# MANX FINANCIAL
## GROUP PLC

ANNUAL REPORT 2019

# 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 ("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
- Conister Finance & Leasing Ltd
- Blue Star Business Solutions Limited
- Edgewater Associates Limited
- Manx FX Limited

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 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.

Conister Finance & Leasing Ltd ("CFL") is a subsidiary of the Bank. It is a credit broker providing brokerage of hire purchase and leasing finance facilities in the UK.

CFL is regulated by the Financial Services Authority in the Isle of Man and the Financial Conduct Authority in the UK.

Blue Star Business Solutions Limited ("BBSL") is a finance broker providing asset finance and commercial loans in the UK to an expanding customer base.

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

EAL 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 £324 million (31 December 2018: £310 million).

EAL provides services in the areas of wealth management, mortgages, general insurance, and retirement planning.

Manx FX Limited provides access to competitive foreign exchange and international payment processing facilities.

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# CHAIRMAN'S STATEMENT

**Dear Shareholders**

**Introduction**

Normally, it would be pleasing to announce that 2019 produced record results, with pre-tax profit increasing by 11.5% to £3.0 million (2018: £2.7 million) and profit after tax increasing by 8.4% to £2.7 million (2018: £2.5 million). However, it would be remiss of me, in the publication of these encouraging figures, to not comment on the impact, both here and across the world, of COVID-19. Government actions to stop the spread of the virus have, in turn, led to a cessation of economic activity in many sectors which, despite unprecedented financial support, will clearly take some time to recover to their previous levels. As a consequence, I have delayed the publication of these accounts to enable me to provide as much clarity as possible on the potential effect of COVID-19 to the Group and its subsidiaries.

As a Group, we are as well prepared as possible for the financial impact of the virus on our operations and, thankfully over the years, we have been cautious in our provisioning and understood the need to maintain maximum liquidity. I will return to this topic later in my report.

Our 2019 results show operating income increasing by 28.1% to £16.9 million (2018: £13.2 million), which includes a 15.2% growth in our net interest income to £17.9 million (2018: £15.6 million) and a further reduction of 11.2% in commission expense to £5.4 million (2018: £6.1 million). These figures represent the effect of a record year for gross new business origination of £153.8 million (2018: £102.1 million), an increase of 50.6%.

Against this, our operating expenses ex-provisions have grown by 24.4% to £11.9 million (2018: £9.6 million), the majority of which reflects the continuing investment in our UK expansion. In line with our continuing policy of reviewing Conister Bank's loan book, we have increased provisions by a further £1.9 million (2018: £0.9 million). Thus, in balance sheet terms, our cumulative provisions of £4.8 million (2018: £3.4 million) against the net loan book stand at only 2.7% (2018: 2.3%) - further confirming the strength of Conister Bank's credit underwriting. Despite our strategic investment in UK expansion, our operating cost (less provisions) to operating income ratio has improved to 70.8% (2018: 72.9%).

Turning to our balance sheet, our loan book has grown by 21.0% to £179.4 million (2018: £148.3 million) which, whilst not quite the growth that I was anticipating, is still a notable achievement. I previously mentioned that we have taken steps to increase Conister Bank's liquidity, and our cash and near cash has increased by 52.4% to £61.4 million (2018: £40.3 million), taking advantage of lower interest rates and, as a consequence, our customer deposits have grown by 32.4% to £209.9 million (2018: £158.5 million). Our net interest yield on deposits at 10.0% remains much the same as the previous year (2018: 10.5%) despite our gain in liquidity. Thus, our total asset base has increased by 28.4% to £252.9 million (2018: £196.9 million).

Shareholder equity has increased by 13.2% to £22.3 million (2018: £19.7 million) and basic earnings per share have grown to 1.98 pence (2018: 1.88 pence).

**Our key objectives for 2020**

Turning to the current year, our fundamental focus is the protection of shareholder value. Thus, following a recent review, our strategic concentration is to:

- Provide the highest quality service throughout our operations to all customers, ensuring that their treatment is both fair and appropriate;
- Adopt a pro-active strategy of managing risk within a structured compliant regime;
- Concentrate on developing our core business by considered acquisitions, increasing prudential lending and augmenting the range of financial services we offer;
- Implement 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 and other associated operational costs;
- Focus on improving the return on the liabilities side of our balance sheet by developing the newly introduced Treasury management function and structure; and
- Manage our balance sheet to exceed, as far as possible, the regulatory requirements for capital adequacy.

**Risk and Governance**

Immediately following this Statement, I detail our approach to risk and governance, including an assessment of the business models and strategies of our operating subsidiaries. In particular, I set out our perceived risks and how these are managed, together with a review of our regulatory compliance and also how we meet the requirements of the QCA Code which we adopted last year. Rather than reiterate these methodologies at this point, I would ask that you take the opportunity to review these topics in conjunction with my report.

**Operating subsidiaries**

**Conister Bank Limited (the "Bank")**

For some time, we have believed our VAT recovery rate was neither fair nor reasonable. I am pleased to report that the decision by the European Union in favour of Volkswagen Financial Services (UK) Limited versus the UK's HMRC will allow progress to be made in recovering our outstanding debtor: this figure now stands at £0.91 million (2018: £1.05 million). I would expect good progress to be made this year to conclude this matter.

Our strategy to increase lending in our two geographical areas has continued to prove successful. Advances during the year

more than doubled the level achieved just two years ago, with lending £51.7 million ahead of last year at £153.8 million (2018: £102.1 million). Of particular note were our Isle of Man advances, which grew by 15.8% to £31.6 million (2018: £27.3 million) and our new Newbury office which advanced £117.4 million (2018: £72.7 million). The Group's recently acquired broker Bluestar Solutions Limited, having integrated well into the Bank's operating structure, generated advances £2.7 million ahead of last year at £4.8 million (2018: £2.1 million). This growth has not been at the cost of asset quality with the performing loan book being a commendable 97.4% (2018: 97.8%). Our net loan book grew by 20.8% to £179.4 million (2018: £148.3 million). This led to interest income increasing by £3.2 million to £22.4 million (2018: £19.2 million).

Our Isle of Man deposit base remains very loyal and during the year we achieved record monthly retention rates which is a tribute to our customers, our people and our new systems. With deposits increasing by £51.4 million to £209.9 million (2018: £158.5 million) we continue to have ample deposits to fund our growth ambitions. Although in the short term this has negatively impacted our Loan to Deposit ratio, normally a key efficiency measure, 85.6% (2018: 93.9%). This prudent growth in deposits increased our interest expense by £0.8 million to £4.8 million (2018: £4.0 million).

I have discussed over the last few years the need to reduce our dependence on overly expensive introducers and I am pleased to report continued progress on this matter despite the 50.6% increase in advances. During the period our commissions paid reduced by 7.1% to £5.7 million (2018: £6.1 million).

As a result of the above our net trading income increased by 31.1%, £2.8 million, to £11.9 million (2018: £9.1 million) which led operating income also increasing by 30.7%, £2.9 million, to £12.4 million (2018: £9.5 million).

Overheads increased by £1.0 million to £7.2 million (2018: £6.2 million) reflecting the first full year of our Newbury office and the continued bolstering of our control functions. With our loan book increasing, provisioning increased in the year by £1.0 million to £1.9 million (2018: £0.9 million). Depreciation increased by £0.3 million (2018: £0.0 million) driven by accounting for leases in relation to a structured product counterparty. Other costs netted to zero year on year. Thus, in total the cost base increased by £2.5 million to £9.8 million (2018: £7.3 million).

For the year, profit before taxation increased by 18.0%, £0.4 million, to £2.6 million (2018: £2.2 million).

Total assets, driven by treasury and net loan book growth, increased by 28.7%, £55.0 million, to £245.7 million (2018: £190.7 million). During the year we continued to improve the capitalisation of the Bank by increasing the called-up share capital by a further £1.7 million to £10.8 million (2018: £9.1 million). Shareholder funds increased by 18.1%, £3.8 million, to £25.0 million (2018: £21.2 million).

**Edgewater Associates Limited ("EAL")**

Our independent financial advisory business remains the largest on the Isle of Man and had a satisfactory year despite strategic headwinds from both a legislative and VAT perspective. Both of these issues were dealt with in the year and the business is now positioned for further growth knowing its competitors have still to navigate these matters. Such uncertainties will create opportunities for EAL which I would expect to be reflected in its performance in the coming year.

A key internal measure, which is driven by customer satisfaction, is renewal income as a percentage of operating income. This year I am pleased to report it has increased by 4.0% to 43.6% (2018: 39.6%) as our dedicated staff continued to deliver unparalleled service in this sector. Renewal income of £1.1 million (2018: £1.0 million) was supported by an improved performance by our general insurance team. This helped to offset a small dip in new business of £0.1 million to £1.2 million (2018: £1.3 million) as uncertainties to changes in pension legislation led to a temporary halt in new pension business. Operating income remained stable at £2.5 million (2018: £2.5 million). With costs decreasing by 5.8%, £0.1 million, to £2.1 million (2018: £2.2 million) EAL's underlying profit for the year increased by 26.5%, £0.1 million, £0.5 million (2018: £0.4 million). After a one-off VAT repayment, the profit for the year was £0.2 million (2018: £0.2 million).

Total assets decreased by 1.4% to £3.1 million (2018: £3.2 million).

**Manx FX Limited ("MFX")**

Our fledgling foreign exchange business continues to perform well with performance slightly ahead of last year. The business is prudently increasing its customer base and considering new products and territories to operate within. I still expect volatility in the results of MFX until it achieves its aim of broadening its client base.

Income increased by 4.6% to £0.8 million (2018: £0.8 million) and costs were in line with last year. Profit for the year increased by 2.4% to £0.5 million (2018: £0.5 million).

The business has a very liquid balance sheet and declared both an interim dividend, £0.4 million, and a final dividend of £0.7 million in the year.

**An update on the provision of a dividend**

In the last Chairman's Statement, I discussed the need for the Group to reward shareholders with a dividend. Unfortunately, the advent of COVID-19 has meant that our regulators are keen to ensure that we preserve as much of our capital within the Group and the Bank as possible. As a result, we are working on a scheme whereby shareholders will be eligible for a script-based payment, with the intention of rewarding long-

term holders. I expect to announce the details of this scheme later this year.

**Post Period Events**

**Beer Swaps Limited ("BSL")**
The agreement entered into with BSL in 2018 included an option to acquire the remaining shares by April 2021. The Bank acquired further shares in BSL to increase its ordinary shareholding to 75% for a cash consideration of approximately £0.5 million. In addition, the Bank simplified the capital structure of BSL by repaying all director loans, being £0.1 million, and all issued preference shares, being £0.2 million. For the year ended 31 March 2019, BSL reported turnover of £0.4 million and a profit before tax of £0.1 million with net assets of £0.2 million. I am pleased to note that this is yet another successful purchase and integration which bodes well for our future acquisition strategy.

**April 2020 EGM**
At the Group's EGM on 9 April 2020, two resolutions were considered by shareholders: firstly, to allow the buyback and cancellation of 16,966,158 ordinary shares in return for entering into a £1.6 million loan; and then to consider a request to waive Rule 9 of the Takeover Code. Both of these resolutions were passed with significant majorities. As a result, the Group has been able to eliminate the selling overhang of the shareholdings associated with Southern Rock which had been depressing the Group's share price since the announcement of an intention of sale made in November 2018. The share cancellation has had a positive effect on the calculation of net asset value per share which is to the benefit of all shareholders.

**Board Changes**
Following the EGM, John Banks stepped down from the Board and I would like to take this opportunity to thank him for his invaluable contribution in the time that he was with us and wish him well for the future. In May 2020, we welcomed John Spellman who has joined the boards of both the Group and the Bank. John's commercial experience will be invaluable as we continue to grow the businesses, both in the Isle of Man and UK.

**Outlook**
The Group's response to COVID-19 was carefully considered and professionally executed with the wellbeing of our staff, their families, and our customers being our principal concern. We deployed our working from home strategy which has allowed the business to continue to function seamlessly for all of our customers for the last ten weeks. As I write, the Isle of Man has had no further cases for thirty seven consecutive days with life returning to much as normal, but with our borders shut. The Bank, in conjunction with the Island's principal clearing banks, has worked very successfully with the Isle of Man Treasury in the provision of disruption loans to those businesses facing financial challenges. These loans are at advantageous terms and are 80% Government backed.

Unfortunately, the situation in the UK, whilst clearly improving, is still somewhat concerning. Conister Finance & Leasing, a subsidiary of the Bank, is working with its clients to obtain the relevant UK Government's business support packages.

Trading for the initial three months of the year was strong in all areas, but as the year progressed, a number of our loan customers have found difficulty in meeting their initial terms. As a result, we are now in continual dialogue with these customers to help them through any unforeseen economic shock. However, the Bank's response has not been confined to forbearance and renegotiation, but has extended to respecting the commitments made to our customers and remaining open for new business. Whilst we have continued with our conservative approach to provisioning, I am pleased to note that recently our clients' circumstances appear to be improving, especially in the Isle of Man where new business acquisition continues apace.

Almost all commentators predict a forthcoming recession in the UK, with the impact of COVID-19 together with Brexit making any realistic assessment almost impossible. Our current view is that it will take some time before the economy becomes stable and, as a result, we anticipate that it will be well into the first half of 2021 before confidence returns.

The earlier slowdown in new advances will, in turn, lead to a reduction in our income interest. The acceptance of forbearance requests will also impact the income statement. As a result, we anticipate that our net loan book will reduce. Factoring this into our planning, we have built up our liquidity to the highest level that we are able, ensuring that we are well placed to take advantage of all lending opportunities. Additionally, any reduction in our net loan book will further improve our regulatory capital ratios.

In short, the financial impact of the virus on the full year's figures is still too uncertain to provide any reliable guidance but our strong cash reserves and diverse income streams will prove valuable assets in the forthcoming months.

I would like to thank my fellow Board members, the Group's executive team and staff for their continued contribution to our ongoing business. I would also like to thank our shareholders and customers for their continued support.

**Jim Mellon**

Executive Chairman
26 June 2020

# BUSINESS MODEL AND STRATEGY

**Conister Bank Limited (the "Bank")**

The Bank's Board of Directors (the "Bank's 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 Bank's 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.

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 and 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 is proud of its heritage and remains heavily centric in the IOM but recognised that as its UK loan book grows it would need to create a UK presence to manage and grow this aspect of its business. As such, in 2019, the Bank continued its expansion of its offices in Newbury with 18 full-time employees, representing nearly a quarter of the Bank's workforce. The office deals with all aspects of the Bank's UK credit broker market and wholesale lending portfolio. These are two markets in which the Bank wishes to increase its presence in the UK.

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 £35.0 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. In the last year, the Bank has launched a notice account offering and penetrated the corporate deposit market. As such, the Bank believes that it has 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 £41.9 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 acquired an established credit broker in the year, Blue Star Business Solutions Limited, with the view of expanding its offering to SMEs.

**Edgewater Associates Limited ("EAL")**

EAL is the largest Independent Financial Advice ("IFA") firm in the IOM and is regulated by the Isle of Man Financial Services Authority. Its strategic objective is to:

- Grow and service its client base;
- Increase assets under advice; and
- Grow and develop its 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 and specialist.

In 2016 EAL embarked on an aggressive and successful acquisition programme covering a two year period; at the outset it had a client base of approximately 4,600 clients. After four acquisitions and an active data cleansing review, EAL now has an active client base of approximately 11,800, with associated assets under advice of £324 million (up from £310 million in 2018).

Whilst EAL will continue to grow and develop its standard business model, it will always be open to new opportunities. It remains nimble and ready to move with economic and regulatory changes as they arise; its team remains up-to-date against industry standards and trends. It retains an appetite for growth either through additional acquisition opportunities that may arise, or via organic growth from its existing clients and business partners with whom it has built strong relationships.

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

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

**Manx FX Limited ("MFX")**

MFX has specialist knowledge of currency operational requirements and has carefully selected the best UK partners

## BUSINESS MODEL AND STRATEGY

to provide foreign exchange and leading payment services. The strategic objectives of MFX are:

- To maintain and develop existing client relationships;
- To increase the number of referrals to its 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 IOM.

MFX believes the foreign exchange and international payment offering via its UK partners is second to none. With its upfront agreed foreign exchange margins the customer has complete pricing transparency. Its 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 reduced rates compared to local high street banks.

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. MFX's professional reputation is important to its business and its colleagues attend local industry events which serve two purposes; to enforce and raise the profile of MFX and support IOM businesses.

Maintaining a close working relationship with its UK partners is core to its business and customer success. 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 MANAGEMENT

**Risk management overview**
Effective risk management is crucial to MFG's sustainability. The MFG's Board of Directors ("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 MFG Group's ("Group") risk tolerance and appetite through enterprise risk management is a key element of MFG's corporate governance framework. This framework has been enhanced during 2019 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.

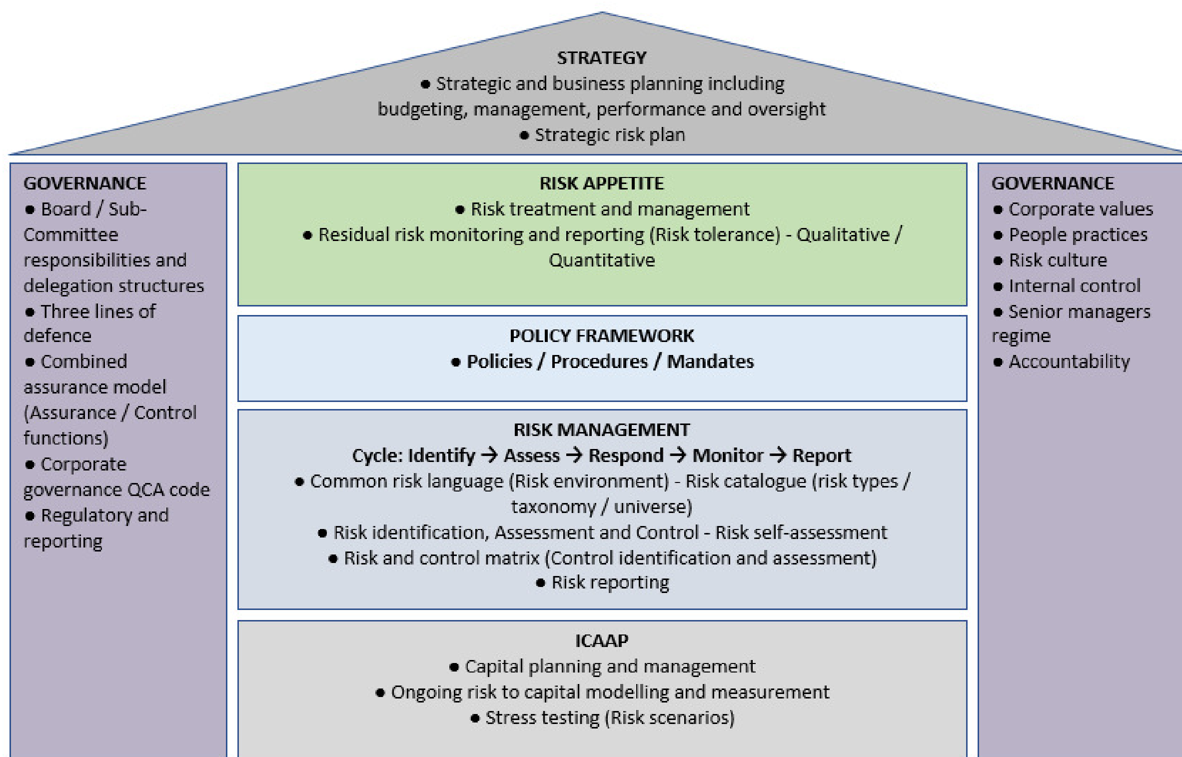
A fundamental principle contained in the code, is for effective risk management: MFG has in place a Risk Management Framework and a Capital Management Framework (undertaken through its Internal Capital Adequacy Assessment Process ("ICAAP")) to support the implementation of some of the principles of the MFG Governance Framework at subsidiary level. The Risk Management Framework 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 three 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 Executive Management, Risk, Compliance and Internal Audit are invited by the Chairman of the ARCC 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 MANAGEMENT

**Culture**
The risk culture, which forms part of MFG's overall culture, encompasses the tone at the top of the organisation 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 are trained to 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 considers all the risks detailed under "Principal risks" on page 8 and is reviewed annually, and as the operating environment changes, it is constantly measured against stated appetite to take appropriate action.

**Risk identification, measurement and 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's 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.

MFG has developed 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 MANAGEMENT

**Risk strategy and overview**
**Risk plan**
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:

- 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;
- Classification 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 the Board, enabling them to focus on overseeing and challenging the risk management framework;
- 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;
- 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;
- Operational risk including regulatory risk;
- Conduct risk;
- Liquidity risk;
- Interest rate risk;
- Regulatory 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 Boards throughout the Group 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.

**Credit risk including counterparty credit risk**
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 – Financial Instruments, effective from 2018, necessitated the move to an expected loss provisioning methodology rather than an incurred loss. This provides an additional credit risk buffer.

**Operational risk including regulatory risks**
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's IT Steering Committee reviews and monitors 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 and 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 Executive Committee.
- 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.
- Onboarding: 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 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.

**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 change its lending rate to match any corresponding change in its cost of funds.
- The Group attempts to efficiently match its deposit taking to its funding requirements.
- The maturity profile 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 banks' 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 any increase.

**Regulatory risk**
Regulatory risk is the risk of material breach of regulation.

The Group holds a Class 1 (1) Banking Licence in the IOM and is accordingly regulated by the Financial Services Authority ("FSA"). The Group also holds permissions with the UK's Financial Conduct Authority ("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 the Board increased the headcount in 2019 and appointed an experienced Operational Risk Manager and Compliance Manager in the UK.

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 approve annually by the 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 the ARCC.

**Reputation risk**
Reputation 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.

**Capital stress testing**
**Internal Capital Adequacy Assessment Process ("ICAAP")**

**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 ongoing 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;
- 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; and
- 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 the 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 the Board.

**ICAAP Results**
The Bank has completed its ICAAP testing for 2019 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.

# 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.

The Group's strategy and business model and amendments thereto, are developed by the Chief Executive Officer ("CEO") and his senior management team, and approved by the Board. The management team, led by the CEO, 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 and payment services.

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 CEO, 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 CEO 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.

- Shareholders – where appropriate shareholder feedback is discussed at the Board, with any actions agreed being tracked to completion by the Company Secretary. Shareholders have an opportunity to raise questions to the Board, in person or via a nominee, at the Annual General Meeting. In addition, the Group CEO meets with and addresses shareholder concerns where appropriate;
- Employees – the Group collates employee feedback on an annual basis, engages employees via workshops, with all outputs analysed and visibly addressed by the Executives of the operational subsidiaries that form the Group; with the aim being to build an engaged, committed and enthusiastic workforce;
- Partners and Suppliers – the Executive and Management regularly meet with our partners and suppliers to ensure the needs of all parties are understood in order to achieve continued excellent working relations;
- Customers - are at the heart of all we do, the Group operates with a shared vision and set of values. The values instil a sense of how all staff form a part of the customer journey. Feedback is encouraged at all points of contact, it is proactively enacted upon as it aids the identification of process and system enhancements; and
- Environment - the Group takes due account of any impact that its activities may have on the environment and seeks to minimise this impact by demonstrating leadership in corporate citizenship. Our continued dedication toward making a positive contribution to our communities and offering a great place to work is demonstrated via the operational subsidiaries' involvement in community events, charitable fundraising and the provision of ongoing support. In doing so the Group ensures continuous improvement in the management of our environmental impact, in line with the principles and standards set out within the Group's Corporate Social Responsibility Policy.

**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 ARCC, and reviewed by Internal Audit. 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.

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 the ARCC as appropriate.

The Directors consider they provide all necessary information to assess the Company's position, performance, business model and strategy.

**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 Clarke (Chairman of the 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. The Group Finance Director is the only Director who 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 2019, with no substantive issues arising. 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 Governance Framework is reviewed to ensure it remains fit for purpose on an annual basis and is approved by the Board.

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.

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, the Remuneration Committee and the Nomination Committee. The Terms of Reference for each of these Committees are published on the Group's website www.mfg.im.

There is a clear separation of the roles of CEO 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 CEO 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 Nomination Committee with formally delegated duties and responsibilities.

**Audit, Risk and Compliance Committee ("ARCC")**
The ARCC meets at least six times each year and comprises of two Non-executive Directors, currently Alan Clarke (Chairman) and David Gibson. Representatives from Compliance and Risk, the Internal and External Auditor and executive management 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 ("REMCO")**
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 Chairman and CEO determine the Non-executive Director fees.

The Directors believe that the above disclosures constitute sufficient disclosure to meet the QCA Code's requirement for a Remuneration Committee Report.

**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 Corporate Governance Manual 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.

**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 | 4/6 | - | - |
| Denham Eke | 6/6 | - | - |
| Douglas Grant | 6/6 | - | - |
| Alan Clarke | 6/6 | 8/8 | 6/6 |
| David Gibson | 6/6 | 8/8 | 6/6 |
| John Banks | 4/6 | - | - |
| Gregory Bailey | 4/6 | - | - |

**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 29 June 2020 and signed on its behalf by:

**Jim Mellon**
Executive Chairman
29 June 2020

# DIRECTORS, OFFICERS AND ADVISERS

## Executive Directors

Jim Mellon (63) ‡
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 companies, both quoted and unquoted, including the chairmanship of Juvenescence Limited and being a non-executive director of Agronomics Limited. He, together with Burnbrae Group Limited, of which he is the beneficial owner, holds 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. He is Chairman of Juvenescence Ltd, and also a director of Agronomics Limited.

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

Denham Eke (68) ‡
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 (55) ‡
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 (69) ‡ † * ≠
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 (73) ‡ † * ≠
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 also deputy chairman of two property investment companies.

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

Gregory Bailey (64) ‡
Non-executive Director

Gregory Bailey, founded Palantir Group Inc which made successful investments in bio-tech company start-ups and financings, and is currently CEO of Juvenescence Ltd, chairman of Portage Biotech Inc, a CSE-traded drug development company and non-executive director of NYSE traded Biohaven Pharmaceuticals Holding Company. 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.

# DIRECTORS, OFFICERS AND ADVISERS

## Non-executive Directors

John Spellman (53) ‡ * ≠
Non-executive Director

John Spellman is both a qualified accountant and banker. He spent his early years in banking, fund management and accountancy specialising in the various parts of the offshore industry before being appointed managing director of Clerical Medical Offshore. He transferred to the UK as chief operating officer within Clerical Medical Financial Services before being appointed managing director of HBoS Financial Services. He has worked with and created a number of successful businesses and has wide experience liaising with government regulators. He has held approved status with the FSA Isle of Man in various roles and has acted as strategic advisor to the Isle of Man government, specialising in finance and foreign direct investment for over 10 years.

**Appointment**
Appointed to the Board on 4 May 2020.

## Company Secretary

Lesley Crossley (52)
Company Secretary

Lesley Crossley is a Fellow of The Chartered Institute of Secretaries and Administrators and an Associate of the Chartered Insurance Institute. She has over 30 years of wide-ranging experience in the financial services industry both in the UK and the Isle of Man and has held the position of Company Secretary with a number of Isle of Man and international companies.

**Appointment**
Appointed as Company Secretary on 2 September 2019.

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

John Banks (51) resigned from the Board and his role as Non-executive Director and Member of the Nominations Committee on 14 April 2020.

### 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**
Canaccord Genuity Wealth Management
Anglo International House
Bank Hill
Douglas
Isle of Man IM1 4LN

**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 its website. The address of the website is www.mfg.im which includes investor relations information and contact details.

# AUDIT, RISK AND COMPLIANCE COMMITTEE

**Dear Shareholders**
I am pleased to set out below an account of the ARCC's role and activities during 2019 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 2019;
  - Audited MFG PLC Group and subsidiary annual financial statements for the year-ended 31 December 2019; and
- 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 Auditor based on reports received and inquiries made into work performed;
- Determined the nature and extent of non-audit services performed by the External Auditor;
- 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 from the External Auditor on the findings from their execution of the audit plan; 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;
- Recommended a revision of the Risk and Compliance policies for Board approval; and
- Recommended a revision of the Internal Capital Adequacy Assessment Process for Board approval.

**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 0.78 to 1 (2018: 0.08 to 1). Non audit services related to transaction services and tax advisory 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.

**External Auditor's reappointment**
The ARCC is responsible for recommending the reappointment of the Group's External Auditor to the Board which, in turn, will make a recommendation to its Shareholders.

It is noted that with good corporate governance, an audit tender process should regularly be conducted. With this in mind, the ARCC are considering whether an audit tender process should commence for the year-ended 31 December 2021. This will allow sufficient time to run a comprehensive and considered tender process.

The ARCC therefore recommend to the Board that its External Auditor be reappointed for the year-ended 31 December 2020, whilst it considers a tender process. Should the process commence, the ARCC are expected to have the tender complete prior to the 2021 AGM.

Firms outside the Big 4 would be invited to take part in this process so long as they have sufficient resources and expertise to merit their inclusion. There are no anticipated conflicts of interest noted at this time and should any arise, they will be mitigated appropriately.

**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 2019 and how they were addressed are detailed below:

| Key accounting matter | ARCC response |
|---|---|
| **Loan impairment – wholesale funding and individual finance agreements**<br>Impairments cover loans specifically identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified.<br><br>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.<br><br>The effect of these matters is that, as part of the External Auditor's risk assessment, they determined that the impairment provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than their materiality for the financial statements as a whole, and possibly many times that amount. | 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.<br><br>The ARCC reviewed reports from executive management on the continued 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 a quarterly basis. |
| **Impairment of goodwill and intangible assets**<br>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 for the goodwill impairment test and in performing a review for indicators of impairment for intangible assets.<br><br>The effect of these matters is that, as part of the External Auditor's risk assessment, they have determined that the value in use of goodwill has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than their materiality for the financial statements as a whole. | 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.<br><br>The ARCC reviewed management's assessment of Goodwill and Intangible Asset impairment and concluded that the recoverable amount is appropriate. |

# AUDIT, RISK AND COMPLIANCE COMMITTEE

| Key accounting matter | ARCC response |
|---|---|
| **VAT receivable**<br>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.<br><br>The effect of these matters is that, as part of the External Auditor's risk assessment, they 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 their materiality for the financial statements as a whole, and possibly many times that amount. | 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.<br><br>The ARCC reviewed management's assessment of VAT receivable impairment and concluded that the recoverable amount is appropriate. |
| **Carrying value of Company's subordinated loans and investment in subsidiaries**<br>The carrying value of the Company's subordinated loans to and investment in subsidiaries represents 97% (2018: 93.0%) of the Parent Company's total assets.<br><br>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.<br><br>However, due to its materiality in the context of the Company financial statements, the External Auditors considered this to be the area that had the greatest effect on their overall Company audit. | The ARCC is satisfied that the going concern assessment over the Group provides sufficient assurance over the recoverability of the 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
29 June 2020

# DIRECTORS' REMUNERATION REPORT

**Dear Shareholders**
On behalf of the Board, I am pleased to present the Directors' Remuneration Report for the year ended 31 December 2019.

**Membership**
Members of the Remuneration Committee ("REMCO") 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 3 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 | 6/6 |
| David Gibson | 12 December 2010 | 6/6 |

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 2019**
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 annual 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.

EAL'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.

Where the Group operates contractually guaranteed performance related pay, the contractual conditions must be approved by the REMCO.

# DIRECTORS' REMUNERATION REPORT

**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 REMCO, 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 and CEO. 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 £ | **2019 Total £** | 2018 Total £ |
|---|---|---|---|---|---|
| **Executives** | | | | | |
| Jim Mellon | 25,000 | - | - | **25,000** | 25,000 |
| Denham Eke | 25,000 | - | - | **25,000** | 25,000 |
| Douglas Grant | 208,720 | 50,000 | 20,589 | **279,309** | 260,604 |
| | 258,720 | 50,000 | 20,589 | **329,309** | 310,604 |
| **Non-executives** | | | | | |
| Alan Clarke | 45,000 | - | - | **45,000** | 42,917 |
| Gregory Bailey | 12,500 | - | - | **12,500** | 22,400 |
| John Banks | 25,000 | - | - | **25,000** | 25,000 |
| David Gibson | 69,167 | - | - | **69,167** | 55,000 |
| John Spellman | - | - | - | **-** | - |
| | 151,667 | - | - | **151,667** | 145,317 |
| Aggregate emoluments | 410,387 | 50,000 | 20,589 | **480,976** | 455,921 |

**Approval**
This report was approved by the Board of Directors on 29 June 2020 and signed on its behalf by:

**Alan Clarke**
Chairman of the Remuneration Committee
29 June 2020

# DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements for the year ended 31 December 2019.

**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.

CFL is authorised by the Financial Conduct Authority ("FCA") to conduct brokerage services.

EAL 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 35. The Directors do not recommend the payment of a dividend (2018: 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 June 2020 are:

| | **Number** | **% of issued capital** |
|---|---|---|
| Jim Mellon[1] | 21,492,232 | 18.83 |
| Gregory Bailey[2] | 17,835,750 | 15.63 |
| Euroclear Nominees Limited[3] | 17,039,623 | 14.93 |
| Lynchwood Nominees Limited | 9,673,385 | 8.48 |
| Island Farms Limited | 4,222,319 | 3.70 |
| Rock (Nominees) Limited | 3,979,914 | 3.49 |

[1] Burnbrae Limited holds 19,164,250 Ordinary Shares. Burnbrae Limited is 100% beneficially owned by Jim Mellon. Denham Eke, CEO of MFG is also a director of Burnbrae Limited. Pershing Nominees Limited holds 166,666 Ordinary Shares and Vidacos Nominees Limited holds 1,468,666 Ordinary Shares in trust for Jim Mellon and 692,650 Ordinary Shares are held in his own name.

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

[3] Euroclear Nominees Limited holds 17,039,623 Ordinary Shares in trust for Aeternitas Imperium Privatstiftung.

**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 26/06/20** | **Number 31/12/19** | Number 31/12/18 |
|---|---|---|---|
| Jim Mellon[4] | **21,492,232** | **21,492,232** | 21,492,232 |
| Gregory Bailey[5] | **17,835,750** | **17,835,750** | 17,835,750 |
| David Gibson[6] | **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. Burnbrae Limited is 100% beneficially owned by Jim Mellon. Denham Eke, CEO of MFG is also a director of Burnbrae Limited. Pershing Nominees Limited holds 166,666 Ordinary Shares and Vidacos Nominees Limited holds 1,468,666 Ordinary Shares in trust for Jim Mellon and 692,650 Ordinary Shares are held in his own name.

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

[6] 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 26/06/20** | **Number 31/12/19** | Number 31/12/18 |
|---|---|---|---|
| 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 2019, there were 127 members of staff (2018: 113), of whom 14 were part-time (2018: 11).

**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.

# ANNUAL FINANCIAL STATEMENTS

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# 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 ("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.

# 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 2019 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 38.

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 2019 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 as applicable to listed entities. 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 2018, with the exception that this year loan impairment has been separated into wholesale funding and individual finance agreements.

| Key audit matter | The risk | Auditor's response |
|---|---|---|
| **Loan impairment – wholesale funding**<br>Loans and advances to customers £40,491,000 (2018: £41,746,000)<br><br>Impairment Provision £536,000 (2018: £nil)<br><br>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(G)(vii) (Accounting Policy for Impairment of Financial Instruments). | **Subjective estimate**<br>Impairments cover loans specifically identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified.<br><br>Wholesale Funding comprises Block Finance, Wholesale Funding Agreements and Stocking Plans. These books comprise individually significant loan balances and are in the nature of a secured business loan. The security is principally an underlying pool of loans.<br><br>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.<br><br>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. | Our procedures included:<br><br>**- Control design:** Understanding the controls in respect of the origination of wholesale funding loans, including borrower due diligence.<br><br>**- Control design:** Understanding 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.<br><br>**- 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.<br><br>**- Test of details:** We tested all specific provisions. This included challenging management's assessment of the specific provision, taking account of such factors as: amount of arrears; financial standing of the business – by reviewing latest accounts; status of underlying security – by verifying a sample of security documentation; and likelihood of recovery of any personal guarantees – by vouching to the personal guarantee agreement and assessing supporting evidence of the ability of the guarantor to meet their obligations.<br><br>**- Historical comparison:** We challenged the inputs used in collective impairment models by comparison to default and recovery experience across each of the loan finance categories.<br><br>**- Assessing transparency:** Assessing the adequacy of the Group's disclosures about the degree of estimation uncertainty involved at arriving at the provisions. |

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

| Key audit matter | The risk | Auditor's response |
|---|---|---|
| **Loan impairment - individual finance agreements**<br>Loans and advances to customers £138,879,000 (2018: £106,532,000)<br><br>Impairment Provision £4,237,000 (2018: £3,394,000).<br><br>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(G)(vii) (Accounting Policy for Impairment of Financial Instruments). | **Subjective estimate**<br>Impairments cover loans specifically identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified.<br><br>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.<br><br>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. | Our procedures included:<br><br>**- Control design:** Understanding the controls in respect of the origination individual finance loans, including borrower due diligence.<br><br>**- Control design:** Understanding 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.<br><br>**- 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.<br><br>**- 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.<br><br>**- 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.<br><br>**- Assessing transparency:** Assessing the adequacy of the Group's disclosures about the degree of estimation uncertainty involved at arriving at the provisions. |

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

| Key audit matter | The risk | Auditor's response |
|---|---|---|
| **Impairment of goodwill and intangible assets**<br><br>Goodwill £3,734,000 (2018: £2,344,000) and Intangibles Assets £2,293,000 (2018: £1,952,000).<br><br>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(K) (Intangible Assets and Goodwill) and note 38(L) (Impairment of Non-Financial Assets) | **Forecast-based valuation**<br><br>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 for the goodwill impairment test and in performing a review for indicators of impairment for intangible assets.<br><br>The effect of these matters is that, as part of our risk assessment, we determined that the value in use of goodwill has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 32) disclose the sensitivity estimated by the Group. | Our procedures included:<br><br>**- Control design:** Understanding 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.<br><br>**- Our sector experience:** Evaluating assumptions used, in particular those relating to forecast revenue growth and profit margins using our own valuation specialist.<br><br>**- Benchmarking assumptions:** Comparing the group's assumptions to externally derived data in relation to key inputs such as projected economic growth, competition, cost inflation and discount rates.<br><br>**- Indictors of impairment for intangible assets:** Analysing latest financial data for the business related to the relevant intangible asset to assess whether there are any indicators of impairment, such as losses being made or downturn in sales.<br><br>**- Sensitivity analysis:** Performing breakeven analysis on the assumptions noted above.<br><br>**- Assessing transparency:** Assessing the adequacy of the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected in the risks inherent in the valuation of goodwill and intangible assets. |
| **VAT receivable**<br><br>VAT receivable exposure £906,000 (2018: £1,049,000).<br><br>Refer to the ARCC report, note 4 (Use of Judgements and Estimates - Assumptions and Estimation Uncertainties) and note 23 (Trade and Other Receivables). | **Uncertainty over recoverability**<br><br>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 European Union Court of Justice ruling regarding the dispute between Volkswagen Financial Services (UK) Limited ("VWFS") v HM Revenue & Customs.<br><br>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. | Our procedures included:<br><br>**- Control design:** Understanding the controls in respect of the assessment of the recoverability of the VAT receivable.<br><br>**- Our tax expertise:** Use of our own tax specialists to assist in testing the revised calculations and to assess the latest position regarding both the VWFS case and discussions between the Group and IOM C&E using our knowledge and experience of the application of relevant tax legislation.<br><br>**- Assessing transparency:** Assessing the adequacy of the Group's disclosures about the degree of estimation uncertainty involved in assessing the recoverability of this balance. |

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

| Key audit matter | The risk | Auditor's response |
|---|---|---|
| **Recoverability of Parent Company's subordinated loans to and investment in subsidiaries**<br><br>Subordinated loans to subsidiaries £7,778,000 (2018: £7,778,000) and investment in subsidiaries £17,822,000 (2018: £16,172,000)<br><br>Refer to the ARCC report, note 32 (Investment in Group Undertakings) and note 38(A)(v) (Separate Financial Statements of the Company). | **Low risk, high value**<br><br>The carrying value of the Parent Company's subordinated loans to and investment in subsidiaries represents 97.0% (2018: 93.0%) 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. | **Our procedures included:**<br><br>**Tests of detail:** Comparing the carrying amount of 100% of the Parent Company's loans to and investments in subsidiaries with the relevant subsidiaries' draft balance sheet to identify whether their net assets, being an approximation of their minimum recoverable amount, supported the carrying amount of the Parent Company's loans to and investments in those subsidiaries and assessing whether those subsidiaries have historically been profit-making |

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

Materiality for the Group financial statements as a whole was set at £150,000 (2018: £130,000), determined with reference to a benchmark of Group profit before tax, of which it represents approximately 5.0%.

Materiality for the Parent Company financial statements as a whole was set at £150,000 (2018: £130,000), determined with reference to a benchmark of Parent Company net assets, but reduced to align with materiality for the Group financial statements.

We agreed to report to the Audit, Risk and Compliance Committee any corrected or uncorrected identified misstatements exceeding £7,500 (2018: £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 trading 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. Certain non-trading subsidiaries were not subject to full scope statutory audit, but were audited by the Group audit team based on their materiality to the Group 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 Parent 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.

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

**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

29 June 2020

# CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

| For the year ended 31 December | Notes | **2019 £000** | 2018 £000 |
|---|---|---|---|
| Interest income | | **22,320** | 19,115 |
| Interest expense | | **(4,391)** | (3,547) |
| **Net interest income** | 10 | **17,929** | 15,568 |
| Fee and commission income | 11 | **3,796** | 3,371 |
| Fee and commission expense | 11 | **(5,426)** | (6,109) |
| **Net trading income** | | **16,299** | 12,830 |
| Other operating income | | **308** | 131 |
| Loss on trading asset | 21 | **(1)** | (4) |
| Realised gains on debt securities | 20 | **179** | 135 |
| Terminal funding | 12 | **80** | 74 |
| **Operating income** | | **16,865** | 13,166 |
| Personnel expenses | 13 | **(6,762)** | (5,703) |
| Other expenses | 14 | **(4,135)** | (3,465) |
| Impairment on loans and advances to customers | 15 | **(1,900)** | (857) |
| Depreciation | 24 | **(638)** | (184) |
| Amortisation and impairment of intangibles | 25 | **(430)** | (396) |
| Share of profit of equity accounted investees, net of tax | 32 | **124** | 30 |
| VAT recovery | 23 | **(101)** | 119 |
| **Profit before tax payable** | 16 | **3,023** | 2,710 |
| Income tax expense | 17 | **(350)** | (243) |
| **Profit for the year** | | **2,673** | 2,467 |
| **Other comprehensive income:** | | | |
| **Items that will be reclassified to profit or loss** | | | |
| Unrealised gains on debt securities | 20 | **51** | 44 |
| **Items that will never be reclassified to profit or loss** | | | |
| Actuarial loss on defined benefit pension scheme taken to equity | 30 | **(128)** | (50) |
| **Total comprehensive income for the period attributable to owners** | | **2,596** | 2,461 |
| **Earnings per share – Profit for the year** | | | |
| Basic earnings per share (pence) | 18 | **2.04** | 1.88 |
| Diluted earnings per share (pence) | 18 | **1.66** | 1.54 |
| **Earnings per share – Total comprehensive income for the year** | | | |
| Basic earnings per share (pence) | 18 | **1.98** | 1.88 |
| Diluted earnings per share (pence) | 18 | **1.62** | 1.54 |

The notes on pages 38 to 80 form part of these financial statements.

The Directors believe that all results derive from continuing activities.

# COMPANY STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

| For the year ended 31 December | Notes | 2019 £000 | 2018 £000 |
|---|---|---|---|
| Dividend income | | 1,466 | - |
| Interest income | | 564 | 466 |
| **Operating income** | | 2,030 | 466 |
| Personnel expenses | | (146) | (177) |
| Administration expenses | | (100) | (132) |
| Depreciation expense | | (101) | (41) |
| **Profit before tax payable** | 16 | 1,683 | 116 |
| Tax payable | | - | - |
| **Profit for the year** | | 1,683 | 116 |
| **Total comprehensive income for the year** | | 1,683 | 116 |

The notes on pages 38 to 80 form part of these financial statements.

The Directors believe that all results derive from continuing activities.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| As at 31 December | Notes | 2019 £000 | 2018 £000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 19 | **14,620** | 9,753 |
| Debt securities | 20 | **46,792** | 30,534 |
| Trading asset | 21 | **19** | 20 |
| Loans and advances to customers | 22 | **179,370** | 148,278 |
| Trade and other receivables | 23 | **2,478** | 2,491 |
| Property, plant and equipment | 24 | **3,299** | 1,384 |
| Intangible assets | 25 | **2,293** | 1,952 |
| Goodwill | 32 | **3,734** | 2,344 |
| Investment in associates | 32 | **282** | 158 |
| **Total assets** | | **252,887** | 196,914 |
| **Liabilities** | | | |
| Deposits from customers | 26 | **209,933** | 158,500 |
| Creditors and accrued charges | 27 | **2,972** | 2,010 |
| Contingent consideration | 32 | **863** | - |
| Block creditors | 28 | **-** | 138 |
| Loan notes | 29 | **15,971** | 15,871 |
| Pension liability | 30 | **688** | 584 |
| Deferred tax liability | 17 | **141** | 88 |
| **Total liabilities** | | **230,568** | 177,191 |
| **Equity** | | | |
| Called up share capital | 31 | **20,732** | 20,732 |
| Profit and loss account | | **1,587** | (1,009) |
| **Total equity** | | **22,319** | 19,723 |
| **Total liabilities and equity** | | **252,887** | 196,914 |

The financial statements were approved by the Board of Directors on 29 June 2020 and signed on its behalf by:

**Jim Mellon**
Executive Chairman

**Denham Eke**
Chief Executive Officer

**Douglas Grant**
Group Finance Director

The notes on pages 38 to 80 form part of these financial statements.

# COMPANY STATEMENT OF FINANCIAL POSITION

| As at 31 December | Notes | **2019 £000** | 2018 £000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 19 | **119** | 1,646 |
| Trade and other receivables | 23 | **231** | 32 |
| Amounts due from Group undertakings | 32 | **1,016** | - |
| Property, plant and equipment | 24 | **450** | 126 |
| Intangible assets | | **7** | - |
| Investment in Group undertakings | 32 | **17,822** | 16,172 |
| Subordinated loans | 32 | **7,778** | 7,778 |
| **Total assets** | | **27,423** | 25,754 |
| **Liabilities** | | | |
| Creditors and accrued charges | 27 | **575** | 94 |
| Amounts due to Group undertakings | 32 | **775** | 1,370 |
| Loan notes | 29 | **15,971** | 15,871 |
| **Total liabilities** | | **17,321** | 17,335 |
| **Equity** | | | |
| Called up share capital | 31 | **20,732** | 20,732 |
| Profit and loss account | | **(10,630)** | (12,313) |
| **Total equity** | | **10,102** | 8,419 |
| **Total liabilities and equity** | | **27,423** | 25,754 |

The notes on pages 38 to 80 form part of these 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 2018 | 20,732 | (3,470) | 17,262 |
| Profit for the year | - | 2,467 | 2,467 |
| Other comprehensive income | - | (6) | (6) |
| Transactions with owners | - | - | - |
| Balance as at 31 December 2018 | 20,732 | (1,009) | 19,723 |
| **Profit for the year** | **-** | **2,673** | **2,673** |
| **Other comprehensive income** | **-** | **(77)** | **(77)** |
| **Transactions with owners** | **-** | **-** | **-** |
| **Balance as at 31 December 2019** | **20,732** | **1,587** | **22,319** |

* The Group has initially applied IFRS 16 at 1 January 2019, using the modified retrospective approach. Under this approach, comparative information is not restated and the cumulative effect of initially applying IFRS 16 is recognised in retained earnings at the date of initial application. See Note 5 for further details.

| Company | Share Capital £000 | Profit and loss account £000 | Total equity £000 |
|---|---|---|---|
| Balance as at 1 January 2018 | 20,732 | (12,429) | 8,303 |
| Profit for the year | - | 116 | 116 |
| Transactions with owners | - | - | - |
| Balance as at 31 December 2018 | 20,732 | (12,313) | 8,419 |
| **Profit for the year** | **-** | **1,683** | **1,683** |
| **Transactions with owners** | **-** | **-** | **-** |
| **Balance as at 31 December 2019** | **20,732** | **(10,630)** | **10,102** |

The notes on pages 38 to 80 form part of these financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

| For the year ended 31 December | Notes | **2019 £000** | 2018 £000 |
|---|---|---|---|
| **RECONCILIATION OF PROFIT BEFORE TAXATION TO OPERATING CASH FLOWS** | | | |
| Profit before tax | | **3,023** | 2,710 |
| Adjustments for: | | | |
| Depreciation | 24 | **638** | 184 |
| Amortisation and impairment of intangibles | 25 | **430** | 396 |
| Realised gains on debt securities | 20 | **(179)** | (135) |
| Share of profit of equity accounted investees | 32 | **(124)** | (30) |
| Contingent consideration interest expense | 32 | **88** | - |
| Pension charge included in personnel costs | 30 | **17** | 15 |
| | | **3,893** | 3,140 |
| Changes in: | | | |
| Trading asset | 21 | **1** | 4 |
| Trade and other receivables | | **118** | (583) |
| Creditors and accrued charges | | **144** | (1,169) |
| | | **4,156** | 1,392 |
| Net cash flow from trading activities | | | |
| Changes in: | | | |
| Loans and advances to customers | | **(31,092)** | (25,732) |
| Deposits from customers | | **51,433** | 16,228 |
| Pension contribution | 30 | **(41)** | (41) |
| **Cash inflow / (outflow) from operating activities** | | **24,456** | (8,153) |

| | Notes | **2019 £000** | 2018 £000 |
|---|---|---|---|
| **CASH FLOW STATEMENT** | | | |
| **Cash from operating activities** | | | |
| Cash inflow / (outflow) from operating activities | | **24,456** | (8,153) |
| Income taxes paid | | **(379)** | (182) |
| **Net cash inflow / (outflow) from operating activities** | | **24,077** | (8,335) |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | 24 | **(1,634)** | (1,118) |
| Purchase of intangible assets | 25 | **(132)** | (629) |
| Sale of tangible fixed assets | 24 | **107** | - |
| Acquisition of subsidiary or associate, net of cash acquired | 32 | **(1,337)** | (90) |
| (Sale) / purchase of debt securities | 20 | **(16,028)** | 3,917 |
| **Net cash (outflow) / inflow from investing activities** | | **(19,024)** | 2,080 |
| **Cash flows from financing activities** | | | |
| Receipt of loan notes | 29 | **100** | 6,876 |
| Payment of lease liabilities (capital) | 5 | **(148)** | - |
| Decrease in borrowings from block creditors | 28 | **(138)** | (613) |
| **Net cash (outflow) / inflow from financing activities** | | **(186)** | 6,263 |
| **Net increase in cash and cash equivalents** | | **4,867** | 8 |
| Cash and cash equivalents at 1 January | | **9,753** | 9,745 |
| **Cash and cash equivalents at 31 December** | | **14,620** | 9,753 |
| **Included in cash flows are:** | | | |
| Interest received – cash amounts | | **21,441** | 18,362 |
| Interest paid – cash amounts | | **(4,251)** | (3,434) |

The notes on pages 38 to 80 form part of these financial statements.

# COMPANY STATEMENT OF CASH FLOWS

| For the year ended 31 December | Notes | **2019 £000** | 2018 £000 |
|---|---|---|---|
| **RECONCILIATION OF PROFIT BEFORE TAXATION TO OPERATING CASH FLOWS** | | | |
| Profit before tax | | **1,683** | 116 |
| Adjustments for: | | | |
| Depreciation | 24 | **101** | 41 |
| Dividend declared | | **(1,466)** | - |
| | | **318** | 157 |
| Changes in: | | | |
| Amounts due from group undertakings | | **-** | 16 |
| Trade and other receivables | | **(199)** | (10) |
| Creditors and accrued charges | | **98** | (45) |
| Amounts due to group undertakings | | **(595)** | (1,147) |
| Cash outflow from operating activities | | **(378)** | (1,029) |
| **CASH FLOW STATEMENT** | | | |
| **Cash from operating activities** | | | |
| Cash outflow from operating activities | | **(378)** | (1,029) |
| Income taxes paid | | **-** | - |
| **Net cash outflow from operating activities** | | **(378)** | (1,029) |
| **Cash flows from investing activities** | | | |
| Dividend received | | **450** | - |
| Increase in investment in group undertakings | 32 | **(1,650)** | (2,400) |
| Issue of subordinated loans | 32 | **-** | (2,000) |
| Purchase of intangible assets | | **(7)** | - |
| **Net cash outflow from investing activities** | | **(1,207)** | (4,400) |
| **Cash flows from financing activities** | | | |
| Receipt of loan notes | 29 | **100** | 6,875 |
| Payment of finance lease liability | | **(42)** | - |
| **Net cash inflow from financing activities** | | **58** | 6,875 |
| **Net (decrease) / increase in cash and cash equivalents** | | **(1,527)** | 1,446 |
| Cash and cash equivalents at 1 January | | **1,646** | 200 |
| **Cash and cash equivalents at 31 December** | | **119** | 1,646 |

The notes on pages 38 to 80 form part of these financial statements.

**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 2019 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 16 Leases has 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(G)(vii) – measurement of Expected Credit Loss ("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;
- Note 32 – Measurement of contingent consideration.

**5. Changes in accounting policies**
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 16 Leases**
The Group has initially adopted IFRS 16 Leases from 1 January 2019. A number of other new standards are effective from 1 January 2019 but they do not have a material effect on the Group's financial statements.

IFRS 16 introduced a single, on-balance sheet accounting model for lessees. As a result, the Group, as a lessee, has recognised right-of-use assets representing its rights to use the underlying assets and lease liabilities representing its obligation to make lease payments. Lessor accounting remains similar to previous accounting policies.

The Group has applied IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings as at 1 January 2019. Accordingly, the comparative information presented for 2018 has not been restated. Therefore it is presented as previously reported under IAS 17 and related interpretations. The details of the changes in accounting policies are disclosed below.

**A. Definition of a lease**
Previously, the Group determined at contract inception whether an arrangement was or contained a lease under IFRIC 4 Determining Whether an Arrangement contains a Lease. The Group now assesses whether a contract is, or contains, a lease based on the new definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

On transition to IFRS 16, the Group elected to apply the practical expedient to grandfather the assessment of which transactions are leases. It applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed. Therefore, the definition of a lease under IFRS 16 has been applied only to contracts entered into or changed on or after 1 January 2019.

**5. Changes in accounting policies (continued)**
**IFRS 16 Leases (continued)**

**B. As a lessee**
The Group leases many assets, including properties and IT equipment.

As a lessee, the Group previously classified leases as operating or finance leases based on its assessment of whether the lease transferred substantially all of the risks and rewards of ownership. Under IFRS 16, the Group recognises right-of-use assets and lease liabilities for most leases, that is these leases are presented on the Statement of Financial Position.

However, the Group has elected not to recognise right-of-use assets and lease liabilities for some leases of low-value assets. The Group recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term. The Group presents right-of-use assets and lease liability separately on the Statement of Financial Position.

**i. Significant accounting policies**
The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less accumulated depreciation and impairment loss and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost of the lease liability and decreased by the lease payment made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised, or a termination option is reasonably certain not to be exercised.

The Group has applied judgment to determine the lease term for some lease contracts in which it is a lessee that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognised.

**ii. Impacts on transition**
Previously, the Group classified property leases as operating leases under IAS 17. The leases typically run for a period of 10 years. The operating lease commitment relating to these leases at 31 December 2018 as disclosed in the Group's consolidated financial statements was £1,166,000 (see note 34).

At transition, for leases classified as operating leases under IAS 17, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as at 1 January 2019. The weighted average rate applied is 5.5% per annum.

Right-of-use assets are measured at an amount equal to the lease liability, adjusted by the amount of net prepaid and accrued lease payments of £118,234.

The impact on transition is summarised below.

| **As at 1 January 2019** | **£000** |
|---|---|
| Right-of-use assets | **737** |
| Net accrued operating lease payments | **118** |
| Lease liabilities | **(855)** |
| Retained earnings | **-** |

**iii. Impacts for the year**

***Right-of-use assets***
The carrying amount of right-of-use assets at the end of the year is as follows:

| | **Property £000** | Right-of-use assets £000 |
|---|---|---|
| Balance at 1 January 2019 | **737** | 737 |
| Depreciation expense | **(165)** | (165) |
| **Balance at 31 December 2019** | **572** | 572 |

**5. Changes in accounting policies (continued)**
**IFRS 16 Leases (continued)**
**B. As a lessee (continued)**
**iii. Impacts for the year (continued)**

***Lease liability***
The carrying amount of lease liability at the end of the year is as follows:

| | Property £000 | Right-of-use assets £000 |
|---|---|---|
| Balance at 1 January 2019 | 855 | 855 |
| Interest expense | 47 | 47 |
| Rent payment | (195) | (195) |
| **Balance at 31 December 2019** | 707 | 707 |

The Group has classified cash payments for the principal portion of lease payments as financing activities.

**iv. Exemptions taken**
The Group used the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- Applied the exemption not to recognise right-of-use assets and liabilities for leases with less than 12 months of lease term; and
- Exclude initial direct costs from measuring the right-of-use asset at the date of initial application.

**C. As a lessor**

The accounting policies applicable to the Group as a lessor are not different from those under IAS 17.

The Group is not required to make any adjustments on transition to IFRS 16 for leases in which it acts as a lessor.

**6. Classification of financial assets and financial liabilities**
For description of how the Group classifies financial assets and liabilities, see Note 38(G)(ii).

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

| 31 December 2019 | Mandatorily at FVTPL £000 | Designated as at FVTPL £000 | FVOCI - debt instruments £000 | FVOCI - equity instruments £000 | Amortised cost £000 | Total carrying amount £000 |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | - | - | - | - | 14,620 | 14,620 |
| Debt securities | - | - | 46,792 | - | - | 46,792 |
| Trading assets | 19 | - | - | - | - | 19 |
| Loans and advances to customers | - | - | - | - | 179,370 | 179,370 |
| Trade and other receivables | - | - | - | - | 2,478 | 2,478 |
| **Total financial assets** | 19 | - | 46,792 | - | 196,468 | 243,279 |
| | | | | | | |
| Deposits from customers | - | - | - | - | 209,933 | 209,933 |
| Creditor and accrued charges | - | - | - | - | 2,972 | 2,972 |
| Block creditors | - | - | - | - | - | - |
| Loan notes | - | - | - | - | 15,971 | 15,971 |
| | | | | | | |
| **Total financial liabilities** | - | - | - | - | 228,876 | 228,876 |

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

| 31 December 2018 | Mandatorily at FVTPL £000 | Designated as at FVTPL £000 | FVOCI - debt instruments £000 | FVOCI - equity instruments £000 | Amortised cost £000 | Total carrying amount £000 |
|---|---|---|---|---|---|---|
| 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 |

### 7. Fair value of financial instruments

For description of the Group's fair value measurement accounting policy, see Note 38(G)(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 2019** | **Level 1 £000** | **Level 2 £000** | **Level 3 £000** | **Total £000** |
|---|---|---|---|---|
| Debt securities | **46,792** | **-** | **-** | **46,792** |
| Trading assets | **19** | **-** | **-** | **19** |
| | **46,811** | **-** | **-** | **46,811** |

| 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 |

## 7. Fair value of financial instruments (continued)

**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 2019 | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total fair values £000 | Total carrying amount £000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | - | 14,620 | - | 14,620 | 14,620 |
| Loans and advances to customers | - | - | 179,370 | 179,370 | 179,370 |
| Trade and other receivables | - | - | 2,478 | 2,478 | 2,478 |
| Investment in associate | - | - | 282 | 282 | 282 |
| | - | 14,620 | 182,130 | 196,750 | 196,750 |
| **Liabilities** | | | | | |
| Deposits from customers | - | 209,933 | - | 209,933 | 209,933 |
| Creditors and accrued charges | - | - | 2,972 | 2,972 | 2,972 |
| Block creditors | - | - | - | - | - |
| Loan notes | - | - | 15,971 | 15,971 | 15,971 |
| | - | 209,933 | 18,943 | 228,876 | 228,876 |

| 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 |
| Trade and other receivables | - | - | 2,491 | 2,491 | 2,491 |
| Investment in associate | - | - | 158 | 158 | 158 |
| | - | 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 |

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 (G)(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 | 2019 £000 | 2018 £000 |
|---|---|---|---|---|---|
| Grade A | 168,796 | - | - | 168,796 | 139,695 |
| Grade B | 1,143 | 1,675 | - | 2,818 | 6,153 |
| Grade C | - | 1,985 | 10,544 | 12,529 | 5,824 |
| Gross value | 169,939 | 3,660 | 10,544 | 184,143 | 151,672 |
| Allowance for impairment | (116) | (467) | (4,190) | (4,773) | (3,394) |
| Carrying value | 169,823 | 3,193 | 6,354 | 179,370 | 148,278 |

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.

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 | 2019 £000 | 2018 £000 |
|---|---|---|---|---|---|
| Current | 145,373 | - | - | 145,373 | 137,196 |
| Overdue < 30 days | 24,259 | - | - | 24,259 | 2,499 |
| Overdue > 30 days | 307 | 3,660 | 10,544 | 14,511 | 11,977 |
| | 169,939 | 3,660 | 10,544 | 184,143 | 151,672 |

For Stage 3 loans and advances that are overdue for more than 30 days, the Bank considers to hold collateral with a value of £8,706,600 (2018: £6,946,660) representing security cover of 60 % (2018: 58%)

**8. Financial risk review (continued)**
**Risk management (continued)**
**A. Credit risk (continued)**
**i. Credit quality analysis (continued)**

**Debt securities, cash and cash equivalents**
The following table sets out the credit quality of liquid assets:

| | 2019 £000 | 2018 £000 |
|---|---|---|
| **Government bonds and treasury bills** | | |
| Rated A to A+ | **44,690** | 30,534 |
| **Floating rate notes** | | |
| Rated A to A+ | **2,102** | - |
| **Cash and cash equivalents** | | |
| Rated A to A+ | **14,620** | 9,753 |
| | **61,412** | 40,287 |

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 2019, 25.5% of loans and advances fell into this category (2018: 37.9%).

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(G)(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 – Financial Instruments: Recognition and Measurement.

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 Significant Increase in Credit Risk ("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.

**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, individual voluntary arragements, abscond or disappearance, fraudulent activity or 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.

There have been no significant changes to ECL assumptions from prior year.

**iv. 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 no introducer that accounted for more than 20% of the Bank's total lending portfolio at the end of 31 December 2019 (2018: one introducer).

**B. Liquidity risk**

For the definition of liquidity risk and information on how liquidity risk is manged 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 year were as follows:

| | **2019** | 2018 |
|---|---|---|
| At 31 December | **29%** | 25% |
| Average for the year | **23%** | 32% |
| Maximum for the year | **29%** | 40% |
| Minimum for the year | **19%** | 25% |

**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 2019 | 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 | 2,900 | 5,127 | 19,670 | 40,315 | 43,792 | 77,746 | 22,397 | - | 211,947 |
| Other liabilities | 5,212 | - | 4,765 | 16 | 7,281 | 1,274 | 1,444 | 2,180 | 22,172 |
| **Total liabilities** | 8,112 | 5,127 | 24,435 | 40,331 | 51,073 | 79,020 | 23,841 | 2,180 | 234,119 |

| 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 |

**Maturity of assets and liabilities at the reporting date:**

| 31 December 2019 | 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 | 14,620 | - | - | - | - | - | - | - | 14,620 |
| Debt securities | - | 5,795 | 15,748 | 17,751 | - | 7,498 | - | - | 46,792 |
| Loans and advances to customers | 12,564 | 2,017 | 12,652 | 14,977 | 32,615 | 77,077 | 27,461 | 7 | 179,370 |
| Other assets | 19 | - | - | - | - | - | - | 12,086 | 12,105 |
| **Total assets** | 27,203 | 7,812 | 28,400 | 32,728 | 32,615 | 84,575 | 27,461 | 12,093 | 252,887 |
| **Liabilities** | | | | | | | | | |
| Deposits from customers | 2,889 | 5,060 | 19,411 | 39,867 | 43,574 | 76,953 | 22,179 | - | 209,933 |
| Other liabilities | 5,250 | - | 4,710 | - | 7,245 | 900 | 350 | 2,180 | 20,635 |
| **Total liabilities** | 8,139 | 5,060 | 24,121 | 39,867 | 50,819 | 77,853 | 22,529 | 2,180 | 230,568 |

**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 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 | 584 | 177,191 |

**iii. Liquidity reserves**
The following table sets out the components of the Group's liquidity reserves:

| | **2019 Carrying amount £000** | **2019 Fair value £000** | 2018 Carrying amount £000 | 2018 Fair value £000 |
|---|---|---|---|---|
| Balances with other banks | **14,620** | **14,620** | 9,753 | 9,753 |
| Unencumbered debt securities | **46,792** | **46,792** | 30,534 | 30,534 |
| Total liquidity reserves | **61,412** | **61,412** | 40,287 | 40,287 |

**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:

| | | **Market risk measure** | |
|---|---|---|---|
| **31 December 2019** | **Carrying amount £000** | **Trading portfolios £000** | **Non-trading portfolios £000** |
| **Assets subject to market risk** | | | |
| Trading assets | **19** | **19** | **-** |
| Debt securities | **46,792** | **-** | **46,792** |
| **Total** | **46,811** | **19** | **46,792** |

| | | Market risk measure | |
|---|---|---|---|
| 31 December 2018 | Carrying amount £000 | 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 |

**8. Financial risk review (continued)**
**Risk management (continued)**
**C. Market risk (continued)**

**i. Exposure to interest rate risk**
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 2019 | 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 | 14,620 | - | - | - | - | - | - | - | 14,620 |
| Debt securities | 5,795 | 15,748 | 17,751 | - | 7,498 | - | - | - | 46,792 |
| Loans and advances to customers | 14,581 | 12,652 | 14,977 | 32,615 | 77,077 | 27,461 | 7 | - | 179,370 |
| Other assets | - | - | - | - | - | - | - | 12,105 | 12,105 |
| **Total assets** | 34,996 | 28,400 | 32,728 | 32,615 | 84,575 | 27,461 | 7 | 12,105 | 252,887 |
| **Liabilities and equity** | | | | | | | | | |
| Deposits from customers | 7,949 | 19,411 | 39,867 | 43,574 | 76,953 | 22,179 | - | - | 209,933 |
| Other liabilities | 586 | 4,710 | 1,188 | 1,200 | 1,268 | 7,882 | - | 3,801 | 20,635 |
| Total equity | - | - | - | - | - | - | - | 22,319 | 22,319 |
| **Total liabilities and equity** | 8,535 | 24,121 | 41,055 | 44,774 | 78,221 | 30,061 | - | 26,120 | 252,887 |
| Interest rate sensitivity gap | 26,461 | 4,279 | (8,327) | (12,159) | 6,354 | (2,600) | 7 | (14,015) | - |
| **Cumulative** | 26,461 | 30,740 | 22,413 | 10,254 | 16,608 | 14,008 | 14,015 | - | - |

| 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 | 19,723 | 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 | - | - |

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 (2018: 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 2019 | Sight- 1 month | >1month -3months | >3months - 6months | >6months - 1 year | >1 year - 3 years | >3 years - 5 years | >5 years | Non-Int. Bearing | Total |
|---|---|---|---|---|---|---|---|---|---|
| Interest rate sensitivity gap £000 | 26,461 | 4,279 | (8,327) | (12,159) | 6,354 | (2,600) | 7 | (14,015) | - |
| Weighting | 0.000 | 0.003 | 0.007 | 0.014 | 0.027 | 0.054 | 0.115 | 0.000 | - |
| £000 | - | 13 | (58) | (170) | 172 | (140) | 1 | - | (182) |

**8. Financial risk review (continued)**
**Risk management (continued)**
**C. Market risk (continued)**

**i. Exposure to interest rate risk (continued)**

| 31 December 2018 | Sight- 1 month | >1month -3months | >3months - 6months | >6months - 1 year | >1 year - 3 years | >3 years - 5 years | >5 years | Non-Int. Bearing | Total |
|---|---|---|---|---|---|---|---|---|---|
| Interest rate sensitivity gap £000 | 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 |

**D. Capital Management**
**i. Regulatory capital**
The lead regulator 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 and intercompany receivable.
- Tier 2 capital, which includes qualifying subordinated liabilities and any excess of impairment over expected losses.

The 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 four (2018: four) 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; Edgewater Associates; and Manx FX.

| For the year ended 31 December 2019 | Asset and Personal Finance £000 | Manx Incahoot £000 | Edgewater Associates £000 | Manx FX £000 | Investing Activities £000 | Total £000 |
|---|---|---|---|---|---|---|
| Net interest income | 17,929 | - | - | - | - | 17,929 |
| Fee and commission income / (loss) | 439 | (9) | 2,529 | 837 | - | 3,796 |
| Operating income / (loss) | 13,518 | (10) | 2,529 | 828 | - | 16,865 |
| **Profit / (loss) before tax payable** | 2,944 | (295) | 219 | 502 | (347) | 3,023 |
| Capital expenditure | 1,744 | - | 14 | - | 8 | 1,766 |
| **Total assets** | 249,449 | 14 | 2,292 | 321 | 811 | 252,887 |

**9. Operating segments (continued)**

| For the year ended 31 December 2018 | Asset and Personal Finance £000 | Manx Incahoot £000 | Edgewater Associates £000 | Manx FX £000 | Investing Activities £000 | Total £000 |
|---|---|---|---|---|---|---|
| Net interest income | 15,568 | - | - | - | - | 15,568 |
| Fee and commission income | - | 12 | 2,562 | 797 | - | 3,371 |
| Operating income | 9,795 | 12 | 2,562 | 797 | - | 13,166 |
| Profit / (loss) before tax payable | 2,267 | (189) | 245 | 490 | (103) | 2,710 |
| Capital expenditure | 1,589 | 1 | 150 | 6 | 1 | 1,747 |
| Total assets | 190,923 | 78 | 3,153 | 608 | 2,152 | 196,914 |

**10. Net interest income**

| | **2019 £000** | 2018 £000 |
|---|---|---|
| **Interest income** | | |
| Loans and advances to customers | **21,824** | 19,037 |
| **Total interest income calculated using the effective interest method** | **21,824** | 19,037 |
| Other interest income | **496** | 78 |
| **Total interest income** | **22,320** | 19,115 |
| **Interest expense** | | |
| Deposits from customers | **(3,383)** | (2,744) |
| Loan note interest | **(873)** | (773) |
| Lease liability | **(47)** | - |
| Contingent consideration | **(88)** | - |
| Block funders | **-** | (30) |
| **Total interest expense** | **(4,391)** | (3,547) |
| **Net interest income** | **17,929** | 15,568 |

**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 – Revenue from Contracts with Customers 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.

| | **2019 £000** | 2018 £000 |
|---|---|---|
| **Major service lines** | | |
| Independent financial advice income | **2,528** | 2,547 |
| Foreign exchange trading income | **837** | 824 |
| Brokerage services income | **431** | - |
| **Fee and commission income** | **3,796** | 3,371 |
| Fee and commission expense | **(5,426)** | (6,109) |
| **Net fee and commission expense** | **(1,630)** | (2,738) |

## 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-offs. 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. Terminal funding continues to generate secondary term rental income following the last repayment date.

| | **2019<br>£000** | 2018<br>£000 |
|---|---|---|
| Interest income | **78** | 181 |
| Fee and commission expense | **-** | (5) |
| Provision for impairment on loan assets | **2** | (102) |
| | **80** | 74 |

## 13. Personnel expenses

| | **2019<br>£000** | 2018<br>£000 |
|---|---|---|
| Gross salaries | **(5,142)** | (4,233) |
| Executive Directors' remuneration | **(259)** | (241) |
| Non-executive Directors' fees | **(152)** | (145) |
| Executive Directors' pensions | **(21)** | (19) |
| Executive Directors' performance related pay | **(50)** | (50) |
| Pension costs | **(302)** | (259) |
| National insurance and payroll taxes | **(628)** | (527) |
| Training and recruitment costs | **(208)** | (229) |
| | **(6,762)** | (5,703) |

## 14. Other expenses

| | **2019<br>£000** | 2018<br>£000 |
|---|---|---|
| Professional and legal fees | **(1,559)** | (1,067) |
| Marketing costs | **(261)** | (237) |
| IT costs | **(633)** | (567) |
| Establishment costs | **(286)** | (434) |
| Communication costs | **(155)** | (146) |
| Travel costs | **(219)** | (174) |
| Bank charges | **(137)** | (119) |
| Insurance | **(199)** | (141) |
| Irrecoverable VAT | **(340)** | (303) |
| Other costs | **(346)** | (277) |
| | **(4,135)** | (3,465) |

## 15. Impairment on loans and advances to customers

The charge in respect of specific allowances for impairment comprises:

| | **2019<br>£000** | 2018<br>£000 |
|---|---|---|
| Specific impairment allowances made | **(2,091)** | (1,246) |
| Reversal of allowances previously made | **64** | 410 |
| **Total charge for specific provision for impairment** | **(2,027)** | (836) |

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

The credit / (charge) in respect of collective allowances for impairment comprises:

| | **2019 £000** | 2018 £000 |
|---|---|---|
| Collective impairment allowances made | **(138)** | (49) |
| Release of allowances previously made | **265** | 28 |
| **Total credit / (charge) for collective allowances for impairment** | **127** | (21) |
| **Total charge for allowances for impairment** | **(1,900)** | (857) |

### 16. Profit before tax payable

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

| | | Group | | Company | |
|---|---|---|---|---|---|
| | | **2019 £000** | 2018 £000 | **2019 £000** | 2018 £000 |
| Auditor's remuneration: - | as Auditor current year | **(110)** | (108) | **-** | - |
| | non-audit services | **(96)** | (7) | **-** | - |
| Pension cost defined benefit scheme | | **(17)** | (15) | **-** | - |
| Operating lease rentals for property | | **(117)** | (251) | **-** | - |

### 17. Income tax expense

| | **2019 £000** | 2018 £000 |
|---|---|---|
| **Current tax expense** | | |
| Current year | **(297)** | (197) |
| Changes to estimates for prior years | **-** | - |
| | **(297)** | (197) |
| **Deferred tax expense** | | |
| Origination and reversal of temporary differences | **(53)** | (46) |
| Utilisation of previously recognised tax losses | **-** | - |
| Changes to estimates for prior years | **-** | - |
| | **(53)** | (46) |
| **Tax expense** | **(350)** | (243) |

| | | **2019 £000** | | 2018 £000 |
|---|---|---|---|---|
| **Reconciliation of effective tax rate** | | | | |
| Profit before tax | | **3,023** | | 2,710 |
| Tax using the Bank's domestic tax rate | **(10.0)%** | **(302)** | (10.0)% | (271) |
| Effect of tax rates in foreign jurisdictions | **(0.8)%** | **(23)** | 0.0 % | - |
| Non-deductible expenses | **(2.6)%** | **(78)** | (1.2)% | (33) |
| Tax exempt income | **0.0 %** | **-** | 0.3 % | 8 |
| Timing difference in current year | **0.0 %** | **-** | 0.3 % | 7 |
| Origination and reversal of temporary differences in deferred tax | **1.8 %** | **53** | 1.7 % | 46 |
| **Tax expense** | **(11.6)%** | **(350)** | (9.0)% | (243) |

### 17. Income tax expense (continued)

The main rate of corporation tax in the Isle of Man is 0.0% (2018: 0.0%). However the profits of the Group's Isle of Man banking activities are taxed at 10.0% (2018: 10.0%). The profits of the Group's subsidiaries that are subject to UK corporation tax are taxed at a rate of 19.0% (2018: 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 £141,000 liability (2018: £88,000 liability). This resulted in an expense of £53,000 (2018: £50,000) to the Consolidated Income Statement.

### 18. Earnings per share

| | 2019 | 2018 |
|---|---|---|
| **Profit for the year** | **£2,673,000** | £2,467,000 |
| Weighted average number of ordinary shares in issue (basic) | **131,096,235** | 131,096,235 |
| Basic earnings per share (pence) | **2.04** | 1.88 |
| Diluted earnings per share (pence) | **1.66** | 1.54 |
| **Total comprehensive income for the year** | **£2,596,000** | £2,461,000 |
| Weighted average number of ordinary shares in issue (basic) | **131,096,235** | 131,096,235 |
| Basic earnings per share (pence) | **1.98** | 1.88 |
| Diluted earnings per share (pence) | **1.62** | 1.54 |

The basic earnings per share calculation is based upon the profit for the year after taxation and the weighted average of the number of shares in issue throughout the year.

| As at: | 2019 | 2018 |
|---|---|---|
| **Reconciliation of weighted average number of ordinary shares in issue between basic and diluted** | | |
| Weighted average number of ordinary shares (basic) | **131,096,235** | 131,096,235 |
| Number of shares issued if all convertible loan notes were exchanged for equity | **41,666,667** | 41,666,667 |
| Dilutive element of share options if exercised | **-** | 10,366 |
| Weighted average number of ordinary shares (diluted) | **172,762,902** | 172,773,268 |
| **Reconciliation of profit for the year between basic and diluted** | | |
| Profit for the year (basic) | **£2,673,000** | £2,467,000 |
| Interest expense saved if all convertible loan notes were exchanged for equity | **£196,150** | £196,000 |
| Profit for the year (diluted) | **£2,869,150** | £2,663,000 |

The diluted earnings per share calculation assumes that all convertible loan notes and share options have been converted / exercised at the beginning of the year where they are dilutive.

| As at: | 2019 | 2018 |
|---|---|---|
| **Reconciliation of total comprehensive income for the year between basic and diluted** | | |
| Total comprehensive income for the year (basic) | **£2,596,000** | £2,461,000 |
| Interest expense saved if all convertible loan notes were exchanged for equity | **£196,150** | £196,000 |
| Total comprehensive income for the year (diluted) | **£2,792,150** | £2,657,000 |

### 19. Cash and cash equivalents

| | Group | | Company | |
|---|---|---|---|---|
| | **2019 £000** | 2018 £000 | **2019 £000** | 2018 £000 |
| Cash at bank and in hand | **14,620** | 9,753 | **119** | 1,646 |
| | **14,620** | 9,753 | **119** | 1,646 |

Cash at bank includes an amount of £1,060,000 (2018: £561,000) representing receipts which are in the course of transmission.

### 20. Debt securities

| | Group | | Company | |
|---|---|---|---|---|
| | **2019 £000** | 2018 £000 | **2019 £000** | 2018 £000 |
| **Financial assets at FVOCI:** | | | | |
| UK Government Treasury Bills | **44,690** | 30,534 | **-** | - |
| Floating Rate Notes | **2,102** | - | **-** | - |
| | **46,792** | 30,534 | **-** | - |

UK Government Treasury Bills are stated at fair value and unrealised changes in the fair value are reflected in other comprehensive income. There were £179,000 (2018: £135,000) realised gains and £51,000 (2018: £44,000) unrealised gains 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 Consolidated Income Statement. Dividend income of £360,500 (2018: £355,000) and £24,000 (2018: £24,000) of sale proceeds have been received from this investment since it was made. The investment made a net loss of £1,000 (2018: £4,000) during the year.

### 22. Loans and advances to customers

| | | 2019 | | | 2018 | |
|---|---|---|---|---|---|---|
| **Group** | **Gross Amount £000** | **Impairment Allowance £000** | **Carrying Value £000** | Gross Amount £000 | Impairment Allowance £000 | Carrying Value £000 |
| HP balances | **65,846** | **(1,537)** | **64,309** | 59,038 | (1,416) | 57,622 |
| Finance lease balances | **40,359** | **(2,125)** | **38,234** | 27,238 | (1,551) | 25,687 |
| Unsecured personal loans | **21,110** | **(199)** | **20,911** | 14,806 | (382) | 14,424 |
| Vehicle stocking plans | **1,494** | **(36)** | **1,458** | 1,486 | - | 1,486 |
| Wholesale funding arrangements | **23,840** | **(300)** | **23,540** | 22,944 | - | 22,944 |
| Block discounting | **15,693** | **(200)** | **15,493** | 17,316 | - | 17,316 |
| Secured commercial loans | **11,652** | **(376)** | **11,276** | 1,967 | (45) | 1,922 |
| Secured personal loans | **4,149** | **-** | **4,149** | 6,877 | - | 6,877 |
| | **184,143** | **(4,773)** | **179,370** | 151,672 | (3,394) | 148,278 |

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.

| **Specific allowance for impairment** | **2019 £000** | 2018 £000 |
|---|---|---|
| Balance at 1 January | **3,126** | 2,440 |
| Specific allowance for impairment made | **2,091** | 1,291 |
| Release of allowances previously made | **(64)** | (410) |
| Write-offs | **(521)** | (195) |
| **Balance at 31 December** | **4,632** | 3,126 |

### 22. Loans and advances to customers (continued)

| Collective allowance for impairment | 2019 £000 | 2018 £000 |
|---|---|---|
| Balance at 1 January | **268** | 247 |
| Collective allowance for impairment made | **138** | 49 |
| Release of allowances previously made | **(265)** | (28) |
| **Balance at 31 December** | **141** | 268 |
| **Total allowances for impairment** | **4,773** | 3,394 |

Advances on preferential terms are available to all Directors, management and staff. As at 31 December 2019 £490,641 (2018: £389,005) 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.

At the end of the current financial year 5 loan exposures (2018: 9) exceeded 10.0% of the capital base of the Bank:

| Exposure | Outstanding Balance 2019 £000 | Outstanding Balance 2018 £000 | Facility limit £000 |
|---|---|---|---|
| Block discounting facility | **15,693** | 14,211 | **28,235** |
| Wholesale funding agreement | **23,840** | 21,423 | **28,119** |

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

| | 2019 £000 | 2018 £000 |
|---|---|---|
| Less than one year | **51,865** | 42,532 |
| Between one and five years | **71,124** | 60,184 |
| **Gross investment in HP and finance lease receivables** | **122,989** | 102,716 |

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

| | 2019 £000 | 2018 £000 |
|---|---|---|
| Less than one year | **44,787** | 37,508 |
| Between one and five years | **61,418** | 48,768 |
| **Net investment in HP and finance lease receivables** | **106,205** | 86,276 |

### 23. Trade and other receivables

| | Group | | Company | |
|---|---|---|---|---|
| | **2019 £000** | 2018 £000 | **2019 £000** | 2018 £000 |
| Prepayments | **385** | 382 | **44** | 32 |
| VAT recoverable | **835** | 936 | **187** | - |
| Other debtors | **1,258** | 1,173 | **-** | - |
| | **2,478** | 2,491 | **231** | 32 |

Included in trade and other receivables is an amount of £835,000 (2018: £936,000) 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.

### 23. Trade and other receivables (continued)

The Group's position rests on the outcome of discussions with C&E which in turn will take into account the final assessment by UK Her Majesty's Revenue and Customs ("HMRC") of the impact of the European Union's ruling in favour of Volkswagen Financial Services (UK) Limited ("VWFS") vs HMRC. On the basis of the discussions and correspondence which have taken place between the Bank, its professional advisors and C&E, in addition to the VWFS ruling, the VAT recovery has moved in the year. The Directors are confident that the VAT claim will be secured.

The Bank's total exposure in relation to this matter reduced to £906,000 (2018: £1,049,000), comprising the debtor balance referred to above plus an additional £71,000 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).

### 24. Property, plant and equipment and right-of-use assets

| Group | Leasehold Improvements £000 | IT Equipment £000 | Furniture & Equipment £000 | Motor Vehicles[1] £000 | Right-of-use assets[2] £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| As at 1 January 2019 | **509** | **335** | **664** | **1,003** | **-** | **2,511** |
| Acquisition of subsidiary | **160** | **-** | **22** | **107** | **-** | **289** |
| Additions | **5** | **58** | **-** | **1,571** | **737** | **2,371** |
| Disposals | **-** | **-** | **-** | **(107)** | **-** | **(107)** |
| **As at 31 December 2019** | **674** | **393** | **686** | **2,574** | **737** | **5,064** |
| **Accumulated depreciation** | | | | | | |
| As at 1 January 2019 | **249** | **213** | **612** | **53** | **-** | **1,127** |
| Charge for year | **66** | **59** | **10** | **338** | **165** | **638** |
| Disposals | **-** | **-** | **-** | **-** | **-** | **-** |
| **As at 31 December 2019** | **315** | **272** | **622** | **391** | **165** | **1,765** |
| **Carrying value at 31 December 2019** | **359** | **121** | **64** | **2,183** | **572** | **3,299** |
| Carrying value at 31 December 2018 | 260 | 122 | 52 | 950 | - | 1,384 |

[1]Motor vehicles relate to operating leases with the Group as lessor.
[2]See Note 5 for implementation of IFRS 16 – Leases and recognition of right-of-use asset.

### 24. Property, plant and equipment and right-of-use assets (continued)

| Company | Leasehold Improvements £000 | IT Equipment £000 | Furniture & Equipment £000 | Right-of use-asset £000 | Total £000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| As at 1 January 2019 | **234** | **13** | **16** | **-** | **263** |
| Additions | **-** | **-** | **1** | **424** | **425** |
| Disposals | **-** | **-** | **-** | **-** | **-** |
| **As at 31 December 2019** | **234** | **13** | **17** | **424** | **688** |
| **Accumulated depreciation** | | | | | |
| As at 1 January 2019 | **131** | **3** | **3** | **-** | **137** |
| Charge for year | **38** | **1** | **2** | **60** | **101** |
| Disposals | **-** | **-** | **-** | **-** | **-** |
| **As at 31 December 2019** | **169** | **4** | **5** | **60** | **238** |
| **Carrying value at 31 December 2019** | **65** | **9** | **12** | **364** | **450** |
| Carrying value at 31 December 2018 | 103 | 10 | 13 | - | 126 |

### 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 2019 | **1,417** | **388** | **2,046** | **3,851** |
| Acquisition of subsidiary (note 32) | **496** | **143** | **-** | **639** |
| Additions | **7** | **8** | **117** | **132** |
| Disposals | **-** | **-** | **-** | **-** |
| **As at 31 December 2019** | **1,920** | **539** | **2,163** | **4,622** |
| **Accumulated amortisation** | | | | |
| As at 1 January 2019 | **195** | **312** | **1,392** | **1,899** |
| Charge for year / impairment | **107** | **131** | **192** | **430** |
| Disposals | **-** | **-** | **-** | **-** |
| **As at 31 December 2019** | **302** | **443** | **1,584** | **2,329** |
| **Carrying value at 31 December 2019** | **1,618** | **96** | **579** | **2,293** |
| Carrying value at 31 December 2018 | 1,222 | 76 | 654 | 1,952 |

### 26. Deposits from customers

| | **2019 £000** | 2018 £000 |
|---|---|---|
| Retail customers: term deposits | **203,241** | 153,735 |
| Corporate customers: term deposits | **6,692** | 4,765 |
| | **209,933** | 158,500 |

## 27. Creditors and accrued charges

| | Group | | Company | |
|---|---|---|---|---|
| | **2019 £000** | 2018 £000 | **2019 £000** | 2018 £000 |
| Commission creditors | **1,044** | 758 | **-** | - |
| Other creditors and accruals | **893** | 897 | **66** | 94 |
| Lease liability (see note 5) | **707** | - | **509** | - |
| Taxation creditors | **328** | 355 | **-** | - |
| | **2,972** | 2,010 | **575** | 94 |

## 28. Block creditors

| | **2019 £000** | 2018 £000 |
|---|---|---|
| Drawdown 3 – repayable 08/03/2019, interest payable at 6.5%, secured on assets of MFL | **-** | 138 |
| | **-** | 138 |

## 29. Loan notes

| | | Group | | Company | |
|---|---|---|---|---|---|
| | **Notes** | **2019 £000** | 2018 £000 | **2019 £000** | 2018 £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 |
| | | **3,410** | 3,410 | **3,410** | 3,410 |
| **Unrelated parties** | **UP** | **12,561** | 12,461 | **12,561** | 12,461 |
| | | **15,971** | 15,871 | **15,971** | 15,871 |

**JM** – Two loans, one of £1,250,000 maturing on 26 February 2020, paying interest of 6.5% per annum, and one of £500,000 maturing on 31 July 2022 with interest payable of 5.0% per annum. Both loans are convertible at the rate of 7.5 pence and 9 pence respectively. See note 35 for the terms of the renewal of the £1,250,000 loan.

**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 previous Non-executive Director, is also a director of SR.

**UP** – Thirty-three loans consisting of an average £380,636 with a average interest payable of 5.5% (2018: 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 Bank 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.

**30. Pension liability (continued)**

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 – IAS 19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, 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 2019 (2018: none).

**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: Employee Benefits, this valuation has been updated by the actuary as at 31 December 2019.

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

| **Total underfunding in funded plans recognised as a liability** | **2019 £000** | 2018 £000 |
|---|---|---|
| Fair value of plan assets | **1,471** | 1,361 |
| Present value of funded obligations | **(2,159)** | (1,945) |
| | **(688)** | (584) |

| **Movement in the liability for defined benefit obligations** | **2019 £000** | 2018 £000 |
|---|---|---|
| Opening defined benefit obligations at 1 January | **1,945** | 2,029 |
| Benefits paid by the plan | **(69)** | (65) |
| Interest on obligations | **55** | 52 |
| Actuarial loss / (gain) | **228** | (71) |
| **Liability for defined benefit obligations at 31 December** | **2,159** | 1,945 |

**30. Pension liability (continued)**

| Movement in plan assets | 2019 £000 | 2018 £000 |
|---|---|---|
| Opening fair value of plan assets at 1 January | **1,361** | 1,469 |
| Expected return on assets | **38** | 37 |
| Contribution by employer | **41** | 41 |
| Actuarial gain / (loss) | **100** | (121) |
| Benefits paid | **(69)** | (65) |
| **Closing fair value of plan assets at 31 December** | **1,471** | 1,361 |

| Expense recognised in income statement | 2019 £000 | 2018 £000 |
|---|---|---|
| Interest on obligation | **55** | 52 |
| Expected return on plan assets | **(38)** | (37) |
| **Total included in personnel costs** | **17** | 15 |
| **Actual return on plan assets** | **142** | (53) |

| Actuarial loss recognised in other comprehensive income | 2019 £000 | 2018 £000 |
|---|---|---|
| Actuarial gain / (loss) on plan assets | **100** | (121) |
| Actuarial (loss) / gain on defined benefit obligations | **(228)** | 71 |
| | **(128)** | (50) |

| Plan assets consist of the following | 2019 % | 2018 % |
|---|---|---|
| Equity securities | **50** | 45 |
| Corporate bonds | **18** | 19 |
| Government bonds | **30** | 28 |
| Cash | **2** | 4 |
| Other | **-** | 4 |
| | **100** | 100 |

| The actuarial assumptions used to calculate Scheme liabilities under IAS19 are as follows: | 2019 % | 2018 % | 2017 % |
|---|---|---|---|
| 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 | 3.0 |
| 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 | **2.9** | 2.6 | 2.6 |
| Inflation | **3.1** | 3.1 | 3.1 |

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 2019** | **200,200,000** |
| At 31 December 2018 | 200,200,000 |

| Issued and fully paid: - Ordinary shares of no par value | Number | £000 |
|---|---|---|
| **At 31 December 2019** | **131,096,235** | **20,732** |
| At 31 December 2018 | 131,096,235 | 20,732 |

There are four convertible loans of £3,410,000 (2018: £3,410,000).

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 (2018:1,050,000) 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.

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 (2018: £nil).

**Analysis of changes in financing during the year**

| Analysis of changes in financing during the year | **2019 £000** | 2018 £000 |
|---|---|---|
| Balance at 1 January | **36,603** | 29,727 |
| Issue of loan notes | **100** | 6,876 |
| | **36,703** | 36,603 |

The 2019 closing balance is represented by £20,732,000 share capital (2018: £20,732,000) and £15,971,000 of loan notes (2018: £15,871,000).

### 32. Investment in Group undertakings

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

| Carrying value of investments | Nature of Business | 31 December 2019 % Holding | Date of Incorporation | Total 2019 £000 | Total 2018 £000 |
|---|---|---|---|---|---|
| Conister Bank Limited | Asset and Personal Finance | 100 | 05/12/1935 | 15,817 | 14,167 |
| 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 | - | - |
| | | | | 17,822 | 16,172 |

**Blue Star Business Solutions Limited**
On 16 April 2019, the Group (through Bradburn Limited) acquired 100% of the shares and voting interest in Blue Star Business Solutions Limited ("BBSL"), obtaining control of BBSL. This acquisition is part of the Group's strategy to increase its distribution in the UK broker market. BBSL was formed in 2004 and is based in Hampshire. The business is a niche brokerage which focuses on delivering excellent customer service to small and medium sized businesses in the UK that require funding for IT equipment amongst other assets. The Group invested in BBSL to allow it to grow profitably by gaining market share and through its banking subsidiary, Conister Bank Limited, writing the majority of its funding requests.

For the 9 months ended 31 December 2019, BBSL contributed revenue of £719,115 and a consolidated profit of £346,241 including its lending contribution to the Group. If the acquisition had occurred on 1 January 2019, management estimates that the consolidated revenue would have been £922,345 and consolidated profit for the year would have been £361,348. Individual results for the 9 months ended 31 December 2019 recorded a loss of £24,378.

**A. Consideration transferred**
The following table summarises the acquisition-date fair value of each major class of consideration transferred:

| | £000 |
|---|---|
| Cash | 1,500 |
| Contingent consideration | 775 |
| | 2,275 |

**i. Contingent consideration transferred**
The Group has agreed to pay the selling shareholders:

- 50% of net profits in BBSL for 3 years post completion; and
- 50% of the incremental net profit that the Group benefits from as a result of taking up BBSL loan proposals post completion up until the third anniversary.

This is to be paid on each anniversary with a final payment in year 4 for the unrealised lending profit. The total consideration is to have a cap of £4,000,000 in total. The contingent consideration is calculated by forecasting 3 years of net profits discounted using an interest rate of 16.0% per annum. Unwinding the discount up to 31 December 2019 has created an £88,000 of interest expense in the Consolidated Income Statement, bringing the balance to £863,000. The range of contingent consideration payable is £nil - £2,500,000.

**B. Acquisition-related costs**
In the current year, the Group incurred acquisition-related costs of £20,000 relating to external legal fees and due diligence costs. These costs have been included in 'administrative expenses' in the Condensed Consolidated Statement of Profit or Loss and Other Comprehensive Income.

**C. Identifiable assets acquired and liabilities assumed**
The following table summarises the recognised amounts of assets acquired, and liabilities assumed at the date of acquisition:

| | £000 |
|---|---|
| Property, plant and equipment | 289 |
| Intangible assets | 639 |
| Trade and other receivables | 114 |
| Cash and cash equivalents | 163 |
| Trade and other payables | (203) |
| Loans and borrowings | (117) |
| **Total identifiable net assets acquired** | 885 |

The trade receivables comprise gross contractual amounts due of £114,000.

**32. Investment in Group undertakings (continued)**
**Blue Star Business Solutions Limited (continued)**

**D. Goodwill**
The goodwill arising from the acquisition has been recognised as follows:

| | £000 |
|---|---|
| Total consideration transferred | 2,275 |
| Fair value of identifiable net assets | (885) |
| **Goodwill** | **1,390** |

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

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

| Creation | Maturity | Interest rate | 2019 £000 | 2018 £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** | 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** | 7,778 |

EAL's subordinated loan that matured on 28 February 2018 continues in existence and has not been called for payment by MFG.

| Goodwill | Group 2019 £000 | Group 2018 £000 |
|---|---|---|
| EAL | **1,849** | 1,849 |
| BBSL | **1,390** | - |
| ECF Asset Finance PLC ("ECF") | **454** | 454 |
| Three Spires Insurance Services Limited ("Three Spires") | **41** | 41 |
| | **3,734** | 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 EAL 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 11.0% discount factor. The sensitivity of the analysis was tested using additional discount factors of 15.0% and 20.0% on stable profit levels.

**32. Investment in Group undertakings (continued)**

**Goodwill impairment (continued)**
The estimated recoverable amount in relation to the goodwill generated on the purchase of BBSL is based on forecasted 3 year interest income calculated at an average yield of 8%, with a terminal value calculated using a 3.0% growth rate of net income and then discounted using a 16.0% discount factor. The sensitivity of the analysis was tested using additional discount factors of up to 20.0% on varying interest income growth rates.

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 11.0% 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 EAL and ECF when compared to 2018. 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 EAL. Based on the above reviews no impairment to goodwill has been made in the current year.

**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 lead 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 £nil (2018: £76,000) at 31 December 2019. This created an impairment charge of £76,000 for intellectual property rights and £32,047 for the website during the current year.

**Investment in associates**

| | **Group 2019 £000** | Group 2018 £000 |
|---|---|---|
| The Business Lending Exchange ("BLX") | **166** | 56 |
| Beer Swaps Limited ("BSL") | **20** | 10 |
| Payitmonthly Ltd ("PIML") | **96** | 92 |
| | **282** | 158 |

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 £110,000 (2018: £18,000).

On April 2018, 20% of the share capital of BSL was acquired for nil consideration. The Group's share of the associate's total comprehensive income during the year was £10,000 (2018: £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 during the year was £4,000 (2018: £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 £446,366 (2018: £173,157), 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.

Commercial loans have been made to various companies connected to Jim Mellon and Denham Eke on normal commercial terms. As at 31 December 2019, £62,746 of capital and interest was outstanding (2018: £113,328).

**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. EAL provides services to the Group in arranging its insurance and defined contribution pension arrangements.

**Loan advance to EAL**
On 14 December 2016, a loan advance was made to EAL by the Bank in order to provide the finance required to acquire MBL. The advance was for £700,000 at an interest rate of 8% per annum repayable over 6 years. A negative pledge was given by EAL to not encumber any property or assets or enter into an arrangement to borrow any further monies. The balance as at 31 December 2019 was £395,172 (2018: £508,000).

**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 2019, £4,000,000 (2018: £2,520,000) 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 leasing portfolio. On 10 October 2018, this facility was increased to £1,500,000. The facility is for 12 months. Interest is charged at commercial rates. During the year, the facility was increased to £2,250,000. At 31 December 2019, £2,250,000 (2018: £1,099,000) 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. During the year, the facility was increased to £1,500,000. At 31 December 2019, £1,424,000 (2018: £322,000) had been advanced to PIML.

**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 (2018: £7,450,000) of subordinated loans to the Bank and £328,000 (2018: £328,000) to EAL at 31 December 2019. See note 32 for more details.

**Loan notes**
See note 29 for a list of related party loan notes as at 31 December 2019 and 2018.

**Key management remuneration including Executive Directors**

| | **2019 £000** | 2018 £000 |
|---|---|---|
| Short-term employee benefits | **309** | 297 |

### 34. Operating leases

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

| | **2019 Leasehold Property £000** | 2018 Leasehold Property £000 |
|---|---|---|
| Less than one year | **101** | 214 |
| Between one and five years | **-** | 790 |
| Over five years | **-** | 162 |
| | **101** | 1,166 |

### 35. Subsequent events

**Acquisition of subsidiary**
On 28 February 2020, the Group announced that it has entered into an agreement to acquire (through its subsidiary, the Bank) additional ordinary shares in BSL (see note 32) for a cash consideration of £506,824. The Bank's shareholding in BSL will increase to 75% (31 December 2019: 20%) on completion of the purchase. Further the Bank will simplify the capital structure of BSL by repaying all issued preference shares, being £200,000, as part of the transaction plus repayment of Director loans of £100,000..

**Loan notes (see note 29)**
The £1,250,000 loan note due to mature on 26 February 2020 and paying interest of 6.5% per annum has been renewed at an interest rate of 5.4% and for a term of 5 years.

The £460,000 loan note due to mature on 26 February 2020 and paying interest of 6.5% per annum was renewed for a further 2 months with no change to other terms.

**COVID-19**
In late February 2020, the UK recorded its first case of the coronavirus "COVID-19", which shortly spread to the IOM in the following month. In an attempt to contain the outbreak, both the UK and Manx Governments, in line with action taken by other Governments throughout the world, introduced a number of significant restrictions on businesses, human movement and social interactions, including shutting down a wide range of economic sectors in which the Group has significant interest.

Both the UK and Manx Governments launched various financial support measures to provide vital liquidity and relief to both individuals and businesses struggling to trade through this global economic crisis.

The Group is closely monitoring the coronavirus pandemic and its potential impacts on its business. The extent to which COVID-19 impacts the Group's business will depend on future developments, which are highly uncertain and cannot be predicted, including new information that may emerge on the severity of COVID-19 and the success of efforts to contain or treat COVID-19.

In line with the Financial Reporting Council's joint statement on 26 March 2020, the Group does not consider COVID-19 to be an adjusting event and as such any impacts are not reflected within this Annual Report.

The Group assessed the changes in the environment on its capital and liquidity positions and is comfortable that it can keep a solid financial standing. Management will continue to monitor the developments and update its strategy and course of actions as necessary in the circumstances.

**Other**
There were no other significant subsequent events identified after 31 December 2019.

## 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.

### 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, though 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.

***Management of credit risk (continued)***

- 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;

**36. Financial risk management (continued)**

**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 the 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 the 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 £282,000 (2018: £158,000) 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 derivate 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.

**36. Financial risk management (continued)**

**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;

***Management of operational risk (continued)***
- 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.

**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 fair value through profit and loss ("FVTPL") | Fair value |
| Financial assets at fair value through other comprehensive income ("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:


| Ref. | Note description | No. |
|---|---|---|
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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. 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.

**38. Significant accounting policies (continued)**
**C. 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.

**D. Fee and commission income**
The Group generates fee and commission income through provision of independent financial advice, insurance brokerage agency, introducer of foreign exchange services and commissions from brokering business finance for small and medium sized enterprises.

**Independent financial advice and insurance brokerage agency**
Income represents commission arising on services and premiums relating to policies and other investment products committed during the year, as well as renewal commissions having arisen on services and premiums relating to policies and other investment products committed during the year and previous years and effective at the balance sheet date. Income is recognised on the date that policies are submitted to product providers with an appropriate discount being applied for policies not completed. As a way to estimate what is due at the year end, a “not proceeded with” rate of 10.0% for pipeline life insurance products and 0.0% for non-life insurance pipeline is assumed. Renewal commissions are estimated by taking the historical amount written pro-rata to 3 months.

**Other**
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 fee relates.

**E. 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.

**F. 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.

**G. 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.

**38. Significant accounting policies (continued)**
**G. 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 solely payments of principal and interest ("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.

**38. Significant accounting policies (continued)**
**G. 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 of financial assets and financial liabilities**
**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 losses 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;

**38. Significant accounting policies (continued)**
**G. 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; and
- 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 Expected Credit Loss ("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 2019 year-end, 37.9% had such credit enhancements (2018: 41.7%); and
- 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.

**38. Significant accounting policies (continued)**
**G. Financial assets and financial liabilities (continued)**
**vii. Impairment (continued)**

**Measurement of ECL (continued)**
ECL are probability-weighted estimates 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; and
- 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; and
- 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.

**38. Significant accounting policies (continued)**

**H. 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.

**I. 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 receivables (see 38 (G)).

**J. 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 |

**K. 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.

**38. Significant accounting policies (continued)**
**K. 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 |

**L. 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 grouped 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.

**M. 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.

**38. Significant accounting policies (continued)**
**N. 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 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.

**O. 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.

**P. Earnings per share ("EPS")**
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 MFG 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.

**Q. 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.

**38. Significant accounting policies (continued)**

**Q. 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 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 2020 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) |
|---|---|
| Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform (issued on 26 September 2019) | 1 January 2020 |
| Amendments to IAS 1 and IAS 8: Definition of Material (issued on 31 October 2018) | 1 January 2020 |
| Amendments to References to the Conceptual Framework in IFRS Standards (issued on 29 March 2018) | 1 January 2020 |

# SHAREHOLDER NOTES

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