



MANX FINANCIAL
GROUP PLC

ANNUAL REPORT 2018

Welcome to Manx Financial Group PLC

Integrity through independence and service

An independent banking group founded in 1935, domiciled in the Isle of Man



MANX FINANCIAL
GROUP PLC

Manx Financial Group PLC ("MFG") is an AIM-listed company (LSE: MFX.L) which has subsidiaries engaged in a suite of financial services based in the Isle of Man and the UK. These companies offer financial services to both retail and commercial customers. MFG's strategy is to grow organically and through strategic acquisition to further augment the range of services it offers.

Principal wholly owned subsidiaries: -

- Conister Bank Limited
- Edgewater Associates Limited
- Manx FX Limited



MANX FOREIGN
EXCHANGE

Manx FX Limited was formed in 2014 and provides specialist solutions and access to competitive foreign exchange and international payment processing facilities.



Conister Bank Limited ("the Bank") is a licensed independent bank, regulated by the Financial Services Authority in the Isle of Man, the Financial Conduct Authority in the UK and is a full member of the MasterCard® network and the Isle of Man's Association of Licensed Banks.

The Bank provides a variety of financial products and services, including savings accounts, asset financing, personal loans, loans to small and medium sized enterprises, block discounting and other specialist secured credit facilities to the Isle of Man and the UK consumer and business sectors.



Edgewater Associates Limited ("EWA") is the largest independent financial adviser in the Isle of Man.

EWA provides a bespoke and personal service to Isle of Man residents and to the Group's business and personal customers and advises on assets in excess of £310 million.

EWA specialises in the areas of wealth management, mortgages, general insurance, and retirement planning.

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STRATEGIC REPORT

CHAIRMAN'S STATEMENT

Dear Shareholders

When I wrote to you in the Interim Results for 2018, I was confident that the full year would continue our growth in profitability. This has proved to be the case, but the effect of the two positive initiatives undertaken during the second half of the year has had a temporary impact on the Income Statement. The first being the investment in the UK by opening a new full-service UK Headquarters in Newbury, with a satellite branch in Manchester. These offices will source new business and manage our UK lending portfolio through our subsidiary Conister Finance and Leasing Limited, thus demonstrating our commitment to this increasingly important segment of our business. Secondly, the increasing economic uncertainty surrounding both the Isle of Man and the United Kingdom has reinforced your Board's decision to adopt an ultra-conservative approach to provisioning under the requirements of the International Financial Reporting Standard 9 ("IFRS 9") by recognising an additional buffer to strengthen the Balance Sheet. I must emphasise that this action does not represent a realized cash outlay and is there, if ever required, solely to protect our future profitability. Indeed, the quality of our underwriting is such that our actual ratio of bad debts written off stands at an enviable 0.6% (2017: 0.5%).

As a consequence, our profit before tax is broadly similar to 2017 at £2.7 million (2017: £2.7 million). However, our total assets have increased by 13.8% to £196.9 million (2017: £173.0 million) and our total shareholder equity has increased by a corresponding 14.3% to £19.7 million (2017: £17.3 million). Whilst the latter figure is gratifying, I am deeply aware that as I write, our market capitalisation stands at only £11.5 million, being a discount of 42%. This discount is regrettable, especially when ranked against our peer group.

Of our core businesses, Conister Bank has enjoyed excellent new business generation, offset by the run-off by mutual agreement of two discontinued lending streams, both nearly complete, but representing a decrease of £14.8 million during the year (2017: £12.7 million). Thus, the fall in interest income to £19.1 million (2017: 19.9 million) belies a total new lending of £102.1 million for 2018 (2017: £73.7 million). I discuss this further below, but suffice to say, this bodes well for the future by diversifying our risk profile. Manx FX Limited produced an encouraging profit before tax of £0.5 million (2017: £0.3 million) and Edgewater Associates Limited, although experiencing a market downturn during the last two months of 2018, produced a profit before tax of £0.3 million (2017: £0.7 million).

Corporate governance

It is important for shareholders to understand the emphasis both I and the Board place upon corporate governance. In May 2018, we adopted the Quoted Companies Alliance corporate governance code ("QCA") with which we expect to be fully compliant in our reporting for the year-end statutory accounts. In essence, the code has ten principles to aid investors in their understanding of our Group and to help build and develop long term trust and maximise our relationship with shareholders. As Chairman, it is my responsibility to make a clear statement on corporate governance and the value we place upon this. Our full year accounts will provide a detailed explanation of how we observe the QCA, but meanwhile, I am keen for investors to understand our strategic objectives both in the near and longer term.

Our key objectives for 2019

Your Board's fundamental objective remains that of increasing shareholder value, both in a prudent yet progressive manner. Thus, our strategic concentration continues to be: -

- Providing the highest quality service throughout our operations to all customers, ensuring that their treatment is both fair and appropriate;
- Adopting a pro-active strategy of managing risk, especially following the implementation of IFRS 9 in full. In doing so, we are committed to regularly review our loan book to allow for any credit impairment resulting from observing strict Expected Credit Loss criteria;
- Concentrating on developing our core businesses by considered acquisitions, increased prudential lending and augmenting the range of financial services we offer;
- Implementing an enhanced and scalable IT infrastructure to better service the operational requirements of a growing Group without the requirement for a disproportionate increase in headcount;
- Focusing on the liabilities side of our balance sheet by introducing a new treasury management function and structure; and
- Managing our balance sheet to exceed, as far as possible, the regulatory requirements for capital adequacy.

We implemented the General Data Protection Regulation on 25 May 2018. Doing this required changes in policy, procedures and technology across the Group to manage how we process and secure data and protect the rights of individuals. Both our Internal Audit and Compliance teams have reviewed the process and will continue to be involved in making sure that the post implementation requirements continue to be met.

We have also instituted an important new position, that of Head of Risk and Compliance, to enhance and monitor our control functions, ensuring that these meet the highest banking standards and are commensurate with the growth in our operations.

Financial performance review

Conister Bank Limited (the "Bank")

Despite the shadow of economic uncertainty, all our lending targets for the year were exceeded. We have been able to make significant inroads into the UK commercial sector, while increasing our lending in the Isle of Man. As I reported above, net new lending increased by 38.4% to £102.1 million (2017: £73.7 million), driven by a 41.9% uplift in lending on the Isle of Man and a substantial increase in demand for our structured product range in the UK. Thus, the net loan book growth of 21.0% to £148.3 million (2017: £122.5 million) has been achieved with no deterioration in loan book quality as performing loans remained at 97.2%. In anticipation of this increase in UK demand, we have opened fully equipped new offices in Newbury and in Manchester. We are confident that we have invested in the most experienced teams available to develop this important market segment.

STRATEGIC REPORT

CHAIRMAN'S STATEMENT

I have previously explained that improving our technology is of primary importance as we increase in scale. During 2018, we successfully installed a new deposit system, representing an investment of £1.0 million spread over five years. This has helped manage the growth of our deposit base by 11.4% to £158.5 million (2017: £142.3 million). One of our key efficiency measures, our Loan to Deposit Ratio, improved by 7.5% to 93.6% (2017: 86.1%) which reflects the improved use of our cash balances. We also continue to almost exactly match our loan terms to our deposit maturities. We note, however, that the average term of our loan book has marginally reduced, reflecting the uncertainty in the market in response to the current economic outlook.

As I mentioned in my 2017 Chairman's Report, we instituted a policy to eliminate any reliance upon UK introducers where we suffer a disproportionately adverse commission-sharing cost. This initiative has continued throughout 2018. Thus, commission expense decreased by 27.4% to £6.1 million (2017: £8.4 million). This movement resulted in net interest income increasing by 13.1% to £12.8 million (2017: £11.3 million) despite interest expense increasing by 8.9% to £3.5 million following the increase in deposit balances. As a result of these factors, trading income improved by 15.9% to £9.5 million (2017: £8.2 million) leading to a 16.3% increase in operating income £9.8 million (2017: £8.4 million).

Although operating expenses decreased by £0.2 million to £6.0 million (2017: £6.2 million), this masks the investment we have made in new personnel, systems and controls, enhancing our skill set throughout the business. The increase in impairment provision, to which I have already referred, to £0.9 million (2017: £0.6 million) reflects a prudent buffer against a potentially adverse outcome following any conclusion of the current economic uncertainty. It is important to note that, despite our conservative approach to approving advances, this figure still only represents 2.0% of the enlarged gross loan book, with the total impairment provision in the Balance Sheet standing at £3.4 million (2017: £2.7 million). Other costs net to £0.2 million (2017: £0.0 million) as the gain last year from the write-off an intercompany payable has not been repeated. Thus, profit before tax improved by 26.0% to £2.2 million (2017: £1.7 million) leading to a 24.0% increase in post-tax profit contribution by the Bank to £2.0 million (2017: £1.6 million).

Total assets, benefitting by a loan book growth of £25.6 million, part financed by the conversion of cash and debt securities of £5.7 million, showed a 13.0% increase to £190.1 million (2017: £168.7 million). As a consequence, shareholder equity improved by 25.0% to £21.1 million (2017: £16.9 million).

Included in the Balance Sheet is a VAT debtor amounting to £1.1 million. This figure represents the VAT recovery relating to a claim under the revised Partial Exemption Special Method. Since the publication of our last financial statements, the Court of the European Union determined in favour of Volkswagen Financial Services Limited in a parallel dispute against HM Revenue & Customs. This is an extremely encouraging development and sets a precedent. Thus, discussions with the Isle of Man Government Customs and Excise Division have commenced regarding a full recovery of this debtor.

During the year, as part of our drive to maximise new business, the Group financed the issue of £2.4 million of new ordinary shares by the Bank which, together with the increase in retained earnings, improved total Tier 1 capital by 23.0% to £19.8 million (2017: £16.1 million). This in turn improved total regulatory capital expressed as a percentage of total risk-weighted assets by 0.6% to 18.1% (2017: 17.5%), well above our notification threshold of 15.0%.

Edgewater Associates Limited ("EWA")

Although fee income appears to have remained steady at £2.6 million (2017: £2.6 million), an unexpected change in UK legislation meant a temporary halt to our ability to service pension transfers to the Isle of Man during the second half of the year. Notwithstanding, all other fee-based services showed encouraging growth. As a result, we were required to make a final top-up payment of £0.1 million to the vendor of our recent acquisitions. This, coupled with the effect of a full year increase in administration costs, including investment in improved systems, to £2.3 million (2017: £1.8 million) caused the profit contribution to decline to £0.3 million (2017: £0.7 million).

Total assets reduced by 2.0% to £3.1 million (2017: £3.2 million), reflecting a decrease in debtors. However, creditors also reduced, resulting in an improvement in net assets to £2.3 million (2017: £2.0 million). Shareholder equity increased by 12% to £2.3 million (2017: £2.0 million).

The underlying business continues to experience considerable excess demand, but is limited by the difficulty of recruiting suitably qualified advisors. Notwithstanding, EWA remains the Isle of Man's largest IFA. We remain encouraged by the opportunities available for this important part of the Group's business and I am pleased to note that we have already seen a meaningful improvement in profitability from the beginning of 2019.

Manx FX Limited ("MFX")

This business is still very much in its infancy. Because of the low-cost structure, relatively small increases in income can generate unusually positive consequences. For example, the introduction of a hedging strategy for clients during the year doubled turnover to £0.8 million (2017: £0.4 million). While this level of income is not necessarily expected to be repeated in 2019, MFX continues to attract new clients, and now services an active Isle of Man customer base of 87 (2017: 58). This rapid growth means that we continue to develop and invest in an enhanced operational infrastructure to provide the necessary resilience in our control functions. As a consequence, our administration expenses have increased to £0.3 million (2017: £0.2 million), leading to a significant profit contribution from MFX of £0.5 million (2017: £0.3 million).

Turning to the balance sheet, total assets increased to £0.6 million (2017: £0.2 million) and shareholder equity stands at £0.6 million (2017: £0.1 million).

STRATEGIC REPORT

CHAIRMAN'S STATEMENT

Outlook

The widely reported current economic uncertainties and potential changes in interest rates will have an impact on credit markets both in the Isle of Man and the UK. Notwithstanding, I believe that the Bank's strategy of asset-backed lending to carefully selected sectors will allow us to continue to grow. We continue to develop new loan products to those entities with significant balance sheets which demonstrate both affordability and credit resilience. Thus far, we have experienced no downturn in demand in both the commercial and consumer marketplace in both jurisdictions and are more than able to maintain rigorous credit and risk control in our underwriting.

In conjunction with this, the Bank continues to seek out suitable acquisitions for our strategy of consolidation, particularly in the UK. So far this year, we have acquired 20% of the issued share capital of Beer Swaps Limited, trading as Ninkasi Brewkit Rentals, a relatively new company financing brewery equipment, together with an option to acquire the remaining shares by April 2021. We have also acquired 30% of the issued share capital of PayltMonthly Limited which provides web-based finance solutions to retailers without the need for them to maintain an onerous compliance resource, allowing their customers the ability to spread repayments over one year, together with an option to acquire the remaining shares after August 2021. Although these initiatives are individually small in scale, they will be integrated to form our own specialist introducer network using the synergies available from central funding, systems, risk management and controls, augmented with dedicated staff capable of developing this important aspect of our portfolio.

Now that the businesses have fully integrated, EWA has the real potential to grow financial advisory services, not only on the Isle of Man but also within the UK, especially as the need to finance a longer retirement becomes a necessity. We continue to review suitable acquisitions capable of increasing profitability. EWA not only has a strong new business pipeline, but approximately half of its income derives from renewals. Our only limitation to this growth is the recruitment of suitably qualified advisors. To counter this, we are concentrating on an internal program of staff development which is proving to be extremely successful.

MFX also has the potential for further growth and, conversely, has the capability of benefitting from any uncertainties in the financial environment as its clients seek the optimum solutions to manage foreign currency exposures. Only a relatively few Isle of Man businesses maintain in-house foreign exchange expertise and the MFX proposition has limited competition.

In short, I believe that the Group as a whole is well placed to achieve continued expansion. Each of our principal operations are profitable and each has identified opportunities, yet unrealised. It is this which will allow us to meet our 2019 strategic priorities. Whilst our organic growth continues to be excellent, any significant growth will require further acquisitions, strategic partnerships and the development of specialist products to meet the ever-changing market needs. Each solution we offer will be assessed in terms of risk profile and subsequent reward. Clearly, those opportunities that utilise technology to the full and fit well within our current operations are of the greatest interest. Meanwhile, we remain in an excellent position to report further success, both at the Interims and the year-end.

I, and the Board, recognise the need to address the question of shareholder return. As ever, the conflicting demands of utilizing shareholder equity as the regulatory platform to support growth versus the compounded cost of a dividend payment are difficult to reconcile. As an example, currently for every £1,000 paid as a dividend, the Group would forgo £6,000 worth of new business with its attendant yield. Added to which, as the Group utilises relatively expensive non-dilutive term loans to augment regulatory capital, we would effectively be undertaking additional borrowing to make payment. Notwithstanding, we are considering potential arrangements which will, we believe, be of benefit to shareholders but without reducing our potential to reach the scale whereby the Group becomes capable of self-generating regulatory capital. It is unlikely that we will be able to implement any scheme during 2019, but depending upon this year's outcome, we may be in a better position to implement a scheme thereafter.

Finally, and as always, I would like to thank our shareholders for your continued support, our customers and clients for their loyalty, and also our excellent staff for their outstanding efforts in continuing to develop the Group.

Jim Mellon
Executive Chairman
27 March 2019

STRATEGIC REPORT

BUSINESS MODEL AND STRATEGY

Conister Bank Limited (the “Bank”)

The Bank’s Board of Directors (the “Board”) has set strategic objectives, aligned to its strategic plan. These objectives provide the framework for setting risk appetite statements and tolerances for all material risks. The strategic objectives set are:-

- Maintain capital adequacy;
- Deliver stable earnings growth;
- Secure stable and efficient access to funding and liquidity, and
- Maintain stakeholder confidence.

These strategic objectives provide the link between the Bank’s strategic planning and its risk management framework, using risk appetite statements, measures and tolerances to manage risk on a day-to-day basis and are reviewed annually and approved by the Board. Key in considering the Bank’s judgement of appetites is its assessment of its regulatory environment (both in the Isle of Man (“IOM”) and the United Kingdom (“UK”); the IOM deposit market; access to regulatory capital; the IOM and UK credit markets; the suitability of its product range; concentrations of advances and historic arrears. The aim is to deliver controlled growth, by providing adequate returns with strong credit profiles. In addition, the Bank has specifically assessed the impact of the Brexit on both sides of its Balance Sheet.

Having considered the above, drawing on both internal and external resources, the Bank continues to believe the credit markets it operates within remains conducive to growth with liquidity sourced from both its balance sheet the IOM’s substantial deposit base. This growth will be achieved through the expansion of existing products organically and through acquisition. The Bank continues to explore opportunities with both new products and new markets. This strategy can be analysed by the two geographical areas the Bank operates within, namely the IOM and the UK.

The Bank’s strategy for stable growth is underpinned by its existing mix of products, both for the IOM and UK markets. The Bank is proud of its heritage and remains heavily centric in the IOM but recognises that as its UK loan book grows it will need to create a UK presence to manage and grow this aspect of its business. As such, in 2018, the Bank opened offices in both Manchester and Newbury. The former is a base for the Bank’s small but growing UK direct sales team and the latter deals with all aspects of the Bank’s UK credit broker market. These are two markets in which the Bank wishes to increase its presence. Furthermore, growth is forecast from the Bank’s Structured Products and a team, led by an experienced banker, has been recruited to manage this product range based in the Newbury office.

Sourcing reliable funding underpins the Bank’s growth objectives. Through the Bank’s Class 1 Isle of Man Deposit Taking licence it has access to £40.0 billion of deposits. The Bank currently restricts itself to the retail market, of which it has circa 1.0% market share, but the Bank recognises it has an opportunity to increase its market share through the reduction in competition experienced in this market and or by increasing interest rates. Also, the Bank is considering accessing other IOM deposit markets, for example, the corporate deposit market where its systems, processes and

reputation may provide a competitive advantage over others. As such, the Bank believes that it is armed with sufficient reliable alternatives to be confident that it can raise the necessary deposits when required.

The Bank’s acquisition strategy is to gain market share in markets it already operates within or to gain access to a desirable market through an existing reputable, profitable operator.

Regarding the former, the Bank continues to enjoy a positive lending experience within the UK credit broker market and currently has circa £20.0 million of net loans outstanding. The strategy for growth is both organic (through improving customer service and increasing the number of brokers on its roster) and acquisitive. The Bank is currently in negotiation with an established credit broker with the view of acquiring its non-regulated business during 2019.

Edgewater Associates Limited (“EAL”)

Edgewater Associates Limited is the largest Independent Financial Advice firm in the Isle of Man and is regulated by the Isle of Man Financial Services Authority. Our strategic objective is to:

- Grow and service our client base;
- Increase assets under advice; and
- Grow and develop our staff complement.

EAL is a generalist IFA practice with a diverse mix of clients requiring a broad range of products and services covering:

- First time buyers --- mortgages;
- Newly qualified professionals --- protection, savings, school fees;
- Established clients --- wealth management, retirement planning; and
- General insurance clients --- home, car, travel, commercial, specialist.

In 2016 EAL embarked on an aggressive and successful acquisition programme covering a two year period; at the outset we had a client base of approximately 4,600 clients. After four acquisitions and an active data cleansing review, we now have an active client base of approximately 11,800, with associated assets under advice of £310 million (up from £273 million in 2017).

Whilst we will continue to grow and develop our standard business model, we will always be open to new opportunities. We remain nimble and ready to move with economic and regulatory changes as they arise; our team remains up to date against industry standards and trends. We retain an appetite for growth either through additional acquisition opportunities that may arise, or via organic growth from our existing client bank and business partners with whom we have built strong relationships.

Diversification opportunities are also encouraged and pursued, as per our successful programme to grow / build Employee Benefit Group Schemes. This incorporates staff pensions (including pension freedom), protection, private medical cover, and death in service.

STRATEGIC REPORT

BUSINESS MODEL AND STRATEGY

To keep pace with our development we continue to train talented young people to progress to rounded, professional advisers who are able to fit into succession planning. To supplement this, we also take the opportunity to recruit quality experienced advisers and para-planners who can further enhance our team.

Manx FX Limited ("MFX")

Established in 2014, MFX has specialist knowledge of currency operational requirements and has carefully selected the best UK partners to provide market foreign exchange and leading payment services. The strategic objectives of MFX are:

- To maintain and develop existing client relationship;
- To increase the number of referrals to our foreign exchange business partners with a view of on-boarding new clients; and
- To raise MFX's profile and build a professional reputation on the Isle of Man ("IOM").

We believe the foreign exchange and international payment offering via our UK partners is second to none. With our upfront agreed foreign exchange margins the customer has complete pricing transparency. Our business partners have been carefully selected to ensure they are able to obtain the best possible pricing from the market.

The international payments fees offer outstanding value, at hugely reduced fees compared to any local high street bank. At MFX, we realise that often our clients just need a facility to send urgent payments quickly and efficiently so we provide access to a FX and payments online system with straight through processing to make these tasks as effortless as possible.

For the next 12 months, MFX will concentrate its efforts in the IOM. The IOM offers large potential having a diverse range of industries.

A small but dedicated team know and understand the importance of offering excellent service and has pride and integrity when dealing with both existing clients and new prospects. Our professional reputation is important to our business and our colleagues attend local industry events which serves two purposes; to enforce and raise the profile of MFX and support IOM businesses.

Maintaining a close working relationship with our UK partners is core to our business. Regular conference calls and quarterly face-to-face meetings are held to discuss new opportunities, changes to product offering, industry updates and just as importantly a chance to develop the personal working relationship.

RISK AND GOVERNANCE

RISK MANAGEMENT

Risk management overview

Effective risk management is crucial to MFG’s sustainability. The Board is ultimately accountable for the effective governance of risk management. The Board maintains its oversight and responsibilities in terms of the three lines of defence risk governance model set out below.

Determining the Group’s risk tolerance and appetite through enterprise risk management is a key element of MFG’s corporate governance framework. This framework has been enhanced during 2018 and sets out the governance principles, practices and guidance to facilitate effective and efficient management of the Group’s business. It is primarily designed to assist the Group in enhancing its corporate governance framework and intended to reinforce the key elements of widely accepted and long established Quoted Companies Alliance (“QCA”) corporate governance principles.

A fundamental principle contained in the code, is for effective risk management: MFG has in place a Risk Management Framework and a Capital Management Framework (undertaken through its Internal Capital Adequacy Assessment Process (“ICAAP”)) to support the implementation of some of the principles of the MFG Governance Framework at subsidiary level. The Risk Management Framework was also significantly enhanced in 2018 and ensures that MFG conducts its business in the correct way and manages its financial resources responsibly to safeguard the interests of all its stakeholders. It further supports the Board and senior management in fulfilling their respective duties in relation to the sustainable operation of the business. The risk management system is supported by

policies, processes and activities relating to the taking, management and reporting of risk.

Management and accountability

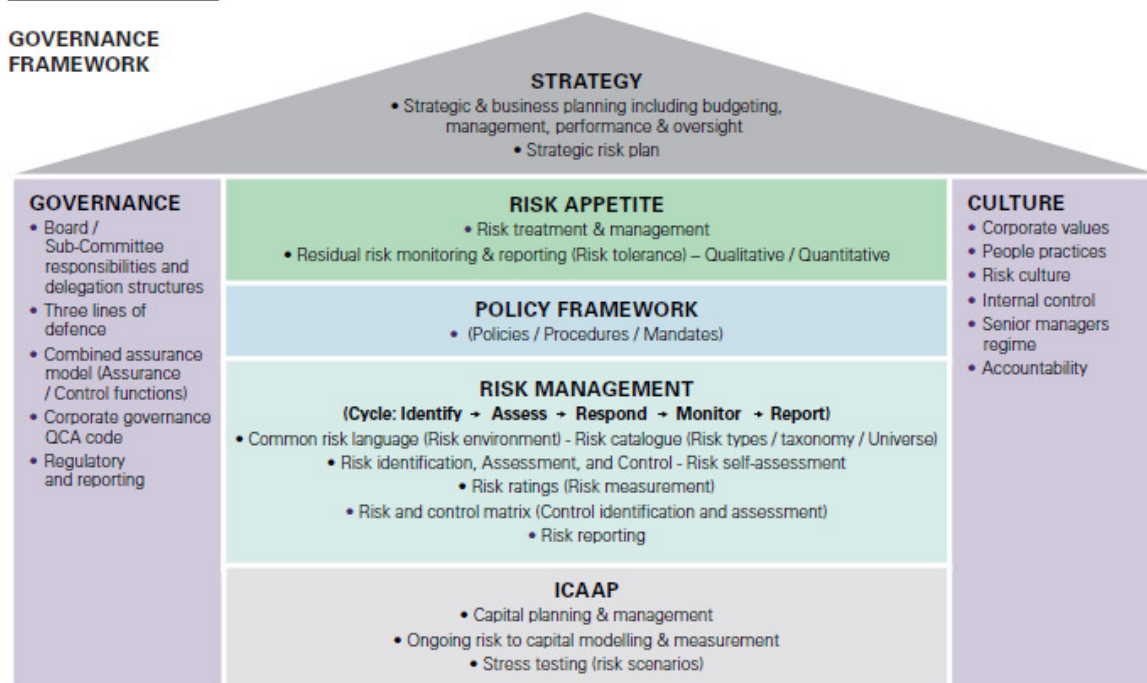
The Audit, Risk and Compliance Committee (“ARCC”) is operated at a group level and currently comprises of two experienced non-executive directors who are both qualified accountants. Only members of the ARCC have the right to attend ARCC meetings to allow for independence. However, other individuals representing Risk, Compliance and Internal Audit are always invited by the Chairman of the Committee to attend all or part of any meeting as and when appropriate.

The main objectives of the ARCC are to review operations and ensure that they are conducted to the highest possible standards. This is accomplished by providing an independent objective assurance function specifically for, but not limited to: Internal Controls and Risk Management Systems; Whistleblowing and Fraud; Risk and Compliance; Internal Audit; and External Audit.

It provides oversight of compliance with all legislation, regulation and applicable codes of practice in the jurisdictions that MFG conducts business; and reviews policies, procedures and processes to effectively identify, quantify and manage all material risks and to advise on best practice.

Governance framework

The following overview of the key governance components that make up the MFG system of governance illustrates the crucial role of risk management:



RISK AND GOVERNANCE

RISK MANAGEMENT

Culture

The risk culture, which forms part of MFG's overall culture, encompasses the tone at the top and a set of shared attitudes, values, behaviours and practices that characterise how individuals at MFG consider risk in their day-to-day business activities. Learnings are taken from previous incidents and ongoing assessment to ensure continuous improvement in the management of risk.

All individuals understand the importance of effective risk management and ensure that risks associated with their role are appropriately understood, managed and reported. Individuals at all levels communicate risk related insights in a timely, transparent and honest manner.

This culture is driven from the top by the Board and Executive Management through how they communicate, make decisions and motivate the business. Managers and leaders ensure that in all their actions and behaviours they continually reinforce the culture that the effective management of risk is critical to MFG's success and that every individual plays a role in the management of risk.

Appetite

Risk appetites are currently only set at subsidiary level and set out the maximum amount of risk that it is prepared to accept in the pursuit of delivering on business objectives. The risk appetite covers all the risk types (e.g. strategic and business risk, market risk, credit risk, liquidity risk, operational risk, conduct risk and compliance & legal risk) and is reviewed annually and as the operating environment changes it is constantly measured against stated appetite to take appropriate action.

Risk identification, measurement & control

Improving a robust understanding of the risks to which the business is exposed is crucial to ensure that all material risks are appropriately monitored, managed and reported on. Each individual within the Group in conjunction with their manager is responsible for understanding the risks associated with their role. An understanding of risk is developed through the identification, assessment and where appropriate, measurement of risks to which the business is exposed.

These processes are performed as part of strategy setting, strategy execution and day-to-day operations and are referred to as risk and control assessments. The Risk team provides tools to aid managers and individuals in developing an understanding of risk within their respective business responsibilities.

The risk and control assessment process of understanding risk and reviewing the adequacy and effectiveness of related controls and risk mitigation approaches is generally performed on a regular basis, at least annually, as part of a continuous risk management cycle.

Three lines of defence and key assurance functions

As part of its overall governance framework, MFG has adopted best practice monitoring and control mechanisms by implementing the three lines of defence governance and combined assurance model. This means that responsibility for governance and oversight is allocated throughout the

organisation according to the 'three lines of defence' principles.

The three lines of defence governance model is regarded as international best practice for ensuring good governance (including governance within risk and capital management) across an organisation. The emphasis is placed on ownership, responsibility, independence, assurance, communication, oversight and transparency across MFG governance.

The term 'key assurance function' refers to a properly authorised function, whether in the form of a person, unit or department, serving as a control or 'checks and balances' function from a governance perspective, and which carries out such activities. These functions typically are second and third line of defence functions.

First line of defence

The first line of defence e.g. business management is primarily accountable for the day-to-day risk origination and management in accordance with risk policy and strategy. This includes identifying, assessing risks and implementing responses.

Second line of defence

The second line of defence is responsible for the development and maintenance of the frameworks and policies. The second line provides oversight of, and challenge to, the first line of defence and drives the implementation of the frameworks and policies.

Third line of defence

The third line of defence is the independent assurance function providing overall assurance to the Board on governance, risk management, and internal controls. The third line of defence comprises of internal audit, external audit and other independent assurance providers. The third line of defence is completely independent from the management of the day-to-day business activities

MFG assurance functions

MFG has effective systems of risk management and internal control. The tasks, processes and obligations of the key assurance functions are transparent and clearly defined, with regular exchange of information between the functions. Each of the functions is structured to ensure that the function has the necessary authority, independence, resources, expertise and access to the Board and all relevant employees and information to exercise its authority. The minimum assurance functions within MFG include:

- Risk management function;
- Compliance function; and
- Internal Audit function.

The head of each of these key functions possesses the necessary skills, experience and knowledge required for the specific positions they exercise, and meet all suitability or 'fit and proper' requirements. Written guidelines for these functions are in place, and compliance with them is assured on a regular basis. All of the key functions within MFG have a direct reporting line to the Board.

RISK AND GOVERNANCE

RISK MANAGEMENT

MFG is developing a combined assurance model to effectively manage the organisation's significant risks and material matters through a combination of the assurance service providers and functions described above.

Risk strategy & overview

Risk plan

The Board has set strategic objectives, aligned to its strategic plan. These objectives provide the framework for setting risk appetite statements and tolerances for all material risks. The strategic objectives set are:-

- Maintain capital adequacy;
- Deliver stable earnings growth;
- Secure stable and efficient access to funding and liquidity, and
- Maintain stakeholder confidence.

These strategic objectives provide the link between the Group's strategic planning and its risk management framework, using risk appetite statements, measures and tolerances to manage risk on a day-to-day basis and are reviewed annually and approved by the Board. Key to considering the Group's judgement of appetites is its assessment of its regulatory environment (both in the IOM and the UK); the IOM deposit market; access to regulatory capital; the IOM and UK credit markets; the suitability of its product range; concentrations of advances and historic arrears. In addition, the Group has specifically considered the impact of a 'hard' Brexit on both sides of its Balance Sheet.

Strategic risk plans are developed at subsidiary level with the intent of improving the risk frameworks and embedding these into a developing risk culture for the Group.

Key deliveries of the Risk Management Framework are split between 'Risk infrastructure' and 'Risk management cycle': The risk infrastructure is the establishment of a consistent foundation and approach to enterprise requirements and supporting components in managing risks. The cycle of risk management is adaptable and continuously progressing and responding to the changing internal and external environment.

This work has resulted in:

- The redesign of Management Committee frameworks, including roles and responsibilities to ensure that all material risks are captured and formally considered prior to presentation to the ARCC and the Board;
- A reclassification of the policies within the policy framework to ensure that the relevant Management Committee is accountable for the policies that support their risk, and to reduce the workload for the ARCC and Board, enabling them to focus on overseeing and challenging the risk management framework;
- The development of more detailed Board approved risk appetite statements, and the design of an underlying risk appetite measures framework, to be owned and monitored by the relevant Management Committee;
- The design of a risk management framework which looks to adopt a common language across the combined assurance model (and all lines of

defence), with a supporting risk catalogue and classification matrix; and

- A high level risk assessment to identify the top risks enabling work to progress in a risk focused manner on completing risk and control assessments, in order to build a key controls monitoring programme.

Principal risks

The Group has exposure to the following key risks:

- Strategic risk;
- Credit risk (including counterparty credit risk);
- Liquidity risk;
- Operational risk (including regulatory risk);
- Market risk (including interest rate risk);
- Concentration risk; and
- Reputation risk.

The Group has considered the above key risks that it faces and the mitigating controls against those risks:

Strategic risk

Strategic risk is the risk to the Group's revenue as set within the budget and the medium term plans arising through sub optimal implementation of the strategic plan due to either internal or external factors faced by its subsidiaries.

Controls and mitigation

The Group controls and mitigates this risk via a number of measures:

- Subsidiaries generally commence their formal planning process in September for the forthcoming year, to inform the budget submitted to the Group Boards for approval. In reality, the planning process is continuous and responsive to change in the internal and external environment.
- Barriers to delivering the strategic plan, and changes to planned activity are captured in the various subsidiary 'Managing Director's Reports' which are submitted to their respective Boards and then ultimately reported to the Group Board at each Board meeting. The reports will take account of input from the Group Executive Directors and current financial performance versus budget and seek to highlight strategic responses for the related subsidiary.
- Key strategic projects are managed under formal project governance with progress of key projects tracked, and communicated and discussed at regular project meetings.
- The impact of limited capital, liquidity, operational capacity and regulator restriction on the achievement of strategy is captured by the planning process, with exceptional items dealt with under the relevant risk category, where the impact on risk appetite and mitigating actions will be formally recorded.

RISK AND GOVERNANCE

RISK MANAGEMENT

Credit risk (including counterparty, concentration, underwriting and credit migration risks)

Credit risk is defined as the risk that counterparties fail to fulfil their contractual obligations. A material decline in credit quality, or the failure of a counterparty could result in higher levels of arrears and ultimately in increased provisions and write-offs, which impacts upon profitability, potentially eroding the capital position for the Group's subsidiaries.

Controls and mitigation

- Delegated authorities: The Group operates to a schedule of delegated authorisation limits linked to an individual underwriter's knowledge and experience. This is bolstered by validations of all significant credit exposures over set limits and ongoing monitoring of credit positions of key suppliers and intermediary networks.
- Distribution strategy: The Group actively monitors and controls the credit risk of all business written to ensure that it is treating customers fairly and as a safeguard against the failure of any business relationship. Mitigation of counterparty credit risk is undertaken through the maintenance, where appropriate, of cash reserves and loss pools to fund any buy-back indemnity. Comprehensive due diligence processes are also undertaken.
- Monitoring of credit quality exposure: The Group monitors its credit risk exposures via an internal credit risk grading methodology that assigns each individual exposure with one of three credit grades based upon the probability of default at product and distribution channel level. This allows for better monitoring of credit quality and impairment of its current book as well as forecast and stress test on a more accurate basis.
- Concentration risk: To protect against the unintentional build-up of exposures where deterioration could materially impact the sustainability and profitability, the Group seeks to maintain a diverse portfolio of products across a variety of geographical regions, customers, sectors and asset classes. This diversity protects the Group against any deterioration in a particular geographical region, the economic environment, commercial sector etc.
- Accounting standards: Finally, the introduction of IFRS 9, effective from 2018, necessitated the move to an expected loss provisioning methodology rather than an incurred loss. This will provide an additional credit risk buffer.

Operational risk (including conduct)

Operational risk is the risk of loss resulting from human error, inadequate or failed internal processes or controls, system failure, improper conduct, fraud or external events.

The principal operational risks for the Group arise from the following areas:

- Resilience of the IT environment: The IT environment is under constant review to identify and implement efficiencies to enable increased customer service through the provision of additional services and products and to automate manual tasks wherever possible to minimise the potential for human error. The Group implemented an IT Steering Committee

during 2017 to review and monitor current service standards, highlight any deficiencies and mitigate accordingly. There are a number of exception reports and scheduled tasks on a daily basis to ensure that any controls within systems are being reported on adequately.

- Third Party administration services: The key operational controls ensure that partners are fulfilling their legal, regulatory obligations in accordance with their service-level agreement with the Group. The Group has an outsourcing policy to ensure obligations are monitored and met. Internal reviews and audits are conducted on counterparties to ensure terms agreed are being adhered to.

Controls and mitigation

- Adherence to internal limits and approval processes through:
 - Delegated authorities: The Group operates to a schedule of delegated credit authorisation limits and payment approval limits, linked to an individual's knowledge and experience.
 - Segregation of Duties: There is appropriate segregation between those authorising transactions and those executing them, with four eyes principals in place where required.
 - Exception reporting: Daily reporting ensures that any regulatory and internal limits are reviewed regularly by the appropriate Management team.
 - New Business approval policy: All material new business is approved in line with a formally approved policy, with ultimate decision making resting with the applicable EXCO.
- Change control: The Group ensures that both changes to existing products and services and new products and services are delivered in a controlled manner with the appropriate checks and controls in place.
- A comprehensive on-boarding process in place for new outsourced partners in the UK.
- Due diligence checks: The operational risk from the Group's third party administrators is mitigated by a comprehensive due diligence process which includes a take-on due diligence and a full review of the partner's policies, procedures and financial stability.
- Key Operational Controls: Key controls are monitored through a combination of management oversight, Risk and Compliance monitoring and Internal Audit reviews.
- New Business Policy and Process - new business and material business change is outlined in a formal policy, which requires that a sequence of assessment and approval is followed. This will ensure that all relevant input is included and material risks considered.
- Exception reports: Exception reporting allows the Group to identify weaknesses in processes and controls which in turn allows for adequate training and the bolstering of systems and processes.

RISK AND GOVERNANCE

RISK MANAGEMENT

Conduct risk

The Group is exposed to conduct risk through its operations and interactions with consumers, either directly or through third parties (brokers, or counter-parties). The risk exposure is regulatory in nature for the Group's UK based operations and consideration of any local jurisdiction guidance on good practice.

Controls and mitigation

The Group has an outsourcing policy to ensure that adherence to conduct and regulatory standards is contracted, and compliance with standards is appropriately monitored through the collection and assessment of relevant data, partner attestation, and onsite audits where appropriate.

General conduct and particularly Treating Customers Fairly ("TCF") principles are applied across the Group's activities.

Liquidity risk

Financial institutions are subject to liquidity risk as an inherent part of their business. Liquidity risk is the risk that the Group may not hold sufficient liquid funds meaning it would be unable to meet its contractual liabilities as they fall due.

Liquidity risk arises where the Group, through its subsidiaries, has contractual credit obligations that can be placed under stress during times of illiquidity. The Group generally accesses wholesale funding markets or builds a core portfolio of liquid assets or buffers as additional sources of liquidity that can be utilised during such times.

Controls and mitigation

Overall the Group's liquidity profile is resistant to stress as the Group:

- Has no contractual credit obligation. The Group has no absolute credit line obligations to its customers meaning that in times of liquidity stress, it is able to reduce its lending appetite accordingly;
- Has a matched funding profile and does not engage in maturity transformation which means that on a cumulative mismatch position the Group is forecast to be able to meet all liabilities as they fall due;
- Maintains an adequate liquidity buffer; and
- Has no exposure to the interbank lending market.

The Group's liquidity position is monitored on a daily basis against internal and external agreed limits. The Group also has a Liquidity Contingency Policy and Liquidity Contingency Committee should a liquidity crisis or potential liquidity disruption event occur.

Reputation risk

Reputational Risk is the risk of loss resulting from damages to the Group's reputation, in lost revenue or increased costs; or destruction of shareholder value.

Controls and mitigation

The Group mitigates this risk by ensuring that its key risks are identified and managed, with an impact assessment of any potential or actual issues considering the impact to the Group's reputation. The Group actively seeks to minimise the occurrence of events or issues which could give rise to loss or negative feedback, and actively manages the impact should issues occur.

Interest rate risk

The principal potential interest rate risk that the Group is exposed to is the risk that the fixed interest rate and term profile of its deposit base differs materially from the fixed interest rate and term profile of its asset base, or basis and term structure risk.

Controls and mitigation

- Funding profile: Interest rate risk for the Group is not deemed to be material currently due to the Group's matched funding profile. In a rising interest rate environment due to the nature of the Group's products and its matched funded profile, it should theoretically be able to increase its lending rate to match any corresponding rise in its cost of funds.
- The Group attempts to efficiently match its deposit taking to its funding requirements.
- The decay of the Group's loan book through staged repayments means interest risk is difficult to hedge effectively so the Group does not currently hedge against this risk, and is therefore not exposed to any additional market interest rate risk in this respect.
- Funding cost: The Group would be exposed to potential risk if its cost of funds, which is linked to the cost of retail deposits, and ultimately the UK base rate, was to increase and it was unable, due to a competitive lending environment, to raise its lending rate correspondingly. The Group's three year plan allows for an increase in its cost of funds, but the Group accepts that these assumptions may not reflect the timing of any interest rate rise or the quantum of the increase(s).

Regulatory risk

Regulatory risk is the risk of material breach of regulation.

The Group holds a Class 1 (1) Banking Licence and is accordingly regulated by the FSA. The Group also holds permissions with the FCA pertaining to regulated credit activities, and other specified regulated products and services in the UK.

The risk of regulatory breach arises through a failure to identify, assess and apply applicable regulation; or a failure to adhere to the applicable regulation as applied.

Monitoring and complying with the requirements of existing regulation across numerous regulatory bodies, along with the rapid pace and volume of regulatory change is a key risk. The risk is compounded due to the size of the Group, and the need to maintain a manageable cost of compliance.

Controls and mitigation

The Group remains well placed to meet the regulatory challenges that bring change to the macro environment. In order to strengthen the Risk and Compliance department, the ARCC and Board have increased the headcount in 2018 and have appointed an experienced Head of Risk and Compliance.

RISK AND GOVERNANCE

RISK MANAGEMENT

Regulatory risks continue to be mitigated by themed and ad-hoc compliance monitoring reviews which are driven using a risk based approach to ensure resource is directed to areas of potential material risk. The monitoring plan is approved annually by ARCC. Monitoring reviews are supplemented by ongoing staff training and guidance.

Wherever possible, legislative and regulatory requirements are built into relevant administration systems, with appropriate monitoring and exception reporting processes in place to monitor compliance.

The Group maintains a watching brief on the regulatory environment and, as active members of a number of IOM and UK trade bodies, it receives additional regulatory updates and guidance on proposed legislative and regulatory issues. Upstream regulatory changes are tracked and assessed for impact by the Compliance Department and material items reported to ARCC.

Internal Capital Adequacy Assessment Process

Overview

ICAAP is a key strategic and risk management tool for the Bank. It is a key component of the Bank's planning process during the short and medium term. The Bank's lead regulator, the FSA, requires the Bank to establish and maintain an internal adequacy assessment process which is appropriate to the nature and scale of its business and review that process annually and evidence that review.

Methodology

The Bank's ICAAP process is as follows:

Formulation of the Bank's strategy and budget

Strategic plans are prepared annually for the forthcoming year, which will consider the Bank's risk appetite, key market sectors to target, products to leverage/introduce, headcount, operational and capital investment required.

Risk assessment

The Executive Team will liaise with the Risk and Compliance department to determine the material risks in the Bank based on incidents and breaches, Internal Audit reports, Risk and Compliance report findings and issues raised at the Board and Committee meetings.

Stress testing and reverse stress testing

The Finance department use Bank of England market assumptions for stress testing and stress the five-year forecasts to identify any capital deficiencies. Reverse stress testing is also used based on the assumption that the Bank ceases to trade, coupled with a run-off scenario to determine the capital distribution.

Reverse stress testing is used to explore the vulnerabilities of the Bank's strategy and plans to extreme adverse events that would cause the business to fail in order to facilitate contingency planning.

Calculation of capital requirement and buffers

Following the setting of strategy, risk assessment and stress tests, the Bank will then calculate its capital requirements by considering the following areas:

- Pillar I - The calculation is based on the minimum regulatory requirement under Pillar I of 10.0% of risk weighted assets for material risks;
- Pillar II - Assessment of any additional business risks not covered by the minimum Pillar I requirement, plus an assessment of Pillar II risks based upon the current material risk assessment and stress tests, to determine whether any additional capital buffers are deemed appropriate. An assessment of Pillar II and applicable capital add-ons have been assessed in Appendix 1; and
- Pillar III - Pillar III establishes measures to make better use of market discipline. Pillar III applies only at the top consolidated level of a banking group and is therefore generally not considered to be applicable to IOM incorporated banks as per FSA ICAAP guidance.
- Buffers - The Bank assesses its position to industry standard for regulatory buffers and calculates its position based on its overall exposures to different jurisdictions.

Review, challenge and adoption of the ICAAP

The ICAAP is prepared by the Finance department in conjunction with the Risk and Compliance department, and reviewed by the Bank's Executive Team, Risk Management Committee, ARCC, Internal Audit and the External Auditor prior to approval by the Board. It is used to measure and benchmark the Bank's risk appetite and to forecast capital usage under both stressed and normal conditions. The ICAAP is challenged at all stages of the review process and presented to the Board by ARCC for approval prior to being submitted to the FSA. The ICAAP is regularly reviewed and updated throughout the year by management and referred to the ARCC and Board.

ICAAP Results

The Bank has completed its ICAAP testing for 2018 in compliance with regulatory requirements. Despite the severity of the risk scenarios modelled, the Bank satisfied the capital and leverage requirements for the purpose of the stress test. The Bank did not require taking of any capital action as a result of the test.

CORPORATE GOVERNANCE REPORT

Corporate governance report

The Manx Financial Group Board (the “Board”) is committed to best practice in corporate governance. Directors have agreed to comply with the provisions of the Quoted Companies Alliance (“QCA”) Corporate Governance Code for Small and Mid-Size Quoted Companies to the extent which is appropriate to its nature and scale of operations. This report illustrates how Manx Financial Group PLC (the “Group”) complies with those principles.

QCA Principle 1: Establish a strategy and business model which promote long-term value for shareholders

The immediate strategy and business operations of the Group are set out in the Strategic Report on pages 4 and 5.

The Group’s strategy and business model and amendments thereto, are developed by the Chief Executive Officer and his senior management team, and approved by the Board. The management team, led by the Chief Executive Officer, is responsible for implementing the strategy and managing the business at an operational level.

The Group’s overall strategic objective is to capitalise on its unique position as owning the only independent Bank within the British Crown Dependencies by developing core businesses within the financial services sector, both organically and by considered acquisitions.

The Group has a balanced portfolio of regulated and unregulated operations, all of which are managed on a risk-based and prudential approach. The principal activities include: deposit taking; lending to consumer and commercial markets in the IOM and the UK; the provision of dedicated financial advice, especially in the areas of pensions and general insurance; and foreign currency advisory. Ultimately, the Directors believe that this approach will deliver significant long-term value for Shareholders.

The Group has adopted a portfolio approach to its strategic assets and is not dependent on one particular platform technology. The Directors believe that this approach helps to mitigate any concentration risk.

The Group largely operates in an inherently heavily regulated sector and this is reflected in the emphasis on compliance and the provision of excellent customer service.

In executing the Group’s strategy and operational plans, management will typically confront a range of day-to-day challenges associated with risks and uncertainties, and will seek to deploy the identified mitigation steps to manage these risks as they manifest themselves.

QCA Principle 2: Seek to understand and meet shareholder needs and expectations

The Group, via the Chief Executive Officer, seeks to maintain a regular dialogue with both existing and potential new Shareholders in order to communicate the Group’s strategy and progress and to understand the needs and expectations of Shareholders.

Beyond the Annual General Meeting, the Chief Executive Officer and, where appropriate, other members of the senior

management team will meet with investors and analysts to provide them with updates on the Group’s business and to obtain feedback regarding the market’s expectations of the Group.

The Group’s investor relations activities encompass dialogue with both institutional and private investors. From time to time, the Company attends private investor events, providing an opportunity for those investors to meet with representatives from the Group in a more informal setting.

QCA Principal 3: Take into account wider stakeholder and social responsibilities and their implications for long-term success

The Group is aware of its corporate social responsibilities and the need to maintain effective working relationships across a range of stakeholder groups. These include not only the Group’s employees, partners, suppliers, regulatory authorities, but also customers, be they depositors, borrowers or seeking financial advice. The Group’s operations and working methodologies take account of the need to balance the needs of all of these stakeholder groups while maintaining focus on the Board’s primary responsibility to promote the success of the Group for the benefit of its members as a whole. The Group endeavours to take account of feedback received from stakeholders, making amendments to working arrangements and operational plans where appropriate and where such amendments are consistent with the Group’s longer-term strategy.

The Group takes due account of any impact that its activities may have on the environment and seeks to minimise this impact wherever possible. Through the various procedures and systems it operates, the Group ensures full compliance with regulatory, health and safety, and environmental legislation relevant to its activities.

QCA Principal 4: Embed effective risk management, considering both opportunities and threats, throughout the organisation

The Board is responsible for the systems of risk management and internal control and for reviewing their effectiveness by a series of committees, overseen by the Audit, Risk and Compliance Committee (“ARCC”), and reviewed by Internal Auditors. The internal controls are designed to manage rather than eliminate risk and provide reasonable but not absolute assurance against material misstatement or loss. Through the activities of the ARCC, which meets at least six times per year, the effectiveness of these internal controls is formally reviewed four times per year.

A comprehensive budgeting process is completed once a year and is reviewed and approved by the Board. The Group’s results, compared with the budget, are reported to the Board on a monthly basis.

The Group maintains appropriate insurance cover in respect of actions taken against the Directors because of their roles, as well as against material loss or claims against the Group. The insured values and type of cover are comprehensively reviewed on at least an annual basis.

CORPORATE GOVERNANCE REPORT

The senior management team (“Executive Committee”) meets weekly to consider new risks and opportunities presented to the Group, making recommendations to the Board and/or ARCC as appropriate.

QCA Principal 5: Maintain the board as a well- functioning, balanced team led by the chair

The Group’s Board currently comprises four Non-executive Directors and three Executive Directors.

All of the Directors are subject to election by Shareholders at the first Annual General Meeting after their appointment to the Board and will continue to seek re-election at least once every three years.

Directors’ biographies are set out on pages 16 and 17.

The Board is responsible to the Shareholders for the proper management of the Group and meets at least four times a year to set the overall direction and strategy of the Group, to review operational and financial performance, and to advise on management appointments. All key operational and investment decisions are subject to Board approval.

The Board considers itself to be sufficiently independent. The QCA Code suggests that a board should have at least two independent non-executive directors. The Board considers that two Non-executive Directors, namely Alan Clark (Chairman of ARCC) and David Gibson, are regarded as independent under the QCA Code’s guidance for determining such independence.

Non-executive Directors receive their fees in the form of a basic cash emolument. Only the Chief Financial Officer holds options over the Group’s shares. The number and terms are found on page 23.

The option grant concerned is not deemed to be significant, either for the individual executive Director or in aggregate. The current remuneration structure for the Board’s Non-executive Directors is deemed to be proportionate.

QCA Principal 6: Ensure that between them the directors have the necessary up-to-date experience, skills and capabilities

The Board considers that all of the Non-executive Directors are of sufficient competence and calibre to add strength and objectivity to its activities, and bring considerable experience in regulatory, financial and operational development within the financial service sector in both the IOM and the UK.

The Directors’ biographies are set out on pages 16 and 17.

The Board regularly reviews the composition of the Board to ensure that it has the necessary breadth and depth of skills to support the ongoing development of the Group.

The Chairman, in conjunction with the Company Secretary, ensures that the Directors’ knowledge is kept up to date on key issues and developments pertaining to the Group, its operational environment and to the Directors’ responsibilities as members of the Board. During the course of the year, Directors receive updates from the Company Secretary and

various external advisers on a number of corporate governance matters.

Directors’ service contracts or appointment letters make provision for a Director to seek personal advice in furtherance of his or her duties and responsibilities, normally via the Company Secretary.

QCA Principal 7: Evaluate board performance based on clear and relevant objectives, seeking continuous improvement

The Board has an internal process for evaluation of its own performance, that of its committees and individual Directors, including the Chairman. This process is conducted annually and last took place in March 2018, with no substantive issues arising. Going forward, the Board intends to utilise the services of an independent third-party organisation to manage the future evaluation process, analyse the results and report back to the Board for subsequent follow-up. Evaluation criteria include Controls and Procedures, Strategic Aims, Entrepreneurial Leadership and Communications and Relationships.

The Board may utilise the results of the evaluation process when considering the adequacy of the composition of the Board and for succession planning.

QCA Principal 8: Promote a corporate culture that is based on ethical values and behaviours

The Board seeks to maintain the highest standards of integrity and probity in the conduct of the Group’s operations. These values are enshrined in the written policies and working practices adopted by all employees in the Group. An open culture is encouraged within the Group, with regular communications to staff regarding progress and staff feedback regularly sought. The Executive Committee regularly monitors the Group’s cultural environment and seeks to address any concerns that may arise, escalating these to Board level as necessary.

The Group is committed to providing a safe environment for its staff and all other parties for which the Group has a legal or moral responsibility in this area. This is enshrined in the Group’s health and safety policy.

QCA Principal 9: Maintain governance structures and processes that are fit for purpose and support good decision-making by the board

The role of the Board

The Board is collectively responsible for the long-term success of the organisation. Its principal function is to determine the strategy and policies of the Group within an effective control framework which enables risk to be assessed and managed.

The Board ensures that the necessary financial and human resources are in place for the Group to meet its objectives and that business and management performances are reviewed. Furthermore, the Board ensures that the Group operates within its constitution, relevant legislation and regulation and that proper accounting records and effective systems of business control are established, maintained, documented and audited.

RISK AND GOVERNANCE

CORPORATE GOVERNANCE REPORT

There are at least four formal Board meetings each year. All Board members have the benefit, at the Group's expense, of liability insurance in respect of their responsibilities as Directors and have access to independent legal or other professional advice if required. The Board has a formal schedule of matters which are reserved for its consideration and it has established three committees to consider specific issues in greater detail, being the ARCC and Nomination Committee. The Terms of Reference for each of these Committees are published on the Group's website.

There is a clear separation of the roles of Chief Executive Officer and Executive Chairman.

Chairman

The Chairman is responsible for leading the Board, ensuring its effectiveness in all aspects of its role, promoting a culture of openness of debate and communicating with the Group's members on behalf of the Board. The Chairman sets the direction of the Board and promotes a culture of openness and debate by facilitating the effective contribution of Non-executive Directors and ensuring constructive relations between Executive and Non-executive Directors. The Chairman also ensures that Directors receive accurate, timely and clear information. In doing so, this fosters a positive corporate governance culture throughout the Group.

Chief Executive Officer

The Chief Executive Officer is responsible for managing the Group's business and operations within the parameters set by the Board.

Non-executive Directors

The Non-executive Directors are responsible for bringing independent judgement to the discussions held by the Board, using their breadth of experience and understanding of the business. Their key responsibilities are to constructively challenge and contribute to strategic proposals, and to monitor performance, resources, and standards of conduct, compliance and control, whilst providing support to executive management in developing the Group.

The Board has established an ARCC, a Remuneration Committee and a Nominations Committee with formally delegated duties and responsibilities. Alan Clarke chairs both ARCC and the Remuneration Committee.

ARCC

ARCC meets at least six times each year and comprises two Non-executive Directors, currently Alan Clarke (Chairman) and David Gibson, Executive Directors. Representatives from Compliance and Risk along with the internal and external Auditor attend by invitation. Its role is to be responsible for reviewing the integrity of the financial statements and the balance of information disclosed in the accompanying Directors' Report, to review the effectiveness of internal controls and risk management systems, to monitor and review the effectiveness of the internal audit function and to consider and recommend to the Board (for approval by the members) the appointment or re-appointment of the external auditor. The ARCC reviews and monitors the external auditor's objectivity, competence, effectiveness and independence, ensuring that if it or its associates are invited to undertake non-audit work it will not compromise auditor objectivity and independence.

Remuneration Committee

The Remuneration Committee meets at least twice a year and comprises of two Non-executive Directors, with the Executive Directors, Head of Human Resources and external advisers attending by invitation when appropriate. It is chaired by Alan Clarke, and is responsible for determining the remuneration of the Executive Directors, the Company Secretary and other members of the management. Committee members do not take part in discussions concerning their own remuneration.

The Directors believe that the above disclosures constitute sufficient disclosure to meet the QCA Code's requirement for a Remuneration Committee Report. However, a separate Remuneration Committee Report will be presented in the Group's next audited Financial Statements.

Nomination Committee

The Nomination Committee is comprised of the whole Board. It is chaired by the Chairman of the Board and is responsible for making recommendations to the Board on matters relating to the composition of the Board, including Executive and Non-executive Director succession planning, the appointment of new Directors throughout the Group and re-election of existing Directors.

Appointments to the Board

The principal purpose of the Nomination Committee is to undertake the assessment of the balance of skills, experience, independence and knowledge on the Board and subsidiary boards against the requirements of the business, with a view to determining whether any shortages exist. Having completed the assessment, the Committee makes recommendations to the board accordingly. Appointments to the Board are made on merit, with due regard to the benefits of diversity. Within this context, the paramount objective is the selection of the best candidate, irrespective of background, and it is the view of the Board that establishing quotas or targets for the diversity of the Board is not appropriate.

All Group Director appointments must be approved by the Company's Nominated Adviser, as required under the AIM Rules, before they are appointed to the Group Board.

Prior to appointment, Non-executive Directors are required to demonstrate that they are able to allocate sufficient time to undertake their duties.

Re-election

The Group's Rules require that all Directors are submitted for election at the AGM following their first appointment to the Board and one third of the Directors are subject to retirement by rotation on an annual basis to refresh the Board, irrespective of performance.

The Group will establish a separate Corporate Governance Committee.

The Corporate Governance Memorandum also contains a schedule of matters specifically reserved for Board decision or approval and sets out the Company's share dealing code and its public interest disclosure ("whistle-blowing") policy and procedures.

RISK AND GOVERNANCE

CORPORATE GOVERNANCE REPORT

Board and committee attendance

The number of formal scheduled Board and committee meetings held and attended by Directors during the year was as follows: -

	Board	ARCC	REMCO
Jim Mellon	3/6	-	-
John Banks	3/6	-	-
Denham Eke	6/6	-	-
Alan Clarke	6/6	8/8	4/4
David Gibson	6/6	8/8	4/4
Douglas Grant	6/6	-	-
Gregory Bailey*	3/6	-	-

* Gregory Bailey appointed to the Board on 7 February 2018

QCA Principal 10: Communicate how the company is governed and is performing by maintaining a dialogue with shareholders and other relevant stakeholders

The Group places a high priority on regular communications with its various stakeholder groups and aims to ensure that all communications concerning the Group's activities are clear, fair and accurate. The Group's website is regularly updated and users can register to be alerted when announcements or details of presentations and events are posted onto the website.

Notices of General Meetings of the Company can be found on:

<https://www.mfg.im/investor-centre/regulatory-news>

The results of voting on all resolutions in future general meetings will be posted to the Group's website, including any actions to be taken as a result of resolutions for which votes against have been received from at least 20 per cent of independent Shareholders.

Approval

This report was approved by the Board of Directors on 27 March 2019 and signed on its behalf by: -

Jim Mellon
Executive Chairman
27 March 2019

RISK AND GOVERNANCE

DIRECTORS, OFFICERS AND ADVISERS

Executive Directors



Jim Mellon (62) ‡
Executive Chairman

Jim Mellon is a well-known and successful entrepreneur, author and economic commentator, starting his career in fund management and now including biopharma, property, mining and information technology amongst his many investments. He holds directorships in a number of publicly quoted companies, many of which are in the financial services sector. He is the beneficial owner of Burnbrae Group Limited which, in turn, indirectly holds approximately 16% of Manx Financial Group PLC. He is the founder, principal shareholder and chairman of the Regent Pacific Group, quoted on the Hong Kong Stock Exchange.

Appointment

Appointed to the Board on 2 November 2007 and appointed as Executive Chairman on 12 February 2009.



Denham Eke (67) ‡
Chief Executive Officer

Denham Eke is the Managing Director of Burnbrae Group Limited, a private international asset management company. He began his career in stockbroking with Sheppards & Chase before moving into corporate planning for Hogg Robinson plc, a major multinational insurance broker. He is a director of many years standing of both public and private companies involved in the financial services, property, mining, and manufacturing sectors.

Appointment

Appointed to the Board on 2 November 2007 and appointed as Chief Executive on 12 February 2009.



Douglas Grant (54) ‡
Group Finance Director

Douglas Grant has over 30 years' experience working in finance, initially with Scottish Power, before moving to the industrial sector to work with ICI and then Allenwest. Prior to joining Manx Financial Group PLC, he was the group financial controller and later financial director of various UK and Isle of Man private sector companies and has extensive capital markets experience.

Appointment

Appointed to the Board on 14 January 2010. He is Managing Director of Conister Bank Limited.

Non-executive Directors



Alan Clarke (68) ‡ † * ≠
Non-executive Director

Alan Clarke is a chartered accountant and former senior partner of Ernst & Young during which time he worked closely with HSBC offshore operations in both the Channel Islands and the Isle of Man. Currently, he specialises in corporate finance and strategic consultancy, advising a variety of both listed and private companies. He holds several non-executive directorships and is a past President of ICAEW Manchester. He is also a registered auditor, being the senior partner of Downham Mayer Clarke.

Appointment

Appointed to the Board on 2 November 2007. Chairman of the Audit, Risk and Compliance Committee and Chairman of the Remuneration Committee.



David Gibson (71) ‡ † * ≠
Non-executive Director

David Gibson qualified as a certified accountant whilst holding posts with Shell-Mex and BP and CIBA-Geigy throughout the UK and abroad, before transferring into treasury management in senior positions with Turner and Newall and Westland Helicopters where he qualified as a corporate treasurer. He joined the Trustee Savings Bank of the Channel Islands as finance director, prior to becoming general manager finance at TSB Retail Bank where he gained his formal qualifications as a banker. Prior to retiring from executive life for family reasons, he was group finance director of Portman Building Society for 9 years. He is currently deputy chairman of commercial property investment companies Chellbrook Properties plc and Mountstephen Investments Limited.

Appointment

Appointed to the Board on 12 February 2009. He is Chairman of Conister Bank Limited.



John Banks (50) ‡
Non-executive Director

John Banks is a solicitor qualified in both England and Wales and Hong Kong. He has worked in private practice with Lovells, in both England and Hong Kong and as an in house counsel for Standard Chartered Bank in Hong Kong. He joined Group Direct Limited, later part of Brightside Group PLC as group legal counsel in 2006, where he worked on the group's admission to trading on AIM. He joined Southern Rock Insurance Company Limited and Eldon Insurance Services Limited in 2013 and is a director of both companies.

Appointment

Appointed to the Board on 5 August 2014.

RISK AND GOVERNANCE

DIRECTORS, OFFICERS AND ADVISERS

Non-executive Directors



Gregory Bailey (63) ‡
Non-executive Director

Gregory Bailey, founded Palantir Group Inc which made successful investments in bio-tech company start-ups and financings, and is currently chairman of Portage Biotech Inc, a CSE-traded drug development company, and non-executive director of AIM-traded SalvaRx Group Plc. Along with comprehensive experience in finance and healthcare, he has served on many public company boards and brings to the Group an extensive involvement in corporate governance.

Appointment

Appointed to the Board on 7 February 2018.

Company Secretary



Rachel Bradley (33)
Company Secretary

Rachel Bradley qualified to the Bar of the Isle of Man in February 2012 and has a broad range of regulatory and compliance experience in the financial services industry, both in the UK and Isle of Man. Prior to joining Manx Financial Group PLC, she worked in the United States of America for two years in the legal profession and prior to that, she worked with several local corporate services providers on the Isle of Man.

Appointment

Appointed as Company Secretary on 15 June 2018.

- * Member of the Audit, Risk and Compliance Committee
- † Member of the Remuneration Committee
- ‡ Member of the Nominations Committee
- ≠ Independent Non-executive Director

Advisers

Registered Office

Clarendon House
Victoria Street
Douglas
Isle of Man IM1 2LN

Registered Agent

CW Corporate Services Limited
Bank Chambers
15-19 Athol Street
Douglas
Isle of Man IM1 1LB

Legal Advisers

As to Isle of Man law
Long & Humphrey
The Old Courthouse
Athol Street
Douglas
Isle of Man IM1 1LD

As to English law
Hill Dickinson LLP
The Broadgate Tower
20 Primrose Street
London EC21 2EW

Independent Auditor

KPMG Audit LLC
Heritage Court
41 Athol Street
Douglas
Isle of Man IM99 1HN

Principal Bankers

Royal Bank of Scotland
135 Bishopsgate
London EC2M 3UR

Consulting Actuaries

Boal & Co Ltd
Marquis House
Isle of Man Business Park
Douglas
Isle of Man IM2 2QZ

Pension Fund Investment Manager

Thomas Miller Investment
(Isle of Man) Limited
Level 2
Samuel Harris House
5-11 St George's Street
Douglas
Isle of Man IM1 1AJ

Nominated Advisor and Broker

Beaumont Cornish Limited
10th Floor
30 Crown Place
London EC2A 4EB

Registrar

Computershare Investor Services (Jersey) Limited
Queensway House
Hilgrove Street
St Helier
Jersey JE1 1ES

Presentation of Annual Report and Accounts

Presented here are the Annual Report and Accounts of Manx Financial Group PLC.

Company Information

The Annual and Interim Reports, along with other supplementary information of interest to Shareholders, are included on our website. The address of the website is www.mfg.im which includes investor relations information and contact details.

RISK AND GOVERNANCE

AUDIT, RISK AND COMPLIANCE COMMITTEE

Dear Shareholders

I am pleased to set out below an account of the ARCC's role and activities during 2018 and up to the date of publication of this Annual Report.

Membership

Members of the ARCC are appointed by the Board, on the recommendation of the Nomination Committee, in consultation with the Chairman of the Committee. The Committee is made up of at least 2 members. All members of the Committee shall be Non-executive Directors and at least one of whom shall have recent and relevant financial experience with a professional qualification from one of the professional accountancy bodies. The Chairman of the Board shall not be a member of the Committee.

Appointments to the Committee shall be for a period of up to 3 years, which may be extended by the Board for a further 3-year period (or, in exceptional circumstances, two further 3 year periods), provided the Director remains independent. The Board may approve annual extensions to any Director who has served 3 consecutive terms.

The Board shall appoint the Chairman of the Committee who shall be a Non-executive Director. In the absence of the Chairman of the Committee and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.

The Committee shall meet at least six times a year. Of these, two will be held to review the annual and interim financial statements. Outside of the formal meeting programme, the Chairman of the Committee will maintain a dialogue with key individuals involved in the Company's governance.

Members	Appointed	Number of meetings attended
Alan Clarke (Chairman)	2 February 2007	8/8
David Gibson	13 February 2009	8/8

Only members of the Committee have the right to attend Committee meetings. However other individuals may be invited by the Chairman of the Committee to attend all or part of any meeting as and when appropriate.

The ARCC holds separate meetings with the Head of Internal Audit, Head of Risk and Compliance and our external auditor, KPMG Audit LLC.

The Chairman of the Board, the executive directors and executive management are invitees to meetings of ARCC but are excluded from the separate meetings held between the ARCC and the external auditor.

Execution of functions

The ARCC has executed its duties and responsibilities during the year in accordance with its terms of reference as it relates to auditor independence, assisting the Board in its evaluation of our control environment and internal controls including information systems and accounting practices.

Due to its adoption of the QCA Corporate Governance standard, the committee reassessed the adequacy of its terms

of reference and its function bearing in mind the requirements of this standard.

During the year under review, the Committee considered among other matters, the following:

Financial reporting and annual financial statements:

- Considered the annual financial statements with the external auditor, Executive Directors and management and reviewed the appropriateness of significant judgements, estimates and accounting policies;
- Reviewed and recommended to the Board for approval:
 - Unaudited condensed interim results for the period ended 30 June 2018;
 - Audited MFG plc Group and subsidiary annual financial statements for the year-ended 31 December 2018; and
- Reviewed changes to impairment model due to adoption of IFRS 9 effective 1 January 2018;
- Discussed any significant and unusual accounting matters including key audit matters identified by the external auditor.

External audit:

- Monitored and assessed the independence of the external auditors based on reports received, inquiries made into work performed;
- Determined the nature and extent of non-audit services performed by the external auditors;
- Reviewed and assessed the significance of non-audit fees compared to audit fees;
- Reviewed and agreed the external audit plan in advance for the year-end audit which set out the scope of audit, significant risks, areas of audit focus and audit timetable.
- Received a presentation of the external auditor findings on from execution of audit plan for discussion; and
- Satisfied itself as to the expertise experience and independence of the engagement partner.

Internal audit

- Reviewed and approved the internal audit plan;
- Reviewed Internal Audit's findings including the design and operating effectiveness of the internal control environment and control activities; and
- Reviewed Internal Audit's findings on the adequacy and reliability of management information.

Risk and compliance

- Assessed the effectiveness of the Group Risk and Compliance function;
- Reviewed the Group Risk and Compliance department findings on the effectiveness of the Group's regulatory controls;
- Recommend a revision of the Risk and Compliance policies for Board approval; and
- Recommend a revision of the Internal Capital Adequacy Assessment Process for Board approval.

RISK AND GOVERNANCE

AUDIT, RISK AND COMPLIANCE COMMITTEE

External auditor's independence

The external auditor, KPMG Audit LLC, has been the Group's auditor since 2007.

Consideration was given to the non-audit work performed by the external auditor. The ratio of non-audit fees to audit fees for the year was 0.08 to 1 (2017: 0.03 to 1). Non audit services related to tax adversary services. Services were performed by a separate team to the audit team to safeguard against the self-review threat to independence.

The ARCC obtained assurance from the external auditor that internal governance processes within KPMG Audit LLC support and demonstrate its claim of independence. This

assurance was provided through the receipt of an ISA 260 letter.

The ARCC is satisfied with the independence of KPMG Audit LLC and is recommending that KPMG Audit LLC be reappointed as the Group's auditor at the 2018 Annual General Meeting.

Key accounting matters

The ARCC considered key accounting matters in relation to the Group's financial statements and disclosures. The primary areas in relation to 2018 and how they were addressed are detailed below:

Key accounting matter	ARCC response
<p>Loan impairment Impairments cover loans specifically identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified.</p> <p>Loan impairment provisions reflect estimates of the amount and timing of future recoveries which require an assessment of matters such as future economic conditions and the value of collateral. Estimates, by their nature, give rise to a higher risk of material misstatement due to error or fraud.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the impairment provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.</p>	<p>The ARCC satisfied itself that the internal control environment and control activities are appropriately designed and implemented. This was supported by review of Internal and External audit reports and findings.</p> <p>The ARCC reviewed reports from executive management on the implementation of IFRS 9 and key changes to internal processes and controls. The ARCC reviewed the key assumptions used by management such as Loss given default, Loss rates, Probability of default on initial implementation at 30 June 2018 and at year ended 31 December 2018.</p>
<p>Impairment of goodwill and intangible assets Goodwill and intangible assets are significant and the estimated recoverable amount of these balances is subjective due to the inherent uncertainty involved in forecasting and discounting future cash flows.</p>	<p>The ARCC satisfied itself that the internal control environment and control activities are appropriately designed and implemented. This was supported by review of Internal and External audit reports and findings.</p> <p>The ARCC reviewed management's assessment of Goodwill and intangible asset impairment and concluded that the recoverable amount is appropriate.</p>
<p>VAT receivable The VAT receivable exposure is significant and its recoverability rests on the outcome of discussions with the Isle of Man Government Customs and Excise Division ("IOM C&E"), which in turn will take into account the final assessment by UK Customs and Excise of the impact of the recent ruling by the Court of Justice of the European Union regarding the dispute between Volkswagen Financial Services (UK) Limited vs HM Revenue & Customs.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the impact of the final assessment of the amount of VAT to be recovered has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.</p>	<p>The ARCC satisfied itself that the internal control environment and control activities are appropriately designed and implemented. This was supported by review of Internal and External audit reports and findings.</p> <p>The ARCC reviewed management's assessment of VAT receivable impairment and concluded that the recoverable amount is appropriate..</p>

RISK AND GOVERNANCE

AUDIT, RISK AND COMPLIANCE COMMITTEE

Key accounting matter	ARCC response
Carrying value of Parent Company's subordinated loans and investment in subsidiaries The carrying value of the Parent Company's subordinated loans to and investment in subsidiaries represents 93% (2017: 98%) of the Parent Company's total assets. The assessment of carrying value is not at a high risk of significant misstatement or subject to significant judgement as the carrying value is supported by the audited net asset value of the subsidiaries. However, due to its materiality in the context of the Parent Company financial statements, this is considered to be the area that had the greatest effect on our overall Parent Company audit.	The ARCC is satisfied that the going concern assessment over the Group provides sufficient assurance over the recoverability of the Parent Company's subordinated loans and investment in subsidiaries.

The ARCC has complied with and discharged its responsibilities as set out in its Terms of reference.

Alan Clarke
Chairman
27 March 2019

RISK AND GOVERNANCE

DIRECTORS' REMUNERATION REPORT

Dear Shareholders

On behalf of the Board, I am pleased to report the Directors' Remuneration Report for the year ended 31 December 2018.

Membership

Members of the Remuneration Committee are appointed by the Board, on the recommendation of the Nomination Committee in consultation with the Chairman of the Committee. The Committee is made up of at least 2 members. All members of the Committee shall be Non-executive Directors. The Chairman of the Board shall not be a member of the Committee.

Appointments to the Committee shall be for a period of up to 3 years, which may be extended by the Board for a further 3-year period (or, in exceptional circumstances, two further 3 year periods), provided the Director remains independent. The Board may approve annual extensions to any Director who has served 3 consecutive terms.

The Board shall appoint the Chairman of the Committee who shall be a Non-executive Director. In the absence of the Chairman of the Committee and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.

The Committee shall meet at least twice a year and at such other times as the Chairman of the Committee shall require.

Membership	Appointed	Number of meetings attended
Alan Clarke (Chairman)	13 February 2009	4/4
David Gibson	12 December 2010	4/4

Only members of the Committee have the right to attend Committee meetings. However, other individuals may be invited by the Chairman of the Committee to attend all or part of any meeting as and when appropriate.

Areas of focus for 2018

During the year, the Committee considered the following:

- Reviewed the overall pay increase of Executive Directors;
- Reviewed the overall non-discretionary annual performance related pay scheme for Group staff; and
- Reviewed and approved all new staff appointments with packages over £50,000.

Remuneration policy

The Group's Remuneration Policy reflects the Group's business strategy and objectives as well as sustained and long-term value creation for shareholders. In addition, the policy aims to be fair and provide equality of opportunity, ensuring that:

- the Group is able to attract, develop and retain high-performing and motivated employees in the competitive local IOM and wider UK markets;
- employees are offered a competitive remuneration package to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their individual contribution to the success of the Group;

- it reflects our culture and values; and
- there is full transparency of the Group's Remuneration Policy.

In line with the Board's approach, which reflects that adopted within other comparable organisations, the Group's Remuneration Policy provides for the reward of Executive Directors through salaries and other benefits.

Executive Directors' Emoluments

The remuneration for Executive Directors reflects their responsibilities. It comprises basic salary, performance related variable pay when this is considered appropriate, and various benefits detailed below.

Performance related payments are not pensionable and are not contracted.

As with staff generally, whose salaries are subject to annual reviews, basic salaries payable to Executive Directors are reviewed each year with reference to jobs carrying similar responsibilities in comparable financial organisations, market conditions generally and local employment competition in view of the Group's geographical position.

The Group operates a non-contractual discretionary annual performance related pay scheme based on the trading performance of the Group and the individual employee's performance assessed for the period under review in a manner which promotes sound risk management and does not promote excessive risk taking.

The non-contractual discretionary annual performance related pay scheme may be paid in one year but that does not confer any entitlement in future years.

Performance assessments are conducted annually to determine the performance rating of each employee's achievements against a mix of targets set and agreed at the beginning of each year between the employee and their manager. No incentives are paid to employees or executives where the performance rating reflects below an agreed expected level for the role employed.

The non-contractual discretionary annual performance related pay scheme may be disbursed as a cash payment through payroll, share based instruments (including share options) or a mixture of both. An element of deferment to align the interests of the employee to the longer term performance of the Group may also be included.

EWA's Financial Advisors are salaried and commission is calculated on a pre-agreed percentage over target which is set at between 2 to 3 times annual gross salary depending on the size of the Advisor's client base and their historical performance. Each Financial Advisor is set objectives at the beginning of the year including a 100% pass in all compliance requirements. Where indemnified commission is paid and the underlying client policy lapses and the commission is clawed back then this is reviewed by an Executive Director in order to monitor trends and is then clawed back from the relevant Financial Advisor.

RISK AND GOVERNANCE

DIRECTORS' REMUNERATION REPORT

Where the Group operates contractually guaranteed performance related pay, the contractual conditions must be considered by the Remuneration Committee.

Executive Directors' Contractual Terms

In keeping with current recommended practice, the standard term for Executive Director appointments, which have a contractual notice period, is 6 months.

Non-executive Directors' Remuneration

Non-executive Directors do not receive any benefits other than their fees and travelling expenses for which they are reimbursed. The level of fees payable to Non-executive Directors is assessed using benchmarks from a group of comparable financial organisations.

The Procedure for Determining Remuneration

The Remuneration Committee, comprising two Non-executive Directors, is responsible for setting the remuneration of the Executive Directors and is chaired by Alan Clarke. Committee members do not take part in discussions concerning their own remuneration. The basic Non-executive Director fee is set by the Group Chairman. The Chairman of the Committee reports at the Board meeting following a Committee meeting.

Implementation report

It is the view of the Committee that Directors' remuneration awarded across the Group for the year has been in accordance with the Group's stated Remuneration Policy and, on behalf of the Committee I recommend that you endorse this Group report. An analysis of Directors' emoluments is as follows: -

Directors' emoluments

	Remuneration/ Fees £	Performance Related Pay £	Pension £	2018 Total £	2017 Total £
Executives					
Jim Mellon	25,000	-	-	25,000	25,000
Denham Eke	25,000	-	-	25,000	25,000
Douglas Grant	191,458	50,000	19,146	260,604	222,986
Juan Kelly ¹	-	-	-	-	47,718
	<u>241,458</u>	<u>50,000</u>	<u>19,146</u>	<u>310,604</u>	<u>320,704</u>
Non-executives					
Alan Clarke	42,917	-	-	42,917	43,000
Gregory Bailey	22,400	-	-	22,400	-
John Banks	25,000	-	-	25,000	25,000
Neil Duggan ²	-	-	-	-	20,000
David Gibson	55,000	-	-	55,000	47,500
	<u>145,317</u>	<u>-</u>	<u>-</u>	<u>145,317</u>	<u>135,500</u>
Aggregate emoluments	374,375	50,000	19,146	443,521	456,204

¹Juan Kelly resigned on 28 March 2017.

²Neil Duggan retired on 30 June 2017.

Approval

This report was approved by the Board of Directors on 27 March 2019 and signed on its behalf by: -

Alan Clarke

Chairman of the Remuneration Committee
27 March 2019

RISK AND GOVERNANCE

DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements for the year ended 31 December 2018.

Principal regulated activities

The principal activities of Manx Financial Group PLC (the "Company" or "MFG") and its subsidiaries (together referred to as the "Group") are the provision of asset and personal finance, investing activities, Foreign Exchange brokerage services and wealth management.

The Bank, a wholly owned subsidiary of the Company, holds a Class 1(1) deposit taking licence issued under Part 2 of the Isle of Man Financial Services Act 2008. Deposits made with the Bank are covered by the Isle of Man Depositors' Compensation Scheme contained in the Banking Business (Compensation of Depositors) Regulations 1991.

EWA is authorised by the Isle of Man Financial Services Authority under section 7 of the Financial Services Act 2008 to conduct investment business as a Class 2, sub-classes (3), (6) and (7) licence holder.

Results and dividends

The proposed transfers to and from reserves are as set out in the Statement of Changes in Equity on page 34. The Directors do not recommend the payment of a dividend (2017: nil).

Share capital

Particulars of the authorised and issued share capital of the Company are set out in note 31 to the financial statements.

Significant shareholdings

The number of shares held and the percentage of the issued shares which that number represented as at 26 March 2019 are:

	Number	% of issued capital
Rene Nominees (IOM) Limited ¹	38,153,158	29.10
Jim Mellon ²	21,492,232	16.39
Gregory Bailey ³	17,835,750	13.60
Lynchwood Nominees Limited	9,752,879	7.44
Island Farms Limited	4,222,319	3.22
Rock (Nominees) Limited	3,955,663	3.02

¹ Arron Banks, a former Director of the Group is beneficially interested in 38,153,158 Ordinary Shares. This holding includes 26,288,992 Ordinary Shares held by Rene Nominees (IOM) limited ("Rene") in trust for Southern Rock Insurance Company Ltd ("SR"), 9,777,166 for ICS Risk Solutions Limited ("ICS") and 2,087,000 for MW SIPP Trustees Ltd. John Banks, a Director of MFG is also a director of SR and ICS.

² Burnbrae Limited holds 19,164,250 Ordinary Shares. Burnbrae Limited is beneficially owned by Jim Mellon. Denham Eke, CEO of MFG is also a director of Burnbrae Limited. Pershing Nominees Limited holds 968,666 Ordinary Shares, Vidacos Nominees holds 666,666 Ordinary Shares in trust for Jim Mellon and 692,650 Ordinary Shares are held in his own name.

³ Vidacos Nominees Limited holds 17,835,750 Ordinary Shares in trust for Gregory Bailey.

Directors and Directors' share interests

Details of current Directors are set out on pages 16 and 17.

The number of shares held by the current Directors is as follows:

	Number 26/03/19	Number 31/12/18	Number 31/12/17
Jim Mellon ⁴	21,492,232	21,492,232	21,492,232
Gregory Bailey ⁵	17,835,750	17,835,750	17,835,750
John Banks ⁶	-	-	1,433,833
David Gibson ⁷	1,721,433	1,721,433	1,721,433
Douglas Grant	505,821	505,821	505,821
Alan Clarke	52,149	52,149	52,149

⁴ Burnbrae Limited holds 19,164,250 Ordinary Shares. Jim Mellon, Executive Chairman of Manx Financial Group PLC, is a Director of Burnbrae Limited. Burnbrae Limited is beneficially owned by Jim Mellon. Denham Eke, CEO of MFG, is also a director of Burnbrae Limited. Pershing Nominees Limited holds 968,666 Ordinary Shares and Vidacos Nominees holds 666,666 Ordinary Shares for the benefit of Jim Mellon.

⁵ Vidacos Nominees Limited holds 17,835,750 Ordinary Shares in trust for Gregory Bailey.

⁶ On the 19 June 2018, 1,443,833 of the Company's ordinary shares were transferred and are now held by Rene in trust for ICS. Following the transfer, John Banks no longer has an interest in the issued ordinary share capital of the Company

⁷ Comprises 1,721,433 Ordinary Shares held by Interactive Investor Services Limited for the benefit of David Gibson.

The number of share options held by the current Directors is as follows:

	Number 26/03/19	Number 31/12/18	Number 31/12/17
Douglas Grant	1,042,466	1,042,466	1,042,466

Directors' liability insurance

The Group maintains insurance cover for Directors' potential liability.

Fixed and intangible assets

The movement in fixed and intangible assets during the year are set out in notes 24 and 25 respectively to the financial statements.

Staff

At 31 December 2018, there were 113 members of staff (2017: 91), of whom 11 were part-time (2017: 13).

Investment in subsidiaries

Investments in the Company's subsidiaries are disclosed in note 32 to the financial statements.

Auditor

KPMG Audit LLC, being eligible, has expressed its willingness to continue in office.

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ANNUAL FINANCIAL STATEMENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

The Directors are required to prepare Group and Parent Company financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the EU (IFRSs as adopted by the EU), as applicable to an Isle of Man Company and applicable law and have elected to prepare the Parent Company financial statements on the same basis.

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

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Isle of Man Companies Act 2006.

They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

ANNUAL FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT, TO THE MEMBERS OF MANX FINANCIAL GROUP PLC

1 Our opinion is unmodified

We have audited the financial statements of Manx Financial Group PLC ("the Company") for the year ended 31 December 2018 which comprise the Consolidated and Parent Company Statements of Profit or Loss and Other Comprehensive Income, the Consolidated and Parent Company Statements of Financial Position, the Consolidated and Parent Company Statements of Cash Flows and the Consolidated and Parent Company Statements of Changes in Equity, and the related notes, including the accounting policies in note 3.

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2018 and of the Group's and Parent Company's profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), as applicable to an Isle of Man Company; and
- have been prepared in accordance with the requirements of the Isle of Man Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

2 Key audit matters: our assessment of risks of material misstatement. Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, are set out below. These are unchanged from 2017, with the exception of the inclusion this year of a key audit matter with respect to the carrying value of the Parent Company's subordinated loans to and investment in subsidiaries.

Key audit matter	The risk	Auditor's response
<p>Loan impairment</p> <p>Loans and advances to customers £148,278,000 (2017: £122,546,000)</p> <p>Impairment Provision £3,394,000 (2017: £2,687,000).</p> <p>Refer to the Audit, Risk and Compliance Report ("ARCC"), note 4 (Use of Judgements and Estimates - Assumptions and Estimation Uncertainties), note 8(A) (Credit Risk), note 15 (Impairment on Loans and Advances to Customers), note 22 (Loans and Advances to Customers), note 36 (B) (Financial Risk Management - Credit risk) and note 38(l)(vii) (Accounting Policy for Impairment of Financial Instruments).</p>	<p>Subjective estimate</p> <p>Impairments cover loans specifically identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified.</p> <p>Loan impairment provisions reflect estimates of the amount and timing of future recoveries which require an assessment of matters such as future economic conditions and the value of collateral. Estimates, by their nature, give rise to a higher risk of material misstatement due to error or fraud.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the impairment provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.</p>	<p>Our procedures included:</p> <p>- Control design and operating effectiveness: Understanding and testing the controls in respect of the Group's loan impairment process such as the timely recognition of impairment provisions, the completeness and accuracy of reports used in the loan impairment process and management review processes over the calculation of collective and specific provisions.</p> <p>- Test of details: We agreed the specific provisions included in the financial statements to management's provisioning schedule and vouched that this schedule was correctly extracted from the loans and advances system, including the arrears information.</p> <p>- Test of details: We tested a sample of specific provisions, weighted towards those against individually significant impaired loans. This included challenging management's assessment of the specific provision, taking into account such factors as: the number of repayments in arrears; the known whereabouts of the hirer/lessor and of the assets under finance; and the amounts received under agreed repayment plans, where scheduled repayments under the original agreement are no longer being met.</p> <p>- Historical comparison: We challenged the inputs used in collective impairment models and considered whether those inputs reflected default and recovery experience across each of the loan finance categories.</p> <p>- Assessing transparency: Assessing the adequacy of the Group's disclosures about the degree of estimation uncertainty involved at arriving at the provisions.</p>

ANNUAL FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT, TO THE MEMBERS OF MANX FINANCIAL GROUP PLC (CONTINUED)

2 Key audit matters: our assessment of risks of material misstatement (continued)

Key audit matter	The risk	Auditor's response
<p>Impairment of goodwill and intangible assets</p> <p>Goodwill £2,344,000 (2017: £2,344,000) and Intangibles Assets £1,952,000 (2017: £1,719,000).</p> <p>Refer to the ARCC report, note 4 (Use of Judgements and Estimates - Assumptions and Estimation Uncertainties), note 25 (Intangible Assets), note 32 (Investment in Group Undertakings), 38(A) (Basis for Consolidation of Subsidiaries and Separate Financial Statements of the Parent Company), note 38(M) (Goodwill and Intangibles) and note 38(N) (Impairment of Non-Financial Assets)</p>	<p>Forecast-based valuation</p> <p>Goodwill and intangible assets are significant and the estimated recoverable amount of these balances is subjective due to the inherent uncertainty involved in forecasting and discounting future cash flows.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> - Control design and operating effectiveness: Understanding and testing the controls in respect of the Group's goodwill and intangibles assets impairment review process such as the timely recognition of impairment provisions and the completeness and accuracy of reports used in the impairment review process. - Benchmarking assumptions: Comparing the forecasts and assumptions included in the calculations of net present value used by the client for impairment testing to historical data, including the profit history of the businesses/groups of assets concerned. - Sensitivity analysis: Assessing the reasonableness of the sensitivity analysis performed by management, using higher discount rates, by considering whether the higher discount rates factored in sufficient downside risk. - Assessing transparency: Assessing the adequacy of the Group's disclosures about the degree of estimation uncertainty involved in performing the impairment assessments.
<p>VAT receivable</p> <p>VAT receivable exposure £1,049,000 (2017: £930,000).</p> <p>Refer to the ARCC report, note 4 (Use of Judgements and Estimates - Assumptions and Estimation Uncertainties) and note 23 (Trade and Other Receivables).</p>	<p>Uncertainty over recoverability</p> <p>The VAT receivable exposure is significant and its recoverability rests on the outcome of discussions with the Isle of Man Government Customs and Excise Division ("IOM C&E"), which in turn will take into account the final assessment by UK Customs and Excise of the impact of the recent CJEU ruling regarding the dispute between Volkswagen Financial Services (UK) Limited ("VWFS") v HM Revenue & Customs.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the impact of the final assessment of the amount of VAT to be recovered has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> - Our tax expertise: Use of our own tax specialists to assist in our assessment of the latest position regarding both the VWFS case and discussions between the Group and IOM C&E and our knowledge and experience of the application of relevant tax legislation. - Test of details: Use of our own tax specialist to assist in our testing of the calculations prepared by the Group based on the revised VAT recoverable calculation. - Assessing transparency: Assessing the adequacy of the Group's disclosures about the degree of estimation uncertainty involved in assessing the recoverability of this balance.

ANNUAL FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT, TO THE MEMBERS OF MANX FINANCIAL GROUP PLC (CONTINUED)

2 Key audit matters: our assessment of risks of material misstatement (continued)

Key audit matter	The risk	Auditor's response
<p>Carrying value of Parent Company's subordinated loans to and investment in subsidiaries</p> <p>Subordinated loans to subsidiaries £7,778,000 (2017: £5,778,000) and investment in subsidiaries £16,172,000 (2017: £13,772,000)</p> <p>Refer to the ARCC report, note 32 (Investment in Group Undertakings) and note 38(A)(v) (Separate Financial Statements of the Company).</p>	<p>High value</p> <p>The carrying value of the Parent Company's subordinated loans to and investment in subsidiaries represents 93.0% (2017: 98.0%) of the Parent Company's total assets. The assessment of carrying value is not at a high risk of significant misstatement or subject to significant judgement as the carrying value is supported by the audited net asset value of the subsidiaries. However, due to its materiality in the context of the Parent Company financial statements, this is considered to be the area that had the greatest effect on our overall Parent Company audit.</p>	<p>Our procedures included:</p> <p>Tests of detail: Assessing the loans to and investment in subsidiaries to identify, with reference to the subsidiaries' accounts, whether each subsidiary has sufficient assets to repay the debt owed and support the carrying value of the investment.</p> <p>Assessing subsidiary audits: A full scope audit of the accounts of the subsidiaries by the group audit engagement team.</p>

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

Materiality for the Group and Parent Company financial statements as a whole was set at £130,000 (2017: £140,000), determined with reference to a benchmark of Group profit before tax, of which it represents approximately 5.0%.

We agreed to report to the Audit, Risk and Compliance Committee any corrected or uncorrected identified misstatements exceeding £7,000 (2017: £7,000) for both the Group and Parent Company financial statements, in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group's subsidiaries were subjected to full scope statutory audit by the Group audit team and subject to a lower level of materiality based on their individual financial statements.

4 We have nothing to report on going concern

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

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

4 We have nothing to report on going concern (continued)

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model, and analysed how those risks might affect the Group's and Parent Company's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5 We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

ANNUAL FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT, TO THE MEMBERS OF MANX FINANCIAL GROUP PLC (CONTINUED)

6 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 25, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

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

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

This report is made solely to the Company's members, as a body, in accordance with Section 80(c) of the Isle of Man 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.

KPMG Audit LLC
Chartered Accountants
Heritage Court
41 Athol Street
Douglas
Isle of Man IM99 1HN

28 March 2019

ANNUAL FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the year ended 31 December	Notes	2018 £000	Restated (Note 5) 2017 £000
Interest income		19,115	19,893
Interest expense		<u>(3,547)</u>	<u>(3,256)</u>
Net interest income	10	15,568	16,637
Fee and commission income	11	3,371	3,115
Fee and commission expense	11	<u>(6,109)</u>	<u>(8,413)</u>
Net trading income		12,830	11,339
Other operating income		131	91
Loss on trading assets	21	(4)	(21)
Realised gains on debt securities	20	135	36
Terminal funding	12	<u>74</u>	<u>90</u>
Operating income		13,166	11,535
Personnel expenses	13	(5,703)	(4,783)
Other expenses	14	(3,465)	(3,152)
Impairment on loans and advances to customers	15	(857)	(585)
Depreciation	24	(184)	(134)
Amortisation and impairment of intangibles	25	(396)	(286)
Share of profit of equity accounted investees, net of tax	32	30	38
VAT recovery	23	<u>119</u>	<u>65</u>
Profit before tax payable	16	2,710	2,698
Income tax expense	17	<u>(243)</u>	<u>(240)</u>
Profit for the year		<u>2,467</u>	<u>2,458</u>
Other comprehensive income: -			
Items that will be reclassified to profit or loss			
Unrealised gain/(losses) on debt securities	20	44	(93)
Items that will never be reclassified to profit or loss			
Actuarial (losses)/gains on defined benefit pension scheme taken to equity	30	(50)	30
Total comprehensive income for the period attributable to owners		<u>2,461</u>	<u>2,395</u>
Basic earnings per share (pence)	18	1.88	2.17
Diluted earnings per share (pence)	18	1.54	1.70

The notes on pages 37 to 78 form part of these financial statements.

The Directors believe that all results derive from continuing activities.

ANNUAL FINANCIAL STATEMENTS

COMPANY STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the year ended 31 December	Notes	2018 £000	2017 £000
Interest income		466	-
Operating income		466	-
Personnel expenses		(177)	(22)
Administration expenses		(132)	(112)
Depreciation expense		(41)	(40)
Profit before tax payable	16	116	(174)
Tax payable		-	-
Profit for the year		116	(174)
Total comprehensive income for the year		116	(174)

The notes on pages 37 to 78 form part of these financial statements.

The Directors believe that all results derive from continuing activities.

ANNUAL FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December	Notes	2018 £000	Restated (Note 5) 2017 £000	Restated (Note 5) 2016 £000
Assets				
Cash and cash equivalents	19	9,753	9,745	6,129
Debt securities	20	30,534	34,272	23,991
Trading asset	21	20	24	70
Loans and advances to customers	22	148,278	122,546	115,929
Trade and other receivables	23	2,491	1,908	2,064
Property, plant and equipment	24	1,384	450	719
Intangible assets	25	1,952	1,719	1,316
Goodwill	32	2,344	2,344	2,344
Investment in associate	32	158	38	-
Total assets		196,914	173,046	152,562
Liabilities				
Deposits from customers	26	158,500	142,272	125,952
Creditors and accrued charges	27	2,010	3,164	2,975
Block creditors	28	138	751	1,390
Loan notes	29	15,871	8,995	8,545
Pension liability	30	584	560	614
Deferred tax liability	17	88	42	40
Total liabilities		177,191	155,784	139,516
Equity				
Called up share capital	31	20,732	20,732	18,933
Profit and loss account		(1,009)	(3,470)	(5,887)
Total equity		19,723	17,262	13,046
Total liabilities and equity		196,914	173,046	152,562

The financial statements were approved by the Board of Directors on 27 March 2019 and signed on its behalf by: -

Jim Mellon Executive Chairman	Denham Eke Chief Executive Officer	Douglas Grant Group Finance Director
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The notes on pages 37 to 78 form part of these financial statements.

ANNUAL FINANCIAL STATEMENTS

COMPANY STATEMENT OF FINANCIAL POSITION

As at 31 December	Notes	2018 £000	2017 £000
Assets			
Cash and cash equivalents	19	1,646	200
Trade and other receivables	23	32	22
Amounts due from Group undertakings	32	-	16
Property, plant and equipment	24	126	166
Investment in Group undertakings	32	16,172	13,772
Subordinated loans	32	7,778	5,778
Total assets		25,754	19,954
Liabilities			
Creditors and accrued charges	27	94	139
Amounts due to Group undertakings	32	1,370	2,517
Loan notes	29	15,871	8,995
Total liabilities		17,335	11,651
Equity			
Called up share capital	31	20,732	20,732
Profit and loss account		(12,313)	(12,429)
Total equity		8,419	8,303
Total liabilities and equity		25,754	19,954

The notes on pages 37 to 78 form part of these financial statements.

ANNUAL FINANCIAL STATEMENTS

CONSOLIDATED AND COMPANY STATEMENTS OF CHANGES IN EQUITY

Group	Share capital £000	Profit and loss account £000	Total equity £000
Balance as at 1 January 2017 (as originally stated)	18,933	(5,763)	13,170
Retrospective impact on initial application of IFRS 9 (see note 5)	-	(124)	(124)
Restated balance at 1 January 2017	18,933	(5,887)	13,046
Profit for the year (See note 8.A.(iv))	-	2,458	2,458
Other comprehensive income	-	(63)	(63)
Transactions with owners: -			
Share-based payment expense (see notes 16 and 31)	-	22	22
Shares issued	1,799	-	1,799
Restated Balance as at 31 December 2017	20,732	(3,470)	17,262
Profit for the year	-	2,467	2,467
Other comprehensive income	-	(6)	(6)
Transactions with owners: -			
Share-based payment expense (see notes 16 and 31)	-	-	-
Balance as at 31 December 2018	20,732	(1,009)	19,723

Company	Share Capital £000	Profit and loss account £000	Total equity £000
Balance as at 1 January 2017	18,933	(12,277)	6,656
Loss for the year	-	(174)	(174)
Transactions with owners: -			
Share-based payment expense (see notes 16 and 31)	-	22	22
Shares issued	1,799	-	1,799
Balance as at 31 December 2017	20,732	(12,429)	8,303
Profit for the year	-	116	116
Transactions with owners: -			
Share-based payment expense (see notes 16 and 31)	-	-	-
Balance as at 31 December 2018	20,732	(12,313)	8,419

The notes on pages 37 to 78 form part of these financial statements.

ANNUAL FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December	Notes	2018 £000	2017 £000
RECONCILIATION OF PROFIT BEFORE TAXATION TO OPERATING CASH FLOWS			
Profit before tax		2,710	2,698
Adjustments for:			
Depreciation	24	184	134
Amortisation and impairment of intangibles	25	396	286
Realised gains on debt securities	20	(135)	(36)
Share in net assets of associate	32	(30)	(38)
Equity settled share-based payment transactions	16, 31	-	22
		3,125	3,066
Changes in:			
Trading asset	21	4	46
Trade and other receivables		(583)	156
Creditors and accrued charges		(1,169)	(21)
		1,377	3,247
Net cash flow from trading activities			
Changes in:			
Loans and advances to customers		(25,732)	(6,617)
Deposits from customers		16,228	16,320
Pension contribution	30	(26)	(24)
Cash (outflow)/inflow from operating activities		(8,153)	12,926
CASH FLOW STATEMENT			
Cash from operating activities			
Cash (outflow)/inflow from operating activities		(8,153)	12,926
Income taxes paid		(182)	(28)
Net cash (outflow)/inflow from operating activities		(8,335)	12,898
Cash flows from investing activities			
Purchase of property, plant and equipment	24	(1,118)	(122)
Purchase of intangible assets	25	(629)	(452)
Sale of tangible fixed assets		-	20
Acquisition of associate	32	(90)	-
Sales/(Purchase) of debt securities at FVOCI	20	3,917	(4,806)
Purchase of debt securities at amortised cost	20	-	(5,532)
Net cash inflow/(outflow) from investing activities		2,080	(10,892)
Cash flows from financing activities			
Receipt of loan notes	29	6,876	450
Increase in share capital		-	1,799
(Decrease) in borrowings from block creditors	28	(613)	(639)
Net cash inflow from financing activities		6,263	1,610
Net increase in cash and cash equivalents		8	3,616
Cash and cash equivalents at 1 January		9,745	6,129
Cash and cash equivalents at 31 December		9,753	9,745
Included in cash flows are: -			
Interest received - cash amounts		18,362	19,109
Interest paid - cash amounts		(3,434)	(3,152)

The notes on pages 37 to 78 form part of these financial statements.

ANNUAL FINANCIAL STATEMENTS

COMPANY STATEMENT OF CASH FLOWS

For the year ended 31 December	Notes	2018 £000	2017 £000
RECONCILIATION OF PROFIT BEFORE TAXATION TO OPERATING CASH FLOWS			
Profit before tax		116	(174)
Adjustments for:			
- Depreciation	24	41	41
- Share-based payment expense	32	-	22
		<u>157</u>	<u>(111)</u>
Changes in:			
Amounts due from group undertakings		16	280
Trade and other receivables		(10)	7
Creditors and accrued charges		(45)	57
Amounts due to group undertakings		(1,147)	18
Cash (outflow)/inflow from operating activities		<u>(1,029)</u>	<u>251</u>
CASH FLOW STATEMENT			
Cash from operating activities			
Cash (outflow)/inflow from operating activities		(1,029)	251
Income taxes paid		-	-
Net cash (outflow)/inflow from operating activities		<u>(1,029)</u>	<u>251</u>
Cash flows from investing activities			
Increase in investment in group undertakings	32	(2,400)	(1,700)
Issue of subordinated loans	32	(2,000)	(600)
Net cash outflow from investing activities		<u>(4,400)</u>	<u>(2,300)</u>
Cash flows from financing activities			
Receipt of loan notes	29	6,875	450
Increase in share capital		-	1,799
Net cash inflow from financing activities		<u>6,875</u>	<u>2,249</u>
Net increase in cash and cash equivalents		1,446	200
Cash and cash equivalents at 1 January		<u>200</u>	<u>-</u>
Cash and cash equivalents at 31 December		1,646	200

The notes on pages 37 to 78 form part of these financial statements.

ANNUAL FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

1. Reporting entity

Manx Financial Group PLC is a company incorporated in the Isle of Man. The consolidated financial statements of Manx Financial Group PLC (the "Company") for the year ended 31 December 2018 comprise the Company and its subsidiaries (the "Group").

2. Basis of accounting

The consolidated and the separate financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations applicable to companies reporting under IFRS, including International Accounting Standards ("IAS").

This is the first set of the Group's annual financial statements in which IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers have been applied. Changes to significant accounting policies are described in Note 5.

3. Functional and presentation currency

These financial statements are presented in pounds sterling, which is the Group's functional currency. All amounts have been rounded to the nearest thousand, unless otherwise indicated. All subsidiaries of the Group have pounds sterling as their functional currency.

4. Use of judgements and estimates

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties at year-end that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year is included in the following notes:-

- Note 23 - measurement of VAT receivable: key assumptions underlying carrying amount;
- Note 30 - measurement of defined benefit obligations: key actuarial assumptions;
- Note 25 and 32 - impairment test of intangible assets and goodwill: key assumptions underlying recoverable amounts; and
- Note 38(l)(vii) - measurement of ECL allowance for loans and advances to customers and assessment of specific impairment allowances where loans are in default or arrears: key assumptions in determining the weighted-average loss rate.

5. Changes in accounting policies

A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Group's financial statements.

Except for the changes below, the Group has consistently applied the accounting policies as set out in Note 38 to all periods presented in these financial statements.

IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The key changes to the Group's accounting policies resulting from the Group's adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Note 6 and 8.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

ANNUAL FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

5. Changes in accounting policies (continued)

Classification of financial assets and financial liabilities (continued)

IFRS 9 largely retains the existing requirements in IAS 39 for classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in fair value that is attributable to changes in the credit risk of the liability is presented in Other Comprehensive Income ("OCI"); and
- the remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the Group classifies financial assets and liabilities under IFRS 9, See Note 38(I)(ii).

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Group applies the impairment requirements of IFRS 9, see Note 38(I)(vii).

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively,

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see note 6 and 8(A)(iv).

B. IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

The Group initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The timing or amount of the Group's fee income from contracts with customers was not impacted by the adoption of IFRS 15.

ANNUAL FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

6. Classification of financial assets and financial liabilities

For description of how the Group classifies financial assets and liabilities, see Note 38(l)(ii)

The following table provides reconciliation between line items in the statement of financial position and categories of financial instruments.

	Mandatorily at FVTPL	Designated as at FVTPL	FVOCI - debt instruments	FVOCI - equity instruments	Amortised cost	Total carrying amount
31 December 2018						
Cash and cash equivalents					9,753	9,753
Debt securities	-	-	30,534	-	-	30,534
Trading assets	20	-	-	-	-	20
Loans and advances to customers	-	-	-	-	148,278	148,278
Trade and other receivables	-	-	-	-	2,491	2,491
Total financial assets	20	-	30,534	-	160,522	191,076
Deposits from customers	-	-	-	-	158,500	158,500
Creditor and accrued charges	-	-	-	-	2,010	2,010
Block creditors	-	-	-	-	138	138
Loan notes	-	-	-	-	15,871	15,871
Total financial liabilities	-	-	-	-	176,519	176,519

	Mandatorily at FVTPL	Designated as at FVTPL	FVOCI - debt instruments	FVOCI - equity instruments	Amortised cost	Total carrying amount
31 December 2017						
Cash and cash equivalents	-	-	-	-	9,745	9,745
Debt securities	-	-	28,740	-	5,532	34,272
Trading assets	24	-	-	-	-	24
Loans and advances to customers	-	-	-	-	122,546	122,546
Trade and other receivables	-	-	-	-	1,908	1,908
Total financial assets	24	-	28,740	-	139,731	168,495
Deposits from customers	-	-	-	-	142,272	142,272
Creditor and accrued charges	-	-	-	-	3,164	3,164
Block creditors	-	-	-	-	751	751
Loan notes	-	-	-	-	8,995	8,995
Total financial liabilities	-	-	-	-	155,182	155,182

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 liabilities at 1 January 2017.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
1 January 2017				
Cash and cash equivalents	Loans and receivables	Amortised cost	6,129	6,129
Trading assets	FVTPL	FVTPL (Mandatory)	70	70
Debt securities	Available-for-sale	FVOCI	23,991	23,991
Debt securities - Certificates of Deposit	Amortised cost	Amortised cost	-	-
Loans and advances to customers	Amortised cost	Amortised cost	116,053	115,929
Trade and other receivables	Loans and receivables	Amortised cost	2,064	2,064
Total financial assets			148,307	148,183

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6. Classification of financial assets and financial liabilities (continued)

1 January 2017	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Deposits from customers	Amortised cost	Amortised cost	125,952	125,952
Creditor and accrued charges	Amortised cost	Amortised cost	2,975	2,975
Block creditors	Amortised cost	Amortised cost	1,390	1,390
Loan notes	Amortised cost	Amortised cost	8,545	8,545
Total financial liabilities			138,862	138,862

In applying IFRS 9 both in the current period and retrospectively in previous periods, there were no reclassifications in the measurement category. As a result, there has been no financial adjustment in transitioning to IFRS 9 with respect to adopting the revised measurement categories.

7. Fair value of financial instruments

For description of the Group's fair value measurement accounting policy, see Note 38(l)(vi).

The following table analyses financial instruments measured at fair value at the reporting date, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position.

31 December 2018	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Debt securities	30,534	-	-	30,534
Trading assets	20	-	-	20
	30,554	-	-	30,554
31 December 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment securities				
Debt securities	28,740	-	5,532	34,272
Trading assets	24	-	-	24
	28,764	-	5,532	34,296

Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised: -

31 December 2018	Level 1 £000	Level 2 £000	Level 3 £000	Total fair values £000	Total carrying amount £000
Assets					
Cash and cash equivalents	-	9,753	-	9,753	9,753
Loans and advances to customers	-	-	148,278	148,278	148,278
Investment in associate	-	-	158	158	158
Trade and other receivables	-	-	2,491	2,491	2,491
	-	9,753	150,927	160,680	160,680
Liabilities					
Deposits from customers	-	158,500	-	158,500	158,500
Creditors and accrued charges	-	-	2,010	2,010	2,010
Block creditors	-	-	138	138	138
Loan notes	-	-	15,871	15,871	15,871
	-	158,500	18,019	176,519	176,519

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7. Fair value of financial instruments (continued)

Financial instruments not measured at fair value (continued)

31 December 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total fair values £000	Total carrying amount £000
Assets					
Cash and cash equivalents	-	9,745	-	9,745	9,745
Debt securities - certificates of deposit	-	-	5,532	5,532	5,532
Loans and advances to customers	-	-	122,546	122,546	122,546
Investment in associate	-	-	24	24	24
Trade and other receivables	-	-	1,908	1,908	1,908
	<u>-</u>	<u>9,745</u>	<u>130,010</u>	<u>139,755</u>	<u>139,755</u>
Liabilities					
Deposits from customers	-	142,272	-	142,272	142,272
Creditors and accrued charges	-	-	3,164	3,164	3,164
Block creditors	-	-	751	751	751
Loan notes	-	-	8,995	8,995	8,995
	<u>-</u>	<u>142,272</u>	<u>12,910</u>	<u>155,182</u>	<u>155,182</u>

The fair value of loans and advances is estimated using valuation models, such as discounted cash flow techniques. Input into the valuation techniques includes expected lifetime credit losses, interest rates, prepayment rates. For collateral-dependent impaired loans, the fair value is measured based on the value of the underlying collateral. Input into the models may include data from third party brokers based on over the counter trading activity, and information obtained from other market participants, which includes observed primary and secondary transactions.

8. Financial risk review

Risk management

This note presents information about the Group's exposure to financial risks and the Group's management of capital. For information on the Group's financial risk management framework, see Note 36.

A. Credit risk

For definition of credit risk and information on how credit risk is mitigated by the Group, see Note 36.

i. Credit quality analysis

Loans and advances to customers

Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 38 (I)(vii).

An analysis of the credit risk on loans and advances to customers is as follows: -

	Stage 1 £000	Stage 2 £000	Stage 3 £000	2018 £000	2017 £000
Grade A ¹	139,695	-	-	139,695	118,373
Grade B	760	5,308	85	6,153	3,090
Grade C	-	1,746	4,078	5,824	3,770
Gross value	<u>140,455</u>	<u>7,054</u>	<u>4,163</u>	<u>151,672</u>	<u>125,233</u>
Allowance for impairment	<u>(125)</u>	<u>(143)</u>	<u>(3,126)</u>	<u>(3,394)</u>	<u>(2,687)</u>
Carrying value	<u>140,330</u>	<u>6,911</u>	<u>1,037</u>	<u>148,278</u>	<u>122,546</u>

¹ Loans are graded A to C depending on the level of risk. Grade C relates to agreements with the highest of risk, Grade B with medium risk and Grade A relates to agreements with the lowest risk.

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8. Financial risk review (continued)

Risk management (continued)

A. Credit risk (continued)

i. Credit quality analysis (continued)

Loans and advances to customers (continued)

The following table sets out information about the overdue status of loans and advances to customers in Stage 1, 2 and 3.

31 December	Stage 1 £000	Stage 2 £000	Stage 3 £000	2018 £000	2017 £000
Current	137,196	-	-	137,196	115,267
Overdue < 30 days	2,499	-	-	2,499	3,106
Overdue > 30 days	760	7,054	4,163	11,977	6,860
	140,455	7,054	4,163	151,672	125,233

Debt securities, Cash and cash equivalents

The following table sets out the credit quality of liquid assets:

31 December	2018 £000	2017 £000
Government bonds and treasury bills		
Rated A to A+	30,534	28,740
Corporate bonds		
Rated A to A+	-	5,532
Cash and cash equivalents		
Rated A to A+	9,754	9,745
	40,288	44,017

The analysis has been based on Standard & Poor's ratings.

ii. Collateral and other credit enhancements

The Group holds collateral in the form of the underlying assets (typically private and commercial vehicles, plant and machinery) to loan arrangements as security for HP, finances leases, vehicle stocking plans, block discounting, wholesale funding arrangements, integrated wholesale funding arrangements and secured commercial loan balances, which are sub-categories of loans and advances to customers. In addition, the commission share schemes have an element of capital indemnified. During 2018, 37.9% of loans and advances fell into this category (2017: 41.7%).

Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. At the time of granting credit within the sub-categories listed above, the loan balances due are secured over the underlying assets held as collateral.

iii. Amounts arising from ECL

See accounting policy in Note 38(I)(vii)

IFRS 9 significantly overhauled the requirements and methodology used to assess credit impairments by transitioning to a forward-looking approach based on an expected credit loss model. The new impairment model applies to financial assets measured at amortised cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognised earlier than under IAS 39.

After a detailed review, the Group devised and implemented an impairment methodology in light of the IFRS 9 requirements outlined above noting the following:

- A SICR is always deemed to occur when the borrower is 30 days past due on its contractual payments. If the Group becomes aware ahead of this time of non-compliance or financial difficulties of the borrower, such as loss of employment, avoiding contact with the Group then a SICR has also deemed to occur.

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For the year ended 31 December 2018

8. Financial risk review (continued)

Risk management (continued)

A. Credit risk (continued)

iii. Amounts arising from ECL (continued)

- A receivable is always deemed to be in default and credit-impaired when the borrower is 90 days past due on its contractual payments or earlier if the Group becomes aware of severe financial difficulties such as bankruptcy, IVA, abscond or disappearance, fraudulent activity and other similar events.
- The ECL was derived by reviewing the Group's loss rate and loss given default over the past 8 years by product and geographical segment.
- The Group has assumed that the future economic conditions will broadly mirror the current environment and therefore the forecasted loss levels in the next 3 years will match the Group's experience in recent years.
- For portfolios where the Group has never had a default in its history or has robust credit enhancements such as credit insurance or default indemnities for the entire portfolio, then no IFRS 9 provision is made.
- If the Group holds objective evidence through specifically assessing a credit-impaired receivable and believes it will go on to completely recover the debt due to the collateral held and cooperation with the borrower, then no IFRS 9 provision is made.

iv. Reconciliation of the primary statements from IAS 39 to IFRS 9

As a result of the change to the Group's accounting policy in regards to credit-impairments, it has restated the previous periods in accordance with IFRS 9. A reconciliation of the primary statements is as follows:

Consolidated Income Statement

31 December 2017	Impact of adopting IFRS 9 at 31 December £000
Profit for the year	2,508
Increase to provision for impairment on loan assets	(50)
Restated profit for the year	2,458
Reduction in basic earnings per share (pence)	(0.04)
Reduction in diluted earnings per share (pence)	(0.03)

Consolidated Statement of Other Comprehensive Income

31 December 2017	Impact of adopting IFRS 9 at 31 December £000
Total comprehensive income for the year attributable to owners	2,445
Increase to provision for impairment on loan assets	(50)
Restated Total comprehensive income for the year attributable to owners	2,395
Reduction in basic earnings per share (pence)	(0.04)
Reduction in diluted earnings per share (pence)	(0.03)

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For the year ended 31 December 2018

8. Financial risk review (continued)

Risk management (continued)

A. Credit risk (continued)

iv. Reconciliation of the primary statements from IAS 39 to IFRS 9 (continued)

Consolidated Statement of Financial Position

	Impact of adopting IFRS 9 at 31 December 2017 £000	Impact of adopting IFRS 9 at 31 December 2016 £000
Assets		
Loans and advances to customers	122,720	116,053
Increase to provision for impairment on loan assets	(174)	(124)
Restated loans and advances to customers	<u>122,546</u>	<u>115,929</u>
Equity		
Profit and loss account	(3,296)	(5,763)
Increase to provision for impairment on loan assets	(174)	(124)
Restated profit and loss account	<u>(3,470)</u>	<u>(5,887)</u>

Consolidated Statement of Cash Flows

Total cash flows from operating, investing and financing activities remains unchanged due to the increase in impairments on loan assets being a non-cash item.

Consolidated Statement of Changes in Equity

For an analysis of the retrospective impact of IFRS 9, see the Consolidated Statement of Changes in Equity which analyses in each year the effect of adopting IFRS 9 for that year.

v. Concentration of credit risk

Geographical

Lending is restricted to individuals and entities with Isle of Man, UK or Channel Islands addresses.

Segmental

The Bank is exposed to credit risk with regard to customer loan accounts, comprising HP and finance lease balances, unsecured personal loans, secured commercial loans, block discounting, vehicle stocking plan loans and wholesale funding agreements. In addition, the Bank lends via significant introducers into the UK. There was one introducer that accounted for more than 20% of the Bank's total lending portfolio at the end of 31 December 2018 (2017: one introducer).

B. Liquidity risk

For the definition of liquidity risk and information on how liquidity risk is managed by the Group see Note 36.

i. Exposure to liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of net liquid assets to deposits from customers and short-term funding. For this purpose, 'net liquid assets' includes cash and cash equivalents and investment-grade debt securities for which there is an active and liquid market.

Details of the reported Group ratio of net liquid assets to deposits from customers at the reporting date and during the reporting period were as follows:

	2018	2017
At 31 December	25%	27%
Average for the period	32%	26%
Maximum for the period	40%	30%
Minimum for the period	25%	23%

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8. Financial risk review (continued)

Risk management (continued)

B. Liquidity risk (continued)

ii. Maturity analysis for financial liabilities and financial assets

The table below shows the Group's financial liabilities classified by their earliest possible contractual maturity, on an undiscounted basis including interest due at the end of the deposit term. Based on historical data, the Group's expected actual cash flow from these items vary from this analysis due to the expected re-investment of maturing customer deposits.

Residual contractual maturities of financial liabilities as at the reporting date (undiscounted)

31 December 2018	Sight- 8 days £000	>8 days - 1 month £000	>1 month - 3 months £000	>3 months - 6 months £000	>6 months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Total £000
Deposits from customers	1,754	5,012	14,397	34,028	35,032	56,643	11,634	-	158,500
Other liabilities	2,061	200	230	216	928	8,705	8,063	584	20,987
Total liabilities	3,815	5,212	14,627	34,244	35,960	65,348	19,697	584	179,487

31 December 2017	Sight- 8 days £000	>8 days - 1 month £000	>1 month - 3 months £000	>3 months - 6 months £000	>6 months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Total £000
Deposits from customers	2,579	3,136	12,710	24,241	30,207	60,820	12,567	-	146,260
Other liabilities	3,094	89	318	1,540	1,754	3,326	3,322	560	14,003
Total liabilities	5,673	3,225	13,028	25,781	31,961	64,146	15,889	560	160,263

Maturity of assets and liabilities at the reporting date

31 December 2018	Sight- 8 days £000	>8 days - 1 month £000	>1 month - 3 months £000	>3 months - 6 months £000	>6 months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Total £000
Assets									
Cash & cash equivalents	9,753	-	-	-	-	-	-	-	9,753
Debt securities	-	17,995	5,989	-	-	-	6,550	-	30,534
Loans and advances to customers	5,273	1,047	9,724	15,977	35,246	64,099	16,910	2	148,278
Other assets	20	225	145	-	-	-	-	7,959	8,349
Total assets	15,046	19,267	15,858	15,977	35,246	64,099	23,460	7,961	196,914
Liabilities									
Deposits from customers	1,754	5,012	14,397	34,028	35,032	56,643	11,634	-	158,500
Other liabilities	2,098	146	92	-	500	7,690	7,581	584	18,691
Total liabilities	3,852	5,158	14,489	34,028	35,532	64,333	19,215	583	177,191

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8. Financial risk review (continued)

Risk management (continued)

B. Liquidity risk (continued)

ii. Maturity analysis for financial liabilities and financial assets (continued)

Maturity of assets and liabilities at the reporting date (continued)

31 December 2017	Sight- 8 days £000	>8 days - 1 month £000	>1 month - 3 months £000	>3 months- 6 months £000	>6 months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Total £000
Assets									
Cash & cash equivalents	9,745	-	-	-	-	-	-	-	9,745
Debt securities	-	1,998	16,983	8,524	-	-	6,767	-	34,272
Loans and advances to customers	3,708	3,649	7,945	10,808	25,849	54,872	15,695	21	122,546
Other assets	103	194	192	-	-	-	-	5,994	6,483
Total assets	13,556	5,841	25,120	19,332	25,849	54,872	22,462	6,015	173,046
Liabilities									
Deposits from customers	2,570	3,105	12,654	24,112	29,716	57,711	12,404	-	142,272
Other liabilities	3,086	55	234	169	3,333	2,945	3,130	560	13,512
Total liabilities	5,656	3,160	12,888	24,281	33,049	60,656	15,534	560	155,784

iii. Liquidity reserves

The following table sets out the components of the Group's liquidity reserves.

	2018 Carrying amount £000	2018 Fair value £000	2017 Carrying amount £000	2017 Fair value £000
Balances with other banks	9,753	9,753	9,745	9,745
Unencumbered debt securities issued by sovereigns	30,534	30,534	34,272	34,272
Total liquidity reserves	40,287	40,287	44,017	44,017

C. Market risk

For the definition of market risk and information on how the Group manages the market risks of trading and non-trading portfolios, see Note 36.

The following table sets out the allocation of assets and liabilities subject to market risk between trading and non-trading portfolios.

31 December 2018	Carrying amount £000	Market risk measure	
		Trading portfolios £000	Non-trading portfolios £000
Assets subject to market risk			
Trading assets	20	20	-
Debt securities	30,534	-	30,534
Total	30,554	20	30,534
31 December 2017			
	Carrying amount £000	Market risk measure Trading portfolios £000	Non-trading portfolios £000
Assets subject to market risk			
Trading assets	24	24	-
Debt securities	34,272	-	34,272
Total	34,296	24	34,272

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8. Financial risk review (continued)

Risk management (continued)

C. Market risk (continued)

i. Exposure to interest rate risk - Non-trading portfolio

The following tables present the interest rate mismatch position between assets and liabilities over the respective maturity dates. The maturity dates are presented on a worst-case basis, with assets being recorded at their latest maturity and deposits from customers at their earliest.

31 December 2018	Sight- 1 month £000	>1month -3months £000	>3months -6months £000	>6months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Non-Int. Bearing £000	Total £000
Assets									
Cash & cash equivalents	9,753	-	-	-	-	-	-	-	9,753
Debt securities	17,995	5,989	-	-	-	6,550	-	-	30,534
Loans and advances to customers	6,319	9,724	15,977	35,247	64,099	16,910	2	-	148,278
Other assets	245	145	-	-	-	-	-	7,959	8,349
Total assets	34,312	15,858	15,977	35,247	64,099	23,460	2	7,959	196,914
Liabilities and equity									
Deposits from customers	6,766	14,397	34,028	35,032	56,643	11,634	-	-	158,500
Other liabilities	2,244	92	-	500	7,690	7,581	584	-	18,691
Total equity	-	-	-	-	-	-	-	19,723	19,723
Total liabilities and equity	9,010	14,489	34,028	35,532	64,333	19,215	584	19,656	196,914
Interest rate sensitivity gap	25,302	1,369	(18,051)	(285)	(234)	4,245	(582)	(11,764)	-
Cumulative	25,302	26,671	8,620	8,335	8,101	12,346	11,764	-	-

31 December 2017	Sight- 1 month £000	>1month -3months £000	>3months -6months £000	>6months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Non-Int. Bearing £000	Total £000
Assets									
Cash & cash equivalents	9,745	-	-	-	-	-	-	-	9,745
Debt securities	1,998	16,983	8,524	-	-	6,766	-	-	34,427
Loans and advances to customers	7,356	7,945	10,808	25,849	54,872	15,695	22	-	122,547
Other assets	297	192	-	-	-	-	-	5,994	6,483
Total assets	19,396	25,120	19,332	25,849	54,872	22,461	22	5,994	173,046
Liabilities and equity									
Deposits from customers	5,675	12,654	24,112	29,716	57,711	12,404	-	-	142,272
Other liabilities	3,141	234	169	3,333	2,945	3,130	560	-	13,512
Total equity	-	-	-	-	-	-	-	17,262	17,262
Total liabilities and equity	8,816	12,888	24,281	33,049	60,656	15,534	560	17,262	173,046
Interest rate sensitivity gap	10,580	12,232	(4,949)	(7,200)	(5,784)	6,927	(538)	(11,268)	-
Cumulative	10,580	22,812	17,863	10,663	4,879	11,806	11,268	-	-

The Bank monitors the impact of changes in interest rates on interest rate mismatch positions using a method consistent with the FSA required reporting standard. The methodology applies weightings to the net interest rate sensitivity gap in order to quantify the impact of an adverse change in interest rates of 2.0% per annum (2017: 2.0%). The following tables set out the estimated total impact of such a change based on the mismatch at the reporting date: -

31 December 2018	Sight- 1 month £000	>1month -3months £000	>3months -6months £000	>6months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Non-Int. Bearing £000	Total £000
Interest rate sensitivity gap	25,302	1,369	(18,051)	(285)	(234)	4,245	(582)	(11,764)	-
Weighting	0.000	0.003	0.007	0.014	0.027	0.054	0.115	0.000	-
£000	-	4	(126)	(4)	(6)	229	(67)	-	30

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8. Financial risk review (continued)

Risk management (continued)

C. Market risk (continued)

i. Exposure to interest rate risk - Non-trading portfolio (continued)

31 December 2017	Sight- 1 month £000	>1month -3months £000	>3months -6months £000	>6months - 1 year £000	>1 year - 3 years £000	>3 years - 5 years £000	>5 years £000	Non-Int. Bearing £000	Total £000
Interest rate sensitivity gap	10,580	12,232	(4,949)	(7,200)	(5,784)	6,927	(538)	(11,268)	-
Weighting	0.000	0.003	0.007	0.014	0.027	0.054	0.115	0.000	-
£000	-	37	(35)	(101)	(156)	374	(62)	-	57

D. Capital Management

i. Regulatory capital

The lead regulatory of the Group's wholly owned subsidiary, Conister Bank Limited ('Bank'), is the Isle of Man Financial Services Authority ('FSA'). The FSA sets and monitors capital requirements for the Bank.

The Bank's regulatory capital consists of the following elements.

- Common Equity Tier 1 (CET1) capital, which includes ordinary share capital, retained earnings and reserves after adjustment for deductions for goodwill, intangible assets, intercompany receivable.
- Tier 2 capital, which includes qualifying subordinated liabilities and any excess of impairment over expected losses.

The lead FSA's approach to the measurement of capital adequacy is primarily based on monitoring the relationship of the capital resources requirement to available capital resources. The FSA sets individual capital guidance (ICG) for the Bank in excess of the minimum capital resources requirement. A key input to the ICG setting process is the Bank's internal capital adequacy assessment process (ICAAP).

The Bank is also regulated by the Financial Conduct Authority in the United Kingdom for credit and brokerage related activities.

ii. Capital allocation

Management uses regulatory capital ratios to monitor its capital base. The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily on regulatory capital requirements.

9. Operating segments

Segmental information is presented in respect of the Group's business segments. The Directors consider that the Group currently operates in one geographic segment comprising of the Isle of Man, UK and Channel Islands. The primary format, business segments, is based on the Group's management and internal reporting structure. The Directors consider that the Group operates in five (2017: five) product orientated segments in addition to its investing activities: Asset and Personal Finance (including provision of HP contracts, finance leases, personal loans, commercial loans, block discounting, vehicle stocking plans and wholesale funding agreements); Manx Incahoot; Conister Card Services; Edgewater Associates; and Manx FX.

For the year ended 31 December 2018	Asset and Personal Finance £000	Manx Incahoot £000	Conister Card Services £000	Edgewater Associates £000	Manx FX £000	Investing Activities £000	Total £000
Net interest income	15,568	-	-	-	-	-	15,568
Operating income /(loss)	9,306	12	-	2,562	493	-	13,166
Profit / (loss) before tax payable	2,267	(189)	(3)	245	490	(100)	2,710
Capital expenditure	1,589	1	-	150	6	1	1,747
Total assets	190,923	78	-	3,153	608	2,152	196,914

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9. Operating segments (continued)

For the year ended 31 December 2017	Asset and Personal Finance £000	Manx Incahoot £000	Conister Card Services £000	Edgewater Associates £000	Manx FX £000	Investing Activities £000	Total £000
Net interest income	16,637	-	-	-	-	-	16,637
Operating income /(loss)	8,298	44	(104)	2,625	447	-	11,310
Profit / (loss) before tax payable	1,910	(293)	(104)	742	249	(186)	2,318
Capital expenditure	254	1	-	319	-	-	574
Total assets	168,052	307	18	2,252	181	2,236	173,046

10. Net interest income

	2018 £000	2017 £000
Interest income		
Loans and advances to customers	19,037	19,839
Total interest income calculated using the effective interest method	19,037	19,839
Other interest income	78	54
Total interest income	19,115	19,893
Interest expense		
Deposits from customers	(2,744)	(2,690)
Subordinated liabilities	(773)	(495)
Block funders	(30)	(71)
Total interest expense	(3,547)	(3,256)
Net interest income	15,568	16,637

11. Net fee and commission income

A. Disaggregation of fee and commission income

In the following table, fee and commission income from contracts with customers in the scope of IFRS 15 is disaggregated by major type of services. The table includes a reconciliation of the disaggregated fee and commission income with the Group's reportable segments.

	2018 £000	2017 £000
Major service lines		
Independent financial advice income	2,547	2,625
FX trading income	824	490
Fee and commission income	3,371	3,115
Fee and commission expense	(6,109)	(8,413)
Net fee and commission expense	(2,738)	(5,298)

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12. Terminal funding

In September 2014, the Bank discontinued funding handheld payment devices (referred to as Terminal Funding) due to the volume of write offs. Ever since, the book is being run off whilst the Bank vigorously pursues historical write off. A decision was made by the Board during 2016 to cease funding and run-off the book upon the final repayment date of August 2019.

	2018 £000	2017 £000
Interest income	181	377
Fee and commission expense	(5)	(92)
Provision for impairment on loan assets	(102)	(195)
	<u>74</u>	<u>90</u>

13. Personnel expenses

	2018 £000	2017 £000
Gross salaries	(4,233)	(3,479)
Executive Directors' remuneration	(241)	(214)
Non-executive Directors' fees	(145)	(185)
Executive Directors' pensions	(19)	(21)
Executive Directors' performance related pay	(50)	(36)
Pension costs	(259)	(226)
National insurance and payroll taxes	(527)	(432)
Training and recruitment costs	(229)	(190)
	<u>(5,703)</u>	<u>(4,783)</u>

14. Other expenses

	2018 £000	2017 £000
Professional and legal fees	(1,067)	(848)
Marketing costs	(237)	(211)
IT costs	(567)	(528)
Establishment costs	(434)	(376)
Communication costs	(146)	(137)
Travel costs	(174)	(149)
Bank charges	(119)	(142)
Insurance	(141)	(133)
Irrecoverable VAT	(303)	(180)
Other costs	(277)	(448)
	<u>(3,465)</u>	<u>(3,152)</u>

15. Impairment on loans and advances to customers

The charge in respect of specific allowances for impairment comprises: -

	2018 £000	2017 £000
Specific impairment allowances made	(1,246)	(1,295)
Reversal of allowances previously made	410	776
Total charge for specific provision for impairment	<u>(836)</u>	<u>(519)</u>

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

The charge in respect of collective allowances for impairment comprises: -

	2018 £000	2017 £000
Collective impairment allowances made	(49)	(78)
Release of allowances previously made	28	12
Total charge for collective allowances for impairment	(21)	(66)
Total charge for allowances for impairment	(857)	(585)

16. Profit before tax payable

The profit before tax payable for the year is stated after charging: -

	Group		Company	
	2018 £000	2017 £000	2018 £000	2017 £000
Share options expense	-	(22)	-	(22)
Auditor's remuneration: - as Auditor current year non-audit services	(108) (7)	(90) (37)	- -	- -
Pension cost defined benefit scheme	(17)	(17)	-	-
Operating lease rentals for property	(251)	(220)	-	-

17. Income tax expense

	2018 £000	2017 £000
Current tax expense		
Current year	(197)	(226)
Changes to estimates for prior years	-	(12)
	(197)	(238)
Deferred tax expense		
Origination and reversal of temporary differences	(46)	(2)
Utilisation of previously recognised tax losses	-	-
Changes to estimates for prior years	-	-
	(46)	(2)
Tax expense	(243)	(240)

	2018 £000		2017 £000	
Reconciliation of effective tax rate				
Profit before tax		2,710		2,698
Tax using the Bank's domestic tax rate	(10.0)%	(271)	(10.0)%	(270)
Effect of tax rates in foreign jurisdictions	0.0 %	-	(1.6)%	(44)
Non-deductible expenses	(1.2)%	(33)	(1.0)%	(28)
Tax exempt income	0.3 %	8	2.4%	67
Timing difference in current year	0.3 %	7	1.8%	49
Origination and reversal of temporary differences in deferred tax	1.7 %	46	(0.1)%	(2)
Changes to estimates for prior years	0.0 %	-	(0.4)%	(12)
Tax expense	(9.0)%	(243)	(8.9)%	(240)

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17. Income tax expense (continued)

The main rate of corporation tax in the Isle of Man is 0.0% (2017: 0.0%). However the profits of the Group's Isle of Man banking activities are taxed at 10.0% (2017: 10.0%). The profits of the Group's subsidiaries that are subject to UK corporation tax are taxed at a rate of 19.0% (2017: 19.0%).

The value of tax losses carried forward reduced to nil and there is now a timing difference related to accelerated capital allowances resulting in a £88,000 liability (2017: £42,000 liability). This resulted in an expense of £50,000 (2017: £2,000) to the consolidated income statement.

18. Earnings per share

A. Basic and diluted earnings per share

The calculation of basic earnings per share has been based on the profit for the year and the weighted average number of ordinary shares outstanding.

The calculation of diluted earnings per share has been based on the profit for the year and the weighted average number of ordinary shares outstanding after adjustment for the effects of all dilutive potential ordinary shares.

	2018	2017
Total comprehensive income for the year	£2,461,000	£2,395,000
Weighted average number of ordinary shares in issue	131,096,235	110,880,711
Basic earnings per share (pence)	1.88	2.17
Diluted earnings per share (pence)	1.54	1.70

B. Reconciliation of earnings between basic and diluted earnings

	2018	2017
Total comprehensive income for the year		
As per basic earnings per share - total comprehensive income	£2,461,000	£2,395,000
Interest expense saved if all convertible loan notes were exchanged for equity (note 29)	£196,150	£196,150
As per dilutive earnings per share	£2,657,150	£2,591,150

C. Reconciliation of weighted average number of ordinary shares outstanding between basic and diluted

	2018	2017
Reconciliation of weighted average number of ordinary shares in issue between basic and diluted earnings per share		
As per basic earnings per share	131,096,235	110,880,711
Number of shares issued if all convertible loan notes were exchanged for equity (note 29)	41,666,667	41,666,667
Dilutive element of share options if exercised (note 31)	10,366	-
As per dilutive earnings per share	172,773,268	152,547,378

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19. Cash and cash equivalents

	Group		Company	
	2018 £000	2017 £000	2018 £000	2017 £000
Cash at bank and in hand	9,753	9,745	1,646	200
	9,753	9,745	1,646	200

Cash at bank includes an amount of £561,000 (2017: £63,000) representing receipts which are in the course of transmission.

20. Debt securities

	Group		Company	
	2018 £000	2017 £000	2018 £000	2017 £000
Financial assets at FVOCI:				
UK Government Treasury Bills	30,534	28,740	-	-
Financial assets at amortised cost:				
UK Certificates of Deposit	-	5,532	-	-
	30,534	34,272	-	-

UK Government Treasury Bills are stated at fair value and unrealised changes in the fair value are reflected in other comprehensive income. There were £135,000 (2017: £36,000) realised gains and £44,000 unrealised gains (2017: unrealised losses £93,000) during the year.

21. Trading asset

The investment represents shares in a UK quoted company, elected to be classified as a financial asset at fair value through profit or loss. The investment is stated at market value and is classified as a level 1 investment in the IFRS 13 fair value hierarchy. The cost of the shares was £471,000. The unrealised difference between cost and market value has been taken to the income statement. Dividend income of £355,000 (2017: £350,000) and £24,000 (2017: £24,000) of sale proceeds have been received from this investment since it was made. The investment made a net loss of £4,000 (2017: £21,000) during the year.

22. Loans and advances to customers

Group	2018			2017		
	Gross Amount £000	Impairment Allowance £000	Carrying Value £000	Gross Amount £000	Impairment Allowance £000	Carrying Value £000
HP balances	59,038	(1,416)	57,622	59,909	(1,327)	58,582
Finance lease balances	27,238	(1,551)	25,687	20,088	(1,101)	18,987
Unsecured personal loans	14,806	(382)	14,424	10,521	(255)	10,266
Vehicle stocking plans	1,486	-	1,486	1,613	-	1,613
Wholesale funding arrangements	22,944	-	22,944	5,830	-	5,830
Block discounting	17,316	-	17,316	13,523	-	13,523
Secured commercial loans	1,967	(45)	1,922	659	(4)	655
Secured personal loans	6,877	-	6,877	13,090	-	13,090
	151,672	(3,394)	148,278	125,233	(2,687)	122,546

Collateral is held in the form of underlying assets for HP, finance leases, vehicles stocking plans, block discounting, secured commercial and personal loans and wholesale funding arrangements. An estimate of the fair value of collateral on past due or impaired loans and advances is not disclosed as it would be impractical to do so.

	2018 £000	2017 £000
Specific allowance for impairment		
Balance at 1 January	2,440	2,099
Specific allowance for impairment made	1,291	1,295
Release of allowances previously made	(410)	(776)
Write-offs	(195)	(178)
Balance at 31 December	3,126	2,440

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22. Loans and advances to customers (continued)

	2018 £000	2017 £000
Collective allowance for impairment		
Balance at 1 January	247	57
Collective allowance for impairment made	49	202
Release of allowances previously made	(28)	(12)
Balance at 31 December	268	247
Total allowances for impairment	3,394	2,687

Advances on preferential terms are available to all Directors, management and staff. As at 31 December 2018 £389,005 (2017: £347,328) had been lent on this basis. In the Group's ordinary course of business, advances may be made to Shareholders but all such advances are made on normal commercial terms.

As detailed below, at the end of the current financial year 15 loan exposures (2017: 3) exceeded 10.0% of the capital base of the Bank: -

Exposure	Outstanding Balance 2018 £000	Outstanding Balance 2017 £000	Facility limit £000
Block discounting facility	14,211	9,487	23,500
Wholesale funding agreement	21,423	-	24,500

HP and finance lease receivables

Loans and advances to customers include the following HP and finance lease receivables: -

	2018 £000	2017 £000
Less than one year	42,532	36,227
Between one and five years	60,184	60,576
Gross investment in HP and finance lease receivables	102,716	96,803

The investment in HP and finance lease receivables net of unearned income comprises: -

	2018 £000	2017 £000
Less than one year	37,508	29,317
Between one and five years	49,289	50,680
Net investment in HP and finance lease receivables	86,797	79,997

23. Trade and other receivables

	Group		Company	
	2018 £000	2017 £000	2018 £000	2017 £000
Prepayments	382	285	32	22
VAT recoverable	936	817	-	-
Other debtors	1,173	806	-	-
	2,491	1,908	32	22

Included in trade and other receivables is an amount of £936,000 (2017: £817,000) relating to a reclaim of VAT. The Bank, as the Group VAT registered entity, has for some time considered the VAT recovery rate being obtained by the business was neither fair nor reasonable, specifically regarding the attribution of part of the residual input tax relating to the HP business not being considered as a taxable supply. Queries have been raised with the Isle of Man Government Customs & Excise Division ("C&E"), and several reviews of the mechanics of the recovery process were undertaken by the Company's professional advisors.

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23. Trade and other receivables (continued)

The decision of the First-Tier Tax Tribunal released 18 August 2011 in respect of Volkswagen Financial Services (UK) Limited (“VWFS”) v HM Revenue & Customs (TC01401) (“VWFS Decision”) added significant weight to the case put by the Bank and a request for a revised Partial Exemption Special Method was submitted in December 2011. The proposal put forward by the Bank was that the revised method would allocate 50.0% of costs in respect of HP transactions to a taxable supply and 50.0% to an exempt supply. In addition, a Voluntary Disclosure was made as a retrospective claim for input VAT under-claimed in the last 4 years. A secondary claim was also made to cover periods Q4 2012 to Q1 2016 for the value of £230,000 and an amount of £249,000 has been accrued to cover periods Q2 2016 to Q4 2018.

In November 2012, it was announced that the HMRC Upper Tribunal had overturned the First-Tier Tribunal in relation to the VWFS Decision. VWFS has subsequently been given leave to appeal and this was scheduled to be heard in October 2013. However, this was delayed and the case was heard by the Court of Appeal on 17 April 2015 who overturned the Upper Tribunal’s decision ruling in favour of VWFS. HMRC have appealed this decision to the Supreme Court, which has referred the issue to the European Court of Justice.

The Court of Justice of the European Union (“CJEU”) has published its determination concerning the Volkswagen Financial Services (UK) Limited (“VWFS”) vs HMRC case. The judgement addressed all specific questions referred and agreed with VWFS on all material points. Specifically, the judgment clarifies that a partial exemption method must reflect the taxable sale of the goods, even where general costs are commercially passed on as part of the exempt supplies of credit. We have approached Customs and Excise with a view of commencing conversations to finalise our historic claims, rolling up the claim to date and agreeing a new partial exempt method going forward.

The Bank’s total exposure in relation to this matter increased to £1,049,000, comprising the debtor balance referred to above plus an additional £113,000 VAT reclaimed under the partial Exemption Special Method, in the period from Q4 2011 to Q3 2012 (from Q4 2012 the Bank reverted back to the previous method). On the basis of the discussions and correspondence which have taken place between the Bank and C&E, in addition to the VWFS case, the Directors are confident that the VAT claim referred to above will be secured.

24. Property, plant and equipment

Group	Leasehold Improvements £000	IT Equipment £000	Furniture & Equipment £000	Motor Vehicles ¹ £000	Total £000
Cost					
As at 1 January 2018	443	294	646	10	1,393
Additions	66	41	18	993	1,118
Disposals	-	-	-	-	-
As at 31 December 2018	509	335	664	1,003	2,511
Accumulated depreciation					
As at 1 January 2018	189	152	599	3	943
Charge for year	60	61	13	50	184
Disposals	-	-	-	-	-
As at 31 December 2018	249	213	612	53	1,127
Carrying value at 31 December 2018	260	122	52	950	1,384
Carrying value at 31 December 2017	254	142	47	7	450

¹Motor vehicles relate to operating leases with the Group as lessor.

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24. Property, plant and equipment (continued)

Company	Leasehold Improvements £000	IT Equipment £000	Furniture & Equipment £000	Total £000
Cost				
As at 1 January 2018	234	13	15	262
Additions	-	-	1	1
Disposals	-	-	-	-
As at 31 December 2018	234	13	16	263
Accumulated depreciation				
As at 1 January 2018	92	2	2	96
Charge for year	39	1	1	41
Disposals	-	-	-	-
As at 31 December 2018	131	3	3	137
Carrying value at 31 December 2018	103	10	13	126
Carrying value at 31 December 2017	142	11	13	166

25. Intangible assets

Group	Customer Contracts & Lists £000	Intellectual Property Rights £000	IT Software and Website Development £000	Total £000
Cost				
As at 1 January 2018	1,284	388	1,550	3,222
Additions	-	-	496	496
Acquisition of MBL	133	-	-	133
Disposals	-	-	-	-
As at 31 December 2018	1,417	388	2,046	3,851
Accumulated amortisation				
As at 1 January 2018	130	162	1,211	1,503
Charge for year / impairment (note 32)	65	150	181	396
Disposals	-	-	-	-
As at 31 December 2018	195	312	1,392	1,899
Carrying value at 31 December 2018	1,222	76	654	1,952
Carrying value at 31 December 2017	1,154	226	339	1,719

On 23 December 2016, the Company acquired the majority of the Isle of Man's IFA business held by Knox Financial Services Limited ("KFSL"). The initial acquisition included approximately 4,000 clients together with 6 members of staff. The basis of consideration was contingent, as it is determined by 4 times renewal income received in the first 12 months of ownership, reduced by any clawbacks in the same period. The final value could not fall below £800,000. The Company entered into a loan agreement with Conister Bank Limited (see note 32 for terms) and paid the non-refundable minimum of £800,000 and a further £200,000 into an escrow account until the final valuation was determined. When the value was finalised, any surplus or shortfall was settled.

At acquisition, by reference to the renewal income received by KFSL in the 12 months prior to disposal, an estimate of £236,906 was assumed for income over the preceding 12 months, which would have generated a consideration sum of £947,624. Therefore, EWA accounted for this transaction by recognising an intangible asset of £947,624 and a receivable of £52,376 of the monies held in escrow. Subsequent to acquisition this estimate was updated to an estimated purchase price of £989,400 as at 31 December 2017. Consequently, the receivable from escrow was reduced to £10,600. The final consideration for the purchase was determined to be £1,101,000. As acquisition accounting was finalised prior to final settlement, the £111,600 additional cost was recognised as an expense in the profit and loss during 2018. The fair value of the assets acquired was considered to be of the same amount as the sum estimated to be paid and principally relates to customer contracts. The period over which these contracts are to be amortised is estimated to be 18.75 years given the average duration of EWA's existing portfolio for renewal income.

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25. Intangible assets (continued)

In tandem, both parties entered into an option agreement, exercisable within three months from the transaction date, for EWA to acquire the remainder of the vendor's IFA business which included approximately 150 clients. This option was exercised on 18 January 2017. The price of the acquisition was calculated by four times the renewal income received over the 12-month period subsequent to completion. The purchase price was estimated to be £198,300 with £75,000 paid upon exercise of the option. During the year, the final purchase consideration was determined to be £231,759. The Company made a final settlement of £156,760 during the year in addition to the £75,000 option price paid during the prior year. This has resulted in a valuation adjustment of £33,403.

On 7 September 2018, the Company acquired a book of insurance and financial services clients from Westwinds Financial Services Limited for a final consideration of £100,000.

26. Deposits from customers

	2018 £000	2017 £000
Retail customers: term deposits	153,735	137,399
Corporate customers: term deposits	4,765	4,873
	<u>158,500</u>	<u>142,272</u>

27. Creditors and accrued charges

	Group		Company	
	2018 £000	2017 £000	2018 £000	2017 £000
Commission creditors	758	2,042	-	-
Other creditors and accruals	897	774	94	139
Taxation creditors	355	348	-	-
	<u>2,010</u>	<u>3,164</u>	<u>94</u>	<u>139</u>

28. Block creditors

	2018 £000	2017 £000
Drawdown 2 - repayable 25/07/2018, interest payable at 5.8%, secured on assets of MFL	-	95
Drawdown 3 - repayable 08/03/2019, interest payable at 6.5%, secured on assets of MFL	138	656
	<u>138</u>	<u>751</u>

29. Loan notes

		Group		Company	
	Notes	2018 £000	2017 £000	2018 £000	2017 £000
Related parties					
J Mellon	JM	1,750	1,750	1,750	1,750
Burnbrae Limited	BL	1,200	1,200	1,200	1,200
Southern Rock Insurance Company Limited	SR	460	460	460	460
Life Science Developments Limited	LS	-	250	-	250
		<u>3,410</u>	<u>3,660</u>	<u>3,410</u>	<u>3,660</u>
Unrelated parties					
	UP	12,461	5,335	12,461	5,335
		<u>15,871</u>	<u>8,995</u>	<u>15,871</u>	<u>8,995</u>

JM - Two loans, one of £500,000 maturing on 31 July 2022 with interest payable of 5.0% per annum, and one of £1,250,000 maturing on 26 February 2020, paying interest of 6.5% per annum. Both loans are convertible at the rate of 7.5 pence and 9 pence respectively.

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29. Loan notes (continued)

BL - One loan consisting of £1,200,000 maturing on 31 July 2022 with interest payable of 5.0% per annum. Jim Mellon is the beneficial owner of BL and Denham Eke is also a director. The loan is convertible at a rate of 7.5 pence.

SR - One loan consisting of £460,000 maturing on 26 February 2020 with interest payable of 6.5% per annum. The loan is convertible at a rate of 9 pence. John Banks, a Non-executive Director, is also a director of SR and Arron Banks is a major shareholder of SR.

LS - One loan of £nil (2017: £250,000) which matured on 3 January 2018 with interest payable of 5.0% per annum. Denham Eke is a director of LS. The loan was repaid on maturity.

UP - Thirty-three loans consisting of an average £377,606 with a weighted average interest payable of 5.4% per annum. The earliest maturity date is 20 January 2019 and the latest maturity is 10 October 2023.

With respect to the convertible loans, the interest rate applied was deemed by the Directors to be equivalent to the market rate at the time with no conversion option.

30. Pension liability

The Conister Trust Pension and Life Assurance Scheme ("Scheme") operated by the Company is a funded defined benefit arrangement which provides retirement benefits based on final pensionable salary. The Scheme is closed to new entrants and the last active member of the Scheme left pensionable service in 2011.

The Scheme is approved in the Isle of Man by the Assessor of Income Tax under the Income Tax (Retirement Benefit Schemes) Act 1978 and must comply with the relevant legislation. In addition, it is registered as an authorised scheme with the FSA in the Isle of Man under the Retirement Benefits Scheme Act 2000. The Scheme is subject to regulation by the FSA but there is no minimum funding regime in the Isle of Man.

The Scheme is governed by two corporate trustees, Conister Bank Limited and Boal & Co (Pensions) Limited. The trustees are responsible for the Scheme's investment policy and for the exercise of discretionary powers in respect of the Scheme's benefits.

The rules of the Scheme state: - "*Each Employer shall pay such sums in each Scheme Year as are estimated to be required to provide the benefits of the Scheme in respect of the Members in its employ*".

Exposure to risk

The Company is exposed to the risk that additional contributions will be required in order to fund the Scheme as a result of poor experience. Some of the key factors that could lead to shortfalls are: -

- investment performance - the return achieved on the Scheme's assets may be lower than expected; and
- mortality - members could live longer than foreseen. This would mean that benefits are paid for longer than expected, increasing the value of the related liabilities.

In order to assess the sensitivity of the Scheme's pension liability to these risks, sensitivity analyses have been carried out. Each sensitivity analysis is based on changing one of the assumptions used in the calculations, with no change in the other assumptions. The same method has been applied as was used to calculate the original pension liability and the results are presented in comparison to that liability. It should be noted that in practice it is unlikely that one assumption will change without a movement in the other assumptions; there may also be some correlation between some of these assumptions. It should also be noted that the value placed on the liabilities does not change on a straight line basis when one of the assumptions is changed. For example, a 2.0% change in an assumption will not necessarily produce twice the effect on the liabilities of a 1.0% change.

No changes have been made to the method or to the assumptions stress-tested for these sensitivity analyses compared to the previous period. The investment strategy of the Scheme has been set with regard to the liability profile of the Scheme. However, there are no explicit asset-liability matching strategies in place.

Restriction of assets

No adjustments have been made to the statement of financial position items as a result of the requirements of IFRIC 14 issued by IASB's International Financial Reporting Interpretations Committee.

Scheme amendments

There have not been any past service costs or settlements in the financial year ending 31 December 2018 (2017: none).

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30. Pension liability (continued)

Funding policy

The funding method employed to calculate the value of previously accrued benefits is the Projected Unit Method. Following the cessation of accrual of benefits when the last active member left service in 2011, regular future service contributions to the Scheme are no longer required. However, additional contributions will still be required to cover any shortfalls that might arise following each funding valuation.

The most recent triennial full actuarial valuation was carried out at 1 April 2016, which showed that the market value of the Scheme's assets was £1,379,000 representing 80.7% of the benefits that had accrued to members, after allowing for expected future increases in earnings. As required by IAS 19 this valuation has been updated by the actuary as at 31 December 2018.

The amounts recognised in the Consolidated Statement of Financial Position are as follows: -

	2018 £000	2017 £000
Total underfunding in funded plans recognised as a liability		
Fair value of plan assets	1,361	1,469
Present value of funded obligations	(1,945)	(2,029)
	<u>(584)</u>	<u>(560)</u>
Movement in the liability for defined benefit obligations		
	2018 £000	2017 £000
Opening defined benefit obligations at 1 January	2,029	2,034
Benefits paid by the plan	(65)	(68)
Interest on obligations	52	54
Actuarial (gain)/loss	(71)	9
Liability for defined benefit obligations at 31 December	<u>1,945</u>	<u>2,029</u>
Movement in plan assets		
	2018 £000	2017 £000
Opening fair value of plan assets at 1 January	1,469	1,420
Expected return on assets	37	37
Contribution by employer	41	41
Actuarial (loss)/gain	(121)	39
Benefits paid	(65)	(68)
Closing fair value of plan assets at 31 December	<u>1,361</u>	<u>1,469</u>
Expense recognised in income statement		
	2018 £000	2017 £000
Interest on obligation	52	54
Expected return on plan assets	(37)	(37)
Total included in personnel costs	<u>15</u>	<u>17</u>
Actual return on plan assets	<u>(53)</u>	<u>76</u>
Actuarial gain recognised in other comprehensive income		
	2018 £000	2017 £000
Actuarial (loss)/gain on plan assets	(121)	39
Actuarial gain/(loss) on defined benefit obligations	71	(9)
	<u>50</u>	<u>30</u>

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30. Pension liability (continued)

Plan assets consist of the following	2018	2017	
	%	%	%
Equity securities	45		48
Corporate bonds	19		18
Government bonds	28		25
Cash	4		5
Other	4		4
	100		100

The actuarial assumptions used to calculate Scheme liabilities under IAS19 are as follows: -	2018	2017	2016
	%	%	%
Rate of increase in pension in payment: -			
Service up to 5 April 1997	-	-	-
Service from 6 April 1997 to 13 September 2005	3.0	3.0	3.1
Service from 14 September 2005	2.1	2.1	2.1
Rate of increase in deferred pensions	5.0	5.0	5.0
Discount rate applied to scheme liabilities	2.6	2.6	2.7
Inflation	3.1	3.1	3.2

The assumptions used by the actuary are best estimates chosen from a range of possible assumptions, which due to the timescale covered, may not necessarily be borne out in practice.

31. Called up share capital

Ordinary shares of no par value available for issue	Number	
At 31 December 2018	200,200,000	
At 31 December 2017	200,200,000	

Issued and fully paid: - Ordinary shares of no par value	Number	£000
At 31 December 2018	131,096,235	20,732
At 31 December 2017	131,096,235	20,732

There are four convertible loans of £3,410,000 (2017: £3,410,000) with no remaining warrants to exercise at 31 December 2018 (2017: £nil).

On 23 June 2014, 1,750,000 share options were issued to Executive Directors and senior management within the Group at an exercise price of 14 pence. The options vest over three years with a charge based on the fair value of 8 pence per option at the date of grant. The period of grant is for 10 years less 1 day ending 22 June 2024. Of the 1,750,000 share options issued, 1,050,000 (2017:1,050,000) remain outstanding; the balance lapsed during 2017.

Performance and service conditions attached to share options that have not fully vested are as follows: -

- (a) The options granted on 25 June 2010 (1,056,000 options) will vest if the mid-market share price of £0.30 is achieved during the period of grant (10 years ending 25 June 2020); and
- (b) The options granted on 25 June 2010 and 23 June 2014 require a minimum of three years' continuous employment service in order to exercise upon the vesting date.

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31. Called up share capital (continued)

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using a binomial probability model with the following inputs for each award: -

	23 June 2014	25 June 2010
Fair value at date of grant	£0.08	£0.03
Share price	£0.14	£0.11
Exercise price	£0.14	£0.11
Expected volatility	55.0%	47.0%
Option life	3	3
Risk-free interest rate (based on government bonds)	0.5%	2.2%
Forfeiture rate	33.3%	0.0%

The charge for the year for share options granted was £nil (2017: £22,000).

Analysis of changes in financing during the year

Analysis of changes in financing during the year	2018 £000	2017 £000
Balance at 1 January	29,727	27,478
Issue of loan notes	6,876	450
Issue of shares	-	1,799
	36,603	29,727

The 2018 closing balance is represented by £20,732,000 share capital (2017: £20,732,000) and £15,871,000 of loan notes (2017: £8,995,000).

32. Investment in Group undertakings

The Company has the following investments in subsidiaries incorporated in the Isle of Man: -

Carrying value of investments	Nature of Business	31 December 2017 % Holding	Date of Incorporation	Total 2018 £000	Total 2017 £000
Conister Bank Limited	Asset and Personal Finance	100	05/12/1935	14,167	11,767
Edgewater Associates Limited	Wealth Management	100	24/12/1996	2,005	2,005
TransSend Holdings Limited	Holding Company for Prepaid Card Division	100	05/11/2007	-	-
Bradburn Limited	Holding Company	100	15/05/2009	-	-
				16,172	13,772

Amounts owed to and from Group undertakings are unsecured, interest-free and repayable on demand.

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32. Investment in Group undertakings (continued)

Subordinated loans

MFG has issued several subordinated loans as part of its equity funding into the Bank and EWA.

Company			2018	2017
Creation	Maturity	Interest rate	£000	£000
Conister Bank Limited				
11 February 2014	11 February 2024	7.0%	500	500
27 May 2014	27 May 2024	7.0%	500	500
9 July 2014	9 July 2024	7.0%	500	500
17 September 2014	17 September 2026	7.0%	400	400
22 July 2013	22 July 2033	7.0%	1,000	1,000
25 October 2013	22 October 2033	7.0%	1,000	1,000
23 September 2016	23 September 2036	7.0%	1,100	1,100
14 June 2017	14 June 2037	7.0%	450	450
12 June 2018	12 June 2038	7.0%	2,000	-
Edgewater Associates Limited				
14 May 2012	14 May 2017	7.0%	-	-
28 February 2013	28 February 2018	7.0%	50	50
21 February 2017	21 February 2027	7.0%	150	150
14 May 2017	14 May 2027	7.0%	128	128
			7,778	5,778

Goodwill	Group 2018 £000	Group 2017 £000
Edgewater Associates Limited ("EWA")	1,849	1,849
ECF Asset Finance PLC ("ECF")	454	454
Three Spires Insurance Services Limited ("Three Spires")	41	41
	2,344	2,344

Goodwill impairment

The goodwill is considered to have an indefinite life and is reviewed on an annual basis by comparing its estimated recoverable amount with its carrying value.

The estimated recoverable amount in relation to the goodwill generated on the purchase of EWA is based on the forecasted 3 year cash flow projections, extrapolated to 10 years using a 2.0% annual increment, and then discounted using a 12.0% discount factor. The sensitivity of the analysis was tested using additional discount factors of 15.0% and 20.0% on stable profit levels.

The estimated recoverable amount in relation to the goodwill generated on the purchase of ECF is based on forecasted 3 year sales interest income calculated at 5.0% margin, extrapolated to 10 years using a 2.0% annual increment, and then discounted using a 12.0% discount factor. The sensitivity of the analysis was tested using additional discount factors of 15.0% and 20.0% on varying sales volumes.

There has been no change in the detailed method of measurement for EWA and ECF when compared to 2017. The goodwill generated on the purchase of Three Spires has been reviewed at the current year end and is considered adequate given its income streams referred to EWA. Based on the above reviews no impairment to goodwill has been made in the current year.

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For the year ended 31 December 2018

32. Investment in Group undertakings (continued)

Acquisition of Incahoot Limited

On 6 March 2015, the business of Incahoot Limited was acquired by Manx Incahoot Limited, a subsidiary of the Group.

On 9 December 2016, a valuation was conducted by an independent firm of professional advisers on the intellectual property rights acquired for the purpose of including within these financial statements. The independent firm addressed the three levels of the IFRS fair value hierarchy and concluded that level 3 was most appropriate as the intellectual property rights acquired had no active markets (Level 1), or comparable assets against which to index prices (Level 2). Therefore, the report valued the intellectual property rights acquired based on internally generated data (Level 3) being: costs incurred to date and cash flow projections. The report averaged two valuation approaches, the replacement cost approach and the income approach using a discount factor of 42.5%, to arrive at a final valuation of £262,474. This created an impairment of £48,026. On 2 February 2018, the valuation was again updated which led to a reduced valuation of £154,427. This created an additional impairment of £108,047.

The Directors performed an internal impairment assessment and consider the recoverable amount of the intellectual property rights to be £76,000 at 31 December 2018. The recoverable amount at 31 December 2017 was considered to be £154,427 based on an external valuation.

Investment in associates

	Group 2018 £000	Group 2017 £000
The Business Lending Exchange ("BLX")	56	38
Beer Swaps Limited ("BSL")	10	-
Pay It Monthly Ltd ("PIML")	92	-
	<u>158</u>	<u>38</u>

On December 2017, 40.0% of the share capital of BLX was acquired for nil consideration. The Group's share of the associate's total comprehensive income during the year was £18,000.

On April 2018, 20% of the share capital of BSL was acquired for nil consideration. The Group's share of the associates total comprehensive income post acquisition and up to year-end was £10,000.

On August 2018, 30% of the share capital of PIML was acquired for £90,000 consideration. The Group's resulting share of the associates total comprehensive income post acquisition and up to year-end was £2,000.

33. Related party transactions

Cash deposits

During the year, the Bank held cash on deposit on behalf of Jim Mellon (Executive Chairman of MFG) and companies related to Jim Mellon and Denham Eke (Chief Executive Officer of MFG). Total deposits amounted to £173,157 (2017: £40,000), at normal commercial interest rates in accordance with the standard rates offered by the Bank.

Staff and commercial loans

Details of staff loans are given in note 22.

Normal commercial loans have been made to various companies connected to Jim Mellon and Denham Eke. As at 31 December 2018, £113,000 of capital and interest was outstanding (2017: £299,000).

Intercompany recharges

Various intercompany recharges are made during the course of the year as a result of the Bank settling debts in other Group companies. EWA provides services to the Group in arranging its insurance and defined contribution pension arrangements.

Loan advance to EWA

On 14 December 2016, a loan advance was made to EWA by the Bank in order to provide the finance required to acquire MBL (see note 25). The advance was for £700,000 at an interest rate of 8% repayable over 6 years. A negative pledge was given by EWA to not encumber any property or assets or enter into an arrangement to borrow any further monies. The balance as at 31 December 2018 was £508,000 (2017: £700,000).

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33. Related party transactions (continued)

Loan advance to BLX

On 11 October 2017, a £4,000,000 loan facility was made available to BLX by the Bank in order to provide the finance required to expand its operations. The facility is for 12 months, followed by a 3 year amortisation period. Interest is charged at commercial rates. At 31 December 2018, £2,520,000 (2017: £550,000) had been advanced to BLX.

Loan advance to BSL

On 27 April 2018, a £1,000,000 loan facility was made available to BSL by the Bank in order to provide the finance required to expand its operations. On 10 October 2018, this facility was increased to £1,500,000. The facility is for 12 months. Interest is charged at commercial rates. At 31 December 2018, £1,099,000 (2017: £nil) had been advanced to BSL.

Loan advance to PIML

On 24 May 2018, a £500,000 loan facility was made available to PIML by the Bank in order to provide the finance required to expand its operations. The facility is for 12 months. Interest is charged at commercial rates. At 31 December 2018, £322,000 (2017: £nil) had been advanced to PIML. Post-year-end on 6 February 2019, the facility was increased to £1,000,000.

Investments

The Bank holds less than 1% equity in the share capital of an investment of which Jim Mellon is a shareholder (note 21). Denham Eke acts as co-chairman.

Subordinated loans

The Company has advanced £7,450,000 (2017: £5,450,000) of subordinated loans to the Bank and £328,000 (2017: £328,000) to EWA at 31 December 2018.

Loan notes

See note 29 for a list of related party loan notes as at 31 December 2018 and 2017.

Key management remuneration including Executive Directors

	2018 £000	2017 £000
Short-term employee benefits	297	300

34. Operating leases

Non-cancellable lease rentals are payable in respect of property and motor vehicles as follows: -

	2018		2017	
	Leasehold Property £000	Other £000	Leasehold Property £000	Other £000
Less than one year	214	-	178	-
Between one and five years	790	-	738	-
Over five years	162	-	276	-
	<u>1,166</u>	<u>-</u>	<u>1,192</u>	<u>-</u>

35. Subsequent events

There were no significant subsequent events identified after 31 December 2018.

36. Financial risk management

A. Introduction and overview

The Group has exposure to the following risks from financial instruments:

- credit risk;
- liquidity risk;
- market risks; and
- operational risks.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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36. Financial risk management (continued)

A. Introduction and overview (continued)

i. Risk management framework

The Company's Board have overall responsibility for the establishment and oversight of the Group's risk management framework. The Board of Directors have established the Group Audit, Risk and Compliance Committee ('ARCC'), which is responsible for approving and monitoring Group risk management policies. ARCC is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the ARCC.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. The risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

B. Credit risk

'Credit risk' is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's loans and advances to customers and investment debt securities. Credit risk includes counterparty, concentration, underwriting and credit mitigation risks.

Management of credit risk

The Bank's Board of Directors created the Credit Committee which is responsible for managing credit risk, including the following:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessments, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to in line with credit policy.
- Reviewing and assessing credit risk: The Credit Committee assesses all credit exposures in excess of designated limits, before facilities are committed to customers. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposures to counterparties, geographies and industries, by issuer, credit rating band, market liquidity and country (for debt securities).
- Developing and maintaining risk grading's to categorise exposures according to the degree of risk of default. The current risk grading consists of 3 grades reflecting varying degrees of risk of default.
- Developing and maintaining the Group's process for measuring ECL: This includes processes for:
 - initial approval, regular validation and back-testing of the models used;
 - determining and monitoring significant increase in credit risk; and
 - incorporation of forward-looking information.
- Reviewing compliance with agreed exposure limits. Regular reports on the credit quality of portfolios are provided to the Credit Committee which may require corrective action to be taken.

C. Liquidity risk

'Liquidity risk' is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises from mismatches in the timing and amounts of cash flows, which is inherent to the Group's operations and investments.

Management of liquidity risk

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

- Funding base: offering six-months to five-year fixed term deposit structure with no early redemption option. This means the Bank is not subject to optionality risk where customers redeem fixed rate products where there may be a better rate available within the market;
- Funding profile: the Bank has a matched funding profile and does not engage in maturity transformation which means that on a cumulative mismatch position the Bank is forecast to be able to meet all liabilities as they fall due;

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36. Financial risk management

C. Liquidity risk (continued)

Management of liquidity risk (continued)

- Monitoring maturity mismatches, behavioural characteristics of the Group's financial assets and financial liabilities, and the extent to which the Group's assets are encumbered and so not available as potential collateral for obtaining funding.
- Liquidity buffer: the Bank maintains a liquidity buffer of 10.0% of its deposit liabilities, with strict short-term mismatch limits of 0.0% for sight to three months and -5.0% for sight to six months. This ensures that the Bank is able to withstand any short-term liquidity shock; and
- Interbank market: the Bank has no exposure to the interbank lending market. The Bank has no reliance on liquidity via the wholesale markets. In turn, if market conditions meant access to the wholesale funding was constrained as per the 2008 credit crisis, this would have no foreseeable effect on the Bank.
- The Bank's liquidity position is monitored daily against internal and external limits agreed with the FSA and according to the Bank's Liquidity Policy. The Bank also has a Liquidity Contingency Policy and Liquidity Contingency Committee in the event of a liquidity crisis or potential liquidity disruption event occur.

The Treasury department receives information from other business units regarding the liquidity profile of their financial assets and financial liabilities and details of other projected cash flows arising from projected future business. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

Regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. The scenarios are developed considering both Group-specific events and market-related events (e.g. prolonged market illiquidity).

D. Market risk

'Market risk' is the risk that changes in market prices - e.g. interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's/issuer's credit standing) will affect the Group's income or value of its holdings of financial instruments. The objective of the Group's market risk management is to manage and control market risk exposures within acceptable parameters to ensure the Group's solvency while optimising the return on risk.

Management of market risks

Overall authority for market risk is vested in Assets and Liabilities Committee ("ALCO") who sets up limits for each type of risk. Group finance is responsible for the development of risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation.

Foreign exchange risk

The Bank is not subject to foreign exchange risks and its business is conducted in pounds sterling.

Equity risk

The Group has investment in associates of £158,000 (2017: £38,000) which are carried at cost adjusted for the Group's share of net asset value. The investment is audited annually and the Bank has access to these accounts. The Bank's exposure to market risk is not considered significant given the low carrying amount of the investment.

The Group's investment in listed equities is not considered significant.

Interest rate risk

The principal potential interest rate risk that the Bank is exposed to is the risk that the fixed interest rate and term profile of its deposit base differs materially from the fixed interest rate and term profile of its asset base, or basis and term structure risk. Additional interest rate risk may arise for banks where (a) customers are able to react to market sensitivity and redeem fixed rate products and (b) where a bank has taken out interest rate derivative hedges especially against longer term interest rate risk, where the hedge moves against the bank.

Interest rate risk for the Bank is not deemed to be currently material due to the Bank's matched funding profile. Any interest rate risk assumed by the Bank will arise from a reduction in interest rates, in a rising environment due to the nature of the Bank's products and its matched funded profile. The Bank should be able to increase its lending rate to match any corresponding rise in its cost of funds, notwithstanding its inability to vary rates on its existing loan book. The Bank attempts to efficiently match its deposit taking to its funding requirements.

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36. Financial risk management

E. Operational risk

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

Management of operational risk

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

The Group has developed standards for the management of operational risk in the following areas:

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

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with ARCC.

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37. Basis of measurement

The financial statements are prepared on a historical cost basis, except for the following material items.

Items	Measurement basis
Financial instruments at FVPL	Fair value
Financial assets at FVOCI	Fair value
Net defined benefit asset/liability	Fair value of plan assets less the present value of the defined benefit obligation

38. Significant accounting policies

Except for the changes explained in Note 5, the Group has consistently applied the following accounting policies to all periods presented in these financial statements.

Set out below is an index of the significant accounting policies, the details of which are available on the pages that follow.

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38. Significant accounting policies (continued)

A. Basis of consolidation of subsidiaries and separate financial statements of the Company

i. Business combinations

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if they are related to issue of debt or equity securities.

ii. Subsidiaries

Subsidiaries are entities controlled by the Group. The Group 'controls' an entity if it is exposed to or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses whether it has control if there are changes to one or more of the elements of control. This includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Group having power over an investee. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

iii. Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related Non-Controlling Interest ("NCI") and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

iv. Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

v. Separate financial statements of the Company

In the separate financial statements of the Company, interests in subsidiaries, associates and joint ventures are accounted for at cost.

B. Interests in equity accounted investees

The Group's interests in equity accounted investees may comprise interests in associates and joint ventures.

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

Interests in associates and joint ventures are accounted for using the equity method. They are initially recognised at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and OCI of equity accounted investees, until the date on which significant influence or joint control ceases.

C. Foreign currency

Foreign currency assets and liabilities (applicable to the Conister Card Services division only) are translated at the rates of exchange ruling at the reporting date. Transactions during the year are recorded at rates of exchange in effect when the transaction occurs. The exchange movements are dealt with in the income statement.

D. Interest

Interest income and expense are recognised in profit or loss using the effective interest rate method.

Effective interest rate

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts of the financial instrument to the net carrying amount of the financial asset or financial liability. The discount period is the expected life or, where appropriate, a shorter period. The calculation includes all amounts receivable or payable by the Group that are an integral part of the overall return, including origination fees, loan incentives, broker fees payable, estimated early repayment charges, balloon payments and all other premiums and discounts. It also includes direct incremental transaction costs related to the acquisition or issue of the financial instrument. The calculation does not consider future credit losses.

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38. Significant accounting policies (continued)

D. Interest (continued)

Effective interest rate (continued)

Once a financial asset or a group of similar financial assets has been written down as a result of impairment, subsequent interest income continues to be recognised using the original effective interest rate applied to the reduced carrying value of the financial instrument.

E. Fees and commission income

Fees and commission income other than that directly related to the loans is recognised over the period for which service has been provided or on completion of an act to which the fees relate.

Income in respect of fiduciary deposit taking is recognised on an accruals basis.

F. Programme costs

Programme costs are direct expenditure incurred in relation to prepaid card programmes. The costs are recognised over the period in which income is derived from operating the programmes.

G. Leases

Leases in which the Group is a lessor

Finance leases and HP contracts

When assets are subject to a finance lease or HP contract, the present fair value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. HP and lease income is recognised over the term of the contract or lease reflecting a constant periodic rate of return on the net investment in the contract or lease. Initial direct costs, which may include commissions and legal fees directly attributable to negotiating and arranging the contract or lease, are included in the measurement of the net investment of the contract or lease at inception.

Operating leases

Assets held for operating leases are presented on the Statement of Financial Position according to the nature of the asset. Lease income is recognised over the lease term on a straight-line basis.

Leases in which the Group is a lessee

Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

H. Income tax

Current and deferred taxation

Current taxation relates to the estimated corporation tax payable in the current financial year. Deferred taxation is provided in full, using the liability method, on timing differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred taxation is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred tax is realised. Deferred taxation assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

I. Financial assets and financial liabilities

i. Recognition and initial measurement

The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Group becomes party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

38. Significant accounting policies (continued)

I. Financial assets and financial liabilities (continued)

ii. Classification

Financial assets

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information provided to management.

Assessment of whether contractual cash flows are solely payments of principal and interest

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

In assessing whether the contractual cash flows are SPPI, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

Reclassifications

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

Financial liabilities

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

iii. Derecognition

Financial assets

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

38. Significant accounting policies (continued)

I. Financial assets and financial liabilities (continued)

iii. Derecognition (continued)

Financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

iv. Modifications

Financial assets

If the terms of a financial asset are modified, then the Group evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs.

If the cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Group plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place. This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Group first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset. If such modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method.

Financial liabilities

The Group derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. Any costs and fee incurred are recognised as an adjustment of the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

v. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

vi. Fair value measurement

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at the date. The fair value of a liability reflects its non-performance risk.

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

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

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments;

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

38. Significant accounting policies (continued)

I. Financial assets and financial liabilities (continued)

vi. Fair value measurement (continued)

- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data; and
- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Group determines fair values using other valuation techniques.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

vii. Impairment

A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.

If a significant increase in credit risk ("SICR") since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired.

- An SICR is always deemed to occur when the borrower is 30 days past due on its contractual payments. If the Group becomes aware ahead of this time of non-compliance or financial difficulties of the borrower, such as loss of employment, avoiding contact with the Group then an SICR has also deemed to occur.
- A receivable is always deemed to be in default and credit-impaired when the borrower is 90 days past due on its contractual payments or earlier if the Group becomes aware of severe financial difficulties such as bankruptcy, IVA, abscond or disappearance, fraudulent activity and other similar events.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Financial instruments in Stage 3 have their ECL measured based on expected credit losses on an undiscounted lifetime basis.

The Group measures loss allowances at an amount equal to lifetime ECL, except for debt investment securities that are determined to have low credit risk at the reporting date for which they are measured as a 12-month ECL. Loss allowances for lease receivables are always measured at an amount equal to lifetime ECL.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of a financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

Measurement of ECL

After a detailed review, the Group devised and implemented an impairment methodology in light of the IFRS 9 requirements outlined above noting the following:

- The ECL was derived by reviewing the Group's loss rate and loss given default over the past 8 years by product and geographical segment.
- The Group has assumed that the future economic conditions will broadly mirror the current environment and therefore the forecasted loss levels in the next 3 years will match the Group's experience in recent years.
- For portfolios where the Group has never had a default in its history or has robust credit enhancements such as credit insurance or default indemnities for the entire portfolio, then no IFRS 9 provision is made. At year-end, 37.9% had such credit enhancements (2017: 41.7%).
- If the Group holds objective evidence through specifically assessing a credit-impaired receivable and believes it will go on to completely recover the debt due to the collateral held and cooperation with the borrower, then no IFRS 9 provision is made

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For the year ended 31 December 2018

38. Significant accounting policies (continued)

I. Financial assets and financial liabilities (continued)

vii. Impairment (continued)

Measurement of ECL (continued)

ECL are probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows; and

undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows that the Group expects to receive.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI, and finance lease receivables are credit-impaired (referred to as 'Stage 3 financial assets'). A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable date:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered credit-impaired even when the regulatory definition of default is different.

In making an assessment of whether an investment in sovereign debt is credit impaired, the Group considers the following factors:

- the market's assessment of creditworthiness as reflected in the bond yields;
- the rating agencies' assessments of creditworthiness;
- the country's ability to access the capital markets for new debt issuance;
- the probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness;
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets
- loan commitments: generally, as a provision;
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

38. Significant accounting policies (continued)

J. Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and deposit balances with an original maturity date of three months or less.

K. Loans and advances

Loans and advances' captions in the statement of financial position include:

- loans and advances measured at amortised cost (see 38 (I)). They are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method; and
- finance lease receivable (see 38 (G)).

L. Property, plant and equipment

Items of property, plant and equipment are stated at historical cost less accumulated depreciation (see below). Historical cost includes expenditure that is directly attributable to the acquisition of the items.

The assets' residual values and useful economic lives are reviewed, and adjusted if appropriate, at each reporting date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

When parts of an item of property, plant and equipment have different useful lives, those components are accounted for as separate items of property, plant and equipment.

Depreciation and amortisation

Assets are depreciated or amortised on a straight-line basis, so as to write off the book value over their estimated useful lives. The useful lives of property, plant and equipment and intangibles are as follows: -

Property, plant and equipment

Leasehold improvements	to expiration of the lease
IT equipment	4-5 years
Motor vehicles	2.5 years
Furniture and equipment	4 -10 years

M. Intangible assets and goodwill

i. Goodwill

Goodwill that arises on the acquisition of subsidiaries is measured at cost less accumulated impairment losses.

ii. Software

Software acquired by the Group is measured at cost less accumulated amortisation and any accumulated impairment losses.

Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate: that the product is technically feasible, its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and that it can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and capitalised borrowing costs, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and any accumulated impairment losses.

Software is amortised on a straight-line basis in profit or loss over its estimated useful life, from the date on which it is available for use. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

iii. Other

Intangible assets that are acquired by an entity and having finite useful lives are measured at cost less accumulated amortisation and any accumulated impairment losses.

Intangible assets acquired as part of a business combination, with an indefinite useful live are measured at fair value. Intangible assets with indefinite useful lives are not amortised but instead are subject to impairment testing at least annually.

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For the year ended 31 December 2018

38. Significant accounting policies (continued)

M. Intangible assets and goodwill (continued)

iii. Other (continued)

The useful lives of intangibles are as follows: -

Customer contracts and lists	to expiration of the agreement
Business intellectual property rights	4 years - indefinite
Website development costs	indefinite
Software	5 years

N. Impairment of non-financial assets

At each reporting date, the Group reviews the carrying amounts of its non-financial assets (other than deferred tax assets) to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. Goodwill is tested annually for impairment.

For impairment testing, assets are group together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or Cash Generating Units ("CGUs"). Goodwill arising from a business combination is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the combination.

The 'recoverable amount' of an asset or CGU is the greater of its value in use and its fair value less cost to sell. 'Value in use' is based on the estimated future cash flows, 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 or CGU.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

The Group's corporate assets do not generate separate cash inflows and are used by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGUs to which the corporate assets are located.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

O. Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities issued and subordinated liabilities are the Group's sources of debt funding.

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments.

Deposits, debt securities issued and subordinated liabilities are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

Fiduciary deposits received on behalf of clients by way of a fiduciary agreement are placed with external parties and are not recognised in the statement of financial position.

The Group could receive funds for its prepaid card activities. These funds would be held in a fiduciary capacity for the sole purpose of making payments as and when card-holders utilise the credit on their cards and therefore would not be recognised in the statement of financial position.

ANNUAL FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

38. Significant accounting policies (continued)

P. Employee benefits

i. Long term employee benefits

Pension obligations

The Group has pension obligations arising from both defined benefit and defined contribution pension plans.

A defined contribution pension plan is one under which the Group pays fixed contributions into a separate fund and has no legal or constructive obligations to pay further contributions. Defined benefit pension plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and remuneration.

Under the defined benefit pension plan, in accordance with IAS 19 Employee benefits, the full service cost for the period, adjusted for any changes to the plan, is charged to the income statement. A charge equal to the expected increase in the present value of the plan liabilities, as a result of the plan liabilities being one year closer to settlement, and a credit reflecting the long-term expected return on assets based on the market value of the scheme assets at the beginning of the period, is included in the income statement.

The statement of financial position records as an asset or liability as appropriate, the difference between the market value of the plan assets and the present value of the accrued plan liabilities. The difference between the expected return on assets and that achieved in the period, is recognised in the income statement in the year in which they arise. The defined benefit pension plan obligation is calculated by independent actuaries using the projected unit credit method and a discount rate based on the yield on high quality rated corporate bonds.

The Group's defined contribution pension obligations arise from contributions paid to a Group personal pension plan, an ex gratia pension plan, employee personal pension plans and employee co-operative insurance plans. For these pension plans, the amounts charged to the income statement represent the contributions payable during the year.

ii. Share-based compensation

The Group maintains a share option programme which allows certain Group employees to acquire shares of the Group. The change in the fair value of options granted is recognised as an employee expense with a corresponding change in equity. The fair value of the options is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options.

At each reporting date, the Group revises its estimate of the number of options that are expected to vest and recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The share option programme was originally set up for Group employees to subscribe for shares in Conister Trust Limited (now Conister Bank Limited). Since the Scheme of Arrangement, the shareholders of the Bank became shareholders of the Company. The share option programme is now operated by the Company. The fair value is estimated using a proprietary binomial probability model. The proceeds received, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium when the options are exercised.

Q. Share capital and reserves

Share issue costs

Incremental costs that are directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

R. Earnings per share

The Group presents basic and diluted EPS data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss that is attributable to ordinary shareholders of the Bank by the weighted-average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting profit or loss that is attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted employees.

S. Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Group's primary format for segmental reporting is based on business segments.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

38. Significant accounting policies (continued) S. Segmental reporting (continued)

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses relating to transactions with any of the Group's other components, whose operating results are regularly reviewed by the Group's chief operating decision maker (CODM) to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results are reported to the Group's CEO (being the CODM) include items that are directly attributable to a segment as well as those that can be allocated on a reasonable basis.

39. Standards issued but not yet effective

A number of new standards are effective for annual periods beginning after 1 January 2018 and earlier application is permitted; however, the Group has not early adopted the new or amended standards in preparing these consolidated financial statements.

Standards	Effective date (accounting periods commencing on or after)
IFRIC 23 Uncertainty over Income Tax Treatments (issued on 7 June 2017)	1 January 2019
Amendments to IFRS 9: Prepayment Features with Negative Compensation (issued on 12 October 2017)	1 January 2019
IFRS 16 Leases (issued on 13 January 2016)	1 January 2019

Of those standards that are not yet effective, IFRS 16 is expected to have a material impact on the Group's financial statements in the period of initial application.

IFRS 16 Leases

The Group is required to adopt IFRS 16 Leases from 1 January 2019. The Group has assessed the estimated impact that initial application of IFRS 16 will have on its consolidated financial statements, as described below. The actual impacts of adopting the standard on 1 January 2019 may change because:

- the Group has not finalised the testing and assessment of controls over its new IT systems; and
- the new accounting policies are subject to change until the Group presents its first financial statements that include the date of initial application.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. These are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard - i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including 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.

Leases in which the Group is a lessor

No significant impact is expected for leases in which the Group is a lessor.

Leases in which the Group is a lessee

The group will recognise new assets and liabilities for its office premises and car parking sub-leases. As at 31 December 2018, the Group's future minimum lease payments under non-cancellable operating leases amounted to £1,166,000 (2017: 1,192,000) on an undiscounted basis. (see note 34)

Transition

The Group plans to apply IFRS 16 initially on 1 January 2019, using the modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information.

The Group plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.



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