Shawbrook Bank

Shawbrook Group plc
Annual Report & Accounts 2018

Proudly different.

How we've done
2018 key highlights

How we have delivered against our strategic pillars:

Maintain excellent credit quality

68bps
Cost of risk*

*43bps including the £13.0 million of insurance proceeds received relating to the controls breach in Business Finance in 2016

Progressively increase originations

20%
Increase in loan book to £5.9 billion

Maintain conservative foundations

12.3%
CET1

17.0%
Total capital ratio

Enhance customer focus

87%
Customer satisfaction**

**feedback from our 2018 Charterhouse survey

Achieve strong risk adjusted returns

6.8%
Gross asset yield

shawbrook.co.uk

twitter.com/shawbrookbank
twitter.com/shawbrookbroker

linkedin.com/company/shawbrook-bank

Contents

Strategic report

The strategic report provides readers with a holistic view of Shawbrook's business model, strategy, 2018 performance and future prospects.

Corporate governance report

In this section we set out our commitment to the highest standards of corporate governance in line with UK best practice, our approach to remuneration and Directors' responsibilities.

Risk management report

The risk management report provides information on actual and potential risks the Group is facing, and how they are managed and controlled to minimise their occurrence and potential loss.

Financial statements

The financial statements comprise of the statutory financial statements and notes to the accounts for 2018.

Other information

The Shawbrook story

Since 2011, we've been quietly growing our business. Our approach to lending and savings is founded on the simple quality of good sense, adopting traditional values with a modern delivery. This is a big part of who we are.

Communication matters. We listen, we understand and we talk to one another. We care about our customers and where they're going.

People are the life force of our business, so our approach is to blend human judgement with technological tools when it comes to decision-making.

That's why ensuring a deep understanding of our customers is our top priority.

Shawbrook – Proudly different.

The difference in being different.

Basis of preparation

The statutory results have been prepared in accordance with International Financial Reporting Standards (IFRS). Where appropriate, certain aspects of the results are presented to reflect the Board's view of the Group's underlying performance without distortions caused by non-recurring items that are not reflective of the Group's ongoing business activities.

Underlying results should be considered in addition to, and not as a substitute for, the Group's statutory results, and the Group's presentation of underlying results should not be construed as an indication that future results will be unaffected by exceptional items. Underlying results have limitations as analytical tools and they should not be considered in isolation or as substitutes for analysis of the Group's results as reported on a statutory basis. Limitations may include, but are not limited to, the following:

- they may not reflect every cash expenditure, future requirements for capital expenditure or contractual commitments; and
- they may not reflect the impact of earnings or charges resulting from matters the Directors consider not to be indicative of ongoing operations.

Due to these limitations, underlying results are not intended as an alternative to the Group's statutory results or as an indicator of the Group's operating performance. The Group compensates for these limitations by using underlying results, along with other comparative tools, together with statutory results, to assist in the evaluation of operating performance.

In the year ended 31 December 2018, there are no underlying adjustments.

In the year ended 31 December 2017, the following items were excluded from the underlying results:

- Costs of £13.2 million relating to expenses incurred during the year in relation to the offer from Marlin Bidco Limited for the entire share capital of Shawbrook Group plc.
- IFRS 2 charges amounting to £5.9 million recognised in 2017 in respect of share; based awards made to employees that vested on Marlin Bidco Limited gaining control of Shawbrook Group plc.
- Corporate activity costs of £0.4 million in 2017 relate to the cost of the incremental deposits raised to prefund the acquisition of a c.£190 million portfolio of property loans at the end of Q3 2017, which completed at the end of November 2017.

International Organisation of Securities Commissions regulation does not permit adjustment for items that are reasonably likely to occur in the foreseeable future, or activities that affected the entity's recent past, when considering underlying results as in their experience there are rarely circumstances where an explanation is sufficiently robust to result in restructuring costs or impairment losses being described as non-recurring. In addition, European Securities and Markets Authority regulation states that items which affected past periods and will affect future periods; such as restructuring costs or impairment losses, will rarely be considered as non-recurring, infrequent or unusual.

Basis of preparation continued

Profit and loss

To ensure equal prominence of the Group's statutory and underlying results, the following table provides a reconciliation of the statutory results to the underlying results:

	2018 £m	2017 £m
Statutory results		
Interest income, net income from operating leases, net fee and commission income, and net gains on financial instruments	**361.4**	314.7
Interest expense and similar charges	**(87.3)**	(76.0)
Net operating income	**274.1**	238.7
Administrative expenses	**(130.3)**	(126.8)
Impairment losses on financial assets[1 2]	**(23.2)**	(23.3)
Provisions for liabilities and charges	**(10.1)**	(2.1)
Total operating expenses	**(163.6)**	(152.2)
Share of results of associates	**(0.5)**	–
Statutory profit before taxation	**110.0**	86.5
Taxation	**(28.4)**	(25.3)
Statutory profit after taxation, attributable to owners	**81.6**	61.2
Reconciliation of statutory to underlying results		
Statutory profit before taxation	**110.0**	86.5
Underlying adjustments		
Project Marlin costs	**–**	13.2
IFRS 2 charges	**–**	5.9
Corporate activity costs	**–**	0.4
Total underlying adjustments	**–**	19.5
Profit before taxation on an underlying basis	**110.0**	106.0
Taxation on an underlying basis[3]	**(28.4)**	(26.8)
Profit after taxation on an underlying basis, attributable to owners	**81.6**	79.2

1 Impairment losses on financial assets in the year ended 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment losses on financial assets in the year ended 31 December 2017 reflect impairment losses calculated in accordance with IAS 39. As such, results are not directly comparable.

2 2018 includes a recovery of £13.0 million received by the Group in relation to the insurance claim in respect of the controls breach identified in the Business Finance division in 2016.

3 The income tax charge on underlying adjustments has been calculated at the implied corporation tax rate. Income tax charge on certain underlying adjustments has been assumed as £nil on the basis of being disallowable for tax purposes.

Key performance indicators

The below table sets out the Group's key performance indicators (KPIs). The Group's KPIs are defined on page 204.

	2018	2017
Assets		
Average principal employed (£m)	**5,351.8**	4,424.9
Loans and advances to customers (£m)	**5,880.0**	4,880.4
Profitability (on an underlying basis)		
Gross asset yield (%)	**6.8**	7.1
Liability yield (%)	**(1.6)**	(1.7)
Net interest margin (%)	**5.1**	5.4
Management expenses ratio (%)	**(2.6)**	(2.5)
Cost of risk (%)	**(0.43)/(0.68)**[1]	(0.53)
Return on lending assets before tax (%)	**2.1**	2.4
Return on lending assets after tax (%)	**1.5**	1.8
Return on tangible equity (%)	**16.1**	19.5
Cost to income ratio (%)	**51.2**	45.9
Asset quality		
Ratio of Stage 3 loans (%)	**2.0**	N/A
Ratio of past due over 90 days and impaired loans (%)	**N/A**	1.2
Liquidity		
Liquidity coverage ratio (%)	**244.9**	290.6
Capital and leverage		
Common Equity Tier 1 capital ratio (%)	**12.3**	12.9
Total Tier 1 capital ratio (%)	**15.2**	16.6
Total capital ratio (%)	**17.0**	19.1
Leverage ratio (%)	**9.2**	9.4
Risk-weighted assets (£m)	**4,206.8**	3,361.7

[1] During 2018, the Group received £13.0 million relating to the Group's insurance claim in respect of the controls breach identified in the Business Finance division in 2016. Cost of risk including this £13.0 million is 0.43%. Cost of risk when adjusted to exclude this £13.0 million is 0.68%.

Our business

What we do

Shawbrook is a specialist UK lending and savings bank focused on Property Finance, Business Finance and Consumer Lending and Savings.

We differentiate ourselves by concentrating on markets where our expert knowledge, judgement and personalised approach to underwriting offer us a competitive advantage. This approach supports attractive, stable returns and sustainable growth, benefiting businesses and individuals in parts of the market that continue to be poorly served by mainstream banks.

Our divisions

Property Finance
Property Finance is comprised of our Commercial Property and Residential Mortgages teams. Serving professional landlords and property traders in residential and commercial asset classes, and personal customers through second charge and specialist first charge mortgages.

£3.7bn
Customer loans

Read more about **Property Finance** 13

Business Finance
The Business Finance division offers an extensive suite of services to address the needs of the UK SME market. Shawbrook International extends the Bank's lending proposition into the Channel Islands.

£1.4bn
Customer loans

Read more about **Business Finance** 19

Consumer Lending and Savings
The Consumer division provides unsecured loans to personal customers for a variety of purposes including home improvement, holiday ownership and point of sale finance and personal loans.

£0.7bn
Customer loans

£5.0bn
Customer deposits

Our savings sub-division provides a wide range of cash savings solutions, targeting UK customers.

Read more about **Consumer** 25

Our differentiated approach

The Shawbrook way
A customer led approach...

Specialists

Thoughtful decision making through judgement

Driven by customer needs

Innovative and tailored products

Focus on quality

Read more about **Our business model** 11

Our five strategic pillars

Achieve strong risk adjusted returns

Enhance customer focus

Maintain excellent credit quality

Progressively increase originations

Maintain conservative foundations

Our values

We are expert: We are quietly confident and enabling.

We are driven: We are ambitious and passionate.

We are practical: We are down to earth and pragmatic.

We act with integrity: We are thoughtful and responsible.

Our people and community

731
Employees (period average)

49
Charities supported

58%
Male

42%
Female

Gender split

P-V12

Chairman's statement
John Callender

During my first year as Chairman, I have found Shawbrook to be a unique business built on the core values of serving customers, collaboration and entrepreneurism.

A year of progress

As my first year as Chairman, I am delighted to introduce this year's Annual Report and Accounts, reflecting on the year's events and our many successes. The Group has continued to generate sustainable returns, achieving an underlying return on tangible equity of 16.1%, and an underlying profit before tax of £110 million. These results mark another year of great progress for the Group, achieving continued profitability despite the heightened economic and political uncertainties.

In 2018, I was pleased to appoint Ian Cowie as Group Chief Executive Officer, following the departure of Steve Pateman from the business in July. I would like to thank Steve for the important role he played over the last three years and for his commended service to the Group. I would also like to extend my gratitude to my predecessor, Iain Cornish, for his positive contributions to the Group.

Building capacity and capability

2018 has been a year of investment, as we continued to support business growth by making significant investments in our operations, IT and risk infrastructure. In November, we welcomed Russ Thornton as our inaugural Chief Technology Officer. Russ will lead our drive to deliver operational efficiencies and improved customer experience through the intelligent application of technology.

Unlocking future potential, our strong income growth has enabled us to invest in the recruitment of new talent to support business development. True to our ongoing commitment to staff training, we have maintained a core focus on developing our people and encouraged lateral movement across the organisation with the introduction of 'My Shawbrook Pathway'. This has been achieved through a wide range of personal development programmes and a new structured leadership programme, with an overarching aim to encourage and incentivise our high-performance culture.

Strong governance

We are committed to maintaining the highest standards of corporate governance throughout the Group. Effective Board oversight is vital to the successful delivery of the Group's strategy and key in embedding a cohesive and high performing culture across the business. In support of this continuing commitment to good corporate governance, an independent Board Effectiveness review was carried out in Q3 2018. Further details of which can be found in the Corporate Governance report page 45.

As a Board, we aim to promote an engaging culture that supports our values and strategy in business. Shawbrook is very much a relationship business serving customers in a way which requires experience, knowledge, judgement and integrity. We actively recruit and develop our people to ensure we have a workforce that possesses these qualities in abundance, and who are passionate about what they do.

Securing healthy foundations

During the year, we continued to balance risk management with reward, encouraging a culture of thoughtful judgement and decision making to build out our business model and secure healthy foundations for the future. In 2018, the composition of our funding shifted slightly, following the final drawdown from the Bank of England Term Funding Scheme (TFS). In 2019, we will look to diversify our wholesale funding sources to optimise the Group's liability mix. The asset side of our balance sheet also remains a model of resilience and flexibility as we close the year with a robust, diversified loan portfolio (63% Property Finance, 24% Business Finance, 13% Consumer Finance). I believe these key drivers position us well for the year ahead, safeguarding the Group against the uncertain economic backdrop.

Strategic opportunities

During my first year as Chairman, I have found Shawbrook to be a unique business built on the core values of serving customers, collaboration and entrepreneurism.

Having met many of the Group's stakeholders, I am encouraged by the relentlessness and ambition that I have seen across the Group and I look forward to watching the business grow from strength to strength.

Throughout 2019 we will continue to evolve our strategy ensuring we identify opportunities for growth and that resource is deployed in areas the add the most value for both customers and the Group.

Outlook

Entering 2019, I am excited to be working with an enthusiastic Management team who will continue to deliver sustainable growth through the deployment of good sense specialist banking products in markets that remain poorly served by the mainstream banks.

Over the past year, the UK banking sector has continued to evolve, driven by increased regulatory oversight, the transformation of financial technology and the ongoing macroeconomic uncertainty resulting from Brexit negotiations. We are mindful of the associated challenges that lie ahead, but I am confident we have a secure model that can capitalise on the opportunities that this climate will present, as we continue to develop a strong and healthy business for all stakeholders.

I would like to thank the Board, the Management team and colleagues across the business for their contribution to everything we have achieved together in 2018.

John Callender
Chairman

Chief Executive Officer's statement
Ian Cowie

In 2018, we continued to leverage our specialist knowledge, innovative lending solutions and tailored decision making to deliver bespoke outcomes for each of our customers.

Financial strength
In 2018, my first period as Chief Executive Officer, we achieved another year of increased profitability. The Group saw new lending improve during the period, resulting in a 20% increase in the customer loan book to £5.9 billion. The year's solid financial performance is attributable to the thoughtful and human approach taken to the way we do business.

Whilst maintaining a core focus on sustainable growth, in 2018 we continued to build our customer base and strengthen our balance sheet. Supporting our customers to achieve their financial goals where others could not or chose not to; we continued to leverage our specialist knowledge, innovative lending solutions and tailored decision making to deliver bespoke outcomes for each of our customers.

Customer led approach
At Shawbrook we are constantly striving to keep the customer at the forefront of everything we do, from our customer-centric solutions to regular broker feedback sessions; positive customer outcomes remain paramount. Our commitment to service did not go unrecognised in 2018, achieving an impressive customer satisfaction score of 87%[1]. I am mindful however, of the importance of keeping up with evolving customer expectations and as a result, in 2019 we will continue to develop our offering by utilising technology to create excellent customer outcomes.

Specialists in our space
Challenging the status quo, in 2018, we continued to build our presence in our specialist markets. Leveraging opportunities as they arose, we invested in and developed our customer propositions.

Our Property Finance business continued to experience sustained growth, increasing the loan book 16% in the year to £3.7 billion. Capitalising on the shift towards the professionalisation of the lettings market, and the solid relationships held across our dedicated broker network, our specialist buy-to-let proposition remained a key driver for business success. Our Property Finance business made a profit before taxation for the year of £118.8 million (2017: £115.0 million).

In our Business Finance division, we have seen the business strengthen and momentum build month on month. The reach of our now established Regional Business Centre network, and the subsequent ability to serve the needs of local businesses has supported the expansion of our wider offering, supporting the aspirations of SMEs in this segment. Our Business Finance division made a profit before taxation for the year of £69.6 million (2017: £50.3 million).

During the year, we also expanded our capability into several new adjacent markets, entering Sports Finance, Renewables and Growth Capital. Moving into 2019 with a strong business pipeline, improved processes and significant growth potential we will continue to identify and explore different opportunities to position ourselves as the specialist lender of choice.

The way we do business in our Consumer division continued to give us a leading edge in our specialist space. In January, we introduced our Transparency Charter, reinforcing our commitment to be honest, open and fair, paving the way for us to champion the customer. In July we integrated an advanced decisioning tool into the business, to further enhance our risk management controls. Our Consumer division made a loss before taxation for the year of £3.1 million (2017: Profit £8.4 million).

Our Consumer savings and Group central costs made a loss before tax of £75.3 million for the year ended 31 December 2018 (2017: Loss £87.2 million). More detailed information on the divisional results are included in Note 3 to the financial statements (pages 167 to 169).

Investing and innovating

In 2018, our strong income growth facilitated several thoughtful investments across the business with the aim of leveraging technology to create a streamlined experience for the customer, while preserving the understanding and expertise that help us support even the most complex of customers. In Consumer Savings, we optimised our infrastructure and enhanced our e-savings portal creating a safer and seamless self-serve platform for our savings customers. In Property Finance, we made further improvements to our commercial mortgages platform to introduce greater automation in support of smarter customer outcomes.

As we invested for the future, our underlying cost to income ratio was impacted by these strategic decisions, increasing to 51.2% (2017: 45.9%). We also chose to take advantage of several inorganic investment opportunities which emerged during the period, acquiring three property portfolios worth c.£0.3 billion with a view to maintaining a diversified portfolio.

Delivering on our strategic objectives

Our markets continued to be challenging in 2018, as increased competition impacted pricing and wider macro-economic factors continued to shape the financial landscape. Despite these pressures, lending remained strong achieving yields of 6.8% across the portfolio. Our enduring commitment to thoughtful underwriting, conduct and risk management has enabled us to maintain a stable underlying cost of risk, achieving 68bps (43bps including the £13.0 million of insurance gains[2]) in 2018 (2017: 53bps). Further information on credit risk is included within the risk management report (pages 72 to 123).

Embedding a collaborative culture

Creating a diverse, inclusive and collaborative workplace is fundamental to business success and thus this remains a core strategic priority for me and my team. In the year, we took steps to strengthen Shawbrook's culture. Recognising the importance of cooperation across the business, we introduced several employee engagement initiatives to secure a shared purpose under one, connected bank.

Outlook

We enter 2019 with heightened ambitions, a healthy business pipeline and a renewed sense of vigor. Trading conditions in our core markets remain positive, and despite ongoing concerns associated with the uncertainty surrounding the impact of the UK leaving the European Union, I believe our agility and entrepreneurial spirit will enable us to capitalise on market movements. I feel very privileged to be at the helm of a business which is well positioned to support a range of customer needs and help them navigate through the economic conditions to realise their ambitions.

Ian Cowie
Chief Executive Officer

[1] Through an independent survey conducted by Charterhouse in 2018

[2] During 2018, the Group received £13.0 million relating to the Group's insurance claim in respect of the controls breach identified in the Business Finance division in 2016. Cost of risk including this £13.0 million is 0.43%. Cost of risk when adjusted to exclude this £13.0 million is 0.68%.

Our business model
A unique model for a 'proudly different bank'...

Our approach to lending and savings is founded on the simple quality of good sense. People are the life force of our business, our method is to blend human judgement with technological tools when it comes to decision making.

Our People

The Shawbrook way.
A customer led approach...

- **Specialists**
- **Thoughtful decision making**
- **Innovative and tailored products**
- **Driven by customer needs**
- **Focus on quality**

We use our expertise and judgement to make individual decisions that balance risk and return with customer needs.

Our Customers

Landlords | **SMEs** | **Homeowners** | **Consumers** | **Savers**

Across our carefully selected markets

Property

Business

Consumer

Our channels to market

Through direct and indirect channels...

KBIs

Key Business Introducers through professional services are primarily utilised by our Business Finance division.

Sponsors

Working with private equity and venture capital firms to support their financial goals.

Direct

Our customer can access our services directly via our website, call centres and relationship staff.

RBCs

We currently have seven regional business centres across the UK.

Brokers

We have a selected panel of brokers and for certain products we utilise broker networks.

Our Stakeholders

How we create value

Customer deposits > **Existing loan book or originations** > **Lend to poorly served customers** > **Interest charged** = **Strong Returns**

Business review
Property Finance

Differentiation

The Property Finance division is our largest business, built on the foundations of longstanding relationships with a network of professional broker intermediaries. Working in partnership, we aim to deliver a service renowned across the specialist market, retaining a strong focus on delivering positive outcomes for all customers. Our approach to lending sits at the heart of our business, utilising personal interactions and thoughtful underwriting over a 'tick box' culture, enabling us to individually cater for each customer.

Commercial

Our Commercial Property division is focused on providing specialist finance solutions to property professionals for investment and refurbishment purposes and to SME's in relation to owner-occupied property. In 2018, our Commercial Property division experienced an exceptional period of progress, achieving strong and progressive originations throughout the year. This growth reaffirms our propositions in our specialist markets and is attributable to our consistently pragmatic and good sense approach to lending.

Activity

The Property Finance division offers a diverse range of residential and commercial mortgage products. Within these broad markets, we actively specialise in the following areas:

- **Commercial:** Serves professional landlords and property traders in residential and commercial asset classes, across long-term and shorter-term funding solutions
- **Residential:** Serves personal customers primarily through second charge mortgages, also offers specialist first charge mortgages

Products are distributed, in the main, through the mortgage intermediary market, leveraging long-established broker relationships.

Financial Performance

- **Loan Book:** 16% growth in loan book during the year to £3.7 billion.
- **Gross Asset Yield:** 5.7%

Buy-to-let

Our specialist buy-to-let offering remains a key driver for business growth, achieving another year of strong performance. 2018 was a year of change for the UK buy-to-let market; experiencing adjustments to tax and regulation, driving an increased level of landlord interest in the professional space. The strength of our specialist buy-to-let proposition and sophisticated approach to underwriting has allowed the Group to capitalise on these changes, leveraging the shift towards the professionalisation of landlords.

Following the success of our previous market reports, in Q3 we published '*The Current buy-to-let Market; General Assessment and Impact of Recent Policy Changes*' in partnership with the Centre for Economics and Business Research (Cebr) continuing the complex conversation regarding the impact of the recent government and regulatory changes in the buy-to-let space. The paper was evidently well-received, gaining over 2,500 downloads thus far.

Business review
Property Finance continued

Short-term Lending
During the year, we continued to grow our market share in the short-term lending space, supporting property investors and developers to add value to their portfolios through refurbishment, conversion or planning. Investing for the future, we grew our specialist teams, then utilising this additional resource we took the time to really understand our customers' business models and enhance relationships with their brokers to efficiently deliver repeat business. Understanding the importance of innovation in this market, during the period we also strengthened our short-term lending range introducing our unique 'lending for refurb costs' product. Giving customers the ability to borrow up to 100% of refurbishment costs on day one has been well-received, demonstrating our commitment to continue to support investors to maximise returns across their portfolios.

Inorganic Activity
Whilst 2018 has seen signs of organic growth, inorganic growth initiatives have also been an important contributor to the Group's success, with the acquisition of three property portfolios in 2018 resulting in a c.£0.3 billion increase in the balance sheet. Additionally, the Group's forward flow arrangements with carefully selected partners have continued to support business growth, contributing to an increased presence in the networks and driving strong flow in the buy-to-let market. We will continue to carefully consider inorganic opportunities that match our strict risk-return criteria when they arise in the future, with a view to sustainably grow our balance sheet.

Residential Mortgages

Our Residential proposition remains predominantly focused on the second charge mortgage market. We provide a wide range of secured loans, principally to prime borrowers for a variety of purposes; including, home improvements, loan consolidation and high-value consumer purchases.

2018 was a period of transformation for our Residential Mortgages business as we sought to align more closely to the needs of the market. We adopted a customer-led approach to prioritise a programme of improvements, including the first of our Broker listening forums.

Looking to the future, we will continue to work closely with our dedicated broker network to increase our presence in the second charge market, aligning our newly introduced residential affordability model to consider customer-specific calculations. As a responsible lender, we understand that delivering robust lending decisions is an ongoing duty and will continue to refine and develop our lending criteria to enhance our residential proposition.

Outlook

Despite forecasts of further contraction in the overall buy-to-let market, and investor uncertainty arising from Brexit negotiations, the market predicts continued growth in specialist buy-to-let lending, driven by the professionalisation of the lettings market. We therefore remain optimistic for the future of our Commercial proposition and are confident that we will continue to be well positioned to capitalise on this market shift.

In 2019, our aim is to provide a friction-free, streamlined experience for customers by utilising technology to automate processes whilst retaining human judgement in our lending decisions and personalised interactions with our networks.

As our property business grows, we will continue to look for opportunities to build out our proposition; enhancing products, and distribution into networks where business will be encouraged whilst also seeking innovative solutions to support our efficiency. As part of our continuous improvement plan, in 2019 we will initiate the staged advancement of our Commercial Mortgages platform. We expect this to be a key business enabler, driving advanced operational performance and improved customer outcomes.

Case Study

Shawbrook helps experienced investor with new 'Lending for Refurbishment Costs'

Shawbrook was approached by Strategic Partner B2B Financial with an experienced customer seeking short-term finance on an auction purchase. The loan of £207,750 was secured against a property value of £300,000. Thanks to Shawbrook's innovative new product allowing customers to access 100% of the refurbishment costs, the Bank was able to offer an additional £27,700 in costs to be covered under the facility, delivering a material benefit to the customer in terms of cash flow.

This was completed on the Short-term-lending residential light refurbishment product on a 12-month term with serviced interest. The teams were under pressure to hit auction timelines and with B2B Financial working closely with the Shawbrook underwriting team, the application journey was completed in just 16 days from start to finish.

Having benefitted from the Shawbrook 'Existing Customer Discount', which is available on the margin and arrangement fee, the customer is now looking for a longer-term solution once the works are complete. This represents a good example of Shawbrook's 'bridge-to-let' offering, and serves to highlight the importance of lender, broker and solicitor working closely together throughout the customer journey.

The customer plans to exit by switching to a Shawbrook term loan once this project is complete, the advantage being no additional fee and the ability to borrow against the new GDV to 75% LTV. This creates further cash flow benefits and opens up more investment opportunities as a result.

"We were really pleased to introduce this product over the summer and it has gained significant traction already. With research just in from our 2018 buy-to-let report that indicates a slightly dampened market, forward thinking products like this allow the professional investor and landlord community to continue to build and grow, and we are delighted to be able to facilitate this."

Gavin Seaholme,
Head of Sales for Shawbrook Commercial Mortgages

"It's encouraging to see this kind of innovative product hit the market at a time where the buy-to let landscape faces some real challenges. The lending for refurbishment costs option really fills a need in the market and the 16-day completion timeline was superb. Our client is delighted with the outcome and we are grateful to Shawbrook for making this an incredibly slick process with excellent service all round."

Adrian Rawle
B2B Financial

Business review
Business Finance

Activity

The primary focus of our Business Finance division is to provide debt-based financing solutions to support UK SMEs. Our portfolio of lending products includes: Asset Finance, Working Capital Solutions (including Asset Based Lending and Senior Debt), Commercial Mortgages and Structured Finance (including Wholesale Finance, Block Discounting and Growth Capital), which are delivered through five distinct business propositions:

Regional Business Centres (RBCs): we operate a network of seven RBCs, each offering a range of facilities direct to regional SMEs and through selected intermediaries.

Specialist Asset Finance: offers leasing and hire purchase finance solutions in specialist SME market segments including; Marine and Aviation, Healthcare, Taxis, Technology, Sport, Agriculture and Renewables.

Structured Finance: predominantly provides finance to non-bank specialist lenders, either through Wholesale Funding or Block Discounting. We are also extending our reach into adjacent markets, introducing new products including Venture Capital-backed finance for fast growth businesses.

Development Finance: provides finance solutions to established regional mid-size developers looking to build and refurbish properties in residential and commercial sectors for sale and investment.

Shawbrook International: provides a range of specialist consumer, property and SME financing solutions in Jersey and Guernsey.

Differentiation

Our Business Finance division offers a diverse range of debt-based financing solutions, targeting those SME's typically under-served by the mainstream lenders, creating increased competition in the market. We differentiate ourselves by challenging the conventional approach to lending, adopting a more thoughtful, human approach to decision making, by creating tailored facilities to meet often complex requirements. In 2018, our specialist approach to lending did not go unrecognised in our market, and the division was awarded *The Best Specialist Commercial Lender* at the 2018 Lending Awards and *Asset-based Lender of the Year* at the 2018 Dealmakers Awards.

In 2018, the division delivered significant growth in both new business and book growth, whilst maintaining yield. In September, we provided over £100 million of lending in the month, a new record. This success is attributable to the effective execution of our growth strategy and investment in several key enablers including; the launch of our new Redhill Business Finance Hub; the continued investment in people; and the investment in operations and process changes. Transitioning into the new year, we will continue to invest for the future to ensure we continue to deliver value to our customers and maximise opportunities over the long term.

Regional Business Centres

Our RBC model is now established across seven locations, each led by an experienced Regional Managing Director and teams focused on integrating with their local professional communities to build profile and demonstrate expertise. Our proposition has expanded to meet local demand, including the pilot of a new commercial mortgage product. After a successful trial period, we now plan to formally launch our commercial mortgage proposition across the RBC network in the first half of 2019. As we continue to capitalise on the meaningful customer relationships generated from our regional business model, we are confident that the Group's increasing ability to offer the comprehensive suite of Shawbrook products will continue to prove popular, giving us that competitive edge in our specialist markets.

Financial Performance

- **Loan Book:** 33% growth in loan book to £1.4 billion.
- **Gross Asset Yield:** 7.8%

Business review
Business Finance continued

Specialist Asset Finance
During the period, the division's portfolio of specialist asset finance businesses continued to demonstrate strong performance, delivering positive originations across our broad suite of products. Mature markets including Marine, Aviation and Healthcare performed well whilst we made significant progress in new markets including Technology, Agriculture & Renewables and Sports Finance. In 2019, we will continue to look for opportunities to expand our presence, by going broader and deeper into current markets, whilst also looking to enter new adjacent markets where we see opportunity and scope to do so.

Structured Finance
During the year, our Wholesale and Block Discounting businesses continued to support other specialist lenders, whether existing customers increasing their facilities or new clients joining Shawbrook. We successfully launched our Growth Capital proposition, providing debt finance to Venture Capital-backed fast growth businesses, whilst also evolving our Funds Finance product and onboarding three new clients. Moving into 2019, the launch of our new Unitranche product will further enhance our specialist offerings in the sponsors market.

Development Finance
In 2018, we continued to actively support established property developers across the UK, financing the development of over 1,600 properties. Whilst initially focused on the South-East, we have grown the team and leveraged the RBC network to extend our reach nationally and by 31 December we had provided facilities exceeding £300 million into this market. During 2019, we expect that our development finance business will continue to grow, as we invest in technology and continue to build our profile in the market.

Shawbrook International
During the year, we extended our presence into Guernsey and moved into our own premises in Jersey, formally launching the business and beginning to build our brand to support direct origination. In the year we also successfully acquired and migrated a portfolio of loans from Lombard and launched a real estate proposition by leveraging the Group's short-term-lending and development finance expertise.

Outlook

This year, the division began to reap the benefits of the re-building work we delivered during 2017. As we move into 2019, the foundations are now in place to focus on managing and growing the sustainable business we have created. Our growth strategy remains centred on taking existing business lines from good to great, by going deeper into the markets we're in; by taking capabilities into new adjacent markets; and getting better connected to address more customer needs. Looking to the future, we will continue to invest in systems and infrastructure to support this growth across our business model to deliver efficiencies and improve our ability to manage data and deliver for our customers.

Business review
Business Finance
continued

Case Study

The first new whisky distillery in the Scottish Borders for almost 200 years is now set to produce 1.8 million litres of spirit per annum.

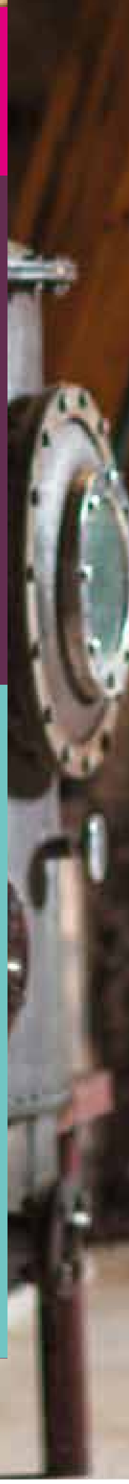
Scottish whisky is vital to the Scottish and UK economies, adding £5 billion in value each year, supporting more than 40,000 jobs and exporting £4 billion of Scotch annually to almost 200 markets.*

The Borders Distillery is the first whisky distillery in the Scottish Borders since 1837. Founded by four Scotch industry veterans, the company has successfully completed the regeneration of an old Victorian site in Hawick, the town in which tweed was invented.

Since the business was established in 2013, part of its five-year plan has always been to bring in a new working capital line in the ordinary course of business. However, with a requirement to lay down single malt whisky for a period of three years, the management team recognised that the structure of the transaction would be less than conventional.

The regional Shawbrook team, with expertise in both complex asset finance and working capital facilities, responded with an amortising structure that led with distillery assets and property and follows-on with receivables to deliver a combined £3.7 million working capital line. A plan is already in place for the facility to evolve to include inventory assets as the stock matures.

The revival of a proud manufacturing tradition in the region will create local jobs, tapping into a highly skilled labour market and attracting tourism to the area via the visitor centre. The company has already developed a traditional blend under the 'Clan Fraser' brand and an edgier blended malt, 'Lower East Side'.



"The biggest challenge is financing because the spirit that comes out of the still cannot be a scotch whisky until it's been in the barrel for at least three years. That costs money and takes time. Shawbrook have been very much in tune with what we wanted to achieve right from the beginning and have an appreciation for what the long-term is about. We think we've got a very exciting future and that Shawbrook will continue to play a part in our story."

Tim Carton
Chief Executive Officer, The Borders Distillery

*Source: Scotch Whisky Association

"There is significant market interest in this deal and it has been exciting to play a part in a landmark transaction with such a compelling narrative. The management team is very experienced, having all held senior roles at global distillers William Grant & Sons, with particular knowledge of sales, distribution and marketing across the globe. What they have achieved is remarkable and we support the management team with working capital that is structured to support the second phase of The Borders Distillery's growth, boosting Scottish manufacturing and export."

Lorna Bell
Relationship Director, Shawbrook Bank Limited

Business review
Consumer Finance

Activity

The Consumer division is responsible for the unsecured consumer lending and retail savings activities of the Bank.

Lending

The lending arm of the Consumer division provides unsecured loans for a variety of purposes. The division is managed into the following two product areas:

- **Partner Finance:** Provides loans to homeowners for the purposes of home improvements (HIL) and holiday ownership (HOL). Also offers point of sale finance to consumers for the purchase of specific goods through established partnerships with recognised retail distributors.
- **Personal Loans:** Provides unsecured loans to personal customers for specific purposes including wedding and car loans, home improvements and debt consolidation.

Savings

The retail savings arm of Consumer offers an extensive suite of savings products to consumers. Products are distributed through several strategic partners, marketplaces and directly to the consumer.

- **Consumer Savings:** Provides a series of savings accounts for our personal customers, including fixed term, notice, cash ISAs and easy access accounts.

Differentiation

Our principal differentiator continues to be our fair and transparent approach to lending, as we remain passionate about being honest, open and fair. To avoid over promising and under delivering, we ensure clarity from the outset, pre-approving (where possible) eligible customers and presenting them with a guaranteed rate without impacting their credit score.

In line with our commitment to be honest, open and fair, we launched two major PR initiatives in 2018; the Transparency Charter (commissioned by the Cebr) and our 'FrOMO- Frustration of Missing Out' campaign. Both campaigns challenge the conventional approach to unsecured lending and the practice of teaser rate advertising, typically amongst larger lenders. Since the launch, both campaigns have received positive national, regional and online coverage.

Recognising the potential opportunities and benefits for customers through the use of Open Banking, we continue to work with key partners to enhance the customer experience, our data strategy and develop our propositions. In order to provide optimal solutions for our customers, we integrated an advanced decision-making tool, enhancing our ability to lend in a sustainable and responsible manner. The tool also enables us to make improved risk and pricing decisions for our customers using enriched datasets. In 2019, we will look to benefit from the modular infrastructure being adopted by the Bank, creating an ecosystem of best-in-class solutions to drive enhanced customer and partner experiences.

Partner Finance

Aligning our Partner Finance model to that which we have developed for personal loans, focusing on fairness and clarity for the end customer, we have worked with a number of our partners to challenge the typical high-rate, high-commission lending model which is adopted across much of the market for financing home improvements. Looking to the future, we will continue to partner with like-minded retailers who value the end customer as much as we do.

During 2018, we have taken the opportunity to refine our approach to the retail point of sale finance market, allowing us to focus and deploy resource in the areas in which we believe we can offer superior propositions to our partners and their target customer bases. Technology continues to transform the Retail point of sale sector and we acknowledge that success in this market is heavily dependent on the ability to be flexible and agile with regards to digital capability.

Financial Performance

- **Loan Book:** 20% growth in loan book to £0.7 billion.
- **Gross Asset Yield:** 9.4%

Business review
Consumer Finance continued

> **"Shawbrook Bank's personal approach differentiates them from other financial companies we have worked with. Our account manager provides us with invaluable training and daily support which has helped us to best serve our customers."**
>
> **Shane Forsythe**
> Premier Kitchens & Bedrooms Limited

Personal Loans

Our personal loan offering has been an important growth driver for the division, with originations of £194 million in 2018, a 43% increase compared with 2017. This success is attributable to our strong proposition, combining innovative solutions with our good sense approach to lending. Our commitment to maintaining a consistent customer-centric proposition has seen us named *Best Unsecured Lender, 2018*, for the third consecutive year.

In 2018, we extended our associated distribution network, building on our existing relationships with Totally Money, Experian and ClearScore, and partnering with the established digital marketplace Money Supermarket.

These partnerships not only provide an additional distribution channel for our personal loans proposition, but also ensure increased levels of transparency and trust among our shared customer bases. Continued roll-out of our real-rate solutions using native integrations into our partners has allowed us to offer pre-approval to customers and will remain the focus for personal loans in 2019.

Savings

Our consumer savings propositions offer a wide range of cash saving solutions, to UK consumers. We continue to maintain consistently competitive rates, across a broad range of simple and straightforward products. Our UK based customer call centre is often recognised for its first-class customer service, demonstrated by encouraging levels of customer satisfaction and retention rates in excess of 73%. Our consistent commitment to positive customer service has been acknowledged in the market, achieving the *Feefo Gold trusted service award* for our outstanding customer service to our consumer customers. In 2019, our primary focus will be on enhancing the customer experience and diversifying our distribution strategy to reduce reliance on the best buy tables. We will continue to develop relationships with strategic partners offering attractive propositions through intermediaries and marketplaces. We will also be launching our digitised journey for Business savings customers.

In November 2018, we upgraded our savings platform which resulted in significant enhancements to our online e-savings portal, making it easier and safer for customers to manage their savings. As well as improving the customer journey, our new self-serve platform provides a faster and streamlined service, whilst also supporting mobile access. Leveraging on these improvements, we will also benefit from increased automation within our operations.

Outlook

As we enter 2019, we will continue to maintain an absolute focus on the customer and delivering on our Transparency Charter against our values of being honest, open, fair, upfront and clear. We will work closely with our strategic partners to deliver innovative propositions as well as extending our distribution through like-minded intermediaries. As enhanced data becomes readily available through initiatives such as Open Banking, we will capitalise on the opportunities this presents to make more informed decisions and deliver better customer outcomes.

In the short to medium term, we will continue to diversify our savings distribution strategy and increase our addressable market, with a core focus on the propositions available to our business customers. Leveraging our SME customer relationships and evolving RBC model, to deliver an automated SME customer deposit proposition, will be key to our diversification strategy.

Corporate Social Responsibility report

At Shawbrook, our Corporate Social Responsibility (CSR) programme is embedded in our day to day business activity, ensuring we maintain a commitment to operate as a responsible and ethical business. We recognise that to deliver comfortable and sustainable long-term growth we must be considerate of our social, economic and environmental impact on the wider society. The Shawbrook approach to CSR addresses the four main priorities listed below. It also incorporates how we engage with our employees and our customers, as well as how we manage our ethical and environmental responsibilities.

Since the launch of our internal CSR programme in 2017, good progress has been made and we would like to take this opportunity to share our CSR activity.

Our approach to CSR and sustainability builds on four main stakeholder areas:

Environment | Marketplace | Workplace | Community

Our Environment

At Shawbrook we understand embedding sustainability in all aspects of our business model is the right thing to do and are committed to creating a strong business that is not achieved at the expense of our environment. Whether it be the way we travel to work, our waste and energy consumption or the way we do business with our partners, Shawbrook strives to entrench sustainability across all aspects of our business operations.

Office investments
In April 2018, we completed a full refurbishment of our Brentwood office, creating an agile working environment. During the project we ensured sustainability was on the agenda, introducing the use of tap limiters and LED lights into the new space. Since the completion, we have seen a dramatic reduction in the energy consumption at our Brentwood office, seeing a 46% reduction in our energy consumption in December 2018 compared to December 2017. In consideration of employee wellbeing, we introduced large office plants and an air handling unit, to improve air quality in our work space. In November, we also consolidated our Croydon and Dorking offices, introducing a new and improved Business Finance hub in Redhill. As a result, our Business Finance team are now operating out of an EPC A-rated building, producing excellent eco credentials and low running costs.

Print and paper solutions
Exploring our optionality in alternative printing solutions, in October we introduced a secure print solution across our main office sites. Providing the ability to cancel items that are no longer required, we have already seen a significant reduction in the Group's paper waste of 41%. To reduce print and mail distribution costs and emissions, we are continuing along the path to become a Hybrid Mail Solution-led organisation. Having made significant headway, we expect to complete the transition in 2020.

Emissions
As part of our commitment to be a sustainable business, in 2018 we continued to utilise the Shawbrook car share scheme. Actively promoting the initiative internally we have seen increased employee involvement, this coupled with additional energy saving solutions saw our CO2 emissions reduce by 31%[1] in 2018. To support our efforts to reduce our carbon footprint, in 2018 we also introduced additional shared shuttle buses to our Brentwood offices, making it easier for colleagues to commute to work by public transport.

Cycle-to-work
Following the success of our inaugural 'Cycle2work' scheme in 2017, in September we relaunched the initiative raising awareness of this benefit to new starters. Incentivising employees to swap their vehicles for pedals, the scheme provides them with an option to lease a bicycle of their choice at a reduced rate, to be used for an environmentally friendly alternative to commute to work.

[1] This reduction was calculated on a like for like basis, inclusive of emissions produced from our London, Glasgow and Brentwood offices.

Corporate Social Responsibility report continued

Our Marketplace

At Shawbrook, we strive to achieve mutually advantageous supplier relationships, built on common values and expectations. It is the commitment to conduct business in a responsible and sustainable manner that underpins our engagement with third party suppliers, only working with those that resonate with our values.

Suppliers

As the business continues to grow, we have seen our supply-chain network expand. As a result, we have sought to improve our internal controls regarding how we source, onboard and manage supplier relationships. As part of our operational resiliency activity, 2018 saw us enhance our Procurement and Supplier Performance Management policy. During the updates we introduced a supplier classification checklist, to determine the level of oversight required for the specific relationship.

Due diligence

As a demonstration of our commitment to improve due diligence across our supply-chain, we also introduced 'Helios' as a partner to augment our internal processes. Helios is recognised for providing total supplier information and risk management solutions, and we are confident that this partnership strengthens our ability to systematically monitor supplier activity, ensuring full compliance with our values and relevant legislation, including the Modern Slavery Act 2015.

Modern Slavery Act ('MSA') Statement

In 2018, we took the appropriate steps to ensure slavery and human trafficking were absent from both our business and supply chain through the introduction of a database for the monitoring of MSA compliance.

To further demonstrate our commitment to the statement we took the following steps to ensure it was ingrained across the Group:

- Identified and addressed risks: We updated our policies and processes for reviewing and evaluating current and prospective suppliers to understand their self-assessment of slavery and human trafficking issues.
- Developed our Policy: We have continuously improved our policies throughout the year. During the year a Group-wide Procurement and Supplier performance management policy was introduced which enhances the onboarding process and reinforces the importance of due diligence and supplier governance in relation to slavery and human trafficking issues.
- Training: Alongside our employee-based training, we also extended training on modern slavery to suppliers and business owners in line with the new procurement and supplier performance management policy.

Our Workplace

At Shawbrook, we are committed to remaining a great place to work, where our people feel valued, engaged and supported to be their best. Our people sit at the heart of our business, so we work hard to create a culture where talent is rewarded, and employees are supported to develop in their careers. We are passionate about promoting an inclusive and welcoming environment where individuals feel respected and diversity is celebrated.

Training and development
True to our ongoing commitment to staff training, in 2018 we continued to invest in our people to support their professional growth across all levels. In the year, we introduced a structured leadership programme to senior managers across the Group, with a view to maintain and develop our experienced leadership team, setting the tone for a culture of determination and success.

My Shawbrook Pathway
In 2018 we launched 'My Shawbrook Pathway', to provide an overview of each employees' position within the Group and how their role impacts the business, professional opportunities available to them and a pathway for internal progression. Online tools and useful information have been made available to all employees, acting as an internal career hub for those wishing to develop their skills and build a fulfilling career at Shawbrook.

Employee engagement
At Shawbrook, we strive to be an open and connected bank, creating a collaborative and transparent culture where all employees feel engaged and aligned to our vision. Improving our Group communications in 2018, we created multiple channels for employees to be seen and heard, including: all staff calls, our annual employee survey, and regular strategic working groups.

Understanding what a great place to work means for our colleagues is essential, so encouraging all colleagues to have their say and feel they can make a difference is vital. As a result, in November we introduced our 'Ask Ian' platform, utilising our intranet to provide all employees with a means to communicate with Ian Cowie and the wider Executive management team. Since its launch, the programme has resulted in several useful feedback sessions garnering useful employee ideas and contributions.

Health and wellbeing
As part of our ongoing commitment to support our employees with their health and wellbeing, in 2018 we introduced our internal Employee Assistance Programme, utilising 'Health Assured', our employee assistance provider, to provide our people and their immediate family with useful tools and information. We now offer a support website, app and 24-hour confidential line to ensure our people feel assisted at every stage of their Shawbrook employment.

Flexible working
At Shawbrook, we are passionate about ensuring our people are given the best opportunities to create a healthy work-life balance. We therefore encourage our employees to re-think how they network, communicate and manage their time effectively to stay on track in their careers alongside responsibilities beyond work. In 2018, we continued to work alongside 'My Family Care', hosting popular workshops to educate our people on how to obtain the right balance.

Corporate Social Responsibility report continued

Our Community

We are committed to supporting our communities and local causes that are close to the hearts of our people. Dedication to our community is embedded in our core values, so we recognise the importance of investing time and support to non-profit organisations, aspiring to make a difference.

Staff fundraising

At Shawbrook we are dedicated to giving back to the communities in which we operate. In 2018, we donated £64,000 to support 49 great causes, seeing the number of organisations assisted increase by 34% compared to 2017. This uplift is attributable to increased staff donations and fundraising activities, including a Macmillan coffee morning, a 5K obstacle course in aid of Queen's Hospital in Romford and a moonwalk for the 'Walk the Walk' breast cancer charity.

Closing the year, in December we worked closely with 'Friends for Families', a charity operating across the Sevenoaks Borough to support families in financial hardship. To support families in need over the festive period, Shawbrook staff built and donated several Christmas hampers, donating over 50 parcels to provide the gift of a warm meal over Christmas.

Charity quiz nights

In October 2018, we held the first of a series of Shawbrook Charity Quiz nights. Our inaugural night was held in aid of The David Randall Foundation, a staff nominated charity. The event was a great success, and over £1000 was raised.

Donations

Our promise is to support our people and their families that gift their time to fundraise for charities that mean a lot to them. In 2018, we are proud to say we have been able to contribute over £60,000 to staff nominated causes.

Making a difference

Engaging with our local communities is important to us, so to encourage our employees to get involved and make a difference we gift each employee up to one paid working day per year. In 2018, we were delighted to see an increase in the number of employees who gave a day back to their local community. To support this increase, we have utilised our established HR Hub to upload, authorise and centrally track each volunteer day.

The strategic report was approved by the Board and signed on its behalf by the Chief Executive Officer.

Ian Cowie
Chief Executive Officer

18 April 2019

Corporate governance report

Corporate governance report.

Chairman's introduction

I am pleased to present my first Corporate governance report. High standards of governance and effective Board oversight are vital to the Group's performance and the successful delivery of its strategy. To support the continuing development of our strong corporate governance framework, I commissioned a Board effectiveness review supported by external consultants. The results of this review have been shared with the Board and a plan to further strengthen our collective Board performance has been agreed.

The Board have focused on assessing the strategy and business model of the Bank which has led to the first phase of changes to the operational and management structure. There were scheduled Board meetings in the year at which strategic matters were discussed and several sessions with Executive management discussing performance and the Bank's strategy. Further sessions with the Board and Executive were held in early February 2019. In these unprecedented times the Board has also maintained a careful watch on external challenges facing the Bank, including regulatory, economic and political developments.

The Board saw a number of changes to its composition with Stephen Johnson, Iain Cornish and Steve Pateman standing down. Sally-Ann Hibberd and David Gagie also stepped down in January 2019. I would like to thank them all for their significant contributions to the development of the Bank over many years. The Nomination Committee oversaw the rigorous process which resulted in my appointment as Chairman and Ian Cowie's appointment as Chief Executive Officer. Further detail on Board and Committee changes in the year can be found at page 43.

The Board's Committees also continued to play an important role in the governance and oversight of the Bank by ensuring adherence to strong governance practice and principles. This section contains a report from key Committees which sets out their approach and considerations.

At Executive Committee level we saw a number of internal moves into these positions. Succession planning throughout the Bank and the composition of the Board remain a key focus. We also remain committed to diversity throughout the organisation and ensuring we have the necessary skills and experience to oversee a business operating in an increasingly regulated market. The Bank has also made the public commitment to increase the proportion of senior roles held by women and creating an inclusive and welcoming work environment where colleagues feel respected and diversity is celebrated.

Looking forward, our corporate governance priorities will be to ensure we are well positioned for the provisions of the new UK Corporate Governance Code and implement the actions from the 2018 external Board effectiveness review.

Finally, I would like to thank each of the Directors for their continuous support and commitment. Profiles of all the Directors are set out on pages 37 and 38.

John Callender
Chairman

18 April 2019

Board of Directors

A Audit Committee

N Nomination Committee

R Remuneration Committee

RI Risk Committee

Committee Chair

John Callender

Chairman

N R

Appointed to the Board in March 2018

Skills and experience

John was appointed to the Board as Chairman in March 2018. John brings extensive financial services experience to the Board, gained through both his Executive and Non-Executive careers. John currently serves as Chairman of ANZ Bank (Europe) Limited and is Senior Independent Director of FCE Bank. John has previously served as Non-Executive Director of Aldermore Group plc and Motability Operations Group plc.

External appointments/ Directorships

John is currently Chairman of ANZ Bank (Europe) Limited; Senior Independent Director of FCE Bank; Director of Inglewood Amenity Management Company Limited and Director of Camberley Heath Limited.

Ian Cowie

Chief Executive Officer

Appointed to the Board in February 2019 (Appointed as a Director of Shawbrook Bank Limited in July 2018)

Skills and experience

Ian joined Shawbrook in April 2017, initially leading the Business Finance division. Ian was appointed permanent Chief Executive Officer in October 2018 having been Interim Chief Executive Officer from July 2018. Ian brings with him a wealth of SME banking experience, after leading the largest business banking franchise in the UK via a number of senior roles at RBS. These include; Chief Executive Officer Business and Commercial Banking, Chairman of SME Banking at NatWest and Director of Lombard Asset finance and RBS Invoice Finance.

External appointments/ Directorships

None

Dylan Minto

Chief Financial Officer

Appointed to the Board in February 2017

Skills and experience

Dylan joined Shawbrook in 2013 from KPMG where he spent 11 years in their Financial Services practice advising large UK and European banks. Dylan was appointed permanent Chief Financial Officer in February 2017 having been Interim Chief Financial Officer from June 2016. He is a Fellow of the ICAEW and holds a dual BA Honours degree in German and Business Studies from Sheffield University.

External appointments/ Directorships

None.

Robin Ashton

Senior Independent Director

A N RI R

Appointed to the Board in March 2015 (Appointed to the Board of Shawbrook Bank Limited in December 2011)

Skills and experience

Robin has extensive experience of retail financial services both in the UK and internationally. He is a chartered accountant and holds a Bachelor of Arts (Hons) degree in Economics and Law from Durham University.

External appointments/ Directorships

Robin has been a Non-Executive Director of Leeds Building Society since April 2011 and Chairman since March 2013.

Andrew Didham

Independent Non-Executive Director

A R RI

Appointed to the Board in February 2017

Skills and experience

Andrew has extensive financial services experience. He is a qualified accountant, having enjoyed a successful career at KPMG, becoming a partner in 1990, and subsequently as Group Finance Director of Rothschild.

External appointments/ Directorships

Andrew is currently an Executive Vice-Chairman for Rothschild and also a Non-Executive Director of Charles Stanley plc and is Non-Executive Chairman of its principal operating company Charles Stanley & Co Limited. He is also Non-Executive Director of Jardine Lloyd Thompson Group plc.

Paul Lawrence

Independent Non-Executive Director

RI A N

Appointed to the Board in August 2015

Skills and experience

Paul has extensive experience in financial services having had a successful career within HSBC Group. Paul has particular strengths in managing risk and internal audit across a number of business lines. Paul previously served as a member on the IIA Committee for Internal Audit Guidance for Financial Services.

External appointments/ Directorships

Paul is currently an Independent Director of HSBC Bank Oman and Chairman of Uley Community Stores Limited.

Roger Lovering

Independent Non-Executive Director

A RI

Appointed to the Board in March 2015 (Appointed to the Board of Shawbrook Bank Limited in January 2013)

Skills and experience

Roger has over 25 years of experience in the consumer finance industry, focusing on lending to individuals. He has extensive knowledge of secured and unsecured lending, both fixed and revolving term via credit cards. Roger is a member of ICAEW and has a degree in Accountancy and Financial Analysis from Warwick University.

External appointments/ Directorships

Roger is a Non-Executive Director of Caswell Consultancy Limited and Amigo Holdings Limited. He is also a Non-Executive of Oodle Finance Services Limited.

Lindsey McMurray

Institutional Director

A N R RI

Appointed to the Board in April 2010 (Appointed to the Board of Shawbrook Bank Limited in January 2011)

Skills and experience

Lindsey has over 20 years of experience as a private equity investor with a particular focus on the financial services sector. She holds a first class Honours degree in Accounting and Finance from Strathclyde University.

External appointments/ Directorships

Lindsey is managing partner of private equity fund manager Pollen Street Capital, an affiliate of Marlin Bidco Limited of which she is also a Director. She is also currently an Executive Director of Pollen Street Capital Limited and a Director of Freedom Acquisitions Limited, Honeycomb Holdings Limited, Honeycomb Finance plc and Cashflows Europe Limited.

Cédric Dubourdieu

Institutional Director

A N R RI

Appointed to the Board in September 2017

Skills and experience

Cédric has close to 20 years of private equity experience, having led a number of investments in a variety of sectors across Europe. He holds a degree from Ecole Polytechnique, Paris.

External appointments/ Directorships

Cédric is a Managing Partner of private equity firm BC Partners and sits on BC Partners' investment committee. BC Partners is an affiliate of Marlin Bidco Limited of which Cédric is also a Director. Cédric currently serves on the Boards of MCS, Nille and Allflex.

Daniel Rushbrook

General Counsel and Company Secretary

Appointed Company Secretary in March 2015 (appointed Company Secretary to Shawbrook Bank Limited in March 2011)

Skills and experience

Daniel has over 25 years' legal experience. He has experience in private practice having worked for both Linklaters LLP and Macfarlanes LLP. Daniel became the first in-house lawyer for Commercial First Mortgages Limited, later joining its Board as Legal Director in 2005. In 2011 Daniel transferred to Shawbrook becoming General Counsel and Company Secretary. Daniel holds a first-class law degree from Oxford University and a Masters law degree from the University of Pennsylvania.

External appointments/ Directorships

None.

Resignations

Stephen Johnson resigned as a Director on 23 January 2018

Iain Cornish resigned as a Director on 8 March 2018

Stephen Pateman resigned as a Director on 27 July 2018

Sally-Ann Hibberd and David Gagie resigned as Directors on 31 January 2019

Leadership structure

An overview of the delegations in place from the Board to its Committees is provided below. On the following page, the Executive management governance structure has been included; it has delegated authorities from the Chief Executive Officer and members of the Executive management team. All authorities have been documented through terms of reference. Board Committee terms of reference can be found on the website: **https://www.shawbrook.co.uk/investors/**.

The Board

The primary role of the Board is to provide leadership to the Group, to set the Group's long-term strategic objectives and to develop robust corporate governance and risk management practices. The Board delegates specific powers to some Committees, details of which are set out on this page.

Nomination Committee

- Recommends Board appointments.
- Oversees appointments under the Senior Managers and Certification Regime.
- Succession planning.

Audit Committee

- Oversees financial reporting.
- Monitors internal control.
- Monitors internal and external auditors.

Disclosure Committee

- Monitors disclosure controls.
- Reviews and advises on the scope and content of the disclosure.

Remuneration Committee

- Monitors the level and structure of remuneration for Executive management.
- Approves annual performance objectives.
- Ensure incentives are aligned key stakeholder expectations.

Risk Committee

- Oversees and reviews the Group's Risk Management Framework.
- Reviews the Group's ICAAP & ILAAP.
- Reviews the Group's Recovery Plan and Resolution pack (collectively the RRP).
- Reviews and provides approval of material risk appetite measures.

Executive Committee

The Executive Committee is responsible for developing the business and delivering against a Board approved strategy, putting in place effective monitoring, control mechanisms and setting out a framework for reporting to the Board.

Operations Committee

- Provides operational oversight.
- Assures quality and performance management.
- Monitors complaints and services provided to customers.
- Provides oversight to change management activities across the Group.

Group Product Committee

- Approves the product governance process and product approval policy.
- Reviews, monitors and challenges the performance of all products across the Group.
- Reviews, approves and recommends variations to existing products.
- Reviews, approves and recommends new products to the Board.
- Challenges and monitors customer outcomes for all products.

Asset and Liability Committee

- Identifies, manages and controls balance sheet risks.
- Oversees and monitors liquidity and capital control frameworks.
- Recommends liquidity, funding, market and counterparty risk policy for approval.
- Recommends liquidity and market risk appetite statements and limits for approval and monitoring.

Enterprise Risk Management Committee

- Leads the design and implementation of the Risk Management Framework; and conduct of business issues including fair outcomes for customers.
- Oversees regulatory reporting requirements and the Financial Crime and Anti-Money Laundering (AML) regime.
- Defines detailed risk appetite limit and statements and recommends to Risk Committee material risk appetite limits and statements.
- Oversees working groups which ensure risks and trends are appropriately managed.
- The Committee has a governance structure beneath it which assists with oversight of the Risk Management Framework and other risk related matters.

Leadership structure continued

The Board

The Board has responsibility for ensuring that the Group is managed effectively and in the best interests of its Shareholder, investors, customers, employees and other stakeholders (including regulators) and its principal banking subsidiary, Shawbrook Bank Limited. A Framework Agreement is in place with Marlin Bidco Limited (the 'Shareholder') which includes a formal schedule of matters reserved for the Board and those matters which require recommendation to the Shareholder for approval. This document is supported by the Memorandum of Understanding, which preserves the Board's independence when making significant decisions. The Board delegates specific powers for some matters to Board Committees, with the outputs from each Committee meeting reported to the Board regularly, thus ensuring the Board maintains the necessary oversight. More detail on the Committees and their work is described in the separate Committee Reports at pages 51 to 71.

Roles and responsibilities

Chairman (John Callender)

Leads the Board, ensuring its effectiveness in all aspects of its role as well as being responsible for its governance. Sets the tone for the Group and ensures effective relationships between management, the Board and the Shareholder are strong.

Key responsibilities:

- Ensure effective communication and information flows with the Shareholder.
- Helps to ensure effective communication with other key stakeholders (such as employees and regulators).
- Provide entrepreneurial leadership.
- Ensure effective communication and flow of information between Executive Directors and Non-Executive Directors.
- Chair Board and Nomination Committee meetings.

Chief Executive Officer (Ian Cowie)

Responsible for the day to day management of the Group's operations, recommending the Group's strategy to the Board and the implementation of the agreed strategy. Accountable to the Board for the Group's operational and financial performance. Supported in decision making by the Executive management team. The Chief Executive Officer chairs the Executive Committee, which meets no less than three times a month.

Key responsibilities:

- Maintain a good working relationship with the Chairman and all Directors.
- Assess the principal risks of the Group.
- Lead relationships with government, authorities, regulators and other key stakeholders.
- Ensure effective internal controls and management information systems are in place.
- Responsibility for the performance of the Group's obligations under the Senior Manager and Certification Regime.

Senior Independent Director (Robin Ashton)

Provides a sounding board for the Chairman and serves as an intermediary for the other Directors when necessary. Available to the Shareholder if they have concerns, which the normal channels of Chairman, Chief Executive Officer or other Executive Directors have failed to resolve, or for which such contact is inappropriate.

Key responsibilities:

- Leads the planning for the succession of the Chairman of the Board.
- Meet with other Non-Executive Directors to appraise the Chairman's performance.
- Provide feedback to the Chairman, Shareholder and Executive Directors on the Non-Executive Directors' views.

Non-Executive Directors

Provide constructive challenge to management and bring experience and objectivity to the Board's discussions and decision making. Monitor the delivery of the Group's strategy against the governance, risk and control framework established by the Board. Led by the Senior Independent Director, the Non-Executive Directors are also responsible for evaluating the performance of the Chairman.

Further responsibilities:

- Scrutinise management performance.
- Ensure the integrity of financial information and ensure that the financial controls and systems of risk management are effective.
- Exercise independent judgement and diligence in decision making.

Company Secretary (Daniel Rushbrook)
All Directors have access to the services of the Company Secretary in relation to the discharge of their duties. Responsible for working with the Chairman to develop Board and Committee agendas and to ensure that all governance procedures are complied with. Advises the Board on corporate governance, legal, regulatory and compliance matters and developments.

Additional duties:

- Ensure the Group's governance framework is maintained.
- Organise Directors' training and induction.
- Oversight of Board and Committee management.
- Act as an independent advisor to the Board.

Division of responsibilities
There is a clear division of responsibility at the head of the Group. The roles of the Chairman and the Chief Executive Officer are separate, clearly defined in writing and have been agreed by the Board.

Board Committees

The Board has a number of Committees: Disclosure, Nomination, Remuneration, Audit and Risk. The written terms of reference of the Committees, including their objectives and the authority delegated to them by the Board, are available upon request from the Company Secretary or via the Group's website at **https://www.shawbrook.co.uk/investors/**. All Committees have access to independent expert advice and the services of the Company Secretary. Each Committee Chairman reports on activities throughout the year, highlighting anything which needs to be brought to the wider Board's attention. The terms of reference of each Committee are reviewed annually to ensure that the Committees are operating effectively and any changes considered necessary are recommended to the Board and the Shareholder for approval.

The Board has a Disclosure Committee, which is responsible for monitoring, evaluating and enhancing disclosure controls and procedures within the Group. In particular, responsibilities set out in its terms of reference include the identification of sensitive and confidential information and maintenance of project lists, the design, implementation and evaluation of disclosure procedures and the resolution of any questions concerning the materiality of certain information. The Disclosure Committee also ensures the Group makes timely and accurate disclosure of all information where disclosure is required to meet legal and regulatory obligations.

The Board delegates daily management responsibility for the Group to the Chief Executive Officer and the Executive management team, who meet no less than three times a month. The Executive Committee is responsible for developing the business and delivering against a strategy approved by the Board and ensuring effective monitoring and control mechanisms. There are also a number of executive sub-committees (a table showing the governance structure is set out on page 40) which assist the Executive Committee in discharging its responsibilities.

Composition, Board balance and time commitment

The Board currently consists of nine members, namely the Chairman, four Independent Non-Executive Directors, two Executive Directors and two Institutional Directors. Biographical details of all Directors are given on pages 37 and 38.

The Non-Executive Directors have strong and relevant experience across all aspects of banking, including relevant skills in financial management, regulatory, credit assessment and pricing, liability management, technology, operational and conduct matters. To ensure the Board continues to have an appropriate balance of skills, these skill sets are reviewed through the completion of a skills matrix which is considered by the Nomination Committee and the Board.

The Board considers that the balance of skills and experience is appropriate to the requirements of the Group's business and that the balance between Executive and Non-Executive Directors allows it to exercise objectivity in decision making and proper control. Each member of the Board has had access to all information relating to the Group, the advice and services of the Company Secretary (who is responsible for ensuring that governance procedures are followed) and, as required, external advice at the expense of the Group.

The Board keeps under review the structure, size and composition of the Board (and undertakes regular evaluations to ensure it retains an appropriate balance of skills, knowledge and experience). The Board also reviews the membership of the various Board Committees and the expected time commitment.

The terms of appointment of the Non-Executive Directors specify the amount of time they are expected to devote to the Group's business. They are currently required to commit to at least four days per month which is calculated based on the time required to prepare for and attend Board and Committee meetings, meetings with the Shareholder and training.

Leadership structure continued

Meetings and attendance

The Board holds joint meetings of Shawbrook Group plc and Shawbrook Bank Limited at regular intervals, at which standing items such as the Group's financial and business performance, risk, compliance, human resources and strategic matters are reviewed and discussed. There is a comprehensive Board pack and agenda which is circulated beforehand so that Directors have the opportunity to consider the issues to be discussed. Detailed minutes and any actions arising out of discussions are documented.

Regular meetings are scheduled up to a year in advance, and if any Director is unable to attend then they may provide comments on the papers to the Chairman before the meeting. Meetings are structured so that appropriate time is devoted to all agenda items. In addition to these regular, scheduled meetings, ad-hoc Board meetings are held outside the published cycle where circumstances require; including but not limited to approval of appointments to the Board, any material transactions or the approval of regulatory submissions.

In 2018, there were 16 Board meetings. nine Board meetings were scheduled and there were seven ad-hoc meetings to discuss matters ranging from acquisitions, full year and half year financial results and appointment of the Chairman and Chief Executive Officer.

Attendance at the scheduled Board meetings is shown below:

Director	Date appointed or resigned in the year	Meetings attended	Meetings eligible to attend as a Director
Iain Cornish	Resigned 8 March 2018	2	2
Robin Ashton		7	9
Cédric Dubourdieu		8	9
Andrew Didham		8	9
David Gagie	Resigned 31 January 2019	7	9
Sally-Ann Hibberd	Resigned 31 January 2019	9	9
Stephen Johnson	Resigned 23 January 2018	0	0
Paul Lawrence		8	9
Roger Lovering		9	9
Lindsey McMurray		9	9
Dylan Minto		9	9
Steve Pateman	Resigned 27 July 2018	7	7
John Callender	Appointed 8 March 2018	7	7
Ian Cowie [1]	Appointed 7 February 2019	3	3

Throughout the relevant period, the Chairman has held a number of meetings with Non-Executive Directors, without the Executive Directors being present. The Senior Independent Director has held meetings with Non-Executive Directors, without the Chairman being present.

[1] Ian Cowie was appointed as Director of Shawbrook Bank Limited on 27 July 2018 and (given the joint Board meetings held with Shawbrook Bank Limited) attended Board meetings for the period he was Interim Chief Executive Officer. Ian was appointed as Chief Executive Officer of Shawbrook Group plc on a permanent basis on 7 February 2019.

Independence

The Board has reviewed the independence of each of the Non-Executive Directors who have served on the Board throughout the financial year and concluded that Robin Ashton, Andrew Didham, Roger Lovering and Paul Lawrence are independent. Lindsey McMurray and Cédric Dubourdieu, who represent the Shareholder, are not considered independent. During the relevant period, the Board has operated with due regard to the UK Corporate Governance Code (the "Code") requirement that at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent.

The Non-Executive Directors are considered to be of sufficient calibre and experience to bring significant influence to bear on the decision making process. The Board has considered the independence of Roger Lovering who is a Non-Executive Director of Amigo Loans, which has a wholesale facility with the Group and Andrew Didham who is a Non-Executive Director of Jardine Lloyd Thompson Group plc who are the Group's insurance broker. The Board have concluded that these outside interests do not affect their independence. This is based on observations of the way the above Directors have discharged their duties as members of the Board Committees and their contribution to and challenge in Board meetings.

Conflicts of interest

All Directors have a duty to avoid situations that may give rise to a conflict of interest (in accordance with s175 of Companies Act 2006). Formal procedures are in place to deal with any conflict of interest. Directors are responsible for notifying the Chairman and the Company Secretary as soon as they become aware of any actual or potential conflict of interest for discussion by the Board, who will take into account the circumstances of the conflict when deciding whether to permit potential conflict or to impose conditions on the Director in the interests of the Group. Any actual or potential conflicts of interest are recorded in a central register and Directors are also required, on an annual basis, to confirm that they are not aware of any circumstances which may affect their fitness and propriety and therefore their ability to continue to serve on the Board. In addition, Directors are required to seek the Board's approval of any new appointments or changes in commitments.

Induction, training and professional development

On appointment, all new Directors receive a comprehensive and tailored induction, having regard to any previous experience they may have as a Director of a financial services company. The Group also provides additional induction materials and training for those Directors who are also Committee Chairs. The content of our Director induction programmes are tailored and scheduled, with input from the new Director. The induction information is delivered in a variety of formats; including face to face meetings with the Chairman, Board Directors and Executive management, and input from external advisers as appropriate. This is supplemented by the provision of key governance documents as reading material, including policies, procedures, Board and Committee minutes, the Board meeting schedule, the Group structure chart and copies of the Code, the FCA Handbook, regulatory codes/requirements and information on Directors' duties and responsibilities under the Companies Act 2006 and other relevant legislation.

Tailored training is made available to all newly appointed Directors, ensuring any previous experience they may have as a Director of a financial services company or otherwise is considered. An ongoing programme of training is available to all members of the Board which includes professional external training, internal online training and bespoke Board training on relevant topics such as regulatory and governance developments, changes to the Companies Act 2006 or accounting requirements. Directors are also encouraged to devote an element of their time to self-development, including attendance at relevant external seminars and events. This is in addition to any guidance that may be given from time to time by the Company Secretary.

The Chairman is responsible for reviewing the training needs of each Director, and for ensuring that Directors continually update their skills and knowledge of the Group. All Directors are advised of changes in relevant legislation, regulations and evolving risks, with the assistance of the Group's advisers where appropriate. During 2018, scheduled training was provided to the Board on Corporate governance developments, Regulatory updates, IFRS 9, Critical Standard for financial services firms and Securitisation.

The Board receives detailed reports from Executive management on the performance of the Group at its meetings and other information as necessary. Regular updates are provided on relevant legal, corporate governance and financial reporting developments. The Board frequently reviews the actual and forecast performance of the business compared against the annual plan, as well as other Key Performance Indicators.

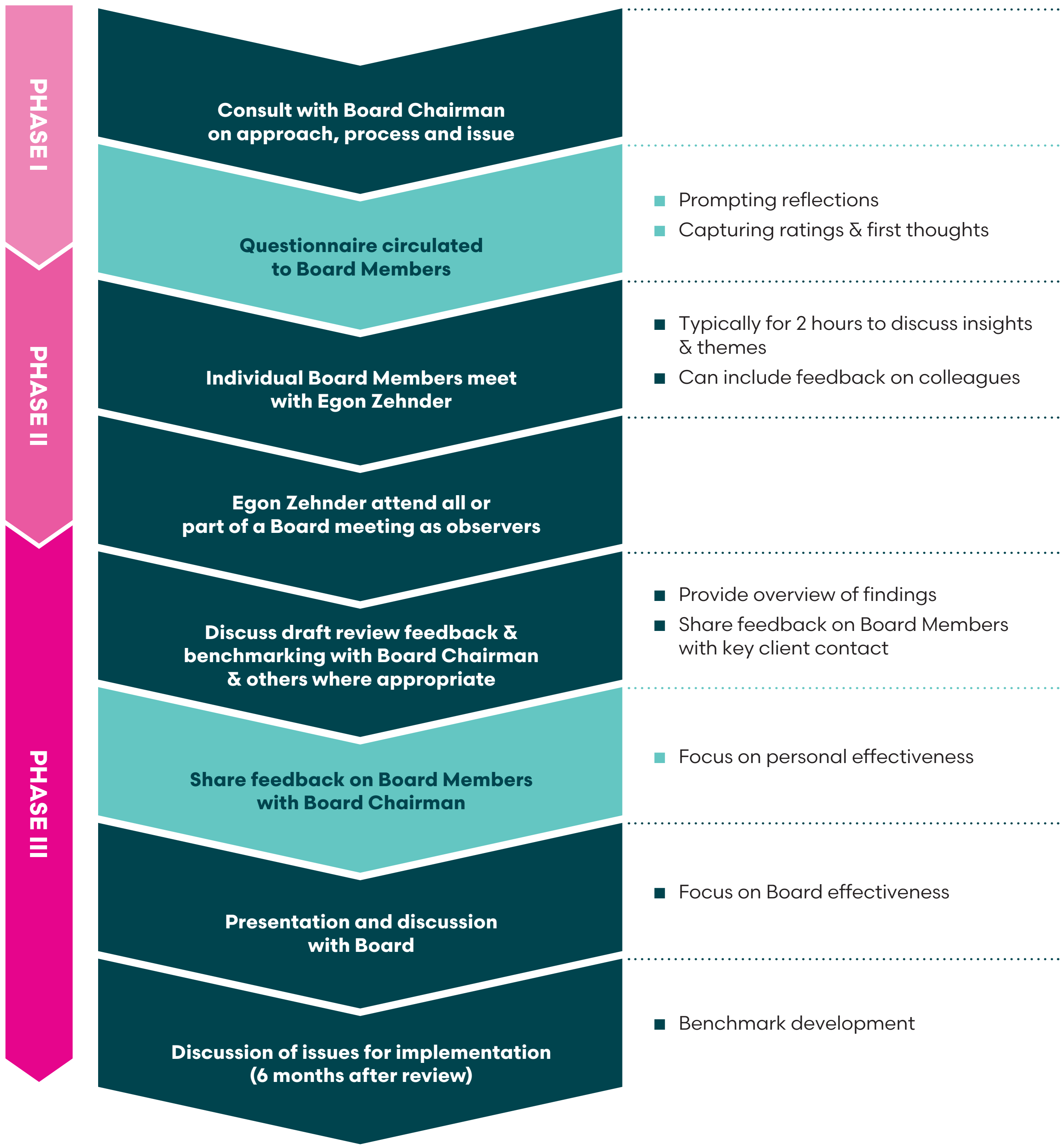
Leadership structure continued

Board effectiveness review

The Board carried out an externally facilitated evaluation, using Egon Zehnder, an independent facilitator with no links to the Group, at the end of 2018. The assessment was conducted according to the guidance set out in the Code.

Given the changes across the membership of the Board and Executive management across 2018, the review sought to address the effectiveness of the governance structure, assessment of the Board's discussions and decision making, succession planning at both Board and Executive management levels and a review of the role, skills, diversity, balance and experience of Directors.

The Review was based on data collected between July and November 2018 and comprised of:



Internal control

The Board has overall responsibility for the Group's system of internal control and for monitoring its effectiveness. The Audit Committee and Risk Committee have been in operation throughout the relevant period and oversee the Group's system of internal control. Material risk or control matters are reported by the Audit Committee and Risk Committee to the Board. The Board monitors the ongoing process by which 'top risks' affecting the Group are identified, measured, managed, monitored, reported and challenged. This process is consistent with both the Group Risk Management Framework and with internal control and related financial and business reporting guidance issued by the Financial Reporting Council in September 2014 and has been in place for the relevant period under review and up to the date of approval of the Annual Report & Accounts. The key elements of the Group's system of internal control include regular meetings of the Executive management and risk governance committees, together with annual budgeting, and monthly financial and operational reporting for all businesses within the Group. Conduct and compliance are monitored by management, the group risk function, internal audit and, to the extent it considers necessary to support its audit report, the external auditor.

The Board assesses the effectiveness of the Group's system of internal controls (including financial, operational and compliance controls and risk management systems) on the basis of:

- established procedures, including those already described, which are in place to manage perceived risks;
- reports by management to the Audit Committee and Risk Committee on the adequacy and effectiveness of the Group's system of internal control and significant control issues;
- under the direction of the Chief Risk Officer, the continuous Group wide process for formally identifying, evaluating and managing the significant risks to the achievement of the Group's objectives; and
- reports from the Audit Committee on the results of internal audit reviews and work undertaken by other departments.

The Group's system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve the Group's objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss. In assessing what constitutes reasonable assurance, the Board considers the materiality of financial and non-financial risks and the relationship between the cost of, and benefit from, the system of internal control. During 2018, the Group continued to strengthen its risk management and internal controls capability to ensure that it remained relevant, appropriate and scalable to support the Group's objectives over the duration of the strategic plan and continued to embed improvements into the Group's Risk Management Framework.

Lines of responsibility and delegated authorities are clearly defined. The Group's policies and procedures are regularly updated and distributed throughout the Group. The Audit Committee and Risk Committee receive reports on a regular basis on compliance with the Group's policies and procedures.

Shawbrook Bank Limited (the main operating subsidiary of the Group) is subject to regulation by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) and as such undertakes an ILAAP and ICAAP on an annual basis. The ICAAP process benefited from ongoing improvements during 2018; the process involves an assessment of all the risks that the Group faces in its operating environment, the likelihood of those risks crystallising and their potential materiality and the effectiveness of the control framework in mitigating each risk. This includes a thorough evaluation of how the Group would be impacted by severe, but plausible, periods of stress in its stress testing programme.

The purpose of the process is to establish the level and quality of capital resources that the business should maintain, both under current market conditions and under a range of stressed scenarios, in order to ensure that financial resources are sufficient to successfully manage the effects of any risks that may crystallise.

Leadership structure continued

Cyber resilience

The Group recognises the importance of cyber resilience. The Board oversees the Group's cyber resilience approach and the level of investment into cyber security, providing robust challenge and scrutiny to ensure that the Group is adequately mitigating the threats it faces. The Board recognises that specialist knowledge is required in this area and therefore seeks relevant advice from third parties where appropriate. The cyber resilience strategy is routinely monitored by the Risk Committee and reviewed by the Board on an annual basis. The review takes into account the latest cyber threat intelligence assessment, the specialist nature of cyber threats and any outsourcing risks faced by the Group in this area. This ensures that the strategy remains fit for purpose to combat the potential cyber threats the Group may face.

Relationship with Marlin Bidco Limited (the 'Shareholder')

The Group is committed to maintaining a constructive relationship with the Shareholder whilst not compromising its independence.

The Chief Executive Officer and the Chief Financial Officer meet with the Shareholder and their representatives on a regular basis outside of Board and Committee meetings. The Shareholder also meets with the Chairman and has the option to meet with other Non-Executive Directors on request.

To ensure that governance arrangements with the Shareholder are formalised, a Framework Agreement and Memorandum of Understanding outlining the responsibilities of each party was established following the change in ownership. The Framework Agreement ensures that information flows are clear, that the independent judgement of the Board is not impacted and that the Board retains its oversight of the business in respect of strategy, performance, risk appetite and assessment of the control framework and governance arrangements. The Memorandum of Understanding seeks to support and protect the independence of the Board, particularly in relation to the appointment of Non-Executive Directors to the Board and its Committees. It ensures that there will always be a majority of independent Non-Executive Directors in line with good governance practice and the Code. As set out in the Framework Agreement the Shareholder has appointed two Directors to the Board, both of whom are considered Institutional Directors.

The Group recognises the importance of ensuring effective communication with all of its stakeholders. This report, together with a wide range of other information, including the half-yearly financial report and regulatory announcements are made available on the Investor section of the Group's website at **https://www.shawbrook.co.uk/investors/**.

Directors' report

Corporate Governance Statement

The strategic report and corporate governance report found on pages 1 to 71, together with this report fulfils section 414C of the Companies Act 2006 by including, by cross reference, details of the Group's position on the Business Model and Strategy, Financial Risk Management Objectives and Policies, Business Overview, Future Prospects and Corporate Social Responsibility activities during 2018.

The Directors consider that the Annual Report & Accounts for the year ended 31 December 2018 taken as a whole are fair, balanced and understandable and provide the information necessary for the Shareholder and other stakeholders to assess the Group's Position and Performance, Business Model and Strategy.

During the period, the Directors have ensured the Group has given due regard to the provisions and principles set out in the Code. Additionally, in preparation for our adoption of the UK Corporate Governance Code 2018 from 1 January 2019, the Group undertook a review of its Corporate Governance Framework. We will report on our application of the UK Corporate Governance Code 2018 in next year's Annual Report.

Following the delisting of the Company in 2017 areas of the Disclosure and Transparency Rules which apply to the Group's Listed Debt are applied.

Results for the year

Results for the Group (including reconciliation of statutory results to underlying results) are laid out on pages 2 to 4. Consolidated statements for the Group are laid out on pages 135 to 139.

Dividends

The Directors are not recommending a final dividend (2017: nil) in respect of the year ended 31 December 2018.

Directors

The names and biographical details of the current Directors are shown on pages 37 and 38. Changes to the composition of the Board since 1 January 2018 up to the date of this report are shown in the table below:

Name	Joined the Board
John Callender	8 March 2018
Ian Cowie (attended Board meetings since July 2018)	7 February 2019

Name	Left the Board
Stephen Johnson	23 January 2018
Iain Cornish	8 March 2018
Steve Pateman	27 July 2018
Sally-Ann Hibberd	31 January 2019
David Gagie	31 January 2019

The Company Secretary during the year was Daniel Rushbrook.

Appointment and retirement of Directors

The Group's Articles of Association sets out the rules for the appointment and replacement of Directors. In accordance with the recommendations of the Code, all Directors shall retire from office and may offer themselves for re-appointment at the Annual General Meeting. This process is also supported by the Framework Agreement and Memorandum of Understanding.

The Directors' powers are conferred on them by UK legislation and by the Group's Articles of Association. Changes to the Group's Articles of Association must be approved by the Shareholders passing a special resolution and must comply with the provisions of the Companies Act 2006.

Directors' interests

None of the Directors hold shares in the Company. Lindsey McMurray and Cédric Dubourdieu are directors of Marlin Bidco Limited, the Group's 100% shareholder.

Directors’ report continued

Directors’ indemnities
The Group’s Articles of Association provide that, subject to the provisions of the Companies Act 2006, the Group may indemnify any Director or former Director of the Group or any associated Group against any liability and may purchase and maintain for any Director or former Director of the Group or any associated Group insurance against any liability.

The Directors of the Group have entered into individual deeds of indemnity with the Group which constituted ‘qualifying party indemnity provisions’ entered into by the Directors and the Company. The deeds of indemnity authorise the Directors to the maximum extent permitted by the law and by the Articles of Association of the Company, in respect of any liabilities incurred in connection with the performance of their duties as a Director of the Company and any associated Group company, as defined by the Companies Act 2006.

The Group has maintained appropriate Directors’ and Officers’ liability insurance in place throughout 2018.

Share capital
Shawbrook Group plc is a public company limited by shares.

Details of the Group’s issued share capital, together with details of the movements in the Group’s issued share capital during the year, are shown in Note 28 of the financial statements.

The Group’s share capital comprises one class of Ordinary Share with a nominal value of 0.01p each. At 31 December 2018, 253,086,879 Ordinary Shares were in issue. There were no share allotments in 2018.

Restrictions on the transfer of shares
According to the Articles of Association and prevailing legislation there are no specific restrictions on the transfer of shares of the Group.

Rights attaching to shares
On a show of hands, each member has the right to one vote at General Meetings of the Group. On a poll, each member would be entitled to one vote for every share held. The shares carry no rights to fixed income. No person has any special rights of control over the Group’s share capital and all shares are fully paid.

New issues of share capital
Under section 551 of the Companies Act 2006, the Directors may allot equity securities only with the express authorisation of Shareholders which may be given in general meeting, but which cannot last more than five years. Under section 561 of the Companies Act 2006, the Board may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to the Shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the Shareholder.

Purchase of own shares
Under section 701 of the Companies Act 2006 a Group may make a purchase its own shares if the purchase has first been authorised by a resolution of the Shareholder.

Significant Shareholder disclosure
The Group is 100% owned by Marlin Bidco Limited (the ‘Shareholder’).

Relationship with the Shareholder
Further information on the relationship with the Shareholder can be found on page 47.

Post balance sheet events
Details of any post balance sheet events can be found in Note 40 of the financial statements.

Business activities
The Group’s business activities, together with the factors likely to affect its future development and performance and its summarised financial position are set out on pages 1 to 33 of the strategic report.

Branches, future developments and financial risk management objectives and policies
The Group operates in the United Kingdom and has a branch in Jersey.

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

Further information on future developments of the Group please refer to the strategic report (pages 1 to 34).

Further information on internal control and financial risk management systems in relation to financial reporting of the Group please refer to the risk management report (page 72 to 123).

Further information on financial risk management objectives and policies in relation to the use of financial instruments of the Group please refer to the risk management report (pages 72 to 123).

Research and development activities
During the ordinary course of business, the Group develops new products and services within the business units.

Employees
The Group is committed to being an equal opportunities employer and opposes all forms of discrimination. Applications from people with disabilities will be considered fairly and if existing employees become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled employees.

The Group regularly provides employees with information of concern to them, which incorporates the Group's current performance and its future aims and strategies. During the year, employees were kept up to date with developments in strategy and changes to management through a number of channels. Specifically, the Chief Executive Officer has held all staff calls and introduced a platform to promote feedback to the Executive management team. The Group conducts an Annual Employee Survey and uses the results of this survey to improve performance in areas that are important to staff. A monthly newsletter providing business updates and background information on the Group is circulated to all staff.

Employee share schemes
Full details of the Group's employee share schemes are set out in Note 10 of the financial statements. During 2018 an Employee share scheme was established with the Shareholder, further details of this can be found in the Directors Remuneration report on pages 54 to 60.

Slavery and human trafficking
This statement is included in the Corporate social responsibility report on page 31.

Political and charitable donations
The Group did not make any political donations during the year (2018: £nil). Further information on charitable donations made by the Group can be found on page 33 as part of the Corporate social responsibility report.

Going concern
The financial statements are prepared on a going concern basis; the Directors are satisfied that the Group has the resources to continue in Business for the 12 months from the reporting date. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including the current state of the balance sheet, future projections of profitability, cash flows and capital resources and the longer-term strategy of the Business. The Group's capital and liquidity plans, including stress tests, have been reviewed by the Directors.

The Group's forecasts and projections show that it will be able to operate at adequate levels of both liquidity and capital for the 12 months from the reporting date, including a range of stressed scenarios, the availability of alternative sources of capital if required and appropriate management actions.

After making due enquiries, the Directors believe that the Group has sufficient resources to continue its activities for the 12 months from the reporting date and to continue its expansion, and the Group has sufficient capital to enable it to continue to meet its regulatory capital requirements as set out by the PRA.

Fair, balanced and understandable
Details of the governance procedures which have been embedded to support this can be found in the Audit Committee report at page 66.

Disclosure of information to the auditor
The Directors confirm that:

1. So far as each of the Directors is aware, there is no relevant audit information of which the auditor is unaware; and
2. The Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

Auditor
Resolutions to reappoint KPMG LLP as the Group's Auditors and to give the Directors the authority to determine the auditor's remuneration will be proposed at the Annual General Meeting.

Annual General Meeting
Shawbrook Group plc's fourth Annual General Meeting will be held on 7 May 2019.

By order of the Board

Ian Cowie
Chief Executive Officer

18 April 2019

Nomination Committee report

I am pleased to present my first report as Chairman of the Nomination Committee (the 'Committee'). With a number of changes at Board level, the Committee played a central role during the year in ensuring adequate succession planning to help contribute to the delivery of the Bank's strategy by ensuring the desired mix of skills and experience of Board members and Executive team members.

The Committee oversaw my appointment as Chairman and Ian Cowie's appointment as Chief Executive Officer. The recruitment processes, in each case, involved the engagement of an external recruitment consultant and was overseen by the Committee to ensure the required skill sets, knowledge and experience whilst complementing the existing Board of the Bank.

Ian Cowie was appointed after a thorough recruitment process involving external candidates. The Committee agreed that Ian, who held the interim position during the search, was the strongest candidate. This evidences the Committee's focus on Executive as well as Board level succession, talent and development, which enables the Bank to identify talent and have the right succession plans and development programmes in place to ensure opportunities for current and future leaders. In addition to this, the Committee also recommended the appointment of a number of senior management positions, including the new Chief Compliance Officer and Chief Technology Officer.

The Committee remains focused on diversity and inclusion, as reflected by us signing the Government's Women in Finance Charter, an initiative by HM Treasury which seeks to increase representation of women in financial services, particularly at senior levels.

Looking to 2019, the Committee will continue to keep under review the structure, size and composition of the Board and its Committees, as well as overseeing succession of senior management within the Bank. It will also consider progress against the recommendations of the independent externally facilitated Board Effectiveness Review.

Further information on the activities of the Committee is provided in the following report.

John Callender
Chairman of the Nomination Committee

18 April 2019

Role of the Nomination Committee

The Committee's principal function is to keep the Board's governance, composition, skills, experience knowledge and independence and succession plans under review and to make appropriate recommendations as to appointments to the Board.

As part of the identification and nomination process, the Committee carries out a formal selection process for Executive and Non-Executive Directors and subsequently recommends to the Board any new appointments. As set out in the Framework Agreement, Shareholder approval is then sought. The Committee also has oversight of the recruitment for anyone designated as a Senior Manager under the Senior Managers and Certification Regime.

Membership, composition and meetings

The Committee is chaired by John Callender (the Chairman of the Group) and its membership comprises five Non-Executive Directors a majority of whom are Non-Executive Directors in line with provision B.2.1 of the Code.

Meetings are held at least four times per year. The Committee met on six occasions during 2018 to discuss proposed appointments, succession and development and to evaluate the balance of skills, experience, independence and knowledge on the Board. Meeting attendance during 2018 is set out as follows.

Member	Meetings attended	Meetings eligible to attend as a member
Robin Ashton	5	6
Paul Lawrence	5	6
John Callender Joined 8 March 2018	5	5
Lindsey McMurray Joined 12 June 2018	5	5
Cédric Dubourdieu Joined 12 June 2018	5	5
Iain Cornish Stepped down 8 March 2018	1	1

* Iain Cornish did not attend meetings relating to his succession planning. In line with provision B.2.1 of the Code, Robin Ashton, as the Senior Independent Director chaired those meetings.

At the invitation of the Chairman of the Committee, on occasion, other attendees included the Chief Executive Officer and Human Resources Director.

Appointments

The Committee ensures that a diverse pool of candidates is considered for any vacancy which arises and any appointments are made based on merit, having regard to the skills, competencies and experience of the candidate.

During the year, a key focus for the Committee was the succession of the Chairman and Executive management team, more notably the Chief Executive Officer. The appointment process for the Chairman and Chief Executive Officer involved Ridgeway Partners and Korn Ferry respectively, who were appointed to support the search. Both recruitment partners confirmed on appointment that they have no other connection with the Group. For both appointments, the Committee were provided with a shortlist of candidates who were compared against the relevant role profiles and candidate briefs. Candidates were interviewed by members of the Committee and Executive management.

Recruitment for the Chairman commenced towards the end of 2017. The Committee appointed Ridgeway Partners to assist with the recruitment for the role. The specification for the role was agreed by the Committee, with input from the Chief Executive Officer, Group HR Director, Senior Independent Director and Committee members. Key attributes for the position included extensive banking and financial services experience with a prior role as Chairman in a financial services company of a significant size. Further to an extensive search of the market, the Committee appointed John Callender at the beginning of March 2018.

Recruitment for the Chief Executive Officer commenced in July 2018; Ian Cowie was appointed as Interim Chief Executive Officer to lead the Group whilst a search was undertaken. The specification for the role was agreed by the Committee, with input from the Group HR Director, Chairman and Committee members. Key attributes for the position included banking and financial services experience, working knowledge of consumer, business and property lending and leadership experience of a similar size business. Following an extensive process the Committee appointed Ian Cowie permanently to the role in September 2018 after holding the interim position since July 2018.

Diversity

The Group is committed to improving diversity in its membership and whilst new appointments continue to be based on skill, experience and knowledge, careful consideration is given to diversity. The Group continually supports the Women in Finance Charter, committing to increasing the representation of women across the business, particularly in relation to senior management.

When searching for candidates for Board appointments, the Committee takes into account a number of factors, including the benefits of diversity, including gender diversity, and the balance of the composition of the Board. The overriding requirement is to ensure that recommendations for appointments are made on merit against objective criteria, and that the best candidates are put forward for Board appointments.

Succession planning

The Committee is responsible for ensuring that appropriate succession and development plans are in place for appointments to the Board. We are satisfied that the succession planning structure in place is appropriate for the size and nature of the Group. The Committee considered in more detail succession planning for Executive management demonstrated through the appointment of Ian Cowie as Chief Executive Officer. Succession planning arrangements for both Board and Executive management will be kept under regular review throughout 2019.

Nomination Committee report continued

Executive and Non-Executive Director induction

All new Directors are required to undertake an induction programme, which includes comprehensive training on their Senior Managers and Certification Regime responsibilities. In addition, Directors are required to undertake training in the regulatory and compliance frameworks, and are also required to gain an understanding of relevant legal requirements such as Money Laundering legislation. Inductions include sessions with the Chairman, Directors, Executive management and external advisors to gain insight into the organisation. Training is tailored to the requirements of each Director's role, knowledge and experience.

Ian Cowie and John Callender received inductions tailored to their knowledge and experience, this included:

- understanding the role of sub-committees and governance structures;
- understanding the role of the Framework Agreement and Memorandum of Understanding
- gaining an overview of Board Director duties, responsibilities and protocols;
- reviewing past Board packs, Committee packs and minutes;
- gaining an understanding of current issues relevant to the Board;
- receiving an overview and understanding the strategic direction of the Group;
- receiving a full briefing on UK Conduct Standards, Senior Managers Regime and Prudential Regulation;
- receiving a full briefing on the UK Corporate Governance Code;
- meeting with Executive management to consider, in depth, the key challenges facing their businesses;
- meeting key external Group advisers; and
- holding discussions with the departing Chairman, Non-Executive and Executive Directors, Shareholder and Company Secretary.

In line with provision B.4 of the Code, in addition to providing an induction when Directors join the Board, care is taken to ensure they update and refresh their skills and knowledge.

Election of Directors

Having reviewed the findings of the Board effectiveness process, the Committee is satisfied that the Board continues to be effective and has recommended to the Board that each of the Directors should stand for re-election (in line with provision B.7.1 of the Code) at the next Annual General Meeting.

Primary areas of focus during the year

During the relevant period the Committee considered the following principal items:

- The appointment of a new Chairman;
- The appointment of a new Chief Executive Officer;
- A review and implementation of the outcomes of external Board effectiveness review;
- A review of succession planning for the Board and Executive management;
- The proposed election and re-election of Directors at the forthcoming Annual General Meeting; and
- Responsibilities under the Senior Managers and Certification Regime.

John Callender
Chairman of the Nomination Committee

18 April 2019

Directors' Remuneration report

On behalf of the Remuneration Committee, I am pleased to present the Directors remuneration report for the 2018 financial year.

The last year has seen the Bank continue to generate sustainable returns in an environment where economic and political uncertainties remain. Against this backdrop, the Committee reviewed performance against the annual bonus scorecard whilst also considering a range of broader factors, including overall Group performance, divisional performance and risk alignment, in order to determine the overall bonus pool for 2018. When determining individual annual bonus outcomes, as well as considering individual performance, the Committee undertook a review of bonus allocations throughout the Company to ensure individuals at all levels were rewarded appropriately.

During 2018, the Committee has, in addition to its routine activities, overseen the design of a new Management Incentive Plan, aimed at ensuring that our incentives appropriately reward strong performance and are aligned with the interests of our Shareholder. In doing so, we sought to take account of the regulatory landscape and broader market practice as well as internal factors including talent progression.

We saw a number of changes to the senior management team during 2018, including changes at Board level. In each of these cases, the Committee carefully considered any relevant compensation arrangements, reflecting performance to the point of departure. Further details on the termination arrangements for Board Directors are included in this report.

The Committee was also involved in the review of the reward proposition for the wider employee base. This review, based on feedback from employee engagement surveys, led to the introduction of a banding structure designed to bring clarity to the comparability of roles across the Bank and will provide a foundation upon which we can build a more transparent, reward and development offering going forward.

In keeping with its regulatory requirements and commitments under the Women in Finance Charter, the Bank published its 2017 and 2018 Gender Pay Gap outcomes during the course of the year. We recognise that, in line with many other financial services firms, our gap is significantly influenced by the number of high earning senior males in the organisation. However, we remain committed to creating a diverse and inclusive workplace and we have undertaken significant work during the year to foster a culture where everyone can thrive.

Looking to 2019, the Committee will maintain a balanced strategy to reward our employees in a manner which drives the long-term security, soundness and success of the Group. Supporting this, we will grant the first awards under our new Management Incentive Plan in 2019 to ensure that our senior leadership team is fully incentivised to grow the business over the long-term in a sustainable manner.

Robin Ashton
Chairman of the Remuneration Committee

18 April 2019

Directors' Remuneration report continued

Remuneration governance

Role of the Remuneration Committee (the 'Committee')

The Committee's principal function is to determine, for onward recommendation to the Board, the terms and conditions of employment, remuneration and benefits of each of the Chairman of the Board, Executive Directors, members of the Executive management, and all other Material Risk Takers. The Committee exercises independent judgement on remuneration policies and practices and the incentives created to align senior management's interests with those of key stakeholders.

Membership, composition and meetings

The Committee is chaired by Robin Ashton (the Senior Independent Director) and, as at the year end, its membership comprised of four Non-Executive Directors, one of whom is the Chairman of the Board and two Institutional Directors. The Committee is mindful of the provisions relating to remuneration within the Code and have continued to adhere to good governance practice during 2018.

The Committee met on seven occasions during 2018. In addition to cyclical agenda items, the Committee discussed the design of new long-term incentive arrangements due to be implemented in 2019 along with the remuneration terms for its new and departing executives, as well as proposed developments to the reward proposition for the Company's wider workforce.

Meeting attendance during 2018 is set out below.

Member	Meetings attended	Meetings eligible to attend as a member
Robin Ashton	7	7
Sally-Ann Hibberd Stepped down 31 January 2019	7	7
Paul Lawrence	6	7
Iain Cornish Stepped down 8 March 2018	0	1
Lindsey McMurray Joined 27 February 2018	6	7
Cédric Dubourdieu Joined 27 February 2018	7	7
John Callender Joined 8 March 2018	6	6

Andrew Didham was appointed to the Committee on 28 February 2019.

At the invitation of the Chairman of the Committee, on occasion, other attendees included the Chief Executive Officer and Group HR Director. No individual was present for discussions relating to their own remuneration.

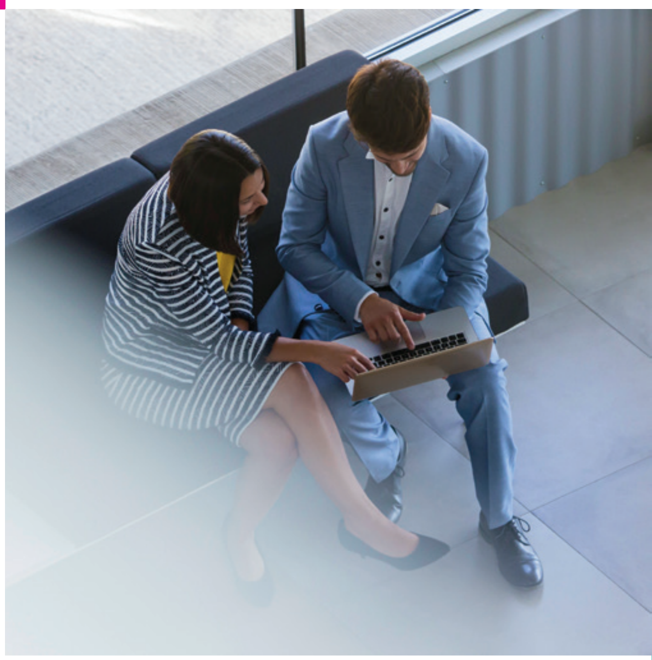
Deloitte LLP provided independent advice to the Committee on all executive remuneration matters. Deloitte LLP is a member of the Remuneration Consultants Group and is a signatory to its Code of Conduct. The Committee is satisfied that the advice received from Deloitte LLP was objective and independent.

In line with the Framework Agreement and Memorandum of Understanding the Shareholder has representation on the Committee. Where applicable decisions are escalated through the Board to the Shareholder for approval.

Guiding reward principles

The Group seeks to reward its employees fairly for their contribution and motivate them to deliver the best outcomes for all stakeholders. This is underpinned by the following principles:

- Reward structures will be developed in alignment with the Group's strategy, ensuring they meet appropriate regulatory requirements.
- Remuneration will be determined within the Group's stated risk appetite defined as maintaining a balanced strategy to reward our employees for appropriate conduct and performance. Safeguarding the right outcomes for customers is at the heart of this.
- There will be an appropriate mix of long-term and short-term variable pay arrangements in place, which will assist in driving the long-term security, soundness and success of the Group.
- The long-term and short-term variable pay plans will be subject to appropriate performance measures, ensuring the right balance between these elements of the reward package.
- Remuneration outcomes will be determined with reference to total reward principles. For example, when making bonus decisions, the Group will take into account an employee's total aggregate remuneration.
- Eligibility for, and payment of, any remuneration will be communicated in a clear and transparent way and in a timely manner.
- Reward structures will be designed to avoid any conflicts of interest. In this regard, employees in Control Functions will be remunerated independently from the performance of the business areas that they oversee.



Directors' Remuneration report continued

Directors' remuneration policy

Following the change in ownership and delisting of its securities in 2017, Shawbrook is no longer required to produce a Directors' Remuneration report in accordance with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended). However, for transparency the Board has produced the table below which summarises the key components of the Group's reward package and how these apply to the Executive Directors.

Element	Purpose & link to strategy	Operation
Salary	To provide a competitive level of base pay to attract and retain talent.	Base salaries are set with reference to the size and scope of the role, the external market as well as the skills and experience of the individual. Salaries are normally reviewed on an annual basis, with increases typically in line with the wider workforce.
Pension	To provide a competitive post-retirement benefit supporting the long-term financial wellbeing of employees.	Executive Directors may participate in the Group's Personal Pension Plan or receive a cash allowance in lieu of pension contributions. Currently Executive Directors receive an allowance of 15% of salary per annum.
Benefits	To provide a suite of competitive benefits to support the wellbeing of employees.	Executive Directors receive a range of benefits, including but not limited to private medical cover, life assurance and permanent health insurance. Additional benefits may be provided as reasonably required.
Annual bonus	To incentivise and reward the achievement of short-term financial and non-financial objectives which are closely linked to the Bank's strategy. Deferral encourages long-term focus and risk alignment.	Annual bonus awards are determined with reference to financial, non-financial and individual performance measures. The Committee considers the overall performance of the Group and the outcome of the independent risk adjustment process before finalising individual award levels. The normal maximum opportunity will be 100% of salary per annum. Awards over a threshold level (set by the Committee each year) are subject to deferral. Deferred awards will normally be released in equal tranches after one, two and three years, subject to continued employment. Annual bonus awards are subject to the Group's malus and clawback provisions.

Element	Purpose & link to strategy	Operation
Long-term incentives	To incentivise and reward the delivery of the Group's long-term strategy and growth over a sustained period.	Following a comprehensive review undertaken in 2018, the Group will be introducing a new Management Incentive Plan ('MIP') in early 2019, which the Executive Directors will participate in. Award levels under the MIP will be determined by reference to individual performance. The shares will deliver value to participants for growth in the underlying value of the Bank by reference to the achievement of hurdles which have been set relative to the Bank's current business plan. The value accrued under the MIP will ordinarily be released to participants at an exit event, i.e. the sale of the Group, the majority of its assets or an Initial Public Offering. The value of the business will depend not only on financial performance but also on the overall health of the business which will consider other non-financial factors. Awards will be subject to the Group's malus and clawback provisions. Participants will be offered the opportunity to fund the purchase price of the shares. Separately, participants will also have the opportunity to co-invest in the Group using their own funds. Any shares acquired via the co-investment will also be released at an exit event and will enable participants to share in the growth in value of the Group on a similar basis to the Shareholder.

Non-Executive Director Fees
The Chairman of the Board and Non-Executive Directors are entitled to an annual fee, with additional fees payable to the Senior Independent Director, the Chairman and members of the respective Committees of the Board. Fee levels are reviewed periodically.

Reasonable expenses incurred in the performance of Non-Executive duties may also be reimbursed or paid directly by the Group, as appropriate.

Directors' Remuneration report continued

Directors' Remuneration in 2018

The tables below set out the remuneration received by Executive and Non-Executive Directors during 2018. The numbers included in the table below have been audited.

Executive Directors	All Executive Directors[1]	2018 Highest paid Executive Director	All Executive Directors	2017 Highest paid Executive Director
Salary (£000)	**712**	**361**	1,185	625
Taxable benefits (£000)	**3**	**1**	5	2
Pension (£000)	**179**	**126**	303	219
Annual bonus (£000)	**670**	**500**	881	500
Subtotal (£000)	**1,564**	**988**	2,374	1,346
Shares vesting upon completion of change of ownership (£000)	**–**	**–**	1,782	875
Payments for loss of office (£000)	**1,214**	**983**	–	–
Total (£000)	**2,778**	**1,971**	4,156	2,221

Non-Executive Directors	2018	2017
Fees (£000)	**721**	686

[1] Following the resignation of Steve Pateman in July 2018, Ian Cowie assumed the role as Interim Chief Executive Officer. He was not however formally appointed to the Board of Shawbrook Group plc until 2019 and therefore his remuneration is not included in the above table.

Notes to the tables

Pension: All Executive Directors received their pension contributions during 2018 by way of a cash allowance.

Annual bonus: All Executive Directors, except Stephen Johnson who stepped down from the Board in January 2018, were eligible to participate in the annual bonus in 2018, with a maximum opportunity of 100% of salary.

The bonus pool outcome for the Group was determined through a rounded assessment of performance that included a review of the following key performance measures, as well as individual performance during the year:

Financial measures

- Profit before tax
- Return on tangible equity
- Cost to income ratio
- Cost of risk

Non-financial measures

- Risk management
- Stakeholder engagement, including customer and employee

When determining the bonus pool outcome, the Committee carefully reviewed performance against all of the above measures, whilst also taking into account broader considerations relating to overall Group and divisional performance, recognising the positive contribution made by senior management during a time of significant structural change for the Group.

The Committee also considered the outcomes of the Chief Risk Officer's independent report, noting the progress made with regards to risk management in the year, and the report from the Group HR Director on stakeholder engagement.

Overall, the Committee noted that the financial performance remained strong but grew on a trajectory that was lower than anticipated due to internal and external factors. The Committee was encouraged by the improvements seen during 2018 in a number of other areas, while acknowledging that there is still progress to be made. As a result, it set the bonus pool at a level which was below target.

Individual performance was assessed to determine individual award levels, and ahead of finalising these for 2018, the Committee reviewed the proposed distribution of awards throughout the organisation to ensure that individuals at all levels were fairly rewarded.

The value of awards for the Executive Directors are included in aggregate in the emoluments table above. In line with policy, 50% of any amount in excess of £100,000 will be subject to deferral in cash and released in three equal tranches after one, two and three years. In line with his departure terms, Steve Pateman's award will not be subject to deferral.

Share related benefits: No share related benefits were exercised during 2018.

Payments for loss of office: Both Steve Pateman and Stephen Johnson ceased to be Executive Directors during 2018, stepping down from the Board in July and January respectively. The Group made total payments to them of £1.2 million in respect of loss of office.

Directors' Remuneration in 2019

The Committee has determined that for 2019 the Remuneration Policy will be implemented as follows for Executive Directors.

Executive Director salaries: The Committee reviewed Executive Director salaries on an individual basis, in line with the normal annual salary review, and determined that no normal increases would be awarded at this time. Following his appointment as Chief Executive Officer, Ian Cowie's salary has been increased to £450,000 per annum.

Pension and benefits will continue to operate in line with the Remuneration Policy.

Annual bonus: The normal maximum annual bonus opportunity for Executive Directors will be 100% of salary. When determining the annual bonus outcomes for 2019, the Committee will give consideration to performance based on a range of key financial and non-financial measures, as well as the individual's overall performance and the outcome of the Chief Risk Officer's independent risk review.

Long-term incentive: The Group will be implementing the Management Incentive Plan in early 2019. The aim of such arrangements is to incentivise and align the interests of selected members of its senior management team with those of the Shareholder in the achievement of the Group's growth strategy to an exit event.

The structure of the plan is outlined in the policy table and it is intended that the initial awards will be granted in 2019.

Non-Executive Director fees

	Fee from 1 January 2019
Chairman fee	£200,000
Non-Executive Director base fee*	£65,000
Senior Independent Director fee	£10,000
Audit and Risk Committee Chairman fee	£20,000
Remuneration Committee Chairman fee	£5,000
Audit and Risk Committee membership fee	£5,000
Remuneration and Nomination Committee membership fee	£2,500

* Each Institutional Director appointed to the Board by the Shareholder, is paid a fee of £50k per annum as set out and agreed within the Framework Agreement.

Robin Ashton
Chairman of Remuneration Committee

18 April 2019

Audit Committee report

I am pleased to present the report of the Audit Committee. As a Committee, we possess recent and relevant financial experience in line with good governance practice across the sector and included within the Code.

The Committee has continued to focus on the issues relevant to the Group's financial reporting, considering emerging trends and overseeing the Group's internal control framework to ensure it remains robust and fit for purpose.

The Committee's annual work plan is framed around the Group's financial reporting cycle which ensures that the Committee considers all matters delegated to it by the Board and covers a review and challenge of the critical accounting estimates and judgments, which are set out in Note 1.9 of the financial statements. We also received reports from the Internal Audit function, which included IT Governance, intermediary monitoring and oversight, General Data Protection Regulations, product governance and complaints handling and Internal Liquidity Adequacy Assessment Process. During the year an effectiveness review was also carried out on the internal audit function.

In the year, the implementation of IFRS 9 has been a significant project across the Group. The Committee has specifically focused its attention on the modelling of the credit risk impairment adequacy and Expected Credit Loss (ECL). The Committee has received reports on the project at every meeting and has challenged management on the scenarios, modelling and assumptions during the implementation process and throughout the year. The changing macro-economic environment in relation to Brexit has been at the forefront of the Committee's discussions when considering our modelling judgements and the macroeconomic scenarios used within the ECL calculation.

Andrew Didham
Chairman of the Audit Committee

18 April 2019

Accountability

Role of the Audit Committee (the 'Committee)

The Committee is responsible on behalf of the Board for, amongst other things:

Financial reporting process

- the significant areas of judgement and their application to the results of the Group;
- reviewing the Group's Annual Report & Accounts and the Group's Interim Report to ensure that, taken as a whole, based on the information supplied to it and challenged by the Committee and on its judgement is fair, balanced and understandable and advising the Board to that effect;
- monitoring the integrity of the Annual Report & Accounts and the Interim Report and reviewing the critical accounting policies, disclosure obligations and changes in accounting requirements;
- reviewing and challenging the going concern and viability assessment undertaken by Executive management, further details of which can be found on page 64; and
- reviewing the Group's Pillar 3 disclosures to ensure compliance with prescribed requirements.

Internal controls and risk management

- considering the process used to evaluate the effectiveness of internal controls, financial reporting and risk management;
- considering the extent of the work undertaken by Group finance and ensuring team has adequate resources to ensure that the control environment continues to operate effectively;
- continuously considering any findings of internal investigations into control weaknesses, fraud or misconduct and management's responses to any deficiencies identified; and
- risk management consideration and monitoring is carried out in partnership with the Risk Committee.

External audit

- making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor and approving the auditor's remuneration and terms of engagement; and
- reviewing the findings of the external audit and the level of challenge produced by the external auditor and considering management's responsiveness to the findings and recommendations.

Internal audit

- monitoring the activity, role and effectiveness of the Internal Audit function and their internal audit plan;
- approving the annual internal audit plan and budget and monitoring the progress against it at regular intervals, confirming that appropriate resource and capability is in place to execute the plan effectively; and
- considering the internal audit reports, including thematic and routine reviews on prudential and regulatory compliance.

Whistleblowing

- continuously considering the Group's whistleblowing policies and procedures, including the protection of whistleblowers.

Membership and meetings

The Committee comprises six members. In line with provision C.3.1 of the Code, the majority of the Committee are Non-Executive Directors and have recent and relevant financial experience.

The Committee meets as required and met formally seven times last year. The attendance of Directors eligible to attend during the period is shown below.

Member	Meetings attended	Meetings eligible to attend as a member
Andrew Didham	7	7
Robin Ashton	5	7
David Gagie Stepped down on 31 January 2019	7	7
Paul Lawrence	7	7
Roger Lovering	7	7
Lindsey McMurray Joined 27 February 2018	6	6
Cédric Dubourdieu Joined 27 February 2018	4	6

During the year, the external auditor, Chairman of the Board, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, General Counsel and Company Secretary, Internal Audit and other senior managers as appropriate (where provision of clarification and explanation on reports is required) attended the meetings of the Committee. The Committee also met with the external and internal auditors without Executive Management during 2018.

The Board is satisfied that Andrew Didham has recent and relevant financial experience, as referred to in the Code. The Committee also believes it has the competence as a whole, relevant to the sector in which the Group operates. Biographical details can be found on pages 37 and 38.

A full copy of the terms of reference for the Committee can be obtained by request to the Company Secretary or via the Group's website at **www.shawbrook.co.uk/investors/**

Audit Committee report continued

Significant areas of judgement

During 2018, the following significant issues and accounting judgements were considered by the Committee in relation to the 2018 Annual Report & Accounts:

Reporting issue	How the Committee addressed the issue
Impairment of loans and advances	The Committee received presentations from Executive management explaining the impairment methodology across the Group's lending operations ahead of both the interim and full year results. The Committee considered and challenged the impairment methodology applied by management and also subsequently impacted by IFRS 9 (discussed further below), including the inputs to the statistical loan loss models prepared by the Group Risk function. The Committee also considered the calibration of model parameters in the light of economic indicators, including Brexit, house price movements and underlying book performance. The Committee reviewed the movements in arrears balances, impairment coverage ratios and non-performing loan ratios throughout the year and concluded that these were appropriately monitored during the year. The Committee reviewed the net asset values recognised in relation to investment made in relation to strategic change programmes, concluding that on balance the various remaining economic lives supported the continued recognition of net asset balance with a number of immaterial legacy projects being impaired where those useful economic lives were insufficient to support the net asset value. The Committee concluded that the impairment provisions, including management's judgements, were appropriate. Refer to Note 1.9(d) of the financial statements for further details.
IFRS 9	The Committee spent a considerable amount of time on reviewing the methodology and application of IFRS 9. Updates were provided at every meeting on the application of IFRS 9 and the impact of expected credit losses and credit risk impairment on each of the divisions and the Group as a whole. The Committee reviewed changes in all key impairment judgements prior to both the interim and full year accounts including recommendations on coverage ratios. This also included the Group's approach to delivering a forward-looking ECL and approved the scenarios and their probability of occurrence. The Committee has recognised the challenges IFRS 9 has presented and will continue to monitor the future expected credit losses and credit risk impairment closely into 2019.
Effective interest rate	Interest earned on loans and receivables is recognised using the Effective Interest Rate (EIR) method. The EIR methodology of accounting uses a discounted cash flow model to spread interest and fee income and expenses attributable to loan assets, including costs and other premium and discounts, over the estimated life of the asset. EIR is calculated on the initial recognition of loan lending through a discounted cash flow model that incorporates fees, costs and other premiums or discounts. There have been no changes to the EIR accounting policies during the year. The Committee considered and challenged the EIR methodology applied by Executive management, including expected future customer behaviours, redemption profiles and changes to existing redemption profiles and concluded that the EIR methodology was appropriate as at 31 December 2018. Refer to Note 1.9(a) of the financial statements for further details.
Impairment assessment of goodwill	The Committee considered and challenged the annual assessment of the carrying value of goodwill. Following the review and challenge of the Group's value in use calculations and key assumptions, the Committee agreed with management's conclusion that the Group's carrying value of goodwill as at 31 December 2018 was reasonably stated. Refer to Note 1.9(b) and Note 18 of the financial statements for details of impairment testing of goodwill and the impairment loss of £1.1 million recognised against the goodwill allocated to the Consumer cash generating unit.

Reporting issue	How the Committee addressed the issue
Conduct risk	The Group's Consumer Lending division is exposed to risk under s.75 of the Consumer Credit Act (CCA), in relation to any misrepresentations or breaches of contract by suppliers of goods and services to customers where the purchase of those goods and services is financed by the Group. While the Group would have recourse to the supplier in the event of such liability, if the supplier becomes insolvent then that recourse would have limited value. The Committee considered the increase in exposures to insolvent suppliers, specifically in the case of the Group's exposure to s.75 of the CCA relating to solar panels. Across 2018 the Group's Consumer Lending division has worked to ensure that all complaints relating to solar panels are being fairly addressed and resolved. The Committee concluded that the provisioning against conduct risk exposures was appropriate as at 31 December 2018. Refer to Note 1.9(c) of the financial statements and Section 9 of the risk management report for further details.

In addition to the matters described above, the Committee considered issues relating to IFRS 9 implementation including expected future credit losses, assumptions, macro-economic scenarios, changes in accounting methodology and operational changes in the finance function to accommodate IFRS 9. Also considered across 2018 were matters relating to hedge accounting, quality of the external audit, the future regulatory environment, Pillar 3 disclosures and a number of Internal Audit Reviews focusing on operating models and third party monitoring.

Financial reporting process

During the year, the Committee reviewed and discussed the financial disclosures made in the Annual Report & Accounts and half-yearly financial report, together with any related management letters, letters of representation and reports from the External Auditors. Significant financial reporting issues and judgments were considered together with any significant accounting policies and proposed changes to them.

Going concern and long-term viability

The Committee reviewed a detailed paper presented by management setting out the assumptions underlying the going concern statement. The paper covered the capital position of the Group, embedding of the Group's Risk Management Framework and governance, and the work performed on the Group's ICAAP and ILAAP. Based on the work performed, the Committee concluded that the Group will have adequate resources to continue in operational existence for the period of assessment of 12 months from the date of signing the accounts. The Committee reported accordingly to the Board, which also considered Going Concern in detail.

In order to support the Board's approval of the statement on page 123 as to the longer-term viability of the Group, the Committee reviewed papers from management setting out the intended approach to the disclosures and providing details in support of the statement based in particular on the Group's medium term plan and the results of stress testing.

Internal controls

The Committee annually assesses principal risks and uncertainties on a financial control basis. Details of the risk management systems in place and principal risks and uncertainties are provided within the Risk management report on pages 72 to 123. The Group's system of internal control has been designed to manage risk and whilst risk cannot be eliminated, the system assists with the provision of reasonable assurance against material misstatement or loss.

The Committee receives reports on a regular basis on compliance with the Group's policies and procedures and the effectiveness of the Group's systems and controls.

The Risk and Internal Audit functions review the extent to which the system of internal control is effective; is adequate to manage the Group's principal risks; safeguards the Group's assets; and, in conjunction with the Company Secretary and the Group's Legal and Compliance functions, ensures compliance with legal and regulatory requirements. It provides independent and objective assurance on risks and controls to the Committee and Executive management.

Audit Committee report continued

Internal Audit

The Internal Audit function as the third line of defence is outsourced to Deloitte LLP providing assurance to the Group that the specialist nature of the Group's activities can be fully assessed. The role of the Internal Audit function and the scope of its work continue to evolve to take account of changes within the business and emerging best practice.

The work of Internal Audit is focused on areas of greatest risk to the Group, as determined by a structured risk assessment process involving Executive management. The output from the process is summarised in an internal audit plan, which is approved by the audit Committee annually.

On behalf of the Board, the Committee through discharging its responsibilities under its terms of reference undertakes regular reviews of the effectiveness of the Group's systems of internal control as detailed in the section above. The Group has outsourced the Internal Audit function to Deloitte LLP since June 2013. The Committee is satisfied that in 2018 this continued to be the most appropriate way of managing the delivery of Internal Audit services.

The terms of reference of the Internal Audit function are set out in the Internal Audit Charter. The Committee approves the annual audit plan and audit methodology for Internal Audit and monitors progress against the plan during the year. The Internal Audit Partner agrees the programme of work and reports directly to the Committee on the outcomes. Additional and project assurance reviews are carried out this also includes follow up audits to test internal controls as required and requested by the Committee.

Internal Audit carried out a significant number of audits during 2018 of varying size and complexity. Thematic audits focused on, amongst other things, Financial Crime, IT Patch Management, Operational Risk Management, Pillar 3 disclosures and prudential regulatory ratios, Divisional deep dives, Arrears and Forbearance, the Senior Manager Regime and Cashflow forecasting. Internal Audit reports are circulated to the Committee members prior to each scheduled meeting and the Committee monitors progress against actions identified in these reports.

The Committee monitors and reviews Internal Audit's effectiveness annually, using feedback from the Board, senior management and other stakeholders of the internal audit process. Additionally, the Committee ensures that there are sufficient resources available to Internal Audit to complete its remit. Internal Audit has unrestricted access to all Group documentation, premises, functions and employees as required to enable it to perform its functions. The appointment and removal of the Internal Audit function is the responsibility of the Audit Committee.

External Audit

The Committee oversees the relationship with the external auditor and considers the external auditor's engagement (including remuneration), their effectiveness, their continued independence and their objectivity. The Committee also considers the audit and audit strategy (including the planned levels of materiality). The external auditor attends the Committee meetings as appropriate and meets at least annually with the Committee without Executive management. The Chairman of the Committee also meets privately with the external auditor before each Committee meeting.

During the year, the Committee received regular detailed reports from the external auditor including formal written reports dealing with the audit objectives; and reports on: the Auditors' qualifications, expertise and resources; the effectiveness of the audit process; procedures and policies for maintaining independence; and compliance with the ethical standards issued by the Auditing Practices Board. The external auditor's management letter is reviewed, as is management's response to issues raised and progress is monitored against actions identified in these reports. The Committee monitors the provision of non-audit services by the external auditor throughout the year.

External Audit independence and objectivity

The Committee is responsible for reviewing the independence of the Group's external auditor, KPMG LLP and making a recommendation to the Board on their engagement. KPMG LLP has a policy of partner rotation which complies with regulatory standards. The Committee monitors the latest ethical guidance regarding rotation of audit partners.

Maintaining an independent relationship with the Group's auditor is a critical part of assessing the effectiveness of the audit process. The Committee has a formal policy on the use of the auditor for non-audit services. It ensures that work is only awarded when permissible and if the auditor's knowledge, skills or experience are a decisive factor and therefore clearly preferred over alternative suppliers.

The Committee receives and reviews each year an analysis of all non-audit work and reviews the level of audit and non-audit fees paid to KPMG LLP and also ensures that significant assignments are not awarded without first being subject to the scrutiny of the Committee. The fees paid to KPMG LLP for audit and non-audit services are set out in Note 8 of the financial statements.

Non-Audit services policy

The key principles of the policy on non-audit services are:

(i) Prohibited services include services remunerated on a success fee or participation in activities normally undertaken by Management.

(ii) The Committee approved a list of permitted audit related reviews of the Group's interim results or any other review of its accounts for regulatory purposes. (Details of the services provided by the external auditor can be found in Note 8 of the financial statements).

(iii) The Committee maintains a list of prohibited services which is aligned to the 'blacklist' of services set out in the EU Audit regulations and directives.

(iv) Pre-approved services up to £100,000 require approval by the Chief Financial Officer/Chief Executive Officer or the Chairman of the Audit Committee. All services that are not pre-approved, or are discretional or exceed the monetary threshold of £100,000 should be referred to the Audit Committee for approval.

The Committee reviewed payments for non-audit services and confirms that no prohibited services were provided by the external auditor and it is satisfied that the policy on the supply of non-audit services could not lead to audit objectivity and independence being compromised.

During the year the Committee assessed the effectiveness of the external auditor. The review included seeking the views of Committee members and Executive management. The review concluded that the external audit process was effective.

The Committee is satisfied with the performance of the external auditor in 2018 and the policies and procedures in place to maintain their objectivity and independence, and has recommended that they be re-appointed at the forthcoming Annual General Meeting.

Whistleblowing

A formalised whistleblowing policy and procedure for staff to raise issues regarding possible improprieties in matters of financial reporting or other matters has been established and was reviewed during the year. The Committee is responsible for monitoring the effectiveness of the Group's whistleblowing procedures and any notifications made. The Committee is charged with ensuring that appropriate arrangements are in place for employees to be able to raise matters of possible impropriety in confidence and performing suitable subsequent follow up action. An alternative reporting channel also exists whereby perceived wrongdoing may be reported via telephone to an external third party.

The Committee has access to the services of the Company Secretarial function and is authorised to obtain independent professional advice if it considers it necessary.

Governance

The Committee's effectiveness was reviewed as part of the overall Board effectiveness review with any outcomes in the process of being implements. The Committee also considered its terms of reference on an annual basis to ensure that they remain relevant and apply any changes or updates to Code and regulatory requirements for Audit Committees.

Fair, balanced and understandable

The Committee considered on behalf of the Board whether the 2018 Annual Report & Accounts taken as a whole is fair, balanced and understandable, and whether the disclosures are appropriate. The Committee is satisfied that the 2018 Annual Report & Accounts meets this requirement, and in particular, that appropriate disclosure has been made with respect to any developments in the year. In justifying this statement, the Committee has considered the robust procedures around the preparation, review and challenge of the Report and the consistency of the narrative sections with the financial statements. The Annual Report & Accounts is drafted by executive management with overall governance and co-ordination provided by a team of cross functional senior management.

Assurances are sought by the Committee on each section of the Annual Report in advance of final sign-off by the Committee and ultimately the Board.

Following its review, the Committee is satisfied that the Annual Report is fair, balanced and understandable, and provides the information necessary for the Shareholder and other stakeholders to assess the Group's position and performance, business model and strategy and has advised the Board accordingly.

Andrew Didham

Chairman of the Audit Committee

18 April 2019

Risk Committee report

I am pleased to present the report of the Risk Committee. The Committee's key role is to provide oversight of and advice to the Board on the management of risk across the organisation, balancing the agenda between risk exposure and the future risk strategy of the Group. The Committee has further provided oversight, review challenge of the suitability of the Group's Risk Management Framework.

The Committee had a full agenda in 2018 which involved oversight of current areas of risk management whilst ensuring emerging risks are appropriately addressed. Specifically, as a Committee we have taken a closer look at our three divisions, focusing on areas such as responsible lending (including affordability), product governance and quality control and quality assurance.

We have continued to evolve and embed an appropriate risk culture across the Group providing consistent challenge to the suitability of scenarios and stress testing in light of the changing macro-economic environment, specifically in relation to Brexit and its impact on the Group's wider risk profile and appetite.

Proposals for the introduction of two new products were also recommended to the Board for approval within the Business Finance division. The Group has also undertaken a significant review and challenge of the Capital Contingency Plan and the Business Continuity Plan (BCP) with a full test of the BCP having been carried out.

The Committee reviewed and recommended to Board for approval the 2018 Risk and compliance plan. The annual review of the Board's risk appetite and the ICAAP. The Committee oversaw the development of the Capital Contingency Plan (CCP) and the Liquidity Contingency Plan (LCP) including the development of early warning indicators and triggers. The Committee also received the Recovery Plan and Resolution Pack (collectively the RRP) and oversaw the first fire drill of the plan and the development of the recovery plan playbook.

The Committee has kept under review the more immediate risks of Brexit whilst also reviewing other risks on the horizon which could have a material impact on the Group looking forward into 2019. I believe that the Committee has established itself as a valuable governance forum for the oversight and monitoring of the environment which the Group operates. Moving into 2019 the Committee will continue to monitor and assess the risks facing the Group and provide valuable insight in what is looking to be a challenging operating environment.

Paul Lawrence
Chairman of the Risk Committee

18 April 2019

Risk Committee (the 'Committee') membership

The Committee comprises six members, a majority of whom are Independent Non-Executive Directors of the Group.

The Committee meets as required, but holds at least six meetings a year. The Committee had six scheduled meetings last year and three additional meetings, to discuss and review the key movements of ICAAP and an annual review of the Group's risk appetite.

The attendance of Directors, at the scheduled meetings is shown below:

Member	Meetings attended	Meetings eligible to attend as a member
Paul Lawrence	5	6
Robin Ashton	5	6
David Gagie Stepped down on 31 January 2019	5	6
Sally-Ann Hibberd Stepped down on 31 January 2019	5	6
Roger Lovering	5	6
Andrew Didham	6	6
Lindsey McMurray Joined 27 February 2018	4	4
Cédric Dubourdieu Joined 27 February 2018	3	4

During the year, the members of the Committee were Andrew Didham, Paul Lawrence, Robin Ashton, David Gagie, Sally-Ann Hibberd, Lindsey McMurray, Cédric Dubourdieu and Roger Lovering, who (with the exception of Sally-Ann Hibberd) also served on the Audit Committee throughout the reporting period.

During the year, the Chairman of the Board, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, General Counsel and Company Secretary, Internal Audit, External Auditor and other senior managers as appropriate (where provision of clarification and explanation on reports is required) attended the meetings of the Committee.

Role of the Risk Committee

The purpose of the Committee is to assist the Board in its oversight of risk within the Group, with particular focus on the Group's risk appetite, risk culture, risk profile and the effectiveness of the Group's Risk Management Framework. As well as reviewing the Group's risk assessment processes and methodology it identifies and manages new risks, alongside advising on proposed transactions and reviewing reports on any material breaches of risk limits. The Committee is also responsible for monitoring and reviewing the effectiveness of the risk function and the capital adequacy requirements of the Group's relevant subsidiaries on an ongoing basis.

Over the course of 2018, the Committee considered a wide range of risks facing the Group both standing and emerging, across all areas of risk management in additional to risk appetite, conduct and culture. On the following page is an outline of these risks with a summary of the material factors considered by the Committee including the conclusions which were ultimately reached.

Governance

The Committee's effectiveness was reviewed as part of the overall Board effectiveness review, with any outcomes for the review in the process of being implemented. The Committee also consider its terms of reference on an annual basis to ensure that they remain relevant and apply any changes or updates to Code and regulatory requirements.

Risk Committee report continued

Significant risks and primary areas of focus during 2018	Risk Committee review
Enterprise risk management	■ The Committee reviewed and recommended for the Board's approval the Risk Management Framework for the Group. ■ The Committee reviewed and recommended for the Board's approval the 2018 Risk and Compliance Plan which included the key areas of focus for the Risk function. ■ The Committee received regular summaries of the enterprise risk profile of the Group through the Chief Risk Officer's report. ■ The Committee reviewed the top and emerging risks for the Group prior to the Interim Report and Annual Report and Accounts. ■ The Committee reviewed the effectiveness of the Risk Management Framework throughout the year through the Chief Risk Officer's report. ■ The Committee received updates on the three lines of defence system through the Chief Risk Officer's report and challenged the effectiveness of quality control and assurance across the divisions.
Board risk appetite	■ The Committee reviewed and recommended for the Board's approval the annual review of the Board's risk appetite statement including material risk appetite limits. ■ The Committee received regular updates on the evolving risk appetite framework, including the provision of a monthly risk appetite dashboard which accompanies the Chief Risk Officers report at each meeting. ■ The Committee reviewed the appropriateness of the risk appetite framework and statements to ensure alignment with enhancements in risk measurement.
Credit risk	■ The Committee received regular updates on the Group's preparations for IFRS 9, this included a joint session with the Audit Committee to understand the impact of future expected credit losses across the divisions. ■ The Committee reviewed and recommended for the Board's approval a number of new and the annual review of a number of Asset Class policies.
Operational risk	■ The Committee reviewed updates on the lessons learnt following the responsible lending review and received updates on implementation of improved decision metrics for Consumer and operational resiliency. ■ The Committee received updates on a wide range of operational risks across the year, including quality control and assurance in underwriting. ■ The Committee received updates the testing of the Cyber Incident Response Plan.

Significant risks and primary areas of focus during 2018	Risk Committee review
Conduct, legal and compliance risk	■ The Committee reviewed the Group's Annual Compliance Monitoring Plan and updates on performance. ■ The Committee received updates on various conduct risk and legal liability risk matters, including training on the new conduct risk framework introduced by the regulator. ■ The Committee reviewed the Group's approach to conduct risk throughout the year in relation to insolvent suppliers through the Chief Risk Officers report.
Liquidity and market risk	■ The Committee reviewed and recommended to the Board approval of the Internal Liquidity Adequacy Assessment Process (ILAAP). ■ The Committee reviewed and recommended to the Board approval of the Contingent Liquidity Plan (CLP).
Stress testing and capital	■ The Committee reviewed the Group's Internal Capital Adequacy Assessment Process (ICAAP) in January 2018 and was actively engaged in the oversight of the risk assessment leading to the recommendation for the Total Capital Requirement (TCR), macroeconomic stress testing, the development of idiosyncratic stress tests and reverse stress testing. The ICAAP was completed under IFRS 9 and included the impact of PS22/17 ■ The Committee received the Capital Contingency Plan (CCP) during the year including the development of early warning indicators and triggers.
Recovery and resolution plan	■ The Committee received the Recovery Plan and Resolution Pack (collectively the RRP) and recommended to Board for approval. The RRP included a recovery plan playbook to support the Group in navigating a crisis and the first 'fire drill' test of the recovery plan in September 2018. ■ The Committee received updates on testing of the Business Continuity Plan.

Risk Committee report continued

Areas of focus during the year

Throughout the year the Committee has continued to monitor the effectiveness of the Risk Management Framework (RMF) across the business with a particular focus on quality assurance and control whilst continuing the embedding of the spirit of the RMF across all of the divisions. The Committee has driven additional review on responsible lending and affordability across all divisions. Building on the outcomes of the FCA audit, the Committee have continued to challenge procedures, policies and processes in place for responsible lending Group wide. This has led to a work stream being created for the development of a Group-wide Affordability policy. The Committee continue to challenge the business areas to ensure all training, policies, procedure and process are aligned to the expectations of the FCA.

The Committee have continued review the contingent liability risk faced by the Group's Consumer Lending division involving suppliers who have gone into liquidation alongside the Audit Committee. The Committee have throughout the year held focused discussions on conduct risk in relation to the responsibilities of the Group and ensuring that these are being monitored and managed appropriately.

Other matters considered in detail by the Committee in 2018

- New product approvals.
- IFRS future expected credit loss.
- EU General Data Protection Regulations.
- Annual insurance review.
- Specific focus on conduct risk matters and affordability across all divisions.

Priorities for 2019

The key projects which the Group Risk function are accountable for delivering in 2019 include:

- Development and implementation of a Group Affordability policy;
- Delivery of the Financial Crime Framework review in partnership with the Chief Compliance Officer;
- In partnership with the Chief Operating Office, enhance Operational Resiliency across the Group;
- Continued embedding of the credit grading system across all divisions in the Group.

Paul Lawrence
Chairman of the Risk Committee

18 April 2019

Risk management report

Risk management report.

1. The Group's approach to risk management

The Group seeks to manage the risks inherent in its business activities and operations through close and disciplined risk management which quantifies the risks taken, manages and mitigates them as far as possible and prices appropriately for the residual level of risk carried in order to produce an appropriate commercial return through the cycle.

The Group's approach to risk management continues to evolve and has benefited from further investment during 2018 in areas such as conduct, compliance, financial crime, technology and the embedding of credit grading within the overall implementation of IFRS 9. There has been further investment in the Group's key operating divisions including additional capacity, quality control and quality assurance and portfolio management to support the Group's lending objectives. The Group's Risk Management Framework was further enhanced in 2018, reflecting an increased focus on capacity and capability in the first line of defence in support of lending growth, technology risk to support the Group's digital strategy and the maturity of the Group's quality assurance and financial crime capabilities. The Group also appointed a Data Protection Officer in 2018 and implemented a new Privacy Working Group as a sub-group of the Enterprise Risk Management Committee to oversee the privacy framework.

This enterprise wide Risk Management Framework is underpinned by the following key elements:

Risk strategy
The risk strategy sets out the risk management objectives which support the achievement of the Group's commercial goals and the operation of business activities which seek to deliver those aims. The risk strategy sets out which risks are to be acquired or incurred and how they will be managed by the organisation.

The strategic risk management objectives are to:
Identify material risks arising in the day-to-day activities and operations of the Group
Quantify the risks attached to the execution of the Group's business plans
Set an appropriate risk appetite with calibrated measures and tolerance levels
Optimise the risk / reward characteristics of business written
Set minimum standards in relation to the acquisition, incurrence and management of risk
Secure and organise the required level and capability of risk infrastructure and resources
Undertake remedial action where any weaknesses are identified
Scan the external horizon for emerging risks

Risk appetite
The level of risk that the Group is willing to tolerate in operating the various elements of its business are defined in a risk appetite statement, which is agreed by the Board and reviewed on a regular basis. This articulates qualitative and quantitative measures of risk which are cascaded across various areas of the Group's operations, calibrated by reference to the Group's absolute capacity for risk absorption, limit of appetite and target thresholds. During 2018, the Group completed a full review of the Group risk appetite framework incorporating greater alignment to the Group Risk Management Framework, enhancements in risk measurement and reflecting changes in the ownership of the Group. The review included a full annual review of the divisional and functional risk appetite statements.

Risk Management Framework
All of the Group's business and support service activities, including those outsourced to third party providers or originated via brokers and other business intermediaries, are executed within the parameters of a single comprehensive Risk Management Framework (RMF). This sets out minimum requirements and ensures consistent standards and processes are set across the organisation. Risks are identified, measured, managed, monitored, reported and controlled using the RMF. The design and effectiveness of the framework is overseen and reviewed by the Risk Committee. The key elements of the framework are set out later in this report.

Governance
All the Group's risk activities are subject to detailed and comprehensive governance arrangements which set out how risk-based authority is delegated from the Board to Executive management and the various risk management committees and individuals. These bodies and senior officers are accountable and responsible for ensuring that the day-to-day risks are appropriately managed within the agreed risk appetite and in accordance with the requirements of the RMF. Escalation and reporting requirements are set out in risk policies and by the risk appetite thresholds.

Culture
The Group is led by an experienced Executive management team with a combination of significant underwriting expertise and institutional and regulatory banking experience at various major financial institutions and specialist lenders. This heritage provides the platform for a set of values and behaviour where the customer is at the heart of the decision-making process and business areas are held fully accountable for risk performance. At the individual level this process begins with the induction programme and job descriptions, is carried into the setting of individual objectives and performance reviews and ultimately reflected in the compensation and reward structure.

Risk appetite statement

The risk appetite statement is a detailed and granular expression of the level of risk the Group is willing to accept in relation to the pursuit of its business strategy. The risk appetite statement is not static and will evolve to both reflect and support the Group's business objectives, the operating environment and risk outlook.

Whilst the risk appetite statement provides an aggregated measure of performance against risk appetite, it is not just a reporting tool. Just as importantly, it also provides a framework which is used dynamically to inform strategic and operational management decisions, as well as supporting the business planning process.

The risk appetite statement is reviewed periodically by the Risk Committee and agreed with the Board on an annual basis as a minimum. A dashboard with the status of each metric is monitored monthly. Executive Management and the Board exercise their judgement as to the appropriate action required in relation to any threshold trigger breach, dependent on the scenario at the time.

The risk appetite statement identifies six groups of risk appetite objectives which are further subdivided into 26 appetite dimensions as set out diagrammatically overleaf. A suite of qualitative statements and quantitative measures have been set for each dimension, with risk limits calibrated by reference to absolute capacity, maximum risk tolerance and a threshold trigger level.

1. The Group's approach to risk management continued

Risk appetite statement objectives and dimensions

Risk appetite objectives	Strategic risk	Liquidity and market risk	Creditworthiness and concentration risk	Operational risk	Conduct	Reputation
Risk appetite dimensions	Profit volatility Financial strength Lending growth	Funding and liquidity Interest rate risk in the banking book	Creditworthiness risk Concentration risk	Technology (including systems) Physical assets and security Information risk Operations risk Change risk Third parties People Financial crime New product approval Financial reporting Model risk	Product design Sales and distribution risk Postsales service Culture	Regulatory perception Change perception Media promoter Social advocacy

Risk Management Framework

Responsibility for risk management sits at all levels across the Group from the Board and Executive Committee down through the Group's divisions, central functions, and in turn to each divisional head and their business managers and risk officers.

In 2018, the Group continued to invest in its risk management capability to position the Group to deliver its strategic and commercial objectives. This included improving the capacity and capability across the Group and specifically included the Executive Committee appointment of a Chief Technology Officer and the appointment of a new Chief Compliance Officer.

The Group's RMF describes the various activities, techniques and tools which are mandated to support the identification, measurement, control, management, monitoring, reporting and challenge of risk across the Group. It is designed to provide an integrated, comprehensive, consistent and scalable structure which is capable of being communicated to and clearly understood by all our employees and is described in the sections overleaf.

The RMF also incorporates the organisational arrangements for managing risk with specific responsibilities distributed to certain functions. This ensures that there is clear accountability, responsibility and engagement at appropriate levels within the organisation which can provide robust review and challenge as well as be challenged. Operationally, the RMF is organised around the key risk categories (see Section 4).

2. Risk governance and oversight

Risk governance describes the architecture through which the Board allocates and delegates primary accountability, responsibility and authority for risk management across the organisation.

Responsibility for risk oversight is delegated from the Board to the Risk Committee and Audit Committee. The ultimate responsibility for risk remains with the Board.

Accountability, responsibility and authority for risk management is delegated to the Chief Executive Officer and Chief Risk Officer, who in turn allocate responsibility for oversight and certain approvals across a number of management committees.

Authority and responsibility for material operational risk management, decision-making and risk assurance is vested in the Chief Risk Officer and the Risk function. Lesser levels of authority are cascaded to the Senior Management within the support functions and business divisions.

Oversight of the key risk categories

Oversight	Board			
	Risk Committee			Audit Committee
Risk category	**First line**	**Second line**		**Third line**
Creditworthiness risk	Credit management in business areas	Credit risk	Enterprise Risk Management Committee	Internal audit
Liquidity and market risk	Treasury	Market and liquidity risk	Asset and Liability Committee	Internal audit
Operational risk	All business divisions, functions and Chief Operating Office	Operational risk	Enterprise Risk Management Committee	Internal audit
Conduct, legal and compliance risk	All business divisions	Compliance	Enterprise Risk Management Committee	Internal audit
Strategic risk	Executive Directors and Senior Management	Finance	Executive Committee	Internal audit
Systems and change risk	Infrastructure and technology / Innovation and delivery	Operational risk	Enterprise Risk Management Committee	Internal audit

These bodies and senior officers are accountable and responsible for ensuring that the risks are appropriately managed within the agreed risk appetite and in accordance with the requirements of the RMF.

Individuals are encouraged to adopt an open and independent culture of challenge which is important in ensuring risk issues are fully surfaced and debated with views and decisions recorded. Risk governance and culture is reinforced by the provisions of the Senior Managers and Certification Regime.

Formal risk escalation and reporting requirements are set out in risk policies, individual committee terms of reference and the approved risk appetite thresholds and limits.

2. Risk governance and oversight continued

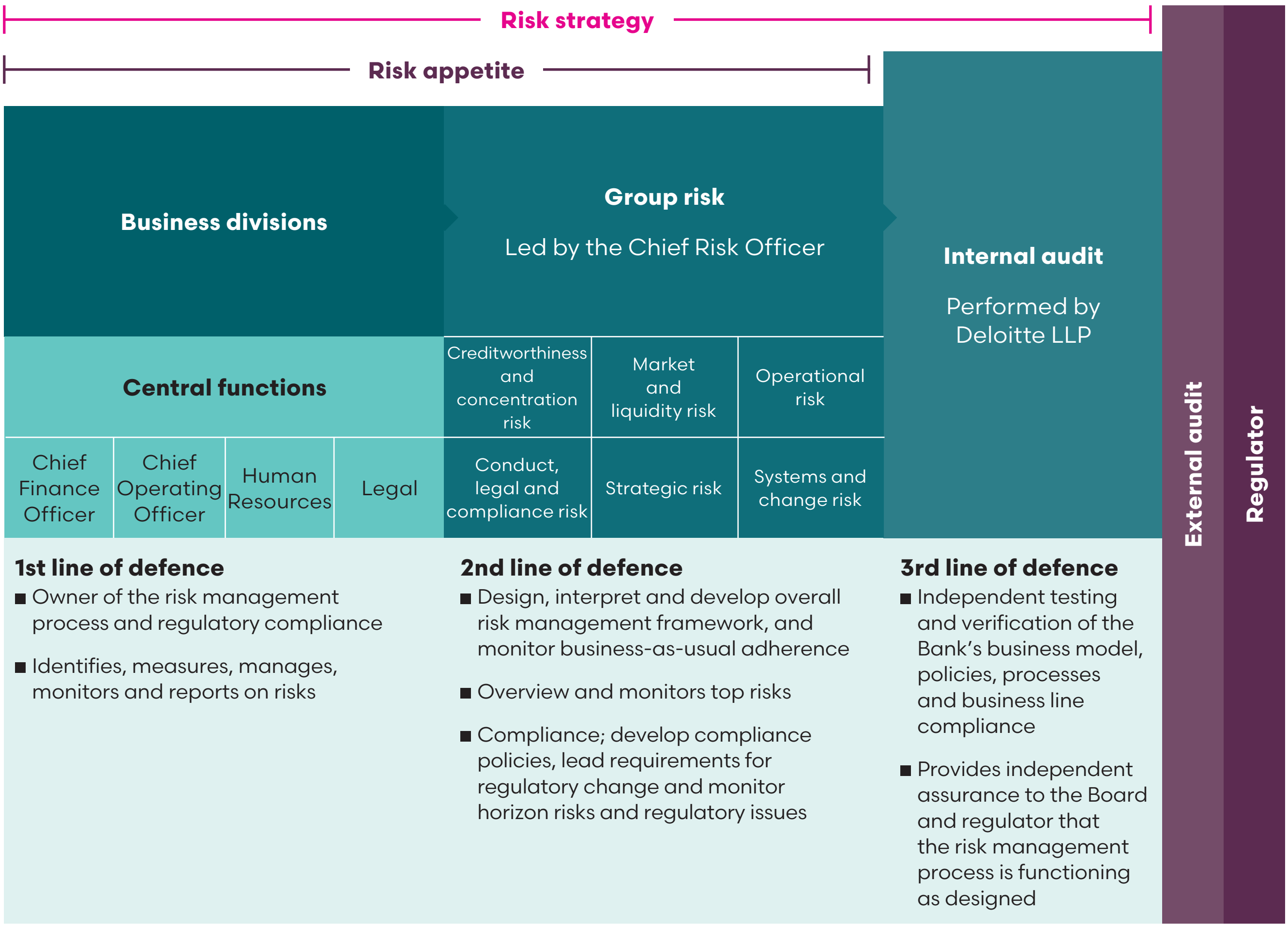
Committee structure and risk responsibilities

An abbreviated Board and Management Committee structure is set out in the corporate governance report at pages 39 to 40. The monitoring and controlling of risk is a fundamental part of the management process within the Group. The Board oversees the management of the key risk categories across the organisation.

During 2018, the Group made a number of changes to enhance its risk governance. The Chief Risk Officer re-instated the Regulatory Change Working Group to oversee the early identification and implementation of changes in the regulatory landscape. The remit of the Policy Review Group was also widened to provide consistency in policy development, approval and the annual review cycle across the Group.

Three lines of defence model

The Group's RMF is underpinned by the 'three lines of defence' model which is summarised in the diagram below:



The Group implemented a change to its key risk categories in 2018 to reflect the Group's focus on assessing a customer's ability and willingness to pay as an integral part of its credit assessment.

First line of defence

Responsibility for risk management resides in the front-line business divisions and central functions, and line management is directly accountable for identifying and managing the risks that arise in their business or functional area. They are required to establish effective controls in line with Group risk policy and act within the risk appetite parameters set and approved by the Board. The first line of defence comprises each of the three lending divisions. The first line of defence also includes the Finance function led by the Chief Finance Officer, Operations led by the Chief Operating Officer, Human Resources led by the Group Human Resources Director and Legal led by General Counsel and Company Secretary. Whilst Human Resources and Legal are not customer facing themselves, they provide support and back-up to the customer facing divisions and have insight into many operational factors that could ultimately impact on Group's exposure to market, liquidity, credit, regulatory, legal, conduct, compliance and operational risk.

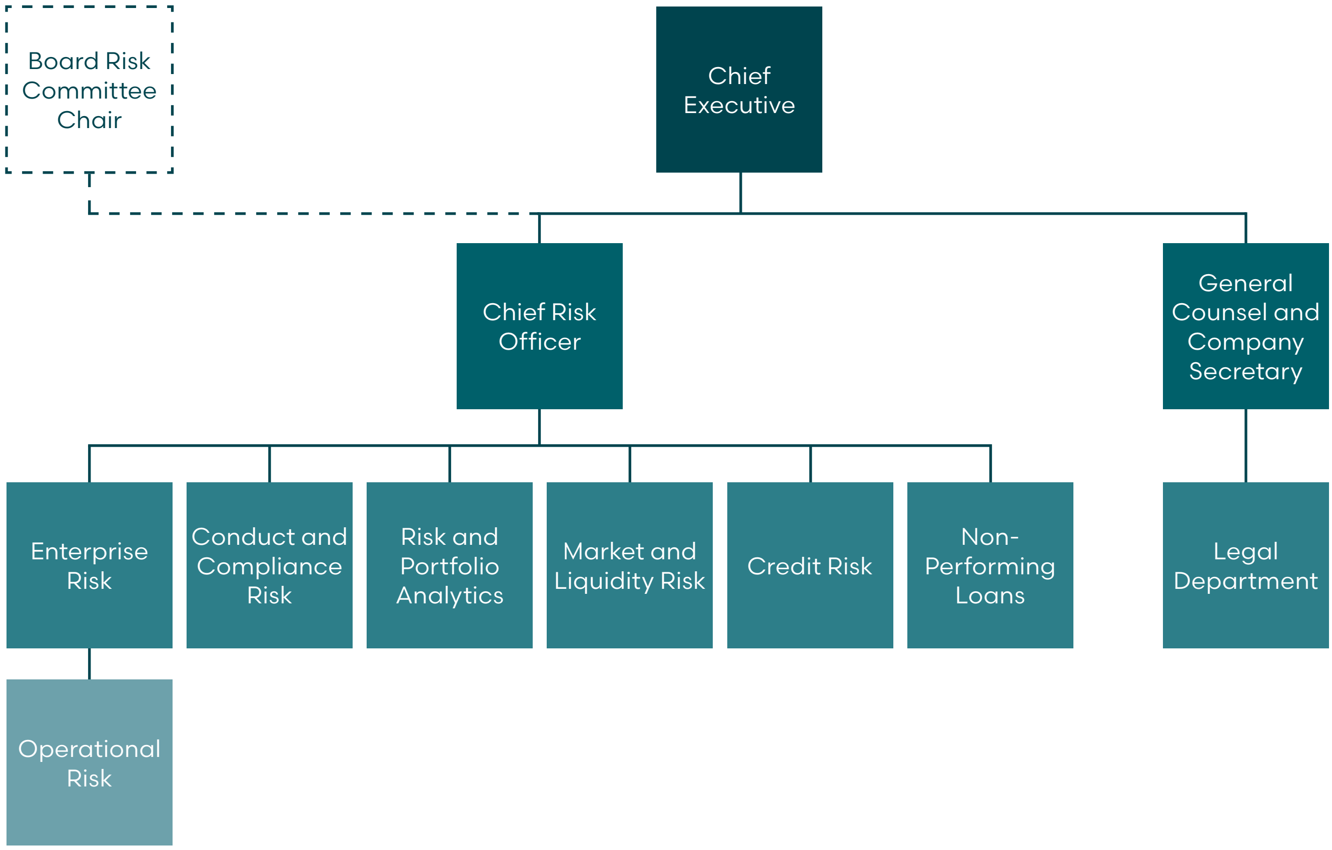
Each division and functional area operates to set risk policies to ensure that activities remain within the Board's stated risk appetite for that area of the Group. The risk policies are approved by the appropriate committee in accordance with their terms of reference and reviewed annually with any material changes requiring approval at committee level.

The first line of defence has its own operational process and procedures manuals to demonstrate and document how it conforms to the approved policies and controls. Likewise, it develops quality control programmes to monitor and measure adherence to and effectiveness of procedures. All employees within a customer facing unit are considered first line of defence. Each employee is aware of the risks to the Group of their particular activity and the divisional and function heads are responsible for ensuring there is a 'risk aware' culture within the first line of defence. For certain key policies, divisional staff complete regular on-line training programmes to ensure knowledge is refreshed and current.

Second line of defence

The second line of defence comprises the Group's central and independent risk management and compliance function led by the Chief Risk Officer, who reports to the Chairman of the Risk Committee and to the Chief Executive Officer. The Chief Risk Officer is also provided with unfettered access to the Chairman of the Board. The second line of defence also includes the General Counsel and Company Secretary who report to the Chief Executive Officer.

The high-level risk structure is shown below:



2. Risk governance and oversight continued

The second line of defence is necessarily and deliberately not customer facing and has no responsibility for any business targets or performance. It is primarily responsible for:

- the design and build of the various components of the Group's RMF and embedding these, together with the risk strategy and risk appetite across the organisation;
- independent monitoring of the Group's activities against the Board's risk appetite and limits, and provision of monthly analysis and reporting on the risk portfolio to the Executive Committee and the Board;
- issuing and maintaining the suite of Group risk policies;
- undertaking physical reviews of risk management, controls and capability in the first line units and providing risk assurance reports to the Executive Committee and the Board on all aspects of risk performance and compliance with the RMF;
- providing advice and support to the first line of defence in relation to risk management activities;
- credit approvals between divisional authority and the threshold for Credit Approval Committee; and
- undertaking stress testing exercises and working with Finance and Treasury on the production of the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP) and the Recovery Plan and Resolution Pack (collectively the RRP).

Third line of defence

The third line of defence, Internal Audit (currently outsourced to Deloitte LLP), provides independent assurance on the activities of the Group, effectiveness of the Group's RMF and internal controls directly to the Board and Audit Committee. Internal Audit reports directly to the Chairman of the Audit Committee as well as the Chief Executive Officer and is independent of the first and second lines of defence.

The third line of defence has access to the activities and records of both the first and second lines of defence. It can inspect and review adherence to policy and controls in the first line, the monitoring of activity in the second line and the setting of policy and controls in the second line. The third line of defence does not independently establish policy or controls itself, outside of those necessary to implement its recommendations with respect to the other two lines of defence. The third line may in some cases use as a starting point the reports and reviews compiled by the second line but is not restricted to them or necessarily influenced by their findings.

The third line of defence's scope of work is agreed with the Audit Committee to provide an independent assessment of the governance, risk management and internal control frameworks operated by the Group and to note the extent to which the Group is operating within its risk appetite. It does this by reviewing aspects of the control environment, key processes and specific risks and includes review of the operation of the second line of defence.

The Group's engagement of Deloitte LLP to carry out the functions of the third line of defence provides the Group with access to specialist capabilities beyond its current scale and provides insight into best practice.

Risk policies and controls

The RMF is enacted through a comprehensive suite of control documents and risk policies, setting out the minimum requirements and standards in relation to the acquisition and management of risk assets as well as the control of risks embedded in the Group's operations, activities and markets.

The Group's high-level control documents and risk policies are owned and managed by the Group Risk function, headed by the Chief Risk Officer and approved by the Board or, where delegated, the appropriate Risk Committee. The suite of policies is grouped according to importance and key risk categories.

Group-level risk policies are supplemented as required by divisional risk processes and procedures, where more specific and tailored criteria are detailed. Divisional processes and procedures are required to be compliant with Group policy and dispensations or waivers are required where gaps are identified. These process and procedure manuals provide staff at all levels with day-to-day direction and guidance in the execution of their duties.

The effectiveness of and compliance with the risk policy framework is evaluated on a continuous basis through the monthly reporting requirements (including risk policy exceptions reporting). Additionally, a quarterly control self-certification process supplemented by a program of audits, thematic risk assurance reviews and quality control testing is undertaken by each of the three lines of defence.

Asset class policies

The Group's lending policies are contained in 15 asset class policies and a further 15 lending policies. These have been arranged to operate on a Group wide basis rather than based upon divisional products. This is considered to provide a more stable, consistent risk standard and control across the Group's portfolio of loan assets. Asset classes can also be aligned more readily with risk-weightings, probability of default (PD), loss given default (LGD) and expected credit loss (ECL) metrics which facilitates risk reporting, risk adjusted profitability analysis and modelling for stress testing and capital adequacy purposes.

Asset class policies are structured on the basis of policy rules which must be adhered to and guidelines where an element of controlled discretion is permitted. All planned exceptions to policy rules require approval at the Group risk level and both planned and unplanned exceptions to policy rules are reported monthly to the relevant risk management committee.

3. Top and emerging risks

The Group's top and emerging risks are identified through the process outlined in the 'Risk Management Framework' (Section 1) and are considered regularly by Management through the Enterprise Risk Management Committee and subsequently by the Risk Committee.

Top risks

The Group sees seven themes as its top risks:

- Geopolitical risk
- Economic and competitive environment
- Pace of regulatory change
- Intermediary, outsourcing and operational resiliency
- Pace, scale of change and people risk
- Credit impairment
- Information risk

These themes, together with the Group's strategy to mitigate the risk and the direction of each theme are considered further in the following sections.

Key: Change in risk environment

↔	No change
↓	Risk decreased
↑	Risk increased

Top risk	Mitigation	Change
Geopolitical risk The Group's financial position continues to improve with continued profitability and strong capital ratios. However, increasing geopolitical risk presents a risk to the business, its financials and earnings volatility following an unprecedented political event. The UK has experienced a number of political events during 2018. Although the European Union (EU) has agreed a withdrawal agreement with the UK there is no parliamentary majority of any option. The UK Prime Minister has successfully defended a no confidence vote amongst the Conservative members, but nothing has materially changed. Global populist trends, terrorist attacks and a continued weakening of sterling remain key features of the wider economy. These risks have the potential to have an impact on the Group and the impact could be wide reaching affecting other risks such as economic, regulatory, business change, outsourcing, people, credit risk impairment and conduct risk.	The Group monitors the environment and its chosen markets on a regular basis and continues to prioritise return on tangible equity over volume. The Group operates in specialist areas where Management and staff have significant expertise and a deep understanding of customer needs to drive a long-term relationship with its customers through the cycle. The Group undertakes a comprehensive assessment of its risk appetite and stress tests its lending and deposit portfolios to ensure that it can meet its objectives in severe but plausible economic conditions. The Group reviews its key outsource partners to establish early warning indicators and to formalise exit plans.	↑ The UK economic outlook is expected to remain favourable in the short term but with increasing risks to the downside driven by weak productivity that may increase the potential for volatility for the Group and its customers. Developments regarding the UK's withdrawal from the EU, and in particular the reaction of households, businesses and asset prices to them, remain a significant influence on, and source of uncertainty about, the economic outlook.

3. Top and emerging risks continued

Top risk	Mitigation	Change
Economic and competitive environment A reversal in UK economic conditions, particularly in England where the majority of the Group's operations are based, could affect the Group's performance in a number of ways. These are set out below: ■ lower demand for the Group's products and services; ■ changes in funding costs resulting from ongoing political uncertainty accompanied by a loss of confidence in the market; ■ rising competition compressing Group margins below sustainable levels; and ■ higher impairments through increased defaults and / or reductions in collateral values.	The Group uses its expertise and deep understanding of its customers' needs to drive long-term relationships with its customers through the cycle. The Group monitors its chosen markets on a regular basis, reviews adjacent markets where it has expertise and considers opportunities for inorganic growth that are consistent with its strategy. The Group operates in specialist areas where Management and staff have expertise and a deep understanding of customer needs to deliver superior service. As a result, loans to Small and Medium Enterprises (SMEs) and consumers are subject to bespoke underwriting based on their ability to repay and sufficient security. The Group undertakes a comprehensive assessment of its risk appetite to ensure that it can meet its objectives in severe but plausible economic conditions. The Group completes comprehensive stress testing of its lending and deposit portfolios to test resilience to severe but plausible economic conditions. The Group also establishes a prudent balance sheet strategy with robust levels of capital and liquidity and a prudent funding structure.	↑ The UK economy has proven to be more resilient during 2018 than expected led by strong employment and conditions that continue to support affordability. However, the strong growth in Q3 has not continued into Q4 2018 and the Board expects there to be a continued period of uncertainty. As at 31 December 2018, the risk of a disorderly exit from the EU has increased with no majority in Parliament for any option.

Top risk	Mitigation	Change
Pace of regulatory change The prudential and conduct regulatory regimes are subject to change and could lead to increases in the level and quality of capital that the Group needs to hold to meet regulatory requirements. The countercyclical buffer increased to 1.0% at the end of November 2018 to add resiliency to the market prior to the UK's withdrawal from the EU. The Financial Policy Committee and the Prudential Regulation Committee (PRC) could use any reduction in Common Equity Tier 1 capital in the event of a disorderly exit from the EU to inform the setting of regulatory buffers. The PRC has indicated that it will set additional Prudential Regulation Authority (PRA) buffers in light of the 2018 stress test results to reflect the judgement that banks need to make substantial improvements to raise the management of model risk to a standard required for stress testing including whether judgements used are well supported through the use of appropriate empirical data or benchmarking analysis. The Financial Conduct Authority (FCA) has undertaken a number of thematic reviews during 2018 including the implementation of the Mortgage Credit Directive in second charge firms, a review of operational resiliency with the PRA and a review of credit worthiness and has set out its plans for 2019.	The regulatory environment continues to evolve and change. The Group actively engages with regulators, industry bodies and advisors to actively engage in consultation processes. The Group undertakes forward capital planning and sensitivity analysis using its ICAAP to ensure that the Group has sufficient time to respond to any changes in capital requirements.	↑ UK financial services businesses remain subject to significant scrutiny and the current level of risk is elevated when compared to last year. The Group adopts the standardised approach to credit risk. The Basel Committee on Banking Supervision announced changes to the risk-weightings under the standardised approach in December 2017 that will lead to an increase in capital requirements over the period of the strategic plan. The Group implemented IFRS 9 from 1 January 2018 and achieved General Data Protection Regulation compliance by 25 May 2018. The Group attested to its compliance with the Mortgage Credit Directive for its residential second charge lending business on 1 May 2018, in line with the requirement of the Dear CEO letter to all second charge lenders from the FCA. The Group attested to the Risk Committee to its compliance with Policy Statement PS18 / 19 on assessing credit worthiness on 1 November 2018.

3. Top and emerging risks continued

Top risk	Mitigation	Change
Intermediary, outsourcing and operational resiliency The Group is a specialist lending and savings bank for SMEs and consumers. The specialist nature of some of its lending through intermediaries and brokers could mean that some customers find themselves with an increased risk of an unfavourable outcome. For the Group this could also lead to increased conduct related redress, additional fraud or credit risk impairments. The Group uses a number of third parties to support the delivery of its objectives. The availability and resiliency of its core customer facing systems play a key role in supporting the Group's reputation in its chosen markets.	The Group works with carefully selected intermediary and broker partners who take on the role of advising SMEs and consumers. The Group recognises that it is ultimately accountable for the lending it originates through its partners and continually undertakes reviews of their performance. The Group continually reviews its risk management approach to intermediaries, brokers and outsource partners to reflect the regulatory environment in which the Group operates.	↑ The Group has continued to invest in its oversight of intermediaries, brokers and outsource partners during 2018. The Group continued to invest in its relationship with Target Servicing Limited and expects to further improve the Group's outsourcing risk profile. This includes (but is not limited to) work on arrears management, forbearance and resiliency planning. The Group continues to explore other third-party relationships through which to deliver its objectives and improve operational resiliency.

Top risk	Mitigation	Change
Pace, scale of change and people risk The scale and pace of change could create delivery challenges and could lead to disruption of the Group's plans and in the delivery of its objectives. The Group is a diverse specialist lending and savings bank and has a need to add a significant number of colleagues over the plan to deliver its objectives. Failure to add the required capacity and capability may lead to a disruption in the delivery of its objectives.	The Group understands the need to manage change without disrupting the Group's operating environment and impacting customer service. The Group has implemented a new change prioritisation process in 2018 to prioritise change and provide effective oversight of the change portfolio to ensure that requirements are delivered within budget and on time. These operational risks are managed through a strong focus on change governance and programme management disciplines and are led by a dedicated executive member. The risks are further mitigated by the Group's strengthening of the Executive Management team.	The Group continues to invest in its change management processes to increase the pace and scale of change without impacting on the Group's operations and customer service. The Group has appointed a Chief Technology Officer in 2018 to support the delivery of its technical transformation over the strategic plan. During 2018, the Group has continued to embed the new target operating model and the implementation of the Chief Operating Office. The Group has a strong appetite for change and the risk of an impact on its operations remains. The Group has invested in its leadership community through an 'Inspire' leadership programme and has focused on the actions arising from its people engagement surveys and regular reviews of the succession and talent management plans.

3. Top and emerging risks continued

Top risk	Mitigation	Change
Credit impairment As at 31 December 2018, the Group had customer loans (including operating leases and net of loss allowances) of £5.9 billion and is exposed to credit impairment if customers are unable to repay loans and any outstanding interest and fees. In addition, the Group has exposure to a small number of counterparties with whom it places surplus funding.	The Group recognises that it will experience credit impairment in connection with its lending activities, but manages its exposure by: ■ undertaking a prudent assessment of through-the-cycle losses in pricing, forecasting and stress testing; ■ maintaining consistent and conservative loan to value ratios and avoiding material weakening of credit quality to drive volumes; ■ lending predominantly on a secured basis against identifiable and accessible assets; ■ operating strong controls and governance with effective oversight by a centralised Group credit team; and ■ maintaining a prudent Treasury counterparty policy with surplus funding placed with the Bank of England and UK clearing banks.	Underlying Group credit impairment has remained low, reflecting favourable market conditions in the UK and the Group's approach to lending. The Group's counterparty exposure has remained broadly unchanged with the majority of surplus funding placed with the Bank of England and balances with UK clearing banks. The Group believes that the potential for additional credit impairment has increased with uncertainty over the outlook of the Brexit negotiations and the outlook for the UK economy given recent forecasts of productivity and increasing consumer debt. The Group has completed its implementation of IFRS 9 and will make use of the transition arrangements. The Group considers that its exposure to the retail sector and construction is manageable.

Top risk	Mitigation	Change
Information risk The pace of technological development is changing the way in which SMEs and consumers want to engage with the Group, leading to a number of risks. These are set out below: ■ increasing customer demand could exceed the Group's ability to provide highly reliable and widely available systems and services; ■ the evolving nature and scale of criminal activity could increase the likelihood and severity of attacks on the Group's systems; and ■ franchise value and customer trust could be significantly eroded by a sustained hack of the Group's systems leading to a diversion of funds or the theft of customer data.	The Group continually reviews its control environment for information security to reflect the evolving nature of the threats to which the Group is exposed. The Group's strategy for mitigating information security risk is comprehensive, including: a documented cyber strategy, ongoing threat assessments, regular penetration testing, the wide deployment of detective controls and a programme of education and training.	↔ The Group continues to invest in its capabilities to reduce its exposure to a cyber-attack and has further refined its risk appetite and controls with respect to information security. However, the risk of information security breaches, threats from cyber-crime and the impact of new technology on the Group's businesses remain.

3. Top and emerging risks continued

Emerging risks

The Group has identified the following emerging risks:

Emerging risk	Mitigation
Brexit Parliament voted against the Government on the Withdrawal Agreement vote on 15 January 2019 and in the absence of any majority for any option the likelihood of a no-deal Brexit has increased. Given the Group does not have operations outside of the UK, the key risk for the Group is considered to be a general downturn in the UK economy. In the event of a no-deal Brexit, the availability of skilled workers or ability to export goods to the EU at competitive prices may impact some of the Group's customers.	As well as keeping abreast of the negotiations and the potential impact to the UK economy, the Group has considered a more severe alternative downside scenario based on a disorderly no-deal Brexit. The scenario is based on a significant reduction in investment which helps to move the UK into a recession, increasing unemployment. In the short-term, the consumer price index remains elevated before deflationary pressures on sterling and gross domestic product start to reduce the consumer price index, presenting an opportunity for the Monetary Policy Committee to reduce interest rates. The Group has considered the first order impacts on its strategy arising from a fall in investment that may lead to a reduction in demand for its lending products and that may impact the Group's ability to grow in its SME markets. It has also considered the impact of a fall in residential and commercial property prices within its Property division and the impact of an increase in default in its Consumer Lending division following an increase in unemployment. The Group has identified a series of early warning indicators that it has set out in each scenario so that it can react in a timely manner. The Group has also invested in its quality control and quality assurance capabilities and its non-performing loan management capabilities so that it is well prepared in case of any scenario emerging. The Group considers that the current alternatives fall within its current stress testing scenarios and has considered through its ICAAP the impact on its key suppliers.
Minimum requirements for own funds and eligible liabilities (MREL) funding requirements MREL is an EU regulation that supports orderly resolution and protects depositors and taxpayers in the event of bank failure. The Group is currently not considered in scope however, over time the Group may fall in scope for more complex resolution strategies and going concern requirements.	The Group actively monitors its position in relation to MREL and as part of its strategic decision making. The Group will engage with the PRA during its strategic planning process to understand the point that the Group may face additional MREL requirements to ensure that the Group has plenty of time to prepare.

Emerging risk	Mitigation
Financial crime The risk of a downturn in the UK economy could result in an increased risk of financial crime activity.	The Group is enhancing its expertise in the first line of defence to ensure a continued focus on strategy and regulatory compliance. In addition, the Chief Operating Office continues to build out their ability to manage financial crime risk as part of the ongoing servicing.
Climate change On 15 October 2018, the PRA published a consultation paper on 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'. Following the consultation period, the PRA will be setting its expectations from banks on how they approach the management of the 'far-reaching and foreseeable' financial risks from climate change. For banks, climate-related risk factors will manifest as credit risk (e.g. increasing flood risk to mortgage portfolios, declining agricultural output increasing default rates, tightening energy efficiency standards impacting property exposures, disruptive technology leading to financial losses), market risks (commodity prices, corporate bonds, equities and certain derivatives contracts) and operational risks (severe weather events impacting business continuity).	The Compliance team will monitor developments during the consultation period and the post-consultation rule-setting period and update the relevant governance forums.
General Data Protection Regulation (GDPR) Whilst the GDPR was implemented on 25 May 2018 and the Group's programme team worked with all the functions to ensure a compliant position was reached, the increased public awareness of data privacy has resulted in a risk of increased data subject rights requests. In addition, the Group must ensure ongoing compliance to the GDPR as well as effective management of privacy.	The Group appointed a Data Protection Officer in May 2018 who supported the GDPR programme through to conclusion, ensuring that compliant record of processing activities had been completed with legitimate, privacy and data protection impact assessments also being completed where required. The existing privacy related policies have been updated and the Privacy Office will now focus on implementing an enhanced privacy program framework to ensure the Group's privacy management structure is enhanced.

4. Key risk categories

The key risk categories faced by the Group are as follows:

Risk category	Definition
Creditworthiness risk (including concentration and single name risk) (Section 5)	■ The risk that a borrowing client or treasury counterparty fails to repay some or all of the capital or interest advanced to them due to lack of willingness to pay (credit risk) and / or lack of ability to pay (affordability). This category also includes credit concentration risk which is the risk of exposure to particular groups of customers or sectors or geographies that uncontrolled may lead to additional losses that the Shareholder or the market may not expect.
Liquidity and market risk (Section 6 and 7 respectively)	■ Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. ■ Market risk is the risk of financial loss through un-hedged or mismatched asset and liability positions that are sensitive to changes in interest rates or currencies.
Operational risk (Section 8)	■ The risk of loss resulting from inadequate or failed internal processes, people and system failures, or from external events including strategy and reputational risks.
Conduct, legal and compliance risk (Section 9)	■ Conduct risk is the risk that the Group's behaviour will result in poor customer outcomes and that our people fail to behave with integrity. ■ Legal and compliance risk is the risk of regulatory enforcement and sanction, material financial loss, or loss to reputation the Group may suffer as a result of its failure to identify and comply with applicable laws, regulations, codes of conduct and standards of good practice.
Strategic risk (Section 10)	■ The risk that the Group is unable to meet its objectives through the inappropriate selection or implementation of strategic plans. This includes the ability to generate lending volumes inside risk appetite.
Systems and change risk (Section 11)	■ Systems risk is the risk that new threats are introduced to our critical systems resulting in them becoming unavailable during core operational times. ■ Change risk is the risk that transition changes in the business will not be supported by appropriate change capability and be improperly implemented. It is also the risk that too many in-flight changes cause disruption to business operations.

A more detailed summary of each key risk is contained in the following sections.

5. Creditworthiness risk

Creditworthiness risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group due to lack of willingness to pay (credit risk) and / or lack of ability to pay (affordability). These risks are managed by the Board Risk Committee and the Asset and Liability Committee (ALCo). This risk has two main components:

- Customer credit risk (from core lending activity); and
- Treasury credit risk (from Treasury activity).

The Group's treasury credit risk exposure is limited to short-term deposits placed with leading UK banks.

5.1. Credit risk approval process

The Group operates a hierarchy of lending authorities based principally upon the size of the aggregated credit risk exposure to counterparties, group of connected counterparties or, where applicable, a portfolio of lending assets that are subject to a single transaction. In addition to maximum amounts of credit exposure, sole lending mandates may stipulate sub-limits and / or further conditions and criteria.

Each division has a maximum authority level allocated, with exposures above these levels requiring approval from an approver in the second line of defence or the Credit Approval Committee. In each lending division, at least one signatory to the loan must be a segregated first line of defence credit approver who has no responsibility for, or remuneration arrangements linked to, sales targets, on-going sales origination or relationship responsibility with the borrower.

The maximum divisional mandate for Business Finance and Commercial Property Finance is £1.25 million. The maximum divisional mandate for Residential Property Finance is £100,000 and for Consumer Lending is £75,000. Exposures beyond these limits up to £5 million may be approved by an approver in the second line of defence and exposures up to the Group single name concentration limit of £25 million must be approved by the Credit Approval Committee. The Group has a nominal appetite for wholesale exposures above £25 million within the lending authority of the Credit Approval Committee. In addition, where transactions involve financing portfolios of lending assets in excess of £15 million, or where an individual loan is required in excess of appetite, Board approval is also required.

Lending is advanced subject to the Group lending approval policy and specific credit criteria. When evaluating the credit quality and covenant of the borrower, significant emphasis is placed on the nature of the underlying collateral. This process also includes the review of the Board's appetite for concentration risk.

The Group is a responsible lender and consumer affordability has remained a key area of focus for the Group. The Group's approach to affordability is set out in a Board approved responsible lending policy that is embedded within each lending division's lending guides.

5.2. Credit monitoring

Approval and on-going monitoring control is exercised both within the divisions and through oversight by the Group's Credit Risk function. This applies to both individual transactions as well as at the portfolio level by way of monthly credit information reporting, measurement against risk appetite limits and testing via risk quality assurance reviews.

The divisions operate through the Chief Operating Office function's timely collections and arrears management processes. The Group further invested in 2018 in the development of its operational arrangements and capabilities for non-performing loan management to ensure that the Group is capable of operating in a more challenging environment where interest rates are rising and there is lower demand and liquidity in property markets.

5.3. Impairment under IFRS 9 (from 1 January 2018)

Audited: *The following section is covered by the independent auditor's report.*

From 1 January 2018, impairment of financial assets is calculated using a forward looking expected credit loss (ECL) model. The Group records an allowance for ECLs ('loss allowance') for all financial assets not held at fair value through profit or loss, together with an allowance for ECLs for financial guarantee contracts and loan commitments. The Group's accounting policy is detailed in Note 1.7(v) of the financial statements.

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

- **Stage 1:** when a financial asset is first recognised it is assigned to Stage 1. If there is no significant increase in credit risk from initial recognition the financial asset remains in Stage 1. Stage 1 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 2. For financial assets in Stage 1, a 12-month ECL is recognised.
- **Stage 2:** when a financial asset shows a significant increase in credit risk from initial recognition it is moved to Stage 2. Stage 2 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 3. For financial assets in Stage 2, a lifetime ECL is recognised.

5. Creditworthiness risk continued

5.3. Impairment under IFRS 9 (from 1 January 2018) continued

- **Stage 3:** when there is objective evidence of impairment and the financial asset is considered to be in default, or otherwise credit-impaired, it is moved to Stage 3. For financial assets in Stage 3, a lifetime ECL is recognised.
- **Purchased or originated credit-impaired (POCI):** POCI assets are financial assets that are credit-impaired on initial recognition. On initial recognition they are recorded at fair value. ECLs are only recognised or released to the extent that there is a subsequent change in the ECLs. Their ECL is always measured on a lifetime basis.

In relation to the above:

- **Lifetime ECL** is defined as ECLs that result from all possible default events over the expected behavioural life of a financial instrument.
- **12-month ECL** is defined as the portion of lifetime ECL that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of that default occurring.

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

For financial guarantee contracts, the Group assigns a stage using the definitions described above.

Under the requirements of IFRS 9, the Group calculates a loss allowance for cash and balances at central banks, loans and advances to banks, loans and advances to customers and investment securities. A further loss allowance is calculated for financial guarantee contracts and loan commitments.

As at 31 December 2018, the loss allowances for cash and balances at central banks, loans and advances to banks, and investment securities are immaterial, totalling less than £0.1 million. The loss allowance for loans and advances to customers is £67.8 million.

The following table provides an analysis of loans and advances to customers by reportable segment and the year-end stage classification:

As at 31 December 2018	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
Stage 1	3,051.5	1,179.7	690.8	4,922.0
Stage 2	607.8	188.5	75.3	871.6
Stage 3	60.6	54.0	6.6	121.2
Gross loans and advances to customers	3,719.9	1,422.2	772.7	5,914.8
Stage 1	(2.0)	(5.9)	(15.6)	(23.5)
Stage 2	(5.5)	(4.0)	(11.2)	(20.7)
Stage 3	(6.2)	(13.0)	(4.4)	(23.6)
Loss allowance	(13.7)	(22.9)	(31.2)	(67.8)
Fair value adjustments for hedged risk	(0.6)	–	(0.5)	(1.1)
Total loans and advances to customers	3,705.6	1,399.3	741.0	5,845.9
Loss allowance coverage (%)	0.4%	1.6%	4.0%	1.1%

As at 31 December 2018, the loss allowance for financial guarantee contracts is £nil because the contract is fully collateralised through a first fixed charge over a blocked deposit account. As such, the amount the Group should have to pay should the guarantee be called upon is £nil.

As at 31 December 2018, the loss allowance for loan commitments is £1.0 million. The following table provides an analysis of loan commitments by reportable segment and the year-end stage classification:

As at 31 December 2018	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
Stage 1	145.6	344.9	52.0	542.5
Stage 2	–	6.8	–	6.8
Gross loan commitments	145.6	351.7	52.0	549.3
Stage 1	–	(1.0)	–	(1.0)
Loss allowance	–	(1.0)	–	(1.0)
Total loan commitments	145.6	350.7	52.0	548.3
Loss allowance coverage (%)	–	0.3%	–	0.2%

Movement in the Group's loss allowance is presented in the financial statements as follows:

- **Loans and advances to customers:** presented as a deduction from the gross carrying amount. See Note 14 of the financial statements.
- **Loan commitments:** presented as a provision. See Note 25 and Note 38 of the financial statements.

Calculation of expected credit losses

ECLs are the discounted product of the probability of default (PD), exposure at default (EAD) and loss given default (LGD), detailed below. ECLs are determined by projecting the PD, EAD and LGD for each future month for each exposure. The three components are multiplied together and adjusted to reflect forward looking information. This calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

Probability of default

PD is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

The Group has developed a credit grading system for all its asset classes and has mapped these to a common master grading scale that has been aligned to the Standard and Poor's grading scale. The Group operates both a model-based PD for its high volume portfolios such as Consumer Lending and Residential Property Finance and has developed and implemented a Slotting approach for the low volume and high value obligors in Business Finance and large ticket commercial property cases. Both processes deliver a measure of a point-in-time measure of default.

For the model-based portfolios, the measure of PD is based on information available to the Group from credit reference agencies and internal product performance data. For the Slotted portfolios, the measure of PD relates to attributes relating to financial strength, political and legal environment, asset / transaction characteristics, strength of sponsor and security.

5. Creditworthiness risk continued

5.3. Impairment under IFRS 9 (from 1 January 2018) continued

The current risk grading framework consists of 25 grades on a master grading scale reflecting varying degrees of risk and default. The responsibility for setting risk grades lies with the approval point for the risk or committee as appropriate. Risk grades are subject to regular reviews by Group Risk. The Group's grading scale is mapped to Standard and Poor's grading scale and aggregated for reporting purposes in the following way:

Grading	Master grading scale	PD range	Standard and Poor's grade
Low risk	1-10	<=0.38%	AAA to BBB-
Medium risk	11-15	>0.38% to <= 1.76%	BB+ to BB-
High risk	16-25	>1.76%	B+ to D

For each asset class, the Group has a proprietary approach to extrapolate its best estimate of the point-in-time PD from 12 months to behavioural maturity, using economic response models that have been developed specifically to forecast the sensitivity of PD to key macroeconomic variables.

Exposure at default

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

EAD is designed to address increases in utilisation of committed limits and unpaid interest and fees that the Group would ordinarily expect to observe to the point of default, or through to the point of realisation of the collateral.

The Group determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding to the multiple scenarios.

Loss given default

LGD is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The Group segments its lending products into smaller homogenous portfolios. In all cases the LGD or its components are tested against recent experience to ensure that they remain current.

- **Property Finance:** the LGD is generally broken down into two parts. These include the Group's estimate of the probability of possession given default, combined with the loss given possession. The Group has continued to focus on the proportion of accounts that have not cured over an emergence period, rather than the proportion of accounts that enter possession to be appropriately conservative. The LGD is based on the Group's estimate of a shortfall, based on the difference between the property value after the impact of a forced sale discount and sale costs, and the loan balance with the addition of unpaid interest and fees and first charge claims with regards to first charge residential mortgages.
- **Business Finance:** the LGD is based on experience of losses on repossessed assets. The LGD on Block and Wholesale portfolios is based on experience of losses supported by key judgements.
- **Consumer Lending:** the Group uses an estimate of the probability of charge-off, defined as six or more payments in arrears, combined with an estimate of the expected write-off based on established contractual forward flow arrangements for the sale of charge-off debt. There is no recovery portfolio.

Measurement of expected credit losses

The measurement of ECLs requires the use of complex models and significant assumptions and key judgements.

Significant increase in credit risk

The Group applies a series of quantitative, qualitative and backstop criteria to determine if an account has demonstrated a significant increase in credit risk and should therefore be moved to Stage 2:

- **Quantitative criteria:** this considers the increase in an account's remaining lifetime PD at the reporting date compared to the expected residual lifetime PD when the account was originated. The Group segments its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency.
- **Qualitative criteria:** this includes the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms.
- **Backstop criteria:** IFRS 9 includes a rebuttable presumption that 30 days past due is an indicator of a significant increase in credit risk. The Group considers 30 days past due to be an appropriate backstop measure and does not rebut this presumption.

Assessment of whether there has been a significant increase in credit risk incorporates forward looking information. The Group undertakes a review of the forward looking economic scenarios at least quarterly and more frequently if required. The results of this review are recommended to the Audit Committee and Board prior to any changes being implemented.

As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Group's quantitative modelling:

Property Finance – Commercial

- External mortgage payments in arrears from the credit reference agencies. The external arrears information is statistically a lead indicator of financial difficulties and potential arrears on the loan book;
- for short-term loans with a modelled PD, PD > 0.38% and the absolute movement in remaining lifetime PD is more than four times the estimate at origination;
- for term loans with a modelled PD, PD > 0.38% and the absolute movement in remaining lifetime PD is more than two times the estimate at origination; or
- for all portfolios with a slotted PD, PD > 0.38% and the absolute movement in remaining lifetime PD is more than three times the estimate at origination.

Property Finance - Residential

- All exposures are graded under the modelled approach. Where the modelled PD > 0.38% and the absolute movement in remaining lifetime PD is more than 5.1 times the estimate at origination;
- where the customer has ever been six or more payments in arrears on any fixed term account at the credit reference agency;
- where the customer has missed a mortgage payment in the last six months at the credit reference agency; or
- loan account is forborne.

Business Finance

- Entry on to watch-list;
- loan account is forborne;
- for accounts with a modelled PD, where the absolute movement in the remaining lifetime PD is more than 4.6 times the estimate at origination; or
- for accounts with a slotted PD, where the absolute movement in the remaining lifetime PD is more than three times the estimate at origination.

Consumer Lending

- Non-personal loans PD > 0.38% and the absolute movement in remaining lifetime PD is more than 3.7 times the estimate at origination;
- personal loans PD > 038% and the absolute movement in remaining lifetime PD is more than 4.6 times the estimate at origination;
- county court judgements registered at the credit reference agencies of > £150 or > £1,000 in last 3-years; or
- loan account is forborne.

For low credit risk exposures, the Group is permitted to assume, without further analysis, that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. The Group has opted not to apply this low credit risk exemption in the year ended 31 December 2018.

The Group undertakes an update of all its key impairment judgements in advance of the interim report and accounts and the annual report and accounts. This includes (and is not limited to) a review of model monitoring, validation of key assumptions based on trends in actual performance, monitoring of stage effectiveness and the forward economic scenarios used to support the lifetime ECL calculations. All key judgements are reviewed and recommended to the Audit Committee for approval prior to implementation. Stage 2 criteria are designed to be effective early indicators of a significant deterioration in credit risk. As part of its six-monthly review of key impairment judgements the Group undertakes detailed analysis to confirm that the Stage 2 criteria remain effective. This includes (and is not limited to):

- **Criteria effectiveness:** this includes the emergence to default for each Stage 2 criterion when compared to Stage 1, Stage 2 outflow as a percentage of Stage 2, percentage of new defaults in Stage 2 in the months prior to default, time in Stage 2 prior to default and percentage of the book in Stage 2 that are not progressing to default or curing.
- **Stage 2 stability:** this incudes stability of inflows and outflows from Stage 2 and 3.
- **Portfolio analysis:** this includes the percentage of the portfolio that is in Stage 2 and not defaulted, the percentage of the Stage 2 transfer driven by Stage 2 criterion other than the back stops and back-testing of the defaulted accounts.

5. Creditworthiness risk continued

5.3. Impairment under IFRS 9 (from 1 January 2018) continued

During 2018, the Group used this process to remove some PD floors as they were not appropriately considering a significant increase in credit risk. In addition, the Group considered the roll back to Stage 1 (ignoring curing requirements) to ensure that the Stage 2 criteria was picking up any significant deterioration in credit risk.

The Group calculates the ECL on an EAD basis and then separately considers how much of the ECL is attributable to loan balances and loan commitments which are then reported separately.

Definition of default and credit-impaired assets

The Group's definition of default is fully aligned with the definition of credit-impaired. The Group applies a series of quantitative and qualitative criteria to determine if an account meets the definition of default and should therefore be moved to Stage 3. These criteria include:

- when the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security (if any is held);
- when the borrower is more than 90 days past due on any material credit obligation to the Group; and
- when a material credit obligation to the Group has gone past maturity or there is a degree of doubt that the exit strategy for the obligation is likely.

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

Curing

A financial instrument is considered to be 'cured' and therefore reclassified back to a lower stage when none of the assessed criteria that caused movement into the higher stage have been present for a consecutive period of at least 12 months (the 'curing period').

For Stage 3 loans with forbearance arrangements in place, the loan must first successfully complete its 12-month curing period to be moved to Stage 2. Following this, the loan must then successfully complete its 24-month forbearance probation period before the forbearance classification can be discontinued.

The Group has not implemented curing for forborne loans as at 31 December 2018. The Group believes that the nature of the cycle and the narrow range of forbearance treatments used means that curing is not material. The Group has decided to focus on stabilising the ECL during 2018 with a view to implementing curing in Q2 2019.

Forward looking information

The Group incorporates forward looking information into the calculation of ECLs and the assessment of whether there has been a significant increase in credit risk.

Scenario analysis

The Group's central view is informed by the HM Treasury Central forecast that is published quarterly and used as part of the Group's corporate planning activity. Intra-quarter the Group considers survey-based data and lead indicators to inform whether the central view continues to be appropriate. In the calculation of the ECL and stage transfer the Group uses two further scenarios to reflect an alternative upside view and an alternative downside view. These are chosen to be plausible alternative base cases and are not stress-testing scenarios. The probabilities assigned to the scenarios are a matter of judgement but are generally set to ensure that there is an asymmetry in the ECL.

The Group is not large enough to have an internal economist and therefore works with a third party on the narrative of the alternative scenarios and the rate paths to ensure that the scenarios are internally consistent using the UK Treasury model. The rate paths used in the scenarios are consistent with the core UK macroeconomic factors that are published by the Bank of England as part of the annual stress testing exercise. These scenarios are reviewed at the Audit Committee and recommended to Board for approval at least quarterly.

The Group has regularly considered Brexit within its economic scenarios and specifically the nature and probability of the alternative downside scenario. In the latter part of 2018, the Board agreed to move from a 50% / 30% / 20% central view / downside view / upside view respectively to a 40% / 40% / 20% central view / downside view / upside view respectively. The Board also agreed to change the nature of the alternative downside view from an orderly no-deal Brexit to a disorderly no-deal Brexit as a result of there being no parliamentary majority for any option.

Estimating forward looking expected credit losses
The Group has developed a proprietary approach to assess the impact of the changes in economic scenarios on the obligor level ECL. The Group has mapped each asset class to an external long-run benchmark series that is believed to behave in a similar way to the Group's portfolio over the cycle. The Group has developed econometric models to establish how much of the historical series can be explained by movements in the UK macroeconomic factors. The models deliver an estimate of the impact of a unit increase in default arising from a 1% increase in the underlying macroeconomic factors. The models are developed in line with the Group's model governance framework and are subject to review at least every six-months. The models are tested across multiple sets of scenarios to ensure that they work in a range of scenarios, the output of the scenarios is a series of scalars by asset class and a scenario that can be applied to the underlying PDs to deliver a forward looking ECL. The Group has developed a proprietary approach to extrapolating its 12-month PDs over the behavioural maturity of the loans that the scalars can be applied to. The nature of the scenarios means that there will be an impact on both the PD and the number of obligors moving from Stage 1 to Stage 2.

Critical accounting estimates and judgements and key sensitivity analysis

Individual Stage 3 ECL on loans and advances to customers are calculated based on an assessment of the expected cash flows and the underlying collateral. For individual Stage 3 ECL, statistical models are used for Consumer Lending and Residential Property Finance, whilst provisions for Business Finance and Commercial Property Finance are assessed on a loan-by-loan basis and reviewed at Group Impairment Committee where the impairment is in excess of £75,000. Where models are used for individual Stage 3 ECLs, score cards are used to calculate PDs based on the recent performance of the portfolios. These PD estimates are translated to lifetime PDs using the approach outlined above. LGDs are calculated taking into account the valuations of available collateral and the experienced forced sale discounts when collateral has been realised. These factors are applied to all the aged portfolios of debt at each statement of financial position reporting date to derive the individual impairment requirement.

For Stage 1 impairment, financial assets are grouped on the basis of similar risk characteristics. In all situations a 12-month PD is multiplied by the EAD and LGD to derive an ECL requirement which is incurred at the statement of financial position reporting date but not yet individually identified.

The key assumptions, being the forced sale discount on the Residential Property Finance portfolio and Commercial Property Finance portfolio, PD of the portfolios and LGD of the Consumer Lending portfolio are monitored regularly to ensure the ECL requirement is entirely reflective of the current portfolio. The accuracy of the ECL calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes. For example, for loans and advances to customers:

Probability of default
The PD is based on internal and external individual customer information that is updated for each reporting period. The external customer information is sourced from credit reference agencies and includes information from a broad range of financial services firms.

- A 10% increase in the PD for each customer would increase the ECL by c.£3.9 million.

Loss given default
For loans where property is taken as collateral the LGD calculates the loss in the event of possession. Not all cases that have reached Stage 3 will enter possession and the Group calculates as part of its judgements the probability of possession given default. The loss in the event of possession is driven predominantly by future property value inflation (or deflation) and changes in force sales discount which affect the underlying value of the collateral.

- A 10-percentage point reduction in property prices would increase the ECL by c.£6.1 million.
- A 5% absolute increase in the force sales discount would increase the ECL by c.£4.1 million.

For loans within Business Finance, the assumption with most judgement is the absolute LGD value calculated through the twice-yearly judgements.

- A 5% absolute increase in the LGD's applied in Business Finance would increase the ECL by c.£3.0 million.

For loans originated within Consumer Lending, the assumption with most judgement applied is the LGD. Not all loans are simultaneously charged-off at 180 days past due so the LGD includes a judgement about the number of loans expected to enter charge-off from default and then the loss given charge-off.

- A 10-percentage point increase in the loss given charge-off would increase the ECL by c.£2.9 million.

5. Creditworthiness risk continued

5.4. Impairment under IAS 39 (prior to 1 January 2018)

Audited: *The following section is covered by the independent auditor's report.*

Prior to 1 January 2018, impairment of financial assets was based on the incurred loss model under IAS 39. The Group's accounting policy is detailed in Note 1.7(v) of the financial statements.

Under the requirements of IAS 39, loans and advances to customers was the only financial asset category for which impairments were recognised.

Loans and advances to customers were regularly reviewed to determine if there was any objective evidence of impairment. They were categorised as follows:

Type of impairment assessment	Description
Individual impairment	Where specific circumstances indicated that a loss was likely to be incurred.
Collective impairment	Impairment allowances were calculated for each portfolio on a collective basis, given the homogenous nature of the assets in the portfolio.

Risk categorisation	Description
Neither past due nor impaired	Loans that were not in arrears and which did not meet the impaired asset definition. This segment could include assets subject to forbearance measures.
Past due but not impaired	This consisted predominantly of loans in Property Finance and Business Finance that were past due and individually assessed as not being impaired. This definition also included unsecured loans in Consumer Lending that were past due but not more than 90 days.
Impaired assets	Loans that were in arrears or where there was objective evidence of impairment and where the carrying amount of the loan exceeded the expected recoverable amount. This definition also included unsecured loans in Consumer Lending that were more than 90 days in arrears and carried identified impairment.

The following table provides an analysis of loans and advances to customers by reportable segment and impairment risk categorisation:

As at 31 December 2017	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
Neither past due nor impaired	3,114.8	1,015.7	611.3	4,741.8
Past due but not impaired				
Up to 30 days	9.2	10.4	1.0	20.6
30-60 days	32.8	4.0	7.4	44.2
60-90 days	7.8	1.2	2.6	11.6
Over 90 days	18.1	2.1	–	20.2
Total past due but not impaired	67.9	17.7	11.0	96.6
Impaired assets	13.3	21.5	4.9	39.7
Gross loans and advances to customers	3,196.0	1,054.9	627.2	4,878.1
Impairment allowance	(6.3)	(15.0)	(10.3)	(31.6)
Fair value adjustments for hedged risk	(2.7)	–	0.5	(2.2)
Total loans and advances to customers	3,187.0	1,039.9	617.4	4,844.3

5.5. Credit risk grading

Audited: *The following section is covered by the independent auditor's report.*

The Group uses the following credit risk grades when assessing the credit risk of its financial assets, financial guarantee contracts and loan commitments:

Cash and balances at central banks, loans and advances to banks and investment securities
The Group assesses credit risk using the rating agency designation on the reporting date. Ratings are based on Moody's long-term ratings.

Loans and advances to customers and financial guarantee contracts and loan commitments
The Group assesses credit risk using the Group's internal classifications based on the point-in-time PD of individual agreements. Classifications are defined as follows:

- **Low risk:** assets have a point-in-time PD less than or equal to 0.38%.
- **Medium risk:** assets have a point-in-time PD greater than 0.38% and less than or equal to 1.76%.
- **High risk:** assets have a point-in-time PD greater than 1.76%.

In 2017, each of the risk classifications detailed above had the additional criteria that loans were 'neither past due nor impaired', as defined in Section 5.4. Loans that were 'past due but not impaired' or 'impaired assets', as defined in Section 5.4, were 'ungraded'.

5.6. Credit risk exposure

Audited: *The following section is covered by the independent auditor's report.*

Financial assets subject to impairment

The following tables contain an analysis of the credit risk exposure of financial assets for which a loss allowance is recognised. For financial assets, the gross carrying amount represents the Group's maximum exposure to credit risk.

The below also provides an analysis of the credit risk exposure of financial guarantee contracts and loan commitments for which a loss allowance is also recognised. For financial guarantee contracts, amounts represent the amount guaranteed. For loan commitments, amounts represent the amounts committed. In both instances, these amounts represent the Group's maximum exposure to credit risk.

Information provided below is based on the credit risk grades defined in Section 5.5 and, for 2018, the year-end stage classification. It should be noted that the credit risk grading assessment is a point-in-time assessment whereas IFRS 9 stages are determined based on the change in credit risk from initial recognition. As such, for non-credit impaired financial instruments, there is not a direct relationship between the credit risk assessment and IFRS 9 stage.

5. Creditworthiness risk continued

5.6. Credit risk exposure continued

Cash and balances at central banks	Stage 1 £m	Stage 2 £m	Stage 3 £m	2018 Total £m	2017 Total £m
Credit grade					
AA2	645.2	–	–	645.2	752.5
Gross carrying amount	645.2	–	–	645.2	752.5
Loss allowance	–	–	–	–	–
Total cash and balances at central banks	645.2	–	–	645.2	752.5

Loans and advances to banks	Stage 1 £m	Stage 2 £m	Stage 3 £m	2018 Total £m	2017 Total £m
Credit grade					
AA3	12.3	–	–	12.3	12.2
A1	7.0	–	–	7.0	2.5
A2	31.3	–	–	31.3	–
A3	–	–	–	–	14.1
Gross carrying amount	50.6	–	–	50.6	28.8
Loss allowance	–	–	–	–	–
Total loans and advances to banks	50.6	–	–	50.6	28.8

Loans and advances to customers	Stage 1 £m	Stage 2 £m	Stage 3 £m	2018 Total £m	2017 Total £m
Credit grade					
Low risk	1,906.5	26.2	7.7	1,940.4	1,945.9
Medium risk	1,910.4	464.5	33.3	2,408.2	2,103.7
High risk	1,105.1	380.9	80.2	1,566.2	692.2
Ungraded	–	–	–	–	136.3
Gross carrying amount	4,922.0	871.6	121.2	5,914.8	4,878.1
Loss allowance	(23.5)	(20.7)	(23.6)	(67.8)	(31.6)
	4,898.5	850.9	97.6	5,847.0	4,846.5
Fair value adjustments for hedged risk				(1.1)	(2.2)
Total loans and advances to customers				5,845.9	4,844.3

Investment securities	Stage 1 £m	Stage 2 £m	Stage 3 £m	2018 Total £m	2017 Total £m
Credit grade					
Low risk	139.9	–	–	139.9	–
Gross carrying amount	139.9	–	–	139.9	–
Loss allowance	–	–	–	–	–
Total investment securities	139.9	–	–	139.9	–

Financial guarantee contracts	Stage 1 £m	Stage 2 £m	Stage 3 £m	2018 Total £m	2017 Total £m
Credit grade					
Low risk	2.5	–	–	2.5	2.5
Gross amount guaranteed	2.5	–	–	2.5	2.5
Loss allowance	–	–	–	–	–
Total amount guaranteed[1]	2.5	–	–	2.5	2.5

Loan commitments	Stage 1 £m	Stage 2 £m	Stage 3 £m	2018 Total £m	2017 Total £m
Credit grade					
Low risk	462.1	–	–	462.1	467.6
Medium risk	70.5	–	–	70.5	–
High risk	9.9	6.8	–	16.7	–
Gross amount committed	542.5	6.8	–	549.3	467.6
Loss allowance	(1.0)	–	–	(1.0)	–
Total loan commitments	541.5	6.8	–	548.3	467.6

[1] The Group has one financial guarantee contract amounting to £2.5 million (2017: £2.5 million). The contract is fully collateralised through a first fixed charge over a blocked deposit account. As such, the amount the Group should have to pay should the guarantee be called upon is £nil (2017: £nil).

5. Creditworthiness risk continued

5.6. Credit risk exposure continued

Financial assets not subject to impairment

The following table contains an analysis of the maximum exposure to credit risk from financial assets not subject to impairment:

	2018 £m	2017 £m
Derivative financial assets	**1.6**	1.8

5.7. Collateral held and other credit enhancements

Audited: *The following section is covered by the independent auditor's report.*

The Group holds collateral and other credit enhancements against certain of its credit exposures. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation. The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

No collateral or other credit enhancements are held against the Group's loans and advances to banks and investment securities.

Details of collateral held against the Group's loans and advances to customers and derivative financial assets are set out below:

Loans and advances to customers

The main types of collateral obtained are:

- **Loan receivables**: includes amounts secured by a first or second charge over commercial and residential property, debt receivables and other assets such as asset backed loans and invoice receivables.
- **Finance lease receivables and instalment credit receivables:** secured on the underlying assets which can be repossessed in the event of a default.

The following table sets out the security profile of loans and advances to customers. The amounts in the table represent gross carrying amounts:

	2018 £m	2017 £m
Secured on commercial and residential property	**3,908.1**	3,197.6
Secured on debt receivables	**517.3**	456.6
Secured on other assets	**93.1**	68.3
Total secured loan receivables	**4,518.5**	3,722.5
Secured by finance lease assets	**95.0**	88.9
Secured by instalment credit assets	**409.4**	350.8
Total secured loans and advances to customers	**5,022.9**	4,162.2
Unsecured loan receivables	**891.9**	715.9
Gross loans and advances to customers	**5,914.8**	4,878.1

Collateral held in relation to secured loans is capped, after taking into account the first charge balance, at the amount outstanding on an individual loan basis.

Derivative financial assets

Credit risk derived from derivative transactions is mitigated by entering into master netting agreements and holding collateral. Such collateral is subject to the standard industry Credit Support Annex and is paid or received on a regular basis. As at 31 December 2018, net cash collateral posted is £4.5 million (2017: £3.9 million).

Quantification of the collateral arrangements relating to derivatives is set out in Note 31(c) of the financial statements.

Credit-impaired financial assets

The Group closely monitors collateral held for financial assets considered to be credit-impaired (Stage 3), as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are set out below:

As at 31 December 2018	Gross carrying amount £m	Loss allowance £m	Carrying amount £m	Fair value of collateral held £m
Credit-impaired loans and advances to customers				
Property Finance	60.6	(6.2)	54.4	54.4
Business Finance	54.0	(13.0)	41.0	41.0
Consumer Lending	6.6	(4.4)	2.2	–
Total credit-impaired loans and advances to customers	121.2	(23.6)	97.6	95.4

The following table shows the distribution of loan-to-value (LTV) ratios for the Group's credit-impaired Property Finance portfolio:

As at 31 December 2018	Gross carrying amount £m
LTV ratio	
Less than 50%	13.3
50-70%	23.6
71-90%	22.7
91-100%	0.5
More than 100%	0.5
Total Property Finance credit-impaired assets	60.6

5.8. Repossessions

Audited: *The following section is covered by the independent auditor's report.*

There were twelve property repossessions in the year ended 31 December 2018 (2017: seven). The total carrying value of repossessed assets in the year ended 31 December 2018 is £2.1 million (2017: £1.1 million). Of the twelve repossessions made during the year, five were disposed of by 31 December 2018 and seven remained on the market. A further one repossession made during 2017 remained on the market as at 31 December 2018.

5. Creditworthiness risk continued

5.9. Forbearance

Audited: *The following section is covered by the independent auditor's report.*

The Group maintains a forbearance policy for the servicing and management of customers who are in financial difficulty and require some form of concession to be granted, even if this concession entails a loss for the Group. A concession may be either of the following:

- a modification of the previous terms and conditions of an agreement, which the borrower is considered unable to comply with due to its financial difficulties, to allow for sufficient debt service ability, that would not have been granted had the borrower not been in financial difficulties; or
- a total or partial refinancing of an agreement that would not have been granted had the borrower not been in financial difficulties.

Forbearance in relation to an exposure can be temporary or permanent depending on the circumstances, progress on financial rehabilitation and the detail of the concession(s) agreed. The Group includes short-term repayment plans within its definition of forbearance.

Year ended 31 December 2018
During the year ended 31 December 2018, the Group adopted the European Banking Authority (EBA) Technical Standards on forbearance and non-performing exposures as defined in Annex V of Commission Implementing Regulation (EU) 2015 / 227. Under these standards loans are classified as performing or non-performing in accordance with the EBA rules.

The EBA standards stipulate that a forbearance classification can be discontinued when all of the following conditions have been met[1]:

- the exposure is considered to be performing, including where it has been reclassified from the non-performing category, after an analysis of the financial condition of the debtor showed that it no longer met the conditions to be considered as non-performing;
- a minimum two-year probation period has passed from the date the forborne exposure was considered to be performing;
- regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period; and
- none of the exposures to the debtor is more than 30 days past-due at the end of the probation period.

The following tables provide a summary of forborne loans and advances to customers as at 31 December 2018 by reportable segment:

	Performing			Non-performing			
As at 31 December 2018	**Instruments with modification to their T&Cs £m**	**Refinancing £m**	**Total £m**	**Instruments with modification to their T&Cs £m**	**Refinancing £m**	**Total £m**	**Total forborne loans £m**
Property Finance	9.5	–	9.5	40.1	–	40.1	49.6
Business Finance	9.1	5.1	14.2	28.3	0.8	29.1	43.3
Consumer Lending	2.9	–	2.9	10.1	–	10.1	13.0
Total	21.5	5.1	26.6	78.5	0.8	79.3	105.9

1 The forbearance probation period of two years (the second condition listed) was not applied in the year ended 31 December 2017 and as such, results are not directly comparable.

As at 31 December 2018	Number	Gross amount of forborne loans			Loss allowance on forborne loans			
		Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Coverage %
Property Finance	1,011	9.5	40.1	49.6	(0.2)	(4.1)	(4.3)	8.7
Business Finance	313	14.2	29.1	43.3	(0.3)	(3.8)	(4.1)	9.5
Consumer Lending	4,687	2.9	10.1	13.0	(0.3)	(5.3)	(5.6)	43.1
Total	**6,011**	**26.6**	**79.3**	**105.9**	**(0.8)**	**(13.2)**	**(14.0)**	**13.2**

The following tables provide a summary of forborne loans and advances to customers as at 31 December 2018 by the year-end stage classification:

As at 31 December 2018	Performing			Non-performing			
	Instruments with modification to their T&Cs £m	Refinancing £m	Total £m	Instruments with modification to their T&Cs £m	Refinancing £m	Total £m	Total forborne loans £m
Stage 1	6.5	–	6.5	6.8	–	6.8[1]	13.3
Stage 2	15.0	5.1	20.1	40.5	–	40.5	60.6
Stage 3	–	–	–	31.2	0.8	32.0	32.0
Total	**21.5**	**5.1**	**26.6**	**78.5**	**0.8**	**79.3**	**105.9**

As at 31 December 2018	Number	Gross amount of forborne loans			Loss allowance on forborne loans			
		Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Coverage %
Stage 1	1,097	6.5	6.8[1]	13.3	(0.1)	(0.4)[1]	(0.5)	3.8
Stage 2	1,421	20.1	40.5	60.6	(0.7)	(2.9)	(3.6)	5.9
Stage 3	3,493	–	32.0	32.0	–	(9.9)	(9.9)	30.9
Total	**6,011**	**26.6**	**79.3**	**105.9**	**(0.8)**	**(13.2)**	**(14.0)**	**13.2**

Year ended 31 December 2017

In the year ended 31 December 2017, the conditions to discontinue the forbearance classification did not include the forbearance probation period of two years applied in the year ended 31 December 2018 and as such results are not directly comparable.

The following table provides a summary of forborne loans and advances to customers as at 31 December 2017:

As at 31 December 2017	Number	Capital balances £m	Provisions £m	Coverage %
Property Finance	239	16.2	1.0	6.2
Business Finance	361	35.8	5.3	14.8
Consumer Lending	830	5.3	2.8	52.8
Total	1,430	57.3	9.1	15.9

[1] As detailed in Section 5.3 on page 97, the Group has not implemented IFRS 9 curing for forborne loans during 2018. Loans are classified as non-performing and Stage 1 where the latest forbearance measure was extended more than a year ago and the number of days past due at the current reporting period is more than zero but less than 30.

5.10. Concentrations of credit risk

Audited: *The following section is covered by the independent auditor's report.*

The Group monitors concentrations of credit risk from its loans and advances to customers by geographic location and by loan size.

Geographic location

An analysis of credit risk from loans and advances to customers by geographic location is shown below:

As at 31 December 2018	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
East Anglia	117.8	69.6	32.3	219.7
East Midlands	120.6	58.2	58.8	237.6
Greater London	1,454.9	300.8	82.3	1,838.0
Guernsey / Jersey / Isle of Man	24.5	46.3	0.1	70.9
North East	52.8	31.4	35.3	119.5
North West	305.6	171.4	92.0	569.0
Northern Ireland	9.6	1.8	2.1	13.5
Scotland	222.1	93.2	89.4	404.7
South East	747.4	221.4	141.1	1,109.9
South West	263.6	113.3	61.3	438.2
Wales	80.0	95.0	31.3	206.3
West Midlands	141.6	151.4	74.9	367.9
Yorkshire / Humberside	179.4	68.4	71.8	319.6
Gross loans and advances to customers	**3,719.9**	**1,422.2**	**772.7**	**5,914.8**

As at 31 December 2017	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
East Anglia	99.0	75.3	25.6	199.9
East Midlands	100.5	34.7	48.6	183.8
Greater London	1,233.8	169.8	64.9	1,468.5
Guernsey / Jersey / Isle of Man	18.6	47.0	0.1	65.7
North East	45.5	16.4	29.9	91.8
North West	264.5	159.9	75.4	499.8
Northern Ireland	13.6	2.8	1.7	18.1
Scotland	183.0	71.0	76.9	330.9
South East	648.3	169.3	109.9	927.5
South West	239.5	89.7	48.3	377.5
Wales	69.4	84.8	24.4	178.6
West Midlands	125.0	74.8	62.0	261.8
Yorkshire / Humberside	155.3	59.4	59.5	274.2
Gross loans and advances to customers	3,196.0	1,054.9	627.2	4,878.1

Loan size

An analysis of credit risk from loans and advances to customers by loan size is shown below:

As at 31 December 2018	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
0 – £50k	**215.3**	**140.5**	**772.5**	**1,128.3**
£50k – £100k	**378.5**	**72.3**	**0.2**	**451.0**
£100k – £250k	**883.5**	**120.4**	**–**	**1,003.9**
£250k – £500k	**797.2**	**107.9**	**–**	**905.1**
£500k – £1.0 million	**609.3**	**135.6**	**–**	**744.9**
£1.0 million – £2.5 million	**463.8**	**200.2**	**–**	**664.0**
£2.5 million – £5.0 million	**208.7**	**156.1**	**–**	**364.8**
£5.0 million – £10.0 million	**108.4**	**157.3**	**–**	**265.7**
£10.0 million – £25.0 million	**55.2**	**331.9**	**–**	**387.1**
Gross loans and advances to customers	**3,719.9**	**1,422.2**	**772.7**	**5,914.8**

As at 31 December 2017	Property Finance £m	Business Finance £m	Consumer Lending £m	Total £m
0 – £50k	246.1	164.6	627.0	1,037.7
£50k – £100k	369.2	79.7	0.2	449.1
£100k – £250k	784.9	113.3	–	898.2
£250k – £500k	657.0	80.3	–	737.3
£500k – £1.0 million	478.1	106.1	–	584.2
£1.0 million – £2.5 million	379.2	153.7	–	532.9
£2.5 million – £5.0 million	167.1	80.2	–	247.3
£5.0 million – £10.0 million	61.8	77.4	–	139.2
£10.0 million – £25.0 million	52.6	199.6	–	252.2
Gross loans and advances to customers	3,196.0	1,054.9	627.2	4,878.1

6. Liquidity risk

Audited: *The following section is covered by the independent auditor's report.*

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost.

The Group has, therefore, developed comprehensive funding and liquidity policies to ensure that it maintains sufficient liquid assets to be able to meet all its financial obligations and maintain public confidence.

The Group's Treasury function is responsible for the day-to-day management of the Group's liquidity and wholesale funding. The Board sets limits over the level, composition, and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk personnel independent of Treasury. Additionally, a series of liquidity stress tests are performed weekly by Risk and formally reported to the ALCo and the Board to ensure that the Group maintains adequate liquidity for business purposes even under stressed conditions.

The Group reports its liquidity position against its liquidity coverage ratio (LCR), net stable funding ratio (NSFR) and other key regulatory ratios for regulatory purposes.

A liquid asset buffer of government Treasury bills acquired under the Funding for Lending Scheme, and reserves with the Bank of England, are maintained as a source of high-quality liquid assets that can be called upon to create sufficient liquidity in order to meet liabilities on demand. The Group also holds extremely high-quality covered bonds.

Further details of the Group's funding sources are as follows:

- **Funding for Lending Scheme:** see Note 1.7(o) of the financial statements.
- **Term Funding Scheme:** see Note 1.7(o) of the financial statements.

Stress testing is a major component of liquidity risk management and the Group has developed a range of scenarios covering a range of market wide and firm specific factors. A comprehensive stress testing exercise is conducted at least annually, and the methodology is incorporated into the Group's statement of financial position risk management model to ensure that stress tests are run on a regular basis. The output of stress testing is circulated to the Board and to the ALCo who use the results to decide whether to amend the Group's risk appetite and liquidity limits.

Maturity analysis for financial assets and liabilities

The table below segments the Group's contractual undiscounted cash flows of its non-derivative financial assets and liabilities into relevant maturity groupings:

As at 31 December 2018	Carrying amount £m	Gross nominal inflow / (outflow) £m	Less than 1 month £m	1-3 months £m	3 months – 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m
Financial assets								
Cash and balances at central banks	645.2	645.2	636.3	–	–	–	–	8.9
Loans and advances to banks	50.6	50.6	50.6	–	–	–	–	–
Loans and advances to customers	5,845.9	5,944.1	285.4	212.9	817.3	814.0	1,269.1	2,545.4
Investment securities	139.9	140.2	0.2	–	–	–	140.0	–
Total financial assets	6,681.6	6,780.1	972.5	212.9	817.3	814.0	1,409.1	2,554.3
Financial liabilities								
Amounts due to banks	(1,029.4)	(1,039.9)	(1.9)	–	–	(273.9)	(764.1)	–
Customer deposits	(4,977.9)	(5,083.8)	(1,507.3)	(292.1)	(1,800.2)	(820.2)	(598.4)	(65.6)
Subordinated debt liability	(75.5)	(120.8)	–	–	(7.5)	(6.4)	(19.1)	(87.8)
Total financial liabilities	(6,082.8)	(6,244.5)	(1,509.2)	(292.1)	(1,807.7)	(1,100.5)	(1,381.6)	(153.4)

As at 31 December 2017	Carrying amount £m	Gross nominal inflow / (outflow) £m	Less than 1 month £m	1-3 months £m	3 months – 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m
Financial assets								
Cash and balances at central banks	752.5	752.5	748.2	–	–	–	–	4.3
Loans and advances to banks	28.8	28.8	28.8	–	–	–	–	–
Loans and advances to customers	4,844.3	4,989.8	211.8	218.7	646.3	690.8	1,222.7	1,999.5
Total financial assets	5,625.6	5,771.1	988.8	218.7	646.3	690.8	1,222.7	2,003.8
Financial liabilities								
Amounts due to banks	(607.3)	(612.4)	(2.4)	–	–	–	(610.0)	–
Customer deposits	(4,376.2)	(4,448.7)	(1,026.3)	(317.1)	(1,818.7)	(837.3)	(440.1)	(9.2)
Subordinated debt liability	(75.4)	(127.1)	–	–	(7.5)	(6.4)	(19.1)	(94.1)
Total financial liabilities	(5,058.9)	(5,188.2)	(1,028.7)	(317.1)	(1,826.2)	(843.7)	(1,069.2)	(103.3)

Amounts due to banks include £875.0 million of drawings made under the Bank of England's Term Funding Scheme (2017: £605.0 million) and £152.0 million of secured bank borrowings (2017: £nil). See Note 23 of the financial statements.

6. Liquidity risk continued

Liquidity buffer

The following table sets out the components of the Group's liquidity buffer:

	2018 £m	2017 £m
Cash and withdrawable central bank reserves	**636.1**	747.9
Extremely high-quality covered bonds	**129.5**	–
Debt securities	**–**	100.9
Total liquidity buffer	**765.6**	848.8

Debt securities are Treasury bills issued by the Bank of England under its Funding for Lending Scheme which are not recognised on the statement of financial position but are available to be sold under repurchase agreements and are therefore included in the liquidity buffer (see Note 1.7(o) of the financial statements).

The average liquidity buffer throughout the year is £805.1 million (2017: £669.3 million).

Liquidity coverage ratio and net stable funding ratio

Liquidity is actively monitored on a daily basis and reported on a monthly basis through the ALCo and the Risk Committee. A range of early warning indicators are monitored for early signs of liquidity risk. These include a range of quantitative and qualitative measures that include the close monitoring of the LCR and NSFR.

The Group's LCR aims to monitor the resilience of the Group to a liquidity risk over a 30-day period. New guidelines were issued by the European Banking Authority (EBA) in March 2017 to complement the disclosure of liquidity risk management under Article 435 of Regulation (EU) No 575 / 2013. The following table sets out the LCR as at 31 December:

	2018	2017
Liquidity buffer (£m)	**765.6**	848.8
Total net cash outflows (£m)	**312.6**	292.1
Liquidity coverage ratio (%)	**244.9**	290.6

The Group's NSFR aims to ensure that the Group has an acceptable amount of stable funding to support assets over a one-year period of extended stress. Based on current interpretations of regulatory requirements and guidance, the NSFR as at 31 December 2018 is 128.5% (2017: 129.2%). This is in excess of the minimum level of 100% proposed by the Basel Committee on Banking Supervision and European Commission[1].

[1] The Basel Committee on Banking Supervision issued its final recommendations for the implementation of the NSFR in October 2016, proposing an implementation date of 1 January 2018 and a minimum ratio of 100%. The European Commission also proposed a NSFR of at least 100% as part of the CRR 2 package of legislative proposals in November 2016. The timing of a binding NSFR in the United Kingdom remains subject to uncertainty.

Assets available to support future funding

The Group's assets can be used to support collateral requirements for central bank operations or third party repurchase transactions. Assets that have been set aside for such purposes are classified as encumbered assets and cannot be used for other purposes. The majority of asset encumbrance arises from participation in the Bank of England's Term Funding Scheme, Funding for Lending Scheme and investment securities.

All other assets are defined as unencumbered assets. These comprise assets that are readily available to secure funding or meet collateral requirements ('available as collateral'), and assets that are not subject to any restrictions but are not readily available for use ('other').

The table below sets out the availability of the Group's assets to support future funding:

	Encumbered		**Unencumbered**		
As at 31 December 2018	**Pledged as collateral £m**	**Other £m**	**Available as collateral £m**	**Other £m**	**Total £m**
Cash and balances at central banks	–	8.9	–	636.3	645.2
Loans and advances to banks	5.3	–	45.3	–	50.6
Loans and advances to customers	1,603.4	–	4,242.5	–	5,845.9
Investment securities	–	–	–	139.9	139.9
Derivative financial assets	–	–	–	1.6	1.6
Non-financial assets	–	–	34.1	107.6	141.7
Total assets	**1,608.7**	**8.9**	**4,321.9**	**885.4**	**6,824.9**

	Encumbered		Unencumbered		
As at 31 December 2017	Pledged as collateral £m	Other £m	Available as collateral £m	Other £m	Total £m
Cash and balances at central banks	–	4.3	–	748.2	752.5
Loans and advances to banks	–	–	28.8	–	28.8
Loans and advances to customers	1,081.7	–	3,762.6	–	4,844.3
Derivative financial assets	–	–	–	1.8	1.8
Non-financial assets	–	–	36.1	95.2	131.3
Total assets	1,081.7	4.3	3,827.5	845.2	5,758.7

Encumbered assets pledged as collateral includes:

- Loans and advances to banks of £5.3 million (2017: £nil) pledged as collateral against derivative contracts.
- Loans and advances to customers of £1,402.7 million (2017: £1,081.7 million) positioned with the Bank of England for use as collateral under its funding schemes. This comprises £1,402.7 million (2017: £902.2 million) for the Term Funding Scheme and £nil (2017: £179.5 million) for the Funding for Lending scheme.
- Loans and advances to customers of £200.7 million (2017: £nil) pledged as collateral against secured bank borrowings.

Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons and includes:

- Mandatory deposits with central banks of £8.9 million (2017: £4.3 million).

7. Market risk

Audited: *The following section is covered by the independent auditor's report.*

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities change as a result of changes in market prices, the principal element being interest rate risk.

The Group's objective is to manage and control market risk exposures while maintaining a market profile consistent with the Group's risk appetite.

The Group's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's treasury policies. The ALCo approves the Group's treasury policies and receives regular reports on all aspects of market risk exposure, including interest rate risk.

Basis risk

Basis risk is the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics (for example, London Inter Bank Offer Rate (LIBOR) and the Bank of England Bank Rate). This is monitored closely and regularly reported to the ALCo. The ALCo is monitoring the Group's transition from LIBOR to the Sterling Overnight Index Average in advance of 2021. This risk is managed by matching and, where appropriate and necessary, through the use of derivatives, with established risk limits and other control procedures.

The Group's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.

Foreign exchange risk

Foreign exchange risk is the risk that the value of, or net income arising from, assets and liabilities changes as a result of movements in exchange rates. The Group has low levels of foreign exchange risk which is managed by natural hedging and appropriate financial instruments including derivatives.

The table below sets out the Group's exposure to foreign exchange risk:

As at 31 December 2018	**Euros £m**	**US Dollars £m**	**Australian Dollars £m**
Loans and advances to banks	4.4	2.1	(0.1)
Loans and advances to customers	28.7	5.7	0.1
Net position	33.1	7.8	–

As at 31 December 2017	Euros £m	US Dollars £m	Australian Dollars £m
Loans and advances to banks	1.9	(0.8)	(0.1)
Loans and advances to customers	24.4	7.7	0.1
Net position	26.3	6.9	–

The Group estimates that a 5% movement in exchange rates would have no greater impact on the Group's profit before taxation than an increase or decrease of £2.0 million (2017: £1.7 million).

Interest rate risk

Interest rate risk is the risk of loss arising from adverse movements in market interest rates. Interest rate risk arises from the loan and savings products that the Group offers. This risk is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures.

The following is a summary of the Group's interest rate gap position. Items are allocated to time bands by reference to the earlier of the next contractual interest rate change and the maturity date.

As at 31 December 2018	Within 3 months £m	3 months but <6 months £m	6 months but < 1 year £m	1 year but < 5 years £m	> 5 years £m	Non-interest bearing £m	Total £m
Assets							
Cash and balances at central banks	636.3	–	–	–	–	8.9	645.2
Loans and advances to banks	50.6	–	–	–	–	–	50.6
Loans and advances to customers	2,941.0	240.9	520.4	1,963.1	172.9	7.6	5,845.9
Investment securities	139.9	–	–	–	–	–	139.9
Derivative financial assets	–	–	–	–	–	1.6	1.6
Non-financial assets	1.7	2.0	4.7	22.3	3.4	107.6	141.7
Total assets	3,769.5	242.9	525.1	1,985.4	176.3	125.7	6,824.9
Equity and liabilities							
Amounts due to banks	1,027.5	–	–	–	–	1.9	1,029.4
Customer deposit	1,765.2	813.5	1,002.9	1,382.3	14.0	–	4,977.9
Derivative financial liabilities	–	–	–	–	–	5.7	5.7
Subordinated debt liability	–	–	–	75.5	–	–	75.5
Non-financial liabilities	–	–	–	–	–	55.3	55.3
Equity	–	–	–	–	–	681.1	681.1
Total equity and liabilities	2,792.7	813.5	1,002.9	1,457.8	14.0	744.0	6,824.9
Notional values of derivatives	430.7	(10.0)	40.0	(433.4)	(27.3)	–	–
Interest rate sensitivity gap	1,407.5	(580.6)	(437.8)	94.2	135.0	(618.3)	–
Cumulative gap	1,407.5	826.9	389.1	483.3	618.3	–	–

7. Market risk continued

As at 31 December 2017	Within 3 months £m	3 months but <6 months £m	6 months but < 1 year £m	1 year but < 5 years £m	> 5 years £m	Non-interest bearing £m	Total £m
Assets							
Cash and balances at central banks	748.2	–	–	–	–	4.3	752.5
Loans and advances to banks	28.8	–	–	–	–	–	28.8
Loans and advances to customers	2,495.5	210.1	363.6	1,533.5	296.4	(54.8)	4,844.3
Derivative financial assets	–	–	–	–	–	1.8	1.8
Non-financial assets	3.6	2.1	4.1	22.2	4.8	94.5	131.3
Total assets	3,276.1	212.2	367.7	1,555.7	301.2	45.8	5,758.7
Equity and liabilities							
Amounts due to banks	607.3	–	–	–	–	–	607.3
Customer deposits	1,412.4	787.7	955.6	1,212.6	7.9	–	4,376.2
Derivative financial liabilities	–	–	–	–	–	3.4	3.4
Subordinated debt liability	–	–	–	–	75.4	–	75.4
Non-financial liabilities	–	–	–	–	–	73.3	73.3
Equity	–	–	–	–	–	623.1	623.1
Total equity and liabilities	2,019.7	787.7	955.6	1,212.6	83.3	699.8	5,758.7
Notional values of derivatives	578.0	(25.0)	(282.0)	(240.0)	(31.0)	–	–
Interest rate sensitivity gap	1,834.4	(600.5)	(869.9)	103.1	186.9	(654.0)	–
Cumulative gap	1,834.4	1,233.9	364.0	467.1	654.0	–	–

The Group considers a parallel 250 basis points (bps) (2017: 200 bps) movement to be appropriate for scenario testing given the current economic outlook and industry expectations.

The Group estimates that a + / - 250 bps (2017: + / - 200 bps) movement in interest rates paid / received would have impacted the economic value of equity as follows:

+250 bps: £10.9 million negative (2017: £10.5 million negative, based on 200 bps)
-250 bps: £31.9 million positive (2017: £41.0 million positive, based on 200 bps)

In addition, the effect of the same two interest rate shocks is applied to the statement of financial position at year end, to determine how net interest income may change on an annualised basis for one year, as follows:

+250 bps: £65.5 million positive (2017: £20.8 million positive, based on 200 bps)
-250 bps: £0.7 million positive (2017: £4.0 million positive, based on 200 bps)

In preparing the above sensitivity analyses, the Group makes certain assumptions consistent with expected and contractual re-pricing behaviour as well as behavioural repayment profiles, under the two interest scenarios, of the underlying statement of financial position items. The results also include the impact of hedge transactions.

8. Operational risk

The Risk Committee received regular reports across the spectrum of operational risks and information security. These reports cover incidents that have arisen to allow the Committee to assess Management's response and proposed remedial actions. Although a number of incidents were raised during the course of 2018, none of these were material in nature and the Risk Committee was satisfied that the action taken was appropriate and that the control of operational incidents continued to improve. A fire-drill test of the Recovery Plan was completed in September 2018 to test the end to end Recovery Plan playbook and to identify priorities for more targeted testing in 2019. The operational risk reports were developed throughout 2018 to include more focus on forward looking risks which permits a more strategic discussion at Risk Committee level.

9. Conduct, legal and compliance risk

The Group continually reviews its risk management approach to reflect the regulatory and legal environment in which the Group operates.

The Group has no appetite for knowingly behaving inappropriately, resulting in unfair outcomes for its customers. During 2018 the Group appointed a new Chief Compliance Officer to further develop its risk appetite for conduct risk and to introduce and embed measures across the conduct risk lifecycle, which includes product design, sales or after sales processes and culture. It also embedded revisions to annual product reviews and risk appetite to support the management of brokers, intermediaries and outsource partners. These measures are reported to the Board monthly and provide the basis for demonstrating that the Group is operating within its risk appetite. The Group also invested in its financial crime capability within the second line of defence and latterly in 2018 invested in additional capacity and capability within the first line of defence. Where the Group identifies potential unintended outcomes for customers the Group uses its risk management process to proactively escalate, agreeing appropriate actions and communicating clearly with its customers to ensure a fair outcome is achieved.

The Group invested in its information risk capability through the appointment of a Data Privacy Officer in 2018 and implemented a Privacy Working Group as a sub-group of Enterprise Risk Management Committee to oversee the Group's privacy framework.

10. Strategic risk

Strategic risk focusses on large, long-term risks that could become a material issue for the delivery of the Group's goals and objectives. Management of strategic risk is primarily the responsibility of Executive Management. The management of strategic risk is intrinsically linked to the corporate planning and stress testing processes and is further supported by the regular provision of consolidated business performance and risk reporting to the Executive Committee and the Board. The Board received and approved a number of reports during 2018 including the Strategy Update and the 2018 Annual Review of Risk Appetite. It has also been engaged actively in the formation of the Group's ICAAP, ILAAP and RRP which are critical tools to managing strategic risk.

11. Systems and change risk

Customer expectations for service availability are rising with the rapid pace of new technologies leading to a significantly lower tolerance for service disruption. The Group recognises that in order to continue to be recognised for very high levels of customer satisfaction it needs to continually monitor systems risk and ensure that change is delivered with minimum disruption to customers. During 2018 the Group reviewed its operational resilience and appointed a new Chief Technology Officer to oversee the Group's strategic technology requirements.

12. Capital risk and management

Capital risk is the risk that the Group has insufficient capital to cover regulatory requirements and / or to support its own growth plans. Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due or can do so only at excessive cost.

The Group's objective in managing Group capital is to maintain appropriate levels of capital to support the Group's business strategy and meet regulatory requirements.

Policies and processes for managing the Group's capital

The Group's approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates.

The Group's principal objectives when managing capital are to:

- address the expectation of the Shareholders and optimise business activities to ensure return on capital targets are achieved though efficient capital management;
- ensure that the Group and Bank hold sufficient risk capital. Risk capital caters for unexpected losses that may arise, protects Shareholders and depositors and thereby supports the sustainability of the Group and Bank through the business cycles; and
- comply with capital supervisory requirements and related regulations.

The PRA supervises the Group on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. In addition, a number of subsidiaries are regulated for prudential purposes by either the PRA or the FCA. The aim of the capital adequacy regime is to promote safety and soundness in the financial system and embed the requirements of Pillar 3 on market discipline. Under Pillar 2, the Group completes an annual self-assessment of risks known as the ICAAP. The ICAAP is reviewed by the PRA which culminates in the PRA setting a Total Capital Requirement on the level of capital the Group and its regulated subsidiaries are required to hold. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that firm's capital, risk exposures and risk assessment process. The Group's Pillar 3 disclosures can be found on the Group's website.

The Group maintains a strong capital base with the aim of supporting the development of the business and to ensure it meets the Total Capital Requirement at all times. As a result, the Group maintains capital adequacy ratios above minimum regulatory requirements. The Group's individual regulated entities complied with all of the externally imposed capital requirements to which they are subject for the years ended 2018 and 2017.

Regulation

Capital Requirements Directive IV (CRD IV) requires the Group to hold Common Equity Tier 1 capital to account for capital conservation, countercyclical and systemic risk buffers. A capital conservation buffer of 0.625% was introduced on 1 January 2016 and will increase each year to 2019 in line with regulations. As at 31 December 2018 the capital conservation buffer is set at 1.875% (2017: 1.250%).

CRD IV also introduced a new leverage ratio requirement. The leverage calculation determines a ratio based on the relationship between Tier 1 capital and total consolidated exposure, being the sum of on-balance sheet exposures, derivative exposures, securities financing transaction exposures and off-balance sheet exposures. This leverage ratio is a risk-based measure that is designed to act as a supplement to risk-based capital requirements.

Minimum requirements for own funds and eligible liabilities (MREL) are applicable from 1 January 2016 and will be phased in fully by 1 January 2020. Prior to 31 December 2019, MREL will be equal to an institution's minimum regulatory capital requirements. The Bank of England has provided MREL guidance to the Group, as well as guidance on the transitional arrangements until 1 January 2020.

The Common Equity Tier 1 capital ratio for the Group is 12.3% as at 31 December 2018 (31 December 2017: 12.9%), compared with a regulatory minimum of 4.5%. The Total Tier 1 capital ratio for the Group is 15.2% as at 31 December 2018 (31 December 2017: 16.6%), compared with a regulatory minimum of 6.0%.

The leverage ratio for the Group (based on the Basel III definition of January 2014, and the CRD IV definition of October 2014) is 9.2% (2017: 9.4%), compared to the minimum requirement of 3.0%. The Group is not required to comply with the PRA leverage ratio framework until its retail deposits exceed the £50 billion threshold; however, the Group maintains a prudent risk appetite for leverage.

The Total Capital Requirement of the Group is 10.27% of risk-weighted assets (2017: 10.50%)[1].

[1] On 28 November 2018, the Prudential Regulation Authority granted permission for the Group to reduce its Total Capital Requirement.

IFRS 9 transitional arrangements

The Group has elected to use a transitional approach when recognising the impact of adopting IFRS 9. The transitional approach involves phasing in the full impact using transitional factors published in Regulation (EU) 2017 / 2395. This permits the Group to add back to their capital base a proportion of the impact that IFRS 9 has upon their loss allowances during the first five years of use. The proportion that the Group may add back in 2018 is 95%. Further details are set out in Note 2.3 of the financial statements.

The following disclosures are for the Group and its principal subsidiary, Shawbrook Bank Limited ('Bank'). Unless otherwise stated, the 2018 figures are prepared under IFRS 9 adjusted for transitional arrangements and the 2017 figures are prepared under IAS 39.

Capital resources

The following table shows the regulatory capital resources managed by the Group and Bank:

	Group 2018 £m	**Bank 2018 £m**	Group 2017 £m	Bank 2017 £m
Share capital	**2.5**	**175.5**	2.5	175.5
Share premium account	**87.3**	**81.0**	87.3	81.0
Capital redemption reserve	**–**	**16.4**	–	16.7
Merger reserve	**–**	**1.6**	–	1.6
Retained earnings	**467.3**	**260.8**	409.3	201.2
Intangible assets	**(66.4)**	**(46.4)**	(65.7)	(44.6)
Transitional adjustment[1]	**25.7**	**25.5**	–	–
Common Equity Tier 1 capital	**516.4**	**514.4**	433.4	431.4
Capital securities	**124.0**	**125.0**	124.0	125.0
Additional Tier 1 capital	**124.0**	**125.0**	124.0	125.0
Total Tier 1 capital	**640.4**	**639.4**	557.4	556.4
Subordinated debt liability[2]	**74.4**	**75.0**	74.2	75.0
Collective impairment allowance	**–**	**–**	11.1	11.0
Tier 2 capital	**74.4**	**75.0**	85.3	86.0
Total regulatory capital	**714.8**	**714.4**	642.7	642.4

1 The year ended 31 December 2018 includes adjustments for phasing in the impact of IFRS 9 adoption in accordance with EU regulatory transitional arrangements.

2 For the purpose of regulatory capital calculations, capitalised interest of £1.1 million is excluded for Group (2017: £1.2 million) and £1.1 million is excluded for Bank (2017: £1.1 million). Accrued interest is payable semi-annually and is therefore excluded from capital reserves.

12. Capital risk and management continued

Regulatory capital reconciles to total equity per the statement of financial position as follows:

	Group 2018 £m	Bank 2018 £m	Group 2017 £m	Bank 2017 £m
Total regulatory capital	714.8	714.4	642.7	642.4
Subordinated debt liability[1]	(74.4)	(75.0)	(74.2)	(75.0)
Collective impairment allowance	–	–	(11.1)	(11.0)
Intangible assets	66.4	46.4	65.7	44.6
Transitional adjustment[2]	(25.7)	(25.5)	–	–
Total equity	681.1	660.3	623.1	601.0

The following table shows the movement in Total Tier 1 capital during the year:

	Group 2018 £m	Bank 2018 £m	Group 2017 £m	Bank 2017 £m
Total Tier 1 capital as at 1 January	557.4	556.4	370.6	367.6
Impact of adopting IFRS 9[3]	(16.0)	(15.7)	–	–
Restated balance as at 1 January	541.4	540.7	370.6	367.6
Movement in Common Equity Tier 1 capital:				
(Decrease) / increase in capital redemption reserve	–	(0.3)	(183.1)	7.5
Movement in retained earnings:				
Profit for the year	81.6	82.6	61.2	74.9
Dividend paid	–	–	(6.8)	(19.5)
Cancellation of capital redemption reserve	–	–	183.1	–
Share-based payments	(0.3)	–	7.5	–
Coupon paid on capital securities (net of tax)	(7.3)	(7.3)	–	–
Increase in intangible assets	(0.7)	(1.8)	(5.8)	(5.8)
Transitional adjustment[2]	25.7	25.5	–	–
Decrease in foreseeable dividend	–	–	6.7	6.7
Total movement in Common Equity Tier 1 capital	99.0	98.7	62.8	63.8
Movement in Additional Tier 1 capital:				
Increase in capital securities	–	–	124.0	125.0
Total movement in Additional Tier 1 capital	–	–	124.0	125.0
Total Tier 1 capital as at 31 December	640.4	639.4	557.4	556.4

[1] For the purpose of regulatory capital calculations, capitalised interest of £1.1 million is excluded for Group (2017: £1.2 million) and £1.1 million is excluded for Bank (2017: £1.1 million). Accrued interest is payable semi-annually and is therefore excluded from capital reserves.

[2] The year ended 31 December 2018 includes adjustments for phasing in the impact of IFRS 9 adoption in accordance with EU regulatory transitional arrangements.

[3] Further details of the impact of IFRS 9 adoption is set out in Note 2 of the financial statements.

Risk-weighted assets

	Group 2018 £m	Bank 2018 £m	Group 2017 £m	Bank 2017 £m
Property Finance	**1,660.7**	**1,660.7**	1,529.1	1,529.1
Business Finance	**1,464.3**	**1,476.2**	967.2	945.3
Consumer Lending	**560.2**	**560.2**	489.8	489.8
Other	**134.4**	**133.8**	70.7	65.8
Operational risk	**383.8**	**383.8**	304.0	304.5
Credit valuation adjustment	**3.4**	**3.4**	0.9	0.9
Total risk-weighted assets	**4,206.8**	**4,218.1**	3,361.7	3,335.4

Capital ratios

	Group 2018 %	Bank 2018 %	Group 2017 %	Bank 2017 %
Common Equity Tier 1 capital ratio	**12.3**	**12.2**	12.9	12.9
Total Tier 1 capital ratio	**15.2**	**15.2**	16.6	16.7
Total capital ratio	**17.0**	**16.9**	19.1	19.3

Leverage

	Group 2018 £m	Bank 2018 £m	Group 2017 £m	Bank 2017 £m
Total Tier 1 capital	**640.4**	**639.4**	557.4	556.4
Exposure measure				
Total statutory assets (excluding derivatives)	**6,823.3**	**6,804.0**	5,756.9	5,699.6
Off-balance sheet items	**197.7**	**197.6**	224.7	224.7
Exposure value for derivatives	**6.3**	**6.3**	2.2	2.2
Transitional adjustment[1]	**25.7**	**25.5**	–	–
Other regulatory adjustments	**(66.4)**	**(46.4)**	(65.7)	(44.6)
Total exposures	**6,986.6**	**6,987.0**	5,918.1	5,881.9
Leverage ratio (%)	**9.2%**	**9.2%**	9.4%	9.5%

Off-balance sheet items comprise pipeline and committed facilities balances which have a credit conversion factor of medium risk attached to them.

Exposure values associated with derivatives have been reported in compliance with CRD IV rules. The derivative measure is calculated as the replacement cost for the current exposure plus an add-on for future exposure and is not reduced for any collateral received or grossed up for collateral provided.

Other regulatory adjustments comprise net replacement costs of securities financing transactions and derivatives to the leverage ratio exposure.

[1] The year ended 31 December 2018 includes adjustments for phasing in the impact of IFRS 9 adoption in accordance with EU regulatory transitional arrangements.

12. Capital risk and management continued

IFRS 9 transitional arrangements impact analysis

To illustrate the impact of IFRS 9 adoption, the following table provides an overview of the Group's capital metrics under IFRS 9 adjusted for transitional arrangements, compared to if IFRS 9 transitional arrangements had not been applied (i.e. full adoption):

	Group		Bank	
As at 31 December 2018	**Adjusted for IFRS 9 transitional arrangements**	**IFRS 9 transitional arrangements not applied**	**Adjusted for IFRS 9 transitional arrangements**	**IFRS 9 transitional arrangements not applied**
Capital resources				
Common Equity Tier 1 capital (£m)	516.4	490.7	514.4	488.9
Total Tier 1 capital (£m)	640.4	614.7	639.4	613.9
Total regulatory capital (£m)	714.8	689.1	714.4	688.9
Risk-weighted assets				
Total risk-weighted assets (£m)	4,206.8	4,189.5	4,218.1	4,202.9
Capital ratios				
Common Equity Tier 1 capital ratio (%)	12.3	11.7	12.2	11.6
Total Tier 1 capital ratio (%)	15.2	14.7	15.2	14.6
Total capital ratio (%)	17.0	16.4	16.9	16.4
Leverage				
Leverage ratio total exposures (£m)	6,986.6	6,960.9	6,987.0	6,961.5
Leverage ratio (%)	9.2	8.8	9.2	8.8

13. ICAAP, ILAAP and stress testing

The ICAAP, ILAAP and associated stress testing exercises represent important elements of the Group's on-going risk management processes. The results of the risk assessment contained in these documents is embedded in the strategic planning process and risk appetite to ensure that sufficient capital and liquidity are available to support the Group's growth plans as well as cover its regulatory requirements at all times and under varying circumstances.

The ICAAP and ILAAP are reviewed at least annually, and more often in the event of a material change in capital or liquidity. On-going stress testing and scenario analysis outputs are used to inform the formal assessments and determination of required buffers, the strategy and planning for capital and liquidity management as well as the setting of risk appetite limits.

The Board and Executive Management have engaged in a number of exercises which have considered and developed stress test scenarios. The output analysis enables Management to evaluate the Group's capital and funding resilience in the face of severe but plausible risk shocks. In addition to the UK Annual Cyclical Scenario on capital prescribed by the Regulator, the stress tests have included a range of Group wide, multi-risk category stress tests, generic and idiosyncratic financial shocks as well as operational risk scenario analyses. Stress testing is an integral part of the adequacy assessment processes for liquidity and capital, and the setting of tolerances under the annual review of Group risk appetite.

The Group also performed reverse stress tests to help Executive Management understand the full continuum of adverse impact and therefore the level of stress at which the Group would breach its individual capital and liquidity guidance requirements as set by the Regulator under the ICAAP and ILAAP processes

14. Recovery Plan and Resolution Pack

The Group has prepared an RRP in accordance with PRA Supervisory Statements SS9 / 17 and SS19 / 13.

The plan represents the Group's 'Living Will' and examines in detail:

- the consequences of severe levels of stress (i.e. beyond those in the ICAAP) impacting the Group at a future date;
- the state of preparedness and contingency plan to respond to and manage through such a set of circumstances; and
- the options available to Executive Management to withstand and recover from such an environment.

This plan is prepared annually, or more frequently in the event of a material change in the Group's status, capital or liquidity position. The Board of Directors and Executive Management are fully engaged in considering the scenarios and options available for remedial actions to be undertaken.

The Board considers that the Group's business model, its supportive owners and the diversified nature of its business markets provides it with the flexibility to consider selective business or portfolio disposals, loan book run off, equity raising or a combination of these actions. The Group would invoke the RRP in the event they are required.

15. Group viability statement

The Directors have assessed the outlook for the Group over a longer period than the 12 months required by the 'going concern' statement in line with good governance practice and reporting.

The assessment relied on the following:

- the Board considered updates to the strategy and four-year plan at various times during 2018. The Board approved the Strategic Update in February 2019 that outlines the business plans and financial projections from 31 December 2018 to 31 December 2022;
- the amount of capital resources available to support the delivery of the Group's objectives following the addition of further verified profits and completion of an issuance of £125 million of Additional Tier 1 in December 2017;
- the ICAAP and ILAAP (as detailed in Section 13);
- a review and evaluation of its top and emerging risks (as reported in Section 3);
- the Group funding plan and the Management plans to manage the refinance of the Term Funding Scheme;
- consideration of the effect of a moving regulatory landscape on the Total Capital Requirement, Pillar 2B and the CRD IV combined buffer requirements, together with the effect of the Group's capital contingency plan to restore the capital position in scenarios of capital headwinds; and
- the effect of the implementation of IFRS 9, taking into account the transitional arrangements published in Regulation (EU) 2017 / 2395 (as detailed in Section 12 and Note 2 of the financial statements).

The Group is not large enough to participate in the annual Bank of England concurrent stress testing programme but has, as part of its ICAAP, performed a variety of equivalent stress tests and reverse stress tests of its business. These include two market wide stress tests and five Group specific (idiosyncratic) stress tests. The stress tests were derived through discussions with Executive Management and the Board, after considering the Group's top risks. The Group also considered its funding and liquidity adequacy in the context of the reverse stress testing. The risk of the UK leaving the EU has been considered and the Board believe this risk was captured within its stress testing scenarios and will keep this risk under review.

The stress tests enable the Group to assess the impact of a number of severe but plausible scenarios on its business model. In the case of reverse stress testing, the Board is able to assess scenarios and circumstances that would render its business model unviable, thereby identifying business vulnerabilities and ensuring the development of early warning indicators and potential mitigating actions.

The Board aims to build a sustainable lending and savings bank for SMEs and consumers over the medium to long term. The Board monitors a four-year strategic plan that provides a robust planning tool against which strategic decisions are made. Whilst the Board has no reason to believe that the Group will not be viable for a four-year period, given the inherent uncertainty involved, the Board concluded that a three-year period is an appropriate length of time to perform a viability assessment with a greater level of certainty.

Based on the results of the above mentioned assessments, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over a period of at least three years.

Financial statements

Financial statements.

Statement of Directors' responsibilities in respect of the Annual Report & Accounts

The Directors are responsible for preparing the Annual Report & Accounts 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. Under that law they are required to prepare the Group financial statements in accordance with IFRSs 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, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the 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 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 for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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 Group's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the annual financial report

The Directors as at the date of this statement whose names and functions are set out on pages 37 and 38 confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and
- the strategic report and Directors' report includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

This responsibility statement was approved by the Board of Directors and is signed on its behalf by:

Daniel Rushbrook
Company Secretary

18 April 2019

KPMG

Independent auditor's report

to the members of Shawbrook Group plc

1. Our opinion is unmodified

We have audited the financial statements of Shawbrook Group plc ("the Group") for the year ended 31 December 2018 which comprise the *Consolidated statement of profit and loss and other comprehensive income, Consolidated and Company statement of financial position, Consolidated statement in changes in equity, Consolidated and Company statement of cash flows*, and the related notes, including the accounting policies in note 1.

In our opinion:

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

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

— the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and

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

Basis for opinion

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

We were first appointed as auditor by the directors in June 2011. The period of total uninterrupted engagement is for the eight financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality: group financial statements as a whole	£4.5m (2017:5.1m) 4.6% (2017: 4.8%) of normalised profit before tax	
Coverage	100% (2017:100%) of Group profit before tax	
Key audit matters		**vs 2017**
Event driven	**New:** Impact of uncertainties due to Britain exiting the European Union on our audit	**New**
Recurring risks	**New:** Expected Credit Loss provisioning	▲
	Effective interest rate accounting	◀▶
	Provisions related to conduct matters	▲
	Valuation of goodwill	◀▶
	Recoverability of parent company's investment in subsidiaries	◀▶

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

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

The impact of uncertainties due to Britain exiting the European Union on our audit

Refer to page 81 (risk management report), page 123 (viability statement), page 63 (Audit Committee Report)

The risk

Unprecedented levels of uncertainty
All audits assess and challenge the reasonableness of estimates, in particular as described in **expected credit loss provisioning, effective interest rate accounting and valuation of goodwill** below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Group and parent Company's future prospects and performance.

In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and the viability statement and to consider the directors' statement that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and parent Company's position and performance, business model and strategy.

Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.

Our response

We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included:

- **Our Brexit knowledge** – We considered the directors' assessment of Brexit-related sources of risk for the Group and parent Company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks.
- **Sensitivity analysis** – When addressing **expected credit loss provisioning and goodwill**, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty.
- **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on **expected credit loss provisioning, effective interest rate accounting and valuation of goodwill**, we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks.

Our results
As reported under **expected credit loss provisioning, effective interest rate accounting, and valuation of goodwill** we found the resulting estimates and related disclosures of credit impairment provisioning, effective interest rate accounting and valuation of goodwill and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Expected Credit Loss provisioning

£68.8 million; 2017: £31.6 million

Refer to page 63 (Audit Committee Report), pages 155-157 (accounting policy) and page 177 (financial disclosures).

The risk

Subjective estimate
This is a key judgemental area due to the level of subjectivity inherent in estimating the recoverability of loan balances on an Expected Credit Loss basis ("ECL").

As a result of the transition to IFRS 9 – Financial Instruments in 2018, the Group is to determine the loan loss provisioning using the 3 stage model:

(i) For loans where the credit risk has not increased significantly since initial recognition, a provision is recognised for the expected 12 month credit losses expected to be incurred.

(ii) For loans where there is deemed to be a significant increase in credit risk, a provision for the expected lifetime credit loss is recognised across this portfolio.

(iii) For loans that are credit impaired, the Group will need to undertake a specific impairment assessment.

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

— The determination of significant increase in credit risk,
— The probability of an account falling into arrears and subsequently defaulting,
— Loss given default, and
— Forward economic guidance.

For loans classified as stage 3, an impairment assessment is required at an individual loan level, based on estimated future cash flows discounted to present value at the rate inherent in the loan. This includes estimating the cost of obtaining and selling the repossessed collateral, and probable sale proceeds.

There is a risk that the overall provision is not reflective of the expected losses at the end of the period due to changes in customer credit quality resulting in unrepresentative probabilities of default. Given the Group's lending has not experienced a full economic cycle, there is increased risk that actual experience may differ from the Group's current expectations.

The effect of these matters is that, as part of our risk assessment, we determined that ECL provisioning has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The risk management report (note 5.3) disclose the sensitivity estimated by the Group.

Disclosure quality
The disclosures regarding the Group's application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgements and material inputs to the IFRS 9 ECL results.

Our response

Our procedures included:

— **Controls testing:** We performed end to end process walk – throughs to identify the key systems, applications and controls used in the ECL processes. We tested the relevant general IT and applications controls over key systems used in the ECL process.

— **Test of details:** For a sample of loans and advances we conducted credit file reviews to assess the appropriateness of the stage allocation and associated ECL estimate.

— **Historical comparisons:** We critically assessed the Group's assumptions in respect of significant increase in credit risk; likely collateral valuations, including timing of recovery; and the probability of possession given default by comparing them to the Group's historical experience. For the Group's probability of default models we assessed the reasonableness of the model predictions by comparing them against actual results.

— **Benchmarking assumptions:** We compared the Group's key assumptions on significant increase in credit risk; likely collateral valuations, including timing of recovery; probability of possession given default; and the probability weightings attached to each economic scenario to comparable peer group organisations.

— **Our sector experience:** We challenged the Group's key assumptions on significant increase in credit risk; the definition of default; likely collateral valuations, including timing of recovery; probability of default; probability of possession given default based on our knowledge of the Group and experience of the industry in which it operates. We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them.

— **Sensitivity analysis:** We performed sensitivity analysis over the Group's key assumptions on significant increase in credit risk; likely collateral valuations, including timing of recovery; probability of possession given default; and the probability weightings attached to each economic scenario.

— **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the expected credit losses. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made was sufficiently clear.

Our Results:
We found the resulting estimate and related disclosures of the provision for expected credit loss to be acceptable (2017 result: acceptable).

Independent auditor's report continued

Effective interest rate accounting

£351.1 million; 2017: £307.1 million

Refer to page 63 (Audit Committee Report), page 159 (accounting policy) and page 170 (financial disclosures).

The risk	Our response
Subjective estimate Using a model, interest earned and fees earned and incurred on loans and advances to customers are recognised using the effective interest rate method that spreads directly attributable expected income over the expected lives of the loans. The Group applies judgement in deciding which cash flows are spread on an EIR basis and assessing the redemption profiles used to spread those cash flows. The most critical element of judgement in this area is the estimation of the redemption profiles of the loans, informed by past customer behaviour of when loans have been paid off.	Our procedures included: — **Methodology choice:** We tested the accuracy of data inputs from the underlying systems into the effective interest rate models and the consistency of methodology and applications across the Group's loan portfolios; — **Independent re-performance:** We evaluated the mathematical accuracy of models through re-performance of the model calculations; — **Sensitivity analysis:** We assessed and challenged the reasonableness of the models key assumptions, expected lives and forecast future cash flows by comparing these to historical trends within the Group and performing stress tests; and — **Assessing transparency:** Considering the adequacy of the Group's disclosures in respect of the sensitivity of revenue to these assumptions. **Our results** We found the amount of EIR income recognised in the year to be acceptable. (2017: acceptable)

Provision relating to conduct matters

£10.2 million; 2017: £2.5 million

Refer to page 64 (Audit Committee Report), page 160 (accounting policy) and page 188 (financial disclosures).

The risk

Estimation of exposure
Certain of the Group's lending activities give rise to ongoing exposure under Section 75 of the Consumer Credit Act.

Due to the uncertainties that can arise in measuring potential obligations resulting from operational, legal and regulatory matters, the directors apply judgement in estimating the value of any associated liabilities.

There is a judgement in how the directors determine the appropriate methodologies to calculate the value of potential liabilities and the assumptions used in these methodologies.

During the prior year, the Group saw an increase in customer complaints relating to its solar lending product where the original supplier is no longer solvent. Management has increased the associated provision in the year as a result of further customer complaints and claim correspondence.

The key element of judgement is the estimation of future customer complaints rate. This judgement is informed by the Group's past complaint and claim experience. Given the limited historical information, there is a risk that the actual experience may differ from the Group's expectation.

The effect of these matters is that, as part of our risk assessment, we determined that the provision related to conduct matters has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.

Our response

Our procedures included:

— **Our sector experience:** We compared common industry issues with those areas provided for by the Group to determine whether these issues were relevant to the business and to consider completeness of the provisions assessed by the directors.

— **Independent evaluation:** We have critically challenged and evaluated management's assumptions in estimating the expected exposure including re-performance of management's calculations;

— **Sensitivity analysis:** We assessed and challenged the reasonableness of the model's key assumption, future customer complaints rate, by comparing this to historical trends within the Group and performing stress tests;

— **Methodology implementation:** We assessed the methodologies used by the Group in determining the estimated values of liabilities by considering whether they are appropriate to the liability being estimated.

— **Assessing transparency:** We considered the adequacy of the Group's disclosures in detailing significant conduct related matters and potential liabilities.

Our results
We found the resulting estimate of the conduct provisions to be acceptable (2017: acceptable).

Independent auditor's report continued

Valuation of goodwill

£43.7 million; 2017: £44.8 million

Refer to page 63 (Audit Committee Report), pages 159-160 (accounting policy) and page 183 (financial disclosures).

The risk

Forecast-based evaluation
The carrying value of goodwill is tested for impairment on the occurrence of an impairment trigger or otherwise annually.

The estimated recoverable amount is subjective due to the inherent uncertainty involved in forecasting future cash flows and selecting an appropriate discount rate.

£34.7 million of the total goodwill balance relates to Business Finance, being the area of most significant judgement in light of the size of the balance and weaker than expected financial performance in the year.

Our response

Our procedures included:

— **Our sector experience:** Evaluating assumptions used, in particular those relating to forecast revenue growth, discount rate and incremental capital requirements in Business Finance;

— **Benchmarking assumptions:** Comparing the Group's assumptions to external comparable data in relation to key inputs such as projected economic growth and discount rates;

— **Sensitivity analysis:** Performing breakeven analysis on the assumptions noted above using our data analytic capabilities;

— **Assessing transparency:** Assessing whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill.

Our results
We found the resulting estimate of the carrying value of goodwill to be acceptable (2017: acceptable)

Recoverability of parent Company's investment in subsidiaries

Parent Company risk
£409.2 million; 2017: £409.5 million

Refer to page 187 (financial disclosures).

The risk

Impairment assessment
The carrying amount of the parent company's investments in subsidiaries represents 84% (2017: 84%) of the company's total assets.

Their recoverability is not at a high risk of significant misstatement or subject to significant judgement or estimate.

However, due to their materiality in the context of the parent company's financial statements, this is considered to be an area that have the greatest effect on our overall parent company audit.

Our response

Our procedures included:

— **Tests of detail:** Comparing the carrying amount of 100% of investments with the relevant subsidiaries' financial statements to identify whether their net assets, being an approximation of their minimum recoverable amount, were in excess of their carrying amount and assessing whether those subsidiaries have historically been profit-making.

Our results
We found the Group's assessment of the recoverability of the investment in subsidiaries to be acceptable (2017: acceptable)

A key audit matter was reported in 2017 in respect of Impairment Provisioning. As a result of the Group's transition to IFRS 9, this key audit matter has been replaced with Expected Credit Loss Provisioning in 2018.

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

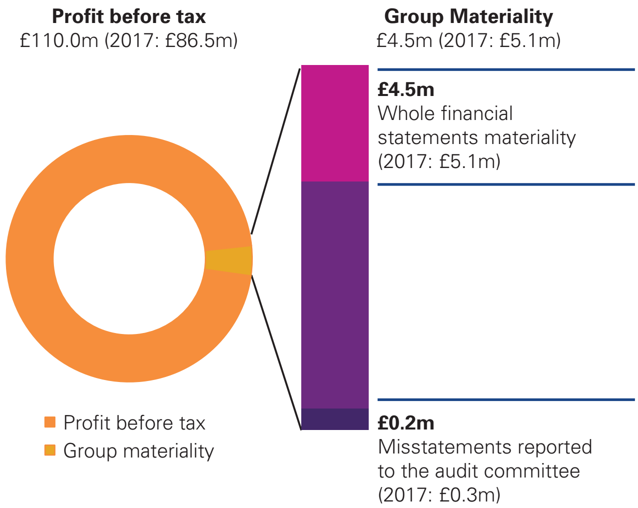
Materiality for the Group financial statements as a whole was set at £4.5m (2017: £5.1m), determined with reference to a benchmark of Group profit before tax, normalised to exclude this year's insurance recoveries as disclosed in note 12, of £13.0m, of which it represents 4.6% (2017: 4.8%).

Materiality for the parent Company financial statements as a whole was set at £4.5m (2017: £5.1m), determined with reference to a benchmark of company total assets, of which it represents 0.9% (2017: 1.2%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.2m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Team structure

The Group team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality level set out above.



4. We have nothing to report on going concern

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

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

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period were:

- availability of funding and liquidity in the event of a market wide stress scenario including the impact of Brexit, and
- impact on regulatory capital requirements in the event of an economic slowdown or recession.

As these were risks that could potentially cast significant doubt on the Group's and the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit and the erosion of customer or supplier confidence, which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on other information in the Annual Report

The directors are responsible for the other information in the Annual Report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

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

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

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

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 117, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

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

Irregularities – ability to detect

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

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

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's license to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering and financial crime and certain aspects of the company legislation recognising the financial and regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. Further detail in respect of conduct related matters is set out in the key audit matter disclosures in section 2 of this report.

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

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

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

Simon Ryder (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
15 Canada Square
London
E14 5GL
18 April 2019

Consolidated statement of profit and loss and other comprehensive income

For the year ended 31 December 2018

	Note	**2018 £m**	2017 £m
Interest income calculated using the effective interest rate method	4	**356.0**	308.9
Other interest and similar income	4	**0.8**	4.4
Interest expense and similar charges	5	**(87.3)**	(76.0)
Net interest income		**269.5**	237.3
Operating lease rentals		**10.0**	12.3
Other operating lease expense		**(0.6)**	–
Depreciation on operating leases	17	**(7.6)**	(10.6)
Net income from operating leases		**1.8**	1.7
Fee and commission income	6	**10.7**	12.3
Fee and commission expense		**(8.4)**	(12.8)
Net fee and commission income / (expense)		**2.3**	(0.5)
Net gains on financial instruments mandatorily at fair value through profit or loss	16(c)	**0.5**	0.2
Net operating income		**274.1**	238.7
Administrative expenses	7	**(130.3)**	(126.8)
Impairment losses on financial assets[1]	12	**(23.2)**	(23.3)
Provisions for liabilities and charges	25	**(10.1)**	(2.1)
Total operating expenses		**(163.6)**	(152.2)
Share of results of associates	20	**(0.5)**	–
Profit before taxation		**110.0**	86.5
Taxation	13	**(28.4)**	(25.3)
Profit after taxation, being total comprehensive income, attributable to owners		**81.6**	61.2

The notes on pages 140 to 201 are an integral part of these financial statements.

[1] Impairment losses on financial assets in the year ended 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment losses on financial assets in the year ended 31 December 2017 reflect impairment losses calculated in accordance with IAS 39. As such, results are not directly comparable.

Consolidated and Company statement of financial position

As at 31 December 2018

	Note	Group 2018 £m	Company 2018 £m	Group 2017 £m	Company 2017 £m
Assets					
Cash and balances at central banks		**645.2**	**–**	752.5	–
Loans and advances to banks		**50.6**	**–**	28.8	–
Loans and advances to customers	14	**5,845.9**	**–**	4,844.3	–
Investment securities	15	**139.9**	**–**	–	–
Derivative financial assets	16(a)	**1.6**	**–**	1.8	–
Property, plant and equipment	17	**39.1**	**–**	39.6	–
Intangible assets	18	**66.4**	**–**	65.7	–
Deferred tax assets	19	**18.0**	**–**	15.7	–
Investment in associates	20	**5.5**	**–**	–	–
Other assets	21	**12.7**	**1.8**	10.3	1.5
Investment in subsidiaries	22	**–**	**409.2**	–	409.5
Subordinated debt receivable	27(b)	**–**	**76.1**	–	76.1
Total assets		**6,824.9**	**487.1**	5,758.7	487.1
Liabilities					
Amounts due to banks	23	**1,029.4**	**–**	607.3	–
Customer deposits	24	**4,977.9**	**–**	4,376.2	–
Provisions for liabilities and charges	25	**11.6**	**–**	2.8	–
Derivative financial liabilities	16(a)	**5.7**	**–**	3.4	–
Current tax liabilities		**4.0**	**–**	7.7	–
Other liabilities	26	**39.7**	**0.3**	62.8	0.4
Subordinated debt liability	27(a)	**75.5**	**75.5**	75.4	75.4
Total liabilities		**6,143.8**	**75.8**	5,135.6	75.8
Equity					
Share capital	28	**2.5**	**2.5**	2.5	2.5
Share premium account		**87.3**	**87.3**	87.3	87.3
Capital securities	29	**124.0**	**124.0**	124.0	124.0
Retained earnings		**467.3**	**197.5**	409.3	197.5
Total equity		**681.1**	**411.3**	623.1	411.3
Total equity and liabilities		**6,824.9**	**487.1**	5,758.7	487.1

The notes on pages 140 to 201 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 18 April 2019 and were signed on its behalf by:

Ian Cowie
Chief Executive Officer

Dylan Minto
Chief Financial Officer

Registered number 07240248

Consolidated statement of changes in equity

For the year ended 31 December 2018

Year ended 31 December 2018	Share capital £m	Share premium account £m	Capital securities £m	Retained earnings £m	Total equity £m
As at 1 January 2018	2.5	87.3	124.0	409.3	623.1
Impact of adopting IFRS 9[1]	–	–	–	(16.0)	(16.0)
Restated balance as at 1 January 2018	2.5	87.3	124.0	393.3	607.1
Profit for the year	–	–	–	81.6	81.6
Share-based payments	–	–	–	(0.3)	(0.3)
Coupon paid on capital securities (net of tax)	–	–	–	(7.3)	(7.3)
As at 31 December 2018	2.5	87.3	124.0	467.3	681.1

Year ended 31 December 2017	Share capital £m	Share premium account £m	Capital securities £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
As at 1 January 2017	2.5	87.3	–	183.1	164.3	437.2
Profit for the year	–	–	–	–	61.2	61.2
Dividend paid	–	–	–	–	(6.8)	(6.8)
Issue of capital securities (net of costs)	–	–	124.0	–	–	124.0
Cancellation of capital redemption reserve[2]	–	–	–	(183.1)	183.1	–
Share-based payments	–	–	–	–	7.5	7.5
As at 31 December 2017	2.5	87.3	124.0	–	409.3	623.1

The notes on pages 140 to 201 are an integral part of these financial statements.

[1] See Note 1.6(a) and Note 2 for details.

[2] In June 2017, the Company cancelled the capital redemption reserve as part of a court confirmed reduction of capital. The entire balance of the capital redemption reserve was cancelled and credited to the Company's retained earnings. Following the cancellation of the capital redemption reserve, the Company created additional distributable reserves of £183.1 million.

Company statement of changes in equity

For the year ended 31 December 2018

Year ended 31 December 2018	Share capital £m	Share premium account £m	Capital securities £m	Retained earnings £m	Total equity £m
As at 1 January 2018	**2.5**	**87.3**	**124.0**	**197.5**	**411.3**
Profit for the year	**–**	**–**	**–**	**0.3**	**0.3**
Share-based payments	**–**	**–**	**–**	**(0.3)**	**(0.3)**
Coupon paid on capital securities (net of tax)	**–**	**–**	**–**	**(7.3)**	**(7.3)**
Coupon received on capital securities from subsidiary (net of tax)	**–**	**–**	**–**	**7.3**	**7.3**
As at 31 December 2018	**2.5**	**87.3**	**124.0**	**197.5**	**411.3**

Year ended 31 December 2017	Share capital £m	Share premium account £m	Capital securities £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
As at 1 January 2017	2.5	87.3	–	183.1	7.1	280.0
Profit for the year	–	–	–	–	6.6	6.6
Dividend paid	–	–	–	–	(6.8)	(6.8)
Issue of capital securities (net of costs)	–	–	124.0	–	–	124.0
Cancellation of capital redemption reserve[1]	–	–	–	(183.1)	183.1	–
Share-based payments	–	–	–	–	7.5	7.5
As at 31 December 2017	2.5	87.3	124.0	–	197.5	411.3

The notes on pages 140 to 201 are an integral part of these financial statements.

[1] In June 2017, the Company cancelled the capital redemption reserve as part of a court confirmed reduction of capital. The entire balance of the capital redemption reserve was cancelled and credited to the Company's retained earnings. Following the cancellation of the capital redemption reserve, the Company created additional distributable reserves of £183.1 million.

Consolidated and Company statement of cash flows

For the year ended 31 December 2018

	Note	Group 2018 £m	Company 2018 £m	Group 2017 £m	Company 2017 £m
Cash flows from operating activities					
Profit before taxation		**110.0**	**0.3**	86.5	6.6
Adjustments for non-cash items and other adjustments included within the statement of profit and loss	30(a)	**40.4**	**6.5**	54.5	6.5
(Increase) / decrease in operating assets	30(b)	**(1,050.2)**	**(0.3)**	(816.4)	0.7
Increase / (decrease) in operating liabilities	30(c)	**589.2**	**(0.1)**	473.0	0.4
Tax paid		**(26.3)**	**–**	(29.6)	–
Net cash (used by) / generated from operating activities		**(336.9)**	**6.4**	(232.0)	14.2
Cash flows from investing activities					
Purchase of investment securities		**(139.7)**	**–**	–	–
Purchase of property, plant and equipment		**(3.6)**	**–**	(1.6)	–
Purchase of intangible assets		**(9.8)**	**–**	(9.8)	–
Purchase of shares in associates		**(6.0)**	**–**	–	–
Investment in subsidiaries net of cash and cash equivalents acquired		**–**	**–**	–	(125.0)
Net cash used by investing activities		**(159.1)**	**–**	(11.4)	(125.0)
Cash flows from financing activities					
Increase in amounts due to banks		**422.1**	**–**	459.6	–
Payment of subordinated debt interest		**(6.4)**	**(6.4)**	(6.4)	(6.4)
Net proceeds from the issue of capital securities		**–**	**–**	124.0	124.0
Coupon paid to holders of capital securities		**(9.8)**	**–**	–	–
Dividends paid to Shareholders		**–**	**–**	(6.8)	(6.8)
Net cash generated from / (used by) financing activities		**405.9**	**(6.4)**	570.4	110.8
Net (decrease) / increase in cash and cash equivalents		**(90.1)**	**–**	327.0	–
Cash and cash equivalents as at 1 January		**777.0**	**–**	450.0	–
Cash and cash equivalents as at 31 December	30(d)	**686.9**	**–**	777.0	–

The notes on pages 140 to 201 are an integral part of these financial statements.

Notes to the financial statements

For the year ended 31 December 2018

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies

1.1. Reporting entity

Shawbrook Group plc (the 'Company') is a public limited company incorporated and domiciled in the UK. The registered office is Lutea House, Warley Hill Business Park, The Drive, Great Warley, Brentwood, Essex, CM13 3BE. The consolidated financial statements of Shawbrook Group plc, for the year ended 31 December 2018, comprise the results of the Company and its subsidiaries (together, the 'Group'), including its principal subsidiary, Shawbrook Bank Limited. The ultimate parent company is detailed in Note 32.

The principal activities of the Group are lending and savings.

1.2. Basis of accounting and measurement

Both the consolidated and Company financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. No individual statement of profit and loss or related notes are presented for the Company as permitted by section 408 (4) of the Companies Act 2006.

As detailed in the Directors' report, the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

The financial statements have been prepared on a historical cost basis, except as required in the valuation of certain financial instruments which are carried at fair value.

1.3. Functional and presentation currency

The financial statements are presented in Pounds Sterling, which is the functional currency of the Company and all of its subsidiaries. All amounts have been rounded to the nearest million, except where otherwise indicated.

Foreign currency transactions are translated into functional currency using the spot exchange rate at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the spot exchange rate at the reporting date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the statement of profit and loss.

Non-monetary assets and liabilities that are measured on a historical cost basis and denominated in foreign currencies are translated into the functional currency using the spot exchange rate at the date of the transaction. Non-monetary assets and liabilities that are measured at fair value and denominated in foreign currencies are translated into the functional currency at the spot exchange rate at the date of valuation. Where these assets and liabilities are held at fair value through profit and loss, exchange differences are reported as part of the fair value gain or loss.

1.4. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries (the 'Group'). The Group's subsidiaries are detailed in Note 33.

Subsidiaries are entities controlled by the Group. Control is achieved when the Group:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power over the investee to affect its returns.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that control ceases. Accounting policies are applied consistently across the Group. Intragroup transactions and balances are eliminated in full on consolidation.

The Group's interests in associates are accounted for using the equity method of accounting as detailed in Note 1.7(n).

1.5. Presentation of risk and capital management disclosures

The disclosures required under IFRS 7 'Financial Instruments: Disclosures' concerning the nature and extent of risks relating to financial instruments and under IAS 1 'Presentation of Financial Statements' concerning objectives, policies and processes for managing capital have been included within the audited section of the risk management report. Where information is marked as 'audited' these are covered by the independent auditor's report.

1.6. Adoption of new and revised standards and interpretations

On 1 January 2018, a number of new and revised standards issued by the International Accounting Standards Board, and endorsed for use in the EU, came into effect. New and revised standards adopted in the period that are deemed significant to the Group are outlined below. A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Group's financial statements.

(a) IFRS 9 'Financial Instruments'

On 1 January 2018, the Group adopted the requirements of IFRS 9 as issued in July 2014 and the amendments to IFRS 9 'Prepayment Features with Negative Compensation'. The amendments to IFRS 9 are effective for annual periods beginning on or after 1 January 2019, with early adoption permitted. The Group elected to early adopt the amendments. The new standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'.

To reflect the difference between IFRS 9 and IAS 39 consequential amendments were also made to other standards including IFRS 7 'Financial Instruments: Disclosures' and IAS 1 'Presentation of Financial Statements'. The Group adopted these consequential amendments, along with IFRS 9, on 1 January 2018.

Changes in accounting policies

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

Classification of financial assets
Under IFRS 9 there are three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income and fair value through profit or loss. The IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale are eliminated.

Classification of financial assets is dependent on the outcome of two assessments which evaluates the business model in which financial assets are managed and their cash flow characteristics.

Full details of the accounting policies relating to the classification and measurement of financial assets and financial liabilities are set out in Note 1.7(u).

Impairment of financial assets
IFRS 9 replaces the incurred loss model implemented under IAS 39 with an expected credit loss (ECL) model which results in earlier recognition of credit losses. The new model applies to all financial assets not held at fair value through profit or loss, together with financial guarantee contracts and loan commitments. Equity instruments are not subject to impairment.

Full details of the accounting policies relating to impairment of financial assets are set out in Note 1.7(v).

Consequential amendments to IFRS 7, introduces the requirement for detailed qualitative and quantitative information about the ECL calculations such as assumptions and inputs. These additional disclosures are set out in Note 1.9(d) and Section 5.3 of the risk management report.

Hedge accounting
As permitted by IFRS 9, the Group has elected to continue to apply the hedge accounting requirements of IAS 39.

Full details of the accounting policies relating to hedge accounting are set out in Note 1.7(j).

Consequential amendments to IFRS 7 introduce the requirement for additional and more detailed disclosures for hedge accounting. These disclosures are required even when continuing to apply the hedge accounting requirements of IAS 39 and are set out in Note 16(b). As permitted by IFRS 7, the Group has not provided comparative information for periods before the date of initial application of IFRS 9 for the new disclosures.

Changes in presentation

Consequential amendments to IAS 1 require interest income calculated using the effective interest rate method, as detailed in Note 1.7(b), to be presented separately on the face of the statement of profit and loss. Comparatives have been restated accordingly to reflect this change in presentation.

Transition

The Group has adjusted the opening balance of retained earnings to reflect the application of the new requirements of IFRS 9. In accordance with the transition requirements, comparative information is not restated. As such, the comparative information for 2017 is reported under the requirements of IAS 39 and is not comparable to the information presented for 2018.

Full details regarding the impact of IFRS 9 adoption and transition disclosures required by IFRS 7 are set out in Note 2.

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.6. Adoption of new and revised standards and interpretations continued

(b) IFRS 15 'Revenue from Contracts with Customers'

On 1 January 2018, the Group adopted the requirements of IFRS 15. The new standard replaces IAS 18 'Revenue', IAS 11 'Construction Contracts' and related interpretations.

Changes in accounting policies

IFRS 15 establishes the principles to apply when reporting information about the nature, amount, timing and uncertainty of revenue and cash flows from a contract with a customer. The standard introduces a five step revenue recognition model to be applied to all contracts with customers to determine whether, how much, and when revenue is recognised. IFRS 15 does not apply to insurance contracts, financial instruments or lease contracts, which fall under the scope of other IFRSs. It also does not apply if two companies in the same line of business exchange non-monetary assets to facilitate sales to other parties. Of particular note, interest income, the main source of revenue for the Group, falls outside the scope of IFRS 15.

Transition

The Group has adopted IFRS 15 using the cumulative effect method (without practical expedients). As such, the standard is applied as of 1 January 2018 with the cumulative effect recognised as an adjustment to the opening balance of retained earnings. Comparative information for 2017 is not restated.

The Group assessed its non-interest revenue streams that fall under the scope of IFRS 15 and determined that the approach to revenue recognition was unchanged and there was no impact on the amount or timing of revenue to be recognised as a result of the adoption of IFRS 15. As such, there is no adjustment to the opening balance of retained earnings or related tax balances. Furthermore, there is no impact to the consolidated statement of financial position or the consolidated statement of profit and loss and other comprehensive income. Revenue is disaggregated by reportable segment as detailed in Note 3.

(c) IFRS 2 amendment 'Classification and Measurement of Share-based Payment Transactions'

On 1 January 2018, the amendments to IFRS 2 became effective in relation to the classification and measurement of share-based payment transactions.

Changes in accounting policies

The amendments to IFRS 2 specifically relate to: effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; classification of a share-based payment transaction with net settlement features for withholding tax obligations; accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

Transition

As at 1 January 2018, the Group had no share schemes in operation. The amendments will be adopted for any new share schemes introduced after this date.

1.7. Significant accounting policies

With the exception of changes to the Group's accounting policies resulting from new and revised accounting standards adopted in the year (see Note 1.6), the Group has consistently applied the following accounting policies to all periods presented in the financial statements.

(a) Operating segments

See disclosures at Note 3

Operating segments are identified on the basis of internal reports and components of the Group which are regularly reviewed by the Chief Operating Decision Maker to allocate resources to segments and to assess their performance. For this purpose, the Group Executive Committee has been determined to be the Chief Operating Decision Maker for the Group.

The Group determines operating segments according to similar economic characteristics and the nature of its products and services. Segment performance is evaluated on an underlying basis which excludes certain items included in the statement of profit and loss determined under IFRS as adopted by the EU.

(b) Interest income and expense

See disclosures at Note 4 and Note 5

Financial instruments measured at amortised cost

Under both IFRS 9 and IAS 39, interest income and expense are recognised in the statement of profit and loss for all instruments measured at amortised cost using the effective interest rate method.

Under IFRS 9 (from 1 January 2018)
The effective interest rate method calculates the amortised cost of a financial asset or financial liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset, or the amortised cost of a financial liability.

Amortised cost is the amount at which the financial instrument is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest rate method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any loss allowance.

When calculating the effective interest rate for financial instruments, with the exception of credit-impaired financial assets, the Group estimates future cash flows considering all contractual terms of the financial instrument, for example prepayment options, but does not consider the loss allowance. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument.

For credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including loss allowances.

In calculating interest income and expense, the calculated effective interest rate is applied to the gross carrying amount of the financial asset (when the asset is not credit-impaired), or to the amortised cost of the financial liability.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying a credit-adjusted effective interest rate to the amortised cost of the financial asset. The calculation of interest income does not revert to the gross basis, even if the credit risk of the asset improves.

Where a financial asset becomes credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, the calculation of interest income reverts to the gross basis.

A financial asset is deemed to be credit-impaired when it is in Stage 3 as detailed in Note 1.7(v).

Under IAS 39 (prior to 1 January 2018)
Interest income and expense were recognised in the statement of profit and loss using the effective interest rate method. The effective interest rate was the rate that exactly discounted the estimated future cash flows through the expected life of the financial instrument (or, where appropriate, a shorter period) to the carrying amount of the financial instrument.

When calculating the effective interest rate, the Group estimated future cash flows considering all contractual terms of the financial instrument, for example prepayment options, but did not consider impairment allowances. The calculation included all fees paid or received between parties to the contract that were an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Derivative financial instruments

The Group recognises net interest income on derivative financial instruments forming part of hedging relationships and economic hedging relationships based on the underlying hedged items. For derivative financial instruments hedging assets, the net interest income is recognised in interest income. For derivative financial instruments hedging liabilities, the net interest income is recognised in interest expense.

(c) Fee and commission income

See disclosures at Note 6

Where fees and commissions are not included in the effective interest rate calculation (see Note 1.7(b)), they are recognised as follows:

Under IFRS 15 (from 1 January 2018)
Income is recognised when performance obligations attached to the fee or commission have been satisfied. Where income is earned from the provision of a service, for example an account maintenance fee, the performance obligations are deemed to have been satisfied when the service is delivered. Where income is earned upon the execution of a significant act, for example CHAPS payment charges, the performance obligations are deemed to have been satisfied when the act is completed for the customer.

Under IAS 18 (prior to 1 January 2018)
Income was recognised on an accruals basis when the service had been provided, or on the completion of the act the fee related to.

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

(d) Administrative expenses

See disclosures at Note 7

Administrative expenses are recognised on an accruals basis. The Group's significant accounting policies relating to specific components of administrative expenses are as follows:

Payroll costs

Salaries and social security costs are recognised over the period in which the employees provide the service to which the payments relate.

Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period that employees are required to provide services.

The Group operates defined contribution pension schemes for eligible employees and does not operate any defined benefit pension schemes. Under the defined contribution pension arrangements, the Group pays fixed contributions into employees' personal pension plans, with no further payment obligations once the contributions have been paid. The Group's contributions to such arrangements are recognised as an expense when they fall due.

The accounting policies for employee share-based payments are detailed in Note 1.7(e).

Depreciation and amortisation

See Note 1.7(k) for details of depreciation and Note 1.7(m) for details of amortisation.

Operating lease payments

The Group leases land and buildings under operating lease agreements. See Note 1.7(l) for details.

(e) Share-based payments

See disclosures at Note 10

The Group historically operated a number of equity-settled share-based payment schemes in respect of services received from certain employees. All such schemes fully vested in 2017. In 2018, no share-based payment schemes have been in operation.

Accounting policies implemented by the Group when share-based payment schemes are in operation are as follows:

The grant date fair value of a share-based payment transaction is recognised as a payroll cost in administrative expenses in the statement of profit and loss, with a corresponding increase in retained earnings in equity, on a straight-line basis over the period that the employees become unconditionally entitled to the awards (the vesting period). In the absence of market prices, the grant date fair value is estimated using an appropriate valuation technique.

The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

For share-based payment awards with market performance conditions or non-vesting conditions, the grant date fair value of the award is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

Taxation on the amount recognised as an expense is recognised in the statement of profit and loss. Tax benefits of equity-settled share-based payment transactions that exceed the tax effected cumulative remuneration expenses are considered to relate to an equity item and are recognised directly in equity.

Expected volatility is determined by reviewing the share price volatility for the expected life of each option / scheme up to the date of the grant.

Cancellations of share-based payments during the vesting period are accounted for as accelerated vesting. The share-based payment is recognised immediately at the amount that would have been recognised for services received over the remainder of the vesting period, as if the service and the non-market performance conditions were met for the cancelled awards.

(f) Taxation

See disclosures at Note 13 and Note 19

Taxation comprises current tax and deferred tax. Taxation is recognised in the statement of profit and loss except to the extent that it relates to items recognised directly in equity or other comprehensive income.

Current tax

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

Deferred tax

Deferred tax is provided in full using the liability method on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(g) Loans and advances

See disclosures at Note 14

Loans and advances comprise both loans and advances to banks and loans and advances to customers.

Under IFRS 9 (from 1 January 2018)
Loans and advances are classified as financial assets measured at amortised cost. See Note 1.7(u) for details.

Under IAS 39 (prior to 1 January 2018)
Loans and advances were classified as loans and receivables. See Note 1.7(u) for details.

Included within loans and advances to customers are assets acquired in exchange for loans, instalment credit and finance lease receivables as part of an orderly realisation. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income.

(h) Investment securities

See disclosures at Note 15

Investment securities are held for long-term yield. These securities may be sold, but such sales are not expected to be more than infrequent. As such, the Group considers these securities to be held within a business model whose objective is to hold assets to collect the contractual cash flows. Accordingly the securities are classified as financial assets measured at amortised cost. See Note 1.7(u) for details.

(i) Derivative financial instruments

See disclosures at Note 16

Derivatives are entered into only for the purposes of matching or eliminating risk from potential movements in interest rates and foreign exchange rates in the Group's assets and liabilities. Derivatives are not used for trading or speculative purposes. The Group uses the International Swaps and Derivatives Association Master Agreement to document these transactions in conjunction with a Credit Support Annex.

Derivatives are mandatorily classified as fair value through profit and loss. They are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value.

To calculate fair values, the Group typically uses discounted cash flow models using yield curves that are based on observable market data. For collateralised positions, the Group uses discount curves based on overnight indexed swap rates. For non-collateralised positions, the Group uses discount curves based on term London Inter Bank Offer Rate (LIBOR). See Note 1.7(u) for further details.

Where derivatives are not designated as part of an accounting hedge relationship, gains and losses arising from changes in fair value are recognised in net gains / (losses) on financial instruments at fair value through profit or loss in the statement of profit and loss. Where derivatives are designated within an accounting hedge relationship, the treatment of the changes in fair value are as described in the hedge accounting section in Note 1.7(j).

Derivatives are classified as financial assets where their fair value is positive and financial liabilities where their fair value is negative. Where there is the legal right and intention to settle net, then the derivative is classified as a net asset or net liability, as appropriate.

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

The Group enters into master netting and margining agreements with all derivative counterparties. In general, under master netting agreements the amounts owed by each counterparty that are due on a single day in respect of all transactions outstanding under the agreement are aggregated into a single net amount payable by one party to the other. In certain circumstances, for example when a credit event such as a default occurs, all outstanding transactions under the agreement are aggregated into a single net amount payable by one party to the other and the agreements terminated.

Under margining agreements where the Group has a net asset position valued at current market values, in respect of its derivatives with a counterparty, then that counterparty will place collateral, usually cash, with the Group in order to cover the position. Similarly, the Group will place collateral, usually cash, with the counterparty where it has a net liability position.

(j) Hedge accounting

See disclosures at Note 16

The Group applies the exemption under IFRS 9 to continue to apply the hedge accounting rules set out in IAS 39. However, the Group has adopted the requirements for additional and more detailed disclosures for hedge accounting introduced by IFRS 9's consequential amendments to IFRS 7. As permitted by IFRS 7, the Group has not provided comparative information for periods before the date of initial application of IFRS 9 for the new disclosures.

IAS 39 permits hedge accounting when documentation, eligibility and testing criteria are met. As such, at the inception of the hedge relationship, the Group formally designates and documents the hedge relationship (the link between the hedging instrument and the hedged item) to which it wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The Group also documents the method that will be used to assess the effectiveness of the hedging relationship. From March 2018, the Group changed the methodology of hedge effectiveness testing from linear regression to the dollar-offset method. This was an interim operational decision to enable the Group to bring hedge effectiveness testing in-house. The Group makes an assessment, both at inception and on a periodic basis (monthly), of whether the derivatives used in hedging transactions are highly effective in offsetting the exposure to changes in the hedged item's fair value. The hedge is deemed to be highly effective where the actual results of the hedge are within a range of 80-125%.

Currently, the Group designates certain derivatives as fair value hedges. The Group does not currently designate any derivatives as cash flow hedges or net investment hedges.

Fair value hedges

The Group applies fair value hedge accounting for portfolio hedges of interest rate risk. The hedged items are portfolios that are identified as part of the risk management process. These comprise either fixed rate assets only, or fixed rate liabilities only, in respect of a benchmark interest rate (currently mainly GBP three-month LIBOR). Each portfolio is grouped into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Interest rate swaps are used as the hedging instruments to manage this interest rate risk to swap the fixed rate interest flows to floating.

Sources of ineffectiveness on the hedged asset portfolios is predominantly driven by the prepayment behaviour deviating from forecast behaviour.

Sources of ineffectiveness on the hedged liabilities portfolios is driven by the repayment behaviour deviating from forecast behaviour.

The Group also holds floating rate assets in the form of property loan portfolios. These contain non-separated embedded purchased floors with the interest rate floors being referenced to the three-month LIBOR index, but with a minimum reference rate of 0.75%. These floors form part of a fair value hedge of interest rate risk due to changes in the benchmark rate. This portfolio of purchased interest rate floors is behaviouralised by the expected prepayment behaviour. The hedging instrument is a series of sold floors (interest rate options). Any changes to the actual prepayment behaviour compared to the expected prepayment behaviour is a source of ineffectiveness.

Changes in the fair value of derivatives designated as fair value hedges and changes in the fair value of the hedged asset or liability attributable to the hedged risk are recognised in net gains / (losses) on financial instruments at fair value through profit or loss in the statement of profit and loss. The hedging gain or loss on the hedged items are included in interest income in the statement of profit and loss.

If the hedge no longer meets the criteria for hedge accounting, hedge accounting is discontinued prospectively. The cumulative fair value adjustment to the carrying amount of the hedged item is amortised to the statement of profit and loss over the remaining period to maturity.

(k) Property, plant and equipment and depreciation

See disclosures at Note 17

Property, plant and equipment is divided into the following asset categories:

- Leasehold property;
- Fixtures, fittings and equipment; and
- Assets on operating leases.

Assets on operating leases refers to assets that are leased to customers under operating lease agreements. The accounting policies relating to such assets can be found at Note 1.7(l). Accounting policies for all other asset categories are detailed below.

Property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Cost includes the original purchase price of the asset and any directly attributable costs of bringing the asset to the location and condition necessary for its intended use. Subsequent expenditure is only capitalised when it improves the expected future economic benefits of the asset. Ongoing repairs and maintenance are expensed to administrative expenses in the statement of profit and loss as incurred.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying amount of the asset and are included in administrative expenses in the statement of profit and loss.

Depreciation is calculated to write off the cost of the asset less its estimated residual value on a straight line basis over its estimated useful life, as follows:

- Leasehold property: Life of the lease
- Fixtures and fittings: 10 years
- Office equipment: 3-5 years
- Motor vehicles: 4 years

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

Depreciation is charged to administrative expenses in the statement of profit and loss.

Assets are reviewed for impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount. Impairment losses are charged to administrative expenses in the statement of profit and loss.

(l) Leases

Group acting as a lessee – finance leases

A lease that transfers substantially all the risks and rewards of ownership to the Group is recorded as a finance lease. The leased asset is initially recognised at the lower of the present value of the minimum lease payments or fair value. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policies detailed in Note 1.7(k). Lease payments are apportioned between finance charges and a reduction of the lease liability to achieve a constant rate of interest on the remaining balance of the liability.

Group acting as a lessee – operating leases

An operating lease is a lease other than a finance lease. Operating leases are not recognised in the Group's statement of financial position. Operating lease payments are charged to administrative expenses in the statement of profit and loss on a straight-line basis over the lease term, unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to administrative expenses in the statement of profit and loss in the period in which termination is made.

Group acting as a lessor – finance leases

Lease agreements in which the Group transfers substantially all the risks and rewards of ownership of the underlying asset to the lessee are classified as finance leases. A finance lease receivable equal to the net investment in the lease (representing the future lease payments less profit and costs allocated to future periods) is recognised and is presented within loans and advances to customers. Lease payments are apportioned between interest income and a reduction of the finance lease receivable to achieve a constant rate of interest on the remaining balance of the receivable.

Group acting as a lessor – operating leases

Lease agreements in which the Group does not transfer substantially all the risks and rewards of ownership of the underlying asset to the lessee are classified as operating leases. The leased asset is included in property, plant and equipment in the statement of financial position at the lower of its fair value (less costs to sell) and the carrying amount of the lease (net of impairment allowance) at the date of exchange. Depreciation is calculated to write off the cost of the asset less its estimated residual value on a straight line basis over the life of the lease. Depreciation is charged to depreciation on operating leases in the statement of profit and loss. No depreciation is charged in respect of assets held for sale. Assets on operating leases are reviewed annually for impairment as detailed in Note 1.7(k). Impairment losses are charged to other operating lease income in the statement of profit and loss.

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

Operating lease income is recognised in the statement of profit and loss on a straight-line basis over the lease term unless a different systematic basis is deemed to be more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made by the lessee in compensation is charged to other operating lease income in the statement of profit and loss in the period in which termination is made.

Where an agreement is classified as an operating lease at inception but is subsequently reclassified as a finance lease following a change to the agreement or an extension beyond the primary term, then the agreement is accounted for as a finance lease.

(m) Intangible assets and amortisation

See disclosures at Note 18

Intangible assets held by the Group primarily consists of computer software and goodwill.

Computer software

Externally acquired computer software is measured at cost less accumulated amortisation and any accumulated impairment losses. Cost includes the original purchase price of the asset and any directly attributable costs of preparing the asset for its intended use.

Internally developed computer software is recognised as an asset only when the Group is able to demonstrate that the following conditions have been met:

- expenditure can be reliably measured;
- the product or process is technically and commercially feasible;
- future economic benefits are probable; and
- the Group has the intention and ability to complete development and subsequently use or sell the asset.

If these conditions are not met, expenditure is recognised in administrative expenses in the statement of profit and loss as incurred. Capitalised costs include all costs directly attributable in preparing the asset so that it is capable of operating in its intended manner. Internally developed computer software is measured at capitalised cost less accumulated amortisation and any accumulated impairment losses.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in administrative expenses in the statement of profit and loss as incurred.

Computer software is amortised on a straight line basis over its estimated useful life of between three and seven years. Amortisation is recognised in administrative expenses in the statement of profit and loss. The amortisation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Computer software is reviewed for indicators of impairment at each reporting date. If such an indication exists, the asset's recoverable amount, being the greater of value in use and fair value less costs to sell, is estimated and compared to the carrying amount. If the carrying amount of the asset exceeds the recoverable amount an impairment loss is recognised in administrative expenses in the statement of profit and loss.

Goodwill

Goodwill may arise on the acquisition of subsidiaries and represents the excess of the aggregate of the fair value of consideration transferred and the fair value of any non-controlling interest over the fair value of identifiable net assets at the date of acquisition. Goodwill is stated at cost less any accumulated impairment losses.

Goodwill is not amortised but is tested annually for impairment and additionally whenever there is an indication that impairment may exist. For the purpose of impairment testing, goodwill is allocated to cash generating units (CGUs). A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. An impairment loss is recognised if the carrying amount of a CGU exceeds its recoverable amount. Recoverable amount is the greater of the CGUs value in use and fair value less costs to sell. Value in use is based on estimated future cash flows less a residual value, discounted at a risk-adjusted discount rate appropriate to the CGU. Where impairment is required, the amount is recognised in administrative expenses in the statement of profit and loss and cannot subsequently be reversed.

(n) Investment in associates

See disclosures at Note 20

An associate is an entity over which the Group has significant influence and that is neither a subsidiary undertaking nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Investments are initially measured at cost, which includes transaction costs, and are presented as investment in associates in the statement of financial position.

Subsequent to initial recognition, the Group includes its share of the post-acquisition profit or loss and other comprehensive income of the associate. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Dividends receivable from associates are recognised as a reduction in the carrying amount of the investment.

Where the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Investment in associates is reviewed for impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the investment is written down immediately to the estimated recoverable amount.

The Group continues to use the equity method of accounting until the date on which significant influence ceases.

(o) Amounts due to banks

See disclosures at Note 23

Amounts due to banks are classified as financial liabilities measured at amortised cost. See Note 1.7(u) for details.

Amounts due to banks includes amounts drawn under the Bank of England's Funding for Lending Scheme and Term Funding Scheme. The Funding for Lending Scheme and Term Funding Scheme were closed to new drawdowns in January 2018 and February 2018 respectively.

Funding for Lending Scheme

The Funding for Lending Scheme allows the Group to borrow highly liquid UK Treasury bills in exchange for eligible collateral.

Receipt of Treasury bills under the Funding for Lending Scheme does not involve the transfer of substantially all the risks and rewards associated with the collateral assets, or the right to receive its related cash flows. As such, the derecognition criteria outlined in Note 1.7(u) are not satisfied and the collateral assets continue to be recognised in their entirety in the statement of financial position. The Treasury bills are not recognised in the statement of financial position as ownership remains with the Bank of England.

Where Treasury bills are sold to third parties under repurchase agreements, the associated liability to the counterparty is recognised in amounts due to banks in the statement of financial position.

Costs of borrowing are recognised in interest expense and similar charges in the statement of profit and loss using the effective interest rate method.

Term Funding Scheme

The Term Funding Scheme allows the Group to borrow central bank reserves in exchange for eligible collateral at rates close to Bank Base Rate.

The Group does not transfer substantially all the risks and rewards associated with the collateral assets. As such, the derecognition criteria outlined in Note 1.7(u) are not satisfied and the collateral assets continue to be recognised in their entirety in the statement of financial position.

Drawings from the scheme are included in amounts due to banks in the statement of financial position.

Costs of borrowing are recognised in interest expense and similar charges in the statement of profit and loss using the effective interest rate method.

(p) Customer deposits

See disclosures at Note 24

Customer deposits are classified as financial liabilities measured at amortised cost. See Note 1.7(u) for details.

(q) Provisions

See disclosures at Note 25

Provisions are recognised when:

- there is a present obligation arising as a result of a past event;
- it is probable (more likely than not) that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

The Group has an obligation to contribute to the Financial Services Compensation Scheme to enable it to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised, to the extent that it can be reliably estimated, when the Group has an obligation and the levy is legally enforceable. Provisions for levies are recognised when the conditions that trigger the payment of the levy are met.

(r) Subordinated debt

See disclosures at Note 27

Under both IFRS 9 (from 1 January 2018) and IAS 39 (prior to 1 January 2018) the subordinated debt liability is classified as a financial liability measured at amortised cost. See Note 1.7(u) for details.

Interest costs arising on the subordinated debt liability are capitalised in accordance with the agreed terms and are incorporated into the total debt payable. Interest costs are recognised on an effective interest rate basis.

The subordinated debt receivable in the Company is subordinated debt issued from the Group's principal subsidiary, Shawbrook Bank Limited, to the Company. It is classified as a financial asset measured at amortised cost.

(s) Capital securities

See disclosures at Note 29

Capital instruments are classified on initial recognition as either financial liabilities or equity instruments in accordance with the substance of the contractual arrangements. Where the contractual arrangements do not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments, the capital instrument is classified as an equity instrument. Where the Group does have a present obligation, the capital instrument is classified as a financial liability.

Based on the characteristics associated with redemption and interest payments, the capital securities are classified as equity instruments. As such, capital securities are measured at the fair value of the proceeds from the issuance less any costs that are incremental and directly attributable to the issuance (net of applicable tax). Distributions to holders of the capital securities are recognised when they become irrevocable and are deducted, net of tax where applicable, from retained earnings in equity.

(t) Cash flows

See disclosures at Note 30

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash and balances at central banks, loans and advances to banks and short-term highly liquid debt securities with less than three months to maturity from the date of acquisition. Loans and advances to banks comprise cash balances and call deposits.

(u) Financial instruments

See disclosures at Note 31

Recognition

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

Classification and measurement

Under IFRS 9 (from 1 January 2018)

Financial assets

There are three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL).

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

The 'business model assessment' determines whether the Group's objective is to generate cash flows from collecting contractual cash flows, or by both collecting contractual cash flows and selling financial assets. The assessment is performed at a portfolio level as this best reflects the way business is managed and how information is provided to Management. The assessment is based on expected scenarios. If cash flows are realised in a manner that is different from the original expectation, the classification of the remaining assets in that portfolio is not changed but such information is used when assessing new financial assets going forward.

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

Based on the two assessments, financial assets are classified as follows:

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

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

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

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are SPPI.

Financial assets not classified as measured at amortised cost or FVOCI are classified as FVTPL. This includes all derivative financial assets.

On initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be classified as measured at amortised cost or FVOCI as FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Equity instruments are normally classified as FVTPL. However, on initial recognition of an equity instrument that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in the statement of other comprehensive income. This election is made on an investment-by-investment basis.

Derivatives embedded in contracts where the host is a financial asset are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

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

Initial measurement of financial assets is as follows:

- **Financial assets at FVTPL:** initially measured at fair value
- **All other financial assets:** initially measured at fair value plus incremental direct transaction costs.

Subsequent measurement of financial asset categories held by the Group is as follows:

- **Financial assets at FVTPL:** subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in the statement of profit and loss.
- **Financial assets at amortised cost:** subsequently measured at amortised cost using the effective interest rate method. Amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment losses are recognised in the statement of profit and loss. Any gain or loss on derecognition is also recognised in the statement of profit and loss.

Financial liabilities

The classification of financial liabilities under IFRS 9 largely retains the requirements prescribed in IAS 39 as detailed below. The exception is the presentation of changes in fair value due to own credit risk under other comprehensive income for financial liabilities designated at FVTPL. The Group currently has no financial liabilities designated at FVTPL that this applies to.

Under IAS 39 (prior to 1 January 2018)

Financial assets

The Group classified its financial assets as either loans and receivables or FVTPL. The Group had no financial assets classified as held-to-maturity or available-for-sale.

Financial assets classified as loans and receivables were defined as non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. Loans and receivables were initially recognised at fair value plus incremental direct transaction costs. Subsequent recognition was at amortised cost using the effective interest rate method, less any impairment allowance.

Financial assets categorised as FVTPL were initially recognised at fair value and were subsequently remeasured at fair value. Net gains and losses were recognised in the statement of profit and loss.

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

Financial liabilities

The Group classified its financial liabilities as either measured at amortised cost or FVTPL.

Financial liabilities categorised as measured at amortised cost were initially recognised at fair value minus incremental direct transaction costs. Subsequent recognition was at amortised cost using the effective interest rate method.

Financial liabilities categorised as FVTPL were initially recognised at fair value and were subsequently remeasured at fair value. Net gains and losses were recognised in the statement of profit and loss.

Derecognition

Derecognition is the point at which the Group ceases to recognise a financial asset or financial liability on its statement of financial position.

Financial assets

The Group derecognises a financial asset (or a part of a financial asset) when:

- the contractual rights to the cash flows from the financial asset have expired;
- the Group transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred; or
- the Group transfers the financial asset in a transaction in which the Group neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the asset. If the Group retains control of the asset it continues to recognise the transferred asset only to the extent of its continuing involvement and derecognises the remainder.

On derecognition of a financial asset the difference between the carrying amount (or the carrying amount allocated to the portion being derecognised) and the sum of the consideration received (including any new asset obtained less any new liability assumed) is recognised in the statement of profit and loss.

Financial liabilities

The Group derecognises a financial liability (or a part of a financial liability) when its contractual obligations are extinguished (i.e. discharged, cancelled, or expired).

On derecognition of a financial liability, the difference between the carrying amount (or the carrying amount allocated to the portion being derecognised) and the sum of the consideration paid (including any new asset obtained less any new liability assumed) is recognised in the statement of profit and loss.

Modifications

Financial assets

The Group sometimes renegotiates or otherwise modifies the contractual cash flow of a financial asset. When this happens, the Group assesses whether or not the new terms are substantially different to the original terms. The Group does this by considering, among others, the following factors:

- if the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay;
- whether any substantial new terms are introduced that substantially affects the risk profile of the loan;
- significant extension of the loan term when the borrower is not in financial difficulty;
- significant change in the interest rate; and
- insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms and cash flows of the modified asset are deemed to be substantially different, the contractual rights to cash flows from the original financial asset are deemed to have expired. This meets the derecognition criteria outlined above and as such the original financial asset is derecognised and a 'new' financial asset is recognised at fair value. The difference between the carrying amount of the derecognised financial asset and the new financial asset with modified terms is recognised in the statement profit and loss.

Under IFRS 9 (from 1 January 2018)

If the cash flows of the modified asset are not deemed to be substantially different, the financial asset is not derecognised and the Group recalculates the gross carrying amount of the financial asset based on the revised cash flows of the financial asset and recognises any associated gain or loss in the statement of profit and loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate.

Financial liabilities
The Group derecognises a financial liability when there is deemed to be a substantial modification of the terms. Where this is the case, the contractual obligations from the original financial liability are deemed to have been extinguished. This meets the derecognition criteria outlined above and as such the original financial liability is derecognised and a 'new' financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the derecognised financial liability and the new financial liability with modified terms is recognised in the statement profit and loss.

Under IFRS 9 (from 1 January 2018)
When a financial liability measured at amortised cost is modified without this resulting in derecognition, a gain or loss is recognised in the statement profit and loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate.

Fair value of financial instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

Where possible, fair value is determined with reference to quoted prices in an active market or dealer price quotations. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Where quoted prices are not available, the Group uses generally accepted valuation techniques to estimate fair value. The valuation techniques used include discounted cash flow models and Black-Scholes option pricing. Wherever possible these valuation techniques use independently sourced market parameters, such as interest rate yield curves, option volatilities and currency rates. This reduces the need for Management judgement and estimation, as well as the uncertainty related with the estimated fair value.

On initial recognition, the best evidence of the fair value of a financial instrument is normally transaction price (i.e. the fair value of the consideration given or received). If the Group determines that the fair value on initial recognition differs from the transaction price, the Group accounts for such differences as follows:

- if fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in the statement of profit and loss on initial recognition (i.e. day 1 profit or loss);
- in all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability). Subsequently, the deferred gain or loss will be released to the statement of profit and loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets at bid price and liabilities at ask price.

The Group does not adjust fair value estimates derived from models for any factors such as credit risk, liquidity risk or model uncertainties.

For measuring derivatives that might change the classification from being an asset to a liability or vice versa, fair values do not take into consideration either the credit valuation adjustment or the debit valuation adjustment as the Group's portfolio is fully collateralised and it is deemed to be immaterial.

The Group uses a fair value hierarchy that categorises financial instruments into three different levels as detailed in Note 31(b). Levels are reviewed at each reporting date and this determines whether transfers between levels are required.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

(v) Impairment of financial assets

See disclosures at Note 12

Under IFRS 9 (from 1 January 2018)

Measurement of ECLs

Impairment of financial assets is calculated using a forward looking ECL model. The Group records an allowance for ECLs ('loss allowance') for all financial assets not held at FVTPL, together with an allowance for ECLs for financial guarantee contracts and loan commitments. Equity instruments are not subject to impairment.

ECLs are an unbiased probability-weighted estimate of credit losses determined by evaluating a range of possible outcomes. They are measured in a manner that reflects the time value of money and uses reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

- **Stage 1:** when a financial asset is first recognised it is assigned to Stage 1. If there is no significant increase in credit risk from initial recognition the financial asset remains in Stage 1. Stage 1 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 2. For financial assets in Stage 1, a 12-month ECL is recognised.
- **Stage 2:** when a financial asset shows a significant increase in credit risk from initial recognition it is moved to Stage 2. Stage 2 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 3. For financial assets in Stage 2, a lifetime ECL is recognised.
- **Stage 3:** when there is objective evidence of impairment and the financial asset is considered to be in default, or otherwise credit-impaired, it is moved to Stage 3. For financial assets in Stage 3, a lifetime ECL is recognised.
- **Purchased or originated credit-impaired (POCI):** POCI assets are financial assets that are credit-impaired on initial recognition. On initial recognition they are recorded at fair value. ECLs are only recognised or released to the extent that there is a subsequent change in the ECLs. Their ECL is always measured on a lifetime basis.

In relation to the above:

- **Lifetime ECL** is defined as ECLs that result from all possible default events over the expected behavioural life of a financial instrument.
- **12-month ECL** is defined as the portion of lifetime ECL that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of that default occurring.

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

For financial guarantee contracts, the Group assigns a stage using the definitions described above.

A summary of ECL measurement is as follows:

- **Financial assets that are not credit-impaired at the reporting date:** as the present value of all cash shortfalls. Cash shortfalls are the difference between the contractual cash flows due to the Group and the cash flows that the Group expects to receive.
- **Financial assets that are credit-impaired at the reporting date:** as the difference between the gross carrying amount and the present value of estimated future cash flows.
- **Financial guarantee contracts:** as the expected payments to reimburse the holder less any amounts that the Group expects to recover.
- **Loan commitments:** as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows the Group expects to receive.

Credit-impaired is defined by the Group as a financial asset in Stage 3 as detailed above.

The Group can elect as an accounting policy choice, to use the 'simplified approach' for trade receivables, contract assets and lease receivables. The Group has chosen not to use the simplified approach.

Further details of the measurement and calculation of ECLs are set out in Section 5.3 of the risk management report.

Modifications

If a financial asset is modified, an assessment is made to determine whether the asset should be derecognised as detailed in Note 1.7(u). Subsequently ECLs are measured as follows:

- if the modification does not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset; or
- if the modification does result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset. The date of renegotiation is considered to be the date of initial recognition for impairment calculation purposes, including in determining whether a significant increase in credit risk has occurred and whether the new financial asset is deemed to be credit-impaired on initial recognition.

Write-offs

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. Write-offs constitute a derecognition event as detailed in Note 1.7(u). Financial assets that are written off can still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due. Amounts subsequently recovered on assets previously written off are recognised in impairment losses on financial assets in the statement of profit and loss.

Presentation of loss allowances in the statement of financial position

Loss allowances are presented in the statement of financial position as follows:

- **financial assets measured at amortised cost:** as a deduction from the gross carrying amount of the financial assets;
- **financial guarantee contracts and loan commitments:** generally, as a provision; and
- where a financial instrument includes both a drawn and an undrawn component, and the Group cannot identify the ECL on the undrawn loan commitment component separately from those on the drawn component: the Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision.

Under IAS 39 (prior to 1 January 2018)

Objective evidence of impairment

On an ongoing basis, the Group assessed whether there was objective evidence that a financial asset or group of financial assets was impaired. A financial asset or a group of financial assets was impaired and impairment losses incurred if, and only if, there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated.

The criteria that the Group used to determine whether there was objective evidence of an impairment loss included, but was not limited to, the following:

- delinquency in contractual payments of principal or interest;
- cash flow difficulties experienced by the borrower;
- initiation of bankruptcy proceedings;
- the customer being granted a concession that would otherwise not be considered; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio.

If there was objective evidence that an impairment loss on an individual financial asset had occurred, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset was reduced through the use of an allowance account ('impairment allowance') and the amount of the loss was recognised in impairment losses on financial assets in the statement of profit and loss. If a loan had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract.

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.7. Significant accounting policies continued

Individual and collective impairment

If the Group determined that no objective evidence of impairment existed for an individually assessed financial asset, whether significant or not, it included the asset in a group of financial assets with similar credit risk characteristics and collectively assessed the group for impairment. Objective evidence of impairment of a portfolio of receivables existed if objective data indicated a decrease in expected future cash flows from the collection of receivables and the decrease could be measured reliably but could not be identified with the individual receivables in the portfolio. When this was the case a collective provision was applied.

Modifications

If a financial asset was modified, an assessment was made to determine whether the asset should be derecognised as detailed in Note 1.7(u). Subsequently impairments were measured as follows:

- if the modified asset did not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset were included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset; or
- if the modified asset did result in derecognition of the existing asset, then the expected fair value of the new asset was treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount was then discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Write-offs

When a loan or receivable was not economic to recover, it was written off against the related impairment allowance. Such loans were written off after all the necessary procedures had been completed and the amount of the loss had been determined. Subsequent recoveries of amounts previously written off were recognised directly in the statement of profit and loss through the impairment losses on financial assets line as post write-off recoveries. If, in a subsequent period, the amount of impairment loss decreased and the decrease could be related objectively to an event that occurred after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss was reversed by adjusting the impairment allowance. The amount of reversal was recognised in impairment losses on financial assets in the statement of profit and loss.

(w) Contingent liabilities

See disclosures at Note 37

Contingent liabilities are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Group. Alternatively, they are present obligations that have arisen from past events where the outflow of resources is uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed, unless the probability of settlement is remote.

(x) Financial guarantee contracts and loan commitments

See disclosures at Note 38

Financial guarantee contracts

Financial guarantee contracts are contracts that require the Group to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. They are included in provisions for liabilities and charges in the statement of financial position. Initially financial guarantees are measured at their fair value, being the premium received. Subsequently, financial guarantees are measured as follows:

Under IFRS 9 (from 1 January 2018)

At the higher of the amount initially recognised less the cumulative amount of income recognised in the statement of profit and loss in accordance with the principles of IFRS 15, and the amount of loss allowance determined in accordance with the policies set out in Note 1.7(v).

Under IAS 39 (prior to 1 January 2018)

At the higher of the amount initially recognised less cumulative amortisation, and the present value of expected payment to settle the liability when a payment under the contract becomes probable.

Loan commitments

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. The Group has not provided any commitment to provide loans at below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

Under IFRS 9 (from 1 January 2018)
The Group recognises loss allowances in accordance with the policies set out in Note 1.7(v). Loss allowances are included within provisions for liabilities and charges in the statement of financial position.

Under IAS 39 (prior to 1 January 2018)
The Group recognised a provision in the statement of financial position only when the contract was considered onerous.

1.8. New and revised standards and interpretations not yet adopted

A number of new and revised standards issued by the International Accounting Standards Board have not yet come into effect. Those deemed relevant to the Group are as follows:

(a) IFRS 16 'Leases'

IFRS 16 becomes effective for annual reporting periods beginning on or after 1 January 2019. Early adoption is permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied. The Group will adopt IFRS 16 from its effective date of 1 January 2019 and will not early adopt. The new standard will replace IAS 17 'Leases' and related interpretations.

IFRS 16 will apply to all leasing arrangements and sets outs the requirements for both lessor and lessee accounting.

The Group will adopt IFRS 16 on 1 January 2019 using the modified retrospective approach. As such, the cumulative effect of initially applying IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings. Comparative information will not be restated.

The Group will utilise the practical expedient set out in IFRS 16 to not reassess whether a contract is, or contains, a lease at the date of initial application and will only apply the new requirements of IFRS 16 to contracts previously identified as leases under IAS 17.

The Group has assessed the estimated impact of IFRS 16 adoption, as described below.

Lessor accounting

Lessor accounting under IFRS 16 is largely unchanged from IAS 17 and lessors will continue to classify leases as either finance or operating leases. Based on information currently available, no significant impact is expected for leases in which the Group acts as a lessor.

Lessee accounting

IFRS 16 introduces a single lessee accounting model that requires a lessee to recognise all leases (subject to certain optional exemptions) on-balance sheet. A lessee will recognise a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items.

On initial application of IFRS 16, lease liabilities will be recognised at the present value of the remaining lease payments and the right-of-use asset will be recognised at the amount of the lease liability.

The Group will apply the optional exemptions for short-term leases and leases of low value items. As such, the Group will not apply the new requirement of IFRS 16 to leases for which the lease term ends within 12 months of the date of initial application. Lease payments under such contracts will continue to be recognised directly to administrative expenses on a straight line basis.

No significant impact is expected in relation to leases currently classified as finance leases under IAS 17.

In relation to leases currently classified as operating leases under IAS 17, based on information currently available, the Group estimates it will recognise:

- additional lease liabilities of £10.2 million, representing the present value of future lease payments for leasehold properties.
- right-of-use assets of £10.2 million, representing the amount of the lease liability.

Under IFRS 16, the income statement charge comprises the right-of-use asset depreciation charge and interest expense on the lease liability. When comparing the income statement charge under IFRS 16 and IAS 17, the total income statement charge over the life of the lease will not change, however the Group estimates there will be immaterial timing differences when comparing the annual charge of up to £0.1 million per annum.

1.9. Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are as follows:

Notes to the financial statements

For the year ended 31 December 2018

1. Basis of preparation and significant accounting policies continued

1.9. Critical accounting estimates and judgements continued

(a) Effective interest rate

See accounting policies at Note 1.7(b) and disclosures at Note 4

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate method. Management must use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. Management reviews the expected lives on a segmental basis, whereby products of a similar nature are grouped into cohorts that exhibit homogenous behavioural attributes.

Key assumptions

The key assumptions applied by Management in the effective interest rate methodology is the behavioural life of the assets. The expected life behaviours are subjected to changes in internal and external factors and may result in adjustments to the carrying amount of loans which must be recognised in the statement of profit and loss. The effective interest rate behavioural models are based on market trends and experience. The actual behaviour of the portfolios is compared to the modelled behaviour on a quarterly basis and the modelled behaviours are adjusted if the modelled behaviour materially deviates from actual behaviour, with adjustments recognised in net interest income in the statement of profit and loss.

Sensitivity analysis

Sensitivity analysis was performed to assess the impact of a 10% decrease in the redemption curves used. A 10% decrease in the redemption curves would result in a net expense to the statement of profit and loss of £0.7 million. This is attributable to the Property Finance and Consumer Lending divisions. Property Finance would see income of £0.3 million, mainly due to income received from early settlement fees. Consumer Lending would see an expense of £1.0 million, mainly attributable to the acceleration of the amortisation of broker commissions.

(b) Impairment testing of goodwill

See accounting policies at Note 1.7(m) and disclosures at Note 18

The review of goodwill for impairment reflects Management's best estimate of future cash flows of the Group's cash generating units (CGUs) and the rates used to discount these cash flows. Both these variables are subject to judgement and estimation uncertainty as follows:

- the future cash flows of the CGUs are sensitive to projected cash flows based on the forecasts and assumptions regarding the projected periods and the long-term pattern of sustainable cash flows thereafter;
- the rates used to discount future expected cash flows can have a significant effect on their valuations and are based on the price-to-book ratio method which incorporates inputs reflecting a number of variables.

An impairment is recognised if impairment testing finds that the carrying amount of a CGU exceeds its recoverable amount. The recoverable amount of the CGU is calculated based on its value in use, determined by discounting the future cash flows (post-tax profits) to be generated from its continuing use. Forecast cash flows are reduced by any earnings retained to support the growth in the underlying CGU's loan books through higher regulatory capital requirements. Forecast post-tax profits are based on expectations of future outcomes taking into account past experience and adjusted for anticipated revenue growth.

Key assumptions

The key assumptions used in the calculation of value in use are as follows:

Discount rate

The post-tax discount rate is an estimate of the return that investors would require if they were to choose an investment that would generate cash flows of amount, timing and risk profile equivalent to those that the entity expects to derive from the asset. The Group calculates discount rates using the price-to-book ratio method which incorporates target return on equity, growth rate and price-to-book ratio. The discount rate for each CGU is adjusted to reflect the risks inherent to the individual CGU.

Discount rates used were as follows:

	2018 Post-tax	**2018** Pre-tax[1]	2017 Post-tax	2017 Pre-tax[1]
Discount rate				
Property Finance	**12.7%**	**15.1%**	12.0%	16.6%
Business Finance	**13.2%**	**15.9%**	12.5%	16.3%
Consumer Lending	**13.7%**	**16.3%**	13.0%	16.8%

[1] Management applies post-tax discount rates to post-tax cash flows when testing the CGU for impairment. The pre-tax discount rate is disclosed in accordance with IAS 36.

Cash flow period
Five years of cash flows (post-tax profits) (2017: four years) are included in the discounted cash flow model based on the Group's business plan.

Terminal value growth rate
A terminal value growth rate is applied into perpetuity to extrapolate cash flows beyond the cash flow period. The terminal value growth rate of 2.0% (2017: 2.0%) is estimated by Management taking into account rates disclosed by comparable institutions.

Sensitivity analysis

The key assumptions described above may change in response to changes in economic and market conditions. Sensitivity analysis was performed for the Property Finance and Business Finance CGUs to assess the impact of reasonable changes in the discount rate, cash flows and terminal value growth rate on the outcome of impairment testing. As detailed in Note 18, Goodwill in the Consumer Lending CGU has been fully impaired in the year ended 31 December 2018. As such, no sensitivity analysis was required for this CGU.

Sensitivity analysis on the discount rate identified that an increase of 2.0% to the individual CGU's discount rate would not result in any impairment to goodwill.

Sensitivity analysis on the cash flows identified that a decrease in cash flows of 10.0% would not result in any impairment to goodwill.

Sensitivity analysis on the terminal value growth rate identified that a decrease in the terminal value growth rate to 0% would not result in any impairment to goodwill.

(c) Customer remediation and conduct issues

See accounting policies at Note 1.7(q) and disclosures at Note 25

Provisions have been recognised in respect of potential instances of misrepresentation or breaches of contract by suppliers where the suppliers have become insolvent, and therefore the Group has limited recourse to those suppliers. The provisions represent Management's best estimate of the likely costs.

Key assumptions

The key factors driving the provision are the estimated number of complaints and the estimated redress costs per case.

Key considerations in deriving the estimated number of complaints include:

- complaint volumes taking into account both the status of current claims and Management's estimate of potential future claims based on existing complaint data;
- the origin of the claim. For example, if the claim relates to a solvent or insolvent supplier, or if the route of the claim is via a claims management company;
- the statutory limitation period (6 years from the date of the loan); and
- Management's estimate of claim uphold rates based on existing complaint data.

Key considerations in deriving the estimated redress costs per case include:

- Management's expected method of redress should claims be upheld based on agreed redress strategies; and
- Management's estimate of legal and complaint handling costs based on existing complaint data.

(d) Impairment losses on financial assets

See accounting policies at Note 1.7(v) and disclosures at Note 12

The measurement of ECLs prescribed by the new requirements of IFRS 9 requires a number of significant judgements. ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Specifically, judgements and estimation uncertainties relate to assessment of whether credit risk on the financial asset has increased significantly since initial recognition, incorporation of forward-looking information in the measurement of ECLs and key assumptions used in estimating recoverable cash flows. These estimates are driven by a number of factors that are subject to change which may result in different levels of loss allowances.

Key assumptions and sensitivities associated with ECL calculations are detailed in Section 5.3 of the risk management report.

(e) Investment in associates

See accounting policies at Note 1.7(n) and disclosures at Note 20

Note 20 describes that The Mortgage Lender Limited is an associate of the Group, even though the Group holds only 19.99% of ownership interest. Management concluded the Group has significant influence as demonstrated by its representation on the Board of Directors, the expectation for material transactions occurring between the Group and the associate and the capacity for the Group to influence policy-making processes and decisions.

Notes to the financial statements

For the year ended 31 December 2018

2. IFRS 9 adoption

On 1 January 2018, the Group adopted the requirements of IFRS 9 and the amendments to IFRS 9 'Prepayment Features with Negative Compensation' (see Note 1.6(a)).

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

2.1. Classification and measurement

(a) Impact of adopting IFRS 9 as at 1 January 2018

Financial assets

As detailed in Note 1.7(u), classification of financial assets under IFRS 9 is dependent on the outcome of two assessments which evaluates the business model in which financial assets are managed (the 'business model assessment') and their cash flow characteristics (the 'SPPI test').

Under IFRS 9, derivative financial instruments are classified as mandatorily at FVTPL as they fail the SPPI test. This is unchanged from the classification under IAS 39.

In relation to debt instruments, the outcomes of the business model assessment and SPPI test are summarised below:

- **Business model assessment:** this assessment is performed at a portfolio level. For all portfolios, the Group concluded that the objective of Management's strategy is to hold the assets to earn contractual cash flows. The intention is not to sell the assets. For portfolios where sales have taken place in the past, Management concluded that the sales were due to increases in credit risk for the purposes of managing credit risk.
- **SPPI test:** the Group considered the contractual terms at an instrument level and concluded that the contractual cash flows of the debt instruments were SPPI.

The conclusions from the business model assessment and SPPI test mean debt instruments meet the conditions to be classified as measured at amortised cost. This is unchanged from the loans and receivables classification under IAS 39.

Financial liabilities

There were no changes in the classification and measurement of financial liabilities. The Group continues to classify all financial liabilities as measured at amortised cost, with the exception of derivatives which are mandatorily at FVTPL.

(b) Transition disclosures

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Group's financial assets and financial liabilities as at 1 January 2018:

	Original classification under IAS 39	**New classification under IFRS 9**	Original carrying amount under IAS 39 as at 31 December 2017 £m	**New carrying amount under IFRS 9 as at 1 January 2018 £m**
Financial assets				
Cash and balances at central banks	Loans and receivables	**Amortised cost**	752.5	**752.5**
Loans and advances to banks	Loans and receivables	**Amortised cost**	28.8	**28.8**
Loans and advances to customers	Loans and receivables	**Amortised cost**	4,844.3	**4,823.2**
Derivative financial assets	FVTPL	**Mandatorily at FVTPL**	1.8	**1.8**
Total financial assets			5,627.4	**5,606.3**
Financial liabilities				
Amounts due to banks	Amortised cost	**Amortised cost**	607.3	**607.3**
Customer deposits	Amortised cost	**Amortised cost**	4,376.2	**4,376.2**
Derivative financial liabilities	FVTPL	**Mandatorily at FVTPL**	3.4	**3.4**
Subordinated debt liability	Amortised cost	**Amortised cost**	75.4	**75.4**
Total financial liabilities			5,062.3	**5,062.3**

There were no reclassifications as a result of the transition to IFRS 9. Going forward it is expected that reclassifications will be very rare, occurring only when there is a change in the business model for managing financial assets.

2. IFRS 9 adoption continued

2.1. Classification and measurement continued

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

	IAS 39 carrying amount as at 31 December 2017 £m	Reclassification £m	Remeasurement £m	IFRS 9 carrying amount as at 1 January 2018 £m	Retained profits impact as at 1 January 2018 £m
Assets					
Loans and advances to customers					
Opening balance	4,844.3	–	–	4,844.3	
Remeasurements:					
Expected credit loss	–	–	(21.1)	(21.1)	(21.1)
Total loans and advances to customers	4,844.3	–	(21.1)	4,823.2	(21.1)
Deferred tax assets					
Opening balance	15.7	–	–	15.7	
Remeasurements:					
Expected credit loss	–	–	5.6	5.6	5.6
Total deferred tax assets	15.7	–	5.6	21.3	5.6
Total change to assets	N/a	–	(15.5)	N/a	(15.5)
Liabilities					
Provisions for liabilities and charges					
Opening balance	2.8	–	–	2.8	
Remeasurements:					
Expected credit loss	–	–	0.5	0.5	(0.5)
Total provisions for liabilities and charges	2.8	–	0.5	3.3	(0.5)
Total change to liabilities	N/a	–	0.5	N/a	(0.5)
Equity					
Retained earnings					
Opening balance	409.3	–	–	409.3	
Increases / decreases:					
Remeasurements due to impairment (after tax)	–	–	(16.0)	(16.0)	(16.0)
Total retained earnings	409.3	–	(16.0)	393.3	(16.0)
Total change to equity	N/a	–	(16.0)	N/a	(16.0)

2.2. Impairment of financial assets

(a) Impact of adopting IFRS 9 as at 1 January 2018

The most significant impact on the Group's financial statements from the adoption of IFRS 9 results from the new impairment requirements as detailed in Note 1.7(v). On the adoption of IFRS 9 on 1 January 2018, the increase in loss allowance (before tax) was £21.6 million. The associated deferred tax impact was an increase in deferred tax assets of £5.6 million.

The deferred tax adjustment of £5.6 million is spread, for tax purposes, on a straight-line basis over the following ten years with the first accounting period beginning on 1 January 2018. This is with the exception of financial instruments maturing in the first accounting period, which are taxed or relieved in full in that accounting period.

(b) Transition disclosures

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for financial guarantee contracts and loan commitments in accordance with IAS 37 as at 31 December 2017, to the opening loss allowance determined in accordance with IFRS 9 as at 1 January 2018:

	Impairment allowance under IAS 39 / provision under IAS 37 as at 31 December 2017 £m	**Reclassification £m**	**Remeasurement £m**	**Loss allowance under IFRS 9 as at 1 January 2018 £m**	**Of which: Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**
Financial assets							
Loans and advances to customers	31.6	–	21.1	52.7	17.3	12.5	22.9
Total financial assets	31.6	–	21.1	52.7	17.3	12.5	22.9
Loan commitments	–	–	0.5	0.5	0.5	–	–
Total allowance and provision	31.6	–	21.6	53.2	17.8	12.5	22.9

Allowances for cash and balances at central banks and loans and advances to banks are immaterial, totalling less than £0.1 million.

Allowance for financial guarantee contracts is £nil because the contract is fully collateralised through a first fixed charge over a blocked deposit account. As such, the amount the Group should have to pay should the guarantee be called upon is £nil.

2. IFRS 9 adoption continued

2.3. Regulatory capital

(a) Impact of adopting IFRS 9 as at 1 January 2018

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

- **Transitional:** this involves phasing in the full impact using transitional factors published in Regulation (EU) 2017 / 2395; or
- **Full adoption:** recognising the full impact on the day of adoption.

The Group has elected the transitional approach and will phase in the full impact using the EU regulatory transitional arrangements. This permits the Group to add back to their capital base a proportion of the impact that IFRS 9 has upon their loss allowances during the first five years of use. The proportion that the Group may add back starts at 95% in 2018 and reduces to 25% by 2022. The impact in relation to loss allowances is the sum of the increase in loss allowances on day one of IFRS 9 adoption plus any subsequent increase in ECLs in the non-credit – impaired book thereafter. Any add-back must be tax-affected and accompanied by a recalculation of capital deduction thresholds, exposure and risk weighted assets.

(b) Transition disclosures

The following table shows the Group's total regulatory capital as at 1 January 2018 calculated under IAS 39 compared with IFRS 9 full adoption and IFRS 9 transitional.

	As at 31 December 2017	**As at 1 January 2018**	
	IAS 39 £m	**IFRS 9 transitional £m**	**IFRS 9 full adoption £m**
Share capital	2.5	**2.5**	**2.5**
Share premium account	87.3	**87.3**	**87.3**
Retained earnings	409.3	**393.3**	**393.3**
Intangible assets	(65.7)	**(65.7)**	**(65.7)**
Transitional adjustment	–	**15.2**	**–**
Common Equity Tier 1 capital	433.4	**432.6**	**417.4**
Capital securities	124.0	**124.0**	**124.0**
Additional Tier 1 capital	124.0	**124.0**	**124.0**
Total Tier 1 capital	557.4	**556.6**	**541.4**
Subordinated debt liability[1]	74.2	**74.2**	**74.2**
Collective impairment allowance	11.1	**–**	**–**
Tier 2 capital	85.3	**74.2**	**74.2**
Total regulatory capital	642.7	**630.8**	**615.6**

[1] Excludes capitalised interest of £1.2 million. Accrued interest is payable semi-annually and is therefore excluded from capital reserves.

Full adoption

Full adoption of IFRS 9 on 1 January 2018 results in a reduction in Common Equity Tier 1 capital of £16.0 million. This is as a result of the following movements:

- a £21.6 million reduction in retained earnings due to a rise in ECLs; and
- a £5.6 million increase in retained earnings due to the impact of these changes on deferred tax.

Total regulatory capital is reduced by an additional £11.1 million due to the reduction of the collective impairment allowance included in Tier 2 capital. This results in an overall reduction to total regulatory capital of £27.1 million.

The corresponding impact of full adoption of IFRS 9 to risk-weighted assets is a decrease of £24.8 million.

Transitional

Under the EU regulatory transitional arrangements, the add back is £15.2 million. This results in an increase in Common Equity Tier 1 capital and total regulatory capital of £15.2 million, when comparing to full adoption.

The corresponding impact of the transitional adjustment to risk-weighted assets is an increase of £12.6 million, when comparing to full adoption.

2.4. Governance and risk management

The Group governed the implementation of IFRS 9 through a steering committee that represented finance, risk and information technology. Subsequent to the implementation of IFRS 9, all governance and risk management processes were adapted to ensure adequate governance and control exist over the IFRS 9 ECL model.

The main change to the governance framework is the implementation of the Model Management Group. This group comprises risk and finance subject matter experts. The purpose of the group is to continuously review and challenge the inputs to the IFRS 9 ECL models, to review and challenge the outputs of the models and to recommend model calibrations where needed.

The Group and Divisional Impairment Committees were adapted to ensure compliance with the new IFRS 9 target operating model, and various layers of review were implemented to ensure appropriate review at divisional level.

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3. Operating segments

See accounting policies in Note 1.7(a)

The Group has four reportable operating segments. These are the Group's three lending divisions plus a central segment representing the savings business, central functions and shared central costs. The following summary describes the operations of each of the reportable operating segments:

Property Finance

Provides mortgages to investors, businesses and personal customers. It serves professional landlords and property traders in residential and commercial asset classes across long-term and shorter-term funding solutions. The division lends to trading businesses to fund the acquisition, refinancing and development of business premises.

The division also serves the needs of personal customers through the provision of loans secured by a second charge on the main residence, for a range of purposes including; home improvements, loan consolidation and larger consumer purchases. It also lends in specialist areas of first charge mortgages, introducing the lending into retirement products.

Business Finance

Provides the following propositions:

- the Regional Business Centres provide finance solutions to established businesses in the UK Small and Medium Enterprises (SME) markets, principally through a direct product offering. The centres primarily provide leasing finance for business critical assets operated by established UK SME businesses, and working capital solutions in the form of invoice discounting and asset-based lending;
- the Structured Finance proposition includes lending to SME finance companies with security against receivables within their portfolios. The Structured Finance product set provides wholesale finance and block discounting to smaller UK financial institutions to allow customers to release cash and grow their businesses;
- the Development Finance proposition provides finance solutions to SME developers looking to build or refurbish properties in the residential and commercial sectors for sale or investment;
- the Specialist Asset Finance proposition includes leasing and hire purchase finance solutions in specialist UK SME market segments such as marine, aviation, healthcare and agriculture; and
- Shawbrook International Limited provides finance solutions to consumers and SMEs in the Channel Islands, with a growing range of products designed to address a breadth of needs in the Jersey and Guernsey market.

Consumer Lending

Provides a broad range of lending products enabling the delivery of unsecured loans to consumers for a variety of purposes, including home improvements, holiday ownership, personal loans and retail finance.

Central

As well as common costs, Central includes the Group's Treasury function and Consumer Savings business which are responsible for raising funding to support the lending divisions.

Information regarding the results of each reportable segment and their reconciliation to the total results of the Group is included below. Performance is measured based on the product contribution as included in the internal management reports. All revenue for each operating segment is earned from external customers.

The underlying basis is the basis on which financial information is presented to the Chief Operating Decision Maker, which excludes certain items included in the statutory results. The following table includes a reconciliation between the statutory results and the underlying basis.

Current taxes, deferred taxes and certain financial assets and liabilities are not allocated to segments as they are managed on a Group basis.

Year ended 31 December 2018	Property Finance £m	Business Finance £m	Consumer Lending £m	Central £m	Total £m
Interest income calculated using the effective interest rate method	194.9	87.1	69.1	4.9	356.0
Other interest and similar income	–	–	–	0.8	0.8
Interest expense and similar charges	(50.5)	(15.8)	(10.0)	(11.0)	(87.3)
Net interest income / (expense)	144.4	71.3	59.1	(5.3)	269.5
Operating lease rentals	–	10.0	–	–	10.0
Other operating lease expense	–	(0.6)	–	–	(0.6)
Depreciation on operating leases	–	(7.6)	–	–	(7.6)
Net income from operating leases	–	1.8	–	–	1.8
Fee and commission income	0.3	9.6	0.8	–	10.7
Fee and commission expense	(3.0)	(0.4)	(4.6)	(0.4)	(8.4)
Net fee and commission income / (expense)	(2.7)	9.2	(3.8)	(0.4)	2.3
Net gains on financial instruments mandatorily at fair value through profit or loss	–	–	–	0.5	0.5
Net operating income / (expense)	141.7	82.3	55.3	(5.2)	274.1
Administrative expenses	(16.6)	(23.1)	(20.6)	(70.0)	(130.3)
Impairment losses on financial assets[1]	(5.6)	10.9	(28.5)	–	(23.2)
Provisions for liabilities and charges	(0.2)	(0.5)	(9.3)	(0.1)	(10.1)
Total operating expenses	(22.4)	(12.7)	(58.4)	(70.1)	(163.6)
Share of results of associates	(0.5)	–	–	–	(0.5)
Statutory profit / (loss) before taxation	118.8	69.6	(3.1)	(75.3)	110.0
Underlying adjustments	–	–	–	–	–
Profit / (loss) before taxation on an underlying basis	118.8	69.6	(3.1)	(75.3)	110.0
Taxation on an underlying basis					(28.4)
Profit after taxation on an underlying basis					81.6
Assets	3,705.6	1,433.4	741.0	944.9	6,824.9
Liabilities	–	–	–	(6,143.8)	(6,143.8)
Net assets / (liabilities)	3,705.6	1,433.4	741.0	(5,198.9)	681.1

[1] Impairment losses on financial assets in the year ended 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9.

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3. **Operating segments** continued

Year ended 31 December 2017	Property Finance £m	Business Finance £m	Consumer Lending £m	Central £m	Total £m
Interest income calculated using the effective interest rate method	178.5	76.5	52.2	1.7	308.9
Other interest and similar income	(0.1)	–	(0.4)	4.9	4.4
Interest expense and similar charges	(41.1)	(13.2)	(8.2)	(13.5)	(76.0)
Net interest income / (expense)	137.3	63.3	43.6	(6.9)	237.3
Operating lease rentals	–	12.3	–	–	12.3
Depreciation on operating leases	–	(10.6)	–	–	(10.6)
Net income from operating leases	–	1.7	–	–	1.7
Fee and commission income	0.4	11.2	0.7	–	12.3
Fee and commission expense	(3.3)	(0.7)	(8.5)	(0.3)	(12.8)
Net fee and commission (expense) / income	(2.9)	10.5	(7.8)	(0.3)	(0.5)
Net gains / (losses) on financial instruments at fair value through profit or loss	0.1	–	0.5	(0.4)	0.2
Net operating income / (expense)	134.5	75.5	36.3	(7.6)	238.7
Administrative expenses	(17.1)	(16.7)	(13.0)	(80.0)	(126.8)
Impairment losses on financial assets[1]	(2.4)	(8.5)	(12.4)	–	(23.3)
Provisions for liabilities and charges	–	–	(2.5)	0.4	(2.1)
Total operating expenses	(19.5)	(25.2)	(27.9)	(79.6)	(152.2)
Statutory profit / (loss) before taxation	115.0	50.3	8.4	(87.2)	86.5
Underlying adjustments	0.4	–	–	19.1	19.5
Profit / (loss) before taxation on an underlying basis	115.4	50.3	8.4	(68.1)	106.0
Taxation on an underlying basis					(26.8)
Profit after taxation on an underlying basis					79.2
Assets	3,187.0	1,076.0	617.4	878.3	5,758.7
Liabilities	–	–	–	(5,135.6)	(5,135.6)
Net assets / (liabilities)	3,187.0	1,076.0	617.4	(4,257.3)	623.1

[1] Impairment losses on financial assets in the year ended 31 December 2017 reflect impairment losses calculated in accordance with IAS 39.

4. Interest and similar income

See accounting policies in Note 1.7(b)

	2018 £m	2017 £m
Interest income calculated using the effective interest rate method		
On cash and balance at central banks	4.7	1.8
On loans and advances to customers	351.1	307.1
On investment securities	0.2	–
Total interest income calculated using the effective interest rate method	356.0	308.9
Other interest and similar income		
On derivative financial instruments	0.8	4.4
Total other interest and similar income	0.8	4.4
Total interest and similar income	356.8	313.3

Interest income recognised during the year on Stage 3 loans under the requirements of IFRS 9 is £7.6 million. In 2017, interest on impaired loans under the requirements of IAS 39 was £2.7 million.

The Group did not capitalise any interest income during 2018 (2017: £nil).

The amounts reported above include £356.0 million (2017: £308.9 million) of interest income on financial assets measured at amortised cost.

5. Interest expense and similar charges

See accounting policies in Note 1.7(b)

	2018 £m	2017 £m
On amounts due to banks	6.2	1.8
On customer deposits	74.3	67.3
On derivative financial instruments	(0.2)	–
On subordinated debt liability	6.5	6.5
Other interest	0.5	0.4
Total interest expense and similar charges	87.3	76.0

The amounts reported above include £87.5 million (2017: £76.0 million) of interest expense on financial liabilities measured at amortised cost.

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For the year ended 31 December 2018

6. Fee and commission income

See accounting policies in Note 1.7(c)

	2018 £m	2017 £m
Fee income on loans and advances to customers	**8.3**	10.4
Credit facility related fees	**2.4**	1.9
Total fee and commission income	**10.7**	12.3

7. Administrative expenses

See accounting policies in Note 1.7(d)

	2018 £m	2017 £m
Payroll costs (Note 9)	**65.0**	66.1
Depreciation (excluding operating lease assets)	**2.0**	2.6
Loss on disposal of property, plant and equipment	**0.1**	–
Amortisation of intangible assets	**6.1**	4.0
Impairment of goodwill	**1.1**	–
Loss on disposal of intangible assets	**1.9**	–
Operating lease payments	**2.4**	1.6
Other administrative expenses	**51.7**	52.5
Total administrative expenses	**130.3**	126.8

Other administrative expenses include fees paid to the Group's auditor as detailed in Note 8.

Other administrative expenses in the year ended 31 December 2017 included £13.2 million of legal and consultancy costs relating to the Marlin Bidco Limited acquisition of the Company.

8. Auditor's remuneration

Fees payable to the Group's auditor, KPMG LLP, are analysed below:

	2018 £000	2017 £000
Audit of these annual accounts	**100**	100
Audit of the annual accounts of the subsidiaries of the Company	**530**	466
Adjustments in respect of prior year and IFRS 9	**45**	–
Other tax advisory services	**19**	4
Audit related assurance services	**87**	135
All other assurance services	**59**	129
All other services	**90**	58
Total auditor's remuneration	**930**	892

9. Employees

See accounting policies in Note 1.7(d)

The average number of persons employed by the Group on a full-time equivalent basis (including Executive Directors) was as follows:

	2018 No.	2017 No.
Property Finance	**99**	143
Business Finance	**170**	133
Consumer Lending	**51**	43
Central	**411**	352
Average employees	**731**	671

The aggregate payroll costs of these persons were as follows:

	2018 £m	2017 £m
Wages and salaries	**56.7**	58.0
Social security costs	**5.2**	5.6
Pension costs	**3.1**	2.5
Total payroll costs	**65.0**	66.1

Wages and salaries include share-based payment charges as detailed in Note 10.

Pension costs represent contributions to defined contribution pension schemes. The Group does not operate any defined benefit pension schemes.

10. Employee share-based payment transactions

See accounting policies in Note 1.7(e)

The employee share-based payment charge comprises:

	Status	**2018 £m**	2017 £m
Save-as-you-earn schemes	Fully vested in 2017	**–**	0.8
Performance share plan – 2015	Fully vested in 2017	**–**	1.4
Performance share plan – 2016	Fully vested in 2017	**–**	1.7
Performance share plan – 2017	Fully vested in 2017	**–**	2.4
Deferred share bonus plan – 2017	Fully vested in 2017	**–**	1.2
Total share-based payments		**–**	7.5

In 2018, no share-based payment schemes have been in operation.

Notes to the financial statements

For the year ended 31 December 2018

10. Employee share-based payment transactions continued

Fully vested schemes

In 2017, following the acquisition of the Group by Marlin Bidco Limited, there was an issue of 2,586,879 £0.01 shares and the vesting of all of the share option schemes in operation was accelerated. The acceleration of the share options were recognised as if the service and the non-market performance conditions of all schemes had been met. Subsequent to vesting, all shares were repurchased by Marlin Bidco Limited at the offer price of £3.40. The total charge relating to the accelerated vesting in 2017 was £5.9 million, with the total share-based payment charge for the year ended 31 December 2017 being £7.5 million. Full details of the share schemes fully vested during 2017 can be found in the 2017 Annual Report and Accounts.

11. Directors' remuneration

	2018 £000	2017 £000
Directors' emoluments[1]	**3,499.6**	5,285.3
Total Directors' remuneration	**3,499.6**	5,285.3

Included in Directors' emoluments is £1.2 million (2017: £nil) relating to termination payments.

Further information about the remuneration of Directors is provided in the Directors' remuneration report.

12. Impairment losses on financial assets

See accounting policies in Note 1.7(v)

Impairment losses on financial assets relate to loans and advances to customers, as set out below:

	2018 £m	2017 £m
Movement in loss allowance / impairment allowance in the year[2]	**15.1**	7.2
Loan balances written-off in the year	**25.6**	18.6
Amounts recovered in the year in respect of loan balances previously written-off[3]	**(17.5)**	(2.5)
Total impairment losses on financial assets	**23.2**	23.3

Impairment losses on cash and balances at central banks, loans and advances to banks and investment securities in the year to 31 December 2018 are immaterial, totalling less than £0.1 million.

[1] Following the resignation of Steve Pateman in July 2018, Ian Cowie assumed the role as Interim Chief Executive Officer. He was not however formally appointed to the Board of the Company until 2019 and therefore his remuneration is not included in the table.

[2] Movement in loss allowance in the year to 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Movement in impairment allowance in the year to 31 December 2017 reflect impairment losses calculated in accordance with IAS 39. See Note 14(b) for further detail of movements.

[3] During 2018, the Group received £13.0 million relating to the Group's insurance claim in respect of the controls breach identified in the Business Finance division in 2016.

13. Taxation

See accounting policies in Note 1.7(f)

Taxation charge recognised in the statement of profit and loss includes:

	2018 £m	2017 £m
Current tax		
Current year	25.6	24.2
Adjustment in respect of prior years	(0.5)	(1.1)
Total current tax	25.1	23.1
Deferred tax		
Origination and reversal of temporary differences	3.5	1.3
Adjustment in respect of prior periods	(0.2)	0.9
Total deferred tax	3.3	2.2
Total taxation charge	28.4	25.3

A reconciliation of profit before taxation per the statement of profit and loss to the total taxation charge per the statement of profit and loss is as follows:

	2018 £m	2017 £m
Profit before taxation	110.0	86.5
Implied tax charge thereon at 19.00% (2017: 19.25%)	20.9	16.7
Adjustments		
Banking surcharge	6.7	4.9
Adjustment in respect of prior years	(0.7)	(0.2)
Disallowable expenses and other permanent differences	0.7	3.9
Effect of tax rate changes	0.8	–
Total taxation charge	28.4	25.3

Reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and further reductions to 17% (effective 1 April 2020) were substantively enacted on 16 March 2016. This will reduce the Company's future current taxation charge accordingly.

Tax of £2.5 million arising on the £9.8 million coupon paid on capital securities is recognised directly in equity.

The deferred tax asset as at 31 December 2018 has been calculated based on an aggregation rate of 25% (2017: 26%). This is based on a rate of 17% substantively enacted at the reporting date (2017: 18%) and the additional 8% of tax suffered in relation to the banking surcharge that will unwind over the remaining life of the underlying assets with which they are associated.

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14. Loans and advances to customers

See accounting policies in Note 1.7(g)

(a) Analysis of loans and advances to customers

	2018			2017		
	Gross carrying amount £m	**Loss allowance[1] £m**	**Carrying amount £m**	Gross carrying amount £m	Impairment allowance[1] £m	Carrying amount £m
Loan receivables	**5,410.4**	**(54.1)**	**5,356.3**	4,438.4	(19.7)	4,418.7
Finance lease receivables	**95.0**	**(7.2)**	**87.8**	88.9	(9.1)	79.8
Instalment credit receivables	**409.4**	**(6.5)**	**402.9**	350.8	(2.8)	348.0
	5,914.8	**(67.8)**	**5,847.0**	4,878.1	(31.6)	4,846.5
Fair value adjustments for hedged risk			**(1.1)**			(2.2)
Total loans and advances to customers			**5,845.9**			4,844.3

Total loans and advances to customers include:

- £1,402.7 million (2017: £1,081.7 million) positioned with the Bank of England for use as collateral under its funding schemes. This comprises £1,402.7 million (2017: £902.2 million) for the Term Funding Scheme and £nil (2017: £179.5 million) for the Funding for Lending scheme.
- £206.9 million (2017: £nil) pledged as collateral against secured bank borrowings.

[1] Loss allowance as at 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment allowance as at 31 December 2017 reflect impairment losses calculated in accordance with IAS 39.

Finance lease receivables and instalment credit receivables

The Group provides finance lease and instalment credit agreements to customers for a variety of assets including, but not limited to, plant and machinery. The underlying assets provide security against the gross receivables.

The following table provides further analysis of finance lease receivables:

	2018 £m	2017 £m
Gross amounts receivable:		
within one year	46.0	47.0
in the second to fifth year inclusive	50.0	49.5
after five years	10.0	3.0
	106.0	99.5
Less: unearned finance income	(11.0)	(10.6)
Gross carrying amount	95.0	88.9
Less: loss allowance / impairment allowance[1]	(7.2)	(9.1)
Total finance lease receivables	87.8	79.8
Amounts falling due:		
within one year	38.0	37.5
in the second to fifth year	41.3	39.7
after five years	8.5	2.6
Total finance lease receivables	87.8	79.8

[1] Loss allowance as at 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment allowance as at 31 December 2017 reflect impairment losses calculated in accordance with IAS 39.

14. Loans and advances to customers continued

The following table provides further analysis of instalment credit receivables:

	2018 £m	2017 £m
Gross amounts receivable:		
within one year	**173.7**	162.5
in the second to fifth year inclusive	**249.2**	204.9
after five years	**26.5**	18.1
	449.4	385.5
Less: unearned finance income	**(40.0)**	(34.7)
Gross carrying amount	**409.4**	350.8
Less: loss allowance / impairment allowance[1]	**(6.5)**	(2.8)
Total instalment credit receivables	**402.9**	348.0
Amounts falling due:		
within one year	**151.9**	143.3
in the second to fifth year	**226.1**	186.8
after five years	**24.9**	17.9
Total instalment credit receivables	**402.9**	348.0

Included within instalment credit receivables are block discounting facilities of £157.2 million (2017: £106.6 million).

The cost of equipment acquired during the year under finance lease and instalment credit agreements is as follows:

	2018 £m	2017 £m
Finance leases	**58.9**	40.1
Instalment credit	**140.2**	161.5
Total cost of equipment acquired during the year	**199.1**	201.6

[1] Loss allowance as at 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment allowance as at 31 December 2017 reflect impairment losses calculated in accordance with IAS 39.

(b) Analysis of impairment losses on loans and advances to customers

				2018	2017
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Total £m
Loan receivables	20.5	18.3	15.3	54.1	19.7
Finance lease receivables	0.5	1.1	5.6	7.2	9.1
Instalment credit receivables	2.5	1.3	2.7	6.5	2.8
Loss allowance / impairment allowance[1]	23.5	20.7	23.6	67.8	31.6

The below table shows an analysis of movements in the loss allowance during 2018 under IFRS 9, together with the loss allowance coverage:

				2018
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
As at 1 January	10.5	7.5	13.6	31.6
Impact of adopting IFRS 9[2]	6.8	5.0	9.3	21.1
Restated balance as at 1 January	17.3	12.5	22.9	52.7
Movements in loss allowance				
Transfer to Stage 1	4.3	(3.8)	(0.5)	–
Transfer to Stage 2	(1.4)	3.2	(1.8)	–
Transfer to Stage 3	(0.8)	(2.7)	3.5	–
New financial assets originated or purchased	13.2	1.3	0.5	15.0
Financial assets that have been derecognised	(3.2)	(1.8)	(3.9)	(8.9)
Changes in models / risk parameters	(5.8)	11.4	11.1	16.7
Modifications without derecognition	(0.1)	0.6	2.9	3.4
Write-offs	–	–	(11.1)	(11.1)
Total movement in loss allowance	6.2	8.2	0.7	15.1
As at 31 December	23.5	20.7	23.6	67.8
Loss allowances coverage as at 31 December	0.5%	2.4%	19.5%	1.1%

[1] Loss allowance as at 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment allowance as at 31 December 2017 reflect impairment losses calculated in accordance with IAS 39.

[2] See Note 1.6(a) and Note 2 for details.

Notes to the financial statements

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14. Loans and advances to customers continued

Significant changes in the gross carrying amount of loans and advances to customers that contributed to changes in the loss allowance were as follows:

- The Group originated c.£2,346 million of loans in 2018 that generated an increase in loss allowance of £15.0 million. The increase in loss allowance was largely attributable to Consumer Lending originations of £490 million (loss allowance £9.1 million) due to the higher loss allowance coverage ratio, Business Finance originations of £813 million (loss allowance £4.8 million) and Property Finance originations of £1,043 million (loss allowance £1.1 million). Property Finance exposure benefits from strong collateral values as set out in the Group's lending policy and therefore has a low loss allowance coverage ratio.
- Financial assets that have been derecognised refers to the loss allowance reduction at the point a loan is redeemed (loss allowance £8.9 million). This is largely due to redemptions in Business Finance (loss allowance £4.5 million) and Consumer Lending (loss allowance £3.2 million) where there is a higher loss allowance coverage.
- Changes in models / risk parameters account for an increase in loss allowance of £16.7 million. These are largely attributable to an increase of £6.8 million due to changes in the nature and probability of the IFRS 9 scenarios used in the ECL. During the year, the Group changed its forward forecast to a central view / disorderly no-deal Brexit / alternative upside view with probability of 40% / 40% / 20% at 31 December 2018. The remainder of the impact is due to updated PD and LGD judgements across the loan portfolios.
- The Group continued to operate a simultaneous charge-off and write-off policy during 2018. The reduction in loss allowance of the write-offs in Consumer Lending accounts for £10.8 million of the £11.1 million Group reduction in loss allowance.

(c) Modifications

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery.

During 2018, loans with a gross carrying amount as at 31 December 2018 of £50.3 million were modified. No material net modification gain or loss was recognised by the Group.

Further details of forborne loans are set out in Section 5.9 of the risk management report.

(d) Write-offs still under enforcement activity

Loans that are written off can still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due. The contractual amount outstanding on loans and advances that were written off during the reporting period, and are still subject to enforcement activity, is £13.5 million (2017: £6.3 million).

15. Investment securities

See accounting policies in Note 1.7(h)

	2018 £m	2017 £m
As at 1 January	**–**	–
Additions	**139.7**	–
Accrued interest	**0.2**	–
As at 31 December	**139.9**	–

Loss allowance for investment securities as at 31 December 2018 is immaterial, totalling less than £0.1 million.

16. Derivative financial instruments and hedge accounting

See accounting policies in Note 1.7(i) and Note 1.7(j)

(a) Derivatives held for risk management

The following table analyses derivatives held for risk management purposes by type of instrument:

	2018				2017			
	Assets		Liabilities		Assets		Liabilities	
	Notional value £m	Fair value £m	Notional value £m	Fair value £m	Notional value £m	Fair value £m	Notional value £m	Fair value £m
Interest rate swaps	431.5	1.4	559.2	1.2	389.0	1.8	189.0	0.3
Interest rate options	–	–	1,150.0	4.3	–	–	500.0	2.8
Cross-currency swaps	28.7	0.2	11.6	0.2	–	–	33.3	0.3
Total derivative financial instruments	460.2	1.6	1,720.8	5.7	389.0	1.8	722.3	3.4

The Group's property loan portfolio includes loans where interest rate terms are referenced to the three-month LIBOR index, but with a minimum reference rate of 0.75%. In March 2017 and March 2018, the Group sold interest rate options with a nominal value of £500.0 million and £650.0 million respectively into the wholesale market in order to hedge the Group's interest rate position against possible increases in the reference rate. Of the £650.0 million interest rate options sold in March 2018, £575.0 million are forward starting, with an effective date beyond 2018.

(b) Hedge accounting

As at 31 December 2018, the Group held interest rate swaps and options as hedging instruments in fair value hedges as detailed in the tables below. The Group's cross-currency swaps are not in hedge accounting relationships.

	Maturity					
As at 31 December 2018	Less than 1 month	1 – 3 months	3 months – 1 year	1 – 5 years	More than 5 years	Total
Interest rate swaps						
Nominal amount (£m)	–	–	50.0	913.4	27.3	990.7
Average fixed interest rate	–	–	1.20%	1.12%	1.34%	1.16%
Interest rate options						
Nominal amount (£m)	–	–	–	850.0	300.0	1,150.0
Average fixed interest rate	–	–	–	0.75%	0.75%	0.75%

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16. Derivative financial instruments and hedge accounting continued

The amounts relating to items designated as hedging instruments and hedge ineffectiveness were as follows:

As at 31 December 2018	Nominal amount £m	Carrying amount £m	Statement of financial position line item	Change in fair value used for calculating hedge ineffectiveness £m	Ineffectiveness recognised in statement of profit and loss £m	Statement of profit qnd loss line item
Interest rate swaps						
Assets	431.5	1.4	(i)	(0.7)	(0.5)	(iii)
Liabilities	559.2	1.2	(ii)	1.7	0.2	(iii)
Interest rate options						
Liabilities	1,150.0	4.3	(ii)	1.6	0.3	(iii)

(i) Derivative financial assets
(ii) Derivative financial liabilities
(iii) Net gains / (losses) on financial instruments mandatorily at fair value through profit or loss

In these hedge relationships, the main sources of ineffectiveness relate to the modelled prepayment behaviour and the assumptions that are used in modelling this behaviour.

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

As at 31 December 2018	Carrying amount £m	Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item £m	Statement of financial position line item	Change in value used for calculating hedge ineffectiveness £m	Accumulated amount of fair value hedge adjustments £m
Assets					
Loans and advances to customers	1,740.6	(6.0)	Loans and advances to customers	(1.1)	(6.0)
Liabilities					
Customer deposits	280.0	(0.1)	Customer deposits	(1.4)	(0.1)

(c) Net fair value gains and losses on derivative financial instruments and hedge accounting

Gains and losses on derivative financial instruments and hedge accounting per the statement of profit and loss are summarised as follows:

	2018 £m	2017 £m
Fair value gains on derivative financial instruments	3.0	3.9
Fair value losses on hedged risk	(2.5)	(3.7)
Net fair value gains on financial instruments	0.5	0.2

17. Property, plant and equipment

See accounting policies in Note 1.7(k)

	Leasehold property £m	Fixtures, fittings and equipment £m	Assets on operating leases £m	Total £m
Cost				
As at 1 January 2017	0.1	10.4	65.9	76.4
Additions	0.7	0.9	11.7	13.3
Disposals	–	(0.1)	(7.2)	(7.3)
Transfer to finance leases	–	–	(6.7)	(6.7)
As at 31 December 2017	0.8	11.2	63.7	75.7
Additions	**–**	**3.6**	**8.2**	**11.8**
Disposals	**(0.1)**	**–**	**(9.8)**	**(9.9)**
Transfer to finance leases	**–**	**–**	**(3.8)**	**(3.8)**
As at 31 December 2018	**0.7**	**14.8**	**58.3**	**73.8**
Depreciation				
As at 1 January 2017	0.1	5.9	27.7	33.7
Charge for the year	0.4	2.2	10.6	13.2
Disposals	–	(0.1)	(5.5)	(5.6)
Transfer to finance leases	–	–	(5.2)	(5.2)
As at 31 December 2017	0.5	8.0	27.6	36.1
Charge for the year	**0.1**	**1.9**	**7.6**	**9.6**
Disposals	**–**	**–**	**(8.0)**	**(8.0)**
Transfer to finance leases	**–**	**–**	**(3.0)**	**(3.0)**
As at 31 December 2018	**0.6**	**9.9**	**24.2**	**34.7**
Carrying amount				
As at 31 December 2017	0.3	3.2	36.1	39.6
As at 31 December 2018	**0.1**	**4.9**	**34.1**	**39.1**

Certain prior year figures in assets on operating leases have been restated. This is to ensure compliance with IFRS 3 'Business Combinations', which requires assets to be recognised at their fair value as at the date of acquisition. There is no change to the prior year carrying amount as a result of this restatement.

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18. Intangible assets

See accounting policies in Note 1.7(m)

	Goodwill £m	Computer software £m	Total £m
Cost			
As at 1 January 2017	44.8	19.3	64.1
Additions	–	9.8	9.8
As at 31 December 2017	44.8	29.1	73.9
Additions	**–**	**9.8**	**9.8**
Disposals	**–**	**(2.6)**	**(2.6)**
As at 31 December 2018	**44.8**	**36.3**	**81.1**
Amortisation			
As at 1 January 2017	–	4.2	4.2
Charge for the year	–	4.0	4.0
As at 31 December 2017	–	8.2	8.2
Charge for the year	**–**	**6.1**	**6.1**
Impairment in the year	**1.1**	**–**	**1.1**
Disposals	**–**	**(0.7)**	**(0.7)**
As at 31 December 2018	**1.1**	**13.6**	**14.7**
Carrying amount			
As at 31 December 2017	44.8	20.9	65.7
As at 31 December 2018	**43.7**	**22.7**	**66.4**

Computer software additions include £9.6 million of internally generated assets (2017: £8.5 million).

Impairment testing of goodwill

For the purposes of impairment testing, goodwill is allocated to the Group's cash generating units (CGUs), which are also the Group's reportable operating segments. These are: Property Finance, Business Finance and Consumer Lending.

Details of impairment testing, including key assumptions and sensitivity analysis, are set out in Note 1.9(b).

In 2018, an impairment loss of £1.1 million is recognised against the goodwill allocated to the Consumer Lending CGU. This was predominantly due to a change in forecast originations as the Group stabilises the portfolio against the backdrop of general macroeconomic uncertainty, resulting in revised cash flow forecasts. The impairment loss is recognised in administrative expenses in the statement of profit and loss. The impairment reduces the carrying amount of goodwill in the Consumer Lending CGU from £1.1 million to £nil. No impairment losses are recognised against the goodwill allocated to the Property Finance or Business Finance CGUs.

No impairment losses were recognised in 2017.

As at 31 December, the carrying amount of goodwill allocated to each CGU, after impairment losses, is as follows:

	2018 £m	2017 £m
Property Finance	**9.0**	9.0
Business Finance	**34.7**	34.7
Consumer Lending	**–**	1.1
Total goodwill	**43.7**	44.8

19. Deferred tax assets

See accounting policies in Note 1.7(f)

Deferred tax assets are attributable to the following items:

	2018 £m	2017 £m
Decelerated tax depreciation	**12.1**	13.6
IFRS 9 adjustment	**4.9**	–
Bad debt provision	**0.7**	2.0
Other	**0.3**	0.1
Total deferred tax assets	**18.0**	15.7

Movements in deferred tax assets are attributable to the following items:

	2018 £m	2017 £m
As at 1 January	**15.7**	17.9
Impact of adopting IFRS 9[1]	**5.6**	–
Restated balance as at 1 January	**21.3**	17.9
Current period movement – recognised in income	**(2.2)**	(0.4)
Adjustment in respect of prior years	**0.2**	(0.9)
Share-based payments	**–**	(1.1)
Bad debt provision	**(1.3)**	0.2
As at 31 December	**18.0**	15.7

The Group's deferred tax assets result primarily from decelerated capital allowances. The business plan projects profits in future years sufficient to fully recognise the deferred tax assets. The tax assets will unwind over the remaining life of the underlying assets with which they are associated.

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and further reductions to 17% (effective 1 April 2020) were substantively enacted on 16 March 2016. The deferred tax asset as at 31 December 2018 has been calculated based on an aggregation of a rate of 17% substantively enacted at the reporting date and the additional 8% of tax suffered in relation to the banking surcharge that will unwind over the remaining life of the underlying assets with which they are associated.

[1] See Note 1.6(a) and Note 2 for details.

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20. Investment in associates

See accounting policies in Note 1.7(n)

The Group acquired 19.99% of the ordinary shares of The Mortgage Lender Limited on 26 March 2018, in exchange for consideration, inclusive of transaction costs, of £6.0 million. Although the Group holds less than 20% of the ordinary shares of The Mortgage Lender Limited, the Group is deemed to have significant influence as detailed in Note 1.9(e).

Details of the Group's material associates at the end of the reporting period is as follows:

Name of associate	Principal activity	Place of incorporation and principal place of business	Proportion of ownership interest / voting rights held by the Group as at 31 December 2018
The Mortgage Lender Limited	Mortgage finance	UK	19.99%

The above associate is accounted for using the equity method in these consolidated financial statements as detailed in Note 1.7(n).

The carrying amount of the investment as at 31 December 2018 is £5.5 million. This includes a £0.5 million share of loss of associate recognised in the statement of profit and loss for the year ended 31 December 2018.

The financial year end date of The Mortgage Lender Limited is 31 August. For the purposes of applying the equity method of accounting, both the financial statements for the year to 31 August 2018 and monthly unaudited management accounts for September to December 2018 were used.

Summarised financial information in respect of The Mortgage Lender Limited is set out below:

	As at 31 December 2018[1] £m
Current assets	3.9
Non-current assets	0.5
Current liabilities	(0.5)
Non-current liabilities	(0.1)
Net assets	3.8

[1] Based on unaudited monthly management accounts as at 31 December 2018.

	9 months from acquisition to 31 December 2018[1] £m
Revenue	4.3
Loss from continuing operations	(2.3)
Other comprehensive income for the period	–
Total comprehensive income for the period	**(2.3)**
Dividends received from the associate during the period	**–**

A reconciliation of the above summarised financial information to the carrying amount of the interest in The Mortgage Lender Limited recognised in the consolidated financial statements is shown below:

	As at 31 December 2018
Net assets of the associate (£m)	3.8
Proportion of the Group's ownership interest in the associate	19.99%
Group's share of net assets (£m)	**0.8**
Goodwill (£m)	4.7
Carrying amount of the Group's interest in the associate (£m)	**5.5**

21. Other assets

	2018 £m	2017 £m
Other debtors	2.9	0.5
Prepayments	9.8	9.8
Total other assets	**12.7**	**10.3**

[1] Calculated based on the financial statements for the year to 31 August 2018 and monthly unaudited management accounts for the months of September to December 2018.

22. Investment in subsidiaries

Investment in subsidiaries comprises:

	Company 2018 £m	Company 2017 £m
Equity shares in Shawbrook Bank Limited	**267.8**	267.8
Capital securities in Shawbrook Bank Limited	**125.0**	125.0
Share-based payments	**16.4**	16.7
As at 31 December	**409.2**	409.5

Details of subsidiary companies are set out in Note 33. The principal terms of the capital securities in Shawbrook Bank Limited are detailed in Note 29.

Movements in investment in subsidiaries are attributable to the following items:

	Company 2018 £m	Company 2017 £m
As at 1 January	**409.5**	277.0
Issue of capital securities in Shawbrook Bank Limited	**–**	125.0
Share-based payments	**(0.3)**	7.5
As at 31 December	**409.2**	409.5

23. Amounts due to banks

See accounting policies in Note 1.7(o)

	2018 £m	2017 £m
Central bank facilities	**876.6**	605.6
Secured bank borrowings	**152.0**	–
Derivative collateral	**0.8**	1.7
Total amounts due to banks	**1,029.4**	607.3

Total amounts due to banks include:

- £875.0 million (2017: £605.0 million) drawn under the Bank of England's Term Funding Scheme which fall due for repayment between 2020 and 2022. These amounts are collateralised by loan assets of £1,402.7 million (2017: £902.2 million).
- Secured bank borrowings of £152.0 million (2017: £nil). These amounts are secured on loan assets of £206.9 million (2017: £nil).

24. Customer deposits

See accounting policies in Note 1.7(p)

	2018 £m	2017 £m
Instant access	**1,365.6**	878.2
Term deposits and notice accounts	**3,612.2**	3,496.0
Fair value adjustments for hedged risk	**0.1**	2.0
Total customer deposits	**4,977.9**	4,376.2

25. Provisions for liabilities and charges

See accounting policies in Note 1.7(q) and Note 1.7(x)

	2018			2017	
	Loss provision £m	**Other provisions £m**	**Total £m**	Other provisions £m	Total £m
As at 1 January	**–**	**2.8**	**2.8**	1.3	1.3
Impact of adopting IFRS 9[1]	**0.5**	**–**	**0.5**	–	–
Restated balance as at 1 January	**0.5**	**2.8**	**3.3**	1.3	1.3
Provisions utilised during the year	**–**	**(1.8)**	**(1.8)**	(0.6)	(0.6)
Provisions made during the year	**0.5**	**9.6**	**10.1**	2.1	2.1
As at 31 December	**1.0**	**10.6**	**11.6**	2.8	2.8

Loss provision

Loss provision represents the IFRS 9 loss allowance on financial guarantee contracts and loan commitments. Further details are set out in Note 38.

Other provisions

Other provisions include:

- £0.4 million (2017: £0.3 million) relating to the Financial Services Compensation Scheme. The amount provided is based on information received from the Financial Services Compensation Scheme, forecast future interest rates and the Group's historic share of industry protected deposits.
- £10.2 million (2017: £2.5 million) relating to potential instances of misrepresentation or breaches of contract by suppliers where the suppliers have become insolvent, and therefore the Group has limited recourse to those suppliers. See Note 1.9(c) for further details.

26. Other liabilities

	2018 £m	2017 £m
Other creditors	**19.5**	46.2
Accruals	**20.2**	16.6
Total other liabilities	**39.7**	62.8

Other creditors include amounts relating to sundry creditors and other taxes.

[1] See Note 1.6(a) and Note 2 for details.

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27. Subordinated debt

See accounting policies in Note 1.7(r)

(a) Subordinated debt liability

In October 2015, the Company issued £75.0 million fixed rate reset callable subordinated notes due 2025. The notes were listed on the London Stock Exchange on 28 October 2015. The notes bear interest on their principal amount at an initial rate of 8.5% per annum until the first reset date of 28 October 2020. Interest is payable semi-annually in arrears.

	2018 £m	2017 £m
As at 1 January	**75.4**	75.3
Interest expense and similar charges	**6.5**	6.5
Repayment of interest	**(6.4)**	(6.4)
As at 31 December	**75.5**	75.4

(b) Subordinated debt receivable

Following the issue of subordinated debt to the market, subordinated debt was issued from Shawbrook Bank Limited to the Company on consistent terms with the listed loan notes. The subordinated debt receivable in the Company statement of financial position is £76.1 million (2017: £76.1 million).

The subordinated debt ranks behind any claims against the Group from all depositors and creditors.

28. Share capital

Ordinary shares of £0.01 each: issued and fully paid

	2018 No.	2017 No.
Ordinary £0.01 shares	**253,086,879**	253,086,879

Movement in share capital is as follows:

	2018		2017	
	No.	**£**	No.	£
On issue as at 1 January	**253,086,879**	**2,530,869**	250,500,000	2,505,000
Issued during the year	**–**	**–**	2,586,879	25,869
On issue as at 31 December	**253,086,879**	**2,530,869**	253,086,879	2,530,869

Each ordinary share of £0.01 has full voting, dividend and capital distribution rights, including on a winding up, but does not have any rights of redemption. Par value is £0.01 per share.

29. Capital securities

See accounting policies in Note 1.7(s)

	2018 £m	2017 £m
As at 1 January	**124.0**	–
Issue of capital securities	–	125.0
Cost of issuance of capital securities	–	(1.0)
As at 31 December	**124.0**	124.0

In December 2017, the Company issued £125.0 million fixed rate reset perpetual Additional Tier 1 write down capital securities. The capital securities were listed on the Irish Stock Exchange on 8 December 2017.

During 2018, the Group paid a coupon of £9.8 million (2017: £nil) to the holders of the capital securities before deduction of taxation.

The principal terms of the capital securities are as follows:

- The capital securities constitute direct, unsecured and subordinated obligations and will rank pari passu without any preference among themselves. On a winding up of the Company they rank ahead of the holders of all other classes of issued shares but junior to the claims of senior unsubordinated and subordinated creditors other than those whose claims rank pari passu with or junior to them.
- The capital securities bear interest on their principal amount at an initial rate of 7.875% per annum. The rate will be reset on 8 December 2022 and every fifth anniversary thereafter. Interest is payable semi-annually in arrears in June and December and is non-cumulative. Interest is fully discretionary and the Company may elect to cancel (in whole or in part) the interest otherwise scheduled to be paid. Any interest not paid when scheduled will be cancelled.
- The capital securities are perpetual with no fixed redemption date. The Company may elect to redeem all, but not part, of the capital securities on the first reset date (8 December 2022) or any reset date thereafter, or for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the Prudential Regulation Authority.
- In the event of the Group's Common Equity Tier 1 capital ratio falling below 7.0%, an automatic and permanent write down shall occur on the next business day, resulting in the reduction of the full principal amount of capital securities to zero, the cancellation of all capital securities and the cancellation of any interest which is accrued and unpaid.

Following the listing of the capital securities to the market, capital securities were issued from Shawbrook Bank Limited to the Company on consistent terms as the listed capital securities.

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30. Notes to the cash flow statement

See accounting policies in Note 1.7(t)

(a) Adjustments for non-cash items and other adjustments included within the statement of profit and loss

	Group 2018 £m	**Company 2018 £m**	Group 2017 £m	Company 2017 £m
Subordinated debt interest and costs	**6.5**	**6.5**	6.5	6.5
Investment securities accrued interest	**(0.2)**	**–**	–	–
Depreciation of property, plant and equipment	**9.6**	**–**	13.2	–
Loss on disposal of property, plant and equipment	**0.1**	**–**	–	–
Amortisation of intangible assets	**6.1**	**–**	4.0	–
Impairment of goodwill	**1.1**	**–**	–	–
Loss on disposal of intangible assets	**1.9**	**–**	–	–
Loss allowance / impairment allowance on financial assets[1]	**15.1**	**–**	23.3	–
Share of results of associates	**0.5**	**–**	–	–
Share-based payments	**(0.3)**	**–**	7.5	–
Total non-cash items	**40.4**	**6.5**	54.5	6.5

(b) Net change in operating assets

	Group 2018 £m	**Company 2018 £m**	Group 2017 £m	Company 2017 £m
Increase in mandatory deposits with central banks[2]	**(4.6)**	**–**	(0.3)	–
Increase in loans and advances to customers	**(1,037.8)**	**–**	(817.2)	–
Decrease in derivative financial assets	**0.2**	**–**	3.4	–
Increase in operating lease assets	**(5.6)**	**–**	(8.6)	–
(Increase) / decrease in other assets	**(2.4)**	**(0.3)**	6.3	0.7
(Increase) / decrease in operating assets	**(1,050.2)**	**(0.3)**	(816.4)	0.7

(c) Net change in operating liabilities

	Group 2018 £m	**Company 2018 £m**	Group 2017 £m	Company 2017 £m
Increase in customer deposits	**601.7**	**–**	432.7	–
Increase in provisions for liabilities and charges	**8.3**	**–**	1.5	–
Increase in derivative financial liabilities	**2.3**	**–**	3.0	–
(Decrease) / increase in other liabilities	**(23.1)**	**(0.1)**	35.8	0.4
Increase / (decrease) in operating liabilities	**589.2**	**(0.1)**	473.0	0.4

[1] Loss allowance as at 31 December 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment allowance as at 31 December 2017 reflect impairment losses calculated in accordance with IAS 39.

[2] Mandatory deposits with central banks are not available for use in day-to-day operations and are non-interest bearing.

(d) Cash and cash equivalents

	Group 2018 £m	Company 2018 £m	Group 2017 £m	Company 2017 £m
Cash and balances at central banks	645.2	–	752.5	–
Loans and advances to banks	50.6	–	28.8	–
Less: mandatory deposits with central banks[1]	(8.9)	–	(4.3)	–
Total cash and cash equivalents	686.9	–	777.0	–

31. Financial instruments

See accounting policies in Note 1.7(u)

(a) Classification of financial instruments

The following tables summarise the classification and carrying amounts of the Group's financial assets and liabilities:

As at 31 December 2018 Under IFRS 9	Mandatorily at FVTPL £m	Amortised cost £m	Total carrying amount £m
Financial assets			
Cash and balances at central banks	–	645.2	645.2
Loans and advances to banks	–	50.6	50.6
Loans and advances to customers	–	5,845.9	5,845.9
Investment securities	–	139.9	139.9
Derivative financial assets	1.6	–	1.6
Total financial assets	1.6	6,681.6	6,683.2
Financial liabilities			
Amounts due to banks	–	1,029.4	1,029.4
Customer deposits	–	4,977.9	4,977.9
Derivative financial liabilities	5.7	–	5.7
Subordinated debt liability	–	75.5	75.5
Total financial liabilities	5.7	6,082.8	6,088.5

There were no reclassifications of financial assets or liabilities during the year ended 31 December 2018.

[1] Mandatory deposits with central banks are not available for use in day-to-day operations and are non-interest bearing.

31. Financial instruments continued

As at 31 December 2017 Under IAS 39	FVTPL £m	Loans and receivables £m	Other amortised cost £m	Total carrying amount £m
Financial assets				
Cash and balances at central banks	–	752.5	–	752.5
Loans and advances to banks	–	28.8	–	28.8
Loans and advances to customers	–	4,844.3	–	4,844.3
Derivative financial assets	1.8	–	–	1.8
Total financial assets	1.8	5,625.6	–	5,627.4
Financial liabilities				
Amounts due to banks	–	–	607.3	607.3
Customer deposits	–	–	4,376.2	4,376.2
Derivative financial liabilities	3.4	–	–	3.4
Subordinated debt liability	–	–	75.4	75.4
Total financial liabilities	3.4	–	5,058.9	5,062.3

There were no reclassifications of financial assets or liabilities during the year ended 31 December 2017.

(b) Fair value of financial instruments

A summary of the Group's valuation methods used to calculate the fair values of its financial assets and financial liabilities is as follows:

- **Cash and balances at central banks:** fair value approximates to carrying amount as cash and balances at central banks have minimal credit losses and are either short-term in nature or re-price frequently.
- **Loans and advances to banks, customer deposits and amounts due to banks:** fair value is estimated using discounted cash flows applying either market rates where practicable or rates offered with similar characteristics by other financial institutions. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.
- **Loans and advances to customers:** fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date, and adjusted for future credit losses if considered material.
- **Derivative financial instruments:** fair values of derivatives are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flows.
- **Investment securities and subordinated debt liability:** fair values are based on quoted prices where available or by discounting cash flows using market rates.

The Group uses a fair value hierarchy which reflects the significance of the inputs used in making the measurements. There are three levels to the hierarchy as follows:

- **Level 1:** quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- **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). A Level 2 input must be observable for substantially the full term of the instrument. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads. Assets and liabilities classified as Level 2 have been valued using models whose inputs are observable in an active market; and
- **Level 3:** inputs for the asset or liabilities that are not based on observable market data (unobservable inputs).

The consideration of factors such as the scale and frequency of trading activity, the availability of prices and the size of bid / offer spreads assists in the assessment of whether a market is active. If, in the opinion of Management, a significant proportion of an instrument's carrying amount is driven by unobservable inputs, the instrument in its entirety is classified as valued at Level 3 of the fair value hierarchy. Level 3 in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

The table below analyses the Group's financial instruments measured at amortised cost into the fair value hierarchy:

			2018			2017
	Level 3 £m	**Level 2 £m**	**Level 1 £m**	Level 3 £m	Level 2 £m	Level 1 £m
Financial assets (at amortised cost)						
Cash and balances at central banks	**–**	**–**	**645.2**	–	–	752.5
Loans and advances to banks	**–**	**50.6**	**–**	–	28.8	–
Loans and advances to customers	**5,845.9**	**–**	**–**	4,844.3	–	–
Investment securities	**–**	**–**	**139.9**	–	–	–
Financial liabilities (at amortised cost)						
Amounts due to banks	**–**	**1,029.4**	**–**	–	607.3	–
Customer deposits	**–**	**4,977.9**	**–**	–	4,376.2	–
Subordinated debt liability	**–**	**75.5**	**–**	–	75.4	–

There were no transfers between the levels of the fair value hierarchy during the year (2017: £nil).

The table below analyses the Group's financial instruments measured at fair value into the fair value hierarchy:

			2018			2017
	Level 3 £m	**Level 2 £m**	**Level 1 £m**	Level 3 £m	Level 2 £m	Level 1 £m
Financial assets (at fair value)						
Derivative financial assets	**–**	**1.6**	**–**	–	1.8	–
Financial liabilities (at fair value)						
Derivative financial liabilities	**–**	**5.7**	**–**	–	3.4	–

There were no transfers between the levels of the fair value hierarchy during the year (2017: £nil).

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31. Financial instruments continued

The below table shows a comparison of the carrying amounts per the statement of financial position, and the fair values of those financial instruments measured at amortised cost:

	2018		2017	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial assets (at amortised cost)				
Cash and balances at central banks	**645.2**	**645.2**	752.5	752.5
Loans and advances to banks	**50.6**	**50.6**	28.8	28.8
Loans and advances to customers	**5,845.9**	**6,105.8**	4,844.3	5,045.9
Investment securities	**139.9**	**139.0**	–	–
Total financial assets (at amortised cost)	**6,681.6**	**6,940.6**	5,625.6	5,827.2
Financial liabilities (at amortised cost)				
Amounts due to banks	**1,029.4**	**1,014.8**	607.3	594.5
Customer deposits	**4,977.9**	**4,972.8**	4,376.2	4,369.3
Subordinated debt liability	**75.5**	**78.0**	75.4	81.0
Total financial liabilities (at amortised cost)	**6,082.8**	**6,065.6**	5,058.9	5,044.8

(c) Offsetting financial assets and financial liabilities

The Group has financial assets and financial liabilities for which there is a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis, or realise the asset and liability simultaneously.

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

- there is an enforceable master netting arrangement or similar agreement in place and an unconditional right to offset is in place (amounts offset);
- there is an enforceable master netting arrangement or similar agreement in place but the offset criteria are otherwise not satisfied (master netting arrangements); and
- financial collateral is paid and received (financial collateral).

The table excludes financial instruments not subject to offset and those that are subject to collateral arrangements only (e.g. loans and advances).

	Amounts subject to enforceable netting arrangements					
	Effect of offsetting on statement of financial position			**Related amounts not offset**		
As at 31 December 2018	**Gross amount £m**	**Amount offset £m**	**Net amount reported on statement of financial position £m**	**Cash collateral[1] £m**	**Net amount £m**	**Amount not subject to enforceable netting arrangements £m**
Financial assets						
Derivative financial assets	**1.6**	**–**	**1.6**	**1.6**	**–**	**–**
Total financial assets	**1.6**	**–**	**1.6**	**1.6**	**–**	**–**
Financial liabilities						
Derivative financial liabilities	**5.7**	**–**	**5.7**	**5.7**	**–**	**–**
Total financial liabilities	**5.7**	**–**	**5.7**	**5.7**	**–**	**–**

	Amounts subject to enforceable netting arrangements					
	Effect of offsetting on statement of financial position			Related amounts not offset		
As at 31 December 2017	Gross amount £m	Amount offset £m	Net amount reported on statement of financial position £m	Cash collateral[1] £m	Net amount £m	Amount not subject to enforceable netting arrangements £m
Financial assets						
Derivative financial assets	1.8	–	1.8	1.8	–	–
Total financial assets	1.8	–	1.8	1.8	–	–
Financial liabilities						
Derivative financial liabilities	3.4	–	3.4	3.4	–	–
Total financial liabilities	3.4	–	3.4	3.4	–	–

[1] Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however, this amount is limited to the net statement of financial position exposure in order not to include any over-collateralisation.

32. Ultimate parent company

The ultimate parent and controlling party of the Group is Marlin Bidco Limited. Marlin Bidco Limited is a company jointly owned by PSCM Pooling LP and Marlinbass Limited, both incorporated in Guernsey, which are investment vehicles of Pollen Street Capital Limited and BC Partners LLP respectively.

The largest company in which the results of the Group are consolidated is that headed by Shawbrook Group plc, incorporated in England and Wales. No other financial statements include the results of the Group.

33. Subsidiary companies

See accounting policies in Note 1.4

The Company has the following subsidiary companies as at 31 December 2018 whose results are included in these consolidated financial statements:

	Country of incorporation	Class of shares	Ownership %	Principal activity
Shawbrook Bank Limited and its subsidiaries, as follows:	England and Wales	Ordinary	100	Banking
Shawbrook International Limited	Jersey	Ordinary	100	Banking
Shawbrook Buildings and Protection Limited	England and Wales	Ordinary	100	Dormant
Singers Corporate Asset Finance Limited	England and Wales	Ordinary	100	Dormant
Singers Healthcare Finance Limited	England and Wales	Ordinary	100	Dormant
Coachlease Limited	England and Wales	Ordinary	100	Dormant
Hermes Group Limited	England and Wales	Ordinary	100	Dormant
Singer & Friedlander Commercial Finance Limited	Scotland	Ordinary	100	Dormant
Link Loans Limited	England and Wales	Ordinary	100	Dormant
Centric SPV 1 Limited	England and Wales	Ordinary	100	Dormant
Resource Partners SPV Limited	England and Wales	Ordinary	100	Dormant
Centric Group Holdings Limited and its subsidiary, as follows:	England and Wales	Ordinary	100	Dormant
Centric Group Finance Limited	England and Wales	Ordinary	100	Dissolved[1]

All subsidiaries have the same registered address as the Company (see Note 1.1), except the following:

- **Shawbrook International Limited:** 1st Floor Kensington Chambers, Kensington Place, St Helier, JE4 0ZE, Jersey.
- **Singer & Friedlander Commercial Finance Limited:** 8 Nelson Mandela Place, Glasgow, Scotland, G2 1BT.

On 9 October 2018, Centric Group Finance Limited sold Centric SPV 1 Limited and Resource Partners SPV Limited to Shawbrook Bank Limited.

During 2018, the following subsidiary companies were struck off the Company Register:

- Centric Commercial Finance Limited (company no: 06406043), a subsidiary of Centric Group Finance Limited, was dissolved on 7 August 2018.
- Centric SPV 2 Limited (company no: 06675843), a subsidiary of Centric Group Finance Limited, was dissolved on 7 August 2018.
- Centric Group Finance 2 Limited (company no: 06675856), a subsidiary of Centric Group Holdings Limited, was dissolved on 7 August 2018.

[1] Centric Group Finance Limited (company no: 06405442), a subsidiary of Centric Group Holdings Limited was dissolved on 12 February 2019.

34. Related party transactions

The ultimate parent and controlling party of the Group is detailed in Note 32. Subsidiaries of the Group are detailed in Note 33.

(a) Transactions with key management personnel

Key management personnel refer to the Executive Management team and Directors of the Group.

Total compensation for key management personnel for the year is as follows:

	2018 £m	2017 £m
Short-term employee benefits	**7.0**	6.4
Other long-term benefits	**0.2**	0.1
Termination benefits	**1.4**	–
Share-based payments	**–**	4.7
Total key management personnel compensation	**8.6**	11.2

During 2018, the Group incurred fees of £0.1 million (2017: £0.1 million) in relation to the Institutional Directors appointed to the Board by the ultimate parent company as set out and agreed within the Framework Agreement. As at 31 December 2018, the balance outstanding is £nil (2017: £nil).

For further details of compensation paid to the Directors of the Group see the Directors' remuneration report.

(b) Transactions with associates

During the period from 26 March 2018 to 31 December 2018, the Group held a 19.99% holding in its associate, The Mortgage Lender Limited (see Note 20). During this period the Group paid £0.8 million of commission and servicing fees to the associate. As at 31 December 2018, the balance outstanding is £nil.

(c) Transactions between the Company and its subsidiaries

Movement in amounts owed to the Company by its subsidiary, Shawbrook Bank Limited, are as follows:

	Company 2018 £m	Company 2017 £m
As at 1 January	**1.0**	1.7
Issue of capital securities	**–**	125.0
Investment in subsidiaries	**–**	(125.0)
Dividend received from Shawbrook Bank Limited	**–**	19.5
Coupon on capital securities paid	**(9.8)**	–
Coupon on capital securities received	**9.8**	–
Professional fees and other costs	**1.5**	(17.8)
Transfer of funds	**(0.8)**	(2.4)
As at 31 December	**1.7**	1.0

In 2015, £75.0 million subordinated debt was issued from Shawbrook Bank Limited to the Company. The terms and conditions are consistent with the subordinated debt listed by the Company on the London Stock Exchange on 28 October 2015 (see Note 27).

In 2017, £125.0 million Fixed Rate Reset Perpetual Additional Tier 1 Write Down Capital Securities were issued from Shawbrook Bank Limited to the Company. The terms and conditions are consistent with the capital securities listed by the Company on the Irish Stock Exchange on 8 December 2017 (see Note 29).

34. Related party transactions continued

(d) Transactions between the Group's subsidiaries

In the year ended 31 December 2018, Shawbrook Bank Limited made payments of £31.4 million (2017: £11.0 million) to Shawbrook International Limited to support its on-going activities and to fund repayment of amounts owing to a bank by Shawbrook International Limited in relation the purchase of a loan book in December 2017. As at 31 December 2018, the balance outstanding from Shawbrook International Limited to Shawbrook Bank Limited is £42.6 million (2017: £11.2 million).

(e) Other transactions

The Group extends a €20.0 million revolving credit facility to Capitalflow (Asset Finance) DAC, which is 100% owned by PSC Nominee 3 Limited, a Pollen Street Capital Limited company. As at 31 December 2018, the balance outstanding is £14.7 million (2017: £5.8 million).

The Group extends a £20.0 million senior revolving facility to 1st Stop Funding Limited, whose ultimate parent is 1st Stop Holdings Limited. 1st Stop Holdings Limited is 100% owned by PSC Nominee 3 Limited, a Pollen Street Capital Limited company. As at 31 December 2018, the balance outstanding is £15.4 million (2017: £20.3 million).

35. Operating lease commitments

See accounting policies in Note 1.7(l)

(a) Operating leases as a lessee

Non-cancellable operating lease rentals on land and buildings are payable as follows:

	2018 £m	2017 £m
Less than 1 year	**1.4**	2.0
Between 1 and 5 years	**7.4**	5.8
More than 5 years	**4.9**	1.8
Total leases as lessee	**13.7**	9.6

(b) Operating leases as a lessor

Operating lease rentals receivable from agreements classified as property, plant and equipment, as disclosed in Note 17, are receivable as follows:

	2018 £m	2017 £m
Less than 1 year	**8.4**	8.6
Between 1 and 5 years	**16.2**	16.7
More than 5 years	**0.9**	1.5
Total leases as lessor	**25.5**	26.8

36. Capital commitments

The Group had no capital commitments as at 31 December 2018 (2017: £nil).

37. Contingent liabilities

See accounting policies in Note 1.7(w)

Part of the Group's business is regulated by the Consumer Credit Act (CCA), which contains very detailed and highly technical requirements. The Group continues to commission external reviews of its compliance with the CCA and other consumer regulations. The Group has identified some areas of potential non-compliance which are not considered to be material. While the Group considers that no material present obligation in relation to non-compliance with the CCA and other consumer regulations is likely, there is a risk that the eventual outcome may differ.

The Group's Consumer Lending division is exposed to risk under Section 75 of the CCA, in relation to any misrepresentations or breaches of contract by suppliers of goods and services to customers where the purchase of those goods and services is financed by the Group. While the Group would have recourse to the supplier in the event of such liability, if the supplier becomes insolvent then that recourse would have limited value.

38. Financial guarantee contracts and loan commitments

See accounting policies in Note 1.7(x)

Financial guarantee contracts

In 2015, the Group entered into a financial guarantee contract to an amount of £2.5 million. This contract is a continuous obligation which may be terminated by the Group on giving three months written notice.

Loss allowance for financial guarantee contracts is £nil (2017: £nil), because the contract is fully collateralised through a first fixed charge over a blocked deposit account. As such, the amount the Group should have to pay should the guarantee be called upon is £nil (2017: £nil).

Loan commitments

The below table shows an analysis of movements in the loss allowance in respect of loan commitments during 2018 under IFRS 9:

	2018	
	Stage 1 £m	Total £m
As at 1 January	–	–
Impact of adopting IFRS 9[1]	0.5	0.5
Restated balance as at 1 January	0.5	0.5
Movements in loss allowance		
New financial assets originated or purchased	0.6	0.6
Financial assets that have been derecognised	(0.1)	(0.1)
Total movement in loss allowance	0.5	0.5
As at 31 December	1.0	1.0

[1] See Note 1.6(a) and Note 2 for details.

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39. Country by country reporting

The Capital Requirements (Country by Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the Capital Requirements Directive IV.

Shawbrook Group plc and its subsidiaries are all UK or Channel Island registered entities. The activities of the Group and its subsidiaries are detailed in the strategic report and Note 33.

Required disclosures are summarised below:

	2018	2017
Net operating income (£m)	**274.1**	238.7
Profit before taxation (£m)	**110.0**	86.5
Income tax charge (£m)	**28.4**	25.3
Tax paid (£m)	**26.3**	29.6
Average number of employees on a full-time equivalent basis	**731**	671

The Group received no public subsidies during the year (2017: £nil).

40. Post balance sheet events

There have been no significant events between 31 December 2018 and the date of approval of the 2018 Annual Report and Accounts that require a change or additional disclosure in the financial statements.

Other information

Other information.

Abbreviations

ALCo	Asset and Liability Committee
bps	Basis point
CCA	Consumer Credit Act
Cebr	Commission for economics research
CET1	Common Equity Tier 1
CGU	Cash generating unit
CRD IV	Capital Requirements Directive IV
CSR	Corporate Social Responsibility
EAD	Exposure at default
EBA	European Banking Authority
ECL	Expected credit loss
EPC	Energy Performance Certificate
EU	European Union
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GDPR	General Data Protection Regulation
GDV	Gross Domestic Value
HIL	Home Improvement Loan
HOL	Holiday Ownership Loan
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
ILAAP	Internal Liquidity Adequacy Assessment Process
LCR	Liquidity coverage ratio
LGD	Loss given default
LIBOR	London Inter Bank Offer Rate
LTV	Loan-to-value
MREL	Minimum requirements for own funds and eligible liabilities
NSFR	Net stable funding ratio
PD	Probability of default
POCI	Purchased or originated credit-impaired
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
RMF	Risk Management Framework
RRP	Recovery Plan and Resolution Pack
SME(s)	Small and medium enterprise(s)
SPPI	Solely payments of principal and interest on the principal amount outstanding

Alternative performance measures

Certain financial measures disclosed in the Annual Report and Accounts do not have a standardised meaning prescribed by International Financial Reporting Standards (IFRS) and may therefore not be comparable to similar measures presented by other issuers. These measures are deemed to be 'alternative performance measures'. Definitions of the Group's key performance indicators are set out below:

Average principal employed	The average of monthly closing loans and advances to customers (net of loss allowance / impairment allowance[1] and fair value adjustments for hedged risk) and assets on operating leases included in property, plant and equipment.
Common Equity Tier 1 (CET1) capital ratio[2]	CET1 capital, divided by, risk-weighted assets.
Cost of risk	Impairment losses on financial assets, divided by, average principal employed.
Cost to income ratio	The sum of administrative expenses and provisions for liabilities and charges, divided by, net operating income.
Gross asset yield	The sum of interest and similar income, net income from operating leases, net fee and commission income and net gains on financial instruments mandatorily at fair value through profit and loss, divided by, average principal employed.
Leverage ratio[2]	Total Tier 1 capital, divided by, total leverage ratio exposure measure. Total leverage ratio exposure measure is total assets excluding derivatives and intangible assets, and adjusted for off-balance sheet items such as pipeline and undrawn collateral, exposure value for derivatives and transitional adjustments[3].
Liability yield	Interest expense and similar charges, divided by, average principal employed.
Liquidity coverage ratio[4]	Liquidity buffer, divided by, total 30-day net cash outflows in a standardised stress scenario.
Loans and advances to customers	The sum of loans and advances to customers (net of loss allowance / impairment allowance[1] and fair value adjustments for hedged risk) and assets on operating leases included in property, plant and equipment.
Management expenses ratio	The sum of administrative expenses and provisions for liabilities and charges, divided by, average principal employed.
Net interest margin	Net operating income, divided by, average principal employed.
Ratio of past due over 90 days and impaired loans	Sum of loans and advances to customers classified as over 90 days past due and loans and advances to customers classified as impaired assets, divided by, total gross loans and advances to customers.
Ratio of Stage 3 loans	Total of loans and advances to customers classified as Stage 3, divided by, total gross loans and advances to customers.
Return on lending assets after tax	Profit after taxation, divided by, average principal employed.
Return on lending assets before tax	Profit before taxation, divided by, average principal employed.
Return on tangible equity	Profit after taxation (adjusted to deduct distributions made to holders of capital securities), divided by, average tangible equity. Average tangible equity is calculated as, total equity less capital securities and intangible assets at the beginning of the period, plus total equity less capital securities and intangible assets at the end of the period, divided by two.
Total capital ratio[2]	Total regulatory capital, divided by, risk-weighted assets.
Total Tier 1 capital ratio[2]	Total Tier 1 capital, divided by, risk-weighted assets.

[1] Loss allowance in 2018 reflect expected credit losses calculated in accordance with IFRS 9. Impairment allowance in 2017 reflect impairment losses calculated in accordance with IAS 39.

[2] See Section 12 of the risk management report for further details.

[3] The year ended 31 December 2018 includes adjustments for phasing in the impact of IFRS 9 adoption in accordance with EU regulatory transitional arrangements.

[4] See Section 6 of the risk management report for further details.

Shawbrook Bank