PCF Group plc

PCF BANK

Simple banking. At your service.

Annual Report & Financial Statements 2019

PCF GROUP

Simple banking. At your service.

PCF Group plc is the AIM-listed parent company of the specialist bank, PCF Bank.

PCF Bank offers retail savings products for individuals and lending products for consumers and businesses to finance motor vehicles, plant, equipment and property.

Our commitment is to provide great customer service through expertise and simplicity.

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PCF GROUP

Company Information

PCF Group plc

Directors	**Tim Franklin** *Non-executive Chairman* **Mark Brown** *Non-executive* **Christine Higgins** *Non-executive* **Marian Martin** *Non-executive (appointed 25 July 2019)* **David Morgan** *Non-executive* **David Titmuss** *Non-executive* **Scott Maybury** *Chief Executive* **Robert Murray** *Managing Director* **David Bull** *Finance Director*
Company Secretary	**Robert Murray**
Registered Office	Pinners Hall 105-108 Old Broad Street London EC2N 1ER
Registered Number	02863246
Auditors	**Ernst & Young LLP** 25 Churchill Place Canary Wharf London E14 5EY
Nominated Adviser & Broker	**Panmure Gordon (UK) Limited** One New Change London EC4M 9AF
Joint Broker	**Shore Capital Limited** Cassini House 57 St. James's Street London SW1A 1LD
Registrars	**Computershare Investor Services PLC** The Pavilions Bridgwater Road Bristol BS99 7NH
Media & Investor Relations	**Tavistock Communications Limited** 1 Cornhill London EC3V 3ND

PCF Bank Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, FRN number 747017. The Bank is registered in England and Wales, registration number 02794633, and is wholly owned by PCF Group plc, a company registered in England and Wales, registration number 02863246 and listed on the Alternative Investment Market. Certain subsidiaries of the Bank are authorised and regulated by the Financial Conduct Authority for consumer credit activities. Registered offices are at Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

Strategic Report

The strategic report provides readers with a holistic view of PCF Group's business model, strategy, 2018/19 performance and future prospects.

Business highlights

- Total new business originations up 86% to £276 million (2018 – £148 million) comprising
  - New business origination for 'own portfolio' increased by 50% to £222 million (2018 – £148 million); and
  - £54 million of 'placed' Azule new business origination generating £1 million of broker commission income
- Portfolio growth of 55% to £339 million (2018 – £219 million)
- Growth focus is on the prime end of the credit spectrum, with 74% (2018 – 70%) of originations in our top four credit grades
- Retail deposits total £267 million (2018 – £191 million) with over 6,250 customers (2018 – 4,500)
- Azule acquisition completed in early November 2018 and is performing ahead of expectation, generating £69 million of originations in the 11 months of ownership (12 months to June 2018 – £55 million)
- Nascent bridging property finance operation originated £14 million of lending in first nine months
- £10.75 million of new share capital was raised in February 2019
- New £15 million Tier 2 capital facility put in place to support growth. This was undrawn at 30 September 2019

Financial highlights

- Operating income up 51% to £22.2 million (2018 – £14.7 million)
- Statutory profit before tax up 54% to £8.0 million (2018 – £5.2 million)
- Earnings per share up 35% to 2.7p (2018 – 2.0p)
- After-tax return on equity increased to 12.6% (2018 – 10.3%), ahead of our medium-term target of 12.5%
- Return on assets of 2.9% (2018 – 3.0%)
- Recommended final dividend of 0.4p (2018 – 0.3p) which, if approved, will be paid on 9 April 2020 to shareholders on the Register at 20 March 2020
- Net Interest Margin ('NIM') reduced slightly to 7.8% (2018 – 8.2%) with continued active management of lending quality through the cycle
- Impairment charge of 0.8% (2018 – 0.5%), including the adoption of IFRS 9 which accounted for 0.1% of the increase
- CET1 Capital Ratio of 18% (2018 – 19.3%)
- Liquidity Coverage Ratio of 715% (2018 – 499%)
- £63 million (2018 – £47 million) of unearned finance charges to contribute to earnings in future years

Strategic Report (cont'd)
Chairman's Statement
for the year ended 30 September 2019

I am delighted to report the Group's results for the year ended 30 September 2019, which show continued growth in our lending portfolio, profits and return on equity. The last 12 months have seen the delivery of key performance targets and accelerated progress and success on many fronts. Most notably, the Bank has successfully achieved our ambitious medium-term targets for our loan portfolio and return on equity. We are fortunate to have a highly committed and talented team at all levels of the business. On behalf of the Board, I would like to extend my congratulations to all our colleagues for their commitment and dedication in achieving these results and for the foundations this creates for the future.

Over the year, we have continued to increase our lending to prime customers, whilst maintaining healthy margins, supported by retail deposits at an attractive funding cost. Our move towards better quality prime lending is aligned to our cautious outlook for the UK economy and we continue to reflect our appetite for risk through the pricing of our lending products. During the year we diversified our operating model by entering into new markets through the acquisition of the broadcast and media asset finance specialist, Azule, and the launch of a property bridging finance division. Through providing high levels of customer service and competitive rates, we have continued to welcome new retail deposit customers to the Bank. At 30 September 2019, over 6,250 customers held deposit balances with PCF Bank totalling £267 million (2018 – £191 million).

Profits, shareholder return and capital

Profit before tax for the year ended 30 September 2019 was £8.0 million (2018 – £5.2 million), an increase of 54%. This delivered 35% growth in earnings per share to 2.7p (2018 – 2.0p) in a year during which we successfully raised £10.75 million of new capital. These results are particularly pleasing as they include the cost of a new property bridging finance operation, as well as a small amount of further one-off costs related to the acquisition of Azule. These costs amounted to £517,000 in the year (2018 – £270,000).

This strong set of results demonstrates our ability to grow our portfolio and improve earnings through operational gearing, putting to work our capital base and utilising our cheaper funding to scale up our banking platform. All the while, we have continued investment for the future through the recruitment of new staff and by making technology enhancements to promote efficiencies and meet the needs of our customers.

Net assets increased by 38% to £58.8 million (2018 – £42.6 million), following the equity fund raising, and the Group Common Equity Tier 1 Ratio ('CET1') remained a healthy 18% (2018 – 19.3%). This capital position has been supplemented with a new £15 million Tier 2 capital facility which can be drawn, as required.

The Board recommends the payment of a final dividend of 0.4p per ordinary share (2018 – 0.3p), which is a 33% increase over the previous year but retains a significant proportion of retained profits for growth. If approved, the dividend will be paid on 9 April 2020 to shareholders on the register at 20 March 2020. We continue to make a good return on our capital and intend to maintain a dividend policy that supports the capital requirement of the business and reinvests for the future.

Governance and culture

The Board plays a key role in supporting and challenging the Group's long-term strategic planning. This includes the responsibility to provide effective governance and a rigorous assessment of risk. This continues to be my focus. We completed a board effectiveness review in July 2019, and we believe the Board and its committees are working well. We have continued to strengthen this area with the recruitment of a new independent non-executive director, Marian Martin. This was in response to the recent changes in the UK Corporate Governance Code and in consultation with the Prudential Regulation Authority. The structure and effectiveness of our governance regime is fundamental to our success in bringing together the Group's purpose, strategy, culture and standards of conduct.

Outlook

This has been a year of significant achievement. The Group has delivered financial success and diversified into two new business areas, while maintaining a prudent approach to lending. We are cognisant that growth is ahead of our original plan and we will therefore continue to invest in our infrastructure and operating model. Some of these costs are being brought forward ahead of plan and will help us build a robust structure for sustainable growth and continued success.

Our lending portfolio is performing well, however, we acknowledge that there may well be some worsening of credit conditions over the next 12 to 24 months and we will maintain a cautious outlook. Given our still relatively small market share, we remain confident that we can continue to grow as planned, whilst maintaining our appetite for risk.

We will continue to set ambitious targets and I look forward to building on the successes of 2019 in the coming year.

Tim Franklin
Chairman

7 February 2020

Strategic Report (cont'd)

Chief Executive's Statement

for the year ended 30 September 2019

Diversification while protecting the core business

We have made strong progress across the whole business this year. The strategy to diversify our asset classes and income streams is proving a great success and will play an important role in growing our lending portfolio in the coming years. Our established core business lines have made excellent progress against ambitious targets and we continue to deliver strong growth despite the challenging economic and political backdrop.

The benefits of our strategic decision to become a bank are becoming increasingly evident. These include lower funding costs, an ability to reach and retain a wider range of customers, greater flexibility to diversify our business and a reduced reliance on wholesale debt. We have executed a low-risk growth strategy by initially growing in existing markets in which we already had an established risk appetite and control framework before looking to diversify our asset classes.

This year's results demonstrate the strength of this approach, delivering record portfolio growth. The benefits of scale will continue to accrue as operational gearing increases our earnings, against the significant fixed cost of establishing our banking platform.

Increasing profitability

Statutory profit for the year has increased to £8.0 million (2018 – £5.2 million). This is an increase of 54% and a considerable achievement, given the expense of establishing the property bridging finance division. Operating income increased to £22.2 million in the year (2018 – £14.7 million) as a result of strong portfolio growth. As expected, we experienced a decrease in our Net Interest Margin ('NIM'), from 8.2% to 7.8%, as we continued to actively manage quality and a greater proportion of our portfolio became lower yielding, prime quality lending.

Earnings per share increased strongly, up 35% to 2.7p (2018 – 2.0p). This is calculated off a larger capital base with an average number of shares in issue of 234 million (2018 – 212 million shares).

Return on equity increased to 12.6% (2018 – 10.3%), taking us past our medium-term target of 12.5%. Return on assets reduced slightly in the year to 2.9% (2018 – 3.0%). The profit after tax for the year was £6.4 million (2018 – £4.2 million) on an effective Corporation Tax rate of 20% (2018 – 19%).

Our cost-to-income ratio[(1)] reduced to 55.6% (2018 – 57.1%). During a growth phase, the costs to build a bank operating model in areas such as IT, risk, compliance and audit are significant. Despite continued investment in the platform, staff resource and new business lines, I am pleased to report that income growth has kept pace with costs.

We have recommended an increased final dividend of 0.4p (2018 – 0.3p). It is our intention to retain a dividend cover that is commensurate with a strongly growing business and the capital-intensive nature of banking. A scrip alternative will also be available.

[(1)] *The cost-to-income ratio is now calculated as 'cost over net interest margin', previously it was 'cost over gross interest'.*

2019 achievements

Our achievements this year are the result of delivering on our key objectives. The main areas of achievement for the year have been

- continued growth of the core businesses of asset finance and consumer motor finance by increased lending, particularly into the prime segments of each market;
- diversification of the balance sheet, introducing new asset classes and new products either organically or through acquisition;
- success against our £350 million portfolio and 12.5% return on equity targets;
- development of a much-improved proposition to the broker-introduced consumer motor finance market by automating credit decision making and proposal acceptance;
- capital planning to maintain shareholder return while preparing for the next stage of growth; and
- continued investment in people, systems and infrastructure to build a bank that can in the longer term support a £1 billion portfolio.

Business lines and portfolio

New business originations in the year increased by 86% to £276 million (2018 – £148 million), meeting our volume targets. The acquisition of Azule introduces a 'hybrid' origination model where an element of new business is brokered to generate fee income. New business is placed with third party banks and finance companies for risk, pricing or concentration of exposure reasons, whilst enhancing return on equity for the Group. Azule placed £54 million of new business. The remainder of new business origination was for our own portfolio, amounting to £222 million (2018 – £148 million).

The quality of new business origination met management expectation, with 74% of new business origination being to prime customers (2018 – 70%). Prime credit for PCF is defined as our top four credit grades where the customer has a clean credit profile and a low probability of default. Two of these credit grades have only been achievable since a lower cost of funds enabled the launch of lower yielding, lower risk products.

Our total customer base is continuing to grow and at 30 September 2019 totalled over 21,250 (2018 – 17,000).

The lending portfolio grew by 55% to £339 million (2018 – £219 million). The portfolio is reported net of unearned finance charges of £63 million (2018 – £47 million). These finance charges are future operating income already on the balance sheet and at this level provide almost 65% of next year's operating income expectation. These future finance charges provide a level of certainty of earnings for future periods.

Earnings are underpinned by the quality of the portfolio, which continues to perform well. We remain alert to trends in the credit cycle and the collection environment, which is less benign than at any time in the last five years. Impairment losses in the year were £2.2 million (2018 – £0.9 million), which represents a charge of 0.8% (2018 – 0.5%), of which 0.1% of the increase was attributable to the adoption of IFRS 9.

Strategic Report (cont'd)

This charge is consistent with the underlying loss rates expected from the portfolio going forward and, in the second half of the year, we saw a slight reduction in the rate from 0.9% to 0.8%. The part of the portfolio reported as 'up to date' deteriorated slightly in the period to 95% (2018 – 96%). The less benign environment has been most noticeable in our Business Finance Division where the UK is experiencing an increased incidence of business failure across most industry sectors. The diversification of business lines will strengthen our asset base and widen our sources of income. In conjunction with our considerable experience in our two existing markets, we will continue to build a quality portfolio by maintaining the disciplines that have stood us in good stead over past credit cycles.

The Group remains committed to its core markets, supporting consumers and SMEs in the purchase of motor vehicles, plant and machinery. We have considerable experience in these markets which continue to produce attractive returns and where the lending is supported by assets with strong collateral characteristics. We currently have no greater than a 1% share in each of these existing markets and there is further scope to increase this. We are also excited to be introducing new business lines and products that show the same characteristics of margin and quality to build a sustainable, diversified portfolio for the future.

Segmental business review

Business finance

The Business Finance Division has provided strong growth. Lending to SMEs to enable them to invest in vehicles, plant and machinery increased by 40% to £120 million (2018 – £86 million). With our reduced cost of funds and longstanding relationships with introducers, we have been better able to penetrate the prime segments of this market, with 71% of originations being to prime customers. In addition, we have made extensive efforts in 2019 to increase our introducer database by recruiting additional business development managers.

At 30 September 2019, the business finance portfolio had increased to £178 million (2018 – £121 million). This business line now makes up 52% of our total lending portfolio (2018 – 55%). Azule offers a product range similar to our Business Finance Division but, in this first year of ownership, we report on it separately below.

Consumer finance

Origination growth in consumer finance was also strong, considering the well documented decline in new motor vehicle sales. Consumer finance lending increased by 18% in the year to £73 million (2018 – £62 million). Our success is a result of our relative size in the used vehicle market, which has been much more resilient to the weakening consumer demand for cars, which has primarily affected new car sales. 96% of our consumer finance originations are for nearly new or older vehicles and PCF does not take residual risk by offering a Personal Contract Purchase ('PCP') product. Our success in consumer finance is also in part due to a specialisation in niche, leisure vehicles such as horseboxes and motorhomes. We also continue to have good customer retention with 10% of the total consumer finance volume this year being for existing customers of PCF.

Our finance proposition in this market has undergone change over the year and this will continue to evolve in 2020 as we extend auto-decisioning, which is a standard capability for operating in the prime consumer market. At 30 September 2019, the consumer finance motor portfolio was £128 million (2018 – £98 million).

Azule asset finance

Azule is a UK market leader in providing specialist funding and leasing services direct to individuals and businesses in the broadcast and media industry. Azule also operates in the audio visual and photography markets and offers its services across Europe, as well as the UK. Azule has a sales capability to place asset finance with banks and lending institutions, as well as originating asset finance for its own portfolio. One of the attractions of the acquisition was the synergies with PCF's existing asset finance operations, given Azule's focus on financing business-critical assets for prime credit grade customers.

In the 11 months of ownership, Azule originated £69 million of asset finance (12 months to June 2018 – £55 million), £54 million of this was placed and contributed £1 million of fee income. The first year has been a great success and has triggered the payment of the first contingent consideration payment of £750,000, which was made on 5 November 2019.

Our initial focus for Azule was very much on supporting the business, understanding the market dynamics and nurturing the successful sales culture within the organisation. Over the course of 2020, we will look to centralise some functions and monetise the synergies between the two businesses.

Property bridging finance

PCF recruited a small team of experienced staff to commence this operation organically. It provides finance for terms up to 18 months to property investors for the purpose of bridging and refurbishment. This is an opportunity to enter a £4 billion market place in a measured way. This product complements our existing businesses with a shorter duration profile and improved capital efficiency through a lower risk weighting. We commenced operations in January 2019 and transacted £14 million of new business in the first nine months. As a new business line, there was a cost to establishing the operation and the division contributed a loss before tax of £428,000 in the year. We expect a strong contribution to profits in 2020.

Capital management and funding

The net assets of the Group increased by 38% to £58.8 million (2018 – £42.6 million). At 30 September 2019 the CET1 Capital Ratio was 18.0% (2018 – 19.3%) and the liquidity measurement of Liquidity Coverage Ratio was 715% (2018 – 499%). These ratios were ahead of the minimum requirement.

During the year, we successfully raised £10.75 million of new equity and supplemented this with a £15 million Tier 2 capital facility, with the ability to access this in tranches as required. In combination, these provide capital to support our strategic plan.

The Bank increased retail deposit balances in the year to £267 million (2018 – £191 million). We now have over 6,250 retail deposit customers (2018 – 4,500). We offer a range of products, with maturities from 100 days to 7 years, and have an average balance outstanding of approximately £43,000 (2018 – £42,000) for an average term of 2.9 years (2018 – 2.5 years). The average cost of retail deposits has increased slightly in the year to 2.2% (2018 – 2.1%). The savings products are targeted at middle to older aged savers, providing ease of service by utilising our on-line application portal or by postal application if they prefer.

Wholesale funding capacity has been enhanced through a new £30 million revolving credit facility. In addition, the Bank is a member of the Bank of England's Sterling Monetary Framework, which provides access to schemes such as the Discount Window Facility and the Term Funding Scheme.

Our funding strategy is to use retail deposits to fund growth, by matching business origination with fixed rate, fixed term deposits to preserve profit margin and reduce interest rate volatility. The Bank uses wholesale facilities to smooth liquidity and maturities where required, and to provide a diversified funding alternative to the retail deposit market.

Regulation and the competitive environment

Operational resilience creates a robust business model and it remains a matter for close scrutiny. We have adopted a proactive approach, having carefully considered the Prudential Regulation Authority ('PRA's') Discussion Paper on 'Building the UK finance sector's operational resilience'. We have updated our plan to ensure we continue to focus and invest in operational resilience. The key is to ensure the Group is adequately identifying, assessing and managing its risks. This extends to managing the third-party risks that may arise within outsourced activities.

In response to the PRA's Supervisory Statement 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change', the Group is formalising its plan to respond to these future risks and will provide further detail as the year progresses.

On 15 October 2019, the Financial Conduct Authority ('FCA') announced plans to regulate the way in which car retailers and brokers in the motor finance sector receive commission. A set of clear rules will be introduced in 2020 to address a lack of transparency and serve consumers better. PCF welcomes this initiative from the FCA, as we believe that disclosed and standardised commission rates will ensure better outcomes for customers and a level playing field for motor finance providers such as PCF. We do not envisage that our adherence to the new rules will have a significant impact on our operations.

This is the first full year for implementation of accounting standard IFRS 9 'Financial Instruments' requiring extensive work to model the impairment provision for our portfolio of loans. The Notes to the Financial Statements contain an explanation of the methodology. Over the course of the year our views on the political and credit environment have changed and, as a result, we have amended our risk weightings to reflect a less benign credit environment and a more uncertain outcome for Brexit. At the start of the year we increased the provision by a net £0.5 million as we moved from an incurred loss basis, IAS 39 to the expected loss basis, IFRS 9. This one-off increase is treated as an adjustment to brought-forward retained profits and not as an expense in the current year income statement. The quantum of this adjustment is consistent with what would be expected from a collateralised lending portfolio. The IFRS 9 provision at 30 September 2019 has increased in line with the growth in the portfolio as well as our changes in risk weightings. Our views on risk weightings will continue to reflect the wider global economic outlook, in addition to Brexit, as well as emerging risks such as the financial risk associated with climate change.

People and resources

During the course of the year PCF moved to larger premises, providing staff with a much-improved working environment and the capacity necessary to embark on the next stage of our growth. We have also taken the opportunity to improve the environment in the available space at Azule's offices in Berkshire. The office relocation was successfully completed without disruption and I would like to thank the project teams for their commitment and excellence in delivery.

Our staff numbers have now reached 110 full time employees (2018 – 73) split between the City of London and Berkshire offices and I would like to thank everyone for their contribution this year. During the year we welcomed Azule staff to PCF and we have enjoyed working with our new colleagues, who have proved to be an ideal fit. We also recruited a new Head of Human Resources, Suzie Yong, and I look forward to working with her on new programmes including topics such as culture, staff development and diversity.

2020 strategic objectives

We continue to set ambitious targets and objectives and our focus in 2020 will be to

- launch our new streamlined system for consumer motor finance;
- trial direct to consumer products on our new consumer platform;
- develop a market leading portal for SME lending;
- build out our property bridging finance division beyond the pilot initiative;
- evaluate how Azule's European capabilities could enhance PCF's business in the future;
- complete the integration of Azule operations to maximise its sales potential;
- improve our customer journey for savers and borrowers with additional online functionality; and
- optimise technology across the organisation to support scale and gain efficiencies.

Current trading and outlook

We have once again delivered on our strategic objectives, achieving our initial targets for portfolio size and return on equity ahead of time. Our next targets of a portfolio of £750 million and a return on equity of 15% by 30 September 2022 remain in place, but our progress to date suggests that an aspiration of a £1 billion portfolio should not be beyond our reach in the medium-term.

New business originations remain strong and we continue to maintain prudent underwriting standards, a cautious risk appetite and sensible terms of business. Our goal is to generate sustainable returns and, with our focus on a greater proportion of prime quality customers, our portfolio continues to perform well. We have a lending portfolio that has a wide spread of risk and, while we are not sanguine about the economic outlook, we feel our size, agility and well-established business model provide confidence for the future.

Economic uncertainty does, however, remain a risk. This could manifest itself as reduced demand in our market places, a fall in our growth rate or rising impairments due to an economic downturn. Should these circumstances arise, we recognise this could slow our progress, but we have built and will continue to build PCF's lending model on sound foundations, which will provide for our continued success.

New business momentum has built up throughout the year, with September 2019 being a record month for the Group, which continued in October. Our diversification strategy has been a success and provides the Group with extra strength in depth. The Group is ahead of its plans in terms of growth, so we have accelerated investment in our technology platform, talent and governance framework. All this will leave us well placed to take advantage of market opportunities as they arise.

Scott Maybury
Chief Executive

7 February 2020

PCF GROUP

Strategic Report (cont'd)
Market and Business Overview

Business model
The Group's core business has historically been the provision of vehicle and asset finance to consumers and SMEs, but during the year it diversified its lending operations by way of the acquisition of Azule Limited ('Azule') in November 2018 and the launch of a property bridging finance business in January 2019. As a result, we now have four lending divisions.

- Business Finance Division, which provides finance for vehicles, plant and equipment to SMEs;
- Consumer Finance Division, which provides finance for motor vehicles to consumers;
- Azule, which specialises in providing finance to the broadcast and media industry; and
- Bridging Finance Division, which provides property finance to professional property investors for the purpose of bridging, refurbishment and developer exit.

These divisions are supported by a savings operation which offers notice and term deposit accounts to retail savers.

Simple banking. At your service.
We offer simple, easy to understand finance products using loan, conditional sale, hire purchase and finance lease agreements.

Customers repay us by way of instalments and, where applicable, by a final balloon payment, and we maintain a focus on ensuring that these payments are affordable.

Savings customers benefit from competitive interest rates for a range of term deposits and notice accounts.

We aim to offer excellent levels of service to our customers, intermediaries and dealers by using technology to speed up processes whenever we can.

Our risk philosophy
The Group's risk philosophy is to

- provide finance for assets (vehicle, plant, equipment and property) which have strong collateral characteristics and readily identifiable re-sale markets;
- have a wide spread of risk and avoid large concentrations of risk; and
- ensure we understand our customers' needs and that they are creditworthy and can afford the monthly payments due to us.

Strategy for 2019
Our strategic objectives for the year ended 30 September 2019 were to

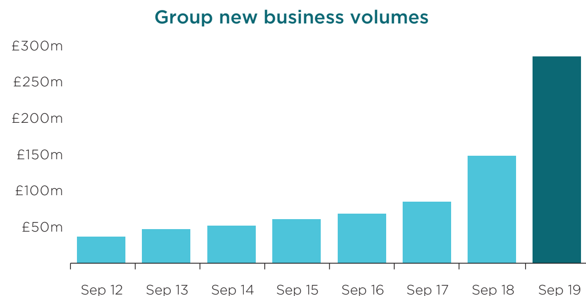
- grow the core Consumer and Business Finance Divisions by way of increased lending to prime customers, who are defined as being in the top four of our eight credit grades, have clean credit profiles and a low probability of default;
- improve the proposition for the broker-introduced consumer finance market by developing a new scorecard and using automation to enhance decision-making;
- integrate and grow the Azule business;
- complete the £20 million pilot scheme for property bridging finance; and
- review capital optimisation and put in place a Tier 2 capital facility to support our strategic plan.

The Group had a successful year with new business originations reaching a record-breaking level of £276 million (2018 – £148million) due to the growth of the existing Consumer and Business Finance Divisions, as well as the impact of the recent diversifications into the broadcast, media and property sectors. The total of £276 million was comprised of the following.

Business Finance Division	£120 million
Consumer Finance Division	£ 73 million
Azule	£ 69 million
Bridging Finance Division	£ 14 million

New business originations across the various business lines met management expectations for the year.

Group new business volumes



Savings
The Bank's target savings market is UK-domiciled, middle to older aged savers, and is estimated to be worth approximately £154 billion in size. Our current market share represents 0.2%, estimate provided by PRA.

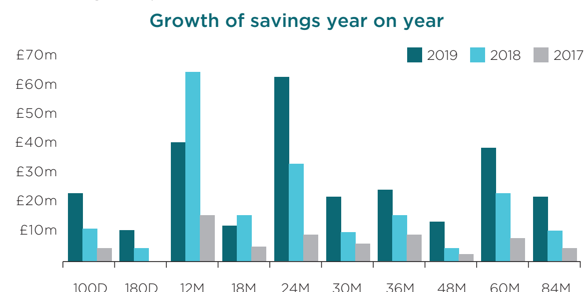
We offer term deposits, ranging from 1 year to 7 years, together with 100-day and 180-day notice accounts, to retail customers, with interest rates appropriate to each duration. We look to naturally match the tenor of the deposits to our lending book but also ensure there is no one month concentration.

Amounts on deposit with PCF Bank increased from £190 million to £267 million to fund the growth of the lending operations. We now have over 6,250 savings customers. Most of our customers apply on-line to open an account, using our portal, which is both quick and simple to understand. On-line applications are typically completed and the account opened within 20 minutes. However, we are one of a small number of banks who also offer a postal application and accept cheques and 30% of our customers opened their account with us using this method.

Savings

The average deposit balance is £43,000 (2018 – £42,000).

Growth of savings year on year



PCF Banks' retail deposit portfolio has a longer blended average term following careful management of the concentration in 1 year deposits. The longer term products attract a slightly higher interest rate but better match to the duration of our lending portfolio.

Business Finance

The Business Finance Division, which was established in 1998, provides hire purchase and finance lease agreements to sole traders, partnerships and limited companies to help them acquire vehicles, plant and equipment. Lending is typically for up to five years with longer terms of up to ten years for specialist niche assets.

Vehicle and asset finance are commonly used sources of finance for businesses, providing significant cash flow benefits for those using them. The market in the UK is both mature and vast, with PCF Bank having a share of no greater than 1%.

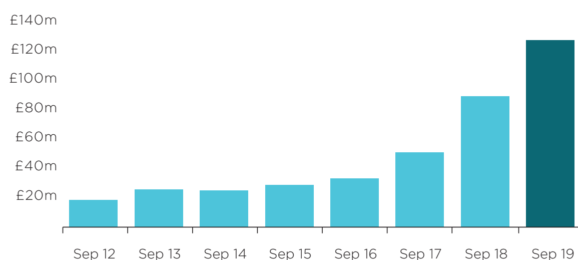
The asset finance market has performed strongly in recent years and, in the 12 months to September 2019, members of The Finance & Leasing Association ('FLA') reported new business lending of £34.5 billion, which represented a 7% increase on the previous year.

The division predominantly uses broker intermediaries as its route to market, with transactions being processed through *eQuote*, the Bank's internet-based proposal system. *eQuote*, which is able to underwrite high volumes of proposals quickly and at low cost, enables us to send information and documentation to our customers, dealers and introducers electronically, therefore speeding up the application process.

The division had another strong year of growth, increasing new business originations by 39% from £86 million to £120 million, of which 71% was for prime customers. As a bank, with a much-reduced cost of funds, we are now better able to penetrate the prime segment of the market and, as it represents approximately 80% of the total market, it remains an area where we believe that PCF Bank can continue to grow.

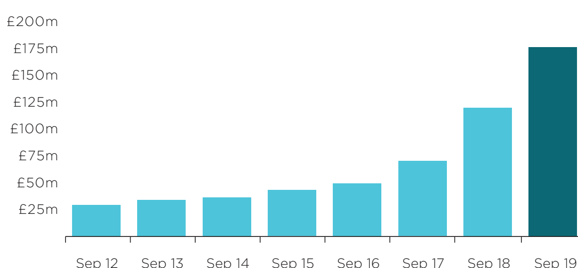
Prime customers tend to acquire newer and more expensive vehicles and equipment, resulting in our average transaction increasing from £40,600 to £45,300 during the year. We expect this trend to continue.

Business finance volumes



As a result of the increase in new business originations, the division's portfolio also increased. At 30 September 2019, it had grown by 49.5% to £175.7 million (2018 – £117.5 million). We expect the division's recent growth record to continue and for it to remain the dominant part of our business in future years.

Business finance portfolio



The portfolio is made up of over 5,700 individual agreements with an average size of approximately £30,700 and no customer having an aggregate exposure of more than 1% of the Group's total portfolio. Most of our largest customers are longstanding, with many of them having had agreements with PCF for more than ten years. Prime business now accounts for 72% (2018 – 74%) of the portfolio.

Consumer Finance

The Consumer Finance Division, which was established in 1994, provides hire purchase and conditional sale agreements to retail customers to help them acquire vehicles. The vast majority of vehicles which we finance are used, so have suffered their initial depreciation and therefore represent good collateral to support our finance. Lending on these assets is for periods up to five years. Whilst the majority of finance we provide is in respect of motor cars, we also have specialist knowledge to enable us to finance classic cars, caravans, motorhomes and horseboxes. Lending for these niche assets can be for periods up to ten years.

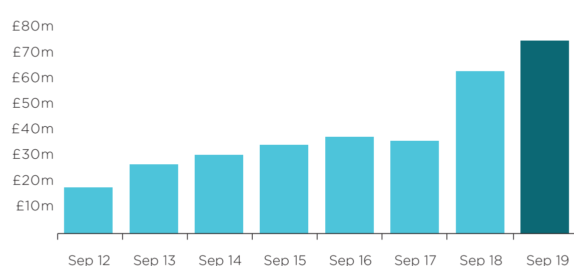
According to the FLA Motor Finance Summary, the consumer car finance market grew slightly in the 12 months period ending in September 2019, with the number of transactions increasing by 3% and the value of completed transactions increasing by 5%. The used car finance market, in which PCF predominantly operates, showed better growth than the new car finance market. Advances in the used car finance market increased by 4% to £18.2 billion and the number of used cars financed increased by 2% to 1.48 million.

This division also predominantly uses broker intermediaries as its route to market, with transactions being processed through *eQuote*, the Bank's internet-based proposal system.

During the year, we completed a project to improve our credit decision making processes. This involved working with our preferred credit reference agency to develop a new scorecard, which was modelled on over 320,000 applications which we had received over the last two years. By completing a retrospective analysis of the applicants, we were able to create a scorecard which reflects more accurately the likely risk of default by these applicants and therefore improves our decision making.

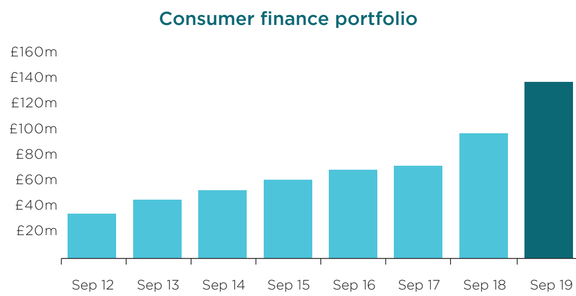
This division also performed well during the year, increasing new business originations by 17.5% from £62.2 million in 2018 to £73.1 million. Following on from the successes of last year, the division increased the level of business written using our long-term finance product, which helps consumers to purchase leisure vehicles such as caravans, motorhomes and horseboxes. This product accounted for £29.5 million (2018 – £11 million) of our new business originations during the year and was typically for prime customers.

Consumer finance volumes



Our Consumer Finance Division's portfolio increased by 44% during the year from £96 million to £138 million.

Strategic Report (cont'd)



The portfolio is made up of almost 11,000 individual agreements with an average size of £12,575. Prime business now accounts for 66% (2018 – 53%) of the consumer finance portfolio.

Azule

Azule was established in 1996 and acquired by PCF Bank in November 2018. It provides direct to end-user asset finance in the UK and across Europe to niche markets, focused on broadcast & media, sound, lighting and audio visual. Business is generated through direct end user relationships along with manufacturer, distributor and dealer introductions. Azule's deals are either written on the Group's balance sheet or placed with other banks, for which Azule receives a commission. Deals placed with other banks are done so for risk, pricing and concentration of exposure reasons.

Azule had its best ever year in terms of originations, writing over £69 million of new business, an increase of 26% on Azule's previous financial year. The average deal size was £45,000. Following the acquisition, there has been a measured focus on increasing Azule 'own book' funded deals, which resulted in £14 million of originations being funded on 'own book', an increase of 36%. This increase has been possible due to Azule's access to PCF's lower cost of funds, which was previously not available to it through its other funding sources. 76% of the 'own book' originations came from customers in our top four credit grades. Azule generated £1 million of fee income from the business it brokered, which is an increase of 33%. The number of deals in arrears was low and the impairment charge was £33,576.

Azule also operates across Europe to support its manufacturers. This business is funded by local partner banks from whom Azule receives an introductory commission. Europe provides a great opportunity for growth as there are no other specialist niche finance providers serving the markets in which Azule operates.

The outlook for the next 12 months looks positive and the division is looking to increase further the growth it has achieved this year. Whilst there are concerns over the economy, the sectors in which Azule operates remain healthy. The television sector continues to grow as a direct result of streaming services such as Netflix and Amazon Prime. The need for these providers to produce high-end content is driving demand for services and studio space across the UK. Recently, both Netflix and Disney have made long-term commitments to the UK by signing leases for studios at Pinewood and Shepperton. The live entertainment market continues to see growth in the number of music festivals and artists touring, all of which require increased levels of sound, lighting and audio-visual equipment. The application of LED screens across retail, public spaces, corporate offices and education provides great opportunity for Azule to increase its share of the audio-visual finance market.

Bridging Finance

The Bridging Finance Division provides unregulated finance towards the purchase or re-mortgage of a property for the purpose of bridging, refurbishment and developer exit. Finance is available to experienced property investment businesses ranging from sole traders to partnerships and limited companies. Security is by way of a first charge and facilities are typically between 6 and 18 months, with a maximum loan to value of 75%.

PCF wrote £14.1 million of bridging business in the nine months to September 2019 and, therefore, represents a very small percentage of the industry.

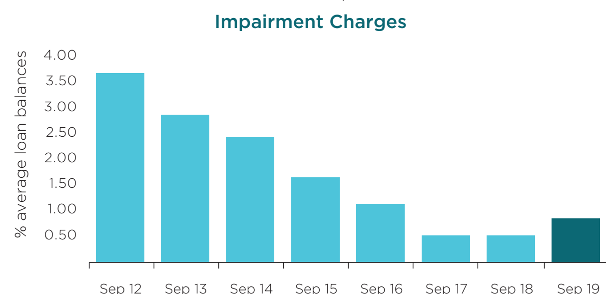
The division was set up in late 2018 and launched its product in January 2019, with the Board having committed to an initial 'pilot scheme' of £20 million. In its first nine months of operation, the division completed transactions aggregating £14.1 million across a wide range of properties and customers.

The portfolio has performed well, with a number of transactions having been redeemed. Based on the success to date, we are targeting originations of £60 million in the coming year and will be expanding our team to ensure we deliver this target as well as maintain our personal service levels.

Group portfolio performance

The Group portfolio increased by 54% from £219 million to £338 million and performed in line with our expectations, with the impairment charge increasing to 0.8%. This charge is consistent with the underlying loss rates expected from the portfolio going forward. The collection environment is less benign than in recent years, however, we saw a slight reduction in the loan loss charge in the second half of the year. The adoption of IFRS 9 added 0.1% to the charge for this year.

The quality of our portfolio is, however, improving as we write increasing levels of prime business. The percentage of our portfolio which is prime business increased from 64.53% to 69.41% during the year. Our continued focus on the prime segments of our markets should enable us to maintain the quality of our portfolio, although uncertainty and economic conditions in the UK remain a potential threat.



At September 2019, 95% of all customers' agreements were up to date.

Strategic Report (cont'd)
Risk Overview

Overview and culture
Managing risk effectively is essential to the Group and is fundamental to our strategy. PCF is a specialist UK bank focused on retail and commercial lending business. This is achieved by maintaining a conservative business model which embodies a culture based on a prudent appetite for risk.

The Group's risk approach is founded on an effective control framework which guides how our employees approach their work, the way they behave and the decisions they make. The type and level of risk we are prepared to seek, accept or tolerate, otherwise known as risk appetite, works in tandem with our strategic plan and is approved by the Board. Our risk appetite is then embedded within policies, authorities and limits across the Group.

A clearly defined Risk Appetite Statement is in place which sets out the level of risk that the Group is willing to take in pursuit of its business objectives.

The Board ensures that the Group actively embraces a strong risk culture, where all staff are accountable for directly assessing, controlling and mitigating risks. The Board leads in setting the risk appetite and ensuring that the Risk Management Framework ('RMF') is fully embedded across the Group, with a strong focus on the adherence to risk appetite in all metrics. Staff performance management and reward practices all have key risk inputs and a focus on risk management in their design. The Group aims for employees to be risk aware and to strike the right balance between delivering on objectives, individual accountability and maintaining a safe and secure business.

Risk is managed using the 'Three Lines of Defence' principle, separating risk origination from risk oversight and risk assurance. Governance is provided through a formal committee process, including the Board and the Audit & Risk Committee ('ARC').

Risk strategy
The Group has clearly defined its risk management objectives and has a strategy to deliver them. The risk management strategy is to

- identify principal and emerging risks;
- define risk appetite and ensure that the strategic plans are consistent with it;
- avoid business activities that are not aligned to the Group's risk appetite or that do not provide the appropriate balance of risk and reward;
- manage risk within the business with independent effective oversight;
- ensure that the business lines are supported by effective risk controls, technology and technical competencies;
- manage the risk profile to ensure that the business strategy can withstand a range of adverse conditions;
- ensure a sound risk control environment and risk-aware culture;
- ensure that remuneration practices take into account prudent risk taking;
- provide enhanced training and compliance awareness sessions to all employees; and
- aggregate and look at risk across the Group so that the business is sufficiently aware of its key vulnerabilities.

The Board focuses on the key risks that could prevent the Group from achieving its strategic objectives. Risk management is integrated into the corporate framework and business planning with regular reporting to the Board and other committees, such as ARC and Executive Committee ('ExCo').

Principal risks
Principal risks are the primary risks that the business faces which could impact the delivery of the Group's strategic objectives. The results, findings and conclusions of the risk appetite metrics are regularly reported to ExCo, ARC and the Board to support their governance role in monitoring material exposures to principal risks and the scope of mitigation strategies.

The Group has identified eight principal risks which could impact the delivery of its strategic objectives and has defined a Board approved risk appetite, with key mitigating factors and controls for the following risks.

Strategic & business risk
Definition - Strategic and business risk is the risk which affects the Group's ability to achieve its corporate and strategic objectives.

Statement - In order to maintain investor confidence in the Group's AIM listing and market expectations, the Board operates the business in such a way as to optimise profits, within the approved risk appetite.

Key mitigating factors and controls
- The Group does not intend to undertake any strategic actions within its business model which would put at risk its vision of being a successful, specialist lender in its chosen and target markets, backed by a strong and dependable savings franchise.
- The Group will monitor, review and challenge its performance against strategy using established key performance indicators.
- The Group will not put its core strategic and business objectives at a level of risk which is beyond its financial resources and operational capabilities under both normal and stressed conditions.
- Where the Group is going through a strategic change programme, it will consider, in addition to readiness and any risks to delivery, the impact of that change on the business in terms of customers, staff, the control environment and reputational impacts.
- The Board will set challenging but achievable financial targets.
- The Board and its committees will regularly monitor the business and macro-economic assumptions underlying its business, capital and liquidity plans.
- The Board will align the remuneration of staff to key strategic objectives.
- The Board will be alert to emerging risks to the business.

Credit risk

Definition - Credit risk is the risk that a borrower fails to pay the interest or to repay the capital on the Group's loans and receivables, thereby giving rise to the Group incurring a financial loss on that borrower's account.

Statement - The Group aims to minimise the impact on profitability from defaults through a prudent underwriting policy and case management when customers are in difficulty.

Key mitigating factors and controls

- The Group will focus its lending on its specific areas of expertise.
- The Group will embed lending policies, a risk control framework and risk management procedures in all business areas.
- The Group will actively manage lending quality through the credit cycle.
- The Group will review performance against risk appetite.
- The Group will hold credit committee meetings for larger exposures, embedding new business lines or new areas at risk.
- The Group will stress the portfolio to test resilience.
- The Group will conduct a product risk assessment on any new business lines.
- The Group will endeavour to avoid concentrations of risk by geography, sector, asset class, single debtor and counterparty name.
- The Group will embed effective collection strategies.

Capital risk

Definition - Capital risk is the risk that the Group will have insufficient capital resources to support the business.

Statement - The Group aims to maintain a sufficient level of capital above the total regulatory capital requirement and Capital Requirements Directive IV ('CRD IV') capital buffers, as detailed in the Internal Capital Adequacy Assessment Process ('ICAAP'). The level of surplus capital held will be formally reviewed by the Asset & Liability Committee ('ALCO'), ExCo and the Board on at least an annual basis, with metrics produced for review by the Board.

Key mitigating factors and controls

- ARC is responsible for reviewing and approving assumptions and stress scenarios in the planning stages of the ICAAP and Internal Liquidity Adequacy Assessment Process ('ILAAP'), including substantive changes to the previous assessment.
- The Group will consider the need for a management buffer, over and above the PRA and CRD IV capital buffers, to mitigate the risks of exposures under appropriate stress scenarios.
- The Group will monitor closely and regularly its capital and leverage ratios to ensure that it meets current and future regulatory requirements.
- The Group is able to accumulate additional capital through profits and by raising new equity as a listed company on a recognised stock exchange.
- The Group has a supportive majority shareholder who has participated in previous capital raisings.
- The Group is able to manage the demand for capital through management actions including adjusting its lending strategy.
- The Group will regularly conduct stress tests and sensitivity analysis on a forward-looking basis.
- The Group will regularly conduct forecasting and scenario planning.

Liquidity & funding risk

Definition - Liquidity and funding risk is the risk that the Group is not able to fund new business originations or meet cash flow or collateral obligations as they fall due, without adversely affecting either its daily operations or its financial health.

Statement - The Group will at all times maintain liquidity resources that are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. The Group will not tolerate liquidity risk that leads to it being unable to meet its liabilities as they fall due in a scenario consistent with its standard Pillar 1 and Pillar 2 ILAAP stress tests. The Group will maintain a diversified funding strategy and strong relationships with its banks for funding purposes, be active in the retail deposit taking market and maintain a diversified funding strategy. The Group will align the tenor of its funding to the average effective life of its loan portfolio. The Group will continue to maintain wholesale debt and have at its disposal an appropriate level of facility headroom.

Key mitigating factors and controls

- The Group will at all times adhere to the Overall Liquidity Adequacy Rule ('OLAR') and operate within its risk tolerance.
- The Group will ensure compliance with the OLAR and liquidity risk tolerance and that liquidity stress testing is conducted as part of the ILAAP review.
- The Group will maintain its unencumbered liquidity resources in the form of high-quality liquid assets ('HQLA'). The amount of these will, at all times, exceed the minimum required by the OLAR and liquidity risk tolerance.
- The Group will ensure that its HQLA will enable it to survive at least 30 days of a worse-case stress scenario.
- The Group will maintain its Net Stable Funding Ratio ('NSFR') above the regulatory minimum of 100%.
- The Group will carry out forward modelling to identify liquidity mismatches.

Market & interest rate risk

Definition - Market risk is the risk of losses in on and off-balance sheet positions arising from adverse movements in market prices. Market risk therefore results from all positions included in the Group's banking book, as well as from foreign exchange and other risk positions. Interest rate risk is the risk that the Group will be adversely affected by changes in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship.

Statement - The Group aims to minimise the adverse impact on NIM caused by an increased cost of variable rate borrowings and, where necessary, to fix the cost of borrowing through the use of interest rate swaps. The Group does not trade wholesale financial instruments and therefore does not have a trading book.

Key mitigating factors and controls

- The Group does not seek to take or expose itself to market risk and does not carry out proprietary trading.
- The Group does not trade wholesale financial instruments and so does not have a trading book.
- The Group's balance sheet exposures are predominantly in Sterling, so it has little foreign exchange risk. Some assets are bought or sold in foreign currency, as are broking transactions, but these are short-term exposures and are managed within Value at Risk ('VaR') limits.
- The Group manages its Interest Rate Risk in the Banking Book ('IRRBB') by identifying and quantifying interest rate risk gaps due to mismatches between assets, liabilities and existing interest rate swaps.
- Where a significant interest rate gap is identified, the Group will execute an interest rate swap to hedge the position. It will ensure that the change in Economic Value of Equity ('EVE') and Earnings at Risk ('EaR') are managed within policy limits at all times.

Operational risk

Definition - Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes legal risk but excludes strategic and reputational risk.

Statement - The Group will maintain a strong internal control environment to mitigate operational risk, which is inherent to its business activities, and to minimise the financial impact of operational risk arising from risks such as IT disruption, human error, a breakdown of procedures, non-compliance with policy and internal or external fraud. The Group will mitigate and limit the impact on business operations and decisions of its cyber risk exposure.

Key mitigating factors and controls

- The Group will continue to implement a robust Operational Resilience Framework and regularly test the ongoing resilience of its operational and IT services, including Business Continuity Management, Disaster Recovery, Incident Management, Crisis Management, Third Party Management and the Cyber Strategy.
- The Group will continue to review IT system architecture to ensure systems are resilient and that the confidentiality, integrity and availability of critical systems and information assets are protected against cyber-attacks.
- The Group will continue to implement a robust project governance structure and delivery framework with respect to IT and change management to ensure there are appropriate controls in place covering scoping and planning, design, initiation, monitoring and risk assessment.
- The Group will continue to implement actions from internal and external IT assurance reviews to enhance the resilience of systems supporting the processes most critical to customers.
- The Group will continue to implement a robust Supplier and Outsourcing Assurance Framework and undertake ongoing due diligence on third parties.
- The Group will continue to maintain competitive working practices to attract, retain and engage high quality employees.
- The Group will continue to invest in enhanced systems and robust processes to protect customer information, including limiting access to key systems and enhancing the security, durability and accessibility of critical information.
- The Group will continue to manage change projects effectively so that they do not cause serious disruption or create processing inefficiencies to the business during or after their implementation.
- The Group will continue to maintain a strong internal control environment and adopt policies and procedures to detect and prevent the use of its business for money laundering, facilitating tax evasion, bribery and activities prohibited by legal and regulatory requirements.
- The Group will continue to provide enhanced operational risk training and compliance awareness sessions to all employees.
- The Group will continue to review and ratify all new products and business lines through its Marketing & New Products Approval Committee ('MNPA').
- The Group, through continual investment in its IT infrastructure, resilience and security, will maintain appropriate levels of control and ongoing testing to identify and counter the increasing level of threat arising from cyber-crime.
- The Group will continue to embed cyber security in the design of technology and services and reduce cyber risk exposure to an acceptable level before deployment.
- The Group will continue to maintain cyber risk insurance and review the policy no less than annually.
- The Group will continue to maintain a robust system of controls in order to prevent the Group being used to further financial crime and minimise the impact of external and internal fraud.
- The Group will continue to maintain external and internal fraud insurance and review the policy no less than annually.

Regulatory risk

Definition - Regulatory risk is the risk that the Group is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings due to failing to comply with applicable laws, regulations, codes of conduct or legal obligations.

Statement – The Group has no appetite for regulatory breaches, fines, censure, legal or enforcement action due to failing to comply with applicable laws, regulations and codes of conduct or legal obligations.

Key mitigating factors and controls

- The Group engages with industry bodies, such as UK Finance and The Finance and Leasing Association, and seeks external advice from advisors and consultants.
- Group policies and procedures set out the principles and key controls that should apply across the business and which are aligned to the Group's risk policies. Business units assess and implement policy and regulatory requirements and establish controls to ensure compliance. There is mandatory training for all employees.
- Risk & Compliance provide oversight, proactive support and constructive challenge to the business in identifying and managing regulatory issues.
- When appropriate, Risk & Compliance will conduct thematic reviews of regulatory compliance across businesses and divisions.
- The Group will implement actions from internal assurance regulatory reviews to enhance the resilience of critical reporting systems and processes.

Conduct risk

Definition - Conduct risk is the risk of customer detriment or a reduction in earnings value, through financial or reputational loss from an inappropriate or poor customer outcome or from business conduct. It is the risk that the Group's behaviour results in poor customer outcomes, exposing the firm to recourse from its customers, loss of business from reduced trading and the potential for regulatory action.

Statement - The Group has no appetite for conduct risk events through inappropriate product design, corporate culture or operational processes. The Group restricts its activities to areas of established expertise and ensures the culture of the organisation delivers a fair outcome for customers.

Key mitigating factors and controls

- The Board has an approved statement on culture, adopted throughout the organisation.
- Customer-focused policies and procedures including Treating Customers Fairly ('TCF') and vulnerable customers. These reflect the customer outcomes the Board intends to achieve (e.g. product development, governance and distribution).
- Customer needs are explicitly considered within business and product level planning and strategy.
- Enhanced product governance framework and The Marketing and New Products Approval Committee ('MNPA') ensures that products continue to offer fair value and meet the needs of the relevant target market throughout their life cycle.
- Enhanced recruitment, training and a focus on how the Group manages employee performance with clear customer accountabilities.
- Learning from past mistakes, including root cause analysis.
- Clear customer accountabilities for staff, with rewards and customer centric feedback built into performance appraisals.
- Complaints are viewed as a valuable source of management information and we recognise that, despite our intolerance of conduct risk failures, mistakes do happen and when they do we must rectify and learn from them.
- A programme of assurance reviews centred on conduct risk clusters, including product design and governance reviews, periodic product reviews, culture measurement, marketing and promotion reviews, the treatment of vulnerable customers and complaint handling.

Emerging risks

Emerging risks are those future risks which have been identified as possibly having an impact on the Bank's strategy, business model and performance.

The most prominent or present emerging risks are detailed below. The Group monitors a wide range of emerging risks, some of which have longer time frames and others which may have more immediate effect. Climate risk is the most obvious of these and the social and economic policy is changing at a fast pace. The Group is developing a roadmap for a climate risk strategy in accordance with PRA guidance. Other risks such as global tensions on trade or other geo-political matters require constant monitoring and consideration.

Brexit and economic environment

Risk - The Group has considered the potential for the process of the UK leaving the European Union ('EU') to lead to stress events in addition to those identified in the ILAAP and ICAAP assessments. Although Brexit has the potential to disrupt UK banks' access to markets in the remainder of the EU, the Group has only limited brokerage business outside the UK.

Management believes that Brexit's potential effect on the Group would be indirect or limited to a small number of industry sectors. Management's immediate concern is primarily focused on the negative effect that the prolonged process of Brexit may have on the economy, capital markets and consumer and business sentiment and the effect may have on demand.

Mitigation - The Group continues to monitor closely the Brexit negotiations and the potential economic impact on credit risk and implications for the business. It will decide whether internal scenario planning is required as the political and economic situation develops. The Bank has increased its pessimistic economic weightings to reflect the uncertainty of an outcome, particularly around a no Brexit deal.

Future direction - The Government has published a series of technical notices to allow businesses and citizens to understand what they would need to do under different Brexit scenarios, so they can make informed plans and preparations. Management will continue to review relevant technical notices as they are released and will model different Brexit outcomes, specifically looking at the effects they may have on the capital and liquidity of the Group.

Technology and system security

Risk - Cyber-attacks and data leakage are daily threats to organisations globally. These threats are becoming increasingly sophisticated. The Group recognises that information is a critical asset and that how data is managed, controlled and protected can have a significant impact on the delivery of its services and the security of its customers. Data must be protected from unauthorised use, disclosure, modification, damage and loss.

Strategic Report (cont'd)

Mitigation - The Board has approved a Cyber Strategy using best practice guidelines from the National Cyber Security Centre, the Financial Conduct Authority ('FCA') and the Bank of England. This strategy sets out in detail how the Group will work to ensure it remains protected against the increasing threat of cyber-attacks. This strategy is the framework for the Group's response to these threats and sets out five core objectives which have been delivered over the course of the financial year by implementing a number of cyber security led initiatives. These objectives are

- to understand cyber risk and act responsibly;
- to understand the extent and potential impact of exposure to the attack;
- to operate defences consistently across the Group's cyberspace, physical site and organisations;
- to have a robust incident response process in place; and
- to strengthen collaboration with industry specialists. The Group continues to be accredited under the Government's Cyber Essentials framework and is a member of the Cyber Security Information Sharing Partnership ('CiSP').

Future direction - The prevention of cybercrime remains a key focus for the Group. The Group continues to invest in its information security controls in response to emerging cybercrime threats and to ensure that controls for known threats remain robust.

Technological and competitive change to the motor vehicle market

Risk - Over 30% of the Bank's total portfolio of loans and receivables is in respect of finance agreements where the asset financed is a motor car. Technological and physical obsolescence, in particular relating to diesel cars, could lead to a diminution of the Bank's underlying security if defensive action is not taken. Several factors may lead to reductions in values for used diesel vehicles.

Mitigation - The sector risks are mitigated by collateral backed lending, sensible loan to value lending, low average lending balances, a wide range of models and marques for residual diversification and an increased focus on prime motor finance. The Group does not offer finance products that take a residual position in the motor vehicle. The Group serves the UK used car market, which unlike the supply of new vehicles, often originating from EU markets and attracting increased tariffs, is largely self-contained.

Future direction - Continued successful participation in this sector requires a good understanding of the upcoming changes in regulation, prudent lending criteria and sensible lending practices. The Group will monitor its portfolio on a regular basis and amend its lending criteria to reflect changes in economic conditions and the vehicle market, including research into the electric vehicle sector. The Group will monitor data, consumer trends and national and local legislation to continue to form a view as to the expected path for diesel vehicle prices and the implications for credit policy and back-book management.

By order of the Board

Scott Maybury

7 February 2020

Corporate Governance Report

The Board of Directors (the 'Board') is committed to the high standards of corporate governance, details of which are set out in this report. In considering the standards of Corporate Governance to apply, the Board has consideration of, but does not purport to fully comply with, the UK Corporate Governance Code issued by the Financial Reporting Council. The Board has adopted the UK Corporate Governance Code 2018 which became effective for the Group in the accounting period commencing 1 October 2019. The Code sets out the principles relating to the good governance of companies.

The Code is available at *www.frc.org.uk*

The current composition of the Board and Audit & Risk Committee ('ARC') represents a departure from the application of the Code. From independence perspective, the Board does not contain an equal balance of non-executive directors. Also, ARC only included one independent non-executive director for the majority of the year representing a departure from the Code. In response to these departures, the Group appointed an additional independent non-executive director, Marian Martin, to the Board on 25 July 2019. She was an attendee at ARC in September 2019 and was appointed a full member of ARC in November 2019. It is our intention to have a balanced Board in respect of independence by 30 September 2020.

Given the size of the Group and the policy of active dialogue being maintained with institutional shareholders by the executive directors, the Board is of the opinion that the appointment of a senior independent director is not necessary at this current time. The Board will re-consider whether to appoint a senior independent director during 2020.

Corporate governance and culture starts at the top of any company and the Board and the Executive Committee together are driving the values, behaviours and attitudes that support the Group's strategy. The Board has an agreed statement on culture which has been adopted throughout the organisation.

This Corporate Governance Report provides a clear and comprehensive description of the Group's governance arrangements.

Chairman's introduction

Dear shareholder,

As the Chairman of PCF Group plc, I am delighted to present our Corporate Governance Report for the year ended 30 September 2019.

The Board consists of nine directors, six of whom are non-executive and three of whom are executive. Two non-executives have been nominated by the majority shareholder. The following pages describe how we comply with the main principles of our Corporate Governance arrangements, how the Board and Committee structures operate and the key areas of focus for both the Board and its committees during the year.

We completed a board effectiveness review in July 2019. The review concluded that the composition of the Board, its understanding of the business and its leadership were of a high standard. The existing governance framework has proved effective in 2019 and, where required, there have been enhancements to the Risk Management Framework to keep pace with changes in the business.

The Board recognises that one of the keys to the Group's long-term success is the development of a healthy corporate culture. As we continue to execute our strategy, the Group's size and complexity continues to increase and the appointment of an additional non-executive during the year is recognition of this evolution. The Board is cognisant that the Group's culture has to evolve as the Group continues to grow.

Tim Franklin
Chairman

7 February 2020

Board of Directors

Tim Franklin

Non-executive Chairman,
appointed 6 December 2016

Tim has extensive experience in the financial services industry, having worked for over 30 years in the retail banking and building society sectors. Tim served as a non-executive director of the Post Office for 7 years until December 2019 and remains Chairman of Post Office Insurance. Additionally, he is a non-executive director of Computershare Loan Services. Tim is an Institute of Leadership & Management Level 7 Coach and works extensively with senior executives across many industries, both in the UK and internationally. In addition, he is an Associate of the Chartered Institute of Bankers.

Tim is Chairman of the Nomination Committee and a member of the Remuneration Committee.

Mark Brown

Non-executive director,
appointed 1 December 2015

Mark was Chairman of Stockdale Securities from November 2014, until it was bought by Shore Capital in April 2019. He was previously Chief Executive of Collins Stewart Hawkpoint and brings a wealth of experience and leadership in both small and large financial services businesses. Having worked as Global Head of Research for ABN AMRO and HSBC and as Chief Executive of ABN's UK equities business, Mark led the successful turnaround of Arbuthnot Securities followed by Collins Stewart Hawkpoint.

Mark is a member of the Nomination Committee and the Remuneration Committee.

Christine Higgins

Independent non-executive director,
appointed 13 June 2017

Christine is a chartered accountant with over 25 years' experience in asset finance for UK and international banks. Over the last 9 years, she has served as non-executive director on a number of boards in the health, housing, leisure and finance sectors, including as chair of the audit committee. She is currently a non-executive director of Buckinghamshire Building Society and chairs its audit committee and is a Trustee at Refuge.

Christine is Chair of the Audit & Risk Committee and a member of the Nomination Committee and the Remuneration Committee.

Marian Martin

Independent non-executive director,
appointed 25 July 2019

Marian Martin is a chartered accountant with a background in risk management and audit. Most recently, Marian was at Virgin Money for 11 years and was Chief Risk Officer throughout a period of significant growth and strategic development of Virgin Money and its risk function, including its successful listing on the London Stock Exchange. Marian was an executive director of the main trading companies of the Virgin Money group during this period. In addition, Marian is a non-executive director of Castle Trust and Starling Bank.

Marian is a member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

David Morgan

Non-executive director,
appointed 9 July 2012

David has over 35 years' experience in international banking, building his career at Standard Chartered Bank in Europe and the Far East. Since leaving Standard Chartered in 2003, he has been involved in a range of business advisory and non-executive roles. He is currently a non-executive director of Somers Limited, Bermuda Commercial Bank Limited and Waverton Investment Management Limited. He is also Chairman of Harlequin FC, the Premiership rugby club.

David is a member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

David Titmuss

Independent non-executive director,
appointed 11 July 2017

David has over 25 years' experience in both large and small financial services organisations, with a particular emphasis on customer acquisition and database management. His corporate background includes working at a senior level in public and privately backed businesses. David has direct experience of credit decisioning and debt collection for companies and consumers gained from holding senior roles in the finance industry over a number of years. He has also led companies both as CEO and as a board director. Latterly, David headed the marketing function of *webuyanycar.com* and is recognised as an expert in digital marketing and advising businesses on cost-effective customer acquisition.

David is Chairman of the Remuneration Committee and a member of the Nomination Committee.

Scott Maybury

Chief Executive ('CEO'),
appointed 12 January 1994

Scott holds a degree in business studies and is a qualified accountant. He spent 6 years with BHP Billiton, Australia's largest multi-national corporation, and 5 years with McDonnell Douglas Bank. He is one of the founding directors of PCF Group plc and was previously Finance Director until October 2008.

Robert Murray

Managing Director ('MD'),
appointed 19 October 1993

Robert holds the ACIB Banking diploma and has over 40 years' banking and finance experience. He has extensive experience in lending to personal, corporate and international customers. He is one the founding directors of PCF Group plc.

David Bull

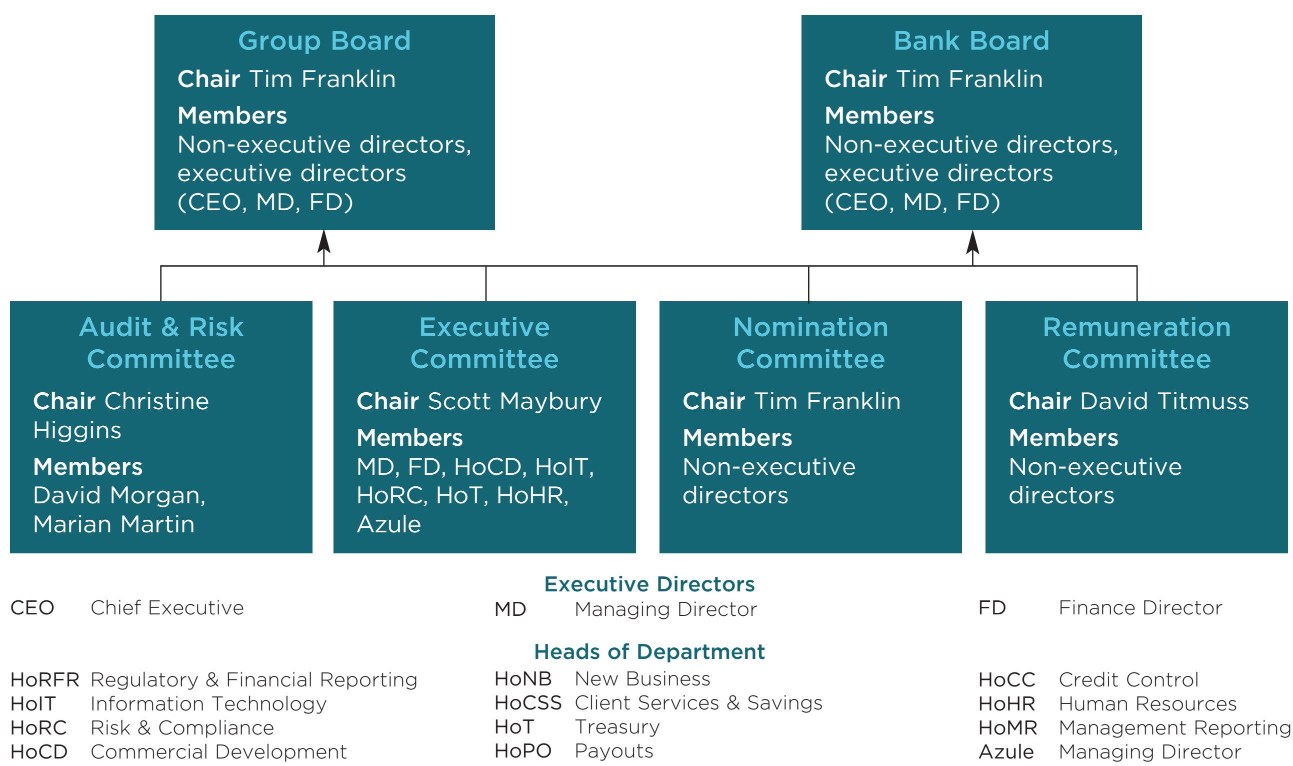
Finance Director ('FD'),
appointed 3 August 2015

David holds a first-class degree in Mathematics and Statistics and is a qualified chartered accountant. After qualifying in 1996, he has worked in the banking sector across a number of institutions, including KPMG, Deutsche Bank and was interim Chief Financial Accountant at the Bank of England. Before joining PCF Group, David was a Director of Finance and Company Secretary at Hampshire Trust Bank plc, a specialist challenger bank, where he was instrumental in setting up their banking operations.

Appointment & resignation of directors during the year

Marian Martin was appointed on 25 July 2019, and there were no resignations during the year.

Corporate Governance Structure



The Board is replicated at Group and PCF Bank Limited (the 'Bank') and the composition of both Boards is identical. The Boards meet no less than nine times a year and their primary responsibilities are to provide leadership, set strategic objectives and develop robust corporate governance and risk management practices. The Boards delegate specific powers to other committees, as shown in the chart above.

The effectiveness of the Board is the responsibility of the independent non-executive Chairman. Board performance is reviewed at least annually. The Chairman will meet formally on an annual basis with the non-executive directors to measure Board effectiveness, but this is also covered on an ongoing basis throughout the year through regular Board meetings. The non-executive directors review the Chairman's performance. The performance of the Chief Executive is appraised annually by the Chairman and the other members of the Remuneration Committee.

The Boards are supported by a number of established Board committees, namely the Executive Committee, Audit & Risk Committee, Nomination Committee and Remuneration Committee. Each committee has a set of clearly defined Terms of Reference. Responsibility for implementation of the Group's strategies and day-to-day business is delegated to management. The organisation structure sets out clear segregation of roles and responsibilities, lines of accountability and levels of authority to ensure effective and independent stewardship.

Board balance and independence

The Group Board and Bank Board consist of four independent non-executive directors, two non-executive directors and three executive directors and are chaired by Tim Franklin, an independent non-executive director. The profiles of the members of the Board are provided on pages 21 and 22. The tenure of each of the independent non-executive directors is less than nine years, which is in accordance with the Code.

The Boards comprise of members with diverse professional backgrounds, skills, extensive experience and knowledge in the areas of banking, finance, risk, marketing, business, general management and strategy required for the successful direction of the Group and the Bank. With their diversity of skills, the Boards have been able to provide clear and effective collective leadership and have brought informed and independent judgement to strategy and performance to ensure that the highest standards of conduct and integrity are always at the core of the Group. None of the independent non-executive directors participate in the day-to-day management of the Group or the Bank.

The presence of the independent non-executive directors is essential in providing unbiased and independent opinions, advice and judgements to ensure that the interests, not only of the Group, but also of shareholders, employees, customers, suppliers and other communities in which the Group conducts its business are well represented and considered.

The Audit & Risk Committee ('ARC') monitors the effectiveness of the Group's financial reporting systems, internal control and risk management and the integrity of the Group's external and internal audit process.

The Nomination Committee ('NomCo') reviews the structure and size of the Board. The committee considered the appropriateness of the Board's composition during the year and concluded that, following the appointment of Marian Martin, it has the appropriate mix of skills and experience to fulfil its responsibilities.

The Remuneration Committee ('RemCo') appraises the performance and remuneration of the executive directors and other senior executives.

The Bank Board holds separate board meetings immediately following the meetings of the Group Board. The Boards are collectively responsible for the success of the Group and the Bank.

Roles and responsibilities

The Board's role is to provide entrepreneurial leadership within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets the strategic aims, reviews management performance and ensures that the necessary financial and human resources are in place to meet objectives.

The Board's roles and responsibilities include, without limitation, the following

- developing corporate objectives, policies and strategies;
- reviewing and adopting the strategic business plan for the Group's effective business performance;
- overseeing the conduct of the Group's business to evaluate whether the business is being managed effectively;
- identifying principal risks and ensuring the implementation of appropriate systems to manage and monitor identified risks effectively;
- ensuring that all candidates appointed to the senior management positions are of sufficient calibre and that there are programmes in place to enable orderly succession of senior management;
- ensuring effective communication with the shareholders and other stakeholders;
- reviewing the efficacy of internal controls and management information, including systems for compliance with applicable laws, regulations, rules, directives, and guidelines;
- setting the Group's values and standards and ensuring that its obligations to all stakeholders are understood and met;
- approval of risk management framework, insurance and mitigation;
- reviewing and approving acquisitions and disposals of undertakings and major investments;
- assessing, monitoring and prompting a sound corporate culture within the organisation; and
- ensuring that appropriate systems are in place to promote whistleblowing and protect confidentiality of whistleblowers.

The Board has adopted Terms of Reference ('ToR'), which set out the Board's strategic intent and outline the Board's roles and responsibilities. ToR is a source reference and primary induction literature for existing and prospective members of the Board and is consistent with the Code.

The Board ToR also sets out the independence, duties and responsibilities that the members of the Board must observe in the performance of their duties. The Board ToR is subject to review on at least an annual basis.

Roles and responsibilities of the Chairman and Chief Executive

The Code recommends that there should be clear division of responsibilities at the head of the company to ensure there is proper balance of power and authority.

All executive and non-executive directors have unrestricted and timely access to all relevant information necessary for informed decision-making. The Chairman encourages challenge and deliberation by the Board members to make best use of their collective wisdom and to promote consensus building.

Matters which are reserved for the Board's approval and delegation of powers to the Board Committees are expressly set out in an approved framework on limits of authority.

The business affairs of the Group are governed by the Group's delegated authorities and its policy and procedures manuals. Any non-compliance issues are brought to the attention of any or all of the Executive Committee, Audit & Risk Committee and the Board for effective supervisory decision-making and proper governance.

As the Group is expanding and its business growing, the division of authority is constantly reviewed to ensure that management's efficiency and performance remain at its best level.

Chairman

Tim Franklin served as Chairman throughout the year. The Chairman is responsible for the leadership of the Board and ensuring the effective running and management of the Board. He is also responsible for the Board's oversight of the Group's affairs, which includes ensuring that the directors receive accurate, timely and clear information, and the effective contribution of the non-executive directors. He has overall responsibility for leading the development of the Group's culture by the governing body as a whole.

Chief Executive

Scott Maybury served as Chief Executive throughout the year. He is responsible for the day-to-day management and executive leadership of the business. His other responsibilities include the progress and development of objectives for the Group, managing the Group's risk exposure, implementing the decisions of the Board and ensuring effective communication with all stakeholders and regulatory bodies. He has overall responsibility for the Group's performance of its obligations under the Senior Managers and Certification Regime.

Board meetings and supply of information

Before each Board meeting, the directors receive, on a timely basis, comprehensive papers and reports on the issues to be discussed at the meeting. In addition to Board papers, directors are provided with relevant information between meetings.

Any director wishing to do so may take independent professional advice at the expense of the Company. All directors are able to consult with the Company Secretary, who is responsible for ensuring that Board procedures are followed.

The directors also have direct access to the advice and services of the outsourced Internal Audit function in addition to other members of the senior management team. There is an agreed audit plan and the Internal Audit function reports directly to the Audit & Risk Committee.

The Board has regular scheduled meetings. During the year there were nine scheduled Board meetings. As and when the need arises, additional meetings are held to deal with any specific time-critical business matters.

Attendance at meetings

The attendance of the directors at Board and the principal committee meetings that took place during the year are shown on page 25.

Number of meetings attended/(eligible)	Board	Audit & Risk Committee	Nomination Committee	Remuneration Committee	Executive Committee
Number of meetings held	11	9	4	6	16
Chairman					
Tim Franklin (2)	11 (11)	1 (1)	4 (4)	6 (6)	–
Chief Executive					
Scott Maybury (1) (3)	11 (11)	8 (9)	4 (4)	6 (6)	16 (16)
Non-executive directors					
David Morgan	10 (11)	9 (9)	4 (4)	6 (6)	–
Mark Brown	11 (11)	–	4 (4)	6 (6)	–
Independent non-executive directors					
Christine Higgins	11 (11)	9 (9)	4 (4)	6 (6)	–
Marian Martin (2)	3 (3)	1 (1)	1 (1)	1 (1)	–
David Titmuss	11 (11)	–	4 (4)	6 (6)	–
Executive directors					
Robert Murray	10 (11)	–	–	–	11 (16)
David Bull (1)	11 (11)	9 (9)	–	–	16 (16)

(1) Attended as standing attendee at Audit & Risk Committee meetings.

(2) Attended as a guest at Audit & Risk Committee meeting.

(3) Attended as a guest at Nomination and Remuneration Committee meetings.

Appointments to the Board

The Nomination Committee ('NomCo') consists of two non-executive directors and four independent non-executive directors and is chaired by Tim Franklin. NomCo makes independent recommendations for appointments to the Board. In making these recommendations, NomCo assesses the suitability of candidates, taking into account the required mix of skills, knowledge, expertise, experience, professionalism, integrity, gender diversity, competencies and other qualities, before recommending them to the Board for appointment. NomCo will take steps to ensure that diversity in candidates is sought for appointment to the Board.

Appointment and re-appointment

The code requires that all directors should stand for re-appointment annually, subject to continued satisfactory performance.

With effect from the AGM to be held on 6 March 2020, the Board will comply with the UK Corporate Governance Code 2018 and all directors will be subject to annual re-election.

No person other than a director retiring at the AGM shall be eligible for appointment or re-appointment as a director at any general meeting unless he is recommended by the directors or if the resolution to propose the person for appointment or re-appointment as a director has been requisitioned by a member in accordance with the Companies Act 2006.

Training and development of directors

Professional development

During the year, specific training sessions were held covering compliance, regulation and corporate governance issues. Topics covered included Financial Crime, Conflicts of Interest, AIM Rules and the Corporate Governance Code. The Board also held a session on culture, diversity and inclusion at the Annual Strategy day. Board members are encouraged to attend relevant training programmes as part of their continuing professional development and additional business, compliance and regulatory updates are also arranged, as appropriate.

Company Secretary

The Company Secretary is responsible for ensuring that board procedures and applicable rules and regulations are observed. He is responsible for advising the Board, through the Chairman, on all governance matters. All directors have direct access to the services and advice of the Company Secretary. Directors are able to take independent external professional advice to assist with the performance of their duties at the Company's expense.

Governance structure and delegated committee

The Board has established a number of committees to which responsibility for certain matters has been delegated. The Board committee structure is shown in the diagram on page 23. Each committee has written Terms of Reference setting out the committee's role and responsibilities and the extent of the authority delegated by the Board. Minutes of each committee are circulated to the Board on a regular basis.

Reports of certain Board's committees are set out later in this Report and provide further detail on their roles, responsibilities and the activities they have undertaken during the year.

Meetings of the Board

At each scheduled meeting, the Board receives reports from the Chief Executive and Finance Director on the performance and results of the Group. The Managing Director updates the Board on performance, strategic developments and the legal and regulatory affairs of the Group and the Bank. In addition, the Board receives regular updates from the Executive Committee ('ExCo') which collates updates from the Credit Committee, Risk, Compliance & Operations Committee ('RCO'), Marketing & New Products Approval Committee ('MNPC') and Asset & Liability Committee ('ALCO').

There is an annual schedule of rolling agenda items to ensure that all matters are given due consideration and are reviewed at the appropriate point in the financial and regulatory cycle. Meetings are structured to ensure that there is sufficient time for consideration and debate of all matters. In addition to scheduled or routine items, the Board also considers key issues that impact the Group and the Bank as they arise.

Executive Committee

The Board has delegated its day-to-day management duties to ExCo, which meets monthly to deliberate and take policy decisions on the effective and efficient management of the Group and to monitor its performance. It also serves as a processing forum for issues to be discussed at Board level. ExCo's primary responsibility is to ensure the implementation of strategies approved by the Board, provide leadership to the senior management team and ensure efficient deployment of the Group's resources, including capital and liquidity.

ExCo meetings provide an avenue for the attendees, which comprise Senior Management of various departments, to engage and align to the strategy and policy as approved by the Board.

Scott Maybury (Chief Executive), Robert Murray (Managing Director) and David Bull (Finance Director) are members of ExCo. Their profiles can be found on page 22. The other members of ExCo are as follows.

Gerald Grimes

Head of Commercial Development ('HoCD')

Gerald joined the Group in July 2018 to help focus on the introduction of new products and markets and to head up Business & Broker Development. He has a wealth of experience in financial services with GE Capital, The Funding Corporation and as Managing Director of Hitachi Capital. Until recently, Gerald was a board director of the Finance and Leasing Association ('FLA'), also serving as Chairman for a number of years, and was a member of the Bank of England Consultative Committee. Gerald now acts in an advisory capacity to the FCA and serves on their Smaller Business Practitioner Panel ('SBPP').

Andrew Barber

Head of IT ('HoIT')

Andrew joined PCF Group in June 2002 and is responsible for developing and managing the IT and cyber strategy within the Group. Andrew oversees the management of systems, operational resilience and third-party vendor management. As a PRINCE2 Registered Practitioner, Andrew is instrumental in ensuring change is managed successfully within the Group. Andrew is a member of the Smaller Banks Operations & IT Forum ('SBOITF') and is one of the founding members of the recently established Specialist Bank Security Forum ('SBSF').

Jim Coleman

Head of Treasury ('HoT')

Jim joined PCF in October 2016 to oversee the establishment of a Treasury function in preparation for bank mobilisation in 2017. Since mobilisation, he has been responsible for funding, liquidity, asset and liability management and funds transfer pricing. Jim has over 30 years' experience of bank and building society financial management, is a Fellow of the Association of Corporate Treasurers and holds an MBA from Imperial College Business School.

Suzie Yong

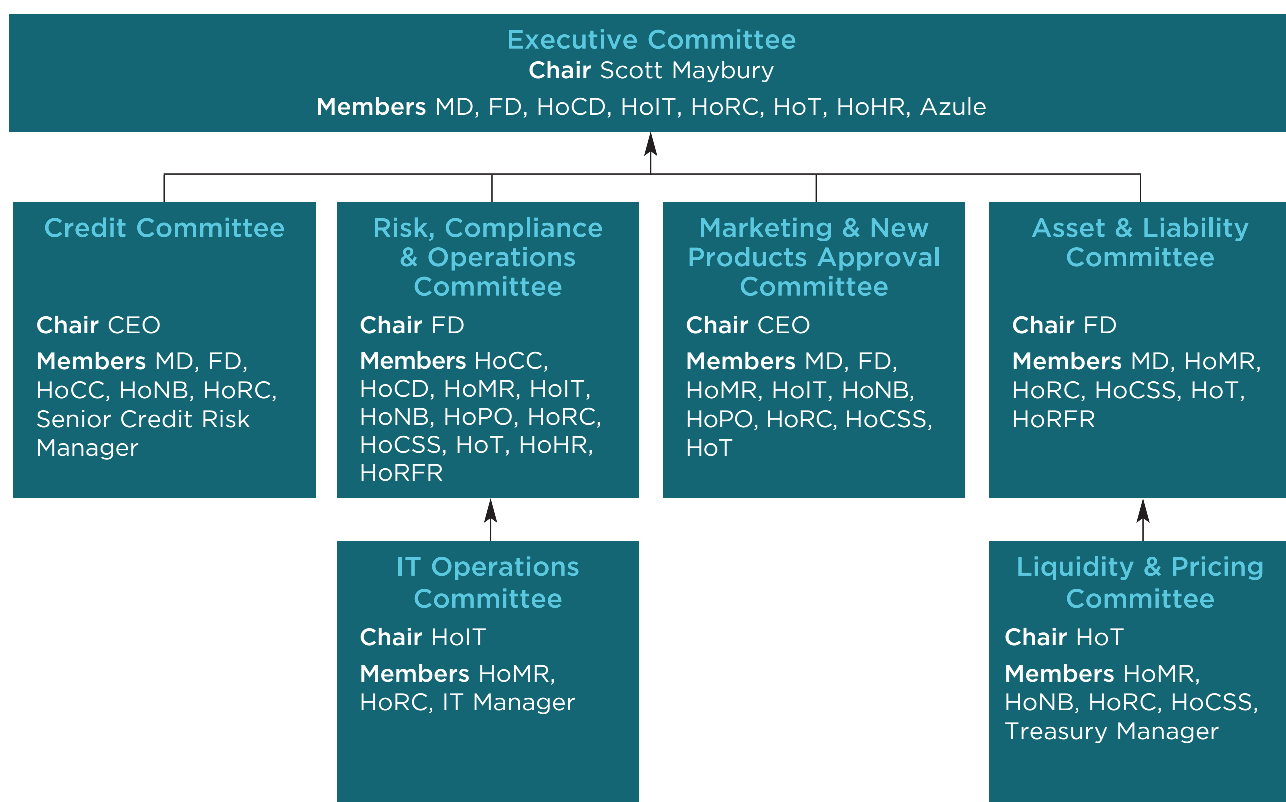
Head of Human Resources ('HoHR')

Suzie joined PCF Group in August 2019 and is responsible for Human Resources and Office Management for the Company. Suzie has over 20 years' HR management experience in both the private and public sectors, with her last role as Head of HR in Fintech, where she was responsible for the set up and management of HR operations globally. Suzie has several years' experience working as an Associate Lecturer and Assessor on CIPD courses at the International Financial Services Centre (Dublin) and is a Chartered Member of the Chartered Institute of Personnel and Development.

Jason McCabe

Head of Risk & Compliance ('HoRC')

Jason joined PCF Group in October 2016 and is responsible for the chief risk, compliance oversight and money laundering reporting senior management functions. He has over 15 years' experience in Risk Management and Compliance and joined from Royal Bank of Canada, where he spent 8 years in various senior roles, including the Global Head of Operational Risk for Treasury Market Services and the Chief Risk Officer for RBC Investor Services UK.



Executive Directors

CEO	Chief Executive	MD	Managing Director	FD	Finance Director

Heads of Department

HoRFR	Regulatory & Financial Reporting	HoNB	New Business	HoCC	Credit Control
HoIT	Information Technology	HoCSS	Client Services & Savings	HoHR	Human Resources
HoRC	Risk & Compliance	HoT	Treasury	HoMR	Management Reporting
HoCD	Commercial Development	HoPO	Payouts	Azule	Managing Director

Where appropriate, delegates attend where members are absent.

Audit & Risk Committee Report

Committee members during the year

Christine Higgins *Non-executive director (Chair)*
David Morgan *Non-executive director*
Anthony Nelson *Advisor (resigned 29 November 2019)*

Standing invitees

Scott Maybury *Chief Executive*
David Bull *Finance Director*
Jason McCabe *Head of Risk & Compliance*
Grant Thornton LLP representatives *(internal auditor)*
Ernst & Young LLP representatives *(external auditor)*

Responsibilities of the Audit & Risk Committee

- Monitor the integrity of the Group's financial statements by debating and challenging critical estimates and judgements and oversee the external audit.
- Advise the Board on the Group's overall risk appetite, tolerance and strategy.
- Monitor the work and effectiveness of the internal audit function and oversee the internal audit.
- Assess and monitor the activities and effectiveness of the Risk & Compliance function.
- Oversee whistleblowing arrangements. The Chair of ARC is the Whistleblowing Champion and an independent point of escalation in accordance with the Group's Whistleblowing Policy.
- Review procedures in place for detecting fraud and financial crime and preventing bribery and money laundering.
- Review and approve assumptions and stress scenarios in the planning stage of the ICAAP and ILAAP, including substantive changes to the previous assessment.

Dear shareholder,

I am pleased to present my report to you on the work of the Audit & Risk Committee ('ARC'/'the Committee') during the year.

One of the Committee's most significant activities was overseeing the implementation of the new accounting standard IFRS 9, which introduces a forward-looking expected credit loss model designed to recognise potential losses earlier. Information on the impact of IFRS 9 is set out in note 1.5.2.

In November 2019, Tony Nelson stepped down as an advisor from the Committee. I would like to thank Tony both personally and on behalf of the Committee for his insights and dedication. Tony has been replaced by Marian Martin, who has recently joined the Board. Marian was formerly the Chief Risk Officer at Virgin Money.

Members of the Committee have recent and relevant financial experience and extensive experience of corporate financial matters in the banking and financial services industry. The Board is satisfied that the committee members have the skills and competence required to fulfil the Committee's duties and responsibilities as set out within the Terms of Reference.

Meetings

ARC met nine times during the year. The Chief Executive, Finance Director, Head of Risk & Compliance, internal audit and the external auditor attended these meetings as standing invitees. An oral report was made to the Board following each meeting and the approved minutes were subsequently provided.

Areas of focus

During the year, the areas of focus for ARC were as follows.

Financial reporting

ARC considered the Group's interim and annual financial statements. In reviewing the annual financial statements, the Committee discussed and challenged management's analysis and judgements and the external auditor's report, focusing particularly on a number of significant areas of potential risk and key audit matters as follows.

- Risk of fraud in the recognition of revenue through the Effective Interest Rate ('EIR') methodology.
- Impairment of loans and advances to customers in accordance with the IFRS 9 expected credit loss model (fraud risk).
- Purchase price allocation and disclosure of acquisition of Azule Limited (fraud risk).

Other areas of audit focus were as follows.

- Management override of controls – this is mandated by International Standards on Auditing (UK) and is considered as part of the fraud risks detailed above, as well as through the execution of general procedures.
- Impairment of Goodwill – annual review.
- Adoption of IFRS 15 'Revenues from Contracts with Customers' – impact and disclosures.

Going concern – ARC assessed the appropriateness of the going concern basis of accounting and the statement that the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due and concluded it was appropriate.

ARC reviewed the content of the Annual Report and Financial Statements for the year ended 30 September 2019 for clarity and completeness of disclosure.

The Committee concluded that the Annual Report and Financial Statements as a whole were 'fair, balanced and understandable' and therefore recommended the Annual Report and Financial Statements to the Board for approval.

Internal audit

ARC oversees the internal audit function, approving its plans and scope, its resources and considers the reports produced.

Grant Thornton, our internal auditors, completed six internal audits during the year and we are pleased to report that their overall assessment was that based on their internal audit work over the year 'the governance and risk and control framework is operating effectively to support PCF Group in adhering to its agreed risk appetite'.

The annual internal audit plan was developed in conjunction with the Second Line of Defence Compliance Monitoring Plan. The areas for audit are linked to strategic objectives, key risks and the core areas of regulatory oversight.

The Committee has satisfied itself as to the effectiveness of the internal audit function during the year through the review of the audit strategy and annual audit plan, discussion of internal audit reports, private meetings with Grant Thornton.

Risk management, compliance and internal controls

The Board is responsible for the overall adequacy of the Group's system of internal controls and risk management. The Board has delegated to ARC the responsibility for reviewing and monitoring the effectiveness of the Group's systems of risk management, regulatory compliance and internal control. In reviewing the adequacy of internal controls, ARC received and discussed a number of internal and external reports during the year including

- Internal audit - The audit reports completed by Grant Thornton this year covered Senior Manager and Certification Review ('SMCR'), IT General Controls, Disaster Recovery Planning and Crisis Management, Third Party Management, Financial Controls and Regulatory Reporting. Management has already implemented a number of the recommendations made, with timely plans in place to address those remaining.

  The internal auditors have observed the culture within the areas they reviewed and also through interaction with management, and have reported that management have been fully engaged in the audits and respond positively to recommendations.

  The Chair of ARC had private discussions with the auditor during the year and the Committee met with external audit at least once during the year, without management.
- External audit - The external auditors, EY, provided the Committee with an update on the implementation of their 2017/18 recommendations and their risk assessment for 2018/19. The Committee also met privately with EY during the year, which provided an opportunity for relevant issues to be discussed directly.
- Risk and Compliance - ARC considered reports from the Head of Risk & Compliance at its meetings which included performance against risk appetite, complaints, financial crime and anti-money laundering compliance, fraud, vulnerable customers, outcomes testing, responsible lending and upcoming regulatory changes. The Committee received presentations from the Head of IT and the Head of Treasury on the key risks in their areas.

The Committee also oversaw the development of further strategic metrics during the year, including those in relation to Azule. A number of policies were approved and reports completed during the year in line with the Compliance Monitoring Plan, with recommendations made and timely plans to implement them.

ARC considered emerging risks and management's plans for avoiding and mitigating these risks. This year, this included the impact of the FCA report on motor finance, fraud, Brexit and headwinds in the wider economy.

A revised Financial Crime Framework, Risk Management Framework and Risk Appetite Statement was reviewed by the Committee during the year and recommended to the Board for approval.

External audit

ARC is responsible for overseeing the relationship with the external auditor, including the ongoing assessment of the auditor's independence. ARC makes recommendations to the Board with regard to the appointment of the external auditor and approves their remuneration and terms of engagement.

EY was appointed as the Company's auditor in 1998. The audit partner for this year is Gary Adams. Gary replaced Michael-John Albert, who had been in place since 2015.

ARC discussed and approved the planning of the external audit, including risk evaluation, scope and the materiality applied as well as the results of the audit. The audit highlighted some areas where management should consider improvements in processes. Importantly, the auditor considered the appropriateness of material judgements and concluded that the balance was appropriate and consistent with previous years, where applicable.

During the year, ARC discussed with EY the review procedures they have in place to ensure audit quality. There was also a discussion of the results of their Financial Reporting Council ('FRC') 2019 Audit Quality Inspection and the impact of the findings on the audit plan.

Independence and effectiveness

ARC has reviewed the independence, objectivity and effectiveness of EY taking into account the auditor's report to the Committee on actions they take to comply with requirements for independence, compliance with the policy for the provision of non-audit services and conclusions from the evaluation undertaken of external audit effectiveness.

The level of audit fees charged by the Group's auditor is set out in note 10. There was no non-audit work carried out by EY during the year.

The Chair of ARC had private discussions with the auditor during the year and the Committee met with external audit at least once during the year, without management.

ARC evaluates the effectiveness of the external auditor on an annual basis, taking into account fees and the engagement letter, a review of the external audit plan, the objectivity and effectiveness of the audit, the quality of formal and informal communications with ARC, and this year the results of an effectiveness survey which included feedback from management. Following its review of the 2018/19 external audit process, ARC concluded that it was effective.

Re-appointment

The Group last tendered its external audit in March 2006 and appointed EY as its auditor. Based on EY's performance, ARC has recommended to the Board that EY be re-appointed as auditor for the coming year. The Board has concurred, and the re-appointment will be proposed to shareholders at the Annual General Meeting.

In terms of re-tender, the Committee decided after further consideration not to put external audit out for tender for the year ending 30 September 2020, but will keep the situation under review. The current auditor appointment falls under the transitional arrangements for mandatory audit firm rotation under the EU Audit Reforms and a change of auditor is not required at this point.

Whistleblowing

ARC has reviewed the effectiveness of whistleblowing arrangements in place within the Group and adherence to the FCA Rules on Whistleblowing. During the year, the Committee received a report on a review and test of the whistleblowing framework, which included the results of mandatory training provided to staff. There have been no whistleblowing reports this year.

Committee effectiveness

ARC undertook an annual review of its own effectiveness during 2019 through a questionnaire sent to ARC invitees, and the conclusions were that the Committee was operating effectively. Recommendations raised will be discussed by the Committee and a time frame agreed for implementation.

This report was approved by the Audit & Risk Committee on 7 February 2020.

Christine Higgins
Chair of the Audit & Risk Committee

7 February 2020

Nomination Committee Report

Dear shareholder,

I am pleased to present my report to you as Chairman of the Nomination Committee.

Introduction
The Nomination Committee ('NomCo') has delegated responsibility from the Board for reviewing the structure, size and composition of the Board. Following advice received from an external review during the year, the activities of the Nomination Committee were separated from the Remuneration Committee and, accordingly, each meeting is held separately.

Membership of NomCo is limited to non-executive directors and was chaired by David Titmuss or myself. Scott Maybury is invited to NomCo on an *ad hoc* basis as an attendee for agenda points linked to our consideration of succession plans and other matters where his input is valued.

Role and activities of the Nomination Committee
In March 2019, we assessed the composition of the Board and its Committees and the balance between independent non-executive directors and non-executive directors in line with the proposals in the UK Corporate Governance Code 2018 and the on-going requirements of our regulators, the Prudential Regulation Authority and the Financial Conduct Authority. The result was the decision to recruit an additional independent non-executive director.

We determined the candidate should have risk experience in a banking environment and, ideally, listed company experience. We undertook a recruitment process based on these identified skills whilst also having regard for board diversity. The search culminated in the appointment of Marian Martin to the Board as an independent non-executive director on 25 July 2019. Marian received thorough induction into her role by meeting senior management and functional heads.

Marian was appointed a member of Audit & Risk Committee on the retirement of Tony Nelson in November 2019. I would like to take this opportunity to thank Tony for his many years' service to ARC and we wish him well in retirement.

The Board underwent a questionnaire-based skills assessment in July 2019. The overall outcome of this evaluation provided confidence that the Board has a broad range of key skills to perform its role in regard to strategic direction, advice and judgement and to the standard required of a dual-regulated bank. Whilst the Board concluded that it is performing well and is effective, a program of continuous board training will remain in place to ensure the skill base is improved further.

Board training is held on a regular basis to provide board members with continuing professional development and updates on regulatory, financial and governance developments. The Board calls upon external organisations where specialist input is required. In addition, the Board will co-opt its own Heads of Department where the specialist skills are available in-house. This has been especially useful in the areas of compliance and human resources.

This year NomCo met four times. Meeting agendas have included items on succession planning, diversity, staff relations, board training and effectiveness.

This report was approved by the Nomination Committee on 29 November 2019.

Tim Franklin
Chairman of the Nomination Committee

31 January 2020

Remuneration Committee Report

Dear shareholder,

I am pleased to present my report to you as Chairman of the Remuneration Committee.

Introduction

The Committee ('RemCo') has delegated responsibility from the Board for reviewing the performance of the executive directors, succession planning and remuneration of the directors and other senior executives. Membership of RemCo is limited to non-executive directors and is chaired by me. Where appropriate, RemCo consults external advisers on remuneration and regulatory issues so as to align with the strategic aims of the Group and regulatory compliance requirements. In addition, the committee gathers information regarding the pay and rewards offered to executives of similar companies.

Approach to remuneration

The approach taken by the Group in respect of remunerating its staff emanates from a combination of regulatory guidance and, in particular, the Dual-Regulated Firms Remuneration Code (SYSC 19D), as appropriate for Level 3 firms, the rules on remuneration as published by the Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA') as amended from time to time, and its own best judgement. These guidelines assist with the design of awards and incentive packages which are effective in not only recruiting and retaining staff, but also in meeting the risk appetite and long-term interests of the Group.

Fundamentally, our approach to remuneration is based on promoting and rewarding the right behaviours which ensure that the interests of our customers and stakeholder value are at the forefront of everything we do. The level of expertise and experience of the executive team also requires the committee to benchmark remuneration and rewards to a peer group of similar companies.

Due to the size of our business, the Group applies proportionally to the principle (SYSC 19D.3.3R (2)) to ensure the practices and processes we promote are appropriate to size, internal organisation and the nature, scope and complexity of activities.

In applying PRA and FCA regulatory guidance, the Group classifies its employees as either Code or Non-Code staff. Code staff are comprised of executive and non-executive directors and also Senior Managers covered by the Senior Managers Regime. No staff have been classified as Material Risk Takers. Other key individuals are covered under the scope of the Conduct Regime.

Remuneration policy

The Group's remuneration policy is applicable to all its employees. The objective of the policy is to recruit and retain high calibre talent, capable of achieving the Group's objectives and to encourage and reward superior performance and the creation of shareholder value. The policy further sets out the use of performance-based remuneration to motivate and reward high performers who strengthen long-term customer relations, generate income, demonstrate the required behaviours (teamwork, co-operation, customer focus, risk awareness), comply with regulation, support a control environment, deliver good customer outcomes and protect and enhance shareholder value.

The Group's remuneration policy does not encourage taking risks that exceed the risk appetite of the Group. The remuneration policy enables incentives to be provided with the purpose of meeting the Group's long-term strategic objectives and general goals in areas of risk management, positive customer outcomes, regulatory and statutory compliance and other key stakeholder expectations.

The following guiding principles underpin the remuneration policy.

- The recognition that the Group operates in a competitive environment for experienced and valued executives.
- Interests of our employees are aligned with the interests of our customers, long-term interests of the Group, shareholders and other stakeholders in the Group, as well as the public interest.
- Employees are not to be rewarded for taking risks that are unwarranted.
- Principles of 'malus' and 'clawback' will be implemented where relevant.

As a Level 3 firm under the Remuneration Code guidance on proportionality (SYSC 19D), the Group does not apply the following rules

- retained shares or other instruments (SYSC 19D.3.56R);
- deferral (SYSC 19D.3.59R); and
- performance adjustment (SYSC 19D.3.61R – 62R).

The Group seeks to combine various remuneration and incentive components to ensure an appropriate and balanced remuneration package that reflects responsibilities, the employee's role in a professional activity as well as market practice. The four remuneration components that every employee may be eligible to receive include

- Basic salary;
- Benefits;
- Cash bonus; and
- Share options.

Share-based payments

During the year, the Company introduced a share-based, long-term incentive plan for senior executives and other key staff. The plan has performance criteria attached in regard to Group performance and shareholder return. Share options under the plan are only settled on achievement of the criteria.

Remuneration for the year

Fixed remuneration

Fixed remuneration comprises basic salaries and benefits including healthcare and life assurance cover. These are provided on the same basis for all employees. The Company has a workplace pension scheme with Standard Life, with a Company contribution rate based on 7% of qualifying earnings.

The Directors' contribution rate is based on 10% of qualifying earnings. These are outside the workplace scheme and contributions are paid to a scheme of their choice or as a cash equivalent where annual or lifetime pension allowances have been reached.

Variable remuneration

The annual performance award is a significant variable component of the overall remuneration and is at the discretion of RemCo. In determining the level of award paid to the Chief Executive, Managing Director and Finance Director, consideration was given not only to the financial performance of the Group, including returns to shareholders and the Group's profitability in 2019, but also to their individual performance, based on a number of personal objectives. In respect of the Chief Executive, these included the strategic development of the Group, leadership and culture, operational performance, risk management and regulatory compliance.

Table of directors' remuneration

A summary of the total remuneration paid to directors is set out below.

	Salary and fees £'000	Bonus £'000	Benefits in kind £'000	Pension contributions £'000	Long-term incentive £'000	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Executive directors							
S D Maybury*	250	197	2	25	2	476	439
R J Murray	175	89	3	18	–	285	298
D R Bull**	185	90	1	18	2	296	332
Non-executive directors							
M F Brown	43	–	–	–	–	43	37
T A Franklin	95	–	–	–	–	95	90
C A Higgins	57	–	–	–	–	57	51
M Martin***	11	–	–	–	–	11	–
D J Morgan	43	–	–	–	–	43	37
D Titmuss	52	–	–	–	–	52	47
	911	376	6	61	4	1,358	1,331

* Pension received in cash

** Part of the pension received in cash

*** Appointed 25 July 2019

Non-executive directors

Non-executive directors are engaged under letters of appointment. Non-executive directors retire and seek re-election at the next AGM on an annual basis, in accordance with the Corporate Governance Code 2018. Non-executive directors who are subject to retirement at the AGM are eligible for re-appointment. Non-executive directors participate in decisions concerning their own fees together with the recommendation of the executive directors, taking into account comparisons with peer group companies, their overall experience and knowledge and the time commitment required for them to undertake their duties and if the non-executive director has undertaken any additional duties during the year. The non-executive directors do not receive variable remuneration.

Remuneration disclosures

Information on the Group's Remuneration Code is set out in the Pillar 3 disclosures and will be published on our website *www.pcf.bank*

This report was approved by the Remuneration Committee on 31 January 2020.

David Titmuss
Chairman of the Remuneration Committee

31 January 2020

Directors' Report

for the year ended 30 September 2019

The directors present their report and audited financial statements for the year ended 30 September 2019.

Results and dividends

The consolidated results for the year are set out in the Consolidated Income Statement on page 48.

The directors recommend the payment of a final dividend of 0.4p per share in respect of the year ended 30 September 2019 (year ended 30 September 2018 – final dividend of 0.3p per share). Subject to approval at the Annual General Meeting to be held on 6 March 2020, the final dividend will be paid on 9 April 2020 to shareholders on the register at 20 March 2020.

Principal activities

The Group's principal activities are the purchase, hire, financing and sale of vehicles, equipment and property, the provision of retail savings products and the provision of related fee-based services. The Group will continue to administer its portfolio of financial assets to improve profitability.

Directors and their interests

The directors of the Company during the year were those listed on page 2.

The directors' interests in the shares of the Company, all of which were beneficial interests, at 30 September 2019 are listed below.

	At 30 September 2019 No. of ordinary shares of 5p each	At 30 September 2018 No. of ordinary shares of 5p each
Scott Maybury	1,717,653	1,717,653
Robert Murray	998,340	998,340
David Bull	230,568	230,568
Mark Brown	200,000	135,000
Tim Franklin	125,783	90,173
Christine Higgins	33,204	19,500
Marian Martin	14,771	–
David Morgan	500,000	500,000
David Titmuss	50,000	–

The following directors also held options in the Company's share option plans. Further details are provided in the Remuneration Committee Report on pages 34 to 35 and in note 9.

	At 30 September 2019 No. of ordinary shares of 5p each	At 30 September 2018 No. of ordinary shares of 5p each
Scott Maybury	2,547,082	1,140,000
Robert Murray	1,680,465	770,000
David Bull	1,310,465	400,000

The Company's Articles of Association permit it to indemnify directors in accordance with the Companies Act.

Substantial shareholdings

At 30 September 2019, the Company had been notified of the following interests of 3% or more in its issued ordinary share capital.

	Percentage
Somers Limited	54.32%
Bermuda Commercial Bank Limited	8.40%
Hof Hoorneman Bankiers	9.22%
Beleggingsclub 'T Stockpaert	3.31%

Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, Directors' Report and the Group Financial Statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

Company law requires the directors to prepare Financial Statements for each financial year. Under that law, the directors must not approve the Group Financial Statements unless they are satisfied that they present fairly the financial position, financial performance and cash flows of the Group for that year. In preparing those financial statements, the directors are required to

- select suitable accounting policies in accordance with IAS 8 'Accounting policies, changes in accounting estimates and errors' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- state that the Group has complied with IFRS, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Financial risk management objectives and policies

Information about 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.

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 (pages 39 to 42).

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 39 to 42).

Statement of Going Concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. The Group's policies and processes for managing its capital are described in the Strategic Report. Details of the Group's financial risk management objectives, its financial instruments and hedging activities and its exposures to credit risk and liquidity risk are also set out in the Notes to the Financial Statements.

The directors have completed a formal assessment of the Group's financial resources, including forecasts and emerging risks such as Brexit. Based on this review, the directors believe that the Group is well placed to manage its business risks successfully within the expected economic outlook.

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Financial Statements.

Corporate governance

The Corporate Governance section provides disclosure of the Group's corporate governance arrangements.

Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Group's auditor, each director has taken all the steps that he or she is obliged to take as a director in order to make himself or herself aware of any relevant audit information and to establish that the auditor is aware of that information.

Re-appointment of auditors

A resolution to re-appoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

On behalf of the Board

Robert Murray
Director and Secretary

7 February 2020

Risk Management

for the year ended 30 September 2019

The management of risk is based on an understanding of the risks that the Group faces, an assessment of these risks and establishing an appropriate control environment. Risks are assessed at the inherent level, before being mitigated by controls, and at the residual level, once controls have been considered. Controls include risk appetite statements, defined limits to risk exposures, policies, procedures, mandates, oversight, and reporting. The design and effectiveness of controls is key and an assessment of these is performed by all 'Three Lines of Defence'.

Risk policies and procedures are the formal documentation of the methods used to manage, control, oversee and govern each principal risk. They articulate the limits, operating standards and procedures by which risks are identified, assessed and managed at all stages of the business and risk life cycle.

Risk accountability

The Risk Management Framework articulates individual and collective accountabilities for risk management, risk oversight and risk assurance and supports the discharge of responsibilities to customers, shareholders and regulators. It establishes a common risk language to facilitate the collection, analysis and synthesis of risk management data for risk aggregation and reporting. The framework is continually evolving and is periodically updated to reflect changes in the business and the external environment.

Governance is maintained through delegation of authority from the Board, down through the management hierarchy to individuals, and is supported by a committee-based structure designed to ensure that risk appetite, policies, procedures, controls and reporting are fully in line with regulations, law, corporate governance and industry best practice.

Board level engagement, coupled with the direct involvement of senior management in Group-wide risk issues at ExCo level, ensures that issues are promptly escalated and remediation plans are initiated, where required.

The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by both the Board and senior management. A strong control framework remains a priority for the Group and is the foundation for the delivery of effective risk management.

Line management is directly accountable for identifying and managing any risks inherent or consequential in their individual businesses. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite.

Assurance

The Group operates a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities.

- Business lines, as the 'First Line of Defence', hold the primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within areas of accountability.
- The 'Second Line of Defence' encompasses the risk oversight function, which is independent of the business and other functions, and includes compliance monitoring and risk reviews.
- The 'Third Line of Defence' is provided by Internal Audit. The Third Line provides independent assurance to senior management and the Board on the effectiveness of risk management policies, processes and practices in all areas.
- The Group's Internal Audit function performs independent audits of the risk management functions, on a periodic basis, to ensure that objectives are achieved. Any deficiencies are reported to management, with significant deficiencies reported to senior management and ARC.
- The Group utilises other forms of evaluation to obtain reasonable assurance about the effectiveness of its risk management functions as required.
- The Group may also periodically use independent consultants to assess the risk management governance structure and management processes.

Information technology and data risk management annual independent assurance reviews include

- Cyber Essential Standards Assessment and Penetration Test;
- External Information Technology Risk Assurance Review;
- Payment Card Industry Data Security Standard ('PCI DSS') Compliance; and
- External Cyber Security Review.

Risk appetite and culture

The Risk Appetite Statement ('RAS') provides an articulation of the Group's tolerance for risk in both quantitative measures and qualitative terms. A clearly defined RAS allows the setting of detailed risk appetite and reporting metrics for principal risks. The RAS sets out the level of risk that the Group is willing to take in pursuit of its business objectives. It has been created following discussions among the Group's executive management and the members of ARC and the Board. It is used in mapping key risks, assessing their materiality and ultimately for underpinning the Group's overall RMF.

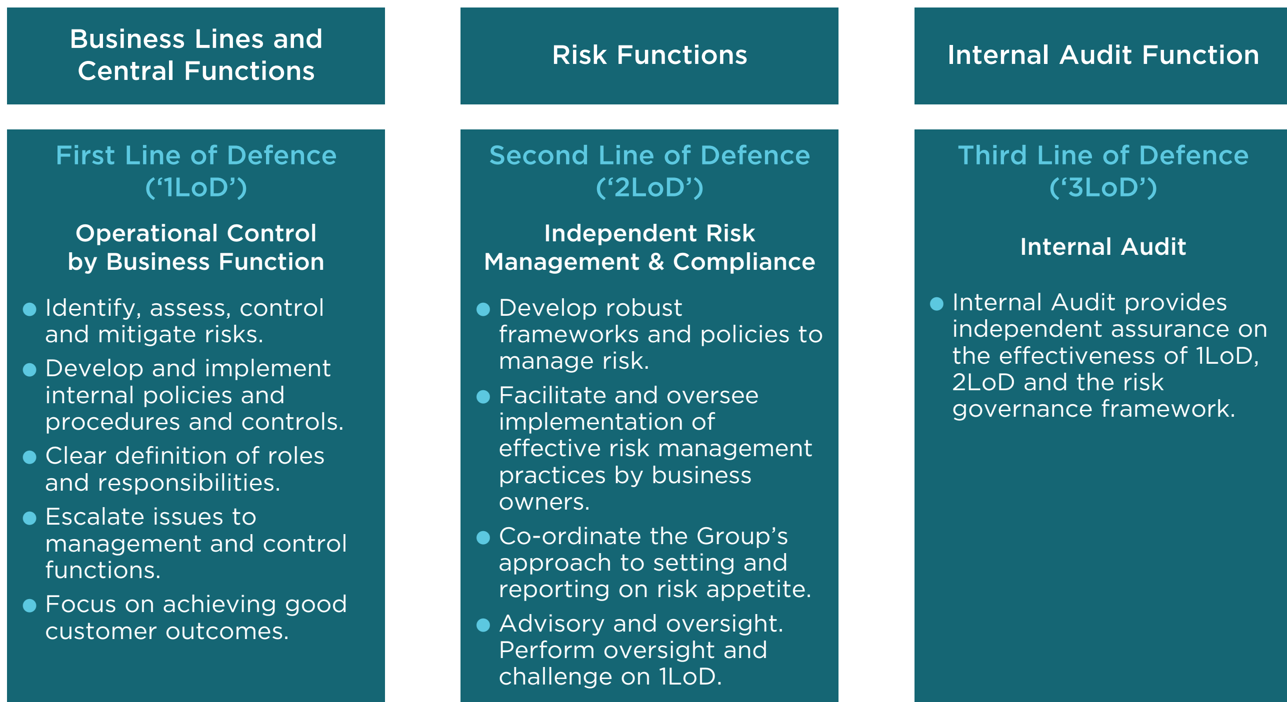
Throughout the year, all aspects of the risk appetite statements and metrics are reported to ARC and the Board by the Head of Risk & Compliance ('HoRC'). The HoRC is responsible for assessing the impact on the Group's risk appetite of any changes in circumstances, internal or external, that may warrant a change to the RAS and recommending any such changes to ARC and the Board ahead of the scheduled annual review.

The Board sets the risk appetite and culture and ensures that this is cascaded into day-to-day operations through policies, qualitative statements, risk appetite metrics, limits, Board and committee review, monitoring and assurance, recruitment of competent employees, training and aligning remuneration to risk appetite.

Risk governance and oversight

The Group's business model is shaped by the assessment of risk and return, together with the management of those risks. The Group recognises the importance of embedding a framework within the organisation that puts in place controls to manage those risks on a continuous basis. Management of risk entails the identification and monitoring of risk regularly and testing that the business operates within the agreed limits.

The Group operates a 'Three Lines of Defence' governance model which defines clear responsibilities and accountabilities and ensures effective independent oversight and assurance activities take place covering key decisions. This model is summarised in the diagram below.



All 'Three Lines of Defence' are responsible for supporting and developing a culture of risk awareness and to support each other in ensuring fair outcomes for the business and its customers. In this way, risk management responsibilities are understood at all levels, ownership and accountability is clear and control and oversight is established throughout the Group.

Management establishes, with Board oversight, structures, reporting lines and appropriate authorities and responsibilities in the pursuit of the business objectives. They ensure that the Group's activities are conducted by staff with the necessary experience, technical capabilities and access to resources. Staff responsible for monitoring and enforcing compliance with the Group's risk policies have authority independent from the units they oversee.

It is the aim of the Risk and Compliance function to co-ordinate the management and reporting of the Group's risks, ensuring that risk management is fully integrated into the day-to-day activities of the business. The Group's approach to managing risk within the business is governed by the Board approved RAS and the Group's RMF. The Group will continually enhance, design, and implement a system of operational monitoring and internal controls to monitor and manage business risk. At the operational level, it is the responsibility of each business function to adhere to and effectively manage all Group mandated risk management processes and standards. The business provides periodic feedback to Group risk functions on the adequacy of risk management processes and standards in relation to their function.

A strong risk culture and good communication among the 'Three Lines of Defence' are important characteristics of good risk management governance.

First Line of Defence (Risk management by business functions)

The 'First Line of Defence' encompasses the controls that the Group has in place to deal with day-to-day business and manages risks in the business to pre-agreed tolerances or limits. It identifies, manages and monitors risk within each area of the business, reporting and escalating issues, as necessary, and evidences control.

Business lines have primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within areas of accountability. They are required to establish effective governance and control frameworks for their business areas that are compliant with Group policy requirements in order to maintain appropriate risk management skills and processes to act within the Group's risk appetite parameters set and approved by the Board.

Second Line of Defence (Independent risk control)
The 'Second Line of Defence' encompasses the risk oversight function, which is independent of the business and other functions. The second line supports a structured approach to risk management by maintaining and implementing the RMF and Group-wide risk policies and monitoring their proper execution by the 'First Line of Defence'. It also provides independent advice and oversight on risks relevant to the Group's strategy and activities, maintains an aggregate view of risk, monitors performance in relation to the Group's risk appetite, monitors changes in and compliance with external regulation, undertakes compliance monitoring and risk reviews and promotes best practice.

The 'Second Line of Defence' reports systematically and promptly to the Board, ARC and senior management about risk management, in particular about perceived new risks or failures of existing controls.

Third Line of Defence (Audit & governance)
Internal Audit will provide independent assurance to the Board through ARC that the First and Second Lines of Defence are both effective in discharging their respective responsibilities. The use of independent compliance monitoring and risk reviews will provide additional support to the integrated assurance programme and ensures that the Group is effectively identifying, managing and reporting its risks.

Approach to assurance
The methods of assurance are

- Self-review - Line management periodically review processes, systems and activities to ensure that all risk management processes continue to be effective and appropriate;
- Risk review, including Risk Control Assessment ('RCA') and compliance monitoring - The purpose is to confirm the continued effectiveness of the management of risk within the business. This includes identification of potential control failures;
- Internal Audit – As part of an agreed audit programme, internal audit will provide the Group with risk based and timely assurance on important aspects of the Group's risk management control frameworks and practices. It is the responsibility of all business heads to provide responses to audit findings that focus on addressing root causes within the agreed timescales; and
- External reviews – ARC receives reporting from the external auditor periodically throughout the year on matters concerning their areas of risk focus, the results of the audit, financial control observations as well as any audit differences identified. ARC may also commission third parties to undertake specific reviews on matters, as considered necessary.

Risk identification, measurement and control
The 'Three Lines of Defence' model is governed and controlled as described in the diagram below and is supplemented by independent external audit and regulators.

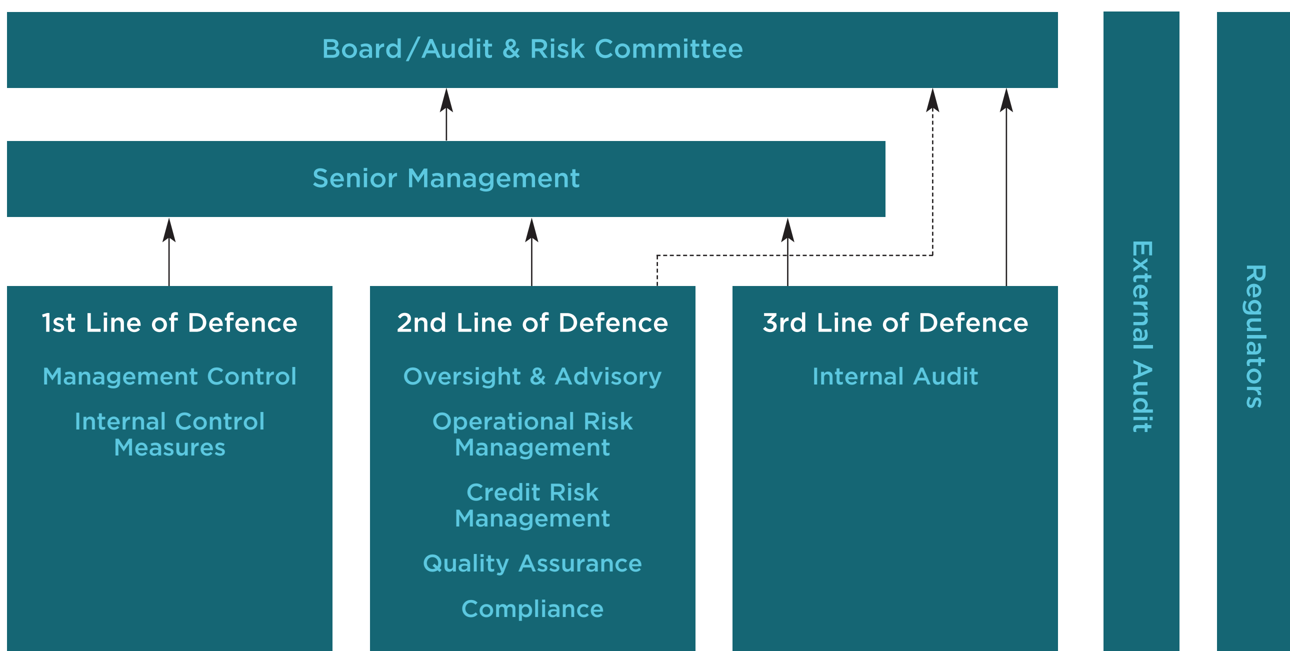
Each line of defence reports independently of the others to senior management. In addition, 'Second Line of Defence' has a 'dotted' reporting line to ARC, and 'Third Line of Defence' reports directly to ARC.

The process of identifying risk exposures is key to the success of the risk management process as all other elements of the process flow from this initial step. It is crucial, therefore, that a thorough process of risk identification is accomplished on a regular basis.

The process for risk identification, measurement and control is integrated into the overall framework for risk governance. Risk identification processes are forward-looking to ensure emerging risks are identified. Risks are captured in a comprehensive risk register and measured using robust and consistent quantification methodologies.

The measurement of risks includes the application of sound stress testing and scenario analysis and considers whether relevant controls are in place before risks are incurred.

When risks have been identified and assessed, the relevant business areas determine an appropriate method for addressing those risks.



PCF GROUP

ILAAP, ICAAP and stress testing

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

The ICAAP and ILAAP are reviewed on at least an annual basis and more often in the event of a material change in capital or liquidity. Ongoing 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 and the setting of risk appetite limits. ARC is responsible for reviewing and approving assumptions and stress scenarios in the planning stages of the ICAAP and ILAAP, including substantive changes to the previous assessment. ALCO will review, challenge and recommend to ExCo and the Board, for approval, the Group's ICAAP and ILAAP.

The Board and senior 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 variant test on capital prescribed by the PRA, the stress tests have included a range of Group-wide, multi-risk category stress tests, market-wide and idiosyncratic financial shocks and 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 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 PRA under the ICAAP and ILAAP processes.

Recovery Plan and Resolution Pack

The Group has prepared and submitted a Recovery Plan and Resolution Pack ('RP&RP') in accordance with PRA Supervisory Statements SS18/13 and SS19/13 and submitted it to the PRA following Board approval.

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 management to withstand and recover from such an environment.

The Group will conduct a review of the Recovery Plan on at least an annual basis and a review on the Resolution Pack on at least a bi-annual basis, or more frequently in the event of a material change in the Group's status, capital or liquidity position. The Board and senior management are fully engaged in considering the scenarios and options available for remedial actions to be undertaken.

The Board considers that the Group's public status, its business model and the diversified nature of its business markets provide 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 Recovery Plan and Resolution Pack if required.

Independent Auditor's Report

to the members of PCF Group plc
for the year ended 30 September 2019

Opinion

In our opinion

- PCF Group plc's group financial statements and parent company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the parent company's affairs as at 30 September 2019 and of the Group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of PCF Group plc which comprise

Group

- Consolidated income statement for the year then ended;
- Consolidated balance sheet as at 30 September 2019;
- Consolidated statement of comprehensive income for the year then ended;
- Consolidated statement of changes in equity for the year then ended;
- Consolidated statement of cash flows for the year then ended; and
- Related notes 1 to 34 to the financial statements, including a summary of significant accounting policies.

Parent company

- Balance sheet as at 30 September 2019;
- Statement of changes in equity for the year then ended;
- Statement of cash flows for the year then ended; and
- Related notes 1 to 34 to the financial statements including a summary of significant accounting policies.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards to the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

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

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

Conclusions relating to going concern

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

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

Overview of our audit approach

Key audit matters

- Risk of fraud in the recognition of revenue in respect of the application of the effective interest rate methodology.
- Impairment of loans and advances to customers as per IFRS 9 expected credit loss model.
- Purchase price allocation and disclosure of acquisition of Azule Limited.

Audit scope

- We performed an audit of the complete financial information of Group and parent company.
- Our Group audit scope included all PCF Group plc trading subsidiaries (two non-trading subsidiaries were excluded).

Materiality

- Overall group materiality of £400,000, which represents 5% of Profit Before Tax.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk

Risk of fraud in the recognition of revenue in respect of the application of the effective interest rate ('EIR') methodology

Interest and similar income £34,499 million (2018 – £25,494 million).

Refer to the Audit & Risk Committee Report on page 29, accounting policies (note 1.6.1) and note 4 of the financial statements.

For certain product fees, the Group operates a model to recognise fee income (included within Interest Income) under the effective interest method. The effective interest method spreads the recognition of product fee income over the life of the financial instrument, as these are in substance an integral part of the overall yield.

Effective interest rate models are sensitive to judgements about the expected lives of the product to which they relate. Due to the complexity of calculations, the degree of judgement exercised by the Group in respect of the expected lives of the product and the different products for which fees are recognised, this is considered a key audit matter.

Our response to the risk

We identified and tested the design and, where relevant, the operating effectiveness of key controls over the effective interest rate model. We determined that we could place reliance on these controls for the purposes of our audit. This is with the exception of interest booked within Azule Limited, for which we concluded that we could not rely on controls, and so we took a fully substantive approach.

We tested the key assumptions used in the EIR calculation including the expected lifecycle of the products. We concluded that the model is appropriate.

We utilised an independent leasing valuation specialist to recalculate the finance lease income using EIR methodology for each product on sample basis. In addition we recalculated finance lease income on a sample of leases and tested completeness and accuracy of data through reconciliation to source systems.

We tested that fees and commissions were appropriately included in the EIR calculations in accordance with the accounting standards.

We selected a risk-based sample of journal entries and examined the journals for validity and appropriateness.

Key observations communicated to the Audit & Risk Committee

We concluded to the Audit & Risk Committee that the EIR calculations and methodology were in accordance with accounting policies and standards and interest income was appropriately derived.

Our testing of journal entries did not highlight any issues and there was no evidence of management override of controls from the sample of journals we examined.

Impairment of loans and advances to customers as per IFRS 9 expected credit loss model

Loans and advances to customers.
£338,503 million (2018 – £219,322 million).

Impairment on loans and advances.
£7,647 million (2018 – £4,370 million).

Refer to the Audit & Risk Committee Report on page 29, accounting policies (note 1.5.3) and note 16 of the financial statements.

The application of IFRS 9 results in fundamental changes to how impairment provisions are determined as IFRS 9 requires a forward looking assessment of expected loss, as opposed to the incurred loss model used under IAS 39. There are also significant changes in disclosures.

Impairment of loans and advances carries a high degree of estimation uncertainty derived from key model assumptions used to build the provision. Such assumptions include probabilities of default, loss given default, exposure at default, assessment of significant increase in credit risk, incorporation of forward-looking information and appropriateness of the staging.

Given the level of judgement and subjectivity involved, there is a risk that the impairment provision could be materially misstated.

Our response to the risk

We understood and evaluated the design effectiveness of key controls. We concluded that there was a lack of sufficient controls over the ECL provision including review of input and output data, data validation, model governance and model testing. Accordingly, we adopted a fully substantive approach.

We read all accounting interpretations and assessed for compliance with IFRS 9.

We performed testing over the completeness and accuracy of the data inputs into the IFRS 9 model.

EY credit risk specialists supported our audit of the IFRS 9 model design, operation integrity, assumptions used, staging methodology and criteria.

We understood and challenged management's key model assumptions and any changes including macro economic factors, the relationship between economic parameters and credit risk, and the methodology for determining significant increases in credit risk.

We tested the mathematical accuracy to confirm internal consistency of the formulae used within the models. We assessed whether material post model adjustments made were appropriate.

We assessed the sensitivity analysis over inputs and assumptions performed by management.

We agreed the quantitative disclosures to source data and assessed the consistency of qualitative disclosures with accounting policies, model documentation and risk governance papers.

Key observations communicated to the Audit & Risk Committee

We concluded to the Audit & Risk Committee that following our challenge of the approach taken in a number of areas, the impairment models and assumptions employed by the Group were reasonable as at 30 September 2019, and for opening balances as at 1 October 2018. We noted that the provision levels held in relation to credit impairment were reasonably estimated and in line with the requirements of IFRS 9.

We highlighted to the Audit & Risk Committee the control observations set out in the 'Our response to the risk' column.

Purchase price allocation and disclosure of acquisition of Azule Limited

Goodwill and other intangible assets relating to the acquisition of Azule Limited £2,500,000 (2018 – nil).

Refer to the Audit & Risk Committee Report on page 29, accounting policies (note 1.6.21), note 2 and 19 of the financial statements.

On 5 November 2018, the Group acquired 100% shareholding of Azule Limited. Accounting standards require the directors to determine the fair value of assets and liabilities acquired including identification of intangible assets on acquisition date and fair value of consideration. Additionally, there is a requirement to perform a purchase price allocation of goodwill, and whether any portion should be reclassified to purchased intangible assets, such as brands or customer lists, if any.

Due to complexity of calculations, degree of judgement in determining fair values and the inherent ability of management to override internal controls in relation to fair value estimation, this is considered a key audit matter.

Our response to the risk

We understood and evaluated the design effectiveness of key controls. We concluded that we could not rely on controls over the acquisition process including valuation methodology, determination of discount rate and identification of intangible assets. Accordingly, we adopted a fully substantive approach.

We examined the agreements and legal documentation entered into for the acquisition of Azule Limited to understand the nature of the transaction.

We tested the key assumptions used, including valuation methodology adopted, reasonableness of future cash flows and discount rate used for determination of fair value of assets and liabilities of Azule Limited on acquisition date.

The directors did not identify any intangible assets other than goodwill. In the absence of a detailed, documented analysis to support this, we engaged EY valuation specialists to challenge this assumption.

We tested the assumptions and methodologies used for determination of fair value of consideration.

We validated that the acquisition of the subsidiary was appropriately accounted for in the financial statements, and that appropriate disclosures have been made.

Key observations communicated to the Audit & Risk Committee

We concluded to the Audit & Risk Committee that following our challenge of the approach taken in determining the fair values and discount rate used (following which updates were made by management), that the methodologies adopted by the Group were appropriate.

We reported that we concurred with the directors' assessment that there were no material, separately identifiable intangible assets, other than goodwill.

Our testing concluded that acquisition transaction was correctly accounted for and appropriately disclosed in the Group financial statements.

We addressed the risk of management override of controls leading to material misstatement, through the execution of our audit procedures in response to the three risks of fraud outlined.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of Group wide controls, changes in the business environment and other factors such as recent internal audit results when assessing the level of work to be performed at each entity. All the Group's subsidiary entities, except for two non-trading entities, were subject to a full scope audit; all work was performed by the UK audit team.

Our application of materiality

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

Materiality

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

We determined materiality for the Group to be £400,000 (2018 – £259,000), which is 5% (2018 – 5%) of statutory profit before tax. We believe that profit before tax is the most appropriate basis for determining our materiality as it is one the most important considerations for shareholders of the Group in assessing the financial performance of the Group, and is consistent with the wider industry and is the standard for listed and regulated entities. Materiality has increased since the prior year due to higher levels of profitability of the Group.

We determined materiality for the Parent Company to be £350,000 (2018 – £240,000), which is 1% (2018 – 1%) of net equity. Materiality has increased since the prior year, principally due to the issuance of shares during the period.

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% (2018 – 75%) of our planning materiality, namely £200,000 (2018 – £194,000). We have set performance materiality at this percentage due to the extent of audit differences identified during the prior year audit.

Audit work at component level for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £40,000 to £150,000 (2018 – £146,000).

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit & Risk Committee that we would report to them all uncorrected audit differences in excess of £20,000 (2018 – £13,000), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the Annual Report set out on pages 2 to 42, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

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

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 38, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

Use of our report

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

Gary Adams (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP
Statutory Auditor
London

12 February 2020

Notes

1 The maintenance and integrity of the PCF Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated Income Statement

for the year ended 30 September 2019

	Note	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Interest revenue calculated using the effective interest method	4	**34,499**	25,494
Interest expense calculated using the effective interest method	5	**(12,884)**	(10,492)
Net interest income		**21,615**	15,002
Fees and commission income		**1,815**	492
Fees and commission expense		**(1,154)**	(844)
Net fees and commission income/(expense)	6	**661**	(352)
Net loss on financial instruments mandatorily at fair value through profit or loss		**(63)**	–
Net operating income		**22,213**	14,650
Personnel expenses	8	**7,640**	5,186
Depreciation of office equipment, fixtures, fittings and motor vehicles	18	**137**	84
Amortisation of intangible assets	19	**416**	385
Other operating expenses	10	**3,827**	2,907
Impairment loss on financial assets	7	**2,175**	915
Total operating expenses		**14,195**	9,477
Profit before tax		**8,018**	5,173
Income tax charge	11	**(1,624)**	(981)
Profit after tax		**6,394**	4,192
Earnings per 5p ordinary share – basic and diluted	12	**2.7p**	2.0p

Consolidated Statement of Comprehensive Income

for the year ended 30 September 2019

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Profit after taxation	**6,394**	4,192
Other comprehensive income that will be reclassified to the income statement		
Fair value (loss)/gain on AFS financial instruments (note 1.5.3)	**–**	18
Fair value loss on FVOCI financial instruments (note 1.5.3)	**(10)**	–
Deferred tax income/(expense)	**2**	(3)
Total items that will be reclassified to the income statement	**(8)**	15
Total comprehensive income, net of tax	**6,386**	4,207

The accounting policies and notes on pages 52 to 95 form part of, and should be read in conjunction with, these financial statements. All activities in the current and prior year relate to continuing operations.

Consolidated Balance Sheet

at 30 September 2019

		Group		Company	
	Note	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Asset					
Cash and balances at central banks	13	**7,371**	21,338	**123**	11
Debt instruments at FVOCI	14	**19,638**	–	**–**	–
Available-for-sale financial instruments	15	**–**	39,902	**–**	–
Loans and advances to customers	16	**338,503**	219,322	**–**	–
Due from Group companies		**–**	–	**6,927**	2,912
Investment in subsidiary undertakings	17	**–**	–	**32,000**	22,000
Office equipment, fixtures, fittings and motor vehicles	18	**579**	224	**–**	–
Other assets	21	**4,932**	1,542	**896**	817
Deferred tax assets	20	**1,105**	1,185	**135**	196
Goodwill and other intangible assets	19	**5,941**	2,957	**–**	–
Total assets		**378,069**	286,470	**40,081**	25,936
Liabilities					
Due to banks	22	**44,412**	48,881	**–**	–
Due to customers	23	**267,070**	191,139	**–**	–
Due to Group companies		**–**	–	**3,239**	–
Derivative financial instruments	25	**63**	–	**–**	–
Current tax liabilities		**1,521**	414	**–**	–
Other liabilities	26	**6,248**	3,485	**1,692**	1,551
Total liabilities		**319,314**	243,919	**4,931**	1,551
Equity					
Issued capital	27	**12,510**	10,611	**12,510**	10,611
Share premium	27	**17,619**	8,527	**17,619**	8,527
Other reserves	27	**7**	15	**–**	–
Own shares	27	**(355)**	(355)	**(355)**	(355)
Retained earnings		**28,974**	23,753	**5,376**	5,602
Total equity		**58,755**	42,551	**35,150**	24,385
Total liabilities and equity		**378,069**	286,470	**40,081**	25,936

The Company reported a profit for the financial year ended 30 September 2019 of £445,000 (year ended 30 September 2018 – profit of £nil).

The financial statements were approved and authorised for issue by the Board on 7 February 2020.

On behalf of the Board

S D Maybury
Director

D R Bull
Director

The accounting policies and notes on pages 52 to 95 form part of, and should be read in conjunction with, these financial statements. All activities in the current and prior year relate to continuing operations.

Consolidated Statement of Changes in Equity

for the year ended 30 September 2019

	Attributable to equity holders of the Group					
	Non-distributable				Distributable	
Group	Issued capital £'000	Share premium £'000	Own shares £'000	Other reserves £'000	Retained earnings £'000	Total equity £'000
Balance at 1 October 2018	10,611	8,527	(355)	15	23,753	42,551
Impact on transition to IFRS 9	–	–	–	–	(502)	(502)
Restated balance at 1 October	10,611	8,527	(355)	15	23,251	42,049
Profit for the year	–	–	–	–	6,394	6,394
Issuance of new shares	1,899	9,092	–	–	–	10,991
Fair value loss on FVOCI financial instruments	–	–	–	(8)	–	(8)
Share-based payments	–	–	–	–	79	79
Cash dividends	–	–	–	–	(750)	(750)
Balance at 30 September 2019	12,510	17,619	(355)	7	28,974	58,755
Balance at 1 October 2017	10,611	8,524	(355)	–	19,880	38,660
Profit for the year	–	–	–	–	4,192	4,192
Issuance of new shares	–	3	–	–	–	3
Fair value loss on AFS financial instruments	–	–	–	15	–	15
Share-based payments	–	–	–	–	84	84
Cash dividends	–	–	–	–	(403)	(403)
Balance at 30 September 2018	10,611	8,527	(355)	15	23,753	42,551

	Attributable to equity holders of the Company				
	Non-distributable			Distributable	
Company	Issued capital £'000	Share premium £'000	Own shares £'000	Retained earnings £'000	Total equity £'000
Balance at 1 October 2018	10,611	8,527	(355)	5,602	24,385
Profit for the year	–	–	–	445	445
Issuance of new shares	1,899	9,092	–	–	10,991
Share-based payments	–	–	–	79	79
Cash dividends	–	–	–	(750)	(750)
Balance at 30 September 2019	12,5109	17,619	(355)	5,376	35,150
Balance at 1 October 2017	10,611	8,524	(355)	5,921	24,701
Profit for the year	–	–	–	–	–
Issuance of new shares	–	3	–	–	3
Share-based payments	–	–	–	84	84
Cash dividends	–	–	–	(403)	(403)
Balance at 30 September 2018	10,611	8,527	(355)	5,602	24,385

The accounting policies and notes on pages 52 to 95 form part of, and should be read in conjunction with, these financial statements. All activities in the current and prior year relate to continuing operations.

Consolidated Statement of Cash Flows

for the year ended 30 September 2019

		Group		Company	
	Note	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Operating activities					
Profit before tax		**8,018**	5,173	**558**	33
Other non-cash items included in profit/(loss) before tax					
Depreciation of office equipment, fixtures, fittings and motor vehicles	18	**137**	84	**-**	–
Amortisation of other intangible assets	19	**416**	385	**-**	–
Net change in AFS financial instruments		**-**	15	**-**	–
Net change in FVOCI financial instruments		**(8)**	–	**-**	–
Share-based payments		**79**	34	**79**	34
Impairment losses on financial assets	7	**2,175**	915	**-**	–
Income tax (paid)/due		**(633)**	(668)	**(113)**	–
Adjustment for change in operating assets					
Net change in loans and advances		**(106,348)**	(74,519)	**-**	4,853
Net change in Group company lending		**-**	–	**(4,015)**	–
Net change in other assets		**(2,231)**	(502)	**(18)**	57
Change in operating liabilities					
Net change in derivative financial instruments		**63**	–	**-**	–
Net change in amounts due to customers		**75,931**	138,019	**-**	–
Net change in Group company borrowing		**-**	–	**3,239**	–
Net change in other liabilities		**(1,492)**	31	**141**	416
Net cash flows from/(used in) operating activities		**(23,893)**	68,967	**(129)**	5,393
Investing activities					
Cash paid for Investment in subsidiary		**(2,283)**	–	**(10,000)**	(5,000)
Net sale of debt instruments at FVOCI		**20,264**	–	**-**	–
Net purchase of AFS financial instruments		**-**	(35,390)	**-**	–
Purchase of office equipment, fixtures, fittings and motor vehicles	18	**(384)**	(36)	**-**	–
Purchase of intangible assets	19	**(900)**	(637)	**-**	–
Net cash flows from/(used in) investing activities		**16,697**	(36,063)	**(10,000)**	(5,000)
Financing activities					
Proceeds from share issue during the year		**10,991**	3	**10,991**	3
Net proceeds from borrowings	24	**(17,012)**	(28,184)	**-**	–
Dividends paid to equity holders		**(750)**	(403)	**(750)**	(403)
Net cash flows (used in)/from financing activities		**(6,771)**	(28,584)	**10,241**	(400)
Net increase/(decrease) in cash and cash equivalents		**(13,967)**	4,320	**112**	(7)
Cash and cash equivalents brought forward		**21,338**	17,018	**11**	18
Cash and cash equivalents carried forward		**7,371**	21,338	**123**	11

The accounting policies and notes on pages 52 to 95 form part of, and should be read in conjunction with, these financial statements. All activities in the current and prior year relate to continuing operations.

Notes to the Financial Statements
for the year ended 30 September 2019

1 Basis of preparation and significant accounting policies

1.1 Corporate information
PCF Group plc (the 'Company') is a public company limited by shares, registered in England and domiciled in the United Kingdom together with its subsidiaries (collectively, the 'Group'). The Company's ordinary shares are listed on the Alternative Investment Market ('AIM') of the London Stock Exchange. The Company's registered office is at Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

The wholly owned subsidiary PCF Bank Limited (the 'Bank') is a specialist bank, offering retail savings products for individuals and lending products for consumers and businesses to finance motor vehicles, plant, bridging finance, equipment and property.

The Group's consolidated financial statements for the year ended 30 September 2019 were authorised for issue in accordance with a resolution of the Board on 7 February 2020.

1.2 Basis of preparation
The consolidated financial statements of the Group have been prepared on a historical cost basis, except for debt financial instruments at fair value through other comprehensive income ('FVOCI') and derivatives at fair value through profit or loss ('FVTPL'). The financial statements are presented in Pound Sterling (£) and all values are rounded to the nearest thousand (£'000), except where otherwise indicated.

1.3 Statement of compliance
The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ('IFRS'), as adopted by the European Union ('EU'), interpretations issued by the International Accounting Standards Board ('IASB') and the Companies Act 2006.

1.4 Basis of consolidation
All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions which are recognised in assets or liabilities, are eliminated in full.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases.

No income statement is presented for the Company as permitted by section 408 of the Companies Act 2006. Of the profit for the financial year, £445,000 (30 September 2018 – £nil) was attributable to the Company.

1.5 Summary of significant accounting policies

1.5.1 New standards, interpretations and amendments adopted by the Group
From 1 October 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 for the Group. New and revised standards adopted in the year that are deemed significant to the Group are outlined below. A number of other new standards are also effective from 1 October 2018, but they do not have a material effect on the Group's financial statements.

1.5.2 Changes in accounting policies and disclosures
The accounting policies applied by the Group differ from those in the 2018 Annual Report, partly due to new standards and interpretations becoming effective. The following amendments to standards have been disclosed, as they were applied for the first time in the 2019 financial year, resulting in consequential changes to the accounting policies and other note disclosures, where applicable.

- IFRS 9 'Financial Instruments'
- IFRS 15 'Revenue from Contracts with Customers'

IFRS 9 'Financial instruments'
IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' with effect for the Group from 1 October 2018, in line with the Standard's requirements of applying the Standard for financial periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments; classification and measurement, impairment, and hedge accounting.

Accounting policies for comparative information measured under IAS 39 are disclosed in the 2018 Annual Report.

Transition

On implementation, the Group has not provided a full restatement of comparatives but has instead reflected changes through the opening balance of retained earnings, as permitted by IFRS 9, and disclosed in the financial statements under consolidated statement of changes in equity.

Classification and measurement

IFRS 9 makes changes to the measurement categories for financial assets and liabilities, with the former categories under IAS 39 such as ‘available-for-sale’ (‘AFS’) and ‘held to maturity’ being replaced.

The measurement categories under IFRS 9 are

- assets, primarily the Group’s conditional sale, hire purchase and personal loan receivables, which are deemed to consist solely of payments of principal and interest (‘SPPI’) and are intended to be held and collected and not sold, are held at amortised cost (note 1.5.3);
- instruments meeting the SPPI criteria, but which may be sold, which are held at fair value through other comprehensive income (‘FVOCI’) (note 1.5.3); and
- assets not meeting the SPPI criteria and not classified under FVOCI, such as derivatives, which are held at fair value through profit or loss (‘FVTPL’).

The accounting for the Group’s financial liabilities remains the same as it was under IAS 39.

The Group’s approach to the adoption of IFRS 9 and a reconciliation of the changes from IAS 39 are set out in note 1.5.3, which applied from 1 October 2018. This resulted in an increase in impairment provisions previously held under IAS 39, which was adjusted through retained earnings. IFRS 9 was applied retrospectively, but the Group did not restate comparatives as permitted by IFRS 9.

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 at 1 October 2018.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 at 30 September 2018 £’000	New carrying amount under IFRS 9 at 1 October 2018 £’000
Financial assets				
Cash and balances at central banks	Loans and receivables	Amortised cost	21,338	21,338
Loans and advances to customers	Loans and receivables	Amortised cost	219,322	218,718
Quoted debt instruments	Available-for-sale	FVOCI	39,902	39,902
Total financial assets			280,562	279,958
Due to banks	Amortised cost	Amortised cost	48,881	48,881
Due to customers	Amortised cost	Amortised cost	191,139	191,139
Total financial liabilities			240,020	240,020

The movement in ‘Loans and advances to customers’ is explained below and is due to an increase in the impairment provision from IAS 39 to IFRS 9.

1 October 2018

Loan provisions	Under IAS 39 £’000	Increase under IFRS 9 £’000	PMA £’000	Total provision £’000	Day one adjustment £’000
Consumer Finance	2,286	77	14	2,377	91
Business Finance	2,084	498	15	2,597	513
	4,370	575	29	4,974	604

Post Model Adjustment (‘PMA’) is a provision overlay.

Derivative financial instruments

The Group uses derivative financial instruments in the form of interest rate swaps to manage its exposure to the interest rate risk. In accordance with its treasury policy, the Bank does not hold or issue derivatives for proprietary trading.

Derivatives are entered into only for the purposes of matching or eliminating risk from potential movements in interest rates in the Bank’s assets and liabilities. The Bank uses the International Swaps and Derivatives Association Master Agreement to document these transactions in conjunction with a Credit Support Annex.

The derivatives are not designated as part of an accounting hedge relationship, and 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 Income Statement. To calculate fair values, the Bank typically applies discounted cash-flow models using yield curves that are based on observable market data. For collateralised and non-collateralised positions, the Bank uses discount curves based on overnight indexed swap rates.

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 on a net basis, then the derivative is classified as a net asset or net liability, as appropriate.

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. At 30 September 2019, net cash collateral posted is nil (2018 – nil).

IFRS 15 'Revenue from contracts with customers'

IFRS 15 'Revenue from contracts with customers' supersedes IAS 11 'Construction Contracts', IAS 18 'Revenue and related Interpretations' and applies to all revenue arising from contracts with customers, unless those contracts are in the scope of other standards. The new standard establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The standard requires entities to exercise judgement, taking into consideration all the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. IFRS 15 is effective for the Group from 1 October 2018.

The Group has assessed the impact of the above and concluded that there is no material impact due to the nature of its business.

1.5.3 Financial Instruments – initial recognition and subsequent measurement

Date of recognition

Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, are initially recognised on the trade date (i.e. the date on which the Group becomes a party to the contractual provisions of the instrument). This includes regular way trades, (i.e. purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place). Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Group recognises balances due to customers when funds are transferred to the Group.

Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments, as described in note 1.5.2. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities subsequently measured at FVTPL, transaction costs are added to, or subtracted from, this amount. Trade receivables are measured at the transaction price.

Measurement categories of financial assets and liabilities

From 1 October 2018, the Group classifies all its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either

- amortised cost, as explained in note 1.5.2; or
- FVOCI, as explained in note 1.5.2.

Financial liabilities are measured at amortised cost, and derivatives at FVTPL (note 1.5.2).

Financial assets and financial liabilities

Balances at central banks, loans and advances to customers, other assets at amortised cost

From 1 October 2018, the Group measures balances at central banks, loans and advances to customers and other assets at amortised cost if both of the following conditions are met.

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows.
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ('SPPI') on the principal amount outstanding.

The details of these conditions are outlined as follows.

Business model assessment

The Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed.
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

The expected frequency, value and timing of sales are also important aspects of the Group's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group does not change the classification of the remaining financial assets held in that business model but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process, the Group assesses the contractual terms of the financial asset to identify whether they meet the solely payments of principal and interest (SPPI) test. The Group's loans assets of Hire Purchase and Conditional Sales Agreements are repaid by instalments of principal and interest with a fee upfront. These meet the SPPI test.

'Principal', for the purpose of this test, is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (e.g. if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Group applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than *de minimis* exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVTPL.

Debt instruments at FVOCI

The Group applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met.

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets.
- The contractual terms of the financial asset meet the SPPI test.

These instruments largely comprise assets that had previously been classified as financial investments available-for-sale under IAS 39.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income and foreign exchange gains and losses are recognised in profit or loss. The calculation of Expected Credit Losses ('ECL') for debt instruments at FVOCI is explained in note 1.5.3. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

Due to banks and due to customers

After initial measurement, due to banks and due to customers are subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issued funds, and costs that are an integral part of the EIR.

Reclassification of financial assets and liabilities

From 1 October 2018, the Group does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Group acquires, disposes of, or terminates a business line. Financial liabilities are never reclassified. The Group did not reclassify any of its financial assets or liabilities for the year ended 30 September 2019.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where

- the rights to receive cash flows from the asset have expired; or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset, nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability.

Impairment of financial assets

From 1 October 2018, the Group is required to recognise Expected Credit Losses ('ECL') based on unbiased forward-looking information for all financial assets at amortised cost, lease receivables, debt financial assets at fair value through other comprehensive income, loan commitments and financial guarantee contracts.

The Group uses the three-stage model for determination of expected credit losses. (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 the segment, as defined below. (iii) For loans that are in default, the Bank undertakes a specific impairment assessment. For loans classified as Stage 1, 2 or 3, 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-looking information.

In addition, for loans that are greater than £100,000 in Stage 3, a further review of the recoverability of the exposure is performed. This includes assessing the value of any collateral held and what form of recovery action the Bank has assessed the exposure to be in. Recoverable actions could include achieving a repayment plan, or charging order.

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 exposure's remaining lifetime Probability of Default ('PD') at the reporting date compared to the expected residual lifetime PD when the exposure 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.

Definition of default, credit-impaired assets, cures, write-offs and interest income recognition

The definition of default for the purpose of determining ECLs has been aligned to the Capital Requirements Regulation ('CRR') article 178 definition of default to maintain a consistent approach with IFRS 9. When exposures are identified as credit impaired, such interest income is calculated on the carrying value, net of the impaired allowance.

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 more than 90 days past due on any material credit obligation to the Group;
- significant financial difficulty of the issuer or the borrower;
- a breach of contract, such as default or past due event; and
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation.

When a loan falls into default and a formal process of recovering the loan has taken place, the loan will initially be fully impaired. The recovery will include a number of actions such as selling the underlying assets and agreeing an arrangement to repay. The Group will assess the likeliness of full recovery and assign each loan into categories for which each will have a different recovery percentage assigned.

The Bank writes off an impaired financial asset, and the related impairment allowance, either partially or in full, when there is no realistic prospect of recovery. Where financial assets are secured, write-off is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier. All write-offs are written down to the average value of a future debt sale. In subsequent periods, any recoveries of amounts previously written off are credited to the provision for credit losses in the profit or loss statement.

The impairment policy does not allow an exposure to be cured (i.e. once a loan goes into default, it stays in default).

Forward-looking information
Expected credit losses ('ECL')

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 use 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. 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.
- 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.
- PCF Group has adopted the general approach for ECLs.

The Group considers three forward-looking economic indicators for each business line as follows.

	Consumer finance	Business finance	Azule finance
Unemployment rate	✓	✓	✓
ONS Used Car Price Index	✓		
CPI	✓	✓	✓
GDP		✓	✓

The key source of these data sets is the Office of National Statistics ('ONS').

The Group considers these indicators in forming the baseline, optimistic and pessimistic scenarios. The scenarios for UK economic growth, inflation, residential property prices and unemployment have been benchmarked against the UK banking sector as a whole. For the used car index, data has been obtained from the ONS and extrapolated for each scenario consistently with the other data. Bridging finance will use these indicators as the book grows. Currently an estimate is made as part of a post model adjustment whilst historical data is collected.

The method of weighting the economic scenarios was based on the Board's view of key risks to the Group's loan book. The Board's key risks were the Brexit outcome and the credit environment. In both cases it was thought there was more uncertainty on the Brexit outcome and a deterioration of the credit environment, mainly seen in the increase of business failures, thus giving rise to increase in weighting. Whilst the overall pessimistic weighting has increased, the Board also concluded that there continues to be favourable outcomes such as an orderly Brexit, to the extent that the optimistic weighting is unchanged from the first implementation of IFRS 9. In conclusion, the Board approved in September 2019 a reduction, from the initial weightings at 1 October 2018, in the base case weighting, from 80% to 65%, an increase in the optimistic weighting from 5% to 10% and an increase in the pessimistic weighting, from 10% to 25%. These scenarios are uniformly applied across all business lines. The changes for loans greater than £100k and in Stage 3 has increased the provision by £73,000.

Model calculation

The definitions of the ECL calculations are outlined below and the key elements are, as follows.

- The 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 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 in full, continued repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities and accrued interest from missed payments.
- The 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.

ECLs are calculated by multiplying three main components, being the PD, LGD and the EAD, discounted at the original Effective Interest Rate ('EIR').

Management adjustments are made to modelled output to account for situations where known or expected risk factors and information have not been considered in the modelling process.

Post model adjustment ('PMA')

The Group assesses the modelled output and where known or expected risk factors and information have not been considered in the modelling process the bank makes a PMA.

These are summarised as follows.

- Management apply a 0.05% provision of the capital balance for the Bridging portfolio. This is due to the lack of historical PD and LGD information in its first year of trading.
- Management has adjusted a customer's provision in Stage 3 due to specific knowledge on the valuation of assets and a charging order in place.
- Management has applied an estimated recovery on debts that will be passed to a debt sales agent based on historical debt sales income.

Total of the PMAs is a net reduction to the impairment provision of £0.3m.

Expected life

Lifetime ECLs must be measured over the expected life. This is restricted to the maximum contractual life and considers expected prepayment and extension.

Discounting

ECLs are discounted at the EIR at initial recognition or an approximation thereof and consistent with income recognition. Lease receivables are discounted at the rate implicit in the lease.

When estimating the ECLs, the model considers three scenarios, a base case, an upside and a downside. Each of these is associated with different PDs, EADs and LGDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered.

The model assesses both Stage 1 on a 12 month ECL and Stage 2 on a lifetime ECL basis.

For Stage 3 where loans are in default, but are not in a formal recovery process, the model above is followed and assesses ECL on a lifetime basis.

Those loans in formal recovery are assessed on a recovery basis having initially recognised a 100% impairment charge. The Group will assess the likelihood of full recovery and assign each loan into categories for which each will have a different recovery percentage assigned.

The baseline recovery rate is the current rate of recovery for the category and is routinely back tested for accuracy. Each category will have a pessimistic and optimistic rate. The pessimistic rate is formulated as the worst recovery rate achieved in the preceding ten years, excluding outliers. The optimistic rate is formed from the best recovery rates achieved over the past ten years and where the rate is at its highest level and used as the current rate, management has agreed a small increase of up to 5% to the current rate.

The Board agreed to take the worst recovery rates in the preceding ten years to further illustrate its concern around the implications of an unknown Brexit outcome.

The Group has an IFRS 9 Model Governance Control Framework which states its objective to ensure the models inputs and outputs are understood and agreed by relevant stakeholders. The models have continued to be developed through the year and will be expanded across all products in the future.

Critical accounting estimates and judgements

IFRS 9 impairment involves several important areas of judgement, including estimating forward-looking modelled parameters (PD, LGD and EAD), developing a range of unbiased future economic scenarios, estimating expected lives and assessing significant increases in credit risk, based on the Group's experience of managing credit risk.

Within the Business Finance and Consumer Finance portfolios, which comprise large numbers of small homogenous assets with similar risk characteristics, where credit scoring techniques are generally used, the impairment allowance is calculated using forward-looking modelled parameters which are typically run at a cohort level.

For assets in Stage 3, impairment allowances are calculated on an individual basis and all relevant considerations that have a bearing on the expected future cash flows across a range of recovery options are taken into account. These considerations can be subjective, but the recovery rates are routinely back-tested and used as the base case.

The Asset & Liability Committee considers the recovery rates, weightings and economic factors on at least a quarterly basis and, where necessary, puts forward changes to the Board for approval.

The adoption of the ECL requirements of IFRS 9 resulted in increases in impairment allowances of the Group's debt financial assets. The increase in allowance resulted in adjustment to retained earnings.

Upon adoption of IFRS 9, the Group recognised additional impairment on its loans and receivables of £604,457.

Set out below is the reconciliation of the ending impairment allowances in accordance with IAS 39 to the opening loss allowances determined in accordance with IFRS 9.

	Allowance for impairment under IAS 39 as at 30 September 2018 £'000	Remeasurement £'000	ECL under IFRS 9 as at 1 October 2018 £'000	ECL under IFRS 9 as at 30 September 2019 £'000
Consumer lending	2,286	91	2,377	3,048
Business lending	2,084	513	2,597	4,471
Azule lending	–	–	–	122
Bridging loans	–	–	–	6
	4,370	604	4,974	7,647

	£'000
Remeasurement of ECL under IFRS 9	604
Deferred tax on remeasurement	(102)
Change in Equity due to impact on transition to IFRS 9	502

Deferred tax asset will be deferred over a ten year period.

1.6 Significant accounting policies

With the exception of changes to the Bank's accounting policies resulting from new and revised accounting standards (note 1.5.1), the Bank has consistently applied the following accounting policies to all periods presented in the financial statements.

1.6.1 Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

Effective Interest Rate ('EIR') method

The Group's EIR methodology recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected behavioural life of loans and deposits and recognises the effect of potentially different interest rates charged at various stages and other characteristics of the product life cycle, including prepayments and penalty interest and charges. This estimation, by nature, requires an element of judgement regarding the expected behaviour and lifecycle of the instruments, as well as expected changes to the Bank of England Base Rate and other fee income/expense that are integral parts of the instrument.

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest-bearing financial assets classified as FVOCI, interest income or expense is recorded using the EIR method. The calculation takes into account all of the contractual terms of the financial instrument (e.g. prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

When the recorded value of a financial asset or a group of similar financial assets has been reduced by an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

1.6.2 Dividend income

Dividend income is recognised when the Group's right to receive the payment is established, which is generally when the shareholders approve the dividend.

1.6.3 Collateral valuation

The Group seeks to use collateral, where possible, to mitigate its risks on default of financial assets. The collateral is the asset subject to financing. The fair value of collateral is generally assessed, as a minimum, at inception.

1.6.4 Collateral repossessed

The Group's policy is to sell repossessed assets. Repossessed assets are sold typically through auction houses and should the asset generate a surplus over the outstanding debt, the surplus is returned to the borrower.

1.6.5 Leasing

The determination of whether an arrangement is a lease, or contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or whether the arrangement conveys a right to use or acquire ownership of the asset.

Group as a lessee

Leases that do not transfer to the Group substantially all of the risks and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. Contingent rental payable is recognised as an expense in the period in which it is incurred.

Group as a lessor

Leases where the Group does not transfer substantially all of the risk and benefits of ownership of the asset are classified as operating leases. Rental income is recorded as earned based on the contractual terms of the lease in other operating income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the year in which they are earned.

1.6.6 Fee and commission income

The Group earns fee and commission income from a range of services it provides to its customers.

Fee income, other than that accounted for using the EIR method, is recognised immediately and can be divided into the following two categories.

- Secondary lease income arising from finance leases which have completed their primary lease period.
- Fees earned from commissions, late payment charges and recharge of costs incurred from the recovery of assets under hire purchase and finance lease agreements.

1.6.7 Investment in subsidiaries

Investments in subsidiaries are initially and subsequently measured at cost. These are assessed for impairment in line with the accounting policy detailed in note 1.6.10.

1.6.8 Cash and cash equivalents

Cash and cash equivalents as referred to in the Consolidated Statement of Cash Flows comprise cash on hand, non-restricted current accounts with central banks and amounts due from banks on demand or with an original maturity of three months or less.

1.6.9 Office equipment, fixtures, fittings and motor vehicles

Office equipment, fixtures, fittings and motor vehicles are stated at cost excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Changes in the expected useful life are accounted for by changing the amortisation period or methodology, as appropriate, and treated as changes in accounting estimates.

Depreciation is calculated using the straight-line method to write down the cost of office equipment, fixtures, fittings and motor vehicles to their residual values over their estimated useful lives as follows.

Office equipment, fixtures and fittings	–	Between 3 to 10 years
Motor vehicles	–	4 years

Office equipment, fixtures, fittings and motor vehicles are derecognised on disposal or when no future economic benefits are expected from their use. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the asset, is recognised in other operating income in the income statement in the year the asset is derecognised.

1.6.10 Goodwill

Goodwill arising on acquisition represents the excess of the cost of a business over the fair values of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired. Goodwill is not amortised but is reviewed at least annually for impairment. For the purpose of impairment testing, goodwill is allocated to each Cash Generating Unit ('CGU'). Each CGU is consistent with the Group's primary reporting segments. Any impairment is recognised immediately through the income statement and is not subsequently reversed.

On disposal of an operation, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

1.6.11 Intangible assets

The Group's other intangible assets consist solely of computer software and capitalised expenses incurred in the project of applying to become a bank.

An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Group.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

Acquired software and subsequent enhancements are capitalised as intangible assets and amortised over their useful lives (3 to 10 years) on a straight-line basis. All other software development and maintenance costs are recognised as an expense as incurred. The assets' residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date.

Intangible assets and amortisation

Other Intangible assets held by the Group consist of 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 Bank 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 Bank 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 ten 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. All intangible assets are 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. Intangible assets not brought-to-use are also subject to annual impairment assessment by the Group.

1.6.12 Impairment of non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value-in-use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre–tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, or other available fair value indicators.

For all non-financial assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

Impairment losses relating to goodwill are not reversed in future periods. The Group did not need to record impairment for its non-financial assets over the reported periods. Disclosures of the assumptions used to test for impairment are given in note 1.7.3.

1.6.13 Share-based payment transactions

The Company operates two equity-settled share option plans for its employees. The cost of equity-settled transactions is determined by the fair value at the date when the grant is made using an appropriate valuation model, further details of which are given in note 9. In accordance with IFRS 2 'Share-based payment', an expense is recognised in respect of the fair value of employee services received in exchange for the grant of share options. A corresponding amount is recorded as an increase in equity within retained earnings. The expense is spread over the period in which the service and, where applicable, the performance conditions are fulfilled (the vesting period). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The expense or credit in the statement of profit or loss for a period represents the movement in cumulative expense recognised at the beginning and end of that period.

Service and non-market performance conditions are not taken into account when determining the grant date fair value of awards, but the likelihood of the conditions being met is assessed as part of the Group's best estimate of the number of equity instruments that will ultimately vest. Market performance conditions are reflected within the grant date fair value. Any other conditions attached to an award, but without an associated service requirement, are considered to be non-vesting conditions. Non-vesting conditions are reflected in the fair value of an award and lead to an immediate expensing of an award unless there are also service and/or performance conditions.

1.6.14 Pension benefits

The Group operates a defined contribution pension plan. The contributions payable to a defined contribution plan is in proportion to the services rendered to the Group by the employees and are recorded as an expense under personnel expenses. Unpaid contributions are recorded as a liability. The Group does not operate a defined benefit plan.

1.6.15 Provisions

Provisions are recognised when the Group has a present obligation, legal or constructive, as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

1.6.16 Taxes

Current tax

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted, or substantively enacted, by the reporting date in the country where the Group operates and generates taxable income.

Current income tax relating to items recognised directly in equity is recognised in equity and not in the statement of profit or loss. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate. Calculations of tax are mentioned in note 11.

Deferred tax

Deferred tax is provided on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities ('DTL') are recognised for all taxable temporary differences, except

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it becomes probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the reporting date.

Current and deferred taxes are recognised as income tax benefits or expenses in the income statement, except for tax related to the fair value remeasurement of FVOCI assets and foreign exchange differences which are charged or credited to other comprehensive income. These exceptions are subsequently reclassified from other comprehensive income to the income statement together with the respective deferred loss or gain. The Group also recognises the tax consequences of payments and issuing costs related to financial instruments that are classified as equity, directly in equity.

The Group only offsets its deferred tax assets against liabilities when there is a legal right to offset, it is the Group's intention to settle on a net basis and that approval has been permitted by the tax authority.

Value Added Tax ('VAT')

Revenues, expenses and assets are recognised net of the recoverable amount of VAT except in the case of overdue loans and receivables, other receivables and other payables which are shown inclusive of VAT.

The net amount of VAT recoverable from, or payable to, the taxation authority is included as part of other receivables or other payables in the balance sheet.

1.6.17 Own shares

Own equity instruments of the Group which are acquired by it or by any of its subsidiaries (treasury shares) are deducted from equity. Consideration paid or received on the purchase, sale, issue or cancellation of the Group's own equity instruments is recognised directly in equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of own equity instruments.

1.6.18 Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Group's shareholders. Dividends for the year that are approved after the reporting date are disclosed as an event after the reporting date.

1.6.19 Short-term benefits

Wages, salaries, commissions, bonuses, social security contributions, paid annual leave and non-monetary benefits, including death-in-service premiums, are accrued in the period in which the associated services are rendered by employees of the Group.

1.6.20 Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date or when an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either the termination of employment or a voluntary redundancy offer.

1.6.21 Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions at the acquisition date.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IFRS 9 'Financial Instruments', is measured at fair value with the changes in fair value recognised in the statement of profit or loss in accordance with IFRS 9. Other contingent consideration that is not within the scope of IFRS 9 is measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group reassesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's CGUs that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a CGU and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the CGU retained.

Contingent liabilities recognised in a business combination

A contingent liability recognised in a business combination is initially measured at fair value. Subsequently, it is measured at the higher amount that would be recognised in accordance with the requirements for provisions above or the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the requirements for revenue recognition.

1.6.22 Fair value measurement

The Group measures financial instruments, such as covered bonds and derivatives, at fair value at each balance sheet date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another

market participant that would use the asset in its highest and best use. The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, based on the lowest level input that is significant to the fair value measurement as a whole.

- Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Fair value related disclosures for financial instruments and non-financial assets that are measured at fair value or where fair values are disclosed, are summarised in the following notes.

Disclosures for valuation methods, significant estimates and assumptions.

- Quantitative disclosures of fair value measurement hierarchy - note 28.4
- Financial instruments (including those carried at amortised cost) - note 28.4

1.7 Significant accounting judgements, estimates and assumptions

The preparation of financial statements in conformity with IFRS requires the directors 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.

1.7.1 Effective interest rate (estimate)

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. 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.

1.7.2 Impairment losses on financial assets (judgement and estimate)

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets in scope requires judgement, in particular the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Group's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include

- the Group's internal credit grading model, which assigns PDs to the individual grades;
- the Group's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a Lifetime Expected Credit Loss('LTECL') basis and the qualitative assessment;
- the segmentation of financial assets when their ECL is assessed on a collective basis;
- development of ECL models, including the various formulas and the choice of inputs;
- determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs; and
- selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

It has been the Group's policy to regularly review its models in the context of actual loss experience and adjust when necessary.

1.7.3 Impairment testing of investment in subsidiaries (judgement)

The Group assesses, at each reporting date, whether there is an indication that goodwill acquired through acquisitions may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount.

The review of goodwill for impairment reflects the Board's best estimate of future cash flows of the investment Group's 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 (pre-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.

The key assumptions used in the calculation of value-in-use are as follows.

Discount rate

The pre-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.

PCF Credit Limited	14.77%
Azule Limited	14.52%

Cash flow period

PCF Credit Limited - Six years of cash flows (pre-tax profits) are included in the discounted cash flow model based on the Bank's business plan.

Azule Limited - Five years of cash flows (pre-tax profits) are included in the discounted cash flow model based on the Bank'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 5.0% per annum is estimated by the Board.

1.8 Standards issued but not yet effective

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.

IFRS 16 'Leases' (effective 2020 financial year).

IFRS 16 'Leases'

IFRS 16 was issued in January 2016 and replaces IAS 17 'Leases', IFRIC 4 'Determining whether an Arrangement contains a Lease', SIC-15 'Operating Leases - Incentives' and SIC-27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g. personal computers) and short-term leases (i.e. leases with a lease term of 12 months or less). The Group will make use of both exemptions.

At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e. the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e. the right of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset, which will lead to a higher charge being recorded in the income statement compared to IAS 17. Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g. a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

During 2019, the Group performed a detailed impact assessment of IFRS 16 and will apply the modified retrospective approach as permitted by the standard. The Group will recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IAS 17. As permitted by the standard, this amount will be equal to the lease liability, adjusted for any prepayments or accrued lease payments relating to that lease. The lease liability will be measured at an amount equal to the outstanding lease payments at the date of initial application, considering extension and termination options, discounted at the Group's incremental borrowing rate in the economic environment of the lease. The capitalised right-of-use asset will mainly consist of office property, namely the Head office in London, and the property in Datchet which is due to the acquisition of Azule.

In summary, the adoption of IFRS 16 is expected to have a £0.1 million impact on retained earnings, while the CET 1 capital is expected to decrease by 15 bps as a result of the increase in the risk-weighted assets (treated as 100% risk-weighted, consistently with the nature of the underlying asset). The recognised right-of-use asset and lease liability will be approximately £2.6 million and £2.2 million respectively.

The Group does not intend to early adopt IFRS 16 and thereby will adopt it from 1 October 2019.

2 Business combinations

Acquisition of Azule Limited and its subsidiaries ('Azule Group')

On 5 November 2018, the Group acquired 100% of the voting shares of Azule Group, a UK market leader in providing specialist funding and leasing services to individuals and businesses in the broadcast and media industry. The Group acquired Azule Group because it offers revenue synergies in a niche class of business-critical assets with strong collateral characteristics and lending to prime credit grade customers.

Assets acquired and liabilities assumed

The fair values of the identifiable assets and liabilities of Azule Limited at the date of acquisition were

	Fair value on acquisition £'000	Book values £'000
Assets		
Property, plant and equipment	108	108
Cash and cash equivalents	900	900
Hire purchase, leasing and loans	15,612	15,612
Prepayment and other debtors	977	977
	17,597	17,597
Liabilities		
Due to banks	(11,593)	(11,593)
Due to related companies	(950)	(950)
Current tax liabilities	(116)	(116)
Other liabilities	(2,005)	(2,005)
	(14,664)	(14,664)
Total identifiable net assets at carrying value	2,933	
Fair value of consideration	(5,433)	
Goodwill	2,500	
Net cash acquired with the subsidiary	900	
Cash paid	(3,183)	
Net cash flow on acquisition	(2,283)	
Purchase consideration		
Issue of shares	750	
Cash paid	3,183	
Contingent consideration	1,500	
	5,433	

The Company issued 1,923,076 ordinary shares in PCF Group plc as part consideration for the 100% acquisition of Azule Group. The fair value of the shares was calculated with reference to the quoted price of the shares of the Company at the date of acquisition, which was £0.39 per share. The fair value of the consideration given in shares was, therefore, £750,000.

Transaction costs of £270,000 were expensed and are included in administrative expenses for the year ended 30 September 2018. A further £89,000 of costs were paid and included as an expense in the income statement for the year ended 30 September 2019.

Contingent consideration

As part of the purchase agreement with the previous owners of Azule Limited and its subsidiaries, two contingent considerations have been agreed. The first consideration totalling £1,500,000 over two years is subject to the level of aggregate new business originations upon the first and second anniversaries of the acquisition. This comprises £750,000 at each anniversary. The second consideration is for £62,500 and is paid if impairment targets are achieved.

The fair value of the contingent consideration at the acquisition date and signing date was £1,500,000.

Since the date of acquisition, Azule Group has contributed £960,000 of net operating income and £283,000 to the net profit before tax to the continuing operations of the Group. If the acquisition had taken place at the beginning of the year, revenue from continuing operations would have been £22,363,000 and the profit from continuing operations for the year before tax and dividends would have been £8,018,000.

3 Segment information

The Group operates in the principal areas of consumer finance for motor vehicles and business finance for vehicles, plant and equipment, specialist funding in the broadcast and media industry and bridging property finance.

For management purposes, the Group has been organised into four operating segments based on products and services.

Consumer finance
Consumer hire purchase, personal loan and conditional sale finance for motor vehicles.

Business finance
Business hire purchase and lease finance for vehicles, plant and equipment.

Azule finance
Specialist funding and leasing services direct to individuals and businesses in the broadcast and media industry. Azule Group was acquired on 5 November 2018.

Bridging finance
Bridging property finance commenced operations in January 2019, for residential, semi-commercial and commercial properties.

The Group's Executive Committee monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profits or losses and is measured consistently with operating profits or losses in the consolidated financial statements. However, income taxes are managed on a Group basis and are not allocated to operating segments.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Group's total revenue for the years ended 30 September 2018 and 30 September 2019.

Segment assets include cash and balances at central banks, loans and advances to customers, financial instruments and tax assets. Segment liabilities comprise amounts due to banks, amounts due to customers, derivative financial instruments and tax liabilities but exclude certain borrowings that are for general corporate purposes.

The following table presents income and profit and certain asset and liability information for the Group's operating segments.

For the year ended 30 September 2018, the profit for the year was allocated based on balance sheet size. For 30 September 2019, the profit for the year has been prepared on an actual profit centre basis, where income and expenses are allocated specifically.

Group Year ended 30 September 2019	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total segments £'000
Interest and similar revenue calculated using the effective interest method	15,505	16,936	1,705	353	34,499
Interest and similar expense calculated using the effective interest method	(5,752)	(6,610)	(496)	(26)	(12,884)
Net interest income	9,753	10,326	1,209	327	21,615
Fee and commission income	121	370	1,324	–	1,815
Fee and commission expense	(602)	(531)	(21)	–	(1,154)
Net fees and commission (expense)/income	(481)	(161)	1,303	–	661
Net loss on financial instruments mandatorily at fair value through profit or loss	(23)	(34)	(4)	(2)	(63)
Net operating income	9,249	10,131	2,508	325	22,213
Personnel expenses	2,858	2,884	1,360	538	7,640
Depreciation of office equipment, fixtures, fittings and motor vehicles	42	57	34	4	137
Amortisation of intangible assets	158	218	24	16	416
Other operating expenses	1,533	1,720	381	193	3,827
Impairment loss on financial instruments	778	1,345	46	6	2,175
Total operating expenses	5,369	6,224	1,845	757	14,195
Segment profit/loss before tax	3,880	3,907	663	(432)	8,018
Income tax expense	(803)	(782)	(129)	90	(1,624)
Profit for the year	3,077	3,125	534	(342)	6,394
Assets					
Additions to office equipment, fixtures, fittings and motor vehicles	160	211	108	13	492
Additions to other intangible assets	366	483	21	30	900
Loans and advances to customers	128,854	186,989	9,712	12,948	338,503
Total assets	153,660	202,855	8,921	12,633	378,069
Total liabilities	129,784	171,325	7,535	10,670	319,314

Group Year ended 30 September 2018	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total segments £'000
Interest and similar revenue calculated using the effective interest method	13,108	12,387	–	–	25,494
Interest and similar expense calculated using the effective interest method	(5,404)	(5,089)	–	–	(10,492)
Net interest income	7,704	7,298	–	–	15,002
Fee and commission income	96	396	–	–	492
Fee and commission expense	(435)	(409)	–	–	(844)
Net fees and commission (expense)/income	(339)	(13)	–	–	(352)
Net loss on financial instruments mandatorily at fair value through profit or loss	–	–	–	–	–
Net operating income	7,365	7,285	–	–	14,650
Personnel expenses	2,667	2,519	–	–	5,186
Depreciation of office equipment, fixtures, fittings and motor vehicles	43	41	–	–	84
Amortisation of intangible assets	198	187	–	–	385
Other operating expenses	1,494	1,413	–	–	2,907
Impairment loss on financial instruments	601	314	–	–	915
Total operating expenses	5,003	4,474	–	–	9,477
Segment profit/loss before tax	2,362	2,811	–	–	5,173
Income tax expense	(448)	(533)	–	–	(981)
Profit for the year	1,914	2,278	–	–	4,192
Assets					
Additions to office equipment, fixtures, fittings and motor vehicles	18	19	–	–	37
Additions to other intangible assets	327	310	–	–	637
Loans and advances to customers	98,440	120,832	–	–	219,322
Total assets	128,863	157,607	–	–	286,470
Total liabilities	109,535	134,384	–	–	243,919

4 Interest and similar revenue calculated using the effective interest method

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Cash and short-term funds	**67**	75
Loans and advances to customers	**33,954**	25,203
Financial instruments - FVOCI	**478**	–
Financial instruments - available-for-sale	**–**	216
Total interest and similar income	**34,499**	25,494

5 Interest and similar expense calculated using the effective interest method

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Due to banks	**836**	3,125
Due to customers	**12,048**	7,367
Total interest and similar income	**12,884**	10,492

6 Net fee and commission income/(expense)

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Fees and commission income		
Secondary lease income	**385**	312
Other fees not forming part of EIR	**1,430**	180
	1,815	492
Fees and commission expenses		
Debt recovery and valuation fees	**(195)**	(338)
Creditworthiness due diligence costs	**(959)**	(506)
	(1,154)	(844)
Net fee and commission income/(expense)	**661**	(352)

7 Impairment losses on financial assets

Impairment losses on financial assets relates to impairment losses on loans and advances to customers. The credit risk inherent in loans and advances to customers is detailed in note 29.3. The charge during the year was as follows.

	Azule finance £'000	Bridging finance £'000	Consumer finance credit £'000	Business finance lease £'000	Total £'000
30 September 2019					
Impairment charge for the year on loans and advances to customers	46	6	778	1,345	2,175
30 September 2018					
Impairment charge for the year on loans and advances to customers	–	–	601	314	915

8 Personnel expenses

The aggregate payroll costs of the Group, including directors and Chairman, were

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Salaries and fees	**6,054**	4,271
Social security cost	**773**	491
Pension costs - defined contribution plan	**267**	147
Share-based payments	**132**	34
Other benefits	**414**	243
	7,640	5,186

The average monthly number of persons employed by the Group during the year was 93 (year ended 30 September 2018 – 67). The number of employees at 30 September 2019 was 110.

9 Directors' remuneration and staff costs

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Directors' remuneration		
Directors' emoluments	**1,293**	1,257
Payments in respect of personal pension plans	**61**	55
Long-term incentive schemes	**4**	19
	1,358	1,331

There are three directors receiving company contributions to personal pension schemes (September 2018 – three).

Table of directors' remuneration

A summary of the total remuneration paid to directors is set out below.

	Salary and fees £'000	Bonus £'000	Benefits in kind £'000	Pension contributions £'000	Long-term incentive £'000	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Executive directors							
S D Maybury*	250	197	2	25	2	476	439
R J Murray	175	89	3	18	–	285	298
D R Bull**	185	90	1	18	2	296	332
Non-executive directors							
M F Brown	43	–	–	–	–	43	37
T A Franklin	95	–	–	–	–	95	90
C A Higgins	57	–	–	–	–	57	51
M Martin***	11	–	–	–	–	11	–
D J Morgan	43	–	–	–	–	43	37
D Titmuss	52	–	–	–	–	52	47
	911	376	6	61	4	1,358	1,331

* Pension received in cash

** Part of the pension received in cash

*** Appointed 25 July 2019

Share-based payments

At 30 September 2019, the Company has two share option plans as follows.

- Senior executive equity-settled share option plans
- Company equity-settled share option plans

During the year, the Company introduced a share-based long-term incentive plan for senior executives and other key staff. The plan has performance criteria attached in regard to Group performance and shareholder return. Share options under the plan are only settled on achievement of the criteria.

Senior executive equity-settled share option plans

The grant price is determined by reference to the average mid-market price of the Company's ordinary shares 9 April 2018, 1 November 2018 and 16 January 2019. The options are both conditional on continued employment with a minimum vesting period of three years and a performance criterion of the Group market value on 9 April 2021 reaching a target price. The target price is in three parts, if 42.41p is reached 3,183,443 options are effectively granted, if 49.47p is reached 4,775,264 options are effectively granted and if 56.54p is reached 6,366,886 are effectively granted. If options remain unexercised after a period of ten years from the date of the grant, the options expire. Furthermore, options are forfeited if the employee leaves the Group before the options vest. The weighted average remaining contractual life is seven years (30 September 2018 – seven years).

Of the pool, the following options have been granted with reference to notionally reaching the performance criteria of 56.54p. The model, however, values the options on a weighted basis across the three performance targets to ensure all outcomes are considered.

Company	30 September 2019 £'000	Weighted average exercise price (pence)	30 September 2018 £'000	Weighted average exercise price (pence)
Granted during the year	**5,960**	**34**	–	–
Outstanding at the end of the year	**5,960**	**34**	–	–
Exercisable at the end of the year	**–**	**–**	–	–

During the year ended 30 September 2019

The fair value was measured at the grant date using the Black-Scholes model. The inputs were as follows.

Grant date	1 November 2018 and 16 January 2019
Share price at grant date	36.5p
Exercise price	Range 32.9p – 36.5p
Shares under option	5,959,783
Vesting period	3 – 10 years
Expected volatility	30%
Expected life	6.5 years
Risk-free rate	0.45%
Expected dividends	nil
Fair value per model at grant date	Range 4.7p to 5.9p

Above plan is introduced in current year, hence no comparatives are provided with respect to model inputs.

Company equity-settled share option plans

This share option plan carries on from prior periods.

The grant price is determined by reference to the average mid-market price of the Company's ordinary shares for the three days immediately preceding the date of the grant. The options are conditional on continued employment and have a minimum vesting period of three years. If options remain unexercised after a period of ten years from the date of the grant, the options expire. Furthermore, options are forfeited if the employee leaves the Group before the options vest. The weighted average remaining contractual life is seven years (30 September 2018 – seven years).

Company	30 September 2019 £'000	Weighted average exercise price (pence)	30 September 2018 £'000	Weighted average exercise price (pence)
Outstanding at the beginning of the year	**3,210**	**17**	2,960	16
Granted during the year	**–**	**–**	250	28
Exercised during the year	**195**	**21**	–	–
Expired during the year	**–**	**–**	–	–
Outstanding at the end of the year	**3,015**	**17**	3,210	17
Exercisable at the end of the year	**2,420**	**15**	2,100	13

During the year ended 30 September 2019

No options were granted.

During the year ended 30 September 2018

The fair value was measured at the grant date using the Black-Scholes model. The inputs were as follows.

Grant date	26 July
Share price at grant date	28.4p
Exercise price	28.4p
Shares under option	250,000
Vesting period	3 – 10 years
Expected volatility	20-30%
Expected life	6.5 years
Risk-free rate	0.6%
Expected dividends	nil
Fair value per model at grant date	8.9p

The expected volatility is based on historical volatility over a period consistent with the expected option life. The risk-free rate is based on UK Government bonds.

10 Other operating expenses

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Advertising and marketing	**271**	217
Administrative expenses	**1,073**	617
Information technology and systems	**995**	717
Professional fees	**957**	769
Rental charges payable under operating lease	**433**	464
Expenses relating to banking services and licences	**98**	123
	3,827	2,907

Professional fees include fees payable to the auditor of £274,000 (year ended 30 September 2018 - £152,000), as analysed below.

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Statutory audit of the Company	**39**	87
Statutory audit of the Company's subsidiaries	**235**	65
Half year independent review report	**30**	-
	304	152

11 Income tax

(a) **The components of income tax expense for the year ended 30 September 2019 and its comparatives**

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Current tax		
UK Corporation Tax on profit for the year	**(1,507)**	(829)
Adjustments in respect of prior periods	**(65)**	(85)
Total current tax	**(1,572)**	(914)
Deferred tax		
Origination and reversal of temporary differences	**(98)**	(175)
Adjustments in respect of prior periods	**36**	90
Change in tax rate	**10**	18
	(52)	(67)
Total tax charge for the year	**(1,624)**	(981)

(b) **Deferred tax on items recognised directly in equity**

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Share-based payments	**131**	34
Deferred tax on share-based payments	**(52)**	50
Statement of changes in equity	**79**	84

(c) **Factors affecting current tax charge for the year**

The tax assessed for the year differs from the standard rate of Corporation Tax in the UK of 19% (year ended 30 September 2019 – 19%). The differences are explained below.

The Finance (No.2) Act 2015 enacted a reduction in the Corporation Tax, for all profits except ring fence profits, to 19% for the years starting 1 April 2017, 2018 and 2019. The Finance Act 2016 enacted a reduction in the Corporation Tax main rate at 17% for the years starting 1 April 2020. Deferred tax balances should be calculated at the rate which the balances are expected to be settled, based on tax rates that have been substantively enacted at the balance sheet date. Therefore, the deferred tax balances have been calculated with reference to these rates.

	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Accounting profit before tax	**8,018**	5,173
UK Corporation Tax of 19% (year ended 30 September 2018 – 19%)	**(1,523)**	(983)
Effects of		
Expenses not deductible for taxation purposes	**(45)**	(47)
Adjustments in respect of prior years	**(29)**	5
Change in tax rate	**15**	18
Other differences	**(42)**	26
Income tax expense as reported in the consolidated income statement	**(1,624)**	**(981)**
Effective tax rate for the year	**20%**	19%

12 Earnings per share

Basic earnings per share ('EPS') is calculated by dividing the net profit for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the year.

The following table shows the income and share data used in the basic and diluted EPS calculations.

	30 September 2019 £'000	30 September 2018 £'000
Net Company profit attributable to ordinary shareholders adjusted for the effect of dilution	**6,394**	4,192

	30 September 2019 '000 units	30 September 2018 '000 units
Share-based payments		
Basic and diluted weighted average number of shares	**234,102**	212,225
Basic and diluted earnings per 5p ordinary share	**2.7**	2.0

13 Cash and balances at central banks

	Group		Company	
	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Cash and demand deposits	**7,371**	21,338	**123**	11
	7,371	21,338	**123**	11

The Group and the Company do not have monies held in trust for clients. The book value of cash and balances at central banks is assessed to approximate its fair value. 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.

14 Debt instruments at FVOCI

Group	30 September 2019 £'000	30 September 2018 £'000
Covered bonds	**19,638**	–
	19,638	–

As from 1 October 2018, financial assets previously classified as available-for-sale were reported as debt instruments at FVOCI (see note 15 for comparatives). There are no material impairment losses on debt instruments at FVOCI during the year and at year end.

15 Available-for-sale financial instruments

Group	30 September 2019 £'000	30 September 2018 £'000
UK Government debt securities	**-**	509
Other OECD sovereign guaranteed debt securities	**-**	7,517
Multilateral development bank debt securities	**-**	18,185
Share-based payments	**-**	13,691
	-	39,902

As from 1 October 2018, financial assets previously classified as available-for-sale were reported as debt instruments at FVOCI (note 14).

16 Loans and advances to customers

Group	30 September 2019 £'000	30 September 2018 £'000
Consumer lending - gross	**131,902**	100,776
Business lending - gross	**191,460**	122,916
Azule lending - gross	**9,834**	–
Bridging lending - gross	**12,954**	–
	346,150	223,692
Allowance for impairment losses	**(7,647)**	(4,370)
	338,503	219,322

A reconciliation of the allowance for impairment losses for loans and advances, by class, is as follows.

Group	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
At 1 October 2018	2,286	2,084	–	–	4,370
Adoption of IFRS 9 (note 1.5.3)	91	513	–	–	604
	2,377	2,597	–	–	4,974
Charge for the year (note 7)	778	1,345	46	6	2,175
(Recoveries)/write offs	(107)	529	76	–	498
At 30 September 2019	3,048	4,471	122	6	7,647
Made up of					
Individual impairment	724	1,163	–	–	1,887
Collective impairment	2,324	3,308	122	6	5,760
Total impairment	3,048	4,471	122	6	7,647

Group	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
At 1 October 2017	2,233	1,732	–	–	3,965
Charge for the year	601	314	–	–	915
(Recoveries)/write offs	(548)	38	–	–	(510)
At 30 September 2018	2,286	2,084	–	–	4,370
Made up of					
Individual impairment	2,186	1,940	–	–	4,126
Collective impairment	100	144	–	–	244
Total impairment	2,286	2,084	–	–	4,370

Loss allowance at 30 September 2019 reflects expected credit losses calculated in accordance with IFRS 9. Impairment allowance at 30 September 2018 reflects impairment losses calculated in accordance with IAS 39. As per note 1.5.2 (transition), the opening balances were adjusted for the change in the accounting standard rather than a full restatement.

Loans and advances at Company level relate to subsidiary undertakings and are eliminated at Group level. These balances arose mainly from daily operations, payments on behalf of and subordinated loans to subsidiary undertakings. Loans and advances to subsidiary undertakings are unsecured, interest-free and repayable on demand.

Due from Group companies is entirely allocated to Stage 1 and based on materiality considerations, no provision has been provided.

17 Investment in subsidiary undertakings

Company

The following UK subsidiaries will take advantage of the audit exemption set out within section 479A of the Companies Act 2006 for the year ended 30 September 2019.

Company Name	Registration number
PCF Credit Limited	01775045
Azule Limited	03151043

The consolidated financial statements include the financial statements of the Company and its subsidiary undertakings. The Company does not have any joint ventures or associates. Significant subsidiaries of the Company were as follows.

Name of company	Incorporated	Nature of business	Percentage of equity interest 30 September 2019	Percentage of equity interest 30 September 2018
PCF Bank Limited	UK	Banking, hire purchase, leasing & bridging	100	100
PCF Credit Limited	UK	Leasing & hire purchase	100*	100
PCF Equipment Leasing Limited	UK	Leasing & hire purchase	100*	100
PCF Financial Leasing Limited	UK	Leasing & hire purchase	100*	100
Azule Limited	UK	Leasing & hire purchase	100*	–
Azule Finance Limited	IE	Leasing & hire purchase	100*	–
Azule Finance GMBH	DE	Leasing & hire purchase	100*	–

*Held by a subsidiary of the Company

The registered office of all subsidiaries incorporated in the United Kingdom is Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

The registered office of Azule Finance Limited is Suite 104, 4/5 Burton Hall Road, Sandyford, Dublin 18.

The registered office of Azule Finance GMBH is Domgarten 12, 47877 Willich, Germany.

All companies have an Accounting Reference Date of 30 September.

Azule Limited, which owns 100% of Azule Finance Limited and Azule Finance GMBH, was acquired by PCF Bank Limited on 5 November 2018 (note 2).

Company	30 September 2019 £'000	30 September 2018 £'000
Cost and net book value		
At beginning of the year	**22,000**	17,000
Increase in investments	**10,000**	5,000
At 30 September	**32,000**	22,000

The Company has an investment in PCF Bank Limited (the 'Bank'). The net asset value of the Bank at 30 September 2019 was £54,938,000 (30 September 2018 – £36,938,000)[(2)]. If the investment had been sold at this valuation, any potential capital gains arising on the sale would have been exempt under the substantial shareholdings legislation. If the disposal had given rise to a loss, the loss would not be an allowable loss for tax purposes. There was an additional investment of £10,000,000 in the Bank during the year (30 September 2018 – £5,000,000).

It is the opinion of the directors that the recoverable amount of the Company's investment in subsidiaries is not less than the amount at which it is stated in the Company's financial statements.

18 Office equipment, fixtures, fittings and motor vehicles

Group	Office equipment, fixtures and fittings 30 September 2019 £'000	Motor vehicles 30 September 2019 £'000	Total 30 September 2019 £'000
Cost			
At 1 October 2018	470	–	470
Additions during the year	381	3	384
Acquisitions through business combinations	21	87	108
Disposals during the year	(37)	–	(37)
At 30 September 2019	835	90	925
Accumulated depreciation			
At 1 October 2018	246	–	246
Depreciation during the year	111	26	137
Disposals during the year	(37)	–	(37)
At 30 September 2019	320	26	346
Net book value	515	64	579

Group	Office equipment, fixtures and fittings 30 September 2018 £'000	Motor vehicles 30 September 2018 £'000	Total 30 September 2018 £'000
Cost			
At 1 October 2017	433	–	433
Additions during the year	37	–	37
At 30 September 2018	470	–	470
Accumulated depreciation			
At 1 October 2017	162	–	162
Depreciation during the year	84	–	84
At 30 September 2018	246	–	246
Net book value	224	–	224

The majority of the office equipment, fixtures and fittings is computer hardware, office furniture and fixtures.

[(2)] *2018 comparative in the note above has been updated from the prior period annual report.*

19 Goodwill and other intangible assets

For the year ended 30 September 2018, all the goodwill related to the Group's Consumer Finance Division. For the year ended 30 September 2019, goodwill relates partly to the Group's Consumer Finance Division which arises from the acquisition of a subsidiary company, TMV Finance Limited ('TMV'), acquired November 2000, and the remainder for the acquisition of Azule on 5 November 2018 (note 2).

Subsequently, a corporate reorganisation resulted in the assets and business model of TMV being transferred to its related companies in the Group, PCF Credit and PCF Bank. New business in respect of the Azule franchise is written in PCF Bank.

The rationale for the TMV acquisition was to increase market share and adopt the business model for new business generation which involved contractual relationship with broker introductory sources. As the business model was new to the Group at the time of acquisition and has continued to be the primary source of new business for the Group, the directors believe that the underlying net assets from PCF Credit and PCF Bank are sufficient to cover the carrying amount against its recoverable amount, and there is no indication of impairment.

The rationale for the Azule acquisition was to diversify and it offers revenue synergies in a niche class of business-critical assets with strong collateral characteristics and lending to prime credit grade customers. The directors believe that the underlying net assets from Azule's business are sufficient to cover the carrying amount against its recoverable amount, and there is no indication of impairment.

In performing the annual impairment test, the Group assesses the economic performance of each acquisition, then there is a need to look at the future of the business acquired and to ensure that the useful economic life of each acquisition is finite, and that growth and profitability are at least the same value as the amount that was paid 'over and above' for the fair value of the assets and liabilities acquired. To assess this, forecasted Board approved profitability has been used and discounted back to present value.

Both the CGU's acquired are expected to continue to perform, but forecasting is only over the next 5 to 6 years, therefore there is requirement to capture expected growth and cashflows beyond these dates. To complete this, there is a terminal valuation that is required to be performed to assess if goodwill has been impaired or not. Terminal value often comprises a large percentage of the total assessed value.

TMV CGU

The recoverable amount of the TMV CGU of £410 million at 30 September 2019 has been determined based on a value-in-use calculation using cash flow projections from financial budgets approved by the Board covering a six year period, and a terminal valuation based on the last year forecast. The projected cash flows have been updated to reflect the increased business over this period which is aligned with recent demand and future expected growth in its products and services. The pre-tax discount rate applied to cash flow projections is 14.5% per annum over a six year period and for the period beyond, a terminal growth rate of 5.0% is used being the expected long-term average growth rate for the Group. It was concluded that the fair value less costs of disposal exceeded the value-in-use. In conclusion, there is no obvious impairment loss existing at balance sheet date and the current goodwill remains appropriate for the carrying value for the TMV acquisition.

Azule CGU

The recoverable amount of the Azule CGU of £13 million at 30 September 2019 has been determined based on a value-in-use calculation using cash flow projections from financial budgets approved by senior management covering a five year period, and a terminal valuation based on the last year forecast. The projected cash flows have been updated to reflect the increased business over this period which is aligned with recent demand and future expected growth in its products and services. The pre-tax discount rate applied to cash flow projections is 14.5% per annum over a five year period and for the period beyond, a terminal growth rate of 5.0% per annum is used being the expected long-term average growth rate for the Group. It was concluded that the fair value less costs of disposal exceeded the value-in-use. In conclusion, there is no obvious impairment loss existing at balance sheet date and the current goodwill remains appropriate.

Key assumptions used in value-in-use calculations and sensitivity to changes in assumptions

The calculation of value-in-use for both TMV and Azule is most sensitive to the following assumptions.

- Terminal value
- Terminal growth rate
- Discount rates
- Free cash flow for the last forecasted year

Terminal value (using the perpetuity method) – Discounting is necessary because the time value of money creates a discrepancy between the current and future values of a given sum of money. In business valuation, free cash flow or dividends can be forecast for a discrete period of time, but the performance of ongoing concerns becomes more challenging to estimate as the projections stretch further into the future. Moreover, it is difficult to determine the precise time when a company may cease operations.

To overcome these limitations, investors can assume that cash flows will grow at a stable rate forever, starting at some point in the future. This represents the terminal value.

Terminal value is calculated by dividing the last cash flow forecast by the difference between the discount rate and terminal growth rate. The terminal value calculation estimates the value of the company after the forecast period.

Terminal growth rate – The terminal growth rate is the constant rate that a company is expected to continue to grow at. This growth rate starts at the end of the last forecasted cash flow period in a discounted cash flow model and goes into perpetuity.

Discounted rates – Discount rates represent the current market assessment of the risks specific to each CGU, taking into consideration the time value of money and individual risks of the underlying assets that have not been incorporated in the cash flow estimates. The discount rate calculation is based on the specific circumstances of the Group and its operating segments and is derived from its weighted average cost of capital.

Growth rate estimates – Both the businesses acquired are expected to continue to grow over the next five years.

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
TMV Finance Limited acquisition	**397**	397
Azule acquisition	**2,500**	–
	2,897	397

Group	Year ended 2019 £'000	Year ended 2018 £'000
Cost and net book value		
At 1 October	**397**	397
Additions during the year	**2,500**	–
At 30 September	**2,897**	397

Other intangible assets

The Group's other intangible assets consist solely of computer software and capitalised expenses incurred in the project of applying to become a bank.

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Cost		
At 1 October	**5,249**	4,611
Additions during the year	**900**	638
At 30 September	**6,149**	5,249
Accumulated depreciation		
At 1 October	**2,689**	2,304
Amortisation during the year	**416**	385
At 30 September	**3,105**	2,689
Net book value at 30 September	**3,044**	2,560

Group	Year ended 30 September 2019 £'000	Year ended 30 September 2018 £'000
Net book value of combined goodwill and other intangible assets	**5,941**	2,957

20 Deferred tax assets

	Group		Company	
	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Accelerated capital allowances	**(17)**	994	**-**	–
Decelerated capital allowances	**904**	85	**65**	80
Other temporary differences	**218**	106	**70**	116
	1,105	1,185	**135**	196
At 1 October	**1,185**	1,205	**196**	163
Recognised in income	**(152)**	(66)	**(8)**	(9)
Adjustment in respect of prior year timing difference	**36**	–	**(1)**	(8)
Adjustments to opening reserves - IFRS 9	**103**	–	**-**	–
On acquisition	**(17)**	–	**-**	–
Recognised in other comprehensive income	**2**	(3)	**-**	–
Recognised in equity	**(52)**	49	**(52)**	50
At 30 September	**1,105**	1,185	**135**	196

In the Summer Budget 2015 and 2016, the UK Government announced legislation reducing the main rate of Corporation Tax from 20% to 19% for the years starting 1 April 2018 and 2019 and to 17% for the year starting 1 April 2020. The deferred tax asset has been calculated based on a rate of 17% to the extent that it is expected to reverse in future years.

The impact of measuring the deferred tax asset at the current tax rate of 19% is £15,904. As the timing of the reversal of the deferred tax asset is uncertain, the Group has taken the approach of measuring the deferred tax asset at the lowest enacted tax rate.

There is an unrecognised deferred tax asset of £1,839 (30 September 2018 – £1,839). This asset relates to tax losses arising in prior years that are unlikely to be offset against future profits.

21 Other assets

	Group		Company	
	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Prepayments	**807**	1,394	**771**	788
Other receivables	**4,125**	148	**125**	29
	4,932	1,542	**896**	817

Other assets are not interest-bearing and are generally on terms of up to 30 days. The maximum exposure to credit risk and the fair value of trade and other receivables approximates to the carrying amount.

22 Due to banks

Group	30 September 2019 £'000	30 September 2018 £'000
Current		
Secured loans and borrowings	**16,644**	9,323
Non-current		
Secured loans and borrowings	**27,768**	39,558
	44,412	48,881

Bank overdrafts
The Group had no bank overdraft facility at 30 September 2019.

Interest-bearing loans and borrowings
£4.4 million block discounting facilities granted to PCF Credit Limited
These facilities when drawn as loans have fixed interest rates and maturity dates of up to five years. The facilities are secured by assigned receivables of PCF Credit.

£6.0 million block discounting facilities granted to Azule Limited
These facilities when drawn as loans have fixed interest rates and maturity dates of up to five years. The facilities are secured by assigned receivables of Azule Limited.

£25.0 million term loan facility granted to PCF Bank by the Bank of England under the Term Funding Scheme
This facility has a rate linked to the Bank of England's Base Rate and is repayable in February 2022.

The loan is secured by a charge over specified loans and receivables and the guarantee of the Company.

£30.0 million revolving credit facility granted to PCF Bank by Leumi ABL Limited
This facility when drawn as a loan has a variable rate linked to 3 month LIBOR plus a margin and a maturity date of up to five years. The facility is secured by a charge over specified loans and receivables and the guarantee of the Company.

£25.0 million repo facility granted to PCF Bank by NatWest Markets plc
This facility when drawn as a loan has a fixed interest rate and maturity dates of up to 1 year. The facilities are secured by bonds owned by the Company.

23 Due to customers

Group	30 September 2019 £'000	30 September 2018 £'000
Retail customers		
Notice account	**32,835**	14,107
Term deposit	**234,235**	177,032
	267,070	191,139

Included in amounts due to customers is accrued interest amounting to £1,681,000 (30 September 2018 – £1,086,000) and £220,000 (30 September 2018 – £58,000) for term deposits and notice accounts respectively.

24 Financing activity

The table below details changes in the Group's liabilities arising from financing activities.

	Note	1 October 2018 £'000	Azule acquisition £'000	Cash flows £'000	30 September 2019 £'000
Due to banks	22	48,881	12,543	(17,012)	44,412
	22	48,881	12,543	(17,012)	44,412

	Note	1 October 2017 £'000	Azule acquisition £'000	Cash flows £'000	30 September 2018 £'000
Due to banks	22	77,065	–	(28,184)	48,881
	22	77,065	–	(28,184)	48,881

25 Derivative financial instruments

The fair value of derivative financial instruments included in the financial statements, together with their notional amounts is summarised as follows.

	Fair value 30 September 2019 £'000	Notional 30 September 2019 £'000	Fair value 30 September 2018 £'000	Notional 30 September 2018 £'000
Interest rate swaps	**(63)**	**10,000**	–	8,000
	(63)	**10,000**	–	8,000

26 Other liabilities

	Group		Company	
	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Other payables	**228**	210	**412**	242
Accruals	**6,020**	3,275	**1,280**	1,309
	6,248	3,485	**1,692**	1,551

Other liabilities includes other payables and accruals that are not interest-bearing and are normally settled on 30 day terms.

27 Issued capital and reserves

	30 September 2019 '000 units	30 September 2018 '000 units	30 September 2019 £'000	30 September 2018 £'000
Ordinary shares issued and fully paid				
At 1 October	**212,230**	212,220	**10,611**	10,611
Issuance of new shares during the year	**36,028**	–	**1,802**	–
Issue of shares for part payment of Azule Limited	**1,923**	–	**96**	–
Dividend reinvestment	**16**	10	**1**	–
At 30 September	**250,197**	212,230	**12,510**	10,611

Share premium	30 September 2019 £'000	30 September 2018 £'000
At 1 October	**8,527**	8,524
Issuance of new shares during the year	**9,092**	–
Dividend reinvestment	**–**	3
At 30 September	**17,619**	8,527

	Number of shares	Issue price	Change in share capital at 5p per share £'000	Change in share premium £'000
30 October 2018				
Shares issued as part of the consideration on acquisition of Azule Limited	1,923,076	39.00p	96	654
11 March 2019				
Shares issued to support increased lending	35,833,333	30.00p	1,792	8,958
Fees relating to share issue				(556)
29 March 2019				
Shares issued pursuant to Employee Share Scheme – Exercise of Options	195,000	21.17p	10	31
12 April 2019				
Dividend reinvestment	15,703	34.5p	1	5
			1,899	9,092

Other reserves

The 'revaluation reserve' for debt instruments at FVOCI (30 September 2018 – AFS financial instruments, note 15) also appears in 'Other reserves'.

Own shares (Employee Share Option Plans)
Own shares represent 751,764 (30 September 2018 – 1,237,925) ordinary shares held by the Company's Employees Benefits Trust 2003 to meet obligations under the Company's Share Option Plans. The shares are stated at cost and their market value at 30 September 2019 was £263,117 (30 September 2018 – £354,666). If they had been sold at this value, there would have been a capital gain of £58,651 (30 September 2018 – £250,680) arising on the sale.

	£'000
At 1 October 2018	(355)
At 30 September 2019	(355)

Dividend
At the forthcoming Annual General Meeting, a final dividend of 0.4 pence per share in respect of the year ended 30 September 2019 (year ended 30 September 2018 – 0.3 pence per share), amounting to a dividend payable of £1,000,787 (year ended 30 September 2018 – £636,689) will be proposed for shareholders' approval. The financial statements for the current financial year do not reflect this proposed dividend. Such dividend, if approved by shareholders, will be accounted for in equity as an distribution of retained earnings in the year ending 30 September 2020.

28 Financial instruments

The Group invests in highly liquid financial instruments to support its liquid asset buffer and raises wholesale funding by issuing financial instruments. The Group also uses derivative financial instruments to manage the risks arising from its operations. The risks associated with financial instruments represents a significant component of the total risks faced by the Group and are analysed in more detail below.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 1.5.3.

28.1 Valuation techniques

Debt instruments at FVOCI
Covered bonds debt securities are financial instruments issued by banks or building societies and collateralised against a pool of assets that, in case of failure of the issuer, can cover claims at any point in time. They are subject to specific legislation to protect bondholders. These instruments are generally highly liquid and traded in active markets resulting in a Level 1 classification. When active market prices are not available, the Group uses discounted cash flow models with observable market inputs of similar instruments and bond prices to estimate future index levels and extrapolating yields outside the range of active market trading, in which instances the Group classifies those securities as Level 2.

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.

28.2 Valuation principal

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price), regardless of whether that price is directly observable or estimated using a valuation technique.

In order to show how fair values have been derived, financial instruments are classified based on a hierarchy of valuation techniques, as explained in note 28.4.

28.3 Valuation governance

The Group's fair value methodology and the governance over its models includes a number of controls and other procedures to ensure appropriate safeguards are in place to ensure its quality and adequacy. All new product initiatives, including their valuation methodologies, are subject to approvals by various functions of the Group, Company and the Bank, including the Risk and Finance functions. The responsibility of ongoing measurement resides with the business and product line divisions.

Once submitted, fair value estimates are also reviewed and challenged by the Risk and Finance functions. The independent price verification process for financial reporting is ultimately the responsibility of the independent price verification team within the Treasury function, which reports to the Finance Director.

28.4 Assets and liabilities by classification, measurement and fair value hierarchy

The following table summarises the classification of the carrying amounts of the Group's financial assets and liabilities.

Group	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
30 September 2019				
Cash and balances at central banks	7,371	–	–	7,371
Loans and advances to customers	338,503	–	–	338,503
Derivative instruments at FVOCI	–	–	19,638	19,638
Total financial assets	345,874	–	19,638	365,512
Office equipment, fixtures, fittings and motor vehicles				579
Other assets				4,932
Deferred tax assets				1,105
Goodwill and other intangible assets				5,941
Total assets				378,069
Due to banks	44,412	–	–	44,412
Due to customers	267,070	–	–	267,070
Derivative financial instruments	–	63	–	63
Total financial liabilities	311,482	63	–	311,545
Current tax liabilities				1,521
Other liabilities				6,248
Total liabilities				319,314

Group	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
30 September 2018				
Cash and balances at central banks	21,338	–	–	21,338
Loans and advances to customers	219,322	–	–	219,322
Available-for-sale financial instruments	–	–	39,902	39,902
Total financial assets	240,660	–	39,902	280,562
Office equipment, fixtures, fittings and motor vehicles				224
Other assets				1,542
Deferred tax assets				1,185
Goodwill and other intangible assets				2,957
Total assets				286,470
Due to banks	48,881	–	–	48,881
Due to customers	191,139	–	–	191,139
Total financial liabilities	240,020	–	–	240,020
Current tax liabilities				414
Other liabilities				3,485
Total liabilities				243,919

Company	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
30 September 2019				
Cash and balances at central banks	123	–	–	123
Due from Group companies	6,927	–	–	6,927
Investment in subsidiary undertakings	32,000	–	–	32,000
Total financial assets	39,050	–	–	39,050
Other assets				896
Deferred tax assets				135
Total assets				40,081
Due to Group companies	3,239	–	–	3,239
Total financial liabilities	3,239	–	–	3,239
Other liabilities				1,692
Total liabilities				4,931

Company	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
30 September 2018				
Cash and balances at central banks	11	–	–	11
Due from Group companies	2,912	–	–	2,912
Investment in subsidiary undertakings	22,000	–	–	22,000
Total financial assets	24,923	–	–	24,923
Other assets				817
Deferred tax assets				196
Total assets				25,936
Due to Group companies	–	–	–	–
Total financial liabilities	–	–	–	–
Other liabilities				1,551
Total liabilities				1,551

The Group holds certain financial assets at fair value grouped into Levels 1 to 3 of the fair value hierarchy, as explained below.

Level 1 – The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio mainly comprises gilts, fixed rate bonds and floating rate notes for which traded prices are readily available.

Level 2 – These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed when no active market exists and quoted prices are available for similar instruments in active markets.

Level 3 – These are valuation techniques for which one or more significant inputs are not based on observable market data. Valuation techniques include net present value by way of discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, similar market products, foreign currency exchange rates and equity index prices. Critical judgement is applied by management in utilising unobservable inputs including expected price volatilities and prepayment rates, based on industry practice or historical observation. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The following table shows an analysis of financial instruments recorded at amortised cost by level of the fair value hierarchy.

Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Carrying value £'000	Fair value £'000
Financial instruments held at amortised cost 30 September 2019					
Cash and balances at central banks	7,371	-	-	7,371	7,371
Loans and advances to customers	-	-	338,503	338,503	376,343
	7,371	-	338,503	345,874	383,714
Due to banks	44,412	-	-	44,412	44,412
Due to customers	-	-	267,070	267,070	267,070
	44,412	-	267,070	311,482	311,482

Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Carrying value £'000	Fair value £'000
Financial instruments held at amortised cost 30 September 2018					
Cash and balances at central banks	21,338	-	-	21,338	21,338
Loans and advances to customers	-	-	219,322	219,322	255,922
	21,338	-	219,322	240,660	277,260
Due to banks	48,881	-	-	48,881	48,881
Due to customers	-	-	191,139	191,139	191,139
	48,881	-	191,139	240,020	240,020

The following table shows an analysis of financial instruments recorded at FVOCI/AFS by level of the fair value hierarchy.

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair value £'000
Financial instruments at fair value through Other Comprehensive Income (FVOCI) 30 September 2019				
Quoted debt instruments	19,638	-	-	19,638

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair value £'000
Financial instruments at available-for-sale (AFS) cost 30 September 2019				
Quoted debt instruments	39,902	–	-	39,902

Following the implementation of IFRS 9, effective from 1 October 2018, quoted debt instruments are now classified as FVOCI instead of previously being valued at available-for-sale.

	Notional Level 1 £'000	Notional Level 2 £'000	Notional Level 3 £'000	Carrying value £'000	Fair value £'000
Derivative financial instruments					
30 September 2019					
Financial assets	–	10,000	–	–	–
Financial liabilities	–	10,000	–	(63)	(63)
30 September 2018					
Financial assets	–	8,000	–	–	–
Financial liabilities	–	8,000	–	–	–

28.5 Impairment allowance for loans and advances to customers

The table below shows the credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and year end stage classification. The amounts presented are gross of impairment allowances.

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 30 September 2019				
Gross carrying amounts				
Performing				
High grade	90,161	–	286	90,447
Standard grade	179,162	15,603	214	194,979
Sub-standard grade	37,430	4,190	29	41,649
Non-performing				
Individually impaired	–	–	4,945	4,945
Collectively impaired	541	2,632	10,957	14,130
Total	307,294	22,425	16,431	346,150

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2018				
Gross carrying amounts				
Performing				
High grade	40,694	–	–	40,694
Standard grade	135,867	14,362	294	150,523
Sub-standard grade	19,018	2,623	49	21,690
Non-performing				
Individually impaired	–	–	4,280	4,280
Collectively impaired	–	1,565	5,559	7,124
Total	195,579	18,550	10,182	224,311

An analysis of changes in the gross carrying amount and the corresponding ECLs is as follows.

Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2018	195,580	18,550	10,183	224,313
New assets originated or purchased	238,564	105	45	238,714
Assets derecognised or matured	(106,857)	(7,814)	(640)	(115,311)
Transfers to Stage 1	2,294	(2,294)	–	–
Transfers to Stage 2	(16,706)	16,706	–	–
Transfers to Stage 3	(5,581)	(2,829)	8,410	–
Amounts written off	–	–	(1,566)	(1,566)
At 30 September 2019	307,294	22,424	16,432	346,150

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2018	757	765	3,452	4,974
New assets originated or purchased	1,223	7	13	1,243
Assets derecognised or matured	(339)	(72)	(281)	(692)
Transfers to Stage 1	136	(136)	–	–
Transfers to Stage 2	(64)	64	–	–
Transfers to Stage 3	(25)	(221)	246	–
ECL transfers	(112)	1,051	2,749	3,688
Amounts written off	–	–	(1,566)	(1,566)
At 30 September 2019	1,576	1,458	4,613	7,647

29 Financial risk management

The Group is based and its operations are predominantly in the United Kingdom, although Azule does operate as a finance broker in the EU. Whilst risk is inherent in the Group's activities, it is managed through an integrated risk management framework, including ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to liquidity risk, market risk and credit risk.

29.1 Liquidity risk

Liquidity risk is defined as the risk that the Group might encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Group might be unable to meet its payment obligations when they fall due as a result of mismatches in the timing of cash flows under both normal and stress circumstances. Such scenarios could occur when funding needed for illiquid asset positions is not available to the Group on acceptable terms. To limit this risk, management has arranged for diversified funding sources in addition to its core deposit base, and adopted a policy of managing assets with liquidity in mind and monitoring future cash flows and liquidity on a daily basis. The Group has developed internal control processes and contingency plans for managing liquidity risk. This incorporates an assessment of expected cash flows and the availability of high-grade collateral which could be used to secure additional funding, if required.

The Group seeks to manage its liquidity by matching the maturity of loans and advances with the maturity of deposits from customers.

The Group maintains a portfolio of highly marketable and diverse assets that may be liquidated quickly in the event of an unforeseen interruption in cash flow, the liquidity of which is regularly tested. The Group also has central bank facilities and lines of credit that it can access to meet liquidity needs. In accordance with the Group's policy, the liquidity position is assessed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Group. Net liquid assets consist of cash, short-term bank deposits and liquid debt securities available for immediate sale, less deposits from customers and other issued securities and borrowings due to mature within the next month. The ratios during the year were as follows.

(a) Liquidity ratios

Advances to deposit ratios

Group	30 September 2019 £'000	30 September 2018 £'000
Year end	**1.3**	1.1
Average	**1.2**	1.5

The Group recognises the importance of notice accounts and savings accounts as sources of funds to finance lending to customers. They are monitored using the advances to deposit ratio, which compares loans and advances to customers as a percentage of core customer notice and savings accounts, together with term funding with a remaining term to maturity in excess of one year.

(b) Undiscounted contractual cash flows

Group	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
At 30 September 2019						
Financial assets						
Cash and balances at central banks	7,371	–	–	–	–	7,371
Loans and advances to customers	13,492	29,692	92,009	247,504	24,593	407,290
Debt instruments at FVOCI	–	–	251	20,502	–	20,753
Other assets	–	4,932	–	–	–	4,932
Total undiscounted financial assets	20,863	34,624	92,260	268,006	24,593	440,346
Financial liabilities						
Due to banks	–	11,607	5,535	28,043	–	45,185
Due to customers	–	9,780	120,859	128,885	20,621	280,145
Other liabilities	–	7,769	–	–	–	7,769
Total undiscounted financial liabilities	–	29,156	126,394	156,928	20,621	333,099
Surplus/(shortfall)	20,863	5,468	(34,134)	111,078	3,972	107,247

Group	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
At 30 September 2018						
Financial assets						
Cash and balances at central banks	21,338	–	–	–	–	21,338
Loans and advances to customers	9,611	10,111	56,068	186,079	8,316	270,185
Available-for-sale financial investments	–	18,338	740	22,275	–	41,353
Total undiscounted financial assets	30,949	28,449	56,808	208,354	8,316	332,876
Financial liabilities						
Due to banks	–	3,526	16,693	30,127	–	50,346
Due to customers	–	9,885	88,034	94,533	8,103	200,555
Other liabilities	–	3,485	–	–	–	3,485
Total undiscounted financial liabilities	–	16,896	104,727	124,660	8,103	254,386
Surplus/(shortfall)	30,949	11,553	(47,919)	83,694	213	78,490

The Group's policy on funding capacity is to ensure there is always sufficient stable funding in place to support the Group's lending. At 30 September 2019 the Group had total wholesale and retail funding of £311.1 million (at 30 September 2018 – £240.0 million) that supported net loans and advances of £337.9 million (at 30 September 2018 – £219.3 million). Moreover, at 30 September 2019 the Group had a net stable funding ratio in excess of the regulatory minimum of 100%.

Surplus liquidity in periods shown above will be used to cover liquidity shortfalls in subsequent periods.

Company	On demand £'000	Over 5 years £'000	Total £'000
At 30 September 2019			
Financial assets			
Cash and balances at central banks	123	–	123
Due from Group companies	6,927	–	6,927
Other assets	896	–	896
Total undiscounted financial assets	7,946	–	7,946
Financial liabilities			
Due to Group companies	3,239	–	3,239
Other liabilities	1,692	–	1,692
Total undiscounted financial liabilities	4,931	–	4,931
Surplus	3,015	–	3,015

Company	On demand £'000	Over 5 years £'000	Total £'000
At 30 September 2018			
Financial assets			
Cash and balances at central banks	11	–	11
Due from Group companies	2,912	–	2,912
Other assets	817	–	817
Total undiscounted financial assets	3,740		3,740
Financial liabilities			
Other liabilities	1,551	–	1,551
Total undiscounted financial liabilities	1,551	–	1,551
Surplus	2,189	–	2,189

(c) **Analysis of encumbered and unencumbered assets**

Group	Encumbered £'000	Unencumbered Available as collateral £'000	Other £'000	Total £'000
At 30 September 2019				
Debt financial instruments at FVOCI	9,083	10,555	–	19,638
Loans secured on equipment, plant and vehicles under conditional sale/hire purchase agreements	48,437	186,899	43,012	278,348
Unsecured loans	572	621	129	1,322
Finance leases of equipment, plant and vehicles	17,537	18,564	10,427	46,528
Bridging loans	–	12,305	–	12,305
Gross assets	75,629	228,944	53,568	358,141

Group	Encumbered £'000	Unencumbered Available as collateral £'000	Other £'000	Total £'000
At 30 September 2018				
AFS financial instruments	25,173	14,727	2	39,902
Loans secured on equipment, plant and vehicles under conditional sale/hire purchase agreements	25,776	203,857	–	229,633
Unsecured loans	–	–	365	365
Finance leases of equipment, plant and vehicles	8,028	32,159	–	40,187
Bridging loans	–	–	–	–
Gross assets	58,977	250,743	367	310,087

29.2 Market risk - Interest rate risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables, such as interest rates, foreign exchange rates and equity prices. Due to the nature and geographical operations of the Group, the Group's market risk is primarily interest rate risk.

The Group lends on an instalment credit basis for up to ten years and holds a portfolio of variable rate liquid assets. It funds itself from a combination of fixed rate retail deposits from 1 year to 7 years, variable rate Term Funding Scheme ('TFS') funding, variable rate retail notice accounts and fixed rate wholesale funding. The Group seeks to match the repayment profile of fixed rate instalment credit with the fixed rate retail and wholesale funding, but it is impossible to match them perfectly. This mismatch gives rise to interest rate sensitivity, which is managed using interest rate swaps as required.

Based on the exposure to interest rate risk, an increase in SONIA by 0.5 percentage point for the whole financial year would have a favourable effect on profits of £21,024 (30 September 2018 – £37,151) and a favourable impact on capital of £17,029 (30 September 2018 – £30,092).

29.3 Credit risk

Credit risk is the risk that the Group will incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Group has an established credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions for the entire Group. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process aims to allow the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Analysis of maximum exposure to credit risk and collateral

	Group		Company	
	30 September 2019 £'000	30 September 2018 £'000	30 September 2019 £'000	30 September 2018 £'000
Financial assets				
Cash and balances at central banks				
Cash and demand deposits	**7,371**	21,338	**123**	11
Loans and advances to customers				
Consumer lending (net)	**128,854**	125,689	**-**	–
Business lending (net)	**186,989**	140,127	**-**	–
Azule lending	**9,712**	–	**-**	–
Bridging finance	**12,948**	–	**-**	–
Due from Related companies	**-**	–	**6,927**	2,912
Available-for-sale financial investments	**-**	39,902	**-**	–
Debt instruments at FVOCI	**19,638**	–	**-**	–
Other assets	**4,932**	1,542	**896**	817
	370,444	328,598	**7,946**	3,740

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Guidelines are in place covering the acceptability and valuation of each type of collateral. The main types of collateral obtained are as follows.

- For securities lending and reverse repurchase transactions, cash or securities.
- For corporate and small business lending, charges over inventory and trade receivables.
- For bridging finance, lending over residential properties.

Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement.

In its normal course of business, the Bank engages external agents to recover funds from repossessed assets in its retail portfolio, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers.

29.4 Impairment assessment

The references below show where the Group's impairment assessment and measurement approach is set out in this report. It should be read in conjunction with the summary of significant accounting policies.

- The Group's definition and assessment of default (note 29.4.2).
- An explanation of the Group's internal grading system (note 29.4.3).
- How the Group defines, calculates and monitors the probability of default, exposure at default and loss given default (notes 29.4.3, 29.4.4 and 29.4.5 respectively).
- When the Group considers there has been a significant increase in credit risk of an exposure (note 29.4.5).
- The Group's policy of segmenting financial assets where ECL is assessed on a collective basis (note 29.4.5).

29.4.1 Definition of default

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments.

As a part of a qualitative assessment of whether a customer is in default, the Group also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Group carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include

- the borrower is deceased;
- the borrower (or any legal entity within the debtor's group) filing for bankruptcy application/protection; or
- the borrower is in default of the legal agreement, i.e. not paid or breached covenants.

29.4.2 The Group's internal rating and PD estimation process

The Group operates an internal rating model. The Group assesses its customers who are rated from AAA to D using an internal credit classification model. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. These information sources are first used to determine the probability of defaults ('PDs') for each segment. PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward-looking information and the IFRS 9 Stage classification of the exposure.

Corporate lending

Corporate lending comprises hire purchase, lease or bridging loans. The borrowers are assessed by credit risk employees of the Group. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as

- historical financial information;
- any publicly available information on the clients from external parties; and
- any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Group and the complexity and size of the customer. Some of the less complex small business loans are rated within the Group's models for retail products.

Consumer lending

Consumer lending comprises hire purchase or conditional sale agreements. These products are rated by an automated scorecard tool primarily driven by credit reference agency data. Additional checks on affordability are made using credit reference agency data and bank statements.

The Group's internal credit rating grades

Business Finance, Bridging and Azule

Internal rating grade	Internal Rating Description	Internal PD range
1	AAA & AA, LTV <=80%	1.93-2.15%
2	AAA & AA, LTV > 80%	2.71-4.29%
3	A & B+, LTV <=80%	3.80-4.23%
4	A & B+, LTV > 80%	7.24-8.35%
5	B & B-, LTV <=80%	5.67-7.18%
6	B & B-, LTV > 80%	11.87-13.29%
7	C & D	13.98-16.35%

Consumer Finance

Internal rating grade	Internal Rating Description	Internal PD range
1	AAA & AA, LTV <=80%	3.30-3.58%
2	AAA & AA, LTV > 80%	4.74-5.06%
3	A & B+, LTV <=80%	6.45-6.98%
4	A & B+, LTV > 80%	9.14-9.75%
5	B & B-, LTV <=80%	8.96-9.95%
6	B & B-, LTV > 80%	14.11-15.20%
7	C & D, LTV <=80%	12.07-13.06%
8	C & D, LTV > 80%	20.80-22.88%

29.4.3 Exposure at default

The exposure at default ('EAD') represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments. To calculate the EAD for a Stage 1 loan, the Group assesses the possible default events within 12 months for the calculation of the 12 month ECL. For Stage 2 and Stage 3, the exposure at default is considered for events over the lifetime of the instruments. The Group determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of the Group's models.

29.4.4 Loss given default

The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held. The Group segments are made up of small homogeneous portfolios, based on the internal credit rating. The applied data is based on historically collected loss data as well as borrower characteristics.

Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each segment of each division. When assessing forward-looking information, the expectation is based on multiple scenarios. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries.

29.4.5 Significant increase in credit risk

The Group continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12 month ECL or Lifetime ECL, the Group assesses whether there has been a significant increase in credit risk since initial recognition. The Group considers an exposure to have significantly increased in credit risk when the IFRS 9 lifetime PD has increased by a factor of 1.6.

The Group also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer to the watch list, or the account becoming forborne. In certain cases, the Group may also consider that events explained in note 29.4.2 are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

30 Commitments and guarantees

Operating lease commitments – Group or Company as lessee

The Company has entered into commercial leases for premises and equipment. These leases have an average life of between three and five years with no renewal option included in the contracts. There are no restrictions placed upon the lessee by entering into these leases (e.g. such as those concerning dividends, additional debt and further leasing). Future minimum lease payments under non-cancellable operating leases at 30 September were as follows.

Group and Company	30 September 2019 £'000	30 September 2018 £'000
Within one year	**611**	223
After one year but not more than five years	**2,443**	–
	3,054	223

31 Material litigation

The Group's Bank subsidiary operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent in its operations. The Group and the Bank have formal controls and policies for managing legal claims. Based on professional legal advice, the Group provides and/or discloses amounts in accordance with its accounting policies described in note 1. At year end, there had been no material litigation against the Group or the Company.

32 Related parties

Apart from non-executive directors holding a total of £186,756 in savings accounts in the Bank at 30 September 2019 (30 September 2018 – £102,805), directors' remuneration disclosed in note 9, and guarantees as also disclosed in note 22, there were no other related party transactions during the year.

The Group had a borrowing arrangement from Bermuda Commercial Bank amounting to £83 million which was repaid fully during 2019. Such arrangement was at arm's length and the total interest expense recorded during the year was £214,342.

33 Events after the balance sheet date

Subsequent to the year end, the Group made the payment of £750,000 in respect of Azule's contingent consideration which is considered to be a non-adjusting event.

34 Capital management

The Group maintains an actively managed capital base to cover risks inherent in the business and is meeting the capital adequacy requirements of the local banking supervisor, the Bank of England. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the Group in supervising the Bank.

The Group and the Bank have complied in full with all its externally imposed capital requirements over the reported period.

The primary objectives of the Group's capital management policy are to ensure that the Group and the Bank comply with externally imposed capital requirements and maintain strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholder value.

The Group has a number of measures which it takes to manage its capital position. Further details of this are provided in the Chief Executive's statement.

The Prudential Regulation Authority ('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 Financial Conduct Authority ('FCA'). The aim of the capital adequacy regime is to promote safety and soundness in the financial system. It is structured around three 'pillars'.

Pillar 1 – Minimum capital requirements

Pillar 2 – Supervisory review process

Pillar 3 – Market discipline

Under Pillar 2, the Group completes a periodic self-assessment of risks known as the 'Internal Capital Adequacy Assessment Process' ('ICAAP'). The ICAAP is reviewed by the PRA which culminates in the PRA setting 'Individual Capital Guidance' ('ICG') 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 Group's capital, risk exposures and risk assessment process. The Group's Pillar 3 disclosures can be found on the Group's website, *www.pcf.bank/investors*

The Group maintains a strong capital base to support the development of the business and to ensure the Group meets Pillar 1 capital requirements, ICG and additional Capital Requirements Directive buffers at all times.

As a result, the Group maintains capital adequacy ratios which are above minimum regulatory requirements.

Notice of Annual General Meeting

Dear shareholder,

I am pleased to invite you to the PCF Group plc Annual General Meeting, which will be held at 1 Cornhill, London EC3V 3ND at 10.00 a.m. on Friday 6 March 2020. The relevant Notice of Annual General Meeting follows on the next page.

You will note that, for the first time, all directors will be retiring as directors and then seeking re-election. The background to this is that whilst the Company's Articles of Association provide that directors shall retire and shall be eligible for re-appointment if they were not appointed or re-appointed at one of the preceding two Annual General Meetings, the Board has confirmed that it will comply with the Corporate Governance Code 2018 (the 'Code'), which took effect for the Company from 1 October 2019. The Code states that all directors should be subject to annual re-election. In addition, the Code states that the Board should set out in the papers accompanying the Notice of Annual General Meeting the specific reasons why each director's contribution is, and continues to be, important to the Company's long-term sustainable success. This information is contained in the Appendix to the Notice of Annual General Meeting.

All the other proposed resolutions are consistent with resolutions from previous Annual General Meetings.

In the event that you are unable to attend the Annual General Meeting, you are entitled to appoint a proxy to attend and vote on your behalf. A Form of Proxy is enclosed and the Notes to the Notice of Annual General Meeting set out the process and timelines for appointing a proxy.

Robert Murray
Company Secretary

12 February 2020

Notice is hereby given that the Annual General Meeting of PCF Group plc (the 'Company') will be held at 1 Cornhill, London EC3V 3ND at 10.00 a.m. on Friday 6 March 2020 to consider and, if thought fit, pass the following resolutions, of which resolutions 1 to 14 will be proposed as ordinary resolutions and resolution 15 as a special resolution.

Ordinary Business

1 To receive and approve the Report of the Directors and the audited Financial Statements of the Company for the year ended 30 September 2019.

2 To receive and approve the Report on the Directors' Remuneration as set out in the audited Financial Statements for the year ended 30 September 2019.

3 To re-elect Tim Franklin, who is retiring as a director and seeking re-election.

4 To re-elect Mark Brown, who is retiring as a director and seeking re-election.

5 To re-elect Christine Higgins, who is retiring as a director and seeking re-election.

6 To re-elect Marian Martin, who is retiring as a director pursuant to Article 93 of the Company's Articles of Association, and seeking re-election.

7 To re-elect David Morgan, who is retiring as a director and seeking re-election.

8 To re-elect David Titmuss, who is retiring as a director and seeking re-election.

9 To re-elect Scott Maybury, who is retiring as a director and seeking re-election.

10 To re-elect Robert Murray, who is retiring as a director and seeking re-election.

11 To re-elect David Bull, who is retiring as a director and seeking re-election.

12 To re-appoint Ernst & Young LLP as auditors of the Company and to authorise the directors to determine their remuneration.

13 To declare a final dividend of 0.40 pence per ordinary share in respect of the year ended 30 September 2019.

Special Business

14 To consider and, if thought fit, pass the following as an ordinary resolution.

'That the directors be and are hereby generally and unconditionally authorised for the purposes of Section 551 of the Companies Act 2006 (the 'Act') to exercise all the powers of the Company to allot shares and grant rights to subscribe for or to convert into shares in the Company ('relevant securities') up to an aggregate nominal amount of £2,500,000 provided that such authority shall expire (unless previously renewed, varied or revoked by the Company in general meeting) at the conclusion of the next Annual General Meeting of the Company, save that the Company may prior to the expiry of such authority make an offer, agreement or other arrangement under which the relevant securities would be or might fall to be allotted after such expiry and the directors may allot such relevant securities pursuant to any such offer, agreement or other arrangement as if the authority conferred by this resolution had not expired'.

15 To consider and, if thought fit, pass the following as a special resolution.

'That the directors be and are hereby empowered, pursuant to Section 571 of the Companies Act 2006 (the 'Act'), to allot equity securities for cash pursuant to the authority conferred by Resolution 9 set out in the Notice of Annual General Meeting of the Company dated 12 February 2020, as if Section 561 (1) of the Act did not apply to such allotment, provided that any such allotment shall be limited to

(a) the allotment of equity securities for cash where such securities have been offered (by rights issue, open offer or otherwise) to holders of equity securities in proportion (as nearly as may be) to their holdings of ordinary shares of 5 pence each of the Company but subject to the directors having the right to make such exclusions or other arrangements in connection with such offer as they deem necessary or expedient to deal with fractional entitlements and legal or practical problems under the laws of any territory or the requirements of any regulatory body or stock exchange or otherwise; and

(b) any allotment (otherwise than pursuant to sub-paragraph (a) of this resolution) of equity securities up to an aggregate nominal value of £500,000,

and shall expire (unless previously renewed, varied or revoked) at the conclusion of the next Annual General Meeting of the Company but so that the directors shall be entitled to make, at any time prior to the expiry of the power hereby conferred, any offer, agreement or other arrangement under which the relevant securities would be or might fall to be allotted after such expiry and the directors may allot securities pursuant to such offer, agreement or other arrangement as if the powers conferred by this resolution had not expired'.

By order of the Board

Robert Murray
Secretary

12 February 2020

Registered Office
Pinners Hall
105-108 Old Broad Street
London
EC2N 1ER

Notes

1 A member entitled to attend and vote at the above Annual General Meeting is entitled to appoint a proxy to attend and vote on their behalf. Members may appoint more than one proxy provided that each proxy is appointed to exercise rights attached to different shares. A proxy need not be a member of the Company.

2 A Form of Proxy is enclosed. To be valid, the Form of Proxy must be lodged with the Company's Registrars, Computershare Investor Services plc, The Pavilions, Bridgwater Road, Bristol BS99 6ZY not less than 48 hours before the time appointed for the holding of the Annual General Meeting.

3 Completion of a Form of Proxy will not prevent a member from attending and voting in person at the Annual General Meeting, if the member so wishes.

4 The Company, pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those members registered in the Register of Members of the Company at 10.00 a.m. on Friday 6 March 2020 shall be entitled to vote at the meeting in respect of the number of ordinary shares registered in their name at the relevant time. Changes to entries in the Register of Members after 10.00 a.m. on Friday 6 March 2020 shall be disregarded in determining the rights of any person to attend or vote at the meeting.

5 CREST members who wish to appoint a proxy or proxies by utilising the CREST electronic proxy appointment service may do so for the meeting and any adjournment(s) thereof by utilising the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members and those CREST members who have appointed (a) voting service provider(s) should refer to their CREST sponsor or voting service provider(s) who will be able to take the appropriate action on their behalf.

6 In order for a proxy appointment made by means of CREST to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with Euroclear UK & Ireland Limited's ('EUI') specifications and must contain the information required for such instructions, as described in the CREST Manual. The message must be transmitted so as to be received by the issuer's agent (ID 3RA50) by the latest time(s) for receipt of proxy appointments specified in the notice of the meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

7 CREST members and, where applicable, their CREST sponsors or voting service providers should note that EUI does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed (a) voting service provider(s), to procure that their CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting service providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

8 The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Tim Franklin

Non-executive Chairman, appointed 6 December 2016

Tim has extensive experience in the financial services industry having worked for over 30 years in the retail banking and building society sectors. Tim served as a non-executive director of the Post Office for 7 years until December 2019 and remains Chairman of Post Office Insurance. Additionally, he is a non-executive director of Computershare Loan Services. Tim is an Institute of Leadership & Management Level 7 Coach and works extensively with senior executives across many industries, both in the UK and internationally. In addition, he is an Associate of the Chartered Institute of Bankers.

Tim is Chairman of the Nomination Committee and a member of the Remuneration Committee.

Contributions and reasons for re-election

Tim has spent his entire career in the financial services sector and was appointed as a director and Chairman of the Board at the time when PCF was granted its banking licence. He is an experienced main board director with a track record of delivery across a wide variety of businesses.

He has been instrumental in leading the Board during a period of sustained growth, ensuring that the growth is measured and that the appropriate governance is in place. In particular, he has re-constituted the Board with the appointment of three new, independent non-executive directors who have added breadth, depth and diversity to the Board. Tim leads the Board with a high degree of professionalism, encouraging full participation and contribution from the other members of the Board.

Mark Brown

Non-executive director, appointed 1 December 2015

Mark was Chairman of Stockdale Securities from November 2014 until it was bought by Shore Capital in April 2019. He was previously Chief Executive of Collins Stewart Hawkpoint and brings a wealth of experience and leadership in both small and large financial services businesses. Having worked as Global Head of Research for ABN AMRO and HSBC and as Chief Executive of ABN's UK equities business, Mark led the successful turnaround of Arbuthnot Securities followed by Collins Stewart Hawkpoint.

Mark is a member of the Nomination Committee and the Remuneration Committee.

Contributions and reasons for re-election

Mark has over 30 years of experience in the financial services sector, the last 15 of which have been spent assisting companies with listing and equity raising. His experience and in-depth knowledge of the stock market has proved invaluable as PCF has sourced new equity and expanded its shareholder register. Mark also has extensive experience of running financial services businesses and, in particular, delivering change to improve profitability.

Christine Higgins

Independent non-executive director, appointed 13 June 2017

Christine is a chartered accountant with over 25 years' experience in asset finance for UK and international banks. Over the last 9 years, she has served as non-executive director on a number of boards in the health, housing, leisure and finance sectors, including as chair of the audit committee. She is currently a non-executive director of Buckinghamshire Building Society and chairs its audit committee.

Christine is Chair of the Audit & Risk Committee and a member of the Nomination Committee and the Remuneration Committee.

Contributions and reasons for re-election

Christine is an experienced non-executive director with extensive knowledge of the financial services sector and, in particular, asset finance. With a background in accountancy, she has in depth knowledge of accounting standards and financial reporting, as well as a strong eye for detail. She chairs the Audit & Risk Committee in an energetic and collegiate style, ensuring that controls, governance and risk management are of the highest standards.

Marian Martin

Independent non-executive director, appointed 25 July 2019

Marian Martin is a chartered accountant with a background in risk management and audit. Most recently, Marian was at Virgin Money for 11 years and was Chief Risk Officer throughout a period of significant growth and strategic development of Virgin Money and its risk function, including the successful listing of Virgin Money on the London Stock Exchange. Marian was an executive director of the main trading companies of the Virgin Money group during this period. In addition, Marian is a non-executive director at Castletrust and Starling Bank.

Marian is a member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

Contributions and reasons for re-election

Marian has a wealth of experience in the financial services sector and has quickly made a contribution to the Board at PCF with her detailed knowledge and skills in risk management. In particular, she has very recent, relevant experience in an executive role of a retail bank whose shares are listed on the Stock Exchange.

David Morgan

Non-executive director, appointed 9 July 2012

David has over 35 years' experience in international banking, building his career at Standard Chartered Bank in Europe and the Far East. Since leaving Standard Chartered in 2003, he has been involved in a range of business advisory and non-executive roles. He is currently a non-executive director of Somers Limited, Bermuda Commercial Bank Limited and Waverton Investment Management Limited. He is also Chairman of Harlequin FC, the Premiership rugby club.

David is a member of the Audit & Risk Committee, the Nomination Committee and the Remuneration Committee.

Contributions and reasons for re-election

David is a highly experienced non-executive director who has significant banking experience, both at an executive and non-executive level. He brings a high level of challenge and direction to the Board, especially in terms of strategy and business development.

David Titmuss

Independent non-executive director, appointed 11 July 2017

David has over 25 years' experience in both large and small financial services organisations, with a particular emphasis on customer acquisition and database management. His corporate background includes working at a senior level in public and privately backed businesses. He has also led companies, both as CEO and as a board director. Latterly, David headed the marketing function of *webuyanycar.com* and is recognised as an expert in digital marketing and advising businesses on cost-effective customer acquisition.

David is Chairman of the Remuneration Committee and a member of the Nomination Committee.

Contributions and reasons for re-election

David adds breadth to the Board with a wide experience in business which covers a number of different sectors, including, but not limited to, financial services. His specialism and expertise in marketing and the digital landscape has proved to be vital. In addition, he has direct experience of credit decisioning and debt collections for retail and corporate customers, gained from holding senior roles in the finance industry for a number of years. David has an abundance of energy, enthusiasm, ideas and passion and provides positive challenge to the Board.

Scott Maybury

Chief Executive, appointed 12 January 1994

Scott holds a degree in business studies and is a qualified accountant. He spent 6 years with BHP Billiton, Australia's largest multi-national corporation, and 5 years with McDonnell Douglas Bank. He is one of the founding directors of PCF Group plc and was previously Finance Director until October 2008.

Contributions and reasons for re-election

Scott is one of the founding directors of PCF and has detailed knowledge of its finances, having previously been the Company's Finance Director. He has been Chief Executive for the past 11 years, successfully steering it through the Global Financial Crisis before subsequently leading it through the banking licence application process and delivering its strategic plan as a bank. He has over 20 years' experience of managing a business which is listed on AIM.

Robert Murray

Managing Director, appointed 19 October 1993

Robert holds the ACIB Banking diploma and has over 40 years' banking and finance experience. He has extensive experience in lending to personal, corporate and international customers. He is one the founding directors of PCF Group plc.

Contributions and reasons for re-election

Robert has spent his entire career in the financial services sector and is one of the founding directors of PCF. He has detailed knowledge of the business and, in particular, its lending activities, customers and introductory sources. He was instrumental in the acquisition of Azule in 2018 and the setting up of the bridging finance operation in 2019. He has over 40 years of banking experience, lending to consumers and corporates as well as over 20 years' experience of managing a business which is listed on AIM.

David Bull

Finance Director, appointed 3 August 2015

David holds a first-class degree in Mathematics and Statistics and is a qualified chartered accountant. After qualifying in 1996, he has worked in the banking sector across a number of institutions, including KPMG, Deutsche Bank and was interim Chief Financial Accountant at the Bank of England. Before joining PCF Group, David was a Director of Finance and Company Secretary at Hampshire Trust Bank plc, a specialist challenger bank, where he was instrumental in setting up their banking operations.

Contributions and reasons for re-election

David has extensive experience in accounting, regulatory reporting and managing the capital and liquidity requirements of a bank. He was instrumental in the execution of PCF's plan to become a bank, taking a leading role in establishing and embedding the governance and risk management framework.

He has over 25 years of banking experience, including strong operational skills, covering areas such as savings and customer services.

PCF Bank Limited Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER

www.pcf.bank

Lending Consumer Finance 020 7227 7506 Business Finance 020 7227 7560
Azule Finance 01753 580 500 Bridging Finance 020 3848 7802

Savings 020 7227 7577 **Credit Control** 020 7227 7517 **Switchboard** 020 7222 2426

PCF Bank Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, FRN number 747017. The Bank is registered in England and Wales, registration number 02794633 and is wholly owned by PCF Group plc, a company registered in England and Wales, registration number 02863246 and listed on the Alternative Investment Market. Certain subsidiaries of the Bank are authorised and regulated by the Financial Conduct Authority for consumer credit activities. Registered offices are at Pinners Hall, 105-108 Old Street, London EC2N 1ER.