	318.2	101.0	325.6	318.1	8.5	1,071.4
Derivative financial instruments	(0.3)	(0.1)	0.4	12.7	69.3	82.0
Other liabilities	6.3	-	-	-	-	6.3
Total financial liabilities	**326.7**	**100.9**	**326.0**	**415.8**	**77.8**	**1,247.2**
Loan commitments liabilities	**34.9**	**0.5**	**7.4**	**13.5**	**0.4**	**56.7**

27 Financial instruments (continued)

e) Maturity profile of financial assets and liabilities (continued)

As at 31 October 2019	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash and balances held at central banks	321.9	-	-	-	-	321.9
Government bonds	3.0	-	5.0	6.2	10.9	25.1
Debt securities	1.0	3.5	1.0	41.4	10.1	57.0
Loans and advances to credit institutions	86.1	-	-	-	-	86.1
Loans and advances to customers	55.6	28.0	29.5	211.9	441.9	766.9
Other assets	10.1	-	-	-	-	10.1
Total financial assets	**477.7**	**31.5**	**35.5**	**259.5**	**462.9**	**1,267.1**
Liabilities						
Deposit from banks	2.5	-	-	70.0	-	72.5
Deposit from customers	170.1	182.4	292.5	394.4	3.4	1,042.8
Derivative financial instruments	0.2	(1.7)	0.5	10.2	71.2	80.4
Other liabilities	6.1	-	-	-	-	6.1
Total financial liabilities	**178.9**	**180.7**	**293.0**	**474.6**	**74.6**	**1,201.8**
Loan commitments liabilities	**4.8**	**0.9**	**2.4**	**59.3**	**3.7**	**71.1**

27 Financial instruments (continued)

f) Maturity profile of financial liabilities-contractual undiscounted cash flows

The table below analyses the Bank's non-derivative financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the period to maturity at the Balance Sheet. Derivative financial liabilities are included in the analysis if their contractual maturities are essential for an understanding of the timing of the cash flows. The amounts disclosed in the table are the contractual undiscounted cashflows.

As at 30 September 2020	Book value	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	£m	£m	£m	£m	£m	£m
Financial liabilities							
Deposit from banks	87.5	2.5	-	-	85.3	-	87.8
Deposit from customers	1,071.4	318.8	101.6	329.0	331.6	9.2	1,090.2
Derivative financial instruments	82.0	0.1	1.9	5.1	43.8	110.4	161.3
Other liabilities	6.3	6.3	-	-	-	-	6.3
Total financial liabilities	**1,247.2**	**327.7**	**103.5**	**334.1**	**460.7**	**119.6**	**1,345.6**

As at 31 October 2019	Book value	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	£m	£m	£m	£m	£m	£m
Financial liabilities							
Deposit from banks	72.5	2.5	-	-	71.2	-	73.7
Deposit from customers	1,042.8	170.2	183.1	296.3	411.4	3.8	1,064.8
Derivative financial instruments	80.4	2.5	0.3	4.8	46.3	128.3	182.2
Other liabilities	6.1	6.1	-	-	-	-	6.1
Total financial liabilities	**1,201.8**	**181.3**	**183.4**	**301.1**	**528.9**	**132.1**	**1,326.8**

The above disclosures do not directly align to those presented for the Balance Sheet as they include interest relating to future periods.

The contractual undiscounted cash flows related to derivative financial instruments used for risk management purposes are the net amounts for derivatives that are settled on a net basis.

g) Foreign currencies

The Bank holds no financial assets or liabilities denominated in foreign currencies.

28 Financial risk management objectives and policies

Risk management

The risk management approach encompasses the requirements for identifying, assessing, managing, monitoring and reporting on risk.

The evaluation of the various risks and the setting of policy is carried out through the Bank's Executive Risk Committee which reports to the Risk and Conduct Committee, which ensures adherence to the Bank's risk management policy and framework.

Risk management objectives

Risk is inherent in all aspects of the Bank's business. A risk management framework is in place to ensure that all material risks faced by the Bank have been identified and measured, and that appropriate controls are in place to ensure that each risk is mitigated to an acceptable degree.

In the normal course of its business, the Bank is exposed to credit risk, liquidity risk, house price risk, interest rate risk, conduct risk and operational risk. These are discussed in more detail in sections a) to f) below.

(a) Credit risk

Credit risk is the risk that borrowers or a counterparty will be unable or unwilling to meet a commitment that they have entered into with the Bank.

The maximum credit risk as at 30 September is the carrying value recognised on the Balance Sheet as disclosed in the table in note 27(a), along with the loan commitments as disclosed in the table in note 27(e).

Credit risk within the commercial lending portfolio is defined as a borrower's inability to repay or service their debt obligations. The primary drivers of credit risk in the Bank's case are property price risk and tenant risk.

The primary driver of credit risk within equity release mortgages and reversionary interests in property is a fall in house prices, which would cause credit losses should house prices fall sufficiently in real terms at the date of redemption.

The primary driver of credit risk within the treasury assets portfolio, which comprises deposits with other banks, government bonds and debt securities is counterparty default, meaning a counterparty can no longer repay its obligations. Only instruments issued by counterparties with a minimum rating of BBB- at the point of purchase are held. The Bank intends to hold its treasury assets to maturity and is therefore not directly affected by market risk.

For both commercial lending and residential mortgages, the Bank takes security in the form of a legal charge over the property against which loans are advanced. The Bank's low risk approach to new business lending is reflected in the loan to value profile of the commercial property and residential property books.

The Bank manages its credit risk through its Retail Credit Committee, Commercial Credit Committee and Assets and Liabilities Committee. Regular credit exposure reports are produced which include information on credit and property underwriting, large exposures, asset concentration and levels of bad debt provisioning.

Credit risk in relation to loans and advances to customers, analysed between residential lending credit risk, commercial lending credit risk and credit risk in relation to treasury financial instruments is described in the relevant sections below.

28 Financial risk management objectives and policies (continued)

Expected Credit Loss Provisioning
Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- PD is the likelihood of a borrower defaulting on its financial obligation either in the next 12-months or over the remaining lifetime of the obligation.

The calculation of PD is specific to each portfolio as set out below:

Portfolio	Methodology for determining the PD
Residential mortgages	Calculated at an individual account level using the customer's credit score. The PD is derived from UK mortgage account performance data and overlaid with economic forecast assumptions to obtain a forward-looking PD.
Commercial and Portfolio Buy-to-Let	Calculated by making an assessment at an individual account level using a scorecard approach to determine the credit rating of the individual exposure which is linked to historical default rates of comparable entities. A credit cycle overlay model of a credit rating agency is used to calculate the forward-looking PD. The economic assumptions used within this model are obtained from multiple external sources.
Debt securities and government bonds	Calculated at an individual security level using the external credit agency's rating of the security which is linked to the historical default rates of comparable securities.

Key Economic Scenario Assumptions
The key economic assumptions used to determine the forward-looking PD are as follows:

Economic Assumption	Y1 %	Y2 %	Y3 %	Y4 %	Y5 %
UK GDP Growth					
Upside	9.1	3.8	2.1	2.0	2.0
Baseline	8.7	3.5	1.6	1.6	1.6
Downside	8.1	3.0	1.4	1.4	1.5
Scenario weighted forecasts	8.5	3.3	1.6	1.6	1.6
UK Unemployment Rate					
Upside	7.4	5.3	4.3	3.7	3.4
Baseline	8.2	6.1	5.0	4.5	4.2
Downside	8.7	6.7	5.7	5.2	5.0
Scenario weighted forecasts	8.2	6.2	5.2	4.6	4.4
% Change in S&P 500 Index[1]	13.0				
% Change in Energy Index	19.0	5.4	5.5	5.3	5.6
% Change in Non-Energy Index	2.5	2.1	2.2	2.1	2.3
% Change in Proportion of Downgrades[1]	136.6				

1 - These are the historical annual changes and therefore these are only input for Y1 and then updated annually.

The PD models produce an estimate of the point-in-time PD reflecting the current and expected position in the current credit cycle. The models are designed to produce ECL estimates under three distinct scenarios, reflecting expectations of general economic conditions.

28 Financial risk management objectives and policies (continued)

The scenario weightings and the three distinct scenarios used to reflect the expectations of the wider economy that feed into the PD models are:

Scenario	Scenario assumptions	Weighting
Upside	• The number of COVID-19 cases is further brought under control and the government continues to reopen the economy making a stronger rebound at the end of 2020 a possibility.	20.0%
Baseline	• A backdrop of fluctuating easing and tightening of restrictions will keep confidence subdued and fuel voluntary social distancing behaviours until a vaccine is made available. • Government measures to minimise unemployment are relatively successful. • The Bank Rate remains at extremely low levels for the foreseeable future, a tightening in credit conditions proves mild and sterling stabilises.	35.0%
Downside	• A second wave of infections and reintroduction of intensive lockdown measures push the economy into a double dip recession. The government is unable to provide ongoing support to businesses and workers to the extent that they have thus far. This will result in an increase in unemployment relative to the base case. • This scenario also represents the real risk that the UK will have to accept significantly less favourable terms of access to the EU market as a result of Brexit, which could undermine prospects for trade and investment.	45.0%

– EAD is based on the amounts the Bank expects to be owed at the time of default.

There are no significant judgements in determining the exposure at default.

– LGD represents the Bank's expectation of the extent of loss on defaulted exposures.

The calculation of LGD is specific to each loan portfolio as set out below:

Portfolio	Methodology for determining the LGD
Residential mortgages	Calculated by using the Black Scholes model to reflect that the portfolio is secured against the underlying property as this will calculate the theoretical value of the total loss, should all policies default.
Commercial and Portfolio Buy-to-Let	Calculated by using an external credit rating agency's ECL model which provides an unbiased estimate of the LGD by blending different probabilities of the economic states occurring (positive, neutral and negative).
Debt securities and government bonds	Calculated on an individual security level using a credit rating agency's published average nominal recovery rate.

A sensitivity analysis has been performed to review the worst-case scenario and the impact on the LGD.

28 Financial risk management objectives and policies (continued)

Credit risk: Residential exposures

The Bank's exposure to credit risk relating to loans and advances to residential customers can be broken down by security as follows:

	2020	
	£m	**%**
Fully secured by a first charge on residential property	534.5	100.0
	534.5	**100.0**
Fair value adjustments	39.3	
	573.8	

	2019	
	£m	**%**
Fully secured by a first charge on residential property	379.0	100.0
	379.0	**100.0**
Fair value adjustments	48.1	
	427.1	

The cumulative change in fair values due to credit risk amounts to losses of £7.9m (2019: £7.2m), and the change in the year is a loss of £0.7m (2019: £2.0m).

Residential: risk concentrations

Loan to Value ('LTV') is one of the main factors used to determine the credit quality of loans secured on residential property along with credit scores. All residential loans and receivables have an LTV of less than 75% when advanced.

The Bank provides loans secured on residential property across England, Northern Ireland, Scotland and Wales.

Residential: performance

The gross exposure on loans and advances to residential customers held at amortised cost and its exposure to credit risk in line with the internal modelling of the Bank for the period ending 30 September 2020 is disclosed below:

Stage	**Description**	**Gross Loan Balance £m**	**ECL provision £m**
Stage 1	Satisfactory	340.4	(0.1)
Stage 2	Watchlist	4.6	(0.0)
Stage 3	Default	0.6	(0.0)
		345.6	
Less: Loan fee deferral		1.5	
Provisions for impairment		(0.1)	
Total		**347.0**	

A deterioration in a customer's credit score since inception of greater than or equal to 160 points results in a loan being moved to Stage 2. Any loan that is 90-days past due is classified as being in default and therefore is allocated to Stage 3.

28 Financial risk management objectives and policies (continued)

The gross exposure on loans and advances to residential customers held at amortised cost and its exposure to credit risk in line with the internal modelling of the Bank for the period ending 31 October 2019 is disclosed below:

Stage	Description	Gross Loan Balance £m	ECL provision £m
Stage 1	Satisfactory	176.6	(0.0)
Stage 2	Watchlist	1.9	(0.1)
Stage 3	Default	-	-
		178.5	
Less: Loan fee deferral		0.4	
Provisions for impairment		(0.1)	
Total		**178.8**	

The movement between stages based on the gross exposure on loans disclosed below:

Stage	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 October 2019	176.6	1.9	-	178.5
Purchases	20.5	-	-	20.5
Advances	157.2	-	-	157.2
Stage transfers	2.0	4.2	1.1	7.3
Repayment and settlement	(15.9)	(1.5)	(0.5)	(17.9)
At 30 September 2020	**340.4**	**4.6**	**0.6**	**345.6**

Arrears
Performance risk is measured by those accounts in arrears. The total balances in arrears at 30 September 2020 amounted to £1.4m (2019: £nil).

Past due but not impaired
As at 30 September 2020 there were no residential exposures that were past due but not impaired (2019: £nil).

Forbearance
There have been no instances of forbearance arising during the year.

Payment holidays
As a result of COVID-19, the Bank granted payment holiday arrangements to a total of 167 Residential customers. 160 of these customers have resumed full payment with 7 customers remaining on payment holidays. The total value of exposures that remain on payment holiday arrangements amounts to £2.3 million and are allocated to Stage 1.

Sensitivity
A 100% weighting for a negative scenario produces an additional ECL provision for Stage 1, 2 and 3 of £0.1m.

28 Financial risk management objectives and policies (continued)

Credit risk: Commercial lending

Commercial: analysis of risk concentration
Loans secured on commercial property are as follows:

	2020		2019	
	Loan Balance £m	Collateral Held £m	Loan Balance £m	Collateral Held £m
Commercial mortgage	30.3	47.8	23.3	38.3
Development finance	34.0	54.8	67.5	97.5
Investment loans	217.9	373.4	216.5	376.5
Renewable energy	17.7	0.3	19.4	-
	299.9	**476.3**	**326.7**	**512.3**
Less: Loan fee deferral	(2.0)	-	(2.0)	-
Provisions for impairment	(7.4)	-	(9.5)	-
	290.5	**476.3**	**315.2**	**512.3**

At inception, commercial property loans are fully secured against the value of the related properties.

The Bank provides loans secured on property across England, Scotland and Wales. An analysis of commercial property and renewable energy sector loans by geographical location of the underlying asset is provided below:

	2020		2019	
	£m	%	£m	%
Wales	59.3	19.8	70.6	21.6
London – England	116.6	38.8	123.5	37.8
South East & East of England	12.6	4.2	25.0	7.6
Midlands – England	27.3	9.1	21.2	6.5
South West of England	44.2	14.8	49.5	15.2
North West & North East of England	29.4	9.8	24.2	7.4
Scotland	10.5	3.5	12.7	3.9
	299.9	**100.0**	**326.7**	**100.0**

The average LTV in respect of commercial loans is estimated to be 60.3% (2019: 56.1%). LTV analysis has been undertaken by using a combination of external valuations and internal and external desktop reviews which consider the type and quality of security, lease term/tenant as well as geographical location.

£10.2m (2019: £22.9m) of exposures have an LTV of greater than 100%. Of these, £10.2m (2019: £22.6m) are already classified as in default.

The largest exposure to one counterparty is £15.2m (2019: £17.9m) or 5.1% (2019: 5.5%) of gross balances.

28 Financial risk management objectives and policies (continued)

Commercial: lending performance
Procedures are in place which grade borrowers in line with the perceived severity of the risk and are designed to identify cases of potential cause for concern to facilitate early risk mitigation or forbearance activity where appropriate. Using this risk grading system, the gross balance of the commercial loan portfolio is classified as follows:

	2020		2019	
	£m	%	£m	%
Stage 1	235.7	78.6	286.7	87.7
Stage 2 – significant increase in credit risk	49.5	16.5	14.3	4.4
Stage 3 – default	14.7	4.9	25.7	7.9
	299.9	**100.0**	**326.7**	**100.0**

The movement between stages based on the gross exposure on loans disclosed below:

Stage	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 October 2019	286.7	14.3	25.7	326.7
Advances	60.8	-	-	60.8
Stage transfers	(33.5)	43.7	4.8	14.9
Repayment and settlement	(78.3)	(8.4)	(15.9)	(102.6)
At 30 September 2020	**235.7**	**49.5**	**14.7**	**299.9**

Exposure by credit rating
The gross exposure on commercial loans and their exposure to credit risk in line with internal risk grades and the corresponding external credit rating agency's credit risk rating at 30 September 2020 is disclosed below:

Risk grade	Description	Stage	S&P Rating	Gross Loan Balance	ECL Provision
				£m	£m
1	Negligible risk	Stage 1	A+	0.7	-
2.1	Minimal risk	Stage 1 or 2	B+	-	-
2.2	Low risk	Stage 1 or 2	B	27.7	-
3.1	Fair risk	Stage 1 or 2	B-	46.9	0.1
3.2	Moderate risk	Stage 1 or 2	BB+	116.7	0.3
4.1	Watch	Stage 1 or 2	BB	55.9	1.1
4.2	Enhanced watch	Stage 1 or 2	BB-	28.3	1.0
5	Substandard	Stage 2	BBB	9.0	0.3
6	Default	Stage 3	CCC+	9.7	1.5
7	Loss	Stage 3	CCC-	5.0	3.1
Total				**299.9**	**7.4**

The gross exposure on commercial loans and their exposure to credit risk in line with internal risk grades and the corresponding external credit rating agencies credit risk rating at 31 October 2019 is disclosed below:

Risk grade	Description	Stage	S&P Rating	Gross Loan Balance	ECL Provision
				£m	£m
1	Negligible risk	Stage 1	A+	1.4	-
2.1	Minimal risk	Stage 1 or 2	B+	17.9	-
2.2	Low risk	Stage 1 or 2	B	10.9	-
3.1	Fair risk	Stage 1 or 2	B-	65.6	0.2
3.2	Moderate risk	Stage 1 or 2	BB+	174.9	1.4
4.1	Watch	Stage 1 or 2	BB	22.2	0.4
4.2	Enhanced watch	Stage 1 or 2	BB-	8.1	0.1
5	Substandard	Stage 2	BBB	-	-
6	Default	Stage 3	CCC+	22.2	4.9
7	Loss	Stage 3	CCC-	3.5	2.5
Total				**326.7**	**9.5**

28 Financial risk management objectives and policies (continued)

Arrears
As at 30 September 2020 there were £4.1m of commercial loans in arrears (2019: £16.8m).

During the period, the Bank settled one default exposure which crystallised a loss of £7.8m. At 31 October 2019, this exposure had a gross balance of £15.3m and a Stage 3 provision of £4.3m.

Past due but not impaired
As at 30 September 2020 there was £nil (2019: £nil) commercial loan balances that were past due but not impaired.

Forbearance
There have been no instances of forbearance arising during the year.

Payment holidays
As a result of COVID-19, the Bank granted payment concessions to 51 Commercial customers. 50 of these customers have resumed full payment with one customer resuming partial payment. The single exposure which remains on a payment holiday arrangement has been allocated to Stage 2.

Sensitivity
A 100% weighting for a Negative scenario produces an additional ECL provision for Stage 1 and Stage 2 of £0.8m.

28 Financial risk management objectives and policies (continued)

Credit risk: Portfolio Buy-to-Let ('PBTL')

PBTL: analysis of risk concentration
Loans secured on PBTL property are as follows:

	2020		2019	
	Loan Balance £m	Collateral Held £m	Loan Balance £m	Collateral Held £m
PBTL lending	63.7	92.6	21.3	30.8
	63.7	**92.6**	**21.3**	**30.8**

On inception, PBTL property loans are fully secured against the value of the related properties.

The Bank's PBTL loan portfolio comprises the following:

	2020		2019	
	£m	%	£m	%
Loans secured on PBTL property	63.7	100.0	21.3	100.0
	63.7	**100.0**	**21.3**	**100.0**
Less: Loan fee deferral	(0.2)		(0.1)	
Provisions for impairment	(0.4)		(0.3)	
	63.1		**20.9**	

The Bank provides loans secured on property across England, Scotland and Wales. An analysis of PBTL property loans by geographical location is provided below:

	2020		2019	
	£m	%	£m	%
London – England	46.1	72.2	19.7	92.5
South East & East of England	7.4	11.7	0.8	3.6
Midlands – England	4.1	6.5	0.8	3.9
South West of England	4.2	6.6	-	-
Wales	1.9	3.0	-	-
	63.7	**100.0**	**21.3**	**100.0**

The average LTV in respect of PBTL loans is 68.6% (2019:68.5%). LTV analysis has been undertaken by using a combination of external valuations and internal and external desktop reviews which consider the type and quality of security, lease term/tenant as well as geographical location. No exposures have an LTV of greater than 100%.

The largest exposure to one counterparty is £11.4m (2019:£11.4m) or 17.9% (2019:53.5%) of gross balances.

28 Financial risk management objectives and policies (continued)

PBTL: lending performance

Procedures are in place which grade borrowers in line with the perceived severity of the risk and are designed to identify cases of potential cause for concern to facilitate early risk mitigation or forbearance activity where appropriate. Using this risk grading system, the gross value of the PBTL portfolio is classified as follows:

	2020		2019	
	£m	%	£m	%
Stage 1	63.7	100%	21.3	100.0
Stage 2 – significant increase in credit risk	-	-	-	-
Stage 3 – default	-	-	-	-
	63.7	**100.0**	**21.3**	**100.0**

The movement between stages based on the gross exposure on loans disclosed below:

Stage	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 October 2019	21.3	-	-	21.3
Stage transfers	-	-	-	-
Advances	42.4	-	-	42.4
Repayment and settlement	-	-	-	-
At 30 September 2020	**63.7**	**-**	**-**	**63.7**

PBTL: lending provisions

Exposure by credit rating

The gross exposure on PBTL financial assets and its exposure to credit risk in line with an external credit rating agency's credit risk rating is disclosed below:

30 September 2020

Risk grade	Description	Stage	Credit Rating	Gross Loan Balance £m	ECL Provision £m
3.1	Fair risk	Stage 1 or 2	B-	3.1	(0.0)
3.2	Moderate risk	Stage 1 or 2	BB+	60.6	(0.4)
Total				**63.7**	**(0.4)**

31 October 2019

Risk grade	Description	Stage	Credit Rating	Gross Loan Balance £m	ECL Provision £m
3.2	Moderate risk	Stage 1 or 2	BB+	21.3	(0.3)
Total				**21.3**	**(0.3)**

Arrears

As at 30 September 2020 there were no PBTL loans in arrears (2019: £nil).

Past due but not impaired

As at 30 September 2020 there were no PBTL loans that were past due but not impaired (2019: £nil).

Forbearance

There have been no instances of forbearance arising during the year.

Payment holidays

As a result of COVID-19, the Bank granted a payment holiday to four PBTL customers. All four of these customers have resumed full payment and have been allocated to Stage 1.

Sensitivity

A 100% weighting for a Negative scenario produces an additional ECL provision for Stage 1 of £0.1m.

28 Financial risk management objectives and policies (continued)

Credit risk: Treasury assets

Treasury risk comprises exposure to central banks, government bonds, debt securities, credit institutions and financial derivatives. The following table shows the maximum exposure to credit risk excluding collateral:

	2020	2019
	£m	£m
Cash and balances held at central banks	147.9	321.9
Government bonds	48.6	25.1
Debt securities	50.7	57.0
Loans and advances to credit institutions	105.2	86.1
	352.4	**490.1**
Provision for impairment	-	-
	352.4	**490.1**

None of these exposures are past due or impaired.

Credit quality of financial assets that are neither past due nor impaired
The following shows the exposures broken down by credit rating:

	2020	2019
	£m	£m
AAA to AA-	352.4	482.2
A+ to A-	-	7.9
	352.4	**490.1**

Concentration of credit risk
The geographical exposure is as follows:

	2020	2019
	£m	£m
UK	335.1	467.1
Other	17.3	23.0
	352.4	**490.1**

The Treasury function monitors exposure concentrations against a variety of criteria including counterparty limits.

28 Financial risk management objectives and policies (continued)

b) Liquidity risk
Liquidity risk is the risk that the Bank will encounter difficulty in realising assets or otherwise raising funds to meet commitments as they fall due. The Bank manages its liquidity risk through its Assets and Liabilities Committee and monitors its liquidity position on a daily basis and has adopted a policy to ensure that it has adequate resources to enable it to conduct its normal business activities without interruption. The maturity analysis of assets and liabilities is disclosed in note 27 (e) & (f) to the financial statements of the Bank.

The customer deposit base represents a stable source of funding due to the number and range of depositors. Liquidity is further managed through dealings in the money markets.

The Board has approved a liquidity risk management policy that sets out the liquidity requirements with which the Bank must comply. The principal liquidity risk mitigants used by management are:

- A buffer of highly liquid assets (comprising high quality government, covered bonds and supranational bank securities) which can meet cash requirements;
- Cash reserves with the Bank of England;
- Cash resources held at other financial institutions.

c) Interest rate risk
Interest rate risk is the risk that arises when there is an imbalance between the maturity dates of rate-sensitive assets, liabilities and commitments. The Bank manages its interest rate risk through its Assets and Liabilities Committee. The Bank’s policy is to maintain interest rate risk at a controlled level within limits set by the Board.

The table in note 27 (d) shows an estimate of the interest rate sensitivity gap as at 30 September 2020. The principal risk management tool to mitigate interest rate risk is the use of derivatives to align the interest rate re-pricing profile of assets and liabilities. All of the derivatives used by the Bank are interest rate swap contracts of varying maturities and start dates.

The Bank’s interest rate risk management policy defines the type of derivative transactions that can be undertaken, which are all actioned by the Bank’s Treasury function, and are subject to review and approval at the dealing stage. The Treasurer, who is responsible for treasury matters on a day to day basis, prepares a treasury report for the Board, which includes analysis of interest rate risk exposures.

d) Operational risk
Operational risk is the risk of economic loss from systemic failure, human error and fraud (control failures) or external events, which result in unexpected or indirect loss to the Bank. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. The Bank cannot expect to eliminate all operational risks but by initiating a rigorous control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access controls, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

The Bank has responded to COVID-19 as it developed, initially through its business continuity processes to ensure the safety of its colleagues and its customers before returning to a more ‘business as usual’ operation albeit operating remotely. Hodge has responded to and follows government guidance and best practice to maintain our customer service levels and protect our employees.

28 Financial risk management objectives and policies (continued)

e) House price risk
House price risk is the risk that arises when there is an adverse mismatch between actual house prices and those implicit in the costing of the Bank's equity release, retirement mortgages and reversionary interests held at FVTPL such that the ultimate realisation of the property would not yield the expected return to the Bank and could, in certain circumstances, result in a capital loss. The Bank mitigates house price risk by monitoring maximum loan to value at inception of the loan and reversionary interests.

Geographical analysis of equity release and retirement mortgages
The Bank provides loans secured on property across England, Scotland, Northern Ireland and Wales. An analysis of residential property by geographical location is provided below:

	2020		2019	
	£m	%	£m	%
Wales	9.3	5.2	10.2	5.2
East Anglia	7.4	4.2	8.8	4.5
East Midlands	8.8	5.0	9.7	4.9
Greater London	16.4	9.2	22.9	11.6
Yorkshire & Humberside	14.0	7.9	14.4	7.3
North West	19.1	10.6	20.4	10.3
Northern Ireland	8.9	5.0	8.6	4.4
Scotland	19.7	11.0	20.3	10.3
Outer Metropolitan	13.7	7.7	15.8	8.0
Outer South East	20.8	11.6	23.2	11.9
South West	20.2	11.4	22.5	11.4
West Midlands	10.8	6.0	11.1	5.6
North	9.2	5.2	9.2	4.6
	178.3	**100.0**	**197.1**	**100.0**

f) Conduct risk
Conduct risk is the risk that the Bank's behaviour results in poor outcomes for customers. The Bank is exposed to this risk by virtue of the markets in which it chooses to operate. The Executive Risk Committee has overall responsibility for implementing and monitoring principles, frameworks, policies and limits. The Committee is responsible for managing risk decisions and monitoring risk levels which it reports to the Risk and Conduct Committee.

The Bank holds a provision of £nil as at 30 September 2020 (2019: £nil).

g) Pension risk
The Bank is exposed to pension risk through its defined benefit scheme. Further information is provided in note 24.

h) Pandemic risk
Pandemic risk is the risk of economic loss from a result of a pandemic. The Executive Risk Committee has overall responsibility for implementing and monitoring risks that a pandemic could cause. The Committee is responsible for managing risk decisions and monitoring risk levels which it reports to the Risk and Conduct Committee.

29 Capital risk management

The Bank conducts an Internal Capital Adequacy Assessment Process ('ICAAP'), at least annually, which is approved by the Board. This is used to assess the Bank's capital adequacy and to determine the level of capital required to support the future development of the business as set out in the strategic plan.

The ICAAP addresses all the Bank's material risks and includes board-approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is used by the PRA to set the Bank's Total Capital Requirements ('TCR').

The Bank's capital resources requirements are calculated based on the CRD IV CRR regulatory framework as implemented by the PRA, namely:
- Pillar 1-based on a Standardised Approach for credit risk, operational risk and market risk;
- Pillar 2-set by the PRA via the TCR to address those risks not covered under Pillar 1.

The Board is ultimately responsible for capital management and monitors the capital position of the Bank at each board meeting through the receipt of management information which sets out the Bank's current and forecast capital position, based on the methodology adopted within its ICAAP. This means that the Bank will:
i) Maintain a level of capital at least equal to the minimum amount set by the PRA in the TCR, and;
ii) Hold all its capital in the form of Common Equity Tier 1 and Tier 2 capital.

	2020 Unaudited	2019 Unaudited
	£m	£m
Common Equity Tier 1 capital	136.4	156.4
Total risk weighted assets	693.8	695.2
Common Equity Tier 1 capital ratio	**19.7%**	**22.5%**
Total own funds	136.4	156.4
Total risk weighted assets	693.8	695.2
Total capital ratio	**19.7%**	**22.5%**

Capital Requirements Directive

Article 89 of the Capital Requirements Directive IV (CRD IV) requires credit institutions and investment firms in the EU to disclose annually, specifying, by Member State and by third country in which it has an establishment, the following information:
- Name, nature of activities and geographical location: The principal activities of the Bank are noted in the Strategic Report.
- Average number of employees: as disclosed in note 6 to the accounts.
- Annual turnover (Net Interest Income) and profit before tax: as disclosed in the Income Statement.
- Corporation Tax paid: 2020: £0.4m (2019: £0.2m).
- Public subsidies: The Bank received £0.3m under the Coronavirus Job Retention Scheme from the UK government.

All minimum regulatory requirements were met during the year and the prior year.

The Bank's objectives when managing capital are:
- To have sufficient capital to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders;
- To comply with the Bank's capital requirements set out by the PRA in the UK;

The Bank's capital comprises all components of equity, movements of which are set out in the Statement of Changes in Equity.

30 Related parties

The Bank has applied the exemptions available under FRS 101 in respect of transactions with members of The Carlyle Trust Limited group. The following balances were owed to or from related parties at 30 September 2020 and 31 October 2019:

	2020	2019
	£m	£m
Amounts due/(owed) from parent and fellow subsidiaries		
The Carlyle Trust Limited – parent	3.1	3.3
Reimbursement asset due from The Carlyle Trust Limited	3.3	2.9
Hodge Life Assurance Company Limited – fellow subsidiary	(2.8)	(3.5)
Group relief debtor	2.9	3.0
Deposits owed to parent and fellow subsidiaries		
Jane Hodge Foundation – shareholder of The Carlyle Trust Limited	(1.8)	(2.5)
Beaufort Park Limited	(0.1)	(0.3)
Sterling House Limited	(0.1)	(0.1)
Wingwest (Fountain Lane) Limited	(0.1)	(0.2)
The Carlyle Trust Limited – parent	(1.3)	(1.1)
Hodge Life Assurance Company Limited – fellow subsidiary	(1.0)	(1.3)
Carlyle Property Development Limited	-	(0.4)
Total	**(2.1)**	**(0.2)**