Julian Hodge Bank Limited

Annual report and financial statements
31 October 2019
Registered number
00743437

Officers and professional advisers

Directors	Adrian Piper	Chairman B.A., M.Sc., M.C.I.P.D., M.C.I.M.
	Stephen Pateman	Chief Executive Officer F.C.I.B.S.
	David Landen	Chief Financial Officer F.C.C.A., B.Sc.
	Alun Bowen	F.C.A., M.A.
	Helen Molyneux	LLD (Hons), LLB (Hons).
	John Barbour	B.Sc., MBA.
	David Gulland	F.I.A. BA.
	Graeme Hughes	A.C.I.B., M.B.A.
Bank secretary	Kirsty Williams	LLB (Hons).
Registered office	One Central Square Cardiff CF10 1FS	
Auditor	Ernst & Young LLP Bristol	
Principal bankers	Lloyds Bank Plc London	
Economic adviser	Professor Patrick Minford Cardiff Business School	

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Chairman's Statement

I am pleased to present the financial statements of Julian Hodge Bank (the 'Bank') for the year ended 31 October 2019.

It is nearly 80 years since Sir Julian Hodge founded the Hodge group (the 'Group') and our 79th year has been one of change as we look towards the future with a strategy that will seek to significantly improve our profitability and scale, with the aim of creating a bank with a £3.0bn Balance Sheet.

Whilst our focus will remain on the later life market, through lifetime mortgages, we will continue to develop our commercial lending activities in development and investment finance and build out new niche markets; this year we have entered the professional buy-to-let market and launched holiday let mortgages.

We continue to see ourselves as an innovator and recently launched a lifetime fixed rate retirement mortgage, we are also considering a range of inter-generational mortgage opportunities that will help address the challenges that society faces in terms of unlocking housing equity to support a longer retirement or, to help the next generation buy their first home.

We continue to place great value on having access to liquidity, primarily in the form of retail savings which now total over £1bn; we seek to remain competitive, whilst offering good value to customers.

Economic environment

The year ended 31 October 2019 was undoubtedly a challenging environment for our business with historically low interest rates which impacted capital levels as well as the financial results. Notwithstanding the clarity provided by the general election result and the potential for a recovery in confidence and investment, there remains uncertainty caused by Brexit which is likely to have a negative impact on the Bank's performance if the consequence is a weakening in residential real estate prices and lower long-term interest rates. Although there are clearly risks which could impact asset valuations and the earnings required to service liabilities, we believe that there are good opportunities for growth across our business within a prudent risk appetite underpinned by a focus on secured lending and we look to the future with a quiet confidence, underpinned by the strength of our people and the long-term commitment of our shareholder.

Financial performance

The overall financial result is a loss after tax of £5.7m for the year (2018: £5.5m profit). Whilst the overall result is disappointing, the Bank continued to be profitable at an operating profit level.

Five Year Summary

	2019	2018	2017	Restated 2016	Restated 2015
	£m	£m	£m	£m	£m
Net operating income	28.0	26.2	18.6	18.3	7.7
Operating profit	6.5	14.3	10.2	3.6	0.4
(Loss)/profit before taxation	(7.8)	6.3	10.5	23.1	1.6
Total assets	1,378.7	1,363.4	1,267.4	1,324.0	1,115.7
Loans and advances to customers	766.9	827.9	757.9	706.9	624.8
Customer deposits	1,042.8	994.6	947.7	991.7	848.6
Shareholder's funds	160.3	171.7	167.3	153.5	140.1

Chairman's Statement (continued)

The net operating income has increased as a result of growth in our residential mortgage business and as a result of increased realised gains on the reversionary product.

The increase in net operating income did not flow through to operating profit, mainly due to a significant impairment on commercial lending exposures of £4.3 million. Progress has been made in 2019 to resolve commercial lending exposures in default, with gross default balances and balances with a significant increase in credit risk decreasing by £4.0m.

Operating profit was also adversely impacted by planned increases in administrative expenses due to substantial investment in people, premises 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.

To reduce our volatility to interest rate movements in the future, we took the opportunity to reduce our holding of legacy equity release mortgages and this crystallised a gain of £19.5m compared with the balance outstanding on the mortgages but a loss of £4.6m on the fair value of £122.0m. The liquidity and capital created from this disposal will be deployed into our core businesses to produce less volatile returns in the future. We will look for further opportunities to reduce our legacy assets over the coming months and we have adjusted the fair value of the remaining assets to reflect the current market conditions.

The IFRS loss was mitigated in part by the gain of £3.1m which arose from selling our holding of corporate bonds as a result of the decision to restructure the treasury portfolio.

The overall result is a loss after tax of £5.7m, this is primarily due to adverse fair value movements as a result of low interest rates. Total fair value losses amounted to £12.8m.

Our shareholder's funds were further depleted due to actuarial losses of £3.3m on the defined benefit pension scheme and adverse adjustments on transition to IFRS 9 of £3.4m.

Our business

We are a privately-owned bank making life better for our customers, colleagues and communities by providing specialist lending, savings and retirement solutions in a manner that is fair, friendly and personal.

Specialist mortgages

Hodge's specialist mortgage business combines our expertise in both residential and later-life lending. We work in partnership with our trusted network of intermediaries, serving professional landlords through our portfolio buy-to-let mortgages, and personal customers through our later-life mortgages.

We rolled out a number of product changes based on feedback from the broker community. Working closely with them to ensure the products we offer deliver for our customers and provide flexibility in a notoriously rigid market. This is essential as we look to evolve our product offering.

We have established a customer forum and continue to work closely with our broker network to ensure the products we design are needed and add value. Our specialist underwriting criteria will also serve to enhance our offering.

Over the past twelve months we have strengthened our team and, as a result, significantly improved our service. We shall continue to invest in this space in the next twelve months.

Portfolio buy-to-let

As the overhaul of the UK buy-to-let market continues, Hodge has been able to make the most of our specialist underwriting approach to take advantage of these changes.

During the year we launched our portfolio buy-to-let mortgage, aimed at those portfolio landlords who want a single lender relationship, flexibility to move properties in and out and the ability to grow.

With the market shifting towards professional landlords, Hodge has been able to focus on bringing innovative products to portfolio landlords and continues to look at developing our product offering.

Chairman's Statement (continued)

Later life

The later life market continues to grow and with brokers continuing to enter this market, we are well positioned to support and add value.

In 2019 we launched the fixed-for-life Retirement Interest Only (RIO) mortgage which allows customers to choose a loan with a fixed rate for the lifetime of the loan, a market-leading development which demonstrates our commitment to delivering certainty to later-life borrowers.

As Hodge created the first equity release product in 1965, the introduction of the first RIO and the first fixed-for-life RIO, we are a true innovator in this space.

Commercial lending

The focus of our commercial business is to be a long-term lending partner for our clients.

The past twelve months have been successful for the team, originating £101m of new lending across our established business lines.

It has also been a year of real progress and collaboration with the launch of a new proposition aimed at smaller property development schemes, and the creation of an innovative portfolio mortgage for buy-to-let investors.

Our risk experience at portfolio level has been generally positive and we have not seen material impact from the recent spate of retail and leisure business failures which have received much media coverage this year.

Notwithstanding political uncertainties, we have found borrower demand for property in the SME space has remained robust. While we continue to be cautious in our appetite, we have found a steady stream of good quality proposals which we have been pleased to support.

Through our property development finance activities, we are proud to have facilitated the construction of many new homes across the country. Not only that, but to have supported in the regeneration of areas in which old buildings have been repurposed into vibrant new mixed-use schemes with community benefits.

We continue to enhance our wider governance and risk protocols which support this performance, including the development of a new and enhanced credit IT system which we expect to implement in 2020.

Our core proposition remains the provision of bespoke real estate funding solutions to experienced, serially-active property investors and developers. These client's value direct access to senior people and the responsiveness of a privately-owned bank.

However, during the year, we have also started to build up our presence in the wider commercial finance broker-led market as part of our strategy to grow the size and spread of our client base.

Similarly, we have worked hard to streamline our on-boarding process and further improve client experience, something which is so important for a business looking to build long-term relationships with clients.

The Commercial Lending team has grown significantly this year. Investing in our people, expanding our team of experienced relationship managers, allowing us to support our future growth plans and to serve our growing client base.

Savings

Customer savings are, and will remain to be, the most important part of our funding base.

During the past year we have continued to invest in our digital offering, leveraging technology to create an enhanced experience for our customers.

Enhancing our on-line savings portal has created a secure, seamless self-serve platform for our customers. We will continue to increase our Savings product offerings and invest in our digital capability to ensure our customers enjoy a positive and worry-free experience.

Chairman's Statement (continued)

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

While we are excited about these improvements to our digital offering, we recognise there will always be a need for human interaction. Some customers will prefer the human touch at every stage of their journey, while others just need the reassurance that any queries can be answered by a person. We are proud of the team of experts who are always on hand to support those customers.

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

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 6.3% of the overall funding from deposits with banks and customers at 31 October 2019.

Governance and the Board

Steve Pateman joined us in January 2019 from Shawbrook and has made a very encouraging start; I and the Board would like to extend our appreciation to David Austin who retired this year after 28 years with the Bank. One cannot overstate his contribution over many years through many challenges and we wish him well in his retirement.

Alongside the changes in executive leadership, the Board has continued to evolve. David Gulland has been appointed as a non-executive director. David has an extensive background in life assurance and his actuarial experience will help the Board provide appropriate challenge and oversight as we seek to optimise our capital profile.

Graeme Hughes has been appointed as Senior Independent Director and will lead the search for my replacement when I stand down at the end of April 2020. Graeme joins us after a long and successful career at Nationwide where he was the Group Distribution Director; responsible for all sales and service activities.

Alun Bowen will continue to chair the Risk and Conduct Committee until his retirement at the end of our next financial year. Alun has been and continues to be someone whose experience and commercial insights are very relevant to our business.

Jonathan Hodge has also stepped down from the Board of the Bank after 36 years initially as an Executive Director and from 2006 as the Director representing the Shareholder's interests. Jonathan launched the application for a deposit taking licence in 1987 and was the first chairman of the Bank. Jonathan will retain an active interest in the business through his role as Chairman of The Carlyle Trust Limited. It is important however to record our thanks to Jonathan for his energy, commitment, professionalism, wise and effective counsel over the many years he has served on the Board.

I would like to close what will be my final Chairman's Statement by extending my thanks to my colleagues on the Board for their wise counsel and support, to the executive leadership team and their staff for all their endeavour and commitment which underpins a robust set of results, in spite of all the headwinds, laying strong foundations for our future and finally to Jonathan Hodge for giving me the opportunity to play a part in a business that has been and continues to be unique in its ownership, ethos and approach not just in South Wales but across the financial services industry.

Adrian Piper
Chairman
19 December 2019

Strategic Report

Principal activities
The Bank is principally engaged in the business of banking and 'later life lending'.

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

Corporate strategy
The Board has adopted a strategic plan with the long-term aim of achieving stable and strong returns for our shareholder. At the heart of the Bank's philosophy is a wish to protect its capital base for the benefit of its depositors and shareholders by conducting business in those areas where it has the greatest expertise and experience and best understands the risks which it is taking.

A rolling five-year strategy is approved by the Board annually, complemented by a detailed business plan for the forthcoming financial year. The Board sets aside specific time during the year to review its strategy and to gauge progress towards its achievement. The current strategy is based on a continuing involvement in (a) residential and lifetime mortgages through its later life lending and buy-to-let activities, both of which it believes will enable it to achieve its strategic objectives (b) commercial property, primarily through the Bank's commercial lending business.

In February 2019, the Board agreed a new strategy for the financial services businesses within Hodge that will target a long-term return on capital of 12%.

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

IBOR reform
In July 2017, the UK Financial Conduct Authority (FCA) announced a transition away from LIBOR as the key interest rate index used in calculating floating or adjustable rates for loans, bonds, derivatives and other financial contracts. The FCA's intention is that, at the end of 2021, it will no longer seek to persuade, or compel, banks to submit rates for calculation of LIBOR. The Bank is currently assessing the impact of this change on its financial instruments which use LIBOR as their benchmark interest rate, this work will continue through 2020 as the impact on markets becomes clearer.

Business review, future developments and key performance indicators
A review of business, future developments and key performance indicators is included in the Chairman's statement on pages 1 to 4. The key performance indicators are considered to be net operating income and operating profit.

Results and dividends
The loss for the year after taxation amounted to £5.7m (2018: profit after taxation of £5.5m). No dividend was paid during the year (2018: £nil) leaving a deficit for the year of £5.7m (2018: surplus of £5.5m) to be taken to reserves.

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

The directors recognise the importance of communication with employees and they make it their policy to be accessible to them.

Strategic Report (continued)

Corporate Governance

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

The Board's agenda during 2019 was focused on overseeing and supporting executive management in delivering on the Bank's strategic objectives.

The Board comprises two executive and six non-executive directors and the roles of Chairman and Chief Executive are separate to ensure that neither can exercise unfettered powers of decision-making on matters of material importance.

The Board has sought to ensure that directors are properly briefed on issues arising at board meetings by:

- distributing papers sufficiently in advance of meetings;
- considering the adequacy of the information provided before making decisions; and
- deferring decisions when directors have concerns about the quality of information.

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

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

There is a well-established internal audit function within the Bank that is provided by PwC on an outsourced basis. Its role is primarily 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 of the Committee to present a summary of audit reports completed during the period and to provide any explanations required by the Committee. During the year the Audit Committee agreed to outsource our internal audit function to Deloitte from 1 January 2020.

Governance framework

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

The Board

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

The Chairman is responsible for the leadership and operation of the Board, setting the agenda and the tone of Board discussions as well as assessing the effectiveness of the Board and directors.

Strategic Report (continued)

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

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

Adrian Piper – Chair
Adrian has been a non-executive director since 2010 and was appointed Chair in July 2017.

Before joining the Board, Adrian enjoyed a career of almost 40 years with the Bank of England, latterly as its Agent for Wales. Adrian is also a member of the Audit Committee of Cardiff Metropolitan University.

Graeme Hughes – Senior Independent Director
Graeme joined the Board in September 2019. He is also the Senior Independent Director of the Hodge Life Assurance Company and a non-executive director of Hodge Limited.

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

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.

Alun Bowen - Non-executive director
Alun joined the Board in 2013 and is Chair of the Risk and Conduct Committee. 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 Committees of PAO Severstal and Transport for Wales and is a Fellow of the Institute of Chartered Accountants in England & Wales. Alun has also been chair of Business in the Community in Wales, a member of the Council of the Prince's Trust Cymru and the BT Wales Advisory Board.

Helen Molyneux - Non-executive director
Helen joined the Board in June 2015. Helen is also the Chair of the Remuneration Committee.

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

In 2011 Helen was named Welsh Woman of the Year and in 2013 the Law Society's Business Woman of the Year. She was a member of the Silk Commission on Devolution in Wales and currently chairs 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.

Strategic Report (continued)

David Gulland – Non-executive director
David joined the Board of the Bank in 2019 and is also a non-executive director of Hodge Life Assurance Company.

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, having previously been Chief Risk Officer of MGM Advantage Life Ltd 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 he is Chair of the Audit & Risk Committee at PG Mutual.

Steve Pateman- Group Chief Executive Officer
Steve joined the Board in February 2019 on his appointment as Chief Executive Officer.

Steve was previously Chief Executive Officer of Shawbrook Bank where he delivered strong balance sheet and revenue growth. Before that he led the UK banking businesses of Santander after having held a number of senior management roles at Royal Bank of Scotland.

Steve is also Vice President of the Chartered Banker Institute and a non-executive director of the Bank of Ireland.

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

Board Committees
The Board has established the following standing committees:

Audit Committee: John Barbour (Chair), Jonathan Hodge, Helen Molyneux, Alun Bowen, David Gulland and Graeme Hughes.

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 review 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.

Risk and Conduct Committee: Alun Bowen (Chair), Jonathan Hodge, Helen Molyneux, John Barbour, Adrian Piper, David Gulland and Graeme Hughes.

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 is committed to meeting at least eight times a year from 1 November 2019.

Strategic Report (continued)

Remuneration Committee: Helen Molyneux (Chair), Jonathan Hodge, Alun Bowen, John Barbour, Adrian Piper, David Gulland and Graeme Hughes.

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.

Nomination committee: Adrian Piper (acting Chair), Jonathan Hodge, Alun Bowen, Helen Molyneux, John Barbour, David Gulland and Graeme Hughes.

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

The function of the Nomination Committee is to recommend the appointment of directors to the Board and board committees and to ensure that the Company has an appropriate succession plan for executive and senior management positions.

The Committee meets at least twice per year.

Board and Committee Membership and Attendance

Name	Board		Audit Committee		Risk and Conduct Committee		Remuneration Committee		Nomination Committee	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
Adrian Piper	9	9	5	5	5	5	4	4	3	3
John Barbour	9	8	5	5	5	5	4	3	3	2
Jonathan Hodge	9	9	5	5	5	5	4	4	3	3
Helen Molyneux	9	8	5	5	5	5	4	3	3	3
Alun Bowen	9	7	5	3	5	5	4	2	3	2
David Gulland	5	4	2	2	2	2	2	2	2	2
Graeme Hughes	2	2	1	1	1	1	1	1	1	-
Steve Pateman	7	7	-	-	-	-	-	-	-	-
David Landen	9	9	-	-	-	-	-	-	-	-
David Austin	3	3	-	-	-	-	-	-	-	-

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

Notes
Steve Pateman joined the Board on 7 February 2019
David Gulland joined the Board on 2 May 2019
David Austin resigned from the Board on 7 February 2019
Graeme Hughes joined the Board on 19 September 2019
Jonathan Hodge retired from the Board on 31 October 2019

Strategic Report (continued)

Risk management

In the normal course of its business, the Bank is exposed to credit risk, liquidity risk, house price risk, interest rate risk, conduct risk and operational risk.

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

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

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

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

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

The table in note 28 shows an estimate of the interest rate sensitivity gap as at 31 October 2019. Assets and liabilities are included in the table at the earliest date at which the applicable interest rate can change.

The Bank enters into derivative transactions, normally interest rate swaps. The purpose of such transactions is to manage the interest rate and other risks arising from the Bank's operations and other resultant positions. The Bank's interest rate risk management policy defines the type of derivative transactions that can be undertaken. Further information is given in note 23 to the financial statements.

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

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

Pension risk - the Bank is also exposed to pension risk through its defined benefit scheme. Further information is provided in note 25.

David Landen
Director
19 December 2019

Directors' Report

The directors present their report together with the audited financial statements for the year ended 31 October 2019. Certain disclosures are given in the Strategic Report and the financial statements are incorporated here by cross-reference. Specifically, these incorporate the following disclosures:

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Directors and their interests
The directors who held office during the year are listed below:

Adrian Piper *	Chairman
Jonathan Hodge * (retired October 2019)	Deputy Chairman
Alun Bowen *	
Helen Molyneux *	
David Gulland * (Joined May 2019)	
John Barbour *	
Graeme Hughes * (Joined September 2019)	Senior Independent Director
Stephen Pateman (Joined February 2019)	Chief Executive Officer
David Austin (resigned February 2019)	Chief Executive Officer
David Landen	Chief Financial Officer

* All non-executive directors excluding Jonathan Hodge are deemed to be independent by the Board. Jonathan Hodge is the holder of 45,724 ordinary shares in the Bank's UK parent entity, The Carlyle Trust Limited. None of the other directors held any interests in the shares of any group companies.

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

Political contributions
The Bank made no political contributions during the year.

Post Balance Sheet events
On the 5 December 2019, the Bank agreed to buy a portfolio of buy-to-let loans from a third party for £20.6m. There are no other post Balance Sheet events.

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

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

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

Directors' Report (continued)

Going concern

The Bank's business activities, together with the factors likely to affect its future development, its financial position, financial risk management objectives, and its exposures to credit and liquidity risk are described above.

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

The directors consider that the overall level of capital, including Tier 1 capital, of £156.4m (22.5% as a percentage of risk weighted assets) and liquidity, including liquid assets (gilts, debt securities, central bank reserves and wholesale cash deposits), of £490.1m (47.0% of total deposits with customers) are adequate. Accordingly, the directors confirm that they are satisfied that the Bank has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in the preparation of the financial statements.

By order of the Board

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David Landen
Director
19 December 2019

Directors’ Responsibilities Statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) including Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

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

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

Opinion

We have audited the financial statements of Julian Hodge Bank Limited for the year ended 31 October 2019 which comprise the Income Statement, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity and the related notes 1 to 31 (except for the sections of notes 2 and 30 which are marked as unaudited), including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 31 October 2019 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Conclusions relating to going concern

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

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

Overview of our audit approach

Key audit matters	• The risk that inappropriate actuarial assumptions are used in the valuation of equity release mortgages and reversionary interest in properties; • The risk that inappropriate property/collateral valuations are applied; in the calculation of the IFRS 9 Expected Credit Loss ('ECL') provision; • The risk that there is 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 S&P scorecard ratings applied in the commercial loan book; • The risk of incorrect valuation of derivatives.
Materiality	• Overall materiality of £2.6m which represents 1.6% 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 mortgages and reversionary interest in properties (loans and advances (equity release mortgages): £144.7m, 2018: £269.9m, investment properties - reversionary interest in properties: £97.3m, 2018: £100.3m) The valuation of the equity release mortgages and reversionary interest in properties 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 in note 14 of the financial statements, with the principal assumptions and sensitivity analysis of changes to key assumptions disclosed in note 28. The reversionary interest in properties are disclosed as investment properties in note 18 of the financial statements, with the principal	We performed a walkthrough to understand the assumption setting process and tested controls within the process. Utilising our actuarial specialists, we assessed and challenged the assumptions used within the valuation of equity release mortgages and reversionary interest in properties 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: <u>No Negative Equity Guarantee</u> We considered each of the assumptions used within the NNEG calculation, considering a combination of historic and projected future house price growth, the potential variability in house price growth and the allowance made for property dilapidations within the portfolio. <u>Voluntary early redemption</u> We compared the voluntary early redemption assumptions in the valuation with observed experience in the portfolio and with those used by peer companies in the sector. Particular attention was paid 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 equity release mortgages and reversionary interest in properties to be within a reasonable range, with the majority of assumptions towards the middle of the range, although the discount rate for equity release mortgages is at the optimistic end of the acceptable range.

assumptions and sensitivity analysis of changes to key assumptions disclosed in note 18.	Discount rate We tested whether the discount rate used in the valuation of equity release mortgages and reversionary interest in properties was consistent with discount rates used by other companies in the sector, relative liquidity levels and customer rates available in the market. 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. 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.	
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): £7.3m (2018: £3.6m). 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.	We performed a walkthrough to understand the provisioning process and tested the controls over the valuation of collateral. For a sample of Stage 3 loans we utilised our property valuation team specialists to perform an independent valuation of the collateral used within the ECL provision calculation. The sample we tested in our audit covered £20.8m, 97% (2018: £30.2m, 91%) of the collateral value for the Stage 3 loans.	The controls within the process were tested and were found to be operating effectively. For the sample of Stage 3 property loan collateral selected for testing, each item was evaluated and the valuation of the collateral was determined to be within an acceptable range.

The loan collateral is disclosed in note 29 of the financial statements.		
The risk that there is 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 S&P scorecard ratings applied in the commercial loan book (gross loan balance for commercial loans): £326.7m (2018: £354.3m) The loan impairment is disclosed in note 15 of the financial statements.	We performed a walkthrough to understand the IFRS 9 estimated credit loss process and tested the controls for the assignment of risk ratings which are used to determine the staging of the loans. We tested the S&P scorecard ratings and a sample of internal risk ratings to ensure the inputs to the staging calculation were appropriate. Using the S&P scorecard ratings and internal risk ratings, we reperformed the staging assessment, to verify the accuracy of the staging formulas within the estimated credit loss model.	The controls within the process were tested and were found to be operating effectively. No material exceptions were identified in the testing of the year end staging assessment.
The risk of incorrect valuation of derivatives: £80.4m (2018: £107.8m) 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 risk. 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 23 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 £70.9m (2018: £85.6m) 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 the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed.

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

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

We determined materiality for the Company to be £2.6m (2018: £2.6m), which is 1.6% (2018: 1.5%) of equity. We believe equity to be the most appropriate basis as the key stakeholders (including the principal shareholder and the PRA) are focused on the financial strength and solvency position of the business, which is represented in the financial statements by equity.

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

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

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

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.1m (2018: £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 Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

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

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

Responsibilities of directors

As explained more fully in the Directors' Responsibilities Statement set out on page 13, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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 were the regulations, license conditions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').
- We understood how the Company is complying with those frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Executive Risk Committees held; and gained an understanding of the Company's approach to governance, demonstrated by the Board's approval of the Company's governance framework and the Board's review of the Company's risk management framework ('RMF') and internal control processes.

- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur by considering the entity level controls that the Company has established to address risks identified by the Company, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making enquiry of those charged with governance, senior management and internal audit for their awareness of any non-compliance of laws or regulations, inquiring about the policies that have been established to prevent non-compliance with laws and regulations by officers and employees, inquiring about the Company's methods of enforcing and monitoring compliance with such policies and inspecting significant correspondence with the FCA and PRA.
- The Company operates in the banking industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- We were appointed by the Company on 22 April 2016 to audit the financial statements for the year ending 31 October 2016 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 4 years, covering the years ending 31 October 2016 to 31 October 2019.
- Non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Use of our report

This report is made solely to the Company's member, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's member 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 member 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
20 December 2019

Notes:

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

Income Statement
For the year ended 31 October 2019

	Notes	2019 £m	2018 £m
Interest receivable and similar income	5	48.3	46.0
Interest payable and similar charges	6	(28.1)	(27.7)
Net interest income		**20.2**	**18.3**
Fees and commissions receivable		0.7	2.5
Fees and commissions payable		(0.1)	(1.1)
Net fee and commission income		**0.6**	**1.4**
Other operating income		-	0.1
Investment income		7.2	6.4
Net operating income		**28.0**	**26.2**
Depreciation and amortisation		(1.2)	(0.9)
Administrative expenses	7	(16.4)	(12.0)
Impairment (losses)/gains on loans and advances to customers	15	(3.9)	1.0
Operating profit		**6.5**	**14.3**
Gains arising from the derecognition of financial assets managed at amortised cost	12	3.1	-
Other fair value losses	8	(12.8)	(8.0)
Loss on disposal of loans and advances to customers held at fair value	14	(4.6)	-
(Loss)/profit before taxation	**9**	**(7.8)**	**6.3**
Tax credit/(charge) on profit	10	2.1	(0.8)
(Loss)/profit for the financial year		**(5.7)**	**5.5**

Statement of Other Comprehensive Income
For the year ended 31 October 2019

	Notes	2019 £m	2018 £m
(Loss)/profit for the financial year		(5.7)	5.5
Items that will not be reclassified subsequently to profit and loss:			
Re-measurement of defined benefit pension plan	25	(3.3)	0.6
Deferred tax thereon	19	0.6	(0.1)
Movement of pension scheme reimbursement asset	20	0.5	(0.1)
Deferred tax thereon	19	(0.1)	-
Items that may be transferred to the Income Statement **Available-for-sale investments:**			
Fair value movements taken to reserves		-	(1.8)
Deferred tax thereon		-	0.3
Total other comprehensive income		**(2.3)**	**(1.1)**
Total comprehensive income for the year		**(8.0)**	**4.4**

The results for the year ended 31 October 2019 relate entirely to continuing operations.

The notes on pages 25 to 76 form part of these financial statements of the Bank.

Balance Sheet
As at 31 October 2019

	Notes	2019 £m	2018 £m
Assets			
Cash and balances held at central banks		321.9	153.2
Treasury bills	11	25.1	81.2
Debt securities	12	57.0	87.5
Loans and advances to credit institutions	13	86.1	96.2
Loans and advances to customers	14	766.9	827.9
Intangible assets	16	5.8	3.1
Property, plant & equipment	17	1.9	2.2
Investment properties	18	97.3	100.3
Deferred tax assets	19	6.6	6.5
Other assets	20	10.1	5.3
Total assets		**1,378.7**	**1,363.4**

	Notes	2019 £m	2018 £m
Liabilities			
Deposit from banks	21	72.5	72.5
Deposits from customers	22	1,042.8	994.6
Derivative financial instruments	23	80.4	107.8
Other liabilities	24	6.1	3.9
Other provisions		-	0.1
Pension liabilities	25	16.6	12.8
Total liabilities		**1,218.4**	**1,191.7**
Share capital and reserves			
Share capital	26	105.0	105.0
Other reserves		55.3	66.7
Total equity		**160.3**	**171.7**
Total equity and liabilities		**1,378.7**	**1,363.4**

These financial statements of the Bank were approved by the Board of directors on 19 December 2019 and were signed on its behalf by:

David Landen
Director

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

	Called up share capital	Retained earnings	Available-for-sale reserve	Pension reserve	Total
	£m	£m	£m	£m	£m
2019					
At beginning of year	105.0	72.7	2.7	(8.7)	171.7
Impact on adoption of IFRS 9 (note 2)	-	(0.7)	(2.7)	-	(3.4)
Restated Balance	**105.0**	**72.0**	**-**	**(8.7)**	**168.3**
Loss for the financial year	-	(5.3)	-	(0.4)	(5.7)
Other comprehensive income	-	-	-	(2.3)	(2.3)
At end of year	**105.0**	**66.7**	**-**	**(11.4)**	**160.3**

	Called up share capital	Retained earnings	Available-for-sale reserve	Pension reserve	Total
	£m	£m	£m	£m	£m
2018					
At beginning of year	105.0	66.8	4.2	(8.7)	167.3
Profit for the financial year	-	5.9	-	(0.4)	5.5
Other comprehensive income	-	-	(1.5)	0.4	(1.1)
At end of year	**105.0**	**72.7**	**2.7**	**(8.7)**	**171.7**

Notes to the accounts

1 Accounting policies

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

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

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

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

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

- A Cash Flow Statement and related notes;
- Reconciliation between carrying amounts of investment properties at the beginning and at the end of the period;
- Disclosures in respect of transactions with members of a group;
- Disclosures in respect of the compensation of Key Management Personnel and related parties.

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

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

Changes in presentation
Following a review of the financial statements of the Bank in the current year, the Board has decided to change the presentation of the Income Statement through the inclusion of the operating profit line. Operating profit is one of the key performance measures that internal stakeholders review to understand the performance of the Bank and as such its inclusion is deemed to supplement and enhance the information provided to external stakeholders. The prior period disclosures have been updated to ensure that there is consistency in the disclosures.

The classification of transactions and balances included within the financial statements of the Bank has been reviewed in the current period to enhance the understandability of the financial statements of the Bank to its users. Where transactions and balances have been presented differently in the current period, the prior period comparative has been updated to ensure consistency with the current period classification.

New Standards and interpretations not yet adopted
A number of IASB pronouncements have been issued but are not yet effective for this financial year. The standards considered most relevant to the Bank are as follows:

IFRS 16 – Leases
IFRS 16 'Leases' was issued in January 2016 and introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees and will supersede the current lease guidance including IAS 17 'Leases' and the related interpretations. The expected impact of adoption has been determined to be immaterial as the Bank has no significant lease transactions.

1 Accounting policies (continued)

Adoption of new and revised standards and interpretations
On 1 January 2018, a number of new and revised standards issued by the International Accounting Standards Board, and endorsed for use in the EU, came into effect. New and revised standards adopted in the period that are deemed significant to the Bank are outlined below.

IFRS 9 – Financial Instruments
On 1 November 2018, the Bank adopted the requirements of IFRS 9 as issued in July 2014 and the amendments to IFRS 9 'Prepayment Features with Negative Compensation'. The new standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'. To reflect the difference between IFRS 9 and IAS 39, consequential amendments were also made to other standards including IFRS 7 'Financial Instruments: Disclosures' and IAS 1 'Presentation of Financial Statements'. The Bank adopted these consequential amendments, along with IFRS 9, on 1 November 2018.

IFRS 9 introduces new requirements for the classification, measurement and impairment of financial assets and liabilities. The key changes to the Bank's accounting policies are as follows:

Classification of financial assets
Under IFRS 9 there are three principal classification categories for financial assets being measured at either:
- Amortised cost,
- Fair value through other comprehensive income (FVOCI), and
- Fair value through profit or loss (FVTPL).

Impairment of financial assets
IFRS 9 replaces the incurred loss model implemented under IAS 39 with an expected credit loss (ECL) model which results in earlier recognition of credit losses. The model applies to all financial assets not held at FVTPL, together with financial guarantee contracts and loan commitments.

Transition
The Bank has adjusted the opening balance of retained earnings to reflect the application of the new requirements of IFRS 9. In accordance with the transition requirements, comparative information is not restated. As such, the comparative information for the year ended 31 October 2018 is reported under the requirements of IAS 39 and is not comparable to the information presented for the year ended 31 October 2019.

The accounting policies under IAS 39 can be found within the financial statements for the year ended 31 October 2018.

IFRS 15 Revenue from Contracts with Customers
On 1 November 2018, the Bank adopted the requirements of IFRS 15. The new standard replaces IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

Changes in accounting policies
IFRS 15 establishes the principles to apply when reporting information about the nature, amount, timing and uncertainty of revenue and cash flows from a contract with a customer. The standard introduces a five-step revenue recognition model to be applied to all contracts with customers to determine whether, how much, and when revenue is recognised.

IFRS 15 does not apply to financial instruments or lease contracts, which fall under the scope of other IFRSs. Of particular note, Interest receivable, the main source of revenue for the Bank, falls outside the scope of IFRS 15.

Transition
The Bank assessed its non-interest revenue streams that fall under the scope of IFRS 15 and determined that the impact on the amount or timing of revenue to be recognised as a result of the adoption of IFRS 15 is immaterial. As such, there is no adjustment to the opening balance of retained earnings or related tax balances.

1 Accounting policies (continued)

New standards and interpretations not yet adopted
A number of IASB pronouncements have been issued but are not yet effective for this financial year. The standards considered most relevant to the Bank are as follows:

IFRIC 23 - Uncertainty over Income Tax Treatments
IFRIC 23 is effective for annual reporting periods beginning on or after 1 January 2019 and the impact of adoption is deemed to be immaterial.

Summary of Significant Accounting Policies

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

Interest receivable and interest payable
Under IFRS 9, interest income and expense are recognised in the Income Statement for all instruments measured at amortised cost using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset to the gross carrying amount of a financial asset.

The Bank estimates future cash flows considering all contractual terms of the financial instrument. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument. The net incremental transactional income/cost is amortised over the period to the contractual maturity date for commercial loans and to the end of the fixed term for residential and buy-to-let mortgages, no adjustment is made for prepayments.

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, a credit-adjusted effective interest rate is calculated using estimated future cash flows including loss allowance. If an asset subsequently cures, the amount by which the provision has increased due to suspended interest is not recognised as interest income but as a reversal of the credit loss allowance.

Investment income
Investment income consists of realised gains and losses on reversionary interests held at 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.

Financial instruments

Recognition
Financial assets and liabilities are recognised when the Bank becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on trade date.

Financial assets
Under IFRS 9, there are three principal classification categories for financial assets: measured at amortised cost, FVOCI and FVTPL. The Bank has determined that under IFRS its financial assets are classified as follows:

- FVTPL - lifetime mortgages including retirement mortgages, equity release mortgages and index-linked treasury bills.
- Amortised cost - residential, buy-to-let and commercial loans, loans and advances to credit institutions, non index-linked treasury bills, debt securities and other assets.

The Bank does not hold any financial instruments that are classified and measured at FVOCI.

1 Accounting policies (continued)

To classify financial assets the Bank performs two assessments to evaluate the business model in which financial assets are managed and their cash flow characteristics.

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

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

A financial asset is classified as measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:
- It is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- Its contractual terms give rise on specified dates to cash flows that are SPPI.

Financial assets not classified as measured at amortised cost or FVOCI are classified as FVTPL.

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

Subsequent to initial recognition, financial assets are reclassified only when the Bank changes its business model for managing financial assets. Where this is the case, the Bank reclassifies all affected financial assets in accordance with the new business model. The reclassification is applied prospectively.

Initial measurement of financial assets is as follows:
- Financial assets at FVTPL: initially measured at fair value,
- All other financial assets: initially measured at fair value plus incremental direct transaction costs.

Subsequent measurement of financial asset categories held by the Bank is as follows:
- Financial assets at FVTPL: subsequently measured at fair value with gains and losses recognised in the Income Statement.
- Financial assets at amortised cost: subsequently measured at amortised cost using the effective interest rate method.

Financial liabilities
Under IFRS 9, there are two principal classification categories for financial liabilities: measured at amortised cost and FVTPL.

The Company has determined that under IFRS its financial liabilities are classified as follows:
- FVTPL - derivatives;
- Amortised cost - other liabilities.

Initial measurement of financial assets is as follows:
- Financial liabilities at FVTPL: initially measured at fair value
- Amortised cost: initially measured at fair value less incremental direct transaction costs.

Subsequent measurement of financial liability categories held by the Company is as follows:
- Financial liabilities at FVTPL: subsequently measured at fair value with gains and losses recognised in the Income Statement.
- Financial liabilities at amortised cost: subsequently measured at amortised cost using the effective interest rate method.

1 Accounting policies (continued)

De-recognition of financial assets and financial liabilities

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

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

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

Fair value of financial instruments
On initial recognition, the best evidence of the fair value of a financial instrument is normally transaction price (i.e. the fair value of the consideration given or received). If the Bank determines that the fair value on initial recognition differs from the transaction price, the Bank accounts for such differences as follows:
- If fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in the Income Statement on initial recognition (i.e. day 1 profit or loss);
- In all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability). Subsequently, the deferred gain or loss will be released to the Income Statement on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

The Bank uses a fair value hierarchy that categorises financial instruments into three different levels as detailed in note 28. Levels are reviewed at each reporting date and this determines whether transfers between levels are required.

Equity release and retirement mortgages
Loans and advances to customer held at fair value include retirement and equity release mortgages and are classified as FVTPL due to the existence of an embedded derivative in the form of a no negative equity guarantee which forms part of the terms and conditions applicable to these products.

On initial recognition, the fair value of these lifetime mortgages is calculated by discounting the future cash flows at swap rates together with an allowance for illiquidity. If the difference between the fair value at transaction date and the transaction price is a gain, it is not recognised but deferred against the lifetime mortgage balance and recognised uniformly over the expected life of the loan into the Income Statement . Any changes to assumptions used in the calculation of this deferred reserve will result in a recalculation which is then spread over the expected total life of the loan from inception. If the difference between the fair value and the transaction price is a loss either upon initial recognition or as a result of a recalculation, it is expensed to the Income Statement.

On subsequent measurement, the value of lifetime mortgages where the interest is rolled-up and added to the capital 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 mortgage assets. An allowance for possible early redemption of the mortgages has been determined by reference to historic rates of lapse within the portfolio.

1 Accounting policies (continued)

Embedded derivatives
The 'No negative equity guarantee' (NNEG) is an embedded derivative. The Company does not separate the NNEG embedded derivative from the host instrument. The fair value of lifetime mortgages takes into account an explicit provision in respect of the NNEG. Further details are disclosed in note 28(d).

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

The current market value of the underlying property is taken as the last formal valuation of the property on a vacant possession basis, modified by the change in the monthly national 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 based on the original cost in the year of disposal within investment income.

Measurement of Expected Credit Loss (ECL)
Under IFRS 9, impairment of financial assets is calculated using a forward looking ECL model. The Bank records an allowance for ECLs ('loss allowance') for all financial assets not held at FVTPL. There is no ECL required for loan commitments 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:

- When an 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 (doubling of the probability of default plus 45bps) 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.

The Bank does not hold any purchased or originated credit-impaired assets or financial guarantee contracts.

1 Accounting policies (continued)

Significant increase in credit risk
The Bank applies a series of quantitative, qualitative and backstop criteria to determine if there has been a significant increase in credit risk:
- Quantitative criteria: this considers the increase in an account's 12-month PD at the reporting date compared to the 12-month PD when the account was originated.
- Qualitative criteria: this includes the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms.
- Backstop criteria: IFRS 9 includes a backstop that 30-days past due is an indicator of a significant increase in credit risk. The Bank considers 30-days past due to be an appropriate backstop measure and does not rebut this presumption.

The Bank undertakes a review of the forward-looking economic scenarios at least annually and more frequently if required.

Definition of default and credit-impaired assets
The Bank's definition of default is fully aligned with the definition of credit-impaired. The Bank applies both a qualitative and quantitative criterion to determine if an account meets the definition of default. These criteria include:
- When the borrower is more than 90-days past due; and
- Qualitative factors to comply with the internal rating systems risk grading approach adopted by the Bank.

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

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

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.

Hedge accounting
The Bank has elected to continue to apply the hedge accounting requirements of IAS 39.

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

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

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

Hedge ineffectiveness is recognised in the Income Statement in other fair value gains and losses. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement under other fair value gains and losses in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk).

1 Accounting policies (continued)

Offsetting financial assets and financial liabilities
In accordance with IAS 32 Financial Instruments; the Bank reports derivative financial instruments on a net basis as there is a legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. A table is provided within note 23 which demonstrates the amounts which have been offset in the Balance Sheet.

Loans and advances to credit institutions include collateral pledged against the market value of derivative instruments. The collateral is subject to an enforceable master netting arrangement but does not qualify for netting under the requirements of IAS 32 as the Bank has no intention to settle on a net basis.

Intangible assets
IAS 38 Intangible Assets requires the capitalisation of certain expenditure relating to software development costs. Software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

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.

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	-	5 years
Short leasehold improvements	-	Shorter of remaining term of the lease and useful life

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

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

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

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

Corporation tax is charged directly to the Income Statement.

Share capital
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares are shown in equity as a deduction, net of tax, from the proceeds.

1 Accounting policies (continued)

Employee benefits

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

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

Pension costs for service in the period are assessed in accordance with advice from a qualified actuary and are recognised in the Income Statement. Gains or losses arising from the re-measurement of the defined benefit plan are recognised in full, in the year they occur, in the Statement of Other Comprehensive Income.

ii) Reimbursement asset on pension deficit
The Bank has recognised a reimbursement asset in respect of its pension scheme deficit which relates to retired employees that were contracted to the Bank's parent, The Carlyle Trust Limited (see note 25). 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 Bank's Income Statement. Any movement in the reimbursement asset which does not relate to the Bank's Income Statement is recognised in the Statement of Other Comprehensive Income. The calculation of the reimbursement asset is based on the split of scheme members by employer.

iii) Short-term employment benefits
The cost of short-term employee benefits, including wages and salaries, social security costs, bonuses payable within twelve months and healthcare, is recognised in the year of service.

iv) Pension reserve
The pension reserve consists of the net position of the defined benefit scheme liability, the reimbursement asset and the net deferred tax position relating to both of these items.

2 Impact on adoption of IFRS 9

The impacts of adopting IFRS 9 and transition disclosures are provided in the following sections.

Classification and measurement

Financial assets
Classification of financial assets under IFRS 9 is dependent on the outcome of two assessments which evaluates the business model in which financial assets are managed (the 'business model assessment') and their cash flow characteristics (the 'SPPI test').

The following table demonstrates the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets.

Financial asset	2018 £m	IAS 39 classification	Business model	Cash flows meet SPPI test?	IFRS 9 classification
Cash and balances held at central banks	153.2	Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost
Treasury bills - index linked	54.2	FVTPL	Recognised at FV to prevent accounting mismatch	N/A	FVTPL
Treasury bills - non-index linked	27.0	Available for Sale (FVOCI) and Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost (1)
Debt securities	87.5	Available for Sale (FVOCI) and Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost (1)
Loans and advances to credit institutions	96.2	Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost
Residential mortgages and commercial loans	452.5	Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost
Amounts owed by parent and fellow subsidiaries	1.7	Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost
Retirement mortgages	103.8	Amortised Cost	Recognised at FV due to existence of no negative equity guarantee	✗	FVTPL (2)
Equity release mortgages	269.9	FVTPL	Recognised at FV due to existence of no negative equity guarantee	✗	FVTPL
Other assets	5.3	Amortised Cost	Held to collect contractual cash flows	✓	Amortised Cost

1 – The non-index linked treasury bills and debt securities are held to maturity and therefore under the business model assessment it was determined that these assets should be classified and measured at amortised cost.
2 – The retirement mortgages are designated at fair value due to the existence of an embedded derivative – the "no-negative equity guarantee" – which causes these assets to fail the SPPI assessment.

2 IFRS 9 Adoption (continued)

The following table sets out the impact of adopting IFRS 9 on the statement of financial position carrying amounts and retained earnings as at 1 November 2018. Only balances impacted by the transition to IFRS 9 are included in the table; all other balances are unchanged.

	Carrying amount 31 Oct 2018 £m	Remeasurement /Reclassification £m	Carrying amount at 1 November 2018 £m
Assets			
Residential mortgages and commercial loans (1)	452.5	(2.2)	450.3
Retirement mortgages (2)	103.8	1.3	105.1
Treasury bills - non-index linked (3)	27.0	(0.2)	26.8
Debt securities (3)	87.5	(3.1)	84.4
Deferred tax asset (4)	6.5	0.8	7.3
Equity			
Retained earnings	72.7	(0.7)	72.0
Available-for-sale reserve	2.7	(2.7)	-

1 – These remeasurements arise from the recognition of the ECL provision.
2 – These remeasurements arise from the reclassification of the retirement mortgage portfolio from amortised cost to FVTPL.
3 – These remeasurements arise from the reclassification of the non-index linked treasury bills and debt securities from available-for-sale (FVOCI) to amortised cost.
4 - The deferred tax adjustment is spread for tax purposes, on a straight-line basis over the following ten years with the first accounting period beginning on 1 November 2018. This is with the exception of financial instruments maturing in the first accounting period, which are taxed or relieved in full in that accounting period.

Impairment of financial assets
The most significant impact from adopting IFRS 9 on the Bank's financial statements results from the new impairment requirements as detailed in note 1 'Impairment of financial assets'.

On the adoption of IFRS 9 on 1 November 2018, the increase in loss allowance (before tax) was £2.2 million.

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for financial guarantee contracts and loan commitments in accordance with IAS 37 as at 31 October 2018, to the opening loss allowance determined in accordance with IFRS 9 as at 1 November 2018:

	Impairment Allowance at 31 Oct 18 £m	Remeasurement /Reclassification £m	Loss allowance at 1 Nov 2018 £m	Stage 1 £m	Stage 2 £m	Stage 3 £m
Residential	-	-	-	-	-	-
Commercial	3.7	2.2	5.9	2.0	0.3	3.6
Debt Securities	-	-	-	-	-	-
Total	**3.7**	**2.2**	**5.9**	**2.0**	**0.3**	**3.6**

An assessment was made on the implementation date and at 31 October 2019 on the Bank's ECL provision for other assets held at amortised cost and it was determined to be £nil. There were also no changes in the classification and measurement of financial liabilities held on the Bank's Balance Sheet.

2 Impact on adoption of IFRS 9 (continued)

Regulatory Capital (unaudited)

The Bank's regulator has issued guidelines regarding transition requirements when adopting IFRS 9. The guidelines allow a choice of two approaches to recognise the impact of adopting IFRS 9 on regulatory capital:

■ Transitional: This involves phasing in the full impact using transitional factors published in Regulation (EU) 2017 / 2395; or

■ Full adoption: Recognising the full impact on the day of adoption.

The Bank has elected the transitional approach and will phase in the full impact using the EU regulatory transitional arrangements. This permits the Bank to add back to their capital base a proportion of the impact that IFRS 9 has upon their loss allowances during the first five years of use. The proportion that the Bank may add back starts at 95% in the current year and reduces to 25% by year five.

The impact in relation to loss allowances is the sum of the increase in loss allowances on day one of IFRS 9 adoption plus any subsequent increase in ECLs in the non-credit – impaired book thereafter. Any add-back must be tax-affected and accompanied by a recalculation of capital deduction thresholds, exposure and risk weighted assets.

Under the EU regulatory transitional arrangements, the add back is £2.2 million. This results in an increase in Common Equity Tier 1 capital and total regulatory capital of £2.2 million. The corresponding impact of the transitional adjustment to risk-weighted assets is an increase of £2.2 million.

3 Judgement in applying accounting policies and critical accounting estimates

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

Judgements

Fair values of financial instruments
The Bank uses widely recognised valuation models for determining the fair value of common and simple financial instruments, such as interest rate swaps that use only observable market data. Further analysis can be found in note 28.

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

Where observable market data is unavailable, unobservable inputs are used in the actuarial valuation models to value equity release and retirement mortgages held at FVTPL. The key judgements and assumptions used, and the related sensitivities are outlined in note 28.

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 29.

Value of investment properties
All gains and losses arising from reversionary interests in property are largely dependent on property prices and longevity of the tenant. The key assumptions used are disclosed in note 18.

Pension scheme assumptions
Estimation uncertainty surrounds the measurement of the pension scheme liabilities. The assumptions used as part of the valuation include the rate of salary increase, the discount rate applied to scheme liabilities and inflation. The key assumptions used are disclosed in note 25.

Value of lifetime mortgages including the value of the no-negative equity guarantee
Estimation uncertainty surrounds the measurement of the fair value of lifetime mortgages and the liability arising from the no-negative guarantee. The key assumptions used as part of the valuation calculation include future property prices and their volatility, mortality and the rate of voluntary redemptions. Further information on these assumptions is given in note 28(d).

Change in accounting estimates
There is significant judgement in the methodologies and assumptions applied in estimating the fair value of lifetime mortgages. 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 to the methodology used to calculate the expense assumption as a result of a project to rationalise expenses across the Group. The impact of these changes is disclosed within note 28 and shows they have been accounted for prospectively as a change in accounting estimate.

4 Segmental information

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

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

As at 31 October 2018	Commercial	Residential	Buy-to-let	Other	Total
	£m	£m	£m	£m	£m
Interest receivable and similar income	19.3	21.0	-	5.7	46.0
Interest payable and similar charges	(9.0)	(18.5)	-	(0.2)	(27.7)
Fees and commissions receivable	-	-	-	2.5	2.5
Fees and commissions payable	-	-	-	(1.1)	(1.1)
Other operating income	-	-	-	0.1	0.1
Investment income	-	6.3	-	0.1	6.4
Depreciation and expenses	(0.2)	(0.2)	-	(0.5)	(0.9)
Administrative expenses	(3.5)	(5.5)	-	(3.0)	(12.0)
Impairment gains on loans and advances to customers	1.0	-	-	-	1.0
Operating profit	**7.6**	**3.1**	**-**	**3.6**	**14.3**

Total assets by business segments	2019	2018
	£m	£m
Commercial	315.2	348.3
Residential	524.4	578.2
Buy-to-let	20.9	-
Other	518.2	436.9
	1,378.7	**1,363.4**

5 Interest receivable and similar income

	2019	2018
	£m	£m
Interest income calculated using EIR method		
Loans and advances to customers	42.4	40.7
Loans and advances to credit institutions	2.2	1.7
Interest on treasury bills & debt securities	3.7	3.6
	48.3	**46.0**

6 Interest payable and similar charges

	2019	2018
	£m	£m
On customer accounts	16.0	13.8
On defined benefit pension scheme	0.4	0.4
On term funding scheme	0.5	0.3
On derivative financial instruments	11.2	13.2
	28.1	**27.7**

7 Administrative expenses

	2019	2018
	£m	£m
Staff costs		
Wages and salaries	8.0	6.0
Social security	1.0	0.7
Pension costs (note 25)	1.8	1.3
	10.8	**8.0**
Other administrative expenses	5.6	4.0
	16.4	**12.0**

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

	2019	2018
	No	No
Provision of finance and banking	169	147
	169	**147**

Staff costs include remuneration in respect of directors as follows:

	2019	2018
	£m	£m
Fees	0.3	0.2
Aggregate emoluments as executives	0.5	0.3
	0.8	**0.5**

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

	2019	2018
	£000	£000
Aggregate emoluments	228	239
	228	**239**

The pension accrued for the highest paid director was £24,186 *(2018: £nil).*
Retirement benefits are accruing to one *(2018: one)* director in the defined benefit scheme.

8 Other fair value losses

	2019	2018
	£m	£m
Movement in fair value of derivatives (note 23)	(27.9)	14.7
Movement in fair value of equity release and retirement mortgages	14.7	(19.1)
Reversal of unrealised gains on disposal of investment properties	(5.9)	(5.8)
Movement in fair value of investment properties (note 18)	6.8	3.0
Movement in fair value of treasury bills (notes 11)	(0.7)	(0.9)
Movement in fair value of hedged items attributable to hedged risk	0.2	0.1
	(12.8)	**(8.0)**

9 Profit on ordinary activities before taxation

	2019	2018
	£000	£000
Profit on ordinary activities before taxation is stated after charging:		
Remuneration of the auditor and its associates		
Audit of these financial statements of the Bank	121	73
Audit of pension scheme	11	10
Other assurance fees	-	63
Non-audit fees	-	5
Amortisation (note 16)	801	453
Depreciation (note 17)	491	377
Impairment provision expense/(credit)	3,861	(1,007)

10 Tax on profit

	2019		2018	
	£m	£m	£m	£m
Analysis of charge in year				
UK corporation tax				
Current tax on income for the year	(2.5)		0.2	
Prior period adjustment	(0.8)		(0.4)	
Total current tax		**(3.3)**		**(0.2)**
Deferred tax (note 19)				
Origination/reversal of timing differences:				
Current period	0.8		0.8	
Prior period adjustment	0.4		0.2	
Total deferred tax		**1.2**		**1.0**
Tax on profit on ordinary activities		**(2.1)**		**0.8**

The total tax charge for the year is lower than (*2018: lower than)* the blended rate of corporation tax in the UK. The differences are explained below.

10 Tax on profit (continued)

	2019 £m	2018 £m
Total tax reconciliation		
(Loss)/profit on ordinary activities before tax	(7.8)	6.3
Current tax at 19.00% (2018: 19.00%)	**(1.5)**	**1.2**
Investment properties	-	(0.1)
Index linked gilt RPI movement	(0.2)	(0.3)
Other	-	0.2
Adjustments in respect of previous years	(0.4)	(0.2)
Total tax charge (see above)	**(2.1)**	**0.8**

Reductions in the UK corporation tax rate to 17% (effective 1 April 2020) were substantively enacted on 6 September 2016. This will reduce the Bank's future current tax charge accordingly. The deferred tax asset at 31 October 2019 has been calculated based on these rates.

11 Treasury bills

	2019 £m	2018 £m
Treasury bills – at amortised cost	21.9	11.2
Treasury bills – available-for-sale	-	13.2
Treasury bills – FVTPL	-	54.2
Fair value adjustment – hedge accounting	3.2	2.4
Fair value adjustment – available-for-sale	-	0.2
	25.1	**81.2**

The movement in treasury bills is summarised as follows:

	2019 £m	2018 £m
At 1 November	81.2	87.3
Adjustment on transition to IFRS 9	(0.2)	-
Additions	5.5	6.1
Disposals due to maturity	(8.0)	(10.7)
Disposals due to restructuring exercise	(53.5)	-
Gain/(loss) from hedge accounting – Income Statement	0.8	(0.4)
(Loss) from changes in fair value – Income Statement	(0.7)	(0.9)
(Loss) from changes in fair value - OCI	-	(0.2)
At 31 October	**25.1**	**81.2**

Of this amount £nil *(2018: £29.5m)* has been provided as collateral for derivative financial instruments (see note 23). Collateral that has been pledged is not restricted.

Of this amount £10.7m *(2018: £26.7m)* has been pledged as collateral under the Term Funding Scheme ('TFS') and £2.6m under repurchase agreements. Collateral pledged is restricted.

During the year, the Bank performed a one-off restructuring exercise which resulted in the disposal of index-linked treasury bills held at FVTPL. The disposal was carried out at fair value and therefore the profit on disposal was £nil.

12 Debt securities

	2019	2018
	£m	£m
Debt securities – at amortised cost	56.4	6.9
Debt securities - available-for-sale	-	76.8
Fair value adjustment – hedge accounting	0.6	0.7
Fair value adjustment – available-for-sale	-	3.1
	57.0	**87.5**

The movement in debt securities is summarised as follows:

	2019	2018
	£m	£m
At 1 November	87.5	77.0
Adjustment on transition to IFRS 9	(3.1)	-
Additions	10.9	30.7
Disposals due to maturity	(10.1)	(18.4)
Disposals due to restructuring exercise	(28.1)	-
(Loss) from hedge accounting - Income Statement	(0.1)	(0.2)
(Loss) from changes in fair value – OCI	-	(1.6)
At 31 October	**57.0**	**87.5**

Of this amount £37.7m *(2018: £nil)* has been pledged as collateral under the TFS. Collateral that has been pledged is restricted.

During the year, the Bank disposed of a portfolio of debt securities held at amortised cost. The profit generated on disposal was £3.1m.

The Bank holds debt securities for liquidity purposes and intends to hold the portfolio to maturity. A decision was made to dispose of a portfolio of debt securities and to reinvest the proceeds in high quality liquid assets. This is viewed as a one-off restructuring exercise and therefore the business model assessment for the remaining assets remains unchanged.

13 Loans and advances to credit institutions

	2019	2018
	£m	£m
Repayable on demand	6.7	13.6
Collateral held by swap counterparties	79.4	82.6
	86.1	**96.2**

The collateral is pledged against the market value of derivative instruments and comprises interest-bearing cash deposits (note 23). 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 (2018: £nil).

14 Loans and advances to customers

	2019 £m	2018 £m
Loans and advances – classified at amortised cost		
Commercial	315.2	348.3
Residential	178.8	104.2
Retirement	-	103.8
Buy-to-let	20.9	-
	514.9	**556.3**
Amounts owed from parent and fellow subsidiaries	3.3	1.7
Fair value adjustment for hedged risk	0.4	-
Loans and advances (equity release and retirement) – classified as FVTPL - see note 28	248.3	269.9
	766.9	**827.9**

Of this amount £57.9m *(2018: £64.7m)* has been pledged as collateral under the TFS. Collateral that has been pledged is restricted.

During the year, the Bank disposed of a legacy portfolio of equity release mortgages to a third party. The consideration on the sale was £117.4m and the carrying value on the Balance Sheet at the date of disposal was £122.0m, resulting in a loss on disposal of £4.6m.

The retirement mortgages are designated at FVTPL under IFRS 9, they were previously held at amortised cost under IAS 39.

The amounts owed from parent is a loan which accrues a market rate of interest.

	2019 £m	2018 £m
Loans and advances to customers at amortised cost		
Gross balances	526.4	562.3
Less: Provision for impairment[1]	(9.8)	(3.7)
Less: Loan fee deferral	(1.7)	(2.3)
Net balance	**514.9**	**556.3**

1 – The impairment provision has been calculated in accordance with IFRS 9 for 2019 with the comparative being calculated in accordance with IAS 39.

15 Impairment provisions on loans and advances to customers

IFRS 9	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
2019				
At 1 November	-	0.1	3.6	3.7
Impact of adopting IFRS 9	2.0	0.2	-	2.2
Restated balance at 1 November	**2.0**	**0.3**	**3.6**	**5.9**
Utilised on redemption	-	-	-	-
Income Statement				
Amounts written off during the year	-	(0.2)	(0.6)	(0.8)
Charge for loan impairment	0.4	-	4.3	4.7
	0.4	**(0.2)**	**3.7**	**3.9**
At 31 October 2019	**2.4**	**0.1**	**7.3**	**9.8**

15 Impairment provisions on loans and advances to customers (continued)

IAS 39	Specific £m	Collective £m	Total £m
2018			
At 1 November	6.2	0.2	6.4
Utilised on redemption	(1.7)	-	(1.7)
Income Statement			
Amounts written back during the year	(1.3)	(0.1)	(1.4)
Charge for loan impairment	0.4	-	0.4
	(0.9)	(0.1)	(1.0)
At 31 October 2018	**3.6**	**0.1**	**3.7**

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

For further details on loans and advances to customers refer to notes 28 and 29.

16 Intangible assets

	Computer software	
	2019 £m	2018 £m
Cost:		
At 1 November	3.9	2.0
Disposals	-	(0.1)
Additions	3.5	2.0
At 31 October 2019	**7.4**	**3.9**
Amortisation:		
At 1 November	(0.8)	(0.3)
Amortisation	(0.8)	(0.5)
At 31 October 2019	**(1.6)**	**(0.8)**
Net book value:		
At 31 October 2019	**5.8**	**3.1**

£1.3m (2018: £0.1m) 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.

17 Property, plant and equipment

	Short leasehold improvements	Fixtures, fittings and equipment	Total
	£m	£m	£m
Cost:			
At 1 November 2018	2.1	0.8	2.9
Additions	-	0.2	0.2
Disposals	-	(0.1)	(0.1)
At 31 October 2019	**2.1**	**0.9**	**3.0**
Depreciation:			
At 1 November 2018	(0.4)	(0.3)	(0.7)
Depreciation	(0.2)	(0.3)	(0.5)
Disposals	-	0.1	0.1
At 31 October 2019	**(0.6)**	**(0.5)**	**(1.1)**
Net book value:			
At 31 October 2019	**1.5**	**0.4**	**1.9**
At 31 October 2018	1.7	0.5	2.2

18 Investment properties

	Reversionary Interests
	£m
At 1 November 2018	100.3
Disposals	(9.8)
Fair value adjustments	6.8
At 31 October 2019	**97.3**

The historical cost of the reversionary interest in properties is £40.2m at 31 October 2019 (2018: £43.8m).

The amounts recognised in the Income Statement in respect of Investment Properties were as follows:

	2019	2018
	£m	£m
Rental income from Investment properties	-	0.1
	-	**0.1**

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

18 Investment properties (continued)

Reversionary interests - principal assumptions
All gains and losses arising from reversionary interests are largely dependent on the longevity of the tenant.

Principal assumptions underlying the calculation of reversionary interests include the following:

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

Expenses
Assumptions for future policy expense levels are based on the Bank's recent expense analyses. Expenses are modelled as an amount per policy per annum that incorporates an annual inflation rate allowance of 4.01% (2018: 4.23%).

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. The average discount rate for the portfolio (assumed to be the 15-year point on the yield curve based on average duration at 31 October 2019) was 1.78% (31 October 2018: 2.62%).

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 House Price Index, this is then adjusted down by an annual underperformance assumption. No future property price inflation is assumed beyond the valuation date.

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

	Reversionary Interests		
	Delay in mortality or entry into long term care - 10%	Expenses +10%	Property prices -10%
	£m	£m	£m
At 31 October 2019	**(0.9)**	**(0.2)**	**(9.1)**
At 31 October 2018	(1.3)	(0.1)	(9.1)

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

19 Deferred tax

	2019	2018
	£m	£m
At 1 November	6.5	7.3
IFRS 9 transition adjustment	0.8	-
Adjusted Opening Balance	**7.3**	**7.3**
Charge to the Income Statement	(1.2)	(1.0)
Credit to the Statement of Other Comprehensive Income	0.5	0.2
At 31 October	**6.6**	**6.5**

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

	2019	2018
	£m	£m
Accelerated capital allowances	(0.2)	0.1
Other timing differences	4.6	5.2
Timing differences on available-for-sale reserve	-	(0.5)
Timing differences on reimbursement asset	(0.5)	(0.4)
Defined benefit pension scheme	2.7	2.1
At 31 October	**6.6**	**6.5**

20 Other assets

	2019	2018
	£m	£m
Prepayments and accrued income	1.5	1.3
Pension reimbursement asset	2.9	2.4
Corporation tax debtor	2.4	1.3
Group relief debtor	3.0	-
Other assets	0.3	0.3
At 31 October	**10.1**	**5.3**

21 Deposits from banks

	2019	2018
	£m	£m
Repurchase agreement	2.5	2.5
Term funding scheme	70.0	70.0
	72.5	**72.5**

22 Deposits from customers

	2019	2018
	£m	£m
Deposit from customers	1,036.1	991.6
Amounts owed to parent and fellow subsidiaries	5.9	3.2
Fair value adjustment for hedged risk	0.8	(0.2)
	1,042.8	**994.6**

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

23 Derivative financial instruments

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

	Contract/notional amount		Fair value	
	2019	2018	2019	2018
	£m	£m	£m	£m
Derivative liabilities held for hedging purposes and designated fair value hedges:				
Interest rate swaps	308.2	363.1	78.8	105.3
RPI index linked interest rate swaps	55.0	55.0	(1.8)	(1.1)
Derivatives held in fair value hedges	293.7	234.8	3.4	3.6
Total recognised derivative liabilities	**656.9**	**652.9**	**80.4**	**107.8**

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 treasury bills and fixed rate commercial loans.
RPI index linked interest rate swaps	Interest rates linked to retail price index	Investment securities linked to RPI

At 31 October 2019, the fixed interest rates vary from 0.5% to 5.4% (2018: 0.3% to 5.4%) and the main floating rates are LIBOR. Gains and losses recognised on interest rate swap contracts are credited to the Income Statement.

23 Derivative financial instruments (continued)

	2019	2018
	£m	£m
Movement in fair value of interest rate swaps	(27.9)	14.7
	(27.9)	**14.7**

The Bank agreed to exit a number of interest rate swaps during the year which were held at fair value of £51.8m (2018: £6.8m), £nil (2018: £nil) profit or loss was incurred on disposal.

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

	2019		2018	
	Book Value £m	Hedged Fair Value £m	Book Value £m	Hedged Fair Value £m
Treasury bills	21.9	3.2	24.4	2.4
Debt securities	56.4	0.6	83.7	0.7
Loans advances to customers	514.9	0.4	556.3	-
Deposits from customers	(1,036.1)	(0.8)	(991.6)	0.2
		3.4		**3.3**

At the 31 October 2019, there was a hedge ineffectiveness of £nil (2018: £0.3m).

Offsetting

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

	Amounts subject to netting arrangements		
	Gross amounts	Amounts offset	Net amounts reported on Balance Sheet
	£m	£m	£m
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)**
2018			
Derivative financial assets	1.5	(1.5)	-
Impact on total assets	**1.5**	**(1.5)**	**-**
Derivative financial (liabilities)	(109.3)	1.5	(107.8)
Impact on total (liabilities)	**(109.3)**	**1.5**	**(107.8)**

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 13), and Treasury bills (note 11).

24 Other liabilities

	2019	2018
	£m	£m
Due within one year:		
Other tax and social security	-	0.2
Amounts owed in relation to mortgages administered for third parties	0.9	0.6
Other creditors	0.4	0.4
Accruals	1.3	2.7
Amounts owed to fellow subsidiaries	3.5	-
	6.1	**3.9**

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

25 Pension scheme

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

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

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

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

The weighted average duration of the defined pension obligation is 23 years (2018: 21 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 31 October 2019. These have been based upon the results of the 1 April 2019 formal triennial valuation projected forward with allowance for benefit accrual and expected investment return. The next triennial valuation will be carried out on 1 April 2022.

The Bank's total expense for the year amounted to £3.0m (2018: £2.0m). Both its fellow subsidiary Hodge Life Assurance Company Limited and the Bank's parent company, The Carlyle Trust Limited, reimbursed the Bank £0.6m for their share of the employer contribution expense. The Bank has agreed that it will aim to eliminate the pension scheme deficit over the next 10 years and additional contributions of £1.0m (2018: £0.5m) were paid into the scheme in the year ended 31 October 2019. Funding levels are monitored on an annual basis and the Bank has agreed to increase the contribution rate to 23.3% from 1 April 2019.

The IAS 19 valuation as at 31 October 2019 has been produced by a qualified independent actuary and is based on the results of the valuation as at 1 April 2019.

25 Pension scheme (continued)

GMP equalisation
On the 26 October 2018, in a long-awaited ruling, the High Court determined that defined benefit pension schemes will be required to equalise benefits for the effect of inequalities between males and females in respect of Guaranteed Minimum Pensions (GMP) accrued after 17 May 1990. The Bank has made an additional provision of £0.7m to cover the cost of equalising the scheme.

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:

	2019	2018
	£m	£m
Fair value of plan assets	27.3	24.2
Present value of defined benefit obligations	(43.9)	(37.0)
Deficit	**(16.6)**	**(12.8)**

Movements in present value of defined benefit obligations

	2019	2018
	£m	£m
Present value of scheme liabilities at start of the period	37.0	37.2
Interest cost	1.1	1.0
Current service cost	1.8	1.6
Member contributions	0.3	0.2
Actuarial loss/(gain) on defined benefit obligation of which:		
due to experience	(1.9)	-
due to demographic assumptions	0.4	(0.4)
due to financial assumptions	5.4	(1.6)
Benefits paid	(0.9)	(1.0)
Past service cost	0.7	-
Present value of scheme liabilities at end of the period	**43.9**	**37.0**

25 Pension scheme (continued)

Cashflows have been adjusted to allow for the IAS19 assumptions detailed below:

Movements in fair value of plan assets

	2019	2018
	£m	£m
Market value of assets at the beginning of the year	24.2	24.2
Interest income	0.7	0.6
Actuarial gain/(loss)	0.6	(1.4)
Member contributions	0.3	0.2
Employer contributions	2.4	1.6
Benefits paid	(0.9)	(1.0)
Market value of assets at the end of the year	**27.3**	**24.2**

Expense recognised in the Income Statement

	2019	2018
	£m	£m
Current service cost – staff costs	1.8	1.6
Net interest expense – other finance costs	0.4	0.4
Past service cost	0.7	-
Other admin costs	0.1	-
	3.0	**2.0**

The total amount recognised in the Statement of Other Comprehensive Income in respect of actuarial gains and losses is a loss of £3.3m (2018: gain of £0.6m) before tax.

Cumulative losses reported in the Statement of Other Comprehensive Income since the date of transition to FRS 101 are losses of £11.4m (2018: losses of £8.1m) before tax.

Plan assets

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

	Fair Value	
	2019	2018
	£m	£m
Quoted equity investments	4.4	1.2
Diversified growth funds	17.8	19.0
Private investments	2.5	2.3
Bonds	1.6	1.4
Cash	1.0	0.3
Total market value of assets	**27.3**	**24.2**

The actual return on assets was £1.3m (2018: £0.7m)

Future contributions

The Bank expects to contribute approximately £3.9m (2018: £2.0m) to its defined benefit plan in the next financial year.

25 Pension scheme (continued)

Major assumptions

The major assumptions underpinning the defined benefit obligation are:

	2019	2018
	%	%
Rate of increase in salaries	4.0	4.4
Rate of increase – RPI capped at 5.0% per annum	2.9	3.3
Rate of CARE revaluation	2.0	2.4
Discount rate applied to scheme liabilities	2.0	2.9
RPI inflation assumption	3.0	3.4

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:

	2019	2018
Current pensioners age 65 - male	86.6	86.7
Current pensioners age 65 - female	88.9	88.6
Future pensioners age 65 (current age 45) - males	87.6	87.8
Future pensioners age 65 (current age 45) - females	90.0	89.9

Sensitivities

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

Impact on present value of obligation:	Change in assumption	Change in deficit £m
Discount rate	0.1%	1.0
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 of one another.

History of the scheme Balance Sheet position

	2019	2018	2017	2016	2015
	£m	£m	£m	£m	£m
Fair value of plan assets	27.3	24.2	24.2	25.7	24.7
Present value of funded defined benefit obligations	(43.9)	(37.0)	(37.2)	(39.2)	(29.1)
Deficit	**(16.6)**	**(12.8)**	**(13.0)**	**(13.5)**	**(4.4)**

25 Pension schemes (continued)

History of experience gains and losses

	2019	2018	2017	2016	2015
Difference between the expected and actual return on scheme assets:					
Amount	**£0.6m**	£(1.4)m	£0.1m	£0.5m	£0.2m
Percentage of year-end scheme assets	**2.2%**	(5.6)%	0.0%	1.5%	0.7%
Experience gains and losses on scheme liabilities:					
Amount	**£1.9m**	£(0.0)m	£(0.0)m	£(0.4)m	£(0.0)m
Percentage of year-end present value of scheme liabilities	**(4.4)%**	0.0%	0.0%	1.0%	0.0%
Total amount recognised in statement of comprehensive income:					
Gain/(losses) before tax	**£(3.3)m**	£0.6m	£0.4m	£(9.1)m	£(0.6)m
Percentage of year-end present value of scheme liabilities	**7.5%**	1.6%	1.1%	23.0%	2.0%

26 Called up share capital

	2019	2018
	£m	£m
Authorised, allotted, called-up and fully paid:		
105,000,000 ordinary shares of £1 each	105.0	105.0
	105.0	**105.0**

27 Financial commitments and contingent assets/liabilities

Loan commitments

	2019	2018
	£m	£m
Commitments		
expiring in less than one year	26.0	33.4
expiring in more than one year	45.1	64.5
	71.1	**97.9**

Capital commitments

The Bank had contracted capital commitments amounting to £nil at 31 October 2019 (2018: £nil).

28 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 31 October 2019	At amortised cost	FVTPL	Total
	£m	£m	£m
Assets			
Cash and balances held at central banks	321.9	-	321.9
Treasury bills	25.1	-	25.1
Debt securities	57.0	-	57.0
Loans and advances to credit institutions	86.1	-	86.1
Loans and advances to customers	518.6	248.3	766.9
Other assets	10.1	-	10.1
Total financial assets	**1,018.8**	**248.3**	**1,267.1**
Total non-financial assets			111.6
Total assets			**1,378.7**
Liabilities			
Deposit from banks	72.5	-	72.5
Deposit from customers	1,042.8	-	1,042.8
Derivative financial instruments	-	80.4	80.4
Other liabilities	6.1	-	6.1
Total financial liabilities	**1,121.4**	**80.4**	**1,201.8**
Total non-financial liabilities			16.6
Share capital and other reserves			160.3
Total reserves and liabilities			**1,378.7**

28 Financial instruments (continued)

a) Categories of financial assets and liabilities (continued)

As at 31 October 2018	At amortised cost	Loans and receivables	Available-for-sale	FVTPL	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances held at central banks	153.2	-	-	-	153.2
Treasury bills	13.7	-	13.3	54.2	81.2
Debt securities	7.6	-	79.9	-	87.5
Loans and advances to credit institutions	96.2	-	-	-	96.2
Loans and advances to customers	1.7	556.3	-	269.9	827.9
Other assets	5.3	-	-	-	5.3
Total financial assets	**277.7**	**556.3**	**93.2**	**324.1**	**1,251.3**
Total non-financial assets					112.1
Total assets					**1,363.4**
Liabilities					
Deposit from banks	72.5	-	-	-	72.5
Deposit from customers	994.6	-	-	-	994.6
Derivative financial instruments	-	-	-	107.8	107.8
Other liabilities	3.9	-	-	-	3.9
Total financial liabilities	**1,071.0**	**-**	**-**	**107.8**	**1,178.8**
Total non-financial liabilities					12.9
Share capital and other reserves					171.7
Total reserves and liabilities					**1,363.4**

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 Bank has access at that date.

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

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

28 Financial instruments (continued)

Where applicable, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an on-going basis. For all other financial instruments, the Bank determines fair value using other valuation techniques.

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

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

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

As at 31 October 2018	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets at fair value through profit or loss				
Treasury bills	54.2	-	-	54.2
Loans and advances to customers	-	-	269.9	269.9
Total financial assets at FVTPL	**54.2**	**-**	**269.9**	**324.1**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	-	107.8	-	107.8
Total financial liabilities at FVTPL	**-**	**107.8**	**-**	**107.8**

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

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

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

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

28 Financial instruments (continued)

d) Level 3 assets and liabilities measured at fair value

Loans and advances to customers – equity release and retirement mortgages:

Loans and advances to customers include £248.3m (2018: £269.9m) of assets which have been classed as FVTPL and include equity release and retirement mortgages.

	Fair Value		Book Value	
	2019	2018	2019	2018
	£m	£m	£m	£m
Loans and advances (equity release and retirement mortgages) – classified as FVTPL	248.3	269.9	197.1	204.6
	248.3	**269.9**	**197.1**	**204.6**

On initial recognition, the fair value of loans secured by mortgages is calculated by discounting the future cash flows at swap rates together with an allowance for illiquidity. If the difference between the fair value at transaction date and the transaction price is a gain, it is not recognised but deferred and recognised uniformly over the expected life of the loan. If the difference is a loss, this is expensed to the Income Statement immediately.

The movement in the aggregate difference yet to be recognised in the Income Statement between the fair value of mortgages and the amount that would have been recognised using the valuation technique is shown below.

	2019	2018
	£m	£m
At start of period	18.5	14.8
Addition on transition to IFRS 9 – retirement mortgages	18.8	-
Disposal of equity release portfolio	(8.8)	-
Amounts deferred in the period	0.2	0.3
Amounts recognised in the Income Statement in the period	(4.5)	3.4
At end of period	**24.2**	**18.5**

Reconciliation of the opening and closing recorded amount of Level 3 loans secured by equity release and retirement mortgages (Grouped as lifetime mortgages in 2018):

	2019	2018
	£m	£m
At start of period	269.9	294.7
Addition on transition to IFRS 9 – retirement mortgages	105.2	-
Disposal of equity release portfolio to a third party	(122.0)	-
Disposal of equity release portfolio to a fellow group company	(10.3)	-
Total gains/(losses) in Income Statement	27.5	(5.5)
Loans advanced	7.7	2.0
Redemptions	(29.7)	(21.3)
At end of period	**248.3**	**269.9**

28 Financial instruments (continued)

The £27.5m 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 84bps from 1.62% to 0.78%. This is partially offset by smaller relative reductions in past and assumed future HPI.

Equity release and retirement mortgages - principal assumptions

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

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

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

Expenses
Assumptions for future policy expense levels are based on the Bank's recent experience analyses. Expenses are modelled as an amount per policy per annum that incorporate an annual inflation rate allowance of 4.01% (2018: 4.23%).

Discount rate
The discount rate applied to the mortgage cash flows comprises two parts: a risk-free yield curve and an allowance for illiquidity. The risk-free yield curve is based on the EIOPA GBP curve. The average discount rate for the portfolio (assumed to be the 15-year point on the yield curve based on average duration at 31 October 2019) was 1.78% (31 October 2018: 2.62%).

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 Nationwide Monthly HPI 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 31 October 2019 was 3.08% (31 October 2018: 3.28%) and 13.0% (31 October 2018: 13%) respectively. The value of the no-negative equity guarantee as at 31 October 2019 was £6.7m (31 October 2018: £9.2m).

28 Financial instruments (continued)

Sensitivity analysis

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

	Interest rates +100 BP	Maintenance expenses +10%	Property inflation -100bps	Property prices -10%	Lapses +10%	Delay in mortality +10%
	£m	£m	£m	£m	£m	£m
At 31 October 2019	**(19.1)**	**(0.2)**	**(3.8)**	**(2.1)**	**(5.1)**	**(2.2)**
At 31 October 2018	(28.1)	(0.4)	(4.9)	(2.8)	(6.6)	(3.1)

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

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

e) Maturity profile of financial assets and liabilities

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

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

28 Financial instruments (continued)

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

As at 31 October 2018	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash and balances held at central banks	153.2	-	-	-	-	153.2
Treasury bills	-	-	2.6	68.5	10.1	81.2
Debt securities	1.4	2.6	7.3	40.3	35.9	87.5
Loans and advances to credit institutions	96.2	-	-	-	-	96.2
Loans and advances to customers	44.1	8.8	37.9	219.3	517.8	827.9
Other assets	5.3	-	-	-	-	5.3
Total financial assets	**300.2**	**11.4**	**47.8**	**328.1**	**563.8**	**1,251.3**
Liabilities						
Deposit from banks	2.5	-	-	70.0	-	72.5
Deposit from customers	299.6	80.2	284.4	330.4	-	994.6
Derivative financial instruments	-	-	0.3	9.0	98.5	107.8
Other liabilities	3.9	-	-	-	-	3.9
Total financial liabilities	**306.0**	**80.2**	**284.7**	**409.4**	**98.5**	**1,178.8**
Loan commitments liabilities	**23.4**	**1.4**	**8.6**	**47.9**	**16.6**	**97.9**

28 Financial instruments (continued)

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

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

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

As at 31 October 2018	Book value	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	£m	£m	£m	£m	£m	£m
Financial liabilities							
Deposit from banks	72.5	2.5	-	-	71.7	-	74.2
Deposit from customers	994.6	299.5	80.8	288.2	342.5	-	1,011.0
Derivative financial instruments	107.8	2.5	0.8	4.1	41.9	75.5	124.8
Other liabilities	3.9	3.9	-	-	-	-	3.9
Total financial liabilities	**1,178.8**	**308.4**	**81.6**	**292.3**	**456.1**	**75.5**	**1,213.9**

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 net settled.

28 Financial instruments (continued)

g) Foreign currencies

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

29 Financial risk management objectives and policies

Risk management

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

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

Risk management objectives

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

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

(a) Credit risk

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

The maximum credit risk as at 31 October is the carrying value recognised on the Balance Sheet as disclosed in the table in note 28(a), along with the loan commitments as disclosed in the table in note 28(e).

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

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

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

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

29 Financial risk management objectives and policies (continued)

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

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

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 which is linked to historical default rates.
Commercial loans and 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 treasury bills	Calculated at an individual security level using the external credit agency's rating of the security which is linked to the historical default rates of comparable securities.

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

Economic Assumption	Y1 %	Y2 %	Y3 %	Y4 %	Y5 %
UK GDP Growth	1.2	1.7	1.8	1.8	1.8
UK Unemployment Rate	4.0	3.0	4.1	4.3	4.2
% Change in S&P 500 Index[1]	12.0				
% Change in Energy Index	(3.1)	1.8	1.9	1.9	2.0
% Change in Non-Energy Index	0.1	1.6	1.7	1.7	1.8
% Change in Proportion of Downgrades[1]	0.1				

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

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

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

29 Financial risk management objectives and policies (continued)

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

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

Portfolio	Methodology for determining the LGD
Residential mortgages	Calculated by using the Black Scholes model to reflect that the portfolio is secured against the underlying property as this will calculate the theoretical value of the total loss, should all policies default.
Commercial loans and 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 treasury bills	Calculated monthly on an individual security level using a credit rating agency's published average nominal recovery rate.

The LGD model produces an estimate of the point-in-time LGD reflecting the current and expected position in the current credit cycle. The model is designed to produce LGD estimates under three distinct scenarios, reflecting expectations of general economic conditions.

The three distinct scenarios used to reflect the expectations of the wider economy that feed into the LGD model are:

Scenario	Methodology for determining the LGD	Weighting
Positive	The Bank has positive economic expectations over the short-term for the UK economy. This is predicated on expectations of positive GDP growth and low and sustained unemployment (amongst other positive indicators), above that which is usually experienced in the average part of the credit cycle.	25.0%
Neutral	This selection is appropriate in cases where the expectations are of little or no GDP growth. Stagnating growth in other relevant factors are also expected. This phase is typically between a trough and peak of a credit cycle.	50.0%
Negative	This selection signals the expectation of an impending economic downturn, typically signalled by the expectation of consecutive quarter-on-quarter declines in GDP. Other signals may also be useful in forecasting a downturn period.	25.0%

The UK government agreed a flexible extension with the EU in relation to Brexit until 31 January 2020. The Prime Minister has negotiated a deal with the EU to prevent a disorderly exit and this deal has been approved by Parliament, but the process of turning the deal into legislation has been put on hold until after the general election. The economic forecasts outline that the UK is entering a period of low GDP growth and sustained low unemployment. It is the view of the Bank that a higher weighting should be applied to the Neutral scenario which is appropriate in cases where the expectations are of little or no GDP growth. It remains uncertain whether the outcome of Brexit will result in either an orderly or disorderly Brexit and as such it is the view of the Bank that equal weightings should be applied to both the Positive and Negative economic scenarios.

A sensitivity analysis has been performed to review the worst-case scenario and the impact on the LGD. A 100% weighting for a Negative scenario produces an ECL provision for Stage 1 and Stage 2 of £4.9m.

29 Financial risk management objectives and policies (continued)

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

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

	2018	
	£m	%
Fully secured by a first charge on residential property	412.1	100.0
	412.1	**100.0**
Fair value adjustments	65.9	
	478.0	

The cumulative change in fair values due to credit risk amounts to losses of £7.2m (2018: £9.2m), and the change in the year is a profit of £2.0m (2018: £4.1m).

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 70% when advanced.

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

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

Stage	Description	Credit Score	Gross Loan Balance £m	ECL provision £m
Stage 1	Satisfactory	>= 676	176.6	-
Stage 2	Watchlist	< = 675	1.9	(0.1)
Stage 3	Default	N/a[1]	-	-
			178.5	**0.1**
Less: Loan fee deferral			0.4	
Provisions for impairment			(0.1)	
Total			**178.8**	

1 – Any loan that is 90-days past due is classified as in default and is categorised in stage 3.

Performance risk is measured by those accounts in arrears. Total arrears balance as at 31 October 2019 amounted to £nil (2018: £nil). The Bank has no accounts where forbearance options have been utilised. There are no residential loans and receivables that are classified as Stage 3.

29 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 2018 is disclosed below:

Stage	Description	Credit Score	Gross Loan Balance £m	ECL provision £m
Stage 1	Satisfactory	>= 676	104.1	-
Stage 2	Watchlist	< = 675	-	-
Stage 3	Default	N/a[1]	-	-
			104.1	-
Less: Loan fee deferral			0.1	
Provisions for impairment			-	
Total			**104.2**	

Credit risk: Commercial lending

Commercial: analysis of risk concentration

Loans secured on commercial property are as follows:

	2019		2018	
	Loan Balance £m	Collateral Held £m	Loan Balance £m	Collateral Held £m
Commercial mortgage	23.3	38.3	35.7	73.8
Development finance	67.5	97.5	62.7	94.4
Investment loans	216.5	376.5	235.2	411.7
Renewable energy	19.4	-	20.7	-
	326.7	**512.3**	**354.3**	**579.9**
Less: Loan fee deferral	(2.0)	-	(2.3)	-
Provisions for impairment	(9.5)	-	(3.7)	-
	315.2	**512.3**	**348.3**	**579.9**

On inception, commercial property loans are fully secured against the value of the related properties. The increase in the provision for impairment is predominantly caused by an increase in Stage 3 provisioning relating to one development finance loan of £4.3m.

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

	2019		2018	
	£m	%	£m	%
Wales	70.6	21.6	81.3	23.0
London – England	123.5	37.8	123.8	34.8
South East & East of England	25.0	7.6	16.2	4.6
Midlands – England	21.2	6.5	31.0	8.8
South West of England	49.5	15.2	68.6	19.4
North West & North East of England	24.2	7.4	19.9	5.6
Scotland	12.7	3.9	13.5	3.8
	326.7	**100.0**	**354.3**	**100.0**

29 Financial risk management objectives and policies (continued)

Commercial: analysis of risk concentration (continued)
The average LTV in respect of commercial loans is estimated to be 56.1% (2018: 54.2%). 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.

£22.9m (2018: £13.2m) of exposures have an LTV of greater than 100%. Of these, £22.6m (2018: £12.8m) are already classified, leaving £0.3m (2018: £0.4m) of exposures considered to be satisfactory. In these instances, management is satisfied that the cash flows generated by the underlying assets will be sufficient to fully repay the debt over time.

The largest exposure to one counterparty is £17.9m (2018: £18.5m) or 5.5% (2018: 5.2%) of gross balances.

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

	2019		2018	
	£m	%	£m	%
Stage 1	286.7	87.7	310.3	87.6
Stage 2 – significant increase in credit risk	14.3	4.4	17.1	4.8
Stage 3 - default	25.7	7.9	26.9	7.6
	326.7	**100.0**	**354.3**	**100.0**

As at 31 October 2019 there were £16.8m of commercial loans in arrears (2018: £16.9m).

Past due but not impaired
As at 31 October 2019 there was £nil (2018: £16.9m) commercial loan balances that were past due but not impaired.

29 Financial risk management objectives and policies (continued)

Commercial: Lending provisions (continued)

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

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

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 agencies credit risk rating at 31 October 2018 is disclosed below:

Risk grade	Description	Stage	S&P Rating	Gross Loan Balance	ECL Provision
				£m	£m
1	Negligible risk	Stage 1	A+	2.2	-
2.1	Minimal risk	Stage 1 or 2	B+	0.4	-
2.2	Low risk	Stage 1 or 2	B	24.2	-
3.1	Fair risk	Stage 1 or 2	B-	111.3	-
3.2	Moderate risk	Stage 1 or 2	BB+	130.8	-
4.1	Watch	Stage 1 or 2	BB	35	-
4.2	Enhanced watch	Stage 1 or 2	BB-	6.4	-
5	Substandard	Stage 2	BBB	17.1	0.2
6	Default	Stage 3	CCC+	23.4	1.1
7	Loss	Stage 3	CCC-	3.5	2.4
Total				**354.3**	**3.7**

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

29 Financial risk management objectives and policies (continued)

Credit risk: buy-to-let lending

The buy-to-let portfolio product was launched in June 2019 and as such, there is no prior year comparative.

Buy-to-let: analysis of risk concentration
Loans secured on buy-to-let property are as follows:

	2019		2018	
	Loan Balance £m	Collateral Held £m	Loan Balance £m	Collateral Held £m
Portfolio buy-to-let Lending	21.3	30.8	-	-
	21.3	**30.8**	**-**	**-**

On inception, buy-to-let property loans are fully secured against the value of the related properties.

The Bank's buy-to-let loan portfolio comprises the following:

	2019		2018	
	£m	%	£m	%
Loans secured on buy-to-let property	21.3	100.0	-	-
	21.3	**100.0**	**-**	**-**
Less: Loan fee deferral	(0.1)		-	
Provisions for impairment	(0.3)		-	
	20.9		**-**	

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

	2019		2018	
	£m	%	£m	%
London-England	19.7	92.5	-	-
South East & East of England	0.8	3.6	-	-
Midlands-England	0.8	3.9	-	-
	21.3	**100.0**	**-**	**-**

The average LTV in respect of buy-to-let loans is estimated to be 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 or 53.5% of gross balances.

29 Financial risk management objectives and policies (continued)

Buy-to-let: lending performance

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

	2019		2018	
	£m	%	£m	%
Stage 1	21.3	100.0	-	-
Stage 2 – significant increase in credit risk	-	-	-	-
Stage 3 - default	-	-	-	-
	21.3	100.0	-	-

As at 31 October 2019 there were no buy-to-let loans in arrears.

Buy-to-let: lending provisions

Provisions are held against impaired loans as follows:

	2019	2018
	£m	£m
Specific provisions	(0.3)	-
	(0.3)	-

Past due but not impaired
As at 31 October 2019 there were no buy-to-let loans that were past due but not impaired.

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

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)

29 Financial risk management objectives and policies (continued)

Treasury credit risk

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

	2019	2018
	£m	£m
UK government and amounts held with central banks	321.9	153.2
Treasury bills	25.1	81.2
Debt securities	57.0	87.5
Loans and advances to credit institutions	86.1	96.2
	490.1	**418.1**
Provision for impairment	-	-
	490.1	**418.1**

None of these exposures are past due or impaired.

Credit quality of financial assets that are neither past due nor impaired

The following shows the exposures broken down by credit rating:

	2019	2018
	£m	£m
AAA to AA-	482.2	388.1
A+ to A-	7.9	14.6
BBB+ to BBB-	-	11.7
BB+ to BB-	-	3.7
Unrated	-	-
	490.1	**418.1**

Concentration of credit risk

The geographical exposure is as follows:

	2019	2018
	£m	£m
UK	467.1	393.3
Other	23.0	24.8
	490.1	**418.1**

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

29 Financial risk management objectives and policies (continued)

b) Liquidity risk
Liquidity risk is the risk that the Bank will encounter difficulty in realising assets or otherwise raising funds to meet commitments as they fall due. The Bank manages its liquidity risk through its Assets and Liabilities Committee and monitors its liquidity position on a daily basis and has adopted a policy to ensure that it has adequate resources to enable it to conduct its normal business activities without interruption. The maturity analysis of assets and liabilities is disclosed in note 28 (e) & (f) to the financial statements of the Bank.

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

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

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

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

The table in note 28 (d) shows an estimate of the interest rate sensitivity gap as at 31 October 2019. The principal risk management tool to mitigate interest rate risk is the use of derivatives to align the interest rate re-pricing profile of assets and liabilities. All of the derivatives used by the Bank are interest rate swap contracts of varying maturities and start dates.

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

29 Financial risk management objectives and policies (continued)

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

Geographical analysis of equity release and retirement mortgages

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

	2019		2018	
	£m	%	£m	%
Wales	9.5	4.8	8.5	4.2
South East	37.4	18.7	46.2	22.5
South West	22.4	11.3	26.2	12.8
London	15.8	8.0	22.7	11.1
East Anglia	18.1	9.2	24.7	12.1
North West	22.8	11.6	20.7	10.1
West Midlands	11.5	6.2	12.3	6.0
North East	23.7	12.0	17.5	8.6
East Midlands	6.7	3.4	9.3	4.5
Scotland	20.5	10.4	7.7	3.8
Northern Ireland & Other	8.7	4.4	8.8	4.3
	197.1	**100.0**	**204.6**	**100.0**

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

The Bank holds a provision of £nil as at 31 October 2019 (2018: £0.1m).

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

30 Capital risk management

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

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

The Bank's capital resources requirements are calculated based on the CRD IV CRR regulatory framework as implemented by the PRA, namely:
- Pillar 1-based on a Standardised Approach for credit risk, operational risk and market risk;
- Pillar 2-set by the PRA via the ICG 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 ICG, and;
ii) Hold all its capital in the form of Common Equity Tier 1 and Tier 2 capital.

	2019 Unaudited	2018 Unaudited
	£m	£m
Common Equity Tier 1 capital	156.4	168.0
Total risk weighted assets	695.2	751.7
Common Equity Tier 1 capital ratio	**22.5%**	**22.3%**
Total own funds	156.4	168.0
Total risk weighted assets	695.2	751.7
Total capital ratio	**22.5%**	**22.3%**

Capital Requirements Directive
Article 89 of the Capital Requirements Directive IV (CRD IV) requires credit institutions and investment firms in the EU to disclose annually, specifying, by Member State and by third country in which it has an establishment, the following information:
- Name, nature of activities and geographical location: The principal activities of the Bank are noted in the Strategic Report.
- Average number of employees: as disclosed in note 7 to the accounts.
- Annual turnover (Net Interest Income) and profit before tax: as disclosed in the Income Statement.
- Corporation Tax expense: 2019 £0.2m *(2018: £0.3m)*.
- Public subsidies: There were none received in the year.

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

30 Capital risk management (continued)

The Bank's objectives when managing capital are:

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

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

31 Related parties

In these financial statements of the Bank, the Bank has applied the exemptions available under FRS 101 in respect of transactions with members of The Carlyle Trust Limited group. The following balances were owed to or from related parties at 31 October:

	2019	2018
	£m	£m
Amounts due/(owed) from parent and fellow subsidiaries		
The Carlyle Trust Limited – parent	3.3	0.3
Reimbursement asset due from The Carlyle Trust Limited	2.9	2.4
Carlyle Property Development Bank Limited – fellow subsidiary	-	0.4
Hodge Life Assurance Company Limited – fellow subsidiary	(3.5)	0.9
Sterling House Limited – fellow subsidiary	-	0.1
Group relief debtor	3.0	**-**
Deposits owed to parent and fellow subsidiaries		
Jane Hodge Foundation – shareholder of The Carlyle Trust Limited	(2.5)	(2.5)
Beaufort Park Limited	(0.3)	-
Sterling House Limited	(0.1)	-
Wingwest (Fountain Lane) Limited	(0.2)	-
The Carlyle Trust Limited – parent	(1.1)	(0.2)
Hodge Life Assurance Company Limited – fellow subsidiary	(1.3)	(0.5)
Carlyle Property Development Limited	(0.4)	-
Total	**(0.2)**	**0.9**