Cambridge & Counties Bank Limited

Annual report and financial statements
Registered number 07972522
31 December 2018

Cambridge &
Counties Bank
Growing business together

Contents

The Business

Cambridge & Counties Bank is a UK bank that specialises in providing lending and deposit products for Small and Medium Enterprises (SMEs).

Unique Ownership

Established in June 2012, Cambridge & Counties Bank has a unique ownership structure being owned jointly by Trinity Hall, a college of the University of Cambridge, and Cambridgeshire County Council as trustees for the Cambridgeshire Local Government Pension Fund.

The Bank is authorised by the Prudential Regulation Authority, regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is registered under the Financial Services Compensation Scheme.

Target Markets

Lending

The Bank's commercial loans are secured on property. It lends to experienced commercial and residential property investors as well as to owner occupied businesses to invest in their own commercial premises.

The Bank also provides finance for businesses to acquire essential assets such as equipment, plant, machinery or vehicles using hire purchase and finance lease facilities. In 2018 the Bank expanded its product offering to include the provision of finance for the purchase of classic cars.

Deposits

The Bank's lending is primarily funded by the acquisition of UK savings balances. It offers a range of deposit accounts that are available to business customers. These accounts are also available to retail customers through a network of brokers and introducers. Business customers include a number of broader organisations such as charities, clubs, societies and associations.

Distribution Network

Cambridge & Counties Bank provides lending products via a network of Relationship Managers who deal via business introducers as well as directly with customers. The Bank delivers a range of savings accounts via the internet, post and business introducers.

Strategic Report

Chairman's Review

Cambridge & Counties Bank continued to perform strongly in a challenging trading year, despite a deterioration in the confidence levels of the Bank's customers driven by slowdowns in property asset price growth and a reduced willingness to invest whilst Brexit uncertainty continues. Competition has intensified during the year from both existing and new players which has had the effect of putting pressure on margins for lending products. A full review of Cambridge & Counties response to these factors is contained within the Strategic Report and I am pleased to say that, notwithstanding the change in business climate, the Bank has continued to perform well protecting income through the provision of its focused, high quality service offering together with close control of costs.

The Bank delivered another good financial performance in 2018, with pre-tax profit up 14% to £27.9m and loans and advances to customers growing by £79.1m to £769.0m, a 11% increase on 2017. The Bank's balance sheet at the year end exceeded £1bn for the first time since it started trading in 2012. The Bank increased its capital strength during the year with Shareholders' Funds increasing by 64% from £76.2m to £125.2m and its total capital ratio (including IFRS 9 transitional relief) increasing from 13.8% to 20.5%.

Capital

To underpin this performance and to provide the fuel for our future growth our owners subscribed for a further capital injection of £31m during the year. This significantly bolsters our capital ratios to 16.8% Common Equity Tier 1 (including IFRS 9 transitional relief) and ensures that the Bank meets both its regulatory requirements and the appetite of the Board for further development of the Bank's business.

Dividends

No dividends are proposed for payment.

The Board

Chris Malyon, one of our longstanding Board members, retired from Cambridge & Counties Bank during 2018 and was replaced by Richard Perry, representing the interests of the Cambridgeshire Local Government Pension Fund. I would like to take the opportunity of thanking Chris for his support, wisdom and effort over the time he has been on the Board.

The Autumn also saw Will German, our Chief Risk Officer, leave us to develop his career elsewhere, and we are joined on an interim basis by Laura Blake who has a long and deep experience as Chief Risk Officer across a number of UK licensed banks.

I am pleased to be able to report that with these changes, the Board and our Executive team are now comprised of 30% and 60% women respectively. As a member of the HM Treasury Women in Finance Initiative we continue to apply policies to ensure that our gender balance enables us to attract the best candidates at all levels across the business.

On behalf of my Non-Executive Board colleagues I would also like to take the opportunity of thanking Mike Kirsopp and his Executive team for the way that they have delivered another year of strong financial performance and recognising that they have continued to lead investment in our people, systems and developed our customer offering in a way that remains relevant and attractive.

The strength of our capital and the strong liquidity position we have been able to maintain provides the confidence that whatever the macro-economic climate produces in 2019, the Bank will continue to thrive.

S. A. Moore

Simon Moore
Chairman

Strategic Report

Chief Executive Officers Review

The Strategic Report forms a major part of our commentary on 2018 and gives a full picture of the risks the Bank faces in a climate which is less benign than any period since the Bank's inception in 2012.

I believe that we have recognised these risks, mitigated them where possible, and have built a strong business which is well placed to deal with what is becoming a more hostile business environment than we have seen to date.

A major part of this is our investment in our Operational Resilience capabilities, designed to enable the Bank to withstand a number of threats over and above the financial, where we continually develop our thinking and ability to respond to a huge number of possible scenarios. The best defence against many of these non-financial threats is ensuring that we have a team of capable, well trained and developed people who recognise the importance of protecting our customers and whose culture is the major defence against the threats we face.

The team at Cambridge & Counties Bank are recognised by our customers, and our business partners, as being one of the most approachable, professional, and easy to deal with and my thanks goes out to each and every one of them for the way that they embody, through our culture, the values and beliefs which our customers tell us make us different from the vast majority of other Banks.

Mike Kirsopp
Chief Executive Officer

Strategic Report

Business Model

Cambridge & Counties Bank (CCB) has seen a small number of changes in the application of its business model during the year although we have broadly maintained our existing model using a small panel of brokers with whom we work closely in the lending market.

We continue to research opportunities to expand our geographical representation and develop our plans for increasing the number of regional offices. In the first instance this has seen the appointment of additional Relationship Managers in Manchester and Cardiff, operating on a hub and spoke basis from Sheffield and Bristol respectively.

Whilst retaining a locally based Relationship Manager in the Cambridge/East Anglia area, early in 2018 saw the closure of our Cambridge office, as we concentrated our frontline resources in geographic areas where we could see better opportunity for meeting our strategic growth appetites. These developments leave the Bank with a head office in Leicester and regional offices in Sheffield, Birmingham and Bristol.

The Asset Finance business operates on a similar basis, and the newly launched Classic Car business which operates from the head office in Leicester, is currently building a panel of introducers covering not only brokers, but also high-end dealers, auction houses, private banking firms, and via business introduced from the existing CCB lending operations.

Key to the relationships with our brokers is our continued ability to provide seamless operation in onboarding new customers, and subsequently managing their accounts in a way that continues to meet their needs.

We have expanded our customer contact programme during 2018 such that our Business Development Managers are now operating as long-term Relationship Managers, delivering as a minimum annual reviews with customers which enables both the Bank and the borrowers to ensure that they continue to enjoy appropriate facilities, and quality service. The key to the business success is the relationship between the Bank's frontline teams and the broker partners who understand our market. This is supported by a programme of broker research which enables the Bank to manage the ongoing relationship with the confidence that it is meeting our broker partners expectations in terms of the technology which underpins our communication, balanced with the ability for personal intervention. They tell us, that above all else, they prize the idiosyncratic and manual underwriting process, coupled to the Bank's ability to deliver in acceptable timescales and without changes to terms and conditions along the way.

Strategy

Our strategic objectives are to maintain the growth of the business, to bring our products and services to a wider geographical footprint and expand our lending activities into new asset classes where the existing capacity and capability of the firm can be brought to bear and realise niche opportunities in markets that offer earnings at a level accretive to those achieved in our core businesses.

Underpinning this activity, is our strategy of ensuring that the business avoids conflicts in its relationships with its major suppliers and its customers. The policy of clear and open communication, and the absence of cross selling of ancillary products to borrowing customers has been met with positive customer responses in terms of their satisfaction with products and services, and their willingness to recommend CCB to their contacts.

During 2018 repeat business from existing borrowers reached a level of 60% of new business during the second half of the year.

In the short term, the strategy will see us investing heavily in our IT capabilities both in terms of Customer Experience, where during 2018 we saw a replacement of our voice communication capability, and the migration of our IT architecture to a cloud-based environment. We also laid the plans for the development of a new CRM system and in 2019, the replacement of our online customer deposit account recruitment and customer self-service capability.

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Our medium-term strategy will see growth across new areas of the country, together with a controlled expansion of our broker introducer panel for all three of our major core lending markets.

We continue to keep the opportunities for development finance under scrutiny, although at this time in the credit cycle development of a product with a satisfactory risk profile means further expansion is unlikely in the short or medium term.

The Bank has maintained relatively high levels of liquidity during the second half of 2018, driven by our need to ensure adequate funding for our lending growth, the uncertainty surrounding market sentiment relating to Brexit in the first half of 2019, and to provide the balance which will enable us to start unwinding our current Funding for Lending Scheme facility, avoiding the need to compete in the market at a time when rates are inflated. The final months of 2018 saw a significant reduction in our balances attributed to our Pension Administrator customers as we pursued our strategy of maintaining a simple business model through the avoidance of operational risk represented by the latest Payment Services Directive II requirements.

Looking further out, the long-term maintenance of our business health has been underpinned by significant investment in the head office premises at Charnwood Court, New Walk, Leicester. Our accommodation has been completely renovated into a modern, sustainable and flexible open plan format with the capacity to provide up to 220 work stations. This underpins our foreseeable growth requirement from the current occupancy of around 140 and gives us the confidence that we have premises that are attractive to our staff, and which will remain sufficient for our needs for at least five years, on current projections.

Similarly, in our regional offices we have expanded our office accommodation to meet foreseeable needs in Bristol and Sheffield.

2018 has also seen significant investment in our Risk & Compliance, Finance and Lending capabilities. Development on our second-generation Credit Grading Model is now underway and the Board continues to ensure that lending portfolio management develops alongside the size and complexity of the business. We have taken the opportunity towards the end of the year to widen the remit of the Risk & Compliance team, to build out our Credit Oversight and Models Management investing in the skills and capability to protect the Bank's lending base in the event of market stress or downturn.

Trends and Factors

The major trends that continue to influence business and its forward prospects can be summarised as follows:

- Changes in the Buy to Let investment market
- Long term trends in technology investment driving disintermediation across financial services
- Access to trained and experienced staff to cover the areas of specialist knowledge required for CCB's operating model

Looking at these each in turn:

Changes in the Buy to Let Market

The fiscal changes to the Buy to Let investment market introduced some two years ago are starting to drive a significant change across the level of demand for Buy to Let mortgages, the sale of existing Buy to Let stock back into the first and second time buyer market and the emergence of a demand for Build to Rent investments.

For CCB this has seen a change in the balance between commercial and residential lending with the former now accounting for approximately 55% of new business during 2018. As the scale of demand for Buy to Let finance continues to reduce, competitors are viewing the SME and professional property market as a good alternative source of business. This has put some strain on pricing across the market, although CCB continues to attract sufficient volumes of acceptable risk with only a marginal impact on the returns achieved. The strategy recognises that it is likely that this pressure will continue in the short term.

Strategic Report

Technological Changes

The rise of FinTech competitors continued at pace during 2018. The advent of a fully technology based service addressed to the SME market is however, yet to emerge. We continue to research the views of our customers, and especially our broker introducers, on the use of technology in our business model and take some comfort from the fact that both parties see the benefit of our individual underwriting and relationship manager based service delivery as having greater value than a technology based transactional offer. Technology should help the client and broker rather than just reduce the funders processing costs – a comment we have heard from brokers for a year or two.

We cannot however remain complacent, as within the medium term there is a market expectation that price comparison sites will appear covering the SME lending market. At this stage it is difficult to see how complex lending can be covered by such an infrastructure, although increasing customer sophistication and general acceptance is that the more vanilla lending propositions will be first to be impacted. Our own positioning and continued liaison with a select number of brokers will protect our franchise, notwithstanding the expectation that other competitors will endeavour to move into the CCB market space over time.

We continue to look at expanding our geographic coverage where there is opportunity for our model to thrive and achieve our growth appetites in the short and medium-term future.

Access to trained and experienced staff

Full employment during 2018, and the growth in the number of new challenger and niche banks means that the market for high quality specialist talent is particularly competitive. This has been particularly true in the Risk, Compliance and Finance functions. However I am pleased to be able to report that we have been able to recruit to underpin our continued investment in all of these areas during the period. Leicester is still a city with good travel connections and an attractive environment which enables the Bank to recruit and retain the talent it wants as the business grows in both size and complexity.

Generally, while these major trends all pose challenges to our current operating model, the strategy for our growth during the short to medium term remains pertinent and relevant to our target markets. The investments that we have made through the last two years in our people, our technology, and our geographical reach will continue into 2019 and will underpin our performance for the future, delivering the growth we want, and protecting our franchise.

Risks

In the proceeding section we have discussed a number of market wide trends that pose some risk to the operating model, and summarised that they remain mitigated through the provision of a value-based offer to a market that also provides ample opportunity for us to expand our services across new geographies and new asset classes. The other major risks that we believe the business faces can be summarised as follows:

- Brexit, and its effects on macro-economics.
- The credit cycle which is closely aligned to Brexit outcomes.
- Increasing competition and its effect on pricing in our targeted market sectors.
- Liquidity costs that continue to rise and the advent of the withdrawal of government funding schemes.
- IT, Data Security, and Cyber Security threats.

Brexit

The Bank has undertaken a thorough review of the effects of the various Brexit alternatives will have on its business model and also reflects the views of our customers, discussions with UK Finance, and specialist commentary from the accountancy and consultancy world. The greatest risk is the absence of a clear route forward either from a no deal or a negotiated deal perspective. Business confidence continues to fall but

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having reviewed Brexit with a significant percentage of our customer base, its effects on their businesses is not felt to be profound, other than the market confidence issue, and the delay in investment. The provision and demand for residential accommodation is expected to continue notwithstanding the threat of a withdrawal of foreign workers from the labour market.

The Bank has no exposure to workers requiring residential permissions to remain in the UK, and neither do we have any major contracts with suppliers based in the EEC which may be affected by the UK withdrawal.

This is extended to our IT services which are provided by a third-party cloud-based provider, and where their primary and secondary hosting systems are all within the UK.

Supply chains for those owner occupier businesses will offer an element of challenge, but again, discussions with relevant customers shows that they have planned for a disruption although without clarity on the final decision, they remain unsure on whether the mitigations they have organised will be required. Once clarity on the issue is delivered we plan to continue the dialogue with our customers to ensure that we have early site of any disruption to their business which might affect their ability to support their borrowing. CCB has minimal exposure to businesses dependant on international trade, especially with Europe.

A fall in levels of business confidence has been reflected in a reduction in the number of transactions in the market, however at present this has not been transferred into asset pricing in either commercial or residential property. The statements from the Bank of England on the continuation of the current regulatory environment provides certainty, and therefore the fundamentals relating to capital and liquidity requirements are not expected to alter.

We continue to carry a healthy level of liquidity, all of which continues to come from SME and retail deposits together with our facility under the Funding for Lending Scheme. The cost of carrying this liquidity is within plan and our current Board appetite and will provide the funding for our lending growth in 2019.

Pricing and Competition

The number of newly launched niche and challenger banks, together with an increase in the non-banking participation in the asset finance market, has had the effect of reducing lending margins and increasing deposit margins across our markets. We have mitigated this in part through repricing the liabilities held for existing customers, whilst ensuring that they continue to enjoy rates comparing favourably to those currently on offer in the market.

On the lending side, we have been able to attract a level of business meeting our planned growth aspirations through increasing the number of brokers with whom we work,and starting to penetrate new markets in Manchester and Cardiff. We have also been helped by 60% of new business written in the latter part of 2018 coming from existing customers who understand the value of our proposition, have a good track record of performance and credit history.

Margin compression is expected to be a feature during 2019, although with the withdrawal from the market by a small number of players, and the curtailment of activity from others, we believe that the level of margin reduction will be within the planned expectations and continue to support our financial performance. We will continue to expand our broker network to ensure that volumes of loans at acceptable price/risk levels will be achieved.

Liquidity

2018 saw some fundamental changes in the way that the Bank attracts funds with the strategic decision to withdraw from the Pension Administrator Current Accounts market concluding at the end of the year.

This is driven by the provision of open payment system accounts to third parties. This area represents an operating risk where the financial returns are minimal and the costs of providing services, whilst having no recompense in terms of liquidity, made the sector unattractive.

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We have grown our relationship with a number of savings brokers and have continued to use best buy tables to successfully combine a growing number of routes to market. Retention of fixed term bonds remains high, and the majority of our funding through notice accounts shows that the balances remain stable with behavioural experience showing a longer dated tenor than headline notice periods would suggest.

Our Funding for Lending Scheme (FLS) exposure reduced during the year and the Bank is accelerating repayments to make sure it avoids any cliff edge as a large number of competitors also seek to replace FLS and Term Funding Scheme funding over the medium-term horizon.

IT & Data Security

This is an area where the Bank has seen a number of challenges to our IT security systems, all of which have been successfully managed without loss. A significant investment in improvements to our IT security has taken place in 2018 and includes:

- A cloud migration programme delivering foundations to enable us to consider middleware deployment and API integration.
- A programme of hardware replacement and investment.

As ever, this will be a continuing requirement and remains part of our strategy going forward.

The successful introduction of the requirements under GDPR were completed during the year. The Bank's strategy remains to automate and digitise communications with our customers and supplier partners wherever they seek it, and we are investing in the necessary systems and processes to accelerate and maintain this stance during 2019.

The GDPR legislation has also called on the Bank to review its third-party service contracts and ensure that they offer the Bank, and our customers, a secure and compliant level of service, protecting their data and its use. This review will be ongoing given the major risk this represents.

Viability

The Board has spent considerable time during 2018 on the commercial viability of the current strategy, and remains confident and positive that it remains pertinent, attractive to the target markets, and provides the opportunity to expand to meet growth appetites. This will be both through the opening of new offices and identifying specialist asset classes where the Bank can bring to bear its capability and capacity to offer finance to niche markets, such as the classic car initiative launched in 2018. This confidence remains in place, notwithstanding the increase in competition although remains tempered by our view on credit cycles, where significant investment has been made in changing the focus of the Business Development sales force into more of a Relationship Management service. This has enabled us to increase the penetration of new business for existing customers. We will maintain this trend, as it reduces our lending acquisition costs, whilst additionally giving us greater insight into the current credit worthiness of our existing customers.

The investment in our new IT hosting platform, the refurbishment and extension of our office accommodation, and the acquisition of fresh talent in our front office and key business functions, have all been delivered with the intent of building a platform that will enable the Bank to safely move into its next stage of growth.

The Board have continued to run a number of stress tests on the operating model, most particularly those affecting our property lending concentrations, and remain confident that we are adequately capitalised to withstand severe contractions in both the number of transactions in the market, and the fall in capital values across both residential and commercial property markets, and any attendant impairment risk. This view is founded on the additional capital of £31m provided by our owners in 2018 to accommodate any potential capital stress and provide the fuel for our next stage of growth.

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Part of the stress scenarios is also to test our Operational Resilience and 2018 saw the appointment of an Operational Resilience Director. We have upgraded our disaster recovery site and executed a number of disaster recovery test scenarios, which have all helped in the development of our plans to cover a variety of financial, systems, and operational threats and disruptions that the business could face. 2019 will see us concentrate on understanding and managing our times to recovery for our customers, and our operational resilience to ensure we meet standards which are expected to be introduced by the Regulators in 2019.

The Board have also looked at the Bank's access to the required talent pools to ensure that it has viable succession plans for the Non-Executive members, in addition to the Executive and senior management who are key to the execution of the Boards strategy. The Board have reviewed the costs of ensuring it can attract and retain the appropriate talent, and believes it offers competitive employment packages at all levels of the business. As part of this, a new Chief Lending Officer will join the Executive early in 2019 as we continue to build out our credit functions to reflect the growing size and diversity of the loan portfolio and support future growth appetites.

On these firm foundations, the Board believes that the business continues to enjoy good prospects for its growth, maintaining return levels in excess of industry averages for niche and challenger banks, supported by a healthy appreciation of the risks Cambridge & Counties Bank faces with appropriate risk mitigations in place to meet disruption challenges should they arise.

Environmental, Social & Governance

The Bank takes its responsibilities under the environmental, social & governance agenda very seriously. The Board debates the issues on a regular basis and receives reports from the executive team on environmental matters relating to the business, regular updates on the company employee structure, the participation of the Bank in charitable and support work, the respect agenda across the Bank, and upholding the highest levels of defence against corruption and bribery.

Sustainability

During 2018 we have seen further progress in addressing the Bank's consumption of key utilities, travel and office supplies. The staff self-organise a Green Team who are focussed on ensuring that we continue to lower our carbon footprint through reductions in the consumption of paper, gas, electricity and water. The office refurbishment, designed purposely to help support our efforts through the provision of new heating and air-conditioning, alongside low power LED lighting which operates on a demand only basis.

The year saw further accolades from Investors in the Environment and Jamie Lea Winch, who has been the Bank's prime advocate of our sustainability actions for the last four years, personally recognised for the work that she has undertaken.

Colleague Matters

The Bank has maintained its association with the Banking Standards Board (BSB) and for the second year underwent a full assessment of our colleague's views on the Bank's culture, where results remain positive and reflect well in comparison to other, albeit larger, organisations. We have also recorded consistently high participation in our employee engagement survey conducted in January 2019.

Staff turnover remained low at around 8%, and total staff numbers increased during the year, all be it marginally. The Board continues to pay close attention to our staff turnover rate, which remains subdued for an organisation that is now six and a half years old, and also the time taken to fill vacancies through recruitment. Here the performance is considered very good for general staff, although as previously highlighted attracting talent into specialist sectors such as Risk, Compliance and Finance is taking longer than we would wish given high levels of current demand for these specialisms.

2018 also saw the introduction of a profit-sharing scheme to replace the previous bonus schemes, for the majority of staff in the business. This pays out up to a maximum of 10% of basic salaries across the staff base, including management.

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The Executive and sales force continue to be incentivised through personal, as well as the whole bank, performance scheme, which includes financial, operational and quality of service areas.

Whilst not being statutorily required to report, the Bank is also highly focussed on gender pay issues. Pleasingly 60% of the Executive are now women, and the Board is made up of a 3:7 ratio of women to men. The Executive continue to work on reducing the gender imbalance across all levels of the business and monitor the gender pay gap closely.

Social Inclusion

On the social inclusion agenda, our people maintain their fantastic record of providing help and support to their chosen charities during the year. This included a collection at Christmas of household goods and toys to help families in temporary accommodation, including those families subject to domestic abuse and violence.

Earlier in the year a project was undertaken to help and support a local Rehabilitation centre. Additionally, the Bank continued to support its staff through the provision of time off from the office, outside of their holiday entitlement to support charitable and educational needs.

The Autumn saw the Bank hold a ball engaging the local business community which raised £15,000 for the local LOROS Hospice Charity.

Through our association with Leicestershire Cares, we have also supported initiatives in promoting student numeracy, adult education and community support.

Operational Performance

Customer Satisfaction

Our customer satisfaction metric continues to perform outstandingly and compares well across the industry and other service sector businesses. 99% of new customers, both borrowing and depositing, report that we dealt with their enquiry and application effectively, with a similar score given for their willingness to recommend Cambridge & Counties Bank. Longer term customers also remain positive regarding their relationships with us, and our 2018 survey told us that around 93% of all customers, of whatever longevity with the Bank, continue to rate our service and recommend us.

Several initiatives during the year, including the repricing of our existing customer deposit accounts following changes in base rate, and the move toward a relationship model introducing regular periodic reviews for lending customers continue to drive this level of satisfaction and high performance, reflecting the increase in the volume of contact between the Bank and its customers. The outcome of these achievements continues to be the stickiness of balances in the deposit book, and the increasing ratio of new business supplied to us generated from existing lending customers. This reduces our cost of acquisition across the board and continues to support the brand in a market where on the deposit side, we would otherwise be left only with price to attract and retain balances.

On the lending side it also supports our brokers in placing business with us notwithstanding the competitive market. This is based on the customer satisfaction with our loan manufacturing and relatively frictionless onboarding, including the time between agreeing a facility and advancing funds. Both broker and client feedback confirm that quality of service is more than just a fast response,and is based on end to end delivery.

Operations

The cost:income ratio at 34% continues to demonstrate the efficiency of the business, and the advantages of running a simple model, without introducing customer conflict in terms of cross selling, supporting multiple product sets and our low risk deposit operating model where funds are received and returned only via a nominated UK current account.

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Operational losses remain low and an annual total of 53 complaints represents a penetration of less than 1% of accounts. Our investment in our Customer Experience team has meant during the year we have undertaken some fundamental reviews of our processes and customer journeys which have provided greater insight into service improvement and root cause analysis to prevent the causes of friction and dissatisfaction for our customers.

The Board continues to adopt a stance of improving general staff performance through significant investment in training and development. A total of 477 days have been provided for both individual and general staff development during 2018. This has also included a complete renewal of our staff performance management tools where we have moved from periodic and for most staff, bi-annual reviews, to a more frequent one to one interaction between individuals and their manager. This is designed to provide a more immediate focus on performance issues, whilst ensuring our staff get the support and recognition that they deserve and crave in terms of their performance and development. It is pleasing to report that the new systems have been welcomed across all levels, and adoption has been widespread with a strong uptake in usage.

These investments have enabled us to ensure that we develop our talent pool, which means we can promote internally as the need arises, rather than depend only on external recruitment.

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Financial Review

The 2018 financial statements have been prepared under International Financial Reporting Standards as adopted by the Bank and endorsed by the EU and the Companies Act 2006. From 1 January 2018 the Bank adopted both IFRS 9 – Financial Instruments and IFRS 15 – Revenue from Contracts with Customers standards. IFRS 15 has had no impact on the Bank's results, whilst the adoption of IFRS 9 has resulted in the implementation of new impairment loss calculation processes, and the implementation of new classification and measurement categories for financial assets. The full impact of IFRS 9 is summarised below and more detail is available within Note 36 to the Financial Statements. There were no other changes to accounting policies in the year.

The Bank's primary financial statements are reported on pages 41 to 44, with a summary of these shown below. Due to the transition approach taken by the Bank, the comparative information has not been presented on an IFRS 9 basis.

The Bank delivered another good financial performance in 2018, with pre-tax profit up 14% to £27.9m and loans and advances to customers growing by £79.1m to £769.0m, a 11% increase on 2017. The Bank's balance sheet at the year end exceeded £1bn for the first time since it started trading in 2012. The Bank increased its capital strength during the year with Shareholders' Funds increasing by 64% from £76.2m to £125.2m and its total capital ratio increasing from 13.8% to 20.5% (including IFRS 9 transitional relief).

Summary Income Statement £'000	2018	2017	% change
Interest income	57,514	48,198	19
Interest expense	(13,089)	(9,767)	34
Net interest income	44,425	38,431	16
Other income	310	528	(42)
Total Operating Income	**44,735**	**38,959**	**15**
Operating expenses (including depreciation)	(15,093)	(12,316)	23
Impairment charge	(1,716)	(2,237)	(23)
Profit Before Tax	**27,926**	**24,406**	**14**
Taxation charge	(5,518)	(4,712)	17
Profit After Tax	**22,408**	**19,694**	**14**

Summary Balance Sheet £'000	2018	2017	% change
Liquid assets	260,020	187,493	39
Loans and advances to customers	769,016	689,954	12
Other assets	3,052	1,785	71
Total Assets	**1,032,088**	**879,232**	**17**
Customer deposits	901,398	798,176	13
Other liabilities	5,510	4,813	14
Shareholders' funds	125,180	76,243	64
Total Liabilities and Equity	**1,032,088**	**879,232**	**17**

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Key Performance Metrics	2018	2017
Gross new lending	£266m	£238m
Net interest margin	4.6%	4.7%
Common Equity Tier 1 capital ratio	16.8%	13.5%
Total capital ratio	20.5%	13.8%
Liquidity Coverage Ratio	331%	207%
ROCE	27.7%	36.6%

Total operating income for 2018 was £44.7m, £5.8m or 15% higher than in 2017.

The Bank's growth in its real estate and asset finance lending balances (11%) resulted in interest income increasing by 19% to £57.5m. During the year the Bank reviewed its effective interest rate calculation processes. As a result of this review the Bank revised its assumptions for the reporting of its real estate early repayment charges (ERC). These charges, which were previously reported within other income, are now reported as part of interest income (ERC received in 2018 totalled £2.9m, 2017: £2.4m). During the year the Bank extended its Asset Finance product offering to provide finance for the purchase of Classic Cars.

The interest paid on the Bank's deposit balances increased by £3.3m to £13.1m during the year, reflecting the competitive nature of the market, the interest rates offered by the Bank and the Bank's strategy of targeting longer term deposit balances. The Bank's deposit balances increased by 13% to £901m, despite the Bank exiting the Pension administrator account segment of the market resulting in balances of around £50m being withdrawn.

UK Bank base rate increased by 0.25% in August 2018, and the rate increase was passed on to both the Bank's loan and deposit customers.

In total, net interest income increased by £6.0m to £44.4m in 2018. The Bank's net interest margin reduced from 4.7% to 4.6% in 2018, reflecting both pricing in both the lending and deposit markets, as well as the Bank's mix of assets and liabilities. The Bank held a significantly higher proportion of lower yielding liquid assets in 2018 in preparation for its withdrawal from the pension administrator segment of the market in Q4 2018, as well as concerns over potential increased liquidity market volatility as a result of the UK's planned exit from the EU in 2019.

We continue to invest in the business, with total operating expenses increasing from £12.3m in 2017 to £15.1m, principally as a result of increased staff numbers. Average staff numbers increased from 125 in 2017 to 143 in 2018, increasing staff and staff related costs by £1.1m to £9.3m. In addition during the year, the Bank completed the implementation of a new telephony system, as well as changing its IT hosting services to strengthen its IT systems resilience and security.

The Bank continues to operate efficiently with a cost:income ratio of 33.7% in 2018. The ratio was higher than the 31.6% in 2017 as a result of the investment in additional resources.

Impairment

The Bank has, and aims to maintain, a high-quality loan book through its lending policies and risk appetite statements. The Bank implemented a maximum loan limit of £15m per customer and its standard loan to value ratio is 70% (excluding fees). The average loan to value ratio of the Bank's lending at 31 December 2018 was 57%.

The Bank's loan portfolio has continued to perform well in 2018, with just 1.6% of balances over 3 months in arrears at the end of December (2017: 0.86%). During 2018 the Bank incurred losses on three loans utilising provisions of £1.1m.

Strategic Report

IFRS 9 financial instruments requires banks to calculate impairment loss provisions on an expected loss basis compared to the previous incurred loss basis under IAS 39. This change results in a higher loss provision requirement. The Bank's impairment provision charge at the 31 December 2017 increased by £3,630k on 1 January 2018 as a result of adopting the new standard. This increase, net of tax, is reported as an adjustment to opening reserves within the Statement of Changes in Equity.

The total impairment charge recognised in the income statement in 2018 was £1,716k (2017: £2,237k). The reduction in the current year's impairment charge reflects higher incurred losses in 2017. The Bank's total loan loss provision at the end of 2018 was £8.1m (2017: £3.6m) representing 1.0% (2017: 0.5%) of loan balances.

	2018	2017
No. of loans in arrears*	61	46
Value of arrears	£900k	£505k
Total value of loans in arrears	£35.1m	£25.5m
Provisions held	£8.1m	£3.6m

*1 or more days in arrears

Taxation

The taxation charge in 2018 is £5.5m (2017: £4.7m), an effective corporation tax rate of 19.69% (2017: 19.31%). The taxation charge includes a £21k credit in respect of deferred tax (2017: £28k charge). In 2018, the Bank had a higher effective tax rate as its profits exceeded the annual bank corporation tax surcharge allowance for the first time. This resulted in an additional charge of £205k during the year.

Shareholders' Funds

£'000	2018	2017	Change %
Share capital	44,955	23,955	88
Convertible loan notes	22,900	12,900	78
Reserves	57,325	39,388	46
Total Shareholder Funds	**125,180**	**76,243**	**64**

During the year the Bank's existing shareholders continued to support the Bank's growth with additional capital invested in June and October. In June both shareholders purchased 0.5m of ordinary shares and in October 2018 they both purchased an additional 10m ordinary shares each. Cambridgeshire County Council Pension Fund also invested £10m in the form of convertible loan notes in October 2018.

Total shareholders' funds increased during the year from £76.2m to £125.2m as a result of the growth in retained earnings and the above investments.

The Bank has elected to adopt the capital transitional arrangements in respect of IFRS 9 and the impact of the increase in loan loss impairment provisions on tier 1 capital. The transitional arrangement in 2018 allows the Bank to increase its tier 1 capital by an amount equal to 95% of the reduction in tier 1 capital on 1 January 2018 as a result of adopting IFRS 9, and the expected credit loss method of calculating provisions. In total the Bank's reported tier 1 capital increased by £2.9m in 2018 as a result of these transitional arrangements.

The Bank's Common Equity Tier 1 capital ratio (including the impact of the transitional arrangement) at the 31 December 2018 was 16.8%, (2017: 13.5%). The Bank's total capital ratio (including the impact of the transitional arrangement) at 31 December 2018 was 20.5% (2017: 13.8%). The Bank's Common Equity Tier 1 capital ratio and total capital excluding the transitional arrangement were 16.3% and 20.0% at 31 December 2018.

Strategic Report

Dividends and Convertible Note Payments

In April 2018 the Bank paid its inaugural ordinary share dividend of £1m (£0.5m to each shareholder) in respect of the Bank's 2017 business performance. On 1 October 2018 the Bank paid the interest payment on its convertible loan notes, with £795k paid to Cambridgeshire County Council Pension Fund, the holder of these loan notes.

The Board does not propose to pay an ordinary share dividend in 2019.

Liquidity

The Bank monitors liquidity on a daily basis to ensure it has sufficient funds available to meet maturing liabilities and uses a range of metrics to monitor this. The Bank maintains a highly liquid balance sheet with its regulatory Liquidity Coverage Ratio (LCR) at 331% at 31 December 2018, compared to 207% for 2017, significantly higher than the regulatory minimum of 100%.

The Liquidity Coverage Ratio (LCR), assesses 30-day net cash outflows as a proportion of High Quality Liquid Assets (HQLA). HQLA comprise cash balances held at the Bank of England and Gilts, while net 30-day outflows are calculated based on regulatory guidance. It should be noted that outflows reduced in 2018 as a result of the Bank withdrawing from holding pension administrator balances. These attract a 100% outflow weighting.

The Bank's liquid assets totalled £260m at the end of the year, an increase of £72.5m compared to 2017. The majority of the Bank's liquid assets are maintained in the form of cash balances held at the Bank of England (2018: £232.3m, 2017: £164.3m). At the 31 December 2018, the Bank held off-balance sheet t-bills drawn through the Bank of England's Funding for Lending Scheme (FLS) totalling £106m (2017: £60m). The t-bills are due to be repaid by January 2022 at the latest.

Outlook

The Bank is planning for continued growth in lending and deposit balances in 2019, although the rate of growth is expected to be lower than in previous years as a result of increased uncertainty in the UK economy. The Bank is prepared for the UK's potential exit from the EU in 2019, with management confident that its future plans, and UK based business model, will enable it to minimise any impacts from a more uncertain operating environment.

We will continue to invest in the business with a particular focus on additional skilled resources within the Risk and Credit functions, as well as continued investment in our IT systems, including the development of a new internet service for deposit customers.

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Corporate Governance

The Bank has a well-established corporate governance structure. The Board supports the principles of good corporate governance as set out in the UK Corporate Governance Code. The Board believe that its existing governance processes are appropriate for the current size and structure of the Bank.

The Bank noted the publication of the 2018 UK Corporate Governance Code by the FRC on 16 July 2018, for all accounting periods beginning on or after 1 January 2019. Whilst the Bank is exempt from a number of the provisions due to it not being a listed entity, and its overall size in terms of employee numbers, it has reviewed the requirements, and will ensure that its governance processes continue to follow best practice, particularly in reporting and managing diversity and employee engagement.

Structure of Board and Board Committees

The Board has overall responsibility for the operations of the Bank, and is comprised of four independent non-executive directors, two non-executive directors (NED) representing the interests of the owners of whom one acts as vice-chair. The non-executives are currently complemented by four executive directors (ED) – the Chief Executive Officer, the Chief Financial Officer, Chief Customer Officer and Chief Development Officer. The Bank currently has an Interim Chief Risk Officer who attends the Board meetings, but is not a member of a Board.

The Board has its own Terms of Reference and has specific committees appointed by it for the purposes of Performance & Remuneration, Nominations & Governance, Audit, Risk & Compliance, and Executive Management. Each of these has its own Terms of Reference.

To ensure independence, and reduce the potential for conflict of interest, the sub-committees (excluding the Executive Committee) are each comprised entirely of NEDs, although individual EDs and others attend either as a matter of course or when requested to provide advice and guidance. A NED chairs all Board Committees except the Executive Committee.

Primary Responsibilities of the Board

While the day-to-day operation of the Bank is delegated to specific individual executives as managers, the Board, appointed by the shareholders to monitor and govern the Bank's operations, is legally responsible for safeguarding the interests of depositors and shareholders' investments. Although the Board does not manage the Bank, one of its foremost duties is to recruit and retain suitable management. The Chief Executive Officer is the key position and the Board appraises him and provides oversight and agreement to the appointment of other EDs and senior managers. In conjunction with the Bank's senior management team, the Board is responsible for formulating broad priorities, goals and strategies for the Bank. The formulation of clear objectives and policies supplies a framework for the Chief Executive Officer to work within.

The Board both lays out the Bank's goals and monitors the progress against these. One of its main duties in this capacity is to limit the Bank's exposure to excessive risk of all kinds, including legal, reputational and financial. By managing risk judiciously, the Board tries to maintain a balance between enterprise and caution. The Board also ensure that the Bank complies with all applicable statutes and regulations. This is achieved by monitoring compliance with regulatory and policy requirements via the Bank’s compliance and audit functions, which inform the Board of how the Bank is being run. The audit operations are not limited to financial purposes and encompass the Bank’s structure and operations. The Board is also responsible for commissioning audits, to provide independent assessment and assurance of the Bank.

The Board is responsible for monitoring conflicts of interests, both in the Bank's executives and on the Board itself. If a person in a position of leadership has compromised motives, the Board must step in and resolve the conflict.

John McGuire is the Bank’s nominated Board member for Whistleblowing disclosures.

Corporate Governance

Responsibilities and Requirements of Non-Executive Directors

The essential role of the NEDs is to provide independent assurance to the Bank's shareholders that the business is being conducted in such a manner as to protect the interests of the Bank's depositors, and to comply with the Principles for Business of the Regulator. This responsibility is discharged via oversight of, and appropriate challenge to, the Bank's senior management via the structure of the Bank's sub-committees. Part of the process for selection and training of NEDs is to ensure they are familiar with the regulatory principles and practices, and to maintain their knowledge of them.

Responsibilities and Requirements of Executive Directors

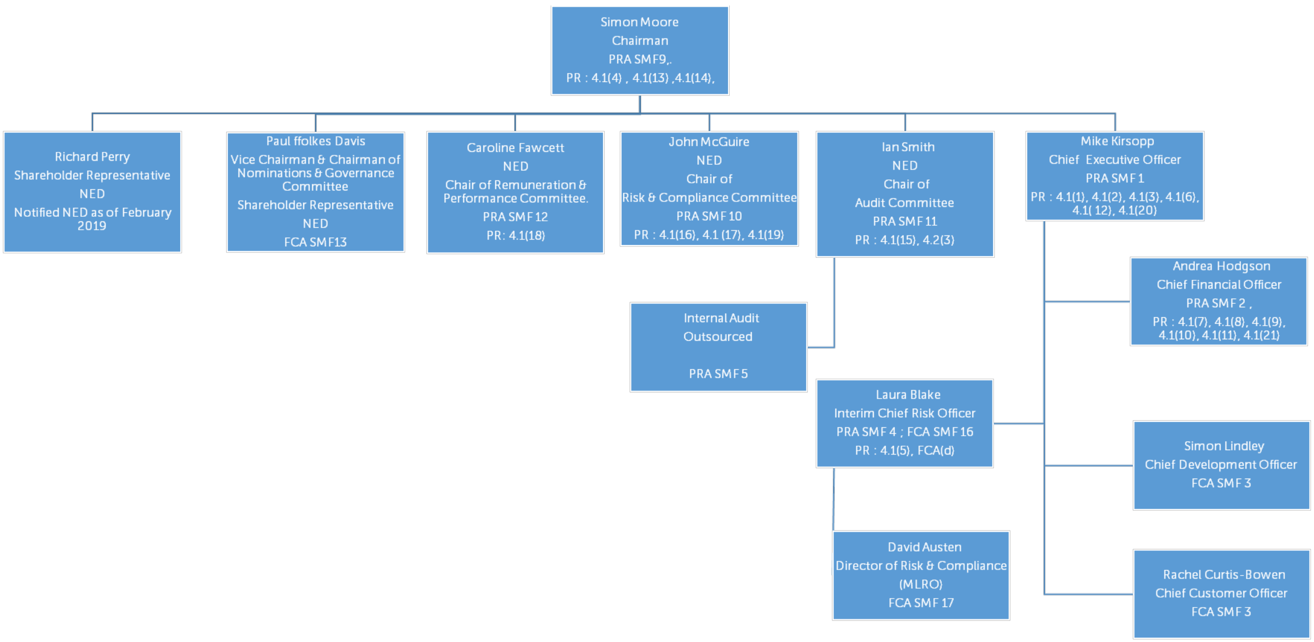
The EDs are responsible for the day-to-day operation of the Bank, supported by the senior management team. This is in part effected via policies and procedures developed with the approval of the Board (directly or indirectly through committees and sub-committees), partly through the Executive Committee and partly by the discharge of duties as specified within individual job descriptions.

Chairman and Chief Executive

The offices of Chairman and Chief Executive Officer are distinct and held by different people. The main role of the Chairman is to lead the Board and to ensure that it operates effectively. The Chief Executive's role is to put into effect the strategies agreed by the Board and the general operational management of the Bank.

Compliance with the Senior Managers Regime

The PRA define a set of Prescribed Responsibilities and Overall Responsibilities, which must be allocated to a senior manager performing a Senior Management Function. The following tables show the composition of the Bank's Board, the management organisation and the PRA defined Senior Management Functions allocated across the Bank. The table below shows those individuals covered by the Senior Management Function regime and the Bank's governance structure as at 1 January 2019.



Corporate Governance

Senior Manager Function	Description	Role	Person
1	Chief Executive Function	CEO	Mike Kirsopp
2	Chief Finance Function	CFO	Andrea Hodgson
3	Executive Director Function	CCO/CDO	Rachel Curtis Bowen / Simon Lindley
4	Chief Risk Function	CRO	Laura Blake
9	Chair of Board	Chairman & Independent NED	Simon Moore
10	Chair of Risk & Compliance Committee	Independent NED	John McGuire
11	Chair of Audit Committee	Independent NED	Ian Smith
12	Chair of Remuneration and Performance Committee	Independent NED	Caroline Fawcett
13	Chair of Nomination and Governance Committee	NED	Paul ffolkes Davis
16	Compliance Oversight	Interim CRO	Laura Blake
17	Money Laundering reporting function	MLO	David Austen

NB: SMF 5, 6, 7, 8, 14 and 18 are not currently applicable to the Bank. SMF 15, 19-23 have not been set by the PRA or FCA.

Board and Committee attendance

The following table sets out individual director's attendance at Board, Risk & Compliance, Audit, Performance & Remuneration and Nominations & Governance Committees meetings during 2018 (attendance is shown only where a director is a member of the committee):

Director	Board	Risk & Compliance Committee	Audit Committee	Performance & Remuneration Committee	Nominations & Governance Committee
No. of meetings in 2018	12	7	4	2	4
Rachel Curtis-Bowen	12				
Caroline Fawcett	11	7	4	2	4
Paul ffolkes Davis	12	7	4	2	4
William German *	10				
Andrea Hodgson	11				
Michael Kirsopp	12				
Simon Lindley	12				
Christopher Malyon **	5	3	2	1	0
John McGuire	11	6	4	2	3
Simon Moore	12	7	4	2	4
Richard Perry ***	-	-	-	-	-
Ian Smith	12	7	4	2	4

* Resigned on 30 November 2018.
** Resigned on 26 October 2018.
***Appointed on 18 February 2019.

Corporate Governance

The Bank's Interim Chief Risk Officer, Laura Blake, attends all Board meetings but is not a member of the Board.

Performance Evaluation and Professional Development

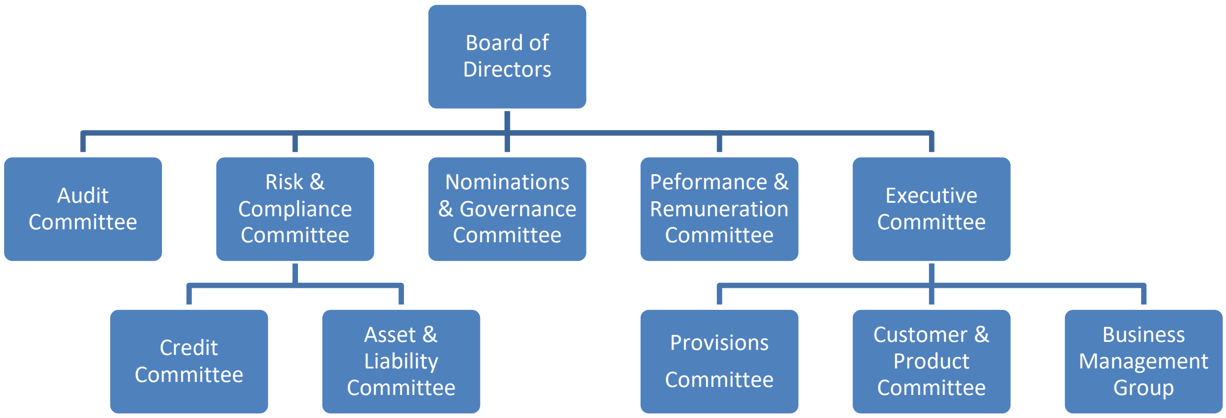
Each year all of the Directors are subject to a formal appraisal. The Chief Executive Officer carries out appraisals of the Chief Financial Officer, Chief Risk Officer, Chief Development Officer and the Chief Customer Officer based on a range of agreed personal and business objectives. The Chairman of the Board completes the Chief Executive Officer's appraisal, performance also being assessed against a range of agreed personal and business objectives.

The Chairman and Chief Executive Officer conduct appraisals on the independent non-executive directors, basing their assessment of each director's contribution to the Board's performance using criteria such as attendance, performance at meetings and additional training and development.

The Board conducts an annual review of its effectiveness, as do the Board Committees.

Board Committee Structure – responsibilities and key issues

The diagram below sets out the Bank's Committee structure. This structure was in place during 2018.



Audit Committee – chaired by Ian Smith; Independent Non-Executive Director

The Audit Committee met 4 times during 2018. The Committee's principal responsibility is to assist the Board in carrying out its responsibilities relating to accounting policies, internal control and financial reporting functions.

The Committee reviews the effectiveness of the Bank's internal controls, approves the internal audit programme and examines internal and external audit reports. The Committee considers the majority findings and ensures, via management, that recommendations are implemented where necessary.

The Committee ensures the financial statements give a true and fair view, as well as provide the reader with sufficient information to assess the Bank's performance. Any significant judgements in relation to financial reporting are reviewed and challenged by Committee. During 2018, the Committee recommended approval to the Board of the 2017 statutory accounts and the supporting management judgement papers including the going concern, effective interest rate, impairment provisions and intangible assets. The Committee approved the changes in the Bank's accounting policies following the adoption of IFRS 9 from 1 January 2018 as well as revisions to the Bank's effective interest rate calculation. As part of approving these accounts the Committee also reviewed the potential impact of Brexit on the Bank's business plans.

The Audit Committee appraises the performance of the internal audit function. The Committee has assessed internal audit resources and is satisfied that these are appropriate to fulfil their responsibilities. The Committee reviews the appointment of the external auditors and approves the audit fees.

Corporate Governance

Performance & Remuneration Committee – chaired by Caroline Fawcett; Independent Non-Executive Director

The Performance & Remuneration Committee met twice during 2018. In these meetings, the Committee, carried out its responsibility for overseeing the performance and remuneration arrangements of the Bank, and the performance of all Executive Directors and the Chairman.

It also reviewed pay and bonus arrangements, approving awards where appropriate based on performance and bench marking for salaries. The Committee approved payment of the 2017 bonus scheme (paid in March 2018) and salary reviews for all staff; they also challenged and approved the performance criteria for the 2018 sales bonus scheme and new profit share scheme (payable in March 2019). The Committee specifically challenged and discussed the Bank's LTIP scheme, approving changes that linked it more directly to the achievement of the 3 year strategic plan targets. The Committee reviewed the Bank's remuneration policy to ensure that it remains up to date and consistent with the relevant requirements of the Financial Conduct Authority (FCA) remuneration code (SYSC 19D) and the Prudential Regulation Authority (PRA) rulebook.

Nominations & Governance Committee – chaired by Paul ffolkes Davis; Vice Chair of the Board

The Nominations & Governance Committee met four times in 2018.

The principal responsibilities of the Committee are to consider and make recommendations in respect of appointments to the Board as well as the membership and chairmanship of Board Committees. The Committee also monitor the governance arrangements of the Bank making recommendations to ensure that such arrangements are consistent with best corporate governance standards and developing best practice.

During the year, the Committee have discussed, and where appropriate recommended for approval, the Bank's certification and senior management regimes (including the responsibilities map), the Board's Effectiveness review and its training needs analysis and plan. The Committee considered the Bank's succession plan and the reforms to the UK Corporate Governance Code. The Committee made recommendations on the tenure of the Bank's Non-Executive Directors and the structure and membership of Board.

Risk & Compliance Committee– chaired by John McGuire; Independent Non-Executive Director

The Risk & Compliance Committee met 7 times during 2018. The Committee's key responsibilities are the provision of oversight and advice to the Board in relation to current and potential future risk exposures of the Bank and future risk strategy, including determination of risk appetite and tolerance and to promote a risk awareness culture within the Bank.

During 2018, the Committee reviewed and challenged the stress scenario assumptions used in the Bank's ICAAP and ILAAP processes, as well as reviewing and recommending approval of the ICAAP and ILAAP documents to the Board. As part of the Bank's IFRS 9 and ICAAP developments the Committee reviewed and approved the Bank's asset finance credit grading model and the real estate lending slotting model. The Committee also challenged, reviewed and recommended approval of updates to the Bank's risk management framework, appetite and indicator documents. The Committee has also monitored the progress and inputted to the Bank's General Data Protection Regulation (GDPR) project.

Corporate Governance

Risk Management

The Bank has developed and implemented a governance and risk management framework that is designed to ensure that the material risks to which the Bank is exposed are identified, measured, monitored and, where necessary, mitigated and controlled.

The Board maintains ultimate responsibility for ensuring that an effective risk management framework is in place. The Board has Audit and Risk & Compliance sub-committees which monitor the internal control environment and ensure that the risk exposures remain within the defined risk appetite.

The Bank has established risk management frameworks, policies and protocols, which include risk indicators commensurate with the Bank's risk appetite. They have also developed risk management information, including risk metrics and early warning indicators, that aim to identify the current and potential level of risks faced by the Bank and measure these against the Board's risk appetite.

Management committees, including Credit, Asset and Liability, Customer and Product, and Provisions Committee, are responsible for monitoring key risks.

The Chief Risk Officer is responsible for overseeing all aspects of the risk management framework within the Bank, including overseeing its implementation and effectiveness.

The Bank's approach is founded on the effective identification and control of risks, a robust framework for the management of risk, and a strong risk management culture that guides how individuals approach their work, the way they behave and the decisions they make.

The principles underlying the Bank's Risk Management Framework are:

- Governance is maintained through the effective delegation of authority from the Board down through the Board sub-committee and management hierarchy to individuals.
- Risk management supports the safe delivery of the Bank's strategic plan and objectives;
- Risk management is based on a Three Lines of Defence model.
- The Board and business management are engaged in, and promote, a culture in which risks are identified, assessed and reported in an open, transparent and objective manner;
- The second line of defence, Risk & Compliance Function, are independent of the businesses and provide both oversight and challenge, together with support and advice on the management of risk across the businesses;
- Risk mitigation and control activities are commensurate with the degree of risk and are proportionate to the scale and complexity of the Bank's business activities; accordingly, it can evolve with the business; and
- Risk management should not inhibit sensible risk taking that is critical to the Bank's success; rather it should enhance decision-making and ensure that emerging risks are identified and addressed as they arise.

Internal Control

The Board has delegated the management of the systems of internal control to senior management who have adopted a Three Lines of Defence approach to the operational management of the Bank's risks.

Corporate Governance

First Line of Defence	Second Line of Defence	Third Line of Defence
The Business *ExCo (Supported by BMG)* (Reports to the Board)	Risk and Compliance *Risk & Compliance Committee* (Reports to the Board)	Internal & External Audit *Audit Committee* (Reports to the Board)
Ownership, responsibility and accountability for risks and controls	Monitoring and facilitating the implementation of effective risk management Oversight & Challenge, Support & Advice	Assurance of: (i) first and second line risk management (ii) regulatory interpretation and reporting
Chief Executive delegates to business heads day-to-day responsibility for risk management, regulatory compliance, internal control and conduct in running their business areas.	*Board Risk Committee delegates to the Chief Risk Officer day-to-day responsibility for oversight and challenge to provide assurance on the management of risk.*	*Independent reviews and opinions reporting to the Audit Committee to test that controls are working effectively and remain up-to-date with current regulation*

First Line of Defence

Business lines are in the best position to assess and manage the risks to which they are exposed and so have primary responsibility for identifying, measuring, monitoring, managing and controlling risks within their area of accountability. They are required to establish effective governance and control frameworks that are compliant with Bank policies, legal and regulatory obligations, sound market practice and which ensure that the Bank remains within its defined risk appetite.

Second Line of Defence

Risk & Compliance function is a centralised and independent function that provides oversight and challenge of the management of risk by the business areas. It supports and advises the business areas with respect to the risk-based decisions made, the control environment established (including Bank policies), regulatory compliance, and the rectification of identified areas of weakness. In addition, the function is responsible for reporting performance against risk appetites to the Risk & Compliance Committee and for providing guidance, advice and training on the application of regulation relevant to the Bank, including (but not limited to) financial crime and data protection.

Third Line of Defence

Internal audit is outsourced to Deloitte LLP who are responsible for providing independent and objective assurance that the Bank's risk and control environment, and regulatory application and compliance, is working effectively, and for making recommendations that improve the efficiency and effectiveness of the Bank's systems and controls.

External Audit provide assurance to the accuracy of the Bank's financial statements.

Principal Risks and Uncertainties

The Bank's principal risks are set out in its risk appetite framework and statements. For each type of risk, the statements define the level of risk that the Bank is willing to take, or tolerate, in pursuit of its strategic objectives.

Management and the Risk & Compliance Committee review the Bank's position against Risk Appetite. The Board requires that the Bank be managed within its defined Risk Appetites. The Bank achieves this by ensuring the following actions are taken:

(i) policies and protocols are maintained that provide staff with rules to which they must adhere;

(ii) management receive daily reports to facilitate the on-going assessment of performance against risk appetite including a Daily Loans Dashboard and the Daily Liquidity Report;

Corporate Governance

(iii) regular financial and balance sheet management information is presented the Board and its sub-committees to enable them to monitor actual performance against budgeted performance;

(iv) any planned or inadvertent deviation from the agreed strategic plan is reported to the Board;

(v) performance against the Bank's Key Risk Indicators (KRIs) are monitored and reported to the Risk & Compliance Committee;

(vi) Risk metrics and early warning indicators are also reported to the Risk & Compliance Committee to provide both analysis of the underlying drivers of the KRIs and, potentially, an early warning of potential future breaches (in the absence of management action).

Structure of The Risk Appetite Statements

The Risk Appetite Statements addresses each major risk category in turn. The statements form part of the overarching Risk Appetite Framework and are presented in terms of qualitative statements and quantitative risk indicators. The key risks faced by the bank are considered below.

Liquidity and Funding

Funding Risk for the Bank is the risk that it is unable to raise funds at an acceptable price or tenor or to access funds markets in a timely manner.

Liquidity Risk for the Bank Is the risk that it is unable to meet its short to medium term commitments as they fall due or that they can only be met at an uneconomic price.

The Board's primary objective is to ensure that Bank can meet is ongoing liabilities in times of severe but plausible stress.

Capital

Capital Risk for the Bank is the risk that the Bank fails to hold sufficient capital to meet its regulatory obligations, support its growth plans or to absorb shocks.

The Capital Risk Appetite forms the basis of ensuring the Bank can remain operational in times of severe but plausible stress.

Credit

Credit Risk for the Bank is the risk that counterparties fail to meet, in a timely manner, the commitments into which they have entered.

Although the Board's Strategy Document has clear financial performance targets, they can only be achieved if the quality of the credit exposures does not deteriorate beyond expected levels. The Credit Risk Appetite focuses on:

a) ensuring the maintenance of the quality of the lending portfolios

b) identifying if the quality of the existing lending portfolio is deteriorating.

The Credit Risk Appetite not only notes the limits on the maximum risks the Board is willing to take, but is enhanced to describe the target minimum level of credit risk that is required to meet the financial objectives. It is recognised that it is only by taking a degree of credit risk that the Bank can maintain its financial viability.

Conduct & Compliance Risk

Compliance & Regulatory Risk is the risk that non-compliance with laws or regulation could give rise to fines, litigation, sanctions and the potential for material adverse impact on the Bank.

Conduct Risk for the Bank is the risk that its customers suffer loss or detriment due to failures in product design, sales marketing processes and operational delivery, or failures in the behaviour or ethics of its staff or its third-party distributors / suppliers.

Corporate Governance

The Board wishes to keep conduct and compliance risk (including financial crime) to a minimum, although this is a risk that is a by-product of undertaking deposit and lending activities. The Board acknowledge that conduct risks can potentially generate high losses, albeit with a very low probability.

Reputational Risk.

Reputational risk for the Bank is the threat or danger to its good name or standing following an adverse risk event.

The growing use of social media has increased the potential for reputational damage for every financial institution. The Bank has established clear guidelines for all staff in the use of social media.

Operational Risk and Resilience Risk

Operational Risk for the Bank is the risk that failures arising from inadequate, or failed, internal processes, people and systems, or from external events, that may cause monetary loss, service disruption or customer detriment.

The Board are conscious of the increasing risk posed by cyber security and systems availability. To this end, they have a clear desire to ensure the Bank has a very high standard of controls in this area.

Tax Risk

Tax Risk for the Bank is the risk of financial or reputational loss from failure to comply with the Bank's tax obligations or failing to correctly report its customers' tax obligations.

Tax risk is limited as the Bank does not employ tax avoidance schemes and does not provide customers with tax advice.

Market Risk

Market Risk for the Bank is the risk that changes in market rates negatively impact the earnings or market value of the Bank's assets or liabilities.

Unlike other banks who have active treasury functions or dealing teams, the Bank has minimal appetite for market risks. The Bank's exposure to interest rate, basis and foreign exchange rate movements is kept very low. It does not have a trading book, it conducts it operations in UK Sterling and its investment of surplus funds is primarily with the Bank of England or in high quality liquid assets.

The main area of concern for the Board is that as interest rates move up assets can be repriced at the same rate as liabilities and vice versa.

Strategic Risk

Strategic Risk for the Bank is the risk that it is unable to execute its strategic plan.

The achievement of the Bank's strategy is only possible by ensuring the risks noted above are managed within the predefined appetite.

The Bank has also set specific financial objectives in terms of net interest income, total income and net profit. It also sets target limits on expenditure.

Treasury Counterparty Risk

Treasury Counterparty Risk for the Bank is the risk of wholesale Treasury counterparties being unable or unwilling to meet their commitments to the Bank.

The Bank has minimal exposures to Treasury Counterparties and all lending deposits are held with high credit quality institutions.

Corporate Governance

Areas of Increasing Risk

The Bank also considers that it is exposed to:

Brexit Risk	The Board and Executive are continually monitoring the possible consequences, on both the Bank and its customers, of the withdrawal of the UK from the European Union.
Climate Change Risk	The potential impact of climate change is integrated into the Bank's Operational Risk management risk taxonomy and framework.

Remuneration Policies

The Bank's remuneration policy is to ensure that we attract and retain key talent in order to create sustainable long-term value for shareholders.

The Bank's remuneration policy is to:

1. Attract, develop and retain high performing people with the ability, experience and skill to deliver the business strategy and objectives
2. Offer competitive and market aligned remuneration packages in which fixed salaries are the significant component and that people, regardless of their gender, are paid the same rate for the same job.
3. Encourage and incentivise employees to create sustainable results, which are consistent with strategic goals and appropriate risk management, and align the interests of the Bank's shareholders, customers and employees
4. Drive behaviour consistent with the Bank's values and the FCA Code of Conduct, so that employees do what is right for the customer, for colleagues and the Bank

The policy and structure are consistent with the Bank's long-term strategy, including the overall business strategy, the risk strategy, and the risk appetite across all types of risk such as credit, market, operational, liquidity, reputational and other risks identified by the Bank.

The Bank applies the following 6 principles when designing or implementing any aspect of remuneration:

i. The Bank offer a competitive total reward package that is designed to be motivating and compelling and is regularly reviewed against market rates;

ii. Reward is linked to employees' behaviours and values as well as achievement: the 'how' as well as the 'what';

iii. Remuneration structures are straightforward; as such they are transparent, communicated and understood by employees and the Bank's stakeholders;

iv. There is a clear link between business, team and individual performance and reward, and people can explain when and why adjustments for performance have been applied;

v. Remuneration practices are consistent with, and promote, sound and effective risk management, and are fully compliant with all appropriate governance, regulatory requirements and codes of practice.

The Bank's remuneration policies, packages and processes are designed to be affordable, consistent and efficient and do not limit the Bank's ability to strengthen its capital base.

Remuneration for executive directors

The table below summarises the executive directors' remuneration policy for 2018:

Corporate Governance

Element of Remuneration	Purpose and Link to Strategy	Operation	Maximum	Performance Targets
Salary	– The Nominations & Governance Committee is committed to adhering to the Financial Services Remuneration Code, thus ensuring that the Bank has risk-focused remuneration policies – Reflects skills and experience over time – Reflects the value of the individual and their role – Provides an appropriate level of basic fixed income – Avoids excessive risk from over reliance on variable income	– Reviewed annually – Takes periodic account of practices of financial institutions of similar size, characteristics and sector comparators	– There is no prescribed maximum annual increase – The Nominations & Governance Committee is guided by the general increase for the broader employee population but on occasions may need to recognise, for example, an increase in the scale, scope or responsibility of a role	– An element of performance-related pay applies
Benefits	– To aid retention and recruitment	– Company car allowance, the provision of private medical insurance, life assurance and permanent health insurance	– Not applicable	– Not applicable
Bonus	– Incentivises annual delivery of financial and strategic goals – Maximum bonus only payable for achieving business and personal targets	– Paid in cash – Not pensionable	– 30% of salary	– A combination of 50% company and 50% individual performance measures with a deferred element of amounts over 20% of salary paid over 3 years
Long Term Incentive Plan (LTIP)	– Aligned to main strategic objectives of delivering sustainable growth as set out in the Bank's strategic plan	– Grant will be awarded each financial year – Paid in cash – Not pensionable	– 20% of base salary	– Measured over three years based on financial and non-financial performance measures with good and bad leaver elements – Cancellation elements apply
Pension	– Provides retirement benefits – Opportunity for executives to contribute to their own retirement plan	– Defined contribution	– Bank contribute 10% of salary provided executives contribute a min 3% of salary – Executives salary exchange on same terms as other employees	– Not applicable

The choice of the performance metrics applicable to the annual bonus scheme reflects the Board's belief that any incentive compensation should be appropriately challenging and tied to the delivery of the defined financial and risk management objectives, along with specific individual objectives. An element of deferral applies to the executive directors' bonus scheme.

Corporate Governance

The LTIP performance conditions were selected by the Nominations & Governance Committee on the basis that they reward the delivery of long-term returns to shareholders and the Bank's financial growth, and are consistent with the Bank's objective of delivering specific long-term value to shareholders.

The Nominations & Governance Committee operates the LTIP in accordance with the plan rules, consistent with market practice, and retains discretion over a number of areas relating to the operation and administration of the plan.

Benefits offered to executive directors apply from the commencement of employment.

Remuneration policy for other employees

The Bank's approach to annual salary reviews is consistent across the business with consideration given to affordability, the level of experience, responsibility, individual performance and salary levels in comparable companies.

Pension and benefits provided to all employees are broadly in line with the policy for executive directors, although the commencement of benefits may be subject to longer periods of eligibility at the start of employment.

Remuneration policy for non-executive directors

All non-executive directors are appointed for an initial term of 36 months and may be terminated by either party upon 3 months' written notice. Non-executive fees are set in line with the policy in the table below. Non-executive directors are not eligible to participate in any of the benefits provided to employees or executive directors with the exception of private medical insurance.

Element of Remuneration	Purpose and Link to Strategy	Operation	Maximum	Performance Targets
Fees	– Reflects time commitments and responsibilities of each role – Reflects fees paid by financial institutions of similar size, characteristics and sector comparators	– Cash fee paid – Reviewed on an annual basis	– There is no prescribed maximum annual increase. The Nominations & Governance Committee is guided by market rates and the general increase for the executive director population	– Non-executive directors do not participate in variable pay elements

Corporate Governance

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Directors' Report

The directors of Cambridge & Counties Bank Limited (referred to as the 'Bank') present their Report and the audited financial statements for the year ended 31 December 2018.

Future developments and financial risk management objectives and policies

Information about the Bank's future developments, internal control and financial risk management systems in relation to financial reporting and financial risk management objectives and policies in relation to the use of financial instruments can be found in the following sections of the Annual Report and financial statements which are incorporated into this report by reference:

Future developments – see the Strategic Report on pages 2 to 15.

Internal control and financial risk management systems in relation to financial reporting – see the Corporate Governance Report on pages 16 to 27.

Financial risk management objectives and policies in relation to the use of financial instruments – see Note 28 to the financial statements, financial risk management.

Results and Dividends

The results for the year are shown on page 41. The directors do not propose to pay a dividend in respect of ordinary shares for the year ended 31 December 2018 (2017: £1,000,000 (4.17449 pence per share)).

Directors

The directors who held office during 2018, and up to the date of signing the Bank's financial statements, are as follows, with further detail on their experience noted below.

The Bank provided all directors with qualifying third-party indemnity provisions during the financial period and at the date of this report.

Simon Moore	Chairman & Independent Non-Executive Director
Paul ffolkes Davis	Non-Executive Director & Vice Chairman
Michael Kirsopp	Chief Executive Officer
Rachel Curtis-Bowen	Chief Customer Officer
Caroline Fawcett	Independent Non-Executive Director
William German*	Chief Risk Officer
Andrea Hodgson	Chief Financial Officer
Simon Lindley	Chief Development Officer
Christopher Malyon**	Non-Executive Director
John McGuire	Independent Non-Executive Director
Richard Perry***	Non-Executive Director
Ian Smith	Independent Non-Executive Director

* Resigned on 30 November 2018
** Resigned on 26 October 2018
***Appointed on 18 February 2019

Simon Moore – Chairman & Independent Non-Executive Director

Simon joined Cambridge & Counties Bank when it was formed in 2012, as Non-Executive Director and chair of the Nominations and Remuneration Committee. He was appointed Chairman of the Bank in October 2016.

Directors' Report

After leaving the British Army, Simon began his banking career in 1992. He completed his training with Lloyds Bank in 1994 and spent the bulk of his career with Chase Manhattan Bank in London and New York. He also worked with Barclays Bank where he was the regional director for the corporate banking business in Wales and the South West of England.

Simon was a member of the management board of the Confederation of British Industry (CBI) from 2013 until 2016 and the director responsible for London, the South of England and Financial Services. Prior to that, he spent three years as CBI International Director leading the work of the CBI in support of its members outside Europe.

Simon is non-executive chairman of Al Rayan Bank and non-executive chairman of Pennant International Group Plc. Formerly he was a governor at the University of the West of England and non-executive board member of the Government Office of the South West.

Paul ffolkes Davis - Non-Executive Director & Vice Chairman

Paul began as an investment banker in New York, even before leaving Oxford University in 1977. His career in international capital markets spanned 26 years and included directorships of N M Rothschild & Sons Ltd, NatWest Markets and Rabobank International.

His activities centred initially on the fixed income markets but following Big Bang he was part of the Rothschild team that developed the privatisation/Equity Capital Market model that has become the industry standard.

Since 2004 Paul has been Bursar of Trinity Hall, one of Cambridge University's oldest colleges. In Cambridge he has chaired the University's Board of Scrutiny and the Bursars' Sub-Committee on Investments. He has been intimately involved in the foundation, design and structure of Cambridge & Counties Bank, the College's investment in which forms a key part of its endowment portfolio. Paul was Chairman of Cambridge & Counties Bank from June 2012 to October 2016.

Mike Kirsopp - Chief Executive Officer

Mike has spent over 40 years working in the financial services industry, specifically within the commercial lending sector. Much of his career was spent lending within the commercial banking arm of Lloyds Bank, which also included senior roles in the business change and strategy functions.

Mike joined Cambridge & Counties Bank in 2011, initially working on developing the plan to gain the new banking licence, which underpinned the launch of the Bank in 2012. Mike initially performed the role of Chief Operating Officer, taking up the position of Chief Executive Officer in 2014.

Rachel Curtis-Bowen - Chief Customer Officer

Rachel has 25 years' experience in financial services. She began her career in a branch of the Halifax Building Society before working with Alliance & Leicester and then Santander, holding senior management positions in customer service, deposit management and marketing.

Rachel was part of the team that developed the new Cambridge & Counties Bank proposition, which launched in 2012 and she became the Bank's first female board member in 2015. Rachel champions customer experience within the Bank and fiercely defends the Bank's 99% customer satisfaction rates. She is responsible for the liabilities side of our balance sheet, raising deposits from UK SMEs and also heads up the Bank's marketing function. Rachel also holds a non-Executive director position at the Loughborough Building Society

Rachel is an advocate of supporting women in business and is the founding member of an East Midlands mentoring scheme which aims to help the next generation of female leaders.

Caroline Fawcett – Independent Non-Executive Director

Caroline has over 25 years' experience in financial services, specialising in marketing and customer experience in both the UK and US. After a decade as Marketing Director with Legal & General, Caroline progressed to become one of the first Customer Experience Directors within the Insurance sector. She has

Directors' Report

since led customer driven change programmes across a range of other organisations in the public and private sectors.

Caroline has held several Non-Executive Director positions in the financial services industry and public sector over the past eight years, and is currently on the Boards of Co-op Insurance, the Rail Safety and Standards Board, and Lifesight Ltd (the Trustee for Willis Towers Watson's Master Trust pension scheme).

Andrea Hodgson - Chief Financial Officer

Andrea joined Cambridge & Counties Bank in 2017, prior to which she worked as CFO for start-up challenger bank Chetwood Financial Limited where she was responsible for establishing the financial management, governance and control framework for the bank in its early design phase.

Andrea began her career at KPMG before moving into the financial services sector, where she has built over 20 years' experience working at, Lloyds Banking Group, Bank of Scotland and National Australia Group in which she held senior executive leadership positions. Previously, she also served as a Non-Executive Director & Deputy Chair at Wirral University Teaching Hospital NHS Foundation Trust.

Andrea is passionate about motivating teams to ensure that Finance are a valued and trusted business partner at the heart of the business.

Simon Lindley - Chief Development Officer

Simon has over 30 years' experience in financial services predominantly centred on business development and property lending. After starting his career in 1985 working for NatWest, Simon moved around the Midlands to broaden his knowledge by leading business development teams for Bank of Ireland, Yorkshire Bank and latterly leading the Handelsbanken in Leicester.

After joining Cambridge & Counties Bank in 2012 as its first Business Development Manager, Simon took over responsibility for the national Property Finance team in 2015 and has been at the centre of the Bank's successful balance sheet growth due to his commitment to delivering a service led and broker-centric business. In 2017, responsibility for the asset finance sales team was added to his duties with Simon joining the Board as the Bank's Chief Development Officer.

Outside of the Bank, Simon is a very proud Non-Executive Trustee of Age UK Leicestershire and has acted as the charity's treasurer for over 10 years.

John McGuire – Independent Non-Executive Director

John spent almost 40 years with The Royal Bank of Scotland Group in commercial and corporate banking.

After 20 years, in a variety of credit control responsibilities, John's final position was as Executive Director of the RBS Group. In this role he was Managing Director of the corporate and commercial businesses within the NatWest and RBS franchises in the North of England and Midland regions.

John has treasury and capital markets experience from his previous roles as General Manager of the RBS operations in Switzerland, and as Credit Control Director for the City of London where he chaired the central credit committee.

John retired from his banking roles in 2005 to focus on a variety of non-executive positions including Trusteeship of the RBS Group Pension Scheme, Investment Director of the £200M North West Fund, a company investing by way of equity/loan participations in SME businesses in North West England, and as Audit Chairman of N Brown Group plc. John began his association with Cambridge & Counties Bank at the launch in 2012.

Richard Perry – Non-Executive Director

Richard has over 35 years' experience in the finance industry. After qualifying in auditing, Richard spent most of his career in the private sector working with FTSE 100 companies in positions that handled Financial Reporting and Control.

In 2013, Richard joined the Pension Service team at Local Government Pension Schemes, taking responsibility for the investments of the LGSS administered by Cambridgeshire County Council and

Directors' Report

Northamptonshire County Council. Richard joined the board of Cambridge & Counties Bank in February 2019.

Ian Smith – Independent Non-Executive Director

Ian qualified as a Chartered Accountant in 1985 and joined KPMG the same year. He was appointed as Partner in 1998, remaining there until his retirement from the partnership in 2010. During his time with KPMG, Ian had responsibility for the firm's Midlands and South West financial services practice.

During Ian's 20 years in the financial services sector, he has provided audit and advisory services for a range of clients including banks, building societies and other regulated bodies. His experience covers commercial and retail banking across a broad range of institutions. Ian began his association with Cambridge & Counties Bank in 2012.

Political Donations

The Bank made no political donations and incurred no political expenditure during the year (2017: £nil)

Employees

Details on the Bank's employees are set out in Note 10 to the financial statements.

Shareholders and Share Capital

Details on the Bank's shareholders and share capital at 31 December 2018 is provided in Notes 25 and 31 to the financial statements.

Going Concern

The directors have a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. Projections for the Bank have been prepared concerning its future performance, capital and liquidity, for a period in excess of 12 months from the date of approval of these accounts. Therefore, the going concern basis of accounting has been used to prepare the financial statements (Full details can be found in Note 4 to the Financial Statements).

Post Balance Sheet Events

There have been no significant events between 31 December 2018 and the date of approval of the financial statements which would require a change to, or additional disclosure, in the financial statements.

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 Bank's auditor is aware of that information.

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

By order of the Board.

R. Bryan

Richard Bryan
Company Secretary

11 March 2019

Statement of directors' responsibilities in respect of the Annual Report, Strategic Report, the Directors' Report and the Financial Statements

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

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

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

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

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

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

Michael Kirsopp
Chief Executive Officer

Independent auditor's report

to the members of Cambridge & Counties Bank Limited

1. Our opinion is unmodified

We have audited the financial statements of Cambridge & Counties Bank Limited ("the Company") for the year ended 31 December 2018 which comprise the Statement of Profit and Loss and Other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and the related notes, including the accounting policies.

— the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2018 and of its profit for the year then ended;

— the Company's financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU); and

— the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

We were first appointed as auditor by the directors on 8 June 2012. The period of total uninterrupted engagement is for the seven financial years ended 31 December 2018.

We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality: financial statements as a whole	£1.0m (2017:£1.0m) 3.8% (2017: 4.1%) of forecast profit before tax	
Key audit matters		**vs 2017**
Event driven	**New:** The impact of uncertainties due to Britain exiting the European Union on our audit	n/a
New risk	Going concern	n/a
Recurring risks	Impairment of loans and advances to customers	◄►
	Revenue recognition – EIR accounting	

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

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

	The risk	Our response
The impact of uncertainties due to Britain exiting the European Union on our audit *Refer to page 6 (Strategic Report), and note 4, page 45 (going concern note).*	**Unprecedented levels of uncertainty:** All audits assess and challenge the reasonableness of estimates, in particular as described Impairment of loans and advances to customers and Revenue recognition – EIR accounting below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the Company's future prospects and performance. In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and to consider the directors' statement that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: — **Our Brexit knowledge:** We considered the directors' assessment of Brexit-related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks; — **Sensitivity analysis:** When addressing Impairment of loans and advances to customers and Revenue recognition – EIR accounting, we compared the directors' sensitivity analysis to our assessment of the worst reasonably possible, known adverse scenario resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty; — **Assessing transparency:** As well as assessing individual disclosures as part of our procedures on Impairment of loans and advances to customers and Revenue recognition – EIR accounting, we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our results** — As reported under Completeness and accuracy of impairment of loans and advances to customers and Revenue recognition – completeness and accuracy of EIR, we found the resulting estimates and related disclosures of accounting estimates and judgements and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

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

	The risk	Our response
Going Concern *Refer to page 45 (Note 4: Going Concern).*	**Disclosure quality** The financial statements explain how the Board has formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Company. That judgement is based on an evaluation of the inherent risks to the Company's business model and how those risks might affect the Company's financial resources or ability to continue operations over a period of at least a year from the date of approval of the financial statements. The risk that we considered most likely to adversely affect the Company's available financial resources over this period was the impact of Brexit on the Company's liquidity and capital resources.	Our procedures included: — **Challenge of assumptions:** We read the Company's forecasts and other relevant reports such as the Internal Capital Adequacy Assessment Process report ('ICAAP') and the Internal Liquidity Adequacy Assessment Process report ('ILAAP') and challenged the key assumptions underpinning the Company's forecasts; — **Historical comparison:** We assessed the historical forecasting accuracy of the Company; — **Sensitivity analysis:** We assessed the stressed scenarios used by the Company in its forecasting of profitability, liquidity and capital and the viability of possible management actions; and — **Tests of detail:** We examined the Company's forecasting model to assess its integrity and accuracy. **Our results** — We found the going concern disclosure without any material uncertainty to be acceptable.

	The risk	Our response

Impairment of loans and advances to customers

(On balance sheet £8,068 thousand; 2017: £3,584 thousand)

Refer to pages 53 to 55 (accounting policy and (financial disclosures).

The risk

Subjective estimate

The expected credit loss ('ECL') relating to the Company's loan portfolios requires the directors to make significant judgements and assumptions over the recoverability of loans and receivables. Following the transition to *IFRS 9 – Financial Instruments*, the Company is required to determine the ECL using a three stage model:

i. For all loans, where the credit risk has not increased significantly since initial recognition, an ECL is recognised based on expected losses over the next 12 months.

ii. For mortgages where there is deemed to be a significant increase in credit risk, the ECL is calculated based on expected losses over the loans behavioural life.

iii. For mortgages that meet the Company's definition of default, a specific impairment assessment is performed.

For all loans classified as either stage 1 or 2, an assessment is performed on a portfolio wide basis for impairment, with the key assumptions being:

– The definition of the significant increase in credit risk;
– The loans' probability of default ('PD') on either a 12 month or lifetime basis;
– The loans' loss given default ('LGD'); and
– The incorporation of forward economic guidance.

For all loans classified as stage 3, an impairment assessment is required at an individual loan level, based on estimated future cash flows discounted to present value at the loans effective interest rate ('EIR'). This is a manual process, with a number of data inputs and assumptions including the cost of obtaining and selling the repossessed property, probable sale proceeds and any rental income prior to sale.

There is a risk that the overall ECL is not reflective of the expected losses of a loan over its behavioural life. This may be due to the limited historical data on losses since the Company's start up in 2012, ECL calculation incorporating inappropriate assumptions and/or the Company's transfer criteria not effectively capturing a significant increase in credit risk.

The effect of these matters is that, as part of our risk assessment, we determined that the collective impairment provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality

Our response

Our procedures included:

— **Controls testing:** We tested controls over the identification of stage 2 and stage 3 accounts, and the lending processes that capture certain static data used in the impairment model;

— **Tests of detail:** We identified a selection of loans using risk based sampling which includes specific items identified based on risk characteristics of current or historical arrears, forbearance flagging, loan type, sector and size to identify individual loans which may have unidentified impairments. We tested the loan staging and the provision attached to these loans by reference to relevant supporting information such as property type and valuation to challenge the completeness and accuracy of the Company's specific impairment provision estimate;

— **Historical comparison:** We critically assessed the Company's assumptions on the ECLs on stage 1 and stage 2 loans; by comparing them to the Company's historical experience;

— **Our sector experience**: We challenged the key assumptions used in the estimate of loss given default, being forced sale discount, selling costs and outcome period using our knowledge of recent impairment experience in this industry, including that of the Company;

— **Challenge of assumptions:** We challenged the assumptions made in the application of forward looking economic scenarios to the ECL;

— **Benchmarking assumptions and outputs:** We compared the Company's key assumptions on the probability weightings attached to each economic scenario, to comparable peer group organisations;

— **Our sector experience**: We reviewed the correspondence with, and reports prepared for, the Company's regulators to identify any factors which could have a significant impact on impairment;

— **Assessing transparency:** We critically assessed the adequacy of the Company's disclosures in respect of the degree of estimation involved in arriving at the balance and sensitivity of the impairment of loans and advances to changes in key assumptions reflected in the inherent risk.

Our results

— We found the resulting estimate of impairment to be acceptable.

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

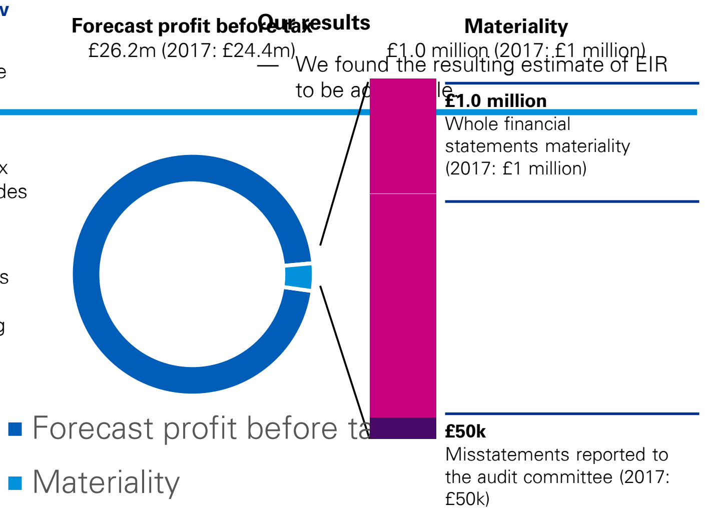
	The risk	Our response
Revenue recognition – EIR accounting (Balance sheet adjustment £2,858 thousand; 2017: £4,114 thousand) *Refer to page 46 (accounting policy) and page 47 (financial disclosures).*	**Subjective estimate:** Accounting standards require interest receivable on loans and advances to customers to be recognised using the effective interest rate ('EIR') method. This results in all directly attributable interest, fees and costs being recognised on an even yield basis over the expected life of the loans. The recognition of interest receivable on loans and advances to customers under the effective interest rate method requires the directors to make significant judgements and estimates, with the most critical estimate being the loans' expected behavioural life. The directors have determined this estimate with reference to product mix, historical customer behaviour since the start up of the Company in 2012, and management judgement over future redemption profiles. In addition, the directors apply judgement in determining whether or not fees and costs, including early redemption charges, should be included in the methodology.	Our procedures included: — **Control design:** We tested the controls over the approval of estimates and over the input of static data on loans and advances into the EIR models; — **Historical comparison:** We assessed the reasonableness of the models' expected repayment profile assumptions against recent historical experience of loan lives; — **Our sector experience:** Using our knowledge of EIR methodologies in peer organisations, and by inspecting the Company's product literature and general ledger, we challenged the fees and costs included or excluded from the EIR estimates — **Sensitivity analysis:** We assessed the model for its sensitivity to changes in the key assumptions by considering different profiles to help us assess the reasonableness of the assumptions used;. — **Re-performance:** We performed recalculations of the EIR adjustment to test the model is in compliance with relevant accounting standard requirements and model inputs are complete and accurate. — **Assessing transparency:** We assessed the adequacy of the company's disclosures about the degree of estimation involved in arriving at the interest income recognised. **Our results** — We found the resulting estimate of EIR to be ac[illegible]le

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

Materiality for the financial statements as a whole was set at £1.0 million (2017: £1.0 million), determined with reference to a benchmark of forecast profit before tax, of which it represents 3.8% (2017: 4.1]%). We consider profit before tax to be the most appropriate benchmark as it provides a stable measure year on year.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £50k (2017: £50k), in addition to other identified misstatements that warranted reporting on qualitative grounds.

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



![KPMG]

4. We have nothing to report on going concern

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

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

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in this respect.

5. We have nothing to report on the strategic report and the directors' report

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

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

— we have not identified material misstatements in those reports;

— in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and

— in our opinion those reports have been prepared in accordance with the Companies Act 2006.

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

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

— adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from locations not visited by us; or

— the financial statements are not in agreement with the accounting records and returns; or

— certain disclosures of directors' remuneration specified by law are not made; or

— we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 32, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

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

Irregularities – ability to detect

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

KPMG

The potential effect of these laws and regulations on the financial statements varies considerably.

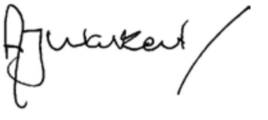
Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws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

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of Company's licence to operate. We identified the following areas as those most likely to have such an effect: anti-bribery, employment law, regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Company's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

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

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

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



Andrew Walker (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snow Hill

Snow Hill Queensway

Birmingham

B4 6GH

11 March 2019

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Statement of Profit or Loss and Other Comprehensive Income
For the year ended 31 December

£'000	Note	2018	2017
Interest income calculated using the effective interest rate	6	57,514	48,198
Interest expense	6	(13,089)	(9,767)
Net interest income		44,425	38,431
Other income	7	310	528
Total operating income		**44,735**	**38,959**
Administrative expenses	9	(14,584)	(11,826)
Depreciation, amortisation and loss on disposals	18,19	(509)	(490)
Operating profit before impairment losses		**29,642**	**26,643**
Impairment losses on loans & advances to customers	16	(1,716)	(2,237)
Profit before tax		**27,926**	**24,406**
Taxation charge	12	(5,518)	(4,712)
Profit after tax		**22,408**	**19,694**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss			
Fair value through other comprehensive income: Debt securities		37	(70)
Fair value through other comprehensive income – net change in value	25	48	(25)
Fair value through other comprehensive income – reclassified to profit or loss	25	-	(50)
Related tax	25	(11)	5
Total other comprehensive income		**37**	**(70)**
Total comprehensive income attributable to owners of the bank		**22,445**	**19,624**

All profit for the year arises from continuing operations.

The notes on pages 45 to 84 are an integral part of these financial statements.

The Bank has adopted IFRS 9 with effect from 1 January 2018. Due to the transition method applied, the comparative year has not been restated.

Statement of Financial Position
At 31 December

£'000	Note	2018	2017
Assets			
Cash and balances at central banks	13	232,286	164,295
Loans and advances to banks	14	14,384	20,091
Debt securities	17	13,350	3,107
Loans and advances to customers	15	769,016	689,954
Other assets and prepayments	20	940	868
Property plant and equipment	18	386	144
Intangible assets	19	846	520
Deferred taxation	12	880	253
Total assets		**1,032,088**	**879,232**
Liabilities			
Customers' accounts	22	901,398	798,176
Derivative financial liabilities	21	94	121
Current tax liabilities	23	2,698	2,364
Other liabilities and accruals	23	2,710	2,194
Provisions	24	8	134
Total liabilities		**906,908**	**802,989**
Equity			
Share capital	25	44,955	23,955
Convertible loan notes	25	22,900	12,900
Fair value through other comprehensive income reserve	25	73	36
Retained earnings		57,252	39,352
Total equity		**125,180**	**76,243**
Total liabilities and equity		**1,032,088**	**879,232**

These financial statements were approved by the Board of Directors on 11 March 2019 and were signed on its behalf by:

Mike Kirsopp
Chief Executive Officer

Company registered number: 07972522

The notes on pages 45 to 84 are an integral part of these financial statements.

The Bank has adopted IFRS 9 with effect from 1 January 2018. Due to the transition method applied, the comparative year has not been restated.

Statement of Changes in Equity
For the year ended 31 December

£'000	Share capital	Contingent convertible loan notes	Fair value through other comprehensive income reserve (1)	Retained earnings	Total equity
Balance at 1 January 2018 (as previously stated)	23,955	12,900	36	39,352	76,243
IFRS 9 transition adjustment	-	-	-	(3,013)	(3,013)
Balance at 1 January 2018 (as restated)	23,955	12,900	36	36,339	73,230
Total comprehensive income for the period					
Profit for the year	-	-	-	22,408	22,408
Other comprehensive income	-	-	37	-	37
Total comprehensive income for the period	-	-	37	22,408	22,445
Transactions with owners, recorded directly in equity					
Dividends paid on ordinary shares	-	-	-	(1,000)	(1,000)
Issue of shares	21,000	10,000	-	-	31,000
Convertible loan note interest (net of tax)	-	-	-	(495)	(495)
Total contributions by and distributions to owners	21,000	10,000	-	(1,495)	29,505
Balance at 31 December 2018	**44,955**	**22,900**	**73**	**57,252**	**125,180**

(1) Following the adoption of IFRS 9, Financial Instruments on 1 January 2018, the fair value through other comprehensive income reserve was introduced replacing the available for sale reserve.

£'000	Share capital	Contingent convertible loan notes	Available for sale reserve	Retained earnings	Total equity
Balance at 1 January 2017	23,955	12,900	106	20,283	57,244
Total comprehensive income for the period					
Profit for the year	-	-	-	19,694	19,694
Other comprehensive income	-	-	(70)	-	(70)
Total comprehensive income for the period	-	-	(70)	19,694	19,624
Transactions with owners, recorded directly in equity					
Convertible loan note interest (net of tax)	-	-	-	(625)	(625)
Total contributions by and distributions to owners	-	-	-	(625)	(625)
Balance at 31 December 2017	**23,955**	**12,900**	**36**	**39,352**	**76,243**

The notes on pages 45 to 84 are an integral part of these financial statements.

The Bank has adopted IFRS 9 with effect from 1 January 2018. Due to the transition method applied, the comparative year has not been restated

Statement of Cash Flow
For the year ended 31 December

£'000	Note	2018	2017
Cash flows from operating activities			
Profit after tax		22,408	19,694
Adjustments for:			
Depreciation, amortisation and loss on disposals		509	490
Taxation charge		5,518	4,712
		28,435	24,896
Net increase in other assets/liabilities			
Net increase in loans and advances to customers	15	(82,692)	(101,602)
Net increase in customers' accounts	22	103,222	113,504
Net (increase)/decrease in value of debt securities	17	6	66
Net decrease in derivatives	21	(27)	(62)
Net increase in other liabilities and provisions	23,24	585	222
Net increase in other assets & prepayments	20	(72)	(419)
Income tax paid		(5,102)	(3,788)
		15,920	7,921
Net cash from operating activities		**44,355**	**32,817**
Cash flows from investing activities			
Proceeds from sales of debt securities	17	-	10,000
Acquisition of debt securities	17	(10,199)	-
Acquisition of property, plant & equipment and intangible assets	18,19	(1,077)	(315)
Net cash from investing activities		**(11,276)**	**9,685**
Cash flows from financing activities			
Proceeds from the issue of share capital	25	21,000	-
Proceeds from the issue of contingent convertible loan notes	25	10,000	-
Convertible loan note interest paid	25	(795)	(775)
Dividends paid on ordinary shares	25	(1,000)	-
Net cash from financing activities		**29,205**	**(775)**
Net increase in cash and cash equivalents		62,284	41,727
Cash and cash equivalents at 1 January		184,386	142,659
Cash and cash equivalents at 31 December		**246,670**	**184,386**

Cash and cash equivalents comprise of:
- Cash and balances at central banks (including any accrued interest).
- Loans and advances to banks (including any accrued interest) all of which have a maturity of less than 3 months.

The notes on pages 45 to 84 are an integral part of these financial statements.

The Bank has adopted IFRS 9 with effect from 1 January 2018. Due to the transition method applied, the comparative year has not been restated.

Notes to the Financial Statements

1. Reporting entity

Cambridge & Counties Bank Limited (referred to as 'the Bank') is a company incorporated and domiciled in the United Kingdom. The Bank is registered in England and Wales and has the registered number 07972522. The registered address of the Bank is Charnwood Court, 5b New Walk, Leicester, England, LE1 6TE. Cambridge & Counties Bank is a UK bank that specialises in providing lending and deposit products for Small and Medium Enterprises (SMEs). The Bank is a private company limited by shares.

2. Basis of accounting

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the Bank and endorsed by the EU and the Companies Act 2006 applicable to companies reporting under IFRS. They have been prepared under the historic cost convention as modified by the revaluation of financial instruments through profit or loss and the revaluation of financial instruments through other comprehensive income. The financial statements are presented in pounds sterling, which is the functional and presentational currency of the Bank.

Judgements made by the Directors in the application of these accounting policies that have significant effect on the financial statements and estimates with a significant risk of material adjustment are discussed in Note 5 to the Financial Statements.

3. Changes in accounting policies

The Bank has initially adopted IFRS 9 and IFRS 15 from 1 January 2018. This is the first set of the Bank's annual financial statements in which these standards have been applied and the impact of these new standards on the financial statements of the Bank is disclosed in each of the appropriate financial notes (in particular notes 6, 14, 15, 16, 17, 22, 27, 28 and 36).

The transition method adopted by the Bank in applying IFRS 9 results in the comparative information throughout these financial statements not being restated.

The adoption of IFRS 15 has had no impact on the Bank's results.

Except for the changes as a result of the adoption of IFRS 9, the Bank has consistently applied the accounting policies set out in these financial statements.

4. Going concern

The Directors have a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. The injection of additional £21m of share capital and £10m of convertible loan notes during 2018 have strengthened the capital position of the Bank and projections for the Bank's future performance, capital strength and liquidity, for a period in excess of 12 months from the date of approval of these accounts all show that Bank has adequate resources to meet its regulatory and operational requirements. Therefore, the going concern basis of accounting has been used to prepare the financial statements.

As part of this assessment the impact of the UK's potential exit from the European Union has been assessed. The Directors do not consider that the proposed exit will have a significantly destabilising impact on the Bank's performance. This conclusion has been reached after taking account of a number of factors including:

- All of the Bank's Staff and key suppliers are based in the UK.
- All of the Bank's customers are UK based and all the assets that it has financed are UK based.
- Management have already incorporated into the Bank's business plan an expectation of greater uncertainty in the UK macro-economic environment which is likely to result in reduced demand for new finance and reduced mortgaging activity in the real estate and asset finance markets as well as potential reduced levels of savings balances.

Notes to the Financial Statements
(Continued)

- The Bank has modelled a scenario where the operating environment has unemployment and inflation increasing and demand for finance and property prices reducing. In particular the scenario includes bank base rate rising to 4%, residential property prices reducing by 33%, commercial property prices falling by 46% and customers income reducing by 10%. This scenario is very similar to that published by the Prudential Regulatory Authority and is considered to be a severe but plausible event. The result of the modelling show that the Bank can withstand this significant downturn and that after taking reasonable management actions, all of which are within its own control, does not breach its regulatory capital and liquidity requirements.
- The Bank maintains a strong liquidity positions with its Liquidity Coverage Ratio around 3 times higher than the regulatory minimum at the end of 2018. The Bank plans to maintain this level of liquidity in the short term until the UK's exit from the EU is complete or the Government's planned exit strategy is agreed.

5. Accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity or areas where assumptions and estimates are significant to the financial statements are disclosed below. Each of these areas of management judgement, along with any others which are considered material, has a paper prepared for review and approval by the Bank's Audit Committee at least once a year.

Loan loss provisioning

The Bank has adopted IFRS 9 in 2018 with the provisioning methodology changing to an expected loss basis.

The Bank has made two key judgements and two key estimates in its loan loss provisions. These are:

- all of the loans and advances to customers meet the criteria to be classified as financial instruments, and therefore held at amortised cost with an associated loan loss provision, as set out in note 15.
- the Bank would use four unbiased probability weighted forward looking economic scenarios in its estimate of loan loss provisions, being the base case, downside, severe downside and upside. These scenarios and their application in the estimate of loan loss provisions are described further in note 28.

The two key estimates are of the Probability of Default (for the expected life of the loans and the next 12 months) and the Loss Given Default.

For loans in stage 1 and 2 the Bank estimates the probability of default (PD) and the loss given default (LGD) based on the historic loss experience of the Bank since its launch in 2012, overlaid with management judgement of current circumstances.

The expected credit loss on loans in stage 3 are estimated on an individual basis. Individual impairment losses on loans and advances are calculated based on assessment of the expected cash flows and the underlying collateral. This assessment includes a discount for any assumed forced sale of the underlying asset.

The Bank assesses all individual customer loans in arrears to decide if they require a specific provision. These are discussed at the monthly Provision Committee meeting and agreed by the CFO. All cases that have an existing specific provision, are in arrears at month-end, or are on the watch list are reviewed. For each loan account in arrears, probabilities are assigned to specific scenarios in order to calculate the provision.

The expected credit losses in all stages are adjusted for the impact of the forward-looking economic scenarios outlined above.

See note 28 for the sensitivity analysis regarding this.

Notes to the Financial Statements
(Continued)

Revenue recognition - effective interest rate

The Bank has made a key judgement and a key estimate in relation to the effective interest rate.

The key judgement relates to the inclusion of early redemption charges in the EIR for the first time in 2018. This judgement, together with its impact on the results for the year, is described further in note 6.

The key estimate relates to the expected life of each type of instrument and hence the expected cash flows relating to it. A critical estimate in determining the effective interest rate is the expected life to maturity of the Bank's commercial loans, as a change in the expected life will have an impact on the period over which the directly attributable costs and fees are recognised. See note 6 for the sensitivity analysis regarding this.

6. Interest income and expense

In accordance with IFRS 9 interest income and expense are recognised in the Statement of Profit or Loss and Other Comprehensive Income for all instruments measured at amortised cost using the Effective Interest Rate method (EIR).

The EIR is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The EIR is the rate that exactly discounts estimated future cash flows through the expected life of the instrument or when appropriate a shorter period, to the net carrying amount of the financial asset or the financial liability. When calculating the EIR, the Bank takes into account all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the EIR, transaction costs and all other premiums or discounts. From 2018, in accordance with IFRS 9, the application of EIR has been applied to the gross carrying amount of non-credit impaired financial assets and to the amortised cost of credit impaired financial assets.

In addition, the Bank has also reviewed its loan fees and charges during the year and in particular whether these are contractual and reliably predictable. This review has resulted in Early Repayment Charges (ERC) that were previously reported within other income now being included within the EIR expected cashflows and reported within net interest income. This change reflects the availability of 6 years of trading performance data which provides management with greater insight from which to predict future ERC receipts. Early Repayment Charges in 2018 totalled £2.9m. The 2017 Early Repayment Charges totalled £2.4m and were reported within other income. The Bank has now reclassified these receipts into interest income.

Income from finance leases and instalment credit agreements is recognised over the period of the lease so as to give a constant rate of return on the net investment in the lease.

Interest income and expense presented in the Statement of Profit or Loss and Other Comprehensive Income include:

- Interest on financial assets and liabilities measured at amortised cost calculated on an EIR basis;
- Interest on fair value through other comprehensive income investment securities;
- Income from finance leases and instalment credit agreements.

Notes to the Financial Statements
(Continued)

£'000	2018	2017
Interest income		
Loans and advances to banks	991	390
Loans and advances to customers	56,476	47,786
Investment securities	47	22
Total interest income	**57,514**	**48,198**
Interest expense		
Deposits from customers	(12,775)	(9,709)
Other	(314)	(58)
Total interest expense	**(13,089)**	**(9,767)**
Net interest income	**44,425**	**38,431**

Included within interest income for the year ended 31 December 2018 is a total of £373k (2017: £551k) relating to interest on impaired financial assets.

Critical accounting estimates and judgements

Management uses its judgement to estimate the expected life of each type of instrument and hence the expected cash flows relating to it. A critical estimate in determining the effective interest rate is the expected life to maturity of the Bank's commercial loans, as a change in the expected life will have an impact on the period over which the directly attributable costs and fees are recognised.

Sensitivity

If the proportion of Real Estate Loans that had redeemed in the past 12 months was 10% lower than the actual recorded, the EIR income recognised in the Bank's profit and loss would have been £0.4m lower.

7. Other income

Other income includes fees and commissions relating to services provided to customers, which do not meet the criteria for inclusion within interest income. The income is recognised as the service is provided.

Other income also includes the fair value movement in derivatives held for risk management purposes. Interest rate swaps are held to hedge against fixed rate savings products. Total other income previously included early repayment charges. As stated in note 6 this income is now included within interest income and the EIR..

£'000	2018	2017
Fair value movement	6	38
Other operating income	304	490
Total other income	**310**	**528**

The Bank has adopted IFRS 15 and it is applied as of 1 January 2018. Comparative information is not restated to this effect. The Bank assessed its non-interest revenue streams that fall under the scope of IFRS 15 and determined that there was no impact on the amount or timing of revenue to be recognised as a result of the adoption of IFRS 15 (See note 35 for more detail).

Notes to the Financial Statements
(Continued)

8. Expenses and auditors' remuneration

The profit on ordinary activities is arrived at after charging:

£'000	2018	2017
Operating lease rentals (including rates and service charges)		
Land and buildings	467	413
The remuneration of the Bank's external auditors:		
Audit services		
Audit of these financial statements	143	114
Audit related assurance services		
Amounts receivable by the company's auditor and its associates in respect of:		
All other services	46	57
Total remuneration payable to the Bank's external auditors	189	171

All services undertaken by the Bank's external auditor are subject to approval by the Bank's Audit Committee. The Bank has a non-audit service policy, which states that non-audit related services provided by the Bank's external auditors should not exceed 70% of the average of the fees paid in the previous three consecutive financial years. The Bank has complied with this policy during 2018.

The Bank complies with the EU Legal Framework for the statutory audit of annual and consolidated financial statements, which applied to all companies from June 2016.

9. Administrative expenses

£'000	2018	2017
Staff costs (see Note 10)	9,312	8,320
Operating lease rentals (land and buildings)	467	413
Other administrative expenses	4,805	3,093
Total	**14,584**	**11,826**

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the Statement of Profit or Loss and Other Comprehensive Income on the same basis.

More detail on the Bank's current and future operating lease expenses are set out in Note 29.

10. Staff numbers and costs

The average number of persons employed by the Bank (including directors) during the year was 143 (2017: 125).

The aggregate payroll costs of these persons, including directors, (directors' remuneration is separately disclosed in Note 11) were as follows:

£'000	2018	2017
Wages and salaries	7,685	7,061
Social security costs	926	735
Contributions to defined contribution pension plans	701	524
Total	**9,312**	**8,320**

11. Directors' remuneration

£'000	2018	2017
Directors' remuneration	1,516	1,300
Amounts receivable under long term incentive schemes	67	121
Company contributions to defined contribution pension plans	94	73
Compensation for loss of office	178	151
Amounts paid to third parties in respect of Directors' services	47	40
Total	**1,902**	**1,685**

Notes to the Financial Statements
(Continued)

The emoluments of the highest paid director were £415k (2017: £408k). This included amounts receivable under long-term incentive schemes of £32k (2017: £50k) and contributions of £24k (2017: £25k) were made to a defined contribution pension scheme on his behalf.

Contributions have been made into 6 executive directors' personal defined contribution pension plans during the year (2017: 6). There were no directors' loans in 2018 (2017: nil)

Compensation for loss of office includes a termination payment to the then CRO of £178k. (2017: CFO of £151k). For full details on 'Amounts paid to third parties in respect of Directors' services' see Note 31.

12. Taxation

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

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

A reduction in the UK corporation tax rate from 19% to 18% (effective 1 April 2020) was substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Company's future tax charge accordingly. The deferred tax asset at the balance sheet date has been calculated based on these rates.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that is has become probable that future taxable profits will be available against which they can be used. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date. The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Bank expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

In 2018, the Bank experienced a higher effective tax rate as its profits exceeded the annual bank corporation tax surcharge allowance for the first time. This resulted in an additional charge of £205k in the year as shown in the table below.

£'000	2018	2017
Current tax expense		
In respect of the current year	5,539	4,738
In respect of prior years	(1)	2
	5,538	**4,740**
Deferred tax expense		
Origination and reversal of temporary differences	(22)	(32)
Adjustments in respect of prior periods	-	2
Effect of tax rate change on opening balance	2	2
	(20)	**(28)**
Total income tax expense	**5,518**	**4,712**

Notes to the Financial Statements
(Continued)

The income tax expense for the year can be reconciled to the accounting profit as follows:

£'000	2018	2017
Profit before tax from continuing operations	27,926	24,406
Income tax expense calculated at 19% (2017: 19.25%)	5,306	4,698
Effects of:		
Expenses not deductible for tax purposes	8	3
Adjustments in respect of previous periods	(1)	4
Surcharge on banking companies	205	-
Tax rate changes	-	2
Deferred tax credited through OCI	-	5
Total tax charge 19.52% (2017: 19.31%)	**5,518**	**4,712**

Deferred tax

Deferred tax assets are attributable as follows:

The Bank had a deferred tax asset of £880k at 31 December 2018 (2017: £253k) resulting primarily from the adoption of IFRS. The business plan projects profits in future years sufficient to recognise this asset.

£'000	Balance Sheet		Movement in period	
	2018	2017	Income	Equity
Deferred tax liability				
Plant, Property & Equipment (PPE) and intangible assets	-	(75)	75	
Other taxable temporary differences	-	-	-	
Total Liabilities	-	(75)	75	-
Deferred tax asset				
Provisions	56	23	33	
PPE and intangible assets	9	-	9	
Pension and post-retirement benefits	16	11	5	
Other deductible temporary differences*	805	289	(73)	589
Total Assets	886	323	(26)	589
Deferred tax on FVOCI				
FVOCI instruments	(6)	5	-	(11)
Net deferred tax asset	**880**	**253**	**49**	**578**

* As a result of the Bank's adoption of IFRS 9 the opening adjustment to reserves of £3,630k gave rise to a deferred tax asset of £617k.

13. Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value and are used by the Bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

There has been no change in the accounting treatment or classification of cash or cash equivalents as a result of the adoption of IFRS 9.

£'000	2018	2017
Unrestricted balances with central banks*	232,286	164,295
Cash and balances with other banks	14,384	20,091
Total	**246,670**	**184,386**

*included within the unrestricted balances with central banks is £195k of accrued interest for 2018 (2017: £40k).

14. Loans and advances to banks

Policy applicable from 1 January 2018:

Loans and advances to banks are measured at amortised cost as the Bank holds these assets for the objective of collecting contractual cash flows and the cash flows associated with the assets include only payments of principal and interest (SPPI). As with loans and advances to customers (note 15) the Bank have assessed whether there are any contractual terms which may cause the financial assets to fail the SPPI test. The Bank has noted no such terms. The Bank do not incur any transactional or other such integral fees which require an effective interest rate to be specifically calculated for these assets. Income is recognised at the contractual interest rate on an accruals basis.

Policy applicable before 1 January 2018:

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in active market and that the Bank does not intend to sell immediately or in the near term. Loans and advances to banks are initially measured at fair value and subsequently carried at amortised cost.

£'000	2018	2017
Gross loans and advances to banks	14,384	20,091
Net loans and advances to banks	**14,384**	**20,091**

15. Loans and Advances to customers

Policy applicable from 1 January 2018:

Loans and advances to customers are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

An analysis of the Bank's opening gross loans and advances to customers by IFRS 9 stage is provided below in note 36.

The Bank has measured its loans and advances to customers at amortised cost on the basis that the Bank holds these assets for the objective of collecting contractual cash flows and the cash flows associated with the assets include only payments of principal and interest (SPPI).

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

In making this assessment the Bank has considered whether the financial asset contains a contractual term that could change the timing or amount of contractual cashflows such that it would not meet this condition. All the Bank's loans contain prepayment features. A prepayment feature is consistent with the SPPI criteria if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable compensation for early termination of the contract.

Policy applicable before 1 January 2018:

Loans and advances to customers are non-derivative financial assets with fixed or determinable payments that are not quoted in active market, and that the Bank does not intend to sell immediately or in the near term. Loans and advances to customers include balances classed as loans and advances, finance leases and instalment credit advances, and are recognised when funds are advanced to customers. Loans and advances are initially measured at fair value and subsequently carried at amortised cost using the effective interest rate (EIR) method less any impairment losses.

The net investment in finance lease agreements and instalment credit agreements represent the future lease rentals and instalments receivable less profit and costs allocated to future periods. Income is recognised throughout the life of the agreement to provide a constant rate of return on the net investment in each agreement.

Gross loans and advances have been reduced by £2.9m (2017: £4.1m) as a result of the EIR liability.

£'000	2018	2017
Gross loans and advances	777,084	693,538
Less: allowance for impairment losses (see note 16)	(8,068)	(3,584)
Net loan receivables	769,016	689,954

Gross loans and advances to customers includes £48m related to Hire Purchase and Finance Lease agreements (2017: £28m). This is made up of £54m (2017: £32m) gross receivables less £6m of unearned finance income (2017: £4m). Of this gross loans and advances balance, £13m is current and £35m is due in more than one year.

The 2018 figures have been prepared on an IFRS 9 basis. In accordance with the transitional provisions of the standard, comparatives have not been restated. See note 36 for further details.

16. Allowance for impairment losses

A description of the Bank's credit risk management and methodology in respect of allowances for impairment losses is provided below in note 28. This note also includes the sensitivity of the Bank's impairment losses to changes in its forward looking economic scenarios.

An analysis of the Bank's opening Expected Credit Loss (ECL) impairment allowance by IFRS 9 stage and a reconciliation from the opening IAS 39 basis to the IFRS 9 basis is provided in note 36.

A reconciliation of the opening to the closing allowance for impairment losses on loans and advances to customers is presented below:

£'000	Not credit impaired		Credit impaired	
	Stage 1: subject to 12-month ECL	Stage 2: subject to lifetime ECL	Stage 3: subject to lifetime ECL	Total
At 1 January 2018	**3,041**	**2,383**	**1,790**	**7,214**
Profit and Loss Charge *	(715)	(212)	2,814	1,887
Write offs			(1,033)	(1,033)
Closing Balance	**2,326**	**2,171**	**3,571**	**8,068**
Income recognition adjustment **			(219)	(219)
Adjusted P&L Charge	**(715)**	**(212)**	**2,595**	**1,667**
At 1 January 2018	**3,041**	**2,383**	**1,790**	**7,214**
Analysis of Profit and Loss Charge				
Increase/(decrease) due to change in credit risk				
- Transfers to and from Stage 1	(599)	667	668	736
- Transfers to and from Stage 2	(90)	(117)	1,306	1,098
- Transfers to and from Stage 3	(10)	(436)	740	294
New loans originated	427	1	0	428
Derecognised loans	(461)	(327)	0	(788)
Loan commitments	18	0	0	18
Allowance utilised in respect of write offs	0	0	(933)	(933)
Write Offs	0	0	1,033	1,033
Total Profit and Loss Charge*	**(715)**	**(212)**	**2,814**	**1,887**
ECL coverage	**0.32%**	**5.41%**	**28.37%**	**1.04%**

* Excludes charges related to debt securities and includes interest originally charged on the gross carrying amount for credit impaired stage 3 assets which has subsequently been recalculated on the net carrying amount.
** Interest originally charged on the gross carrying amount for credit impaired stage 3 assets which has subsequently been recalculated on the net carrying amount. This resulted in a reduced interest income and impairment charge in the income statement of £219k.

Notes to the Financial Statements
(Continued)

£'000	Not credit impaired		Credit impaired	
	Stage 1: subject to 12-month ECL	Stage 2: subject to lifetime ECL	Stage 3: subject to lifetime ECL	Total
Real Estate Finance	2,215	2,163	3,557	7,935
Asset Finance	112	8	13	133
At 31 December 2018	2,327	2,171	3,570	8,068

The above tables have been prepared on an IFRS 9 basis.

The table below shows the bank's impairment loss provisions as at the 31 December 2017 on an IAS 39 incurred loss basis:

£'000	Individual provisions	Collective provisions	Total provisions
Balance as at 1 January 2017	1,016	1,492	2,508
Impairment loss for the year:			
Charge to income statement	2,005	303	2,308
Write-offs net of recoveries	(1,176)	-	(1,176)
Provisions released	(56)	-	(56)
Balance as at 31 December 2017	1,789	1,795	3,584

The P&L impairment charge includes recoveries on non-real estate and asset finance loans written off in previous periods and also fees received to cover the Bank's costs relating to the administration of defaulted loans.

17. Debt securities

Policy applicable from 1 January 2018:

Under IFRS 9 the Bank's debt securities are measured at fair value through other comprehensive income.

The Bank's debt securities (Gilts) are initially recognised at fair value and subsequently measured at Fair Value through Other Comprehensive Income. The Gilt instruments meet the SPPI criteria as the Bank hold debt securities for the purpose of collecting contractual cash flows until a decision is taken to sell the asset or it reaches its maturity date.

Changes in the fair value of debt securities are recognised in other comprehensive income and presented in the fair value through other comprehensive income reserve. When the debt security is sold or matures, the gain or loss accumulated in equity, together with the tax thereon, is reclassified to profit and loss.

Policy applicable before 1 January 2018:

Under IAS 39 the Bank's Gilt holdings were initially measured at fair value and subsequently designated as available for sale. Changes in the fair value were recognised in other comprehensive income and presented in the available for sale reserve within equity.

UK Government Gilts with a nominal value of £10m were acquired in September 2018. The fair value of the UK Government Gilts held by the Bank on 31 December 2018 decreased in value by £44k during 2018 (2017: decrease £25k).

£'000	2018	2017
Fair value through other comprehensive income securities*:		
UK Government Gilts	13,350	3,107
Total	13,350	3,107

*Debt securities fair value includes accrued interest.

18. Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leases in which the Bank assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item. The estimated useful lives are as follows:

- Computer hardware 1 to 5 years
- Fixtures and fittings 3 to 10 years

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

£'000	Computer hardware	Fixtures and fittings	Total
Cost			
Balance at 1 January 2018	302	77	379
Additions	102	256	358
Disposals	(47)	-	(47)
Balance at 31 December 2018	**357**	**333**	**690**
Depreciation			
Balance at 1 January 2018	199	36	235
Charge for the year	66	32	98
Disposals	(29)	-	(29)
Balance at 31 December 2018	**236**	**68**	**304**
Net book value			
At 1 January 2018	103	41	144
At 31 December 2018	**121**	**265**	**386**

Fixtures and fittings in the table above include leased assets relating to office machines. At 31 December 2018, the net carrying amount of finance lease assets was £35k (2017: £41k).

During 2018 the Bank, with its Landlord, has started a refurbishment of its Head Office building. As part of the project the Bank has replaced its office furniture incurring expenditure of £232k in 2018 (2017: write-off of previous furniture £128k)

During the current year assets relating to an IT contract cancelled during the year were disposed of, resulting in a loss on disposal of £18k.

19. Intangible assets

Intangible assets that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses. Expenditure on computer software development is capitalised if the product or process is technically and commercially feasible, future economic benefits are probable and the Bank can measure reliably the expenditure attributable to the intangible asset during its development. The expenditure capitalised includes the cost of direct labour and software licence costs. Capitalised developments are stated at cost less accumulated amortisation.

Notes to the Financial Statements
(Continued)

Amortisation
Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Intangible assets with an indefinite useful life are systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. The estimated useful life of capitalised software development costs is 3 to 5 years.

£'000	Computer software development
Cost	
Balance at 1 January 2018	1,437
Additions	719
Disposals	(118)
Balance at 31 December 2018	**2,038**
Amortisation	
Balance at 1 January 2018	917
Amortisation for the year	363
Disposals	(88)
Balance at 31 December 2018	**1,192**
Net book value	
At 1 January 2018	520
At 31 December 2018	**846**

During the current year assets related to a ceased contract were disposed of, resulting in a loss on disposal of £30k.

20. Other assets

£'000	2018	2017
Other debtors	106	122
Prepayments	324	551
Cash Ratio Deposit	510	195
Total	**940**	**868**

The Bank is required to hold a Cash Ratio Deposit by the Bank of England. This is calculated twice yearly at 0.18% of average eligible liabilities over the previous six months in excess of £600m.

21. Derivatives held for risk management

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivative financial instruments are recognised at fair value. As at 31 December 2018 the Bank had £5m nominal value of derivatives (2017: £30m), all related to the hedging of fixed rate deposit balances.

£'000	Nominal value		Fair value	
	2018	2017	2018	2017
Instrument type				
Interest rate Designated in fair value hedges	5,000	30,000	(94)	(121)
Total interest rate derivatives	5,000	30,000	(94)	(121)

On initial designation of the hedge, the Bank formally documents the relationship between the hedging instruments and the hedged items, including the risk management objective, together with the method that will be used to assess the effectiveness of the hedging relationship. The Bank makes an assessment, both at inception of the hedge relationship and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the retrospective hedged items during the period in which the hedge is designated, and whether the actual results of each hedge are within a range of 80% - 125%.

All of the Bank's hedging relationships are currently fair value hedges. As permitted by IFRS 9, the Bank has elected to continue to apply the hedge accounting requirements of IAS 39.

Notes to the Financial Statements
(Continued)

Fair value hedges

Where a derivative financial instrument is designated as a hedge of the variability in fair value of a recognised asset or liability or an unrecognised firm commitment, all changes in the fair value of the derivative are recognised immediately in the income statement. To the extent to which the hedge is effective, the carrying value of the hedged item is adjusted by the change in fair value that is attributable to the risk being hedged (even if it is normally carried at cost or amortised cost) and any gains or losses on premeasurement are recognised immediately in the income statement (even if those gains would normally be recognised directly in reserves).

On the discontinuance of hedge accounting, any adjustment made to the carrying amount of the hedged item as a consequence of the fair value hedge relationship, is recognised in the income statement over the remaining life of the hedged item.

The Bank uses interest rate swaps to minimise interest rate risk exposure in specific periods by hedging the interest rate risk associated with fixed rate deposit balances. The terms of the hedged items and hedging instrument are aligned to minimise hedge ineffectiveness arising. Hedge ineffectiveness, the difference between the hedging gains or losses of the hedging instrument and the hedged item recognised in profit or loss was £6k (2017: £38k).

Fair value hedges of interest rate risk	2018		2017	
£'000 Instrument type:	Assets	Liabilities	Assets	Liabilities
Interest rate	-	94	-	121
Total	**-**	**94**	**-**	**121**

The fair value of the Bank's derivatives in place at the year-end increased by £6k during the year. The Bank has not been required to post any collateral in respect of its derivatives.

Credit risk derivative risk management

The Bank mitigates the credit risk of derivatives by entering into transactions under International Swaps and Derivatives (ISDA) master netting agreements. The Bank has executed a Credit Support Annex (CSA) in conjunction with the ISDA agreement, which requires the Bank and its counterparty (Nat West Markets PLC) to post collateral to mitigate counterparty credit risk in the event of specific triggers being met.

Type of credit exposure	% of exposure that is subject to collateral requirements		Principal type of collateral	Collateral received/given
	2018	2017		
Derivatives held for risk management	100%	100%	Cash	Nil (MTM below VM threshold)

The following table sets out the Bank's Financial assets and Financial liabilities that are subject to an enforceable master netting arrangement, irrespective of whether they are offset in the statement of financial position. The values reflect the instruments fair value. The Bank's ISDA does not meet the criteria for offsetting in the statement of financial position. This is because it creates a right of set-off of recognised amounts that is only enforceable following a predetermined event.

The Bank could be required to give, or receive, collateral in the form of cash, or other marketable securities, in respect of its derivative transactions. The Bank has not had to post any collateral in respect of its derivatives, as the aggregate mark-to-market has remained below the CSA VM threshold throughout the year.

Notes to the Financial Statements
(Continued)

£'000				Related amounts not offset in the statement of financial position		
Type	Gross amounts of recognised financial assets	Gross amounts of financial liabilities offset in the statement of financial position	Net amounts of financial liabilities in the statement of financial position	Financial instruments liabilities	Cash collateral received	Net amount
2018						
Assets	-	-	-	-	-	-
Liabilities						
Derivatives held for risk management	-	-	-	94	-	94
2017						
Assets	-	-	-	-	-	-
Liabilities						
Derivatives held for risk management	-	-	-	121	-	121

22. Deposits from customers

Policy applicable from 1 January 2018:

IFRS 9 stipulates that all financial liabilities be classified at amortised cost, except for those recognised at fair value through profit or loss (including derivative contracts). This includes:

- financial liabilities which have been designated as FVTPL on the basis that this provides more relevant financial information
- Financial liabilities which arise when a transfer of a financial asset does not qualify for derecognition (or when the continuing involvement approach applies);
- Financial guarantee contracts;
- Commitments to provide a loan at a below market rate of interest; or
- Contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies.

The Bank have assessed all financial liabilities to classify and measure them appropriately. As with financial assets, financial liabilities are initially measured at their fair value, plus or minus any transaction costs which are directly attributable to the financial liability.

In respect of Customer Deposits, the Bank classifies its customer deposits as being held at amortised cost, which is consistent with the criteria outlined above.

Under the amortised cost method, the Bank spread any transaction costs or integral fees paid or received across the expected life of the financial instrument. The Bank do not have any such fees in respect of its deposit accounts. The Bank's commission payments to brokers are already spread over the life of the deposit account and are accounted for within interest payable.

Policy applicable before 1 January 2018:

Under IAS 39 Deposits were initially measured at fair value less any incremental direct transaction costs and subsequently measured at their amortised cost using the effective interest rate.

Deposits are the Bank's primary source of debt funding. £5.0m of the Bank's fixed rate deposits are hedged using interest rate derivatives, these deposits are held at fair value.

Notes to the Financial Statements
(Continued)

£'000	2018	2017
Instant access	62,538	105,365
Term and notice accounts		
Payable within 1 year	770,245	637,239
Payable after one year	68,705	55,680
Total	**901,488**	**798,284**
Fair value adjustment for hedged risk	(90)	(108)
Total deposits from customers	**901,398**	**798,176**

£'000	2018	2017
Variable rate deposit balances	680,942	667,048
Fixed rate deposit balances	220,546	131,236
Total	**901,488**	**798,284**
Fair value adjustment for hedged risk	(90)	(108)
Total deposits from customers	**901,398**	**798,176**

23. Other liabilities

£'000	2018	2017
Accruals	2,655	1,683
Corporation tax	2,698	2,364
Other creditors	55	511
Total	**5,408**	**4,558**

24. Provisions

A provision is recognised in the Statement of Financial Position when the Bank has a present legal or constructive obligation as a result of a past event, that can be reliably measured, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects risks specific to the liability.

Financial services compensation scheme £'000	2018	2017
1 January	134	70
Provided during the year	-	155
Utilised during the year	(48)	(91)
Released during the year	(78)	-
31 December	**8**	**134**

- Financial services compensation scheme (FSCS)

In common with all regulated UK deposit takers, the Bank paid levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy covers the costs of running the scheme and the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. The FSCS meets these current claims by way of loans received from HM Treasury.

On 1 October 2018, FSCS made the final payment for interest accrued up to and including 23 May 2018. As a result, FSCS has no outstanding liabilities to HM Treasury for the failures of 2008/9. The FSCS is however, expected to levy additional costs to member firms in Q1 2019 in respect of the cost of meeting claims received for the failure of a Credit Union in Q3 2018. The Bank's share of this cost is expected to be around £8k.

Notes to the Financial Statements
(Continued)

25. Capital and reserves

- Share capital

	£'000		No. of shares	
	2018	2017	2018	2017
Ordinary shares of £1 each authorised, issued and fully paid				
1 January	23,955	23,955	23,955,000	23,955,000
Shares issued during the year	21,000	-	21,000,000	-
31 December	**44,955**	**23,955**	**44,955,000**	**23,955,000**

Perpetual subordinated contingent convertible loan notes				
1 January	12,900	12,900	12,900,000	12,900,000
Authorised notes issued during the year	10,000	-	10,000,000	-
Fully paid notes as at 31 December	**22,900**	**12,900**	**22,900,000**	**12,900,000**

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank.

Dividends on ordinary shares are recognised in equity in the period in which they are approved by shareholders. Dividends on ordinary shares of £1m were paid during the year; £500,000 to each shareholder, being 4.1745 pence per share (2017: £nil).

During the year 21m £1 Ordinary Shares were authorised, issued and fully paid (2017: nil).

Cambridgeshire County Council holds the perpetual subordinated contingent convertible loan notes. Interest on these securities is due and payable only at the sole discretion of the Bank.

- **Fair value through other comprehensive income reserve (FVOCI reserve)**

The FVOCI reserve includes the cumulative net change in the fair value of financial assets until the investment is derecognised or impaired.

£'000	
FVOCI reserve as at 31 December 2017	**36**
FVOCI financial assets - net change during 2018	48
Related tax	(11)
FVOCI Reserve as at 31 December 2018	**73**

- **Convertible loan note interest payments**

The following convertible loan note interest payments were recognised as distributions to owners during the year ended 31 December:

£'000	2018	2017
Convertible loan note interest 6.1613 pence per loan note (2017: 6.011 pence per loan note)	795	775
Total	**795**	**775**

26. Employee benefits

- Defined contribution pension plans

A defined contribution plan is a post-employment benefit plan under which the company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement in the periods during which services are rendered by employees.

The Bank operates a defined contribution Personal Pension Scheme, which is provided by Royal London, and also contributes to the personal pension plans of certain employees. The pension cost for the year represents the contributions payable by the Bank under these arrangements and amounted to £701k (2017: £524k).
There was an outstanding contribution of £82k (2017: £58k) at the end of the year.

Notes to the Financial Statements
(Continued)

27. Financial instruments and fair values

The Bank has set out in notes 14, 15, 17 and 22, how it classifies financial assets and liabilities both under IFRS 9 in 2018 and previously under IAS39 in 2017.

The following table summarises the classification and carrying amounts of the Bank's financial assets and liabilities:

2018 £'000	Amortised cost	At fair value through other comprehensive income	At fair value through profit or loss	Liabilities at amortised cost	Total
Cash & balances at central banks	232,286				232,286
Loans and advances to banks	14,384				14,384
Debt securities		13,350			13,350
Loans and advances to customers	769,016				769,016
Total	**1,015,686**	**13,350**	**-**	**-**	**1,029,036**
Customers' accounts			(90)	901,488	901,398
Derivatives			94		94
Total	**-**	**-**	**4**	**901,488**	**901,492**

2017 £'000	Loans and receivables	Available for sale	At fair value through profit or loss	Liabilities at amortised cost	Total
Cash & balances at central banks	164,295				164,295
Loans and advances to banks	20,091				20,091
Debt securities		3,107			3,107
Loans and advances to customers	689,954				689,954
Total	**874,340**	**3,107**	**-**	**-**	**877,447**
Customers' accounts			(108)	798,284	798,176
Derivatives			121		121
Total	**-**	**-**	**13**	**798,284**	**798,297**

Derecognition

The following sets out how the Bank derecognises assets and liabilities and fair value its assets in accordance with IFRS 9:

- **Derecognition of financial assets**

The Bank derecognises a financial asset only when the contractual rights to the associated cash flows expire, or the Bank transfers the financial asset and the transfer qualifies for derecognition in accordance with the provisions set out in IFRS 9. To qualify for a transfer the Bank must meet either of the following:

- The contractual right to receive the cash flows of the financial asset have been transferred; or
- The contractual right to receive the cash flows of the financial asset is retained by the Bank, but the Bank also assume a contractual obligation to pay the cash flows to one or more recipients.

In respect of point 2 above, the Bank assess whether the following three conditions are all met before treating the financial asset as having been derecognised:

- The Bank assumes no obligation to pay amounts to the eventual recipients unless those amounts have been collected from the original financial asset;
- The Bank is prohibited under the terms of the transfer contract from selling or pledging the original asset, other than as security to the recipients of the cash flows; and
- The Bank has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. The Bank may also not reinvest any such cash flows received.

Notes to the Financial Statements
(Continued)

Where the above criteria are met, and a transfer is deemed to have occurred, the Bank evaluate the extent to which it retains the risk and rewards of ownership of the financial asset. Where the Bank determines that the risk and reward of ownership of the assets has been transferred, the Bank derecognises the asset. If the Bank determines that the risk and reward remains with them, the asset is not derecognised and remains in the statement of financial position.

On derecognition of the financial asset, the Bank recognises the difference between the carrying amount of the asset and the consideration received in its profit or loss.

- Derecognition of financial liabilities

The Bank derecognises a financial liability only when the obligation, which is specified in the contract has been discharged, is cancelled or expires. The Bank may also be required to derecognise a financial liability where there has been a substantial modification. A modification is considered to be substantial where the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

- Derecognition under IAS 39

Derecognition under IAS 39 was defined as:

Derecognition is the point at which an asset or liability is removed from the balance sheet. The Bank's policy is to derecognise financial assets when the contractual rights to the cash flows from the financial asset have expired or where all the risks and rewards of ownership have been transferred. The Bank derecognises a financial liability when its contractual obligations are discharged, cancelled or expired.

<u>Fair value</u>

Fair value of financial assets and financial liabilities are based on quoted market prices. If the market is not active, the Bank establishes a fair value by using appropriate valuation techniques.

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

- Level 1: quoted prices in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within level 1 that are observable either directly (e.g. prices) or indirectly (e.g. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data.

Key considerations in the calculation of the disclosed fair values for those financial assets carried at amortised cost include the following:

- Cash and balances at central banks

These represent amounts with an initial maturity of less than 3 months and their carrying value is considered to be the fair value.

- Loans and advances to banks

These represent amounts with a maturity of less than 3 months, where adjustments to fair value in respect of the credit rating of the counterparty are not considered necessary. The carrying value of the asset is considered to be the fair value.

- Loans and advances to customers

The Bank's standard lending is via products with a variable interest rate, which it considers equivalent to a current market product rate. Therefore, the Bank considers the discounted future cash flows of these mortgages to be equal to the carrying value. The Bank has a small number of loans that have a fixed interest rate, which the Bank considers to be aligned to current market rates.

- Customers' accounts

Customers' accounts at variable rates are at current market rates and therefore the Bank regards the fair value to be equal to the carrying value. The fair value of fixed rate customers' accounts that have

Notes to the Financial Statements
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been designated as hedged with interest rate derivatives have been determined by discounting estimated future cash flows based on market interest rates on equivalent deposits. The unhedged portion of fixed rate deposits comprise primarily of short-term bonds whose rates are considered to be in line with the market rates.

- Debt securities

Where securities are actively traded in a recognised market, with available and quoted prices, these have been used to value these instruments. These securities are therefore regarded as having level 1 fair values.

- Derivatives

The fair values of derivative assets and liabilities are calculated based on the present value of future interest cash flows, discounted at the market rate of interest at the balance sheet date. The Bank has not been required to post any collateral in respect of its derivatives.

Derivative financial liabilities are classified at fair value through profit or loss.

The fair values of all financial assets and financial liabilities by class together with their carrying amounts and fair value valuation level are as shown in the following table.

£'000	2018					
	Level 1		Level 2		Level 3	
	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
<u>Financial Assets</u>						
Cash & balances at central banks	232,286	232,286				
Loans and advances to banks					14,384	14,384
Debt securities	13,350	13,350				
Loans and advances to customers					769,016	769,016
<u>Financial liabilities</u>						
Customers' accounts			(90)	(90)	901,488	901,488
Derivatives			94	94		

£'000	2017					
	Level 1		Level 2		Level 3	
	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
<u>Financial Assets</u>						
Cash & balances at Central banks	164,295	164,295				
Loans and advances to banks					20,091	20,091
Debt securities	3,107	3,107				
Loans and advances to customers					689,954	689,954
<u>Financial liabilities</u>						
Customers' accounts			(108)	(108)	798,284	798,284
Derivatives			121	121		

- The fair values of the Bank's debt securities (UK Gilts and EIB bonds) are based on quoted bid prices in active markets.

- The fair value of derivative assets and liabilities are determined using widely recognised valuation models for determining the fair values of interest rate swaps.
- There have been no transfers between levels in 2018 or 2017.

28. Financial risk management

A key component of the Bank's business is the effective management of risk in order to ensure that the Bank maintains sufficient capital, liquidity and controls at all times and acts in a reputable way, taking into account the interests of customers, Regulators and shareholders. The principal risks the Bank is exposed to are;

- Credit risk – loans and advances to customers
  – loans and advances to banks and debt securities
- Liquidity risk
- Market risk
- Operational risk
- Capital management

The Bank's risk management framework and strategic risk appetite is set out in the Corporate Governance report.

- **Credit risk – loans and advances to customers**

Credit risk is the risk of financial loss to the Bank if a customer to a financial instrument fails to meet its contractual obligations.

Credit risks associated with lending are managed through the use of detailed lending policies which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Bank seeks to mitigate credit risk by focusing on business sectors where it has specific expertise and through limiting concentrated exposures on larger loans, certain sectors and other factors that can represent higher risk. The Bank also seek to obtain security cover and where appropriate, personal guarantees from borrowers. Credit risk is principally assessed through the manual underwriting of all transactions.

The Risk & Compliance Committee has oversight responsibility for credit risk.

- Credit exposure

The Bank's maximum exposure to credit risk after provisions for impairment is as follows:

£'000	2018	2017
Cash and balances at central banks	232,286	164,295
Loans and advances to banks	14,384	20,091
Debt securities	13,350	3,107
Loans and advances to customers	777,083	693,538
	1,037,103	881,031
Commitments to lend*	43,868	84,781
Gross credit risk exposure	**1,080,971**	**965,812**
Less allowance for impairment losses	(8,068)	(3,584)
Net credit risk exposure	**1,072,903**	**962,228**

*Commitments to lend represent agreements entered into but not advanced as at 31 December.

The above table represents the maximum credit risk exposure to the Bank at 31 December 2018 and 2017 without taking account of any underlying security. At 31 December 2018 the value of securities held as collateral against drawn loans and advances to customers is £1,291m (2017: £1,162m) of which £1,290m (2017: £1,161m) is in the form of property and £0.8m (2017: £0.8m) is in the form of cash deposits.

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(Continued)

- Credit risk management

The Bank specialises in providing lending for Small and Medium Enterprises (SMEs). Its lending is secured on property. The Bank lends to owner occupied businesses to invest in their own commercial premises, as well as to experienced commercial and residential property investors. It also has a growing asset finance business providing finance to SMEs for business-critical assets and Classic Cars through hire purchase and finance lease facilities. At 31 December 2018 these loans totalled £48m (2017: £28m).

Credit risk is managed in accordance with lending policies, the risk appetite and risk management framework. Lending policies and performance against risk appetite are reviewed regularly. All applications are reviewed and assessed by a team of experienced underwriters.

All properties are individually valued, and detailed property reports are produced to ensure the property represents suitable security. Affordability assessments are also performed on all loans and other forms of security are often obtained, such as personal guarantees.

Loans are secured on properties solely located in the UK, concentration risks are monitored, and credit exposures are diversified by sector and geography.

- Concentration of credit risk

The Bank monitors concentration of credit risk by product type, borrower type, geographic location and loan size.

Lending by product and type %	2018	2017
Commercial real estate lending		
Residential	40%	42%
Commercial	52%	50%
Other	2%	4%
Asset finance	6%	4%
Total	**100%**	**100%**

The Bank's lending real estate portfolio is geographically diversified across the UK:

Region	2018	2017
East Anglia	4%	4%
East Midlands	20%	18%
Greater London	4%	3%
North East	4%	5%
North West	19%	20%
Scotland	6%	4%
South East	6%	5%
South West	6%	7%
Wales	7%	7%
West Midlands	7%	8%
Yorkshire/Humberside	17%	19%
Total	**100%**	**100%**

The Bank's total lending portfolio (by number of accounts) falls into the following concentration by loan size:

Loan size	2018	2017
0 - £250k	66%	56%
£251k -£500k	17%	21%
£501k-£1,000k	9%	12%
£1,001k-£3,000k	7%	9%
£3,001k+	1%	2%
Total	**100%**	**100%**

- LTV banding

The Bank's real estate lending balances falls into the following LTV bandings:

Notes to the Financial Statements
(Continued)

LTV banding	2018	2017
0-50%	21%	17%
51-60%	24%	25%
61-70%	49%	51%
71-80%	3%	4%
81+%	3%	3%
Total	100%	100%

- Credit risk – security

The Bank enters into loan agreements with customers and where appropriate takes security. The security profile of the loans receivable book is shown below:

	2018		2017	
	£m	%	£m	%
Secured on property	729	94	666	96
Secured on other assets	48	6	28	4
Unsecured	-	-	-	-
Total	**777**	**100**	**694**	**100**

In addition to security over property, the Bank may also take additional security in the form of Director Guarantees and cash deposits. Collateralised deposits at the end of 2018 totalled £0.8m (2017: £0.8m).

- Credit risk – allowance for impairment losses (see also Note 16)

Policy applicable after 1 January 2018

IFRS 9 replaced the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. This requires considerable management judgement over how changes in economic factors affect ECLs, which are determined on a probability-weighted basis.

As the Bank has to date incurred limited arrears and losses in its initial six years of trading, it has had to use significant management judgement in calibrating the weightings and values. Over time as the Bank obtains more performance data, it will continue to develop its models and incorporate this performance data into them.

Expected credit loss recognition

IFRS 9 requires a loss allowance to be recognised at an amount equal to either 12-month ECL or lifetime ECL. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument (in the Bank's case for customer loans and advances this is the same average life assumption as used for its effective interest rate calculation), whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12-month period after the reporting date, based on the estimated loss curve.

In respect of real estate lending, the Bank recognises loss allowances at an amount equal to lifetime ECL, except where the credit risk has not increased significantly since initial recognition and repayments are fully up to date. For these the amount recognised will be 12-month ECL.

Inputs into measurement

The inputs into the measurement of ECLs include the following variables:

- **Probability of default (PD)** is based on the historical performance of the Bank's loans together with management judgement.
- **Loss given default (LGD)** is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counter parties and management experience. The Bank calculates its real-estate LGD using the drivers of loan to value ratio (LTV) together with the quality, location and type of property.
- **Expected credit loss (ECL) percentage.** By taking the appropriate PD and LGD, the Bank can calculate an ECL percentage.

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(Continued)

- **Exposure at default (EAD)** represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counterparty and any potential changes to the current amount allowed under the contract. The Bank does not have a significant amount of undrawn commitments linked to existing customer loan agreements and any new commitments would not be drawn in the event that the Bank considered them likely to cause a default.

Default is defined in the Bank if the loan is in arrears for four or more consecutive payments (i.e. over 90 days), the loan is linked to another account in default, the customer has been declared bankrupt or the company has been wound up or a liquidator/administrator appointed. This is aligned to the regulatory definition of default.

Credit risk grades

The Bank allocates each exposure a credit risk grade using its Credit Grading Model. Each exposure has been allocated a credit risk grade on initial recognition. Credit grades are formally reviewed on an annual basis. The grades are reassessed earlier if the customer falls into arrears or contacts the Bank with information that impacts its credit quality.

The table below shows the Bank's real estate lending split by Credit risk grade. Each loan account is allocated a grade of between 1 and 10. Grades 1 to 3 are classified as low risk, Grades between 3 and 6 are classified as medium risk and Grades over 6 are high risk. Customer grades are reassessed at each annual review.

£k	Stage 1	Stage 2	Stage 3	Total
Low risk	271,205	5,258	569	277,032
Medium Risk	401,612	22,374	9,679	433,665
High Risk	9,945	9,760	2,231	21,936
Real Estate Gross loans and advances to customers (excluding effective interest rate)	682,762	37,392	12,479	732,633

Provisioning stages

Under IFRS 9 all the Bank's lending exposures are allocated a stage based on the current status of the loan. The Bank has set the following definitions for each of the three stages within IFRS 9.

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(Continued)

IFRS 9 Stage	Definition	Provisioning Basis	Cure Criteria
Stage 1	- All performing loans which do not feature on the watchlist. '- Loans which have no arrears on them.	12m Expected Credit Losses	n/a
Stage 2	- The customer is at least one day in arrears and the arrears do not relate to any administrative (e.g. incorrect standing order or direct debit) or system errors. - The customer is in financial difficulty and the Bank have no robust explanation as to why the arrears have occurred (e.g. due to loss of rental income in order to progress a collateral sale). - The customer is on the Bank's watchlist either due to arrears or payment history issues, or is a connected exposure to another account which has been included on the watchlist for those reasons. - The customer is in a period of forbearance. -The loan has been restructured due to arrears. - The underlying loan collateral is located in a particular region or sector as defined by the Credit Committee where required. - Any other significant decline in credit quality has been identified by the Bank.	Lifetime Expected Credit Losses	Movement back to stage 1 will only occur where the borrower meets all of the following: - Arrears have been fully cleared on the account. - The account has been 'performing' for a period of at least 6 consecutive months. - The account is not under any form of forbearance measure. - The account has been removed from the Bank's watchlist and is not considered an increase in credit risk for internal risk management purposes.
Stage 3	- The account is over 90 days in arrears. - The customer has been declared bankrupt. - The company has been wound up or a liquidator/administrator has been appointed. - The account is part of a connected exposure where the borrower meets at least one of the above criteria across any connected account.	Lifetime Expected Credit Losses	Movement from stage 3 back to stage 2 will only occur when the borrower meets all of the following: - The account is no longer more than 90 days down. - No connected accounts are more than 90 days down. - The customer has not been more than 90 days down for a consecutive period of 3 months. - The Bank are actively seeking resolution and have obtained cooperation from the borrower to work to resolve the arrears.

Under IFRS 9 customers may move from a stage 1 provision exposure to a stage 2 exposure as a result of a significant increase in credit risk. To determine whether the credit risk on a particular financial instrument has increased significantly since initial recognition the Bank reviews each account annually or more regularly should the customer's payment record show any deterioration. . Any account with a payment over 1 day late will be reviewed for a potential increase in credit risk.

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As a backstop, and as required by IFRS 9, the Bank will presumptively consider that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. .

For an account to be 'cured' i.e. see a significant reduction in credit risk and return from stage 2 back to stage 1, the customer would need to demonstrate a good track record of payments of at least 6 months in length..

Movement from stage 3 back to stage 2 will only occur when the borrower meets the criteria in the table above.

The table below provides information on the payment due status of loans and advances to customers:

£'000	2018	2017
Neither past due nor impaired	741,202	667,940
Past due but not impaired:		
Up to and including 1 payment missed	9,474	17,949
Over 1 and up to 3 payments missed	13,611	348
Over 3 payments missed	75	1,386
Credit impaired – stage 3	12,721	5,915
Total	777,083	693,538
Less allowances for impairment losses	(8,068)	(3,584)
Total loans and advances to customers	**769,015**	**689,954**

Forbearance

The Bank can implement forbearance agreements for the servicing and management of customers who are in financial difficulty and require some form of concession to be granted, even if this concession entails a loss for the Bank. A concession may be either a modification of the previous terms and conditions of an agreement, which the borrower is considered unable to comply with due to financial difficulties or a total or partial refinancing of an agreement that would not have been granted had the borrower not been in financial difficulties.

The Bank may modify the contractual terms of a loan for several reasons, including to reflect changing market conditions or where forbearance (i.e. a renegotiation of the terms of a loan) is granted at the request of a borrower. This modification may have an impact on the IFRS 9 stage to which as asset is allocated.

An existing loan whose terms have been modified may require derecognition and the renegotiated loan recognised as a new loan at fair value, with any adjustments taken through the profit or loss account. Derecognition is assessed using the same '10 percent' test applied to financial liabilities. Where a modification does not result in derecognition the gross carrying amount of the asset is recalculated as the present value of the modified cash flows, discounted at the financial assets original effective interest rate. Any subsequent modification gain or loss is then recognised in profit or loss.

When the terms of a financial asset are modified, and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparisons of:

- *the remaining lifetime PD at the reporting date based on the modified terms; with*
- *the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.*

Should modification result in a derecognition event, the Bank would make an assessment as to whether the new financial asset is credit impairment at initial recognition.

The Bank has not, and does not expect to, renegotiate a significant number of loans. All loans in forbearance are treated as being in stage 2 for IFRS 9 provisioning purposes and the lifetime ECL is recognised for the period of forbearance and an appropriate cure period.

Forbearance can be temporary or permanent depending on the circumstances, progress on rehabilitation and the detail of the concession agreed.

At the 31 December 2018 there were four forbearance arrangements in place (2017: nil).

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Write-off

A write off is a direct reduction of a financial assets gross carrying amount when there is no reasonable expectation of recovering the financial asset in either its entirety or a portion thereof. A write off therefore constitutes a derecognition event. The Bank have to date experienced only 6 write offs on its REF portfolio and 2 write offs on its AF portfolio. The Bank would write off all or part of the gross carrying amount of a financial asset under the following circumstances:

- Where the underlying collateral of a loan has been sold, with the proceeds received by the Bank, and there is no reasonable expectation of recovering the remainder of the outstanding balance;
- The write off has been approved in line with the Bank's policy; and
- The Bank have explored reasonable avenues of realising the outstanding loan amount.

The release of provisions and the write-off of any bad debts is subject to appropriate delegated authorities.

Forward looking information

IFRS 9 requires that ECLs be calculated in an 'unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes'. For REF lending the Bank apply a range of scenarios in the calculation of the provision, for all impairment classification stages.

IFRS 9 also requires that the Bank incorporate forward looking information in respect of future economic conditions into the calculation of the provision, where this information is available without undue cost and effort.

To meet both the above requirements, the Bank have included a range of scenarios, each of which factors in forecasts of future economic conditions. These range from a severe downside, through to an upside.

The economic scenarios are approved by the Bank's Audit Committee and reviewed at least every six months. In producing the economic forecasts which are utilised within the provision calculation, the Bank have incorporated data published by the Bank of England, economic forecasting organisations such as the E&Y item club and companies such as Experian. The Bank have also aligned the severe downside scenario to that used in the Bank's 2019 ICAAP document.

During the year the outlook for the UK economy has generally deteriorated with a number of commentators forecasting lower growth rates and increasing uncertainty in respect of the impact of BREXIT. The Bank has therefore reviewed the weightings allocated to each of its forward-looking scenarios and reduced the weighting allocated to its base case with a corresponding increasing in the weighting allocated to the downside scenario. The revision to the weightings resulted in the Bank's impairment provision increasing by £200k.

The Bank apply the economic scenarios via the application of a recalculated PD and LGD respectively. The adjustments which the Bank makes reflects assumed movements in the Bank of England base rate and property price index levels. These variables have a direct impact on both the ability of a customer to meet the loan repayments as they fall due (PD driver) and where a customer does default, the ability of the Bank to be able to clear the outstanding loan balance thorough realisation of the collateral (LGD driver). This is supported by the following:

- The Bank's REF loans are all floating rate loans and as such a customer's ability to meet the interest costs on a loan is directly impacted by movements in base rate; and
- Property price inflation rates directly impact on the LTV – where property prices decline the Bank are more exposed to a decline in the value of the collateral where this is relied upon by the Bank to clear the outstanding loan balance.

The table below outlines the Bank's economic scenarios applicable to both the stage 1 and stage 2 impairment calculation:

Scenario	PD as a % of original	LGD as a % of original	Original Weighting Applied	Revised Weighting Applied
1. Base Case	100%	100%	80%	65%
2. Downside	90%	90%	10%	25%
3. Severe Downside	60%	60%	5%	5%
4. Upside	105%	105%	5%	5%

When the weightings above are applied to each respective provision, the Bank arrive at a stage 1 and stage 2 provision which is both probability weighted and inclusive of forward looking economic information.

For stage 3 REF loans, the Bank also calculate the provision, on an account by account basis, using 4 scenarios. These scenarios are aligned to those which have been used within the stage 1 and 2 provisioning. As stage 3 loans are in default and therefore have a 100% PD, the Bank do not adjust the PD within each scenario. The Bank adjust the LGD element of the stage 3 ECL calculation via the application of a forced sale discount which is applied to the collateral valuation. Whilst the stage 3 provisions vary on the valuation type used (market value versus forced sale) the Bank apply consistent adjustments when arriving at the weighted provision. The weightings for each scenario are consistent with those used in the stage 1 and stage 2 provisioning.

The Bank also consider whether or not the application of the above scenarios may have an impact on the staging classification of accounts. The Bank do not consider that the scenarios themselves cause any accounts to tip from stage 1 to stage 2.

Impairment loss allowance methodology under IAS 39 - applicable before 1 January 2018

On an ongoing basis, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. An asset is impaired and losses incurred if there is objective evidence of impairment because of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or group of assets that can be reliably estimated.

To identify objective evidence of impairment loss the Bank considers a number of factors including:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Forbearance.

If there is evidence of impairment the amount of the loss is measured as the difference between the asset's carrying value and the present value of estimated future cash flows discounted as the financial asset's EIR. The carrying amount of the asset is reduced through an allowance account and the amount of loss is recognised in the income statement.

When a financial asset is uncollectable, it is written off against the related provision for impairment once all necessary procedures have been completed and the amount of the loss determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for impairment in the income statement.

If the Bank determines that no objective evidence of impairment exists for an individually assessed asset it includes the asset in a pool of financial assets with similar characteristics and collectively assesses them for impairment.

Sensitivity

The accuracy of the impairment calculation would be affected by unanticipated changes to the economic situation. A 15% reduction in the weighting applied to the Bank's forward-looking base case economic scenario and a corresponding increase in the downside scenario would increase the impairment provision by £0.2m, whilst a 5% increase in the severe downside scenario would result in a

Notes to the Financial Statements
(Continued)

£0.5m increase in impairment. A 10% increase in the lifetime probability of default would increase the stage 2 provision by £0.8m.

- **Credit risk – loans and advances to banks and debt securities**

Credit risk exists in respect of Loans and Advances to Bank's and Debt securities where the Bank has acquired securities or placed cash deposits with other financial institutions. No assets are held for speculative purposes or actively traded. Certain liquid assets are held as part of the Bank's liquidity buffer.

The Bank hold balances in its Bank of England reserve account, along with nostro accounts held with RBS and Barclays. These counterparties to which the Bank is exposed are domestically and globally systemic banks and as such the Bank considers that the risk of default across these balances is extremely low. The Bank's debt securities are UK Government gilts.

The Bank consider that the loans and advances to Banks and the debt securities are of low credit risk and as such provide only for a 12m ECL, with the assets being classified in stage 1.

The Bank monitor their exposures to all counterparties on an ongoing basis and whether there have been any changes in the credit rating which may cause an increase in the probability of said counterparty defaulting. As at 31 December 2018 the Bank hold no provisions against loans and advances to banks given the low credit risk of these financial instruments, their high propensity to meet contractual cash flow obligations as they fall due and the instant access terms of these balances.

The Bank holds a £49k provision against its debt securities holding. This has been calculated using external observable market data..

The table below sets out the credit quality of the Bank's on-balance sheet Loans and Advances to Bank's and Debt securities. Full details on the Bank's derivative instruments can be found in Note 21.

£'000	2018	2017
Cash and balances at central banks	232,286	164,295
Deposits at other banks		
- Rated* A or above	14,384	20,091
UK Government Gilts	13,350	3,107
Derivatives held for risk management purposes**		
- Rated* A or above	(94)	(121)

*Ratings based on Moody's long-term rating
**Net assets

The Bank's Loans and Advances to Banks and Debt Securities credit risk is managed through a series of policies and procedures including:

- Cash placements

  Credit risk of counterparties is controlled through the counterparty placements policy, which limits the maximum exposure by entity where the Bank can place cash deposits.

- Gilts and Treasury Bills

  As part of the liquidity buffer, the Bank holds a portfolio of Gilts. These instruments carry sovereign risk.

- Derivatives

  Credit risk on derivatives is controlled through a policy of only entering into contracts with a limited number of UK credit institutions, with a credit rating of at least A (using Moody's long term rating) at inception.

- **Liquidity risk**

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

The Bank's Board of Directors sets the Bank's strategy for managing liquidity risk and delegates responsibility for oversight of the implementation of this policy to the Assets & Liabilities Committee (ALCO). ALCO approves the Bank's liquidity policies and procedures. The Bank's liquidity position is monitored on a day-to-day basis and a summary report, including any exceptions and remedial action taken, is provided to management on a daily basis.

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when they are due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained.

Regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. The scenarios are developed taking into account both Bank-specific events (e.g. a negative media comment) and market-related events (e.g. prolonged market illiquidity, reduced fundability of currencies, natural disasters or other catastrophes).

The Bank's key liquidity risk management drivers include the following items:

- Deposit funding risk

The deposit funding risk is the primary liquidity risk driver for the Bank. This could occur if there was a concern by depositors over the current or future credit worthiness of the Bank. The Bank mitigates this risk with a high proportion of its deposits being protected by the UK Government's Financial Services Compensation Scheme (FSCS) and by having a diversified mix of deposit accounts with varying maturity profiles.

- Pipeline loan commitments

The Bank needs to maintain liquidity to cover the outstanding pipeline of loan offers. Although certain pipeline offers may not be legally binding, the failure to adhere to an expression of intent to finance a loan brings reputation risk, therefore liquidity is held for such pipeline offers.

- Contingency funding plan

The Bank is required to maintain Resolution, Recovery and Liquidity Funding Contingency Plan documents by its Regulator, the PRA. The plans involve a two-stage process, covering preventive measures and corrective measures to be invoked when a potential or actual risk to the Bank's liquidity or capital position arises from either an internal or external event. The plans set out what actions the Bank would take to ensure it complies with the liquidity adequacy rules and operates within its risk appetite and limits set by the Board.

- Funding for Lending Scheme (FLS)

The Bank is a participant in the FLS, which enables it to borrow highly liquid UK Treasury Bills in exchange for eligible collateral. The Treasury Bills issued are for an original maturity of nine months and if delivered back prior to their maturity date can be exchanged for further nine-month bills. Costs of borrowing are charged directly to the income statement.

The Treasury Bills are not recorded on the Bank's balance sheet as ownership remains with the Bank of England. The risk and rewards of the collateral provided remains with the Bank and continues to be recognised in the Bank's financial statements.

The Bank monitors its liquidity risk using a number of metrics including the liquidity coverage ratio, the ratio of deposits to loans and an internal survival days metric. The Bank's liquidity coverage ratio at 31 December 2018 was 331% (2017: 207%) and the gross loans to deposit was 86% (2017: 87%).

The table below analyses the Bank's contractual undiscounted cash flows of its financial liabilities. Customer deposits includes any accrued interest as at 31 December. The contractual date is the earliest repayment date of the deposits.

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31 December 2018 £'000	Total	Undiscounted contractual cash flows		
		Less than 3 months	3 months to 1 year	Greater than 1 year
Liabilities				
Customer deposits	901,398	391,758	441,027	68,613
Derivatives	94	-	-	94
Total	901,492	391,758	441,027	68,707

31 December 2017 £'000	Total	Undiscounted contractual cash flows		
		Less than 3 months	3 months to 1 year	Greater than 1 year
Liabilities				
Customer deposits	798,176	382,705	390,522	24,949
Derivatives	121	-	32	89
Total	798,297	382,705	390,554	25,038

The following table sets outs the Bank's liquid assets:

£'000	2018	2017
Balances with Central banks	232,286	164,295
Loans and advances to banks	14,384	20,091
Debt securities	13,350	3,107
Total	260,020	187,493

The following table sets outs the Bank's off-balance sheet assets:

£'000	2018	2017
Funding for Lending Scheme Treasury Bills	106,000	60,000
Total	106,000	60,000

- Asset encumbrance

The Bank's assets can be used to support collateral requirements for central bank operations or third party repurchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered assets' and cannot be used for other purposes. All other assets are defined as 'unencumbered assets'. These comprise assets that are readily available to secure funding or meet collateral requirements and assets that are not subject to any restrictions but are not readily available for use.

As at 31 December 2018 the Bank had drawn £106m (2017: £60m) of Treasury bills under the Funding for Lending Scheme (FLS). These Treasury bills are held off balance sheet, as at 31 December 2018 they had not been monetised. The Bank has a total of £197m (2017: £127m) of loans which are available as collateral to support FLS drawings.

- Market risk

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates, and equity prices will affect the Bank's income or the value of its holdings of financial instruments. All of the Bank's exposure to market risks relates to non-trading portfolios. The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates.

- Interest rate risk

Interest rate risk is the risk of loss arising from adverse movements in market interest rates. Interest rate is the main market risk faced by the Bank and primarily arises from loans and deposits to customers, liquidity holdings and debt securities. Oversight of interest rate risk is covered by ALCO on a monthly basis and is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures.

Interest rate risk consists of asset-liability gap risk and basis risk.

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- Asset-liability gap risk

Where possible the Bank seeks to match the interest rate structure of assets with liabilities, creating a natural hedge. Where this is not possible the Bank will enter into interest rate swap transactions to convert the fixed rate exposures on loans and advances, customer deposits and debt securities into variable rate exposures.

- Basis risk

Basis risk is the risk of loss arising from changes in the relationship between interest rates, which have similar but not identical characteristics. This risk is managed by matching and, where appropriate, through the use of derivatives with established risk limits and other control procedures.

The Bank's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed in line with PRA guidance. The following table summarises the re-pricing periods for the Bank's assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate change and the maturity date.

The interest rate sensitivity exposure of the Bank at 31 December 2018 was:

31 December 2018 £'000	Within 3 months	More than 3 but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non-Interest Bearing	Total
Assets							
Cash and balances at central banks	232,286						232,286
Loans and advances to:							
Banks	14,384						14,384
Customers	727,727	3,637	7,988	34,097	2,550	(6,983)	769,016
Debt Securities				13,000		350	13,350
Other						3,052	3,052
Total Assets	974,397	3,637	7,988	47,097	2,550	(3,581)	1,032,088
Off balance sheet assets							
Derivatives					5,000		5,000
Liabilities							
Customers accounts	(712,883)	(15,387)	(104,513)	(68,615)			(901,398)
Other Liabilities						(5,510)	(5,510)
Total Equity		(22,900)				(102,280)	(125,180)
Total liabilities	(712,883)	(38,287)	(104,513)	(68,615)	0	(107,790)	(1,032,088)
Off Balance sheet items:							
Notional value of derivatives	(5,000)						(5,000)
Interest Rate Gap	256,514	(34,650)	(96,525)	(21,518)	7,550	(111,371)	0
Cumulative gap	256,514	221,864	125,339	103,821	111,371	0	0

Notes to the Financial Statements
(Continued)

The interest rate sensitivity exposure of the Bank at 31 December 2017 was:

31 December 2017 £'000	Within 3 months	More than 3 but less than 6 months	More than 6 months but less than 1 year	More than 1 years but less than 5 years	More than 5 years	Non-interest bearing	Total
Assets							
Cash and balances at central banks	164,255					40	164,295
Loans and advances							
to banks	20,091						20,091
to customers	655,279	5,382	9,917	22,945	1,076	(4,645)	689,954
Debt securities				3,000		107	3,107
Other assets						1,785	1,785
Total assets	**839,625**	**5,382**	**9,917**	**25,945**	**1,076**	**(2,713)**	**879,232**
Liabilities							
Customers' accounts	(687,436)	(28,993)	(53,597)	(24,728)		(3,422)	(798,176)
Other liabilities						(4,813)	(4,813)
Total equity		(12,900)				(63,343)	(76,243)
Total liabilities	**(687,436)**	**(41,893)**	**(53,597)**	**(24,728)**		**(71,578)**	**(879,232)**
Off-balance sheet items: Notional value of derivatives	30,000	(14,000)	(11,000)	(5,000)			
Interest rate sensitivity gap	182,189	(50,511)	(54,680)	(3,783)	1,076	(74,291)	-
Cumulative gap	**182,189**	**131,678**	**76,998**	**73,215**	**74,291**	**-**	**-**

Sensitivity analysis

The Bank considers a 200 basis points (bps) movement to be appropriate for scenario testing given the current economic outlook and industry expectations.

The Bank estimates that a +/-200bps movement in interest rates paid/received would have impacted the overall balance sheet values as follows:

+200bps: £1,534k (2017: -£33k)

-200 bps: £1,594k (2017: £53k)

This calculation assumes that the change occurred at the balance sheet date and had been applied to risk exposures existing at that date.

- Foreign currency risk

The Bank operated a small number of deposit accounts denominated in € or $ during 2018, however these were repaid by the year end. The funds were placed in the market in the same currency thus avoiding any material foreign exchange risk. Foreign currency deposits were nil at 31 December 2018 (2017: €2.9m and $0.9m).

- Equity price risk

The Bank does not undertake any equity investments and therefore is not exposure to equity market risk.

- **Operational risk**

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and innovation. In all cases, Bank policy requires compliance with all applicable legal and regulatory requirements.

The Board of Directors has delegated responsibility for operational risk to its Risk & Compliance Committee, which is responsible for the development and implementation of controls to address operational risk. This responsibility is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is cost effective.

A programme of periodic reviews undertaken by Internal Audit supports compliance with standards. The results of Internal Audit reviews are discussed with the Audit Committee.

- Capital management

The Bank manages its capital under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV) framework. The framework is enforced in the UK by the Prudential Regulation Authority (PRA) who sets and monitors capital requirements for the Bank.

The Bank's policy is to maintain a strong capital base to maintain investor and market confidence and to sustain the future development of the business. The Board manages its capital levels for both current and future activities and documents its risk appetite and capital requirements during stress scenarios as part of the Bank's Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP represents the view on risk for the Bank and is used by the Board, management and shareholders to understand the levels of capital required to be held over the year, the medium term and to assess the reliance of the Bank against failure. The Bank submitted its last ICAAP to the PRA in February 2019. The Bank presents regular reports on the current and forecast level of capital to Executive Committee, ALCO, Risk & Compliance Committee and to Board. The key assumptions and risk drivers used to create the ICAAP are regularly monitored and reported and any material deviation from the forecast and risk profile of the Bank would mean the ICAAP would need to be reviewed.

The Bank's Total Capital Requirement (TCR) is set by its regulator, the PRA. During 2018 its TCR was increased from 10.34% to 11.6% of Risk Weighted Assets. The Bank's regulatory capital at 31 December 2018 totalled £124.3m, £52.2m (before IFRS 9 transitional relief) above its TCR requirement. In addition to the TCR requirement the Bank is required to hold additional capital buffers, referred to as Pillar 2B, which includes the Counter Cyclical Buffer and the Capital Conservation Buffer. The Capital Conservation Buffer increased from 1.25% at 31 December 2017 to 1.875% in 2018 and increases to 2.5% from 1 January 2019. The Counter Cyclical Buffer was 0.5% from 1 July 2018 and increased to 1% from 1 November 2018.

As at 31 December 2018, the Bank's regulatory capital consists entirely of Tier 1 capital which includes ordinary share capital, convertible loan notes, retained earnings, reserves, and deductions for intangible assets which are included in equity but treated differently for capital adequacy purposes.

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(Continued)

- Impact of IFRS 9 on capital planning

The Bank's regulator issued guidelines on the transition requirements for the implementation of IFRS 9. The guidelines allow a choice of two approaches to the recognition of the impact of adoption of the standard on regulatory capital:

1. Phasing in the full impact on a phased basis over a five-year period; or
2. Recognising the full impact on the day of adoption.

The Bank elected to adopt the first approach and has informed its regulator of this decision. Under the transition guidelines the financial impact of the increase in provision balances on tier 1 regulatory capital is phased in over 5 years with 95% of the increase in requirements being excluded in 2018, 85% in 2019, 70% in 2020, 50% in 2021 and 25% in 2022.

The principal impact on the Bank's regulatory capital of the implementation of IFRS 9 arose from the new impairment calculation methodology. The Bank's capital requirement is calculated based on the gross exposures net of specific provisions.

IFRS 9 increased the loss allowance associated with individual assets by £3.6m and therefore the resulting net exposure and capital requirement reduced. The impact on capital resources of the implementation of IFRS 9 was a reduction in CET1 of £3.0m (after tax) on 1 January 2018, After the implementation of the transitional arrangements the reduction in CET1 reduced to £0.7m as the transitional arrangement allow for 95% relief in the first year.

The tables below set out the Bank's capital resources at 31 December and reconciles these resources to the Bank's reported regulatory capital.

£'000	31 December 2018	31 December 2017
Tier 1		
Ordinary share capital	44,955	23,955
Perpetual subordinated contingent convertible loan notes	22,900	12,900
Retained earnings	57,252	39,352
FVOCI reserve	73	36
Deductions: Intangible assets	(846)	(520)
Total Tier 1 capital	124,334	75,723
Tier 2		
Add: Collective impairment allowance**	-	1,795
Total Tier 2 capital	-	1,795
Total regulatory capital before IFRS 9 transitional relief*	**124,334**	**77,518**
IFRS 9 transitional relief available for 2018	2,905	-
Total regulatory capital after IFRS 9 transitional relief	**127,239**	**77,518**

*after applying the transitional factor

£'000	31 December 2018	31 December 2017
Equity as per statement of financial position	125,180	76,243
Regulatory adjustments		
Add collective impairment allowance	-	1,795
Less intangible assets	(846)	(520)
Total regulatory capital before IFRS 9 transitional relief*	**124,334**	**77,518**
IFRS 9 transitional relief available for 2018	2,905	-
Total regulatory capital after IFRS 9 transitional relief	**127,239**	**77,518**

*after applying the transitional factor
**Under IFRS 9 there is no collective loss impairment allowance

29. Leases

- Operating leases

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement on the same basis.

The Bank leases its head office in Charnwood Court, Leicester under a series of operating leases. These leases run for a period of 7 years, ending in 2021. These operating leases will be brought onto the balance sheet from 1 January 2019 after adopting IFRS 16 and will be depreciated over its remaining term. The Bank is expected to recognise a finance lease liability of £360k and an associated asset of £400k, which includes the prepayment of lease costs as at 31 December 2018. The Bank's other regional offices are on 12-month operating leases and these will be exempt under IFRS 16 due to the short-term contract length.

At 31 December, the future minimum lease payments under operating leases were payable as follows:

£'000	2018	2017
Less than one year	225	306
Between one and five years	360	621
More than five years	-	-
Total	**585**	**927**

During the year £467k (2017: £413k) was recognised as an expense in the income statement in respect of operating leases.

- Finance leases

Leases in which the Bank assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Finance lease liabilities are payable as follows:

£'000	2018			2017		
	Minimum lease payments	Interest	Principal	Minimum lease payments	Interest	Principal
Less than one year	21	1	20	14	2	12
Between one and five years	16	1	15	26	1	25
More than five years	-	-	-	-	-	-
Total	**37**	**2**	**35**	**40**	**3**	**37**

30. Commitments

At 31 December 2018, the Bank had undrawn credit lines commitments of £43.9m (2017: £84.8m) and capital commitments of £1.0m (2017: £nil).

At 31 December 2018, the Bank had contingent liabilities of £nil (2017: £nil).

31. Related parties

Related parties of the Bank include key management personnel and entities that have a significant voting power. The following transactions with related parties are included in the profit and loss account for the period.

Notes to the Financial Statements
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- Transactions with Controlling parties

£'000	2018	2017
Cambridgeshire County Council		
Rent charge for 42 Castle Street Cambridge	-	7
Sums paid in respect of Directors' services	47	40
Interest payments on perpetual subordinated contingent convertible loan notes	795	775
Trinity Hall, Cambridge		
Hospitality services	6	9
Interest on 31-day business notice account	13	62

The Bank continues to have a number of professional relationships with Trinity Hall. The Bank has used the college facilities and services for a number of meetings and events during 2018. Trinity Hall currently hold a 31-day business notice account. The account balance at 31 December 2018 was £92k (2017: £79k). The account earns interest at the standard rate for this type of account.

The Bank's Cambridge regional office moved in 2017 to a property which was owned by an external party and subsequently closed in 2018.

- Key management personnel compensation

  The key management personnel of the company comprised the executive and non-executive directors of the Bank. The compensation of key management personnel is shown in the following table.

£'000	2018	2017
Directors' remuneration	1,516	1,300
Amounts receivable under long term incentive schemes	67	121
Company contributions to defined contribution pension plans	94	73
Compensation for loss of office*	178	151
Amounts paid to third parties in respect of Directors' services	47	40
Total	**1,902**	**1,685**

*Compensation for loss of office includes a termination payment to the then CRO of £178k. (2017: CFO of £151k).

- Transactions with key management personnel

  The amounts paid to third parties in respect of director's services relate to the non-executive director fees for Chris Malyon & Richard Perry (amounts paid to Cambridgeshire County Council for both 2018 and 2017).

  Caroline Fawcett, an Independent Non-Executive Director is the Director of a company who had £95,000 on deposit at the end of the year and accrued interest, at standard Bank rates, of £577 during the year.

  There were transactions totalling £750 in 2018 with Kiloran Howard Photography. Kiloran Howard Photography is a company run by the Vice Chairman's wife (2017: £750).

  There were no loans or deposits outstanding to any directors at 31 December 2018 (2017: nil).

32. Ultimate parent company

The legal title to the ordinary share capital of the company is held equally by:

- Cambridgeshire County Council as trustees for the Cambridgeshire Local Government Pension Fund; and

- The master or keeper, fellows and scholars of the hall of the Holy Trinity in the University of Cambridge (commonly called Trinity Hall, Cambridge).

33. Subsequent events

The Bank has evaluated subsequent events between 31 December 2018 and 11 March 2019, the date the financial statements were issued. The Bank concluded that no subsequent events have occurred that would require recognition or disclosure in the financial statements.

34. Standards issued but not yet adopted

A number of new standards and amendments to standards have been endorsed by the EU and are effective for annual periods beginning on or after 1 January 2019. The Bank has not applied the following new or amended standards in preparing these financial statements.

New or amended standards	Summary of the requirements	Possible impact on financial statements
IFRS 16 Leases	IFRS 16, endorsed in October 2017, changes fundamentally the accounting for leases by lessees. It eliminates the current IAS 17 dual accounting model which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases and introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting. IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions. IFRS 16 is effective for annual reporting on or after 1 January 2019.	The Bank has assessed the requirement and has updated its operating lease policies and procedures to ensure compliance with the standard ahead of the effective date. The financial impacts are shown in note 29 above.
Amendments to IFRS 9 Financial Instruments	Prepayment Features with Negative Compensation (Amendments to IFRS 9) contains two amendments: • financial assets containing prepayment features with negative compensation can now be measured at amortised cost. • Clarification that an entity recognises any adjustment to the amortised cost of the financial liability arising from a modification or exchange in profit or loss at the date of the modification or exchange.	The Bank has considered these amendments and considered that they will not have an impact on the financial statements.

35. IFRS 15 Revenue from Contracts with Customers

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.

The new standard replaces IAS 18 'Revenue', IAS 11 'Construction Contracts' and related interpretations. It applies to all revenue arising from contracts with customers but does not apply to insurance contracts, financial instruments or lease contracts, which fall under the scope of other IFRSs. It also does not apply if two companies in the same line of business exchange non-monetary assets to facilitate sales to other parties. Of particular note, interest income, the main source of revenue for the Group, falls outside the scope of IFRS 15.

The Bank has adopted IFRS 15 and it is applied as of 1 January 2018 and comparative information is not restated. The Bank assessed its non-interest revenue streams that fall under the scope of IFRS 15 and determined that there was no impact on the amount or timing of revenue to be recognised as a result of the adoption of IFRS 15.

As such there is no adjustment to the opening balance of retained earnings or related tax balances. Furthermore, there is no impact to the statement of financial position or the statement of profit or loss and other comprehensive income.

36. IFRS 9 Financial Instruments transition impacts

IFRS 9 is effective for annual periods beginning on or after 1 January 2018 and replaced IAS 39 Financial Instruments.

The table below summarise the changes in categorisation and adjustments recorded on adoption of IFRS 9 on the Bank's balance sheet at 1 January 2018. There has been no change in the carrying amount of financial instruments on the basis of their measurement categories. All adjustments have arisen solely due to a replacement of the IAS 39 incurred loss impairment approach with an expected credit loss approach. The Bank's classification and measurement policies for assets and liabilities are included in their respective notes above while the loss impairment accounting policy is provided above in note 28.

£'000	31 Dec 2017 IAS 39 measurement category	1 Jan 2018 IFRS 9 measurement category	31 Dec 2017 IAS 39 carrying amount	1 Jan 2018 ECL adjustment	1 Jan 2018 IFRS 9 carrying amount
Assets					
Cash and balances at central banks	Loans and receivables	Amortised cost	164,295	-	164,295
Loans and advances to banks	Loans and receivables	Amortised cost	20,091	-	20,091
Debt securities	FVOCI	FVOCI	3,107	-	3,107
Loans and advances to customers	Loans and receivables	Amortised cost	689,954	(3,630)	686,324
Other assets and prepayments	n/a	n/a	868	-	868
Property plant and equipment	n/a	n/a	144	-	144
Intangible assets	n/a	n/a	520	-	520
Deferred taxation	n/a	n/a	253	617	870
Total Assets			**879,232**	**(3,013)**	**876,219**
Liabilities					
Customers' accounts	Amortised cost*	Amortised cost*	798,176	-	798,176
Derivative financial liabilities	FVTPL	FVTPL	121	-	121
Other liabilities and accruals	n/a	n/a	4,558	-	4,558
Provisions	n/a	n/a	134	-	134
Total Liabilities			**802,989**	**-**	**802,989**
Equity					
Share capital	n/a	n/a	23,955	-	23,955
Convertible loan notes	n/a	n/a	12,900	-	12,900
Available for sale reserve	n/a	n/a	36	-	36
Retained earnings	n/a	n/a	39,352	(3,013)	36,339
Total Equity			**76,243**	**(3,013)**	**73,230**
Total Liabilities and Equity			**879,232**	**(3,013)**	**876,219**

*£5m (less than 1% of total deposits) are categorised at FVTPL

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An analysis of the Bank's opening gross loans and advances to customers and ECL impairment allowance by IFRS 9 stage is provided below:

£'000	Not credit impaired		Credit impaired		
1 January 2018	Stage 1: Subject to 12-month ECL	Stage 2: subject to lifetime ECL	Stage 3: subject to lifetime ECL	Total	Provision cover %
Gross loans and advances					
Commercial real estate lending	623,605	38,267	3,510	665,382	-
Asset finance	28,015	-	141	28,156	-
Total on balance sheet	651,620	38,267	3,651	693,538	-
Loan commitments	84,781	-	-	84,781	-
ECL Impairment allowance					
Commercial real estate lending	(2,901)	(2,383)	(1,662)	(6,946)	1.0%
Asset finance	(140)	-	(128)	(268)	1.0%
Impairment allowance against balance sheet assets	(3,041)	(2,383)	(1,790)	(7,214)	1.0%

The following table reconciles the Bank's closing 2017 IAS 39 impairment allowance to the opening IFRS 9 allowance as at 1 January 2018. The Bank's impairment loss provision increased by £3.63m (before tax) as a result of adopting IFRS 9. This increase was higher than the anticipated £1.2m reported in the 2017 Financial Statement as a result of further reviews and enhancements to the Bank's expected credit loss models and processes.

£'000	Closing IAS 39 balance at 31 December 2017	ECL adjustment	Opening IFRS 9 balance at 1 January 2018
Specific allowances for impairment	1,789	5,425	7,214
Collective allowances for impairment	1,795	(1,795)	-
	3,584	3,630	7,214

37. Country by country reporting

The regulations under Article 89 of the CRD IV require the Bank to disclose the following information about the source of the Bank's income and the location of its operations:

Requirement	Disclosure
Name, nature of activities and geographical location	Cambridge & Counties Bank operates as a single entity exclusively in the United Kingdom. The principle activities of the Bank can be found in Note 1.
Average number of employees	As disclosed in Note 10 to the accounts.
Annual turnover and profit before tax	As disclosed in the Income Statement on page 41.
Corporation tax paid	As noted in the Cash Flow Statement on page 44.
Public subsidies	There were none received in the current or prior year.

Notes to the Financial Statements
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Contact Details

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