

Company Registration No. SC386922 (Scotland)



Hampden & Co.
BANKERS

HAMPDEN & CO PLC

**ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019**

Hampden & Co plc
Company Information

Directors

R A Hammond-Chambers* (appointed as Chairman 2 October 2019)
A R F Hughes (retired as Chairman 2 October 2019)
G T Hartop (Chief Executive Officer)
A K Mulligan (Chief Financial Officer)
V W C Kubitscheck*
C G Camroux-Oliver**
P S R Shedden (appointed 19 February 2019 and resigned 22 April 2020)**
P A Sparkes**

* Independent Non-Executive Director

** Shareholder Nominated Non-Executive Director

Secretary **R F H Lyon**

Company number **SC386922**

Registered office **9 Charlotte Square**
Edinburgh
EH2 4DR

Auditor **Deloitte LLP**
Statutory Auditor
Edinburgh
United Kingdom

Hampden & Co plc
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Hampden & Co plc
Financial Highlights

Five Year Performance Summary

| | 2019 | 2018 | 2017 | 2016 | 2015 | Growth 2018-19 | Growth 2017-18 |
|---|----------------|---------|---------|---------|--------|-------------------|-------------------|
| Loans and advances to clients | £203.8m | £132.5m | £94.2m | £48.0m | £11.8m | +54% | +41% |
| Deposits from clients | £409.4m | £267.5m | £193.9m | £143.5m | £30.2m | +53% | +38% |
| Total Income | £8.7m | £6.4m | £3.9m | £1.6m | £0.2m | +36% | +63% |
| Underlying loss before tax ¹ | -£5.0m | -£5.8m | -£6.4m | -£6.3m | -£8.1m | | |
| Statutory loss before tax | -£5.5m | -£5.8m | -£6.4m | -£6.3m | -£8.1m | | |
| Shareholders' equity | £44.9m | £40.0m | £43.7m | £34.9m | £37.1m | | |

¹ 2019 excludes £0.5m of direct external costs associated with acquisition activities. There are no adjustments for 2015-2018.

Chairman's Statement

The Chairman's Statement normally focuses on the year past and the prospects that lie ahead. However, I should comment that, as shareholders know, the world has been struck by a very serious virus: coronavirus: at the time of writing, the world is engulfed in a pandemic, the likes of which have not been experienced since the outbreak of Spanish 'flu in 1918. The extreme impact of Covid-19 on the global economy has begun to unfold, evidenced by the daily news about the economy and its finances. The effects have been on an unprecedented scale and are likely to persist for some time. This may well curtail the pace of growth of Hampden & Co ("the Bank") over the short to medium-term and so extend our path to profitability. The Chief Executive's Business Review, which follows this, adds further comments on the situation but your Board of Directors, Coronavirus notwithstanding, remain very positive about the long-term outlook for the Bank.

June 2015 to December 2019

I'd like to take the opportunity of using my Chairman's Statement to look back and reflect upon what we have achieved in building our Bank to where we are today. We opened our doors for business in June 2015, having taken somewhat longer to attain our banking licence than we had originally envisaged. You will remember that we set out to build a modern private bank – one that combined personal and professional banking services for our clients with the facility for them to monitor and manage their accounts with the use of modern information technology ("IT").

"Personal" involves looking after our clients individually – caring about them and understanding their circumstances - thereby building trust between them and us. It lies at the heart of our culture; nothing else is as important as our reputation as we continue on the journey of building the Bank.

There are three facets that I will dwell on in assessing our achievements to-date and the health and prospects of our business today: our financial resources (our balance sheet), our team of people and our IT.

As the table on page 1 shows, we have built our deposit and lending books steadily over the period, reaching c.£409m and c.£204m at the end of the year just completed. I do not intend to elaborate on the year's results, leaving that to Graeme Hartop in his CEO's Review, which follows this statement, but I would comment that 2019 was a good year in terms of building the balance sheet and thence the business. Of note was the achievement of winning and acquiring the portfolio loan business of wealth managers Smith & Williamson. Numbers seldom tell a story; they just present facts. The growth of our deposit book reflects, I believe, the growing reputation of Hampden & Co (helped by winning the Spears Private Bank of the year award in 2018) and, of course, the conservative nature of our balance sheet.

Since we opened for business in June 2015, revenues derived from our balance sheet have risen to the £8.7m earned in 2019, driven predominantly by interest on our loan book. Interest rates, at close to zero for most of the period, have meant that the deposit book has contributed comparatively less to our revenues. It is at this point that I would like to commend and thank you, our shareholders, for the important financial support that you have given the Bank. Starting up a new bank from scratch involves the need for capital to finance start-up losses and balance sheet growth. During 2019 we raised an additional £9.8m from – and a further £10.0m has been committed this year by - our four largest shareholders.

The second of our three facets is people. Led by our CEO, Graeme Hartop, a team has been built to manage and develop the Bank. While our business model is quite simple, modern day banking is made complex by ever-growing regulation and accounting standards. So, the team has to have the skills and experience to cope with these stewardship responsibilities as well as, of course, managing the accounts of our clients and developing the business. We have made some important new senior appointments in the last year including a new Chief Commercial Officer who is based in London and who will help us take advantage of the huge opportunities in the world's chief financial centre. We have three offices (in Edinburgh and London) and just over 100 members of staff. Our remuneration policies focus on team performance which, with our people sensitive leadership, means that there is a good team spirit within the organisation. Happy employees tend to convey their mood to clients and potential clients which is good for business. I would like to thank our staff for the contribution they have made to the development of the business ever since we launched the Bank.

June 2015 to December 2019 (continued)

A third facet of modern banking is IT. We aim to provide reliable functioning IT platforms for computers, tablets and mobile phones. At the beginning of 2019 we launched our digital mobile platform which has been well received. We do not aim to be at the leading edge of digital banking innovation which many banks, large as well as small, provide as a substitute for personal service. Looking after one's wealth (be it tied up in houses, businesses, stocks and shares, pensions etc.) can be a complex matter and often requires help - personal help - especially for those with a higher than average net worth or higher income earners. We won't substitute IT for personal service but rather use it to help us provide it.

Governance

During the year just past, Alan Hughes chose to retire as a Director and as Chairman of the Board of Directors. On behalf of my Board colleagues and indeed of shareholders, I would like to convey a huge thanks to him for his contribution to our development since he joined us. It has been most important. Thank you, Alan.

As shareholders already know, I succeeded him as Chairman. However, I had already decided to retire from the Board during 2020, having served the Board since the start, nearly ten years ago. We have conducted two very thorough search programmes to identify a successor for me and to appoint another Director to take on the role of chair of the Audit Committee. An announcement has already gone out that Simon Miller will be appointed a Director and Chairman of the Board. He has wide-ranging financial services experience, including as Chairman of Brewin Dolphin, one of the UK's leading wealth managers, and as a former director of Adam & Co. In addition, Finlay Williamson, who has extensive financial and retail banking experience at the Royal Bank of Scotland and Virgin Money, will join the Board and become chair of the Audit Committee.

Both appointments will take effect from the 2020 Annual General Meeting. We are excited about these two appointments and believe that they will strengthen the all-round skills and experience of the Board as a whole. A good, strong and effective Board, with the requisite skills and experience, is as vital to the success of any business as any other attribute. I believe that our Board will fulfil those demands.

Prospects

I hope I have adequately described how we've done over the past nearly five years and where we've got to. We have laid a base to develop the business onto a rather greater scale than that of today and to attain profitability such that shareholders can expect a satisfactory return in the years to come. While we have established that good base, it would be wrong of me to say that it has always been plain sailing. There have been, and will continue to be, headwinds (including ultra-low interest rates, the effect of Brexit on London's property market and now Covid-19). But good companies overcome their challenges.

We have the financial resources, we have our team of people (Board and management), strengthened by some new appointments and by the experience of the past five years, and we have our IT. So, we have the resources. Despite our challenges the opportunities, it seems to me, are as great as, maybe greater than ever – particularly so given the modern trend in business (and particularly in banking) to substitute personal service for impersonal IT.

Marrying good resources with good opportunities could - and indeed should – allow us to achieve what we want to achieve, a profitable, modern private bank of benefit to our clients, to those who work for us, to our community and thence for you, the shareholders.



Alex Hammond-Chambers
Chairman

24 April 2020

Chief Executive's Business Review

Principal Activities

2019 represents the fourth full year of trading. The Bank's strategy is not just about combining traditional personal relationships with new digital convenience, it is to be the bank that clients want. The Bank's strategy is to offer bespoke service delivered by experienced private bankers. We believe a thorough knowledge of our clients and their families, combined with tailored services, is how banking should be.

In 2019 the Bank considered two potential acquisitions. Following an extensive due diligence exercise, the Board decided not to proceed with the acquisition of a banking business, due largely to concerns over compatibility with the Bank's strategy and business model. Later in the year, the Bank was selected to take on Smith & Williamson's £31m loan book, following its decision to relinquish its banking licence. The loans are secured against Smith & Williamson client investment portfolios and had been successfully transferred by the year end.

Our priority is to continue to grow the Bank both organically and, where appropriate, by selective acquisitions, whilst remaining focused on the interests of clients and the provision of a high-quality service. In 2019 the Bank continued to add to the services offered with the launch of a mobile digital banking app. Although the Bank does not intend to be at the leading edge of technological development, it does need to be competitive in its use of technology to enhance services to clients. This can be achieved at lower cost by using proven technology.

Financial Performance

In 2019 the Bank's underlying loss² (which excludes items not reflective of ongoing trading performance) reduced by 14% to £5.0m (2018: £5.8m). Income grew by 36% to £8.7m (2018: £6.4m), driven by continued balance sheet growth. Underlying operating expenses² increased by 13% to £13.8m (2018: £12.1m), driven primarily by investment in staff and IT as the Bank continues to develop. Impairment on loans and advances is a credit of £23k (2018: charge of £17k), driven by the full recovery of balances which were credit impaired at 31 December 2018 and the release of the associated impairment allowance. The continued low level of impairment allowances is reflective of strong asset quality. Deposits from clients grew by 53% to £409.4m (2018: £267.5m), whilst client lending increased by 54% to £203.8m (2018: £132.5m). The latter includes £31m from the acquisition of Smith & Williamson's loan book.

There is no tax income or expense for 2019 (2018: income of £0.2m) due to the loss for the year. The income in 2018 related to a research and development tax credit.

IFRS 16 *Leases* has been implemented from 1 January 2019. The Bank elected to apply the modified retrospective approach and, accordingly, there is no prior year restatement. Right-of-use assets of £2.5m in respect of property leases, and associated lease liabilities of £2.5m, were recognised at 1 January 2019. The total charge for property leases in the statement of comprehensive income in 2019 is £0.6m (2018: £0.5m). The increase is due to the effect of discounting under IFRS 16 which front-loads the recognition of costs over the lease term. The adoption of IFRS 16 did not have an impact on shareholders' equity or cash flows. Further details can be found in notes 2.5 and 13.

The Bank's capital and liquidity levels exceeded regulatory requirements throughout 2019. At 31 December the regulatory capital base comprised Total Equity of £44.8m (2018: £39.9m) less Intangible Assets of £2.3m (2018: £2.9m) equating to £42.5m (2018: £37.0m), an increase of £5.5m in the year. The key items behind the increase in Total Equity were £9.8m capital raised in 2019, partially offset by the £5.5m loss for the year. At year end the Tier 1 Capital Ratio was 26% (2018: 41%). The movement in the Tier 1 Capital Ratio was due to the increase in lending, including the acquisition of the Smith & Williamson book, and the trading loss.

² 2019 excludes £0.5m of direct external costs associated with acquisition activities. There were no adjustments for 2018.

Chief Executive’s Business Review (Continued)

Financial Performance (continued)

The Bank does not borrow from other financial institutions to fund its activities.

In April 2019 the three Cornerstone shareholders invested £9.8m to support balance sheet growth, costs and regulatory requirements. Further capital investment is, and will continue to be, required for this until a profitable scale is reached as currently forecast within the next 2-3 years. Many factors influence the timing of that, most significantly the economic environment and the pace of growth. The next funding round commenced in early 2020 and the four largest shareholders have committed to provide £10m during 2020, of which £7.1m was capitalised prior to the date of approval of the financial statements.

Key Performance Indicators (“KPI’s”)

The overall progress and performance of the Bank is continually monitored by the Board and management. Performance during the year is summarised below:

| | 2019 | 2018 |
|-----------------------------|-------------|-------------|
| Income growth | 36% | 63% |
| Lending growth | 54% | 41% |
| Deposit growth | 53% | 38% |
| Client loan : deposit ratio | 50% | 50% |
| Total Capital Ratio | 26% | 41% |

Economic and Political Context

The economic outlook is extremely uncertain. The financial shock from the outbreak of Covid-19 has led to a marked deterioration in the outlook for global and UK growth. In addition, whilst the Bank does not anticipate any significant direct operational disruption as a result of the UK’s exit from the European Union, there is continued economic uncertainty around the wider impact of Brexit. This environment of intense uncertainty, together with other factors such as global trade tensions, will affect the UK’s economic growth trajectory and may restrict the Bank’s ability to grow its lending in 2020. In addition, although the credit quality of the existing book is strong, there could also be higher impairment allowances.

The Bank of England recently announced a package of measures to respond to the economic shock from Covid-19, including reducing base rate by 0.65% to 0.10%, the lowest level in the history of the UK. Whilst this may be temporary and short-term, it will depress the Bank’s income in 2020 and extend the path to profitability.

Priorities for 2020

The particular challenges arising from the Covid-19 global pandemic serve to reinforce the Directors’ on-going focus on maintaining the safety and soundness of the Bank, and growing our reputation as the UK private bank to be with. This entails continued balance sheet growth, securing necessary capital investment for the development of the Bank and achieving profitable scale. Key priorities include:

- protecting the safety and wellness of employees, supporting clients and maintaining the quality of service throughout the Covid-19 outbreak;
- increasing client acquisition, both organically and from collaborative relationships with specialist mortgage and wealth professionals;
- enhancing client experience by improving the efficiency of our services and processes; and
- assessing selective acquisitions, should suitable opportunities arise.

Principal Risks and Uncertainties

The Bank is particularly exposed to business and capital risks in its growth years which may adversely impact its nascent reputation. This will remain the case until the viability of the business is established and the Bank has reached profitable scale. During this growth period the availability of sufficient additional capital is uncertain. The success of capital raising depends upon the Bank achieving its planned growth and investors' appetites at the time.

Safe growth and a prudent lending policy remain central to the Bank's risk appetite. Management is cognisant of the need to balance this with the required growth.

The Board has identified the principal risks and uncertainties which could threaten the Bank's business and successful delivery of the Bank's strategy and business plan. These risks, which are monitored and assessed for their impact on the Bank's reputation, are noted below and further detailed risk management disclosures are set out in note 18 to the financial statements. The Directors' Report provides an explanation of the Bank's risk management and governance framework. Supporting the Board's oversight of the Bank's risk management are the Board's Audit Committee ("BAC") and Risk Committee ("BRC"), both made up of Non-Executive Directors. In addition to the Executive's Risk Management Committee ("RMC"), there are four management committees at the operational level – Credit Committee, Assets and Liabilities Committee ("ALCO"), Compliance & Conduct Committee and Operational Resilience Committee - which meet at least once each month, comprising executives and other senior managers. Collectively, these committees are referred to as "Risk Committees".

Business/Strategic Risk

Business risk is the risk that the Bank fails to execute its strategy or fails to execute elements of its business plan effectively. This includes failing to build capabilities, or the inability to meet goals due to changes in the economic or political environment. Management monitors performance trends on a weekly basis with monthly actual and forecast management information and action needed is discussed by both the Management and the Board.

The Bank recognises that climate change is a global issue which has significant implications for its clients, suppliers, partners and employees. A strategic review of climate related risks and opportunities has been initiated as part of a wider plan of work addressing climate change, including delivering on the regulatory requirements through enhancing the measurement of the Bank's exposure to the physical and transition risks that may arise. To date no material exposure to financial risks from climate change has been identified. The onus on companies to demonstrate their commitment to tackling climate change is expected to increase and the Bank will keep its plans under review to ensure they remain appropriate and in line with evolving regulatory requirements.

The Bank's response to the Covid-19 outbreak is being closely managed by the Executive Management Committee ("EMC"), supported by the Bank's operational resilience framework. Around 98% of employees are working from home, with office attendance restricted to a small number of staff and only for essential tasks which cannot be undertaken remotely. Disruption to service levels has been minimal with clients still able to contact their nominated Private Banker via the normal channels and to access the full range of transactional services. Regular contact is being maintained with key suppliers who continue to deliver their contracted services and payments to suppliers have not been affected. The Bank is committed to supporting its employees and clients and to maintaining the quality of its service throughout the Covid-19 outbreak. The Board recognises, however, that the economic impact of Covid-19 will slow the Bank's growth and likely extend its time to profitability, at least in the short to medium-term.

Capital Risk

Capital risk is the risk that the Bank does not have sufficient capital to meet the requirements of the business including under stressed conditions. The Bank is, and will continue to be, dependent on new capital investment until the Bank becomes profitable and generates sufficient capital to support continued growth.

Principal Risks and Uncertainties (*continued*)

Forecasts including the quantum and timing of further capital raising are modified to reflect actual and forecast performance.

With help from professional advisers, the Bank's capital plan evaluates the requirements, the sources and the appetite of investors for fresh capital.

The Bank monitors and assesses optimal use of its capital and capital adequacy regularly to ensure its capital exceeds requirements with regular reporting to the Risk Committees and the Board. This is in line with the Bank's Capital Management Policy for maintaining a strong capital base that is above the capital requirement level set for it by the regulator, the Prudential Regulation Authority ("PRA"). In line with all UK banks, the Bank maintains a Recovery Plan that sets out recovery options which could be deployed if required. The Recovery Plan is reviewed and approved by the Board on an annual basis.

The Bank's regulatory disclosure requirements under Pillar 3 (defined in note 26) are published annually and are available to review on the Bank's website (www.hampdenandco.com).

Conduct Risk

Conduct risk refers broadly to practices that give rise to unfair outcomes. The Bank manages this risk by putting clients' interests at the heart of the business, seeking to develop and maintain long term relationships with its clients and by being focused on providing products and services relevant to their needs. The Bank relies on its reputation to build its business and sees the adherence to good conduct risk principles and delivery of fair outcomes as of paramount importance. The results from the monitoring of client outcomes and other conduct risk indicators are reported to the Risk Committees and the Board. High levels of client advocacy contribute to the Bank's growth and help promote shareholder confidence. All staff are required to adhere to an internal Code of Conduct and regulatory conduct rules, which require attainment of the highest levels of integrity and ethical behaviour towards the business, colleagues, clients, suppliers and regulators.

Credit Risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Bank and arises from lending to clients, a mix of private individuals, trusts and SME business lending, and treasury counterparties. Credit policies, principles and risk appetite metrics are designed to protect the business throughout economic cycles by ensuring the credit portfolio is of high quality, with a low overall percentage of unsecured lending and relatively low monetary limits for individual unsecured lending cases. Client lending is undertaken within prescribed limits and risk appetite measures, which are reviewed regularly by the Credit Committee and approved by the Board.

Credit risk includes treasury counterparty risk, being the loss that might arise from counterparties of the Bank to whom it lends its surplus funds. These counterparties are required to meet a minimum credit rating as defined in the Bank's Counterparty Policy approved by the Board. The use of treasury counterparties is approved and monitored by ALCO. Credit risk information is reported to RMC, BRC and the Board.

Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its obligations as they fall due. Liquidity is the on-going ability to accommodate liability maturities and withdrawals, fund asset growth and otherwise meet contractual obligations through unconstrained access to funding at reasonable market rates. The risk is inherent within the Bank's operating model as profit generation relies on short term contractual maturity of deposits versus long term lending to generate revenues.

The Board accepts a limited level of risk to achieve the Bank's strategic goals and sets its risk appetite and liquidity requirement measures accordingly. It recognises that in the early stages of development, there is a concentration of depositors and so seeks to establish a loyal, diverse and stable client base. The Treasury function seeks to minimise liquidity risk on a forward-looking basis under the supervision of ALCO. Liquidity

Principal Risks and Uncertainties (*continued*)

and funding positions are reviewed and analysed daily and a monthly review of the liquidity position and the composition of the balance sheet is undertaken by ALCO. Liquidity risk information is reported to RMC, BRC and the Board.

Market Risk

Market risk is the risk that the value of the Bank's earnings and economic value will decrease due to changes in the value of financial market prices. The Bank is exposed to two main types of market risk - interest rate and foreign currency risks - both of which are managed to reduce the impact of market movements.

Interest rate risk is the risk that arises from the volatility in interest rates. The Bank's exposure to interest rate changes and sensitivity is closely managed within set limits by the Treasury function and regularly reported to and reviewed by ALCO.

The Treasury function manages the risk of failing to control the effects of material movements in foreign exchange markets through adherence to agreed limits and risk appetite metrics, overviewed by members of ALCO, and reported to RMC, BRC and the Board. Client deposit accounts denominated in foreign currencies are currently, and for the foreseeable future, naturally hedged on both sides of the balance sheet.

Operational Risk

Operational risk is defined as the risk of loss resulting from failed or inadequate internal processes, systems, people or from external events. The principal sources of operational risk for the Bank stem from client account management, IT systems, information security, outsourcing, financial reporting and regulatory risk including financial crime. These risk sources include "cyber" risks, principally in relation to information security and financial crime. Availability, resilience and security of IT Systems are core objectives which are fundamental to meeting clients' needs and maintaining their confidence in the Bank's services. As the pace of technological development increases, so does the threat of new cyberattacks. Accordingly, the Board and the Risk Committees have increased their focus on maintaining an effective cyber threat identification and control framework. An Operational Resilience Committee oversees the Bank's arrangements and information is reported to RMC, BRC and the Board.

Inherent in any growth plan are volume related risks arising from increased transactions, client numbers, new products and distribution methods. These are managed through a matched or proportionate increase in operational capability and capacity as well as internal control.

As the Bank grows and enhances its client services and digital capabilities, it will have due regard to emerging and evolving risks and will develop its people, systems and processes accordingly. Other threats and opportunities to the business arise from the economic, political and regulatory arena, not least the UK's departure from the European Union, and these are subject to on-going monitoring and review. Material events are escalated in line with policy to the Board and/or the most appropriate risk committee(s).

The Bank's insurance coverage is reviewed annually. Key risk appetite metrics are monitored, at a minimum, on a monthly basis and reported to RMC, BRC and the Board.

Section 172 Statement

Under S172 of the Companies Act 2006 the Directors, both collectively and individually, have a duty to promote the success of the Bank. This statement describes how the Directors have had regard to the matters set out in S172(1) (a) to (f) when performing their duty under S172.

a. The likely consequences of any decision in the long-term

The Bank is a growing business and the Board is focussed on prioritising its long-term success. Material decisions taken during 2019 in this regard were:

Section 172 Statement (*continued*)

Share capital restructure

This is described in the Directors' Report and in note 20. The Board's decision to propose the share capital restructure to shareholders was taken primarily to protect the Bank's ability to raise equity in the future, even in adverse market conditions and, secondly, to pave the way for the Bank to be able to make distributions to shareholders at an appropriate time in the future.

Acquisition activities

Two proposed acquisitions were assessed during 2019. Following a due diligence exercise the Board ultimately decided not to proceed with the acquisition of a banking business due to concerns over its compatibility with the Bank's strategy and business model which, in the Board's view, could have adversely impacted the long-term success of the Bank. The acquisition of the Smith & Williamson loan book, described on pages 2 and 4, was approved by the Board due to its quality and the potential future opportunities from the development of a collaborative relationship with Smith & Williamson for the long term. The Board considered that this transaction represents a significant step forward in the development of the Bank in the drive towards achieving profitability.

b. Employee engagement

The Bank seeks to inspire, engage and develop all staff to reach their full potential. Information on the Bank's strategy and performance is shared at monthly Colleague Update meetings, to which all employees are invited. There is a regular, independent "Great Place to Work" survey via which staff are encouraged to share their views. The most recent survey was completed by 92% of employees with a positive engagement score of 82%. The results were shared with staff and reviewed by the Board. Associated action plans to address areas identified for improvement have been agreed and are being implemented. Specific actions taken include enhancements to the performance management process and people manager training, and the augmentation of the Bank's reward package to include enhanced maternity pay and a season ticket loan scheme.

c. Fostering the Bank's business relationships with clients, suppliers and others

Clients

Each client has a nominated Private Banker who provides a tailored service, and who will work collaboratively with other advisers to provide clients with a superior banking experience and to develop long-term, valued relationships. To this end, the Bank does not operate any volume sales incentives to ensure focus is maintained on the needs of clients and providing them with exceptional client service. The Bank encourages feedback from clients and, at the Board's request, client satisfaction surveys are conducted periodically. Positive feedback was received from the most recent survey with a Net Promoter Score of over 70.

Suppliers

The Bank works responsibly with its suppliers in accordance with its Supplier Management Framework. This is monitored via a Key Suppliers KPI Dashboard which the Board reviews. Designated supplier managers are responsible for maintaining and building relationships with suppliers as well as ensuring that contractual obligations are met. They also work with suppliers to improve quality, reduce costs, mitigate supplier risk and drive innovation and continuous improvement. New suppliers are subject to suitability and due diligence checks and all critical suppliers are subject to periodic performance and risk reviews, the outcomes of which are provided to the Board. There were no significant supplier-related issues during the year which required Board action.

Section 172 Statement (*continued*)

Others

The Bank continues to build new and develop existing collaborative relationships with relevant professional services firms in order to grow and develop its client base.

d. The impact of the Bank's operations on the community and the environment

Community

The Bank is a socially responsible business and all colleagues are encouraged to support our society and our communities. Funds are set aside annually to match colleagues' charity fund-raising activities, up to £250 per person. The Bank also makes a number of "volunteer days" available to allow colleagues to take advantage of volunteering opportunities, usually in small groups.

Environment

The Bank has a small environmental footprint but is committed to minimising its impact by:

- minimising energy consumption in its offices;
- minimising business travel;
- reducing the volume of paper it uses; and
- recycling and waste management

e. Maintaining the Bank's reputation for high standards of business conduct

The Bank relies on its reputation to build its business and the adherence to high standards of business conduct is of paramount importance. The results from the monitoring of client outcomes and other conduct risk indicators are reported to the Risk Committees and the Board. All staff are required to adhere to an internal Code of Conduct and regulatory conduct rules, which require attainment of the highest levels of integrity and ethical behaviour towards the business, colleagues, clients, suppliers and regulators. In addition, a whistleblowing process is in place should staff require to escalate an issue outside of the normal management processes and reporting lines.

f. The need to act fairly as between shareholders of the Bank

The Bank is dependent on its shareholders for new capital investment and works to ensure that they and their representatives have a good understanding of its strategy, business model and performance. The Bank engages with its shareholders in various ways, which in 2019 included:

- the three Cornerstone shareholders being represented on the Board;
- the Annual General Meeting held in Edinburgh followed by a Shareholders' Meeting in London, at which shareholders were able to question and challenge the Directors;
- other shareholder meetings and communications, including a General Meeting at which shareholders were consulted about, and voted on, the proposed share capital restructure; and
- the Investor Relations section of the website.

This Strategic Report was approved by the Board and signed on its behalf by:



G T Hartop

Chief Executive Officer

24 April 2020

Directors' Report

The Directors present their report and financial statements for the year ended 31 December 2019. Information regarding future developments and risk management as required by Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Accounting Regulations) to be contained in the Directors' Report has been included in the Strategic Report and Chairman's Statement in accordance with section 414C(11) of the Companies Act 2006.

Governance Structure

The Bank is led by its Board comprising of a majority of non-executive directors including the Chairman. The Board has established three sub-committees to support proper discharge of its responsibilities: the Nomination Committee, the Remuneration Committee and the Audit and Risk Committee. The changes to Board membership in 2019 are shown below.

Directors

The following Directors held office during the year, except as noted:

R A Hammond-Chambers* (Chair of the Nomination Committee and the Remuneration Committee), (appointed Chairman 2 October 2019)

A R F Hughes (retired as Chairman 2 October 2019)

G T Hartop (Chief Executive Officer)

A K Mulligan (Chief Financial Officer)

V W C Kubitscheck* (Independent Director, Chair of the Audit and Risk Committee)

C G Camroux-Oliver**

P S R Shedden** (appointed 19 February 2019 and resigned 22 April 2020)

P A Sparkes**

* Independent Non-Executive Director

** Shareholder Nominated Non-Executive Director

Alex Hammond-Chambers, Chairman

Alex worked for 27 years at the investment management firm, Ivory & Sime, ending up as Executive Chairman. He also served as overseas governor of the National Association of Securities Dealers, which ran the NASDAQ, and as Chairman of the Association of Investment Companies. Since retiring from Ivory & Sime, Alex has served as a director of many companies. He joined the Bank in 2010 and is Chairman of the Remuneration Committee. He became Chairman in October 2019.

Graeme Hartop, Chief Executive Officer

Graeme is a qualified Chartered Accountant and Chartered Banker with over 30 years' experience in the banking industry. He was Head of Finance at Adam & Company before joining Scottish Widows Bank in 1993 as Finance & Operations Director and where he became Managing Director in 2003. Graeme joined the Bank in 2013. He was a Council member at the Chartered Banker Institute and Vice-President from 2007 to 2010.

Andrew Mulligan, Chief Financial Officer

Andrew is a qualified Chartered Accountant with over 15 years' experience in the banking industry. After qualifying, he started his career in finance with Scottish & Newcastle plc, before joining the Royal Bank of Scotland Group in 2004. He became Finance Director of Adam & Company in 2006 and joined the Bank in 2011.

Directors (*continued*)

Vicky Kubitscheck, Independent Non-executive Director

Vicky is a specialist in risk governance with over 35 years' experience in financial services, having established and led risk, compliance and audit functions at the height of regulatory and strategic change within organisations such as AEGON, AXA and latterly at Police Mutual. Vicky serves as a director on the boards at First State Investments. She is also a board advisor, an author and the President and former Founding Chair of the Insurance Internal Audit Group. Vicky joined the Board in 2014 and is Chair of the Audit and Risk Committee.

Charlie Camroux-Oliver, Non-executive Director

Charlie practiced as a solicitor with Barlow Lyde Gilbert and Charles Russell between 1993 and 2003, specialising in company commercial and (re)insurance law. In 2003 he joined the Hampden Group as General Counsel and now deals with transactional matters on behalf of the Hampden Group. Charlie joined the Board in 2016.

Peter Sparkes, Non-executive Director

Peter is an experienced Finance Director who has held senior roles in industry across the world. He is fluent in Mandarin and, together with financial skills acquired over a period of more than 25 years, Peter brings experience in a wide range of other areas, including IT, business planning, project management and strategic acumen. Peter now runs Corvus Management Services Ltd, a Management and Consulting Company based in Hong Kong that provides family management services. Peter joined the Board in 2015.

Paul Shedden, Non-executive Director

Paul is the Chief Executive of Insurance Pricing and Strategic Analysis at Axa XL. He joined the Board in February 2019.

Risk Management and Governance

The Bank has established a comprehensive risk management and governance framework as an integral part of delivering the Bank's aims and meeting client and shareholder expectations. The Board, being ultimately responsible for identifying and managing the Bank's principal risks, sets and regularly reviews the Bank's risk appetite in the light of strategic, commercial and economic aims alongside statutory and regulatory requirements.

Strong risk management that is strategic in its outlook and underpinned by an overall cautious approach to risk taking is fundamental to building the Bank in line with the traditional nature of private banking on a long term, sustainable basis. This means, amongst other things, that the Bank will remain predominantly UK-focused, does not undertake any proprietary trading and manages capital and liquidity in a controlled manner. The Bank adheres to prudent lending policies, with lending undertaken within defined limits and overviewed at the Credit Committee. The Bank's regulatory liquidity, capital and leverage ratios are closely monitored and have been maintained within regulatory requirements. The Bank continually reviews and develops its client proposition and services that are relevant to its clients while maintaining a prudent approach to managing risks to the long-term success of the Bank.

The Board considers the principal risks, as set out in the Strategic Report, and system of risk governance and internal control, as outlined below, to be appropriate to the nature of its activities and proportionate to its scale and stage of development.

Risk Management and Governance (*continued*)

Risk and Internal Control Governance Framework

Supporting the Board's oversight of the Bank's risk management is the BRC, made up of Non-Executive Directors. In addition to the Executive's RMC, there are four management committees at the operational level - Credit, ALCO, Compliance & Conduct and Operational Resilience - which meet at least once each month, comprising executives and other senior managers. Collectively, these committees are referred to as "Risk Committees".

The Bank adopts the 'three lines of defence' model as a core component of its system of risk management and internal control:

- First line of defence: Line management and operational business functions such as Banking, Finance, Operations and Treasury. They are accountable for owning and managing, within a defined risk appetite, the risks that exist in their business area and complying with the Bank's policies;
- Second line of defence: The second line consists of Compliance and Risk Management functions and the Risk Committees. The Compliance and Risk Management function is responsible for owning and developing the risk framework within the Bank and is managed by the Chief Risk Officer who is independent of the business areas in the first line of defence. The Risk Committees have an integral role within their stated Terms of Reference; and
- Third line of defence: Internal Audit provides independent assurance to the Board on the appropriateness and effectiveness of the internal controls, processes and procedures across the control framework.

The Bank currently outsources the Internal Audit function to Grant Thornton UK LLP. While governance responsibility lies with the Board, responsibility for approving the Internal Audit annual budget has been delegated to the BAC. Internal Audit and other third party experts periodically perform independent reviews of the Bank's risk management and system of internal control.

Information on risk management performance is aggregated across the lines of defence and reported to each regular meeting of the Board and Risk Committees.

The Bank continues to invest in its risk management and internal control capabilities to ensure it operates competently within its appetite.

Risk Management Framework

The risk management framework aims to ensure that emerging risks and the risks inherent in operating and growing the Bank are identified proactively, monitored and managed within the Board's defined risk appetite and reported to the Risk Committees and the Board. Appropriate policies, authorities, risk tolerances and limits are set that seek to balance opportunities, risks and rewards.

In addition to the Bank's risk governance arrangements, a key element of the risk framework is the business culture as reinforced by important objectives of the Board, which include having:

- Board and Committee members that openly champion client needs and fair outcomes for clients, voice the views of the business areas they represent and challenge each other in an open and constructive manner thus demonstrating an appropriate tone from the top to others within the organisation;
- a Board that promotes a robust governance, risk and compliance culture, ensuring appropriate segregation of duties and avoiding conflicts of interest;

Risk Management and Governance (*continued*)

Risk Management Framework (*continued*)

- staff who seek to understand the needs of our clients and treat clients fairly;
- staff who act with integrity and honesty and act within the limits of their delegated authorities and accountabilities; and
- staff who understand and manage the risks they take on behalf of the Bank and are given appropriate training to do so.

The Board is conscious of the need to ensure that the Bank's reputation is effectively managed. As such there is proactive identification and vigilant monitoring of, and response to, events which could potentially damage the Bank's reputation. Staff are actively encouraged to identify and report failings and to take proactive steps to address weaknesses when they are discovered. A whistleblowing process is in place should staff require to escalate an issue outside of the normal management processes and reporting lines.

Potential risks identified are evaluated to ensure that appropriate mitigation actions are taken promptly. A risk database is deployed to assist with the recording, analysis and reporting of risks. Scenario analysis and stress testing are additional tools used for gaining more insight and assessing the resilience of internal control strategies, for example, during capital and liquidity adequacy assessments and detailed risk reviews.

The remuneration policy promotes teamwork, reinforcing the culture required to deliver the strategy, and the performance appraisal process takes the achievement of risk management objectives into account for all staff.

Capital Structure

Details of the Bank's share capital, together with movements in the Bank's issued share capital are shown in notes 20 & 26.

In April 2019 the Bank raised additional capital of £9.8m from the three Cornerstone shareholders.

The Bank also implemented a share capital restructure during the year, as follows:

1. Share capital consolidation: Every 20 existing ordinary shares of £0.05 each were converted into 1 ordinary share of £1.00. This reduced the number of ordinary shares in issue from 1,328,902,840 to 66,445,142.
2. Reduction of capital: The nominal value of ordinary shares was reduced from £1.00 to £0.05 by cancelling capital to the extent of £0.95 on each ordinary share. The amount of share capital so cancelled (£63.1m) has been credited to retained earnings.
3. Share premium cancellation and redemption reserve cancellation: The balances on the share premium account and the capital redemption reserve (total £18.1m) have been cancelled and transferred to retained earnings.

The share capital consolidation, reduction of capital, share premium cancellation and redemption reserve cancellation (collectively "the share capital restructure") were approved by the Bank's shareholders at a general meeting on 19 November 2019. The reduction of capital, share premium cancellation and redemption reserve cancellation were also approved by the Court of Session in Edinburgh on 17 December 2019.

As well as simplifying the Bank's capital base, the share capital restructure provides greater assurance that the Bank will be able to raise equity in the future, even in adverse market conditions, as shares

Capital Structure (*continued*)

cannot be issued at a discount to their nominal value. It also gives the Bank flexibility to make distributions to shareholders in the future as the Bank now has net distributable reserves rather than retained losses. However, there is no intention to make any distributions to shareholders until the Bank has achieved capital self-sufficiency and for as long as capital is required to grow the business.

The share capital restructure had no impact on cash, net assets or the Bank's regulatory capital, other than the implementation costs of £0.1m which have been charged to the share premium account.

Going Concern

The Directors, having made such enquiries as they considered appropriate and having reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future, consider the preparation of the financial statements using the going concern basis of accounting to be appropriate.

In making this assessment the Directors relied on:

- the need to raise new capital and its likely availability;
- the Business Plan;
- the impact of the Covid-19 pandemic and robustness of the Bank's business continuity plans;
- the Bank of England supervisory measures available for addressing the challenge of Covid-19;
- their evaluation of the Bank's principal risks and uncertainties, including those that could threaten the Bank's business model, its future performance or solvency;
- the Internal Capital Adequacy Assessment Process; and
- the Internal Liquidity Adequacy Assessment Process.

The Bank has prepared a 5-year Business Plan ("the Business Plan"), an integral part of which is the assessment of the quantum and timing of capital as well as the funding it requires as it reaches profitability and capital self-sufficiency. The Business Plan provides the basis for the Bank's financial forecasts which include a detailed annual budget for year one (2020) and forecasts for years two to five (2021-2024). The Directors need to raise additional capital to support business growth, absorb forecast losses and to allow the Bank to adhere to regulatory capital requirements.

In April 2020, the four largest shareholders have committed to provide £10m in 2020, of which £7.1m has been capitalised.

In making this assessment of going concern, the Directors have conducted a detailed review of the Business Plan and relevant stress scenarios taking into consideration recent developments arising from the impact of Covid-19. Key considerations include client, deposit and lending growth, regulatory capital requirements, the necessary investment in operational capability and the resultant impact on profitability. Mitigating actions available to the Directors to conserve capital resources include the management of lending flows, restriction of capital expenditure and limiting operational expenses.

In the wake of the Covid-19 outbreak the Bank has invoked business continuity plans in order to maintain high quality service and support its clients throughout the pandemic whilst maintaining the safety and well-being of staff. The Directors have assessed the operational resilience measures taken to provide continuity of service to clients throughout a prolonged period, including:

- the operational resilience of the Bank's critical functions and key suppliers;
- the resilience of core and auxiliary IT systems; and
- the impact of staff working from home.

The Directors are satisfied that the Bank's continuity plans are robust with 98% of staff working

Going Concern (*continued*)

remotely whilst maintaining a high level of client service. A weekly Covid-19 Dashboard has been created for the EMC and the Board that collates existing and new key operational indicators. Other risk mitigation strategies have been introduced including enhanced credit risk monitoring and increased client communication.

The Directors considered the effect of the Covid-19 pandemic on the Bank's capital position. The timeline of social distancing is unclear with business growth assumptions particularly on lending being potentially more sensitive and unpredictable. The Bank's income is likely to be depressed during this period of uncertainty through reduced interest rates and client activity, extending the path to profitability.

The Directors noted the measures introduced by the Bank of England to assist banks to maintain their safety and soundness and to support the economy during this temporary shock. Measures included the reduction of the Countercyclical Capital Buffer and the expectation that capital and liquidity buffers would be used if required. The Bank does not plan to use these buffers however the Directors are cognisant that these measures are available in extremis. The Directors expect to support clients directly rather than through the government-backed SME lending support schemes.

As a result of the assessment outlined above, the Directors have a reasonable expectation that, for a period of at least 12 months from the date that the financial statements have been authorised for issue, the Bank will be able to raise additional capital, continue in operation and meet its liabilities as they fall due.

Financial Instruments

Information about the use of financial instruments by the Bank is given in notes 16 & 18 to the financial statements.

Research and Development

The Bank continued to invest in the development of its core banking platform in 2019, including a mobile digital banking app. See note 14 for further details.

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable 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 financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 company for that period. In preparing these financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies;
- 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 IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Bank's ability to continue as a going concern.

Statement of Directors' Responsibilities (*continued*)

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 the 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.

Statement of Disclosure to Auditor

The Directors confirm that;

- (a) so far as they are aware, there is no relevant audit information of which the Bank's auditor is unaware, and
- (b) they have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

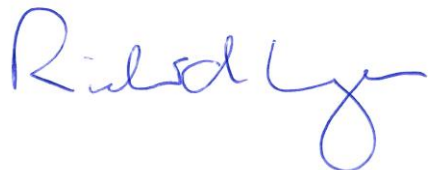
Indemnity Insurance

The Bank has made qualifying third party indemnity provisions for the benefit of its Directors which were made during the year and remain in force at the date of this report.

Post Balance Sheet Events

Significant events which have arisen between 31 December 2019 and the date of this report are disclosed in note 29.

On behalf of the Board



R F H Lyon

Company Secretary

24 April 2020

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HAMPDEN & CO PLC

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of Hampden & Co plc (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 December 2019 and of its loss for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the statement of comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 29.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

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 Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the company for the year are disclosed in note 7 to the financial statements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

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


3. Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- The appropriateness of preparing the financial statements using the going concern basis of accounting; and
- The measurement of expected credit losses on loans and advances to clients.

Within this report, key audit matters are identified as follows:

 Similar level of risk to the prior year

| | |
|--------------------|---|
| Materiality | The materiality that we used in the current year was £448.5k (2018: £399k) which was determined on the basis of 1% of the total equity balance as at 31 December 2019 (31 December 2018: 1%). |
| Scoping | Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team. |

4. Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

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

We have nothing to report in respect of these matters.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, 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 forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1. The appropriateness of preparing the financial statements using the going concern basis of accounting

| | |
|-------------------------------------|--|
| Key audit matter description | <p>The company is required by its regulator to maintain sufficient capital and liquidity to continue in operational existence for the foreseeable future. The company's ability to maintain sufficient capital and liquidity is therefore central to the assessment of the appropriateness of preparing the financial statements using the going concern basis of accounting.</p> <p>As disclosed in note 29 to the financial statements, the four largest shareholders of the company have committed to provided £10m of capital in 2020, of which £7.1m was capitalised prior to the approval of the financial statements. This capital is required to absorb the company's forecast future losses and to support the forecast growth in the company's balance sheet.</p> <p>There are reasonably possible scenarios, including those related to the COVID-19 pandemic, the impact of which on the business is described in note 1.2, where the company's forecast capital requirement could be higher than anticipated although management could take actions wholly within their control to manage the company's overall capital requirement and maintain a capital surplus.</p> |
|-------------------------------------|--|

Given the judgement required in determining the company's forecast capital requirements, we have therefore identified a key audit matter in relation to the appropriateness of the going concern basis of accounting.

The director's statement on going concern is on pages 15-16, with the related accounting policy disclosure on pages 32 to 33 and statement in relation to the impact of COVID-19 on page 63.

How the scope of our audit responded to the key audit matter

We considered as part of our risk assessment the nature of the company, its business model and related risks including the impact of the Covid-19 pandemic, the requirements of the applicable financial reporting framework and the system of internal control.

Our procedures to assess the ability of the company to continue as a going concern included the following:

Controls

We obtained an understanding of key controls over the going concern assessment including the preparation of the company's key financial, capital and liquidity forecasts.

Financial, capital and liquidity forecasting

We reviewed the papers prepared by management to support the going concern assumption, including the company's Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process.

We evaluated the reliability of management's forecasting process by comparing historical forecasts to actual results for the year ended 31 December 2019. We also challenged the achievability of management's financial, capital and liquidity forecasts with reference to the company's historic performance, the specific growth strategies that management has put in place and the performance of the company since 31 December 2019.

We considered the timing and likelihood of potential supervisory action in connection with the company's forecast position. This included reviewing correspondence with the company and the regulator and making direct enquiries with the regulator.

We have reviewed the evidence to support the subscription of capital in 2020 and assessed the mitigating actions that management could take that are wholly within their control to make sure that the company continues to meet its regulatory capital requirements in the event of reasonably possible downside scenarios, including the impact of the COVID-19 pandemic. We also considered the likelihood of potential scenarios under which the company would need to raise additional capital in order to remain above its regulatory capital requirements during the period of at least 12 months from the date the financial statements are authorised for issue.

In considering the potential downside scenarios, we also reviewed management's business continuity plans and where key operational services have been outsourced to third parties, management's assessment of those service providers' operational and financial resilience, or where necessary, the contingency plans in place where a supplier has been deemed at risk.

Disclosures

We reviewed management's statements on going concern disclosed in the company's financial statements with reference to the evidence obtained through the procedures above.

Key observations Based on our audit procedures, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

5.2. The measurement of expected credit losses on loans and advances to clients 

Key audit matter description The company has recorded an impairment provision of £7k at 31 December 2019 (31 December 2018: £29k) on loans and advances to clients of £203,814k (31 December 2018: £132,517k).

Impairment provisions on loans and advances to clients are detailed within note 18. Management's associated accounting policies are detailed on pages 36 to 39.

The company measures the impairment provision on loans and advances to clients using an expected credit losses model. Determining expected credit losses is a judgemental area which requires the formulation of assumptions including the probability of default, the exposure at default and the loss given default, all of which should incorporate forward-looking information. Given the degree of judgement involved, we consider that there is a potential for fraud through possible manipulation of this balance.

We have determined the most significant areas of management judgement in the measurement of expected credit losses to be:

- The calibration of the loss given default ("LGD") assumption for loans with a loan to value of over 65% and secured by commercial property and undeveloped land, given the additional judgement required to determine the realisable values of such collateral; and
- The incorporation of forward-looking macro-economic information into the measurement of expected credit losses. Specifically, management has concluded that there is limited demonstrable correlation between potential changes in macro-economic variables and the estimated probabilities of default of the company's loan portfolio. Furthermore, management's estimate of loss given default does not specifically incorporate multiple forward-looking macro-economic scenarios on the basis that this would not have a material impact on the measurement of expected credit losses, given the highly collateralised nature of the company's loan portfolio.

We have therefore identified a key audit matter in relation to these specific judgements.

How the scope of our audit responded to the key audit matter Our procedures to assess these judgements included the following:

Controls

We obtained an understanding of the overall loan impairment provisioning process. We performed a specific assessment of the controls over the level of challenge at key management review forums over the probability of default and loss given default assumptions, including whether forward-looking macro-economic information should be included when modelling these assumptions.

LGD calibration

For a sample of loans, we checked relevant documentation to make sure that the company had first charge over the collateral.

We obtained the third party collateral valuation reports which the company had commissioned and engaged internal Deloitte Real Estate specialists to challenge the valuation of the collateral that was used as the basis of the LGD calibration, with reference to similar market transactions and other relevant information. We also engaged our specialists to support our challenge of the haircuts applied by management to the collateral valuation in determining the LGD.

Incorporation of forward-looking macro-economic information into the measurement of expected credit losses

Probability of default

We reviewed the report produced by management's third party expert which concluded that there was limited demonstrable correlation between changes in macro-economic variables and the probabilities of default on the company's loan portfolio, based on the data sources available to the third party.

This included reviewing the statistical approach used by the third party to identify potential correlations to make sure that that it was appropriate and also checked that the historic data sets used by the third party in their analysis correlated to the types of loans in the company's current loan portfolio. We also assessed the competence of third party and confirmed that the scope of the work was appropriate for management's purposes.

In addition, we challenged management with regards to how they had rolled forward the third party expert's conclusion to the 31 December 2019 year-end date.

Loss given default

We reviewed the analysis performed by management which modelled the impact of a downturn economic scenario on the measurement of expected credit losses. This involved a critical assessment of the key macro-economic assumptions used by management in their analysis (including the potential impact of Brexit) and benchmarking to publicly available information, with support from internal Deloitte specialists.

| | |
|-------------------------|---|
| Key observations | Based on our audit procedures, we concluded that management's methodology was appropriate. We concur with their judgement that the incorporation of forward-looking macro-economic information does not have a material effect on the measurement of expected credit losses on loans and advances to clients. |
|-------------------------|---|

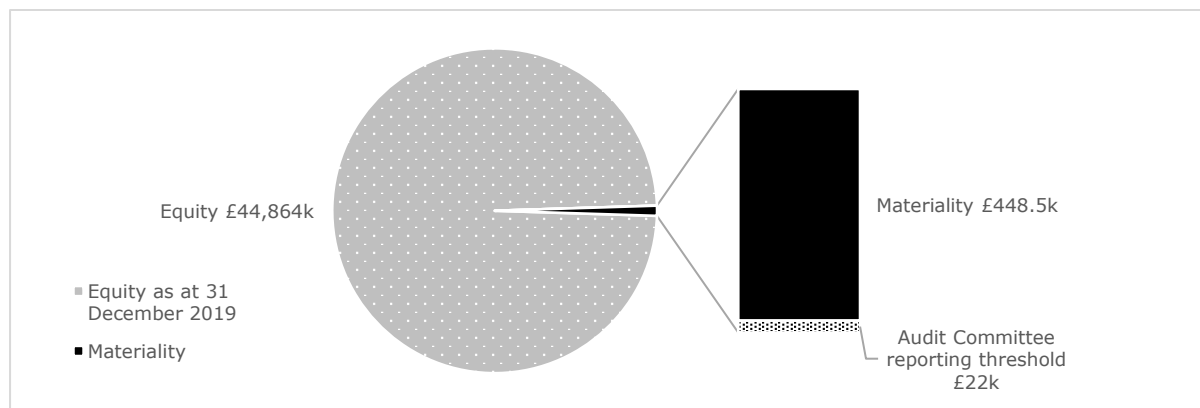
6. Our application of materiality

6.1. Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

| | |
|--|---|
| Materiality | £448.5k (2019: £399k) |
| Basis for determining materiality | Materiality has been determined as 1% of equity as at 31 December 2019 (2018: 1% of equity as at 31 December 2018) |
| Rationale for the benchmark applied | In our professional judgement, the equity balance was determined as the appropriate measure as income statement results are volatile given the early stages of the company's operation. |



6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 70% of materiality for the 2019 audit (2018: 70%).

In determining performance materiality, we considered our understanding of the entity and its environment, the entity's internal controls over financial reporting and the fact that we were able to rely upon controls for a number of key business processes. We also took into account the fact that there is no history of uncorrected misstatements.

As such, we concluded that the 30% error rate was sufficient.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £22k (2019: £20k), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1. Scoping

Our audit was scoped by obtaining an understanding of the entity and its environment, including controls, and assessing the risks of material misstatement at the entity level. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

7.2. Our consideration of the control environment

The key IT system relevant to our audit is the combined general ledger and banking platform. This is provided to the company by a third party service organisation. This IT system supports the processing of all transactions related to loans and advances to clients and deposits from clients.

We relied on the IT controls associated with this system and therefore assessed the operating effectiveness of the general IT controls within it. This included reviewing the System and Organisation Controls 1 ("SOC1") report prepared by the independent service auditor of the service organisation, as well as assessing the specific controls which operate at the company.

We took a controls reliance strategy over the client lending and deposit product cycles (loans and advances to clients and deposits from clients). This included testing the controls associated with client account opening, client account closing and the application of transactions to client accounts.

8. Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

9. Responsibilities of directors

As explained more fully in the directors' responsibilities statement, 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.

10. Auditor's responsibilities for the audit of the financial statements

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

the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud and non-compliance with laws and regulations are set out below.

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

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the company's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the company's documentation of their policies and procedures relating to:
 - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
 - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
 - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and involving relevant internal specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the measurement of expected credit losses. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act and the HM Revenue and Customs (HMRC) Tax Legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty. These included the requirements of the United Kingdom's Prudential Regulation Authority ("PRA") and Financial Conduct Authority ("FCA") which are fundamental to the company's ability to continue as a going concern.

11.2. Audit response to risks identified

As a result of performing the above, we identified the measurement of expected credit losses as a key audit matter related to the potential risk of fraud and going concern as a key audit matter in relation to compliance with laws and regulations. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management and the audit committee concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the PRA and FCA; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Companies Act 2006

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

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

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

13. Matters on which we are required to report by exception

13.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

13.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

14. Other matters

14.1. Auditor tenure

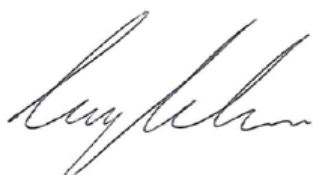
Following the recommendation of the Audit Committee, we were appointed by the Board of Directors on 09 March 2015 to audit the financial statements for the year ended 31 December 2015 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 5 years, covering the years ended 31 December 2015 to 31 December 2019.

14.2. Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

15. 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.



Craig Cosham (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

24 April 2020

Hampden & Co plc
Statement of Comprehensive Income

| | Note | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|---|------|--|--|
| Interest receivable and similar income | | 9,241 | 6,022 |
| Interest payable and similar charges | | (1,661) | (561) |
| Net interest income | 4 | 7,580 | 5,461 |
| Non-interest income | | 627 | 577 |
| Net non-interest income | 5 | 627 | 577 |
| Income from currency operations | | 476 | 326 |
| Total income | | 8,683 | 6,364 |
| Administrative expenses | | (13,028) | (11,501) |
| Depreciation and amortisation | | (1,211) | (642) |
| Operating expenses | 6 | (14,239) | (12,143) |
| Operating loss before impairment losses | | (5,556) | (5,779) |
| Impairment credit/(charge) on loans and advances to clients | 18 | 23 | (17) |
| Loss before tax | 6 | (5,533) | (5,796) |
| Tax income | 8 | - | 219 |
| Loss for the year from continuing operations (attributable to equity holders) and total comprehensive loss | | (5,533) | (5,577) |

Hampden & Co plc
Statement of Financial Position

| | Note | 2019 £'000 | 2018 £'000 |
|-------------------------------------|------|----------------|----------------|
| Assets | | | |
| Cash and balances at central banks | 16 | 119,691 | 91,135 |
| Loans and advances to banks | 16 | 129,085 | 81,759 |
| Loans and advances to clients | 16 | 203,807 | 132,488 |
| Prepayments and accrued income | | 714 | 503 |
| Other assets | | 233 | 220 |
| Property, plant and equipment | 12 | 141 | 195 |
| Right-of-use assets | 13 | 2,093 | - |
| Intangible assets | 14 | 2,342 | 2,910 |
| Total assets | | <u>458,106</u> | <u>309,210</u> |
| Liabilities | | | |
| Deposits from clients | 16 | 409,374 | 267,483 |
| Accruals and deferred income | 15 | 1,662 | 1,756 |
| Lease liabilities | 13 | 2,076 | - |
| Other liabilities | | 14 | 1 |
| Provisions | 25 | 116 | 118 |
| Total liabilities | | <u>413,242</u> | <u>269,358</u> |
| Equity | | | |
| Share capital | 20 | 3,322 | 59,902 |
| Share premium account | 20 | - | 15,066 |
| Other reserves | 20 | - | 19 |
| Retained earnings | 21 | 41,542 | (35,135) |
| Total equity | | <u>44,864</u> | <u>39,852</u> |
| Total liabilities and equity | | <u>458,106</u> | <u>309,210</u> |

The financial statements on pages 28 to 63 were approved by the Board of Directors and authorised for issue on 24 April 2020 and were signed on its behalf by:



G T Hartop
Chief Executive Officer



A K Mulligan
Chief Financial Officer

Company Registration No. SC386922

Hampden & Co plc
Statement of Changes in Equity

| | | Share capital £'000 | Share premium account £'000 | Other reserves £'000 | Retained earnings £'000 | Total equity £'000 |
|--|----|---------------------------|--------------------------------------|----------------------------|-------------------------------|--------------------------|
| At 1 January 2018 after adopting IFRS 9 | | 59,369 | 14,812 | 19 | (30,491) | 43,709 |
| Loss for the year and total comprehensive loss | | - | - | - | (5,577) | (5,577) |
| Issue of share capital | 20 | 533 | 268 | - | - | 801 |
| Direct share issue costs | 20 | - | (14) | - | - | (14) |
| Equity settled share-based payments | 11 | - | - | - | 933 | 933 |
| At 31 December 2018 | | 59,902 | 15,066 | 19 | (35,135) | 39,852 |
| Loss for the year and total comprehensive loss | | - | - | - | (5,533) | (5,533) |
| Issue of share capital | 20 | 6,543 | 3,271 | - | - | 9,814 |
| Direct share issue costs | 20 | - | (145) | - | - | (145) |
| Share capital restructure | 20 | (63,123) | (18,083) | (19) | 81,225 | - |
| Direct share capital restructure costs | 20 | - | (109) | - | - | (109) |
| Equity settled share-based payments | 11 | - | - | - | 985 | 985 |
| At 31 December 2019 | | 3,322 | - | - | 41,542 | 44,864 |

Hampden & Co plc
Statement of Cash Flows

| | Year ended 31 December 2019 £000 | Year ended 31 December 2018 £000 |
|---|--|--|
| Cash flows from operating activities | | |
| Loss for the year | (5,533) | (5,577) |
| Reconciliation from loss before tax to net cash flows from operating activities: | | |
| Depreciation and amortisation | 1,211 | 642 |
| Equity settled share-based payments | 985 | 933 |
| Impairment (credit)/charge for the year | (23) | 17 |
| (Increase) in prepayments and accrued income | (328) | (86) |
| Increase in accruals and deferred income | 189 | 53 |
| (Increase) in loans and advances to clients and banks | (95,184) | (45,597) |
| Increase in deposits by clients and banks | 144,772 | 70,389 |
| (Increase) in other assets | (11) | (36) |
| Increase/(decrease) in other liabilities and provisions | 11 | (38) |
| Elimination of foreign exchange differences | 8 | 1 |
| Net cash inflow from operating activities | <u>46,097</u> | <u>20,701</u> |
| Cash flows from investing activities | | |
| Purchase of property, plant and equipment | - | (3) |
| Purchases / development of intangible assets | (457) | (245) |
| Net cash outflow from investing activities | <u>(457)</u> | <u>(248)</u> |
| Cash flows from financing activities | | |
| Repayment of lease liabilities | (385) | - |
| Proceeds from issue of shares | 9,814 | 801 |
| Direct costs of share issuance and share capital restructure | (184) | (14) |
| Net cash inflow from financing activities | <u>9,245</u> | <u>787</u> |
| Net increase in cash and cash equivalents | 54,885 | 21,240 |
| Cash and cash equivalents at beginning of year | 148,975 | 125,284 |
| Effects of foreign exchange rate changes on cash and cash equivalents | (2,890) | 2,451 |
| Cash and cash equivalents at end of year | <u>200,970</u> | <u>148,975</u> |
| Net cash inflow from operating activities includes the following cash flows: | | |
| Interest received | 8,917 | 5,754 |
| Interest paid | 1,426 | 453 |
| Analysis of cash and cash equivalents at end of year | | |
| Cash and balances at central banks | 119,961 | 91,135 |
| Loans and advances to banks repayable on demand | 81,279 | 57,840 |
| | <u>200,970</u> | <u>148,975</u> |

Notes to the financial statements

For the year ended 31 December 2019

1 General information

Hampden & Co plc (“the Bank”) is a bank incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is 9 Charlotte Square, Edinburgh, EH2 4DR. The nature of the Bank and its principal activities is the provision of banking services to high net worth individuals.

1.1 Presentation of financial statements

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and IFRIC interpretations, as endorsed by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs. The impact of accounting standards and interpretations issued but not yet effective is summarised in note 28. The financial statements are presented in sterling.

1.2 Going concern

The Directors, having made such enquiries as they considered appropriate and having reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future, consider the preparation of the financial statements using the going concern basis of accounting to be appropriate.

In making this assessment the Directors relied on:

- the need to raise new capital and its likely availability;
- the Business Plan;
- the impact of the Covid-19 pandemic and robustness of the Bank’s business continuity plans;
- the Bank of England supervisory measures available for addressing the challenge of Covid-19;
- their evaluation of the Bank’s principal risks and uncertainties, including those that could threaten the Bank’s business model, its future performance or solvency;
- the Internal Capital Adequacy Assessment Process; and
- the Internal Liquidity Adequacy Assessment Process.

The Bank has prepared a 5-year Business Plan (“the Business Plan”), an integral part of which is the assessment of the quantum and timing of capital as well as the funding it requires as it reaches profitability and capital self-sufficiency. The Business Plan provides the basis for the Bank’s financial forecasts which include a detailed annual budget for year one (2020) and forecasts for years two to five (2021-2024). The Directors need to raise additional capital to support business growth, absorb forecast losses and to allow the Bank to adhere to regulatory capital requirements.

In April 2020, the four largest shareholders have committed to provide £10m in 2020, of which £7.1m has been capitalised.

In making this assessment of going concern, the Directors have conducted a detailed review of the Business Plan and relevant stress scenarios taking into consideration recent developments arising from the impact of Covid-19. Key considerations include client, deposit and lending growth, regulatory capital requirements, the necessary investment in operational capability and the resultant impact on profitability. Mitigating actions available to the Directors to conserve

1 General information

1.2 Going concern (*continued*)

capital resources include the management of lending flows, restriction of capital expenditure and limiting operational expenses.

In the wake of the Covid-19 outbreak the Bank has invoked business continuity plans in order to maintain high quality service and support its clients throughout the pandemic whilst maintaining the safety and well-being of staff. The Directors have assessed the operational resilience measures taken to provide continuity of service to clients throughout a prolonged period, including:

- the operational resilience of the Bank's critical functions and key suppliers;
- the resilience of core and auxiliary IT systems; and
- the impact of staff working from home.

The Directors are satisfied that the Bank's continuity plans are robust with 98% of staff working remotely whilst maintaining a high level of client service. A weekly Covid-19 Dashboard has been created for the Executive Management Committee and the Board that collates existing and new key operational indicators. Other risk mitigation strategies have been introduced including enhanced credit risk monitoring and increased client communication.

The Directors considered the effect of the Covid-19 pandemic on the Bank's capital position. The timeline of social distancing is unclear with business growth assumptions, particularly on lending, being potentially more sensitive and unpredictable. The Bank's income is likely to be depressed during this period of uncertainty through reduced interest rates and client activity, extending the path to profitability.

The Directors noted the measures introduced by the Bank of England to assist banks to maintain their safety and soundness and to support the economy during this temporary shock. Measures included the reduction of the Countercyclical Capital Buffer and the expectation that capital and liquidity buffers would be used if required. The Bank does not plan to use these buffers however the Directors are cognisant that these measures are available in extremis. The Directors expect to support clients directly rather than through the government-backed SME lending support schemes.

As a result of the assessment outlined above, the Directors have a reasonable expectation that, for a period of at least 12 months from the date that the financial statements have been authorised for issue, the Bank will be able to raise additional capital, continue in operation and meet its liabilities as they fall due.

2 Summary of significant accounting policies

The financial statements have been prepared on the historical cost basis. The principal accounting policies adopted are set out below.

2.1 Property, plant and equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|------------------------|----------|
| Leasehold improvements | 10 years |
| Computer equipment | 5 years |

2 Summary of significant accounting policies (*continued*)

2.1 Property, plant and equipment (*continued*)

The residual values, useful lives and methods of depreciation are reviewed at each financial period end and adjusted prospectively, if appropriate. Property, plant and equipment are reviewed annually for indicators of impairment. If there are any indicators of impairment the recoverable amount is determined and compared to the carrying amount to identify whether an impairment loss should be recognised. The recoverable amount is the greater of the fair value less cost to sell and value in use. Any impairment losses are recognised immediately in profit or loss.

2.2 Intangible assets

Intangible assets, which represent developed software and software licences, are measured on initial recognition at cost. Staff and development costs in relation to the development of software are capitalised at cost and are recognised when it is deemed probable that the future economic benefits that are attributable to the asset will flow to the Bank. Intangible assets arising from development are recognised when it is demonstrated that the asset can be identified and will be available for use or sale, it is probable that the asset will generate future economic benefit and the expenditure attributable to the intangible asset during its development can be reliably measured. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses. Amortisation commences on development assets when the intangible asset is available for use. Intangible assets are deemed to have a finite life and are amortised over 5 to 7 years using the straight-line method and are reviewed for indicators of impairment annually. If there are any indicators of impairment the recoverable amount is determined and compared to the carrying amount to identify whether an impairment loss should be recognised. The recoverable amount is the greater of the net realisable value of the asset and the amount recoverable from its future use. Any impairment losses are recognised immediately in profit or loss.

2.3 Cash and balances at central banks

Cash and balances at central banks represent balances held with the Bank of England and any cash holdings. These are stated at amortised cost, which is equivalent to their fair values.

Loans and advances to banks that are short-term, readily convertible to known amounts of cash and are subject to insignificant changes in value are classified as cash-equivalents.

2.4 Equity

Equity is recorded at the proceeds received. Direct incremental costs relating to the issue of shares and other equity transactions are charged to equity through the share premium account.

2.5 Leases (policy applicable from 1 January 2019)

At the inception of a contract, the Bank assesses whether it is, or contains, a lease. A right-of-use asset and a corresponding lease liability are recognised for all lease arrangements where the Bank is the lessee, except for short-term leases (12 months or less) and leases of low value assets (typically office equipment). For these leases the Bank recognises the lease payments as an operating expense on a straight-line basis over the lease term.

The lease liability is initially recognised based on the present value of the future lease payments, discounted at the interest rate implicit in the lease or, if that rate cannot be readily determined, at the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate, determined as the market swap rate for the lease term plus a margin based on the Bank's size and credit rating and any lease-specific adjustment as deemed appropriate, estimated at the inception of the lease contract. The lease liability is subsequently

2 Summary of significant accounting policies (*continued*)

2.5 Leases (policy applicable from 1 January 2019) (*continued*)

measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount for the lease payments made. The Bank has used the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- excluded initial direct costs from measuring the right-of-use asset at the date of initial application; and
- used hindsight when determining the lease term if the contract contains options to extend or terminate the lease.

The right-of-use asset comprises the initial measurement of the corresponding lease liability. It is depreciated on a straight-line basis over the shorter of the lease term or the asset's useful life. The right-of-use asset is subsequently measured at cost less accumulated depreciation and impairment losses. Impairment losses are assessed and accounted for as described in note 2.1 Property, plant and equipment.

When the Bank incurs an obligation for costs to restore a leased asset to the condition required by the terms and conditions of the lease, a provision is recognised and, where appropriate, the costs are included in the related right-of-use asset.

2.5 Leases (policy applicable prior to 1 January 2019)

Rentals payable under operating leases are charged to the statement of comprehensive income on a straight-line basis over the term of the relevant lease except where another systematic basis is more representative of the time pattern in which economic benefits from the lease asset are consumed.

2.6 Taxes

Current tax

Current tax assets and liabilities for the current period are measured at the amount that it is expected to be recovered 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, at the reporting date in the United Kingdom.

Deferred tax

Deferred tax can only be recognised to the extent to which losses carried forward will be recoverable against future taxable profits. Due to the uncertainty associated with the recovery of these amounts against future profits, no deferred tax asset has been recognised at this stage. The recognition of deferred tax requires management to make estimates and judgements about future conditions and events, changes in which could have a material impact on the Bank's reported financial position or performance.

2.7 Foreign currencies

The financial statements are presented in pounds sterling, which is the currency of the primary economic environment in which the Bank operates (its functional currency).

Transactions in currencies other than the Bank's functional currency (foreign currencies) are recognised at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when

2 Summary of significant accounting policies (*continued*)

2.7 Foreign currencies (*continued*)

fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognised in the statement of comprehensive income in the period in which they arise.

2.8 Financial instruments

Financial assets and financial liabilities are recognised in the Bank's statement of financial position when the Bank becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Financial assets

All financial assets are recognised and derecognised on a trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned and are initially measured at fair value, plus transaction costs.

From a classification and measurement perspective the new standard requires all financial assets except equity instruments and derivatives to be assessed based on the Bank's business model for managing assets and the instruments' contractual cash flow characteristics. Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest (SPPI), and that are not designated at fair value through the profit and loss account, are classified and subsequently measured at amortised cost. The carrying value of these financial assets is adjusted by expected credit losses. All financial assets are measured at amortised cost as they are held to collect contractual cash flows and those cash flows meet the SPPI condition.

Effective interest rate method

The effective interest rate (EIR) method is a way of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The EIR is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the EIR, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Impairment of financial assets

The Bank assesses expected credit losses (ECLs) associated with its financial assets, including the exposures arising from loan commitments, on a case by case basis and does not measure ECLs on an overall portfolio basis.

The measurement of ECLs reflects reasonable and supportable information that is available without undue cost or effort at the reporting date.

All loan commitments provided by the Bank are contracts that include a loan and an undrawn committed facility. The ECLs on undrawn loan commitments are recognised as a loss provision.

The carrying amount of financial assets are reduced by the impairment loss. The low credit risk exemption has not been applied.

2 Summary of significant accounting policies (*continued*)

2.8 Financial instruments (*continued*)

Determining significant increase in credit risk since origination

ECLs are calculated in line with the requirements of IFRS 9 using a three-stage impairment model which assesses significant changes in credit risk since origination of financial assets. The measurement of ECLs is dependent on the classification stage of the assets.

Stage 1: For assets that are not credit impaired and have not had a significant increase in credit risk since initial recognition, 12 months ECLs are recognised.

Stage 2: For assets that have experienced a significant increase in credit risk since initial recognition but are not credit impaired, lifetime ECLs are recognised.

Stage 3: For financial assets that are credit impaired at the reporting date, lifetime ECLs are recognised.

The Bank uses a credit scorecard methodology for assessing significant increase in credit risk based on a number of quantitative, qualitative and backstop measures.

Quantitative criteria:

For each financial asset, if the credit score, determined by the credit scorecard methodology, has increased by more than a predetermined threshold relative to the origination score.

Qualitative criteria:

A number of qualitative criteria are also used to assess significant increase in credit risk:

- Bankruptcy;
- Borrowers who are placed on watch list; and
- Pre-delinquency information.

Backstops:

As defined within IFRS 9, the following backstops have been factored into the Bank's credit scorecard:

1. The Bank considers that if an asset's contractual payments are more than 30 days past due then a significant increase in credit risk has taken place;
2. If a position is greater than 90 days past due it is considered to be in default.

Definition of default

At each reporting date the Bank assesses whether or not any financial assets carried at amortised cost are credit impaired; the Bank's definition of credit impaired is aligned with the definition of default. A position is defined as in default when it meets one of the following criteria:

- A facility's contractual payment is more than 90 days past due;
- It is considered that the client is unlikely to pay their credit obligation to the Bank in full, without recourse actions such as the realisation of security (if held).

An instrument is considered to be no longer in default when it no longer meets the above default criteria and has returned to being up to date on its contractual repayments.

2 Summary of significant accounting policies (*continued*)

2.8 Financial instruments (*continued*)

Write-off policy

In situations where it is evident that a non performing loan/debt is not going to be repaid or there is a shortfall following realisation of security then the Bank may take the decision to write-off the residual debt but may still pursue the client for recovery of the debt.

No assets were written off during the years ended 31 December 2019 and 2018.

Model inputs and assumptions

The ECLs are measured on a 12 month or lifetime basis depending on whether or not a significant increase in credit risk has occurred since initial recognition. The IFRS 9 model developed by the Bank has a number of inputs and assumptions:

- ECLs are determined by assessing the probability of default (PD), loss given default (LGD), exposure at default (EAD) and discount factor for each individual exposure. The four components are multiplied together in order to derive expected ECLs for the relevant period.
- PD represents the likelihood of a borrower defaulting on their financial obligation either over the next 12 months or over the remaining lifetime of the obligation, depending on what stage the financial asset is in at the reporting date. The Bank uses an external consultant to provide PD data that has been profiled against the Bank's lending book. As the Bank historically has no instances of default it is not possible to use internally collected data to derive PD rates.
- LGD is based on collateral recovery value to give an expected loss at default, defined as a percentage of EAD. The model uses the market value less a defined haircut to work out the value of collateral for calculating LGD. The haircuts vary between 20-50% and are assessed on a case by case basis depending on the type, location, size and nature of the collateral. The haircut to the market value of the collateral also includes assumptions to reflect the cost of liquidating collateral in a forced sale, legal costs and the time value of money. Haircut percentages and values remain under constant review with the option to increase or decrease to reflect any market movements or forward-looking macro-dependencies of LGD. If the expected proceeds from the collateral exceeds the amount loaned, the entity may have an LGD of 0% and hence an allowance of zero.
- EAD – the model predicts EAD as the expected principal balance outstanding plus three months interest at the time of default. Partial prepayment is excluded from the modelling of EAD as the Bank does not have sufficient prepayment information to accurately predict prepayment rates.
- Discount factor – IFRS 9 expects credit losses to reflect the time value of money, which is achieved by discounting the estimated losses at the reporting date. The Bank has applied an operational simplification to use the interest rate at the time of origination as the basis for the discount rate as an approximation of the EIR. This operational simplification of using the interest rate at origination rather than the EIR is not deemed to have a material impact on the ECLs. ECLs are discounted to the reporting date.
- Lifetime ECLs – Lifetime ECLs are the ECLs that result from all possible default events over the contractual life of the financial instrument. For revolving credit facilities, such as overdrafts, the contractual term is 12 months. The lifetime of the overdraft facility is therefore taken to be 12 months.

2 Summary of significant accounting policies (*continued*)

2.8 Financial instruments (*continued*)

- Forward looking macroeconomic judgements – IFRS 9 requires ECLs to reflect a range of possible outcomes and consider possible future economic conditions. Through analysis received from an economic consultant and management's own analysis (which included consideration of the potential impact of Brexit), management did not deem it necessary to incorporate forward looking economic assumptions into the ECL model for either 2018 or 2019 based on the fact that adjusting for forward looking information would not have a material impact on the measurement of ECLs.

Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

Financial liabilities and equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Financial liabilities

Financial liabilities are classified as 'financial liabilities at amortised cost'.

Financial liabilities at amortised cost

Financial liabilities at amortised cost, including borrowings, are initially measured at fair value, net of transaction costs.

Financial liabilities are subsequently measured at amortised cost using the EIR method, with interest expense recognised on an effective yield basis.

The EIR method is a way of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The EIR is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

2.9 Non-interest income

Non-interest income is recognised on an accruals basis when the underlying performance obligation has been satisfied.

2.10 Interest receivable and payable

Interest income is recognised when it is probable that the economic benefits will flow to the Bank and the amount of revenue can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the EIR applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset

2 Summary of significant accounting policies (*continued*)

2.10 Interest receivable and payable (*continued*)

to that asset's net carrying amount on initial recognition.

2.11 Pension costs

As part of the Workplace pension law, the Bank has organised that an independent specialist pension provider offers members of staff a defined contribution pension scheme. Payments to the defined contribution pension scheme are recognised as an expense when employees have rendered service entitling them to the contributions. The assets of the scheme are administered separately from those of the Bank in independently administered funds.

2.12 Share-based payments

Employees receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for options in the Bank's shares. The fair value of share options at the grant date is recognised as an employee expense in the statement of comprehensive income over the vesting period on a straight-line basis, based on the Bank's estimate of equity instruments that will eventually vest. The overall cost of the award is calculated using the number of options expected to vest and the fair value of the options at the grant date.

The fair value of the share option plan is calculated at the grant date using either a Binomial valuation model or Black Scholes valuation model, depending on the rules of the scheme. Inputs into the valuation model include the risk-free interest rate and volatility assumptions. Further details regarding the determination of the fair value of equity settled share-based transactions are set out in note 11. The fair value includes the effect of non-vesting conditions and any market-based performance conditions.

2.13 Provisions

A provision is recognised where there is a present legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of economic resource will be required to settle the obligation, and the amount can be reliably estimated.

3 Critical accounting judgements and key sources of estimation uncertainty

In the application of the Bank's accounting policies, which are described in note 2, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. The Directors do not consider there to be any critical accounting judgements or key sources of estimation uncertainty.

4 Net interest income

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|---|---|---|
| Interest income on loans and receivables to banks | 2,743 | 1,520 |
| Interest income on loans and receivables to clients | 6,498 | 4,502 |
| Interest receivable | 9,241 | 6,022 |
| Interest expense on deposits from banks | - | (4) |
| Interest expense on deposits from clients | (1,493) | (557) |
| Interest expense on lease liabilities | (168) | - |
| Interest payable | (1,661) | (561) |
| Net interest income | 7,580 | 5,461 |

5 Net non-interest income

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|--------------------------------|---|---|
| Banking income | 627 | 577 |
| Net non-interest income | 627 | 577 |

6 Loss before tax

Loss before tax is stated after charging:

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|---|---|---|
| Staff costs & Directors' remuneration | 7,695 | 6,822 |
| Depreciation of property, plant and equipment (note 12) | 54 | 66 |
| Depreciation of right-of-use assets (note 13) | 443 | - |
| Amortisation of intangible assets (note 14) | 714 | 576 |
| Expenses relating to successful and unsuccessful acquisitions | 488 | - |
| Operating lease expense | - | 543 |
| Other property-related expenses | 451 | 413 |
| Other administrative expenses | 4,394 | 3,723 |
| Operating expenses | 14,239 | 12,143 |

7 Auditor's remuneration

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|--|---|---|
| The analysis of the auditor's remuneration is as follows: | | |
| Fees payable to the Bank's auditor and its associates for the audit of the Bank's annual financial statements | 148 | 102 |
| Total audit fees | 148 | 102 |
| Corporate finance services | 83 | - |
| Other assurance services | - | 35 |
| Total non-audit fees | 83 | 35 |

8 Taxation

Total tax income on loss on ordinary activities was £nil for the year ended 31 December 2019 (2018: £219k).

The differences between the total tax income shown above and the amount calculated by applying the standard rate of UK corporation tax to the loss before tax are as follows:

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|--|---|---|
| Loss before tax | (5,533) | (5,796) |
| Tax on loss before tax at standard UK corporation tax rate of 19 per cent (2018: 19 per cent) | (1,051) | (1,101) |
| Effects of: | | |
| - Research and development tax credit | - | (219) |
| - Expenses not deductible for tax purposes | 92 | 20 |
| - Increase in unrecognised deferred tax assets | 959 | 1,081 |
| Total tax credit for year | - | (219) |

R&D eligible deductions in the period since the Bank opened resulted in a tax credit from HMRC of £219k, received in 2018.

The standard rate of UK corporation tax applied to reported profit is 19% (2018: 19%). The standard rate of UK corporation tax will reduce to 17% from 1 April 2020. The effective tax rate of nil differs from the standard rate of tax applied to the reported loss primarily as a result of the non-recognition of a deferred tax asset in respect of the current year tax loss.

The Bank has tax losses carried forward to future periods of £33,339k (2018: £29,408k). Due to the uncertainty surrounding when sufficient future taxable profits will be generated by the Bank which these tax losses can be offset against, no deferred tax asset has been recognised on the losses.

8 Taxation (continued)

No deferred tax asset has been recognised on other deductible temporary differences amounting to £1,684k, comprising fixed asset temporary differences (£1,578k), pension contributions unpaid at the balance sheet date (£45k) and transitional adjustments arising under IFRS 9 and IFRS 16 that are spread for tax purposes (£61k).

9 Employees

The monthly average Full Time Equivalent number of employees (including Directors) was 92 (2018: 87).

Aggregate remuneration for the year comprised:

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|-----------------------|---|---|
| Wages and salaries | 5,426 | 5,098 |
| Social security costs | 765 | 599 |
| Pension costs | 519 | 192 |
| | <u>6,710</u> | <u>5,889</u> |

10 Directors' remuneration

The aggregate remuneration of the Directors is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*.

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|------------------------------|---|---|
| Short term employee benefits | 679 | 1,099 |
| Post-employment benefits | 13 | 6 |
| Share options granted | 375 | 566 |
| | <u>1,067</u> | <u>1,671</u> |

The total amount of Directors' remuneration in accordance with Schedule 5 to the Accounting Regulations was £679k (2018: £1,099k) relating to salary and variable pay and £13k of contributions to a money purchase pension scheme (2018: £6k).

One director has retirement benefits accruing under a defined contribution scheme (2018: one).

No Directors exercised share options during the year. Remuneration of the highest paid Director in respect of qualifying services was £309k (2018: £330k). The Bank does not have a defined benefit pension scheme so there are no defined benefit pension arrangements for the highest paid Director.

11 Share-based payments

The Bank operates a share option scheme with two parts, the details of which are set out below. No new share options were granted in 2019 under either part.

During 2019 the Bank implemented a share capital consolidation which reduced the number of shares in issue by a factor of 20 (see note 20). The outstanding share options have been adjusted to take account of the share capital consolidation by reducing the number of shares subject to each option by a factor of 20 and increasing the exercise price per share by a factor of 20. As such the share capital consolidation had no impact on the commercial position of the outstanding share options. The effect of the share capital consolidation on the outstanding share options is shown in the movement tables below.

Part 1 - Share Option Plan

The Share Option Plan (SOP) is for the executive management team and was launched during 2017. The options have a five-year vesting period and, if they remain unexercised after a period of twenty years from the grant date, the options expire. All options are equity settled and have non-market performance conditions. Some of the options also include non-vesting conditions.

The movement in SOP share options outstanding during the year was as follows:

| | 2019 | | 2018 | |
|---|---------------|---|-------------|---|
| | Number | Weighted average exercise price (pence) | Number | Weighted average exercise price (pence) |
| At 1 January | 250,000,000 | 9.79 | 250,000,000 | 9.79 |
| Granted during the year | - | - | - | - |
| Exercised during the year | - | - | - | - |
| Forfeited during the year | - | - | - | - |
| Expired during the year | - | - | - | - |
| Share capital consolidation (note 20) | (237,500,000) | 186.01 | - | - |
| At 31 December | 12,500,000 | 195.80 | 250,000,000 | 9.79 |
| Options exercisable at the end of the year | - | - | - | - |
| Weighted average remaining contractual life | 18 years | | 19 years | |
| Fair value of options awarded during the year | N/A | | N/A | |

It is expected that, at the end of the five-year vesting period, all of the share options will vest.

11 Share-based payments (continued)

Part 2 - Company Share Option Plan

A HMRC approved Company Share Option Plan (CSOP) was introduced during 2018 and offered to all employees including Executive Directors. Each employee share option converts into one ordinary share on exercise and no amounts were payable by the recipient on receipt of the option. Options may be exercised at any time from the date of vesting to the date of their expiry. The vesting period is five years and, if they remain unexercised after a period of ten years from the date of grant, the options will expire. There are no performance conditions or vesting conditions other than a five-year service condition. Options are forfeited if the employee leaves the Bank before the options vest.

The movement in CSOP share options outstanding during the year was as follows:

| | 2019 | | 2018 | |
|---|--------------|---|------------|---|
| | Number | Weighted average exercise price (pence) | Number | Weighted average exercise price (pence) |
| At 1 January | 16,574,285 | 6.5 | - | - |
| Granted during the year | - | - | 16,574,285 | 6.5 |
| Exercised during the year | - | - | - | - |
| Forfeited during the year | (2,000,000) | 6.5 | - | - |
| Expired during the year | (200,000) | 6.5 | - | - |
| Share capital consolidation (note 20) | (13,655,573) | 123.5 | - | - |
| At 31 December | 718,712 | 130.0 | 16,574,285 | 6.5 |
| Options exercisable at the end of the year | - | - | - | - |
| Weighted average remaining contractual life | 9 years | | 10 years | |
| Fair value of options awarded during the year (pence) | N/A | | 2.538 | |

A Black Scholes option-pricing model was used to derive the fair value of options awarded, based on the following inputs:

| | 2019 | 2018 |
|---------------------------------|------|---------|
| Weighted average share price | - | 7.5p |
| Weighted average exercise price | - | 6.5p |
| Expected volatility | - | 30% |
| Expected life | - | 5 years |
| Risk-free rate | - | 1.08% |

11 Share-based payments (*continued*)

As an unlisted entity, the expected volatility was determined by considering the expected volatility of publicly quoted companies that have private banking / wealth management operations in the UK, and also of recently listed companies with banking operations. The expected life used in the fair value models has been adjusted, based on management's best estimates, for the effects of exercise restrictions and behavioural considerations.

It is expected that, at the end of the five-year vesting period, 80 per cent of the share options will vest.

During 2019 the Bank recognised a total expense of £985k related to equity settled share-based payments transactions (2018: £933k).

12 Property, plant and equipment

| | Leasehold improvements £'000 | Computer equipment £'000 | Total £'000 |
|-----------------------|------------------------------------|--------------------------------|----------------|
| Cost | | | |
| At 1 January 2019 | 239 | 203 | 442 |
| Additions | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| At 31 December 2019 | 239 | 203 | 442 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| Depreciation | | | |
| At 1 January 2019 | 86 | 161 | 247 |
| Charge for the year | 24 | 30 | 54 |
| | <hr/> | <hr/> | <hr/> |
| At 31 December 2019 | 110 | 191 | 301 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| Net book value | | | |
| At 31 December 2019 | 129 | 12 | 141 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| | | | |
| | Leasehold improvements £'000 | Computer equipment £'000 | Total £'000 |
| Cost | | | |
| At 1 January 2018 | 239 | 200 | 439 |
| Additions | - | 3 | 3 |
| | <hr/> | <hr/> | <hr/> |
| At 31 December 2018 | 239 | 203 | 442 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| Depreciation | | | |
| At 1 January 2018 | 62 | 119 | 181 |
| Charge for the year | 24 | 42 | 66 |
| | <hr/> | <hr/> | <hr/> |
| At 31 December 2018 | 86 | 161 | 247 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| Net book value | | | |
| At 31 December 2018 | 153 | 42 | 195 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |

13 Leases

IFRS 16 was adopted from 1 January 2019 and the Bank has applied the modified retrospective approach to transition, with the cumulative effect of initial application being recognised at 1 January 2019. Comparative information has therefore not been restated.

IFRS 16 specifies a single lease accounting model. There is no classification test and the distinction between finance and operating leases is removed. As such, IFRS 16 has changed how the Bank accounts for property leases which were previously classified as operating leases under IAS 17 and so were off-balance sheet. In applying IFRS 16 for these leases the Bank has:

- Recognised right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the remaining lease payments, discounted at the Bank's incremental borrowing rate at 1 January 2019 for the remaining lease term (rates of 6.78-6.84%). The right-of-use assets and lease liabilities are presented on the face of the statement of financial position.
- Recognised depreciation of right-of-use assets and interest expense on lease liabilities in the statement of comprehensive income.
- Separated the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the statement of cash flows.
- Used the practical expedients:
 - excluded initial direct costs from measuring the right-of-use asset at the date of initial application; and
 - used hindsight when determining the lease term if the contract contains options to extend or terminate the lease.

For other leases that are short-term (lease term of 12 months or less), and leases of low-value assets (typically office equipment), the Bank has opted to recognise the lease expense on a straight-line basis as permitted by IFRS 16. This expense is presented within other administrative expenses in note 6.

Right-of-use assets of £2.5m and associated lease liabilities of £2.5m were recognised at 1 January 2019. The adoption of IFRS 16 did not have an impact on shareholders' equity or cash flows.

The total charge for property leases in the statement of comprehensive income for the year ended 31 December 2019 (depreciation and interest expense) is £611k (2018: operating lease payments £543k). The increase is due to the effect of discounting under IFRS 16 which front-loads the recognition of costs over the lease term.

13 Leases (continued)

Right-of-use assets

| | Property £'000 | Total £'000 |
|------------------------------|---------------------------|------------------------|
| Cost | | |
| At 1 January 2019 - restated | 2,536 | 2,536 |
| Additions | - | - |
| | <hr/> | <hr/> |
| At 31 December 2019 | <u>2,536</u> | <u>2,536</u> |
| Depreciation | | |
| At 1 January 2019 | - | - |
| Charge for the year | 443 | 443 |
| | <hr/> | <hr/> |
| At 31 December 2019 | <u>443</u> | <u>443</u> |
| Carrying amount | | |
| At 31 December 2019 | <u>2,093</u> | <u>2,093</u> |

The Bank leases three offices, two in Edinburgh and one in London. The average original lease term is 8 years 8 months, and the average remaining lease term at 31 December 2019 was 4 years 4 months. One of the leases has a rent review date and early termination option in September 2020. The latter has not been factored into the assessment of lease liabilities as the Bank does not expect to terminate the lease early.

There are no leases to which the Bank was committed and which had not yet commenced at 31 December 2019.

Amounts recognised in the statement of comprehensive income

| | 2019 £'000 |
|--|-----------------------|
| Depreciation expense on right-of-use assets | 443 |
| Interest expense on lease liabilities | 168 |
| Expense relating to leases of low-value assets | 73 |

Total cash outflow for leases during the year ended 31 December 2019 was £626k.

Lease liabilities

| | 2019 | | |
|------------------------------|--------------------------|----------------------------------|------------------------|
| | Current £'000 | Non- current £000 | Total £'000 |
| Lease liabilities – property | <u>412</u> | <u>1,664</u> | <u>2,076</u> |

None of the leases have variable lease payments not included in the measurement of lease liabilities.

The lease liabilities are recognised in accordance with IFRS 16 which has been adopted from 1 January 2019. The weighted average incremental borrowing rate applied at the date of initial application was 6.82%.

13 Leases (continued)

Lease liabilities (continued)

The lease liabilities reconcile to operating leases commitments disclosed in the 2018 financial statements under the previous leasing accounting standard (IAS 17) as follows:

| | |
|---|--------------|
| | £'000 |
| Future minimum lease payments at 31 December 2018 | 1,699 |
| Lease payments due over remainder of lease term (after early break option date) | 1,356 |
| Effect of discounting | (593) |
| Lease liabilities at 1 January 2019 | <u>2,462</u> |

A maturity analysis of lease liabilities is included within note 18.

14 Intangible assets

| | Developed software £'000 | Software licences £'000 | Total £'000 |
|-----------------------|--------------------------------|-------------------------------|----------------|
| Cost | | | |
| At 1 January 2019 | 4,025 | 896 | 4,921 |
| Additions | 146 | - | 146 |
| | <u>4,171</u> | <u>896</u> | <u>5,067</u> |
| At 31 December 2019 | 4,171 | 896 | 5,067 |
| Amortisation | | | |
| At 1 January 2019 | 1,543 | 468 | 2,011 |
| Charge for the year | 583 | 131 | 714 |
| | <u>2,126</u> | <u>599</u> | <u>2,725</u> |
| At 31 December 2019 | 2,126 | 599 | 2,725 |
| Net book value | | | |
| At 31 December 2019 | <u>2,045</u> | <u>297</u> | <u>2,342</u> |

During the year £96k of costs incurred on the development of mobile banking were capitalised (2018: £184k). The carrying amount of mobile banking software was £886k at 31 December 2019 (2018: £923k) with a remaining amortisation period of 6.2 years at 31 December 2019 (2018: 7 years).

The total carrying value of intangible assets whereby amortisation had not yet commenced was £31k as at 31 December 2019 (2018: £954k).

14 Intangible assets (continued)

| | Developed software £'000 | Software licences £'000 | Total £'000 |
|-----------------------|--------------------------------|-------------------------------|----------------|
| Cost | | | |
| At 1 January 2018 | 3,780 | 896 | 4,676 |
| Additions | 245 | - | 245 |
| | <hr/> | <hr/> | <hr/> |
| At 31 December 2018 | 4,025 | 896 | 4,921 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| Amortisation | | | |
| At 1 January 2018 | 1,098 | 337 | 1,435 |
| Charge for the year | 445 | 131 | 576 |
| | <hr/> | <hr/> | <hr/> |
| At 31 December 2018 | 1,543 | 468 | 2,011 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| Net book value | | | |
| At 31 December 2018 | 2,482 | 428 | 2,910 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |

15 Accruals and deferred income

| | 2019 £'000 | 2018 £'000 |
|---------------------|---------------|---------------|
| Deferred fee income | 153 | 157 |
| Expense accruals | 1,509 | 1,599 |
| | <hr/> | <hr/> |
| | 1,662 | 1,756 |
| | <hr/> <hr/> | <hr/> <hr/> |

16 Financial instruments

Categories of financial instruments

| | 2019 | | 2018 | |
|------------------------------------|--|----------------|--|----------------|
| | Financial assets at amortised cost £'000 | Total £'000 | Financial assets at amortised cost £'000 | Total £'000 |
| Financial assets: | | | | |
| Cash and balances at central banks | 119,691 | 119,691 | 91,135 | 91,135 |
| Loans and advances to banks | 129,085 | 129,085 | 81,759 | 81,759 |
| Loans and advances to clients | 203,807 | 203,807 | 132,488 | 132,488 |
| Total financial assets | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| | 452,583 | 452,583 | 305,382 | 305,382 |

16 Financial instruments (*continued*)

| | 2019 | | 2018 | |
|------------------------------------|--|----------------|--|----------------|
| | Financial liabilities at amortised cost £'000 | Total £'000 | Financial liabilities at amortised cost £'000 | Total £'000 |
| Financial liabilities: | | | | |
| Deposits from clients | 409,374 | 409,374 | 267,483 | 267,483 |
| Lease liabilities | 2,076 | 2,076 | - | - |
| Total financial liabilities | 411,450 | 411,450 | 267,483 | 267,483 |

17 Fair value

Fair value measurements

The information set out below provides information about how the Bank determines fair values of various financial assets and financial liabilities.

The following provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

There are no financial assets or liabilities measured at fair value at the end of the current or prior reporting period.

Fair value measurements recognised in the statement of financial position

For financial assets and liabilities held at amortised cost, as the majority are at variable rates of interest, the fair value (classified as Level 3) is not materially different from the carrying value.

18 Financial risk management

Financial risk management objectives

The Bank's Treasury function provides services to the business, co-ordinates access to financial markets, monitors and manages the financial risks relating to the operations of the Bank through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including currency risk and interest rate risk), counterparty credit risk and liquidity risk.

The Bank seeks to minimise the effects of these risks by using both natural hedging and derivative financial instruments to hedge these risk exposures. The use of financial derivatives is governed by the Bank's policy principles (approved by the Board of Directors), which provide written principles on foreign exchange risk, interest rate risk, counterparty credit risk, the use of financial derivatives and non-derivative financial instruments, and the investment of excess liquidity. The Bank does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

18 Financial risk management (continued)

The Treasury function reports monthly to ALCO and appropriate metrics are reported monthly to the Board and the RMC. Metrics are also presented quarterly to the BRC, an independent body that monitors risks and policies implemented to mitigate risk exposures.

Market risk

Foreign currency risk management

The Bank undertakes transactions denominated in foreign currencies; consequently, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts where required.

The Bank does not maintain any material open currency positions, and as such has no material exposure to the effects of fluctuations in foreign exchange rates. The Bank's foreign exchange rate risk is managed by natural hedges and/or FX Forward contracts to leave no material FX open positions.

Interest rate risk management

The Bank is exposed to interest rate risk because the Bank accepts deposits from clients and other counterparties at both fixed and floating rates and lends money at both fixed and floating rates. The risk is managed by the Bank by maintaining an appropriate mix between fixed and floating rate assets and liabilities, and by the use of interest rate swap contracts if required. Hedging activities are evaluated regularly to align with the defined risk appetite; ensuring the most cost-effective hedging strategies are applied.

Interest rate sensitivity analysis

The Bank's interest rate exposure is shown in the interest rate repricing table below. The assets and liabilities are shown at the carrying amounts, categorised by the earlier of the next contractual interest repricing date and the maturity date.

Lease liabilities are classified as non-interest bearing as they are not sensitive to changes in market interest rates.

At 31 December 2019

| | Up to 1 month £000 | 1-3 months £000 | 3-12 months £000 | 1-5 years £000 | Over 5 years £000 | Non- interest bearing £000 | Total £000 |
|--------------------------------------|--------------------------|-----------------------|------------------------|----------------------|-------------------------|-------------------------------------|----------------|
| Assets | | | | | | | |
| Cash and balances at central banks | 119,691 | - | - | - | - | - | 119,691 |
| Loans and advances to banks | 102,088 | 7,673 | 19,324 | - | - | - | 129,085 |
| Loans and advances to clients | 187,329 | - | 500 | 15,926 | - | 52 | 203,807 |
| Other assets | - | - | - | - | - | 5,523 | 5,523 |
| Total assets | 409,108 | 7,673 | 19,824 | 15,926 | - | 5,575 | 458,106 |
| Liabilities | | | | | | | |
| Deposits from banks | - | - | - | - | - | - | - |
| Deposits from clients | 348,100 | 10,850 | 50,424 | - | - | - | 409,374 |
| Other liabilities and provisions | - | - | - | - | - | 3,868 | 3,868 |
| Total liabilities | 348,100 | 10,850 | 50,424 | - | - | 3,868 | 413,242 |
| Interest rate sensitivity gap | 61,008 | (3,177) | (30,600) | 15,926 | - | 1,707 | |
| Cumulative gap | 61,008 | 57,831 | 27,231 | 43,157 | 43,157 | 44,864 | |

18 Financial risk management (*continued*)

At 31 December 2018

| | Up to 1 month £000 | 1-3 months £000 | 3-12 months £000 | 1-5 years £000 | Over 5 years £000 | Non- interest bearing £000 | Total £000 |
|--------------------------------------|--------------------------|-----------------------|------------------------|----------------------|-------------------------|-------------------------------------|----------------|
| Assets | | | | | | | |
| Cash and balances at central banks | 91,135 | - | - | - | - | - | 91,135 |
| Loans and advances to banks | 64,597 | 3,008 | 14,154 | - | - | - | 81,759 |
| Loans and advances to clients | 131,937 | - | - | 500 | - | 51 | 132,488 |
| Other assets | - | - | - | - | - | 3,828 | 3,828 |
| Total assets | 287,669 | 3,008 | 14,154 | 500 | - | 3,879 | 309,210 |
| Liabilities | | | | | | | |
| Deposits from banks | - | - | - | - | - | - | - |
| Deposits from clients | 216,436 | 7,451 | 43,596 | - | - | - | 267,483 |
| Other liabilities and provisions | - | - | - | - | - | 1,875 | 1,875 |
| Total liabilities | 216,436 | 7,451 | 43,596 | - | - | 1,875 | 269,358 |
| Interest rate sensitivity gap | 71,233 | (4,443) | (29,442) | 500 | - | 2,004 | |
| Cumulative gap | 71,233 | 66,790 | 37,348 | 37,848 | 37,848 | 39,852 | |

The Bank monitors its exposure to interest rate risk, and reports this to ALCO. One such internally reported measure is calculating the net present value of a 2% change in the yield curve. The results at both 31 December 2019 and 31 December 2018 do not show a material change in net present value.

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has established an appropriate liquidity risk management framework for the management of the Bank's short, medium and long-term funding and liquidity management requirements. The Bank manages liquidity risk by maintaining a high-quality liquid assets buffer, by continuously monitoring forecast and actual cash flows, and by matching the maturity profiles of financial assets and liabilities. The Bank's liquidity risk is monitored by ALCO.

Liquidity risk tables

The table below analyses the contractual undiscounted cash flows receivable and payable including future interest receipts and payments of interest by contractual maturity. The amounts presented in the disclosure below differ from those presented in the statement of financial position due to the inclusion of contractual future interest flows.

18 Financial risk management (*continued*)

| At 31 December 2019 | Up to 1 month £000 | 1-3 months £000 | 3-12 months £000 | 1-5 years £000 | Over 5 years £000 | Total £000 |
|------------------------------------|--------------------------|-----------------------|------------------------|----------------------|-------------------------|----------------|
| Financial assets | | | | | | |
| Cash and balances at central banks | 119,691 | - | - | - | - | 119,691 |
| Loans and advances to banks | 102,100 | 7,699 | 19,458 | - | - | 129,257 |
| Loans and advances to clients | 46,266 | 4,227 | 18,896 | 105,808 | 59,335 | 234,532 |
| Total financial assets | 268,057 | 11,926 | 38,354 | 105,808 | 59,335 | 483,480 |
| Financial liabilities | | | | | | |
| Deposits from clients | 373,209 | 11,346 | 25,054 | - | - | 409,609 |
| Lease liabilities | - | 138 | 415 | 1,817 | 132 | 2,502 |
| Total financial liabilities | 373,209 | 11,484 | 25,469 | 1,817 | 132 | 412,111 |
| Maturity gap | (105,152) | 442 | 12,885 | 103,991 | 59,203 | |
| Cumulative gap | (105,152) | (104,710) | (91,825) | 12,166 | 71,369 | |
| | | | | | | |
| At 31 December 2018 | Up to 1 month £000 | 1-3 months £000 | 3-12 months £000 | 1-5 years £000 | Over 5 years £000 | Total £000 |
| Financial assets | | | | | | |
| Cash and balances at central banks | 91,135 | - | - | - | - | 91,135 |
| Loans and advances to banks | 64,482 | 3,072 | 14,209 | - | - | 81,763 |
| Loans and advances to clients | 15,854 | 871 | 9,040 | 89,311 | 42,175 | 157,251 |
| Total financial assets | 171,471 | 3,943 | 23,249 | 89,311 | 42,175 | 330,149 |
| Financial liabilities | | | | | | |
| Deposits from clients | 216,436 | 7,462 | 43,711 | - | - | 267,609 |
| Total financial liabilities | 216,436 | 7,462 | 43,711 | - | - | 267,609 |
| Maturity gap | (44,965) | (3,519) | (20,462) | 89,311 | 42,175 | |
| Cumulative gap | (44,965) | (48,484) | (68,946) | 20,365 | 62,540 | |

Credit risk

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Bank. The Bank has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults.

Credit risk arises from lending to clients, a mix of private individuals, SME business lending and treasury counterparties. Credit policies, principles and risk appetite metrics aim to ensure the credit portfolio is of high quality, with a low overall percentage of unsecured lending and relatively low monetary limits for individual unsecured lending cases. Client lending propositions are subject to

18 Financial risk management (continued)

thorough credit assessment, including affordability and stress testing at increased rates at a percentage over the prevailing rate at loan origination.

The Bank only transacts with treasury counterparties that are rated the equivalent of investment grade and above. This information is supplied by independent rating agencies where available, and if not available, the Bank uses other publicly available financial information and its own trading records to rate its major clients. The Bank's exposure and the credit ratings of its counterparties are continuously monitored and the aggregate value of transactions concluded is spread amongst approved counterparties. Credit exposure is controlled by counterparty limits that are reviewed and approved by ALCO annually.

The Bank structures its level of credit risk by placing limits on the amount of risk it takes by individual borrower, groups of borrowers, in addition to concentration risk by product, industry and geographical sectors. These limits are monitored monthly at Credit Committee and Board. Management has considered reasonable and possible changes in the key assumptions to the ECL model and have determined that these would not have a material impact on the ECLs. Further details on the recognition and measurement of financial assets and liabilities can be found in note 2.8.

Impairment of financial assets

The table below summarises the impairment (credit)/charge for the year in the income statement. Details of the ECL methodology and model assumptions is discussed in detail in accounting policy 2.8.

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|--|---|---|
| Impairment (credit)/charge on loans and advances to | (22) | 15 |
| Provision charge on loan commitments | (1) | 2 |
| Impairment (credit)/charge and other provisions | (23) | 17 |

The £23k credit (2018: £17k charge) reflects changes in impairment provisions under IFRS 9 and is driven by the release of the impairment allowance held against loans and advances to clients in stage 3 at 31 December 2018 due to the full recovery of the outstanding balances. The closing impairment provision as at 31 December 2019 is £8k (2018: £31k).

The table below analyses the movement of the loss allowance during the year by asset class:

Loss allowance – Loans and advances to clients at amortised cost

| Year ended 31 December 2019 | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|------------------|------------------|------------------|----------------|
| Loss allowance as at 1 January 2019 | 10 | - | 19 | 29 |
| Changes in the loss allowance | | | | |
| - Increase in credit risk due to change in credit risk | - | - | - | - |
| - Decrease due to change in risk parameters | (1) | - | - | (1) |
| New financial assets originated or purchased | 4 | - | | 4 |
| Financial assets that have been derecognised due to repayment | (6) | - | (19) | (25) |
| Loss allowance as at 31 December 2019 | 7 | - | - | 7 |

18 Financial risk management (continued)

| Year ended 31 December 2018 | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|--------------------------|--------------------------|--------------------------|------------------------|
| Loss allowance as at 1 January 2018 | 13 | - | - | 13 |
| Changes in the loss allowance | | | | |
| - Increase in credit risk due to change in credit risk | - | - | 19 | 19 |
| - Decrease due to change in risk parameters | (8) | - | - | (8) |
| New financial assets originated or purchased | 7 | - | - | 7 |
| Financial assets that have been derecognised due to repayment | (2) | - | - | (2) |
| Loss allowance as at 31 December 2018 | 10 | - | 19 | 29 |

There were no modifications or renegotiations that resulted in derecognition of financial assets. Information about significant changes in gross carrying amount of financial assets during the year that contributed to changes in the loss allowance is provided at the table below:

Loans and advances to clients at amortised cost

| Year ended 31 December 2019 | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|--------------------------|--------------------------|--------------------------|------------------------|
| Gross carrying amount as at 1 January 2019 | 125,408 | 7,090 | 19 | 132,517 |
| Changes in the gross carrying amount | | | | |
| - Transfer to stage 1 | 2,753 | (2,753) | - | - |
| - Transfer to stage 2 | (4,726) | 4,726 | - | - |
| - Transfer to stage 3 | - | (370) | 370 | - |
| New financial assets originated or purchased | 99,805 | 2,508 | 5 | 102,318 |
| Financial assets that have been derecognised due to repayment | (26,543) | (2,236) | (19) | (28,798) |
| Other changes | (2,124) | (96) | (3) | (2,223) |
| Gross carrying amount as at 31 December 2019 | 194,573 | 8,869 | 372 | 203,814 |

| Year ended 31 December 2018 | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|--------------------------|--------------------------|--------------------------|------------------------|
| Gross carrying amount as at 1 January 2018 | 91,984 | 2,214 | - | 94,198 |
| Changes in the gross carrying amount | | | | |
| - Transfer to stage 2 | (4,846) | 4,846 | - | - |
| - Transfer to stage 3 | - | (21) | 21 | - |
| New financial assets originated or purchased | 56,677 | 2,279 | - | 58,956 |
| Financial assets that have been derecognised due to repayment | (17,950) | (2,204) | - | (20,154) |
| Other changes | (457) | (24) | (2) | (483) |
| Gross carrying amount as at 31 December 2018 | 125,408 | 7,090 | 19 | 132,517 |

18 Financial risk management (*continued*)

Maximum exposure to credit risk

The table below details the value of collateral held against the Bank's loans and advances to clients.

| | Year ended 31 December 2019 £'000 | Year ended 31 December 2018 £'000 |
|------------|--|--|
| Exposure | 273,327 | 158,901 |
| Collateral | 712,258 | 315,661 |
| Cover | 261% | 199% |

As the result of the acquisition of Smith and Williamson's loan portfolio, the nature of collateral held changed in 2019 to include investment portfolios against which the Bank holds a charge, in addition to commercial and residential property.

Credit quality

Credit risk is also differentiated by credit ratings using a combination of the value of security held and utilising an external ratings agency. In addition, our credit policy requires that all mortgages, term loans, overdraft facilities and charge card facilities greater than £10k are reviewed on an annual basis with knowledge of the client's financial affairs being of paramount importance in the credit assessment process.

The internal credit grades (ICG) are based on the following ratings:

- ICG 1: Very strong affordability, very low loan to security value, negligible risk of default
- ICG 2: Strong affordability, low loan to security value, minimal risk of default
- ICG 3: Good affordability, acceptable loan to security value, very unlikely to result in default
- ICG 4: Satisfactory affordability, either partially secured or unsecured, unlikely to result in default
- ICG 5: Affordability / repayment ability questionable, security may have deteriorated, much greater risk of default

The table below provides a summary of the Bank's asset quality analysed by ICG. At 31 December 2019 the ECL was £7k against loans and advances (2018: £29k) and £1k against commitments (2018: £2k).

The accruing past due category captures any exposures that are up to 90 days past due.

No balances were in category ICG 5 in 2019 or 2018.

No impairment allowance is recognised in respect of loans and advances to clients in stage 3 at 31 December 2019 due to the value of property held as collateral.

18 Financial risk management (*continued*)

| At 31 December 2019 | ICG 1 £000 | ICG 2 £000 | ICG 3 £000 | ICG 4 £000 | Accruing past due £000 | Non- accrual £000 | Impairment allowance £000 | Total £000 |
|--|----------------|---------------|---------------|---------------|------------------------------|-------------------------|---------------------------------|----------------|
| Cash and balances at central banks: | | | | | | | | |
| <i>Stage 1</i> | 119,691 | - | - | - | - | - | - | 119,691 |
| Loans and advances to banks: | 129,085 | - | - | - | - | - | - | 129,085 |
| <i>Stage 1</i> | | | | | | | | |
| Loans and advances to clients: | | | | | | | | |
| <i>Stage 1</i> | 170,745 | 14,538 | 8,337 | 953 | - | - | (7) | 194,566 |
| <i>Stage 2</i> | 8,226 | - | 502 | 141 | - | - | - | 8,869 |
| <i>Stage 3</i> | - | - | - | - | - | 372 | - | 372 |
| | 427,747 | 14,538 | 8,839 | 1,094 | - | 372 | (7) | 452,583 |
| Commitments | | | | | | | | |
| <i>Stage 1</i> | 62,694 | 2,490 | 540 | 3,704 | - | - | (1) | 69,427 |
| <i>Stage 2</i> | 68 | - | - | 18 | - | - | - | 86 |
| <i>Stage 3</i> | - | - | - | - | - | 7 | - | 7 |
| | 62,762 | 2,490 | 540 | 3,722 | - | 7 | (1) | 69,520 |
| At 31 December 2018 | ICG 1 £000 | ICG 2 £000 | ICG 3 £000 | ICG 4 £000 | Accruing past due £000 | Non- accrual £000 | Impairment allowance £000 | Total £000 |
| Cash and balances at central banks: | | | | | | | | |
| <i>Stage 1</i> | 91,135 | - | - | - | - | - | - | 91,135 |
| Loans and advances to banks: | 81,759 | - | - | - | - | - | - | 81,759 |
| <i>Stage 1</i> | | | | | | | | |
| Loans and advances to clients: | | | | | | | | |
| <i>Stage 1</i> | 111,279 | 6,479 | 6,726 | 924 | - | - | (10) | 125,398 |
| <i>Stage 2</i> | 7,064 | - | - | 26 | - | - | - | 7,090 |
| <i>Stage 3</i> | - | - | - | - | - | 19 | (19) | - |
| | 291,237 | 6,479 | 6,726 | 950 | - | 19 | (29) | 305,382 |
| Commitments | | | | | | | | |
| <i>Stage 1</i> | 16,907 | 3,878 | 2,480 | 3,416 | - | - | (2) | 26,679 |
| <i>Stage 2</i> | 21 | - | - | 15 | - | - | - | 36 |
| <i>Stage 3</i> | - | - | - | - | - | - | - | - |
| | 16,928 | 3,878 | 2,480 | 3,431 | - | - | (2) | 26,715 |

Collateral

The Bank has £252k (2018: £259k) of financial assets which it has pledged as collateral.

19 Reconciliation of liabilities arising from financing activities

| | At 1 January 2019 £'000 | Financing cash flows £'000 | Non-cash movements £000 | At 31 December 2019 £'000 |
|------------------------------|----------------------------------|----------------------------------|-------------------------------|------------------------------------|
| Lease liabilities | 2,461 | (385) | - | 2,076 |
| Financing liabilities | 2,461 | (385) | - | 2,076 |

20 Share capital

Share capital restructure

The Bank restructured its share capital during 2019 as follows:

Share capital consolidation

The purpose of the share capital consolidation was to reduce the number of shares in issue to a more manageable number. A 20:1 consolidation was implemented whereby the number of ordinary shares in issue was reduced by a factor of 20 (from 1,328,902,840 to 66,445,142) and, consequently, the nominal value per ordinary share increased by a factor of 20 (from £0.05 to £1.00).

Reduction of capital

Following the share capital consolidation, the nominal value of each ordinary share was reduced from £1.00 to £0.05 by cancelling capital to the extent of £0.95 on each ordinary share. The amount of share capital so cancelled (£63,123k) has been credited to retained earnings. The reduction of capital provides greater assurance that the Bank will be able to raise equity in the future, even in adverse market conditions, as shares cannot be issued at a discount to their nominal value. Also, together with the share premium cancellation and redemption reserve cancellation explained below, the reduction of capital provides the Bank with flexibility to make distributions to shareholders in the future as, collectively, they result in the Bank having net distributable profits rather than retained losses. However, there is no intention to make any distributions to shareholders until the Bank has achieved capital self-sufficiency and for as long as the Bank requires capital to grow its business.

Share premium cancellation and redemption reserve cancellation

The balance on the share premium account (£18,083k), which arose from various issues of ordinary shares by the Bank at prices in excess of their nominal value, less direct share issue costs, has been cancelled and transferred to retained earnings. The balance on the capital redemption reserve (£19k), which arose from the cancellation of the Bank's former B and C shares in 2016, has also been cancelled and transferred to retained earnings.

The share capital consolidation, reduction of capital, share premium cancellation and redemption reserve cancellation (collectively "the share capital restructure") were approved by the Bank's shareholders at a general meeting on 19 November 2019. The reduction of capital, share premium cancellation and redemption reserve cancellation were also approved by the Court of Session in Edinburgh on 17 December 2019.

The share capital restructure had no impact on cash, net assets or the Bank's regulatory capital, other than the implementation costs incurred by the Bank which amounted to £109k and which were charged to the share premium account prior to its cancellation.

20 Share capital (continued)

Ordinary shares

| | 2019 | | 2018 | |
|---|-------------------|--------------|----------------------|---------------|
| | Number | £'000 | Number | £'000 |
| Allotted, called up and fully paid | | | | |
| At 1 January (£0.05 per share) | 1,198,049,600 | 59,902 | 1,187,382,934 | 59,369 |
| Issued ordinary shares | 130,853,240 | 6,543 | 10,666,666 | 533 |
| Share capital consolidation | (1,262,457,698) | - | - | - |
| Reduction of capital: transfer to retained earnings | - | (63,123) | - | - |
| At 31 December (£0.05 per share) | 66,445,142 | 3,322 | 1,198,049,600 | 59,902 |

During the year 130,853,240 (2018: 10,666,666) ordinary shares were issued at a gross premium of £3,271k (2018: £268k). Direct issue costs of £145k (2018: £14k) associated with fundraising activities, and direct costs of £109k (2018: £nil) incurred in respect of the share capital restructure, have been recorded in the share premium account.

At 31 December 2019 121,683,854 (2018: 2,048,049,600) ordinary shares were authorised with a par value of £0.05 (2018: £0.05).

There are currently no conditions or restrictions in respect of dividends, voting or repayment of capital. Ordinary shares cannot be issued at a discount to par.

Share premium account

| | 2019 | 2018 |
|---|----------|---------------|
| | £'000 | £'000 |
| At 1 January | 15,066 | 14,812 |
| Premium arising on issue of equity shares | 3,271 | 268 |
| Direct share issue costs | (145) | (14) |
| Direct share capital restructure costs | (109) | - |
| Share premium cancellation: transfer to retained earnings | (18,083) | - |
| At 31 December | - | 15,066 |

Other Reserves

| | 2019 | 2018 |
|--|----------|-----------|
| | £'000 | £'000 |
| At 1 January | 19 | 19 |
| Redemption reserve cancellation: transfer to retained earnings | (19) | - |
| At 31 December | - | 19 |

21 Retained earnings

| | 2019 | 2018 |
|--|---------------|-----------------|
| | £'000 | £'000 |
| At 1 January | (35,135) | (30,491) |
| Loss for the year attributable to equity holders | (5,533) | (5,577) |
| Equity settled share-based payments | 985 | 933 |
| Reduction of capital | 63,123 | - |
| Share premium cancellation | 18,083 | - |
| Redemption reserve cancellation | 19 | - |
| At 31 December | 41,542 | (35,135) |

22 Control

The Directors have assessed that there is no overall controlling party.

23 Related parties

In accordance with IAS 24 *Related Party Disclosures*, the Bank's key management personnel, being those persons having responsibility for planning, directing and controlling the Bank's activities, are considered to be the Directors. Directors' remuneration for the year is disclosed in note 10.

Key management personnel and their close family members' aggregate deposits were £37,451 (2018: £84,557) and aggregate lending was £3,912,814 (2018: £4,036,067) at year end. Committed loans at 31 December 2019 were £15,000 (2018: £nil).

Hampden Holdings Limited and its subsidiary undertakings are related entities by virtue of a member of the key management personnel's significant influence over the Hampden Holdings Group. The following transactions were undertaken during the year with Hampden Holdings Group entities:

Hampden Holdings Limited:

- Deposits at 31 December 2019 were £1,517,955 (2018: £1,557,511) and lending was £722 (2018: £128).
- A fee of £nil (2018: £12,005) has been charged to Hampden Holdings Limited for the provision of staff and related services, of which £nil was due at 31 December 2019 (2018: £nil).
- A fee of £18,000 (2018: £nil) has been charged by Hampden Holdings Limited in respect of a marketing agreement.

Hampden Agencies Limited:

- Deposits at 31 December 2019 were £209 (2018: £95) and lending was £nil (2018: £nil).

Hampden Legal PLC:

- Deposits at 31 December 2019 were £151,470 (2018: £81,090) and lending was £nil (2018: £nil).

The Bank received insurance services from XL Insurance Company SE, part of the AXAXL Group. The charge for the year was £23,670 (2018: £22,119).

No impairment losses have been recognised in respect of amounts owed by related parties (2018: £nil).

These transactions were made on terms equivalent to those that prevail in arm's length transactions.

24 Commitments

The commitments shown in the table below provide an indication of the business volume committed and committed spend on intangible assets at the year end. Commitments to lend include loan commitments and unutilised overdraft facilities.

| | 2019 | 2018 |
|--|---------------|---------------|
| | £'000 | £'000 |
| Commitments to lend | 69,520 | 26,715 |
| Commitments for intangible asset development | - | 312 |
| | <u>69,520</u> | <u>27,027</u> |

25 Provisions

| | 2019 | | 2018 | |
|-------------------------------------|----------------|------------------------|----------------|------------------------|
| | Loss provision | Dilapidation provision | Loss provision | Dilapidation provision |
| | £'000 | £'000 | £'000 | £'000 |
| At 1 January | 2 | 116 | 1 | 119 |
| (Released)/provided during the year | (1) | - | 1 | - |
| Utilised during the year | - | (1) | - | (3) |
| At 31 December | 1 | 115 | 2 | 116 |

The dilapidation provision relates to the anticipated costs of restoring leased assets to their original condition. It is expected that the provision will be utilised at the end of the lease terms, the longest of which is due to end in 2025. The loss provision represents ECLs on undrawn lending commitments.

26 Capital management policy

The European Capital Requirements Directive (Basel II) came into force on 1 January 2007. On 1st of January 2014 Basel III regulations, commonly known as CRD IV, revised the definition of capital resources and included additional capital and disclosure requirements. Basel III is an international initiative aimed at implementing a more risk sensitive framework for the calculation of regulatory capital. The Prudential Regulation Authority (PRA) is responsible for the implementation and enforcement of the Directive. The framework consists of three pillars:

- Pillar 1 sets minimum capital requirements that firms must meet for credit, market and operational risk.
- Pillar 2 requires that firms undertake an overall assessment of their capital adequacy, taking into account all risks to which the firm is exposed and whether additional capital should be held to cover risks not adequately covered by Pillar 1 requirements.
- Pillar 3 complements Pillars 1 and 2 and improves market discipline by requiring firms to disclose information on their capital resources and requirements, risk exposures and their risk management framework.

The Bank's primary objective in managing capital is to ensure that it has capital which is permanent and meets the requirements of the regulator. The Bank monitors its capital regularly and ensures that its capital exceeds its requirements. This is in line with the Bank's Capital Management Policy to maintain a strong base that is comfortably above the minimum capital level set for it by the PRA which enforces the Directive.

The Bank's disclosure requirements under Pillar 3 are published annually and are available on the Bank's website (www.hampdenandco.com).

27 Adoption of new and amended IFRSs

During the year to 31 December 2019, the Bank has adopted a number of new accounting standards and amendments to standards which became effective with relevant EU endorsement for annual periods beginning on or after 1 January 2019:

IFRS 16 Leases

The Bank has applied the modified retrospective approach to transition to IFRS 16, with the cumulative effect of initial application being recognised at 1 January 2019. Comparative information has therefore not been restated. The effect of the transition to IFRS 16 is covered in detail in notes 2.5 and 13.

27 Adoption of new and amended IFRSs (*continued*)

Amendments to IFRS 9 *Prepayment features with negative compensation*

These narrow-scope amendments enable the measurement at amortised cost of some prepayable financial assets with negative compensation which would otherwise have been measured at fair value through profit or loss. Their adoption has not had a significant impact on the Bank.

Annual improvements to IFRSs cycle 2015-17

Amendments were made to IFRS 3 *Business Combinations*, IFRS 11 *Joint Arrangements*, IAS 12 *Income Taxes* and IAS 23 *Borrowing Costs* with an effective date of 1 January 2019. These amendments have not had a significant impact on the Bank's accounting policies or reporting.

28 New accounting standards and interpretations not adopted

The International Accounting Standards Board has issued a number of minor amendments to IFRSs effective 1 January 2020, including:

- Amendments to IFRS 3 *Business Combinations* – definition of a business
- Amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* – definition of material
- Amendments to references to the *Conceptual Framework* in IFRS Standards

None of these amendments are expected to have a significant impact on the Bank.

29 Post balance sheet events

Capital

The four largest shareholders have committed to provide £10m in 2020, of which £7.1m was capitalised prior to the approval of the financial statements.

Covid-19

Since the year end the Bank has invoked business continuity plans in the wake of the Covid-19 outbreak in order to maintain high quality service and support its clients throughout the pandemic whilst maintaining the safety and well-being of staff.

The global impact of the Covid-19 pandemic has only begun to unfold with no certainty as to the scale or timescales of its effects. The Bank's pace of growth in 2020 is likely to be adversely affected and its income is expected to be depressed through reduced interest rates and client activity, extending the path to profitability.

Further information is given in the Strategic Report and the Directors' Report (pages 2-17).