PRESS RELEASE

Thursday 7 May 2020
For immediate release

SECURE TRUST BANK PLC

Audited Final Results for the year ended 31 December 2019

Continued strong performance in 2019 delivering increased profits

Secure Trust Bank PLC ("STB", the "Bank" or the "Group") is pleased to announce an 11.5% increase in Group profit before tax to £38.7m for the year ended 31 December 2019.

Controlled growth in both our Business Finance and Consumer Finance businesses continued to deliver increased profits in 2019. Customer numbers, lending balances and income increased whilst the cost of risk continued to decrease. These factors have driven strong growth in reported and adjusted earnings despite the slowdown in UK economic activity in the second half of 2019.

The first two phases of the Motor Finance transformation programme were successfully completed in 2019. The Group expanded its savings offering with the launch of its fixed term Cash ISA in 2019 and the Access product range developed for launch in 2020. Capital and liquidity positions remain healthy.

In the light of the COVID-19 outbreak, the Group has implemented contingency plans to ensure the wellbeing of its workforce, the majority of whom are now working from home, while focusing on supporting its customers and business partners, managing risks and safeguarding capital. HM Government's lockdown strategy has led to diminished Consumer Finance new business, with no new Motor Finance lending being written at present and Retail Finance running at circa 50% of normal, supported by demand for sports equipment and consumer electronics such as laptops. Significantly increased impairment charges are likely due to higher unemployment and falls in asset values and will impact the 2020 result. Additional stress testing has been undertaken and is continuing to assess the potential impact of the crisis on capital and liquidity positions, which remain healthy. Assessments to date indicate that the short duration of the loan books helps to maintain capital and liquidity levels above regulatory requirements. Given the uncertain impact of the outbreak on the UK economy, the Group has currently suspended forward guidance for 2020 and has decided not to recommend a final dividend for 2019.

FINANCIAL HIGHLIGHTS

- Statutory profit before tax up 11.5% to £38.7m (2018: £34.7m)
- Adjusted profit before tax of £41.1m (2018: £36.7m), up 12.0%
- Continued improvement in loan book quality has reduced cost of risk to 1.4% (2018: 1.8%)
- Healthy common equity tier 1 ratio of 12.7% (2018: 13.8%*) supporting the strong growth in the loan portfolios
- Total capital ratio of 15.0% (2018: 16.3%*)
- Operating income £165.5m (2018: £151.6m) up 9.2%
- Basic earnings per share 168.3p (2018: 153.2p) up 9.9%
- Adjusted earnings per share 178.6p (2018: 161.8p) up 10.4%
- Adjusted return on average equity of 13.5% (2018: 13.1%)
- Total assets £2,682.8m (December 2018: £2,444.3m) up 9.8%
- No final dividend recommended for 2019 (2019 interim dividend: 20p per share; 2018 total dividend: 83p per share)

* Note: After accounting for the 2018 dividend, the CET 1 ratio for 2018 is 13.2% and the total capital ratio for 2018 is 15.7%

OPERATIONAL HIGHLIGHTS

- Total customer numbers increased by 24.9% to 1,598,256 (2018: 1,279,783)
- Customer satisfaction scores, as measured by Feefo, continue to be above 90%
- New Cash ISA products launched in April 2019
- V12 Vehicle Finance brand launched and first two phases of Motor Transformation Programme implemented
- Overall loan book £2,450.1m (2018: £2,028.9m) up 20.8%
- Total annual new business lending volumes grew 12.0% to £1,413.0m (2018: £1,261.9m)
- Total Consumer Finance balances now exceed £1,200.9m (2018: £990.4m), with Retail Finance balances growing by 15.4% since December 2018 to £688.9m
- Total Business Finance balances rose to £1,241.6m following continued strong growth in Real Estate Finance and Commercial Finance balances
- The Commercial Finance invoice financing operation has now funded over £3bn of customer invoices since inception in 2014

- Customer deposits increased to £2,020.3m (2018: £1,847.7m) up 9.3%

Lord Forsyth, Chairman, said:

"2019 was another successful year for the Group with double digit growth in profits before tax delivered for the second successive year. This and a strong start to 2020 would ordinarily see the Board recommend an increased dividend. However we have rapidly entered a period of extreme uncertainty driven by the COVID-19 outbreak and in these exceptional circumstances the Board considered that it was more prudent to preserve capital. Accordingly, the Board is not recommending a final dividend for approval by shareholders at the Annual General Meeting. The Board will keep this under review. The Group has plans in place which seek to mitigate business disruption as far as practical and to continue supporting customers, colleagues and business partners during this unsettling period."

Paul Lynam, Chief Executive, said:

"In 2019 we delivered a strong performance across a broad range of customer, staff and financial metrics and delivered 11.5% growth in profit before tax, notwithstanding the marked slowdown of the UK economy in the second half of the year and a substantial fall in used motor car values during the summer. The Group entered 2020 aspiring to deliver double digit profit before tax growth for the third successive year. After the first quarter the group was trading in line with management expectations, despite increasing impairment provisions to recognise the threat of COVID-19. From mid-March we have seen a slowdown in demand for our products, particularly in respect of our Consumer Finance lending. The extent to which this contraction continues will be influenced by any revival in economic activity and our credit risk appetites which will remain cautious. Healthy capital and liquidity positions, combined with the Group's flexible business model, means it is well placed to navigate the current crisis."

This announcement together with the associated investors' presentation are available on:

www.securetrustbank.com/results-reports/results-reports-presentations

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Forward looking statements

This document contains forward looking statements with respect to the business, strategy and plans of Secure Trust Bank PLC and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Secure Trust Bank PLC's or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Secure Trust Bank PLC's actual future results may differ materially from the results expressed or implied in these forward looking statements as a result of a variety of factors. These include UK domestic and global economic and business conditions, risks concerning borrower credit quality, market related risks including interest rate risk, inherent risks regarding market conditions and similar contingencies outside Secure Trust Bank PLC's control, any adverse experience in inherent operational risks, any unexpected developments in regulation or regulatory and other factors. The forward looking statements contained in this document are made as of the date hereof, and Secure Trust Bank PLC undertakes no obligation to update any of its forward looking statements.

Chairman's statement

Despite some headwinds, 2019 has been another successful year for the Group.

Statutory profit before tax grew by 11.5% to £38.7 million, basic earnings per share by 9.9% and lending balances exceeded £2.4 billion at the end of the year.

By the end of the year we had more than 1.5 million customers, deposits of £2,020.3 million and the cost of risk had fallen from 1.8% in 2018 to 1.4% (see page 190 for definition).

COVID-19 will cause substantial damage to the UK and global economy. The Group has plans in place which seek to mitigate business disruption, protect the welfare of our employees and continue supporting customers and business partners during this unsettling period.

The strong start to 2020 would ordinarily see the Board recommend an increased dividend. We have now entered a period of extreme uncertainty driven by the COVID-19 outbreak, however, and in these exceptional circumstances the Board considers that it is prudent to preserve capital and is not recommending a final dividend for approval by shareholders at the Annual General Meeting.

In accordance with the current UK Government guidance on social distancing, prohibition on non-essential travel and public gatherings, the Board regrets that it will not be possible for shareholders to attend this year's AGM in person. We would encourage all shareholders to vote on the resolutions proposed at the AGM however, and further details are set out in the Notice of AGM.

The Group Employee Council established last year is working well and the Group was ranked as the 29th best large company to work for by Great Place to Work® in 2019. We have made changes to benefits and to flexible working to help encourage diversity in our workforce. Our matched giving scheme has been extended to support the impressive charitable work undertaken by our employees.

As a responsible business, we are determined to make a positive contribution to the communities in which we operate, the impact of climate change features on our agenda and you can see the impressive activities conducted by our employees set out on page 55 of the annual report and accounts.

As a Board we are committed to good governance and will continue to strive to ensure our committees, our Directors' Remuneration Policy and our actions maintain compliance with best practice.

At the year-end we announced changes to the composition of the Board and its Committees arising from the appointment of David McCreadie as a Non-Executive Director, the resignation of Neeraj Kapur as Chief Financial Officer and the prospective retirement of Paul Marrow at the 2020 AGM. Paul is deemed to be no longer independent under the Corporate Governance Code after nine years' service. He will be much missed and has made an outstanding contribution to our business. I should also like to wish Neeraj well in his new role at Provident Financial. I am especially grateful to Ann Berresford, Paul Myers, Victoria Stewart, Lucy Neville-Rolfe and David McCreadie for taking on additional Board responsibilities.

Finally, I would like to thank all my colleagues for another year of achievement and for their continued dedication and commitment and especially our Chief Executive Paul Lynam who has delivered double-digit growth in profits before tax for the second year in succession. I am grateful too for the resilience my colleagues at STB have shown as we navigated the troubled waters of COVID-19 to continue to serve our customers and support our wider workforce.

Given the resources at our disposal, the talents of our people, the flexibility of our business model and our clear strategy, we are well placed to tackle the exceptional challenges arising from COVID-19.

Lord Forsyth
Chairman

6 May 2020

Chief Executive's statement

I am delighted to report a strong year's performance for 2019 when viewed across a broad range of customer, staff and financial metrics. I would like to thank the entire STB team for their commitment and professionalism last year and for the way they have continued delivering good outcomes for our customers.

As expected, the strategic repositioning of the business model, initiated in 2017 towards lower risk lending, and ongoing growth in both Business Finance and Consumer Finance, have continued to deliver benefits. Customer numbers, lending balances and income have grown whilst the cost of risk (see page 190 for definition) has continued to fall. These factors have driven strong growth in reported and adjusted earnings.

The financial results for 2019 show the Group statutory profit before tax increasing by 11.5% to £38.7 million compared to the £34.7 million of profit before tax generated during 2018. Adjusted profit before tax on the same basis has increased by 12.0% to £41.1 million. Adjusted earnings per share increased by 10.4% over the same period with basic earnings per share increasing by 9.9%.

It is noteworthy that the profit growth above was achieved after accommodating a significant fall in used car values in the summer of 2019, which impacted impairment provisions, and a very marked slowdown in UK economic activity last autumn ahead of the planned Brexit date of 31 October and then the General Election.

The Group entered 2020 aspiring to deliver double digit profit before tax growth for the third successive year. After the first quarter performance was in line with management expectations, with strong performance achieved despite increased impairment provisioning to recognise the threat of COVID-19. However in recent weeks the UK and global economies have become exposed to unprecedented levels of uncertainty with recessions looking inevitable in many countries. Therefore, notwithstanding a very positive start to the year it is currently impossible to estimate with any degree of accuracy how damaging this virus will be for the UK economy. The lockdown imposed by HM Government in late March 2020 has resulted in demand for the Group's Motor Finance products drying up completely and our Retail Finance lending volumes are circa 50% of expectations. Demand for new Invoice Finance and Real Estate Finance has largely evaporated. The consequence of the material falls in new lending business being written means that the Group's customer lending balances have started to contract for the first time in many years. This contraction is likely to persist and will be influenced by any revival in economic activity and our credit risk appetites which will remain cautious. In light of the rapidly evolving situation the Group has undertaken significant additional stress testing to assess the potential impact of the crisis on capital and liquidity positions which remain healthy. Assessments to date indicate that the short duration of loan books helps to maintain capital and liquidity levels above regulatory requirements throughout a very severe recession. Given the extreme uncertainty we are not providing forward guidance for 2020 at this time.

The Group's immediate focus is on supporting colleagues, customers and business partners and a range of plans is in place to seek to mitigate the operational and economic impact of COVID-19. The Group expects that once through the worst of the outbreak, and assuming a trade deal is agreed with the EU, the UK economic outlook will improve strongly which the Group will seek to leverage as it continues to execute its clearly defined growth strategy. We are well placed to support an increase in demand for working capital funding from businesses and residential development finance from house builders. The latter is aided by a regulatory capital efficient Enable Guarantee we have agreed with the British Business Bank. We are progressing significant investment in our Motor Finance business which will see this portfolio grow considerably over the next five years via the provision of dealer stocking finance (now live) and a prime motor proposition for consumers.

Ongoing growth in customer base with satisfaction levels remaining very positive

Across our consumer and SME business products we are serving well over 1.5 million customers. Total customer numbers are a record 1,598,256 customers which is an increase of 24.9% on the total customer base of 1,279,783 as at 31 December 2018.

We continue to focus on consistently delivering good outcomes for customers and ensuring that the design of our products is appropriate for their needs. From a conduct and behaviour perspective, we do not cross-subsidise losses or low profits on some products with super profits on others. Nor do we discriminate between customers by, for example, paying very low deposit interest rates to existing loyal customers whilst offering much higher rates to new ones. We believe that our approach is the appropriate way to interact with our customers for the long-term benefit of all parties.

Customer satisfaction is measured in a number of ways. It is reassuring that 2019 has once again seen us consistently achieve customer satisfaction ratings in excess of 90% across all of our products as measured by Feefo. We also use Net Promoter Scores to assess our customer service and these scores exhibit similar positive trends to those derived from Feefo.

I am delighted to confirm that for the seventh year running we have retained the Customer Service Excellence standard. This indicates our customer service has been judged to meet Government standards of excellence which are benchmarked against high-performing organisations.

Whilst being pleased with external accolades and ongoing high customer satisfaction scores we are in no way complacent. We are focused on improving our existing service and products and diversifying our customer proposition via targeted investment in people, systems, processes and products.

Operational progress

Operational resilience remains a key matter for regulatory scrutiny and we have adopted a proactive approach. Having carefully considered the various discussion and consultation papers published by the regulators we have updated our operational risk plans in relation to the identification, assessment and management of risks. This extends to managing the third party risks that arise when outsourcing activities. I am pleased to note that the Group received Cyber Essentials Plus accreditation in the second half of 2019, which is a good reflection on our continued cyber security focus.

Given the continuing growth across the Group and our ongoing ambitions, we acquired new freehold premises in Solihull very close to the existing Head Office building. This is now operational and with an eye on the future, this is geared to accommodate more agile working practices, including those which will reduce our carbon footprint. These practices, and our well-established business continuity plans, will help us deal with the impact of COVID-19.

Healthy capital position

Our ongoing priority is to safeguard the reputation and sustainability of the Group through conservative balance sheet management, investment for long-term sustainable growth and robust risk and operational controls.

Our year-end CET1 capital levels are healthy with a CET1 ratio of 12.7% compared to the 2018 year-end position of 13.8%. The Total Capital Ratio was 15.0% (2018: 16.3%) and our leverage ratio as at 31 December 2019 was 9.8% (2018: 10.0%). The year-on-year movement in CET1 is a function of the investment of capital to support the strong growth in the loan portfolios.

In December 2019 the Bank of England announced an increase in the countercyclical capital buffer from 1% of risk-weighted assets to 2%, with effect from December 2020, and its intention to consult on offsetting this increase via reductions in variable Pillar 2A add-ons, to ensure the levels of capital in the system stay broadly unchanged. Since then, as part of the package of measures introduced to mitigate the impact of COVID-19, the buffer has been reduced to 0%. This intervention is welcomed and we will continue to monitor capital levels closely throughout the period affected by the outbreak.

Prudent liquidity management

Our year-end loan to deposit ratio was 121.3% (2018: 109.8%). This ratio was higher than normal due to the strong conversion of new business pipeline ahead of year-end. The ratio has reverted to normal levels in the first part of 2020. Customer demand for our deposit products remains very strong, and I am pleased to continue to note that the majority of customers with maturing medium-term savings bonds continue to reinvest their funds into deposit products with us.

The Bank has continued broadly to match-fund its customer lending with customer deposits. This strategy seeks to mitigate maturity transformation and interest basis risks. Given the growth in the balance sheet in recent years, we have continued to invest in our Treasury function and capabilities to further mitigate interest rate risks via the use of hedging instruments. This is a significant step in the development of the Group's capabilities.

We continued to leverage the benefits from the deposit platform installed in 2017 via the launch of a new Cash ISA product to coincide with the new tax year in April 2019. Cash ISAs are the second biggest pool of consumer deposit liquidity in the UK and typically attract margins around 20% below non-cash ISA deposits. Access Account products have also been developed and tested and are ready for launch.

Usage of the Term Funding Scheme ('TFS') is broadly unchanged over the last 12 months. This remains a modest part of the Bank's funding. We note the extension to this funding in light of COVID-19 and will be considering whether the Group will take advantage of it.

Income grew and cost of risk reduced

The Group's operating income grew by 9.2% to a record level of £165.5 million compared to £151.6 million in 2018. Operating costs rose 11.5% to £94.2 million from £84.5 million in 2018, reflecting continued investment in the business. The cost to income ratio has increased to 56.9% (2018: 55.7%) for reasons explained on the following page.

In overall terms the loan portfolios have performed as expected with the benefits of the strategic repositioning remaining evident. This is reflected in a reduction in the cost of risk to 1.4% in 2019 compared to 1.8% for 2018. This is driven by the improving book quality and consequent reduction in probability of default. This improvement would have been more pronounced save for the UK car market experiencing unusually severe seasonal falls in asset values during the summer of 2019.

During the year we have recognised £2.1 million of improvements in credit quality relating to our debt collection business as an impairment gain, whereas in the previous year we included the equivalent £2.0 million of improvements in income. This makes no difference to the profit figures but does serve to reduce both income and the cost of risk. Adjusting for this and for costs relating to our freehold property purchase, on a like-for-like basis compared to 2018, the 2019 cost income ratio is stable at 55.5% and the 2019 cost of risk is 1.5%, still well below the 2018 level of 1.8%.

We have continued to refine our credit risk appetite and acceptance criteria over 2019. As a matter of course, we regularly review our credit criteria and pricing to take into account our view of the current and future economic conditions. We have also continued to develop our ability to use artificial intelligence and machine learning to further refine our credit decisions.

Customer lending activities

Once again, double digit percentage growth was achieved across the Group's loan portfolio in 2019, notwithstanding the closure of the consumer mortgage operations in the spring. Total annual new business lending volumes grew 12.0% to £1,413 million (2018: £1,262 million) which translated to an increase of 20.8% in overall balance sheet customer lending assets to £2,450 million (2018: £2,029 million).

Consumer Finance

In 2019 total consumer lending, excluding mortgages, increased 20.9% to £1,095.0 million (2018: £905.7 million). Our Consumer Finance lending strategy during 2019 was to cease new mortgage originations and continue to allocate capital to support the strong ongoing growth in Retail Finance, which is shorter term in duration and prime in nature, and to progress the investment in Motor to support the entry into dealer and prime consumer finance.

The Retail Finance point of sale business grew strongly as intended, with net customer lending balances at 31 December 2019 increasing 15.4% to £688.9 million (2018: £597.0 million). Our Retail Finance business has continued to evolve as we have grown into one of the largest participants in this market. The average loan duration has remained short and provides optionality in the event of worsening economic conditions, such as those arising due to the COVID-19 outbreak. On the assumption the government negotiates a trade deal with the EU which is not economically disruptive, clear scope exists for us to offer Retail Finance in long duration loan sectors that we have not heavily targeted in the past.

2019 was a busy year for our Motor business which was successfully rebranded as V12 Vehicle Finance in the summer. The first two phases of our Motor Transformation Programme focused on the provision of auction and dealer stocking finance. These were successfully completed in 2019. The next phase is the launch of a prime lending proposition for consumers towards the end of 2020 with the final phase being the re-platforming of the existing near prime portfolio. This will give us a very strong dealer and consumer proposition allowing us to compete directly with the likes of Close, Blue and Startline. We will also continue to grow the near prime book. As noted above, the very large fall in used car prices during the summer increased the Motor Finance impairment charge. The improvement in the underlying credit quality of the customers has been such that we have been able to accommodate this unexpected charge and still deliver a broadly on plan performance for Motor in 2019.

Motor net lending balances have increased by 17.1% to £323.7 million at 31 December 2019 compared to £276.4 million in the prior year.

Debt Managers (Services) Limited ('DMS'), which is active in third party debt collection and portfolio acquisition, continued to perform well during 2019. DMS revenue from external customers increased to £8.4 million from £7.0 million in 2018.

When announcing our decision to cease originating consumer mortgage lending last year, I noted my expectation that the trend of increasing loan-to-value metrics and lower new net lending margins was likely to be sustained throughout 2019. This has proved to be the case with net interest margins in the sector being squeezed despite the risk indicators including Loan to Value, Loan to Income and average loan duration all increasing. These market dynamics show no sign of abating given the ambitions of the ring-fenced banks to grow market share in UK mortgages. 2019 was the first year since 2009 when the 'big 6' lenders grew their share of gross new mortgage lending. Inevitably this has squeezed other lenders.

This would seem to vindicate our decision to deploy capital elsewhere across our business model. The decision to cease lending was obviously very tough on the staff members impacted who behaved very professionally during this difficult period. Fulfilment of our pipeline led to our mortgage lending balances increasing from £84.7 million as at 31 December 2018 to £105.9 million as at 31 December 2019, representing growth of 25.0%. This book is performing in line with our expectations. As expected the cessation of new lending did not have a material impact on the Group's earnings in 2019.

Business Finance

The Group's SME lending operations have grown strongly, as targeted, and I expect further positive progress in 2020 (subject to the impact of COVID-19) given we started the year with a strong new business pipeline. Total business customer lending balances in 2019 increased by 20.9% to £1,241.6 million (2018: £1,027.3 million). Real Estate Finance lending balances increased by 25.0% to £962.2 million as at 31 December 2019 (2018: £769.8 million).The loan book is performing well and remains biased in favour of modestly leveraged residential investment lending. This is reflected in the portfolio composition, which in round terms is split 75% / 25% in favour of investment lending versus development lending. We have continued to adopt a cautious stance towards Central London house building finance. Demand for property development finance slowed during 2019 albeit the units we have financed have continued to sell well with the underlying loans being satisfactorily repaid. We had seen an increase in enquires about housing development finance since the general election and expected this to translate into increased lending here in 2020. The economic shock arising from COVID-19 has seen this demand fall away and the extent and speed at which this returns remains to be seen. The average LTV across the whole Real Estate Finance portfolio remains less than 60% which means we are very well placed to support customers disrupted by COVID-19 without materially increasing our risk profile.

The asset finance market continued to see very aggressive risk appetites and pricing during 2019. We have allocated capital to our other products in 2019 and allowed Asset Finance lending balances to contract rapidly to £27.7 million as at 31 December 2019 compared to £62.8 million a year ago. At these trajectories these balances will be de minimis by the end of 2020. We will revisit our appetite for recommencing new lending, possibly via inorganic routes, in light of developments in this market post COVID-19.

Secure Trust Bank Commercial Finance, the invoice finance division of the Bank, had another excellent year and has now funded over £3.0 billion of customers' invoices since launch. Excluding the high street banks, based on customer lending balances we are now the 9th largest operator in the invoice finance market but given the fragmented nature of the market we have substantial opportunities to continue to grow very strongly in this sector. This is evidenced by net customer lending balances, which grew 29.3% to £251.7 million at 31 December 2019 (2018: £194.7 million). This growth would have been more pronounced but for the insolvencies of two large steel businesses where we avoided any credit losses despite lending facilities of circa £60 million. These are good examples of why I believe we have one of the most capable teams of invoice financiers in the UK, supported by a scalable modern IT platform. This, coupled with Group management's experience in SME and corporate lending, gives STB a distinct advantage when it comes to structuring transactions and responding rapidly to opportunities. Impairment levels here have been immaterial reflecting very robust credit management disciplines.

Fee-based accounts

As expected, the legacy OneBill product, which closed for new business in 2009, continues to see customer numbers decline over time. Customer numbers fell to 17,024 by 31 December 2019 compared to 18,032 a year earlier.

Evolving regulatory and competitive environment

It has been a very busy year from a Prudential Regulation and Conduct Regulation perspective. Regulatory expectations have continued to become more demanding in respect of issues such as operational resilience, financial crime, regulatory reporting and cyber security. The Group is continuing to invest and evolve to ensure it meets these changing expectations.

The UK's exit from the EU could have far reaching consequences for the Finance industry in this country. As a UK only firm, we do not expect to be directly impacted by any trade deal reached but will remain very alert to developments.

Another significant challenge facing the industry in the next year or so is the transition from LIBOR to SONIA, which will be very demanding for many firms. Given our very short duration balance sheet, we have been able to manage our exposure to LIBOR such that the move to SONIA is not an issue for us.

The large banks were required to implement ring-fencing of most of their UK operations with effect from 1 January 2019. These firms can no longer move surplus capital and funding around their operations overseas to maximise marginal returns. Instead, surplus capital and funding is effectively trapped in the UK. The introduction of the ring-fencing has usefully highlighted the sheer scale of the advantages enjoyed by these firms in terms of capital requirements and funding costs. As a result these firms are able to offer extremely low priced mortgages to new customers in order to gain market share. As I've noted above, 2019 saw the 'big 6' lenders grow their share of the new mortgage lending market for the first time since 2009. These firms are clearly interested in growing in the scale lending markets in the UK and it seems likely returns for lenders in mortgages will remain under pressure.

In the short term from a consumer perspective ever-cheaper mortgages will be seen as a good thing. However, it is not difficult to see how continued competitive aggression by the largest firms, with the lowest capital requirements and cheapest funding costs, will see them continuing to gain market share at the expense of smaller firms. So, absent of steps to create a genuinely level playing field, it is not difficult to envisage a future where UK banking becomes extremely polarised with systemic firms on one side holding the vast majority of the market in the scale lending sectors, small specialist lenders, like the Group, operating in niches that are sub-scale for the large firms on the other side with no medium-sized firms in the middle ground.

The very tight concentration of UK banking market share in the hands of a small number of 'too big to fail' banks was a key factor in the severity and duration of the last UK recession. It is therefore encouraging to note that the regulators and the new Government recognise that more needs to be done to safeguard and promote competition in UK banking without making the system weaker. As I have noted before, post-Brexit the Government could choose to adopt a much more proportionate approach to the regulation of smaller non-internationally active banks than is possible today. One option could be for the UK to adopt a similar approach to that in the US where there are five tiers of regulation rather than the largely 'one size fits all' Capital Requirements Regulation implementing the Capital Requirements Directive IV, in the UK at present.

In summary, whilst the situations above remain somewhat fluid, I am increasingly optimistic that key stakeholders will take the opportunity arising from the UK's exit from the EU to take action to help improve the competitive positioning of smaller banks in the UK. I expect the need for a level competitive playing field will become very obvious as the UK navigates the economic effects of COVID-19. Clearly any changes in the regulatory regimes that enable non systemic banks to offer more choice to consumers and SMEs to support economic growth will be a positive development for the UK and for the smaller firms.

Strategic priorities

The Group's medium-term strategy remains unchanged, albeit for obvious reasons our number one priority is to support colleagues, customers and business partners as we navigate the challenges arising from the COVID-19 virus outbreak. The benefits of a diversified business model have been evident over the last two years. Despite a slowing economy and a fierce price war in mortgages, the largest lending market in the UK, we have been able to continue to increase customer lending balances and profit before tax by taking market share in our chosen market segments, without compromising our targeted risk parameters.

Once the virus has passed we plan to refocus the Group on the strategic priorities of:

1. Organic growth in responsible lending across a diverse portfolio of attractive segments
2. Continued investment in broadening our product offerings to customers
3. Pursuing M&A activity in line with our strategy
4. Optimising our capital and liquidity strategies
5. Continuing to target delivery of profit growth in the medium term to create shareholder value

We have been active across all five of these areas during 2019 and will remain disciplined and focused here in the year ahead and beyond.

Current trading and outlook

Notwithstanding the slowing in UK economic activity in the second half of 2019, we delivered a strong set of results for the year. 2020 started well with trading being in line with management expectations.

Management and the Board are very carefully monitoring the ongoing trade negotiations between the UK and EU. Whilst I believe these parties will agree at least a limited agreement before the transitional period expires at the end of the year, there is the potential for an economic shock should this not be the case. We have a range of early warning indicators ('EWIs') and contingency plans in place in the event that the absence of a robust trading agreement with the EU leads to an economic downturn.

As noted earlier in this statement, it is difficult to predict the economic impact of the COVID-19 outbreak, though it will clearly be significant. The imposition of the UK lockdown has materially reduced our new lending volumes. As a result our short duration lending portfolio has started to contract. This contraction is likely to persist and will be influenced by any revival in economic activity and our credit risk appetites which will remain cautious. In light of the rapidly evolving situation the Group has undertaken significant additional stress testing to assess the potential impact of the crisis on capital and liquidity positions which remain healthy. Assessments to date indicate that short duration of loan books help to maintain capital and liquidity levels above regulatory requirements throughout a very severe recession. Plans are in place which seek to limit the operational and economic impact of COVID-19 but, given the highly fluid situation, at this stage it is impossible to quantify potential impacts with certainty.

In summary, the Group's lending portfolio is appropriately positioned for the current conditions and the short duration nature of the asset portfolio means the Group can react quickly to both opportunities and threats.

The Group entered 2020 on the back of successful years in 2018 and 2019. With sufficient capital and liquidity positions, we are now extremely focused on supporting customers, colleagues and business partners as we navigate the COVID-19 induced economic challenges, and are prioritising the safeguard of capital and liquidity resources over balance sheet growth at this time. Once the COVID-19 storm has passed we will look to refocus on the pursuit of our strategic priorities.

Paul Lynam
Chief Executive Officer

6 May 2020

Key performance indicators

The following key performance indicators are the primary measures used by management to assess the performance of the Group.

Certain KPIs represent alternative performance measures that are not defined or specified under IFRS. Definitions of the financial KPIs, their calculation and an explanation of the reasons for their use can be found in the Appendix to this preliminary announcement. In the narrative of this financial review, KPIs are identified by being in bold font.

Margin ratios

	2019	2018
Net interest margin %	**6.5**	7.4

Why we measure this
Shows the interest margin earned on the Group's loan books, net of funding costs

	2019	2018
Net revenue margin %	**7.3**	8.3

Why we measure this
Shows the overall net margin earned on the Group's loan books, including fees and commissions

	2019	2018
Gross revenue margin %	**9.4**	10.4

Why we measure this
Shows the yield of the Group's loan books, including fee and commission income

Cost ratios

	2019	2018
Cost of funds %	**2.0**	2.0

Why we measure this
Measures the cost of the Group's customer deposits and other funding sources

	2019	2018
Cost to income ratio %	**56.9**	55.7

Why we measure this
Measures how efficiently the Group utilises its cost base to produce income

	2019	2018
Cost of risk %	**1.4**	1.8

Why we measure this
Measures how effectively the Group manages impairment losses

Loans

	2019	2018
Loans and advances to customers £m	**2,450.1**	2,028.9

Why we measure this
Shows the growth in the Group's lending balances, which generate income

	2019	2018
Loan to deposit ratio %	**121.3**	109.8

Why we measure this
Measures the adequacy of liquidity by comparing loan balances to customer deposits

	2019	2018
Total funding ratio %	**107.5**	118.2

Why we measure this
Measures the adequacy of liquidity by comparing all funding held by the Group to loan balances

Adjusted profit

	2019	2018
Adjusted profit before tax %	**41.1**	36.7

Why we measure this
Adjusts profit to improve comparability of information between reporting periods

	2019	2018
Adjusted profit after tax %	**33.0**	29.9

Why we measure this
Adjusts profit to improve comparability of information between reporting periods

EPS

	2019	2018
Basic earnings per share pence	**168.3**	153.2

Why we measure this
Demonstrates the earnings attributable to each shareholder

	2019	2018
Adjusted basic earnings per share pence	**178.6**	161.8

Why we measure this
Demonstrates the earnings attributable to each shareholder, adjusted to improve comparability of information between reporting periods

Return ratios

	2019	2018
Adjusted return on average equity %	**13.5**	13.1

Why we measure this
Measures the Group's ability to generate profit from the equity available to it

	2019	2018
Adjusted return on required equity %	**14.1**	14.8

Why we measure this
Relates profitability to the capital that the Group is required to hold

	2019	2018
Adjusted return on average assets %	**1.3**	1.4

Why we measure this
Demonstrates how profitable the Group's assets are in generating revenue

Non-financial KPIs

	2019	2018
Customer FEEFO ratings Stars	**4.7**	4.7

(mark out of 5 based on star rating from 1,754 reviews. 2018: 1,175 reviews)

Why we measure this
Indicator of customer satisfaction with the Group's products and services

	2019	2018
Employee survey trust index score %	**79**	77

(based on 2019 all staff survey)

Why we measure this
Indicator of employee engagement and satisfaction

	2019	2018
Environmental intensity indicator	**4.7**	3.5

(tonnes carbon dioxide per £1 million Group income)

Why we measure this
Indicator of the Group's impact on the environment.

Please see page 58 of the annual report and accounts for an explanation of the movement in this indicator, which is due to a change in measurement methodology

Financial review

Adjusted profit reconciliation	**2019 Total £million**	2018 Total £million
Interest, fee and commission income	212.3	188.6
Interest, fee and commission expense	(46.8)	(37.0)
Operating income	165.5	151.6
Impairment losses	(32.6)	(32.4)
Operating expenses	(94.2)	(84.5)
Profit before tax	**38.7**	**34.7**
Adjustments to profit before tax (see below)	2.4	2.0
Adjusted profit before tax	**41.1**	**36.7**
Adjusted tax	(8.1)	(6.8)
Adjusted profit after tax	**33.0**	**29.9**
Adjusted basic earnings per share (pence)	**178.6**	**161.8**

Statutory results		
Profit before tax	**38.7**	**34.7**
Tax	(7.6)	(6.4)
Profit after tax	**31.1**	**28.3**
Basic earnings per share (pence)	**168.3**	**153.2**
Adjustments to profit before tax		
Fair value amortisation	0.2	0.3
Transformation costs	1.0	0.4
Bonus payments	0.1	1.3
Revaluation deficit	1.1	–
Adjustments to profit before tax	**2.4**	**2.0**

Profit and earnings

We have continued to deliver strong profit growth, despite the slowing of economic growth in the second half of the year. Statutory profit before tax rose to £38.7 million (2018: £34.7 million) and **adjusted profit before tax** rose to £41.1 million (2018: £36.7 million). This represents increases of 11.5% and 12.0% respectively.

Consequently, earnings per share rose from 153.2p per share to 168.3p per share. On an **adjusted earnings per share** basis, the increase was from 161.8p per share to 178.6 per share. Detailed disclosures of earnings per ordinary share are shown in Note 9.

Return measures

We measure **adjusted returns on average assets, average equity and required equity** as set out in the KPIs table on page 18.

The increase in profit year-on-year led to an increase in the **adjusted return on average equity**. The small decrease in the **adjusted return on average assets** was primarily due to the significant growth in assets over 2018 (29.2%). In 2019, the growth in profit was slightly higher than the growth of assets over the year (9.2%). As expanded upon below, the increase in **loans and advances to customers** was greater than the increase in profit, which led to a fall in the **adjusted return on required equity**.

The components of our profit are analysed in the following sections.

Interest, fee and commission income

Interest, fee and commission income is made up of interest income, which is predominantly earned on loans and advances to customers, and fee and commission income, which consists principally of fees from the OneBill, Commercial Finance, Retail Finance and Motor Finance products and commissions earned on debt collection activities in DMS.

Interest income was £191.4 million for 2019, increasing by 13.1% (2018: £169.2 million), which was driven by the growth of our loan books over the year**. Loans and advances to customers** increased from £2,028.9 million to £2,450.1 million over the year, a 20.8% increase.

Fee and commission income increased by 7.7% to £20.9 million (2018: £19.4 million).

The **gross revenue margin** reduced from 10.4% to 9.4%. This reflects two factors: the continued shift of our Consumer Finance business to lower risk lower return lending, the impact of which on impairments is noted below, and the change in the overall mix of lending during the year. While growth in higher margin Motor Finance and Retail Finance lending balances exceeded 15% year-on-year, this was lower than the more significant growth in the lower risk Business Finance portfolios.

Interest, fee and commission expense

Interest, fee and commission expenses is made up of interest expense, which is incurred in respect of deposits from customers, subordinated liabilities, TFS and index long-term repo ('ILTR') borrowings, and fee and commission expense, comprising mainly fees and commissions on the Motor product and commissions paid on debt collection activities in DMS.

Interest expense was £46.0 million (2018: £35.5 million for 2018), an increase of 29.6%. The **cost of funds** remained stable at 2.0% (2018: 2.0%). The increase in interest expense arises due to the Bank of England base rate rise during 2018 applying throughout 2019, and interest on the Tier 2 capital issued in 2018 also applying throughout the year.

Fee and commission expense was £0.8 million (2018: £1.5 million). The main reductions were in DMS and OneBill.

The Group's **net interest margin** reduced from 7.4% in 2018 to 6.5%% in 2019, primarily due to the continued shift to lower risk lending and the mix of business referred to above.

Operating income
Operating income increased by 9.2% to £165.5 million (2018: £151.6 million).

The **net revenue margin** for 2019 was 7.3% compared with 8.3% for 2018. The reduction in this margin is due to the factors referred to above.

Impairment losses
Impairment losses during the year were £32.6 million (2018: £32.4 million). The very modest increase in impairment losses, given the 20.8% increase in **loans and advances to customers** over the year, demonstrates the continued improvement of the quality of the loan book. The **cost of risk** reduced significantly from 1.8% in 2018 to 1.4%.

This improvement has arisen despite the fall in used vehicles valuations, noted in the 2019 Interim Report, which had increased credit loss provisions in respect of the Motor Finance portfolio. The impairment charge in respect of Motor Finance increased by 23.9% from £11.3 million to £13.8 million, driven in part by these valuations, on a book which grew by 17.1%. The credit quality of Motor Finance borrowers continued to improve over 2019. The accelerated recognition of losses brought about by the requirements of IFRS 9, particularly for growing books, has also been offset by the improvement in performance.

As in previous years, our impairment losses are focused almost entirely on the Consumer Finance businesses, with negligible losses incurred in the Business Finance portfolio.

The provision charge includes the impact of applying expert credit judgement, resulting in overlays being added to provision levels estimated using the Group's models. A breakdown of the charge by product is shown in Note 3.

Further analysis of the Group's loan book and its credit risk exposures is provided in Notes 12,13,14 and 34.

Operating expenses
Operating expenses increased by 11.5% to £94.2 million (2018: £84.5 million). This growth is proportionately lower than the increase in our lending balances as efficiencies have been derived from increasing scale. Investment in lending businesses to support growth and in the Savings team to widen the product and digital offering have continued. We have also continued to invest in our compliance and risk functions, particularly in respect of the prevention of financial crime, and in IT infrastructure.

The Group's **cost to income ratio** increased from 55.7% in 2018 to 56.9%. However, the ratio for 2019 is impacted by two factors: one-off costs of £1.1 million in respect of the purchase of our Yorke House property in the year; and a change in accounting treatment for DMS which has classified £2.1 million of improvement in credit quality as an impairment gain, whereas in 2018 the equivalent improvement was treated as income. Without these two factors, the **cost to income** ratio would have improved slightly to 55.5%, with the **cost of risk** moving to 1.5%.

Derivatives and hedge accounting
Over 2019 we developed interest rate hedging capability and entered into a portfolio of derivatives, in order to manage interest rate risk. We adopted hedge accounting in order to mitigate the potential profit and loss volatility arising from movements in the fair value of derivatives. The Group's hedge accounting policy is described in Note 1.

Interest income and interest expense arising from the derivatives are disclosed in Note 4.

Taxation
The effective adjusted tax rate rose to 19.7%, which is higher than the currently enacted rate of 19%:

	2019 Effective adjusted tax rate £million	**2019 Effective statutory tax rate £million**	2018 Effective adjusted tax rate £million	2018 Effective statutory tax rate £million
Tax	**8.1**	**7.6**	6.8	6.4
Profit before tax	**41.1**	**38.7**	36.7	34.7
Effective rate (%)	**19.7%**	**19.6%**	18.5%	18.4%

The tax charge reflects Bank Corporation Tax Surcharge of 8% on taxable profits of Secure Trust Bank PLC in excess of £25.0 million. The effective rate in the year was also increased by a deferred tax debit of £0.2m arising from a reassessment of the rates that the deferred tax asset on the IFRS 9 transition adjustment will reverse out at over the next eight years. Future effective tax rates for the Group will be sensitive to the level of projected profit in the Bank and in other Group companies as well as the level of corporation tax. The tax charge reflects the enacted reduction in the corporation tax rate to 17% on 1 April 2020. The announcement in the Budget to reverse this reduction will cause the deferred tax asset to increase by £0.7 million. Current forecasts show the effective tax rate is expected to increase by up to 5%, given the reversal of the corporation tax rate reduction, over the forecast period as the effect of the banking surcharge becomes more significant.

Distributions to shareholders
Given the uncertainty in UK and global markets arising from the COVID-19 outbreak, the Directors do not recommend the payment of a final dividend for 2019. An interim dividend of 20 pence per share was paid on 27 September 2019. The total dividend for 2018 was 83 pence per share.

Balance sheet
Our assets increased by 9.8% to £2,682.8 million. This was driven by the 20.8% growth in our loan portfolios, with levels of cash and debt securities lower than at the end of 2018.

Liabilities increased by 10.0% to £2,428.7 million. Deposits from customers increased by 9.3% and other funding by 17.1%, the latter primarily due to the raising of ILTR borrowings towards the end of 2019. Further details are provided in respect of this funding in the sections below.

Summarised balance sheet

	2019 £million	2018 £million
Assets		
Cash and balances at central banks	**105.8**	169.7
Debt securities	**25.0**	149.7
Loans and advances to banks	**48.4**	44.8
Loans and advances to customers	**2,450.1**	2,028.9
Derivative financial instruments	**0.9**	–
Other assets	**52.6**	51.2
	2,682.8	2,444.3
Liabilities		
Due to banks	**308.5**	263.5
Deposits from customers	**2,020.3**	1,847.7
Tier 2 subordinated liabilities	**50.6**	50.4
Derivative financial instruments	**0.6**	–
Other liabilities	**48.7**	45.6
	2,428.7	2,207.2

Loans and advances to customers
Loans and advances to customers include secured and unsecured loans and finance lease receivables. The composition of the loan book remains broadly consistent with 2018, with the Consumer Finance book being approximately 49% of total lending (2018: 49% including Consumer Mortgages), and the Business Finance book being approximately 51% (2018: 51%).

Loan originations in the year, being the total of new loans and advances to customers entered into during the year, increased by 12.0% to £1,413.0 million (2018: £1,261.9 million). As in 2018, over half of the new business volume (£716.6 million) was generated by the Retail Finance business.

Further analysis of loans and advances to customers, including a breakdown of the arrears profile of our loan books, is provided in Notes 12,14 and 34.

Debt Securities
Debt Securities consist solely of sterling UK Government treasury bills ('T-bills'). The number of T-bills held reduced significantly over the year, from £149.7 million to £25 million, the higher level no longer being required as collateral against TFS drawings with the Bank of England.

Due to banks
At 31 December 2018, the amount due to banks consisted solely of drawings from the TFS. Towards the end of 2019, we added to this funding with £45 million of ILTR. This serves to provide the Group with an additional inexpensive funding buffer that can be used to fund new business.

Deposits from customers
Customer deposits include term, notice and sight deposits, as well as the OneBill product. A Fixed Term Cash ISA was added to the product set in 2019. Customer deposits grew by 9.3% during the year to close at £2,020.3 million, to fund increasing lending balances. As set out in the Capital and Liquidity section on page 24, we have managed down our funding

balances in relation to lending balances. Deposit growth is therefore significantly lower than the growth in lending assets over 2019.

Tier 2 subordinated liabilities

Tier 2 subordinated liabilities represent two £25 million tranches of 6.75% Fixed Rate Callable Subordinated Notes, including interest accrued. Further details of the note issuances are provided in Note 28. The notes qualify as Tier 2 capital.

New accounting standards

IFRS 16 'Leases' became effective for the period beginning on 1 January 2019 and was adopted by the Group from that point. The standard replaces IAS 17 'Leases' and related interpretations, and sets out principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract: the lessee and lessor. Adoption of the standard has changed how the Group accounts for a number of its property leases and motor vehicle leases, where the Group is the lessee. The standard requires such leases to be recognised on the balance sheet as 'the lease liability' with the right to use the underlying asset ('the right-of-use asset') also recognised. We have elected to recognise the initial impact of implementing IFRS 16 through the opening balance of retained earnings and have not restated comparatives. Further detail is provided in Note 1.

Capital and liquidity

	2019 £million	2018 £million
Capital		
CET1 capital	**268.0**	251.8
Total Tier 2 capital	**50.0**	45.7
Total capital	**318.0**	297.5
Proposed dividend	**–**	11.8
Total capital after proposed dividend	**318.0**	285.7
Total Risk Exposure	**2,118.1**	1,824.6
	2019 %	2018 %
CRD IV ratios – excluding proposed dividend		
CET1 capital ratio	**12.7**	13.8
Total capital ratio	**15.0**	16.3
Leverage ratio	**9.8**	10.0
CRD IV ratios – after proposed dividend		
CET1 capital ratio	**12.7**	13.2
Total capital ratio	**15.0**	15.7
Leverage ratio	**9.8**	9.5

Typical risk weighting

	Risk weighting %
Standard on-balance sheet risk weighting	
Real Estate Finance: residential investment	35
Real Estate Finance: commercial investment	100
Real Estate Finance: development*	150
Commercial Finance**	100
Retail Finance	75
Motor Finance	75
Debt Management	100
Consumer Mortgages (up to 80% LTV)	35

* The Group has entered into an ENABLE Guarantee with the British Business Bank, whereby the UK Government will take on a portion of the risk on a portfolio of loans to smaller business in return for a fee. When the Guarantee is triggered it will reduce the net risk weighting applied to Real Estate Finance development lending.

** A lower risk weighting than 100% is applied to Commercial Finance lending where the customer is a small to medium enterprise due to applying an 'SME factor'.

The CET1 capital ratio is the ratio of CET1 capital divided by the Total Risk Exposure. The total capital ratio is total capital divided by Total Risk Exposure. Figures for 2019 and 2018 comparatives are both presented to reflect IFRS 9 transitional rules, details of which are provided below.

The Basel III leverage ratio is defined by the Capital Requirements Regulation as Tier 1 capital divided by on and off balance sheet asset exposure values, expressed as a percentage. The UK leverage ratio framework sets a minimum ratio of 3.25%. As shown in the table above, our leverage ratio remains comfortably ahead of the minimum requirement.

We have applied the IFRS 9 transitional rules. For 2019, this allows 85% (2018: 95%) of the initial IFRS 9 transition adjustment, net of attributable deferred tax, to be added back to eligible capital. Further information is provided in Note 37.

The Group's regulatory capital is divided into:

- CET1 which comprises shareholders' funds, after adding back the IFRS 9 transition adjustment and deducting intangible assets, both of which are net of attributable deferred tax
- Tier 2 capital, which is solely subordinated debt net of unamortised issue costs, capped at 25% of the capital requirement

Capital resources increased over 2019, from £297.5 million to £318.0 million. This was driven by retained earnings growth, with the Group's subordinated notes issued in 2018 also becoming fully eligible as Tier 2 capital. The year-on-year reduction in the IFRS 9 adjustment restricted the increase in capital resources.

The Group has continued to invest capital to support lending growth. This investment, plus the impact of the IFRS 9 adjustment, results in lower CET1 and total capital ratios at the end of 2019 compared with the end of 2018. Ratios remain ahead of regulatory requirements.

The Group operates the standardised approach to credit risk, whereby risk weightings are applied to our on and off balance sheet exposures. The weightings applied are those stipulated in the Capital Requirements Regulation.

The Group's Individual Capital Adequacy Assessment Process ('ICAAP') includes a summary of the capital required to mitigate the identified risks in its regulated entities and the amount of capital that the Group has available. All regulated entities within the Group have complied during the year with all of the externally imposed capital requirements to which they are subject.

The Total Capital Requirement, set by the PRA, includes both the calculated requirement derived using the standardised approach and the additional capital derived in conjunction with the ICAAP. In addition, capital is held to cover generic buffers set at a macro-economic level by the PRA. These buffers have risen significantly in recent years, with the requirement at 31 December 2019 being £74.0 million.

Capital requirements

	2019 £million	2018 £million
Total Capital Requirement	**212.0**	182.7
Capital conservation buffer	**52.9**	34.2
Countercyclical capital buffer	**21.1**	18.2
Total	**286.0**	235.1

Liquid assets

	2019 £million	2018 £million
Aaa – Aa3	**130.8**	319.4
A1 – A3	**3.8**	39.7
Baa2	**39.5**	–
Unrated	**5.1**	5.1
Liquidity exposures	**179.2**	364.2

Management of capital

Our capital management policy is focused on optimising shareholder value over the long term. Capital is allocated to achieve targeted risk adjusted returns whilst ensuring appropriate surpluses are held above the minimum regulatory requirements.

Key factors influencing the management of capital include:

- the level of buffers set by the PRA
- estimated credit losses calculated using IFRS 9 methodology, and the applicable transitional rules

- new business volumes
- the product mix of new business

These last two factors are actively managed by the Group in order to balance growth, profitability and conservation of capital. The variation in the risk weightings applied to our key lending assets, and our willingness and ability to adapt our lending volumes and mix, provide significant flexibility in our management of capital. The recent announcements from the PRA, regarding the level of the countercyclical capital buffer have been factored into our plans.

Liquidity
We continued to hold significant surplus liquidity over the minimum requirements throughout 2019. High Quality Liquid Assets ('HQLA') are held in the Bank of England Reserve Account and UK Treasury Bills. Levels of HQLA reduced over the year, as we introduced more sophisticated analysis of liquidity requirements for new and existing products, allowing funding levels to be set on a more efficient basis. As a consequence, total liquid resources reduced from £364.2 million to £179.2 million.

The Group uses a number of measures to manage liquidity. These include:

- the Overall Liquidity Adequacy Requirement ('OLAR'), which is the Board's view of the Group's liquidity needs as set out in the Board approved Internal Liquidity Adequacy Assessment Process ('ILAAP')
- the Liquidity Coverage Ratio ('LCR'), which is a regulatory measure that assesses net 30-day cash outflows as a proportion of HQLA
- total funding ratio, as defined in the Appendix to the preliminary announcement
- for LCR purposes the HQLA excludes UK Treasury Bills which are encumbered to provide collateral as part of the Group's Term Funding Scheme with the Bank of England. On this basis, the HQLA at 31 December 2019 was £96.4 million (31 December 2018: £240.8 million)

We continue to manage liquidity on a conservative basis by holding HQLA and utilising predominantly retail funding from customer deposits. Details of how our savings product set and digital proposition have developed are provided in the Savings section of the Strategic Report.

Secure Trust Bank is a participant in the Bank of England's Sterling Money Market Operations under the Sterling Monetary Framework and has drawn £263.0 million under the TFS, this level being unchanged from that reported at 31 December 2018. Towards the end of 2019 we added £45 million of ILTR.

We have no liquid asset exposures outside of the United Kingdom and no amounts that are either past due or impaired.

Business review

Business Finance

Real Estate Finance

Revenue and lending performance vs prior years

	2019	2018	2017
Lending revenue	**48.9**	41.2	32.3
Lending balance	**962.2**	769.8	580.8
Impairment charge	**0.1**	0.5	(0.2)

What we do: Residential Development
We lend to enable the development of new build property, commercial to residential conversions (including those with permitted development rights) and refurbishment projects.

Residential Investment
We lend on portfolios of residential property where the rental income will repay the underlying borrowing over a fixed term period. This excludes the regulated buy-to-let mortgage sector.

Other lending
We have limited appetite for other commercial lending (either development or investment) and have limited exposure to mixed development schemes.

How we do it
Financing is typically provided over a term of up to five years with conservative loan-to-value criteria, with a 60% Loan to Gross Development Value to residential house builders. More restrictive policies are implemented from time-to-time as

required. Our Loan to Gross Development Value/Loan to Value ratios continue to average below 60% across all lending areas. We have no significant exposure to any one property scheme or developer.

The Real Estate Finance team is staffed by experienced bankers with proven property lending expertise. The team provides full support to customers and introducers over the life of the products.

2019 performance

We have continued to grow our Real Estate Finance business, with balances up 25% in 2019, generating a 19% increase in revenue. The rate of growth slowed in 2019 due to an increase in repayments in the year, coupled with the impact of the change in mix of the book, with development lending reducing to 25% of the book during 2019.

The credit quality of the book has however remained strong, with no crystallised impairments. In addition, we have been able to successfully manage two cases with full repayment. The overall LTV of the portfolio has also remained stable, reflecting the cautious approach taken by the business in 2019 due to the uncertain market conditions. The effect of the above has been to see no increase in impairment provisions in the year.

Looking forward

The business remains focused on effective risk management, and ensuring that we continue to support our customers. Our experienced team remains able to manage opportunities and threats in a timely manner. We will manage our appetite in respect of growth opportunities to reflect market conditions.

Commercial Finance

Revenue and lending performance vs prior years

	2019	2018	2017
Lending revenue	**16.8**	13.4	7.2
Lending balance	**251.7**	194.7	126.5
Impairment charge	**0.1**	-	0.1

What we do

Commercial Finance specialises in providing a full range of invoice financing solutions to UK businesses including invoice discounting and factoring.

Invoice discounting services provide access to funding and release typically up to 90% of the value of qualifying invoices, in confidence and allowing clients to stay in control of sales ledger management.

Factoring services, where the sales ledger management is passed on to the Group, may also provide access to funding of typically up to 90% of the value of qualifying invoices and often results in the Group managing credit control, cash allocation, statement and reminder letter distribution.

Other assets can also be funded either long or short term and for a range of loan-to-value ratios alongside these facilities.

How we do it

Commercial Finance complements the broader SME lending proposition which has been developed by the Group. The business also provides SME commercial owner occupiers with finance to buy the property they trade from in conjunction with other financing facilities.

We have built a strong team of proven business development, credit and operational professionals who have delivered a robust and compliant operational model.

2019 performance

We have continued to grow the Commercial Finance business, with lending balances again increasing significantly by 29% in 2019, generating a 25% increase in revenue. The close management and prudent approach to credit risk has ensured that where client administrations have occurred the related collect out fees have far exceeded any actual impairment losses, which are much lower than industry average, well below 0.1% of lending balances.

Whilst the cost base is proportionally very low, the regional presence of the business was extended in the year with key recruits across its Manchester, Leeds, Birmingham and London offices.

Looking forward

The success of the implementation of the regional model seen in the year will be built on in 2020. Whilst we plan to expand the product base to further penetrate the existing market we operate in, the immediate focus is on the impact of COVID-19. The close management of our existing client base will be key and we are already supporting businesses via Coronavirus Business Interruption Loan Scheme lending.

Asset Finance

Revenue and lending performance vs prior years

	2019	2018	2017
Lending revenue	**3.2**	6.6	8.5
Lending balance	**27.7**	62.8	116.7
Impairment charge	**0.7**	2.2	1.0

What we do
The Asset Finance business provides funding to support SME businesses in acquiring commercial assets, such as building equipment, commercial vehicles and manufacturing equipment.

How we do it
The Asset Finance business is operated via a joint venture with Haydock, a well-established asset finance company operating across the UK. Following the change in ownership of Haydock in January 2018, we have ceased writing new business through the joint venture, although Haydock continues to provide a full business process outsourcing service to the Group in relation to the portfolio we fund.

The current portfolio reflects hire purchase and finance lease arrangements with terms of up to five years.

2019 performance
Following the decision to cease new business in 2018, the portfolio has continued to run off with lending balances continuing to reduce in 2019, down by 56% against 2018, and 36% in H2 2019. This reduction in balances has then led to the drop-off of income seen in 2019 with income being 52% lower in 2019. The overall contribution from the business has however been aided by lower impairment levels, with the charge reducing by £1.5 million (68%) in 2019, reducing the cost of risk by 55 bps. This reflects the continued robustness of the portfolio and the close management of collections.

Looking forward
We ceased originating Asset Finance business in 2018. We expect the book to continue to reduce in 2020.

Consumer Finance

Retail Finance

Revenue and lending performance vs prior years

	2019	2018	2017
Lending revenue	**74.7**	62.8	50.7
Lending balance	**688.9**	597.0	452.3
Impairment charge	**19.8**	19.3	13.8

What we do
The Retail Finance business, branded as ‘V12’, provides unsecured, prime lending products to the UK customers of its retail partners to facilitate the purchase of a wide range of consumer products across in-store, mail order and online channels. This business is driven by V12 Retail Finance, which was acquired in 2013 and has provided finance in cooperation with its retail partners for more than 20 years. The V12 point of sale system is used by the Group’s retail partners and Retail Finance is administered from the V12 offices in Cardiff.

Retail Finance products are unsecured, fixed rate and fixed term loans, to UK residents with a good credit history, of up to 84 months in duration with a standard maximum loan size of £25,000. The average new loan is for £1,100 over a 24-month term.

The finance products are either interest bearing or have promotional credit subsidised by retailers, allowing customers to spread the cost of purchases into more affordable monthly payments.

How we do it
We operate an online e-commerce service to retailers, providing finance to customers of those retailers. The online processing system allows customers to digitally sign their credit agreements, thereby speeding up the pay-out process, and removing the need to handle and copy sensitive personal documents through electronic identity verification.

Retail Finance serves retailers across a broad range of sectors including cycle, music, furniture, outdoor/leisure, electronics, dental, jewellery, home improvements and football season tickets.

We provide finance to customers of a large number of retailers including household names such as Beaverbrooks, Watches of Switzerland, DFS, Sofology and Watchfinder.

2019 performance

Growth across each of the three largest sub-markets for the Retail Finance business (sports and leisure, furniture and jewellery) has resulted in new gross lending volumes increasing to £716.6 million, an increase of 10% on the previous year. This has driven a further significant increase in lending assets, which during the year rose to £688.9 million (December 2018: £597.0 million). Overall growth has been achieved through a combination of gaining increased market share and sector growth.

A combination of continued investment in technology, focus on customer experience and retailer needs has led to us increasing market share from 6.8% in 2018 to 8.0%% in 2019 (based on Finance & Leasing Association new business values within retail store and online credit).

Despite margin pressures from new entrants to the market, the growth in lending assets has increased revenue by 19% to £74.7 million (2018: £62.8 million).

Improvements in credit quality have limited impairment losses to £19.8 million (2018: £19.3 million) despite the significant loan book growth.

Customer feedback, measured by Feefo, provided the business with a consistent score of 4.8 out of 5 for the year, based on 1,000 reviews (2018: 4.8 based on 400 reviews). Customer feedback, measured by Trustpilot, provided the business with a five star rating based on 1,200 reviews.

Looking forward

During 2020 we envisage reduced volumes across the majority of retail sectors impacted by COVID-19 due to social distancing rules which have led to the closure of shops and placed restrictions on some warehouse and manufacturing facilities. Our online e-commerce service to retailers mitigates the impact of COVID-19 in many sectors, especially cycle, outdoor/leisure and electronics.

We will continue to invest in initiatives to further enhance systems capabilities, to ensure that quality of service to both retailers and customers is maintained or improved as well as generating operational efficiencies. This includes the rollout of improved telephony systems across customer facing staff and enhancements to the customer application process. This will provide a slicker customer journey by recognising returning customers of V12 Retail Finance in order to reduce customer time inputting their details.

V12 has been awarded the Feefo Platinum Award in the Feefo 2020 Annual Trusted Service Awards. The platinum award recognises businesses that have achieved three consecutive years of Gold Trusted Service ratings of 4.5 or higher.

Motor Finance

Lending performance v prior years

	2019	2018	2017
Revenue	**49.7**	48.5	47.1
Lending balance	**323.7**	276.4	274.6
Impairment charge	**13.8**	11.3	20.8

What we do

Our Motor Finance business began lending in 2008 under the Moneyway brand and provides hire purchase lending products to a wide range of customers including those who might otherwise be declined by other finance companies. This helps our customers to gain the freedom and flexibility that motoring gives to their lives as well as helping introducers to sell more cars.

In 2019 the Motor Finance business launched a new brand, V12 Vehicle Finance, and a new Used Vehicle Stocking product in partnership with Aston Barclay Auctions. The product allows dealers to finance vehicles on their forecourt which have been purchased through Aston Barclay Auctions.

Motor Finance agreements are secured against the vehicle being financed.

We ceased writing new business in the subprime market and predominantly lend to finance the purchase of volume franchise used cars in the near-prime market.

How we do it

We distribute our Motor Finance products via UK motor dealers, brokers and internet introducers. New dealer relationships are established and managed by our UK-wide Motor Finance sales team with all introducers subject to a strict vetting policy, which is reviewed on a regular basis.

The technology platform used allows us to: receive applications online from introducers; provide an automated decision; facilitate document production through to pay-out to dealer; and manage in-life loan accounts.

Motor lending is administered in Solihull, however the UK motor dealers and brokers are UK-wide.

2019 performance
Our business has continued to focus on narrowed credit parameters in order to reduce potential future impairment losses. New business volumes in 2019 reflect lower margins but higher credit quality. New business volumes from consumers increased from £141.3 million in 2018 to £178.2 million for 2019. Revenue increased slightly, by 2.5%, reflecting the reduction in margin for higher credit quality business.

The impairment charge for the period has increased from £11.3 million in 2018 to £13.8 million in 2019. The level of charge was impacted by the reduction in used vehicle prices seen in 2019. Overall credit quality has improved as noted above, and the probability of default of the portfolio has reduced significantly since the implementation of IFRS 9 at the beginning of 2018.

Following the launch of the new Used Vehicle Stocking product in July 2019, there were £1.5 million of lending balances in respect of this product at the end of 2019.

Looking forward
Restrictions imposed during the COVID-19 lockdown have resulted in used vehicle sales, and as a result new used vehicle finance, largely halting. The Motor Finance business has therefore taken the decision to cease funding new agreements during this period and to focus on servicing existing customers.

Looking forward we retain the view that a clear opportunity exists to deliver prime and near-prime products and services in the Motor lending market for an innovative and technology-led funding provider. Our Motor Finance business will re-enter the near prime credit market and will also be expanding into the prime credit market. A programme of work is underway to deliver a new platform and business transformation through 2019/2020 with £6.5 million already invested since the programme started in 2018. As part of this programme we are enhancing system capabilities to deliver a broader range of products. Planned product development includes launch of a PCP and Prime Hire Purchase product and technology integrations with a panel of auction partners. We have also integrated with a leading dealer management system provider in the independent dealer space, to make dealing with our Motor Finance business an easy process. Overall, these investments are expected to improve the credit quality of the portfolio, drive business growth and deliver stable earnings. Alongside these initiatives, we will continue to focus on the near-prime market sector through our existing introducer channels.

Debt Managers (Services) Limited

Revenue and lending performance vs prior years

	2019	2018	2017
Lending revenue	**8.4**	7.0	4.9
Lending balance	**82.4**	32.3	15.6
Impairment charges	**negative (£2.1)**	£nil	£nil

What we do
DMS is the Group’s debt collection business. DMS collects debt on behalf of a range of clients as well as for Group companies. It also selectively invests in purchased debt portfolios from fellow subsidiary undertakings and external third parties.

How we do it
Debt Managers (Services) offers three services across credit management and in order to meet the needs of its clients:

- Business process outsourcing allows DMS to assist in the performance of early arrears accounts on behalf of clients
- Contingent collection allows a client to place accounts for DMS to manage those accounts in its own name
- Debt purchase allows DMS to acquire accounts and choose how to liquidate those accounts over a period of 10 years

We aim to provide all customers with the best possible customer service by recognising every customer is different. All customer facing staff receive training on how to effectively use industry recognised techniques such as TEXAS and IDEA to help identify signs of vulnerability and on how to use tailored signposting relevant to customers’ circumstances. Customers that need additional support are managed by a specialist Customer Care Team. We work closely with debt charities such as StepChange, Payplan and Christians Against Poverty and a range of other third parties including the Samaritans, MIND and Marie Curie to ensure that customers receive an appropriate service.

2019 performance
2019 saw significant levels of growth for DMS due to the entering of new target markets assisted by leveraging its commitment to customer service and new technologies. Lending balances more than doubled which delivered strong revenue and profit growth in 2019.

In the year performance of externally purchased portfolios continued to be very strong, with actual collections far exceeding those forecast at the pricing stage. Consequently an impairment credit of £2.1 million was taken, recognising that outperformance.

Looking forward
The start of 2020 was very positive as a result of the high lending balance brought forward. This, together with excellent client and customer feedback, will help us to continue to develop the business and support our customers throughout the challenging period ahead.

Consumer Mortgages

Revenue and lending performance vs prior years

	2019	2018	2017
Lending revenue	**3.7**	1.5	0.1
Lending balance	**105.9**	84.7	16.5
Impairment charges	**0.1**	0.2	£nil

Consumer mortgages represents fixed rate mortgages provided to individuals, to purchase a property or remortgage their current property. We ceased originating new consumer mortgages in the first quarter of 2019. The pipeline of new business was fulfilled in the first half of the year and balances at the end of year were £105.9 million (31 December 2018: £84.7 million).

Savings

Savings balances vs prior years

	2019	2018	2017
Notice deposits	**663.7**	516.4	455.3
Fixed term savings	**1,295.6**	1,316.8	1,013.4
Sight/instant access	**22.6**	14.5	14.5
Individual savings accounts	**38.4**	£nil	£nil
Total	**2,020.3**	1,847.7	1,483.2

What we do
We offer a range of savings, including simple and straightforward Notice and Fixed Bond accounts. We extended our product offering in 2019, launching our first Fixed Term Cash ISA in April and developing an Access Account for launch in 2020. These products are all available to UK-based individuals saving with a minimum deposit of £1,000. We have also historically offered business accounts priced to reflect the associated costs and risks.

All products offered by the Group are covered under the UK Financial Services Compensation Scheme, up to the specified limit of £85,000. The full suite of accounts are made consistently available and are priced in line with our ongoing funding needs, allowing individuals to hold a maximum balance of £1 million, and £2 million for joint and business accounts.

In addition to savings, we continue to service OneBill for existing customers; this has been closed to new customers since 2009. This service is designed to help customers with household budgeting. For a monthly fee, details of annual bills are aggregated and calculated into a fixed weekly or monthly schedule. This enables customers to spread the cost of their bills throughout the year, accessing direct debit discounts as well as support in liaising with providers.

How we do it
The continued approach of not cross-subsidising loss-making products with profitable ones, maintaining a stable funding base and utilising an operational model based on digital self-service rather than a branch network, enables us to offer competitive rates and attract high volumes of deposits quickly, from a broad range of customers.

We aim to maintain a full suite of savings products at all times, covering Access, 14 to 180 day Notice, 1 to 7 year Fixed Bonds and Fixed Rate ISAs. This enables us to access most of the UK personal savings market and compete for significant liquidity pools, achieving a lower marginal cost with the volume, mix and the rates offered optimised to the demand of our funding needs.

Product terms and rates broadly match the term and tenor of customer savings to the desired maturity profiles of the Group, which are primarily determined by the interest rates and terms offered on loans and advances to customers. This strategy aims to help mitigate maturity transformation and interest rate risks.

All of the above provides us with a funding profile which gives additional financial security, diversification and flexibility to the Group.

As well as attracting and retaining customers with competitive rates of interest, customers choose us based on our financial standing, independent customer review scores and award-winning digital services and UK-based operation with high standards of cyber and operational security.

2019 performance

Following the implementation of the core banking platform in late 2017, and positive results in 2018, 100% of our new customers now apply for a savings product online and all register for Internet Banking as part of the process, demonstrating an important shift in operational efficiency. Indeed, over 38,000 customers are now registered for Internet Banking, representing 81% of the total customer base.

Savings balances are growing at a strong pace. In 2019, we grew our retail savings by £172.6 million, an increase of 9% – equivalent to nearly £5.50 every second. Over 58% of our customers chose to reinvest their savings into Secure Trust Bank retention product offerings, equating to almost £280 million. At year-end, the total balance of savings customer deposits was over £2 billion, £560 million of which was received during the year across over 40,000 deposit transactions.

Following the launch of short-dated Notice Accounts in 2018, balances increased throughout 2019 whilst we also launched our Fixed Term Cash ISA and developed our Access Account. The ISA contributed to the largest monthly inflow of new funds on record, with over £122 million deposited in Savings accounts during June 2019.

We once again won a number of independent awards, including Best Savings Provider, Best Fixed Rate Bond Provider and Best Notice Account Provider from Savings Champion, as well as Best Notice Account Provider from Moneyfacts. Customer experience is of great importance, which is why the Savings team was delighted to have achieved a rating of 4.5 out of 5 on Feefo and 4.3 out of 5 on Trustpilot, making the Group one of the best providers amongst savings brands.

Looking forward

In 2020, we are focused on continuing to improve all aspects of our digital services for both new and existing Savings customers. Key areas of focus will be streamlining the application journey for both new and existing customers, making it easier for customers to stay with us when their bond matures, and introducing new functionality for customers servicing their accounts online.

This move, as well as the digitisation of large scale customer communications, should continue to improve customer experience leading to cost efficiency.

Our recently developed Access Account is now ready to offer to both existing and new customers and we plan to continue to investigate how to help more people access our products and broaden our product range to support those customers who want to drawdown their savings in retirement. These offerings will help to deliver our aim of increasing product holdings to improve the stability of funds through deeper customer relationships.

Secure Trust Bank has already been recognised by customers through its strong levels of online review scores as well as in the Savings Champion Awards 2020, winning the Best Notice Account Provider category and also being highly commended in the Best Savings Provider category. We look to continue this recognition through the ongoing delivery of simple, competitive products and great customer experience throughout 2020.

Principal risks and uncertainties

Risk overview

On an ongoing basis, the Directors carry out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. The following were considered to be the principal risks facing the Group in 2019:

Principal Risk	Movement from Prior year
Credit Risk The risk that a counterparty will be unable to pay amounts in full when due.	Improved
Liquidity and Funding Risk The risk that the Group is unable to meet its obligations as they fall due or can only do so at excessive cost.	Improved
Operational Risk The risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than the risks identified above.	Stable
Capital Risk The risk that the Group will have insufficient capital resources to support the business.	Stable

Market Risk The risk that the value of, or revenue generated from, the Group's assets and liabilities is impacted as a result of market movements, predominantly interest rates.	Improved
Conduct Risk The potential for customers (and the business) to suffer financial loss or other detriment through the actions and decisions made by the business and its staff.	Stable
Regulatory Risk The risk that the Group fails to be compliant with all relevant regulatory requirements.	Stable

Notes 34 to 37 provide further analysis of certain financial risks.

Further details of the principal risks, the changes in risk profile during the 2019 financial year and the Group's risk management framework are set out in the following section. There is also analysis of the key strategic and emerging risks which impact the Group. As for the previous year, these risks also include the UK's withdrawal from the European Union, the direct impacts of which are considered to be limited given the Group's UK operation and focus. Consideration is also given to risks arising from climate change. **Emerging risks include the impact of COVID-19, which as a matter emerging post year-end, is not reflected in the risk status movements shown above.**

Credit Risk – IMPROVED

Description

Credit Risk is the risk that a counterparty will be unable to satisfy their debt servicing commitments when due. Counterparties include the consumers to whom we lend on a secured and unsecured basis and the SMEs to whom we lend on a secured basis as well as the market counterparties with whom we deal.

Mitigation

We manage Credit Risk through internal controls and through a three lines of defence model. The first line is the business operation team with the Credit Risk team being the second line and Internal Audit being the third line. The Consumer Credit Risk Committee and SME Credit Committees, which are the monitoring committees for credit risk, report to the Board Risk Committee. The Board Risk Committee also approves lending authorities in respect of SME lending. Each consumer lending product has a monthly portfolio review which analyses business performance from new application metrics through to loss performance by business type and introducer. Policy and scorecard changes are approved at the Consumer Credit Risk Committee.

For Real Estate Finance and Commercial Finance, lending decisions are made on an individual transaction basis, using expert judgement and assessment against criteria set out in the lending policies. Asset Finance lending is managed via a joint venture with Haydock, who operate in line with the Group's credit policies and risk appetite. Since the change in ownership of Haydock in January 2018, we have allowed the Asset Finance portfolio to reduce in line with contractual repayments from customers.

Exposure to Credit Risk is also managed in part by obtaining security. Motor Finance loans are secured against motor vehicles. Mortgages are secured against land/property and Real Estate Finance and Asset Finance loans are secured against property and tangible assets respectively. Commercial Finance advances are secured against a debtor book, inventory or property if a commercial mortgage is provided.

Management monitors the ratings of the counterparties in relation to the Group's loans and advances to banks. There is no direct exposure to the Eurozone and peripheral Eurozone countries.

Forbearance

Throughout 2019, our policy was not to routinely reschedule contractual arrangements where customers defaulted on their repayments. In cases where customers were offered the option to reduce or defer payments for a short period, the loan retained the normal contractual payment due dates and would be treated the same as any other defaulting cases for impairment purposes. Forbearance arrangements in respect of Consumer Mortgages customers are described in Note 34.2.

Change

Consumer Finance Credit Risk

Application trends, arrears and loss trends for the Retail Finance Portfolio are monitored monthly by the Credit Risk Team. The portfolio quality has been improving throughout 2019, leading to a reduction in cost of risk from 1.8% to 1.4%, and we implemented a new artificial intelligence scorecard in the third quarter of 2019 which is expected to reduce impairments even further. Recent changes to the mix of retail market segments served by Retail Finance are expected to improve portfolio quality over time.

Our Motor Finance business has continued to grow despite a very competitive landscape. We have continued our strategy of repositioning the Motor Finance business away from those customers that are most susceptible to an economic downturn. We have expanded the Motor Finance product range to include a unit stocking product, to provide short-term finance to motor dealers so that they can buy stock. In 2020, the Group expects to launch a prime Hire Purchase ('HP') and Personal Contract Purchase ('PCP') product offering. The PCP offering will introduce a new risk for the Group, with potential for losses should the residual value of the vehicles at the end of the agreement be less than expected at inception of the contract. We have recruited specialists, introduced additional governance over acceptance criteria and specified appropriate levels of buffer within residual value calculations, to mitigate this risk.

In the first quarter of 2019 due to the difficult economic climate, increased competition and continued uncertainties we announced the decision to cease new mortgage originations until market conditions improve.

Business Finance Credit Risk

Lending balances in both the Real Estate Finance and Commercial Finance portfolios have continued to grow, with both portfolios remaining well within all key risk appetite measures. The ongoing focus on high quality, secured lending has continued to serve the Group well.

Following the change in ownership of Haydock, in January 2018, the Asset Finance portfolio has continued to run-off over the course of the year in line with expectations. We continue to assess its options with regards to future opportunities within the Asset Finance market.

We have not relaxed any of our key risk appetite parameters during the year and thanks to the continued adherence to our robust lending policies, alongside the significant experience within the lending teams, impairments within the Business Finance portfolios have remained minimal in the period. Management continues to monitor each of the portfolios closely and regularly reviews the external events and changes to the wider environment that could have a material impact on any of them.

Concentration Risk

Management assesses the potential concentration risk from geographic, product and individual loan concentration. Due to the well diversified nature of its lending operations, we do not consider there to be a material exposure arising from concentration risk.

Liquidity and Funding Risk – IMPROVED

Description

Liquidity and Funding Risk is the risk that the Group is unable to meet its obligations as they fall due or can only do so at excessive cost. We maintain adequate liquidity resources and a prudent stable funding profile at all times to cover liabilities as they fall due in normal and stressed conditions.

We manage our liquidity in line with internal and regulatory requirements, and at least annually assess the robustness of the liquidity requirements as part of the Group's Internal Liquidity Adequacy Assessment Process ('ILAAP').

Mitigation

Risk tolerance

In line with the PRA's self-sufficiency rule (the Overall Liquidity Adequacy Rule ('OLAR')) we seek to at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that our liabilities cannot be met as they fall due under stressed conditions. We define liquidity adequacy as the:

- ongoing ability to accommodate the refinancing of liabilities upon maturity and other means of withdrawal
- ability to fund asset growth,
- capacity to otherwise meet contractual obligations through unconstrained access to funding at reasonable market rates

To meet our liquidity requirements we maintain a buffer of unencumbered High Quality Liquid Assets ('HQLA').

The Group's Liquidity Risk Appetite and Funding Risk Appetite are approved by the Board:

- Liquidity Risk Appetite: to maintain a sufficient pool of high quality liquid resources at all times to survive a combined stress event for a minimum survival horizon of at least 90 days, including any peak requirement over the 90-day stress period; and meet the higher of the internal stress test (OLAR) and the regulatory requirement (LCR) plus any applicable Pillar 2 add-ons
- Funding Risk Appetite: STB's Funding Risk Appetite is to ensure that the Group has access to stable funding markets and is not reliant on any single source of funding. STB places no material reliance on wholesale funding markets. The Group's primary source of funding is retail deposits from individuals and SMEs

We assess and formally demonstrate the adequacy of our liquidity through the ILAAP. As part of the ILAAP, we conduct regular and comprehensive liquidity stress testing to ensure compliance with internal and regulatory requirements.

Structure and responsibilities for Liquidity Risk management

The Group has a formal governance structure in place to manage and mitigate Liquidity and Funding Risk on a day-to-day basis. The Board sets and approves the Group's Liquidity and Funding Risk appetites. The Assets and Liabilities Committee ('ALCO'), comprising senior management and executives of the Group, meets monthly to review Liquidity and Funding Risk against set thresholds and risk indicators including early warning indicators. These metrics are managed on a day-to-day basis by the Group's Treasury function. The Risk function is responsible for ensuring that appropriate risk management processes and controls are in place, and that they are sufficiently robust, so as to ensure that key risks are identified, assessed, monitored and mitigated.

Internal liquidity reporting

Liquidity and funding metrics are monitored daily through liquidity reporting and on an ongoing basis through monthly ALCO meetings. Metrics are also included in the Monthly Financial Information pack tabled at the Group's Executive Committee, Board Risk Committee and the Board.

The Liquidity Working Group ('LWG'), a working group of ALCO, embeds the identification, monitoring, measurement and management of Liquidity and Funding Risks in the day-to-day activities of the Bank.

The aim is not to measure liquidity and funding with a single metric but rather a range of principles and metrics which, when taken together, helps ensure that our Liquidity and Funding Risk is maintained at an acceptable level.

The primary measure used by management to assess the adequacy of liquidity is the OLAR which, in line with the PRA's self-sufficiency rule described above, is the Board's own view of the Group's liquidity needs as set out in the Board approved ILAAP.

Communication of Liquidity Risk strategy, policies and practices across business lines and with the Board

The Group's ALCO is responsible for implementing and controlling the Liquidity and Funding Risk appetite established by the Board. ALCO monitors compliance with the Group's policies and oversees the overall strategy, guidelines and limits so that the Group's future plans and strategy can be achieved within risk appetite.

Liquidity and Funding Risk management framework

We maintain a comprehensive internal reporting framework which seeks to mitigate Liquidity and Funding Risk:

- Risk Identification: activities are embedded through integration with key business processes to ensure the Group:
  - Considers how existing activities may impact the current and future Liquidity and Funding Risk profile
  - Considers the implications of new products
  - Has an awareness of how external influences may affect the liquidity position.
- Risk Management: focuses on the application of tools, techniques and processes to quantify risks in order to effectively measure the Group's Liquidity and Funding Risk
- Risk Monitoring: Board and senior management are provided with timely identification of the Group's liquidity and funding position, current emerging risks, material threats and opportunities to enable appropriate management actions
- Risk Reporting: the Board, relevant Committees, and senior management are informed of any changes in the Group's Liquidity and Funding Risk profile or position and necessary actions via regular liquidity reporting. In addition, ad hoc reporting to address any specific concerns affecting Liquidity and Funding Risk management or strategies is available

Stress testing

A comprehensive stress testing framework is used to support Liquidity and Funding Risk measurement and takes into account all known sources of liquidity and funding risks as documented within the ILAAP (and as updated upon changes in material risks). The stress testing covers Idiosyncratic, Marketwide and Combined stress scenarios, with additional stress scenarios including reverse stresses, tailored to our business model and operating environment.

Stress testing is conducted to identify sources of potential liquidity strain and to ensure that the Group's liquidity position remains within the Board Risk Appetite and prudential regulatory requirements and limits. Stress testing and sensitivity analyses are performed on a regular basis to assess the key business vulnerabilities.

We use various short- and medium-term forecasts to monitor future liquidity requirements and these include stress testing assumptions to identify the required levels of liquidity. Stress testing is performed on a daily basis and levels of liquidity under stress are forecast regularly and monitored by ALCO and management.

Contingency funding plans

If, for reasons which may be beyond the business's control, the Group was to encounter a significant and sustained outflow of deposits or other stress on liquidity resource, the Recovery Plan incorporates the Group's plans to ensure that it remains sufficiently liquid to remain a viable independent financial institution during a severe liquidity stress event. Recovery Plan Early Warning Indicators and Invocation Trigger Points ('ITP') are regularly monitored and reported against.

The Recovery Plan is applied consistently with the Group's ILAAP as part of the overall liquidity risk management framework dealing with contingent funding requirements as they arise. The Group also retains access to the Bank of England liquidity schemes, including the Discount Window Facility.

Change

We have maintained our liquidity ratios in excess of regulatory requirements throughout the year and continue to hold significant levels of HQLA.

We made a number of enhancements to the liquidity and funding risk governance framework in 2019. These include approval of a revised policy framework by the Board and additional analysis of liquidity requirements for new and existing products.

The stress tests performed as part of the ILAAP confirmed that the Group has sufficient funds to satisfy the OLAR requirement and there is no significant risk that liabilities cannot be met as they fall due. Our LCR at 31 December 2019 was significantly higher than the regulatory requirement.

Operational Risk – STABLE

Description

Operational Risk is the risk that the Group may be exposed to direct or indirect loss arising from inadequate or failed internal processes, personnel and succession, technology/infrastructure, or from external factors.

The scope of Operational Risk is broad and includes Business process, Business Continuity, Third party, Financial Crime, Change, Human Resources, Information Security and IT risk, including Cyber Risk.

Mitigation

We have adopted an Operational Risk Policy and Framework designed in accordance with the 'Principles for the Sound Management of Operational Risk' issued by the Basel Committee on Banking Supervision.

The approach ensures appropriate governance is in place to provide adequate and effective oversight of the Group's Operational Risk. The governance framework includes the Board Risk Committee and Group Operational Risk Committee.

We have a defined set of qualitative and quantitative Operational Risk appetite measures. Quantitative measures cover operational losses, complaints, key operational risks, systems availability and information security. The appetite measures are reported and monitored on a monthly basis.

Change

In 2018 the Group successfully transitioned to 'The Standardised Approach' for assessing its operational risk capital, in recognition of the enhancements made to its framework and embedding this across the Group. In 2019 we have continued to enhance these standards and have introduced a number of improvements to the control frameworks in place across our principal operational risks.

Key risk themes of Operational Risk focus in 2019 include:

- **Supplier Management** – The Group uses a number of third parties to support its IT and operational processes. We recognise that it is important to effectively manage these suppliers and have embedded a suite of standard controls for all our material suppliers to reduce the risk of operational impacts on these critical services. Further tools have been developed, and are being rolled out, to help understand the quality of the resilience controls in operation at our critical suppliers. We have also enhanced our assurance capability with the recruitment of a dedicated resource in this area. This will continue to be an area of focus for 2020
- **Operational and IT Resilience** – Many elements of the Operational Risk Framework support the ongoing resilience of our operational and IT services, including Business Continuity Management, Disaster Recovery, Incident Management, Process Management and the Cyber Strategy. We have defined a formal plan to respond to the new requirements of the Consultation Papers issued on this subject by the FCA and PRA. Compliance with these requirements and continuing to enhance the resilience of our services will be a key priority in 2020
- **Information Security and Cyber Risk** – We have paid considerable attention to ensuring the effective management of risks arising from a failure or breach of our information technology systems that could result in customer exposure, business disruption, financial losses, or reputational damage
- **Change Management** – The effective delivery of Change Management programmes plays an important role in meeting our regulatory requirements, improving services and implementing strategic decisions. Ineffective change management processes could lead to poor customer outcomes, business disruption, financial loss and regulatory breaches. Change Management processes and governance are defined and embedded within the Group. Significant changes are planned in 2020, including delivery of dealer stocking and the prime proposition as part of the Motor Finance transformation, and these will be a key area of focus to ensure we maintain our customer and operational service standards and deliver our strategic objectives

Capital Risk – STABLE

Description

Capital Risk is the risk that the Group will have insufficient capital resources to meet minimum regulatory requirements and to support the business. We adopt a conservative approach to managing capital and at least annually assess the robustness of the capital requirements as part of the Group's Internal Capital Adequacy Assessment Process ('ICAAP').

Mitigation

Capital Management is defined as the operational and governance processes by which capital requirements are established and capital resources maintained and allocated, such that regulatory requirements are met while maximising returns. These processes and associated roles and responsibilities are set out in the Group's Capital Management Policy, which is approved by the Risk Committee. The Board regularly reviews the current and forecast capital position to ensure capital resources are sufficient to support planned levels of growth.

In accordance with the EU's Capital Requirements Directive IV ('CRD IV') and the required parameters set out in the EU's Capital Requirement Regulation, the Group maintains an ICAAP which is updated at least annually.

The ICAAP is a process that brings together the management framework (i.e. the policies, procedures, strategies and systems that the Group has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted an approach to determine the level of capital we need to hold. This method takes the Pillar 1 capital formula calculations (standardised approach for credit, market and operational risk) as a starting point, and then considers whether each of the calculations delivers a sufficient capital sum adequate to cover management's assessment of anticipated risks. Where it is considered that the Pillar 1 calculations do not reflect the risk, an additional capital add-on in Pillar 2 is applied, as per the Total Capital Requirement issued by the PRA.

A complete assessment of the Group's capital requirement is contained in its Pillar 3 disclosures. Pillar 3 disclosures for the Group for the year ended 31 December 2019 are published as a separate document on our website.

Change

We maintained our capital ratios in excess of regulatory requirements throughout the year. At 31 December 2019, the CET1 ratio was 12.7% (2018: 13.8%), the total capital ratio was 15.0% (2018: 16.3%) and the leverage ratio was 9.8% (2018: 10.0%) on a Group consolidated basis. We have continued to invest capital to support lending growth.

Capital resources increased during the year to £318.0 million as at 31 December 2019 (31 December 2018: £297.5 million) on a Group consolidated basis. The increase was due to retained earnings.

We have continued to explore options available to raise alternative forms of capital as and when such is required. The recent announcements from the PRA regarding the countercyclical capital buffer, which has now been reduced to 0% as part of the COVID-19 response, have been considered and factored into our plans.

The 2019 ICAAP demonstrated the Group's continued ability to meet its minimum capital requirements, even in severe stress scenarios. Our forecasting capability covers a five-year time horizon, with modelling of capital resources and requirements provided over that period. The relatively short duration of our lending portfolios allows us to flex balance sheet growth if required in times of stress, thereby conserving capital.

We adopted transitional provisions in respect of the implementation of IFRS 9, as set out by the European Banking Authority. These provisions allow the capital impact of the standard to be phased in over a five-year period. Further details are provided in Note 37.

Market Risk – IMPROVED

Description

For the Group, Market Risk is primarily limited to interest rate risk. Interest rate risk refers to the exposure of the Bank's financial position to adverse movements in interest rates.

When interest rates change, the present value and timing of future cash flows can change. This in turn changes the underlying value of the Group's assets, liabilities and off-balance sheet instruments and hence its economic value. Changes in interest rates also affect our earnings by altering interest-sensitive income and expenses, affecting our net interest income.

The principal currency in which the Group operates is Sterling, although a small number of transactions are completed in US Dollars, Euros and other currencies in the Commercial Finance business. We have no significant exposures to foreign currencies and hedge any residual currency risks to Sterling.

Mitigation

We maintain a comprehensive internal reporting framework which seeks to mitigate interest rate risk:

- Risk identification: activities are embedded through integration with key business processes to ensure the Group:
  - Considers how existing activities may impact the current and future interest rate risk profile
  - Considers the implications of new products
  - Has an awareness of how external influences may affect the market risk position
- Risk Management: focuses on the application of tools, techniques and processes to quantify risks in order to effectively manage the Group's interest rate risk
- Risk Monitoring: the Board and senior management are provided with timely identification of the Group's interest rate risk position, current emerging risks, material threats and opportunities to enable appropriate management actions
- Risk Reporting: the Board, Committees, and senior management are informed of any changes in the Group's interest rate risk profile or position and necessary actions via regular reporting. In addition, ad hoc reporting to address any specific concerns affecting interest rate risk management or strategies must be available

Market Risk is managed by the Group's Treasury function and is overseen by the ALCO. We do not take significant unmatched positions and do not operate a trading book.

Our risk management framework, policies and procedures are regularly reviewed and updated to ensure that they accurately identify the risks that we face in our business activities and are appropriate for the nature, scale and complexity of our business.

The Group uses an Interest Rate Sensitivity Gap analysis to identify mismatched interest rate risk positions that require hedging. The Group reports the interest rate mismatch to ALCO and the Board on a monthly basis in the form of a Market Value Sensitivity and Economic Value of Equity to a parallel 200 basis point rise and fall in the yield curve. Risk appetite for Market Value Sensitivity is calibrated against the amount of capital resource available to the Group. The Group's Earnings at Risk is also calculated monthly against a 100 basis point parallel stress and reported to ALCO and the Board.

All such exposures are maintained within the risk appetite set by the Board and are monitored by ALCO. The Group also monitors its exposure to optionality and basis risk.

Change

The Group's exposure to Market Risk continues to be limited primarily to interest rate risk, with only modest exposures to foreign exchange risk. The Group remained within risk appetite in respect of interest rate risk throughout the year.

The increasing size of our balance sheet increases the inherent level of interest rate risk, and we have responded by enhancing our Treasury capabilities and risk framework. The Group has developed its capability to use interest rate swaps to further mitigate interest rate risk in 2019.

The Group is embedding new regulatory guidance on Interest Rate Risk in the Banking Book, as prescribed by the European Banking Authority.

We consider the enhanced framework, and particularly the introduction of derivatives capability, to have led to a reduction in the Group's market risk position.

Conduct Risk – STABLE

Description

We define Conduct Risk as the risk that the Group's products and services, and the way they are delivered, result in poor outcomes for customers, or harm to the Group. This could be as a direct result of poor or inappropriate execution of the Group's business activities or staff behaviour.

Mitigation

We take a principles-based approach and include retail and commercial customers in our definition of 'customer', which covers all business units and both regulated and unregulated activities.

Across the Group, Conduct Risk exposure is managed via monthly review of key risk indicators ('KRIs') at business units' executive committee meetings and aggregated reporting to the Group Executive Committee. Oversight is provided by the Customer Focus Committee, which considers complaints, Feefo and Customer Service Excellence as well as Conduct Risk.

The KRIs vary across the business units to reflect the relevant conduct risks; the business units' key risk indicators are aggregated for measurement against our risk appetite, which is also reported to the Risk Committee and the Board.

Change – STABLE

Review of Conduct Risk and controls within the business units is managed through the regular cycle of risk and control self-assessments, in line with other operational risk categories.

Members of the Customer Focus Committee review key risk indicators across all business units, and meet on a quarterly basis for oversight and challenge of the first line activities to assure senior management that the first line is identifying conduct risks when they arise and taking appropriate actions to mitigate them.

Training on Conduct Risk continues to be delivered to new starters, with an eLearning module completed by all staff during the year.

Regulatory Risk – STABLE

Description

Regulatory Risk is the risk that the Group fails to be compliant with all relevant regulatory requirements. This could occur if the Group failed to interpret, implement and embed processes and systems to address regulatory requirements, emerging risks, key focus areas and initiatives or deal properly with new laws and regulations.

Mitigation

We seek to manage regulatory risks through the Group-wide risk management framework. The Group Compliance and Regulatory Risk Committee is responsible for reviewing and monitoring regulatory changes, and ensuring that appropriate actions are taken, and also reviewing and approving the Compliance universe and risk management framework. Further details can be found on the Group's website: www.securetrustbank.com/our-corporate-information/risk-management.

Change

In the year ended 31 December 2019, we have delivered changes to address new and revised regulations and legislation that have come into force including extending the Senior Managers and Certification Regime to the Group's regulated subsidiaries; European Banking Authority guidelines on security measures for operational and security risks and fraud reporting under PSD2; Buy Now Pay Later and Financial Promotions changes in consumer credit; widening access to the Financial Ombudsman for small businesses; supporting the Group through the management of the PPI deadline in August 2019.

Projects and initiatives are in place for changes required in 2020 including disclosures of commission models in consumer credit, breathing space, regulatory returns, the FCA directory and operational resilience.

Strategic and emerging risks

In addition to the principal risks disclosed above, the Board considers strategic and emerging risks, including key factors, trends and uncertainties which can influence our results. These risks include the following:

COVID-19

The impact of the outbreak on the economy and on the Group's operations is subject to close monitoring by the Group's Crisis Management Team ('CMT') and Group and business unit Executive Committees. Contingency plans have been established for each business unit and are overseen by the CMT. Where process changes have been required in order to maintain services, these have been subject to formal risk review with the CEO, under authority delegated from the Board, accountable for risk acceptance.

It is now clear that the COVID-19 outbreak will have a significant impact on economic activity. The main impacts on the Group are expected to be in relation to reduced demand for new business, particularly for Consumer Finance products, and to increase impairment losses. Stress testing has been undertaken to assess the potential impact of future economic conditions, brought about by COVID-19, on the Group's financial performance and position, including consideration of capital and liquidity. Details of the stress testing and conclusions drawn are set out in the Viability and Going Concern Statement on page 50.

From an operational perspective, the Group has focused on the following potential impacts arising from COVID-19:

- Supply chain failure
- Restricted distribution channels
- Restricted ability to operate due to public policy changes and requirement to respond to regulatory and government measures
- Geographical impacts on markets and key operating locations
- Employee absence or home working

The restricted distribution channels refers to introducers and intermediaries used by the Group to source new business, as well as retailers and motor dealers which are integral to the Consumer Finance business. The resultant reduction in new business activity is considered in the stress testing referred to above, and has allowed business areas to redeploy resource to support existing customers and collections activity.

In respect of the other items listed above, the CMT has assessed the actions undertaken both centrally and in individual business areas and considers them to be working well in mitigating the operational risks brought by COVID-19. These actions include: the rollout of technology solutions which have enabled a significant number of employees to work from home; introduction of social distancing policies for employees who are currently required to work from an STB office; review of key supplier business continuity arrangements and identification of alternative suppliers; and implementation of payment holiday processes.

The Board has considered these potential impacts and the actions undertaken in response and has taken them into account when making its assessment of Viability and Going Concern. Frequent reports have been provided to the Board on the operational impacts of COVID-19 and the Group's responses to mitigate. In addition the CEO provides regular updates on progress to Board members.

Macroeconomic environment and market conditions
Political and economic uncertainty continued throughout 2019. UK economic fundamentals demonstrably weakened in the second half of the year, as businesses and consumers became more cautious and less active whilst they awaited the impact of the planned Brexit date of 31 October, and when this did not happen, the outcome of the General Election. Growth of GDP flat-lined in the autumn and turned negative in November which dampened demand for consumer and house building finance. Some degree of recovery followed the decisive result of the election.

UK withdrawal from European Union
Following the passing of the UK Withdrawal Agreement and the withdrawal itself on 31 January 2020, the UK remains in a transitional arrangement with the European Union. Uncertainty remains as to whether a new trade deal between the UK and the European Union can be struck before the transitional arrangement ends on 31 December 2020. The UK Government has indicated that it will not extend the deadline, and indeed passed legislation to that effect. The risk of leaving without a robust new trade deal with the EU therefore remains.

Our core business planning assumption is that the transitional arrangement will conclude in an orderly basis and that the direct impact of a disorderly scenario is limited. All continuing trade is within the UK and the lending sectors that the Group operates in are not significantly reliant on cross border arrangements. The indirect impact however could be material. Details of the indirect consequences of a no deal scenario were set out in the Principal risks and uncertainties section of the 2018 Annual Report. Our view of these indirect impacts has not materially changed, and the potential impact on our most significant business units is set out on page 49 of the 2019 Annual Report.

We consider the most significant potential impact of a failure to agree a robust trading agreement to be that on credit risk. The Principal risks and uncertainties section of the 2018 Annual Report sets out details of how the Group worked with external consultants to assess the likely impact of a no deal scenario on its Consumer Finance portfolios. The stress test modelling undertaken showed higher impairment provisions than those set out in our central plan, but not at a level that was considered to compromise the Group's viability. It was concluded at that time that the Group did not need to change strategy in the anticipation of a potential no deal exit from the EU. This continues to be the case, and our view of the impact of a disorderly scenario remains unchanged from that set out in the 2018 analysis.

Additional early warning indicators, that could indicate the need to change strategy, were set up following the work undertaken in 2018 and these have been monitored throughout 2019. Continuing stress test modelling, including that undertaken in respect of our ICAAP, has continued to demonstrate that the Group can withstand significant macroeconomic shocks, including those significantly more adverse than that expected to arise from a disorderly exit from the European Union. The short duration of our balance sheet provides significant flexibility, should we need to reduce our lending activity in the event of such a stress.

Business unit	Potential indirect impact of no deal exit, assessed in 2018
Real Estate Finance	Direct consequences on the procedures for the transfer, renting and mortgaging of property are considered unlikely. If there is a reduction in UK finance providers, then contraction of supply could affect the choice and terms of funding available for investment or development projects. The timing or cost of development projects could be affected by price increases and/or shipping delays. Developers on some, particularly larger projects, may be more cautious about committing to dates and costs without scope for adjustment for the effect of a no deal withdrawal. An increase in the cost of borrowing and weaker demand could push UK property prices lower. These factors could reduce demand for the Group’s products whilst increasing credit risk.
Commercial Finance	No direct consequence is expected due to this division’s UK customer base. Invoice financing has some countercyclical characteristics, though its medium-term performance is directly linked to macroeconomic conditions, given lending balances are secured against the customer’s sales ledger.
Retail Finance	The key market sectors funded by Retail Finance could be impacted by rising raw material or finished goods input prices. Retailers would need to decide whether to pass on costs or absorb them into margins. Rising consumer prices would likely lead to reduced consumer confidence and demand and reduced retailer margins would likely lead to retailers halting or slowing UK expansion. These factors could reduce demand for the Group’s products. Consumer affordability issues could also impact on the Group’s profitability through increased impairment provisions.
Motor Finance	This division serves the UK used car market, which unlike the supply of new vehicles (often originating from other EU markets and attracting increased tariffs), is largely self-contained. However, subdued economic conditions and lower consumer confidence or spending power may have a potential adverse impact on used car demand, and associated demand for the Group’s financing. Affordability issues may also adversely impact the Group’s profitability through increased bad debts.

Model risk and the impact of IFRS 9
We enhanced our controls around Model Risk and Model Governance in 2019. Improvements have been made in all aspects of Model Governance including the Model Governance Policy through to Model Standards and Model Inventories. Material or high risk models are reviewed by the Model Governance Committee on an annual basis. The Group Chief Risk Officer chairs the Model Governance Committee, with the Committee reporting to the Risk Committee.

We continue to derive the probability of default (‘PD’), loss given default (‘LGD’) and exposure at default (‘EAD’) of the Group’s lending portfolios, and therefore impairment provisions, through a suite of IFRS 9 models. The models have been monitored throughout the year and found to be working effectively. Minor enhancements have been made where appropriate. The Group uses a weighted view comprising a number of macro-economic scenarios including benign, base, stress and ICAAP cases to provide the aggregated impairment provision each month.

Climate change
Climate change presents financial risks for the banking industry and whilst it is difficult to assess how climate change will unfold, we are assessing our risk exposure in relation to both the potential ‘Physical’ effects and the ‘Transition’ risks from the adjustment towards a carbon neutral economy.

The risk assessment process has been integrated into existing Risk Frameworks and will be governed through existing risk governance structures, including reporting to the Board Risk Committee.

In accordance with the requirements of the PRA’s Supervisory Statement ‘Enhancing banks’ and insurers’ approaches to managing the financial risks from climate change’, we have allocated responsibility for identifying and managing the risks from climate change to the relevant existing Senior Management Function. In addition, we are evaluating the requirements of the ‘Taskforce on Climate-related Financial Disclosures’ and will continue to enhance our reporting and disclosures in line with these standards.

Risk management

Details of the Group’s risk management framework, including risk appetite, governance arrangements and key committees, can be found on the Group’s website: www.securetrustbank.com/our-corporate-information/risk-management.

Viability and Going Concern Year-end 2019

Going concern

In assessing the Group as a going concern, the Directors have given consideration to the factors likely to affect its future performance and development, the Group’s financial position and the principal risks and uncertainties facing the Group, as set out in the Strategic Report. The Group uses various short- and medium-term forecasts to monitor future capital and liquidity requirements and these include stress testing assumptions to identify the headroom on regulatory compliance measures. As set out in the assessment of business viability, for the 2019 Annual Report and Accounts the stress testing assumptions have included specific scenarios relating to the COVID-19 outbreak.

The Directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future as going concerns. For this reason they continue to adopt the going concern basis.

Business viability

In accordance with provision 31 of the UK Corporate Governance Code, the Directors confirm that there is a reasonable expectation that the Company and the Group will be able to continue in operation and meet their liabilities as they fall due, for the period up to 31 December 2022. The assessment of ongoing viability covers this period as it falls within the Group’s five-year planning horizon and the period covered by the Group’s stress testing.

Given the Group’s continuing long-term growth potential, further improvements in credit quality over 2019 and the Group’s flexible business model, the directors are confident of the Group’s viability over the longer term. However, the continuing uncertainties regarding the economic, regulatory and market environment that the Group operates in, particularly those related to COVID-19, may compromise the reliability of longer range forecasts. The Board has therefore decided to continue to use a three-year period for its assessment of viability rather than extending this over the full planning horizon.

The Directors have based the assessment on:

- the latest annual budget (approved before the outbreak started), which contains information on the expected financial position and performance for the period to 31 December 2024 and by considering the potential impact of the principal risks facing the Group
- the analysis of key sensitivities, undertaken as part of the budget process, which could impact on profitability over the period covered by the budget. Assumptions made to calculate risk weighted assets and capital requirements are clearly stated and additional scenarios are modelled to demonstrate the potential impact of risks and uncertainties on capital
- the Group’s ILAAP, which uses stress scenarios to assess the adequacy of liquidity resources. The results of this scenario analysis are used to set the Group’s OLAR and are also the basis of the liquidity requirements set by the PRA. The Group has maintained liquidity levels in excess of regulatory requirements throughout the year and is forecast to continue to do so
- the Group’s ICAAP, which considers macroeconomic stress and severe shock scenarios in order to assess the adequacy of capital resources. The results of the scenario analysis are used to set the Group’s internal and regulatory capital requirements. The Group has maintained capital levels in excess of regulatory requirements throughout the year and is forecast to continue to do so. The macroeconomic stress scenarios were based on the ‘rates up’ and ‘rates down’ scenarios set out in the H1 2019 Bank of England stress test scenario, with the severe shock scenario assuming key economic variables to be either worsened or accelerated compared to the rates up scenario
- consideration of the other principal risks as set out on pages 40 to 49 of the Annual Report, to identify any other severe but plausible scenarios that could threaten the Group’s business model, future performance, solvency or liquidity
- analysis of further scenarios related to the UK’s withdrawal from the European Union. Further details of this analysis are provided above
- analysis of the operational impact of the COVID-19 outbreak on the Group. Further details are provided above
- consideration of the potential impact of COVID-19 on future earnings, capital and liquidity requirements.

COVID-19 stress testing

Although the Group regularly undertakes capital and liquidity stress testing, particularly to inform the ICAAP and ILAAP, the nature of the economic impact of COVID-19 is likely to be different to the scenarios that are normally considered. Most commentators are suggesting a sharp and deep decline in economic activity, brought about by Government measures to restrict movement and hence reduce contagion, followed by a recovery as measures are lifted. In addition, unlike in the scenarios generally considered in stress testing, operational restrictions introduced by those Government measures also have an impact on the Group's performance and position.

The Group has therefore undertaken bespoke stress testing, covering capital and liquidity, to consider such scenarios. A range of market and idiosyncratic variables were used as scenario inputs, with unemployment levels being the variable to which the Group's impairment losses are most sensitive. Two plausible but severe core scenarios were considered:

- medium stress, whereby unemployment rises to more than 7%, new business levels decrease significantly due to falling demand, collection performance is degraded, and the value of the Group's security against bad debt losses reduces due to house and used car prices falling
- hard stress, whereby unemployment rises to more than 10%, accompanied by more severe falls in demand, collection performance and asset values.

Given the uncertainty over the true impact of the outbreak, a range of sensitivities was then applied, to provide comfort that the Group could withstand even more adverse conditions than those set out in the Hard stress scenario. These included raising the unemployment rate to even higher levels, further degrading collection performance, changing the assessment of the effectiveness of Government interventions on impairment rates, and prolonging the period of unemployment. The sensitivities also served as a reverse stress test, to identify the circumstances that could cause the Group to fail.

Analysis of the stress testing results showed that the Group did not breach capital or liquidity requirements, or need to utilise buffers, in either the Medium or Hard stress scenario. Strategic management actions such as formal cost reduction programmes were also not required. The liquidity position remained robust, indicating the Group's ability to withstand contagion should another financial institution fail.

The most extreme sensitivities applied would either require the Group to implement strategic management actions or to temporarily utilise capital buffers. The PRA has notified financial institutions that it expects them to utilise buffers if required, in order to continue lending, and so this is not considered to compromise the Group's Viability or Going Concern status. The Board considers that the circumstances required to cause the Group to fail, as demonstrated by the reverse stress testing, are considered sufficiently remote.

In undertaking this stress testing analysis the Group has made use of models. Models are imperfect representations of reality, reliant on historical data, model inputs and assumptions. These model risks are exacerbated when dealing with unprecedented scenarios, such as the COVID-19 pandemic, due to the lack of credible, reliable historical data to use as a reference point. The Group has sought to reduce this risk by comparing different model methodologies, applying expert judgement and senior management review.

In making this statement, the Board has sought input from the Audit Committee and the Risk Committee.

Directors' responsibility statement

The responsibility statement below has been prepared in connection with the full annual accounts of the Company for the year ended 31 December 2019. Certain parts of these accounts are not presented within this announcement.

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. As required by the Listing Rules, they are required to prepare the Group financial statements in accordance with IFRS as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- state whether they have been prepared in accordance with IFRS as adopted by the EU
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group and parent company's financial position and financial performance

- assess the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent 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 Group and parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent 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 to safeguard the assets of the Group and parent company and for taking such steps as are reasonably open to them to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

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.

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and parent company and the undertakings included in the consolidation taken as a whole
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and parent company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group and parent company's performance, business model and strategy

This responsibility statement was approved by the Board of Directors on 6 May 2020 and signed on their behalf by:

Lord Forsyth
Chairman

Paul Lynam
Chief Executive Officer

Consolidated statement of comprehensive income

	Note	**2019 £million**	2018 £million
Income statement			
Interest income and similar income	4.1	191.4	169.2
Interest expense and similar charges	4.1	(46.0)	(35.5)
Net interest income	4.1	**145.4**	**133.7**
Fee and commission income	4.2	20.9	19.4
Fee and commission expense	4.2	(0.8)	(1.5)
Net fee and commission income	4.2	**20.1**	**17.9**
Operating income		**165.5**	**151.6**
Net impairment losses on loans and advances to customers		(32.6)	(32.4)
Operating expenses	6	(94.2)	(84.5)
Profit before income tax		**38.7**	**34.7**
Income tax expense	8	(7.6)	(6.4)
Profit for the year		**31.1**	**28.3**
Other comprehensive income			

Items that will not be reclassified to the income statement			
Revaluation reserve		0.2	(0.3)
Taxation		(0.2)	0.1
Other comprehensive income for the year, net of income tax		**–**	**(0.2)**
Total comprehensive income for the year		**31.1**	**28.1**

Profit attributable to:			
Equity holders of the Company		**31.1**	**28.3**
Total comprehensive income attributable to:			
Equity holders of the Company		**31.1**	**28.1**

Earnings per share for profit attributable to the equity holders of the Company during the year (pence per share)			
Basic earnings per share	9.1	**168.3**	**153.2**
Diluted earnings per share	9.2	**166.4**	**150.9**

All comprehensive income relates to continuing operations.

Consolidated statement of financial position

	Note	**2019 £million**	2018 £million
ASSETS			
Cash and balances at central banks		105.8	169.7
Loans and advances to banks	11	48.4	44.8
Loans and advances to customers	12	2,450.1	2,028.9
Debt securities	15	25.0	149.7
Fair value adjustment for portfolio hedged risk		(0.9)	–
Derivative financial instruments		0.9	–
Investment property	16	4.8	–
Property, plant and equipment	17	11.3	11.0
Right-of-use assets	18	3.6	–
Intangible assets	19	9.0	9.9
Deferred tax assets	21	7.5	7.9
Other assets	22	17.3	22.4
Total assets		**2,682.8**	**2,444.3**
LIABILITIES AND EQUITY			
Liabilities			
Due to banks	23	308.5	263.5
Deposits from customers	24	2,020.3	1,847.7
Fair value adjustment for portfolio hedged risk		(0.7)	–
Derivative financial instruments		0.6	–
Current tax liabilities		3.3	4.2
Lease liabilities	25	4.5	–
Other liabilities	26	40.9	40.1
Provisions for liabilities and charges	27	0.7	1.3
Subordinated liabilities	28	50.6	50.4
Total liabilities		**2,428.7**	**2,207.2**

Equity attributable to owners of the parent			
Share capital	30	7.4	7.4
Share premium		81.2	81.2
Revaluation reserve		1.1	1.1
Retained earnings		164.4	147.4
Total equity		**254.1**	**237.1**
Total liabilities and equity		**2,682.8**	**2,444.3**

Company statement of financial position

	Note	**2019 £million**	2018 £million
ASSETS			
Cash and balances at central banks		105.8	169.7
Loans and advances to banks	11	45.2	41.9
Loans and advances to customers	12	2,353.6	1,980.3
Debt securities	15	25.0	149.7
Fair value adjustment for portfolio hedged risk		(0.9)	–
Derivative financial instruments		0.9	–
Investment property	16	4.8	–
Property, plant and equipment	17	6.5	6.0
Right-of-use assets	18	2.5	–
Intangible assets	19	7.4	8.1
Investments	20	4.1	3.9
Deferred tax assets	21	8.1	7.8
Other assets	22	103.8	65.6
Total assets		**2,666.8**	**2,433.0**
LIABILITIES AND EQUITY			
Liabilities			
Due to banks	23	308.5	263.5
Deposits from customers	24	2,020.3	1,847.7
Fair value adjustment for portfolio hedged risk		(0.7)	–
Derivative financial instruments		0.6	–
Current tax liabilities		2.2	3.6
Lease liabilities	25	3.3	–
Other liabilities	26	42.0	49.1
Provisions for liabilities and charges	27	0.7	1.3
Subordinated liabilities	28	50.6	50.4
Total liabilities		**2,427.5**	**2,215.6**
Equity attributable to owners of the parent			
Share capital	30	7.4	7.4
Share premium		81.2	81.2
Revaluation reserve		0.7	0.6
Retained earnings		150.0	128.2
Total equity		**239.3**	**217.4**
Total liabilities and equity		**2,666.8**	**2,433.0**

The Company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the parent company income statement. The profit for the parent company for the year of £35.9 million is presented in the Company statement of changes in equity.

Registered number: 00541132

Consolidated statement of changes in equity

	Share capital £million	Share premium £million	Revaluation reserve £million	Retained earnings £million	**Total £million**
Balance at 1 January 2018	**7.4**	**81.2**	**1.3**	**133.4**	**223.3**
Total comprehensive income for the period					
Profit for 2018	–	–	–	28.3	28.3
Other comprehensive income, net of income tax					
Revaluation reserve	–	–	(0.3)	–	(0.3)
Tax on revaluation reserve	–	–	0.1	–	0.1
Total other comprehensive income	–	–	**(0.2)**	**–**	**(0.2)**
Total comprehensive income for the period	–	–	**(0.2)**	**28.3**	**28.1**
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Dividends	–	–	–	(14.8)	(14.8)
Share-based payments	–	–	–	0.8	0.8
Tax on share-based payments	–	–	–	(0.3)	(0.3)
Total contributions by and distributions to owners	**–**	**–**	**–**	**(14.3)**	**(14.3)**
Balance at 31 December 2018 (as previously stated)	**7.4**	**81.2**	**1.1**	**147.4**	**237.1**
IFRS 16 transition adjustment net of tax (see Note 1)	–	–	–	(0.1)	(0.1)
Balance at 1 January 2019 (as restated)	**7.4**	**81.2**	**1.1**	**147.3**	**237.0**
Total comprehensive income for the period					
Profit for 2019	–	–	–	31.1	31.1
Other comprehensive income, net of income tax					
Revaluation reserve	–	–	0.2	–	0.2
Tax on revaluation reserve	–	–	(0.2)	–	(0.2)
Total other comprehensive income	**–**	**–**	**–**	**–**	**–**
Total comprehensive income for the period	**–**	**–**	**–**	**31.1**	**31.1**
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Dividends	–	–	–	(15.5)	(15.5)
Share-based payments	–	–	–	1.2	1.2
Tax on share-based payments	–	–	–	0.3	0.3
Total contributions by and distributions to owners	**–**	**–**	**–**	**(14.0)**	**(14.0)**
Balance at 31 December 2019	**7.4**	**81.2**	**1.1**	**164.4**	**254.1**

Company statement of changes in equity

	Share capital £million	Share premium £million	Revaluation reserve £million	Retained earnings £million	**Total £million**
Balance at 1 January 2018	**7.4**	**81.2**	**0.5**	**121.7**	**210.8**
Total comprehensive income for the period					
Profit for 2018	–	–	–	20.8	20.8
Other comprehensive income, net of income tax					
Revaluation reserve	–	–	0.1	–	0.1
Total other comprehensive income	**–**	**–**	**0.1**	**–**	**0.1**
Total comprehensive income for the period	**–**	**–**	**0.1**	**20.8**	**20.9**
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Dividends	–	–	–	(14.8)	(14.8)
Share-based payments	–	–	–	0.8	0.8
Tax on share-based payments	–	–	–	(0.3)	(0.3)
Total contributions by and distributions to owners	**–**	**–**	**–**	**(14.3)**	**(14.3)**
Balance at 31 December 2018 (as previously stated)	**7.4**	**81.2**	**0.6**	**128.2**	**217.4**
IFRS 16 transition adjustment net of tax (see Note 1)	–	–	–	(0.1)	(0.1)
Balance at 1 January 2019 (as restated)	**7.4**	**81.2**	**0.6**	**128.1**	**217.3**
Total comprehensive income for the period					
Profit for 2019	–	–	–	35.9	35.9
Other comprehensive income, net of income tax					
Revaluation reserve	–	–	0.1	–	0.1
Total other comprehensive income	**–**	**–**	**0.1**	**–**	**0.1**
Total comprehensive income for the period	**–**	**–**	**0.1**	**35.9**	**36.0**
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Dividends	–	–	–	(15.5)	(15.5)
Share-based payments	–	–	–	1.2	1.2
Tax on share-based payments	–	–	–	0.3	0.3
Total contributions by and distributions to owners	**–**	**–**	**–**	**(14.0)**	**(14.0)**
Balance at 31 December 2019	**7.4**	**81.2**	**0.7**	**150.0**	**239.3**

Consolidated statement of cash flows

	Note	**2019 £million**	2018 Restated £million
Cash flows from operating activities			
Profit for the year		31.1	28.3
Adjustments for:			

Income tax expense	8	7.6	6.4
Depreciation of property, plant and equipment	17	1.2	1.3
Depreciation of right-of-use assets	18	0.9	–
Loss on disposal of computer software		–	0.1
Amortisation of intangible assets	19	1.9	1.8
Impairment losses on loans and advances to customers	14	32.6	32.4
Share-based compensation	31	1.2	0.8
Revaluation loss	17	1.1	–
Lease interest charged	25	0.1	–
Amortisation of subordinated liabilities issue costs	28	0.2	–
Cash flows from operating profits before changes in operating assets and liabilities		77.9	71.1
Changes in operating assets and liabilities:			
– net increase in loans and advances to customers		(453.8)	(494.8)
– net decrease/(increase) in other assets		4.6	(17.0)
– net increase in deposits from customers		172.6	364.5
– net increase/(decrease) in other liabilities		1.3	(0.5)
Income tax paid		(7.8)	(6.4)
Net cash outflow from operating activities		**(205.2)**	**(83.1)**
Cash flows from investing activities			
Redemption of debt securities		320.1	305.0
Purchase of debt securities		(195.4)	(449.7)
Purchase of investment property	16	(1.6)	–
Purchase of property, plant and equipment	17	(5.5)	(1.1)
Purchase of intangible assets	19	(1.1)	(1.4)
Net cash inflow/(outflow) from investing activities		**116.5**	**(147.2)**
Cash flows from financing activities			
Increase in amounts due to banks		45.0	150.0
Issue of subordinated liabilities		–	50.0
Subordinated liabilities issue costs		–	(0.8)
Dividends paid	10	(15.5)	(14.8)
Repayment of lease liabilities	25	(1.1)	–
Net cash inflow from financing activities		**28.4**	**184.4**
Net decrease in cash and cash equivalents		**(60.3)**	**(45.9)**
Cash and cash equivalents at 1 January		214.5	260.4
Cash and cash equivalents at 31 December	32.1	**154.2**	**214.5**

Redemption and purchase of debt securities have been grossed up and moved from operating activities to investing activities, as this better represents the nature of the underlying activity.

Company statement of cash flows

	Note	**2019 £million**	2018 Restated £million
Cash flows from operating activities			
Profit for the year		35.9	20.8
Adjustments for:			
Income tax expense	8	5.3	4.9

Depreciation of property, plant and equipment	17	0.7	0.7
Depreciation of right-of-use assets	18	0.5	–
Loss on disposal of computer software		–	0.1
Amortisation of intangible assets	19	1.6	1.6
Impairment losses on loans and advances to customers	14	37.5	33.1
Share-based compensation	31	1.0	0.6
Revaluation deficit	17	1.1	–
Lease interest charged	25	0.1	–
Amortisation of subordinated liabilities issue costs	28	0.2	–
Cash flows from operating profits before changes in operating assets and liabilities		83.9	61.8
Changes in operating assets and liabilities:			
– net increase in loans and advances to customers		(410.8)	(480.3)
– net increase in other assets		(38.7)	(32.4)
– net increase in deposits from customers		172.6	364.5
– net (decrease)/increase in other liabilities		(6.6)	6.0
Income tax paid		(6.5)	(4.3)
Net cash outflow from operating activities		**(206.1)**	**(84.7)**
Cash flows from investing activities			
Redemption of debt securities		320.1	305.0
Purchase of debt securities		(195.4)	(449.7)
Purchase of investment property	16	(1.6)	–
Purchase of property, plant and equipment	17	(5.3)	(0.5)
Purchase of intangible assets	19	(1.0)	(1.3)
Net cash inflow/(outflow) from investing activities		**116.8**	**(1.8)**
Cash flows from financing activities			
Increase in amounts due to banks		45.0	150.0
Issue of subordinated liabilities		–	50.0
Subordinated liabilities issue costs		–	(0.8)
Dividends paid	10	(15.5)	(14.8)
Repayment of lease liabilities	25	(0.8)	–
Net cash inflow from financing activities		**28.7**	**184.4**
Net decrease in cash and cash equivalents		**(60.6)**	**(46.8)**
Cash and cash equivalents at 1 January		211.6	258.4
Cash and cash equivalents at 31 December	32	**151.0**	**211.6**

Redemption and purchase of debt securities have been grossed up and moved from operating activities to investing activities, as this better represents the nature of the underlying activity.

Notes to the preliminary statements

1. Accounting policies

The principal accounting policies applied in the preparation of this preliminary announcement are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

1.1. Reporting entity

Secure Trust Bank PLC is a public limited company incorporated in England and Wales in the United Kingdom (referred to as ‘the Company’) and is limited by shares. The Company is registered in England and Wales and has the registered number 00541132. The registered address of the Company is One Arleston Way, Solihull, West Midlands, B90 4LH. The consolidated financial statements of the Company as at and for the year ended 31 December 2019 comprise Secure Trust

Bank PLC and its subsidiaries (together referred to as ‘the Group’ and individually as ‘subsidiaries’). The Group is primarily involved in banking and financial services.

1.2. Basis of presentation

The figures shown for the year ended 31 December 2019 are not statutory accounts within the meaning of section 435 of the Companies Act 2006. The statutory accounts for the year ended 31 December 2019 on which the auditors have given an unqualified audit report and did not contain an adverse statement under section 498(2) or 498(3) of the Companies Act 2006 will be delivered to the Registrar of Companies after the Annual General Meeting. The figures shown for the year ended 31 December 2018 are not statutory accounts. A copy of the statutory accounts has been delivered to the Registrar of Companies, contained an unqualified audit report and did not contain an adverse statement under section 498(2) or 498(3) of the Companies Act 2006. This announcement has been agreed with the Company’s auditors for release.

The Directors have assessed, in the light of current and anticipated economic conditions, the Group’s ability to continue as a going concern. The Directors confirm they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the ‘going concern’ basis for preparing accounts, as set out in the Going concern and viability section of the Strategic Report starting on page 2.

The consolidated financial statements were authorised for issue by the Board of Directors on 6 May 2020.

1.3. IFRS 16 ‘Leases’

IFRS 16 ‘Leases’, which has been issued and endorsed by the EU, is effective for annual periods beginning on or after 1 January 2019.

The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract i.e. the customer (‘lessee’) and the supplier (‘lessor’). It replaces the previous leases standard, IAS 17 ‘Leases’, and related interpretations.

IFRS 16 uses a new single model that applies to all leases, thus eliminating the classification of leases as either operating leases or finance leases for a lessee. Applying that model, on commencement of a lease, the lessee recognises a liability to make lease payments (‘the lease liability’), an asset representing the right to use the underlying asset during the lease term (‘the right-of-use asset’), and depreciation of right-of-use assets is shown separately from interest on lease liabilities in the income statement.

The lease liability is initially measured based on the net present value of the lease payments to be made over the remaining lease term, using the lessee’s incremental borrowing rate as the discount rate. After commencement of the lease, the lease liability is measured on an amortised cost basis, with interest being calculated on an effective interest rate basis on the remaining balance of the liability, and lease payments reducing the lease liability when paid.

The right-of-use assets are initially measured at cost, being the amount of the initial measurement of the lease liability, adjusted for any prepaid rentals less any lease incentives plus any initial direct costs incurred by the lessee and dismantling or restoration costs. Subsequently, the right-of-use assets are amortised on a straight-line basis over the remaining term of the lease. The right-of-use assets are tested for impairment in accordance with IAS 36.

In the cash flow statement, lease interest is included in cash flow from operating activities and repayments of lease liabilities are included in cash flow from financing activities.

Transition choices

The Group has elected to recognise the cumulative effect of implementing IFRS 16 as an adjustment to the opening balance of retained earnings at 1 January 2019. Accordingly, prior year comparatives shall not be restated. As a practical expedient, the Group will apply the new standard only to contracts that had previously been identified as leases. Therefore, the new standard will not be applied to contracts that had not previously been identified as leases.

The Group has also elected not to apply IFRS 16 to the following, as they are not material:

- Short-term leases of 12 months or less
- Leases for which the underlying asset is of low value

This has resulted in the new standard only being applicable to a number of property leases and motor vehicle leases.

The Group has chosen to measure the initial right-of-use asset for property leases at its carrying amount as if the standard has been applied since the commencement date, but discounted using the incremental borrowing rate as at 1 January 2019. The initial right-of- use asset for all other leases is measured at an amount equal to the lease liability.

The adjustments (net of tax) arising from the adoption of IFRS 16 on 1 January 2019, and their effect on the 31 December 2018 balance sheet, were as follows:

	As originally stated 31 December	**IFRS 16 transition adjustment 1 January**	**As restated 1 January 2019 £million**

	2018 £million	**2019 £million**	
ASSETS			
Cash and balances at central banks	169.7	–	169.7
Loans and advances to banks	44.8	–	44.8
Loans and advances to customers	2,028.9	–	2,028.9
Debt securities	149.7	–	149.7
Lease right-of-use asset	–	4.5	4.5
Deferred tax assets	7.9	0.2	8.1
Other assets	43.3	(0.4)	42.9
Total assets	**2,444.3**	**4.3**	**2,448.6**
LIABILITIES AND EQUITY			
Liabilities			
Due to banks	263.5	–	263.5
Deposits from customers	1,847.7	–	1,847.7
Lease liabilities	–	5.5	5.5
Other liabilities	45.6	(1.1)	44.5
Subordinated liabilities	50.4	–	50.4
Total liabilities	**2,207.2**	**4.4**	**2,211.6**
Equity attributable to owners of the parent			
Share capital	7.4	–	7.4
Share premium	81.2	–	81.2
Revaluation reserve	1.1	–	1.1
Retained earnings	147.4	(0.1)	147.3
Total equity	**237.1**	**(0.1)**	**237.0**
Total liabilities and equity	**2,444.3**	**4.3**	**2,448.6**

Adjustments to other assets
These relate to the release of rent prepayments that are no longer required now that the leases are recognised as right-of-use assets.

Adjustment to other liabilities
This relates to the release of a reverse lease premium, which under IAS 17 was included in accruals and was being spread over the term of the lease.

The weighted average incremental borrowing rate applied to lease liabilities recognised in the statement of financial position on transition at 1 January 2019 was 2.61%.

The table below presents a reconciliation from operating lease commitments disclosed at December 2018 to lease liabilities recognised at 1 January 2019:

	£million
Operating lease commitment disclosed under IAS 17 at December 2018	7.4
Effect of discounting	(1.9)
	5.5

In terms of the income statement impact, the application of IFRS 16 resulted in a decrease in other operating expenses and an increase in depreciation and interest expense compared to IAS 17. During the year, in relation to leases under IFRS 16 the Group recognised the following amounts in the consolidated income statement:

	£million
Depreciation	0.9

Interest expense	0.1
	1.0

Lessor accounting
Lessor accounting, which comprises Motor Finance, Asset Finance and the RentSmart business, remains unchanged from IAS 17.

1.4. Consolidation

Subsidiaries
Subsidiaries are all investees controlled by the Group. The Group controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are fully consolidated from the date on which control is transferred to the Group.

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition, excluding directly attributable costs, over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

The parent company's investments in subsidiaries are recorded at cost less, where appropriate, provision for impairment. At the year-end, there was no indication that investments in subsidiaries were impaired, so impairment testing was not performed.

Inter-company transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The parent company's expected credit loss on amounts due from related companies, calculated by applying probability of default and loss given default the amount outstanding at the year-end, was not material at 31 December 2019.

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Discontinued operations
Subsidiaries are de-consolidated from the date that control ceases. Discontinued operations are a component of an entity that has been disposed of, and represents a major line of business and is part of a single co-ordinated disposal plan.

1.5. Interest income and expense
For all financial instruments measured at amortised cost, the effective interest rate method is used to measure the carrying value and allocate interest income or expense. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset or
- the amortised cost of the financial liability

In calculating the effective interest rate for financial instruments, other than assets that were credit-impaired on initial recognition, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, early redemption penalty charges and broker commissions) and anticipated customer behaviour, but does not consider future credit losses. For financial assets that were impaired on initial recognition (also referred to as purchased or originated credit-impaired assets – 'POCI'), a credit adjusted effective interest rate is calculated using estimated future cash flows, including expected credit losses.

The calculation of the effective interest rate includes all fees received and paid that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument.

For financial assets that are not considered to be credit-impaired ('stage 1' and 'stage 2' assets), interest income is recognised by applying the effective interest rate to the gross carrying amount of the financial asset. For financial assets that become credit-impaired subsequent to initial recognition ('stage 3' assets), from the next reporting period onwards interest income is recognised by applying the effective interest rate to the amortised cost of the financial asset. The credit risk of financial assets that become credit-impaired are not expected to improve such that they are no longer considered credit-impaired, however, if this were to occur the calculation of interest income would revert back to the gross basis. The Group's definition of stage 1, stage 2 and stage 3 assets is set out in Note 1.9.

For financial assets that were credit-impaired on initial recognition (POCI assets), income is calculated by applying the credit adjusted effective interest rate to the amortised cost of the asset. For such financial assets the calculation of interest income will never revert to a gross basis, even if the credit risk of the asset improves.

Further details regarding when an asset becomes credit-impaired subsequent to initial recognition is provided within Note 1.9.

1.6. Net fee and commission income

Fees and commission income and expenses that are an integral part of the effective interest rate of a financial instrument are included in the effective interest rate and presented in the Statement of Comprehensive Income as interest income or expense.

Fees and commission income that is not considered an integral part of the effective interest rate of a financial instrument are recognised under IFRS 15 when the Group satisfies performance obligations by transferring promised services to customers.

1.7. Financial assets and financial liabilities

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all of the risks and rewards of ownership. There have not been any instances where assets have only been partially derecognised. The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire, including in the event of a substantial modification as described in Note 1.9.

Amortised cost measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, minus principal payments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market for a financial instrument is not active the Group establishes a fair value by using an appropriate valuation technique. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis.

Financial assets (with the exception of derivative financial instruments)

The Group classifies its financial assets at inception into three measurement categories; 'amortised cost', 'fair value through other comprehensive income' ('FVOCI') and 'fair value through profit and loss' ('FVTPL'). A financial asset is measured at amortised cost if both the following conditions are met and it has not been designated as at FVTPL:

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

The Group's current business model for all financial assets, with the exception of derivative financial instruments, is to hold to collect contractual cash flows and all assets held give rise to cash flows on specified dates that represent solely payments of principal and interest on the outstanding principal amount. All the Group's assets are therefore currently classified as amortised cost. Loans are recognised when funds are advanced to customers and are carried at amortised cost using the effective interest method.

The amortised cost of an instrument is the amount at which it is measured at initial recognition, less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, less any expected credit loss allowance. The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

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

- the asset is held within a business model whose objective is achieved by both collecting its contractual cash flows and selling the financial asset

- the contractual terms of the financial asset give rise to cash flows on specified dates that represent payments of solely principal and interest on the outstanding principal amount

The Group currently has no financial instruments classified as FVOCI.

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election would be made on an investment by investment basis. The Group currently holds no such investments.

All other assets are classified as FVTPL. The Group currently has no financial assets classified as FVTPL.

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets. The Group has not reclassified any financial assets during the reporting period.

Deposits from customers
The Group classifies its financial liabilities as measured at amortised cost. Such financial liabilities are recognised when cash is received from depositors and carried at amortised cost using the effective interest method.

Other financial liabilities (with the exception of derivative financial instruments)
The subordinated liabilities comprise of 6.75% Fixed Rate Reset Callable Subordinated Notes due 2028 (the 'Notes'):

- The notes are redeemable for cash at their principal amount on a fixed date
- The Company has a call option to redeem the securities early in the event of a 'tax event' or a 'capital disqualification event', which is at the full discretion of the Company
- Interest payments are paid at six monthly intervals and are mandatory
- The notes give the holders rights to the principal amount on the notes, plus any unpaid interest, on liquidation. Any such claims are subordinated to senior creditors, but rank pari passu with holders of other subordinated obligations and in priority to holders of share capital

The above features provide the issuer with a contractual obligation to deliver cash or another financial asset to the holders, and therefore the notes are classified as financial liabilities. Further information in respect of the notes is provided in Note 28

Transaction costs that are directly attributable to the issue of the notes and are incremental costs that would not have been incurred if the notes had not been issued are deducted from the financial liability and expensed to the income statement on an effective interest rate basis over the expected life of the notes.

The fair value of other liabilities repayable on demand is assumed to be the amount payable on demand at the statement of financial position date.

The Group has not elected to measure any financial liabilities at fair value.

1.8. Foreign currencies
Transactions in foreign currencies are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into the Company's functional currency at the rates prevailing on the balance sheet date. Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the income statement for the period.

1.9. Impairment of financial assets and loan commitments
The Group recognises loss allowances for Expected Credit losses ('ECLs') on all financial assets carried at amortised cost, including lease receivables and loan commitments.

Credit loss allowances are measured as an amount equal to lifetime ECL, except for the following assets, for which they are measured as 12-month ECL:

- Financial assets determined to have low credit risk at the reporting date
- Financial assets which have not experienced a significant increase in credit risk since their initial recognition
- Financial assets which have experienced a significant increase in credit risk since their initial recognition but have subsequently met the Group's cure policy, as set out below

Such assets are classified as stage 1 assets.

Assets which have experienced a significant increase in credit risk since their initial recognition and have not subsequently met the Group's cure policy are classified as stage 2 assets. The Group's definitions of a significant increase in credit risk and default are set out below.

A financial asset is considered to have low credit risk when its credit risk rating is equivalent to the widely understood definition of 'investment grade' assets. The Group has assessed all its debt securities, which represents UK Treasury bills, and loans held in STB Leasing Limited, for which credit risk is retained by its partner RentSmart, to be low credit risk.

Definition of default/credit-impaired financial assets (Stage 3 loans)
At each reporting date, the Group assesses whether financial assets carried at amortised cost are credit-impaired (stage 3). A financial asset is considered to be credit-impaired when an event or events that have a detrimental impact on estimated future cash flows have occurred. Evidence that a financial asset is credit-impaired includes the following observable data:

- Initiation of bankruptcy proceedings
- Notification of bereavement
- Identification of loan meeting debt sale criteria
- Initiation of repossession proceedings

In addition, a loan that is 90 days or more past due is considered credit-impaired for all portfolios. The credit risk of financial assets that become credit-impaired are not expected to improve such that they are no longer considered credit-impaired.

For Commercial Finance facilities that do not have a fixed term or repayment structure, evidence that a financial asset is credit-impaired includes:

- the client ceasing to trade
- unpaid debtor balances that are dated at least six months past their normal recourse period

Significant increase in credit risk (Stage 2 loans)
For Consumer Finance, the credit risk of a financial asset is considered to have experienced a significant increase in credit risk since initial recognition where there has been a significant increase in the remaining lifetime probability of default of the asset. The Group may also use its expert credit judgement and where possible relevant historical and current performance data, including bureau data, to determine that an exposure has undergone a significant increase in credit risk.

For Business Finance, the credit risk of a financial asset is considered to have experienced a significant increase in credit risk where certain early warning indicators apply. These indicators may include notification of county court judgements or, specifically for the Real Estate Finance portfolio, cost over-runs and timing delays experienced by borrowers.

As a backstop, the Group considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due for all portfolios.

Performing assets which have experienced a significant increase in credit risk since initial recognition are reclassified from stage 1, for which loss allowances are measured at an amount equal to 12-month ECL, to stage 2, for which ECL is measured as lifetime ECL.

Cure policy
The credit risk of a financial asset may improve such that it is no longer considered to have experienced a significant increase in credit risk if it meets the Group's cure policy. The Group's cure policy for all portfolios requires sufficient payments to be made to bring an account back within less than 30 days past due and for such payments to be maintained for six consecutive months.

The Group has determined stage 3 to be an absorbing state. Once a loan is in default it is not therefore expected to cure back to stage 1 or 2.

Calculation of expected credit loss
ECLs are probability weighted estimates of credit losses which are measured as the present value of all cash shortfalls. Specifically, this is the difference between the contractual cash flows due and the cash flows expected to be received, discounted at the original effective interest rate or, for portfolios purchased outside of the Group by Debt Managers (Services) Limited, the credit adjusted effective interest rate. For undrawn loan commitments ECL is measured as the difference between the contractual cash flows due if the commitment is drawn and the cash flows expected to be received.

Lifetime ECL is the ECL that results from all possible default events over the expected life of a financial asset.

12-month ECL is the portion of lifetime ECL that results from default events on a financial asset that are possible within 12 months after the reporting date.

ECLs are calculated by multiplying three main components: the probability of default ('PD'), exposure at default ('EAD') and loss given default ('LGD') discounted at the original effective interest rate of an asset. These variables are derived from internally developed statistical models and historical data, adjusted to reflect forward-looking information and are discussed in turn further below. Management adjustments are made to modelled output to account for situations where known or expected risk factors have not been considered in the modelling process.

Probability of default ('PD') and credit risk grades
Credit risk grades are a primary input into the determination of the PD for exposures. The Group allocates each exposure to a credit risk grade at origination and at each reporting period to predict the risk of default. Credit risk grades are determined using qualitative and quantitative factors that are indicative of the risk of default e.g. arrears status and loan applications scores. These factors vary for each loan portfolio. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. In monitoring exposures information such as payment records, request for forbearance strategies and forecast changes in economic conditions are considered for Consumer Finance. Additionally, for Business Finance portfolios information obtained during periodic client reviews, for example audited financial statements, management accounts, budgets and projections are considered, with particular focus on key ratios, compliance with covenants and changes in senior management teams.

Exogenous, Maturity, Vintage ('EMV') modelling is used in the production of forward-looking lifetime PDs. This method entails modelling the effects of external (exogenous) factors against cohorts of lending and their time on the books creating a clean relationship to best demonstrate the movement in default rates as macro-economic variables are changed. These models are extrapolated to provide PD estimates for the future, based on forecasted economic scenarios.

Exposure at default ('EAD')
EAD represents the expected exposure in the event of a default. EAD is derived from the current exposure and potential changes to the current amount allowed under the terms of the contract, including amortisation overpayments and early terminations. The EAD of a financial asset is its gross carrying amount. For loan commitments the EAD includes the amount drawn as well as potential future amounts that may be drawn under the terms of the contract, estimated based on historical observations and forward-looking forecasts.

For Commercial Finance facilities that have no specific term, an assumption is made that accounts close 36 months after the reporting date for the purposes of measuring lifetime ECL. This assumption is based on industry experience of average client life. These facilities do not have a fixed term or repayment structure but are revolving and increase or decrease to reflect the value of the collateral i.e. receivables or inventory. The Group can cancel the facilities with immediate effect, although this contractual right is not enforced in the normal day-to-day management of the facility. Typically, demand would only be made on the failure of a client business or in the event of a material event of default, such as a fraud. In the normal course of events, the Group's exposure is recovered through receipt of remittances from the client's debtors rather than from the client itself.

The ECL for such facilities is estimated taking into account the credit risk management actions that the Group expects to take to mitigate against losses. These include a reduction in advance rate and facility limits or application of reserves against a facility to improve the likelihood of full recovery of exposure from the debtors. Alternative recovery routes mitigating ECL would include refinancing by another funding provider, taking security over other asset classes or secured personal guarantees from the client's principals.

Loss given default ('LGD')
LGD is the magnitude of the likely loss in the event of default. This takes into account recoveries either through curing or, where applicable, through auction sale of repossessed collateral and debt sale of the residual shortfall amount. For loans secured by retail property, loan-to-value ratios are key parameters in determining LGD. LGDs are calculated on a discounted cash flow basis using the financial instrument's origination effective interest rate as the discount factor.

Incorporation of forward-looking data
The Group incorporates forward-looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of expected credit loss. This is achieved by developing a number of potential economic scenarios and modelling expected credit losses for each scenario. To ensure material non-linear relationships between economic factors and credit losses are reflected in the calculation of ECL a deeper stress scenario is used as one of these scenarios. The outputs from each scenario are combined using the estimated likelihood of each scenario occurring to derive a probability weighted expected credit loss. The four scenarios adopted and probability weighting applied are approved by the Assumptions Committee and are set out in Note 2.

The Group has considered which economic variables impact credit risk and credit losses. The key drivers of credit risk and credit losses included in the macro-economic scenarios for all portfolios, with the exception of Real Estate Finance, have been identified as annual unemployment rate growth and annual house price index growth. In addition, for Asset Finance and Commercial Finance, changes to the consumer price index are also included in the macro-economic scenarios. For the Real Estate Finance portfolio the key drivers have been identified as unemployment rate growth and Bank of England base rates. Base case assumptions applied for each of these variables have been sourced from external consensus or Bank of England forecasts. Further details of the assumptions applied to other scenarios are presented in Note 2.

Presentation of loss allowance
Loss allowances for ECL are presented in the statement of financial position as follows with the loss recognised in the statement of comprehensive income:

- Financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets
- Other loan commitments: generally, as a provision

For the Real Estate Finance and Commercial Finance portfolios, where a loan facility is agreed that includes both drawn and undrawn elements and the Group cannot identify the ECL on the loan commitment separately, a combined loss allowance for both drawn and undrawn components of the loan is presented as a deduction from the gross carrying amount of the drawn component, with any excess of the loss allowance over the gross drawn amount presented as a provision.

When a loan is uncollectible, it is written off against the related ECL allowance. Such loans are written off after all necessary procedures have been completed and the amount of the loss has been determined.

Motor voluntary termination provision

In addition to recognising allowances for ECLs, the Group holds a provision for voluntary terminations ('VT') for all Motor Finance financial assets. VT is a legal right provided to customers who take out hire purchase agreements. The provision is calculated by multiplying the probability of VT of an asset by the expected shortfall on VT discounted back at the original effective interest rate of the asset. VT allowances are not held against loans in default (stage 3 loans).

The VT provision is presented in the statement of financial position as a deduction from the gross carrying amount of Motor Finance assets with the loss recognised in the statement of comprehensive income.

Write off

Loans and advances to customers are written off partially or in full when the Group has exhausted all viable recovery options. The majority of write offs arise from Debt Relief Orders, insolvencies, IVAs, deceased customers where there is no estate and vulnerable customers in certain circumstances. Amounts subsequently recovered on assets previously written off are recognised in impairment losses in the income statement.

Modification of loans

A customer's account may be modified to assist customers who are in or have recently overcome financial difficulties and have demonstrated both the ability and willingness to meet the current or modified loan contractual payments. Substantial loan modifications result in the derecognition of the existing loan, and the recognition of a new loan at the new origination effective interest rate ('EIR') based on the expected future cash flows at origination. Determination of the origination PD for the new loan is required, based on the PD as at the date of the modification, which is used for the calculation of the impairment provision against the new loan. Any deferred fees or deferred interest, and any difference between the fair value of the derecognised loan and the new loan, is written off to the income statement on recognition of the new loan.

Where the modification is not considered to be substantial, neither the origination EIR nor the origination PD for the modified loan changes. The net present value of changes to the future contractual cash flows adjusts the carrying amount of the original debt with the difference immediately being recognised in profit or loss. The adjusted carrying amount is then amortised over the remaining term of the (modified) liability using the original effective interest rate.

1.10. Derivative financial instruments

The Group enters into derivatives to manage exposures to fluctuations in interest rates. Derivatives are not used for speculative purposes. Derivatives are carried at fair value with movements in fair value recognised in the income statement. Derivatives are valued by discounted cash flow models using yield curves based on overnight indexed swap ('OIS') rates. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Group does not hold contracts containing embedded derivatives.

Where cash collateral is received, to mitigate the risk inherent in the amounts due to the Group, it is included as a liability within the due to banks line within the statement of financial position. Where cash collateral is given, to mitigate the risk inherent in amounts due from the Group, it is included as an asset in the loans and advances to banks line within the statement of financial position.

Hedge accounting

Following transition to IFRS 9, the Group has elected to apply IAS 39 for all of its hedge accounting requirements. When transactions meet specified criteria the Group can apply two types of hedge accounting:

- Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges)
- Hedges of highly probable future cash flows attributable to a recognised asset or liability (cash flow hedges)

The Group does not have cash flow hedges or hedges of net investments.

At inception of a hedge, the Group formally documents the relationship between the hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of the hedged items (i.e. the fair value offset between the hedged item and hedging instrument is within the 80% –125% range).

When the European Union adopted IAS 39 in 2004, it removed certain hedge accounting requirements, commonly referred to as the EU carve-out. The relaxed requirements under the carve-out allow the Group to apply the ‘bottom up’ method when calculating macro-hedge ineffectiveness. This option is not allowed under full IFRS. The Group has applied the EU carve-out accordingly.

Fair value hedge accounting
Fair value hedge accounting results in the carrying value of the hedged item being adjusted to reflect changes in fair value attributable to the hedged risk, thereby offsetting the effect of the related movement in the fair value of the derivative. Changes in the fair value of derivatives and hedged items that are designated and qualify as fair value hedges are recorded in the income statement.

In a one-to-one hedging relationship in which a single derivative hedges a single hedged item, the carrying value of the underlying asset or liability (the hedged item) is adjusted for the hedged risk to offset the fair value movement of the related derivative. In the case of a portfolio hedge, an adjustment is included in the fair value adjustments for portfolio hedged risk line in the statement of financial position to offset the fair value movements in the related derivative. The Group currently only designates portfolio hedges.

If the hedge no longer meets the criteria for hedge accounting, expires or is terminated, the cumulative fair value adjustment to the carrying amount of a hedged item is amortised to the income statement over the period to maturity of the previously designated hedge relationship and recorded as net interest income. If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately recognised in the income statement.

1.11. Intangible assets

(a) Goodwill
Goodwill represents the excess of the cost of the acquisition over the fair value of the Group’s share of the net identifiable assets acquired at the date of acquisition. Goodwill is held at cost less accumulated impairment losses and is deemed to have an infinite life.

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. Impairment losses are recognised in the income statement if the carrying amount exceeds the recoverable amounts.

(b) Computer software
Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred unless the technical feasibility of the development has been demonstrated, and it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance, in which case they are capitalised.

These costs are amortised on a straight-line basis over their expected useful lives, which are between three to ten years.

(c) Other intangibles
The acquisition of subsidiaries was accounted for in accordance with IFRS 3 ‘Business Combinations’, which requires the recognition of the identifiable assets acquired and liabilities assumed at their acquisition date fair values. As part of this process, it was necessary to recognise certain intangible assets which are separately identifiable and which are not included on the acquiree’s balance sheet, which are amortised over their expected useful lives, as set out in Note 19.

The Group applies IAS 36 to determine whether an intangible asset is impaired.

1.12. Investment property
Investment property, which is property held to earn rentals and for capital appreciation, is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is measured at fair value. Gains or losses arising from changes in the fair value of investment property are included in the income statement in the period in which they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the period in which the property is derecognised.

1.13. Property, plant and equipment
Property is held at its revalued amount, being its fair value at the date of valuation less any subsequent accumulated depreciation. Revaluations are carried out annually at the reporting date, and movements are recognised in Other Comprehensive Income, net of any applicable deferred tax.

Plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Pre-installed computer software licences are capitalised as part of the computer hardware it is installed on. Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, which are subject to regular review:

Land	not depreciated
Freehold buildings	50 years
Leasehold improvements	shorter of life of lease or 7 years
Computer equipment	3 to 5 years
Other equipment	5 to 10 years

Gains and losses on disposals are determined by comparing proceeds with carrying amounts. These are included in the income statement.

The Group applies IAS 36 to determine whether property, plant and equipment is impaired.

1.14. Leases

(a) As a lessee
The Group assesses whether a contract is or contains a lease at inception of the contract. The Group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets. For these leases, the Group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

The lease liability is initially measured at the present value of the future lease payments, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the Group uses its incremental borrowing rate. It is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made, and is presented as a separate line in the consolidated statement of financial position.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses, and are depreciated over the shorter of the lease term and useful life of the underlying asset. The depreciation starts at the commencement date of the lease. The right-of-use assets are presented as a separate line in the consolidated statement of financial position. The Group applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the 'Property, Plant and Equipment' policy.

Rentals made under operating leases for less than 12 months in duration, and operating leases on low value items, are recognised in the income statement on a straight-line basis over the term of the lease.

(b) As a lessor
The present value of the lease payments on assets leased to customers under agreements which transfer substantially all the risks and rewards of ownership, with or without ultimate legal title, are recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

1.15. Cash and cash equivalents
For the purpose of the statement of cash flows, cash and cash equivalents comprise cash in hand and demand deposits, and cash equivalents, being highly liquid investments which are convertible into cash with an insignificant risk of changes in value with a maturity of three months or less at the date of acquisition, including certain loans and advances to banks and short-term highly liquid debt securities.

1.16. Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issuance costs. Any amounts received over nominal value are recorded in the share premium account, net of direct issuance costs. Costs associated with the listing of shares are expensed immediately.

1.17. Employee benefits

(a) Post-retirement obligations

The Group contributes to defined contribution schemes for the benefit of certain employees. The schemes are funded through payments to insurance companies or trustee-administered funds at the contribution rates agreed with individual employees. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. There are no post-retirement benefits other than pensions.

(b) Share-based compensation

The fair value of equity settled share-based payment awards are calculated at grant date and recognised over the period in which the employees become unconditionally entitled to the awards (the vesting period). The amount is recognised as personnel expenses in the income statement, with a corresponding increase in equity. Further details of the valuation methodology is set out in Note 31.

The fair value of cash settled share-based payments is recognised as personnel expenses in the income statement with a corresponding increase in liabilities over the vesting period. The liability is remeasured at each reporting date and at settlement date based on the fair value of the options granted, with a corresponding adjustment to personnel expenses.

1.18. Taxation

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

Deferred tax is provided in full on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, when they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

1.19. Dividends

Final dividends on ordinary shares are recognised in equity in the period in which they are approved by shareholders. Interim dividends on ordinary shares are recognised in equity in the period in which they are paid.

2. Critical accounting judgements and key sources of estimation uncertainty

2.1. Judgements

The Group considers the COVID-19 outbreak to be a non-adjusting event occurring after the balance sheet date. Further information in respect of this event is provided in Note 42. No other critical judgements have been identified.

2.2. Key sources of estimation uncertainty

Estimations which could have a material impact on the Group's financial results and are therefore considered to be key sources of estimation uncertainty are outlined below. The potential impact of COVID-19 has been considered in determining reasonably possible changes in key sources of estimation uncertainty which may occur in the next 12 months.

2.2.1. Impairment losses on loans and advances to customers

As discussed in Note 1.9 ECLs are calculated by multiplying three main components: the PD, EAD and LGD. These variables are derived from internally developed statistical models and historical data, adjusted to reflect forward-looking information. The determination of both the PD and LGD require estimation which is discussed further below.

2.2.2. Probability of default ('PD')

As set out in Note 1.9 Exogenous, Maturity, Vintage ('EMV') modelling is used in the production of forward-looking lifetime PDs in the calculation of ECLs. As the Group's performance data does not go back far enough to capture a full economic cycle, the proxy series of the quarterly rates of write offs for UK unsecured lending data is used to build an economic response model ('ERM') to incorporate the effects of recession.

The portfolios for which external benchmark information represents a significant input into the measurement of ECL are Real Estate Finance, Asset Finance and Commercial Finance. The benchmarks used for all three portfolios are Standard & Poor's Ratings and Bank of England UK Possessions as proxy data for ERM.

With the exception of the Motor Finance and Retail Finance portfolios, sensitivity to reasonably possible changes in PD is not considered to result in material changes in the ECL allowance. A 10% change in the PD for Motor Finance would immediately impact the ECL allowance by £2.0 million (2018: £1.8 million) and a 10% change in the PD for Retail Finance would immediately impact the ECL allowance by £2.3 million (2018: £2.0 million).

The composition of the Retail Finance portfolio remains stable with minimal movement in PDs and the ECL allowance held for the Business Finance, Consumer Mortgages and Other portfolios remains low. Reasonably possible changes in the PD for these portfolios are not considered to result in a material change in the ECL allowance.

2.2.3. Loss given default ('LGD')

The Group's policy for the determination of LGD is outlined in Note 1.9.

With the exception of the Motor Finance portfolio, the sensitivity of the ECL allowance to reasonably possible changes in the LGD is not considered material. For the Motor Finance portfolio a 20% change in the LGD is considered reasonably possible due to potential difficulties in the vehicle collection process and reduced asset values brought about by COVID-19. A 20% change in the vehicle recovery rate assumption element of the LGD for Motor Finance would impact the ECL allowance by £2.6 million (2018: £3.2 million).

During 2019, market factors caused used car prices to fall by more than seasonal norms over the summer months. The fall was approximately 6% greater than expectations and increased expected credit losses for the year by £0.9 million.

2.2.4. Incorporation of forward-looking data

The Group incorporates forward-looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of expected credit loss by developing a number of potential economic scenarios and modelling expected credit losses for each scenario. Further detail on this process is provided in Note 1.9. Whilst not material and therefore not required by IAS 1, the Group has included the disclosure below as it is considered useful to readers of the Annual Report and Accounts.

The macroeconomic scenarios and weightings applied on adoption of IFRS 9 are summarised below:

Scenario	Derivation	**2019**	2018
Base case	Derived from external consensus forecasts and used in the Group's strategic planning and budgeting processes.	65%	65%
Benign case	Assumes macroeconomic variables will move with a more positive trajectory than the base case.	10%	10%
Stressed case	Management's assessment, based on historic data, of an adverse scenario that could occur once every 7 to 8 years.	20%	20%
Deeper stress	Based on the scenario used by the PRA for the H1 2019 ICAAP. This can be found on the Bank of England's website: www.bankofengland.co.uk	5%	5%

Weightings applied to the macro economic scenarios were reconfirmed at the January 2020 Assumptions Committee and remain unchanged since December 2018.

The sensitivity of the ECL allowance to reasonably possible changes in macro-economic scenario weighting is presented below:

	Increase in stressed case weighting by 5% and reduction in base case		Increase in deeper stress case weighting by 5% and reduction in base case	
	2019 £million	2018 £million	**2019 £million**	2018 £million
Motor Finance	**0.1**	0.1	**0.4**	0.3
Retail Finance	**0.2**	0.1	**0.7**	0.8

The sensitivity is immaterial for other lending products.

Were each of the macroeconomic scenarios to be applied 100%, rather than using the weightings set out above, the impact on ECL for 2019 would be as follows:

Scenario	Impact	**2019 £million**
Base case	Decrease in provision of	2.3
Benign case	Decrease in provision of	2.7

Stressed case	Increase in provision of	4.2
Deeper stress	Increase in provision of	18.6

2.2.5. Debt Management forecast collections on 'POCI' debt

A +/-5.0% change in Debt Management forecast collections, which the Directors consider to be a reasonable possible change, would increase or decrease Loans and advances to customers by £4.0 million respectively, resulting in a corresponding £4.0 million increase or decrease in profit or loss. A similar change applied to the December 2018 position would result in an increase or decrease to Loans and advances to customers of £3.5 million respectively, resulting in a corresponding £3.5 million increase or decrease in profit or loss.

Given the improving quality of the Group's loan books year-on-year, the Debt Management forecast collections have improved. The year-on-year improvement resulted in an increase to Loans and advances to customers of £4.5 million, resulting in a corresponding £4.5 million increase in profit or loss.

3. Operating segments

The Group is organised into seven operating segments, which consist of the different products available, disclosed below:

Business Finance

1) Real Estate Finance: residential and commercial investment and development loans secured by UK real estate
2) Asset Finance: loans to small and medium sized enterprises to acquire commercial assets
3) Commercial Finance: invoice discounting and invoice factoring

Consumer Finance

4) Motor Finance: hire purchase agreements secured against the vehicle being financed
5) Retail Finance: point of sale unsecured finance for in-store and online retailers
6) Debt Management: debt collection
7) Residential mortgages for the self-employed, contract workers, those with complex income and those with a recently restored credit history, sold via select mortgage intermediaries

Other

The 'Other' segment includes other products, which are individually below the quantitative threshold for separate disclosure and fulfils the requirement of IFRS 8.28 by reconciling operating segments to the amounts in the annual report.

Other includes principally OneBill (the Group's consumer bill management service, which has been closed to new customers since 2009) and RentSmart (principally the funding and operation of finance leases through a disclosed agency agreement with RentSmart Limited).

Currently, the Debt Management and Consumer Mortgages segments both fall below the quantitative threshold for separate disclosure, but the Directors consider that they represent sufficiently distinct types of business to merit separate disclosure. Also since the Group ceased new mortgage operations, the Consumer Mortgages business is now managed as part of Consumer Finance, so the prior year figures have been restated accordingly.

Management review these segments by looking at the income, size and growth rate of the loan books, impairments and customer numbers. Except for these items no costs or balance sheet items are allocated to the segments.

	Interest income and similar income £million	Fee and commission income £million	Revenue from external customers £million	Net impairment losses on loans and advances to customers £million	Loans and advances to customers £million
31 December 2019					
Real Estate Finance	47.9	1.0	48.9	0.1	962.2
Asset Finance	3.2	–	3.2	0.7	27.7
Commercial Finance	7.5	9.3	16.8	0.1	251.7
Business Finance	58.6	10.3	68.9	0.9	1,241.6
Retail Finance	71.1	3.6	74.7	19.8	688.9
Motor Finance	48.7	1.0	49.7	13.8	323.7
Debt Management	7.3	1.1	8.4	(2.1)	82.4

Consumer Mortgages	3.6	0.1	3.7	0.1	105.9
Consumer Finance	130.7	5.8	136.5	31.6	1,200.9
Other	2.1	4.8	6.9	0.1	7.6
	191.4	**20.9**	**212.3**	**32.6**	**2,450.1**

	Interest income and similar income £million	Fee and commission income £million	Revenue from external customers £million	Net impairment losses on loans and advances to customers £million	Loans and advances to customers £million
31 December 2018					
Real Estate Finance	41.1	0.1	41.2	0.5	769.8
Asset Finance	6.6	–	6.6	2.2	62.8
Commercial Finance	5.5	7.9	13.4	–	194.7
Business Finance	53.2	8.0	61.2	2.7	1,027.3
Retail Finance	58.7	4.1	62.8	19.3	597.0
Motor Finance	47.4	1.1	48.5	11.3	276.4
Debt Management	6.1	0.9	7.0	–	32.3
Consumer Mortgages	1.5	–	1.5	0.2	84.7
Consumer Finance	113.7	6.1	119.8	30.8	990.4
Other	2.3	5.3	7.6	(1.1)	11.2
	169.2	**19.4**	**188.6**	**32.4**	**2,028.9**

Funding costs and operating expenses are not aligned to operating segments for day-to-day management of the business, so they cannot be allocated on a reliable basis. Accordingly, profit by operating segment has not been disclosed.

All of the Group's operations are conducted wholly within the United Kingdom and geographical information is therefore not presented.

4. Operating income

All items below arise from financial instruments measured at amortised cost unless otherwise stated.

4.1 Net interest income

	2019 £million	2018 £million
Loans and advances to customers	189.6	167.4
Cash and balances at central banks	1.0	1.0
Debt securities	0.7	0.8
	191.3	169.2
Derivative financial instruments measured at fair value through profit and loss		
On financial instruments hedging assets in a qualifying hedge accounting relationship	0.1	–
Interest income and similar income	**191.4**	**169.2**
Deposits from customers	(40.4)	(32.8)
Due to banks	(2.1)	(1.5)
Subordinated liabilities	(3.4)	(1.2)
	(45.9)	(35.5)
Derivative financial instruments measured at fair value through profit and loss		
Net expense on financial instruments hedging liabilities	(0.1)	–
Interest expense and similar charges	**(46.0)**	**(35.5)**

Net interest income	**145.4**	**133.7**

4.2 Net fee and commission income

	2019 £million	2018 £million
Fee and disbursement income	17.5	16.3
Commission income	1.9	2.0
Other income	1.5	1.1
Fee and commission income	**20.9**	**19.4**
Other expenses	(0.8)	(1.5)
Fee and commission expense	**(0.8)**	**(1.5)**
Net fee and commission income	**20.1**	**17.9**

Fees and commissions income consists principally of the following:

- weekly and monthly fees from the OneBill product
- associated insurance commissions and commissions earned on debt collection activities in DMS
- discounting, service and arrangement fees in Commercial Finance
- account management and administration fees from retailers in Retail Finance

Fee and commission expenses consist primarily of recovery fees payable in respect of Motor Finance and Debt Management.

5. Gains/losses from derivatives and hedge accounting

Group and Company
The Group holds interest rate swaps for risk mitigation purposes. For further information on the Group's risk management strategy for market risk refer to the Principal risks and uncertainties section of the Group's Strategic Report. No comparatives are presented as the Group held no interest rate swaps during the prior year. Interest rate swaps are designated on initial recognition as measured at fair value through profit and loss. The tables below provide an analysis of the notional amount and fair value of derivatives held:

	Notional £million	Assets £million	Liabilities £million	Changes in fair value used for calculating hedge ineffectiveness in the period £million
31 December 2019				
Interest rate swaps designated as fair value hedges	987.7	0.8	(0.6)	–
Interest accruals on interest rate swaps	–	0.1	–	–
	987.7	**0.9**	**(0.6)**	**–**

	Notional £million	Assets £million	Liabilities £million
31 December 2019			
In not more than one year	214.5	–	(0.1)
In more than one year	773.2	0.9	(0.5)
	987.7	**0.9**	**(0.6)**

The notional amount represents the amount on which payment flows are derived and does not represent amounts at risk.

In order to manage interest rate risk arising from fixed rate financial instruments the Group reviews interest rate swaps requirements on a monthly basis. The exposure from the portfolio frequently changes due to the origination of new instruments, contractual repayments and early prepayments made in each period. As a result, the Group adopts a dynamic hedging strategy (sometimes referred to as 'macro' or 'portfolio' hedge) to hedge its exposure profile by closing and entering into new swap agreements on a monthly basis. The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged.

The following table sets out details of the hedged exposures covered by the Group's hedging strategies:

	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item			
	Assets £million	Liabilities £million	Assets £million	Liabilities £million	Balance Sheet line item	Change in fair value of hedged item for ineffectiveness assessment in the period £million
31 December 2019						
Interest rate fair value hedges						
Fixed rate Real Estate Finance loans	296.8	–	(0.6)	–	Loans and advances to customers	–
Fixed rate Motor Finance loans	100.1	–	(0.2)	–	Loans and advances to customers	–
Fixed rate Retail Finance loans	66.0	–	(0.1)	–	Loans and advances to customers	–
Fixed rate Consumer Mortgage loans	9.2	–	–	–	Loans and advances to customers	–
Fixed rate customer deposits	–	515.6	–	0.6	Deposits from customers	–
Total	**472.1**	**515.6**	**(0.9)**	**0.6**		**–**

The accumulated amount of fair value hedge adjustments remaining in the statement of financial position for hedged items that have ceased to be adjusted for hedging gains and losses is £nil million.

Fair value gains and losses arising from derivatives and hedge accounting recognised in the Group income statement was £nil million.

Although the Group uses derivatives exclusively to hedge interest rate risk exposures, income statement volatility can still arise due to hedge accounting ineffectiveness or because hedge accounting is not achievable. This arises from the application of accounting rules which do not reflect the economic reality of the business. Where such volatility arises it will trend back to zero over time.

All derivatives held by the Group have been highly effective in the period resulting in minimal hedge accounting ineffectiveness recognised in the income statement. Future ineffectiveness may arise as a result of:

- differences between the expected and actual volume of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience
- hedging derivatives with a non-zero fair value at the date of initial designation
- differences in the timing of cash flows for the hedged item and the hedging instrument

The following table shows the impact of financial assets and financial liabilities relating to transactions where:

- there is an enforceable master netting agreement in place but the offset criteria are not otherwise satisfied, and
- financial collateral is paid and received

	Gross amount reported on balance sheet £million	Master netting arrangements £million	Financial collateral £million	Net amounts after offsetting £million

31 December 2019				
Derivative financial assets	0.9	(0.6)	(0.3)	–
Derivative financial liabilities	(0.6)	0.6	(0.1)	(0.1)

Master netting arrangements do not meet the criteria for offsetting in the statement of financial position. This is because the arrangement creates an agreement for a right of set-off of recognised amounts which is enforceable only following an event of default, insolvency or bankruptcy of the Group or counterparties. Furthermore, the Group and its counterparties do not intend to settle on a net basis or realise the assets and settle the liabilities simultaneously.

Financial collateral consists of cash settled, typically daily or weekly, to mitigate the credit risk on the fair value of derivatives.

6. Operating expenses

	2019 £million	2018 £million
Staff costs, including those of Directors:		
Wages and salaries	43.1	39.1
Social security costs	5.1	6.0
Pension costs	1.7	1.4
Share-based payment transactions	1.2	0.8
Depreciation of property, plant and equipment (Note 17)	1.2	1.3
Depreciation of lease right-of-use assets (Note 18)	0.9	–
Amortisation of intangible assets (Note 19)	1.9	1.8
Operating lease rentals	0.8	1.7
Other administrative expenses	38.3	32.4
Total operating expenses	**94.2**	**84.5**

As described in Note 3, operating expenses are not aligned to operating segments for day-to-day management of the business, so they cannot be allocated on a reliable basis.

Remuneration of the auditor and its associates, excluding VAT, was as follows:

	2019 £'000	2018 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	325	233
Fees payable to the Company's auditor for other services:		
The audit of the Company's subsidiaries, pursuant to legislation	30	37
Audit related assurance services	–	–
Other assurance services	57	95
All other non-audit services	12	140
	424	**505**

Other assurance services related to the half year review and profit certification.

All other non-audit services related to the Financial Services Compensation Scheme reporting health check (2018: the issue of the subordinated liabilities, recovery plan support, review of share scheme documentation and Financial Services Compensation Scheme reporting health check).

7. Average number of employees

	2019 Number	2018 Number
Directors	8	7
Management	157	88
Administration	814	766
	979	**861**

8. Income tax expense

	2019 £million	2018 £million
Current taxation		

Corporation tax charge – current year	7.0	7.3
Corporation tax charge – adjustments in respect of prior years	(0.1)	0.3
	6.9	7.6

Deferred taxation		
Deferred tax charge – current year	0.7	(1.0)
Deferred tax charge – adjustments in respect of prior years	–	(0.2)
	0.7	(1.2)
Income tax expense	**7.6**	**6.4**

Tax reconciliation		
Profit before tax	38.7	34.7
Tax at 19.00% (2018: 19.00%)	7.4	6.6
Permanent differences	–	–
Banking surcharge	0.1	0.3
Rate change on deferred tax assets	0.2	(0.6)
Prior period adjustments	(0.1)	0.1
Income tax expense for the year	**7.6**	**6.4**

The Government has substantively enacted a reduction in the main rate of UK corporation tax from 19% to 17% (effective 1 April 2020). However, on 17 March 2020, the Government legislated to retain the current rate of 19%. The Group is also subject to an 8% surcharge on the profits of banking companies in excess of £25 million that is reflected in the 2019 tax charge and reconciliation.

9. Earnings per ordinary share

9.1 Basic

Basic earnings per ordinary share are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares as follows:

	2019	2018
Profit attributable to equity holders of the parent (£million)	31.1	28.3
Weighted average number of ordinary shares (number)	18,476,280	18,475,229
Earnings per share (pence)	**168.3**	**153.2**

9.2 Diluted

Diluted earnings per ordinary share are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the year, as noted above, as well as the number of dilutive share options in issue during the year, as follows:

	2019	2018
Weighted average number of ordinary shares	18,476,280	18,475,229
Number of dilutive shares in issue at the year-end	216,943	277,234
Fully diluted weighted average number of ordinary shares	**18,693,223**	**18,752,463**
Dilutive shares being based on:		
Number of options outstanding at the year-end	598,065	511,706
Weighted average exercise price (pence)	528	678
Average share price during the period (pence)	1,390	1,489
Diluted earnings per share (pence)	**166.4**	**150.9**

10. Dividends

	2019 **£'000**	2018 £'000

2017 final dividend – 61 pence per share (paid May 2018)	–	11.3
2018 interim dividend – 19 pence per share (paid September 2018)	–	3.5
2018 final dividend – 64 pence per share (paid May 2019)	11.8	–
2019 interim dividend – 20 pence per share (paid September 2019)	3.7	–
	15.5	**14.8**

The Directors do not recommend the payment of a final dividend for 2019. An interim dividend of 20 pence per share was paid on 27 September 2019. Total dividends for 2018 were 83 pence per share.

11. Loans and advances to banks

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Placements with banks included in cash and cash equivalents (Note 32)	48.4	44.8	45.2	41.9

Moody's long-term ratings are as follows:

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
A1	3.8	11.2	3.6	11.1
A1*/A2	–	28.6	–	25.8
Baa2	39.5	–	36.5	–
Arbuthnot Latham & Co., Limited – No rating	5.1	5.0	5.1	5.0
	48.4	**44.8**	**45.2**	**41.9**

None of the loans and advances to banks are either past due or impaired.

Loans and advances to banks includes £9.1 million in relation to collateral held under credit support and similar agreements, with a corresponding payable included within other liabilities.

12. Loans and advances to customers

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Gross loans and advances	2,510.7	2,096.0	2,422.3	2,048.9
Less: allowances for impairment on loans and advances (Note 14)	(60.6)	(67.1)	(68.7)	(68.6)
	2,450.1	**2,028.9**	**2,353.6**	**1,980.3**

The fair value of loans and advances to customers is shown in Note 39. For a maturity profile of loans and advances to customers, refer to Note 38.

Group and Company

At 31 December 2019 loans and advances to customers of £433.4 million (2018: £326.5 million) were pre-positioned under the Bank of England's liquidity support operations and Term Funding Scheme, and were available for use as collateral within the schemes.

The following loans are secured upon real estate:

	2019 Loan balance £million	**2019 Loan-to-value %**	2018 Loan balance £million	2018 Loan-to-value %
Real Estate Finance	962.2	59%	769.8	57%
Consumer Mortgages	105.9	56%	84.7	59%
	1,068.1		**854.5**	

Under its credit policy, the Real Estate Finance business lends to a maximum loan-to-value of 70% for investment loans and 60% for residential development loans and up to 65% for pre-let commercial development loans (based on gross development value), and the Consumer Mortgages business lends to a maximum of 90%.

All property valuations at loan inception, and the majority of development stage valuations, are performed by independent Chartered Surveyors, who perform their work in accordance with the Royal Institution of Chartered Surveyors Valuation – Professional Standards.

Group

£2.0 million (2018: £1.9 million) of collateral is held from RentSmart, against loans of £7.2 million (2018: £10.8 million), which is not recognised on the balance sheet. This is based upon the balance of customer receivables and expected new agreements during the following month.

13. Finance lease receivables

Loans and advances to customers include finance lease receivables as follows:

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Gross investment in finance lease receivables:				
– No later than 1 year	176.0	175.3	171.6	168.7
– Later than 1 year and no later than 5 years	338.6	326.9	335.7	322.0
– Later than 5 years	–	0.2	–	0.2
	514.6	502.4	507.3	490.9
Unearned future finance income on finance leases	(144.6)	(135.8)	(142.9)	(132.8)
Net investment in finance leases	**370.0**	**366.6**	**364.4**	**358.1**
The net investment in finance leases may be analysed as follows:				
– No later than 1 year	110.2	112.0	107.0	107.6
– Later than 1 year and no later than 5 years	259.8	254.4	257.4	250.3
– Later than 5 years	–	0.2	–	0.2
	370.0	**366.6**	**364.4**	**358.1**

14. Allowances for impairment of loans and advances

Group

	Not credit-impaired		**Credit impaired**			
	Stage 1: Subject to 12-month ECL £million	**Stage 2: Subject to lifetime ECL £million**	**Stage 3: Subject to lifetime ECL £million**	**Total provision £million**	**Gross loans and receivables £million**	**Provision cover %**
31 December 2019						
Business Finance:						
Real Estate Finance	0.5	–	0.1	0.6	962.8	0.1%
Asset Finance	–	0.1	1.7	1.8	29.5	6.1%
Commercial Finance	0.3	–	0.6	0.9	252.6	0.4%
Consumer Finance:						
Retail Finance	10.0	11.1	4.4	25.5	714.4	3.6%
Motor Finance:						
Voluntary termination provision	6.8	–	–	6.8		
Other impairment	3.7	12.9	10.2	26.8		
	10.5	12.9	10.2	33.6	357.3	9.4%
Debt Management	–	–	(2.1)	(2.1)	80.3	(2.6%)
Consumer Mortgages	0.3	–	–	0.3	106.2	0.3%
Other	–	–	–	–	7.6	0.0%
	21.6	**24.1**	**14.9**	**60.6**	**2,510.7**	**2.4%**

	Not credit-impaired		Credit impaired			
	Stage 1: Subject to 12-month ECL £million	Stage 2: Subject to lifetime ECL £million	Stage 3: Subject to lifetime ECL £million	Total provision £million	Gross loans and receivables £million	Provision cover %

31 December 2018

Business Finance:						
Real Estate Finance	0.6	–	–	0.6	770.4	0.1%
Asset Finance	0.2	0.1	2.7	3.0	65.8	4.6%
Commercial Finance	0.2	0.2	0.4	0.8	195.5	0.4%
Consumer Finance:						
Retail Finance	8.9	9.8	4.3	23.0	620.0	3.7%
Motor Finance:						
Voluntary termination provision	6.0	–	–	6.0		
Other impairment	4.2	13.8	15.4	33.4		
	10.2	13.8	15.4	39.4	315.8	12.5%
Debt Management	–	–	–	–	32.3	0.0%
Consumer Mortgages	0.2	–	–	0.2	84.9	0.2%
Other	–	–	0.1	0.1	11.3	0.9%
	20.3	**23.9**	**22.9**	**67.1**	**2,096.0**	**3.2%**

Total provisions above include expert credit judgements as follows:

	2019 £million	2018 £million
Specific overlays held against credit-impaired secured assets held within the Business Finance portfolio	0.5	1.4
Planned enhancements to LGD elements of the IFRS 9 models	(0.8)	0.8
Management judgement in respect of PD elements of the IFRS 9 models	(0.8)	(0.2)
POCI adjustment (see below)	(2.1)	–
Other	(0.1)	–
Expert credit judgements over the Group's IFRS 9 model results	(3.3)	2.0

The specific overlays have been estimated on an individual basis by assessing the recoverability and condition of the secured asset, along with any other recoveries that may be made.

POCI adjustment

The Group's debt management business purchases credit-impaired loans from the Company and other unrelated third parties. Under IFRS 9, these are classified as Purchased and Originated Credit Impaired ('POCI') loans. As a practical expedient, income on POCI loans is initially recognised by applying the original credit-adjusted EIR to the expected future cash flows arising from the POCI assets. The Group's accounting policy is to recognise POCI income by applying the original credit-adjusted EIR to the amortised cost of the assets. Expected changes in cash flows since the date of purchase are recognised as an impairment gain or loss in the income statement. At December 2019, improvements in credit quality resulted in a £2.1 million impairment gain.

Provisions included in 'Other' are in respect of various legacy products. This segment also includes loans of £7.2 million (2018: £10.8 million) held in STB Leasing Limited. The credit risk associated with those loans is retained by its partner, RentSmart. Accordingly, no provision is held against the RentSmart loans.

The impairment losses disclosed in the income statement can be analysed as follows:

	2019 £million	2018 £million
Incurred loss individual provision: charge for impairment losses	28.1	30.4
Loans written off, net of amounts utilised	5.3	4.3
Recoveries of loans written off	(0.8)	(2.3)
	32.6	**32.4**

Reconciliations of the opening to closing impairment allowance for losses on loans and advances are presented below:

	Not credit-impaired		Credit impaired	
	Stage 1: Subject to 12-month ECL £million	Stage 2: Subject to lifetime ECL £million	Stage 3: Subject to lifetime ECL £million	Total £million

At 1 January 2019	20.3	23.9	22.9	67.1
(Decrease)/increase due to change in credit risk				
– Transfer to stage 2	(5.9)	36.9	–	31.0
– Transfer to stage 3	–	(23.5)	30.3	6.8
– Transfer to stage 1	1.5	(3.5)	–	(2.0)
Passage of time	(10.1)	(6.8)	(6.3)	(23.2)
New loans originated	17.2	–	–	17.2
Derecognised loans	(1.9)	(4.7)	(0.1)	(6.7)
Changes to model methodology	0.7	1.2	(0.2)	1.7
Changes to credit risk parameters	(1.1)	0.6	(0.1)	(0.6)
Other adjustments	3.9	–	–	3.9
Charge to income statement	4.3	0.2	23.6	28.1
Allowance utilised in respect of write offs	(3.0)	–	(31.6)	(34.6)
31 December 2019	**21.6**	**24.1**	**14.9**	**60.6**

	Not credit-impaired		Credit impaired	
	Stage 1: Subject to 12-month ECL £million	Stage 2: Subject to lifetime ECL £million	Stage 3: Subject to lifetime ECL £million	Total £million
At 1 January 2018	18.9	24.9	27.9	71.7
(Decrease)/increase due to change in credit risk				
– Transfer to stage 2	(6.3)	33.0	–	26.7
– Transfer to stage 3	(0.1)	(23.4)	30.8	7.3
– Transfer to stage 1	1.5	(3.2)	–	(1.7)
Passage of time	(6.7)	(1.7)	(3.9)	(12.3)
New loans originated	17.4	–	–	17.4
Derecognised loans	(1.8)	(4.0)	–	(5.8)
Changes to model methodology	(1.3)	(0.2)	–	(1.5)
Changes to credit risk parameters	(1.2)	(1.5)	0.6	(2.1)
Other adjustments	2.4	–	–	2.4
Charge to income statement	3.9	(1.0)	27.5	30.4
Allowance utilised in respect of write offs	(2.5)	–	(32.5)	(35.0)
31 December 2018	**20.3**	**23.9**	**22.9**	**67.1**

The table above has been prepared based on monthly movements in the ECL.

Passage of time represents the impact of accounts maturing through their contractual life and the associated reduction in PDs. For stage 3 assets it represents the unwind of the discount applied in calculating the ECL.

Changes to model methodology represents movements that have occurred due to enhancements made to the models during the year.

Changes to credit risk parameters represents movements that have occurred due to the Group updating model inputs. This would include the impact of, for example, updating the macro-economic scenarios applied to the models.

Other adjustments represents the movement in the Motor Finance voluntary termination provision.

Stage 1 write offs arise on Motor Finance accounts where borrowers have exercised their right to voluntarily terminate their agreements.

Interest income on loans classified as impaired totalled £2.5 million (2018: £2.0 million).

A breakdown of the gross receivable by internal credit risk rating is shown below:

	Stage 1 £million	Stage 2 £million	Stage 3 £million	Total £million

31 December 2019				
Business Finance:				
Strong	272.1	4.1	–	276.2
Good	770.4	4.7	10.1	785.2
Satisfactory	126.3	23.5	0.3	150.1
Weak	10.2	15.1	8.1	33.4
	1,179.0	**47.4**	**18.5**	**1,244.9**

Consumer Finance:				
Good	317.1	58.3	3.1	378.5
Satisfactory	317.7	54.8	5.9	378.4
Weak	229.8	71.3	13.3	314.4
Consumer mortgages	105.6	0.3	0.3	106.2
Debt management	–	–	80.7	80.7
	970.2	**184.7**	**103.3**	**1,258.2**

Internal credit risk rating is based on the most recent credit risk score of a customer.

Company

	Not credit-impaired		**Credit impaired**			
	Stage 1: Subject to 12-month ECL £million	**Stage 2: Subject to lifetime ECL £million**	**Stage 3: Subject to lifetime ECL £million**	**Total provision £million**	**Gross loans and receivables £million**	**Provision cover %**
31 December 2019						
Business Finance:						
Real Estate Finance	0.5	–	0.1	0.6	962.8	0.1%
Asset Finance	–	0.1	1.7	1.8	29.5	6.1%
Commercial Finance	0.3	–	0.6	0.9	251.6	0.4%
Consumer Finance:						
Retail Finance	10.5	11.6	4.5	26.6	714.4	3.7%
Motor Finance:						
Voluntary termination provision	6.8	–	–	6.8		
Other impairment	4.4	15.2	12.0	31.6		
	11.2	15.2	12.0	38.4	357.3	10.7%
Consumer Mortgages	0.3	–	–	0.3	106.2	0.3%
Other	–	–	0.1	0.1	0.5	20.0%
	22.8	**26.9**	**19.0**	**68.7**	**2,422.3**	**2.8%**

	Not credit-impaired		Credit impaired			
	Stage 1: Subject to 12 month ECL £million	Stage 2: Subject to lifetime ECL £million	Stage 3: Subject to lifetime ECL £million	Total provision £million	Gross loans and receivables £million	Provision cover %
31 December 2018						
Business Finance:						
Real Estate Finance	0.6	–	–	0.6	770.4	0.1%
Asset Finance	0.2	0.1	2.7	3.0	65.8	4.6%
Commercial Finance	0.2	0.2	0.4	0.8	191.4	0.4%

Consumer Finance:						
Retail Finance	9.2	9.8	4.4	23.4	620.0	3.8%
Motor Finance:						
Voluntary termination provision	6.0	–	–	6.0		
Other impairment	4.3	14.2	16.0	34.5		
	10.3	14.2	16.0	40.5	315.8	12.8%
Consumer Mortgages	0.2	–	–	0.2	84.9	0.2%
Other	–	–	0.1	0.1	0.6	16.7%
	20.7	**24.3**	**23.6**	**68.6**	**2,048.9**	**3.3%**

Total provisions above include expert credit judgements as follows:

	2019 £million	2018 £million
Specific overlays held against credit-impaired secured assets held within the Business Finance portfolio	0.5	1.4
Planned enhancements to LGD elements of the IFRS 9 models	(0.8)	0.8
Management judgement in respect of PD elements of the IFRS 9 models	(0.8)	(0.2)
Other	(0.1)	–
Expert credit judgements over the Company’s IFRS 9 model results	(1.2)	2.0

The specific overlays have been estimated on an individual basis by assessing the recoverability and condition of the secured asset, along with any other recoveries that may be made.

Reconciliations of the opening to closing impairment allowance for losses on loans and advances are presented below:

	Not credit-impaired		**Credit impaired**	
	Stage 1: Subject to 12-month ECL £million	**Stage 2: Subject to lifetime ECL £million**	**Stage 3: Subject to lifetime ECL £million**	**Total £million**
At 1 January 2019	20.7	24.3	23.6	68.6
(Decrease)/increase due to change in credit risk				
– Transfer to stage 2	(6.2)	39.1	–	32.9
– Transfer to stage 3	–	(24.6)	31.7	7.1
– Transfer to stage 1	1.6	(3.6)	–	(2.0)
Passage of time	(10.3)	(5.2)	(4.0)	(19.5)
New loans originated	18.4	–	–	18.4
Derecognised loans	(1.9)	(4.9)	(0.1)	(6.9)
Changes to model methodology	0.7	1.2	(0.2)	1.7
Changes to credit risk parameters	(1.1)	0.6	(0.1)	(0.6)
Other adjustments	3.9	–	–	3.9
Charge to income statement	5.1	2.6	27.3	35.0
Allowance utilised in respect of write offs	(3.0)	–	(31.9)	(34.9)
31 December 2019	**22.8**	**26.9**	**19.0**	**68.7**

	Not credit-impaired		Credit impaired	
	Stage 1: Subject to 12-month ECL £million	Stage 2: Subject to lifetime ECL £million	Stage 3: Subject to lifetime ECL £million	Total £million
At 1 January 2018	19.0	25.1	28.2	72.3
(Decrease)/increase due to change in credit risk				
– Transfer to stage 2	(6.5)	33.9	–	27.4

– Transfer to stage 3	(0.1)	(24.0)	31.6	7.5
– Transfer to stage 1	1.5	(3.2)	–	(1.7)
Passage of time	(6.7)	(1.6)	(4.6)	(12.9)
New loans originated	17.9	–	–	17.9
Derecognised loans	(1.8)	(4.1)	2.8	(3.1)
Changes to model methodology	(1.3)	(0.2)	–	(1.5)
Changes to credit risk parameters	(1.2)	(1.5)	0.6	(2.1)
Other adjustments	2.4	–	–	2.4
Charge to income statement	4.2	(0.7)	30.4	33.9
Allowance utilised in respect of write offs	(2.5)	(0.1)	(35.0)	(37.6)
31 December 2018	**20.7**	**24.3**	**23.6**	**68.6**

The table above has been prepared based on monthly movements in the ECL. Stage 1 write offs arise on Motor accounts that have exercised their right to voluntarily terminate their agreements.

Passage of time represents the impact of accounts maturing through their contractual life and the associated reduction in PDs. For stage 3 assets it represents the unwind of the discount applied in calculating the ECL.

Changes to model methodology represents movements that have occurred due to enhancements made to the models during the year.

Changes to credit risk parameters represents movements that have occurred due to the Group updating model inputs. This would include the impact of, for example, updating the macro economic scenarios applied to the models.

Other adjustments represents the movement in the Motor voluntary termination provision.

Stage 1 write offs arise on Motor accounts that have exercised their right to voluntarily terminate their agreements.

Interest income on loans classified as impaired totalled £1.8 million (2018: £1.1 million).

15. Debt securities

Group and Company

Debt securities of £25.0 million (2018: £149.7 million) represent UK Treasury Bills. The Company's intention is to hold them to maturity and, therefore, they are stated in the statement of financial position at amortised cost. The decrease over the year is due to Bills maturing.

All of the debt securities had a rating agency designation at 31 December 2019, based on Moody's long-term ratings of Aa2 (2018: Aa2). None of the debt securities are either past due or impaired.

16. Investment property

Group and Company

	2019 £million
Fair value	
At 1 January 2018	–
Additions	1.6
Transfer from property, plant and equipment	3.2
At 31 December 2019	**4.8**

During the year, the Group acquired Yorke House, Arleston Way, Shirley, Solihull, B90 4LH, half of which was let to third party occupiers. Accordingly, 50% of this property, excluding land, is classified as an investment property at its fair value. The Directors assessed the fair value as being 50% of the original purchase price excluding land and VAT and stamp duty.

Also during the year, the Group vacated its portion of Secure Trust House, Boston Drive, Bourne End, SL8 5YS, and let the space to one of its existing third party occupiers. Accordingly, this property was transferred from property, plant and equipment to investment properties at its fair value. The Directors assessed the fair value as being the same as the valuation at December 2018 performed by Knight Frank LLP.

Investment properties are stated at fair value at December 2019. The Directors have assessed the value of the freehold property at the year-end through comparison to current rental yields on similar properties in the same area.

17. Property, plant and equipment

Group

	Freehold land and buildings £million	Leasehold property	Computer and other equipment £million	Total £million
Cost or valuation				
At 1 January 2018	9.0	–	11.7	20.7
Additions	–	0.1	1.0	1.1
Disposals	–	–	(2.0)	(2.0)
Revaluation	(0.8)	–	–	(0.8)
At 31 December 2018	**8.2**	**0.1**	**10.7**	**19.0**
Additions	3.5	–	2.0	5.6
Disposals	–	–	(4.5)	(4.5)
Revaluation	(1.1)	–	–	(1.1)
Transfer from intangible assets	–	–	0.2	0.2
Transfer to investment property	(3.2)	–	–	(3.2)
At 31 December 2019	**7.4**	**0.1**	**8.4**	**15.9**
Accumulated depreciation				
At 1 January 2018	–	–	(9.2)	(9.2)
Depreciation charge	(0.5)	–	(0.8)	(1.3)
Disposals	–	–	2.0	2.0
Revaluation	0.5	–	–	0.5
At 31 December 2018	**–**	**–**	**(8.0)**	**(8.0)**
Depreciation charge	(0.2)	–	(1.0)	(1.2)
Disposals	–	–	4.5	4.5
Revaluation	0.2	–	–	0.2
Transfer from intangible assets	–	–	(0.1)	(0.1)
At 31 December 2019	**–**	**–**	**(4.6)**	**(4.6)**
Net book amount				
At 31 December 2018	**8.2**	**0.1**	**2.7**	**11.0**
At 31 December 2019	**7.4**	**0.1**	**3.8**	**11.3**

Company

	Freehold property £million	Computer and other equipment £million	Total £million
Cost or valuation			
At 1 January 2018	4.6	10.1	14.7
Additions	–	0.5	0.5
Disposals	–	(2.0)	(2.0)
At 31 December 2018	**4.6**	**8.6**	**13.2**
Additions	3.5	1.8	5.3
Disposals	–	(4.5)	(4.5)
Transfer from intangible assets	–	0.2	0.2
Transfer to investment property	(3.2)	–	(3.2)
Revaluation	(1.4)	–	(1.4)

At 31 December 2019	**3.5**	**6.1**	**9.6**
Accumulated depreciation			
At 1 January 2018	–	(8.6)	(8.6)
Depreciation charge	(0.4)	(0.3)	(0.7)
Disposals	–	2.0	2.0
Revaluation	0.1	–	0.1
At 31 December 2018	**(0.3)**	**(6.9)**	**(7.2)**
Depreciation charge	(0.1)	(0.6)	(0.7)
Disposals	–	4.5	4.5
Transfer from intangible assets	–	(0.1)	(0.1)
Revaluation	0.4	–	0.4
At 31 December 2019	**–**	**(3.1)**	**(3.1)**

Net book amount			
At 31 December 2018	**4.3**	**1.7**	**6.0**
At 31 December 2019	**3.5**	**3.0**	**6.5**

The Group and Company's freehold properties comprise:

- the Registered Office of the Company, which is fully utilised for the Group's own purposes
- Yorke House, Arleston Way, Shirley B90 4LH, 50% of which is used for the Group's own purposes
- 25 and 26 Neptune Court, Vanguard Way, Cardiff CF24 5PJ, which is fully utilised for the Group's own purposes

Freehold properties are stated at fair value as at December 2019. The Directors have assessed the value of the freehold property at the year-end through comparison to current rental yields on similar properties in the same area, which resulted in the following revaluation movements:

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Revaluation surpluses recognised in other comprehensive income	0.2	0.3	0.1	0.1
Revaluation deficit recognised in the income statement	(1.1)	–	–	–

The revaluation deficit arose from stamp duty and irrecoverable VAT incurred on the acquisition of a freehold property during the year.

The carrying value of freehold land which is included in the total carrying value of freehold land and buildings and which is not depreciated is £1.5 million (2018: £1.9 million).

The historical cost of freehold property included at valuation is as follows:

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Cost	6.8	7.9	9.2	4.1
Depreciation	(1.6)	(1.6)	(0.3)	(0.2)
Net book value	**5.2**	**6.3**	**8.9**	**3.9**

18. Leasing right-of-use assets

Group

	Leasehold property £million	Leased motor vehicles £million	Total £million
Cost			
On transition at 1 January 2019	4.2	0.3	4.5
At 31 December 2019	**4.2**	**0.3**	**4.5**
Accumulated depreciation			
Depreciation charge	(0.7)	(0.2)	(0.9)

At 31 December 2019	**(0.7)**	**(0.2)**	**(0.9)**
Net book amount			
At 31 December 2019	**3.5**	**0.1**	**3.6**

Company

	Leasehold property £million	Leased motor vehicles £million	Total £million
Cost			
On transition at 1 January 2019	2.9	0.2	3.1
At 31 December 2019	**2.9**	**0.2**	**3.1**
Accumulated depreciation			
Depreciation charge	0.5	0.1	0.6
At 31 December 2019	**0.5**	**0.1**	**0.6**
Net book amount			
At 31 December 2019	**2.4**	**0.1**	**2.5**

19. Intangible assets

Group

	Goodwill £million	Computer software £million	Other intangible assets £million	Total £million
Cost or valuation				
At 1 January 2018	1.0	16.2	2.3	19.5
Additions	–	1.4	–	1.4
Disposals	–	(0.6)	(0.1)	(0.7)
At 31 December 2018	**1.0**	**17.0**	**2.2**	**20.2**
Additions	–	1.1	–	1.1
Transfers to property, plant and equipment	–	(0.2)	–	(0.2)
Disposals	–	(1.2)	–	(1.2)
At 31 December 2019	**1.0**	**16.7**	**2.2**	**19.9**
Accumulated amortisation				
At 1 January 2018	–	(7.9)	(1.2)	(9.1)
Amortisation charge	–	(1.6)	(0.2)	(1.8)
Disposals	–	0.6	–	0.6
At 31 December 2018	**–**	**(8.9)**	**(1.4)**	**(10.3)**
Amortisation charge	–	(1.7)	(0.2)	(1.9)
Transfers to property, plant and equipment	–	0.1	–	0.1
Disposals	–	1.2	–	1.2
At 31 December 2019	**–**	**(9.3)**	**(1.6)**	**10.9**
Net book amount				
At 31 December 2018	**1.0**	**8.1**	**0.8**	**9.9**
At 31 December 2019	**1.0**	**7.4**	**0.6**	**9.0**

Goodwill above relates to the following cash generating units, which are part of the Retail Finance operating segment:

	2019 £million	2018 £million
Music business	0.3	0.3

V12	0.7	0.7
Total	**1.0**	**1.0**

The recoverable amount of these cash generating units are determined on a value in use calculation which uses cash flow projections based on financial forecasts covering a three-year period, and a discount rate of 8% (2018: 8%). Cash flow projections during the forecast period are based on the expected rate of new business. A zero growth based scenario is also considered. The Directors believe that any reasonably possible change in the key assumptions on which recoverable amount is based would not cause the aggregate carrying amount to exceed the aggregate recoverable amount of the cash generating unit.

Other intangible assets were recognised as part of the V12 Finance Group acquisition. These were recorded at fair value, and are being amortised on a straight-line basis as follows:

	Years
IT system	5
Distribution channel	10
Brand name	5

Company

	Goodwill £million	Computer software £million	Total £million
Cost or valuation			
At 1 January 2018	0.3	12.3	12.6
Additions	–	1.3	1.3
Disposals	–	(0.7)	(0.7)
At 31 December 2018	**0.3**	**12.9**	**13.2**
Additions	–	1.0	1.0
Transfers to property, plant and equipment	–	(0.2)	(0.2)
Disposals	–	(1.3)	(1.3)
At 31 December 2019	**0.3**	**12.4**	**12.7**
Accumulated amortisation			
At 1 January 2018	–	(4.1)	(4.1)
Amortisation charge	–	(1.6)	(1.6)
Disposals	–	0.6	0.6
At 31 December 2018	**–**	**(5.1)**	**(5.1)**
Amortisation charge	–	(1.6)	(1.6)
Transfers to property, plant and equipment	–	0.1	0.1
Disposals	–	1.3	1.3
At 31 December 2019	**–**	**(5.3)**	**(5.3)**
Net book amount			
At 31 December 2018	**0.3**	**7.8**	**8.1**
At 31 December 2019	**0.3**	**7.1**	**7.4**

Goodwill above relates to the music business cash generating unit, which is part of the Retail Finance operating segment. The recoverable amount is determined on the same basis as for the Group.

20. Investments

Company

	£million
Cost and net book value	

At 1 January 2018	3.7
Equity contributions to subsidiaries in respect of share options	0.2
At 31 December 2018	**3.9**
Equity contributions to subsidiaries in respect of share options	0.2
At 31 December 2019	**4.1**

Shares in subsidiary undertakings of Secure Trust Bank PLC at 31 December 2019 are stated at cost less any provision for impairment. All subsidiary undertakings are unlisted and none are banking institutions. All are 100% owned by the Company. The subsidiary undertakings were all incorporated in the UK and wholly owned via ordinary shares. All subsidiary undertakings are included in the consolidated financial statements and have an accounting reference date of 31 December.

Details are as follows:

	Principal activity
Owned directly	
Debt Managers (Services) Limited	Debt collection company
Secure Homes Services Limited	Property rental
STB Leasing Limited	Leasing
V12 Finance Group Limited	Holding company
Owned indirectly via intermediate holding companies	
V12 Personal Finance Limited	Dormant
V12 Retail Finance Limited	Sourcing and servicing of unsecured loans

The registered office of the Company, and all subsidiary undertakings, is One Arleston Way, Shirley, Solihull, West Midlands B90 4LH.

Secure Homes Services Limited, STB Leasing Limited and V12 Personal Finance Limited are exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of s479A, and the Company has given guarantees accordingly under s479C in respect of the year ended 31 December 2019.

21. Deferred taxation

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Deferred tax assets:				
Other short-term timing differences	7.5	7.9	8.1	7.8
Deferred tax assets	**7.5**	**7.9**	**8.1**	**7.8**

Deferred tax assets:				
Prior period closing	7.9	0.6	7.8	0.6
Tax on IFRS 9 transition adjustment	–	6.3	–	6.4
Tax on IFRS 16 transition adjustment	0.2	–	0.2	–
At 1 January	8.1	6.9	8.0	7.0
Income statement	(0.7)	1.2	(0.2)	1.1
Other comprehensive income	0.1	(0.2)	0.3	(0.3)
At 31 December	**7.5**	**7.9**	**8.1**	**7.8**

The Government substantively enacted a reduction in the main rate of UK corporation tax from 19% to 17% (effective 1 April 2020). However, on 17 March 2020, the Government legislated to retain the current rate of 19%. The Group is also subject to an 8% surcharge on the profits of banking companies in excess of £25 million that is reflected in the 2019 tax charge and reconciliation. Deferred tax has been calculated based on the enacted rate of 17.5% (being an average of the rate of 19% to March 2020 and 17% thereafter) to the extent that the related temporary differences are expected to reverse in future periods, and is recognised on the basis that future taxable profits are in excess of the profits arising from the reversal of existing taxable temporary differences. The potential effect of the rate remaining at 19% would be to increase deferred tax assets by £0.7 million. A deferred tax asset was recognised on the IFRS 9 transition adjustment on 1 January 2018 and the current year credit includes a reassessment of the rates at which it is projected to reverse over the period to 31 December 2027.

22. Other assets

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Other receivables	5.2	16.2	4.5	16.1
Amounts due from related companies	–	–	88.5	44.5
Cloud software development prepayment	6.4	–	6.4	–
Other prepayments and accrued income	5.7	6.2	4.4	5.0
	17.3	**22.4**	**103.8**	**65.6**

Cloud software development costs of £6.4 million that do not meet the intangible asset recognition criteria are included within other prepayments and accrued income. The costs principally relate to the Group's Motor Transformation Programme, and once the software comes into use will be expensed to the income statement over the useful economic life of the software.

23. Due to banks

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Amounts due to other credit institutions	308.0	263.0	308.0	263.0
Accrued interest	0.5	0.5	0.5	0.5
	308.5	**263.5**	**308.5**	**263.5**

24. Deposits from customers

Group and Company

	2019 £million	2018 £million
Current/demand accounts	22.6	14.5
Term deposits	1,959.3	1,833.2
Individual savings accounts	38.4	–
	2,020.3	**1,847.7**

25. Lease liabilities

Group

	2019 £million
On transition at 1 January 2019	5.5
Payments	(1.1)
Interest expense	0.1
	4.5
Lease liabilities – Gross	
– No later than one year	1.0
– Later than one year and no later than five years	3.9
	4.9
Less: Future finance expense	(0.4)
	4.5
Lease liabilities – Net	
– No later than one year	0.9
– Later than one year and no later than five years	3.6
	4.5

Company

	2019 £million
On transition at 1 January 2019	4.0
Payments	(0.8)
Interest expense	0.1
	3.3
Lease liabilities – Gross	
– No later than one year	0.7
– Later than one year and no later than five years	2.9
	3.6
Less: Future finance expense	(0.3)
Lease liabilities – Net	**3.3**
Lease liabilities – Gross	
– No later than one year	0.7
– Later than one year and no later than five years	2.6
	3.3

26. Other liabilities

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Other payables	27.2	25.8	25.5	22.8
Amounts due to related companies	–	–	5.5	14.1
Accruals and deferred income	13.7	14.3	11.0	12.2
	40.9	**40.1**	**42.0**	**49.1**

27. Provisions for liabilities and charges

Group and Company

	Customer redress £million	ECL allowance on loan commitments £million	Fraud £million	Total £million
Balance at 1 January 2018	1.2	0.3	0.2	1.7
(Credited)/charged to income statement	(0.4)	0.1	(0.1)	(0.4)
Balance at 31 December 2018	**0.8**	**0.4**	**0.1**	**1.3**
Credited to income statement	(0.6)	–	–	(0.6)
Balance at 31 December 2019	**0.2**	**0.4**	**0.1**	**0.7**

Customer redress provision

The Group provides for its best estimate of redress payable in respect of outstanding claims relating to historical sales of accident, sickness and unemployment insurance, by considering the likely future uphold rate for claims, in the context of confirmed issues and historical experience. The accuracy of these estimates would be affected, were there to be a significant change in the incidence of claims upheld by the Financial Ombudsman Service.

The Financial Conduct Authority announced a deadline for making these customer redress claims, which gave consumers until 29 August 2019 to make a claim, so no further claims were accepted after this date.

Fraud

The fraud provision relates to cases where the Bank has reasonable evidence of suspected fraud, but further investigation is required before the cases can be dealt with appropriately.

ECL allowance on loan commitments

In accordance with the requirements of IFRS 9 the Group holds an ECL allowance against loans it has committed to lend but have not yet been drawn. For the Real Estate Finance and Commercial Finance portfolios, where a loan facility is agreed that includes both drawn and undrawn elements and the Group cannot identify the ECL on the loan commitment separately, a combined loss allowance for both drawn and undrawn components of the loan is presented as a deduction from the gross carrying amount of the drawn component, with any excess of the loss allowance over the gross drawn amount presented as a provision. At 31 December 2019 no provision was held for losses in excess of drawn amounts.

The Directors expect all provisions to be fully utilised within the next 12 months.

28. Subordinated liabilities

	2019 £million	2018 £million
Notes at par value	50.0	50.0
Unamortised issue costs	(0.6)	(0.8)
Accrued interest	1.2	1.2
	50.6	**50.4**

Subordinated liabilities comprises two tranches of 6.75% Fixed Rate Reset Callable Subordinated Notes due 2028 (‘the Notes’) issued in 2018. The Notes mature in 2028 but the issuer may at its discretion redeem the Notes in 2023. The Notes are listed on the Global Exchange Market of the Irish Stock Exchange plc trading as Euronext Dublin.

The Notes are treated as Tier 2 regulatory capital which is used to support the continuing growth of the business taking into account increases in regulatory capital buffers. The issue of the Notes is part of an ongoing programme to diversify and expand the capital base of the Group.

29. Contingent liabilities and commitments

29.1 Contingent liabilities

As a financial services business, the Group must comply with numerous laws and regulations, which significantly affect the way it does business. Whilst the Group believes there are no material unidentified areas of failure to comply with these laws and regulations, there can be no guarantee that all issues have been identified.

29.2 Capital commitments

At 31 December 2019, the Group had no capital commitments (2018: £nil).

The Company had no capital commitments (2018: £nil).

29.3 Credit commitments

Commitments to extend credit to customers were as follows:

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Business Finance				
Real Estate Finance	120.9	173.4	120.9	173.4
Commercial Finance	48.7	45.6	48.7	45.6
Consumer Finance				
Retail Finance	33.2	28.3	33.2	28.3
Motor Finance	0.5	0.5	0.5	0.5
Consumer Mortgages	–	15.3	–	15.3
	203.3	**263.1**	**203.3**	**263.1**

30. Share capital

	Number	£million
At 1 January 2018 and 31 December 2018	18,475,229	7.4
Issued during 2019	2,271	–
At 31 December 2019	**18,477,500**	**7.4**

Share capital comprises ordinary shares with a par value of 40 pence each.

31. Share-based payments

At 31 December 2019, the Group had five share-based payment schemes in operation:

- Share option Scheme

- 2017 long term incentive plan
- 2017 sharesave plan
- 2017 deferred bonus plan
- 'Phantom' share option scheme

A summary of the movements in share options during the year is set out below:

	Outstanding at 1 January 2019 Number	Granted during the year Number	Forfeited lapsed and cancelled during the year Number	Exercised during the year Number	Outstanding at 31 December 2019 Number	Vested and exercisable at 31 December 2019 Number	Vesting dates	Weighted average exercise price of options outstanding at 31 December 2018 £	Weighted average exercise price of options outstanding at 31 December 2019 £
Equity settled									
Share option scheme	177,084	–	(35,417)	–	141,667	141,667	2016	7.20	7.20
2017 long term incentive plan	161,597	134,046	(32,549)	–	263,094	–	2020–2024	0.40	0.40
2017 sharesave plan	145,009	65,789	(46,284)	(872)	163,642	–	2020–2022	13.39	12.28
2017 deferred bonus plan	14,690	28,775	(12,404)	(1,399)	29,662	3,497	2019–2022	0.40	0.40
	498,380	**228,610**	**(126,654)**	**(2,271)**	**598,065**	**145,164**		**6.60**	**5.26**
Cash settled									
'Phantom' share option scheme	**312,917**	**–**	**(31,250)**	**–**	**281,667**	**281,667**		**2019**	**25.00**

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Expense incurred in relation to share-based payments	**1.2**	**0.8**	**1.0**	**0.6**

31.1. Share option scheme

The share option scheme was established on 17 October 2011.

On 2 November 2011, 934,998 share options were granted at an exercise price of £7.20 per share, entitling three Directors and certain senior employees to purchase shares in the Company. Approximately half of the share options vested and were exercised on 2 November 2014, with the remainder vesting and becoming exercisable on 2 November 2016. The bulk of the remainder were exercised on 7 November 2016, and 35,417 were cancelled during 2019 leaving 141,667 share options unexercised. Vested options are exercisable for a period of 10 years from the date of grant.

The intrinsic value of unexercised options is £1.2 million (2018: £0.8 million).

31.2. Long term incentive plan

The long term incentive plan was established on 3 May 2017.

Awards under this plan are subject to three performance conditions, which are based on:

- annual compound growth in earnings per share ('EPS') over the performance period
- rank of the total shareholder return ('TSR') over the performance period against the TSR of the comparator group of peer group companies
- maintaining appropriate risk practices over the performance period reflecting the longer-term strategic risk management of the Group

The awards will vest on the date on which the Board determines that these conditions have been met.

The awards have a performance term of three years. Those awards granted to the Executive Directors are subject to a holding period of two years following the vesting date. Those awards not subject to a holding period will be released to the participants on the vesting date. Vested options are exercisable for a period of 10 years from the date of grant.

The following awards have been granted under the plan, entitling two Executive Directors and certain other key senior employees to purchase shares in the Company:

	Subject to a holding period Number	Subject to no holding period Number	Total Number
At 1 January 2018	33,467	34,525	67,992
Granted	30,429	64,075	94,504
Forfeited, lapsed and cancelled	–	(899)	(899)
At 31 December 2018	63,896	97,701	161,597
Granted	54,312	79,734	134,046
Forfeited, lapsed and cancelled	(32,549)	–	(32,549)
At 31 December 2019	**85,659**	**177,435**	**263,094**

The original grant date valuation was determined using a Black-Scholes model for the EPS and risk management tranches, and a Monte Carlo model for the TSR tranche. Measurement inputs and assumptions used for the grant date valuation were as follows:

	Granted 2019 Subject to a holding period	Granted 2019 Subject to no holding period	Granted 2018 Subject to a holding period	Granted 2018 Subject to no holding period
Share price at grant date	£15.20	£15.20	£20.85	£20.85
Exercise price	£0.40	£0.40	£0.40	£0.40
Expected dividend yield	6.18%	6.18%	4.05%	4.05%
Expected stock price volatility	25.9%	29.1%	25.2%	26.9%
Risk free interest rate	0.86%	0.72%	1.15%	0.89%
Average expected life (years)	5.00	3.00	5.00	3.00
Discount for lack of marketability during holding period	10.0%	N/A	10.0%	N/A
Original grant date valuation	**£9.02**	**£10.48**	**£14.26**	**£15.47**

31.3. Sharesave plan

The sharesave plan was established on 3 May 2017.

This plan allows all employees with more than 12 months' service to save for three years, subject to a maximum monthly amount of £500, with the option to buy shares in Secure Trust Bank PLC when the plan matures. Participants cannot change the amount that they have agreed to save each month but they can suspend payments for up to six months. Participants can withdraw their savings at any time but, if they do this before the completion date, they lose the option to buy shares at the Option Price, and if participants cease to hold plan-related employment before the third anniversary of the grant date, then the options are also lost. The options ordinarily vest approximately three years after grant date, and are exercisable for a period of six months following vesting.

The original grant date valuation was determined using a Black-Scholes model. Measurement inputs and assumptions used were as follows:

	Awarded during 2019	Awarded during 2018
Share price at grant date	£13.00	£17.53
Exercise price	£10.64	£14.03
Expected stock price volatility	28.34%	28.14%
Expected dividend yield	6.77%	4.57%
Risk free interest rate	0.46%	0.89%
Average expected life (years)	3.00	3.36
Original grant date valuation	**£2.10**	**£3.67**

31.4. Deferred bonus plan

The deferred bonus plan was established on 3 May 2017.

Since 2017, 50% of the bonus earned by two Executive Directors, amounting to £450,000 (2018: £280,000), is deferred into shares under the deferred bonus plan. The awards vest in three equal tranches after one, two and three years following deferral. One of the Executive Directors resigned during the year, leaving only one Executive Director remaining in the plan. Accordingly, the following awards remain outstanding under the plan, entitling one Executive Director to purchase shares in the Company:

	Awards granted Vesting after 1 year Number	Awards granted Vesting after 2 years Number	Awards granted Vesting after 3 years Number	Awards granted Total
At 1 January 2018	–	–	–	–
Granted	4,896	4,896	4,898	14,690
At 31 December 2018	**4,896**	**4,896**	**4,898**	**14,690**
Granted	9,591	9,591	9,593	28,775
Exercised	(1,399)	–	–	(1,399)
Cancelled	(3,202)	(4,601)	(4,601)	(12,404)
At 1 December 2019	**9,886**	**9,886**	**9,890**	**29,662**
Vested and exercisable	**3,497**	**–**	**–**	**3,497**

The original grant date valuation was determined using a Black-Scholes model. Measurement inputs and assumptions used were as follows:

	Granted 2019 Awards vesting after one year	**Granted 2019 Awards vesting after two years**	**Granted 2019 Awards vesting after three years**	Granted 2018 Awards vesting after one year	Granted 2018 Awards vesting after two years	Granted 2018 Awards vesting after three years
Share price at grant date	£11.90	£11.90	£11.90	£20.85	£20.85	£20.85
Exercise price	£0.40	£0.40	£0.40	£0.40	£0.40	£0.40
Expected dividend yield	7.06%	7.06%	7.06%	3.96%	3.96%	3.96%
Expected stock price volatility	27.34%	24.79%	28.82%	25.25%	30.90%	27.68%
Risk free interest rate	0.74%	0.74%	0.76%	0.69%	0.77%	0.82%
Average expected life (years)	1.00	2.00	3.00	1.00	2.00	3.00
Original grant date valuation	**£10.69**	**£9.94**	**£9.59**	**£19.64**	**£18.87**	**£18.12**

31.5. Cash settled share-based payments

On 16 March 2015, a four-year ‘phantom’ share option scheme was established in order to provide effective long-term incentive to senior management of the Group. Under the scheme, no actual shares would be issued by the Company, but those granted awards under the scheme would be entitled to a cash payment. The amount of the award is calculated by reference to the increase in the value of an ordinary share in the Company over an initial value set at £25 per ordinary share, being the price at which the shares resulting from the exercise of the first tranche of share options under the share option scheme were sold in November 2014.

As at 31 December 2019, 281,667 (2018: 312,917) share options remained outstanding. The options vested during 2019 and are exercisable for a period of 10 years after grant date.

As at 31 December 2019, the estimated fair value has been prepared using the Black-Scholes model. Measurement inputs and assumptions used were as follows:

	2019	2018
Share price at reporting date	£16.00	£11.80
Expected stock price volatility	30.34%	24.76%
Expected dividend yield	5.5%	7.12%
Risk free interest rate	0.60%	0.76%
Average expected life (years)	2.60	3.71
Fair value	**£0.53**	**£0.05**

This resulted in the following being recognised in the financial statements:

	2019 £million	2018 £million
Liability	**0.2**	**0.2**

The fair value at December 2018 was not used to calculate the liability, as management concluded that it was appropriate to hold the accrual at the same level as 2017 because the options can be exercised at any point during the seven years after vesting, and given high levels of share price volatility at that date.

For each award granted during the year, expected volatility was determined by calculating the historical volatility of the Group's share price over the period equivalent to the expected term of the options being granted. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

32. Cash flow statement

32.1 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months' maturity from the date of acquisition.

	Group 2019 £million	Group 2018 £million	**Company 2019 £million**	Company 2018 £million
Cash and balances at central banks	105.8	169.7	105.8	169.7
Loans and advances to banks (Note 11)	48.4	44.8	45.2	41.9
	154.2	**214.5**	**151.0**	**211.6**

32.2 Changes in liabilities arising from financing activities

All changes in liabilities arising from financing activities arise from changes in cash flows, apart from £0.1 million of lease liabilities interest expense, as shown in Note 25, and £0.2 million amortisation of issue costs on subordinated liabilities, as shown in Note 28.

33. Financial risk management strategy

By their nature, the Group's activities are principally related to the use of financial instruments. The Directors and senior management of the Group have formally adopted a Group risk appetite statement which sets out the Board's attitude to risk and internal controls. Key risks identified by the Directors are formally reviewed and assessed at least once a year by the Board, in addition to which key business risks are identified, evaluated and managed by operating management on an ongoing basis by means of procedures such as physical controls, credit and other authorisation limits and segregation of duties. The Board also receives regular reports on any risk matters that need to be brought to its attention. Significant risks identified in connection with the development of new activities are subject to consideration by the Board. There are budgeting procedures in place and reports are presented regularly to the Board detailing the results of each principal business unit, variances against budget and prior year, and other performance data.

A more detailed description of the risk governance structure is contained in the Strategic Report beginning on page 2.

The principal financial risks inherent in the Group's business are credit risk (Note 34), market risk (Note 35), liquidity risk (Note 36), and capital risk (Note 37).

34. Credit risk

The Company and Group take on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. A formal Credit Risk Policy has been agreed by the Board whilst credit risk is monitored on a monthly basis by the Credit Risk Committees which review performance of key portfolios including new business volumes, collections performance, provisioning levels and provisioning methodology. A credit risk department within the Group monitors adherence to the Credit Risk Policy, implements risk tools to manage credit risk and evaluates business opportunities and the risks and opportunities they present to the Group whilst ensuring the performance of the Group's existing portfolios is in line with expectations.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to individual borrowers or groups of borrowers. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. The limits on the level of credit risk are approved periodically by the Board of Directors and actual exposures against limits monitored daily.

Impairment provisions are provided for expected credit losses at the statement of financial position date. Significant changes in the economy could result in losses that are different from those provided for at the statement of financial position date. Management therefore carefully manages the Group's exposures to credit risk as it considers this to be the most significant risk to the business.

Exposure to Consumer Finance and Consumer Mortgages credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. Exposure to credit risk for these portfolios is also managed in part by obtaining collateral, principally motor vehicles on Motor Finance loans, residential property on Consumer Mortgages and a credit support balance provided by RentSmart. The assets undergo a scoring process to mitigate risk and are monitored by the Board.

For Real Estate Finance and Commercial Finance, lending decisions are made on an individual transaction basis, using expert judgement and assessment against criteria set out in the lending policies. Asset Finance lending is outsourced to Haydock, who operate in line with the Group's credit policies and risk appetite, and is currently closed to new business. The loans are secured against the assets lent against (real estate, trade receivables and commercial plant and equipment, respectively). Disclosures relating to collateral and arrears on loans and advances to customers are disclosed in Notes 12 and 14 respectively.

The Board monitors the ratings of the counterparties in relation to the Group's loans and advances to banks. Disclosures of these at the year-end are contained in Note 34.1. There is no direct exposure to the Eurozone and peripheral Eurozone countries.

Group

With the exception of loans and advances to customers, the carrying amount of financial assets represents the Group's maximum exposure to credit risk. The Group's maximum exposure to credit risk for loans and advances to customers by portfolio and IFRS 9 stage without taking account of any collateral held or other credit enhancements attached was as follows:

	Stage 1	Stage 2			Stage 3			Total
		<= 30 days past due	> 30 days past due	Total	Excl. purchased credit-impaired	Purchased credit-impaired	Total	
	£million	£million	£million	£million	£million	£million	£million	£million
31 December 2019								
Business Finance								
Real Estate Finance	910.2	33.7	2.8	36.5	16.1	–	16.1	962.8
Asset Finance	23.8	3.6	0.3	3.9	1.8	–	1.8	29.5
Commercial Finance	245.0	7.0	–	7.0	0.6	–	0.6	252.6
Consumer Finance								
Retail Finance	624.1	80.3	4.5	84.8	5.5	–	5.5	714.4
Motor Finance	240.5	96.9	2.7	99.6	17.2	–	17.2	357.3
Debt Management	–	–	–	–	10.3	70.0	80.3	80.3
Consumer Mortgages	105.6	–	0.3	0.3	0.3	–	0.3	106.2
Other	7.6	–	–	–	–	–	–	7.6
Total drawn exposure	**2,156.8**	**221.5**	**10.6**	**232.1**	**51.8**	**70.0**	**121.8**	**2,510.7**
Off balance sheet								
Loan commitments	203.3	–	–	–	–	–	–	203.3
Total gross exposure	**2,360.1**	**221.5**	**10.6**	**232.1**	**51.8**	**70.0**	**121.8**	**2,714.0**
Less:								
Impairment allowance	(21.6)	(19.8)	(4.3)	(24.1)	(17.0)	2.1	(14.9)	(60.6)
Provision for loan commitments	(0.4)	–	–	–	–	–	–	(0.4)
Total net exposure	**2,338.1**	**201.7**	**6.3**	**208.0**	**34.8**	**72.1**	**106.9**	**2,653.0**

	Stage 1	Stage 2			Stage 3			Total
		<= 30 days past due	> 30 days past due	Total	Excl. purchased credit-impaired	Purchased credit-impaired	Total	
	£million	£million	£million	£million	£million	£million	£million	£million
31 December 2018								
Business Finance								
Real Estate Finance	723.3	47.1	–	47.1	–	–	–	770.4
Asset Finance	55.6	6.5	0.5	7.0	3.2	–	3.2	65.8
Commercial Finance	186.1	8.8	–	8.8	0.6	–	0.6	195.5
Consumer Finance								

Retail Finance	537.1	74.1	3.9	78.0	4.9	–	4.9	620.0
Motor Finance	200.2	92.7	2.4	95.1	20.5	–	20.5	315.8
Debt Management	–	–	–	–	9.3	23.0	32.3	32.3
Consumer Mortgages	84.9	–	–	–	–	–	–	84.9
Other	11.3	–	–	–	–	–	–	11.3
Total drawn exposure	**1,798.5**	**229.2**	**6.8**	**236.0**	**38.5**	**23.0**	**61.5**	**2,096.0**
Off balance sheet								
Loan commitments	263.1	–	–	–	–	–	–	263.1
Total gross exposure	**2,061.6**	**229.2**	**6.8**	**236.0**	**38.5**	**23.0**	**61.5**	**2,359.1**
Less:								
Impairment allowance	(20.3)	(19.9)	(4.0)	(23.9)	(22.9)	–	(22.9)	(67.1)
Provision for loan commitments	(0.4)	–	–	–	–	–	–	(0.4)
Total net exposure	**2,040.9**	**209.3**	**2.8**	**212.1**	**15.6**	**23.0**	**38.6**	**2,291.6**

A reconciliation of opening to closing impairment allowance for losses on loans and advances to customers is presented in Note 14.

Company

The Group's maximum exposure to credit risk for loans and advances to customers by portfolio and IFRS 9 stage without taking account of any collateral held or other credit enhancements attached was as follows:

	Stage 1			Stage 2			Stage 3	Total
	£million	<= 30 days past due £million	> 30 days past due £million	Total £million	Excl. purchased credit-impaired £million	Purchased credit-impaired £million	Total £million	£million
31 December 2019								
Business Finance								
Real Estate Finance	910.2	33.7	2.8	36.5	16.1	–	16.1	962.8
Asset Finance	23.8	3.6	0.3	3.9	1.8	–	1.8	29.5
Commercial Finance	244.0	7.0	–	7.0	0.6	–	0.6	251.6
Consumer Finance								
Retail Finance	624.1	80.3	4.5	84.8	5.5	–	5.5	714.4
Motor Finance	240.5	96.9	2.7	99.6	17.2	–	17.2	357.3
Consumer Mortgages	105.6	–	0.3	0.3	0.3	–	0.3	106.2
Other	0.5	–	–	–	–	–		0.5
Total drawn exposure	**2,148.7**	**221.5**	**10.6**	**232.1**	**41.5**	**–**	**41.5**	**2,422.3**
Off balance sheet								
Loan commitments	203.3	–	–	–	–	–	–	203.3
Total gross exposure	**2,352.0**	**221.5**	**10.6**	**232.1**	**41.5**	**–**	**41.5**	**2,625.6**
Less:								
Impairment allowance	(22.8)	(22.1)	(4.8)	(26.9)	(19.0)	–	(19.0)	(68.7)
Provision for loan commitments	(0.4)	–	–	–	–	–	–	(0.4)
Total net exposure	**2,328.8**	**199.4**	**5.8**	**205.2**	**22.5**	**–**	**22.5**	**2,556.5**

	Stage 1			Stage 2			Stage 3	Total

	£million	<= 30 days past due £million	> 30 days past due £million	Total £million	Excl. purchased credit-impaired £million	Purchased credit-impaired £million	Total £million	£million
31 December 2018								
Business Finance								
Real Estate Finance	723.3	47.1	–	47.1	–	–	–	770.4
Asset Finance	55.6	6.5	0.5	7.0	3.2	–	3.2	65.8
Commercial Finance	182.0	8.8	–	8.8	0.6	–	0.6	191.4
Consumer Finance								
Retail Finance	537.1	74.1	3.9	78.0	4.9	–	4.9	620.0
Motor Finance	200.2	92.7	2.4	95.1	20.5	–	20.5	315.8
Consumer Mortgages	84.9	–	–	–	–	–	–	84.9
Other	0.6	–	–	–	–	–	–	0.6
Total drawn exposure	**1,783.7**	**229.2**	**6.8**	**236.0**	**29.2**	**–**	**29.2**	**2,048.9**
Off balance sheet								
Loan commitments	263.1	–	–	–	–	–	–	263.1
Total gross exposure	**2,046.8**	**229.2**	**6.8**	**236.0**	**29.2**	**–**	**29.2**	**2,312.0**
Less:								
Impairment allowance	(20.7)	(20.2)	(4.1)	(24.3)	(23.6)	–	(23.6)	(68.6)
Provision for loan commitments	(0.4)	–	–	–	–	–	–	(0.4)
Total net exposure	**2,025.7**	**209.0**	**2.7**	**211.7**	**5.6**	**–**	**5.6**	**2,243.0**

34.1. Concentration risk

Management assesses the potential concentration risk from geographic, product and individual loan concentration. Due to the nature of the Group's lending operations the Directors consider the lending operations of the Group as a whole to be well diversified. Details of the Group's loans and advances to customers and loan commitments by product is provided in Note 3.

Geographical concentration

The Group's Real Estate Finance and Consumer Mortgages are secured against UK property only. The geographical concentration of these business loans and advances to customers, by location of the security is as follows:

Group and Company

	Real Estate Finance £million	**Consumer Mortgages £million**
31 December 2019		
Central England	127.1	19.9
Greater London	601.8	13.5
Northern England	48.5	21.2
South East England (excl. Greater London)	160.8	35.3
South West England	12.8	11.0
Scotland, Wales and Northern Ireland	11.8	5.3
Gross loans and receivables	962.8	106.2
Allowance for impairment	(0.6)	(0.3)
Total	**962.2**	**105.9**

	Real Estate Finance £million	Consumer Mortgages £million
31 December 2018		

Central England	35.1	16.2
Greater London	451.5	12.2
Northern England	37.6	16.6
South East England (excl. Greater London)	209.0	26.3
South West England	9.6	9.3
Scotland, Wales and Northern Ireland	27.6	4.3
Gross loans and receivables	770.4	84.9
Allowance for impairment	(0.1)	(0.2)
Total	**770.3**	**84.7**

34.2. Forbearance

At year-end, all bar an insignificant number of customers within the Group's Consumer Mortgage business were up to date with their monthly payments. Should customers face financial difficulties, the Group may, depending on individual circumstances, offer customers one of a number of forbearance options. The types of forbearance the Group was prepared to offer in 2019 included the following:

- Temporary interest only concessions are offered to customers in financial difficulty on a temporary basis with formal periodic review. The concession allows the customer to reduce monthly payments to cover interest only, and if made, the arrears status will not increase
- Arrangement payment plans are agreed to enable customers to reduce their arrears balances by an agreed amount per month which is paid in addition to their standard monthly repayment
- Payment concessions can be agreed on a temporary basis whereby the customer may pay less than the contractual monthly payment, in line with their individual affordability. If a customer is within this type of concession, their arrears position will increase
- In exceptional circumstances, capitalisations of arrears may occur or an interest rate adjustment may be applied. These are used under strict controls, explicitly where the customer circumstances offer no other option

All forbearance arrangements are formally discussed and agreed with the customer. By offering customers in financial difficulty the option of forbearance the Group potentially exposes itself to an increased level of risk through prolonging the period of non-contractual payment and/or potentially placing the customer into a detrimental position at the end of the forbearance period.

All forbearance arrangements are reviewed and monitored regularly to assess the ongoing potential risk, suitability and sustainability to the Group.

Where forbearance measures are not possible or are considered not to be in the customer's best interests, or where such measures have been tried and the customer has not adhered to the forbearance terms that have been agreed, the Group will consider realising its security and taking possession of the property in order to sell it and clear the outstanding debt.

No forbearance arrangements are currently in place in respect of Consumer Mortgages.

Other than Consumer Mortgages, throughout 2019 the Group did not routinely reschedule contractual arrangements where customers default on their repayments. In cases where it offered the customer the option to reduce or defer payments for a short period, the loans retained the normal contractual payment due dates and were treated the same as any other defaulting cases for impairment purposes. Arrears tracking would continue on the account with any impairment charge being based on the original contractual due dates for all products.

35. Market risk

Market risks arise from open positions in interest rate and currency products, all of which are exposed to general and specific market movements. There are no significant exposures to foreign currencies and therefore there is no significant currency risk. The Group does not operate a trading book.

Interest rate risk

Group and Company

Interest rate risk is the risk of potential loss through unhedged or mismatched asset and liability positions, which are sensitive to changes in interest rates. When interest rates change, the present value and timing of future cash flows change. This in turn changes the underlying value of the Group's assets, liabilities and off-balance sheet instruments and hence its economic value. Changes in interest rates also affect the Group's earnings by altering interest sensitive income and expenses, affecting its net interest income.

The Group seeks to ‘match’ interest rate risk on either side of the statement of financial position. However, this is not a perfect match and interest rate risk is present on the mismatch between fixed rate loans and savings products and variable rate assets and liabilities.

The Group monitors the interest rate mismatch on at least a monthly basis using market value sensitivity and earnings at risk. At 31 December 2019 these were as follows:

	2019 £million	2018 £million
Market value sensitivity		
+200bps parallel shift in yield curve	2.6	0.2
-200bps parallel shift in yield curve	(1.0)	–
Earnings at risk sensitivity		
+100bps parallel shift in yield curve	0.6	1.0

The Directors consider that 200bps in the case of Market value sensitivity and 100bps in the case of Earnings at risk are a reasonable approximation of possible changes.

The Group maintained such exposures within the risk appetite set by the Board throughout the year.

Interest rate risks inherent in new products or through changes to the terms and conditions of existing products were assessed over the course of the year.

This potential exposure is managed by the Group Treasury function and overseen by ALCO. The policy is not to take significant unmatched positions.

36. Liquidity risk

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

The Group’s approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group’s reputation. The liquidity requirements of the Group are met through withdrawing funds from its Bank of England Reserve Account to cover any short-term fluctuations and longer-term funding to address any structural liquidity requirements.

The Group has a formal governance structure in place to manage and mitigate liquidity risk on a day-to-day basis. The Board sets and approves the Group’s liquidity risk management strategy. The ALCO, comprising senior executives of the Company, monitors liquidity risk. Key liquidity risk management information is reported by the Treasury function and monitored by the Chief Executive Officer and Chief Financial Officer on a daily basis. The ALCO meets monthly to review liquidity risk against set thresholds and risk indicators including early warning indicators, liquidity risk tolerance levels and ILAAP metrics.

The Group raised new fixed rate deposits during the year as set out below:

	2019 £million	2018 £million
Fixed rate bonds	192.4	448.4
Notice accounts	329.0	247.6
Individual Savings Accounts	38.2	–
Total	**559.6**	**696.0**

The terms of the deposits ranged from 1 to 7 years, and were issued to broadly match the term lending by the Group.

The PRA requires a firm to maintain at all times liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. There is also a requirement that a firm ensures its liquidity resources contain an adequate buffer of high quality, unencumbered assets (i.e. Government Securities in the liquidity asset buffer), and it maintains a conservative funding profile. The liquidity assets buffer is a pool of highly liquid assets that can be called upon to create sufficient liquidity to meet liabilities on demand, particularly in a period of liquidity stress. The liquidity resources outside the buffer must either be marketable assets with a demonstrable secondary market that the firm can access, or a credit facility that can be activated in times of stress.

The Group has a Board approved ILAAP. The ILAAP rules require the Group to identify, measure, manage and monitor liquidity and funding risks across different time horizons and stress scenarios, consistent with the Group’s risk appetite as established by the Board. The ILAAP seeks to document the Group’s approach to liquidity and funding, and demonstrate that it complies with the Overall Liquidity Adequacy Rule. The PRA’s approach to liquidity supervision is based on the principle that a firm must have adequate levels of liquidity resources and a conservative funding profile, and that it comprehensively manages and controls liquidity and funding risks. The liquidity buffer required by the ILAAP has been put in place and maintained since that time. Liquidity resources outside of the buffer are made up of deposits placed at the Bank of England. The ILAAP is updated annually.

The primary measure used by management to assess the adequacy of liquidity is the Overall Liquidity Adequacy Rule, which is the Board's own view of the Group's liquidity needs as set out in the Board approved ILAAP. The Group maintained liquidity in excess of the Overall Liquidity Adequacy Rule throughout the year ended 31 December 2019.

The LCR regime has applied to the Group from 1 October 2016, requiring management of net 30-day cash outflows as a proportion of High Quality Liquid Assets. The Group has set a more conservative internal limit. The actual LCR has significantly exceeded both limits throughout the year.

The Group is exposed to daily calls on its available cash resources from maturing deposits and loan draw-downs. The Group maintains significant cash resources to meet all of these needs as they fall due.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates.

The tables below analyse the contractual undiscounted cash flows for the financial liabilities into relevant maturity groupings:

	Carrying amount £million	**Gross nominal outflow £million**	**Not more than 3 months £million**	**More than 3 months but less than 1 year £million**	**More than 1 year but less than 5 years £million**	**More than 5 years £million**
At 31 December 2019						
Non-derivative financial liabilities						
Due to banks	308.5	312.1	0.5	46.7	264.9	–
Deposits from customers	2,020.3	2,086.4	292.3	1,055.0	706.8	32.3
Subordinated liabilities	50.6	61.8	0.9	2.5	58.4	–
Other financial liabilities	27.2	27.2	27.2	–	–	–
	2,406.6	**2,487.5**	**320.9**	**1,104.2**	**1,030.1**	**32.3**
Derivative financial liabilities						
Derivative financial instruments	0.6	0.7	0.1	0.2	0.4	–
	0.6	0.7	0.1	0.2	0.4	–
	2,407.2	**2,488.2**	**321.0**	**1,104.4**	**1,030.5**	**32.3**

	Carrying amount £million	Gross nominal outflow £million	Not more than 3 months £million	More than 3 months but less than 1 year £million	More than 1 year but less than 5 years £million	More than 5 years £million
At 31 December 2018						
Non-derivative financial liabilities						
Due to banks	263.5	263.5	263.5	–	–	–
Deposits from customers	1,847.7	1,916.3	644.3	404.7	855.8	11.5
Subordinated liabilities	50.4	66.9	0.8	2.5	63.6	–
Other financial liabilities	26.3	26.3	26.3	–	–	–
	2,187.9	**2,273.0**	**934.9**	**407.2**	**919.4**	**11.5**

Company

	Carrying amount £million	**Gross nominal outflow £million**	**Not more than 3 months £million**	**More than 3 months but less than 1 year £million**	**More than 1 year but less than 5 years £million**	**More than 5 years £million**
At 31 December 2019						
Non-derivative financial liabilities						

Due to banks	308.5	312.1	0.5	46.7	264.9	–
Deposits from customers	2,020.3	2,086.4	292.3	1,055.0	706.8	32.3
Subordinated liabilities	50.6	61.8	0.9	2.5	58.4	–
Other financial liabilities	31.0	31.0	31.0	–	–	–
	2,410.4	**2,491.3**	**324.7**	**1,104.2**	**1,030.1**	**32.3**
Derivative financial liabilities						
Derivative financial instruments	0.6	0.7	0.1	0.2	0.4	–
	0.6	0.7	0.1	0.2	0.4	–
	2,411.0	**2,492.0**	**324.8**	**1,104.4**	**1,030.5**	**32.3**

	Carrying amount £million	Gross nominal outflow £million	Not more than 3 months £million	More than 3 months but less than 1 year £million	More than 1 year but less than 5 years £million	More than 5 years £million
At 31 December 2018						
Non-derivative financial liabilities						
Due to banks	263.5	263.5	263.5	–	–	–
Deposits from customers	1,847.7	1,916.3	644.3	404.7	855.8	11.5
Subordinated liabilities	50.4	66.9	0.8	2.5	63.6	–
Other financial liabilities	37.4	37.4	37.4	–	–	–
	2,199.0	**2,284.1**	**946.0**	**407.2**	**919.4**	**11.5**

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing financial liabilities as they mature are important factors in assessing the liquidity of the Company and Group and its exposure to changes in interest rates and exchange rates.

Other financial liabilities, as shown above, do not include non-interest accruals as these are not classed as financial liabilities.

37. Capital risk

The Group's capital management policy is focused on optimising shareholder value, in a safe and sustainable manner. There is a clear focus on delivering organic growth and ensuring capital resources are sufficient to support planned levels of growth. The Board regularly reviews the capital position.

In accordance with CRD IV and the required parameters set out in the Capital Requirements Regulation, the Group's ICAAP is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. However, as a minimum, the ICAAP is updated annually as part of the business planning process. The ICAAP is a process that brings together the management framework (i.e. the policies, procedures, strategies, and systems that the Group has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a 'Pillar 1 plus' approach to determine the level of capital the Group needs to hold. This method takes the Pillar 1 capital formula calculations (standardised approach for credit, market and operational risk) as a starting point, and then considers whether each of the calculations delivers a sufficient capital sum adequate to cover management's view of anticipated risks. Where it is considered that the Pillar 1 calculations do not reflect the risk, an additional capital add-on in Pillar 2 should be applied, in line with the Total Capital Requirement issued by the PRA.

Pillar 3 complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). Its aim is to encourage market discipline by developing a set of disclosure requirements which would allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes. Pillar 3 disclosures for the Group for the year ended 31 December 2019 are published as a separate document on the Group's website.

The following table, which is unaudited and therefore not in scope of the independent auditor's report, shows the regulatory capital resources for the Group. The Group has adopted the IFRS 9 transitional rules. For 2019 this allowed 85% (2018: 95%) of the initial IFRS 9 transition adjustment, net of attributable deferred tax, to be added back to eligible Tier 1 capital. Tier 2 capital comprises solely subordinated debt issued during the year net of unamortised issue costs and excluding accrued interest, capped at 25% of the capital requirement.

	2019 £million (unaudited)	2018 £million (unaudited)
Tier 1		
Share capital	7.4	7.4
Share premium	81.2	81.2
Retained earnings	164.4	147.4
Revaluation reserve	1.1	1.1
IFRS 9 transition adjustment	22.8	24.5
Goodwill	(1.0)	(1.0)
Intangible assets net of attributable deferred tax	(7.9)	(8.8)
CET1 capital before foreseen dividend	**268.0**	**251.8**
Proposed dividend	–	(11.8)
CET1 capital	**268.0**	**240.0**
Tier 2		
Subordinated liabilities	50.6	50.4
Less ineligible portion	(0.6)	(4.7)
Total Tier 2 capital	**50.0**	**45.7**
Own Funds	**318.0**	**285.7**
Reconciliation to total equity:		
IFRS 9 transition adjustment	(22.8)	(24.5)
Eligible subordinated liabilities	(50.0)	(45.7)
Goodwill and other intangible assets net of attributable deferred tax	8.9	9.8
Proposed dividend	–	11.8
Total equity	**254.1**	**237.1**

The Group ICAAP includes a summary of the capital required to mitigate the identified risks in its regulated entities and the amount of capital that the Group has available. The PRA sets a Total Capital Requirement ('TCR') for each UK bank calibrated by reference to its Capital Resources Requirement, which is broadly equivalent to 8% of risk weighted assets and thus representing the capital required under Pillar 1 of the Basel III framework. The ICAAP is a key input into the PRA's TCR setting process, which addresses the requirements of Pillar 2 of the Basel II framework. The PRA's approach is to monitor the available capital resources in relation to the TCR. The Group maintains an extra internal buffer and capital ratios are reviewed on a monthly basis to ensure that external and internal requirements are adhered to. The PRA reviewed the Group's ICAAP in 2018 and issued its updated TCR in March 2019.

The Group is also subject to further capital requirements imposed by the PRA on all financial services firms. During the periods, the Group complied with these requirements.

The Group raised Tier 2 capital in 2018. Further details of the capital issuance are given in Note 28.

38. Maturity analysis of consolidated assets and liabilities

Group

	Due within one year £million	Due after more than one year £million	No contractual maturity £million	Total £million
Contractual maturity analysis at 31 December 2019				
ASSETS				
Cash and balances at central banks	105.8	–	–	105.8
Loans and advances to banks	48.4	–	–	48.4
Loans and advances to customers	1,080.6	1,341.3	28.2	2,450.1

Debt securities	25.0	–	–	25.0
Fair value adjustment for portfolio hedged risk	–	–	(0.9)	(0.9)
Derivative financial instruments	–	0.8	0.1	0.9
Other assets	–	–	53.5	53.5
Total assets	**1,259.8**	**1,342.1**	**80.9**	**2,682.8**
LIABILITIES				
Due to banks	45.5	263.0	–	308.5
Deposits from customers	1,355.6	664.7	–	2,020.3
Fair value adjustment for portfolio hedged risk	–	–	(0.7)	(0.7)
Derivative financial instruments	0.1	0.5	–	0.6
Current tax liabilities	3.3	–	–	3.3
Lease liabilities	0.8	3.7	–	4.5
Other liabilities	–	–	41.6	41.6
Subordinated liabilities	1.2	50.0	(0.6)	50.6
Total liabilities	**1,406.5**	**981.9**	**40.3**	**2,428.7**

	Due within one year £million	Due after more than one year £million	No contractual maturity £million	Total £million
Contractual maturity analysis at 31 December 2018				
ASSETS				
Cash and balances at central banks	169.7	–	–	169.7
Loans and advances to banks	44.8	–	–	44.8
Loans and advances to customers	1,035.1	960.2	33.6	2,028.9
Debt securities	149.7	–	–	149.7
Other assets	–	–	51.2	51.2
Total assets	**1,399.3**	**960.2**	**84.8**	**2,444.3**
LIABILITIES				
Due to banks	263.5	–	–	263.5
Deposits from customers	1,016.6	831.1	–	1,847.7
Current tax liabilities	4.2	–	–	4.2
Other liabilities	–	–	41.4	41.4
Subordinated liabilities	1.2	50.0	(0.8)	50.4
Total liabilities	**1,285.5**	**881.1**	**40.6**	**2,207.2**

The Directors have reviewed behavioural maturity of the loan book and have concluded that it would not significantly affect the analysis above.

Company

	Due within one year £million	Due after more than one year £million	No contractual maturity £million	Total £million
Contractual maturity analysis at 31 December 2019				
ASSETS				
Cash and balances at central banks	105.8	–	–	105.8
Loans and advances to banks	45.2	–	–	45.2
Loans and advances to customers	994.5	1,338.7	20.4	2,353.6
Debt securities	25.0	–	–	25.0
Fair value adjustment for portfolio hedged risk	–	–	(0.9)	(0.9)

Derivative financial instruments	0.1	0.8	–	0.9
Other assets	–	–	137.2	137.2
Total assets	**1,170.6**	**1,339.5**	**156.7**	**2,666.8**
LIABILITIES				
Due to banks	45.5	263.0	–	308.5
Deposits from customers	1,355.6	664.7	–	2,020.3
Fair value adjustment for portfolio hedged risk	–	–	(0.7)	(0.7)
Derivative financial instruments	0.1	0.5	–	0.6
Current tax liabilities	2.2	–	–	2.2
Lease liabilities	0.7	2.6	–	3.3
Other liabilities	–	–	42.7	42.7
Subordinated liabilities	1.2	50.0	(0.6)	50.6
Total liabilities	**1,405.3**	**980.8**	**41.4**	**2,427.5**

	Due within one year £million	Due after more than one year £million	No contractual maturity £million	Total £million
Contractual maturity analysis at 31 December 2018				
ASSETS				
Cash and balances at central banks	169.7	–	–	169.7
Loans and advances to banks	41.9	–	–	41.9
Loans and advances to customers	1,026.5	953.8	–	1,980.3
Debt securities	149.7	–	–	149.7
Other assets	–	–	91.4	91.4
Total assets	**1,387.8**	**953.8**	**91.4**	**2,433.0**
LIABILITIES				
Due to banks	263.5	–	–	263.5
Deposits from customers	1,016.6	831.1	–	1,847.7
Current tax liabilities	3.6	–	–	3.6
Other liabilities	–	–	50.4	50.4
Subordinated liabilities	1.2	50.0	(0.8)	50.4
Total liabilities	**1,284.9**	**881.1**	**49.6**	**2,215.6**

The Directors have reviewed behavioural maturity of the loan book and have concluded that it would not significantly affect the analysis above

39. Classification of financial assets and liabilities

Group

	Total carrying amount £million	**Fair value £million**	**Fair value hierarchy level**
At 31 December 2019			
Cash and balances at central banks	105.8	105.8	Level 1
Loans and advances to banks	48.4	48.4	Level 2
Loans and advances to customers	2,450.1	2,416.2	Level 3
Debt securities	25.0	25.0	Level 1
Fair value adjustment for portfolio hedged risk	(0.9)	(0.9)	Level 3
Derivative financial instruments	0.9	0.9	Level 2
Other financial assets	5.2	5.2	Level 3

	2,634.5	**2,600.6**	
Due to banks	308.5	308.5	Level 2
Deposits from customers	2,020.3	2,016.9	Level 3
Fair value adjustment for portfolio hedged risk	(0.7)	(0.7)	Level 3
Derivative financial instruments	0.6	0.6	Level 2
Other financial liabilities	27.2	27.2	Level 3
Subordinated liabilities	50.6	50.6	Level 2
	2,406.5	**2,403.1**	

	Total carrying amount £million	Fair value £million	Fair value hierarchy level
At 31 December 2018			
Cash and balances at central banks	169.7	169.7	Level 1
Loans and advances to banks	44.8	44.8	Level 2
Loans and advances to customers	2,028.9	2,032.5	Level 3
Debt securities	149.7	149.7	Level 1
Other financial assets	16.2	16.2	Level 3
	2,409.3	**2,412.9**	
Due to banks	263.5	263.5	Level 2
Deposits from customers	1,847.7	1,859.7	Level 3
Other financial liabilities	26.3	26.3	Level 3
Subordinated liabilities	50.4	50.4	Level 2
	2,187.9	**2,199.9**	

All financial assets and liabilities at 31 December 2019 and 31 December 2018 were carried at amortised cost, except for derivative financial instruments which are value at fair value through profit and loss. Therefore for these assets and liabilities, the fair value hierarchy noted above relates to the disclosure in this note only.

Company

	Total carrying amount £million	**Fair value £million**	**Fair value hierarchy level**
At 31 December 2019			
Cash and balances at central banks	105.8	105.8	Level 1
Loans and advances to banks	45.2	45.2	Level 2
Loans and advances to customers	2,353.6	2,319.7	Level 3
Debt securities	25.0	25.0	Level 1
Fair value adjustment for portfolio hedged risk	(0.9)	(0.9)	Level 3
Derivative financial instruments	0.9	0.9	Level 2
Other financial assets	93.0	93.0	Level 3
	2,622.6	**2,588.7**	
Due to banks	308.5	308.5	Level 2
Deposits from customers	2,020.3	2,016.9	Level 3
Fair value adjustment for portfolio hedged risk	(0.7)	(0.7)	Level 3
Derivative financial instruments	0.6	0.6	Level 2
Other financial liabilities	31.0	31.0	Level 3
Subordinated liabilities	50.6	50.6	Level 2
	2,410.3	**2,406.9**	

	Total carrying amount £million	Fair value £million	Fair value hierarchy level
At 31 December 2018			
Cash and balances at central banks	169.7	169.7	Level 1
Loans and advances to banks	41.9	41.9	Level 2
Loans and advances to customers	1,980.3	1,983.9	Level 3
Debt securities	149.7	149.7	Level 1
Other financial assets	60.6	60.6	Level 3
	2,402.2	**2,405.8**	
Due to banks	263.5	263.5	Level 2
Deposits from customers	1,847.7	1,859.7	Level 3
Other financial liabilities	37.4	37.4	Level 3
Subordinated liabilities	50.4	50.4	Level 2
	2,199.0	**2,211.0**	

All financial assets and liabilities at 31 December 2019 and 31 December 2018 were carried at amortised cost except for derivative financial instrument which are value at fair value through profit and loss. Therefore for these assets, the fair value hierarchy noted above relates to the disclosure in this note only.

Fair value classification

The tables above include the fair values and fair value hierarchies of the Group and Company's financial assets and liabilities. The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making 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 for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs)

Cash and balances at central banks

The fair value of cash and balances at central banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

At the end of each year, the fair value of cash and balances at central banks was calculated to be equivalent to their carrying value.

Loans and advances to banks

The fair value of loans and advances to banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

Loans and advances to customers

The fair value of loans and advances to customers was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date, and the same assumptions regarding the risk of default were applied as those used to derive the carrying value.

Debt securities

The fair value of debt securities is based on the quoted mid-market share price.

At the end of December 2019 the fair value of debt securities was calculated to be equivalent to their carrying value.

Derivative financial instruments

The fair value of derivative financial instruments was calculated based on the present value of the expected future cash flows of the instruments. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

Due to banks

The fair value of amounts due to banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

At the end of each year, the fair value of amounts due to banks was calculated to be equivalent to their carrying value due to the short maturity term of the amounts due.

Deposits from customers

The fair value of deposits from customers was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date for the notice deposits and deposit bonds. The fair value of instant access deposits is equal to book value as they are repayable on demand.

Dividends and other financial liabilities

The fair value of dividends and other financial liabilities was calculated based upon the present value of the expected future principal cash flows.

At the end of each year, the fair value of dividends and other financial liabilities was calculated to be equivalent to their carrying value due to their short maturity. The other financial liabilities include all other liabilities other than non-interest accruals.

Subordinated liabilities

The fair value of subordinated liabilities was calculated based upon the present value of the expected future principal cash flows.

40. Related party transactions

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

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits as set out below. The tables on the following page relate to Key Management Personnel, members of their close family and related entities as described above.

	2019 £million	2018 £million
Loans		
Loans outstanding at 1 January	4.2	3.7
Loans advanced	1.3	0.4
Loan repayments	(1.3)	–
Interest applied	0.2	0.1
Loans outstanding at 31 December	**4.4**	**4.2**
Deposits		
Deposits outstanding at 1 January	0.4	0.4
Change in related parties during the year	(0.2)	–
Deposits outstanding at 31 December	**0.2**	**0.4**

The loans outstanding above comprise the following:

- A £0.4million advance (2018: £0.4 million) as part of a £2.5 million facility agreed with a company in which a member of the Key Management Personnel of the Company holds 50% of the voting shares, which is secured by property and personal guarantees
- A £4.0 million advance (2018: £3.8 million) as part of a revised £4.4 million facility agreed with a member of the Key Management Personnel of the Company, which is secured by property and certain other undertakings

Both of these transactions were agreed by the Group's Real Estate Finance business and arose during the normal course of business. Both loans were subject to the usual Board governance and Credit Committee approval procedures and are on substantially the same terms as for comparable transactions with third parties.

The Company undertook the following transactions with other companies in the Secure Trust Bank Group:

	2019 £million	2018 £million
Debt Managers (Services) Limited – income from sale of debt portfolio	(0.2)	(0.2)
Debt Managers (Services) Limited – interest charged	(1.1)	–
Debt Managers (Services) Limited – debt collection services	0.6	1.0

Secure Homes Services Limited – building rental paid	0.4	0.4
STB Leasing Limited – interest charged	(0.2)	–
V12 Finance Group Limited – dividend received	(15.1)	–
V12 Retail Finance Limited – fees and commission		
Loan management services	16.2	14.9
Sales commission	7.3	6.5
	7.9	**22.6**

The loans and advances with, and amounts receivable and payable to, related companies are noted below:

	Company 2019 £million	Company 2018 £million
Amounts receivable from subsidiary undertakings	88.5	44.5
Amounts due to subsidiary undertakings	(5.5)	(14.1)
	83.0	**30.4**

All amounts above are repayable on demand and interest is charged at a variable rate.

Directors' remuneration

The Directors' emoluments (including pension contributions and benefits in kind) for the year are disclosed in the Directors' Remuneration Report beginning on page 82.

At the year-end the ordinary shares held by the Directors are disclosed in the Directors' report beginning on page 106. Details of the Directors' holdings of share options, as well as details of those share options exercised during the year, are also disclosed in the Directors' report.

41. Immediate parent company and ultimate controlling party

The Company has had no immediate parent company or ultimate controlling party.

42. Post balance sheet event – COVID-19

The outbreak of COVID-19 and its impact on the global and UK economies is considered to be a non-adjusting event as, at the balance sheet date, the scale of the outbreak remained limited and therefore there was not sufficient information available to have caused changes to the assumptions applied to the financial position as at 31 December 2019. The full impact of the outbreak is currently uncertain and therefore the financial impact on the Group, which will depend upon the extent of the economic downturn and duration of the current lockdown, cannot be reliably estimated.

The most significant financial impacts of the COVID-19 crisis on the Group are expected to be in respect of significantly reduced demand for the Group's Consumer Finance products while the UK Government restricts movements, particularly for Motor Finance while the UK used car market remains effectively closed, and on the level of impairment provisioning required. Contraction of the lending portfolio started to become evident after 31 March 2020, with demand for Motor Finance lending dropping to almost zero, Retail Finance volumes falling to approximately 50% of expectations and Business Finance new business falling significantly from this point. The impact on impairments is not yet clear though charges are expected to increase, and the sensitivity analysis in Note 2.2 indicates the potential magnitude of this increase in the event of material changes to loan book performance or economic factors. As at 31 March 2020, 0.5% of Retail Finance customers and 2.1% of Motor Finance customers had been granted payment holidays, these being the portfolios where the most material impacts on impairment are expected.

In assessing its viability, the Group has undertaken specific stress testing which considers the potential impact of the outbreak on profitability, capital and liquidity levels. These tests considered two core scenarios, whereby the economy shows a significant fall in GDP and increase in unemployment prior to recovery. The more severe scenario assumed unemployment to peak at over 10%. The scenarios were subject to a range of sensitivities, including even higher unemployment rates and a more prolonged period of poor economic conditions prior to recovery. The Group considers that the results of the stress tests demonstrate that the Group continues to be viable and a going concern in both scenarios.

The ability to operate effectively is also impacted and steps have been taken in order to mitigate the operational impact on the business. The senior leadership team is closely monitoring the guidance provided by the UK Government and making changes to operational practices in order to continue to provide services and support for customers, whilst also maintaining the health and safety of employees.

Five year summary (unaudited)

	2019 £million	2018 £million	2017 £million	2016 £million	2015 £million
Profit for the year					

Interest and similar income	191.4	169.2	149.3	141.1	139.7
Interest expense and similar charges	(46.0)	(35.5)	(26.7)	(26.3)	(21.6)
Net interest income	**145.4**	**133.7**	**122.6**	**114.8**	**118.1**
Net fee and commission income	20.1	17.9	14.9	14.5	14.4
Operating income	**165.5**	**151.6**	**137.5**	**129.3**	**132.5**
Impairment losses on loans and advances	(32.6)	(32.4)	(36.9)	(30.3)	(24.3)
Arbuthnot Banking Group recharges	–	–	–	–	(0.8)
Operating expenses	(94.2)	(84.5)	(71.6)	(71.5)	(70.9)
Profit on sale of equity instruments available-for-sale	–	–	0.3	–	–
Profit before income tax	**38.7**	**34.7**	**29.3**	**27.5**	**36.5**

	2019 £million	2018 £million	2017 £million	2016 £million	2015 £million
Earnings per share for profit attributable to the equity holders of the Group during the year					
(expressed in pence per share) – basic	168.3	153.2	128.8	754.1	157.8

	2019 £million	2018 £million	2017 £million	2016 £million	2015 £million
Financial position					
Cash and balances at central banks	105.8	169.7	226.1	112.0	131.8
Loans and advances to banks	48.4	44.8	34.3	18.2	11.5
Loans and advances to customers	2,450.1	2,028.9	1,598.3	1,321.0	1,074.9
Debt securities	25.0	149.7	5.0	20.0	3.8
Fair value adjustment for portfolio hedged risk	(0.9)	–	–	–	–
Derivative financial instruments	0.9	–	–	–	–
Other assets	53.5	51.2	27.9	38.8	25.4
Total assets	**2,682.8**	**2,444.3**	**1,891.6**	**1,510.0**	**1,247.4**
Due to banks	308.5	263.5	113.0	70.0	35.0
Deposits from customers	2,020.3	1,847.7	1,483.2	1,151.8	1,033.1
Fair value adjustment for portfolio hedged risk	(0.7)	–	–	–	–
Derivative financial instruments	0.6	–	–	–	–
Subordinated liabilities	50.6	50.4	–	–	–
Other liabilities	49.4	45.6	46.3	52.2	38.1
Total shareholders' equity	254.1	237.1	249.1	236.0	141.2
Total liabilities and shareholders' equity	**2,682.8**	**2,444.3**	**1,891.6**	**1,510.0**	**1,247.4**

Appendix to the preliminary announcement (unaudited)

Key performance indicators

(i) Margin ratios

Net interest margin is calculated as interest income and similar income less interest expense and similar charges for the financial period as a percentage of the average loan book, net revenue margin is calculated as operating income for the financial period as a percentage of the average loan book and gross revenue margin is calculated as interest income and similar income plus fee and commission income for the financial period as a percentage of the average loan book. The calculation of the average loan book is the average of the monthly balance of loans and advances to customers, net of provisions, over 13 months:

	2019 £million	2018 £million

Net interest margin		
Interest income and similar income	191.4	169.2
Interest expense and similar charges	(46.0)	(35.5)
Net interest income	145.4	133.7
Net revenue margin		
Net interest income	145.4	133.7
Net fee and commission income	20.1	17.9
Operating income	165.5	151.6
Gross revenue margin		
Interest income and similar income	191.4	169.2
Fee and commission income	20.9	19.4
Gross revenue	212.3	188.6
Opening loan book	2,028.9	1,566.5
Closing loan book	2,450.1	2,028.9
Average loan book	2,252.4	1,818.2
Net interest margin	**6.5%**	**7.4%**
Net revenue margin	**7.3%**	**8.3%**
Gross revenue margin	**9.4%**	**10.4%**

The margin ratios all measure the yield of the loan book.

A reconciliation of the opening loan book at 1 January 2018 to the balance sheet is as follows:

	1 January 2018 £million
Loan book	1,598.3
IFRS 9 transition adjustment	(31.8)
	1,566.5

(ii) Cost ratios

Cost of risk is calculated as impairment losses on loans and advances to customers for the financial period as a percentage of the average loan book, cost of funds is calculated at interest expense for the financial period as a percentage of average loan book and cost to income ratio is calculated as operating expenses for the financial period as a percentage of operating income for the financial period:

	2019 £million	2018 £million
Net impairment losses on loans and advances to customers	32.6	32.4
Average loan book	2,252.4	1,818.2
Cost of risk	**1.4%**	**1.8%**
Interest expense	46.0	35.5
Average loan book	2,252.4	1,818.2
Cost of funds	**2.0%**	**2.0%**
Operating expenses	94.2	84.5
Operating income	165.5	151.6
Cost to income ratio	**56.9%**	**55.7%**

The cost of risk measures how effective the Group has been in managing its impairment losses. The cost of funds measures the cost of money being lent to customers. The cost to income ratio measures how efficiently the Group is utilising its cost base in producing income.

(iii) Return ratios

Annualised adjusted return on average assets is calculated as the adjusted profit after tax for the previous 12 months as a percentage of average assets, annualised adjusted return on average equity is calculated as the adjusted profit after tax for the previous 12 months as a percentage of average equity and annualised adjusted return on required equity is calculated as the adjusted profit after tax for the previous 12 months as a percentage of average required equity.

Adjusted profit after tax is profit after tax, adjusted for items that are non-controllable items or other items that fall outside of the Group's core business activities. A reconciliation of adjusted profit after tax to statutory profit after tax is provided on page 20.

Average assets is calculated as the average of the monthly assets balances, average equity is calculated as the average of the monthly equity balances and average required equity is calculated as the average of the monthly balances of total required equity. Total required equity is calculated as the equity required to achieve a CET1 ratio of 12%:

	2019 £million	2018 £million
Adjusted profit after tax	33.0	29.9
Opening assets (after IFRS 16/IFRS 9 transition adjustments – see following page)	2,448.6	1,866.1
Closing assets	2,682.8	2,444.3
Average assets	2,554.9	2,182.4
Opening equity (after IFRS 16/IFRS 9 transition adjustments – see following page)	237.0	223.3
Closing equity	254.1	237.1
Average equity	243.6	228.9
Opening required equity	217.8	173.3
Closing required equity	251.8	220.9
Average required equity	234.5	201.7
Annualised adjusted return on average assets	**1.3%**	**1.4%**
Annualised adjusted return on average equity	**13.5%**	**13.1%**
Annualised adjusted return on required equity	**14.1%**	**14.8%**

A reconciliation of assets to the balance sheet is as follows:

	2019 (opening balance) £million	2018 (opening balance) £million
Balance sheet assets	2,444.3	1,891.6
IFRS 9 transition adjustment	–	(25.5)
IFRS 16 transition adjustment	4.3	–
	2,448.6	**1,866.1**

A reconciliation of equity to the balance sheet is as follows:

	2019 (opening balance) £million	2018 (opening balance) £million
Equity	237.1	249.1
IFRS 9 transition adjustment	–	(25.8)
IFRS 16 transition adjustment	(0.1)	–
	237.0	**223.3**

Return on average assets demonstrates how profitable the Group's assets are in generating revenue. Return on average equity is a measure of the Group's ability to generate profit from the equity available to it. Return on required equity relates profitability to the capital that the Group is required to hold.

(iv) Funding ratios

The loan to deposit ratio is calculated as the loan book at the year-end, divided by deposits from customers at the year-end, and the total funding ratio is calculated as the total funding at the year-end, being the sum of deposits from customers, borrowings under liquidity support operations and the Term Funding Scheme, and equity, divided by the loan book at the year-end:

	2019 £million	2018 £million
Loan book	2,450.1	2,028.9

Deposits from customers	2,020.3	1,847.7
Borrowings under liquidity support operations and the Term Funding Scheme	308.5	263.5
Tier 2 capital (including accrued interest)	50.6	50.4
Equity	254.1	237.1
Total funding	2,633.5	2,398.7
Loan to deposit ratio	**121.3%**	**109.8%**
Total funding ratio	**107.5%**	**118.2%**

The funding ratios measure the Group's liquidity.

(v) Adjusted earnings per share

Adjusted earnings per ordinary share are calculated by dividing the adjusted profit attributable to equity holders of the parent by the weighted average number of ordinary shares as follows:

	2019	2018
Adjusted profit attributable to equity holders of the parent (£million)	33.0	29.9
Weighted average number of ordinary shares (number)	18,476,280	18,475,229
Adjusted earnings per share (pence)	**178.6**	**161.8**

(vi) Adjusted profit and effective adjusted tax rate

Adjusted profit before tax was £41.1 million (2018: £36.7 million). Adjusted profit after tax was £33.0 million (2018: £29.9 million).

The Group uses adjusted profit for planning and reporting purposes, as it improves the comparability of information between reporting periods. The adjustments to profit relate to non-controllable items or other items that fall outside of the Group's core business activities.

Fair value amortisation relates to the acquisition of V12 Finance Group. The acquisition accounting required identifiable assets and liabilities to be adjusted to their fair value, and these adjustments are subject to amortisation.

Transformation costs comprise principally costs of the Motor Transformation Programme and treasury development (31 December 2018: comprised principally costs of closing the unsecured personal lending product, the cost of potential corporate acquisition work and treasury development).

Bonus payments of £0.1 million (2018: £1.3 million) relate to a long term incentive plan that was set up for a small number of employees on the creation of the Commercial Finance business. The scheme is based on profits earned by that business up to the end of 2019, and is payable in 2020.

The revaluation deficit of £1.1 million (2018: £nil) relates to stamp duty and irrecoverable VAT incurred on the acquisition of a freehold property during the year.