

**PCF Bank Limited
Annual Report &
Financial Statements
2020**



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Company Information

PCF Bank Ltd

Directors	Tim Franklin <i>Non-executive Chairman</i> Mark Brown <i>Non-executive</i> Christine Higgins <i>Non-executive</i> Marian Martin <i>Non-executive</i> David Morgan <i>Non-executive</i> David Titmuss <i>Non-executive</i> Garry Stran <i>Interim Chief Executive Officer (appointed 28 May 2021)</i> Caroline Richardson <i>Chief Financial Officer (appointed 29 October 2021)</i> Scott Maybury <i>Chief Executive Officer (resigned 21 May 2021)</i> Robert Murray <i>Managing Director (resigned 31 March 2021)</i> David Bull <i>Finance Director (resigned 16 March 2020)</i>
Company Secretary	Robert Murray <i>(resigned 31 March 2021)</i> LDC Nominee Secretary Limited <i>(appointed 31 March 2021)</i>
Registered Office	Pinnars Hall 105-108 Old Broad Street London EC2N 1ER
Registered Number	02794633
Auditors	Ernst & Young LLP 25 Churchill Place Canary Wharf London E14 5EY

PCF Bank Limited ('Bank') is a private limited company (registration number 02794633), and a wholly owned subsidiary of PCF Group plc ('Group'). It is registered in England and Wales with its registered office at Pinnars Hall, 105-108 Old Broad Street, London EC2N 1ER. The Bank is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, FRN number 747017. Certain subsidiaries of PCF Bank Limited are authorised and regulated by the Financial Conduct Authority for consumer credit activities and the registered offices of which are at Pinnars Hall, 105-108 Old Broad Street, London EC2N 1ER.

The Group employs all colleagues. However, the Bank constitutes the majority of the Group, including 99% of the Group's total assets and 100% of the retail and wholesale funding. Therefore, any statements made within the Annual Report & Financial Statements, including references to colleagues, should be considered in this context.

Strategic Report

Chairman's Statement

For the year ended 30 September 2020

Before commenting on the financial year ended 30 September 2020, I begin my statement with an apology on behalf of the Board to all stakeholders for the delay in publishing this report and for the reporting, control and governance shortcomings that caused this delay. For further details please refer to pages 28 to 31 of the Completion of the Annual Report & Financial Statements section.

Post 30 September 2020 events

Accounting errors and misstatements, initially identified by the Bank's new Chief Financial Officer, as a result of audit enquiries, resulted in trading in the Group's shares being suspended on 19 May 2021 after discussions with the Group's nominated adviser ('NOMAD').

This situation has been deeply concerning, unsatisfactory and a huge disappointment to the Board.

Putting it right

Since the discovery of and in response to these events the Board has taken, and is in the progress of taking, the following actions:

- 1) Discovery and Investigation;
 - Commissioned PricewaterhouseCoopers LLP ('PwC') to conduct independent forensic investigations into accounting errors and misstatements, see page 28 for more information.
 - The Finance team then reviewed the output of the PwC investigations and also performed a further detailed review of the Bank's balance sheet. Details of this finance review, overseen by the CFO is set out in the Completion of the Annual Report & Financial Statements section on pages 28 to 31.
 - Appointed Garry Stran as Interim Chief Executive Officer to lead the Group and the remediation programme.
- 2) Short-term mitigation;
 - New executive appointments in the key roles of Chief Risk Officer, Chief Operating Officer, General Counsel, and Chief of Staff, bringing significant industry knowledge and experience.
 - Strengthen the Risk, Finance and Change functions to deliver the short-term 'repair' activity, whilst supporting the longer-term, more efficient, sustainable solutions.
 - Instigated cultural change initiatives in advance of a wider Culture Programme, focusing on understanding personal responsibility for risk, active listening and speaking up. This includes clear and open communications to all our stakeholders whilst adhering to market rules.
 - Initiating longer-term programmes to deliver the required changes in financial control and culture that will underpin the Bank now and into the future.
- 3) Longer-term sustainable solutions;
 - Deliver and embed a Culture Programme across the Bank as part of building back our reputation with key stakeholders.
 - Deliver and embed a comprehensive Risk Management Framework ('RMF'), embedding this across the Bank, in conjunction with the planned appointment of a Senior Independent Director to the Board.
 - Deliver the Finance transformation programme focused around financial controls and the provision of timely and accurate data.
 - Continue our investment in IT systems to develop a technologically advanced digital and modern operating platform replacing residual manual processes.

Strategic Report (cont'd)

The discovery and investigation phase is complete, with short-term mitigation actions in place. We are mobilising the programmes to deliver sustainable solutions, demonstrating our long-term commitment to change.

Business' performance for the year ended 30 September 2020

Turning to the Bank's business performance for the year ended 30 September 2020, the pandemic was completely unforeseen and has presented individuals, families, businesses and economies with challenges not seen in living memory. However, with significant effort and support from all colleagues, the business remained operational throughout, whilst maintaining customer and colleague wellbeing.

I therefore thank all my colleagues for their efforts and dedication to serving the Bank's customers through a hugely challenging period for everyone.

Profitability, balance sheet strength and the effect of the pandemic

Net operating income increased by 26% in the twelve months driven by strong loan growth which more than offset the reduction in the net interest margin which reflected a particular focus on a tightening of the Group's credit risk appetite throughout the pandemic. Lending in the Consumer Finance Division ('CFD') and Bridging Finance was strong, while Business Finance experienced lower demand due to competing Government support schemes such as the Coronavirus Business Interruption Loan Scheme ('CBILS'). The continuing presence of similar schemes will restrict growth in this segment.

Operating expenses, excluding the impairment on investment in subsidiaries and credit impairment charges, were well managed but increased to support the growth of the business. As a result, profit before tax, excluding the impairment on investment in subsidiaries and credit impairment charges, increased to £13.7 million (2019 – £10.2 million), demonstrating that the core business performed well.

The Bank's credit impairment charge increased significantly in 2020 to £10.0 million (2019 – £3.3 million), reflecting the impact of COVID-19 and a more cautious economic outlook on future expected losses. Under IFRS 9, credit impairment charges cover the potential future losses which would arise from the effects of COVID-19 on the performance of the loan book. The charge for the year also includes the £3.7 million increase to impairments on defaulted receivables⁽¹⁾, resulting from revisions to recovery expectations against those exposures. There are also additional specific provision increases related to forbearance and COVID-19 provisions (£1.0 million) and customer specific provisions (£1.1 million).

This resulted in the Bank generating a statutory loss before tax of £(0.9) million (2019 – profit of £8.9 million). The loss after tax was £(1.1) million (2019 – profit of £7.8 million), equivalent to a return on equity of (2.0)% (2019 – 17.1%).

The Bank's net assets decreased to £53.2 million (2019 – £54.2 million). At 30 September 2020, the Bank's total capital ratio of 18.1% (2019 – 18.2%) was above the regulatory requirement. Liquidity was managed in excess of risk appetite and regulatory requirements throughout the period.

Governance and culture

The discovery of reporting, control and governance shortcomings is hugely disappointing. The management team is absolutely focused on building the tactical initiatives already undertaken into a full cultural programme of change alongside RMF.

The commitment of colleagues continues to be one of the Bank's greatest strengths. The Board and management have supported and will continue to support colleagues with a safe, healthy working environment and with increased communications, training and development to enable each of them to achieve their potential. The Board is determined that the Bank, alongside cultural change, will drive programmes around governance and financial control. This will provide a fit for purpose, long term and sustainable plan and deliver the improvements identified, which in turn will create the foundations to build long-term value for stakeholders.

(1) receivables that were either seriously in arrears or where the asset which acted as security for the receivable had been sold and a balance of the receivable remained outstanding.

Strategic Report (cont'd)

Outlook

This outlook should be read in conjunction with the emerging risks and uncertainties section on page 21.

The Bank has a well-established business model, which gives the Board confidence that the business will overcome the current challenges and return to growth over the medium term.

Increased operating costs are expected as the Bank significantly increases headcount and the investment in IT to improve and embed the new reporting controls and systems. In addition, the Bank expects to incur high remediation costs while it addresses the issues identified and implements the required remediation actions.

Conclusion

In conclusion, whilst the Bank has faced substantial difficulties, the Board is confident that the business is on the path to recovery from these challenges, after which all colleagues will be able to turn their full focus to the delivery of sustainable profits and long-term value for all stakeholders.

T A Franklin

Chairman

22 DECEMBER 2021

Strategic Report (cont'd)

Chief Executive Officer's Review for the year ended 30 September 2020

This is my first report as Interim CEO following my appointment in May 2021. The circumstances that led to my appointment have created many challenges for the business in addition to those already in existence due to COVID-19, and these challenges have dominated my time in the role to date.

I regret that the time since my appointment has been an uncertain one for all stakeholders, but it was absolutely essential that my team and I focused on carrying out the review of the Bank's financial controls and processes to ensure that we could plan for the future with confidence. The issues facing us were inter-linked and complex and have taken time to resolve. For further details please refer to pages 28 to 31 of the Completion of the Annual Report & Financial Statements section.

Moreover, I thank all my colleagues who make up the PCF team for their commitment and support during a difficult period. Many of them are long serving and have been devastated by the discovery of the issues that have so consumed us over the last few months. This, combined with the challenges of the pandemic, including working remotely for 18 months, has undoubtedly resulted in many colleagues experiencing circumstances in their work and personal lives that they would never wish to see repeated. Their commitment and desire to see PCF repair its reputation is clear to me and the executive team.

Turning to business performance, taking account of the pandemic impacts and before the higher one-off impairment charges, the underlying business performance of our core business was resilient.

Response to the pandemic

The second half of the financial year to September 2020 was disrupted by the operational and economic impacts of the pandemic. The business acted swiftly to deploy home working and supported by our technology team, our entire team was working from home within days without business interruption.

Throughout the pandemic period, our focus has been on protecting our core assets – our people, our customers and our balance sheet. These have been challenging times for both our colleagues and our customers and of particular importance to us was our effort to support colleague well-being and to assist customers who may have suffered hardship through no fault of their own.

In respect of our colleagues, we have put in place support mechanisms and new ways of working which have enabled them to have the flexibility to continue to contribute fully to our business whilst ensuring that they are able to dedicate time to take care of themselves and their loved ones. We are proud of the way they have risen to the challenges they have faced.

Where our customers have approached us to assist them, we have met our regulatory obligations, supporting customers with payment deferral plans where necessary. However, at 30 September 2020 less than 8.5% of the value of our loan book was in forbearance or COVID-19 related payment deferral plans.

Trading and profitability

In the twelve months to 30 September 2020, the Bank incurred a statutory loss before tax of £(0.9) million (2019 – profit of £8.9 million). This was driven by a significant increase in credit impairment charges which more than offset the increase in net operating income.

Net operating income of £24.5 million increased 26% in the year (2019 – £19.5 million) and was supported by loan growth, particularly in Consumer and Bridging finance. Net loans and advances to customers increased to £409 million (2019 – £315 million). The quality of new business improved, with 85% of business written in our highest credit grades, compared to 73% in 2019. Whilst this improved the overall quality of the loan book, it has led to some compression to the Bank's net interest margin which fell to 6.9% (2019 – 7.8%).

Strategic Report (cont'd)

Operating expenses, excluding impairment on investment of subsidiaries and credit impairment charges, increased to £13.7 million from £10.2 million in 2019. The Bank's cost:income ratio¹ increased to 56.1% (2019 – 52.6%).

Profit before tax, excluding impairment on investment of subsidiaries and credit impairment charges, increased to £13.5 million (2019 – £12.2 million).

The Bank's credit impairment charge increased significantly in 2020 to £10.0 million (2019 – £3.3 million), reflecting the impact of COVID-19, a more cautious economic outlook on future expected losses and significant items of £5.8m set out below. Under IFRS 9, credit impairment charges cover the potential future losses which would arise from the effects of COVID-19 on the performance of the loan book. The charge for the year also includes the previously announced £3.7 million increase to impairments on defaulted receivables, resulting from revisions to recovery expectations against those exposures. There are also additional specific provision increases related to forbearance and COVID-19 provisions (£1.0 million) and client specific provisions (£1.1 million).

The Bank's impairment charge for the year, as a percentage of average gross loan balances, was 2.7% (2019 – 1.3%). The IFRS 9 expected credit loss provision on the balance sheet, as a percentage of gross loan balances, increased to 3.4% (2019 – 1.5%).

As a result, the Group generated a loss before tax of £(0.9) million (2019 – profit of £8.9 million). After tax, this represents a return on equity of (2.0)% (2019 – 17.1%).

The Bank also received £2.75m in dividends from its subsidiary companies during the year, although this was more than offset by the impact of a £4.4m impairment charge in respect of the carrying value of those subsidiaries.

Business lines and portfolio quality

New business origination in the year increased 15% to £241 million (2019 - £209 million) which is a strong performance in the context of the pandemic with the diversification into Bridging finance contributing to that success.

The quality of new business origination continued to improve with 85% of originations in our highest credit grades, compared to 73% in the previous year.

The total gross loan book grew to £423 million (2019 - £320 million) and the overall quality of the loan book improved, with 78% of the portfolio in our highest credit grades (2019 - 68%).

The Bank continued to be cash generative through all trading months by way of a combination of the embedded recurring cashflows from our loan book and a continued focus on cost control.

Segmental business review

Consumer finance division

The used motor vehicle finance market has proved resilient throughout the period. After an initial fall in demand following lockdown in March 2020, new business origination picked up in May 2020 and further increased when dealerships re-opened on 1 June 2020. This is consistent with data on used car sales and used car asset values. The leisure market has also been buoyant, in particular for motorhome finance, as a greater number of people took holidays in the UK.

New business originations in the year were £91 million (2019 - £73 million), an increase of 24%, and the loan book grew by 35% to £168 million (2019 - £125 million). Credit quality was strong with 93% of originations in our highest credit grades (2019 - 80%), and we have maintained cautious underwriting terms in respect of loan to values.

Levels of forbearance and COVID-19 related payment deferrals in this portfolio are relatively low at less than 4% of balances at 30 September 2020. The impairment charge for the year was £3.5 million (2019 - £1.3 million).

¹ Cost:income ratio calculated excluding impairment on investment of subsidiaries and credit impairment charges.

Strategic Report (cont'd)

Business finance division

New business origination in this division has been more noticeably affected by lower demand. Sole traders and small companies understandably deferred investment decisions and, where working capital can be accessed through one of the Government's support schemes at preferential terms, our asset finance products have become less competitive. We remain focused on prudent underwriting as the difficult trading conditions for most small and medium-sized enterprises ('SME') raises questions about the long-term sustainability of SME financial commitments.

New business originations in the year were £81 million (2019 - £120 million), a decrease of 33%. However, the gross loan book was up by 8% to £186 million (2019 - £172 million) with 78% of origination in our highest credit grades (2019 - 71%).

Levels of forbearance and COVID-19 related payment deferrals have been high in this portfolio but had reduced to 13% of balances at 30 September 2020. The impairment charge for the year was £5.8 million (2019 - £2.0 million).

Azule

Azule Limited ('Azule'), PCF's specialist broker of funding for the broadcast and media sector, has been particularly affected by the lockdown with TV, film, sports, and live events all severely impacted. In the second half of the year the division focused its activity on assisting customers with applications under the UK Government's CBILS scheme. The business has more recently seen increased activity as the sector returns to business as usual.

During 2019, the Bank began to write business under the Azule brand, generating new business originations in the year of £8 million (2019 - £2 million). At the end of the year the loan book in relation to Azule finance stands at £8 million (2019 - £10 million).

The impairment charge for the year was £0.2 million (2019 - £nil).

Bridging finance

This division has seen strong demand. The Bank took advantage of several non-bank competitors withdrawing from the market in the early months of the pandemic and this has allowed us to build relationships with new introducers. We are pleased with the quality and terms of business in this market and encouraged by the performance and outlook for this sector.

Originations in the year were £61 million (2019 9 months - £14 million) and from a small base this division has been a key contributor to the Bank's asset growth with a gross loan book of £61 million (2019 - £13 million). We lend primarily on residential property with first charge security and conservative loan to values.

While the portfolio experienced no actual losses in the year, the IFRS 9 Expected Credit Loss provision for potential future losses was £0.5 million (2019 - £nil).

Savings

We continued to offer a range of good value savings products through the year, increasing savings balances to £342 million (2019 - £267 million) demonstrating our ability to raise funds as required at rates which facilitate our business objectives. The Bank offers a range of fixed term and notice accounts that are designed to offer good value to our retail customers whilst meeting our need to manage the liquidity and interest rate risks associated with our loan books. Savings customer numbers grew to over 7,950 in 2020, from just over 6,100 in 2019.

Capital management and treasury

The Bank entered the pandemic period with a diversified funding model utilising retail deposits, wholesale debt and drawings from the Bank of England's Term Funding Schemes. At 30 September 2020, we had drawn £62.4 million (2019 - £25 million) from TFS and TFSME and held £342 million in retail deposits (2019 - £267 million). Our retail deposits have been relatively consistent, with an average balance of £42,500 (2019 - £42,200).

Strategic Report (cont'd)

The Bank's cost of funding fell to 1.7% (2019 - 2.1%) and we retain a strong liquidity position with a Liquidity Coverage Ratio of 1,238% at 30 September 2020 (2019 – 1,346%).

The Bank had a total capital ratio of 18.1% (2019 – 18.2%) which exceeds our regulatory minimum total capital requirement. The Bank has utilised its Tier 2 capital facility, issuing a total of £7 million of subordinated notes to British Business Investments Limited (BBI) between November 2019 and May 2020 (2019 - nil). Prudent management of capital resources has been a particular focus since the start of the pandemic.

Regulatory capital and ratios are set out in the Risk Management Report on pages 38 to 57.

2021 strategic objectives, current trading and outlook

This outlook should be read in conjunction with the emerging risks and uncertainties section on page 21.

The objectives for 2021 were to maintain and stabilise the business following the pandemic, to maintain credit quality and to continue to invest in our IT infrastructure. Events have overtaken a significant part of our strategic objectives and whilst we have remained focused on the credit quality of our lending and continued investment in our IT infrastructure, a significant amount of management time has inevitably been directed to the remediation activities highlighted elsewhere in this report.

As a result of the current position in respect of our controls framework and the pandemic, we have taken the decision to manage our lending volumes carefully to ensure that the next stage of our development is built on firm governance, culture, systems and controls, and we continue to focus on maintaining credit quality.

However, once our planned remedial actions have been completed, we will be well placed to return to a strategy of controlled and prudent growth.

Implementation of the remediation plan

I anticipate the implementation of our remediation plan by the executive team will take a further 18-24 months to fully complete.

The aim of this plan is to build firm foundations for the future growth of the business and to restore confidence with our key stakeholders.

The Bank's transformation programme started with experienced financial services hires joining my executive team including a General Counsel, a Chief Risk Officer, and Chief of Staff, and a replacement Chief Operating Officer. This strengthened executive team is already making significant change.

Strategic Report (cont'd)

Conclusion

Despite the challenges, the core competencies within our customer-facing business remain strong and we have long established relationships with our customers and intermediaries.

Our core operating platform and balance sheet are robust and through utilisation of an increased headcount, assistance from our external advisers, and close governance, we will successfully deliver the transformation required. Combining this with a new progressive ethos, the underlying strength of the business model and the direction that the executive team will give will make the Bank unrecognisable when compared to the past. This will be supported by a data driven, automated and digitalised operating platform providing remarkable service and products to drive shareholder value.

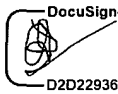
We remain confident that the opportunity for growth will return once our remediation is complete. We have relatively small shares of our chosen lending markets and the potential to grow them and to develop new products remains unchanged.

I am proud to be leading the PCF team towards a brighter future and thank all my colleagues at PCF and our investors, regulators, and all stakeholders for the patience they have shown during these difficult times. Finally, I join the Chairman in apologising once again for the legacy challenges faced by the business and the impact on our stakeholders.

GG Stran

Interim Chief Executive Officer

22 DECEMBER 2021

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Strategic Report (cont'd)

Market and Business Overview

The market and business overview stated below has described our performance for the year ended 30 September 2020.

PCF Bank. At your service

The Bank offers a range of savings products for retail customers that are term or notice. The Bank offers straightforward lending products using loans, conditional sales, hire purchases and finance lease agreements which are available to individuals and businesses. Lending customers primarily repay through monthly instalments, and we maintain a focus on ensuring that these payments are affordable.

We seek to improve our service to our customers, intermediaries and dealers by adopting technology to simplify and speed up processes.

Borrowers

The Bank categorises its borrowing customers according to their type and needs and supports them with four lending divisions:

- SMEs and business owners requiring finance for vehicles, plant and equipment are supported by the Group's Business Finance Division ('BFD').
- Consumers' needs for motor vehicle finance are met by the Consumer Finance Division ('CFD').
- Specialist finance for business customers in the broadcast and media industry is arranged by Azule.
- Professional property investors requiring finance for bridging, refurbishment and developer exit are supported by Bridging finance.

The Bank's two largest and most established lending divisions, CFD and BFD, provide hire purchase and finance lease facilities to consumers and corporate customers respectively. Both divisions operate a finance broker-introduced model, which provides a cost effective route to market and enables a national presence without the costs of a sales force. Some repeat business is also achieved directly with existing customers. CFD specialises in financing used motor vehicles. BFD specialises in financing a wide range of vehicles including cars, light and heavy commercial vehicles, coaches, buses and minibuses. In addition, it finances equipment for the construction, engineering and manufacturing industries.

Azule specialises in originating financing for equipment such as cameras, lenses, audio-visual equipment, lighting and post-production equipment. This business is sourced through direct relationships with manufacturers, distributors and customers.

In early 2019, the Bank established the Bridging finance division and since then has built a team of experienced industry professionals. The business is sourced from brokers and repeat customer relationships.

Lending activities by CFD, BFD and Azule are undertaken solely within the United Kingdom and are denominated in sterling. Bridging finance also lends exclusively in sterling and operates in England and Wales only.

The Bank's portfolio risk is managed and diversified through asset-backed lending, providing a wide spread of risk by asset type, contract size, industry sector and UK geographical spread.

Strategic Report (cont'd)

Our lending philosophy

The Bank's lending philosophy is to:

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

Savers

The Bank accepts sterling denominated deposits from UK resident individuals, with products targeted at specific customer segments, namely:

- Customers looking to maximise their return whilst preserving capital and who are willing to commit to leave their money with the Bank for an agreed term are offered competitive fixed term, fixed rate deposit products with terms of between twelve months and 84 months.
- Savers requiring more immediate access to their money have the option of competitive variable rate accounts with notice periods of 100 and 180-days.

The Bank offers online and telephone service to its savings customers, enabling them to service their accounts in the way they prefer.

For customers whose fixed term deposits are nearing maturity, the Bank ensures that it offers a full range of renewal products with fixed rates that are at least as attractive as those offered to new depositors.

Strategy for 2020

The Bank's strategic objectives for the year ended 30 September 2020 were to:

- Launch our new streamlined, automated decisioning system for consumer motor finance, as well as a more 'prime proposition'.
- Trial new direct to consumer products on the new consumer finance platform.
- Build out our Bridging finance division beyond the pilot initiative.
- Improve our customer journey for savers and borrowers with additional online functionality.
- Optimise technology across the organisation to support scale and gain efficiencies.

Whilst we were successful with a number of these objectives, in particular, those relating to our CFD and Bridging finance divisions, some were curtailed by the onset of the pandemic in March 2020. Our new, automated decisioning system for consumer motor finance and the launch of a prime proposition into that market were undoubted successes, resulting in CFD increasing gross new business originations by 24% to £91million. Similarly, Bridging finance achieved a year of significant growth, meeting the objective of lending £61 million. Work is underway to increase the level of automation across all our operations.

The Bank's new business originations across the four lending divisions combined was £241 million (2019 – £209 million). The pandemic obviously had an impact on origination levels, especially in the early months of lockdown when they fell quite dramatically. This was followed by an encouraging rebound in the summer months. The impact of the pandemic is best highlighted by the difference between origination levels in the first half of the year, £134 million, and the second half, £107 million, and by the differing results in each of our lending divisions, which saw growth in CFD, Bridging finance and Azule, but a reduction in new business originations in BFD.

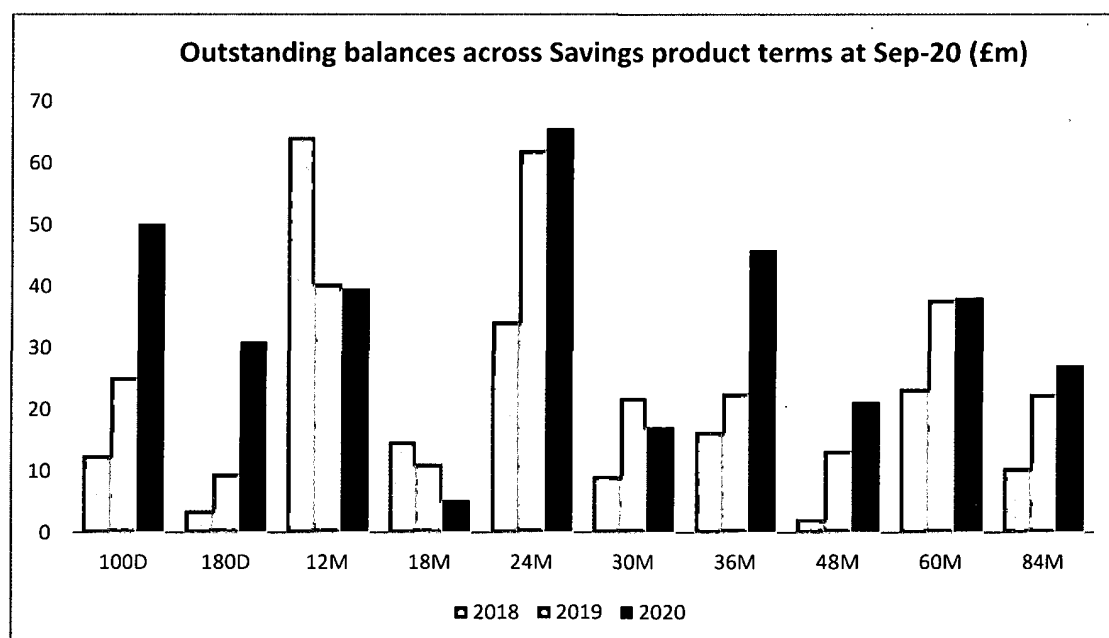
Strategic Report (cont'd)

The total of £241 million was comprised of:

- Business Finance £81 million (2019 - £120 million)
- Consumer Finance Division £91 million (2019 - £73 million)
- Azure £8 million (2019 - 11 months - £2 million)
- Bridging finance Division £61 million (2019 - 9 months - £14 million)

Savings

Amounts on deposit with the Bank increased from £267 million to £342 million to fund the growth of the lending operations. We now have over 7,950 savings customers as of 30 September 2020. We offer an online application process to all our customers, using our own portal, which is both quick and simple to understand and operate. On-line applications are typically completed and the account opened within 15 minutes.



Key

M – Months

D – Days

The average deposit balance has been relatively stable at approximately £42,500 (2019 - £42,200)

Strategic Report (cont'd)

Business Finance Division

BFD provides hire purchase and finance lease agreements to sole traders, partnerships and limited companies to help them acquire vehicles, plant and equipment. Lending is typically for up to 5 years with longer terms of up to 10 years for specialist niche assets. The average transaction size of agreements written in 2020 was approximately £46,800 (2019 - £45,200).

Vehicle and asset finance are commonly used sources of finance for businesses, providing significant cash flow benefits for those using them. The market in the UK is both mature and vast, with the Group having a share of less than 1%. (2019 – less than 1%).

The business asset and vehicle finance markets were affected by the pandemic, in particular during the period April to June 2020 when new business lending dropped to its lowest levels since 2014.

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

The division's activities were noticeably affected in the second half of the year by the pandemic, which resulted in many SMEs putting their investment plans on hold or using the UK Government's Coronavirus Business Interruption Loan Scheme ('CBILS') and Bounce Back Loan Scheme ('BBLs') as a preferable form of finance than that offered by the Bank. Volumes in the second half of the year totalled only £14 million, compared to £67 million in the first half. Consequently, new business origination levels for the full year were below our forecasts at £81 million (2019 - £120 million). COVID-19 also caused us to review our risk appetite, resulting in the percentage of business written to customers in our top four credit grades increasing from 71% to 78%. We will keep our lending strategy, and the focus on the higher quality risk grades, under review.

Notwithstanding the fall in new business originations since September 2019, the division's gross lending portfolio was up by 8%, with new business replacing maturing agreements. At 30 September 2020 gross lending was £186 million (2019 - £172 million). The portfolio is made up of approximately 5,500 agreements (2019 – 5,200) individual agreements with an average balance of approximately £33,870 (2019 - £33,030) with no customer having an aggregate exposure of more than 1% (2019 – 1%) of the Bank's total portfolio. Most of our largest customers are longstanding, with many of them having had agreements with the Group for more than 10 years.

We expect demand for our Business Finance products to remain subdued in the coming year due to the economic situation and the continuation of the Government's financial support schemes. We will remain cautious in our risk appetite during this period.

Consumer Finance Division

CFD provides hire purchase and conditional sale agreements to retail customers. Whilst most of the finance we provide is in respect of motor cars, we also have specialist knowledge to enable us to finance classic cars, caravans, motorhomes and horseboxes. Most of the vehicles financed are used, so have suffered their initial depreciation and, therefore, represent good collateral to support our finance. CFD provides terms of up to five years on cars and up to ten years on leisure vehicles. The average transaction size of agreements written in 2020 was approximately £18,000 (2019 - £17,100).

The consumer car finance market experienced a contraction during the year as a result of the lockdown in spring 2020, when many dealerships were forced to close temporarily and business picked up strongly when they re-opened on 1 June 2020. Terms of business over the past three years has progressively limited exposure to diesel cars.

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

Strategic Report (cont'd)

During the year ended September 2020, we launched an improved product to the broker base aimed at attracting increased business volumes through technology led automated decisioning functionality to support the point-of-sale market. The proposition, which provides instant credit and affordability assessments in line with our responsible lending guidelines, proved to be a success, particularly following the onset of the pandemic lockdown in March 2020 as independent, non-bank competitors withdrew from the market or cut back on their lending activities.

In addition, the Bank's offering in the leisure vehicle market continued to be well received and during the peak season of June to August 2020 accounted for over 60% of all business written in CFD. The Group now has an established foothold and good reputation in this specialist market where there are only a handful of competitors.

The Bank's CFD portfolio increased by 35% during the year from £125 million to £168 million.

The portfolio is made up of approximately 12,370 (2019 – 10,420) individual agreements with an average balance of £13,620 (2019 - £12,000). Our highest credit grades now account for 82% (2019 – 69%) of the total portfolio and we will keep this strategy under review.

In January 2021, we introduced new commission structures for our motor finance products, in line with new FCA rules and guidance, and will closely monitor these to ensure we remain competitive in our chosen markets.

Azule

In 2018 the Bank acquired Azule, a broadcast and media lending and broking specialist. Azule provides direct to end user asset finance origination in the UK and across Europe to niche markets, including broadcast and media, sound, lighting and audio visual. It finances assets such as cameras, lenses, sound equipment, lighting equipment, post-production equipment and audio-visual equipment. Business is generated through direct end user relationships along with manufacturer, distributor and dealer introductions. The broadcast and media loans are either written on the Bank's balance sheet or placed with other banks for which Azule receives a commission. Loans placed with other banks are done so for risk, pricing and exposure reasons. Azule has historically operated across Europe to support its manufacturers, funded by local partner banks for which Azule receives a commission. New business originations increased from £2 million last year to £8 million in 2020.

Whilst there continue to be concerns over the economy, the pandemic and the impacts of both on the broadcast and media sector, the film and television sector is likely to see an improvement as a direct result of streaming services such as Netflix, Disney+ and Amazon Prime. The need for these providers to produce high-end content is driving demand for services and studio space across the UK. Both Netflix and Disney have made long-term commitments to the UK by signing leases for studios at Pinewood and Shepperton.

Bridging finance

The division launched its first product in early 2019. It provides unregulated Bridging finance facilities to experienced property investment businesses, ranging from sole traders to partnerships and limited companies, secured on residential and commercial real estate in England and Wales. The primary focus is lending for the purchase, refinance and refurbishment of property. Facilities are typically for between 6 and 18 months with a maximum loan to value of 75%, and the Bank wrote £61 million of bridging business in the year (2019 - 9 months - £14 million).

Strategic Report (cont'd)

Short-term finance for developers has been the predominant product, accounting for 45% (2019 – 13%) of all business and benefitting from a noticeable increase in transactions between April and June 2020 as we took the opportunity to gain a greater foothold in the market whilst competitors took defensive positions withdrawing or cutting back on lending activities. Traditional Bridging finance has accounted for 41% (2019 – 55%) of business and refurbishment finance for 14% (2019 – 32%). 81% (2019 – 82%) of business written was on residential properties with the other 19% written on semi-commercial and commercial properties.

Bank portfolio performance

The portfolio increased by 32% from £320 million to £423 million.

Due to the growth in CFD and Bridging finance, the composition of the Bank portfolio by division has changed over the course of the year:

	Sep-20		Sep-19	
	£'000		£'000	
Business Finance Division	186,120	44%	171,692	54%
Consumer Finance Division	168,439	40%	125,126	39%
Azule	8,125	2%	10,309	3%
Bridging finance	60,612	14%	12,955	4%
Gross lending	423,296	100%	320,082	100%

As noted in the Group's announcement on 28 June 2021, certain intercompany transfers between the Bank and Azule were not supported by legal assignments over the period between December 2018 to October 2019. As at 30 September 2019, the Bank's Loans and Advances to Customers included £8.3m that had not been legally assigned from its subsidiary Azule. The Bank's receivable from Azule is therefore understated by £8.3m. As the net impact on total assets is immaterial, the 2019 comparatives have not been restated. For further details please refer to pages 28 to 31 of the Completion of the Annual Report & Financial Statements section.

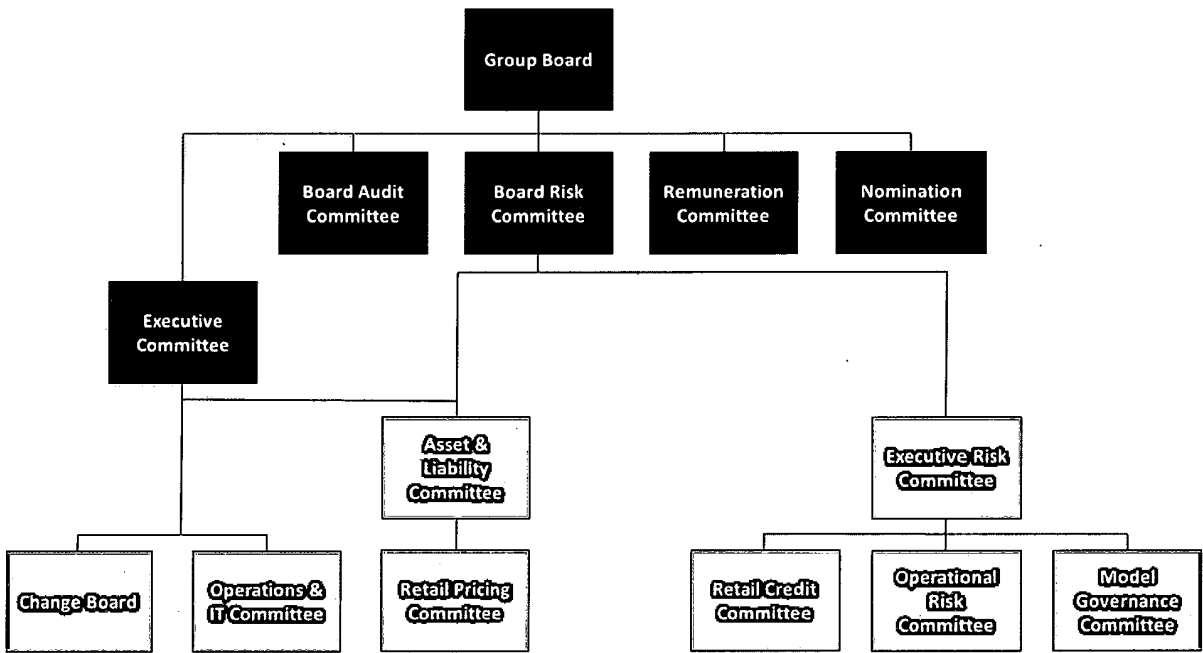
Our focus since becoming a bank in 2017 has been to grow the business in distinct segments of our chosen markets. Our portfolio is secured on vehicles, equipment and property assets.

Forbearance levels were impacted by the COVID-19 pandemic but recovered during the year.

Strategic Report (cont'd)

Corporate Governance Structure

The Group's corporate governance structure is as set out below. The Bank's operations account for nearly all of the Group and its subsidiaries' operations and in this section (and throughout these reports) references to the Group corporate governance structure incorporates and covers the Bank, unless stated otherwise, and that due consideration of the Bank's operations has been given by the respective committees referenced.



Membership

Directors
Executive Directors and Senior Executives
Executive Directors, Senior Executives and nominated Heads of Department

Board

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

Strategic Report (cont'd)

Responsibilities of the Audit & Risk Committee and subsequently the Board Audit Committee

- Monitor the integrity of the Group's and Bank's financial statements by debating and challenging critical estimates and accounting judgements and overseeing the external audit.
- Advise the Board on the Group's overall risk appetite, tolerance and strategy¹.
- Oversee the internal audit plan and effectiveness of the fully outsourced internal audit function provided by Grant Thornton.
- Monitor the external auditor's independence and objectivity and assess the effectiveness of the external audit process.
- Assess and monitor the activities and effectiveness of the Risk and Compliance function¹.
- Oversee whistleblowing arrangements. The Chair of Audit & Risk Committee ('ARC' and now Chair of Board Audit Committee 'BAC') is the Whistleblowing Champion and an independent point of escalation in accordance with the Group's Whistleblowing Policy.
- Review procedures in place for detecting fraud and financial crime and preventing bribery and money laundering¹.
- Review and approve assumptions and stress scenarios in the planning stage of the Internal Capital Adequacy Assessment Process ('ICAAP') and Internal Liquidity Adequacy Assessment Process ('ILAAP'), including substantive changes to the previous assessment¹.

¹As a result of the separation of the Audit & Risk Committee, these responsibilities passed over to Board Risk Committee on its establishment.

Responsibilities of the Board Risk Committee

- Review and advise the Board on the Group's overall risk appetite, tolerance & strategy.
- Review and advise the Board on the adequacy of the Group's RMF.
- Review and advise the Board on the Group's compliance with prudential requirements.
- Advise the Board on the risk aspects of proposed changes to strategy and strategic transactions.
- Safeguard the independence, and oversee the performance, of the Group's Risk Function including the sufficiency of resources.
- Monitor and review the effectiveness of the Group's risk management and risk related internal control systems.
- Oversee adherence to the Group's risk principles, policies and standards.
- Review exceptions and breaches to Board approved policies, including lending outside of Credit Policy.
- Oversee the risks associated with the Group's complex and material financial models.
- Review the procedures in place for detecting fraud and financial crime and preventing bribery and money laundering.
- Review and approve the assumptions and stress scenarios in the planning stage of the ICAAP and ILAAP.

Remuneration Committee

The Remuneration Committee has delegated responsibility from the Board for reviewing the performance of the executive directors and the remuneration of the directors and other senior executives.

Executive Committee

The Board has delegated its day-to-day management responsibilities to the Executive Committee ('ExCo'), which meets monthly to deliberate and take policy decisions on the effective and efficient management of the Group and to monitor its performance. ExCo's primary responsibility is to ensure the implementation of strategies and culture approved by the Board, provide leadership to the senior management team and ensure appropriate deployment of the Group's resources, including capital and liquidity.

Strategic Report (cont'd)

Risk Overview

Risk is a natural consequence of the Bank's business activities and the environment in which it operates. Managing risk is therefore essential to the Bank and is fundamental to the successful implementation of its strategy.

Following the announcements made by the Group in 2021 and the events that led to them, including the delay to the Annual Report and Financial Statement, see page 28, significant remediation work has been, and continues to be, undertaken. A strong culture of risk awareness, listening and speaking up need to be at the heart of PCF and its RMF. Strong frameworks guide colleagues' approach to their work, the way they behave and the decisions they make. They make clear the type and level of risk that the business is prepared to tolerate in pursuit of its business objectives; the 'risk appetite'.

Through its recently launched culture project the Board seeks to ensure that the Bank actively embraces a culture of risk awareness, where colleagues are accountable for assessing, controlling, and mitigating risks; where colleagues are encouraged to speak up if they see something that does not look or feel right; and where any concerns will be listened to. Colleague performance management and reward practices will all have key risk inputs and a focus on risk management in their design. The Bank aims for colleagues to be risk aware and to strike the right balance between delivering on objectives, individual accountability and maintaining a safe and secure business.

Risk within the Bank is managed using a 'Three Lines of Defence' model, separating risk origination (First Line) from risk oversight (Second Line) and internal audit (Third Line). Controls and expertise are being strengthened across the two internal lines of defence (First & Second), and significant additional Third Line assurance is now being provided by external parties. The Corporate Governance structure, described on pages 18 to 19, includes the Executive Risk Committee (ERC) and the Audit & Risk Committee which has subsequently separated into the Board Risk Committee (BRC) and Board Audit Committee (BAC). The Board acknowledges its systems and controls did not operate to prevent the financial and regulatory misstatements that have come to light since 30 September 2020, and it is remediating this.

Risk strategy

The Bank has defined its risk management objectives and strategy and is building up the culture of risk awareness. Ongoing activities that continue to support the strategy include:

- Strengthening the RMF and control environment to be appropriate for future business aspirations.
- Articulating the Bank's risk profile, ensuring that principal and emerging risks are appropriately identified, owned and managed.
- Defining risk appetite and ensuring that the strategic plans are consistent with it.
- Ensuring risk appetite metrics are proportionate and regularly reported to the Group's ERC, ExCo, BRC and the Board to support oversight and the scope of mitigation strategies.
- Ensuring an appropriate return for risks taken within product pricing.
- Continuing to develop the Risk function with programmes covering the independent oversight of business risk exposures, and comprehensive risk and compliance monitoring.
- Utilising stress testing to support a robust business strategy which is able to withstand a range of adverse conditions.
- Reviewing remuneration practices to ensure these do not detract from prudent risk taking.
- Providing enhanced risk and compliance awareness sessions to all employees.

The Board focuses on the principal risks that could prevent the Bank from achieving its strategic objectives.

Strategic Report (cont'd)

Principal risks

Principal risks are the inherent risks faced by the Bank in pursuit of its strategic objectives.

The Bank has identified eight principal risks that could impact the delivery of its strategic objectives, and each has a Board approved risk appetite. The RMF identifies ownership, responsibilities, management approaches, mitigants and controls. Each of these risks is defined and considered in more detail within the Risk Management Report on pages 38 to 57. In future reporting periods Climate Change risk will be added as an additional Principal risk.

- Strategic and business risk
- Credit risk
- Capital risk
- Liquidity and funding risk
- Market risk
- Operational risk
- Regulatory risk
- Conduct risk

Emerging risks and uncertainties

Corporate governance and the RMF need to operate effectively to manage risk appropriately, with the Bank focused on delivering improvements in both these key areas. Emerging risks and uncertainties are either newly identified risks with the inherent potential to impact the Bank's strategy, business model or material performance; or a previously identified principal risk where the residual risk has materially increased.

COVID-19 and macro-economic uncertainty

Uncertainties arising from the longer-term impacts of COVID-19 continue to affect many of the key risks faced by the Bank.

As COVID-19 financial support measures unwind, including the loan payment deferral scheme, job retention and various other lending schemes available to small business, the impact on credit arrears and losses is not clear. The Bank has so far seen that the majority of its customers who had requested COVID-19 related payment deferrals have returned to full servicing of their loans. The Bank continues to monitor this and any subsequent payment arrears that might result in higher credit losses closely.

PCF Bank is a member of the Sterling Monetary Framework (SMF) through which it obtains TFSME funding and liquidity facilities from the Bank of England (BoE). Such facilities are collateralised, and the BoE currently only accepts into its collateral pools business finance loan receivables written by PCF Bank that are not subject to the provisions of the Consumer Credit Act. The pandemic has significantly reduced the quantum of such loans written and as a consequence it may be necessary to redeem TFSME funding before its final maturity in 2024.

The pandemic has had an unprecedented impact on the world economy, with the Office for National Statistics (ONS) initially estimating a decline in UK GDP of more than 20% during the early part of 2020. Nevertheless, despite a downturn of 9.7% in 2020, the UK economy has rebounded significantly since vaccination against COVID-19 was rolled out in the first half of 2021. Therefore, as of October 2021 Oxford Economics (OE) is forecasting the UK economy to grow by 7.2% in 2021 and 5.7% in 2022.

OE identifies several risks to the UK economic recovery it forecasts for late 2021 and 2022. The greatest risk to this forecast comes from the potential for rising COVID-19 cases, especially as the weather cools and there is greater indoor mixing, which in turn could damage consumer confidence and discourage social consumption; and the reimposition of some restrictions cannot be ruled out. Rising unemployment is also a risk, given financial pressures on the corporate sector and the ending of the Job Retention Scheme at the end of September 2021. Inflation also presents a risk, with the potential for consumer price inflation to increase on the back of higher commodity prices, higher inflation expectations, and a disappointing recovery in labour market participation, which in turn leads to a downturn in domestic demand.

Strategic Report (cont'd)

While these macroeconomic risks are far from certain, if one or more materialise it may restrict market prospects for the Bank and increase the risk of loan impairments.

Implications of the delayed finalisation of the Annual Report & Financial Statements the resulting remediation project

As highlighted in the Chairman's Statement, accounting errors and misstatement uncovered by management as a result of audit enquiries have resulted in a delay in the finalisation of the Annual Report & Financial Statements (see pages 28 to 29). The Board is particularly conscious of the risk of potential impacts arising from this. The specific risks identified, together with appropriate mitigation, are reviewed by the Group's Board Risk Committee.

During this period of remediation, which commenced in the 2021 financial year, the Bank's cost base has and will continue to increase significantly, both in the short term, due to advisor fees and remediation activity, and in the longer term as the Bank ensures sufficiently qualified and experienced colleagues are in place to ensure an appropriate level of accountability, control and oversight.

We have kept in close contact with our regulators as we have finalised the Annual Report & Financial Statements and will continue to do so as we implement the necessary changes.

The remediation required in the Bank's control functions has dependencies on both systems and people and will take time to develop and fully embed. A culture programme, recently approved by the Board, with risk at its heart is also being implemented. There is a risk that the remediation required is not implemented effectively, on a timely basis, or to the required scope and expected cost. Additionally, there is the risk that whilst manual processes, controls and models persist and whilst the Bank's financial control framework is being further developed and implemented, new errors could arise in financial reporting. This together with the potential impact of ineffective remediation could result in increased cost, continuing higher levels of operational and people risk, an extended remediation period and further management distraction.

Recognising the particular importance of a successful remediation programme, the Bank has invested in additional senior change resources and updated the governance of change so that there is appropriate oversight of the remediation programme by the Executive Committee and the Board. This reinvigorated change governance will, once fully embedded, monitor and ensure progress on all change including the remediation programme and provide oversight to management and the Board.

As at 30 September 2020 and currently, capital and liquidity metrics were above regulatory requirements. However, options to access capital and financial markets are limited in the current circumstances, reducing the Group's ability both to raise capital and transact financial instruments for the purpose of interest rate hedging. There is a risk that the Bank may experience volatility in its profit and loss should it not be able to freely adjust its interest rate swap positions as facilities are currently restricted. Management believes that following the Annual Report & Financial Statements 2020 finalisation our bankers will reinstate these facilities once this has been reviewed. Management monitors the interest rate gap risk closely and, where required, seeks to hedge asset exposures naturally with appropriate tenor retail deposits.

The Bank has a term loan facility from the Bank of England under the Term Funding Scheme with additional incentives for SMEs (TFSME), a subordinated note facility from British Business Investments Limited (BBI) and a revolving credit facility from Leumi ABL Limited (Leumi). The Group and the Bank are required under the terms of the facilities to file their Annual Report & Financial Statements 2020 with BBI and Leumi. BBI has since agreed a further filing extension to 31 December 2021 whereas Leumi has not agreed a formal extension and the facility will be terminated by 31 December 2021.

Currently the Bank has £7 million drawn down under the BBI facility and no drawings under the Leumi facility. The Bank has agreed with BBI that no new drawings will be undertaken under the facility until the Annual Report & Financial Statements 2020 have been published. The Bank has agreed with Leumi that no drawings will be undertaken under the facility as the facility will be terminated by 31 December 2021.

Strategic Report (cont'd)

Regulatory risk and legislative change

The issues leading to the delay in the finalisation of the Annual Report & Financial Statements have been discussed extensively with both the Prudential Regulatory and the Financial Conduct Authorities. The control and other issues identified have resulted in an increased level of interaction with both regulators. The current position gives rise to an increased level of risk of regulatory scrutiny, which in turn may lead to regulatory action and/or increased levels of regulatory requirements.

The UK regulatory landscape continues to move at pace. Regulators' continued guidance on COVID-19 financial support measures place considerable responsibility on technology, control and operations functions. Significant policy initiatives including operational resilience, climate stress testing, UK Capital Requirements Regulation ('CRR') and the Basel 3.1 package of capital framework reforms will require significant consideration and implementation effort. In addition, the pace of regulatory change and evolving practice results in a risk that the Bank does not meet new requirements on a timely basis and may therefore leave itself open to regulatory action, increased operational risk or speculative approaches from claims management companies.

The Bank has increased the size and experience of its Risk, Compliance and Legal teams to help position itself appropriately to address these issues. It also is engaging with regulators and industry trade bodies, such as the Finance and Leasing Association, on these and other industry significant issues arising.

Planning uncertainties

A reduced level of retained profits, combined with the suspension of trading of the Group's shares, will affect the Bank's ability to grow capital reserves and its balance sheet over the coming year. Therefore, the Bank will effectively be capital constrained during this period, which will impact its ambitions for growth.

The Bank is currently rebuilding the level of surplus capital it holds by lowering new business volumes below those required to replace lending paid down. The future plans will use the surplus capital above the Board's risk appetite to lend sustainably with the intention of maintaining its capital buffers at this level.

The business is currently capital constrained with resulting reductions in business lending as set out above. The strategic plan for the Bank includes costs associated with remediation activity, but a return to profitability and growth that will once again enable the Bank to generate shareholder value by capitalising on significant growth opportunities in our core operating segments.

The Bank's performance, and return to profitability in the medium-term plan, is underpinned by a number of key inputs and assumptions that cover:

- The raising of external capital by Group.
- The funding of new business through retail deposits and other wholesale funding.
- New business origination levels.
- Net interest margin on new business originations.
- The expected date of completion of the Bank's remediation activities and the impact on expenses.
- The level of impairment losses on financial assets.
- Capital requirements, both from a regulatory and internal management perspective.

As with any medium-term planning process, there is a risk that these assumptions do not materialise. The most significant of these are the raising of external capital by the Group and the extent to which we can raise funding through our retail deposit franchise and wholesale funding. As discussed in the Directors' Report and the Board Audit Committee report, there is a risk that this cannot be achieved in line with the plan, which indicates a material uncertainty in respect of going concern and is summarised in note 1.2 Basis of Preparation to the Annual Report & Financial Statements.

Strategic Report (cont'd)

In addition to this, the overall shape and outcome of the medium-term plan could be adversely impacted by a number of factors, including an extended period of remediation activity, a deterioration in the credit outlook, levels of new business originations, an increase in the cost of funding, increases to the amount of regulatory capital that the Bank is expected to hold or other future regulatory measures the Bank may become subject to.

People risk

People risk can arise in many forms and continues to be the subject of close management attention. COVID-19 has given rise to remote working together with new operational processes. Additionally, increased flexibility in working arrangement across many different sectors has given rise to new norms and the Group, as the employing entity, has sought to ensure that new working arrangements continue to deliver high standards of competency, compliance and oversight, whilst ensuring that we remain an employer of choice that is able to attract, develop and retain the best talent.

The Bank recognises the impact COVID-19 has had on colleagues. Significant investment has been made in adapting systems to enable colleagues to work remotely during the pandemic. It has also adopted a hybrid return to the office policy, which will support colleagues to continue to work from home for part of the working week. This is part of the Group's approach to ensure that it remains an attractive choice for employment.

The uncovering of issues leading to a delay in finalising the Annual Report & Financial Statements and the Group's subsequent share trading suspension, may also lead to uneasiness amongst colleagues, and may result in higher levels of unplanned attrition. Additionally, the Group is increasing the skills and resources in new hirings however the recruitment market is competitive for financial services control function skillsets. The new executive team has adopted a strategy of regular and open communication with all colleagues. A recent colleague survey shows evidence that this is providing reassurance to colleagues. The executive team monitors risk associated with its people and is seeking to reduce key person dependencies in the Group and improving the skills and colleague resources through additional recruitment and increased learning and development opportunities. Finally, succession planning is being improved to ensure key roles have appropriate cover.

Operational Resilience including cyber risk

Operational resilience is the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover and learn from operational disruptions. These disruptions and the unavailability of important business services have the potential to cause wide-reaching harm to consumers and market integrity, threaten the viability of firms and cause instability in the financial system.

In December 2019, the FCA consulted – in CP19/32 – on proposed changes to how firms approach their operational resilience. By 31 March 2022, firms must have identified their important business services, set impact tolerances for the maximum tolerable disruption and carried out mapping and testing to a level of sophistication necessary to do so. Firms must also have identified any vulnerabilities in their operational resilience. PCF has established an Operational Resilience Framework with an independent review, but this has not currently been presented to Regulators.

The dependency on suppliers and outsourcing of services introduces risk where the failure of specific suppliers could have an impact on the Bank's ability to continue to provide important services to its customers. A Supplier & Outsourcing Assurance Framework provides corporate visibility of risks arising from contracts with third-party suppliers and confidence that they are being effectively identified and proportionately managed.

Cyberattacks continue to be a threat globally that is inherent across all industries, with the Bank observing a 500% increase in the number of phishing attacks observed during the pandemic.

With more people working from home comes an increase in vulnerability to cyber fraud, as criminals sought to exploit the changing circumstances. To ensure the Bank continued to remain secure a cyber and working from home internal audit was completed focusing on remote working guidance/standards; maintaining data protection and privacy good practice; and information and system security including data loss prevention.

Strategic Report (cont'd)

We continue to invest in the Cyber Control Environment, including Cyber protection, benchmarking ourselves using the Cyber Essentials Framework, and significantly enhanced our cyber control profile to support increased remote working with no significant risk events or change in security posture.

The Bank acknowledges the evolving threat and will continue to focus on the 'Defend, Deter, Develop' themes as recommended by the National Cyber Security Centre: These key themes have been broken down into a series of initiatives that will be implemented using best practice guidance published by the National Cyber Security Centre, the FCA and PRA, and based upon established frameworks including PCI-DSS, 10 Steps to Cyber Security, and Cyber Essentials.

Financial loss resulting from physical or transitional impacts of climate change

Climate change represents a material financial risk to regulated firms as social and economic policy is changing at a fast pace. Climate change risk is defined as the risk of financial or reputational loss as a result of the inadequate management of the transition to a low carbon economy (climate change transition risk) or the inadequate management of the risks associated with global warming (climate change physical risk).

The Bank is developing a roadmap for the development of a model framework to manage financial risks from climate change in accordance with PRA guidance including consideration of the impacts on the Bank's business strategy relating to vehicle financing. Senior management responsibility for the oversight of the management of financial risks from climate change is assigned to the Bank's Chief Compliance Officer. The Bank's approach to identifying and managing climate change risk is founded on it impacting other principal risks: strategic and business risk, credit risk, market risk, capital risk, operational risk, regulatory risk, liquidity, funding and conduct risk.

Benchmark interest rate reforms

The BoE set out a timeline to achieve the transition from London Interbank Offered Rate ('LIBOR') by no later than the end of 2021, with the expectation that firms use other rates such as the Sterling Overnight Index Average ('SONIA'). Legislation to enhance regulator powers around benchmarking rates and to support firms in moving legacy contracts away from LIBOR continues to be developed.

In 2017 the Group's Asset & Liability Committee ('ALCO') set a policy that the Bank would wherever possible avoid the use of LIBOR rates in its lending, borrowing or derivative activities. In compliance with this policy, all floating rate assets, liabilities and interest rate swaps are linked to either SONIA, BoE Bank Rate or a PCF managed rate. The sole exception to this policy is the revolving credit facility provided by Leumi ABL Limited, which when drawn accrues at overnight LIBOR plus a fixed spread. Leumi has advised that it intends to rebase the facility to SONIA by the end of 2021 in line with the LIBOR transition.

Strategic Report (cont'd)

Stakeholder Engagement Report

Section 172 Statement

Section 172 of the Companies Act 2006 requires a director of a company to act in a way that he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard, amongst other factors, to:

- The likely consequences of any decision in the long term.
- The interests of the company's employees.
- The need to foster the company's business relationships with suppliers, customers and others.
- The impact of the company's operations on the community and the environment.
- The desirability of the company maintaining a reputation for high standards of business conduct.
- The need to act fairly, as between members of the company.

Members (shareholders and investors)

- PCF Bank Limited is a wholly owned subsidiary of PCF Group plc.

Employees

- PCF Group plc is the employing entity for all colleagues that support the Bank
- The Group's employees are important to us. We seek to ensure that we attract, develop and retain talent. We actively encourage the Group's employees to gain professional qualifications and are pleased to have seen a number of our team do so over the last twelve months.
- Historically we have maintained a small company ethos which has helped us to maintain a high colleague retention rate over many years. Since the year end, headcount has significantly increased with new employees, contractors and advisors both to support our remediation and to support our existing employees through the changes we are undertaking.
- We provide our employees with regular updates on all issues relating to the business and in the last year this engagement was enhanced during the pandemic to include our response to lockdown and the introduction of remote working from home. The wellbeing and mental health of our workforce during COVID-19 have been carefully supported through our HR team and through access to employee helplines.
- Our new executive team has put a programme of cultural change in place covering more tactical short-term solutions and longer-term initiatives including:
 - Ensuring new employees are adequately supported on joining, especially when joining remotely and can assimilate the new Group culture whether in the office or homeworking.
 - Promoting colleague engagement initiatives through our Human Resources team and encouraging colleague engagement through a variety of colleague working groups such as our Diversity & Inclusion group who worked with our Human Resources team to develop our new Diversity and Inclusion policy.

Customers

- Our customers are at the heart of our business and we treat them fairly, professionally and respectfully in line with regulatory rules and guidance.
- We provide our savings customers with high levels of services, as evidenced by our achievement of receiving the 'Feefo' Platinum Trusted Service Award, which is only available to businesses which have been awarded the Gold Trusted Service Award for three successive years.
- We responded to our customer's requests for financial assistance during COVID-19 effectively and efficiently.
- We developed an online application process to speed up the processing of forbearance requests.
- We regularly reviewed the numbers and details of customers in forbearance and COVID-19 related deferrals as to how best to deal with their requests for assistance.
- We maintained good customer service levels and remained open to new lending throughout the year, albeit focusing on our highest credit grades, given COVID-19.

Strategic Report (cont'd)

Suppliers

- We take pride in the longstanding nature of our relationships with many suppliers, including our intermediaries and others such as software providers and credit information bureaux.
- We review our Supplier & Outsourcing Assurance Framework, which provides the Board with oversight of the risks arising from third party supplier contracts, on an annual basis.
- During the year, we implemented a new purchase order and invoice processing system to enhance efficiency and improve internal and external process of payment to our suppliers.

Regulators

- Our compliance with regulation is overseen by the Group's Board Audit and Risk Committees.
- Our executive team is committed to maintaining open and transparent regular direct engagement with our regulators. In 2021, the Bank as part of the Group has increased the focus and depth of engagement with our regulators with senior hires in our Risk function, ensuring they are kept up to date with progress on our remediation programme.
- We review and act on regulatory developments and monthly digests from the PRA and FCA. We increased interactions during COVID-19, ensuring that our operations complied with regulatory rules and guidance.
- Given weaknesses identified in our Regulatory reporting we have undertaken a thorough independent review of our regulatory reporting processes and capabilities. The remediation programme to address these issues is well progressed and this work is expected to complete in 2022. We will continue to invest in our regulatory reporting processes, systems and staffing.

Communities and the environment

- We commenced participation in a scheme which restores the wilderness through rewilding and reforestation projects across a variety of ecosystems around the world (the Mossy Earth project).
- Group employees collectively contributed to a number of charitable causes such as Headway, Macmillan Cancer Support and KidsOut, by way of a variety of engagement initiatives throughout the year.

Modern slavery and human rights

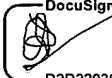
- Modern slavery is a crime and a violation of fundamental human rights. We are also committed to ensuring there is transparency in our own business and in our approach to tackling modern slavery throughout our supply chains, consistent with our disclosure obligations under the Modern Slavery Act 2015. We expect the same high standards from all of our contractors, suppliers and other business partners. Further details of our modern slavery policy are included on our website <https://pcf.bank/modern-slavery>.

Anti-Bribery and Corruption

- Our Anti-Bribery and Corruption Policy forms part of our Financial Crime Framework. It is our policy to conduct all of our business in an honest and ethical manner. We take a zero-tolerance approach to bribery and corruption and are committed to acting professionally, fairly and with integrity in all our business dealings and relationships wherever we operate and implementing and enforcing effective systems to counter bribery and corruption.

The Strategic Report has been approved by the Board of Directors and signed on its behalf by:

GG Stran
Interim Chief Executive
22 December 2021

DocuSigned by:

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Completion of the Annual Report & Financial Statements 2020

The Group's Audit & Risk Committee until 15 May 2020 ('ARC') and then subsequently the Group's Board Audit Committee ('BAC' or 'Audit Committee') is responsible, amongst other activities, for monitoring the integrity of both the Group's and Bank's Annual Report & Financial Statements by debating and challenging critical estimates and accounting judgements and overseeing the external audit.

The most significant issues for the BAC relating to the 2020 financial year have been those that came to light post year-end and which resulted in the suspension of trading of the Group's shares and the assessment and quantification of the impact of these on the Ernst & Young LLP ('EY') audit and completion of the Annual Report & Financial Statements 2020.

Finalisation of the Annual Report & Financial Statements 2020 and audit has taken significantly longer than expected and this reflects a number of factors including, as they arose:

- The disruption of the pandemic increased the uncertainties within key accounting judgements such as expected credit losses and goodwill impairment. Additionally, with both Group and EY colleagues working from home the Annual Report & Financial Statements process was more complicated and took longer than in previous years.
- Challenges for the Bank in providing sufficient appropriate audit evidence to the auditors because of an absence of, or poor, underlying documentation. This work was also hindered by virtually all of the Finance team being completely new to the Bank in financial year 2021 and with the Finance Director having left the Group in September 2020.
- On 11 March 2021 the Group announced that during the process of finalising the Group 2020 audit a number of adjustments to its unaudited 2020 preliminary results (previously declared in December 2020) were required of up to £750,000. The principal adjustments related to the charging to the profit and loss of previously capitalised costs for software projects, a reduction in an interest receivable balance from the employee benefit trust and adjustments to accruals for interest due on stage 3 loans, offset by lower colleague incentive rewards.
- Later in March 2021, when reviewing information required to address EY audit enquiries for the Group 2020 audit, our new CFO, Caroline Richardson, became aware of potential errors and misstatements. This was promptly reported to the Group's Audit Committee and the Group's Board.
- In April 2021, the Board engaged PwC to undertake an initial independent forensic investigation of the concerns raised (as reported in the Regulatory News Service ('RNS') dated 28 June 2021) and as a result of the findings of this review, the RNS highlighted:
 - That these errors and misstatements resulted in the failure to properly report: 1) under the Prudential Regulation Authority's Large Exposure reporting framework between December 2018 and June 2019; and 2) an overstatement of the Common Equity Tier 1 Ratio and Total Capital Ratio in the Group's 30 September 2019 regulatory reporting. These two issues had no impact on the consolidated Group or Bank's Annual Report & Financial Statements and the reported capital positions for the financial year ending 30 September 2019 previously published.
 - The review enabled the Board and Executive team to identify a number of deficiencies and failures in the Bank's financial control and reporting function, including members of the historical Finance team, under instruction, manually adjusting certain accounting entries for both financial and regulatory reporting purposes which appeared to the Group Board to have been a deliberate effort to facilitate specific results.
 - That the Group Board believed there may have been possible collusion by some members of the historical Finance team in making these adjustments, and that other contributory factors to the control failures were under resourcing, an inadequate level of skill and experience within the historical Finance team, technological limitations and a poor culture in the Finance team resulting in a lack of, and a reluctance to, challenge its leadership.
- At the end of June 2021, following Group Board's consideration of the results from the initial PwC independent forensic investigation, further work was commissioned to explore a number of the initial findings in more depth and to highlight other potential areas of concern or misstatement in related areas.
- The Finance team, overseen by the new CFO, undertook a detailed review to explore areas of concern and potential misstatement, in order to provide comfort that the Annual Report & Financial Statements 2020 were free from material misstatement. The detailed steps of the work undertaken are set out below in the section on the Further Finance Review.

Completion of the Annual Report & Financial Statements 2020 (Cont'd)

- On 10 September 2021 the Group announced that the adjustments to its 2020 preliminary results would exceed the £750,000 announced on 11 March 2021 and by way of a further announcement issued on 21 October 2021 the Group outlined the revised total adjustment to the preliminary results for the year ended 30 September 2020 would be approximately £7 million of which £3.7 million related to the Bank. The principal adjustments being a revision to the impairment methodology for defaulted receivables as detailed in that announcement.

All in all, there have been structural control, resourcing and reporting weaknesses in the Group's, and therefore the Bank's, Finance function contributing to the extended delay in finalising the Annual Report & Financial Statements 2020.

The Further Finance Review – end July to November 2021

- The further review period started in early July 2021, concluded in November 2021 and was undertaken by the Group's CFO and the Finance Team.
- The further Finance review work which ran from July to November, involved: analysing accounting records, determining the underlying reasons for previous entries made, assessing the appropriate accounting treatment and the appropriate accounting periods, undertaking profit and loss impact analysis, full balance sheet reconciliations and looking back to assess if any of these items resulted in any material impact on the internal management accounts, the Group's and Bank's Annual Report & Financial Statements and the Group's Interim Financial Statements for the two years ending 30 September 2019 and 30 September 2020. This detailed work was very time consuming and resulted in further significant delay in the finalisation of the Annual Report & Financial Statements.
- In addition to supporting the work of internal and external investigations, given the deficiencies and failures in the Bank's financial control and reporting function identified by management, the Finance team was required to provide a further substantial amount of additional audit evidence and analysis to support the statutory audit and entries in the Group's, including the Bank's, accounting records.
- In analysing the results of this further Finance review, consideration was given to the nature of and materiality of certain findings as well as any adjustments required to be implemented as a result, both on a qualitative and quantitative assessment basis. The results of this review work have provided:
 - further examples of misstatements. These were most prevalent in internal management reporting *but several instances of which persisted in external reporting though not to a material extent for the Bank.*
 - Multiple errors that may not lead to a misstatement.
- The required adjustments in relation to the various errors or issues identified from the further Finance review have been reflected in these Annual Report & Financial Statements to ensure they are free from material misstatement. The results of this review work have been scrutinised by the CFO, and carefully overseen by, BAC.

This further review has also reaffirmed that there continues to be no evidence of monies having left the Group inappropriately as a result of any of these practices and behaviours. However:

- The Group has authorised the commencement of recovery action (where it is commercially sensible and legally feasible to instigate such action) to recover previously paid remuneration (and consequential losses) from individuals in the context of certain findings of the various investigations undertaken by the Group.
- There will be costs associated with the investigation and remediation which will be reflected in the 2021 financial statements and significantly increased audit fees which are reflected in these 2020 financial statements.

Completion of the Annual Report & Financial Statements 2020 (Cont'd)

The Audit Committee's Recommendation

As a result of this work and its oversight, together with consideration of the significant accounting issues and judgements as described below, the BAC recommended the Bank's Annual Report & Financial Statements for the financial year to 30 September 2020 to the Board, who subsequently approved the Annual Report & Financial Statements. In order to form this recommendation, the BAC considered the additional audit work undertaken by EY prior to the decision taken to cease providing audit evidence (see Auditor opinion below), the PwC investigation, the detailed further Finance review work overseen by the CFO, the consequent analysis and conclusions reached on the findings, and the papers and analysis prepared by the CFO and Finance team being a material risk of misstatement report for the current and prior financial year, a Going Concern assessment, an assessment of post balance sheet events and a fair, balanced and understandable assessment of the same.

In addition, BAC:

- Reviewed the content of the Annual Report & Financial Statements for the year ended 30 September 2020 for clarity and completeness of disclosure.
- Concluded that the Annual Report & Financial Statements as a whole were fair, balanced and understandable and provide the information necessary for stakeholders to assess the Bank's position, performance, business model and strategy.

Auditor opinion

The time required to perform the independent forensic investigations and further Finance review set out above has delayed the finalisation of the Annual Report & Financial Statements and the audit. Given the nature and extent of the findings identified by Management, the final stages of the audit were very delayed and would involve a very considerable amount of extended testing and auditor information requests. These requests then placing ongoing significant demands on the Finance team. Also, given turnover in the finance team and the past poor record keeping, it wasn't clear that the Bank would be able to provide the level of detailed information needed by EY for an unmodified audit opinion. Lastly the additional assurance work would further the extended time period to finalise the the Annual Report & Financial Statements 2020 and would further increase audit costs.

In the circumstances, management recommended to the Group's Audit Committee and the Board that it was in the best interests of the Group and the Bank to proceed with the audit work so far as was necessary for a disclaimer of opinion on the financial statements for the year. This recommendation meant; 1) The finance function would no longer provide the substantial amount of additional audit evidence requested and 2) It was solely for the Board to reach a view on whether the Bank Annual Report & Financial Statements were free from material misstatement, in order to prevent further additional delays in presenting these financial statements to stakeholders. The Audit Committee supported this pragmatic recommendation.

Significant Accounting Issues and Judgements

In reviewing the Bank's Annual Report & Financial Statements 2020, the BAC considered significant accounting issues and judgements as follows:

- Risk of fraud in the recognition of revenue through the Effective Interest Rate ('EIR') methodology. This risk is consistent with last year. However, it is potentially affected by COVID-19 and material changes in the expected lives of products as a result of changes in customer behaviour. The Group's Audit Committee discussed and considered the key assumptions used in the EIR methodology, including the impact of COVID-19 forbearance and payment deferral measures.

Completion of the Annual Report & Financial Statements 2020 (Cont'd)

- Impairment of loans and advances to customers in accordance with the IFRS 9 expected credit loss ('ECL') model (fraud risk). The identification of this risk is consistent with last year. However, this year it is significantly affected by the impact of COVID-19 on the potential creditworthiness of customers. The Group's Audit Committee discussed the key assumptions used in the IFRS 9 models and the assumptions and rationale that supported additional provisions through overlays and post-model adjustments. The Group's Audit Committee also considered the application of IFRS 9 in relation to regulatory guidance and took account of the extensive Government support measures and the specific circumstances of our customers. The Group's Audit Committee concluded on a number of overlays and Post Model Adjustments (PMAs). In addition, as part of the extensive work led by the CFO as referenced in the above section, it became apparent that additional provisions for expected credit loss were required for defaulted loans where the agreements had been terminated and assets recovered with a residual outstanding balances. The Group's Audit Committee agreed the impairment methodology for these residual balances with a resulting increase in provisions being the significant part of the £7m Group adjustment announced on 21 October 2021 (of which £3.7 million related to the Bank). Further details of loan and advances to customers and the IFRS 9 provision are set out in Notes 1.6.2 in Accounting Policies and also in notes 26.5 and 27.3.
- Impairment of the carrying value of subsidiaries in relation to Azule. This is a new risk for 2020 arising as a result of the impact of COVID-19 on the future expected cash-flows relating to the Azule business. The Group's Audit Committee considered a number of possible future growth scenarios for the business but due to the impact of COVID-19 on the near-term prospects for the business supported the decision to impair the carrying value of the subsidiaries by £4.4 million. In 2019 there had been financial statement risks relating to the purchase price allocation and disclosure of the acquisition of Azule which are non-recurring.
- COVID-19 considerations have arisen across all areas of the Committee's work.
- Going Concern – Due to the events giving rise to the delay in the 2020 ARA (set out above), the current suspension of trading in the Group's shares on AIM and residual pandemic impacts, there was a detailed consideration of the going concern assumption for the Bank. Refer to the summary in note 1.2 Basis of preparation to the financial statements.
 - BAC assessed the appropriateness of the going concern assumption considering planned performance including future remediation costs, funding, liquidity, market risks, as well as other business and emerging risks.
 - BAC also assessed the Group (which substantially consists of the Bank) medium-term plan against a number of sensitivities and a severe but plausible downside scenario. Even under the severe but plausible scenario it was demonstrated that the Group (and therefore Bank) would continue to operate and meet regulatory requirements for at least the next twelve months
 - The Board concluded that based on the planned performance, assessments of key risks to the business, and the exercise to confirm that there was no material misstatement in the Bank accounts (set out in detail above) that the going concern basis of accounting was appropriate.
 - The Bank has made a statutory loss before tax of £(0.9) million in the year. The Group Board approved a medium-term plan in which the Group (and therefore the Bank) returns to profitability, but this is dependent on building scale to support an increased cost base. Remediation costs are expected to be incurred for at least the next twelve months. This growth requires capital to be raised by the Group, which given the delay to the Annual Report & Financial Statements 2020, the disclaimer of auditor opinion and the temporary suspension of trading in the Group's shares, means there are risks associated with the Group's ability to raise capital, fund planned future balance sheet growth of the Bank and the understandable increase in regulatory focus these events have brought. Therefore, the Board concluded that it was appropriate to disclose a material uncertainty in relation to Going Concern in these Financial Statements.

Sustainability Report

In July 2019, the Financial Reporting Council issued a joint statement with other regulators on how companies should report on the effect of their activities on climate change. This follows the Government's publication of its Green Finance Strategy which anticipates mandatory disclosures by 2022.

PCF's Consumer Finance and Business Finance Divisions provide finance to consumers and businesses to acquire a wide range of vehicles. Whilst we have no control over our customers' choice of vehicles, we do have the ability to adapt our lending policies to ensure that we are making a contribution to climate change and a carbon neutral economy. We have started to achieve this by limiting the term of finance for certain diesel vehicles and we monitor and review this policy on at least an annual basis.

At a corporate level, we are implementing two new initiatives to demonstrate our commitment to the environment and the transition to a carbon neutral economy:

- In financial year 2021, we commenced participation in the Mossy Earth project, which restores the wilderness through rewilding and reforestation projects across a variety of ecosystems around the world. Our commitment to this project takes the form of a donation of £2 for every finance agreement we process.
- We are seeking to introduce electric vehicle company cars for our Sales employees.

GHG Emissions and Energy Use Summary

The Group takes its responsibility towards the environment seriously and recognises the important part it has to play in supporting the transition to a carbon neutral economy. We will consider our approach to the Taskforce for Climate Related Financial Disclosures ('TCFD') in the coming year. The Group's emissions have been calculated in line with the Greenhouse Gas Protocol Standard, using the Environmental Reporting Guidance published by the UK Government. All our emissions are UK based.

UK	tCO ₂ e	kWh
Scope 1 Emissions from activities for which the Bank is responsible	-	-
Scope 2 Emissions from the purchase of electricity for own use	26	113,401
Total Scope 1 and Scope 2 emissions	26	113,401
Emission intensity Scope 1 and Scope 2 in tCO ₂ e / Net operating income in £m	1.1	

Directors' Report

The directors present their report and audited Financial statements for PCF Bank Limited for the year ended 30 September 2020.

Principal activities

The Bank's principal activities are the purchase, hire, financing and sale of vehicles, equipment and property, the provision of related fee-based services and the provision of retail savings products.

Business review, Strategic review, results and dividends

The review of the business of the Bank, operations, principal risks and outlook are contained in the Strategic Report section on pages 4 to 27.

The results for the financial year are set out in the Income Statement on page 67.

The directors do not recommend the payment of a dividend in respect of the year ended 30 September 2020 (year ended 30 September 2019 - nil).

Share capital

PCF Bank Limited is a private limited company incorporated in England and Wales and as at 30 September 2020 100% of its shares were owned by PCF Group plc (the 'Group'). Details of the Bank's immediate and ultimate parent are disclosed in note 32 of the Annual Report & Financial Statements.

Directors and their interests

The directors of the Bank during the financial year were those listed on page 3. No directors held any shares in the Bank (year ended 30 September 2019 – nil).

Details of the interests in the Group's shares of the directors, including their connected persons and share options granted to previous executive directors are detailed in the Group Annual Report & Financial Statements 2020.

Directors' compensation

Details of the remuneration of the directors and other benefits are provided in note 9 of the financial statements.

Directors' indemnification

The Bank's Articles of Association permit it to indemnify directors in accordance with the Companies Act. The Bank's parent company granted contractual indemnities to each of the current directors of the Bank in July 2021 to cover against liabilities which they may sustain or incur in the proper performance of their duties as directors of the Bank. These indemnities are available for inspection at the registered office of PCF Group plc.

Political donations

The Bank made no political donations during the year to 30 September 2020 (year to 30 September 2019 – nil).

Directors' Report (cont'd)

Financial risk management objectives and policies

Information about financial risk management systems in relation to financial reporting can be found in the Risk Management Report on pages 38 to 57.

Financial instruments

The financial risk management objectives and policies in relation to the use of financial instruments can be found in the Risk Management Report on pages 38 to 57.

Going concern statement

The Bank's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. In particular this going concern statement should be read in conjunction with the Emerging risks and uncertainties section on page 21 of the Strategic Report which sets out those risks and mitigations.

The financial position of the Bank, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. The Bank's policies and processes for managing its Risks are described in the Strategic Report and the Risk Management Report.

After making enquiries, the directors have a reasonable expectation that the Bank has adequate resources to continue in operational existence for at least the next twelve months. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report & Financial Statements.

The Directors have assessed the appropriateness of the going concern assumption taking into account a detailed review of the Group's (the Group substantially consists of the Bank) medium-term plan which includes increased remediation costs alongside a consideration of capital, funding and liquidity requirements. This consideration also included other business and emerging risks.

The Bank made a £(0.9) million statutory loss before tax in the year. The Group Board has approved a medium-term plan in which the Group returns to profitability (and therefore the Bank), but this is dependent on building scale to support an increased cost base. Remediation costs are expected to be incurred for at least the next twelve months. The growth in the medium-term plan requires capital to be raised. However, given the delay to both the Bank and Group's Annual Report & Financial Statements 2020, the disclaimer of auditor opinion and the temporary suspension of trading in the Group's shares, there are risks associated with our ability to raise capital at the Group level and fund the planned future balance sheet growth of the Bank. This indicates that the Group's and Bank's ability to operate as a going concern is subject to material uncertainties.

Group (and therefore Bank) performance, and the return to profitability in the medium-term plan, is underpinned by a number of key inputs and assumptions which cover:

- The raising of external capital.
- The funding of new business through retail deposits and other wholesale funding.
- New business origination levels.
- Net interest margin on new business originations.
- The expected date of completion of the Group's remediation activities and the impact on the Group's expenses.
- The level of impairment losses on financial assets.
- Capital requirements, both from a regulatory and internal management perspective.
- Dividends, which have been assumed at zero in the medium-term plan.

Directors' Report (cont'd)

As with any medium-term planning process, there is a risk that these assumptions do not materialise. As part of the review of the medium-term plan, the Group Board was presented with a severe but plausible downside in which the Group is unable to raise external capital, and a number of sensitivities to the medium-term plan in which the Group's (and therefore the Bank's) net interest margin, impairment losses and business volumes were subject to materially adverse performance. Even under the severe but plausible scenario it was demonstrated that the Group (and therefore the Bank) would continue to operate and meet regulatory requirements for at least the next twelve months, albeit at the expense of balance sheet growth.

The Board has concluded based on the items below that the going concern basis of accounting was deemed appropriate (refer to note 1.2 Basis of preparation):

- Planned performance, including a medium-term plan which returns the Group (and therefore the Bank) to profitability.
- The assessment of downside risk to the medium-term plan.

Assessment of principal risks

The Board is responsible for monitoring the nature and extent of the principal risks it faces as well as determining the level of appetite it is willing to take in order to achieve its strategic objectives. The principal risks the Bank actively monitors and manages are described in the Strategic Report pages 4 to 27 and the Risk Management Report.

Risk management and internal controls

As described in the Corporate governance structure section on pages 18 to 19, the Group's risk management and internal control systems are monitored at Board level. A review of the Group's RMF has been undertaken overseen by the Group's Board Risk Committee.

The Group's prospects are assessed primarily through a strategic plan. This process for the production of the strategic plan included a full review of current performance by the CFO and the key assumptions in the plan being proposed by the CFO and reviewed by the interim CEO and the Executive Committee. After review by the CFO, interim CEO and Executive Committee the plan and key assumptions were presented to the Board and approved by the Board. In view of the extended time taken to complete the 2020 accounts the latest Strategic Plan was signed off by the Board in October 2021.

Subsequent events disclosure

Since 30 September 2020 year end there have been the events detailed in the Chairman's Statement and more particularly in the section headed Completion of the Annual Report & Financial Statements. For further details please refer to note 30 Non-adjusting events after the balance sheet date on page 121.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report & Financial Statements in accordance with applicable United Kingdom law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the Bank financial statements in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 ("IAS"). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and of the profit or loss of the Bank for that period.

Directors' Report (cont'd)

In preparing these financial statements the directors are required to:

- select suitable accounting policies in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IAS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Bank's financial position and financial performance;
- in respect of the Bank financial statements, state whether IAS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is appropriate to presume that the Bank will not continue in business.

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

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report, Directors' Report, Report on Completion of the Annual Report and Financial Statements 2020, Sustainability Report and Risk Management Report that comply with that law and those regulations. The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website.

The directors confirm, to the best of their knowledge:

- that the financial statements, prepared in accordance with IAS give a true and fair view of the assets, liabilities, financial position and profit of the Bank;
- that the Annual Report & Financial Statements, including the Strategic Report, includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal risks and uncertainties that they face; and
- that they consider the Annual Report & Financial Statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for the shareholder to assess the Bank's position, performance, business model and strategy.

Disclosure of information to the auditors

As explained in the section on Auditor Opinion in the Audit & Risk Committee Report, in order to prevent further additional delays in presenting these financial statements to the Group's stakeholders, and given that it was not clear that the Group would be able to provide the level of detailed information needed by the auditor for an unmodified audit opinion, the Group's Audit Committee and the Board approved the approach that it was in the best interests of the Group to proceed with such audit work and provision of information to the auditor so far as was necessary for the Auditor to issue a disclaimer of opinion and therefore to provide only such information to it as the Bank considered necessary and appropriate as a result. This was with the knowledge of the auditor.

Following this decision in July 2021, and notwithstanding this new approach to the provision of audit information, and that a disclaimer of audit opinion would be issued, the Bank continued to keep the auditor updated on its ongoing investigations, as well as wider business developments of relevance.

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

Resignation of Ernst & Young LLP and the appointment of new auditors

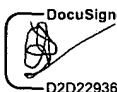
After the completion of the Annual Report & Financial Statements 2020 Ernst & Young LLP will resign as auditors and pursuant to section 485 (3) (c) of the Companies Act 2006 the directors will appoint MHA MacIntyre Hudson to replace them pending confirmation of that appointment at the Bank's General Meeting at which the Bank's report and audited financial statements for the year ended 30 September 2020 will be presented by way of a resolution to be taken to that meeting.

The Directors Report was approved by the Board on 22 December 2021.

On behalf of the Board

GG Stran
Interim Chief Executive

22 December 2021

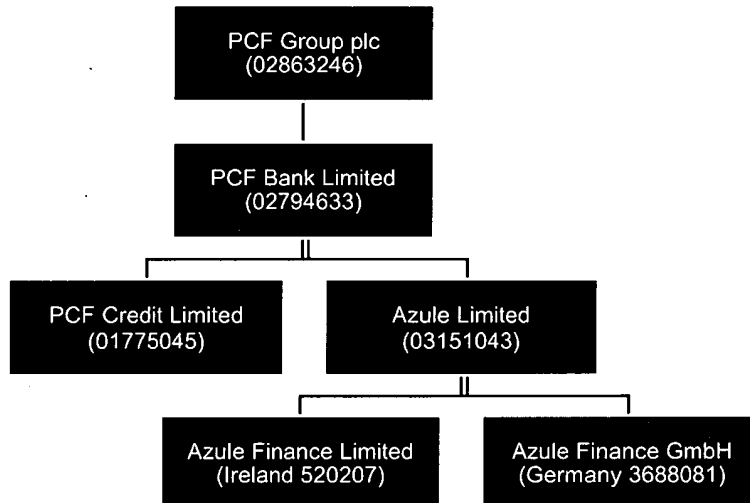
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Risk Management Report

for the year ended 30 September 2020

Management of Risk within PCF Bank Limited and PCF Group plc

The Bank is wholly and exclusively owned by the Group and the Bank's operations account for nearly all of the Group and its subsidiaries' operations within the consolidated Group, the structure of which is set out in the chart below.



The Group manages risk at a consolidated level that ensures monitoring and oversight of the Bank's risk appetite and regulatory limits, and the risk management governance processes encompass both the Bank and Group. Therefore, key risk and prudential documents are written at the level of the consolidated Group, including:

- Risk Appetite Statement
- RMF
- Internal Capital Adequacy Assessment Process ('ICAAP')
- Internal Liquidity Adequacy Assessment Process ('ILAAP')
- Recovery Plan
- Liquidity Contingency Plan
- Resolution Pack
- All risk management policies

This Risk Management Report should therefore be read in this context.

Introduction

The report relates to the year ended 30 September 2020. This report is dated 22 December 2021. Given the passage of time since the year end, this report is brought up to date for recent events and matters relevant to the Bank's current operating model where appropriate and where material, changes since then have been highlighted.

The Bank's management of risk is based on: the identification of risks faced; an assessment of each of these, determining which merit designation as principal risks and; establishing a RMF to create the control environment that will support the safe delivery of the Group's strategic objectives and business plan.

The Board is responsible for ensuring that the RMF is proportionate, relevant, and operating effectively. Whilst the RMF has been in place throughout the year, it has recently been externally reviewed and a programme of work is underway to enhance and fully embed this enhanced RMF across the Bank.

Risks are initially identified and designated as Principal based upon their inherent impact (i.e. prior to mitigants and controls). The level of risk post management and mitigation is reflected in residual risk exposures. It is these residual risk exposures upon which risk appetite is set.

Risk Management Report (cont'd)

Along with the setting of risk appetite by the Board, the control and management of risk includes the provision of risk exposure limits, the creation of procedures and policy to ensure risk management techniques are consistently applied and adhered to, and governance and oversight through risk committees and teams who are independent from those with direct responsibility for managing the risks. While the framework has remained consistent throughout the period, the level of control, governance and oversight has been significantly enhanced during 2021.

The Bank applies the 'Three Lines of Defence' approach which is an industry standard, and which identifies those with responsibility for managing the risk (the First Line), those with responsibility for providing independent oversight of that management (the Second Line), and those with responsibility for providing independent assurance over both First and Second Line activities (the Third Line).

Principal Risks

The eight principal risks to which the Bank's business model is inherently exposed to are set out below. More information is included in the following sections of this report. Post 2020 the Bank has identified that Climate Change risk warrants inclusion as a Principal risk.

Risk Management Report (Cont'd)

Information on the emerging risks and uncertainties faced by the Bank are provided in the Strategic Report on page 21.

Risk Categories	Risk Statement
Strategic and business risk The risk that the Bank, as part of the Group, is unable to support achievement of the overall corporate and strategic objectives.	In order to maintain stakeholder confidence and market expectations, the Board seeks to operate the business in a way that optimises long term returns, within approved risk appetite.
Credit risk The risk of a borrower or wholesale counterparty failing to meet its obligations in accordance with agreed terms leading to a financial loss on that borrower or counterparty's account.	The Bank aims to minimise the impact on profitability from defaults through its diversification of lending operations, a prudent underwriting policy, and a considerate case management process when customers are in difficulty.
Capital risk The risk that the Bank has insufficient capital or contingency to maintain its required regulatory or internally set minimum capital ratios and buffers or sustain its long-term lending operations.	The Bank seeks to maintain an appropriate level of capital above its total capital requirements plus capital buffers and monitor this against the overall business plan as part of the Group's Internal Capital Adequacy Assessment Process ('ICAAP').
Liquidity & funding risk The risk that the Bank is unable to fund new business originations or meet cash flow or collateral obligations as they fall due, without adversely affecting its deposit franchise, daily operations or financial health.	The Bank seeks to maintain a diversified funding strategy with close relationships to its wholesale counterparties and be an active participant in the retail deposit market. This is supported with prudent levels of high-quality liquid assets; in excess of that needed to withstand a severe but plausible stress. Liquidity requirements and buffers are monitored against the overall business plan as part of the Group's Internal Liquidity Adequacy Assessment Process ('ILAAP').
Market risk The risk of losses or reduced value arising from on and off-balance sheet exposures when impacted by adverse movements in market prices and rates.	A chief mitigant of the Bank's market risk is its predominance of fixed rate and term exposures across both asset and liability sides of the balance sheet, along with regular monitoring of its interest rate gaps and risk metrics.
Operational risk The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.	The Bank seeks to identify, assess and manage the operational risks to which it is exposed and continues to review IT system architecture to ensure protection from cyber-attack, operational resilience, data confidentiality, and the integrity and availability of critical systems and information assets.
Regulatory risk The risk that the Bank is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings due to failing to comply with applicable laws, regulations, codes of conduct or legal obligations.	The Bank actively monitors new and emerging regulations through horizon scanning intended to both forewarn of change and provide guidance on interpretation and implementation. The activities of the Group are complemented with 3 rd party legal support, and regular dialogue with its regulators.
Conduct risk The risk of customer detriment or a reduction in earnings value, through financial or reputational loss from an inappropriate or poor customer outcome from business conduct.	The Bank restricts its activities to areas of established expertise and ensures the culture of the organisation is focused on delivering a fair outcome for customers. This is supported by a programme of assurance reviews centred on the customer journey and product lifecycle.

Risk Management Report (Cont'd)

Controlling and managing risks

Risk Management Framework ('RMF')

The Bank recognises the importance of embedding a framework within the organisation that applies proportionate controls to managing risks on a continuous basis. The Bank's approach to managing risk within the business is governed by the Board approved Risk Appetite Statement ('RAS') and the RMF.

The Bank is currently enhancing its RMF to ensure an appropriate articulation of individual and collective accountabilities for risk management, risk oversight and risk assurance that supports the discharge of responsibilities to customers, shareholders and regulators. The RMF seeks to establish a common risk language to facilitate the collection, analysis and aggregation of risk data for risk reporting and management information.

At the operational level, the RMF is the responsibility of each business function to adhere to and manage all Bank mandated risk management processes and standards. The business provides periodic feedback to the Bank's Risk functions on the adequacy of risk management processes and standards in relation to their function.

The framework is periodically updated to reflect changes in the business and the external environment. As identified, the Bank is currently going through a process of further enhancing its RMF in 2021, which was the subject of an external review that concluded in June 2021. A roadmap to enhance and embed the control framework referred to in the previous sections of this Annual report & Financial Statements 2020 is being developed and resourced to meet the identified roles and responsibilities across the three lines of defence.

Three lines of defence

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

Board Risk Strategy and Appetite		
Business Lines & Central Functions	Risk Functions	Internal Audit Function
First Line of Defence ('1LoD') Operational Control by Business Functions <ul style="list-style-type: none"> Identify, assess, control and mitigate risks within risk appetite. Develop and implement internal procedures and controls. Clear definition of roles and responsibilities. Escalate issues to management and control functions. Focus on achieving fair customer outcomes. 	Second Line of Defence ('2LoD') Independent Risk Management & Compliance <ul style="list-style-type: none"> Develop robust frameworks and policies to manage risk. Facilitate and oversee implementation of effective risk management practices by business owners Co-ordinate the Bank's approach to setting and reporting on risk appetite. Advisory and oversight. Perform oversight and challenge on 1LoD 	Third Line of Defence ('3LoD') Internal Audit <ul style="list-style-type: none"> Internal Audit provides independent assurance on the effectiveness of 1LoD, 2LoD and the risk governance framework.

Risk Management Report (Cont'd)

- Business lines, as the 'First Line of Defence', have the primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within Board approved risk appetite. They are required to establish effective governance and control frameworks for their business areas that are compliant with Group policy requirements. This includes the need to develop and maintain appropriate risk management skills and processes to enable them to operate within the Board's risk appetite.
- The 'Second Line of Defence' encompasses the Risk and Compliance function, which is independent of other functions, reporting into the Chief Risk Officer ('CRO'), and which undertakes risk and compliance monitoring and thematic reviews. The second line provides independent oversight and advice to the business with assessments going up to Board Risk Committee ('BRC'). It is the aim of the Risk and Compliance function to coordinate the management and reporting of the Bank's risks, ensuring that risk management is fully integrated into the day-to-day activities of the business.
- The 'Third Line of Defence' is provided through an externally sourced Internal Audit function. The Third Line provides independent assurance to senior management and the Board, principally through Board Audit Committee ('BAC') on the effectiveness of risk management policies, processes and practices in all areas. The work of Internal Audit is undertaken as part of an agreed audit programme with activities determined by risk based prioritisation.

Risk appetite and culture

The risk appetite statement (RAS) provides an articulation of the Board's tolerance for risk in both quantitative measures and qualitative terms. A clearly defined RAS allows the setting of detailed risk appetite and reporting metrics for principal risks. The RAS sets out the level of risk that the Bank, as part of the Group, is willing to take in pursuit of its business objectives; noting that in some instances the Bank will have a separate risk appetite to the Group.

Throughout the year to 30 September 2020, the risk appetite statements and metrics were reported to the Audit & Risk Committee ('ARC') (now BAC and BRC) by the deputy Chief Risk Officer and Chief Compliance Officer. The CRO is responsible for assessing the impact on the Board's risk appetite from changes in circumstance (internal or external) that warrant a change to the RAS, and recommending any such changes to BRC and the Board ahead of the scheduled annual review. During the 2019/20 financial year, the Board undertook a review of the Bank's key risks on 24 April 2020, with a focus on COVID-19 related risks and the associated impact on strategic and business objectives.

The Board sets the risk appetite and culture and cascades this into day-to-day operations through policies, qualitative statements, risk appetite metrics, limits, Board and committee review, monitoring, assurance, recruitment, and training.

Governance and oversight

Governance is maintained through delegation of authority from the Board, down to Board sub-committees and lower-level management and risk committees. The committee-based structure has been enhanced to ensure that risk appetite, policies, procedures, controls and reporting are all fully in line with regulations, law, good corporate governance standards and industry best practice.

The interaction of the executive and non-executive governance structures requires a culture of transparency and openness. Further development of the RMF and subsequent embedding continues to be a priority for the Bank and, along with a refocus towards a risk-centric culture, is seen as the foundation for effective risk management going forward.

The structure of committees is set out in the Corporate Governance Structure section pages 18 to 19. The role of key executive led committees is given below:

Executive Committee ('ExCo')

The Board has delegated responsibility for the day-to-day management of the Bank to the Executive Management team, led by the Chief Executive Officer, through the Executive Committee. ExCo's primary responsibility is to lead, oversee and direct the activities of the Bank, and to ensure the implementation of strategies approved by the Board, provide leadership to the Management team and ensure appropriate deployment of the Bank's resources, including capital and liquidity.

Risk Management Report (Cont'd)

Assets & Liabilities Committee ('ALCO')

The ALCO is responsible for ensuring the effective operation of the RMF within the Bank to enable management of Treasury including capital management, market risk (interest rate and basis risk), liquidity and funding risk, wholesale credit risk and funds transfer pricing.

It monitors and ensures compliance with the approved Treasury Policies including the Liquidity and Funding Risk Policy, Market Risk Policy, Wholesale Credit Risk Policy, Funds Transfer Pricing Policy and associated risk appetite. This extends to oversight over the Internal Capital Adequacy Assessment (ICAAP), the Internal Liquidity Adequacy Assessment (ILAAP) and the Recovery Plan. The ALCO also sets the operational procedures and processes associated with these policies.

Executive Risk Committee ('ERC')

The ERC is responsible for development, implementation, monitoring and effectiveness of the RMF.

This committee commenced duties in April 2021.

The role of the Remuneration Committee, Board Risk Committee and Board Audit Committee are described within the Corporate Governance Structure Report on pages 18 to 19.

Principal Risk categories

Strategic and business risk

Strategic and business risk is the risk that the Bank, as part of the Group, is unable to support the overall corporate and strategic objectives.

Management of strategic and business risk

The Board seeks to operate the business in such a way as to ensure the delivery and sustainability of optimal returns, while meeting the needs of its stakeholders and operating within its approved risk appetite.

To achieve this, the Group does not intend to undertake any strategic actions within its business model that would put at risk its vision of being a successful, specialist lender in its chosen target markets, being backed by its savings franchise. The Bank supports this strategy by monitoring, reviewing and challenging its performance against its strategic objectives using established risk appetite and performance indicators; with regular monitoring of the business and macro-economic assumptions underlying its business, capital and liquidity plans. The Bank seeks to comply with its stated risk appetite by not putting its core strategic and business objectives at a level of risk which is beyond its financial resources and operational capabilities under both normal and stressed conditions.

To help ensure that product design and delivery supports the Group's strategic and business objectives, the Bank has an embedded Product Governance policy which states the product, market and risk assessments needed for each new product. This is reviewed annually by the Board.

The current view of strategic and business risks along with activities to address identified risks and issues are included within the earlier Strategic Report to these Annual report & Financial Statements.

Credit risk

Credit risk is the risk of a borrower or wholesale counterparty failing to meet its obligations in accordance with agreed terms leading to a financial loss on that borrower or counterparty's account.

Risk Management Report (Cont'd)

Management of Credit risk

The successful management of credit risk is central to the Bank's business. The Bank therefore regularly reviews its lending criteria as well as its credit exposure to all customers. However, default risk may arise from events which are outside the Bank's control, primarily customer behaviour changes due to factors such as loss of employment, family circumstances, illness, business failure, adverse economic conditions or fraud. In order to ensure that arrears are minimised, emphasis is placed on retaining a diversified portfolio, using prudent underwriting methods.

As a key mitigant to losses arising from credit risk, the majority of the Bank's lending is secured and amortised over the life of the assets.

The Bank aims to minimise the impact on profitability from defaults through a prudent underwriting policy and case management process when customers are in difficulty. The Bank's risk and underwriting philosophy incorporates:

- The customer's ability to afford their monthly payments, their credit rating and their probability of default.
- The collateral value of the asset being financed, or the security provided to support a finance agreement; all assets financed have strong collateral characteristics and a readily available and liquid market for re-sale.
- A wide spread of risk with no unduly high exposure to individual customers.

On a portfolio basis, credit risk arising from the build-up of concentrations is limited due to the relatively low value of each customer's debt, to the Group's large and diverse customer base, and to set and monitor limits and exposures to different lending channels, different classes of lending, different classes of risk.

Analysis of maximum exposure to credit risk

The Bank has an established credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. The credit quality review process aims to allow the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

The table below presents the Bank's maximum exposure to credit risk, before taking account of any collateral and credit risk mitigation, arising from its on balance sheet financial instruments. For off balance sheet instruments, the maximum exposure to credit risk represents the contractual nominal amounts.

Risk Management Report (Cont'd)

Analysis of maximum exposure to credit risk

Bank balance sheet		
	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
On Balance Sheet		
Financial assets		
Cash and balances at central banks		
- Cash and demand deposits	23,811	6,110
Debt financial instruments at FVOCI	9,095	19,638
Loans and advances to customers (net)		
Consumer Lending	163,634	123,414
Business lending	177,497	168,641
Azule lending	7,719	10,309
Bridging finance	60,132	12,949
Due from related companies	17,853	6,001
Other assets	590	1,572
	460,331	348,634
Off-Balance Sheet		
Undrawn facilities	17,270	1,760

In its normal course of business, the Bank engages external agents to recover funds from repossessed assets in its retail portfolio, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers.

Forbearance and COVID-19 related payment deferrals

Forbearance occurs when a customer is experiencing difficulty in meeting their financial commitments and a concession is granted by temporarily changing the terms of the financial arrangement which would not otherwise have been considered. The unprecedented COVID-19 global pandemic led to significant numbers of customers seeking COVID-19 related payment deferrals within the Bank's lending portfolio. As a result, the Bank introduced a range of additional measures to support its customers during this difficult period.

Additional support for customers impacted by COVID-19

The Bank recognised that the impact of COVID-19 was a significant concern for our customers, and we offered help and support through the introduction of several additional concession tools. Concessions granted to customers are varied across the Bank's lending portfolio and in line with regulatory guidance.

The concessions include the creation of COVID-19 related payment deferrals, which are a form of 'breathing space' without payment followed by a payment plan, for customers of CFD, BFD and Azule. This period of flexibility ranged from 3 to 9 months depending on underlying mitigating factors and is reviewed and approved by the Bank's Customer Operations Department.

There were no negative impacts on the customer's credit file as a result of these measures.

The cure periods of these forbore exposures are subject to judgement and careful consideration. The approach varies depending on the relevant division and ranges from instant resumption of payments when the period of concession ends (subject to confirmation of no adverse performance) to a six-month 'grace' period applicable in relevant circumstances where payments are either initially deferred or part payment accepted.

Risk Management Report (Cont'd)

Analysis of forbearance and COVID-19 related payment deferrals

At 30 September 2020, the gross carrying amount of exposures with forbearance measures was £36.0 million (2019 - £nil). As set out in note 1.4.3, a COVID-19 related concession does not in itself constitute a significant increase in credit risk. The full forbearance analysis is shown in note 27.3.2.

IFRS 9 treatment of credit risk

Under IFRS 9 the Bank calculates impairment provisions on loans and advances to customers on an expected credit loss ('ECL') basis. ECL provisions are based on an assessment of probability of default, loss given default and exposure at default in a range of forward-looking scenarios.

IFRS 9 requires the Bank to categorise customer loans into one of three stages at the balance sheet date. Assets that are 'performing' are shown in stage 1; assets where there has been a significant increase in credit risk ('SICR') since initial recognition or 'deteriorating' assets are in stage 2; and accounts which are credit impaired or in 'default' are in stage 3.

Impairment allowance for loans and advances to customers

The references below show where the Bank's impairment assessment and measurement approach is set out in this report. It should be read in conjunction with the Summary of significant accounting policies set out in note 1.4 to the financial statements.

- The Bank's definition and assessment of default (note 27.3.4).
- An explanation of the Bank's internal grading system (note 27.3.5).
- How the Bank defines, calculates and monitors the probability of default, exposure at default and loss given default (notes 27.3.5, 27.3.6 and 27.3.7 respectively).
- When the Bank considers there has been a significant increase in credit risk of an exposure (note 27.3.8).
- The Bank's policy of segmenting financial assets where ECL is assessed on a collective basis (note: 27.3.8).

Risk Management Report (Cont'd)

The table below shows the credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and year-end stage classification. The amounts presented show both gross loans and advances to customers and net balance after impairment allowances.

Impairment allowance for loans and advances to customers

As at 30 September 2020

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Loans and advances to customers	333,172	75,784	14,340	423,296
Allowance for impairment losses	(2,723)	(3,175)	(8,416)	(14,314)
Net total	330,449	72,609	5,924	408,982

As at 1 October 2019

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Loans and advances to customers	291,424	20,476	8,182	320,082
Allowance for impairment losses	(1,428)	(1,312)	(2,029)	(4,769)
Net total	289,996	19,164	6,153	315,313

Further analysis of impairment allowance for loans and advances to customers is contained in note 26.5 to the financial statements.

The internal rating and PD estimation process

The Bank operates an internal credit grading model and Probability of Default estimation process. The Probability of Default ('PD') is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period if the facility has not been previously derecognised and is still in the portfolio.

The Bank assesses its customers at origination and rates them on an internal AAA to D grade scale using an internal credit classification model. Collateral is also considered when grouping credit grades together. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. These information sources are used to determine the original probability of defaults (PDs) for each segment. PDs are then adjusted for IFRS 9 expected credit loss ('ECL') calculations to incorporate forward-looking information and the IFRS 9 stage classification of the exposure.

Corporate lending (Business Finance Division, Bridging Finance and Azule)

Corporate lending comprises hire purchase, lease or bridging loans. The borrowers are assessed by the internal credit risk team. The credit risk assessment is based on a credit scoring model that considers historical, current and forward-looking information which includes:

- Historical financial information.
- Publicly available information on the clients from external parties.
- Other objectively supportable information on the quality and abilities of the client's management relevant for the Bank's performance.

The complexity and granularity of the rating techniques vary based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Risk Management Report (Cont'd)

Consumer lending

Consumer lending comprises hire purchase or conditional sale agreements. The application for these products are rated by an automated scorecard tool, primarily driven by credit reference agency data. Additional checks on affordability are made using credit reference agency data and bank statements.

The internal credit rating grades

The tables below identify the internal ratings used by the Bank with the highest quality grades considered to be grades 4 and above.

- **Business Finance, Bridging Finance and Azule**

Internal rating grade	Internal Rating Description	Internal PD range
1	AAA & AA, LTV <=80%	1.37-2.15%
2	AAA & AA, LTV > 80%	2.58-4.29%
3	A & B+, LTV <=80%	2.70-4.23%
4	A & B+, LTV > 80%	5.05-8.35%
5	B & B-, LTV <=80%	3.72-7.18%
6	B & B-, LTV > 80%	8.37-13.29%
7	C & D	9.14-16.35%

- **Consumer Finance**

Internal rating grade	Internal Rating Description	Internal PD range
1	AAA & AA, LTV <=80%	2.57-3.58%
2	AAA & AA, LTV > 80%	4.18-5.06%
3	A & B+, LTV <=80%	5.06-6.98%
4	A & B+, LTV > 80%	8.09-9.75%
5	B & B-, LTV <=80%	7.02-9.95%
6	B & B-, LTV > 80%	12.01-15.20%
7	C & D, LTV <=80%	9.26-13.06%
8	C & D, LTV > 80%	17.19-22.88%

Risk Management Report (Cont'd)

Capital risk

Capital risk is risk that the Bank has insufficient capital or contingency to maintain its required regulatory or internally set minimum capital ratios and buffers or sustain its long-term lending operations.

Management of Capital risk

The Bank aims to maintain a sufficient level of capital above its regulatory requirements in order to meet both unexpected losses as they arise and maintain the trust and confidence of investors, regulators, customers and the Group. Regulatory requirements are set on a risk basis covering total capital requirement, regulatory buffers, plus a management overlay.

The PRA supervises the Group on a consolidated basis incorporating the Bank and receives information on the capital adequacy of, and sets capital requirements for, the Bank as well as the Group. The Bank is dual regulated with the Financial Conduct Authority ('FCA').

The Bank assesses its capital position and risks as part of the Group through an annual Internal Capital Adequacy Assessment Process (ICAAP) in line with prudential requirements; and through more regular monthly reporting as part of its standard recovery plan early warning indicator set. The ICAAP considers the key capital risks and the amount of capital it should retain to cover these risks. These requirements are assessed against the current position and throughout its five year business plan.

Stress testing is a major part of the ICAAP and ensures the Bank is resilient to a range of stresses including the ability to meet requirements under a severe but plausible stress.

In the UK, banks are required to meet minimum capital requirements as prescribed by CRD IV for Pillar 1, namely a CET1 capital requirement of 4.5% of RWAs, a Tier 1 capital requirement of 6% of RWAs and a Total capital requirement of 8% of RWAs.

Risk Weighted Assets

The Bank does not operate a trading book and has no Market Risk pillar 1 risk weighted asset exposure ('RWA'). Its RWAs are therefore driven predominantly by Credit risk with a component of additional Operational risk and a credit valuation adjustment (reflecting changes in the value of derivatives arising from the credit risk of the derivative counterparty).

Risk Weighted Asset exposure	2020 £'000	2019 £'000
Central Government & central banks	1,849	672
Institutions	170	181
Corporates	17,500	22,000
Retail	203,862	206,857
Other items	82,515	30,199
Total credit risk	305,897	259,909
Operational risk	33,174	26,204
Credit valuation adjustment	19	90
Total Risk Weighted Assets	339,089	286,203

Risk Management Report (Cont'd)

Risk based capital

A Pillar 2 capital requirement reflects wider risks within the ICAAP assessment and any capital add-ons arising from the supervisory review of those assessments. In addition, a PRA buffer may be applied to reflect both the outcome of stress testing, and where the PRA views that controls need to be strengthened.

In addition to these requirements CRD IV requires lenders to hold supplementary capital buffers. As at 30th September 2020, these included a Capital Conservation buffer (CCoB) of 2.5%, a Systemic Risk buffer (SRB) of 0%, and a Counter-Cyclical buffer (CCyB) of 0% (reduced from 1% in March 2020).

Capital resource and key ratios	2020 £'000	2019 £'000
Total CET1 capital	54,435	52,226
Total Tier 1 capital	54,435	52,226
Total Capital	61,435	52,226
CET1 capital ratio	16.1%	18.2%
Tier 1 capital ratio	16.1%	18.2%
Total capital ratio	18.1%	18.2%

The Bank applies the Standardised approach for calculating its credit risk and capital management. In the UK, banks are required to meet minimum capital requirements as prescribed by CRD IV for Pillar 1, namely a CET1 capital requirement of 4.5% of RWAs, a Tier 1 capital requirement of 6% of RWAs and a Total capital requirement of 8% of RWAs.

Following the publication of the response to consultation CP14/21 on the UK Leverage Framework (PS 21/21), PCF will not have sufficient retail deposits or non-UK exposure to be classified as an 'LREQ' firm and therefore is not in scope for a formal leverage ratio requirement under the UK CRR. However, in line with the expectations identified in the regulation, the Bank continues to monitor its leverage ratio as though the minimum requirement of 3.25% plus buffers was applicable.

Leverage Ratios (%)	2020	2019
Leverage Ratio – Using a transitional definition of Tier 1 capital	12.1%	14.7%

Liquidity and funding risk

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

Management of Liquidity & funding risk (unaudited)

At all times, the Bank maintains sufficient high quality liquid resources to ensure that there is no significant risk from being unable to meet its liabilities as they fall due during a severe but plausible stress. The Bank maintains a diversified funding strategy with close relationships with its banking counterparties and being an active participant in the retail deposit taking market, seeking to align the tenor of its funding to the average effective life of its loan portfolio. The current ability of the Bank to access wholesale debt facilities is discussed further in the Emerging risks and uncertainties section on page 21 of the Strategic Report.

Risk Management Report (Cont'd)

The Bank assesses its liquidity position through both an internal set of measures which assess adherence to the Overall Liquidity Adequacy Rule ('OLAR') and through the regulatory defined Liquidity Contingency Ratio (LCR). The Bank maintains the entirety of its Liquid Asset Buffer (LAB) in the form of high-quality liquid assets ('HQLA'). The amount of these, at all times, has been significantly in excess of the 100% LCR minimum requirement. Within both the LCR and OLAR assessments, the Bank sets an intra-day limit to ensure that sufficient funds are held over and above daily requirements to account for volatility in intra-day cash flows. The regulatory requirement for the LCR is in excess of 100%, currently the Bank is subject to solo reporting to the Regulator.

In order to ensure that levels and concentrations of funding do not lead to future liquidity risks, the Bank monitors the stability of its funding exposures through a regulatory defined Net Stable Funding Ratio ('NSFR'). The regulatory requirement for the NSFR is in excess of 100%, similarly to the LCR the bank is currently subject to solo reporting to the Regulator.

	2020	2019
Measure		
LCR %	1,238%	1,346%
NSFR %	123%	122%

Liquidity Resources

The Bank maintains a portfolio of highly marketable and diverse assets that may be liquidated quickly in the event of an unforeseen interruption in cash flow, the liquidity of which is regularly tested. The Bank also has central bank facilities and lines of credit that it can access to meet liquidity needs. In accordance with the Bank's policy, the liquidity position is assessed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

	2020	2019
Liquidity resources	£'000	£'000
Cash and balances with the Bank of England	23,039	5,277
UK Government securities and other qualifying securities	9,095	10,800
Sub-total High Quality Liquid Assets (HQLA)	32,134	16,077
Cash at Bank	772	833
Contingent central bank facilities	18,667	20,080
Total	51,573	36,990

Risk Management Report (Cont'd)

Contractual maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and financial liabilities based on the remaining contractual life to the maturity date. In practice, the contractual maturity will differ to actual repayments; 'on demand' customer deposits will be repaid later than the earliest date on which repayment can be requested, and loans may be repaid ahead of their contractual maturity.

Undiscounted contractual cash flows

	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
30 September 2020						
Undiscounted financial assets	55,260	27,894	120,450	283,453	39,175	526,232
Undiscounted financial liabilities	10,650	19,078	152,525	217,598	24,190	424,041
Net contractual liquidity gap	44,610	8,816	(32,075)	65,855	14,985	102,191
30 September 2019						
Undiscounted financial assets	18,089	28,339	85,084	259,678	24,578	415,768
Undiscounted financial liabilities	-	21,757	121,000	154,136	20,621	317,651
Net contractual liquidity gap	18,089	6,582	(35,916)	105,542	3,957	95,254

Asset Encumbrance

Some of the Bank's assets are used to support collateral requirements for secured funding, central bank operations or third-party repurchase transactions. The assets used in this way are referred to as encumbered. Encumbrance provides cheaper and more stable funding, but it also creates the risk that some creditors may be unable to benefit from the liquidation of encumbered assets in the unlikely event that the Bank was to become insolvent. While these risks are remote, limits on encumbrance are set by the Board and encumbrance levels are managed within these limits.

Below is a summary of the Bank's encumbered and unencumbered assets that would be available to obtain additional funding as securities. For this purpose, encumbered assets are: Assets which have been pledged as collateral (e.g. which are required to be separately disclosed under IFRS 7). Unencumbered assets are the remaining assets that the Bank owns.

Risk Management Report (Cont'd)

Analysis of encumbered and unencumbered assets

	Encumbered		Unencumbered		Total
	Pledged as collateral	Other	Available as collateral	Other	
30 September 2020	102,854	-	272,827	42,396	418,077
30 September 2019	60,821	-	226,481	47,649	334,951

Refer to note 27.1(c) for further information of encumbered and unencumbered assets by asset type.

Market risk

Market risk is the risk of losses or reduced value arising from on and off-balance sheet exposures when impacted by adverse movements in market prices and rates. Market risk predominantly results from interest rate exposures within the Bank's banking book and credit effects. Interest rate risk in the banking book (IRRBB) is the risk that the Bank will be adversely affected by: changes in the absolute level of interest rates; the spread between two rates; the shape of the yield curve; or in any other interest rate relationship. The Bank is indirectly exposed to foreign exchange risk and euro interest rate risk through euro denominated lending by Azule Finance Limited, the Irish Group company, which is included in the Group's risk appetite and internal reporting, although this risk is not considered material (total assets were less than €1,000,000 throughout the year).

Management of market risk

The Bank seeks to limit the adverse impact on net interest margin ('NIM') and where necessary the Bank will fix the cost of borrowing using interest rate swaps to achieve that goal.

Appetite for interest rate generated market risk is calibrated against limiting the effect of a 2% rate shock to approximately 1% of the value of own funds (Tier 1 + Tier 2 capital); significantly below the regulatory requirement to be below 20% of own funds. It is assessed by calculating changes in Economic Value ('EV') through a standardised 2% rate shock (EV 200bp).

Market risk is managed on a Group consolidated basis. There is a risk that the Bank, in supporting the Group may experience volatility in its profit and loss should it not be able to freely adjust its interest rate swap positions as facilities are currently withdrawn though Management anticipate following the Annual Report & Financial Statements 2020 finalisation and the Group's shares are no longer suspended from trading our bankers will, on review, reinstate these facilities. Management monitors the interest rate gap risk closely and, where required, seeks to hedge asset exposures naturally with appropriate tenor retail deposits.

The Bank will not carry out proprietary trading nor operate a trading book.

The Bank has limited appetite for foreign exchange risk and where assets are bought or sold in foreign currency (e.g., where a UK-based customer wishes to finance an asset sourced from mainland Europe), these are limited to short-term exposures.

Reprice risk

The Bank is exposed to interest rate risk arising from when the Bank's assets and liabilities reprice on different dates such that the Bank is negatively impacted. This type of risk is managed by natural offsets across the balance sheet and through the use of swaps and other derivatives. The Bank as part of the Group assessed its interest rate risk in the banking book ('IRRBB') primarily through Earnings at Risk plus a series of economic value ('EV') measures which included a +/-200 basis points parallel yield curve shift. The Group has since developed its regulatory measures to incorporate the full suite of Supervisory Outlier Tests using economic value of equity ('EVE') and Net Interest Income (NII) measures.

Risk Management Report (Cont'd)

Shock applied	2020 £'000	2019 £'000
Impact on present value of assets and liabilities at year end from a parallel change in the yield curve:		
+200 basis points shift	358	74
- 200 basis points shift	(503)	(147)

Basis risk

The Bank is exposed to the risk that the impact of relative changes in interest rates for balance sheet exposures that have similar tenors but are priced using different interest rate indices. However, the Bank has limited basis risk as its balance sheet is predominantly fixed; limiting the exposure to differing rate bases.

Interbank Offered Rate (IBOR) reform means that interest rate benchmarks such as LIBOR are expected to cease at the end of 2021. The movement away from using LIBOR was undertaken by the Group's Treasury team with oversight from ALCO. All the Bank's swaps are entered into at the SONIA rate, the Bank of England's preferred risk-free alternative rate to LIBOR. The sole exception to this policy is the revolving credit facility provided by Leumi ABL Limited, which when drawn accrues at overnight LIBOR plus a fixed spread. Leumi has advised that it intends to re-base the facility to SONIA by the end of 2021 in line with the LIBOR transition. As of the date of signing the Annual Report and Financial Statements there is currently no outstanding balance on this facility.

Option risk

The Bank is exposed to the risk that an embedded option is incorporated into a product or derivative, and where the use of the option may change the interest rate exposure. For example, the ability to prepay a car loan before the end of the loan's term is a product option which can create risk to the Bank in a falling rate environment. The risk predominately arises from the early termination of fixed rate loans or deposits. However, the contractual terms of PCF's loans and deposits significantly limit the propensity for option risk.

Refinance risk

The Bank is exposed to the risk that at the maturity of an asset or liability, which may be otherwise perfectly hedged, the rate received or paid on the replacement asset or liability reduces the overall Net Interest Margin. This risk is managed by limiting the concentration of maturities across the two sides of the balance sheet.

Foreign Currency Risk

The Group operates primarily in sterling markets, but it has a small book of euro denominated assets held by Azure Finance Limited. The total currency exposure to euro denominated assets is managed within Board limits.

Foreign Exchange exposure to an immediate +/-15% change in the value of sterling	£'000
30 September 2020	(12)
30 September 2019	13

Risk Management Report (Cont'd)

Operational risk

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

Management of Operational risk

The Bank seeks to maintain an internal control environment to both mitigate operational risk, which is inherent to its business activities, and to minimise the financial impact of operational risk arising from IT disruption, human error, a breakdown of procedures, non-compliance with policy and internal or external fraud. Additionally, the Bank will mitigate and limit the impact of business decisions on its cyber risk exposure. Activities against the most relevant operational risk sub-categories are given below.

Operational Resilience, Information security and Information Technology

The Bank continues to review its IT system architecture to ensure systems remain resilient and that the confidentiality, integrity and availability of critical systems and information assets are protected against cyber attacks. This includes continuing to enhance the resilience of systems based on emerging best practice and seeking advice from external IT advisors where necessary.

This overarching operational resilience framework is supported by processes and policies for business continuity and disaster recovery planning, crisis communication, cyber incident response & resilience and supplier outsourcing assurance, which are currently all board approved documents.

Change management

The Bank has further developed its project governance structure and delivery framework with respect to IT and change management. This seeks to ensure that appropriate controls are in place with the aim of avoiding serious disruption or processing inefficiencies to the business during or after the implementation of change.

3rd Party Outsourcing

The Bank has a minimal amount of outsourced functions, including postal services and payroll. The Bank continues to implement a robust Supplier and Outsourcing Assurance Framework and undertakes ongoing due diligence on third parties. This includes a risk assessment which requires due diligence on their IT security, physical and logical access to information held on the Bank's assets or liabilities, the commercial risks associated with a service provider, and the processes that will be used to monitor and oversee performance and ongoing delivery of the service.

People

The Bank as part of the Group seeks to attract, retain and engage high quality employees which was of particular significance over the pandemic and as we work through remediation activities, and is covered in more detail within the Strategic Report. It has continued to make significant investments in people in order to secure and grow expertise across its Finance, Treasury and Risk functions; supporting the remediation initiatives that have taken place since then. Over the period the Bank has rolled out and enhanced its operational risk training and compliance awareness sessions to employees.

Internal control environment

As identified in the emerging risks and uncertainties section of the Strategic Report, the Bank is making significant investments in its RMF, controls, and processes supporting regulatory and financial returns and disclosures. The framework that had been in operation had not kept pace with growth and expectations of a new bank, exacerbated by the poor culture and lack of expertise at that time. The associated remediation programme to address these issues is progressing with full embedding expected to complete in 2023.

Risk Management Report (Cont'd)

Regulatory risk

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

Management of regulatory risk

A significant mitigant to regulatory risks is to be aware of when regulatory change is being considered and implemented. To control the risks around this, the Bank undertakes a process termed horizon scanning - a process of extracting new requirements by searching web sites, correspondence (formal letters and regular regulatory releases), accessing 3rd party training and updates, and face to face meetings.

Horizon scanning is conducted by the second line and is in the process of being formally split between the Compliance team with responsibility for horizon scanning on conduct matters and regulation identified by the Financial Conduct Authority (FCA), and the Financial Risk Management team with responsibilities covering the Bank of England's regulatory bodies (the Prudential Regulatory Authority and the Resolution Directorate). That change has since been completed.

Aligned with a revised approach to risk culture, the Board and Executive team wish to ensure communication to all stakeholders including the regulator is as transparent as possible; an approach the Bank believes will foster stronger relationships and ultimately limit the regulatory risks faced by PCF.

Following the commencement of remediation activity, the Bank as part of the Group has access to external legal and regulatory specialist support along with a growing level of in-house expertise to advise the business on an appropriate course of action. This is aided through an engagement with industry bodies, such as UK Finance and The Finance and Leasing Association.

Bank policies and procedures set out the principals and key controls that are to be applied across the business and which are aligned to the Board's risk policies. These are reassessed in the context of revisions to the regulation by the business units with oversight of implementation and compliance provided by the second line Risk & Compliance function; which can take the form of thematic reviews or gap analysis against the regulations.

Conduct risk

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

Management of conduct risk

The Bank has no appetite for customer harm or conduct risk events through inappropriate product design, corporate culture, or operational processes. The Bank therefore restricts its activities to areas of established expertise and seeks to create a culture that delivers a fair outcome for customers.

The Bank has identified customer-focused policies and procedures including Responsible Lending, Treating Customers Fairly ('TCF') and Vulnerable Customers; reflecting the customer outcomes the Board intends to achieve through product design, governance and distribution.

The Bank continues to perform outcomes testing and assurance checks on fair outcomes for customers, including monitoring and analysing key information, training on vulnerable customers and complaints handling, and independent assurance from Second and Third line.

Customer needs are considered within business and product level planning and strategy; articulated through the product governance framework. The framework seeks to ensure that products continue to offer fair value and meet the needs of the relevant target market throughout their life cycle.

Risk Management Report (Cont'd)

The Group is enhancing its recruitment, training and focus on management of colleague performance with clear customer accountabilities and customer centric feedback to be built into performance appraisals.

The Bank seeks to learn from past mistakes on customer complaints using techniques such as root cause analysis. Complaints are viewed as a valuable source of management information and in recognition of that, despite an intolerance for conduct risk failures, mistakes do happen and, when they do, they must be rectified, fully understood, and the learning taken from them. The programme of assurance reviews undertaken has centred on conduct risk clusters, and has included product design and governance, periodic product reviews, culture measurement, marketing and promotion, the treatment of vulnerable customers, and complaint handling.

Independent Auditor's Report

to the members of PCF Bank Limited

for the year ended 30 September 2020

Disclaimer of opinion

We were engaged to audit the financial statements of PCF Bank Limited (the 'Company') for the year ended 30 September 2020 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Statement of Cash Flows, and the related notes 1 to 32, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Accounting Standards ('IAS') in conformity with the requirements of the Companies Act 2006.

We do not express an opinion on the accompanying financial statements of PCF Bank Limited.

Due to the significance of the matter described in the basis for disclaimer of opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

As set out in 'Completion of the Annual Report and Financial Statements 2020' on pages 28 to 31 of the Annual Report, as a result of enquiries raised by us during our audit of the financial statements, the new Chief Financial Officer identified certain accounting errors and misstatements that led to the immediate parent company of PCF Bank Limited (PCF Group PLC), engaging a third-party accounting firm to undertake an independent forensic investigation into those errors and misstatements. Following this, the Chief Financial Officer and Finance Function undertook its own further analysis and reconciliation procedures.

The independent forensic investigation identified certain manual adjustments made by employees of PCF Group PLC for internal management, financial and regulatory reporting purposes, relating to the Company. We concluded that certain of these matters were indicators of fraud.

Given the potential wider consequences of this on our audit, we sought to extend our procedures and presented a plan to the PCF Group PLC Audit Committee in July 2021. We were unable to complete our audit for the following reasons:

- Management was unable to provide sufficient and appropriate audit evidence in response to our extended testing requests.
- The Board of Directors resolved in July 2021 that management should only continue to provide us with the information necessary for us to issue a disclaimer of opinion on these financial statements.

For the same reasons as set out above, we were also unable to complete audit procedures over reclassifications as described in note 1.8 to the financial statements.

Key audit matters

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

These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

In addition to the matters described in the Basis for disclaimer of opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Risk	Our response to the risk
<p>Risk of misstatement of expected credit losses (ECL)</p> <p>Loans and advances to customers: £408,982k (2019: £315,313k)</p> <p>Allowance for impairment losses on loans and advances: £14,314k (2019: £4,769k)</p> <p>Refer to accounting policies (note 1.6.2) and note 12 of the Financial Statements</p> <p>Impairment of loans and advances carries a high degree of estimation uncertainty derived from key model assumptions used to determine the provision. The key assumptions we focused on were assessment of significant increase in credit risk, incorporation of macro-economic factors and other top sided management adjustments such as post-model adjustments or overlays.</p> <p>In light of the level of judgement and subjectivity involved, there is a risk that as a result of fraud or error the impairment provision could be materially misstated.</p>	<p>We understood and evaluated the design effectiveness of key controls. We concluded that there were no effective controls over the ECL provision including review of input and output data, data validation, model governance and model testing. Accordingly, we planned to adopt a fully substantive approach.</p> <p>We planned to perform the following audit procedures:</p> <p>We planned to perform an overall assessment of the ECL provision levels by stage to determine if they were reasonable by considering the:</p> <ul style="list-style-type: none"> ▪ overall credit quality of the company's portfolio; ▪ collateral values; ▪ impact of COVID-19 and high risk industries; ▪ impact of government support measures, such as payment deferrals, may have had on delaying expected defaults; ▪ credit risk management practices; and, ▪ the macroeconomic environment by considering trends in the economy and sectors to which the Company is exposed. <p>We planned to evaluate the criteria used to allocate a financial asset to stage 1, 2 or 3 in accordance with IFRS 9. We planned to involve modelling specialists to assess and test that implementation of significant increase in credit risk is in accordance with IFRS 9. We planned to perform sensitivity analysis to assess the impact of different criteria on the ECL.</p> <p>We planned to involve modelling specialists to assist us in testing ECL model assumptions, inputs and formulae. This plan included a combination of assessing the appropriateness of model design and formulae used, alternative modelling techniques, and recalculating the Probability of Default, Loss Given Default and Exposure at Default.</p> <p>We planned to involve economic specialists to assist us in evaluating the base case and alternative economic scenarios, including assessing probability weights and comparing these to other scenarios from a variety of external sources. This planned assessment</p>

	<p>included the latest developments related to COVID-19. We planned to assess whether forecasted macroeconomic variables were appropriate and complete.</p> <p>We planned to test post-model adjustments and overlays, assess the completeness of these adjustments and their appropriateness by considering the data, judgments, methodology, sensitivities and governance, particularly in the context of the impact of COVID-19, as well as model limitations. We planned to involve our modelling and collateral valuation specialists supported us in the execution of this work.</p> <p>We planned to undertake testing over the completeness and accuracy of the data inputs into the IFRS 9 model.</p> <p>We planned to agree the quantitative disclosures to source data and assess the consistency of qualitative disclosures with accounting policies, and our understanding of the modelling process, which would be gained during the course of the audit.</p>
Key observations communicated to the Audit Committee	
<p>We communicated to the Audit Committee, in accordance with the requirements of ISA (UK) 265, significant deficiencies in respect of the internal control environment over process documentation, data accuracy and completeness, formalised model approval, validation, monitoring and back-testing, underlying documentation to support assumptions and the framework for identifying and measuring post model adjustments and overlays.</p> <p>As a result of the issues outlined in the Basis of Disclaimer section of our report, we were unable to complete our audit procedures and accordingly, we are unable to conclude on this key audit matter.</p>	

Risk	Our response to the risk
<p>Risk of incorrect valuation of investments in subsidiaries</p> <p>Investment in subsidiaries: £1,209k (2019: £5,605k)</p> <p>Impairment in investment in subsidiaries: £4,396k (2019: nil)</p> <p>Refer to the accounting policies (note 1.6.3) and note 14 of the Financial Statements</p> <p>Investment in subsidiaries (notably Azule Limited and PCF Credit Limited) are carried at cost less impairment losses in the financial statements of PCF Bank Limited.</p> <p>Impairment assessment carries a high degree of estimation uncertainty, derived from cashflow forecasts, long-term growth rates and calculation of an appropriate discount rate.</p> <p>Given the level of judgement and subjectivity involved, there is a risk that investments in subsidiaries are overstated.</p>	<p>We understood and evaluated the design effectiveness of key controls. We concluded that there were no effective controls over the investments in subsidiaries impairment process. Accordingly, we planned to adopt a fully substantive approach.</p> <p>For Azule Limited, we planned to obtain the Directors' cashflow projections in order to challenge the reasonableness of assumptions used, including the long-term growth rate and discount rate.</p> <p>We planned to involve valuation specialists to support us in evaluating the discount rate and long-term growth rate used in the model. We planned to compare the rates used by the Directors to ranges which had been independently calculated by our valuation specialists with reference to comparable companies and external market data.</p> <p>For the cash flow forecast used in the model, we planned to test the arithmetic accuracy of the model and to evaluate the assumptions used.</p> <p>We planned to perform sensitivity and scenario analysis on assumptions such as cashflow, discount rate and long-term growth rate.</p> <p>We planned to perform an independent recalculation of the net present value and terminal value of cashflows.</p> <p>For PCF Credit Limited, we planned to compare the financial position as at 30 September 2020 (which had been subject to audit procedures) with the value of the investment recorded. We also planned to understand whether the entity was in 'run-off' and whether there was any new business expected to be booked in the future.</p> <p>For both investments, as appropriate, we planned to evaluate the adequacy of disclosures in the financial statements including the assumptions and sensitivities disclosed.</p>

Key observations communicated to the Audit Committee	
<p>We communicated to the Audit Committee, in accordance with the requirements of ISA (UK) 265, significant deficiencies in respect of the internal control environment around preparation of cashflow forecasts, underlying documentation to support assumptions and review of the impairment model.</p> <p>As a result of the issues outlined in the Basis of Disclaimer section of our report, we were unable to complete our audit procedures and accordingly, we are unable to conclude on this key audit matter.</p>	
Risk	Our response to the risk
<p>Risk of fraud in the recognition of revenue in respect of the application of the effective interest rate methodology - estimation uncertainty of expected life of the loans and termination income</p> <p>Interest income calculated using the effective interest method (loans and advances to customers): £39,994k (2019: £29,732k)</p> <p>Refer to accounting policies (note 1.6.1) and note 2 of the Financial Statements</p> <p>For product fees relating to hire purchase and finance leases, the Company operates a model to recognise fee income within 'Interest income calculated using the effective interest method'. The effective interest method spreads the recognition of product fee income over the life of the financial instrument, as these are in substance an integral part of the overall yield.</p> <p>Effective interest models are sensitive to judgements about the expected lives of the product to which they relate. Due to the complexity of calculations, the degree of judgement exercised by the Company in respect of the expected lives of the product and the different products for which fees are recognised, this is considered a key audit matter.</p>	<p>We understood and evaluated the design effectiveness of key controls. We concluded that there were no effective controls over the process to estimate EIR inputs. Accordingly, we planned to adopt a fully substantive approach.</p> <p>We planned to assess the key assumptions used in the EIR calculation including the expected behaviour and lifecycle of the products and termination income as well as the impact of COVID-19 on the assumptions used.</p> <p>We planned to perform sensitivity analysis over the key inputs to understand the impact which they have on revenue recognition.</p> <p>We planned to test the data flows used and evaluate the arithmetic accuracy of the EIR calculation. We also planned to recalculate settlement income on a sample basis</p> <p>In addition to our work over the estimation process, we planned to:</p> <ul style="list-style-type: none"> - recalculate finance lease income on a sample of leases and test completeness and accuracy of data through reconciliation to source systems. - test that fees and commissions were appropriately included in the EIR calculations in accordance with the accounting standards and by reference to underlying client agreements. - select a risk-based sample of journal entries and examine the journals for validity and appropriateness. <p>We also planned to evaluate the adequacy of disclosures in the financial statements including the assumptions and sensitivities disclosed.</p>

Key observations communicated to the Audit Committee

<p>We communicated to the Audit Committee, in accordance with the requirements of ISA (UK) 265, significant deficiencies in respect of the internal control environment around data inputs, underlying documentation to support key assumptions, and review of the EIR calculation.</p>

<p>As a result of the issues outlined in the Basis of Disclaimer section of our report, we were unable to complete our audit procedures and accordingly, we are unable to conclude on this key audit matter.</p>
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In the current year report, we have included an additional key audit matter relating to the risk of incorrect valuation of investments in subsidiaries. Other than for this item, the current and prior year key audit matters are consistent.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed.

Our application of materiality

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

Materiality

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

In planning our audit, we determined materiality for the Company to be £260k (2019: £445k), which was based on 5% of profit before tax for the first six months of the financial year, annualised.

We believed that adjusted profit before tax is the most appropriate measurement basis for determining our materiality as it is a consistent basis for computing materiality across the banking industry. The primary stakeholders of the financial statements are the parent company, investors in the parent company, deposit holders and regulators, who regard the operating performance, particularly profit before tax, as the most relevant measure, as this reflects either profits available for distribution to shareholders or retained earnings forming part of the Company's equity.

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 50% (2019: 50%) of our planning materiality, namely £130k (2019: £222k). We set performance materiality at this percentage due to the number of audit differences identified during the prior year audit.

As set out in the Basis of Disclaimer section above, we have been unable to complete our audit and we do not express an opinion on the accompanying financial statements of PCF Bank Limited.

Opinions on other matters prescribed by the Companies Act 2006

Due to the significance of the matter described in the basis for disclaimer of opinion section of our report, we have been unable to form an opinion, whether based on the work undertaken in the course of the audit:

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

Matters on which we are required to report by exception

Due to the significance of the matter described in the basis for disclaimer of opinion section of our report, we have been unable to form an opinion as to whether there are material misstatements in the strategic report or the directors' report.

Arising from the limitation of our work referred to above:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and,
- we were unable to determine whether adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; and,
- we were unable to determine whether the Company financial statements are not in agreement with the accounting records and returns; and,
- we were unable to determine whether certain disclosures of directors' remuneration specified by law are not made.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on pages 35 to 36, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to conduct an audit of the Company's financial statements in accordance with International Standards on Auditing (UK) and to issue an auditor's report. However, because of the matter described in the basis for disclaimer of opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant are those that relate to the reporting framework (Companies Act 2006 and International Accounting Standards in conformity with the requirements of Companies Act 2006), regulations and supervisory requirements of the Prudential Regulation Authority, Financial Reporting Council and the Financial Conduct Authority, as well as relevant tax law.
- We understood how the Company is complying with those frameworks by performing a combination of inquiries of senior management (including those within Risk and Compliance) and those charged with governance as required by auditing standards, review of Board and Audit & Risk Committee minutes and gaining an understanding of the Company's approach to governance. We also inspected regulatory correspondence and met with the Prudential Regulation Authority and Financial Conduct Authority during the audit.
- Through these procedures, we became aware of actual or suspected non-compliance with laws and regulations as well as indicators of fraud; which was sufficiently significant to our audit that it resulted in the requirement to perform additional audit work. This included plans to:
 - Extend testing over the intercompany balance substantiation process.
 - Select additional journals for testing using a specialist forensics tool.
 - Extend journal entry testing further using new criteria.
 - Revisit and challenge the sufficiency and appropriateness of audit evidence provided to us during the audit to date.
 - Assess and apply a significant risk of fraud across all accounts in the financial statements and consequently, revisit and re-sample across the audit.
 - Consider impact on IT audit conclusions given the heightened risk of management override of controls.
 - Involve conduct specialists in performing a risk assessment over undetected conduct matters, which could have a material impact on the financial statements.

We were unable to complete our procedures as set out in the Basis of Disclaimer section above.

- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur by considering if there are sufficient controls established by the Company to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. Our response included those procedures set out above as part of the key audit matter: *Risk of fraud in the recognition of revenue in respect of the application of the effective interest rate methodology.*
- We communicated significant deficiencies in respect of the Company's internal control environment to the Audit Committee, including those which are outlined in the key audit matters above. We concluded that the internal control environment over financial reporting was ineffective
- The Company operates in the banking industry, and the primary scope of its regulated activities is the acceptance of deposits, and to engage in consumer credit activities.
- Banking is a highly regulated environment, and as such the Senior Statutory Auditor considered the experience and expertise of the engagement team, to ensure that the team had the

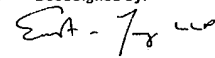
appropriate competence and capabilities. The Senior Statutory Auditor included the use of specialists in the following fields: econometrics, valuation, forensics, quantitative modelling, regulatory capital and tax.

Other matters we are required to address

- We were appointed by the Company in 1994 to audit the financial statements for the year ending 31 December 1994 and for subsequent periods. The Company changed its accounting reference date in 2006 and 2016. The period of total uninterrupted engagement including previous renewals and reappointments of this Company is 27 years, covering the periods ended 31 December 1994 to 30 September 2020.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Use of our report

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

DocuSigned by:

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Gary Adams (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
22 December 2021

Income Statement

for the year ended 30 September 2020

	Notes	Year ended 30 September 2020 £'000	Year ended 30 September 2019* £'000
Interest income calculated using the effective interest method	2	40,246	30,277
Interest expense calculated using the effective interest method	3	(15,421)	(10,942)
Net interest income		24,825	19,335
Fee and commission income*	4	924	940
Fee and commission expense	4	(1,231)	(733)
Net fee and commission (expense)/income		(307)	207
Net loss on financial instruments classified at fair value through profit or loss		(55)	(63)
Net operating income		24,463	19,479
Depreciation of office equipment, fixtures and fittings	15	(338)	(103)
Amortisation of intangible assets	16	(552)	(416)
Other operating expenses	7	(12,790)	(9,719)
Impairment loss on software	16	(51)	-
Impairment loss on investments	14	(4,396)	-
Impairment losses on financial assets*	5	(10,015)	(3,332)
Total operating expenses		(28,142)	(13,570)
Operating (loss)/profit		(3,679)	5,909
Dividend income	6	2,750	3,000
(Loss)/Profit before tax		(929)	8,909
Income tax charge	10	(131)	(1,116)
(Loss)/Profit after tax		(1,060)	7,793

Statement of Comprehensive Income

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
(Loss)/Profit after taxation	(1,060)	7,793
Other comprehensive income that will be reclassified to the income statement:		
Fair value gain/(loss) on debt instruments at FVOCI**	51	(10)
Deferred tax (charge)/income	(7)	2
	44	(8)
Total comprehensive income, net of tax	(1,016)	7,785

*Comparatives for the recoverable amount of fees charged on credit impaired accounts have been re-presented from Impairment losses on financial assets to Fees and commission income to make the Income Statement more relevant following a review of the disclosures and accounting policies applied (please see note 1.8).

**Fair value gain/(loss) on debt instruments at FVOCI are presented net of deferred tax.

The notes on pages 71 to 122 form part of, and should be read in conjunction with, these Financial Statements. All activities in the current and prior year relate to continuing operations.

Balance Sheet

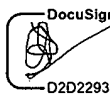
at 30 September 2020

	Notes	30 September 2020 £'000	30 September 2019 £'000
Assets			
Cash and balances at central banks	11	23,811	6,110
Debt instruments at FVOCI	13	9,095	19,638
Loans and advances to customers	12	408,982	315,313
Due from related companies	19	17,853	6,001
Investment in subsidiaries	14	1,209	5,605
Office equipment, fixtures and fittings	15	888	500
Intangible assets	16	3,180	3,044
Deferred tax assets	17	740	204
Other assets	18	590	1,572
Total assets		466,348	357,987
Liabilities			
Due to banks	21	62,412	34,050
Due to customers	20	341,784	266,695
Subordinated liabilities	22	7,126	-
Derivative financial instruments	26.4	80	63
Other liabilities	23	1,718	2,935
Total liabilities		413,120	303,743
Equity			
Issued capital	25	31,298	31,298
Other reserves	25	51	7
Retained earnings		21,879	22,939
Total Equity		53,228	54,244
Total liabilities and equity		466,348	357,987

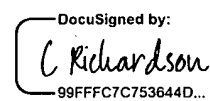
The Financial Statements were approved and authorised for issue by the Board on 22 December 2021

Signed on behalf of the Board of Directors by,

GG Stran
Director

DocuSigned by:

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Caroline Richardson
Director

DocuSigned by:

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The notes on pages 71 to 122 form part of, and should be read in conjunction with, these Financial Statements.

Statement of Changes in Equity

for the year ended 30 September 2020

	Issued capital £'000	Other Reserves £'000	Retained Earnings £'000	Total Equity £'000
Balance as at 1 October 2019	31,298	7	22,939	54,244
Fair value gain on debt instruments at FVOCI	-	44	-	44
Loss for the year	-	-	(1,060)	(1,060)
Balance as at 30 September 2020	31,298	51	21,879	53,228
Balance as at 1 October 2018	21,298	15	15,625	36,938
Impact on transition to IFRS 9	-	-	(479)	(479)
Restated as at 1 October 2018	21,298	15	15,146	36,459
Issuance of new shares during the year	10,000	-	-	10,000
Fair value loss on debt instruments at FVOCI	-	(8)	-	(8)
Profit for the year	-	-	7,793	7,793
Balance as at 30 September 2019	31,298	7	22,939	54,244

The notes on pages 71 to 122 form part of, and should be read in conjunction with, these Financial Statements.

Statement of Cash flows

for the year ended 30 September 2020

		30 September 2020 £'000	30 September 2019 £'000
Operating activities	Notes		
Total operating (loss)/profit		(3,679)	5,909
Other non-cash items			
Depreciation of office equipment, fixtures and fittings	15	338	103
Amortisation of other intangible assets	16	552	416
Net change in FVOCI financial instruments	13	-	(8)
Impairment loss in investments	14	4,396	-
Accrued finance costs	24	138	-
Impairment loss on software	16	51	-
Net change in derivative financial instruments	26.4	-	63
Impairment charge on loans and advances ⁽¹⁾		10,015	3,332
Loss on disposals of fixed assets	7	3	-
Adjustment for change in operating assets			
Net change in loans and advances ⁽¹⁾	12	(103,685)	(135,862)
Net change in amounts due from related companies	19	(11,852)	(1,685)
Net change in other assets	18	982	(901)
Change in operating liabilities			
Net change in amounts due to customers	20	75,089	75,556
Net change in derivative financial instruments	26.4	17	-
Net change in other liabilities	23	(1,217)	88
Cash generated from operating activities		(28,852)	(52,989)
Income tax paid		(666)	-
Net cash flows used in operating activities		(29,518)	(52,989)
Investing activities			
Dividends received	6	2,750	3,000
Net sale of debt instruments at FVOCI	13	10,587	20,264
Purchase of office equipment, fixtures and fittings	15	(729)	(379)
Investment in subsidiary		-	(3,183)
Purchase of intangible assets	16	(739)	(900)
Net cash flows from investing activities		11,869	18,802
Financing activities			
Proceeds from share issue during the period	25	-	10,000
Proceeds from subordinated debt facility	24	7,000	-
Proceeds from borrowings	24	28,350	9,013
Net cash flows from financing activities		35,350	19,013
Net increase / (decrease) in cash and cash equivalents		17,701	(15,174)
Cash and cash equivalents brought forward		6,110	21,284
Cash and cash equivalents carried forward		23,811	6,110

(1) Comparatives for the impairment charge amount of fees charged on credit impaired accounts have been re-presented from Impairment losses on financial assets to Fees and commission income to make the Net fee and commission note more relevant following a review of the disclosure and accounting policies applied (please see note 1.8).

The accounting policies and Notes on pages 71 to 122 form part of, and should be read in conjunction with, these Financial Statements.

Notes to the Financial Statements

for the year ended 30 September 2020

1. Basis of preparation and significant accounting policies

1.1 Corporate information

PCF Bank Limited ('the Bank') is a private company, limited by shares, registered in England and domiciled in the United Kingdom. The Bank is wholly owned by PCF Group plc ('the Parent' or 'the Group') whose shares are listed on the Alternative Investment Market ('AIM') of the London Stock Exchange. The Bank's registered office is at Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

The Bank is a specialist bank, offering retail savings products for individuals and lending products for consumers and businesses to finance motor vehicles, plant, equipment and property.

The Bank's financial statements for the year ended 30 September 2020 were authorised for issue in accordance with a resolution of the Board of Directors on 22 December 2021.

1.2 Basis of preparation

The financial statements of the Bank have been prepared on a historical cost basis, except for debt financial instruments measured at fair value through other comprehensive income ('FVOCI') and derivatives measured at fair value through profit or loss ('FVTPL'). The financial statements are presented in pound sterling (£) and all values are rounded to the nearest thousand (£'000), except where otherwise indicated. The Bank is exempt from preparing group financial statements by virtue of s400 of Companies Act 2006 as the Bank is part of a larger group, with the Parent preparing group financial statements.

Going concern

The Bank's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. In particular this going concern statement should be read in conjunction with the Emerging risks and uncertainties section on page 21 of the Strategic Report which sets out those risks and mitigations.

The financial position of the Bank, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. The Bank's policies and processes for managing its Risks are described in the Strategic Report and the Risk Management Report.

After making enquiries, the directors have a reasonable expectation that the Bank has adequate resources to continue in operational existence for at least the next twelve months. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report & Financial Statements.

The Directors have assessed the appropriateness of the going concern assumption taking into account a detailed review of the Group's (the Group substantially consists of the Bank) medium-term plan which includes increased remediation costs alongside a consideration of capital, funding and liquidity requirements. This consideration also included other business and emerging risks.

The Bank made a £(0.9) million statutory loss before tax in the year. The Group Board has approved a medium-term plan in which the Group returns to profitability (and therefore the Bank), but this is dependent on building scale to support an increased cost base. Remediation costs are expected to be incurred for at least the next twelve months. The growth in the medium-term plan requires capital to be raised. However, given the delay to both the Bank and Group's Annual Report & Financial Statements 2020, the disclaimer of auditor opinion and the temporary suspension of trading in the Group's shares, there are risks associated with our ability to raise capital at the Group level and fund the planned future balance sheet growth of the Bank. This indicates that the Group's and Bank's ability to operate as a going concern is subject to material uncertainties.

Notes to the Financial Statements

Group (and therefore Bank) performance, and the return to profitability in the medium-term plan, is underpinned by a number of key inputs and assumptions which cover:

- The raising of external capital.
- The funding of new business through retail deposits and other wholesale funding.
- New business origination levels.
- Net interest margin on new business originations.
- The expected date of completion of the Group's remediation activities and the impact on the Group's expenses.
- The level of impairment losses on financial assets.
- Capital requirements, both from a regulatory and internal management perspective.
- Dividends, which have been assumed at zero in the medium-term plan.

As with any medium-term planning process, there is a risk that these assumptions do not materialise. As part of the review of the medium-term plan, the Group Board was presented with a severe but plausible downside in which the Group is unable to raise external capital, and a number of sensitivities to the medium-term plan in which the Group's (and therefore the Bank's) net interest margin, impairment losses and business volumes were subject to materially adverse performance. Even under the severe but plausible scenario it was demonstrated that the Group (and therefore the Bank) would continue to operate and meet regulatory requirements for at least the next twelve months, albeit at the expense of balance sheet growth.

The Board has concluded based on the items below that the going concern basis of accounting was deemed appropriate:

- Planned performance, including a medium-term plan which returns the Group (and therefore the Bank) to profitability.
- The assessment of downside risk to the medium-term plan.

1.3 Statement of compliance

The financial statements of the Bank have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006.

Notes to the Financial Statements

1.4 Summary of significant accounting policies

1.4.1 New standards, interpretations and amendments adopted

From 1 October 2019, a number of new and revised standards issued by the International Accounting Standards Board, and endorsed for use in the EU, came into effect for the Bank. New and revised standards adopted in the period that are deemed significant to the Bank are outlined below. A number of other new standards are also effective from 1 October 2019, but they do not have a material effect on the Bank's financial statements.

1.4.2 Changes in accounting policies and disclosures

The accounting policies applied by the Bank do not differ from those in the 2019 Annual Report, except where noted.

IFRS 16 Leases

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to recognise most leases on the balance sheet.

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. IFRS 16 did not, therefore, have an impact for leases where the Bank is the lessor.

The Bank adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 October 2019. Under this method, the standard is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application. The Bank did not have any operating leases as at 30 September 2020 (30 September 2019: £ nil).

1.4.3 Financial instruments - initial recognition and subsequent measurement

Date of recognition

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

Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Recognised financial assets and financial liabilities are initially measured at fair value. Transaction costs which are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at FVTPL) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in profit or loss. Trade receivables are measured at the transaction price.

Notes to the Financial Statements

Measurement categories of financial assets and liabilities

The Bank classifies all its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either

- Amortised cost; or
- Fair value through other comprehensive income (FVOCI).

Financial liabilities are measured at amortised cost, and derivatives at FVTPL (see below).

Financial assets and liabilities

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

The Bank measures balances at central banks, loans and advances to customers and other assets at amortised cost if both of the following conditions are met

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows; 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 the principal amount outstanding.

The details of these conditions are outlined below.

Business model assessment

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

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

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

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

The Solely Payments of Principal and Interest ('SPPI') test

As a second step of its classification process, the Bank assesses the contractual terms of the financial asset to identify whether they meet the SPPI test. The Bank's loans, hire purchase agreements and conditional sales agreements are repaid by instalments of principal and interest except Bridging loans which are largely bullet payments, together with an administration fee. These meet the SPPI test.

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

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

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

Notes to the Financial Statements

Derivative financial instruments recorded at fair value through profit or loss

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

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

The derivatives are not designated as part of an accounting hedge relationship, and gains and losses arising from changes in fair value are recognised in net gains / losses on financial instruments at fair value through profit or loss in the Income Statement. To calculate fair values, the Bank typically applies discounted cash-flow models using yield curves that are based on observable market data. For collateralised and non-collateralised positions, the Bank uses discount curves based on overnight indexed swap rates.

Derivatives are classified as financial assets where their fair value is positive and as financial liabilities where their fair value is negative. Where there is the legal right and intention to settle on a net basis, then the derivative is classified as a net asset or net liability, as appropriate.

Credit risk derived from derivative transactions is mitigated by entering into master netting agreements and holding collateral. Such collateral is subject to the standard industry Credit Support Annex and is paid or received on a regular basis. As at 30 September 2020, net cash collateral posted is £ nil (2019: £ nil).

Debt instruments at FVOCI

FVOCI debt instruments are measured at fair value with gains and losses arising due to changes in fair value recognised in Other Comprehensive Income ('OCI'). Interest income and foreign exchange gains and losses are recognised in profit or loss. When a debt instrument measured at FVOCI is derecognised, the cumulative gain/loss previously recognised in OCI is reclassified from equity to the Income Statement.

The ECL for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the assets.

Due to banks and due to customers

After initial measurement, amounts due to banks and due to customers are subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issued funds, and costs that are an integral part of the Effective Interest Rate ('EIR') as defined in note 1.5.1.

Subordinated Liabilities

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

Transition from LIBOR

In anticipation of the migration from LIBOR to SONIA, since 2017 the Bank has had a policy of no exposure to LIBOR rates either on or off-balance sheet. Therefore, all variable rate bonds and the variable rate leg of all interest rate swaps are linked to SONIA. The Bank has no exposure to sterling LIBOR or any other IBOR-based instruments or contracts. The sole exception to this policy is the revolving credit facility provided by Leumi, which when drawn accrues at overnight LIBOR plus a fixed spread. Leumi has advised that it intends to rebase the facility to SONIA by the end of 2021 in line with the LIBOR transition.

Notes to the Financial Statements

De-recognition of financial assets and liabilities

Financial assets

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is de-recognised where:

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

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

Financial liabilities

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

Modification of financial assets and financial liabilities

Financial Assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognized and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows: - fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and - other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximize 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 (see below for write off policy). 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. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. 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.

Notes to the Financial Statements

Financial Liabilities

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

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to 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.

Impairment of financial assets

The Bank is required to recognise Expected Credit Losses ('ECL') based on unbiased forward-looking information for financial assets at amortized cost, debt financial assets at fair value through other comprehensive income, loan commitments and financial guarantee contracts.

The Bank uses a three-stage model for determination of Expected Credit Losses: (i) For loans where the credit risk has not increased significantly since initial recognition, a provision is recognised for the expected 12-month credit losses expected to be incurred; (ii) For loans where there is deemed to be a significant increase in credit risk, a provision for the expected lifetime credit loss is recognised across the segment (as defined below); and, (iii) For loans that are in Stage 3, the Bank undertakes a specific impairment assessment. For loans classified as Stage 1 or 2 an assessment is performed on a portfolio wide basis for impairment, with the key judgements and estimates being:

- The determination of a significant increase in credit risk;
- The probability of an account falling into arrears and subsequently defaulting;
- Loss Given Default ('LGD'); and,
- Forward-looking information.

In addition to the above, the Bank undertakes a review of the recoverability of the exposure for loans that are in Stage 3.

ECLs are a probability-weighted estimate of the present value of credit losses. These are measured as the present value of the difference between the cash flows due to the Bank under the contract and the cash flows that the Bank expects to receive arising from the weighting of multiple future economic scenarios, discounted at the asset's original EIR.

For undrawn loan commitments, the ECL is the difference between the present value of the difference between the contractual cash flows that are due to the Bank if the holder of the commitment draws down the loan and the cash flows that the Bank expects to receive if the loan is drawn down.

The Bank measures ECL on an individual basis or on a collective basis for portfolios of loans that share similar economic risk characteristics.

Notes to the Financial Statements

Significant Increase in Credit Risk ('SICR')

The Bank applies a series of criteria to determine if an account has demonstrated a SICR and should therefore be moved to Stage 2:

- Quantitative criteria: This considers the increase in an exposure's remaining lifetime Probability of Default ('PD') at the reporting date compared to the expected residual lifetime PD when the exposure was originated. The Bank segments its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency;
- Backstop criteria: IFRS 9 includes a rebuttable presumption that 30 days past due is an indicator of a SICR. The Bank considers 30 days past due to be an appropriate backstop measure and does not rebut this presumption.

Due to the impact and uncertainty introduced on the external environment by COVID-19, it has been necessary to consider whether a SICR has occurred for certain loans, in particular where a COVID-19 payment concession or loan extension has been granted. The granting of such a concession or an extension has not in itself been considered an indication of a SICR (transfer to Stage 2) in line with regulatory guidance but nevertheless it has been considered to calculate additional overlays or Post Model Adjustments ('PMA') for such exposures within the Business Finance Division ('BFD') and Azule. For exposures within the Consumer Finance Division ('CFD'), these have been assessed based on their status immediately prior to requesting forbearance and, if up to date, the forbearance has not been considered a SICR. In all cases these exposures in all the divisions have remained in Stage 1 unless in arrears, in which case the exposure has been moved to Stage 2.

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

The definition of default for the purpose of determining ECLs has been aligned to the Capital Requirements Regulation ('CRR') article 178¹ definition of default to maintain a consistent approach with IFRS 9. When exposures are identified as credit impaired, such interest income is calculated on the carrying value, net of the impaired allowance.

The Bank applies a series of quantitative and qualitative criteria to determine if an account meets the definition of default and should therefore be moved to Stage 3. These criteria include:

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

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

Loans remain on the balance sheet, net of associated provisions, until they are deemed to have no reasonable expectation of recovery. Loans are generally written off after realisation of any proceeds from collateral and upon conclusion of the collections process, including consideration of whether an account has reached a point where continuing attempts to recover are no longer likely to be successful. Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the value of impairment losses recorded in the income statement.

The impairment policy allows an exposure to be cured (i.e. once a loan goes into default, it does not have to stay in default). This allows loans in Stage 3 that have resumed repayment for 6 months and are current to be reclassified as Stage 2.

¹ CRR Article 178 definition of default considers indicators that the debtor is unlikely to pay, includes exposures in forbearance and is no later than when the exposure is more than 90 days past due.

Notes to the Financial Statements

Forward looking information

Expected credit losses ('ECL')

ECLs are unbiased, probability-weighted estimates of credit losses determined by evaluating a range of possible outcomes. They are measured in a manner that reflects the time value of money and uses reasonable and supportable information that is both available, without undue cost or effort at the reporting date, and about past events, current conditions or forecasts of future economic conditions. Measurement of ECLs depends on the 'stage' of the financial asset, based on changes in credit risk occurring since initial recognition, as described below:

- Stage 1. When a financial asset is first recognised, it is assigned to Stage 1. If there is no SICR from initial recognition, the financial asset remains in Stage 1. Stage 1 also includes financial assets where the credit risk has improved and the financial asset has been reclassified back from Stage 2. For financial assets in Stage 1, a 12-month ECL is recognised.
- Stage 2. When a financial asset shows a SICR from initial recognition, it is moved to Stage 2. For financial assets in Stage 2, a lifetime ECL is recognised.
- Stage 3. When there is objective evidence of impairment and the financial asset is considered to be in default, or otherwise credit-impaired, it is moved to Stage 3. For financial assets in Stage 3, a lifetime ECL is recognised.
- Lifetime ECL is defined as the ECL that results from all possible default events over the expected behavioural life of a financial instrument.
- 12-month ECL is defined as the portion of lifetime ECL that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of that default occurring.

For debt instruments measured at FVOCI: the loss allowance is recognised in the statement of Comprehensive Income.

Economic Scenarios

The Bank considers three forward-looking economic indicators for each business line as follows:

	Consumer finance	Business finance & Azure	Bridging finance
Unemployment rate	✓	✓	✓
Used Car Price Index	✓		
Consumer Prices Index (CPI)	✓	✓	
UK Gross Domestic Product (GDP) growth		✓	✓
Nationwide House Price Index (HPI)			✓

The scenarios for UK economic growth, inflation, residential property prices, unemployment and used car prices are obtained from a reputable economic research consultancy firm and reviewed and agreed by the Group's Audit Committee.

The consultancy combines historical forecast errors with their quantitative assessment of the current risks facing the economy to produce robust forward-looking distributions. The method of weighting the economic scenarios has been approved by the Group's Audit Committee and is based on the framework provided by the consultancy as detailed below. The weightings applied are based on an evenly spread scenario weighting of 40% base, 30% upside and 30% downside.

Notes to the Financial Statements

	Upside	Base	Downside
5-year average			
GDP (year on year change)	3.26%	2.66%	1.42%
CPI (year on year change)	1.97%	1.68%	1.01%
Unemployment (5-year average)	3.63%	4.06%	6.69%
HPI (year on year change)	4.02%	1.58%	-3.13%
Used Car Price Index (year on year change)	-1.57%	-1.61%	-1.62%
Peak Values			
GDP	9.17%	5.05%	2.77%
CPI	3.57%	1.95%	2.13%
Unemployment Rate	4.89%	6.50%	8.42%
HPI	9.91%	5.60%	6.22%
Used Car Price Index	0.32%	0.80%	1.68%

Sensitivity analysis

The calculation of the Bank's impairment provision is sensitive to changes in the chosen weightings. The effect on the closing modelled provision of each portfolio as a result of applying 100% weightings to each of the chosen scenarios is shown below:

	Upside	Base	Downside
30 September 2020	£'000	£'000	£'000
Business finance division	(108)	(80)	488
Consumer finance division	(533)	(22)	699

Notes to the Financial Statements

Model calculation

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

- PD - The Probability of Default ('PD') is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio;
- EAD - The Exposure at Default ('EAD') is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments in full, continued repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities and accrued interest from missed payments;
- LGD - The Loss Given Default ('LGD') is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

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

Management adjustments are made to the modelled output to account for situations where known or expected risk factors and information have not been considered in the modelling process. In particular, where segments of the portfolio have little or no historical information to compute either PD or LGD, ECLs are extrapolated from a related segment. This is particularly relevant for the highest credit grade business across all divisions and in particular Bridging Finance.

Overlays and Post model adjustments (PMA)

Against the background of COVID-19, the Bank has assessed the modelled output and, where known or expected risk factors and information have not been considered fully in the modelling process, the Bank applies an overlay or a post model adjustment ('PMA').

The COVID-19 related additional provisions are summarised as follows:

- A small number of provisions have been applied to large client agreements in default (Stage 3). These overlays are based on known information about the specific cases, such as the depressed value of the assets and whether a charging order is in place, with a recovery rate estimated on the shortfall. These specific overlays contributed to an additional £1.1 million to the total ECL (2019: £nil).
- COVID-19 and subsequent national lockdown, with its adverse effect on asset values, necessitated an overlay for recovery rates. An additional overlay was calculated for this risk. The overlay accounted for an additional £0.1 million increase on the total ECL (2019: £nil).
- It is perceived that the likelihood of default may have increased for those customers who have applied for COVID-19 specific forbearance within CFD. Therefore, the Bank applied an additional provision for the Consumer Finance loans that are in forbearance. The overlay accounted for an additional £0.1 million to the total ECL (2019: £nil).
- Due to the high level of COVID-19 forbearance experienced in the coach, bus and minibus portfolio within BFD, a further overlay was considered appropriate. The gross carrying amount of this portfolio in forbearance at year end was £6.1 million (September 2019: £nil). A comprehensive review of the portfolio was undertaken and an additional provision was made against the large exposures deemed most at risk of entering Stage 3 or going into arrears. The overlay accounted for an additional £0.3 million in the total ECL (2019: £nil).

Notes to the Financial Statements

- COVID-19 has had an adverse impact on the film and TV market which Azure serves. The lifting of the initial restrictions meant that the film and TV sector could return to work, but the government continued the ban on mass gathering events such as concerts, festivals, conferences and exhibitions. This has resulted in those who service live events being forced to remain closed, therefore requiring additional support from the government through furlough, CBILS and BBLs and then also support from their creditors such as asset finance providers extending forbearance. Management deemed it necessary to provide an additional overlay to cover the risks associated with agreements in forbearance in the Azure book. The overlay accounted for an additional £0.3 million in the total ECL (2019: £nil).
- An overlay is in place for customers who are entering their third round of forbearance, as in some cases they may not have made full payments to the Bank for nine months. Management perceives there to be additional risk associated with these customers and therefore, an additional provision has been applied to these agreements. The overlay accounts for an additional £0.1 million in the total ECL (2019: £nil).
- A PMA was implemented to take additional provisions on defaulted loans, where the agreements had been terminated and assets recovered with residual outstanding balances, resulting from revisions to recovery expectations against those exposures. The overlay accounts for an additional £3.7 million in the total ECL (2019: £nil).
- The ECL model applied to the Bank uses three economic scenarios in the impairment calculations. Management deemed it necessary to replace the downside scenario with a severe downside scenario in the calculations. The overlay contributed an additional £0.1 million in the total ECL (2019: £nil).
- The Bank's Impairment model does not allow an exposure to be cured (moved from Stage 3 to Stage 2) unless the loan has returned to full payment and has been making such payments for at least the last six months. The Bank has included an overlay to account for these cured agreements which has resulted in the provision reducing by £0.1 million (2019: £nil).
- A PMA has been implemented to address the re-grading of credit grades. The Bank has carried out a re-grade of the Business Finance and Consumer Finance portfolios to address the possible deterioration in the quality of the loan book. The overlay accounts for an additional £0.3 million in the total ECL (2019: £nil).

The total of the overlays and PMAs is a net increase to the impairment provision of £6.0 million (2019 - £0.03 million).

Expected life

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

Discounting

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

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

The model assesses Stage 1 on a 12-month ECL and Stage 2 on a lifetime ECL basis. For Stage 3, where loans are in default but are not in a formal recovery process, the model above is followed and assesses ECL on a lifetime basis.

For those loans in formal recovery, the Bank assesses the ECL by estimating future cash receipts over the expected period before the outstanding balance is expected to be written off, discounted at the EIR at initial recognition or an approximation thereof.

Notes to the Financial Statements

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

1.5 Significant accounting policies

With the exception of changes to the Bank's accounting policies resulting from new and revised accounting standards (note 1.4.2), the Bank has consistently applied the following accounting policies to all periods presented in the financial statements.

1.5.1 Recognition of income and expenses

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

Effective Interest Rate ('EIR') method

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

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance. The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Interest and similar income and expense

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

When the recorded value of a financial asset or a group of similar financial assets has been reduced by an impairment loss, stage 1 and stage 2 interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. For stage 3 the interest income is based on amortised cost less the impairment charge, multiplied by the EIR.

1.5.2 Dividend income

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

Notes to the Financial Statements

1.5.3 Fee and commission income

The Bank earns fee and commission income from a range of services which it provides to its customers. Fee income, other than that accounted for using the EIR method, is recognised immediately and can be divided into the following two categories:

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

1.5.4 Leasing (Policy applicable before 1 October 2019)

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

Bank as a lessee

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

Bank as a lessor

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

1.5.5 Leasing (Policy applicable after 1 October 2019)

The Bank assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Bank as a lessee

The Bank did not have any right-of-use assets or lease liabilities in the financial year ended 30 September 2020.

Bank as a lessor

Leases in which the Bank does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. Rental income arising is accounted for on a straight-line basis over the lease term and is included in revenue in the statement of profit or loss due to its operating nature. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

Finance Leases

A finance lease is a lease or hire purchase contract that transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee. Finance leases are recognised as loans at an amount equal to the gross investment in the lease, which comprises the lease payments receivable and any unguaranteed residual value, discounted at its implicit interest rate. Finance charges on finance leases are taken to income in proportion to the net funds invested.

Notes to the Financial Statements

1.5.6 Cash and cash equivalents

Cash and cash equivalents as referred to in the Statement of Cash Flows comprise of amounts due from banks on demand or with an original maturity of three months or less.

1.5.7 Office equipment, fixtures and fittings

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

Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives. The estimated useful lives are as follows:

Office equipment, fixtures and fittings	Between 3 and 10 years
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Office equipment, fixtures and fittings are de-recognised on disposal or when no future economic benefits are expected from their use. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in other operating income in the income statement in the year the asset is de-recognised.

1.5.8 Intangible assets

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

Internally developed intangible assets including subsequent expenditure on them, are capitalised as an asset only when the Bank is able to demonstrate that the following conditions have been met. If these conditions are not met, expenditure is recognised in administrative expenses in the income statement as incurred:

- Expenditure can be reliably measured.
- The product or process is technically and commercially feasible.
- Future economic benefits are probable.
- The Group has the intention and ability to complete development and subsequently use or sell the asset.

The cost of externally acquired computer software includes the original purchase price of the asset and any directly attributable costs of preparing the asset for its intended use. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Capitalised computer software and intangible assets are subsequently measured at cost less accumulated amortisation and any accumulated impairment losses.

Computer software is amortised on a straight-line basis over its estimated useful life of between three and ten years. Amortisation is recognised in administrative expenses in the income statement. The amortisation method, useful lives and residual values are reviewed at each reporting date and adjusted, if appropriate.

All intangible assets are reviewed for indicators of impairment at each reporting date. If such an indication exists, the asset's recoverable amount, being the greater of value in use and fair value less costs to sell, is estimated and compared to the carrying amount. If the carrying amount of the asset exceeds the recoverable amount an impairment loss is recognised in administrative expenses in the income statement.

Notes to the Financial Statements

1.5.9 Provisions

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

1.5.10 Taxes

Current tax

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

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

Deferred tax

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

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

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

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

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

Current and deferred taxes are recognised as income tax benefits or expenses in the income statement except for tax related to the fair value remeasurement of debt instruments at fair value through Other Comprehensive Income ('OCI') and foreign exchange differences.

Notes to the Financial Statements

Value Added Tax ('VAT')

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

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

1.5.11 Investment in subsidiary undertakings

The Bank's investments in its subsidiary undertakings are stated at cost less any impairment losses (carrying value).

1.5.12 Write-offs

Financial assets are written off either partially or in their entirety only when the Bank has no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to income statement.

1.5.13 Forborne and modified loans

The Bank considers a loan to be forborne when such concessions or modifications to it are provided as a result of the borrower's present or expected financial difficulties and the Bank would not have otherwise agreed to them. Indicators of financial difficulties include temporary changes to a customer's circumstances, defaults on covenants or significant concerns raised by the Collections Department.

Forbearance includes a variety of concessions including payment plans, reduced monthly payments, payment deferrals of 3 to 9 months and extensions to the term of the agreement. In all instances, the objectives are to treat customers fairly, to ensure that the forbearance is sustainable and affordable and to ensure that the forbearance complies with regulatory rules and guidance.

During the financial year, the Bank received unprecedented levels of forbearance requests from customers as a result of the impact of COVID-19. Forbearance is usually considered to be a potential indicator of a significant increase in credit risk. However, due to the impact and complexity of COVID-19, it has been necessary to enhance the approach in determining whether this has indeed occurred. In particular, a COVID-19 payment concession in line with regulatory guidance has not in of itself constituted that a significant increase in credit risk (transfer to stage 2) has occurred for the majority of the Bank's loans. Instead, a request for COVID-19 forbearance has been considered with the usual indicators of a significant increase in credit risk such as recent customer payment history and whether the customer was up to date with payments at the time of granting the concession.

However, given the continuing nature of the pandemic and the requests for forbearance at the year-end an additional overlay has been applied to reflect the increase risk in the Bank's portfolio as a result of granting forbearance due to COVID-19.

Details of forborne assets are disclosed in note 27.3.1

If modifications are substantial, the loan is derecognised, as explained in note 1.4.3.

1.6 Significant accounting judgements, estimates and assumptions

The preparation of financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 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.

Notes to the Financial Statements

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

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are as follows.

1.6.1 Effective interest rate (estimate)

Under IFRS 9, interest and termination income is recorded using the Effective Interest Rate method. Management must use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. Management reviews the expected lives on a segmental basis, whereby products of a similar nature are grouped into cohorts that exhibit homogenous behavioural attributes. The key assumption applied by management in the Effective Interest Rate methodology is the behavioural life of the assets. The expected life behaviours are subjected to changes in internal and external factors and may result in adjustments to the carrying amount of loans, which must be recognised in the statement of profit and loss. The effective interest rate behavioural models are based on market trends and experience.

Different scenarios were evaluated by management in order to estimate the most reliable estimated termination profit of the year. The parameters considered for this calculation were the percentage of early settled agreement, the estimated terms and the average profit made by PCF Bank for each termination. Settlement percentage and term were calculated analysing historical trends of early settled agreements occurring during the period January 2016 and March 2020, so the impact of COVID-19 was minimised. Average Profit per agreement has been calculated considering the historical termination profit from January 2016 to March 2020.

Management considered whether any acceleration in the recognition of interest income was appropriate, as a result of revisiting certain customer behavioural assumptions, which included looking at historical data over different historical periods. Management's assessment generated a range of possible values between £0.01million and £0.37million credit to the income statement. Management concluded to adopt the scenario, whereby £0.01million was recognised.

1.6.2 Impairment losses on financial assets (judgement and estimate)

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

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

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

The Group's Asset and Liability Committee ('ALCO') considers the recovery rates, weightings and economic factors, and where necessary, recommends changes to the Board for approval.

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

Notes to the Financial Statements

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

- The Bank's internal credit grading model, which assigns PDs to the individual grades.
- The Bank's criteria for assessing if there has been a SICR and so allowances for financial assets should be measured on a Lifetime Expected Credit Loss ('LTECL') basis and the qualitative assessment.
- Lifetime to default ('LTD') is the number of months agreements are expected to default after inception.
- Lifetime to write-off ('LTW') is the number of months after default that agreements are expected to be written off.
- The segmentation of financial assets when their ECL is assessed on a collective basis.
- Development of ECL models, including the various formulas and the choice of inputs.
- Determination of associations between macroeconomic scenarios and economic inputs such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs.
- Selection of forward-looking macroeconomic scenarios and their probability weightings to derive the economic inputs into the ECL models.

It is the Bank's policy to regularly review its models in the context of actual loss experience and to adjust them when necessary.

The ECL provision is sensitive to judgement and estimations made with regard to the selection and weighting of multiple macroeconomic scenarios. To supplement the models, the Bank also applied expert credit risk judgement through post-model adjustments (PMAs). These are designed to account for factors that the models cannot incorporate or where the sensitivity is not as would be expected under what is an unprecedented economic stress scenario. Through this process, the Bank applied PMAs of £6.0 million (September 2019 £nil) comprising overlays in relation to the Bank's expected payment deferral experience, the evolving macroeconomic dynamics that may not be fully captured in inputs or models and the assumptions on defaulted receivables.

Certain asset classes are less sensitive to specific macroeconomic factors, showing lower relative levels of sensitivity. To ensure appropriate levels of ECL, the relative lack of sensitivity is compensated for through the application of PMAs, further detail of which can be found in note 1.4.3.

The majority of the residual PMAs increases is to address a lack of sensitivity in the modelled outcome.

1.6.3 Impairment testing of investment in subsidiaries (judgement)

The Bank assesses, at each reporting date, whether there is an indication that investments in its subsidiaries may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount.

The review of investment in subsidiary for impairment reflects the Board's best estimate of future cash flows of the Bank's subsidiary and the rates used to discount these cash flows. Both these variables are subject to judgement and estimation uncertainty as follows:

- the future cash flows are sensitive to projected cash flows based on the forecasts and assumptions regarding the projected periods and the long-term pattern of sustainable cash flows thereafter;
- the rates used to discount future expected cash flows can have a significant effect on their valuations and are based on the price-to-book ratio method which incorporates inputs reflecting a number of variables.

An impairment is recognised if impairment testing finds that the carrying amount of the investment exceeds its recoverable amount. The recoverable amount of the subsidiary is calculated based on its value-in-use, determined by discounting the future cash flows to be generated from its continuing use.

Notes to the Financial Statements

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

Discount rate

The discount rate is an estimate of the return that investors would require if they were to choose an investment that would generate cash flows of amount, timing and risk profile equivalent to those that the entity expects to derive from the asset.

The Bank calculates discount rates using the price-to-book ratio method which incorporates target return on equity, growth rate and price-to-book ratio. The discount rate used was 14.88%.

Cash flow period

Five years of cash flows (pre-tax profits) are included in the discounted cash flow model based on the business plan and terminal value.

Terminal value growth rate

A terminal value growth rate is applied into perpetuity to extrapolate cash flows beyond the cash flow period. A terminal value growth rate of 1.0% is estimated by the Board.

Sensitivity analysis

The Bank has performed sensitivity analysis on the key assumptions for its investment in subsidiary amount. The investment in Azure is considered sensitive to the key variables and any individual movements on the estimates (discount rate, long term growth rate and cash flow):

	<u>Assumptions</u>		Carrying value exceeded recoverable amount	<u>Consequential impact of 1% adverse movement</u>		<u>Consequential impact of 5% adverse movement</u>
	Discount rate	Long term growth rate		Discount rate increase	Long term growth rate decline	Cash flow reduction
30 September 2020 Investment in subsidiary	%	%	£'000	%	%	%
Azure Limited	14.88	1.00	-	(85)	(50)	(94)

1.7 Standards issued but not yet effective

Minor amendments to IFRSs effective for the Bank from 1 October 2020 have been issued by the International Accounting Standards Board (IASB). These amendments are expected to have no or an immaterial impact on the Bank.

1.8 Amendments to prior year comparatives

Amendments to the previously reported 2019 disclosures have been made relating to the treatment of other account charges and income on termination, in respect of defaulted agreements.

Amounts in the profit and loss account have been reclassified with the recognition of other fees and commissions of £0.7 million and a corresponding increase in impairment losses on financial assets for the same amount. These adjustments have no impact on the previously reported profit before or after tax, nor on the net assets of the Bank.

Notes to the Financial Statements

2 Interest income calculated using the effective interest method

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Cash and short term-funds	51	67
Loans and advances to customers	39,994	29,732
Financial instruments – FVOCI	201	478
Total interest and similar income	40,246	30,277

3 Interest expense calculated using the effective interest method

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Paid and accrued to banks	687	298
Paid and accrued to customers	6,917	4,712
Credit-related fees and commission	7,817	5,932
Total interest and similar expense	15,421	10,942

4 Net fee and commission expense

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Fee and commission income		
Secondary lease income	85	49
Other fees not forming part of EIR*	451	664
Other fees and commissions	388	227
	924	940
Fee and commission expenses		
Debt recovery and valuation fees	(305)	(112)
Credit assessment costs	(926)	(621)
	(1,231)	(733)
Net fee and commission expense	(307)	207

*Comparatives for the recoverable amount of fees charged on credit impaired accounts have been re-presented from Impairment losses on financial assets to Fees and commission income to make the Net fee and commission note more relevant following a review of the disclosure and accounting policies applied (please see note 1.8).

Notes to the Financial Statements

5 Impairment losses on financial assets

Impairment losses on financial assets relates to impairment losses on loans and advances to customers. The credit risk inherent in loans and advances to customers are detailed in note 26.5. The charge during the year is as follows:

	Consumer Finance £'000	Business Finance £'000	Azule Finance £'000	Bridging finance £'000	Total £'000
30 September 2020					
Impairment charge for the year on loans and advances to customers	3,465	5,839	237	474	10,015

30 September 2019*

Impairment charge for the year on loans and advances to customers	1,289	2,037	-	6	3,332
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*Comparatives for the impairment charge amount of fees charged on credit impaired accounts have been re-presented from Impairment losses on financial assets to Fees and commission income to make the Net fee and commission note more relevant following a review of the disclosure and accounting policies applied (please see note 1.8).

6 Dividend income

During the year, the Bank received dividend income amounting to £2.75million (30 September 2019 - £3.0million) from its subsidiaries.

7 Other operating expense

Other operating expenses relate mainly to management service charges agreed with the Parent inclusive of audit fees and director's remuneration as disclosed in notes 8 and 9 below.

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Management fee	12,096	9,481
Irrecoverable VAT	594	150
Legal and Professional	11	28
Bank Charges	64	57
Customer compensation	22	3
Loss on disposal of fixed asset	3	-
	12,790	9,719

8. Audit fees

Audit fees were paid by the Parent during the year and recharged through a management service charge. Audit fees were £817,000 (30 September 2019 - £235,000).

Notes to the Financial Statements

9 Directors' emoluments and staff costs

Staff salaries were paid by the Parent during the year and recharged through a management service charge. Directors' emoluments were included as part of the management service charge. The total amount of emoluments paid to the Directors for their services as Board members of both PCF Group plc and PCF Bank Limited, were as follows:

A summary of the total remuneration paid to Directors	Salary and fee £'000	Bonus £'000	Benefits in kind £'000	Pension £'000	Long-term incentive £'000	Other £'000	30 Sept 2020 £'000	30 Sept 2019 £'000
Executive directors								
S D Maybury*	289	-	2	-	-	-	291	476
R J Murray**	190	-	2	15	-	-	207	285
D R Bull***	191	-	2	19	-	202	414	296
Non-executive directors								
M F Brown	43	-	-	-	-	-	43	43
T A Franklin	95	-	-	-	-	-	95	95
C A Higgins	57	-	-	-	-	-	57	57
D J Morgan	43	-	-	-	-	-	43	43
D Titmuss	52	-	-	-	-	-	52	52
M Martin	43	-	-	-	-	-	43	11
	1,003	-	6	34	-	202	1,245	1,358

*pension was received in cash

**part of the pension received in cash

*** resigned 16 March 2020 and left the Bank's employment on 30 September 2020. Part of the pension was received in cash and the 'other' amount represents a payment for compensation for loss of office, including £87k as a payment in lieu of six months' notice, £85k as an incentive award measured against specific pre-determined performance criteria and £30k as an ex gratia payment. Share options previously granted were not cancelled on David Bull's departure from the Group.

Directors' emoluments have been calculated as follows:

- Consistent with the financial year 2019 accounts, prior year recharges are based on 92.5% of salaries only.
- There has been a change in policy and current year recharges at 92.5% are based on all costs.
- The disclosure shows all emoluments paid to Group and Bank Directors in the current and prior years, before applying the recharge percentages.

Notes to the Financial Statements

10 Taxation

The components of income tax charge for the year ended 30 September 2020 and its comparative were as follows.

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Current tax		
UK Corporation Tax on profit of the year	582	1,115
Adjustments in respect of prior periods	91	15
Total current tax	673	1,130
Deferred tax		
Origination and reversal of temporary differences	(408)	28
Adjustments in respect of prior periods	(99)	(39)
Change in tax rate	(35)	(3)
Total tax charge for the year	131	1,116

Factors affecting current tax credit for the year

The tax assessed for the year differs from the standard rate of Corporation Tax in the UK of 19% (30 September 2019 – 19%). The differences are explained in the below table. Deferred tax balances should be calculated at the rate which the balances are expected to be settled, based on tax rates that have been substantively enacted at the balance sheet date. Therefore, the deferred tax balances have been calculated with reference to these rates.

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Profit/(Loss) before tax as stated in the income statement	(929)	8,909
less: Dividend income received from subsidiaries	(2,750)	(3,000)
Operating profit before tax	(3,679)	5,909
Corporation Tax in the UK of 19% (30 September 2019 - 19%)	(699)	1,125
Effects of:		
Expenses not deductible for tax purposes	873	19
Change in tax rate	(34)	(3)
Adjustments in respect of prior years	(9)	(25)
Income tax charge as reported in income statement	131	1,116

Factors affecting future tax charge

The budget on 3 March 2021 announced that the UK corporation tax rate will increase from 19% to 25% with effect from 1 April 2023. This will increase the Bank's future tax charge accordingly. An increase in rate may also increase the deferred tax asset. The maximum impact would be to increase the deferred tax asset by £0.2million. It is not practicable to schedule the timing of the reversal of the temporary differences giving rise to the deferred tax asset in order to determine the precise impact of the rate change.

Notes to the Financial Statements

11 Cash and balances at central banks

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Cash and demand deposits	23,811	6,110
	23,811	6,110

The Bank does not have monies held in trust for clients. The book value of cash and balances at central banks is assessed to approximate its fair value. Fair value approximates to carrying amount as cash and balances at central banks have minimal credit losses and are either short-term in nature or re-price frequently.

12 Loans and advances to customers

	Year ended 30 September 2020 £'000	Year ended 30 September 2019* £'000
Consumer Finance – gross	168,439	125,126
Business Finance – gross	186,120	171,692
Azule lending – gross	8,125	10,309
Bridging Finance – gross	60,612	12,955
	423,296	320,082
Allowance for impairment losses (note 26.5)	(14,314)	(4,769)
	408,982	315,313

*Comparatives for the recoverable amount of fees charged on credit impaired accounts have been re-presented from Allowance for Impairment losses to Loans and advances to make the Loans and advances to customers note more relevant following a review of the disclosure and accounting policies applied (please see note 1.8). Segmental allocations were revised for the year ended 30 September 2020 at the PCF Group PLC level, and comparatives for the 30 September 2019 were re-presented in the PCF Group PLC accounts in accordance with IFRS 8, paragraph 29. In order to be consistent, similar changes have been adopted in these financial statements.

Loans and advances to customers include the following receivables:

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Less than one year	68,702	23,157
Between one and five years	280,475	249,975
More than five years	74,119	46,950
Impairment allowance (note 26.5)	(14,314)	(4,769)
	408,982	315,313

Notes to the Financial Statements

Finance lease receivables - Minimum lease payments

The following minimum lease payments are receivable on finance leases:

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Within one year	3,235	2,043
1-2 years	4,227	2,522
2-3 years	9,711	7,639
3-4 years	14,094	14,671
4-5 years	11,828	14,400
More than five years	1,123	2,428
	44,218	43,703

The following table shows a reconciliation of minimum future lease payments to the gross and net investment in lease payments receivable:

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Minimum future lease payments/gross investment in leases	44,218	43,703
Unearned finance income	(6,940)	(7,267)
Net investment in finance leases	37,278	36,436

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

	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
At 1 October 2019	1,712	3,051	-	6	4,769
Charge for the year (note 5)	3,465	5,839	237	474	10,015
(Recoveries) / write offs	(372)	(267)	169	-	(470)
As 30 September 2020	4,805	8,623	406	480	14,314
Made up of					
Individual impairment	769	1,517	383	180	2,849
Collective model provisions including overlays and PMAs	4,036	7,106	23	300	11,465
Total impairment	4,805	8,623	406	480	14,314

Notes to the Financial Statements

	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
At 1 October 2018	296	985	-	-	1,281
Adoption of IFRS 9	722	(146)	-	-	576
	1,018	839	-	-	1,857
Charge for the year (note 5)	1,289	2,037	-	6	3,332
(Recoveries) / write offs	(595)	175	-	-	(420)
As 30 September 2019	1,712	3,051	-	6	4,769
Made up of					
Individual impairment	2	222	-	-	224
Collective impairment	1,710	2,829	-	6	4,545
Total impairment	1,712	3,051	-	6	4,769

13 Debt financial instruments at fair value through other comprehensive income ('FVOCI')

	30 September 2020 £'000	30 September 2019 £'000
Balance as at 1 October	19,638	39,902
Net Sale of covered bonds	(10,587)	(20,256)
Change in fair value during the year	44	(8)
Balance as at 30 September	9,095	19,638

There are no material allowances for impairment losses on debt financial instruments during the year and at year end.

14 Investment in subsidiaries

The financial statements of the Bank are prepared on a solo basis excluding its subsidiaries. The Bank is exempt from preparing consolidated financial statements by virtue of s400 of the Companies Act 2006 as the Bank is part of a larger group with the Parent (PCF Group plc) preparing the consolidated financial statements. The Bank does not have any joint ventures or associates. The subsidiaries of Bank are as follows.

Name of company	Incorporated	Nature of business	Percentage of equity interest 30 September 2020	Percentage of equity interest 30 September 2019
PCF Credit Limited	UK	Leasing & hire purchase	100	100
PCF Equipment Leasing Limited	UK	Leasing & hire purchase	-	100
PCF Financial Leasing Limited	UK	Leasing & hire purchase	-	100
Azule Limited	UK	Leasing & hire purchase	100	100
Azule Finance Limited	IE	Leasing & hire purchase	100*	100*
Azule Finance GMBH	DE	Leasing & hire purchase	100*	100*

*Held by a subsidiary of the Bank

PCF Equipment Leasing Limited and PCF Financial Leasing Limited were both dissolved on 26 November 2019.

Notes to the Financial Statements

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

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

The registered office of Azule Finance GmbH is Kirchtruderinger Straße 17, 81829 München, Germany.

All companies have an Accounting Reference Date of 30 September.

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Cost and net book value:		
At beginning of the year	5,605	150
Increase in investments	-	5,455
Impairment loss on investment	(4,396)	-
At the end of the year	<u>1,209</u>	<u>5,605</u>

It is the opinion of the directors that the recoverable amount of the Bank's investment in both Azule Limited and PCF Credit Limited are less than the amount at which they are stated in the Bank's financial statements.

During the year ended 30 September 2020, impairment losses of £4.396,000 were recorded in respect of the investments held in Azule Limited (£4,246,000) and PCF Credit Limited (£150,000). Losses in respect of these impairments are recorded as operating expenses in the income statement. The major contribution to the impairment of Azule was due to the impact of COVID-19 on the loan portfolio and new business being booked in the Bank both had on the future expected cash-flows relating to the Azule business.

The impairment calculation for the investment in Azule Limited was carried out using a discount rate of 14.88%, representing management's estimate of the expected return on the investment; with an additional risk factor applied. An increase in the discount rate of 1% would further reduce the carrying value of the investment by £51k.

The impairment in the value of the investment in PCF Credit Limited to nil reflects the fact that the company is now being wound down.

Notes to the Financial Statements

15 Office equipment, fixtures and fittings

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Cost		
At beginning of the year	649	307
Additions during the year	729	379
Disposals during the year	(192)	(37)
At end of the year	<u>1,186</u>	<u>649</u>
Accumulated Depreciation		
At beginning of the year	149	83
Depreciation during the year	338	103
Disposals during the year	(189)	(37)
At end of the year	<u>298</u>	<u>149</u>
Net book value as at 30 September	<u>888</u>	<u>500</u>

There are tangible fixed assets with an original cost of £63,000 that have been fully depreciated and that are still in use.

Notes to the Financial Statements

16 Intangible assets

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Cost		
At beginning of the year	3,845	2,945
Additions during the year	487	900
At end of the year	4,332	3,845
Software in development	252	-
Write off – impairment loss	(88)	-
	4,496	3,845
Accumulated amortisation		
At beginning of the year	801	385
Amortisation during the year	552	416
Write off – impairment loss	(37)	-
At end of the year	1,316	801
Net book value as at 30 September	3,180	3,044

(1)

Notes to the Financial Statements

17 Deferred Tax

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Decelerated capital allowances	443	128
Provisions	230	-
IFRS 9 COAP ⁽¹⁾ adjustments	76	-
Corporate bond	(9)	76
	740	204
Opening deferred tax asset	204	90
Recognised in income/(expense)	444	(25)
Adjustment in respect of prior year timing difference	99	40
Adjustment to reserves on adoption of IFRS 9	-	97
Recognised in other comprehensive income	(7)	2
Closing deferred tax asset	740	204

1) COAP – Change of Accounting Practice

The standard rate of Corporation Tax is 19% (30 September 2019 - 19%).

The deferred tax asset has been measured at 19% (30 September 2019 - 17%). As the timing of the reversal of the deferred tax asset is uncertain, the Bank has taken the approach of measuring the deferred tax asset at the lowest enacted tax rate.

Notes to the Financial Statements

18 Other assets

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
Other receivables	590	1,572
	<u>590</u>	<u>1,572</u>

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

19 Due from related companies

The following outstanding balances are due from the Parent and related companies.

	30 September 2020 £'000	30 September 2019 £'000
Due from Parent	5,242	3,256
Due from subsidiary companies	12,611	2,745
	<u>17,853</u>	<u>6,001</u>

These balances are unsecured, interest free and repayable on demand. Other material related party transactions relate to management fee recharges of £12.1million by PCF Group plc, and dividend income from PCF Credit and Azule of £1.0million and £1.8million respectively for year ended 30 September 2020.

There are no material allowances for impairment losses on amounts due from related companies during the year and at year end.

20 Due to customers

	30 September 2020 £'000	30 September 2019 £'000
Retail customers:		
Notice account	79,635	32,835
Term deposit	262,149	233,860
	<u>341,784</u>	<u>266,695</u>

Included in amounts due to customers is accrued interest amounting to £2.1million (30 September 2019: £1.7million) and £0.9million (30 September 2019: £0.2million) for term deposits and notice accounts, respectively.

Notes to the Financial Statements

21 Due to banks

	30 September 2020 £'000	30 September 2019 £'000
Current		
Secured bank borrowings	-	9,050
Non-current		
Secured bank borrowings	62,412	25,000
	62,412	34,050

Interest bearing facilities:

£25.0 million term loan facility granted to PCF Bank by the Bank of England under the Term Funding Scheme

This facility has a rate linked to the Bank of England's Base Rate and has a maturity in February 2022.

The loan is secured by a charge over specified loans and receivables and the guarantee of the Bank. The interest rate charged on these loans is the Bank of England base rate. The loans are secured by a charge over loans and receivables and the guarantee of the Parent.

£37.4 million term loan facility granted to PCF Bank by the Bank of England under the Term Funding Scheme with additional incentives for SMEs

This facility has a rate linked to the Bank of England's Base Rate and has a maturity between June 2024 and September 2024.

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

£30.0 million revolving credit facility granted to PCF Bank by Leumi ABL Limited

This facility when drawn as a loan has a variable rate linked to overnight LIBOR plus a margin and a maturity date of up to five years. The facility is secured by a charge over specified loans and receivables and the guarantee of the Bank. At 30 September 2020, this facility was undrawn and the facility will terminate on 31 December 2021.

£25.0 million repo facility granted to PCF Bank by NatWest Markets plc

This facility when drawn as loans has fixed interest rates and maturity dates of up to 1 year. The facilities are secured by bonds owned by the Bank. At 30 September 2020, this facility was undrawn.

Notes to the Financial Statements

22 Subordinated Liabilities

	30 September 2020 £'000	30 September 2019 £'000
Subordinated debt	7,000	-
Accrued Interest	126	-
	<u>7,126</u>	<u>-</u>

£7.0 million subordinated notes issued by PCF Bank Limited

At 30 September 2020 PCF Bank Limited had a £15 million subordinated note facility from British Business Investments Limited (30 September 2019: £15 million). The notes may be issued once per quarter in tranches of between £1 million and £5 million, and each tranche has a fixed coupon of 8% per annum, a final maturity 10 years from the date of issue and is callable by the issuer 5 years from the date of issue. These notes meet the conditions for tier 2 capital and at 30 September 2020 £7 million of notes had been issued (30 September 2019: £ nil).

23 Other liabilities

	30 September 2020 £'000	30 September 2019 £'000
Other payables and accruals	1,704	2,921
Bank fees and charges	14	14
	<u>1,718</u>	<u>2,935</u>

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

24 Financing activity

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

	Notes	1 October 2019 £'000	Cash flows financing £'000	Cash flows interest £'000	30 September 2020 £'000
Due to banks	21	34,050	28,350	12	62,412
Subordinated Liabilities	22	-	7,000	126	7,126
		<u>34,050</u>	<u>35,350</u>	<u>138</u>	<u>69,538</u>

Notes to the Financial Statements

25 Issued capital and reserves

	30 September 2020 £'000	30 September 2019 £'000
Ordinary shares issued and fully paid		
At 1 October	31,298	21,298
Issuance of new shares at £1 par value during the year	-	10,000
At 30 September	<u>31,298</u>	<u>31,298</u>

10,000,000 new shares were issued to the Parent on the 29 March 2019 fully paid at par.

Other reserves

	30 September 2020 £'000	30 September 2019 £'000
Fair value gain / (loss) for financial instruments at FVOCI		
Fair value movements in debt instruments at FVOCI	<u>51</u>	<u>7</u>

26 Financial instruments

The risk associated with financial instruments represents a significant component of the risks faced by the Bank and is analysed in more detail in note 27.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 26.4.

26.1 Valuation techniques

Debt instruments at FVOCI

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

Derivative financial instruments

Fair values of derivatives are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flows.

26.2 Valuation principles

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

In order to show how fair values have been derived, financial instruments are classified based on a hierarchy of valuation techniques, as explained in note 26.4.

Notes to the Financial Statements

26.3 Valuation governance

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

Once submitted, fair value estimates are also reviewed and challenged by the Risk and Finance functions.

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

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

	Amortised Cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
30 September 2020				
Cash and balances at central banks	23,811	-	-	23,811
Loans and advances to customers	408,982	-	-	408,982
Due from related companies	17,853	-	-	17,853
Debt financial instruments at FVOCI	-	-	9,095	9,095
Other assets	590	-	-	590
Total financial assets	451,236	-	9,095	460,331
Due to banks	62,412	-	-	62,412
Due to customers	341,784	-	-	341,784
Subordinated Liabilities	7,126	-	-	7,126
Derivative financial instruments	-	80	-	80
Other liabilities	1,704	-	-	1,704
Total financial liabilities	413,026	80	-	413,106
30 September 2019				
Cash and balances at central banks	6,110	-	-	6,110
Loans and advances to customers	315,313	-	-	315,313
Due from related companies	6,001	-	-	6,001
Debt financial instruments at FVOCI	-	-	19,638	19,638
Total financial assets	327,424	-	19,638	347,062
Due to banks	34,050	-	-	34,050
Due to customers	266,695	-	-	266,695
Derivative financial Instruments	-	63	-	63
Total financial liabilities	300,745	63	-	300,808

The Bank holds certain financial assets and liabilities at fair value, grouped into Levels 1,2 and 3 of the fair value hierarchy as explained below.

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

Notes to the Financial Statements

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

Level 3 - These are valuation techniques for which one or more significant inputs are not based on observable market data. Valuation techniques include net present value by way of discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates and similar market products. Critical judgement is applied by management in utilising unobservable inputs including expected price volatilities and prepayment rates, based on industry practice or historical observation. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The following table shows an analysis of financial instruments recorded at amortised cost by level of the fair value hierarchy:

Financial Instruments held at Amortised cost	Carrying Value	Level 1	Level 2	Level 3	Fair value
30 September 2020	£'000	£'000	£'000	£'000	
Assets					
Cash and balances at central banks	23,811	23,811	-	-	23,811
Loans and advances to customers	408,982	-	-	408,982	466,632
Due from related companies	17,853	-	-	17,853	17,853
	450,646	23,811	-	426,835	508,296
Liabilities					
Due to banks	62,412	62,412	-	-	62,412
Due to customers	341,784	-	-	341,784	341,784
Subordinated Liabilities	7,126	-	-	7,126	8,289
	411,322	62,412	-	348,910	412,485
30 September 2019					
Assets					
Cash and balances at central banks	6,110	6,110	-	-	6,110
Loans and advances to customers ⁽¹⁾	315,313	-	-	315,313	363,247
Due from related companies	6,001	-	-	6,001	6,001
	327,424	6,110	-	321,314	375,358
Liabilities					
Due to banks	34,050	34,050	-	-	34,050
Due to customers	266,695	-	-	266,695	266,695
	300,745	34,050	-	266,695	300,745

For due to Banks and Due to Customers, carrying value is assessed to approximate fair value.

Notes to the Financial Statements

	Carrying Value £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair Value £'000
Financial instruments held at fair value adjusted through other comprehensive income					
30 September 2020					
Debt financial instruments at FVOCI	9,095	9,095	-	-	9,095
30 September 2019					
Debt financial instruments at FVOCI	19,638	19,638	-	-	19,638
	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair Value £'000	Notional £'000
Derivative financial instruments					
30 September 2020					
Derivative financial assets	-	-	-	-	-
Derivative financial liabilities	-	(80)	-	(80)	15,770
30 September 2019					
Derivative financial assets	-	-	-	-	-
Derivative financial liabilities ⁽¹⁾	-	(63)	-	(63)	10,000

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

30 September 2020 £'000	Carrying value assets	Carrying value liabilities	Notional amount
Derivatives in economic relationships			
Interest rate swaps	-	(80)	15,770
Total derivative financial instruments	-	(80)	15,770
30 September 2019 £'000	Carrying value assets	Carrying value liabilities	Notional amount
Derivatives in economic relationships			
Interest rate swaps	-	(63)	10,000
Total derivative financial instruments	-	(63)	10,000

Notes to the Financial Statements

26.5 Impairment allowance for loans and advances to customers

The table below shows the credit quality and the maximum exposure to credit risk per based on the Bank's internal credit rating system and year-end stage classification. The amounts presented show both gross loans and advances to customers and net balance after impairment allowances.

As at 30 September 2020				
Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Performing				
High grade	261,771	59,912	896	322,579
Standard grade	39,071	6,921	-	45,992
Sub-standard grade	32,330	7,207	-	39,537
Non-performing				
Impaired loans ⁽¹⁾	-	1,744	13,444	15,188
Gross total	333,172	75,784	14,340	423,296
Allowance for impairment losses	(2,723)	(3,175)	(8,416)	(14,314)
Net total	330,449	72,609	5,924	408,982

As at 30 September 2019				
Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Performing				
High grade	89,751	-	285	90,036
Standard grade	165,075	14,232	169	179,476
Sub-standard grade	36,598	3,927	25	40,550
Non-performing				
Impaired loans	-	2,317	7,702	10,020
Gross total	291,424	20,476	8,182	320,082
Allowance for impairment losses	(1,428)	(1,312)	(2,029)	(4,769)
Net total	289,996	19,164	6,153	315,313

(1) For 2020, impaired loans comprise of individually impaired loans totalling £2.9 million and collectively impaired loans totalling £12.3 million.

Notes to the Financial Statements

An analysis of changes in the gross carrying amounts of loans and advances to customers and the corresponding ECLs is as follows.

Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
As at 1 October 2019	291,424	20,476	8,182	320,082
New assets originated or purchased	215,540	-	-	215,540
Assets derecognised or matured, and remeasurements	(84,279)	(18,891)	(8,686)	(111,856)
Transfers to Stage 1	4,037	(4,037)	-	-
Transfers to Stage 2	(84,652)	84,652	-	-
Transfers to Stage 3	(8,898)	(6,416)	15,314	-
Amounts written off	-	-	(470)	(470)
At 30 September 2020	333,172	75,784	14,340	423,296

Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
As at 1 October 2018	171,234	10,799	2,512	184,545
New assets originated or purchased	226,671	130	238	227,039
Assets derecognised or matured, and remeasurements	(85,878)	(4,388)	(483)	(90,749)
Transfers to Stage 1	1,488	(1,488)	-	-
Transfers to Stage 2	(16,851)	16,851	-	-
Transfers to Stage 3	(5,240)	(1,428)	6,668	-
Amounts written off	-	-	(753)	(753)
At 30 September 2019	291,424	20,476	8,182	320,082

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
As at 1 October 2019	1,428	1,312	2,029	4,769
New assets originated or purchased	2,241	-	-	2,241
Assets derecognised or matured, and remeasurements	277	(8)	2,443	2,712
Impact on ECL of transfers	(148)	1,695	3,515	5,062
Transfers to Stage 1	209	(209)	-	-
Transfers to Stage 2	(875)	875	-	-
Transfers to Stage 3	(409)	(490)	899	-
Amounts written off	-	-	(470)	(470)
At 30 September 2020	2,723	3,175	8,416	14,314

Notes to the Financial Statements

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
As at 1 October 2018	639	452	767	1,858
New assets originated or purchased	874	8	63	945
Assets derecognised or matured, and remeasurements	(24)	(40)	(245)	(309)
Transfers to Stage 1	83	(83)	-	-
Transfers to Stage 2	(56)	56	-	-
Transfers to Stage 3	(21)	(125)	146	-
ECL transfers*	(67)	1,044	2,051	3,028
Amounts written off	-	-	(753)	(753)
At 30 September 2019	1,428	1,312	2,029	4,769

*Comparatives for the recoverable amount of fees charged on credit impaired accounts have been re-presented from Allowance for Impairment losses to Loans and advances to make the ECL allowance table more relevant following a review of the disclosure and accounting policies applied (please see note 1.8).

The total ECL charge during the year was £10.0million (2019: £3.3million). ECL transfers are movements to or from other stages.

The ECL on cash and balances at central bank, debt instruments at FVOCI, due from related companies and other assets have been assessed as approximately zero.

27 Financial risk management

The Bank is based and its operations are predominantly in the United Kingdom.

Whilst risk is inherent in the Bank's activities, it is managed through an integrated RMF, including ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to liquidity risk, market risk and credit risk.

27.1 Liquidity risk

Liquidity and funding risk is the risk that the Bank is not able to fund new business originations or meet cash flow or collateral obligations as they fall due, without adversely affecting either its daily operations or its financial health. Liquidity risk arises when the Bank might be unable to meet its payment obligations when they fall due as a result of mismatches in the timing of the cash flows under both normal and stress circumstances. Such scenarios could occur when funding needed for illiquid asset positions is not available to the Bank on acceptable terms. To limit this risk, management has arranged for diversified funding sources in addition to its core deposit base and adopted a policy of managing assets with liquidity in mind and monitoring future cash flows and liquidity on a daily basis. The Bank has developed internal control processes and contingency plans for managing liquidity risk. This incorporates an assessment of expected cash flows and the availability of high-grade collateral which could be used to secure additional funding if required.

The Bank seeks to manage its liquidity by matching the maturity of loans and advances with the maturity of deposits from customers. The £32.0 million shortfall for three to twelve months as detailed in 27.1b below is managed by the treasury department of the Bank to ensure the liquidity risk strategy is executed.

Notes to the Financial Statements

The Bank maintains a portfolio of high quality liquid assets that may be liquidated quickly in the event of a liquidity stress including unforeseen cash outflows, the liquidity of which is regularly tested. The Bank also has central bank facilities and lines of credit that it can access to meet liquidity needs. In accordance with the Bank's policy, the liquidity position is assessed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. Net liquid assets consist of cash, short-term bank deposits and liquid debt securities available for immediate sale, less deposits from customers and other issued securities and borrowings due to mature within the next month. The ratios during the year were, as follows:

a) Liquidity ratios

Advances to deposit ratios	30 Sept 2020	30 Sept 2019
Year-end	1.2	1.2
Average	1.2	1.1

The Bank acknowledges the importance of savings accounts as sources of funds to finance lending to customers. They are monitored using the advances to deposit ratio, which compares loans and advances to customers as a ratio of core customer current and savings accounts, together with term funding with a remaining term to maturity in excess of one year.

b) Undiscounted contractual maturities

	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
At 30 September 2020						
Financial assets						
Cash and balances at central banks	23,811	-	-	-	-	23,811
Loans and advances to customers	13,596	27,304	120,450	274,339	39,175	474,864
Due from related companies	17,853	-	-	-	-	17,853
Debt instruments at FVOCI	-	-	-	9,114	-	9,114
Other assets	-	590	-	-	-	590
Total undiscounted financial assets	55,260	27,894	120,450	283,453	39,175	526,232
Financial liabilities						
Due to banks	12	-	-	62,400	-	62,412
Due to customers	10,638	17,362	152,363	155,166	17,190	352,719
Subordinated Liabilities	-	-	126	-	7,000	7,126
Derivative financial instruments	-	12	36	32	-	80
Other liabilities	-	1,704	-	-	-	1,704
Total undiscounted financial liabilities	10,650	19,078	152,525	217,598	24,190	424,041
Surplus/(shortfall)	44,610	8,816	(32,075)	65,855	14,985	102,191

Notes to the Financial Statements

At 30 September 2019	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
Financial assets						
Cash and balances at central banks	6,110	-	-	-	-	6,110
Loans and advances to customers	5,978	26,767	84,833	239,176	24,578	381,332
Due from related companies	6,001	-	-	-	-	6,001
Debt instruments at FVOCI	-	-	251	20,502	-	20,753
Total undiscounted financial assets	18,089	26,767	85,084	259,678	24,578	414,196
Financial liabilities						
Due to banks	-	9,056	141	25,251	-	34,448
Due to customers	-	9,780	120,859	128,885	20,621	280,145
Other liabilities	-	3,058	-	-	-	3,058
Total undiscounted financial liabilities	-	21,894	121,000	154,136	20,621	317,651
Surplus/(shortfall)	18,089	4,873	(35,916)	105,542	3,957	96,545

The Bank's policy on liquidity risk management is to ensure that it holds sufficient overall liquidity so that it can survive a worst case liquidity stress for at least 90 days, in line with its overall liquidity adequacy rule. Overall liquidity includes high quality liquid assets, cash and central bank facilities for which collateral has been pre-positioned with the Bank of England. Additional funding from related companies will be utilised whenever required.

Surplus liquidity in periods shown above will be used to cover liquidity shortfalls in subsequent periods.

c) Analysis of encumbered and unencumbered assets

Below is the analysis of the Bank's encumbered and unencumbered assets that would be available to obtain additional funding as securities. For this purpose, encumbered assets are:

Assets which have been pledged as collateral e.g. which are required to be separately disclosed under IFRS 7.

Unencumbered assets are the remaining assets that the Bank owns.

Notes to the Financial Statements

	Encumbered		Unencumbered		
	Pledged as collateral	Other	Available as collateral	Other	Total
	30 September 2020 £'000	30 September 2020 £'000	30 September 2020 £'000	30 September 2020 £'000	30 September 2020 £'000
Debt financial instruments at FVOCI	-	-	-	9,095	9,095
Loans secured on equipment, plant and vehicles under conditional sale/hire purchase agreements	82,620	-	204,728	27,487	314,835
Unsecured loans	-	-	-	-	-
Finance leases of equipment, plant and vehicles	20,234	-	7,967	5,814	34,015
Bridging finance	-	-	60,132	-	60,132
Total	102,854	-	272,827	42,396	418,077

	Encumbered		Unencumbered		
	Pledged as collateral	Other	Available as collateral	Other	Total
	30 September 2019 £'000	30 September 2019 £'000	30 September 2019 £'000	30 September 2019 £'000	30 September 2019 £'000
Debt financial instruments at FVOCI	9,083	-	10,555	-	19,638
Loans secured on equipment, plant and vehicles under conditional sale/hire purchase agreements	39,973	-	186,252	39,133	265,358
Unsecured loans	-	-	619	1	620
Finance leases of equipment, plant and Vehicles	11,765	-	17,414	8,515	37,694
Bridging finance	-	-	11,641	-	11,641
Total	60,821	-	226,481	47,649	334,951

Notes to the Financial Statements

27.2 Market risk - Interest rate risk

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

The Bank lends on an instalment credit basis for up to ten years and holds a portfolio of variable rate liquid assets. It funds itself from a combination of fixed rate retail deposits from 1 year to 7 years, variable rate Term Funding Schemes ('TFS' and 'TFSME') funding, variable rate retail notice accounts and fixed rate wholesale funding. Interest rate sensitivity is managed using interest rate swaps as required.

Based on the exposure to interest rate risk, an increase in the Sterling Overnight Index Average rate ('SONIA') by 0.5% for the entire financial year would have an unfavourable effect on profits of £(145,746) (30 September 2019 – favourable £21,024) and an unfavourable impact on capital of £(118,054) (30 September 2019 - favourable £17,029).

27.3 Credit risk

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

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has an established credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions for the entire Bank. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. The credit quality review process aims to allow the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Analysis of maximum exposure to credit risk

	Year ended 30 September 2020 £'000	Year ended 30 September 2019 £'000
On Balance Sheet		
Financial assets		
Cash and balances at central banks		
- Cash and demand deposits	23,811	6,110
Debt financial instruments at FVOCI	9,095	19,638
Loans and advances to customers (net)		
Consumer Lending	163,634	123,414
Business lending	177,497	168,641
Azule lending	7,719	10,309
Bridging finance	60,132	12,949
Due from related companies	17,853	6,001
Other assets	590	1,572
	460,331	348,634
Off-Balance Sheet		
Undrawn facilities	17,270	1,760

Notes to the Financial Statements

In its normal course of business, the Bank engages external agents to recover funds from repossessed assets in its retail portfolio, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers.

27.3.1 Forborne and modified loans

As explained in note 1.5.13, forbearance occurs when a customer is experiencing difficulty in meeting their financial commitments and a concession is granted by providing them a temporary payment plan based on their ability to meet the contractual obligations. The unprecedented COVID-19 global pandemic has led to a significant increase in customers seeking payment deferrals within the Bank's lending portfolio. The Bank has introduced a range of additional forbearance measures to support its customers during this difficult period.

Additional support for customers impacted by COVID-19

We recognise that the impact of COVID-19 is a concern for our customers, and we have offered them help and support in these challenging times by introducing several additional concession tools. Concessions granted to customers are varied across the Bank's lending portfolio and in line with regulatory guidance.

The concessions included the creation of payment deferrals (COVID-19 Deferral Plans provided six months of assistance with all payment holidays ending by 31 July 2021 in line with the guidance issued by the Financial Conduct Authority), which were a form of 'breathing space' without payment followed by a payment plan, for customers of the Consumer Finance Division ('CFD'), the Business Finance Division ('BFD') and Azule. This period of flexibility was dependent on underlying mitigating factors and is reviewed and approved by the Bank's Collections Department.

There will be no negative impacts on the customer's credit file as a result of these measures. However, should additional assistance be required after the six months of assistance and if full payments were not being maintained, a true reflection of the customer repayment history would once again start being recorded with the credit reference agencies as the agreement would move into arrears under a payment plan as with any non-COVID-19 related support.

The cure periods of these forborne exposures are subject to expert judgement and careful consideration. The approach varies depending on the relevant division and ranges from instant resumption of payments when the period of concession ends (subject to confirmation of no adverse performance) to a six-month 'grace' period applicable in relevant circumstances where payments are either initially deferred or part payment accepted.

Forbearance analysis

At 30 September 2020, the gross carrying amount of exposures with forbearance measures was £36.0 million (30 September 2020: £ nil). This relates to 953 agreements in forbearance which are COVID-19 related. As set out in note 1.5.13, a COVID-19 related concession does not in itself constitute a significant increase in credit risk. See the table below for forbearance analysis:

Notes to the Financial Statements

27.3.2 Forborne and modified loans

Risk Management

Credit risk

Overview of modified and forborne loans

The following tables provide a summary of the Bank's forborne assets.

Accounting policies for forbearance are described in note 1.5.13

30 September 2020

In £ 000s	Gross carrying amount of forborne loans					Forbearance ratio
	Gross Carrying Amount	Stage 1 - Performing forborne loans	Stage 2 - Performing forborne loans	Stage 3 Non-performing forborne loans	Total forborne loans	
Due from banks	-	-	-	-	-	-
Loans and advances to customers						
CFD	168,439	4,496	1,664	68	6,228	3.70%
BFD	186,120	11,180	13,416	180	24,776	13.31%
Azule	8,125	2,822	2,223	-	5,045	62.09%
Bridging	60,612	-	-	-	-	0.00%
Total loans and advances to customers	423,296	18,498	17,303	248	36,049	8.52%

30 September 2020

In £ 000s	ECLs on forborne loans						Total
	Stage 1 Individual	Stage 1 Collective	Stage 2 Individual	Stage 2 Collective	Stage 3 Individual	Stage 3 Collective	
Due from banks	-	-	-	-	-	-	-
Loans and advances to customers							
CFD	61	15	118	1	16	-	209
BFD	150	65	392	393	-	44	1,044
Azule	126	48	103	-	-	-	277
Bridging	-	-	-	-	-	-	-
Total loans and advances to customers	337	128	613	392	16	44	1,530

The Bank had no forborne assets in the prior year.

Notes to the Financial Statements

27.3.3 Impairment assessment

The references below show where the Bank's impairment assessment and measurement approach is set out in this report. It should be read in conjunction with the *Summary of significant accounting policies* set out in note 1.4 to the financial statements.

- The Bank's definition and assessment of default (note 27.3.4);
- An explanation of the Bank's internal grading system (note 27.3.5);
- How the Bank defines, calculates and monitors the probability of default, exposure at default and loss given default (notes 27.3.5, 27.3.6 and 27.3.7, respectively);
- When the Bank considers there has been a significant increase in credit risk of an exposure (note 27.3.8); and,
- The Bank's policy of segmenting financial assets where ECL is assessed on a collective basis (note: 27.3.8).

27.3.4 Definition of default

As stated in note 1.4.3, the definition of default for the purpose of determining ECLs has been aligned to the Capital Requirements Regulation ('CRR') article 178 definition of default to maintain a consistent approach with IFRS 9. When exposures are identified as credit impaired, such interest income is calculated on the carrying value, net of the impaired allowance.

The Bank applies a series of quantitative and qualitative criteria to determine if an account meets the definition of default and should therefore be moved to Stage 3. These criteria include:

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

27.3.5 The Bank's internal rating and PD estimation process

The Bank operates an internal credit grading model and Probability of Default estimation process. The Probability of Default (PD) is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

The Bank assesses its customers and grades them from AAA to D using an internal credit classification model. Collateral is also considered when grouping credit grades together. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. These information sources are first used to determine the probability of defaults (PDs) for each segment. PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward-looking information and the IFRS 9 Stage classification of the exposure.

Corporate lending

Corporate lending comprises hire purchase, lease or property bridging loans. The borrowers are assessed by credit risk employees of the Group. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information;
- Publicly available information on the clients from external parties; and,
- Other objectively supportable information on the quality and abilities of the customer's management relevant for the company's performance.

Notes to the Financial Statements

The complexity and granularity of the grading techniques vary based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are graded within the Bank's models for retail products.

Consumer lending

Consumer lending comprises hire purchase or conditional sale agreements. These products are graded by an automated scorecard tool primarily driven by credit reference agency data. Additional checks on affordability are made using credit reference agency data and bank statements.

The Bank's internal credit rating grades

- **Business Finance, Azule and Bridging**

Internal rating grade	Internal Rating Description	Internal PD range
1	AAA & AA, LTV <=80%	1.37-2.15%
2	AAA & AA, LTV > 80%	2.58-4.29%
3	A & B+, LTV <=80%	2.70-4.23%
4	A & B+, LTV > 80%	5.05-8.35%
5	B & B-, LTV <=80%	3.72-7.18%
6	B & B-, LTV > 80%	8.37-13.29%
7	C & D	9.14-16.35%

- **Consumer Finance**

Internal rating grade	Internal Rating Description	Internal PD range
1	AAA & AA, LTV <=80%	2.57-3.58%
2	AAA & AA, LTV > 80%	4.18-5.06%
3	A & B+, LTV <=80%	5.06-6.98%
4	A & B+, LTV > 80%	8.09-9.75%
5	B & B-, LTV <=80%	7.02-9.95%
6	B & B-, LTV > 80%	12.01-15.20%
7	C & D, LTV <=80%	9.26-13.06%
8	C & D, LTV > 80%	17.19-22.88%

Notes to the Financial Statements

27.3.6 Exposure at default ('EAD')

The exposure at default represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the customer's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12 months ECL. For Stage 2 and Stage 3, the exposure at default is considered for events over the lifetime of the instruments. The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding to the multiple macroeconomic scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

27.3.7 Loss given default ('LGD')

The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rates. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held. The Bank segments are made up of small homogeneous portfolios, based on the internal credit grading. The applied data is based on historically collected loss data as well as borrower characteristics.

Furthermore, recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each segment of each division. When assessing forward-looking information, the expectation is based on multiple scenarios. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries.

27.3.8 Significant increase in credit risk ('SICR')

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12-month ECL or Lifetime ECL, the Bank assesses whether there has been a SICR since initial recognition. A SICR is deemed to have arisen if a single loan is over 30 days in arrears or it is not in default but has had a significant increase in PD, as a result of which the loan will move from stage 1 to stage 2. This parameter (i.e. the level deemed significant) is set at the multiple of the lifetime PD at origination at which a group of accounts are in stage 2. The movement of these agreements changes the provisions from what the ECL is in the next 12 months, to a lifetime ECL. The Bank considers an exposure to have significantly increased in credit risk when the IFRS 9 lifetime PD has increased by a factor of 1.6 for CFD and 1.7 for BFD and Azule.

The Bank also applies a secondary qualitative method for triggering a SICR for an asset, such as moving a customer to the watch list or the account becoming forborne as indicated in note 27.3.1. In certain cases, the Bank may also consider that events explained in note 27.3.4 are a SICR as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

Changes to the overall SICR thresholds can also impact staging, driving accounts into higher stages with the resultant impact on the ECL allowance:

	30 September 2020	30 September 2019
	£'000	£'000
Increase in SICR by 20 basis points in the Business finance portfolio	(8)	(1)
Increase in SICR by 20 basis points in the Consumer finance portfolio	(1)	(10)
Decrease in SICR by 20 basis points in the Business finance portfolio	8	1
Decrease in SICR by 20 basis points in the Consumer finance portfolio	5	2

Notes to the Financial Statements

28. Material Litigation

The Bank operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent in its operations. The Bank have formal controls and policies for managing legal claims. Based on professional legal advice, the Bank provides and/or discloses amounts in accordance with its accounting policies described in note 1 at year end. From time to time the Bank receives legal claims relating to its business activities. The total value of claims as at 30 September 2020, assessed to have a greater than remote likelihood of economic outflow is £172k; the Bank is robustly defending such matters.

29. Related parties and other Group companies

Non-executive directors held a total of £167,932 in savings accounts at the Bank at 30 September 2020 (30 September 2019 - £186,756). Directors' emoluments and staff costs are disclosed in note 9.

In addition, there were other material related party transactions related to management fee recharges of £13,680,000 to PCF Bank Limited by PCF Group plc for the year ended 30 September 2020.

The Bank has an intercompany balance with the Parent and a subsidiary company, as detailed in note 19. There were no other related party transactions.

Key management personnel of the Group are the Board Directors.

30 Non-adjusting events after the balance sheet date

As COVID-19 evolves, the UK Government is implementing additional measures to address the resulting public health issues and the economic impact. The Bank continues to monitor COVID-19 situation and will take further action as necessary in response to economic disruption. There may be further adverse effects on revenue and impairments depending on severity and duration of nationwide lockdowns.

Along with COVID-19 economic impacts, there remains continued uncertainty of the implications for the UK economy by reason of leaving the EU. Although a limited trade deal was agreed on 24th December 2020, the Bank continues to monitor developments and the potential economic impact on credit risk.

On 30 September 2021 the Bank sold £8.4million of gross credit impaired loans (£1million net of ECL impairments) for £1.7million realising a profit on disposal of £0.7million.

31 Capital management

The Bank maintains an actively managed capital base to cover risks inherent in the business and is meeting the capital adequacy requirements of the local banking supervisor, the Prudential Regulation Authority ('PRA'). The Bank calculates the capital resources and requirements using the Basel 3 framework, as implemented in the European Union through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) IV, as amended by the CRR II and CRD V. Following the end of the Brexit transitional period, the EU rules (including binding technical standards) have been onshored and now form part of the domestic law in the UK virtue of the European Union (Withdrawal) Act 2018. The Bank has complied in full with all of its externally imposed capital requirements over the reported period.

The primary objectives of the Bank's capital management policy are to ensure that the Bank makes efficient use of capital to support business growth and shareholder value whilst adhering to minimum Boards appetite and regulatory limits supporting strong credit ratings. The Bank has a number of measures which it takes to manage capital position further details of this are provided in the strategic report.

Notes to the Financial Statements

The Prudential Regulation Authority ('PRA') supervises the Bank and receives information on the capital adequacy of, and sets capital requirements for, the Bank. The Bank is authorised by the PRA and regulated by the FCA and the PRA. The aim of the capital adequacy regime is to promote safety and soundness in the financial system. It is structured around three 'pillars'.

Pillar 1 - Minimum capital requirements

Pillar 2 - Supervisory review process

Pillar 3 - Market discipline

Under Pillar 2, the Bank completes a periodic self-assessment of risks known as the 'Internal Capital Adequacy Assessment Process' ('ICAAP'). The ICAAP is reviewed by the PRA which culminates in the PRA setting 'Individual Capital Guidance' ('ICG') on the level of capital the Bank and its regulated subsidiaries are required to hold. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that Bank's capital, risk exposures and risk assessment process. The Bank's Pillar 3 disclosures can be found on the Bank's website, www.pcf.bank/investors

The Bank maintains a strong capital base to support the development of the business and to ensure the Bank meets all regulatory requirements and buffers.

As a result, the Bank maintains capital adequacy ratios which are above minimum regulatory requirements.

32 Ultimate Parent

The Bank's ultimate parent is Somers Limited, a Bermuda exempted company incorporated with limited liability, whose shares are traded on the Bermuda Stock Exchange. The Bank's parent is PCF Group plc, which is incorporated and domiciled in England and Wales, and is a company limited by shares. The Parent's financial statements are available from its registered office: Pinners Hall, 105-108 Old Broad Street, London, EC2N 1ER.