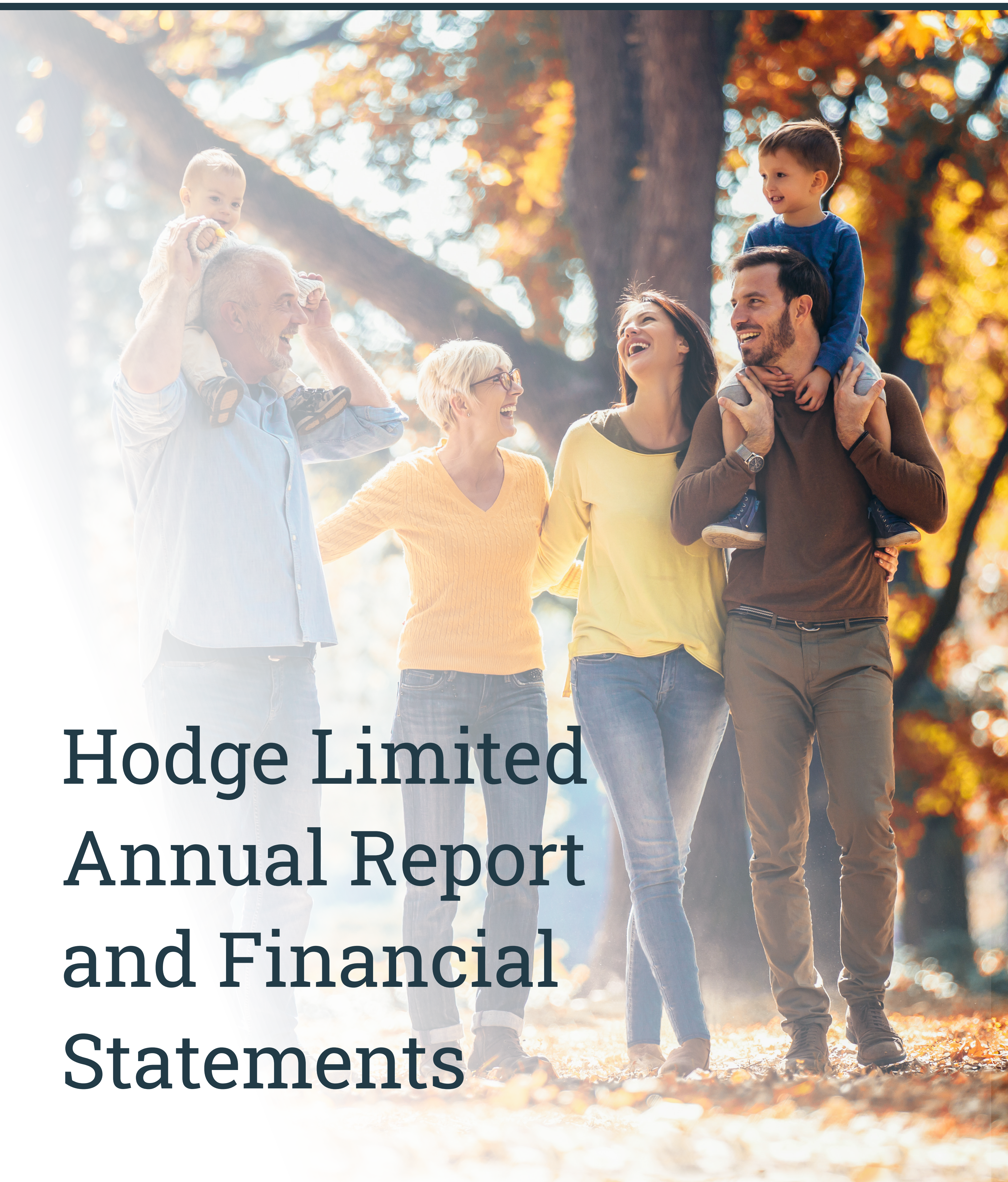
HODGE



Hodge Limited Annual Report and Financial Statements

30 September 2020 – Registered number 0390216

Officers and Professional advisers

Chairman
Graeme Hughes

M.B.A., D.M.S.,
A.C.I.B.

Senior Independent Director

Alison Halsey

B.A. (Hons) F.C.A.

Director
David Landen

Chief Executive Officer
F.C.C.A., B.Sc.

Director
Matthew Burton

Group Retail Director and Deputy CEO
F.C.A., B.Sc.

Director
Richard Jones

Interim Chief Financial Officer
ACA.

Non-Executive Director
Alun Bowen

F.C.A.,
M.A.

Officers and Professional advisers

Non-Executive Director
Helen Molyneux

L.L.D (Hons),
L.L.B (Hons).

Non-Executive Director
John Barbour

M.B.A., B.Sc.

Non-Executive Director
David Gulland

F.I.A, BA.

Non-Executive Director
Aileen Wallace

M.C.B.I
C.I.R.M.
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Non-Executive Director
Iain Laing

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Company Secretary
Kirsty Williams

L.L.B. (Hons).

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01 Strategic Report

Chairman's Statement

Graeme Hughes
Chairman

I was deeply honoured to be appointed as the Chair of Hodge Limited 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 Group itself. I would like to say a huge thank you to Adrian Piper for all of his years of leadership and support to the Group, and for his personal guidance and help to me in achieving a smooth handover.

We were disappointed to see our previous Chief Executive Officer (CEO) resign at the turn of the year but that created the opportunity for our Chief Financial Officer (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 Group 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 so as to preserve service levels and to ensure the safety and security of all colleagues. The Board was extremely impressed with the response and grateful to all of the leadership team for such a tremendous achievement.

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.

The Group has two subsidiaries: Julian Hodge Bank Limited (the 'Bank') and Hodge Life Assurance Company Limited ('Hodge Life').

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. Our longer-term strategy remains to optimise the allocation of capital across the business so as to increase the return both in terms of 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 Hodge Bank growing our retail mortgage business in 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 attract new savers using both traditional and digital channels.

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

For Hodge Life we are assessing a wide range of potential strategic options for its future.

Our Strategy remains rooted in the traditional values of the Group established some fifty years ago by Sir Julian Hodge.

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

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.

The Group's strategy remains to show how much we value colleagues, to provide flexibility and opportunity for all, and to offer an upper quartile package.

Returning to the theme of change, 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 Director (NED) changes to continue the strengthening of the governance of the Bank.

Iain Laing joined as Chair of the Risk 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 Hodge 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 Group. Aileen will be chairing the newly created Change and Innovation Committee to oversee the transformation of the Group's infrastructure and to ensure the strategic alignment of the investment programme.

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 Group Retail Director and Deputy CEO to lead the very important growth of that business area. I would also like to welcome Richard Jones to the Board as Interim CFO.

Finally, the Board would like to put on record our thanks to all colleagues across the Group who have responded so effectively, flexibly and pragmatically to the extreme changes caused by the COVID-19 crisis.

Graeme Hughes
Chairman
11 December 2020

Our Business, Social Responsibility and Stakeholder Engagement

Our Business

We are a privately owned group 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 mortgage markets offering professional and holiday buy-to-let products. In addition, through our commercial lending business, we offer real estate finance to property 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 Group'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 interest only mortgages, both with and without a fixed-term end date and equity release. 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 team, 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 'year of two halves' with our markets very active and loan volumes strong in 2019 and Q1 of 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 with 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.

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, development finance and residential investment have proved attractive to our target market and both 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, processes 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 with investment 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 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 Group 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 7.9% of the overall funding from deposits with banks and customers at 30 September 2020.

Hodge Life

Hodge Life's business focuses on the retirement market and, in particular, pension annuities where we offer our products through financial intermediaries.

We back our annuity liabilities with a range of long-term assets, including equity release mortgages which are a good match for these liabilities given their long-term fixed rates of interest. The mortgages are originated by our mortgages business which means collaborative working is vital to our approach.

The events of 2020 have highlighted further the needs for holistic retirement planning. Stock market falls and low interest rates continue to put pressure on retirees' pension savings, and has brought into focus their investment risk appetite. Securing a guaranteed income for life remains a priority for many retirees, and we expect the annuity market to grow as a result.

The role of property during retirement is also of growing importance. We anticipate these developments encouraging a greater use of equity release and other later life lending solutions, alongside annuities and similar products, to provide an appropriate level of retirement income. We are therefore very confident that our business model is well placed to benefit from these developments, with the drivers of change having been accelerated by the COVID pandemic.

Hodge Life reached a strategic milestone during the year by concluding a significant longevity reinsurance transaction. Longevity risk is the risk that annuity policyholders live longer than expected. It is a significant risk to Hodge Life which required high levels of capital to held to mitigate it. The transaction transfers the longevity risk on £475m of annuities to a highly-rated reinsurer, which releases capital within Hodge Life to fund future new business growth.

Colleagues

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.

- **Learning and Development:** Throughout this year, we have continued to develop learning and training platforms to support our colleagues and help them flourish and grow in their careers at Hodge. Investing in key leadership training for 'rising stars' in the business and supporting career paths and progression in a number of key areas has created new opportunities for many of our team. Alongside the Welsh Financial Services Graduate programme, we are a founding sponsor of a new Tech Graduate scheme for Wales as we look to help nurture the next generation of FinTech talent.
- **Colleague Wellbeing:** We've developed our 'Healthy Hodge' scheme giving our people resources and support for maintaining healthy minds, bodies, families, finances and connections. With the ongoing implications of COVID-19 we have created the opportunity for colleagues to prioritise their mental, emotional, physical and financial wellbeing.
- **Flexible Benefits:** As we continue to evolve our total reward package for colleagues, we have introduced a flexible benefits portal. This has empowered our team to design the total reward package they receive as part of their role with Hodge. This flexible benefits scheme has been well-received and we are considering how to evolve it further.
- **Inclusivity & Flexibility:** In July 2020 we launched a new Parental Leave policy which, among other important elements, unifies our enhanced maternity and paternity pay offerings at twenty weeks for eligible colleagues. We have also strengthened our commitment to flexible working for colleagues, ensuring that our people can support their families and operate a work/life balance that works for them. This has proven to be particularly effective with the switch to home working as a consequence of COVID-19.

Corporate Social Responsibility

Through 2020 we have continued to make a difference to the lives of others through our corporate social responsibility commitment. In forging these relationships, we have helped make life changing improvements to a significant number of people.

- **Re-engage** is the only charity specifically committed to help combat isolation in older people from 75 years old through providing regular face-to face contact and social interaction.

  Hodge has funded a minibus service so more isolated older people have the opportunity to attend social events on a regular basis and combat loneliness.

- **Care & Repair Cymru** focuses on helping older people in Wales live independently in their own homes, ensuring that they are accessible, safe and warm to live in.

  Hodge has supported many older homeowners by funding essential repairs and home improvements necessary to live in a safe and clean environment.

- **Maggies** operates a network of cancer support centres across the UK. Each centre aims to make the experience of cancer more manageable for everyone, helping people regain control when cancer turns life upside down.

  Hodge helped fund the operation of a local centre and ensure more people benefit from the valuable support it provides to the sufferer and their families.

- **Hourglass** is the only charity committed to preventing abuse against older people. The primary service is the helpline which offers support to older people who have experienced abuse.

  Hodge has funded the establishment of a Wales based branch of the helpline, providing access to a bilingual advice and a wider support network in addressing this growing issue.

Stakeholder Engagement – S172 Statement

The Companies Act 2006 requires the directors of the Group to act in the way he or she considers, in good faith, would be most likely to promote the success of the Group 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 Group's employees;
- need to foster the Group's business relationships with suppliers, customers and others;
- desirability of the Group maintaining a reputation for high standards of business conduct;
- impact of the Group's operations on the community and environment; and
- interests of the Group's Shareholder.

In discharging its s172 duties, the Group 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 Group's stakeholders. By considering the Group'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 Group's CEO and, through him, to the Executive Committee to set, approve and oversee the execution of the Group'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 Group's strategy at least twice a year. A high-level summary of the Group's strategy can be found in the Chairman's Statement on page 7.

The Group 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 Group 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 Group uses a range of methods to involve and engage with our customers. The Board values feedback from customers to ensure the Group is providing them with what they want and need.

The Group 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 Group.

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 buy-to-let product, engaging with the broker community in its development.

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.

Hodge continues to make significant investment in technology to improve our operational and digital capability which is vital in delivering great service to our customers. This investment brings efficiency and scalability to our operations. In 2020 the Group has worked with a third party to build a new mortgage servicing platform which provides the Group 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 Group in improving the level of service it provides to its customers.

Our Employees

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 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.

The importance of communication became evident in March 2020 when the Board took the decision to enable employees to work from home as a result of COVID-19. A series of townhalls have taken place remotely since and all employees have been provided with the opportunity to ask any questions they have to members of the Board and

senior leadership team. Both the Board and senior leadership team members have made significant efforts to ensure that all questions were answered.

One of the impacts of the COVID-19 pandemic which became clear at an early stage was that it was highly unlikely that the performance targets set by the Board would be met to enable payments to be made under the Group's Incentive Scheme. The Board informed employees of the situation as early as possible in order to manage expectations.

In addition, during the period, the Group made use of the government's Coronavirus Job Retention scheme and the Board made every effort to engage with colleagues early, keeping them informed of the decisions made and the reasons behind those decisions.

Our Suppliers

Our suppliers play an important role in the operation of the Group's business to enable the delivery of an effective and efficient business model. The Group 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 impacts, risk exposure, legal and compliance considerations and financial implications. The Group 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 Group has a focus on the wider community, supporting four charity partners during the year, further information with regards to the charities supported by the Group can be found within the Corporate Social Responsibility section on page 12. Additionally, colleagues are able to take up to four days off work per year to support good causes with the Group'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 Group 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 Group regularly to obtain a clear understanding of their views and requirements.

Chief Executive Officer's Statement

David Landen
Chief Executive Officer

I am incredibly proud and honoured to have been appointed Chief Executive Officer for Hodge. Hodge has a proud heritage built upon a unique ownership structure which helps create an environment that truly looks to build long term sustainable returns with a focus on delivering innovative products for our customers and a dedication to delivering great customer outcomes.

The last year has certainly been a tale of mixed fortunes. The first half of the year saw us make great strides to the achievement of our long-term vision for the business. We saw a significant increase in lending volumes especially in our revitalised retail division and delivered significant enhancements to our technology platforms to help support our long-term ambitions.

The second half of the year was dominated by the challenges created by COVID-19. As the global pandemic worsened during February and March it was clear that it would have a devastating effect on our country and our economy. Whilst the economic effects of COVID-19 has meant reduced customer activity and higher loan impairments the Group's capital position remains strong and we are well placed to continue towards our long-term vision to be a real specialist providing innovative lending and savings products for our customers.

COVID-19 Response

We responded quickly to the unprecedented events in March moving our whole business from our offices to home based working. This included all of our customer facing teams and was a huge effort from all involved, I was incredibly proud of how the Hodge teams seamlessly changed the way we worked whilst continuing to provide full services to our customers. This was considered to be the best plan of action from all stakeholders perspectives.

We successfully implemented new technology to further support our customer facing colleagues within weeks of moving to remote working and demonstrated what can be achieved in a challenging environment. I thank all colleagues for adapting so well to the new way of working. Our offices remain open for those that need it, but we anticipate predominately working from home into 2021.

Financial Performance

Our results, which are discussed in greater detail in the Chief Financial Officer's Report on page 18, reflect the impact of COVID-19. We have set aside £3.2m in expected credit loss provisions to cover potential future losses, partly due to the impact of COVID-19 which could adversely affect our customer's ability to repay their loans. We work closely with our customers who have been impacted by this unprecedented situation to continue to support them and the economy and to minimise any future impairments.

Coupled with the direct impacts of COVID-19, the Group is operating in a challenging economic backdrop. The policy response to reduce interest rates to near zero has depressed our ability to generate net interest income and as a result impacted operating performance but new business margins have remained robust. This demonstrates the value of the business we are originating and how this will feed into improved operating performance in the future.

The Group has invested significantly in our people and technology in readiness for our planned growth. The investment sets up our business for our future growth ambitions and we will receive the benefits of this moving forward as we enhance functionality across our platforms to improve the customer experience and enhance our ability to make fast and informed decisions.

The Group loss before tax of £12.4m (2019: £6.6m profit before tax) is after recognising loan loss provisions of £5.4m (2019: £3.9m) and a net non-operating loss before tax of £23.5m. The Group's performance along with adverse movements to our defined benefit scheme, has reduced capital resources but our capital position remains strong with a CET1 ratio of 19.7% at 30 September 2020 (2019: 23.0%).

Within our Life business we benefitted from the successful completion of a reinsurance trade improving our solvency position and providing a solid base for our business. Profit before tax of £8.8m in Hodge Life (2019: £14.4m) has been impacted by the continued lower volumes of new business and updates to our mortgage valuation assumptions. The life business has a strong capital position with SCR coverage of 183% at 30 September 2020 (2019:165%) and this enables us to plan and move forward confidently.

2021 Outlook

We anticipate continuing the growth in our specialist mortgage range. Our later life lending range remains our core offering but has been supplemented by portfolio and holiday buy-to-lets. We continue to increase our specialist products using our underwriting and product expertise to develop our offerings to provide valuable solutions for our customers.

We have made great strides in developing our on-line services to further enhance our intermediaries experience when dealing with Hodge. In May 2020, during the height of COVID-19, we launched our on-line portal so that intermediaries can automatically upload cases. This is a first step; and we will continue to quickly develop the portals capabilities to provide intermediaries a fast and easy way to do business with us.

We have a clear vision for growth across our business, utilising our long heritage and knowledge of the commercial and residential property markets to continue to build on our specialist lending capability.

We predominantly fund our asset growth with retail savings which have grown to £1.07bn at 30 September. Whilst we will make use of the Bank of England's new TFSME announced in March, we will also continue to provide competitive savings products to our customers, which is more important than ever in this low interest rate environment. We will renew our focus to enhance our range of products and provide great value and service to our customer base and broaden our appeal to new customers through the enhanced use of technology and product innovation.

We continue to explore options for exiting our legacy equity release and reversionary portfolios as and when market opportunities arise, allowing us to redeploy capital and liquidity into our core businesses.

Technology

The Board remains committed to the use of technology to broaden our appeal and provide a seamless customer journey for our intermediary partners and customers alike. Whilst the negative economic impact of COVID-19 is clear the Board has recommitted to and reaffirmed our significant investment across our business to enhance the use of technology and the pace of digitalisation globally has only increased. We have started to receive the benefits of this investment during 2020 and this will continue at pace into 2021.

During 2021 we will bring our mortgage servicing in-house to provide a further enhancement to our end-to-end service for our mortgage customers, we will deliver further enhancements to our intermediary mortgage portfolio, making life easier for our intermediary partners and to our on-line savings customers.

Technology will help support customers who want to deal with us on-line, helping us to make quicker more informed decisions and enhance their customer experience but we will still allow customers the choice of how they want to do business with us.

Technology will play an increasingly important part in our business; we have capitalised £2.8m and expensed £2.5m in relation to technology projects in 2020 and intend to spend in excess of £20m over the next 3 years. The ability to apply the human touch to product development, origination, underwriting and service remain integral to our philosophy of providing a personal tailored approach.

Our people

We continue to work to become a truly diverse and inclusive business, we know we have some way to go in our ambitions to achieve this, but the Board is fully committed to make the positive changes to our business to promote true diversity. During 2019 we signed up to the Women in Finance Charter which was a great step to promote gender diversity across our business, we have made good progress in our desire to have a more diverse Board and Executive Committee and this will continue to be a key measure of our success.

We pride ourselves on our corporate social responsibilities and allow colleagues 4 days a year to support local causes and we have protected our commitment to providing support to partners in areas that matter to our colleagues, our business and our customers.

Hodge believes passionately in providing a great environment for people to work and through that we get the best outcomes for our business and the customers which we serve.

Our people have responded incredibly well to the challenges of 2020 and it's through their great work we will succeed in delivering our vision.

DJ Landen

David Landen
Chief Executive Officer
11 December 2020

Chief Financial Officer's Report

Richard Jones
Interim Chief
Financial Officer

Despite 2020 being a year which was challenging as a result of the economic environment caused by COVID-19, the Group increased its loans and advances to customers by 15.4%.

Key performance indicators

The Group monitors several key performance indicators to measure progress against objectives and to demonstrate financial soundness.

During the year the Group changed its reporting period from 31 October to 30 September as Hodge staff have 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 a 12-month period:-

	2020	2019
Financial performance	**£m**	**£m**
Net interest income	37.1	41.7
Net operating income	45.5	57.5
Operating profit	11.1	29.5
(Loss)/profit before tax	(12.4)	6.6
Group financial ratios	**%**	**%**
Net interest margin[1]	1.8	2.1
Cost income ratio[2]	60.0	39.6
Financial soundness - Hodge Bank	**%**	**%**
Common Equity Tier 1 ratio	19.7	22.5
Leverage ratio	9.6	11.1
Liquidity Coverage Ratio	272.9	516.9
Financial soundness - Hodge Life		
Solvency Capital Ratio	183.0	165.0

1 Net interest margin: net interest income as a proportion of total assets.
2 Cost income ratio: administration expenses; as a proportion of net operating income.

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

The Group's performance at a net operating income level was also impacted by reduced reversionary asset sales due to the disruption caused by COVID-19 compared to the prior year. This reduced net operating income by £8.2 million.

We had to constrain our capacity to write annuities within Hodge Life to a low level during the year as low interest rates as a results of COVID-19 adversely impacted Solvency Capital levels.

The Group's performance at an operating profit level reduced as a result of the movements noted above but also 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 £10.0 million.

The Group 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 before tax of £12.4 million, which is mainly driven by the reduction in operating profit of £18.4 million but also due to additional non-operating losses before tax of £0.6 million. The non-operating loss is mainly due to a revised valuation methodology of lifetime mortgages and reversions implemented in the period. The Group 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.

Balance Sheet overview

	2020 £m	2019 £m	% Change
Liquid assets[1]	467.7	599.5	(22.0)
Loans and advances to customers	1,433.7	1,242.6	15.4
Investment properties	170.9	170.1	0.5
Other assets[2]	24.6	17.9	37.4
Total assets	**2,096.9**	**2,030.1**	**3.3**
Deposits from banks	87.5	72.5	20.7
Deposits from customers	1,070.3	1,041.6	2.8
Provision for long term business	528.0	498.7	5.9
Other liabilities[3]	107.4	100.9	6.4
Share capital and reserves	303.7	316.4	(4.0)
Total liabilities and equity	**2,096.9**	**2,030.1**	**3.3**

1 Liquid assets: made up of Cash and balances held at central bank, Government bonds, Debt securities and Loans and advances to credit institutions
2 Other assets: made up of Intangible assets, Property plant and equipment, Deferred tax assets, Reinsurance asset and Other assets
3 Other liabilities: made up of Derivative financial instruments, Other liabilities and the net deficit on the Pension scheme

Liquidity

The Group holds liquid assets to meet its financial obligations in both business-as-usual and stressed situations. As at the year-end, the Group held £467.7m of liquid assets (31 October 2019: £599.5 million) which are available to protect it from liquidity stresses.

Hodge Bank
Liquidity levels continued to be within board risk appetite and regulatory requirements throughout the period.

This includes the Liquidity Coverage Ratio ('LCR'), which ensures that sufficient high-quality liquid assets are held to survive a short term severe but plausible liquidity stress. The Bank's LCR as at 30 September 2020 was above the regulatory minimum of 100% at 272.9% (2019: 516.9%), this was reduced as planned during the year as the Group has utilised the proceeds received from the disposal of the equity release mortgage portfolio at the end of the prior period.

Hodge Life
Hodge Life's liquidity risk appetite sets liquidity requirements based upon a short-term liquidity stress as well as a long-term structural liquidity test. Liquid assets are held to maintain liquidity to meet both tests.

Loans and advances to customers

The Group continues to focus on its core markets of commercial and residential mortgages. The net lending figure has been driven by record gross lending of residential mortgages which has been offset by redemptions and the successful exit of a number of legacy commercial lending exposures.

Funding

Retail savings remain a primary funding source and we have focused on enhancing the services we provide to customers through improving our digital efficiency. At the year-end savings balances were £1,070.3 million (31 October 2019: £1,041.6 million); this was a slight increase on the prior year as the Group utilised its available liquid assets which were inflated due to the disposal of an equity release mortgage portfolio at the end of the prior period.

The Group also provides pension annuities in the open market offering competitive annuity products to our customers, regularly featuring in best buy tables. During the year the Group generated £22.8 million (2019: £41.6 million) of new annuity premiums.

Defined benefit pension scheme

The Group operates a defined benefit scheme available to all employees. As at 30 September 2020 the scheme had a deficit (the difference between scheme assets and scheme liabilities) of £21.0 million (31 October 2019: £16.6 million); the increase in the deficit was mainly caused by an increase in the scheme liabilities due to a decrease in bond yields which decreased the discount rate for scheme liabilities. The Group made contributions to the scheme of £3.4 million in 2020 (2019: £3.0 million).

Capital and Leverage

The Group holds capital to protect itself, its depositors and annuitants against unexpected losses. The amount of capital required to be held is determined as part of the Group's capital risk appetite which assesses the material risks to which the Group is exposed, how those risks are managed and the level of capital to be held against them.

Hodge Bank
The Bank's primary measure for assessing capital adequacy is the Common Equity Tier 1 ratio ('CET1'). This ratio assesses the amount of the highest quality of capital as a proportion of risk weighted assets. The Bank uses standardised risk weights to calculate the risk weighted exposure. As at 31 October 2020 the Bank's CET1 ratio stood at 19.7% (2019: 22.5%).

Alongside the CET1 ratio we actively monitor our Leverage ratio. This is a capital ratio that excludes the risk weighting of assets. The Leverage ratio at 31 October 2020 was 9.6% (2019: 11.1%). At present, we are not captured under the Financial Policy Committee's leverage ratio framework. However, the leverage ratio will become a binding requirement in 2022, albeit the Bank comfortably meets the requirements.

Hodge Life
Hodge Life's primary metric in assessing capital adequacy is the Solvency Capital Requirement Coverage ratio. The ratio assesses available capital resources as a proportion of capital requirements. Hodge Life uses the Standard formula to calculate its capital requirements and as at 30 September 2020, the Solvency Capital Requirement stood at 183% (2019: 165%).

The capital strain of writing new business remains high because Hodge Life does not benefit from the Matching Adjustment under Solvency II. Hodge Life entered into a reinsurance agreement during the period which has transferred significant insurance risk, from Hodge Life to the reinsurer, on the majority of our annuity portfolio which helped improve the capital position.

Richard Jones
Interim Chief Financial Officer
11 December 2020

Long-term Viability Statement and Going Concern

Hodge assessment of prospects

The resilience of our business model is relevant to any consideration of our prospects and viability. We benefit from diversification between our specialist mortgages, Hodge Life and our commercial lending businesses, which enables our services to be provided in a capital-effective way allied with our track record in attracting funding from different sources. We assess our prospects on a regular basis through our financial planning process. Our rolling five-year strategy forecasts Hodge's profitability, cash flows, capital and funding requirements and is reviewed by the Board each year.

Our business and financial planning also takes into account our obligations to depositors, annuitants and the funding of our defined benefit pension scheme.

The Board believes that the market for our later life lending products will be strong for at least the next ten years. This is supported by demographic trends and the increasing customer demand. In addition, during the year the Group has started to diversify with the introduction of the portfolio and holiday buy-to-let mortgages.

The market for annuity products is less clear; however, the Board believes that there is still good baseline demand. The reduction in annuity providers has reduced competition and a 'normalisation' of interest rates over the next ten years would make annuities more attractive.

Our commercial lending proposition is more dependent on shorter-term client relationships; however, the team has a good track record of identifying new relationships and converting them into customers. The digitalisation of our savings business will assist in making Hodge less dependent on its existing customer base and our commitment to ensuring that customers can deal with us through their channel of choice means that the directors are confident that Hodge will continue to retain and attract loyal depositors. Given the long-term nature of many of the businesses mortgage products, the directors have also given due regard to the possible impact of climate change on its future prospects.

Impact of COVID-19 and UK withdrawal from EU

The impact of COVID-19 and the ongoing negotiations between the UK and EU ahead of the transition period ending on 31 December 2020 is still being realised today. There has been huge economic uncertainty in 2020 and this is expected to continue into 2021. At the date of signing the financial statements, there remains a range of outcomes in relation to both COVID-19 and the outcome of the negotiations between the UK and the EU.

Hodge response

The Group continues to track its own metrics, political developments and discussions on these matters are commonplace in committees and the Board, particularly given the material uncertainty and its impact on economic fundamentals. The risks associated with individual topics are given considerable thought and discussion as to how they may materialise and impact the Group's strategy, customer base and the capital and liquidity implications of these.

Consideration of risks

Consideration of the risks may be summarised as follows:

- Credit risk – analysis of the impact on mortgage affordability and house prices caused by adverse economic conditions arising. The loan book has been stressed extensively over a five-year horizon against a range of macro-economic assumptions, some severely adverse;
- IFRS 9 Stage 1 and Stage 2 provision has been run under a variety of economic scenarios including a 100% weighting to the negative scenario to reflect the worst-case position.
- Capital – credit losses and net interest income impacts have been considered including those associated with the Bank of England's publicised scenarios; and
- Liquidity – the risks associated with adverse impacts on liquidity have been considered.

Extensive modelling and stress testing around macroeconomic outcomes from COVID-19 and Brexit associated risks has determined that the business remains viable and able to meet its risk appetite limits and regulatory obligations.

In relation to the UK withdrawal from the EU and the end of the transition period Hodge has no direct exposures to the EU and does not rely on its markets or customer base. In addition, our data storage and transmission has led to no reliance on EU data centres that may lead to disruption.

Viability statement

The directors have carried out an assessment of the longer-term viability of the Group. The assessment covers a period of five years, as this is the period covered by the Group's rolling five-year strategy and regulatory and internal stress testing. The time period chosen reflects the consideration that the level of uncertainty relating to the assessment increases the longer the period chosen. The pace of change of the economic, market and regulatory environments in which the Group operates may undermine the reliability of longer forecasts. The directors have based this statement on a robust assessment of those risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the Group.

In making the assessment, the directors considered a range of information concerning each of its principal risks, individually and collectively, over a range of scenarios, including but not limited to, the Group's rolling five-year Plan and the programme of regulatory and internal stress testing it undertakes, further details of which are as follows:

- The Plan is reviewed by the directors in detail at least annually. The Plan makes certain assumptions about the performance of the Group and the economic, market and regulatory environments in which it operates. The planning process is underpinned by a robust stress testing framework to ensure compliance with the Group's risk appetite.
- Alternative forecasts are also constructed against a number of stress scenarios, including a robust downside scenario as part of the Board's review of Hodge Bank's Internal Capital Adequacy Assessment Process ('ICAAP'). This involves considering a severe stress to the UK economy, with a significant fall in both residential property prices and secondary commercial real estate values and low interest rates for a sustained period.

  The results of the ICAAP are submitted to and discussed with the PRA. Hodge Life carries out a similar process as part of its Own Risk and Solvency Assessment ('ORSA'). The principal stress scenarios that have been tested are a significant fall in residential house prices, a significant increase in longevity and sustained low interest rates.
- Liquidity stress tests are conducted as part of the Bank's Internal Liquidity Adequacy Assessment Process ('ILAAP'). The ILAAP demonstrates that the Bank holds sufficient liquid assets to meet cash outflows during a severe-but-plausible scenario where there is a combined, market-wide and firm specific stress.
- The review also considered all aspects of emerging regulation where there is sufficient clarity to inform the analysis. For example, the assessment of the Bank's capital position reflects the latest understanding of the capital buffer and leverage requirements likely to be imposed on the Bank.

Based on this assessment, the directors confirm that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due during the period to 30 September 2025. Accordingly, the financial statements continue to be prepared on a going concern basis.

Graeme Hughes
Chairman
11 December 2020

02 Governance

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 Hodge 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 Hodge's strategic objectives. It is during periods of significant change, which Hodge is currently undergoing, that leadership and good governance are more important than ever.

The Boards of Hodge Limited and those of its regulated subsidiaries, Hodge Bank and Hodge Life comprise three executive and eight non-executive directors. In each case 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 Group'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 Group's business and can provide only reasonable and not absolute assurance against material misstatement or loss.

The Group'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 Group 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, the Nestor advisors presented recommendations, including at a high-level:

- 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 Group.

The Board

The Board has ultimate responsibility for the proper stewardship of the Group in all its undertakings. It meets regularly throughout the year to discharge its responsibilities for all important aspects of the Group'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 Group'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 Group.

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 Group. 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 – Chair
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 its 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.

Alison Halsey – Senior Independent Director
Alison joined the Board as Senior Independent Director in November 2020. With 30 years of experience at KPMG, Alison headed up UK Financial Services before becoming Global Lead Partner, a position she held for 10 years. Prior to that, she was 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 the Chair of the Risk and Conduct Committee until 31 July 2020 and a trustee of the Hodge Foundation.

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 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 the Chair of the Remuneration Committee.

Until November 2016, Helen was the CEO of New Law 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 is 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.

David Gulland – Non-Executive Director
David joined the Board in May 2019 and from July 2019 became Chair of the Hodge Life Risk and Conduct Committee.

David brings insurance expertise from working with businesses across the UK financial services sector with a particular focus on the strategic implications of regulatory change. With early-career experience at Deloitte, David went on to become Chief Executive of the Marine & General Mutual Life Assurance Society and, before that, Managing Director of RGA Re's UK and Ireland business. David currently sits on the Independent Governance Committee of Royal London, on the Compliance Committee of the Funeral Planning Authority, and is Chair of the Audit & Risk Committee at PG Mutual and of Scottish Friendly's With Profits Committee.

Aileen Wallace – Non-Executive Director
Aileen joined the Board in April 2020 and is a Chair of the Change and Innovation Committee. She 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 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.

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

David Landen – Chief Executive Officer
David was appointed Chief Executive Officer in September 2020, stepping up from CFO and Deputy CEO. David joined the Group 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.

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), Graeme Hughes, Helen Molyneux, Alun Bowen, Aileen Wallace, Iain Laing and David Gulland.

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 four times a year. A report from the Chair of the Audit Committee can be found on page 42.

- **Risk and Conduct Committee**
  HLAC: David Gulland (Chair), Graeme Hughes, John Barbour, Helen Molyneux and Alun Bowen.

  JHB: Iain Laing, (Chair), Graeme Hughes, 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. A report from the Chair of the Risk and Conduct Committee can be found on page 48.

- **Nomination and Governance Committee:** Graeme Hughes (Chair), Helen Molyneux, John Barbour and Aileen Wallace.

All members of the Nomination and 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 Group has an appropriate succession plan for executive and senior management positions. It also is responsible for ensuring that the Group's diversity and inclusion policy is being delivered.

The Committee meets at least twice per year. A report from the Chair of the Nomination and Governance Committee can be found on page 55.

- **Remuneration Committee:** Helen Molyneux (Chair), Graeme Hughes, John Barbour, Aileen Wallace, Iain Laing and David Gulland.

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. A report from the Chair of the Remuneration Committee can be found on page 56.

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

All members of the Change and Innovation 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 Group's product and services. It monitors investment and management of risk associated with the delivery of change associated with the Group's strategic initiatives.

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

Board and Committee Membership and Attendance

Name	Board		Audit Committee		Hodge Bank Risk & Conduct Committee		Hodge Life Risk & Conduct Committee		Remuneration Committee		Nomination & Governance Committee		Change & Innovation Committee	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
Graeme Hughes	13	11	8	8	9	9	9	9	6	6	7	5		
John Barbour	13	13	8	8	9	9	9	9	6	3	7	6		
Helen Molyneux	13	13	8	7	9	9	9	8	6	6	7	7	1	1
Alun Bowen	13	13	8	7	9	9	9	8						
Aileen Wallace	13	7	8	3	9	5			6	-	7	3	1	1
Iain Laing	13	7	8	2	9	5			6	3				
Alison Halsey														
David Gulland	13	12	8	8	9	8	9	9	6	5			1	1
David Landen	13	12												
Matthew Burton	13	10												
Richard Jones														
Steve Pateman	13	3												
Adrian Piper	3	7												

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

Notes
David Gulland joined Board on 1/11/2019
Steve Pateman resigned from Board on 16/03/2020
Matthew Burton joined Board on 9/04/2020
Aileen Wallace joined Board on 24/04/2020
Adrian Piper retired from Board on 30/04/2020
Iain Laing joined Board on 30/07/2020
Richard Jones joined Board on 9/10/2020
Alison Halsey joined Board on 5/11/2020

Risk Management

Managing risk effectively is fundamental to our strategy and to operating successfully. Hodge has a strong culture of risk awareness and control and actively monitors and manages the risks of its business, as well as emerging industry risks which may have an impact on those activities, through a robust and embedded risk management framework.

The Group's Risk Management Framework is an integral part of the Hodge business model to support:

- Delivering against its strategy within an appropriate risk culture;
- Building greater resilience to organisational threats;
- Protecting its customers from unfair outcomes.

The Group's strategy and business model is underpinned by clearly defined risk governance, ensuring alignment with the Board's appetite for risk. Hodge operates entirely within the UK financial services market and only takes on risks, which it has the capability to understand and manage effectively. A risk management framework, supported by a three lines of defence governance model, ensures strong risk awareness, assessment, monitoring and management across all principal and emerging risks. Risks are managed within the risk appetite set by the Board and stress testing is undertaken to ensure that the capital and liquidity of the Group would enable it to survive severe but plausible market-wide and firm specific stresses.

Through 2019/2020 the Group has continued to embed improved risk management by developing its processes and procedures and recruitment of risk resources and, as identified through the risk strategy, will make further improvements over the course of 2021 to mature and refine its risk management capabilities.

Risk Culture

The Group prides itself on a strong risk culture, which stems from the Board's approach to and appreciation of the risks faced by the business. This culture is embedded through clear expectations set by the risk appetite and risk management policies, together with effective training for all levels of staff. This is underpinned by an emphasis on good customer outcomes and sustainability of the business.

Three Lines of Defence Model

The Group operates a three lines of defence model which clearly sets out responsibilities for the management and oversight of risk. The Board retains ultimate responsibility for risk management. The three lines of defence model is summarised below:

First Line of Defence – Day-to-Day Risk Management

The first line of defence has responsibility for implementation of the Group's strategy and for the management of risk across the organisation and comprises executive committees, management and staff.

Second Line of Defence – Risk Oversight

The second line of defence is responsible for providing independent oversight and challenge of activities undertaken by the first line and provides guidance on risks relevant to the strategy. This is provided through the Risk & Compliance function, which is led by the Chief Risk Officers ('CROs') of both Hodge Bank and Hodge Life, who report to the CEO and have an independent reporting lines to the Chairmen of the Risk and Conduct Committees. It maintains and reports an aggregate view of risks and performance in relation to risk appetite to the Risk and Conduct Committee. The Risk function is not customer facing and has no responsibility for business targets or performance.

Third Line of Defence – Internal Audit

The third line of defence provides objective assurance on the design and effectiveness of the Group's governance, and activities of the first line and second line of defence. This assurance is obtained through the use of internal audit services provided by Deloitte. Internal audit reports directly to the Chair of the Audit Committees of Hodge Bank and Hodge Life as well as the CEO and is independent of the first and second lines of defence.

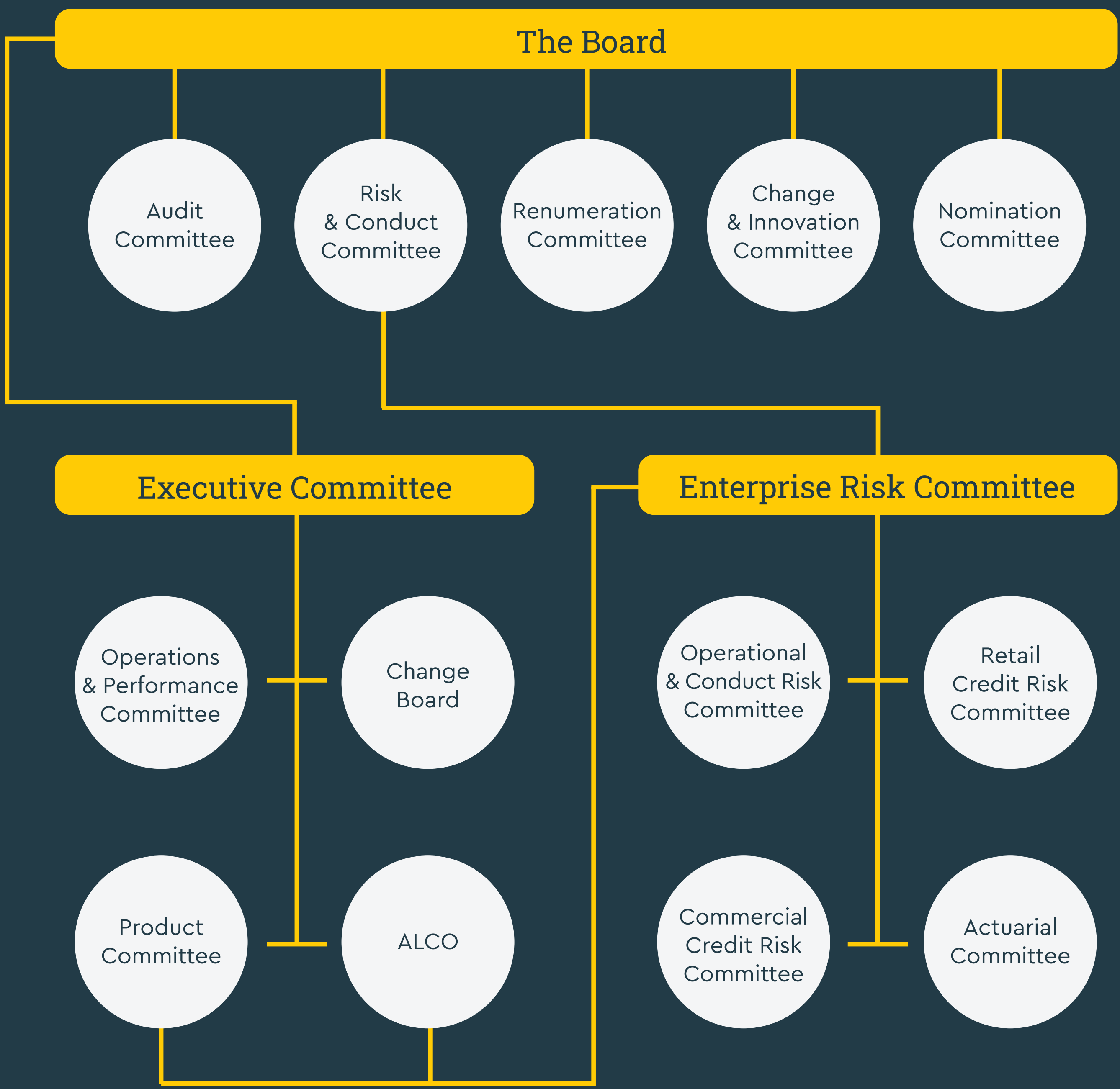
Risk Governance Structure

The Board is ultimately responsible for the overall risk governance and effective management of risk within the Group. The Board determines the risk strategy and ensures that risk is monitored and controlled effectively.

The Risk and Conduct Committee is a board committee that reviews, on behalf of the Board, the key risks inherent in the business and the control framework in place to manage such risks, presenting its findings to the Board.

There is a formal structure of risk management policies in place, setting out risk limits and triggers and minimum operating standards, which are aligned to the Board's risk appetite.

Risk governance is supported by a structure comprising of executive committees, each with escalation routes through the Risk and Conduct Committees and Board as shown below:



Executive Committees:

Each committee includes appropriate representation from the Executive Committee and risk specialists. The responsibilities of each of the Committees is set out below:

Enterprise Risk Committee is chaired by the Chief Risk Officer of Hodge Bank and Hodge Life. The Committee is responsible for oversight and monitoring of all enterprise wide risks and for the development of the Risk Management Framework.

Operations & Performance Committee is chaired by the Chief Operations Officer. The Committee's purpose is to provide operational governance across the firm. This governance covers a range of key activities inclusive of oversight of internal and outsourced operations, operational resilience and forward-looking operational impacts to the business.

Change Board is chaired by the Chief Technology Officer. The purpose of the Change Board is to ensure the Group's Change Programme is aligned with the Group's strategy and business plans and to monitor programme delivery, budget and resources.

Product Committee is chaired by the CEO. The purpose of the Committee is to assist and encourage new product developments by developing and recommending new product ideas and significant changes to existing products.

Assets & Liabilities Committee ('ALCO') is chaired by the Chief Financial Officer. The Committee is responsible for the implementation and maintenance of the overall Risk Management Framework relating to market risks, asset/liability matching, and liquidity and capital management.

Operations & Conduct Risk Committee is chaired by the Chief Risk Officer of Hodge Bank and Hodge Life. The purpose of the Committee is to assist the Risk & Compliance function in the development and implementation of the Risk Management Framework to manage the operational and conduct risk profile, and to ensure the adequacy of the internal control environment.

Retail Credit Risk Committee is chaired by the Managing Director of Mortgages. The Committee is responsible for the implementation and maintenance of retail credit risk policy. The scope of the Committee covers monitoring and development of all retail lending activity.

Commercial Credit Risk Committee is chaired by the Managing Director of Commercial Lending. The Committee is responsible for the implementation and maintenance of commercial credit risk policy. It is also responsible for reviewing, challenging and if appropriate, approving credit proposals for new commercial lending deals within its delegated authority.

Actuarial Committee is chaired by the Chief Actuary and is responsible for monitoring the insurance risk exposure of the Group including insurance risk and house price risk. It also monitors and provides input to the methods and assumptions used to undertake actuarial valuations of the Group's assets and liabilities.

Risk Strategy

The Group's risk strategy sets out the risk management approach to support the achievement of the Group's strategic ambitions. It sets out which risks will be avoided, mitigated or accepted and is implemented by defining tolerances to the risks it faces through its risk appetite.

Risk Appetite

The Board sets a risk appetite to define the level of risk that the Group is willing to accept or wishes to avoid in order to meet its business objectives. A risk appetite statement is in place that includes both qualitative statements and quantitative measures and addresses each of the key risk types faced by the Group as articulated within the Risk Strategy.

The risk appetite statements are linked to the Group's strategy and supported by a suite of risk metrics, limits and triggers designed to monitor the Group's exposure to the principal risks and together outline parameters within which the Group operates.

The risk appetite statement provides a framework against which all business decision making must be assessed.

Top and Emerging Risks

In addition to the principal risk categories noted below the Group's top and emerging risks are identified through the Group's risk management processes. These are specific risks within the Group's principal risk categories that are significant to the Group throughout its strategic plan. The key risks and details of how they are mitigated is set out below:

Current threat/ Emerging risk	Principal risk category	Mitigation/Strategic response
Pandemic Risk/COVID The current global pandemic due to COVID has, and continues to, cause significant disruption to global economies and populations. This is resulting in widespread impacts across all aspects of life including; financial markets, employment, consumer spending, commercial & residential asset prices and markets, government intervention.	The potential to impact all risk categories	The Group 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. Hodge assessed the potential economic impact using the May 2020 Monetary Policy Report (MPR) illustrative scenario compared to our ICAAP scenario. The capital held against the ICAAP is deemed greater than that the MPR would require. Economic developments are regularly discussed in governance forums and monitored closely. Lessons learned from our progress through this pandemic have led to improvements in the firm's operational resilience processes.
UK political and economic uncertainty The focus required to respond to COVID has led to a lack of progress and clarity on the eventual outcome of the EU withdrawal. This is still weighing on investment and purchase activity and therefore macroeconomic fundamentals. In addition, the withdrawal from the EU could lead to changes in the regulatory framework.	• Strategic risk • Market risk • Credit risk	It is anticipated the UK withdrawal from the EU will have limited direct impact on the Group as its operations are wholly UK based with no services or relationships with other EEA countries. However, the Group remains exposed to the impact that the withdrawal may have on the UK economy including housing market, interest rates, unemployment and inflation. Economic conditions are actively monitored. Risk appetites have been established for Balance Sheet sensitivity to external factors. Supporting this, is the wider stress testing framework that tests for scenario vulnerabilities and impacts on capital & liquidity required to cover risks. The disorderly exit scenarios are considered to be within the severity of impact modelled within the ICAAP & ORSA.

Continued

Top and Emerging Risks – (continued)

Current threat/ Emerging risk	Principal risk category	Mitigation/Strategic response
Market/competitive environment COVID has changed customers behaviours and requirements which has the potential to change their financial service requirements, along with disruptive technologies, new competitors (traditional and non-traditional) and a search for yield all have the ability to threaten the current business model and achievement of the Group's strategy.	• Strategic risk • Market risk	Continual monitoring of customer needs and the competitive environment is undertaken and discussed regularly alongside strategy development. Competitor benchmarking and networking forums allow insight into firm's potential strategic intent. Appropriate market research and a new product development governance process are conducted to ensure strategic initiatives are properly controlled.
Change & execution risk The Group has committed to a number of strategic change initiatives which are key to the achievement of our strategic objectives. These significant activities increase cost and execution risk.	• Strategic risk • Operational risk	The change programme will deliver additional resilience to the Group's business model and its operational resilience once fully implemented. The change programme has risk management processes in place to ensure safe and controlled delivery of the initiatives required.
Climate risk Financial risks from climate change arise through two primary channels; physical i.e. specific weather events & damage to assets and transition risks i.e. increased regulation to adjust to low carbon economy. These manifest as increasing underwriting, credit, or market risk for firms.	• Strategic risk • Credit risk • Operational risk	A climate change policy has been implemented outlining governance structures, disclosures, risk management approach, SMF responsibility allocated in the business and an internal working group established to develop Hodge's approach and understanding of the risk posed by climate change. Climate change is being addressed specifically as part of the regulatory risk management documents; ORSA & ICAAP.

The Group conducts on-going horizon scanning to identify new risks that could threaten achievement of the strategy and ensure they are captured in the Risk Management Framework as early as possible. The governance structure in place enables a strong awareness of current and emerging risks, which are recorded and monitored to ensure that appropriate mitigation and monitoring strategies are adopted. Mitigating actions are logged, business owners allocated, and warning indicators identified to ensure effective ongoing monitoring. Oversight of emerging risks is provided by the Risk and Conduct Committee.

Principal Risks

These are the most significant risks faced by Hodge which could impact the viability of the Group and delivery of our strategic objectives. Risk appetite limits and triggers as well as key risk indicators are in place for each principal risk and reported to the relevant executive committee. Aggregated reporting is provided to the Risk and Conduct Committee to support it in its duties.

CREDIT RISK – the risk that a counterparty will be unable or unwilling to meet a commitment that it has entered into with the Group when it falls due.

Key drivers and appetite	Our approach
Credit risk emerges from commercial lending exposures, residential mortgages to retail customers and from investments held by the Treasury function. Concentration risks within and across these portfolios is also considered. The Group is willing to be exposed to a moderate level of risk for an acceptable return	The Group assesses its exposure to and management of credit risk with reference to three sub-categories: • **Retail credit risk** – the risk of financial loss from residential mortgages due to the customer's failure to service interest or repay capital. • **Commercial credit risk** – the risk of financial loss from a commercial lending customer's failure to settle financial obligations as they fall due or movements in commercial real estate prices. • **Treasury credit risk** – the risk that a debt issuer or counterparty will fail to make payments (either interest or principal) in a timely manner or the credit worthiness of borrowers deteriorate reducing the value of investments. Within each business line there is dedicated first line risk management provided by appropriately skilled credit managers and treasury staff. Pricing of lending products includes a component of margin to cover expected credit losses. Treasury counterparties are restricted to a number of well-established and externally rated institutions. The following mitigation practices are in operation: • Board approved underwriting policies and authorisation mandates are in place for each sub-category in order to direct lending decisions, ensuring that the Group lends responsibly while taking an acceptable level of credit risk. • Rating and scoring systems in place and controls to support lending decisions with the addition of affordability stress tests for individual retail customers. • Limitations on concentration risk across portfolios are implemented via risk appetite limits on large exposures, geographical and sectoral exposures, and loan to income ratios. • Appropriately skilled colleagues are employed by the Group to monitor and manage credit risk within the defined parameters set by the Board. • Portfolio level stress testing and scenario analysis.

This principal risk has a direct link to the longer-term viability statement.

Principal Risks - (continued)

LIQUIDITY RISK – The risk that the Group is unable to meet its financial obligations as they fall due or unable to maintain customer and stakeholder confidence or can only do so at an uneconomic cost.

Key drivers and appetite	Our approach
The Group maintains a prudent liquidity profile to ensure it has sufficient liquid resources to meet anticipated outflows in business-as-usual and under stressed conditions.	Treasury provides strong first line risk management expertise in liquidity risk management and risk management processes and has day to day responsibility for the management of liquidity within defined board policies and limits. The following mitigation techniques are in operation: • Maintenance of a liquidity buffer of high-quality liquid assets. • Well matched maturity profile of assets and liabilities. • Composition, credit quality and maturity profile of liquidity portfolio and funding balances in line with agreed policies. • Liquidity stress tests run to ensure the Group maintains adequate levels of liquidity for business purposes even under stress. • Extensive contingency funding plans in place. • Reporting of regulatory liquidity metrics; Liquidity Coverage Ratio, Net Stable Funding Ratio and internal metrics i.e. Overall Liquidity Adequacy Requirement. • Weekly monitoring of liquidity adequacy, portfolio composition and changes and refreshed cashflow forecasts by the Asset and Liability Committee.

This principal risk has a direct link to the longer-term viability statement.

Principal Risks - (continued)

MARKET RISK – The risk that the net value of, or net income arising from, assets and liabilities is impacted because of market price or rate changes.

Key drivers and appetite	Our approach
Market Risk for the Group arises from several different drivers: **Interest rate risk** arises due to the different repricing characteristics of the Group's assets and liabilities. **Property price risk** is driven by reversions, equity release and retirement mortgages and the no negative equity guarantee (NNEG) on these product lines. The Group is willing to accept a moderate level of property price risk for an acceptable return but wishes to employ risk management strategies to reduce associated volatility. **Pension risk** arises due to adverse movements in market factors such as interest rates and inflation, as well as longevity assumptions negatively affecting the value of the scheme assets and liabilities.	The Group aims to minimise the interest rate risk that it is exposed to where it is commercially viable to do so. The following mitigation techniques are in operation: • The interest rate structure of assets is matched with liabilities to create a natural hedge and supported by derivatives where appropriate. • Well defined board policies and limits. • Various interest rate stress tests are applied to the portfolio to help identify any potential weaknesses that require further remediation. • Reporting, monitoring and analysis by Treasury team and the Asset and Liability Committee. The Group has a depth of risk management expertise within its first line underwriting functions to ensure the active management and on-going monitoring of property price risk exposure and the Actuarial Committee monitors historical performance and the future outlook for house prices. The following mitigation techniques are in operation: • Limits on the loan-to-value acceptable for individual loans, • Limits on the exposure to individual borrowers, • Geographical concentration limits on lending The Trustees actively manage risks arising from its defined benefit scheme through the scheme's investment strategy to mitigate the potential mismatch of investments with its obligations. The Trustees regularly monitor the scheme deficit and future funding requirements. Every three years, the Trustees of the scheme agree a plan to ensure the scheme eliminates any deficit arising over an acceptable time horizon. The Group regularly monitors actual performance of the scheme against this agreed recovery plan.

This principal risk has a direct link to the longer-term viability statement.

STRATEGIC RISK – The risk of significant loss or damage arising from business decisions made in setting and executing the Group's Strategic Plan, and/or from an inability to adapt to external developments.

Key drivers and appetite	Our approach
Strategic risk can arise from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, political, regulatory or other impacts. The risk to delivery of the strategy is deemed to be the principal risk.	Close management and monitoring of the strategic plan along with in-depth stress testing reported regularly through the Group's committee structure to the Board and senior management. This is supported through additional risk reporting and monitoring of the key threats to the business on risk registers and horizon scanning to ensure the business can respond appropriately.

Principal Risks - (continued)

UNDERWRITING RISK INCLUDING:
INSURANCE/MORTALITY RISK – The risk that longer/shorter policyholder life expectancy results in financial losses for the Group.
LAPSE RISK – The risk that a high rate of mortgage lapse results in financial losses for the Group

Key drivers and appetite	Our approach
Insurance risk exposure is driven primarily through annuities and legacy reversions and is partially offset by the exposure to mortality risk driven through equity release and retirement mortgages. The exposure to lapse risk is primarily driven by equity release and retirement mortgages and is heightened in times of low interest rates and increased competitor activity.	Strong expertise is maintained within the first line Actuarial function to support the active management and monitoring of underwriting risk exposure. The Chief Actuary is treated as a first line role rather than formal second line oversight. Additional oversight in this area is provided by an external technical adviser, to help to mitigate potential conflicts of interest and to assist the Board with decision-making on technical actuarial matters. A reinsurance trade was successfully implemented during the year and has significantly reduced the exposure to insurance risk.

This principal risk has a direct link to the longer-term viability statement.

CONDUCT RISK – The risk that the Group's behaviour results in poor outcomes for customers

Key drivers and appetite	Our approach
Conduct risk is inherent in any business that provides products or services to customers. Failing to treat customers fairly and deliver good outcomes would have a detrimental impact on the success and sustainability of the Group. The Group assesses its exposure to and management of conduct risk with reference to four sub-categories: Product design, Distribution and sales, Product servicing, and Culture and governance.	• Product design – a product governance policy is in place to ensure that all new products are subject to an appropriate level of scrutiny and that existing products are subject to regular review to identify any risk of poor customer outcome. • Distribution and sales –all customer lending products are distributed via independent brokers to ensure that customers receive independent advice. Deposits and commercial lending products are offered on an execution-only basis. Approval processes are in place to ensure that product literature is clear, fair and not misleading and complies with relevant regulation and legislation. • Product servicing – performance against service levels is monitored and customer feedback used to determine whether good outcomes are achieved. Internal quality assurance is undertaken. All complaints are thoroughly investigated and responded to promptly. Monitoring is in place to identify and quickly address any trends or systemic issues. • Culture and governance – reward strategies and incentives are not based on sales targets and mandatory conduct risk and customer outcomes training is in place for all new and existing employees.

Principal Risks - (continued)

OPERATIONAL RISK – The risk of economic loss from control failures or external events, which result in unexpected or indirect loss to the Group.

Key drivers and appetite

The Group accepts that operational risks arising from its people, processes, systems or the external environment are a natural consequence of its business operations but seeks to avoid or mitigate the risk to a minor level wherever practical. The Group assesses its exposure to and management of operational risk with reference to nine core sub-categories:

- **Process** – losses from failed transaction processing or process management.
- **Model** – models are incorrect or mis-used, leading to inappropriate business decisions.
- **Financial crime** – losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or the Group's policy.
- **People** – failure to manage the human resources of the Group in order to maximise its value.
- **Legal & Regulatory** – failure to comply with legal and regulatory requirements.
- **Systems** – IT systems do not meet the requirements of the Group or are not maintained to a high standard to ensure agreed availability.
- **Change** – failure to successfully deliver change to achieve defined strategic benefits or failure to operate robust change implementation controls resulting in disruption to operational processes and/or the customer journey.
- **Security** – failure to manage the physical or information security of the Group leading to disruption to operational processes, customer impact and/or financial loss.
- **Third party** – services provided by third parties fail to meet required standards leading to disruption to operational processes, customer impact and/or financial loss.

Our approach

Operational policies and procedures, supported by staff training, are in place to govern the way in which these risks are managed across the business. Senior management are responsible for understanding the nature and magnitude of risks within each business area, and for implementing appropriate controls to mitigate those risks. Operational losses and near-misses are recorded and analysed to determine whether there are any systemic issues that need to be addressed by the business.

Horizon scanning is conducted to identify emerging regulatory and legal developments to ensure that the business can respond appropriately.

The Board is mindful that, as the digital capability of the Group increases, the risk associated with cyber-attacks also increases. As such, particular focus continued to be given to this area throughout the year to ensure a robust cyber response.

Stress Testing and Planning

A key component of the Risk Management Framework is stress testing and scenario analysis through which the Group assesses the impact of risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the Group. The Board and senior management have engaged in a number of exercises which have considered and developed stress-test scenarios covering a range of groupwide, multi-risk category stress tests, generic and idiosyncratic financial shocks, and operational and conduct risk scenario analysis in addition to the scenarios prescribed by the regulator.

Stress testing is central to the annual business planning process and to the annual review and ongoing development of the Group's risk appetite. It is also core to the adequacy assessment processes for liquidity and capital and for assessing and improving management of the Group's risk profile. The assessment processes for capital and liquidity are articulated through Hodge Bank's Internal Capital Adequacy Assessment Process ('ICAAP') and Internal Liquidity Adequacy Assessment Process ('ILAAP') and Hodge Life's Own Risk and Solvency Assessment ('ORSA') documents. These activities and associated documents are updated at least annually or following any significant change in the business model or risk profile.

Banking segment

- The ICAAP evaluates the level and quality of capital required by the Bank as defined by the Capital Requirements Directive (CRD IV) to ensure it adequately covers all current and future risks in the business over the medium term. In addition to the assessment these risks may pose to capital, consideration is given to the contingency actions available to the Board to mitigate those risks.
- The purpose of the ILAAP is to consider the Bank's liquidity risk management processes, an element of which is evaluating liquidity positions and requirements in both business-as-usual and stress situations. The ILAAP demonstrates that sufficient liquid assets are held to meet cash outflows during a severe but plausible scenario where there is a combined market-wide and firm-specific stress, resulting in, among other things, a significant outflow of savings accounts. The document also outlines the contingency funding arrangements available for use in a stress.

Life assurance segment

- The ORSA is a firm's own assessment of the risks it faces and the solvency capital requirements that it believes are appropriate. The ORSA is an integral part of the Solvency II regime, bringing together risk management and solvency needs. It is designed to be a continual point of reference for the board and help guide decision-making by taking into account the risks the firm faces.

Reverse Stress Testing

The Group also undertakes reverse stress testing which is used to explore potential vulnerabilities of the Group's strategies and plans to extreme events that could cause the business to fail. The reverse stress tests push the severity of the stress scenario to the point at which the firm's business model becomes unviable. These exercises are designed to assess the resilience of the business to adverse competitive, economic or financial developments and ensure that robust, forward-looking capital and liquidity management processes are in place to deal with the identified risks.

The reverse stress tests complement the ICAAP, ILAAP and ORSA and assist management in understanding the full continuum of the levels of stress which the business can tolerate within its current resources and risk appetite. Any plausible scenarios identified with unacceptably high risks will lead the Group to adopt measures to prevent or mitigate those risks through a change in strategy, increased controls and early warning indicators or contingency plans.

Recovery Planning

There continues to be a strong focus on 'resolvability' from UK and European regulators with requirements issued through the Bank Recovery and Resolution Directive allowing a common approach to be taken. A key element of this directive is the continual maintenance of a formal Recovery Plan and a Resolution Plan.

The Recovery Plan describes the strategy and a 'menu of actions' that could be taken by management to allow the recovery of the Bank from a significant adverse event which would otherwise lead to failure. The Recovery Plan is informed by the outcomes of the stress and scenario testing framework which the Board and senior management use to determine the strategy and actions to support a potential recovery.

The Resolution Plan provides data required by the PRA to be used to facilitate a rapid and orderly resolution in the event that the recovery of the Bank could not be achieved whilst maintaining any critical functions provided by the Bank to the economy.

Operational Resilience
The regulatory direction provided on operational resilience through discussion and consultation papers has led the Group to strengthen its previous approach to business continuity by assessing the firm's critical services and the supporting processes to identify potential disruptions that could crystallise under various operational scenarios i.e. cyber-attacks or head office unavailability. These detailed assessments have allowed a much greater understanding of where to devote resources to provide effective resilience for these critical services.

The impact of COVID-19 has tested our operational resilience framework during 2020 and its proven appropriate during this time. Feedback from this process has led to refinements and improvements to different aspects of our operational resilience that have strengthened it further.

Operational resilience coupled with the financial resilience assessed through the Recovery Planning outlined above combines to provide a firmwide resilience framework that approaches and tests resilience of the Group from multiple viewpoints and scenarios.

Report from the Chair of the Audit Committee

John Barbour
Chairman of the Audit Committee

The financial period ended 30 September 2020 has proven to be a year of unexpected challenges, with the UK going into a COVID-19 induced lockdown in March. In addition, our previous CEO resigned, creating the opportunity for our CFO, David Landen to step into this role initially as interim CEO before his permanent appointment in September. He was immediately faced with managing Hodge through a very difficult time. Since lockdown, all Audit Committee meetings have been conducted remotely.

A further change was the engagement of Deloitte as Internal Auditor, replacing PwC in December 2019.

The Audit Committee's agenda continues to include its responsibilities as the third line of defence in Hodge's Risk Management Framework; oversight of the performance and effectiveness of internal and external audit; ensuring the integrity of the financial statements of all companies within the Group; and oversight of Hodge's system of internal control.

Financial and Regulatory Reporting

The Committee's main responsibility in relation to the Group's financial statements is debating and challenging the judgements made by management and questioning the assumptions and estimates on which they are based. The exercise of appropriate judgement in preparing the financial statements is critical to ensure that Hodge's financial statements are fair, balanced and understandable.

The following are the significant judgements, issues and actions taken by the Committee in relation to the annual report and financial statements. Each of these matters was discussed with EY during the year and, where appropriate, addressed as areas of key audit matters in their audit report.

COVID-19 and IFRS 9 Impairment

Area of focus
COVID-19 has generated a great deal of uncertainty when it comes to assessing the credit quality of asset portfolios. This is further complicated by the payment holidays and deferred payment arrangements offered to customers and associated guidance provided by the PRA and FCA as to how to treat customers accepting such payment relief.

In addition, IFRS 9 modelling of expected credit losses relies on the formulation of a number of economic scenarios (positive, neutral and negative) and the allocation of probability weightings to each scenario.

Role of the Audit Committee
The Audit Committee reviewed a detailed paper presented by the Interim CFO providing a high-level assessment of the potential impact of COVID-19 on the Bank from both an accounting and capital perspective.

The Committee considered the recommendations made by the Interim CFO and challenged the proposed weightings for the positive, neutral and negative scenarios which underpin the IFRS 9 modelling of expected credit losses.

Conclusion/Action taken
The Committee accepted the recommendations of the Interim CFO regarding the classification of customers taking up payment holiday or deferred payment arrangements but required that the weightings for the economic scenarios be adjusted to reflect a more severe negative potential outcome.

Assessment of Risk Weighting of Mortgage Assets

Area of focus
In order to ensure Hodge Bank is correctly risk weighting its various mortgage assets, KPMG was appointed to review the decision processes used by Hodge to arrive at the risk weightings on certain of its mortgage assets. Such weightings are used for purposes of allocating capital.

Role of the Audit Committee
Because of the favourable conclusions of KPMG, compared with the conservative assumptions made by management, with respect to classifying certain corporate mortgages as retail, and the positive impact on Hodge's capital ratios, it was felt necessary to get an objective third opinion. To that end the Committee requested that Internal Audit review the workings and findings of both management and KPMG.

Through the course of the process the Committee were provided with verbal updates from management, the Committee reviewed a report from management and considered the Internal Audit report compiled by Deloitte. The Committee, being mindful of events at Metro Bank, strongly challenged the findings to ensure the conclusions would stand up to robust inspection by the regulator.

Conclusions/Actions taken
The Committee approved both the updated decision tree for assigning risk weightings and the reclassification of the risk weighting of certain existing assets based on the new decision trees.

Equity Release Mortgages and Reversions – Accounting Methodology and Valuation

Area of focus
Historically Hodge has calculated and valued its Day 1 gains on lifetime mortgage assets using a deferred reserve mechanism and a relatively fixed risk margin discount rate. Based on analysis of general market practice and taking into account broader feedback, it was proposed by the Actuarial Committee that the current deferred reserve mechanism should be changed in favour of calculating the deferral through a discounting process using an "active" risk margin determined by reference to current market pricing.

Role of the Audit Committee
The Committee reviewed a detailed paper prepared by the Chief Actuary, in which the new mechanism and the impacts on the financial results of both Hodge Bank and Hodge Life were set out. It also considered comments made by the second line of defence regarding the proposed change as well as audit feedback by EY with respect to current market practice.

The Committee challenged the basis on which the discount rate was arrived at, given the fact that it is not a liquid market with transparent pricing.

Conclusion/Action taken
The Committee approved the change in methodology and accepted that the proposed discount rates adequately reflected market conditions.

The Committee is satisfied that this change should be treated as a change in accounting estimate as opposed to a prior period adjustment.

Equity Release Mortgages and Reversions – Valuation Assumptions

Area of focus

In addition to the discounting methodology discussed above, a number of further assumptions are made in the valuation of ERM and Reversion portfolios. These assumptions are regularly tested against experience and adjusted as necessary when actual outcomes diverge from those expected under the assumptions, such that the accuracy of the valuation of these assets are correct.

Role of the Audit Committee

The Committee reviewed a paper produced by the Chief Actuary setting out a number of assumptions which no longer produced outcomes in line with expectations. These were lapses (relating to refinancing, downsizing and moving into long-term care), mortality and property underperformance. The impact of proposed changes was a mix of positive and negative outcomes, with the net effect negative to valuations.

The Committee obtained a second line of defence perspective from the Head of Risk for Hodge Life as well as the CRO of Hodge Limited.

Conclusion/Action taken

The Committee concluded that the proposed changes to assumptions provided a more accurate reflection of the value of its lifetime mortgage assets and accordingly approved the changes to assumptions.

Longevity Swap – Accounting for Day 1 Gains

Area of focus

During 2020, Hodge Life executed a longevity swap to reduce its longevity risk exposure. The swap generated a Day 1 gain, the treatment of which is not explicitly covered under IFRS 4. Upcoming accounting standard IFRS 17, however, would require that the Day 1 gain be deferred over the life of the transaction.

Role of the Audit Committee

A paper was presented by the Interim CFO in which the two options were set out: take 100% of the Day 1 gain in FY 2020 or defer the gain over the life of the transaction, as envisaged by IFRS 17. The Committee discussed the relative merits of the two courses of actions, with both prudence and the expected treatment under IFRS 17 being of primary concern.

Conclusion/Action taken

The Committee agreed to defer the Day 1 gain over the life of the transaction.

Equity Release Mortgages – National HPI vs Regional HPI

Area of focus

Hodge has historically used the Nationwide National HPI index as the basis for valuing its equity release mortgages. As a result of the process to sell part of the mortgage portfolio in 2019, and discussion with the regulator, it became apparent that it is current market practice to reflect regional HPI rather than national HPI when valuing equity release mortgages. The concern is that using national HPI hides variations in regional house price performance, leading to incorrect valuations.

Role of the Audit Committee

The Committee considered a number of papers presented by management, challenging both the use of regional vs national indices and which of Nationwide, Halifax and Office for National Statistics (Land Registry data) indices would give most reliable and timely data. The Committee also examined the impact of such a change to the valuation of the equity release mortgage assets.

Conclusion/Action taken

The Committee approved the switch to use of the Nationwide Regional HPI index, acknowledging that it would best capture house price performance for purposes of valuing the house price and dilapidation elements of the equity release mortgage portfolio.

Valuation of Derivatives

Area of focus

Hodge has a substantial amount of derivative financial instruments, relative to its Balance Sheet size. These hedge the risk to changes in interest rates and yield curves. These derivatives are valued at fair value as at the Balance Sheet date.

A proportion of interest rate derivatives are accounted for under IAS 39 hedge accounting rules. Significant changes in rates can affect their effectiveness as a hedge, which might lead to income volatility or a different accounting treatment.

Role of the Audit Committee

The Committee obtained confirmation from management that the valuation of derivatives at the year-end are in accordance with the amounts recognised by the relevant counterparties and that the hedge effectiveness calculations had been carried out appropriately.

Management were also able to evidence, for all the derivatives settled in the year, that the value attributed by counterparties prior to breaking the derivative was in line with the valuation held by the Group.

Conclusion/Action taken

The Committee was satisfied that the fair value of the derivatives was appropriately reflected in the financial statements and that, where hedge accounting was applied, it was effective.

Change in Year End

Area of Focus

Historically Hodge has conformed to an October year-end. Although this has been beneficial in that the annual audit avoids the peak demand for auditing services from those companies with a December year-end, it has meant that Hodge staff have been operating under pressure to complete the accounts in the lead up to the December holiday season.

Role of the Audit Committee

Following the closure of the 2019 financial statements, the Committee proposed that the CFO investigate the benefits and challenges to moving the year end to 30 September, starting with the 2019/2020 financial year.

Conclusion/Actions taken
The Committee considered a paper presented by the CFO in which the pros and cons of such a change were set out. It was considered that, on balance, Hodge would be better served with a September year-end and, as such, the change was approved.

Long-Term Viability Statement

Area of focus
The directors make a statement in the Annual Report as to the long-term viability of Hodge. The Committee provides advice to the Board on the form and content of the statement, including the underlying assumptions. This year the Committee needed to consider the uncertainties associated with COVID-19 as part of its deliberations.

Role of the Audit Committee
The Committee reviews the Board's assessment of long-term viability through consideration of the Group's rolling five-year strategy, the Bank's assessment of capital (ICAAP), the Bank's assessment of liquidity (ILAAP) and Hodge Life's Own Risk and Solvency Assessment (ORSA). In addition, the Committee specifically considered the impact of potential loan losses due to COVID-19 and Brexit and the impact on Hodge's capital position.

Conclusion/Action taken
The Committee agreed to recommend the long-term viability statement to the Board.

Fair, Balanced and Understandable Reporting

Area of focus
Hodge endeavours to ensure that its external reporting is fair, balanced and understandable. The Committee undertakes an assessment on behalf of the Board in order to provide the Board with assurance that it can make the statement recommended by the Financial Reporting Council's Corporate Governance Code.

Role of the Audit Committee
The Committee assessed, via discussion with, and challenge of, management (including the Chief Executive and CFO), as to whether disclosures in Hodge's published financial statements were fair, balanced and understandable.

Conclusion/Action taken
Having evaluated all of the available information and the assurances provided by management the Committee concluded, and were able to recommend to the Board, that Hodge's published report and financial statements were fair, balanced and understandable.

External Audit

A formal review of the effectiveness and audit quality of EY was carried out in 2020 following closure of the 2019 accounts, including an assessment of the professional scepticism and objectivity of the EY team. The Committee is responsible for assessing the objectivity and independence of EY. This responsibility was discharged through the Audit Committee meetings and during private meetings with EY. The Committee has a policy whereby all services which are not covered in the audit are approved by the Committee.

Hodge continues to examine non-audit fees in light of the Ethical Standard issued by the Financial Reporting Council (FRC). The payments made to EY for non-audit fees in the year ended 30 September was £nil (2019: £85k). This reflects a non-audit fee to audit fee ratio of nil%, the average for the last three financial years is 25%. The average non-audit fee for the last three financial years is below the 70% limit set by the FRC.

Internal Audit

The three-year appointment of PwC as Internal Auditors expired in December 2019. The Committee conducted a tender to replace PwC, and appointed Deloitte as a consequence. Continuing to outsource the role of Internal Audit remains appropriate for Hodge as it enables the Group to access a far wider group of specialists and expertise than could be maintained in-house.

Deloitte was chosen on the basis of:

- a deep grounding and knowledge of the UK financial services sector;
- a good working knowledge of emerging business and regulatory issues;
- its ability to ensure that appropriate skilled resources are brought to bear on the internal audit of Hodge from wherever in the UK this skill resides;
- its ability to provide the Committee with informal benchmarking, comparing Hodge with similar companies in the financial sector to questions from the Audit Committee;
- the availability of key personnel throughout the three-year term of the appointment.

The Committee scrutinises and agrees Internal Audit's plans, including agreeing the areas of focus, which this year included cyber security (perimeter defences), a review of KPMG's work on risk weightings, treasury management, capital and liquidity reporting, product governance, and compliance and second line assurance.

The Committee tracks the implementation of the recommendations of Internal Audit, in conjunction with Deloitte, and is satisfied that these are being implemented on a timely basis.

It is planned that the Committee will review the effectiveness of the Internal Audit service at the end of the first year following Deloitte's appointment, using a self-assessment questionnaire to be completed by management and members of the Committee during the year and discussed with Deloitte thereafter.

Internal Control

The Audit Committee has responsibility on behalf of the Board for Hodge's systems of internal control. The Audit Committee discharges this responsibility by discussing and challenging reports issued by Internal Audit. Further, through my membership of the Risk and Conduct Committee, I am made aware of any issues raised by the second line of defence assurance team which monitors the implementation of its and Internal Audit's recommendations. Collectively these reports provide assurance that there are effective internal controls within the Group.

The Audit Committee also discusses any control observations raised by EY. The Audit Committee continues to encourage management to reduce the volume of manual internal controls and automate as many controls as possible to reduce operational risk.

Whistleblowing

I am the Whistleblowing Champion for Hodge and have reviewed the integrity, independence and effectiveness of Hodge's whistleblowing policies and procedures and also those policies and procedures intended to protect whistle-blowers from being victimised and I am satisfied that these are appropriate.

Committee Composition and Meetings

The Committee's membership is designed to provide the depth of financial expertise and commercial acumen it needs to fulfil its responsibilities. Alun Bowen is the designated financial expert on the Committee.

Committee meetings were attended by the Chief Executive, CFO, Head of Risk, Head of Compliance, Managing Director of Hodge Life, Head of Commercial Lending, the Chief Actuary, representatives of Deloitte and EY and by other members of the business, as appropriate.

During the year private meetings were held with the Lead Audit Partner from EY, as well as the Head of Internal Audit from Deloitte, without management present.

Interaction with Regulators

As Chair of the Audit Committee I meet with the members of Hodge's regulatory team at the PRA, without management present, during their annual visit to Hodge.

Committee Performance

The Committee updated its self-assessment of its performance and concluded that the changes from previous assessments had now been appropriately implemented. One of the issues outstanding was training for members of the Committee.

Looking Ahead

Climate change, and the risk that it poses to society, has become an issue of elevated concern. This is echoed in the level of regulatory scrutiny, with Sarah Breedon at the Bank of England taking a leading role in pushing for change within the financial services industry. Hodge is dedicated to doing its part and will be developing its climate risk framework over the course of 2020/2021.

The Audit Committee will also embrace the recommendations made by Sir Donald Brydon in his report on the effectiveness of audit issued last year. In particular, it is likely that his recommendations on issuing an Audit and Assurance Policy and a Resilience Statement will be implemented when appropriate guidance is issued.

John Barbour
Chairman of the Audit Committee
11 December 2020

Report from the Chairs of the Risk and Conduct Committees of Julian Hodge Bank and Hodge Life Assurance Company

David Gulland
Chair of Risk and Conduct Committee, Hodge Life Assurance Company

Iain Laing
Chair of Risk and Conduct Committee, Julian Hodge Bank

Committee Structures and responsibilities

Since 1 July 2019 our two regulated entities, Hodge Bank and Hodge Life, have had separate governance arrangements for risk, including distinct Risk and Conduct Committees. This has enabled focused oversight of detailed projects within the two companies, while close cooperation between the two committees avoids duplication of effort and maximises efficiency. Since there remains much work that is common to both committees, and to assist the reader, this single report has been prepared covering the work of both committees with clear identification of items that are specific to each company.

There is a useful overlap of membership across the two committees but with increasing specialism so as to reflect the different needs of the two companies. Full details of membership are shown on page 28. David Gulland has been the Chair of Hodge Life's Committee throughout the financial year. Alun Bowen was the Chair of Hodge Bank's Committee until July 2020, when Iain Laing assumed the chairmanship.

Our prescribed responsibilities as Chairs of the Risk and Conduct Committees are to safeguard the independence of, and oversee the performance of, both the Risk and Compliance functions. As such we have regular meetings with the members of the Risk team who undertake assurance reviews to ensure that the work they are doing, as part of the second line of defence, is as effective as possible and enable them to air any issues and views. During the year, as explained later, we have significantly increased the technical capacity within Hodge Life's Risk team. We are confident that we have a team which is carrying out robust work and adding value to both the businesses.

Activities during the year – as highlighted last year
The table below shows the areas highlighted in last year's report on which we planned to focus during this year, and the actions taken.

	Progress during 2019/2020
Combined areas for Hodge Bank and Hodge Life	
Ensuring that the remaining gaps in both the operational resilience and the cyber security programmes are closed and that they are appropriate to address the new types of disruption that might appear during the year.	Tests of our Disaster Recovery Plan were carried out during early March 2020. The results of this exercise were invaluable when the country subsequently went into "lockdown" as a result of the COVID-19 pandemic and as a result, as reported elsewhere, we were able to maintain high levels of customer service despite not being able to access our offices.
Areas for Hodge Bank	
Continuing to encourage management to reduce volatility in the remaining legacy business.	The Bank disposed of a substantial part of its equity release portfolio in 2019 and has made progress towards disposing of its reversionary portfolio. The Committee approved an updated Interest Rate Risk policy, setting limits and controls over interest rate risk.
Monitor management's plans to transition away from LIBOR are carried out with appropriate speed and managed from a risk perspective.	The Committee has received a report on the Bank's LIBOR linked exposures, plans for the transition away from LIBOR, and regular updates on the progress of this plan. Adequate progress has been made.
Carrying out reviews of the new products launched in the last eighteen months to ensure that they are performing in line with expectation.	The Committee has received debriefs from the Product Committee's reviews of holiday buy-to-let, portfolio buy-to-let, and retirement interest-only mortgages; home reversion plans; partnerships with Raisin and Flagstone for deposit gathering; the lending partnership with Landbay; and product proposals for second charge mortgages, mortgages over Houses in Multiple Occupancy (HMOs) and lifetime ISAs. The holiday buy-to-let pilot and launch was the subject of several deep-dive reviews by the Committee. Whilst these products are performing adequately, ongoing review in this manner will continue.
Areas for Hodge Life	
Working with management to further strengthen the overall Risk Management Framework for Hodge Life including an increased detail in how the solvency position is monitored.	The resources dedicated to risk management for Hodge Life were significantly strengthened during the year through the hiring of a risk actuary to the role of Head of Risk and the appointment of an external experienced risk actuary, Neil Cantle of Milliman, as our Chief Risk Officer. As explained in further detail in this report, significant technical work has been carried out to increase the detail around the risk appetite for Hodge Life, and to improve the monitoring of the exposure of Hodge Life to underlying risks.
Overseeing from a risk perspective the proposed longevity transaction.	The longevity reinsurance was implemented during the year. The Committee played a major role in assessing the proposed transaction, the design of its features, and its actual implementation. The Risk function has also overseen the consequent changes to Hodge Life's risk appetite and risk reporting that were required as a result of this transaction.
Providing overall governance to the potential application for a Partial Internal Model for use in determining capital requirements.	The Risk function, and the Committee, supported the decision taken during the year to cancel the project to seek a Partial Internal Model.
Ensuring that Hodge Life is fully compliant with the PRA's expectations around liquidity management as set out in their Supervisory Statement 5/19.	No significant issues were found around the new requirements.

Activity during the year – other areas

In addition to the activities signposted from last year discussed above, the significant matters addressed by the two committees during the year are summarised in the following tables. The first sets out the risks that had many common features for both entities, such as cyber risk and operational resilience. In such cases our main activity was carried out in one of the two committees but with care to ensure that any special aspects that affected the other entity was also dealt with at that entity's committee. In this way we avoided duplication of effort but also ensured due consideration to each company's particular requirements.

Activities common to both companies

Area of focus	Action taken by the Risk and Conduct Committees	Conclusion or further action taken
Operational resilience	• The remaining gaps in resilience identified last year were closed early in the year. • A successful Fire Drill was carried out which identified further minor issues that were quickly resolved. • After the lockdown from COVID-19 the Committees monitored the successful migration of the business to remote working, and the initial plans to resume some office-based work.	• The Committees were satisfied with the resilience of the Group during the lockdown and the robustness of management's plans. • The minor lessons learned from remote working have been acted on, in particular exposure to third-party providers of services.
Cyber security	• Risk assurance reviews of Data Deletion, Data Retention, Role Based User Access, GDPR were undertaken. The conclusions of these reviews and progress resolving the actions raised by these reviews have been reported to the Committee.	• The Committees were satisfied with the results of the reviews carried out. • Review of Hodge's information security and data protection arrangements should remain a theme within the risk assurance plan in coming years.
Conduct risk	• The Committees continued to review all of Hodge's products on a cyclical basis to ensure that product features remain appropriate and reviewed management's proposed actions to address any issues identified during the reviews. • A particular focus was placed on the approach being taken to vulnerable customers. • A retrospective review of some customer communications was carried out that identified some historic practices that could have led to some customer dissatisfaction. The remedial action carried out by management was monitored. • Further improvements to the management information provided to the Committee were implemented.	• The Committees were satisfied with the results of the reviews carried out. Although some historic practices were identified that were not optimal these had not led to any customer detriment and no further action is needed. • Further changes to the management of conduct risk will be implemented to assist the embedding of risk management directly into the business operations.
Climate Change	• The Committee approved a Climate Change policy, establishing responsibilities for identification and management of financial risks of climate change, and a plan to improve understanding and management of these risks, aligned to the requirements of SS3/19.	• Although Hodge has so far kept pace with regulatory expectations in this area, over the coming year further progress will need to be seen in quantifying Hodge's exposures, defining risk appetite measures, and embedding controls.

Hodge Bank

Area of focus	Action taken by the Risk and Conduct Committees	Conclusion or further action taken
Risk Management Framework	• The Committee approved proposed improvements to Risk Management Policy, the Risk Policy Framework, Risk Strategy, Risk Reporting and Risk and Conduct Management Information.	• The Committee was satisfied with the proposals and the progress that has been made. • Further progress will be required to complete the refresh of all relevant policies, to increase the value of risk reporting, and to ensure ownership of risks management in the first line of defence.
COVID-19	• The Committee received a COVID-19 risk assessment, and proposals to increase risk acceptance and defer risk assurance to mitigate some of the impacts of the transition to remote working. • The Committee reviewed the Bank's Commercial and Retail Lending criteria, and undertook a line-by-line review of the Bank's Commercial Credit exposures reflecting upon the potential impacts of the pandemic.	• The Committee were satisfied with the Risk Assessment, and found the measures proposed to be well-balanced. • Continuing review of the Bank's weaker commercial exposures and resultant action plans as the impacts of the COVID-19 pandemic mature.
Compliance	• The Committee approved the Compliance Monitoring Plan, including an ongoing rolling review of BCOB and MCOB compliance. • The Committee received a roadmap for the development of the Hodge Bank's Compliance Framework. • The Committee reviewed progress made resolving identified gaps in MCOB compliance.	• The Committees were satisfied with the results of the reviews carried out, and the progress made addressing BCOB gaps. • The Committee were satisfied with the Roadmap for the Compliance Framework, and will review the proposals it produces in the year ahead. • The Committee were satisfiedwith progress made against gaps identified in MCOB compliance.
Complaints	• The Committee received the results of a review of customer outcomes of a sample of complaints.	• The Committee was satisfied that no systemic issue with complaints handling had been identified. • The Committee felt that more work was required to make sure that all complaints were being reported, and their root cause effectively identified.
Mortgage Risk Weights	• In a joint effort with the Audit Committee, the Bank Risk and Conduct Committee undertook a detailed review of the risk weights assigned to buy-to-let mortgages, and the arrangements in place to ensure holiday buy-to-let mortgages would justify a 35% risk-weight, supported by a second line review of the proposals.	• The Committee were satisfied that the risk weights and controls proposed were appropriate.

Hodge Life

Area of focus	Action taken by the Risk and Conduct Committees	Conclusion or further action taken
Risk Appetite and Framework	During the year the Committee has overseen the: • Increased focus on SCR coverage as the key financial risk for Hodge Life, replacing the composite indicators previously used; • Calibration of the aggregate risk appetite and the development of target and limits for the SCR coverage; • Establishment of appetites for the individual risks underlying the aggregate position; • Planned actions being proposed for each risk exposure (as detailed below).	The detailed work indicated that further actions were needed on some specific risk exposures. Much of this action was successfully carried out during the year but where necessary further de-risking will be carried out in the coming year.
Longevity and counterparty risk	The Committee approved the calibration of the risk appetite for longevity and the consequent implementation of the reinsurance treaty. In particular it: • Reviewed and approved the appropriate assessment of counter-party risk that arises from the treaty, including assessing the appropriateness of the Standard Formula for such an exposure; • Reviewed and approved the financial and operational terms of the treaty; • Ensured it was receiving appropriate indicators around the new counter-party risk.	• The reinsurance treaty was successfully implemented and has significantly reduced the exposure to longevity risk, and also to interest rate risk. • The Committee was satisfied with the controls in place around the implementation of the transaction. • The results of an Internal Audit around the transaction were satisfactory.
Interest rate risk	• The Committee approved the calibration of the risk appetite for interest rate risk and monitored management's subsequent actions to reduce this exposure. • Increased management information was requested and provided to the Committee so as to gain greater understanding to Hodge Life's exposure to potential movements in the interest rate curve, and the reasons for such exposure (measured by the coverage of the SCR). • Alternative methods of reducing interest rate exposure were assessed.	• Actions taken during the year (both on investments and the reinsurance treaty) have significantly reduced Hodge Life's exposure to interest rate risk. • Further action on investments is planned and expected to be completed by the end of 2020.
Property risk	The During the year the Committee oversaw significant work that increased the level of detail around Hodge Life's exposure to property risk. This included: • Assigning a notional credit rating to each of the equity release mortgages based on the level of property shock that each could support; • Reviewing alternative approaches to obtaining reliable current property valuations; • Considering alternative potential paths for future house prices, both in aggregate and for individual properties. This work helped the Committee to approve the calibration of the risk appetite for property risk and to consider alternative methods to reduce such exposure.	• The results of the detailed work indicated that further action on property risk, particularly on reversions, is required. This will be progressed in the coming year. • The improved methods of obtaining updated property valuations will be implemented on a regular basis.

Hodge Life – continued

Area of focus	Action taken by the Risk and Conduct Committees	Conclusion or further action taken
Liquidity risk	The Committee continued to monitor the results of the various liquidity stress tests that Hodge Life uses, and their appropriateness. In particular the Committee: • Considered the potential collateral requirements arising from the reinsurance treaty; • Assessed the compliance with the PRA's document SS5/19.	• The Committee will continue to monitor the reinsurance treaty with particular focus on management of potential liquidity calls. • No issues around compliance with SS5/19 were identified, as the current tests and controls are considered to meet the requirements of the document.
Risk management and governance	The Committee addressed some areas of potential weakness during the year. In particular: • A dedicated Head of Risk was hired for Hodge Life. This provides the Committee with increased technical support. • It was decided to appoint an external expert as the Chief Risk Officer. Neil Cantle from Milliman, a leading actuarial and risk consulting business, was duly appointed. • The nature of the information provided to the Committee was reviewed so as to ensure greater focus on the key drivers of risk.	• The development of the Risk function will continue to be monitored, with particular focus on ensuring that internal staff benefit from exposure to the external specialists. • The nature of the risk information provided to the Committee will continue to be assessed so that it meets the Committee's evolving needs.
Capital adequacy and recovery plans	During the year the Committee, supported by the Risk Function: • Reviewed and challenged the design and execution of the capital adequacy assessment processes, including any changes to methodology and assumptions; • Reviewed and challenged the regular financial and risk reports from the Chief Actuary including the appropriateness of the methodology and assumptions used and the controls used in preparation of the results of models used; • Managed the preparation of the ORSA, including the design, calibration and execution of stress and scenario testing, including reverse stress testing; • Oversaw and reviewed the SFCR prepared by the Chief Actuary, ahead of recommending for Board approval; • Reviewed the development of the CFMAP including its amendment following the implementation of the reinsurance treaty.	• The increased technical skills of the Risk function enabled appropriate challenges to be made to the methods and assumptions being used by the business. • The range of actions available under the CFMAP will assist Hodge Life in developing its strategy.

Interaction with management

Both committees are mindful of the need to hold management directly accountable when issues have arisen and been reported by the CRO, Head of Compliance or other parties. Members of Senior Management attend Committee meetings for deeper discussions in such instances.

The Chair of the Hodge Life Committee held weekly meetings with the CRO of Hodge Life after his appointment so as to ensure close coordination of efforts and early identification of any issues.

Interaction with regulators

Hodge Bank: The Committee reviewed the closure of actions arising from the PRA skilled persons report into management of Interest Rate Risk in the Banking Book ('IRRBB'). The Committee received feedback from the FCA in relation to the findings of their MCOB compliance review, and reviewed management's response to this feedback. The Committee also reviewed and supported management's response to the FCA consultation on Single Easy Access Rate for Savings.

Hodge Life: During the year feedback from the PRA was received around its views on several aspects of Hodge Life's risk profile and management. Actions from this feedback have been carried out and described in the earlier sections of this report from the Committee.

Committee performance

Each committee carried out a self-assessment of its performance as well as a review of its Terms of Reference. The results from the former were satisfactory with the suggested actions implemented. Minor changes to the Terms of Reference have been made.

Looking ahead

Iain Laing, Chair of the Hodge Bank Risk and Conduct Committee, will be encouraging the Bank's Committee to focus on the following areas during the next financial year:

- Continued development of credit management capabilities, policies and controls, including embedding capital considerations into pricing and lending decisions;
- Ensuring the strengthening of retail credit capabilities keeps pace with the growth of retail exposures;
- Ensuring the down-side risks of the commercial credit portfolio are managed proactively;
- Continued oversight over the new products and change initiatives required by the Bank's strategy;
- Continuing the programme of improvements to the Bank's risk and compliance frameworks;
- Strengthening fraud and financial Crime control;
- Ensuring effective first line of defence ownership of all risks;
- Establishing responsibilities for identification and management of financial risks of climate change.

David Gulland, Chair of the Hodge Life Risk and Conduct Committee, will be encouraging Hodge Life's Committee to focus on:

- Further embedding of the various capital and liquidity stress tests into the ongoing management of the business;
- Continued development of the Risk function;
- Ensuring that risk issues are appropriately considered in all potential strategic actions.
- Identifying and managing the financial risks of climate change and improving Hodge's understanding of these risks.

Iain Laing

Chair of Risk and Conduct Committee, Julian Hodge Bank

11 December 2020

Chair of the Risk and Conduct Committee, Hodge Life Assurance Company

11 December 2020

Report by the Chair of the Nominations and Governance Committee

Graeme Hughes
Chair of the Nominations and Governance Committee

Following Adrian Piper's resignation, I assumed Chair of the Committee on the 1st of May this year and am pleased to report that the Committee met 7 times during the year and fully complied with the terms of reference of the Committee, with a particular focus on the Board composition, leadership succession and robust Corporate Governance.

The Committee was responsible for defining and leading the culture and values of the organisation as well as overseeing the resourcing strategy with increased investment in our digital capabilities, leadership capabilities and risk management capabilities in particular.

With the resignation of the CEO at the start of the year, a key priority has been executive succession. David Landen was appointed Interim CEO with Matthew Burton Interim CFO in March, both appointments coinciding with the significant market and operational impacts of COVID-19. The leadership succession plan worked very effectively as an additional 3 key leadership roles were appointed on an interim basis from within the existing teams.

Following a robust recruitment process using the expertise of Ridgeway Partners the Committee confirmed David Landen as CEO and Matthew Burton as Deputy CEO in September.

Alongside the Executive appointments, the Nominations and Governance Committee also oversaw the successful appointment of a Chair of the Board as well as welcoming Alison Halsey as Senior Independent Director, Iain Laing as Chair of Hodge Bank's Risk and Compliance Committee, Aileen Wallace as Acting Chair of Change and Innovation Committee and Rebecca Jonson Hall to the Hodge Life Board.

The appointments bring a wide range of expertise and experience, and each director has a personal development plan in place to enable them to maximise their contribution to the effective governance of the organisation.

Iain's appointment follows on from Alun Bowen's resignation after many years of significant contribution to the Board and he leaves with the thanks and best wishes of the Board.

Looking forward, a key priority remains to build a fully inclusive organisation at all levels within the organisation in order to better reflect the communities that we serve and to improve the effectiveness of decision making throughout. The strategy has been defined and will be led by the Committee with a recognition that we have to make real progress in the forthcoming years.

Having signed up to the Women in Finance charter in 2019, work has been underway to help us to achieve the targets we set for senior management roles occupied by women by 2022. Having started at 35% in September 2019, we have been able to increase this to 38% as of September 2020 – a good start towards our target of 45% in 2022. At Board level, we have increased our female representation from 11% in September 2019 to 30% in September 2020. Alongside this target, work has begun to review our internal processes and strategy to ensure that inclusion is a key facet of the way in which Hodge is set up to work. In FY 2021, Hodge will pursue key diversity, equality & inclusion milestones that will see evolution across policy, recruitment, networking and engagement areas. In this first instance, executive sponsors for each aspect of this work will be identified from our Executive Committee and the Board.

Graeme Hughes
Chair of the Nominations and Governance Committee
11 December 2020

Report by the Chair of the Remuneration Committee

Helen Molyneux
Chairman of the
Remuneration Committee

Last year, the Remuneration Committee completed the important task of shaping and agreeing a reward strategy for Hodge that sets out our guiding principles and direction for the Group's reward policies, practices and offerings.

At the start of this year, this reward strategy was instrumental in ensuring that we were clear about what we are trying to achieve when it comes to rewarding and recognising our colleagues, helping us to recruit and retain the brightest and the best, in a period of strategic, fast paced growth.

As part of our strategy, 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, the Committee 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 in this regard.

At the beginning of 2020, the resignation of the CEO and the impact of the COVID-19 pandemic on the business meant that the Remuneration Committee was required to deal with a number of important issues that were outside the annual meeting agenda.

Following the resignation of the CEO, the Remuneration Committee advised the Board on appropriate exit terms and, having considered advice from Ridgeway partners on benchmark salaries for the role, advised on the remuneration approach to be taken to the recruitment of the replacement CEO in order to inform the recruitment process. An interim CEO and an interim CFO were appointed, and remuneration packages were also considered and adopted in order to secure the leadership of the business pending the appointment of the new CEO.

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 Committee recommended to the Board that all colleagues received 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 Group's performance and the economic outlook, it was highly unlikely that the performance targets set by the Committee would be met to enable payments to be made under the Group's Incentive Scheme. The Committee therefore advised the Board in May that the staff should be informed of the situation as early as possible in order to manage expectations.

Last year, we also introduced a non-contractual reward scheme for a group of our strategic leaders that was designed to recognise long-term performance against the 2023 plan. In the light of the economic and social conditions that the business has faced this year, the Committee has recommended to the Board that no payment is made under the scheme for this year and that the scheme is subjected to a strategic review in light of the appointment of a new CEO, the economic climate and the strategic direction of the business.

The Remuneration Committee will work with the executive team to devise a new long term, sustainable reward scheme that ensures that our leadership reward proposition remains competitive and appealing to colleagues whilst remaining affordable, supportive of effective customer outcomes and risk controls and which is proportionate in its design.

At the end of last year, the Committee agreed to conduct a gender pay audit during 2020 and to publish the results. In view of the exceptional trading circumstances and the pressure on the Human Resources team, the Committee agreed to postpone this audit. However, a review was conducted of the exceptional awards made under the all staff bonus scheme and the Committee considered a breakdown of the bonus. The main recommendation arising from the analysis was that in future, sufficient time needed to be provided for the consideration of exceptional bonuses, applying a 'diversity' lens early in the process to ensure that sufficient challenge took place. The Committee will seek to ensure that the correct processes are put into place to ensure that future awards are fair and balanced throughout the business and that our colleagues have the skills to appropriately evaluate and challenge. The formal gender pay audit will be conducted in 2020/21.

In what has been a busy year for the Committee, we continued to seek to develop our skills and understanding of the market in which we operate. The Chair, Senior Independent Director, Chair of the Committee, Chief People Officer, CFO and CEO took part in a training session with Juliet Halfhead of Deloitte, on reward and recognition in financial services, which was subsequently shared with the whole committee, as part of its continued development.

Over the next 12 months, the Committee will be focusing on ensuring that our long-term incentive schemes support and motivate our colleagues to deliver the recovery required and the strategic vision that the new CEO will bring to the business.

Helen Molyneux

Chair of the Remuneration Committee

11 December 2020

Directors' Report

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

Group strategy - page 7
Financial performance review - page 18
Risk management policies - page 29
Derivative financial instruments - note 25

Directors and Directors' interests
The directors who held office during the year were as follows:

David Landen (CEO)

Matthew Burton (Deputy CEO) (Appointed April 2020)

Stephen Pateman (CEO) (Resigned March 2020)

Graeme Hughes* (Chairman)

Alun Bowen* (Non-Executive Director)

Aileen Wallace* (Non-Executive Director)
(Appointed April 2020)

Iain Laing* (Non-Executive Director)
(Appointed July 2020)

Helen Molyneux* (Non-Executive Director)

John Barbour* (Non-Executive Director)

David Gulland* (Non-Executive Director)
(Appointed November 2019)

Adrian Piper* (Chairman)
(Retired April 2020)

No contract was entered into by the Group in which a director had a material interest.

* All non-executive directors are deemed to be independent by the Board. None of the directors held any interests in the shares of any group companies.

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

Change in year end
During the year the Group changed its year end from 31 October to 30 September.

Political contributions
The Group made no political contributions during either year.

Post Balance Sheet events
There were no post Balance Sheet events to disclose.

Dividend
No dividends have been declared or paid during the year.

Qualifying third-party indemnity provisions
The Group 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 Director's Report.

Re-appointment of auditors
A resolution for the re-appointment of EY as auditor of the Company is to be proposed at the forthcoming Annual General Meeting of the Company's parent, The Carlyle Trust Limited.

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

- The impact on the Group's profits from an expected reduction in income from residential and commercial lending combined with increased credit impairment charges;
- The sufficiency of the Group'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 Group's liquidity.

The Group's forecasts and projections include scenario testing undertaken in accordance with the Internal Capital Adequacy Assessment Process, Individual Liquidity Adequacy Assessment Process and Own Risk and Solvency Assessment, 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 Group will continue in business for a period of at least 12 months from the date of signing the Annual Report and Financial Statements. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

By order of the Board

DLanden

David Landen
Director
11 December 2020

Statement of Directors' Responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the Group financial statements in accordance with International Financial Reporting Standards and Interpretations (collectively IFRSs) issued by the International Accounting Standards Board (IASB) as adopted by the European Union ('adopted IFRSs') and those parts of the Companies Act 2006 that are applicable to companies that prepare financial statements in accordance with IFRS. The Company has 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 Group and parent Company and of their profit or loss for that period. In preparing each of the Group and parent Company 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 IFRS or UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and 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 its 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 Group 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.

Each of the directors who is a director at the date of the approval of this Annual Report confirms to the best of their knowledge:

1. The Group and parent Company financial statements prepared in accordance with IFRS and FRS 101, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the Company.
2. The Strategic Report includes a fair view of the development and performance of the business and the position of the Group together with the description of the principal risks and uncertainties that it faces.
3. The Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for the shareholder to assess the Group's position and performance, business model and strategy.
4. The directors who held office at the date of approval of the Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group'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 Group's auditor is aware of that information.

03 Auditor’s Report

Independent Auditor's Report to the Members of Hodge Limited

Opinion

In our opinion:

- Hodge Limited's Group financial statements and parent Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the parent Company's affairs as at 30 September 2020 and of the Group's profit for the period then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Hodge Limited which comprise:

Group	Parent Company
Consolidated Income Statement for the period then ended	Company Balance Sheet as at 30 September 2020
Consolidated Statement of Comprehensive Income for the year then ended	Company Statement of Changes in Equity for the period then ended
Consolidated Balance Sheet as at 30 September 2020	Related notes 1 to 36 to the financial statements (except for the sections of 36 which are marked as unaudited), including a summary of significant accounting policies
Consolidated Statement of Changes in Equity for the period then ended	
Consolidated Statement of Cash Flows for the period then ended	
Related notes 1 to 36 to the financial statements (except for the sections of 36 which are marked as unaudited), including a summary of significant accounting policies	

The financial reporting framework that has been applied in the preparation of the Group's financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent Company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

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 Group and parent 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 Group's or the parent 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 lifetime mortgage and reversion assets and annuity liability technical provisions. • The risk that inappropriate and inaccurate IFRS 9 Expected Credit Loss ('ECL') provision. • The risk of incorrect valuation of derivatives.
Audit scope	• To support the Group audit opinion we performed an audit of the complete financial information of the parent entity and both regulated entities within the Group, Julian Hodge Bank Limited and Hodge Life Assurance Limited.
Materiality	• Overall Group materiality of £15.8m which represents 5.2% of equity.

Key audit matters

Key audit matters are those matters that, in our professional judgement, 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 mortgage and reversion assets (Loans and advances - equity release mortgages): equity release mortgages: £634.3m, 2019: £620.4m, reversion assets: £170.9m, 2019: £170.1m, long term business provision: £528.0m, 2019: £498.8m). 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. 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 15 of the financial statements, with the principal assumptions and sensitivity analysis of changes to key assumptions disclosed in note 31. The reversion assets are disclosed as investment properties in note 19 of the financial statements, with the principal assumptions and sensitivity analysis of changes to key assumptions disclosed in note 19.	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 focussed our audit work on were as follows: **No Negative Equity Guarantee** We considered each of the assumptions used within the NNEG calculation, considering a combination of historic and projected future house price growth, the potential variability in house price movement and the allowance made for property dilapidations 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. **Voluntary early redemption** 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. 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.	Overall, we consider the assumptions that are used in the valuation of the lifetime mortgages, reversion assets and annuity liability technical provisions 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 reasonable range.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
The annuity liabilities are disclosed as long-term business provisions - liabilities arising from insurance contracts in note 26 of the financial statements, which also includes sensitivity analysis of changes to key assumptions.	**Discount rate** 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. We also tested the discount rates used in the annuity liability valuation, given the underlying assets. **Policyholder mortality/ longevity** 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. **Expenses** 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.	

Risk	Our response to the risk	Key observations communicated to the Audit Committee
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 and 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 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 loans 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 IFRS9 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.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
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. **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 16 and 32 of the financial statements respectively.	We evaluated management's assessment of the appropriateness of the external 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. 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.	
The risk of incorrect valuation of derivatives: £81.9m (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 25 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.

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 each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements we performed a full scope audit of both Julian Hodge Bank Limited and Hodge Life Assurance Company Limited. Together with the parent entity this represents 100% of the equity of the consolidated group. All audit work performed for the purposes of the audit was undertaken by the group audit team.

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 Group to be £15.8m (2019: £6.3m), which is 5.2% of equity (2019: 2.0%). We believe equity to be the most appropriate basis as the key stakeholders (including the principal shareholder and the PRA for the regulated subsidiaries) are focused on the financial strength and solvency position of the business, which is represented in the financial statements by equity.

We determined materiality for the parent Company to be £4.1m (2019: £1.6m), which is 5.0% (2019: 2.0%) of equity. We believe equity to be the most appropriate basis as the parent Company is a holding Company with limited trading activity.

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 Group's overall control environment, our judgement was that performance materiality was 75% (2019: 75%) of our planning materiality, namely £11.9m (2019: £4.7m) for the Group. We have set performance materiality at this percentage because our prior year audit experience indicates a lower risk of misstatements, both corrected and uncorrected.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the allocated performance materiality for the Group opinion was as follows:

- Hodge Limited parent entity: £6.0m (2019: £2.4m)
- Julian Hodge Bank Limited: £6.0m (2019: £2.6m)
- Hodge Life Assurance Company Limited: £6.5m (2019: £3.1m).

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.

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

Responsibilities of directors
As explained more fully in the Directors' Responsibilities Statement set out on page 58, 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.

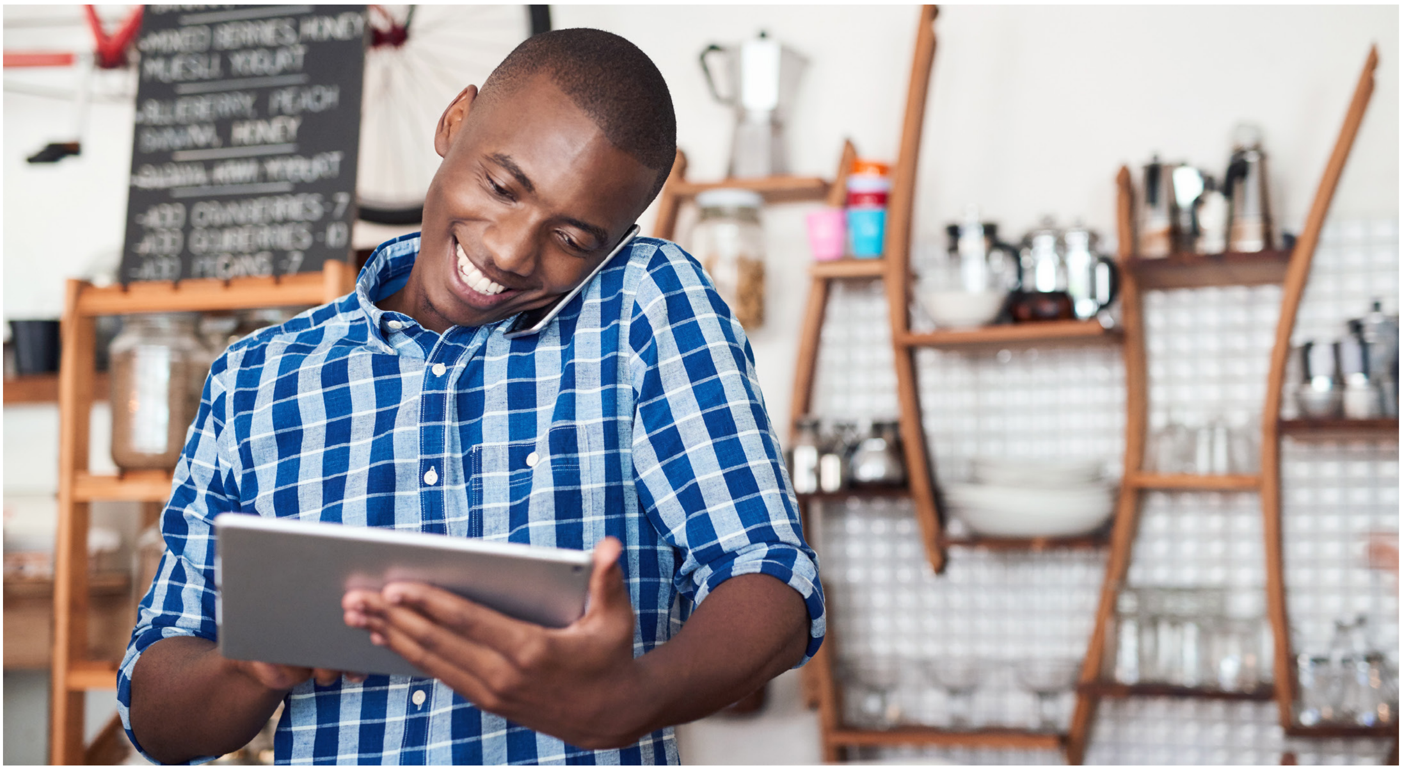
In preparing the financial statements, the directors are responsible for assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or parent 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.

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 Group operates in the banking and insurance industries which are considered as highly regulated environments. 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 Group 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.
- Non-audit services prohibited by the FRC's Ethical Standard were not provided to the parent Company or Group and we remain independent of the parent Company and Group in conducting the audit.
- The audit opinion is consistent with the reporting to the Audit Committee.

Use of our report

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

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 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.

04 Financial Statements

Consolidated Income Statement

For the 11-month period ended 30 September 2020

	Notes	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Interest receivable and similar income	4	59.9	69.9
Interest payable and similar charges	5	(22.8)	(28.2)
Net interest income		**37.1**	**41.7**
Fees and commissions receivable		0.7	0.6
Fees and commissions payable		(0.4)	(0.9)
Net fee and commission income		**0.3**	**(0.3)**
Earned premiums	6	22.8	41.6
Impact of new insurance contracts	26	(23.4)	(42.4)
Investment income		8.7	16.9
Gross claims and benefits paid	26	(25.4)	(26.9)
Impact of gross claims and benefits paid on the provision for long-term business	26	25.4	26.9
Net operating income		**45.5**	**57.5**
Administrative expenses	7	(27.2)	(22.8)
Depreciation and amortisation	17/18	(1.8)	(1.3)
Impairment losses on loans and advances to customers	16	(5.4)	(3.9)
Operating profit		**11.1**	**29.5**
Other fair value gains	8	3.1	24.9
Gains arising from the derecognition of financial assets managed at amortised cost	12/13	4.1	3.1
Reinsurance recoveries		394.3	-
Reinsurance expense		(393.7)	-
Loss on disposal of loans and advances to customers		-	(4.6)
Movement in long-term business provision	26	(31.3)	(46.3)
(Loss)/profit before taxation		**(12.4)**	**6.6**
Tax on profit	10	3.1	(0.6)
(Loss)/profit for the financial period		**(9.3)**	**6.0**

Consolidated Statement of Other Comprehensive Income

For the 11-month period ended 30 September 2020

	Notes	2020 £m	2019 £m
(Loss)/profit for the financial period		(9.3)	6.0
Items that will not be reclassified subsequently to profit and loss:			
Re-measurement of defined benefit pension plan	28	(4.4)	(3.3)
Deferred tax thereon	21	0.7	0.6
Movement of pension scheme reimbursement asset	**22**	**0.4**	**0.5**
Deferred tax thereon	21	(0.1)	(0.1)
Total other comprehensive income		**(3.4)**	**(2.3)**
Total comprehensive income for the period		**(12.7)**	**3.7**

The results for the 11-month period ended 30 September 2020 relate entirely to continuing operations. The notes on pages 80 to 148 form part of these financial statements.

Consolidated Balance Sheet

As at 30 September 2020

	Notes	2020 £m	2019 £m
Assets			
Cash and balances held at central banks	11	147.9	321.9
Government bonds	12	77.9	55.5
Debt securities	13	124.8	134.8
Loans and advances to credit institutions	14	117.1	87.3
Loans and advances to customers	15	1,433.7	1,242.6
Intangible assets	17	7.3	5.8
Property, plant and equipment	18	1.9	1.9
Investment properties	19	170.9	170.1
Reinsurance asset	20	0.9	-
Deferred tax assets	21	6.2	3.0
Other assets	22	8.3	7.2
Total assets		**2,096.9**	**2,030.1**

	Notes	2020 £m	2019 £m
Liabilities			
Deposit from banks	23	87.5	72.5
Deposits from customers	24	1,070.3	1,041.6
Derivative financial instruments	25	81.9	80.4
Provisions for long term business - liabilities arising from insurance contracts	26	528.0	498.7
Other liabilities	27	4.5	3.9
Pension scheme deficit	28	21.0	16.6
Total liabilities		**1,793.2**	**1,713.7**
Share capital and reserves			
Called-up share capital	29	66.0	66.0
Other reserves		237.7	250.4
Total equity		303.7	316.4
Total equity and liabilities		**2,096.9**	**2,030.1**

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

DLanden

David Landen
Director

Company Balance Sheet

As at 30 September 2020

	Notes	2020 £m	2019 £m
Assets			
Shares in group undertakings	34	82.0	82.0
Total assets		**82.0**	**82.0**

	Notes	2020 £m	2019 £m
Liabilities			
Other liabilities		0.1	-
Total liabilities		**0.1**	**-**
Share capital and reserves			
Called-up share capital	29	66.0	66.0
Other reserves		15.9	16.0
Total equity		81.9	82.0
Total equity and liabilities		**82.0**	**82.0**

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

DLanden

David Landen
Director

Consolidated Statement of Changes in Equity

For the 11-month period ended 30 September 2020

Group	Called up share capital £m	Retained earnings £m	Pension reserve £m	Total £m
2020				
At beginning of period	66.0	261.8	(11.4)	316.4
Loss for the financial period	-	(9.7)	0.4	(9.3)
Other comprehensive income	-	-	(3.4)	(3.4)
Net operating income	**66.0**	**252.1**	**(14.4)**	**303.7**

Group	Called up share capital £m	Retained earnings £m	Available-for-sale reserve £m	Pension reserve £m	Total £m
2019					
At beginning of year	66.0	256.1	2.7	(8.7)	316.1
IFRS 9 adoption impact	-	(0.7)	(2.7)	-	(3.4)
Restated balance	**66.0**	**255.4**	**-**	**(8.7)**	**312.7**
Profit for the financial year	-	6.4	-	(0.4)	6.0
Other comprehensive income	-	-	-	(2.3)	(2.3)
At end of year	**66.0**	**261.8**	**-**	**(11.4)**	**316.4**

Company Statement of Changes in Equity

For the 11-month period ended 30 September 2020

Company	Called up share capital £m	Retained earnings £m	Total £m
2020			
At beginning of period	66.0	16.0	82.0
Loss for the financial period	-	(0.1)	(0.1)
At end of period	**66.0**	**15.9**	**81.9**

Company	Called up share capital £m	Retained earnings £m	Total £m
2019			
At beginning of year	66.0	16.0	82.0
IFRS 9 adoption impact	-	-	-
Restated Balance	**66.0**	**16.0**	**82.0**
Profit for the financial year	-	-	-
At end of year	**66.0**	**16.0**	**82.0**

Consolidated Statement of Cash Flows

For the 11-month period ended 30 September 2020

	Notes	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Cash flows from operating activities		**(126.5)**	**91.6**
Taxation paid		(0.3)	(0.2)
Net cash (outflow)/ inflow from operating activities		**(126.8)**	**91.4**
Cash flows from investing activities			
Proceeds from sale of government bonds	12	92.1	83.0
Purchase of government bonds	12	(124.5)	(92.4)
Disposals due to restructuring exercise	12	7.6	53.4
Purchases of debt securities	13	(29.1)	(34.5)
Proceeds from sale of debt securities	13	34.4	18.8
Disposals due to restructuring exercise	13	5.4	28.1
Additions to intangible assets	17	(2.8)	(3.5)
Additions to plant property and equipment	18	(0.5)	(0.2)
Net cash (outflow)/ inflow from investing activities		**(17.4)**	**52.7**
Net (decrease) /increase in cash and cash equivalents		(144.2)	144.1
Cash and cash equivalents at start of year		409.2	265.1
Cash and cash equivalents at end of year		**265.0**	**409.2**
Cash held at central banks repayable on demand	11	147.9	321.9
Loans and advances to credit institutions repayable on demand (1)	14	117.1	87.3
Cash and cash equivalents at year end		**265.0**	**409.2**

(1) Loans and advances to credit institutions includes collateral held by swap counterparties of £86.3m (2019: £79.5m) which is pledged against the market value of derivative instruments and comprises interest-bearing cash deposits. Collateral that has been pledged and held is not restricted and is returned at the end of the contract.

A) Analysis of the balance of cash and cash equivalents

2020	Notes	At 31 October 2019 £m	Cash flow £m	At 30 September 2020 £m
Cash held at central banks repayable on demand	11	321.9	(174.0)	147.9
Loans and advances to credit institutions repayable on demand	14	87.3	29.8	117.1
		409.2	**(144.2)**	**265.0**

2019	Notes	At 31 October 2018 £m	Cash flow £m	At 31 October 2019 £m
Cash held at central banks repayable on demand	11	153.2	168.7	321.9
Loans and advances to credit institutions repayable on demand	14	111.9	(24.6)	87.3
		265.1	**144.1**	**409.2**

B) Reconciliation of profit before tax to operating cash flows

	Notes	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Cash flows from operating activities			
(Loss)/Profit before tax		(12.4)	6.6
Net loss/(gain) on government bonds	12	2.4	(0.1)
Net gain on debt securities	13	(0.7)	(1.8)
Net change in loans and advances to customers	15/16	(196.5)	(4.1)
Impairment provision charge for losses on loans	16	5.4	3.8
Amortisation of intangible assets	17	1.3	0.8
Depreciation of plant property and equipment	18	0.5	0.5
Net change in investment property	19	(0.8)	9.0
Net change in reinsurance asset	20	(0.9)	-
Net change in other assets	22	0.2	(1.4)
Net change in deposits from banks	23	15.0	-
Net change in deposits from customers	24	28.7	47.5
Net change in derivatives	25	1.5	(27.2)
Net change in provision for long term business liabilities	26	29.3	61.7
Net change in other liabilities	27	0.5	(4.1)
Net change in other provisions		-	(0.1)
Net change in pension scheme deficit	28	-	0.5
Net cashflow from operating activities		**(126.5)**	**91.6**

Notes to the Financial Statements

For the 11-month period ended 30 September 2020

1. Accounting policies

Basis of preparation

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards and Interpretations (collectively IFRSs) issued by the International Accounting Standards Board (IASB) as adopted by the European Union ('adopted IFRSs') and those parts of the Companies Act 2006 that are applicable to companies that prepare financial statements in accordance with IFRS.

The preparation of the Group's financial statements in compliance with adopted IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in applying the Group's accounting policies. The areas where significant judgements and estimates have been made in preparing the financial statements and their effect are disclosed in note 2.

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

The Company financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ("FRS 101").

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- A Cash Flow Statement and related notes;
- Disclosures in respect of transactions with members of a group;
- Disclosures in respect of the compensation of key management personnel and related parties.

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

The parent company has taken advantage of Section 408 of the Companies Act 2006 and has not included its own Income Statement in these financial statements. The parent company loss for the eleven months after taxation includes is £0.1m (2019: £nil) which is dealt with in the financial statements of the parent company.

Going concern

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

- The impact on the Group's profits from an expected reduction in income from residential and commercial lending combined with increased credit impairment charges;
- The sufficiency of the Group'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 Group's liquidity.

The Group's forecasts and projections include scenario testing undertaken in accordance with the Internal Capital Adequacy Assessment Process, Individual Liquidity Adequacy Assessment Process and Own Risk and Solvency Assessment, 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 Group will continue in business for a period of at least 12 months from the date of signing the Annual Report and 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 Group in these financial statements:

The Group 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 Group or do not have a significant impact on the Group's financial statements.

Standards and interpretations effective for the Group in future periods:

IFRS 17 'Insurance Contracts'
IFRS 17, 'Insurance Contracts' was issued in May 2017 and is effective for the Group for the annual period commencing 1 October 2023. The standard will be applied retrospectively, subject to the transitional options provided for in the standard and provides a comprehensive approach for accounting for insurance contracts including their valuation, Income Statement presentation and disclosure. The Group has mobilised a project team to assess the financial and operational implications of the standard and work will continue throughout 2021 to ensure technical compliance and to develop the required system capability to implement the standard.

None of the other standards issued by the IASB but not yet effective, are expected to have a material impact on the Group's financial statements in future periods.

Summary of Significant Accounting Policies

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

Basis of consolidation
The Group consolidates the assets, liabilities and results of the Company and its subsidiaries.

Subsidiaries are all entities controlled by the Company. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns, through its power over the entity and voting rights.

The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date when control ceases. Intra-group transactions and balances and unrealised gains on transactions between intra-group companies are eliminated in the consolidated accounts.

The Company's investment in its subsidiaries are recognised on the Balance Sheet at cost, less where appropriate, provisions for impairment.

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 Group 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 Group 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 mortgages on behalf of third-parties. Fee income is recognised when performance obligations attached to the fee or commission have been satisfied.

Premium income
Premiums received in respect of pension annuity insurance contracts are recognised as revenue when they become payable by the policyholder when the policy commences and are shown before deduction of commission. All premium revenue is in respect of single premium insurance business.

1. Accounting policies (continued)

Insurance contracts
The Group offers insurance products in the form of annuities and also has one reinsurance contract. Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly over time. As the Group's products are single premium contracts, acquisition expenses are expensed to the Income Statement as incurred.

Financial Instruments

Recognition
Financial assets and liabilities are recognised when the Group 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 Group has classified its financial assets as follows:

- **Amortised cost:** Cash and balances held with central bank, Residential, Portfolio buy-to-let and Commercial, 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 and Government bonds/ Debt securities recognised at fair value to prevent an accounting mismatch. Lifetime 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 Group 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 Group'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.

On initial recognition, the Group 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 Group has classified its financial liabilities as follows:

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

De-recognition of financial assets and financial liabilities

(i) Financial assets
A financial asset is de-recognised when:

- The rights to receive cash flows from the asset have expired,
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a pass-through arrangement; and either:
- The Group has transferred substantially all the risks and rewards of the asset; or
- The Group 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.

1. Accounting policies (continued)

(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 Group determines that the fair value on initial recognition differs from the transaction price, the Group 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 Group uses a fair value hierarchy that categorises financial instruments into three different levels as detailed in note 31. 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 expected future 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.

Embedded derivatives
The NNEG is an embedded derivative. The Group 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 which is calculated using a variant of the Black Scholes option pricing model. Further details are disclosed in note 31(d).

Measurement of Expected Credit Loss (ECL)
Impairment of financial assets is calculated using a forward looking ECL model. The Group 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.

1. Accounting policies (continued)

Significant increase in credit risk
The Group 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 Group 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 Group's definition of default is fully aligned with the definition of credit-impaired. The Group 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 Group.

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

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

At inception of the hedge relationship, the Group 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 Group 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 macro fair value hedge portfolio. This 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.

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 administration expenses 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.

1. Accounting policies (continued)

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.

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 regional Nationwide 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.

Long term business provision - liabilities under insurance contracts
The long-term business provision has been determined by the Board, on advice from the Chief Actuary. The estimation process used in determining the long-term business provision involves projecting annuity payments and the costs of maintaining the contracts.

Reinsurance asset
The Group transfers certain risks arising on its underlying insurance contracts through entering into contracts with reinsurers. Such contracts are classified as reinsurance contracts within the scope of IFRS 4 where significant insurance risk is transferred from the Group to the reinsurer. Reinsurance assets are the net contractual rights arising from cashflows due from and to reinsurers regarding ceded insurance liabilities.

The present value of the cash flows under the reinsurance contract comprises the expected cash flows receivable from the counterparty (i.e. the "floating" leg), net of the expected cash flows payable by the Group (i.e. the "fixed" leg) and reinsurance fees, all discounted at a rate consistent with that used for the gross insurance liabilities.

Gains on purchasing reinsurance are deferred and recognised as income within 'Reinsurance recoveries' in the Income Statement by amortising the initial day 1 gain over the lifetime of the reinsurance asset and through the revaluation of the cash flows from the present value element based on experience and economic assumptions.

The movement in the expected cash flows receivable are disclosed within 'Reinsurance recoveries' and the movement in the expected cash flows payable and the reinsurance fees paid are disclosed within 'Reinsurance expense' in the Income Statement.

Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Group may not receive all outstanding amounts due under the terms of the contract and the event has a measurable impact on the amounts that the Group will receive from the reinsurer. The impairment charge is recorded within 'Reinsurance recoveries' as an expense in the Income Statement.

Government Grants
A grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in income in the period in which it becomes receivable. Under IAS 20 the income is netted off against the related expenses.

Taxation including deferred tax
Corporation tax on profits for the year comprises current and deferred taxation. Where group relief is received or surrendered from or to a group company, the corresponding liability or asset is settled in full.

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.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. 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.

1. Accounting policies (continued)

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 recognised in the Income Statement.

Employee benefits

i) Pensions

The Group operates a defined benefit pension scheme for members of staff. The Company's subsidiary undertakings Julian Hodge Bank Limited and the Hodge Life Assurance Company Limited are participating employers 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 Group.

The Group'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 Group's accounts at the Balance Sheet date.

ii) Reimbursement asset on pension deficit

The Group has recognised a reimbursement asset in respect of its pension scheme deficit which relates to retired employees that were contracted to the Group's ultimate parent, The Carlyle Trust Limited (note 28). The movement in the reimbursement asset each year is recognised in the Income Statement to the extent that the reimbursement relates to a charge in the Group'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 Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. 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 Group 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 notes 25 and 31.

The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

Where observable market data is unavailable, unobservable inputs are used in the actuarial valuation models to value equity release and retirement mortgages. The key assumptions used, and the related sensitivities are outlined in note 31.

Reinsurance deferred reserve
Judgement is applied in amortising the day 1 gain recognised as a result of the reinsurance trade. The Group's policy is to amortise the deferred gain to the Income Statement over the lifetime of the reinsurance contract.

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 32.

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 19.

- 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 assumptions used are disclosed in note 28.

Value of lifetime mortgages including the value of the no-negative equity guarantee
There is significant judgement applied in setting the assumptions used in calculating the fair value of lifetime mortgages and the liability arising from the NNEG. Further information on the following assumptions is provided in note 31.

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

2. Judgement in applying accounting policies and critical accounting estimates (continued)

Measurement of insurance liabilities arising from annuity insurance contracts
The estimation of the ultimate liability arising from insurance contracts is Hodge Life's most critical accounting estimate.

For insurance contracts, the liabilities are calculated using a projection of cash flows after making assumptions about matters such as mortality and expenses. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets. The most critical non-economic assumptions are mortality rates in respect of annuity business written and levels of future expenses. Such assumptions are based on recent actual experience, supplemented by industry information where appropriate.

At each reporting date, the estimates and assumptions referred to above are reassessed for adequacy and changes will be reflected in adjustments to the liability, through the Income Statement. Further information on these assumptions is given in note 26.

Measurement of reinsurance asset
The reinsurance asset as a result of the longevity swap held by the Group represents the present value of the contractual cash flows less the carrying value of the deferred reserve. Further information on the methodology and assumptions used to calculate the reinsurance asset are disclosed within note 20.

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 31 and are recognised prospectively as a change in accounting estimate.

3. Segmental information

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

The Group operates within the banking and annuity life assurance services sector wholly within the United Kingdom.

11-month period to 30 September 2020	Commercial	Residential	Portfolio Buy-to-Let	Hodge Life	Other	Reclass and consolidation adjustments	Total
	£m	£m	£m	£m	£m	£m	£m
Interest receivable and similar income	15.7	18.0	1.8	-	2.9	21.5	59.9
Interest payable and similar charges	(6.1)	(14.9)	(1.0)	-	(0.9)	0.1	(22.8)
Fees and commissions receivable	0.3	1.3	-	-	0.2	(1.1)	0.7
Fees and commissions payable	-	-	-	-	-	(0.4)	(0.4)
Earned premiums	-	-	-	22.8	-	-	22.8
Impact of new insurance contracts	-	-	-	(23.4)	-	-	(23.4)
Investment income	-	3.5	-	7.9	-	(2.7)	8.7
Gross claims and benefits paid	-	-	-	(25.4)	-	-	(25.4)
Impact of gross claims and benefits paid	-	-	-	25.4	-	-	25.4
Administrative expenses	(5.4)	(11.6)	(1.1)	(6.5)	(4.2)	1.6	(27.2)
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 profit	**(0.9)**	**(4.2)**	**(0.4)**	**0.8**	**(3.2)**	**19.0**	**11.1**

The £19.0m (2019: £18.9m) profit presented in the 'Reclass and consolidation adjustments' segment mainly relates to interest receivable on equity release mortgages and is reclassified from other fair value gains which is presented below operating profit.

3. Segmental information (continued)

Total assets by business segments	2020 £m	2019 £m
Commercial	290.5	315.2
Residential	671.2	524.4
Portfolio Buy-to-Let	63.1	20.9
Hodge Life	697.8	663.6
Other	374.3	506.0
	2,096.9	**2,030.1**

Year ended 31 October 2019	Commercial £m	Residential £m	Portfolio Buy-to-Let £m	Hodge Life £m	Other £m	Reclass and consolidation adjustments £m	Total £m
Interest receivable and similar income	19.7	22.4	0.1	-	6.1	21.6	69.9
Interest payable and similar charges	(8.0)	(19.5)	(0.1)	-	(0.5)	(0.1)	(28.2)
Fees and commissions receivable	-	-	-	-	0.7	(0.1)	0.6
Fees and commissions payable	-	(0.1)	-	-	-	(0.8)	(0.9)
Earned premiums	-	-	-	41.6	-	-	41.6
Impact of new insurance contracts	-	-	-	(42.4)	-	-	(42.4)
Investment income	-	7.5	-	12.3	(0.3)	(2.6)	16.9
Gross claims and benefits paid	-	-	-	(26.9)	-	-	(26.9)
Impact of gross claims and benefits paid	-	-	-	26.9	-	-	26.9
Administrative expenses	(4.6)	(8.0)	(0.2)	(7.4)	(3.6)	1.0	(22.8)
Depreciation and amortisation	(0.2)	(0.2)	-	-	(0.8)	(0.1)	(1.3)
Impairment losses on loans and advances to customers	(3.5)	(0.1)	(0.3)	-	-	-	(3.9)
Operating profit	**3.4**	**2.0**	**(0.5)**	**4.1**	**1.6**	**18.9**	**29.5**

4. Interest receivable and similar income

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Loans and advances to customers	56.1	62.6
Loans and advances to credit institutions	1.0	2.3
On intra-group loans	0.1	-
Interest on government bonds and debt securities	2.7	5.0
	59.9	**69.9**

5. Interest payable and similar charges

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
On customer accounts	14.6	16.0
On defined benefit pension scheme	0.2	0.4
On term funding scheme	0.2	0.5
On derivative financial instruments	7.8	11.3
	22.8	**28.2**

6. Earned premiums

Earned premiums, all of which relate to direct insurance contracts, are individual, single premiums from annuity business.

All premiums are derived from contracts concluded in the United Kingdom. Commissions payable in respect of direct insurance amounted to £0.4m (2019: £0.7m).

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Earned premiums	22.8	41.6
	22.8	**41.6**

7. Administrative expenses

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Staff costs		
Wages and salaries	11.3	9.1
Social security	1.3	1.1
Pension costs (note 28)	3.0	2.2
	15.6	**12.4**
Other administrative expenses	11.6	10.4
	27.2	**22.8**

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

7. Administrative expenses (continued)

Directors and employees
The average number of employees of the Group during the year was as follows:

	2020	2019
Provision of finance and banking	277	169
Provision of life assurance services	11	41
	288	**210**

Staff costs include remuneration in respect of Directors as follows:

	2020 £m	2019 £m
Fees	0.4	0.3
Aggregate emoluments as executives	0.8	0.7
	1.2	**1.0**

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

	2020 £m	2019 £m
Aggregate emoluments	0.3	0.3
	0.3	**0.3**

The pension accrued for the highest paid director was £61,362 (2019: £31,669). Retirement benefits are accruing to three directors in 2020 (2019: one) in the defined benefit scheme.

8. Other fair value gains

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Losses on derivatives designated as fair value (note 25)	(4.5)	(28.4)
Movement in fair value of equity release and retirement mortgages	6.1	54.4
Reversal of unrealised gains on disposal of investment properties	(8.2)	(14.9)
Movement in fair value of investment properties (note 19)	11.7	12.2
Movement in fair value of debt securities and government bonds (notes 12 & 13)	2.2	1.3
Movement in fair value of hedged items attributable to hedged risk	(4.2)	0.3
	3.1	**24.9**

9. Loss on ordinary activities before taxation

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Loss on ordinary activities before taxation is stated after charging:		
Remuneration of the auditor and its associates		
Audit of these financial statements	25	17
Audit of financial statements of subsidiaries	295	202
Audit of pension scheme	11	11
Other assurance fees	29	-
Non audit fees	-	85
Impairment provision expense (note 16)	5,435	3,861
Amortisation (note 17)	1,308	801
Depreciation (note 18)	452	491

	11 months ended 30 September 2020 £m		Year ended 31 October 2019 £m	
Analysis of charge in year				
UK corporation tax				
Current tax on income for the year	-		0.9	
Prior period adjustment	(0.5)		(0.8)	
Total current tax (credit)/ charge		**(0.5)**		**0.1**
Deferred tax (note 21)				
Origination/reversal of timing differences:				
Current year	(2.3)		0.1	
Prior period adjustment	0.1		0.4	
Effect of tax rate change on opening balance	(0.4)		-	
Total deferred tax		**(2.6)**		**0.5**
Tax (credit)/ charge profit on ordinary activities		**(3.1)**		**0.6**

10. Tax on profit

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

	11 months ended 30 September 2020 £m	Year ended 31 October 2019 £m
Total tax reconciliation		
(Loss)/profit on ordinary activities before tax	(12.4)	6.6
Current tax at 19.00% (2019: 19.00%)	**(2.4)**	**1.3**
Index linked gilt RPI movement	-	(0.2)
Rate differences	(0.4)	-
Adjustments in respect of previous years	(0.4)	(0.4)
Other	0.1	(0.1)
Total tax charge (see above)	**(3.1)**	**0.6**

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%.

11. Cash and balances held at central banks

	2020 £m	2019 £m
Repayable on demand:		
Deposits with central banks	147.9	321.9
	147.9	**321.9**

12. Government bonds

	2020 £m	2019 £m
Government bonds – at amortised cost	48.6	21.9
Government bonds – fair value through profit and loss	29.3	30.4
Fair value adjustment – hedge accounting	-	3.2
	77.9	**55.5**

The movement in government bonds is summarised as follows:

	2020 £m	2019 £m
At start of period	55.5	99.4
Additions	124.5	92.4
Disposals due to maturity	(92.1)	(83.0)
Disposals due to restructuring exercise	(7.6)	(53.4)
(Loss)/gain from hedge accounting – Income Statement	(3.3)	0.8
Gain/(loss) from changes in fair value – Income Statement	0.9	(0.7)
	77.9	**55.5**

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 Group 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 £11.0m, resulting in a profit on disposal of £3.4m. 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 Group 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.

13. Debt securities

	2020 £m	2019 £m
Debt securities – at amortised cost	50.7	56.4
Debt securities – fair value through profit and loss	74.1	77.8
Fair value adjustment – hedge accounting	-	0.6
	124.8	**134.8**

The movement in debt securities is summarised as follows:

	2020 £m	2019 £m
At start of period	134.8	145.3
Additions	29.1	34.5
Disposals due to maturity	(34.4)	(18.8)
Disposals due to restructuring exercise	(5.4)	(28.1)
Losses from hedge accounting - Income Statement	(0.6)	(0.1)
Gains from changes in fair value – Income Statement	1.3	2.0
	124.8	**134.8**

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

During the year, the Group 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 Group 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.

14. Loans and advances to credit institutions

	2020 £m	2019 £m
Repayable on demand	30.8	7.8
Collateral held by swap counterparties	86.3	79.5
	117.1	**87.3**

The collateral is pledged against the market value of derivative instruments and comprises interest-bearing cash deposits (note 25). 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).

15. 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
Portfolio Buy-to-Let	63.1	20.8
	700.6	**514.8**
Amounts owed from parent	3.0	3.3
Fair value adjustment for hedged risk	0.4	0.5
Loans and advances (equity release and retirement mortgages) – classified as FVTPL (note 31)	729.7	724.0
	1,433.7	**1,242.6**

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 held at amortised cost		
Gross balances	709.2	526.3
Less: Provision for impairment (note 16)	(7.9)	(9.8)
Less: Loan fee deferral	(0.7)	(1.7)
Net balance	**700.6**	**514.8**

16. Impairment provisions on loans and advances to customers

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total
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**

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total
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 2020.

The methodology and assumptions used to calculate the IFRS 9 ECL provision is disclosed in note 32.

17. Intangible assets

	Computer software	
	2020 £m	**2019 £m**
Cost:		
At start of period	7.4	3.9
Disposals	(0.1)	-
Additions	2.8	3.5
At 30 September 2020	**10.1**	**7.4**
Amortisation:		
At start of period	(1.6)	(0.8)
Disposals	0.1	-
Amortisation	(1.3)	(0.8)
At 30 September 2020	**(2.8)**	**(1.6)**
Net book value:		
At 30 September 2020	**7.3**	**5.8**

£2.5m (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.

18. Property, plant and equipment

	Fixtures, fittings and equipment	
	2020 £m	**2019 £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

19. Investment properties

All investment properties relate to reversionary interests in properties.

Group	2020 £m	2019 £m
At start of period	170.1	179.1
Disposals	(10.9)	(21.2)
Fair value adjustments	11.7	12.2
At 30 September 2020	**170.9**	**170.1**

The historical cost of the reversionary interests in properties is £65.5m at 30 September 2020 (2019: £72.0m).

Reversionary interests are categorised as Level 3 assets 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. The 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 Group'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 Group 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 by 10% £m	Discount rate +1% £m	Expenses +10% £m	Property prices -10% £m
At 30 September 2020	(1.8)	(8.2)	(0.3)	(14.9)
At 31 October 2019	(1.4)	(9.2)	(0.2)	(15.6)

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.

20. Reinsurance asset

In March 2020 the Group entered into a reinsurance agreement in relation to the annuity portfolio disclosed within 'Liabilities arising from insurance contracts' in note 26. This was part of the strategy to de-risk the Solvency II Balance Sheet position by reducing the longevity risk exposure and capital requirement. Management has assessed that significant insurance risk had been transferred to the reinsurer.

The reinsurance asset held as a result of this longevity swap represents the present value of the future contractual cash flows less the carrying value of the deferred reserve.

The present value of the cash flows under the reinsurance trade comprises the expected cash flows receivable from the counterparty (i.e. the "floating" leg), net of the expected cash flows payable by the Group (i.e. the "fixed" leg) and reinsurance fees, all discounted at a rate consistent with that used for the gross insurance liabilities.

The floating cash flows are projected using future mortality assumptions consistent with those used for the gross insurance liabilities. The fixed cash flows form part of the contractual agreement with the counterparty to the reinsurance trade.

The deferred gain is calculated at inception of the reinsurance trade, it is subsequently amortised to the Income Statement over the lifetime of the reinsurance asset and through the revaluation of the cash flows from the present value element based on experience and economic assumptions.

The deferred gain calculated at inception remains fixed and is not recalculated in future reporting periods.

The reinsurance asset is adjusted to reflect the possibility of default by the counterparty over the lifetime of the treaty.

A breakdown of the reinsurance asset is provided below:

	2020 £m	2019 £m
Reinsurance receivable	417.0	-
Deferred reserve	(22.8)	-
Reinsurance payable	(393.3)	-
	0.9	**-**

Following the completion of the reinsurance agreement, the present value of the reinsurance cashflows at 31 March 2020 amounted to £23.5m. The related deferred reserve is amortised over the life of the reinsurance asset and the carrying value of this deferred reserve at 30 September amounted to £22.8 million.

A collateral agreement is in place to mitigate any exposure to the counterparty in the event that the value of the reinsurance contract changes depending on observed experience and changes to assumed future longevity. The collateral requirements will be recalculated quarterly, with the first calculation taking place at 31 March 2022.

21. Deferred tax

	2020 £m	2019 £m
At start of period	3.0	3.0
Charge to the Income Statement	2.6	(0.5)
Credit to the Statement of Other Comprehensive Income	0.6	0.5
	6.2	**3.0**

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	0.9	1.0
Timing differences on reimbursement asset	(0.6)	(0.5)
Defined benefit pension scheme	4.0	2.7
Tax losses	2.2	-
	6.2	**3.0**

22. Other assets

	2020 £m	2019 £m
Prepayments and accrued income	2.8	2.0
Pension reimbursement asset	3.3	2.9
Corporation tax debtor	1.2	0.4
Group relief	-	1.1
Other assets	1.0	0.8
	8.3	**7.2**

23. Deposits from banks

	2020 £m	2019 £m
Repurchase agreement	2.5	2.5
Term funding scheme	85.0	70.0
	87.5	**72.5**

24. Deposits from customers

	2020 £m	2019 £m
Deposits from customers	1,066.6	1,036.3
Amounts owed to parent and fellow subsidiaries	3.3	4.6
Fair value adjustment for hedged risk	0.4	0.7
	1,070.3	**1,041.6**

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

25. Derivative financial instruments and hedge accounting

Interest rate swaps are used by the Group 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 £m	**2019 £m**	**2020 £m**	**2019 £m**
Derivative liabilities held for hedging purposes and designated fair value hedges:				
Interest rate swaps	267.3	310.7	81.8	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	**420.0**	**659.4**	**81.9**	**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: 0.4% 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.

25. Derivative financial instruments and hedge accounting (continued)

	2020 £m	2019 £m
Movement in fair value of interest rate swaps	(4.5)	(28.0)
Breakage costs	-	(0.4)
	(4.5)	**(28.4)**

The Group agreed to exit a number of interest rate swaps during the year which were held at fair value of £0.7m (2019: £52.6m), £nil (2019: £nil) profit or loss was incurred on disposal.

In addition, the Group 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	700.6	0.4	514.9	0.4
Deposits from customers	(1,066.6)	(0.4)	(1,036.1)	(0.8)
		-		**3.4**

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

25. Derivative financial instruments and hedge accounting (continued)

Offsetting
In accordance with IAS 32 Financial Instruments; the Group 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 £m	Amounts offset £m	Net amounts reported on Balance Sheet £m
2020			
Derivative financial assets	1.1	(1.1)	-
Impact on total assets	**1.1**	**(1.1)**	**-**
Derivative financial (liabilities)	(83.0)	1.1	(81.9)
Impact on total (liabilities)	**(83.0)**	**1.1**	**(81.9)**
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 14).

26. Provisions for long term business – liabilities arising from insurance contracts

	2020 £m	2019 £m
At 1 November	498.7	437.0
Gross claims and benefits paid	(25.4)	(26.9)
Impact of new insurance contracts	23.4	42.4
Fair value movement on existing liabilities		
Expense cash flows and discount unwind	7.4	9.4
Mortality experience	(1.1)	(1.2)
Interest rate gain	25.6	46.9
Movement in illiquidity premium	2.0	6.4
Change in expense inflation	0.6	(1.3)
Impact of methodology and assumption changes		
Expense policy assumption change	(0.6)	(7.6)
LTM accounting basis assumption change	(2.6)	-
CMI mortality assumption change	-	(6.4)
	528.0	**498.7**

26. Provisions for long term business – liabilities arising from insurance contracts (continued)

The long-term business provision for insurance contracts has been calculated using estimation techniques for each contract, by use of a prospective calculation on the basis set out below.

a) Rates of interest

Principal assumptions:
The interest rates used to discount liabilities comprise three parts: a risk-free yield curve, an allowance for illiquidity based on the yield on the assets backing the liabilities less an appropriate deduction for risk. The risk-free yield curve is the GBP curve published by EIOPA.

The average discount rate for each product (assumed to be the 15-year point on the yield curve based on the average duration of the portfolio) at 30 September 2020 and October 2019 is as follows:

	2020 %	2019 %
Pension business annuities	1.8	2.2
Reversionary scheme and renewable reversionary scheme	1.9	1.6
Purchased life annuities	1.9	1.6
Mortgage scheme annuities	0.8	1.0

b) Mortality tables

The mortality table used to calculate the technical provisions for annuity liabilities is the PCMA/PCFA00 table. 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 which varies by the duration in force of the contract.

c) Provision for expenses

An explicit provision for expenses based on an amount per policy per annum has been determined from recent experience analysis. This provision increases with an annual inflation rate of 4.09% (2019: 4.01%). For 2019, a £0.4m provision for expense overruns is held in addition to the basic provision for per-policy expenses.

26. Provisions for long term business – liabilities arising from insurance contracts (continued)

d) Sensitivity analysis

Changes to inputs used in the valuation could give rise to significant changes in the value of the provisions. The Group has estimated the net increase/(decrease) in profit before tax for the period to changes to these inputs as follows:

	Delay in mortality by 10% £m	Expenses + 10% £m	Interest rates +100bps £m
At 30 September 2020	(16.4)	(3.2)	58.1
At 31 October 2019	(14.4)	(2.9)	54.3

The interest rate sensitivity of insurance contracts should be considered in conjunction with the offsetting interest rate sensitivity of financial instruments.

27. Other liabilities

Group	2020 £m	2019 £m
Due within one year:		
Amounts owed in relation to mortgages administered for third parties	2.3	0.9
Other creditors	0.3	0.4
Other taxation and social security	0.3	0.2
Amounts owed in relation to insurance contracts	0.5	0.5
Accruals	1.1	1.9
	4.5	**3.9**

28. Pension scheme

The 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, 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 Group 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 scheme liabilities. This would detrimentally impact the Balance Sheet and may give rise to increased charges in future periods. The Group 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 Group's total expense for the year amounted to £3.4m (2019: £3.0m). The Group 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 Group has agreed to maintain the contribution rate at 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.

28. 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 £m	2019 £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 £m	2019 £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 obligation

	2020 £m	2019 £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**

28. Pension scheme (continued)

Expense recognised in the Income Statement

	2020 £m	2019 £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 actuarial losses net of deferred tax reported in the Statement of Other Comprehensive Income are losses of £14.4m (2019: losses of £11.4m) before tax.

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

	Fair Value	
	2020 £m	2019 £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)

28. Pension scheme (continued)

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

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

	2020 %	2019 %
Rate of increase in salaries	2.9	4.0
Pension increases – 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 Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension scheme liability. The sensitivity of a 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%	1.0
Rate of Inflation (RPI or CPI)	0.1%	0.9
Life expectancy	1 year	1.4

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 from one another.

28. Pension scheme (continued)

History of the scheme Balance Sheet position

	2020 £m	2019 £m	2018 £m	2017 £m	2016 £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)**

History of experience gains and losses

	2020	2019	2018	2017	2016
Difference between the expected and actual return on scheme assets:					
Present value of funded defined benefit obligations	**£(0.4)m**	£0.6m	£(1.4)m	£0.1m	£0.5m
Percentage of year-end scheme assets	**1.3%**	2.2%	5.6%	-	1.5%
Experience gains and losses on scheme liabilities:					
Amount	**£(0.0)**	£1.9m	-	-	£(0.4)m
Percentage of year end present value of scheme liabilities	**0.0%**	(4.4)%	-	-	1.0%
Total amount recognised in Statement of Comprehensive Income:					
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%

29. Called up share capital

	2020 £m	2019 £m
Authorised, allotted, called-up and fully paid:		
66,045,191 (2019: 66,045,191) ordinary shares of £1 each	66.0	66.0
	66.0	**66.0**

30. Financial commitments and contingent assets/liabilities

	2020 £m	2019 £m
Loan commitments		
Expiring in less than one year	37.4	26.0
Expiring in more than one year	19.9	47.3
	57.3	**73.3**

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

31. 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 disclosures to Balance Sheet totals.

As at 30 September 2020	At amortised cost £m	Fair value through profit and loss £m	Total £m
Assets			
Cash and balances held at central banks	147.9	-	147.9
Government bonds	48.6	29.3	77.9
Debt securities	50.7	74.1	124.8
Loans and advances to credit institutions	117.1	-	117.1
Loans and advances to customers	704.0	729.7	1,433.7
Other assets	8.3	-	8.3
Total financial assets	**1,076.6**	**833.1**	**1,909.7**
Total non-financial assets			187.2
Total assets			**2,096.9**
Liabilities			
Deposit from banks	87.5	-	87.5
Deposit from customers	1,070.3	-	1,070.3
Derivative financial instruments	-	81.9	81.9
Other liabilities	4.5	-	4.5
Total financial liabilities	**1,162.3**	**81.9**	**1,244.2**
Total non-financial liabilities			549.0
Share capital and other reserves			303.7
Total equity and liabilities			**2,096.9**

31. Financial instruments (continued)

As at 31 October 2019	At amortised cost £m	Fair value through profit and loss £m	Total £m
Assets			
Cash and balances held at central banks	321.9	-	321.9
Government bonds	25.1	30.4	55.5
Debt securities	57.0	77.8	134.8
Loans and advances to credit institutions	87.3	-	87.3
Loans and advances to customers	518.6	724.0	1,242.6
Other assets	7.2	-	7.2
Total financial assets	**1,017.1**	**832.2**	**1,849.3**
Total non-financial assets			180.8
Total assets			**2,030.1**
Liabilities			
Deposit from banks	72.5	-	72.5
Deposit from customers	1,041.6	-	1,041.6
Derivative financial instruments	-	80.4	80.4
Other liabilities	3.9	-	3.9
Total financial liabilities	**1,118.0**	**80.4**	**1,198.4**
Total non-financial liabilities			515.3
Share capital and other reserves			316.4
Total equity and liabilities			**2,030.1**

b) Fair value estimation

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The table below summarises the fair value of the Group'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.

Where applicable, the Group 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 Group determines fair value using other valuation techniques.

31. Financial instruments (continued)

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

As at 30 September 2020	Level 1 £m	Level 2 £m	Level 3 £m	Level 4 £m
Financial assets at fair value through profit or loss				
Government bonds	29.3	-	-	29.3
Debt securities	74.1	-	-	74.1
Loans and advances to customers	-	-	729.7	729.7
Total financial assets at FVTPL	**103.4**	**-**	**729.7**	**833.1**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	-	81.9	-	81.9
Total financial liabilities at FVTPL	**-**	**81.9**	**-**	**81.9**

As at 31 October 2019	Level 1 £m	Level 2 £m	Level 3 £m	Level 4 £m
Financial assets at fair value through profit or loss				
Government bonds	30.4	-	-	30.4
Debt securities	77.8	-	-	77.8
Loans and advances to customers	-	-	724.0	724.0
Total financial assets at FVTPL	**108.2**	**-**	**724.0**	**832.2**
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

Government bonds and debt securities:
The fair value of financial instruments traded in active markets is based on quoted market prices at the Balance Sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Instruments included in Level 1 comprise primarily UK government bonds and debt securities classified as FVTPL.

31. Financial instruments (continued)

Derivative financial instruments:
Derivative products using a valuation technique with observable market inputs are interest rate swaps. 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.

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 £729.7m (2019: £724.0m) of assets which have been classed as FVTPL as they relate to equity release and retirement mortgages.

	Fair Value		Book Value	
	2020 £m	2019 £m	2020 £m	2019 £m
Loans and advances (equity release and retirement mortgages) – classified as FVTPL	729.7	724.0	537.3	548.9
	729.7	**724.0**	**537.3**	**548.9**

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

	2020 £m	2019 £m
At start of period	724.0	790.4
Disposal of equity release portfolio to a third party	-	(122.0)
Total gains in the Income Statement arising on fair value movements	28.7	81.6
Loans advanced	20.0	33.2
Redemptions	(43.0)	(59.2)
At end of period	**729.7**	**724.0**

The £28.7m increase (2019: £81.6m increase) in fair value is predominantly driven by the fall in benchmark interest rates over the year. 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.

31. 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 Group's own experience on this product.

Expenses
Assumptions for future policy expense levels are based on the Group's recent expense 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 reversion 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 (assumed to be the 15-year point on the yield curve). As at 30 September the 15-year point was 0.39%. The average discount rate for the portfolio was 2.39% (31 October 2019: 1.78%).

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).

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 Group has estimated the net decrease in profit before tax for the period arising from changes to these inputs as follows:

	Interest rates +100 BP £m	Maintenance expenses +10% £m	Property inflation -100bps £m	Property prices -10% £m	Lapses +10% £m	Increase in mortality by 10% £m
At 30 September 2020	(52.4)	(0.6)	(6.5)	(7.7)	(13.3)	(4.3)
At 31 October 2019	(79.1)	(0.6)	(11.7)	(6.3)	(16.7)	(7.2)

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 Group'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.

31. Financial instruments (continued)

e) Maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and liabilities into relevant maturity groupings 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 Group 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 £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Assets						
Cash and balances held at central banks	147.9	-	-	-	-	147.9
Government bonds	14.4	6.0	-	-	57.5	77.9
Debt securities	1.6	4.3	1.5	61.9	55.5	124.8
Loans and advances to credit institutions	117.1	-	-	-	-	117.1
Loans and advances to customers	94.3	45.3	48.9	377.5	867.7	1,433.7
Other assets	8.3	-	-	-	-	8.3
Total financial assets	**383.6**	**55.6**	**50.4**	**439.4**	**980.7**	**1,909.7**
Liabilities						
Deposit from banks	2.5	-	-	85.0	-	87.5
Deposit from customers	317.1	101.0	325.6	318.1	8.5	1,070.3
Derivative financial instruments	(0.3)	(0.1)	0.4	12.6	69.3	81.9
Other liabilities	4.5	-	-	-	-	4.5
Total financial liabilities	**323.8**	**100.9**	**326.0**	**415.7**	**77.8**	**1,244.2**
Loan commitments liabilities	**34.9**	**0.5**	**7.4**	**13.5**	**1.0**	**57.3**

31. Financial instruments (continued)

As at 31 October 2019	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Assets						
Cash and balances held at central banks	321.9	-	-	-	-	321.9
Government bonds	15.0	-	5.0	16.7	18.8	55.5
Debt securities	3.5	6.0	7.0	71.5	46.8	134.8
Loans and advances to credit institutions	87.3	-	-	-	-	87.3
Loans and advances to customers	69.8	32.6	39.0	292.4	808.8	1,242.6
Other assets	7.2	-	-	-	-	7.2
Total financial assets	**504.7**	**38.6**	**51.0**	**380.6**	**874.4**	**1,849.3**
Liabilities						
Deposit from banks	2.5	-	-	70.0	-	72.5
Deposit from customers	168.8	182.4	292.6	394.4	3.4	1,041.6
Derivative financial instruments	0.2	(1.7)	0.5	10.2	71.2	80.4
Other liabilities	3.9	-	-	-	-	3.9
Total financial liabilities	**175.4**	**180.7**	**293.1**	**474.6**	**74.6**	**1,198.4**
Loan commitments liabilities	**4.8**	**0.9**	**2.4**	**59.3**	**5.9**	**73.3**

31. Financial instruments (continued)

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

The table below analyses the Group'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.

At 30 September 2020	Book value £m	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial liabilities							
Deposit from banks	87.5	2.5	-	-	85.3	-	87.8
Deposit from customers	1,070.3	317.7	101.6	329.0	331.6	9.1	1,089.0
Derivative financial instruments	81.9	0.1	1.9	5.1	43.6	110.4	161.1
Other liabilities	4.5	4.5	-	-	-	-	4.5
Total financial liabilities	**1,244.2**	**324.8**	**103.5**	**334.1**	**460.5**	**119.5**	**1,342.4**

As at 31 October 2019	Book value £m	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial liabilities							
Deposit from banks	72.5	2.5	-	-	71.2	-	73.7
Deposit from customers	1,041.6	169.0	183.1	296.3	411.4	3.7	1,063.5
Derivative financial instruments	80.4	2.5	0.3	4.8	46.3	128.4	182.3
Other liabilities	3.9	3.9	-	-	-	-	3.9
Total financial liabilities	**1,198.4**	**177.9**	**183.4**	**301.1**	**528.9**	**132.1**	**1,323.4**

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 net.

g) Foreign currencies

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

32. 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 Group's Executive Risk Committee which reports to the Risk and Conduct Committee, which ensures adherence to the Group's risk management policy and framework.

Risk management objectives

Risk is inherent in all aspects of the Group's business. Within the Group, a risk management framework is in place to ensure that all material risks faced by the Group 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 Group is exposed to credit risk, liquidity risk, house price risk, interest rate risk, conduct risk, operational risk, insurance risk and pension risk. These are discussed in more detail in sections a) to h) below. In addition, whilst not a principal risk category we also consider the risk of economic loss as a result of the COVID-19 pandemic in point i) 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 Group.

The maximum credit risk as at 30 September is the carrying value recognised on the Balance Sheet as disclosed in the table in note 31(a), along with the loan commitments as disclosed in the table in note 31(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 Group's case are property price risk and tenant risk.

The primary driver of credit risk within equity release and retirement 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, gilts and debt securities is counterparty default, meaning the 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 Group 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 Group takes security in the form of a legal charge over the property against which loans are advanced. The Group'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 Group manages 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, portfolio buy-to-let credit risk and credit risk in relation to treasury financial instruments is described in the relevant sections below.

32. 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.

32. Financial risk management objectives and policies (continued)

Key Economic Scenario Assumptions

The key economic assumptions used in the model to determine the forward-looking PD are as follows:

Portfolio	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 rather 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.

32. 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 Group expects to be owed at the time of default.

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

- LGD represents the Group'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 PD
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 monthly 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.

32. Financial risk management objectives and policies (continued)

Credit risk: Residential exposures

The Group'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	903.6	100.0
	903.6	**100.0**
Fair value adjustments	173.2	
	1,076.8	**100.0**

	2019	
	£m	%
Fully secured by a first charge on residential property	738.3	100.0
	738.3	**100.0**
Fair value adjustments	164.5	
	902.8	**100.0**

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 profit 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 Group provides loans secured on residential property across England, Northern Ireland, Scotland and Wales.

32. Financial risk management objectives and policies (continued)

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 Group 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.

32. 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 Group 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 Group 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.

32. 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 Group 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	£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.

32. 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 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	60.9	-	-	60.9
Stage transfers	(33.5)	43.7	4.7	14.9
Repayment and settlement	(78.4)	(8.5)	(15.7)	(102.6)
At 30 September 2020	**235.7**	**49.5**	**14.7**	**299.9**

32. Financial risk management objectives and policies (continued)

Exposure by credit rating

The gross exposure on commercial financial assets and its 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:

Stage	Description	Stage	S&P Rating	Gross Loan Balance £m	ECL Provision £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 financial assets and its exposure to credit risk in line with internal risk grades and the corresponding external credit rating agency's credit risk rating at 31 October 2019 is disclosed below:

Stage	Description	Stage	S&P Rating	Gross Loan Balance £m	ECL Provision £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**

32. 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 Group 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 Group 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.

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 Group'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**	

32. Financial risk management objectives and policies (continued)

The Group 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	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.

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**

32. 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 PBTL loan 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**

Exposure by credit rating
The gross exposure on PBTL financial assets and its exposure to credit risk in line with credit rating agencies credit risk ratings 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 and the FCA guidance the Group granted payment concessions to four PBTL loan customers. All four of these customers have resumed full payment.

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

32. 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 £m	2019 £m
Cash and balances held at central banks	147.9	321.9
Government bonds	77.9	55.5
Debt securities	124.8	134.8
Loans and advances to credit institutions	117.1	87.3
	467.7	**599.5**
Provision for impairment	-	-
	467.7	**599.5**

None of these exposures are past due or impaired.

The following shows the exposures broken down by rating:

	2020 £m	2019 £m
AAA to AA-	438.9	559.7
A+ to A-	15.3	27.2
BBB+ to BBB-	13.5	12.6
	467.7	**599.5**

Concentration of credit risk
The geographical exposure is as follows:

	2020 £m	2019 £m
UK	411.1	548.0
Other	56.6	51.5
	467.7	**599.5**

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

32. Financial risk management objectives and policies (continued)

b) Liquidity risk
Liquidity risk is the risk that the Group will encounter difficulty in realising assets or otherwise raising funds to meet commitments as they fall due. The Group 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 31 (e) & (f) 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.

The Board has approved a liquidity risk management policy that sets out the liquidity requirements with which the Group 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.

The maturity analysis of financial assets and liabilities is disclosed in note 31(e) to the financial statements. For insurance contract liabilities and the reinsurance asset, maturity profiles are determined based on estimated timing of net cash outflows from the recognised insurance liabilities and the reinsurance asset.

Insurance contract liabilities	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
As at 30 September 2020	7.3	7.2	14.3	106.7	392.5	528.0
As at 31 October 2019	7.0	7.0	13.8	102.7	368.2	498.7

Reinsurance asset	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
As at 30 September 2020	-	-	-	0.2	0.7	0.9
As at 31 October 2019	-	-	-	-	-	-

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 Group manages its interest rate risk through its Assets and Liabilities Committee. The Group's policy is to maintain interest rate risk at a controlled level within limits set by the Board.

The table in note 31(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 Group are interest rate swap contracts of varying maturities and start dates.

The Group's interest rate risk management policy defines the type of derivative transactions that can be undertaken, which are all actioned by the Group'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.

32. Financial risk management objectives and policies (continued)

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 Group. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. The Group cannot expect to eliminate all operational risks but by initiating a rigorous control framework and by monitoring and responding to potential risks, the Group 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 Group 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.

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 Group's equity release, retirement mortgages and reversionary interests, such that the ultimate realisation of the property would not yield the expected return to the Group and could, in certain circumstances, result in a capital loss. The Group mitigates house price risk by monitoring maximum loan to value at inception of the loan and reversionary interests. The reversionary interests are a legacy product which is being run-off over the medium term.

Geographical analysis of loans secured on equity release and retirement mortgages.

The Group 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	20.6	3.8	21.4	3.9
East Anglia	21.0	3.9	22.3	4.1
East Midlands	24.4	4.5	25.2	4.6
London	90.1	16.8	94.6	17.2
Yorkshire & Humberside	27.2	5.1	27.5	5.0
North West	39.0	7.3	40.8	7.4
Northern Ireland	17.8	3.3	17.5	3.2
Scotland	35.6	6.6	37.0	6.7
Outer Metropolitan	80.6	15.0	80.2	14.6
Outer South East	72.1	13.4	72.6	13.3
South West	63.2	11.8	64.3	11.8
West Midlands	29.9	5.6	29.9	5.4
North	15.8	2.9	15.6	2.8
	537.3	**100.0**	**548.9**	**100.0**

32. Financial risk management objectives and policies (continued)

f) Conduct risk
Conduct risk is the risk that the Group's behaviour results in poor outcomes for customers. The Group 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 Group holds a provision of £nil as at 30 September 2020 (2019: £nil).

g) Insurance risk
Life insurance risk includes the possibility of loss due to uncertainty of rates of death. The principal risk the Group faces under insurance contracts is that the actual claims and benefits payments exceed the amounts expected at the time of determining the insurance liabilities.

The Group principally writes annuity contracts where typically the policyholder is entitled to payments which cease upon death. For annuity contracts, the most significant factor is continued improvement in medical science and social conditions that would increase the length of time of annuity payments.

The risk exposure is mitigated by a diversification across a large portfolio of insurance contracts and geographical areas. Much of the Hodge Life's longevity risk is mitigated by the use of reinsurance in the form of a longevity swap arrangement.

h) Pension risk
The Group is exposed to pension risk through its defined benefit scheme. Further information is provided in note 28.

i) 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.

33. Ultimate parent undertaking

The ultimate parent undertaking and controller is The Carlyle Trust (Jersey) Limited (incorporated in Jersey), a company controlled by a Hodge family trust, whose sole natural trustee is Jonathan Hodge.

34. Shares in Group undertakings

Company	£m
At beginning of year	82.0
Additions	-
Issue of new shares	-
At end of year	**82.0**

The undertakings in which the Group's and/or Company's interest at the year-end is more than 20% are as follows:

Subsidiary Undertaking	Country of incorporation	Principal Activity	Class and Percentage of shares held	
			Group	Company
Hodge Life Assurance Company Limited	United Kingdom	Life Assurance	100%	100%
Julian Hodge Bank Limited	United Kingdom	Banking	100%	100%

35. Related parties

The Company has relationships with its immediate parent company, The Carlyle Trust Limited and fellow subsidiaries of The Carlyle Trust Limited. The other Group related party transactions are disclosed below:

	Interest income/(expense)	
	2020 £'000	**2019 £'000**
The Carlyle Trust Limited – parent	107.7	9.9
	107.7	**9.9**

The following balances were owed to or from related parties at 30 September:

	2020 £m	**2019 £m**
Amounts owed from parent and fellow subsidiaries		
The Carlyle Trust Limited – parent	3.0	3.3
Reimbursement asset due from The Carlyle Trust Limited	3.3	2.9
Group relief	-	1.1
Deposits owed to parent and fellow subsidiaries		
Jane Hodge Foundation – shareholder of The Carlyle Trust Limited	(1.8)	(2.5)
The Carlyle Trust Limited – parent	(1.3)	(1.1)
Hodge Developments (Beaufort Park) Limited	(0.1)	(0.3)
Sterling House Limited	-	(0.1)
Wingwest (Fountain Lane) Limited	(0.1)	(0.2)
Carlyle Property Development Limited	-	(0.4)
	3.0	**2.7**

Key management personnel comprise only the directors of the Group. There were no material transactions between the Group and its key management personnel other than those disclosed below.

Key management compensation is as follows:

	2020 £m	**2019 £m**
Short-term employee benefits:	1.2	1.0

36. Capital risk management

Banking segment
The banking segment conducts an Internal Capital Adequacy Assessment Process ('ICAAP'), at least annually, which is approved by the Board. This is used to assess the Group'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 Requirement ('TCR').

The Bank's capital resources requirements are calculated based on the CRD IV and 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 £m	2019 Unaudited £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 Bank operates only in the United Kingdom. The principal activities of the Bank are noted in the Strategic Report.
- Average number of employees: as disclosed in note 7 to the accounts.
- Annual turnover (Net Interest Income) and profit before tax: as disclosed in the Income Statement.
- Corporation Tax paid by Julian Hodge Bank Limited: 2020 £0.3m (2019: £0.2m).
- Public subsidies: The Group received a £0.3m grant from the UK government in relation to the Coronavirus Job Retention Scheme.

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

36. Capital risk management (continued)

The banking segment'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.

Life assurance segment
The insurance segment is required to maintain a minimum margin of solvency capital in excess of the value of its liabilities to comply with regulatory requirements.

The amount of regulatory and economic capital required also depends on the level of risk facing the insurance business, and as such correlates to economic market cycles. The insurer must assess its capital resources on both a Pillar 1 (regulatory capital) and a Pillar 2 (own risk and solvency assessment) basis. The Pillar 1 capital requirement is calculated by applying the Solvency II standard formula for solvency capital requirements whereas the Pillar 2 capital requirement is determined following an internal capital assessment by the insurer.

All minimum regulatory requirements were met during the year.

The objectives when managing capital are:

- To have sufficient capital to safeguard its 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 insurance capital requirements set out by the regulators of the insurance markets in which the insurer operates (the PRA in the UK);
- To provide an adequate return to the shareholder by pricing insurance contracts according to the level of risk associated with the business written.

The insurer's capital comprises solely equity, movements of which are set out in the Statement of Changes in Equity.

Pillar 1 capital position

	2020 Unaudited £m	2019 Unaudited £m
Total capital resources	149.2	148.5
Solvency capital requirement	(81.7)	(90.1)
Excess available capital resources	67.5	58.4
Solvency Coverage Percentage	183%	165%

A reconciliation of Hodge Life's total equity to distributable reserves is summarised below:

	2020 Unaudited £m	2019 Unaudited £m
Total equity	162.7	156.0
Less: share capital	(6.8)	(6.8)
Less: other non-distributable reserves	(88.4)	(90.8)
Distributable reserves	**67.5**	**58.4**

HODGE

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