Close Brothers

Close Brothers Limited
Annual Report 2019

COMPANY NUMBER: 195626

PROFILE

Close Brothers Limited is a member of Close Brothers Group plc ("CBG" or "the Group"), a leading UK merchant banking group providing financial support to small businesses and individuals in the UK.

Close Brothers Limited ("the group") provides specialist lending to small and medium-sized businesses and individuals across a diverse range of asset classes, and also offers deposit taking services.

The group provides specialist finance solutions through three lending segments: Retail, which provides intermediated finance, principally to individuals, through motor dealers and insurance brokers; Commercial, which focuses on providing specialist, secured lending to the SME market; and Property, primarily focused on providing specialist residential development finance to well established professional developers in the UK.

The Treasury function provides funding for the group's lending activities through corporate deposits and retail savings products, as well as wholesale funding.

HIGHLIGHTS

	31 July 2019 £ million	1 August 2018 £ million
Operating profit before amortisation of intangible assets on acquisition	**256.0**	252.4
Statutory profit on ordinary activities before taxation	**254.1**	250.5
Loans and advances to customers	**7,649.6**	7,239.3
Deposits by customers	**5,638.4**	5,497.2
Shareholders' funds	**1,177.4**	1,072.5
Total assets	**9,710.7**	9,350.7

COMPANY INFORMATION

Directors

M. N. Biggs*	Chairman
P. Prebensen*	Chief Executive Officer
M.B. Morgan*	Director
A.J. Sainsbury	Director
O.R.P. Corbett*	Director
P.B. Duffy*	Director (Appointed 1 January 2019)
G.M.T. Howe*	Director
M.L. Jones*	Director
B.A. Macaskill*	Director
J. A. G. Howell	Director (Resigned 15 November 2018)
E.A. Lee	Director (Resigned 31 July 2019)

* Director of Close Brothers Group plc

Company Secretary

J.E. Hudspith

Independent Auditors

PricewaterhouseCoopers LLP

Registered Office

10 Crown Place
London EC2A 4FT
Telephone: +44 (0) 333 321 6100
Website: www.closebrothers.com

Registered Number

195626

STRATEGIC REPORT

Business Review[1]

Adjusted operating profit was up 1% to £256.0 million (2018: £252.4 million), with solid loan book growth and broadly stable net interest margin offsetting an increase in investment. Statutory operating profit from continuing operations increased 1% to £254.1 million (2018: £250.5 million).

The loan book grew 5.7% (2018: 6.6% excluding discontinued operations), with growth across all our lending businesses, reflecting our strong customer proposition and benefiting from the diversity of our loan portfolio. The return on net loan book remained strong at 3.3% (2018: 3.5%).

Adjusted operating income was up 4% at £604.9 million (2018: £581.6 million), supported by loan book growth across the lending businesses.

The net interest margin remained strong at 7.9% (2018: 8.0%), reflecting continued pricing discipline. The slight reduction compared to the prior year reflects a combination of lower fee income and higher cost of funds.

Adjusted operating expenses increased 6% to £300.5 million (2018: £282.5 million). Over two-thirds of the increase relates to investment in strategic projects and new business initiatives, in line with our long-term strategy. This includes our multi-year investment programme in Motor Finance, our new customer deposit platform and investment to support our IRB application.

The remaining cost increase largely relates to strengthening our operational resilience and core technology. Despite the increase in overall costs, we have continued with our efforts to improve operating efficiency and carefully manage non-investment spend. Staff costs, which represent the majority of the cost base, remained flat on the prior year. The expense/income ratio was marginally up to 50% (2018: 49%), while the compensation ratio reduced slightly to 28% (2018: 29%).

We have maintained strong credit quality across our businesses and the bad debt ratio remained low at 0.6% (2018: 0.6%).

Return on opening equity remained strong at 18% (2018: 20%) reflecting the ongoing strong profitability of the business, offset by continued growth in the equity base.

Key Financials[1,2]

	2019 £ million	2018 £ million	Change %
Continuing operations			
Adjusted operating income	**604.9**	581.6	4
Adjusted operating expenses	**(300.5)**	(282.5)	6
Impairment losses on financial assets	**(48.4)**	(46.7)	4
Adjusted operating profit	**256.0**	252.4	1

Key Performance Indicators[3]

	2019 %	2018 %
Net interest margin[4]	**7.9%**	8.0%
Expense/income ratio[5]	**50%**	49%
Compensation ratio[6]	**28%**	29%
Bad debt ratio[7]	**0.6%**	0.6%
Return on net loan book[8]	**3.3%**	3.5%
Return on opening equity[9]	**18%**	20%

	2019 £ million	2018 £ million	Change %
Average loan book and operating lease assets[10]	**7,654.0**	7,261.1	5

1 Results from continuing operations exclude the unsecured retail point of sale finance business, which has been classified as a discontinued operation in the income statement for the 2018 and 2019 financial years.
2 Adjusted measures are used to increase comparability between periods and exclude amortisation of intangible assets on acquisitions, any exceptional items and discontinued operations.
3 The calculation of the key performance indicators excludes the unsecured retail point of sale finance loan book from both the opening and closing loan book.
4 Adjusted income generated by lending activities, including interest income net of interest expense, fees and commissions income net of fees and commissions expense, and operating lease income net of operating lease expense, less depreciation on operating lease assets, divided by average loans and advances to customers (net of impaired loans) and operating lease assets.
5 Total adjusted operating expenses on adjusted operating income.
6 Total adjusted staff costs on adjusted operating income.
7 Impairment losses as a percentage of average net loans and advances to customers and operating lease assets.
8 Adjusted operating profit from lending activities divided by average net loans and advances to customers and operating lease assets.
9 Adjusted operating profit after tax and non-controlling interests on opening equity, excluding non-controlling interests.
10 Re-presented to exclude the unsecured retail point of sale finance loan book in both the 2018 and 2019 financial years and is used to calculate net interest margin, bad debt ratio and return on net loan book.

STRATEGIC REPORT

Loan Book

Loan book growth has always been an output of our business model, and we continue to prioritise our margins and credit quality. We have a diverse portfolio of businesses, which ensures that our model remains resilient through the cycle. Loan book growth was 5.7% in the year to £7.6 billion (1 August 2018: £7.2 billion), with all five businesses growing, reflecting a resilient performance in our core businesses and new product initiatives and extensions.

We achieved particularly good growth in our Commercial business lines, across both our core Asset and Invoice Finance businesses, as well as the newer Novitas business.

Premium Finance also delivered good growth in the year and Motor Finance saw a slight return to growth, benefiting from recent investment, while we continue to prioritise our strict lending criteria in the face of ongoing competition.

Property grew modestly in the year, with a focus on strong regional growth offsetting a significant level of repayments and more subdued activity in London and the South East. We continue to see strong structural demand for new build family housing, and the new business pipeline remains solid.

Loan Book Analysis

	31 July 2019 £ million	1 August 2018 £ million[1,2]	Change %
Commercial [3]	**2,991.3**	2,747.5	8.9
Asset Finance	**1,946.4**	1,828.2	6.5
Invoice and Speciality Finance	**1,044.9**	919.3	13.7
Retail [1]	**2,810.7**	2,670.5	5.2
Motor Finance	**1,775.6**	1,722.7	3.1
Premium Finance	**1,035.1**	947.8	9.2
Property	**1,847.6**	1,821.3	1.4
Closing Loan Book	**7,649.6**	7,239.3	5.7
Operating lease assets [4]	**220.4**	198.6	11.0
Closing loan book and operating lease assets	**7,870.0**	7,437.9	5.8

1 The loan book at 1 August 2018 excludes the unsecured retail point of sale finance loan book of £66.2 million, which was classified as held for sale at the balance sheet date.
2 The 2018 loan book reflects the 1st August 2018 position post the IFRS 9 opening adjustment of £58.2 million
3 The Asset Ireland loan book has been reclassified in the period from Asset Finance to Invoice and Speciality Finance, to align with where this business is managed. Both 31 July 2019 and comparative 1 August 2018 opening loan book figures have been re-presented accordingly.
4 Operating lease assets of £4.2 million (1 August 2018: £7.0 million) relate to Asset Finance and £216.2 million (1 August 2018: £191.6 million) to Invoice and Speciality Finance.

Commercial

The Commercial businesses provide specialist, secured lending principally to the SME market and include Asset and Invoice and Speciality Finance. The latter includes smaller specialist businesses such as Novitas, a specialist provider of finance to clients of the legal profession, Brewery Rentals, which provides service and finance solutions for brewery equipment and containers, and Vehicle Hire, which provides heavy goods and light commercial vehicles on a predominantly long-term hire basis.

The Commercial loan book increased 9% overall to £3.0 billion (1 August 2018: £2.7 billion), with particularly strong growth in the core Asset and Invoice Finance businesses, and in Novitas. The Asset Finance loan book was up 6% in the year, benefiting from solid performance in our well-established sectors, with good growth in transport, and particularly our aviation and marine business, notwithstanding continued active competition from both new and existing lenders in the asset finance market. We have also made good progress in expanding our core offerings, with increased uptake of personal contract hire within Asset Finance and of our asset based lending proposition within Invoice Finance.

Adjusted operating profit of £87.4 million (2018: £76.3 million) was up 15%, driven by good income growth and continued low bad debt. Statutory operating profit increased 15% to £85.8 million (2018: £74.7 million).

Operating income of £250.8 million (2018: £225.7 million) was 11% higher than the prior year, reflecting strong growth in the loan book. We have maintained a strong net interest margin of 8.1% (2018: 7.9%), ahead of the prior year reflecting growth in higher margin business lines.

Costs grew by 6% to £140.1 million (2018: £132.2 million), significantly below the increase in operating income, and resulting in an expense/income ratio that reduced to 56% (2018: 59%).

The bad debt ratio increased to 0.8% (2018: 0.6%), reflecting very low bad debts in the prior year, and remains close to historically low levels, with good credit performance overall.

Retail

The Retail businesses provide intermediated finance, principally to individuals and small businesses, through motor dealers and insurance brokers.

The Retail loan book increased 5% to £2.8 billion (1 August 2018: £2.7 billion), reflecting loan book growth in both Premium Finance and Motor Finance.

Premium Finance delivered good growth of 9% to £1.0 billion (1 August 2018: £0.9 billion) driven by several new significant broker relationships in the period, with strong growth in Personal lines and continued good growth in Commercial. The Premium Finance business continues to be well positioned competitively, benefiting from the multi-year investment programme in its infrastructure over recent years to improve both broker and end customer experience.

The Motor Finance loan book increased 3% to £1.8 billion (1 August 2018: £1.7 billion). The UK book returned to growth in the period, benefiting from recent improvements in sales capability. This was supported by further growth in the Republic of Ireland, which accounts for 28% (2018: 26%) of the Motor Finance loan book, where we operate through a local partner, First Auto Finance, who provide the distribution and dealer relationships. In both the UK and Ireland, our core product remains hire-purchase contracts for second-hand vehicles, with Personal Contract Plans ("PCP") accounting for only 12% of the Motor Finance loan book at 31 July 2019.

On 1 January 2019 we completed the sale of our unsecured retail point of sale finance business, which provides finance to consumers through retailers, and had a loan book of £66.2 million classified as held for sale as at 31 July 2018.

Overall, adjusted operating profit for Retail of £73.4 million (2018: £81.3 million) was down 10% on the prior year, and statutory operating profit from continuing operations reduced 10% to £73.1 million (2018: £81.0 million).

Adjusted operating income was marginally down 1% year-on-year at £224.1 million (2018: £225.7 million) with a slight decline in net interest margin to 8.2% (2018: 8.4%), due to lower fee income in the Motor Finance business and the mix impact of growth in lower margin business in Ireland.

Adjusted operating expenses increased 5% to £125.5 million (2018: £119.2 million), reflecting our ongoing investment in both Premium Finance and Motor Finance. Our investment in the infrastructure of the Premium Finance business is now delivering substantial benefits in the form of significant new broker relationships and cost savings through operational efficiencies. This has resulted in a 20% growth in the number of cases and a 34% increase in loan book since the 2016 financial year. We are making good progress with our Motor Finance transformation programme which is aimed at improving the service proposition, enhancing operational efficiency, improving our credit acceptance process and increasing sales effectiveness. We expect to realise further benefits as this investment programme progresses. As a result, the expense/income ratio increased to 56% (2018: 53%).

Credit performance remains in line with our expectations at this stage of the cycle, with the bad debt ratio stable at 0.9% (2018: 0.9%), reflecting continued commitment to our strict lending criteria.

Property

Property comprises Property Finance and Commercial Acceptances. The Property Finance business is focused on specialist residential development finance to established professional developers in the UK. Commercial Acceptances provides bridging loans and loans for refurbishment projects. We do not lend to the buy-to-let sector, or provide residential or commercial mortgages.

Property delivered 1% loan book growth, to £1.8 billion (1 August 2018: £1.8 billion), reflecting a significant level of repayments, which offset new business. We continued to see good regional growth, with an increase in the number of clients in the period, albeit at smaller loan sizes, which is offsetting a slowdown in London and the South East.

We continue to see good structural demand in our core market of property development finance for new build family housing. London and the South East represent c.70% of the portfolio, however there remains strong growth opportunity in regional locations around major commuting hubs. During the year we launched a new bridging finance office in Manchester and expanded our development finance offering in Northern Ireland. Our long track record, expertise and quality of service ensure the business remains resilient to competition and continues to generate high levels of repeat business.

The business delivered an operating profit of £95.2 million (2018: £94.8 million), broadly flat on the prior year. The net interest margin reduced to 7.1% (2018: 7.5%), reflecting an increase in cost of funds driven by the base rate increase in August 2018, and lower transactional fees in the latter part of the year. The business reported a bad debt ratio of 0.0% (2018: 0.2%).

Operating expenses of £34.9 million (2018: £31.1 million) were up 12%, reflecting the increase in technology investment across the group. The expense/income ratio remained low at 27% (2018: 24%), reflecting the lower operational requirements of the business with larger transaction sizes and a relatively small number of loans.

STRATEGIC REPORT

Capital

The Prudential Regulation Authority ("PRA") supervises Close Brothers Limited on an individual consolidated basis as permitted under Capital Requirements Regulation ("CRR") article 9. The individual consolidation group does not include all subsidiary undertakings and therefore differs to the accounting consolidation group under IFRS. All figures shown below are for this individual consolidation group.

The group's strong capital generation has allowed us to support continued loan book growth in the year while maintaining capital ratios comfortably ahead of minimum requirements. Overall, the common equity tier 1 ("CET1") capital ratio increased to 12.3% (1 August 2018: 12.0%), reflecting continued profitability and slower loan book growth at this stage in the cycle. The total capital ratio increased to 14.6% (1 August 2018: 14.5%).

In the last year, we generated £73.3 million of CET1 capital, reflecting £193.8 million of profit in the year, partially offset by the regulatory deduction of dividends paid and foreseen of £100.4 million, an increase in intangibles, and other movements in reserves. As a result, CET1 capital increased 8% to £1,039.8 million (1 August 2018: £966.5 million).

Risk weighted assets also increased 5% to £8.5 billion (1 August 2018: £8.1 billion), primarily reflecting continued loan book growth.

The group's capital ratios at 31 July 2019 are presented on a transitional basis after applying IFRS 9 arrangements that allow the capital impact of expected credit losses to be phased in over a five-year period, and the CRR transitional arrangements for grandfathered Tier 2 capital instruments. Before the transitional adjustments, the group's fully loaded CET1 and total capital ratios at 31 July 2019 were 11.8% (1 August 2018: 11.5%) and 13.9% (1 August 2018: 13.7%), respectively.

	31 July 2019 £ million	1 August 2018 £ million
Common equity tier 1 capital	**1,039.8**	966.5
Total capital	**1,237.3**	1,171.5
Risk weighted assets	**8,453.6**	8,066.1
Common equity tier 1 capital ratio	**12.3%**	12.0%
Total capital ratio	**14.6%**	14.5%

Funding

The primary purpose of our Treasury function is to manage funding and liquidity to support the lending businesses and manage interest rate risk. We maintain a conservative approach, with diverse funding sources and a prudent maturity profile, which increases our resilience and flexibility and helps to manage changes in the cost of funding.

Total funding increased to £9.6 billion (1 August 2018: £9.3 billion) and accounted for 125% (1 August 2018: 128%) of the loan book at the balance sheet date. Our average cost of funding of 1.7% (2018: 1.6%) was marginally up on the prior year, though our effective management of funding sources kept this increase comfortably below the 25 bps rise in the Bank of England base rate in August 2018.

We maintain a diverse range of funding sources across a series of maturities, including several public debt securities as well as a number of securitisation facilities. Over the year, we increased our volumes of customer deposits, and have continued to make use of smaller private placements.

Our range of secured funding facilities include securitisations of our Premium and Motor Finance loan books. During the year we renewed and increased our Motor Finance securitisation facility by £100 million, at lower pricing, and renewed and increased our Premium Finance securitisation facility to £500 million over a two-year period. We have made limited use of the Term Funding Scheme, which accounted for only c.5% of our total funding at the year end. The first of our public Motor Finance securitisations was fully redeemed on 16 September 2019, with all public interest repaid as at 31 July 2019.

Deposits increased 3% overall to £5.6 billion (1 August 2018: £5.5 billion) with non-retail deposits decreasing slightly to £3.5 billion (1 August 2018: £3.6 billion) and retail deposits increasing by 12% to £2.1 billion (1 August 2018: £1.9 billion). Unsecured funding remained broadly unchanged at £1.1 billion (1 August 2018: £1.1 billion).

We have maintained a prudent maturity profile. Term funding, with a residual maturity over one year, increased to £5.1 billion (1 August 2018: £4.5 billion), reflecting the renewal of long-term facilities, and now covers 67% (1 August 2018: 62%) of the loan book. The average maturity of funding allocated to the loan book remained broadly in line with the prior year at 20 months (1 August 2018: 23 months), while the average loan book maturity remained at 14 months (1 August 2018: 14 months).

During the year we implemented a new customer deposit platform, which will allow us to offer a wider range of deposit products to further diversify our funding as well as improve customer experience. We completed the successful migration of c.37,000 customers and £3.8 billion of deposits onto the new platform in December 2018, and have since launched new notice accounts as an additional product for our retail, pension and SME customers. In the 2020 financial year we will be introducing a suite of new savings products and a new online portal.

Our strong credit ratings have been reaffirmed by both Moody's Investors Services ("Moody's") and Fitch Ratings ("Fitch") during the year. Moody's rates Close Brothers Group A3/P2 and Close Brothers Limited Aa3/P1, with stable outlook. Fitch affirmed ratings for both entities "A/F" in August 2019, having previously revised the outlook to rating watch negative alongside UK peers in March 2019 to reflect their view of the increased risk of a disruptive "No Deal" Brexit scenario.

STRATEGIC REPORT

Funding Analysis[1]

	31 July 2019 £ million	1 August 2018 £ million
Customer deposits	**5,638.4**	5,497.2
Secured funding	**1,404.8**	1,360.4
Unsecured funding[2]	**1,118.0**	1,081.0
Intercompany	**254.1**	250.0
Equity	**1,176.4**	1,071.8
Total available funding	**9,591.7**	9,260.4
Of which term funding (>1 year)	**5,103.3**	4,481.7
Total funding % loan book	**125%**	128%
Term funding % loan book	**67%**	62%
Average maturity of funding allocated to loan book[3]	**20 Months**	23 Months

1 Numbers relate to core funding and exclude working capital facilities at the business level
2 Unsecured funding excludes £16.4 million (2018: £3.5 million) of non-facility overdrafts included in borrowings and includes £205.0 million (2018: £205.0 million) of undrawn facilities
3 Average maturity of total funding excluding equity and funding held for liquidity purposes

Liquidity

The group maintains a strong liquidity position, ensuring it is comfortably ahead of both internal risk appetite and regulatory requirements. The majority of our liquidity requirements and surplus funding are held with central banks. In the year, treasury assets remained broadly stable at £1.4 billion (1 August 2018: £1.4 billion) and were predominantly held on deposit with the Bank of England, giving us continued good headroom to both internal and external liquidity requirements.

We regularly assess and stress test our liquidity requirements and continue to comfortably meet the liquidity coverage ratio requirements under CRD IV, with a 12-month average liquidity coverage ratio of 747% (2018: 845%).

	31 July 2019 £ million	1 August 2018 £ million
Cash and balances at central banks	**1,106.4**	1,140.3
Sovereign and central bank debt	**48.3**	44.5
Certificates of deposit	**240.7**	250.3
Treasury assets	**1,395.4**	1,435.1

STATEGIC REPORT

Principal Risks and Uncertainties

Risk Management

The group faces a number of risks in the normal course of business providing lending to small businesses and individuals. The management of the risks we face is central to everything we do. The key elements to the way we manage risk are as follows:

- adhering to our established and proven business model;
- implementing an integrated risk management approach based on the concept of "three lines of defence"; and
- setting and operating within clearly defined risk appetites, monitored with defined metrics and set limits.

We believe the key risks facing the group include; the current economic uncertainty; the regulatory landscape and how it may impact some or all of our businesses; the competitive environment; and maintaining operational resilience in the face of growing cyber threats. The potential impact of the UK's anticipated departure from the EU and how it could impact our customers also continues to be closely monitored and managed through the Group's emerging risk framework.

Risks and uncertainties

The following pages set out the principal risks and uncertainties which may impact the group's ability to deliver its strategy, how we seek to mitigate these risks and the change in the perceived level of risk over the year. While we constantly monitor our portfolio for emerging risks, the group's activities, business model and strategy remain unchanged. As a result, the principal risks and uncertainties which the group faces and our approach to mitigating them remain broadly consistent with prior years. This consistency in approach has underpinned the group's track record of trading successfully and supporting our clients over many years.

The summary below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties faced by the group but reflect those which the group currently believes may have a significant impact on its performance and future prospects.

No change

Risk decreased

Risk increased

Credit Risk

Risk
As a lender to businesses and individuals, the group is exposed to credit losses if customers are unable to repay loans and outstanding interest and fees. At 31 July 2019 the group had loans and advances to customers amounting to £7.6 billion.

The group also has exposure to counterparties with which it places deposits or trades, and also has in place a small number of derivative contracts to hedge interest rate and foreign exchange exposures.

Mitigation
We seek to minimise our exposure to credit losses from our lending by:

- applying strict lending criteria when testing the credit quality and covenant of the borrower;
- maintaining consistent and conservative loan to value ratios with low average loan size and short-term tenors;
- lending on a predominantly secured basis against identifiable and accessible assets;
- maintaining rigorous and timely collections and arrears management processes; and
- operating strong control and governance both within our lending businesses and with oversight by a central credit risk team.

Our exposures to counterparties are mitigated by:

- excess liquidity of £1.1 billion placed with the Bank of England; and
- continuous monitoring of the credit quality of our counterparties within approved set limits.

Change

Credit losses have again remained low during the year to 31 July 2019 while other counterparty exposures are broadly unchanged with the majority of our liquidity requirements and surplus funding placed with the Bank of England.

We continue to monitor closely the uncertainty over Brexit and the UK economic outlook combined with rising consumer debt levels. These factors could increase the risk of higher credit losses in the future.

Further commentary on the credit quality of our loan book is outlined on pages 3 to 7. Further details on loans and advances to customers and debt securities held are in notes 10 and 11 on pages 46 to 52 of the financial statements.

STATEGIC REPORT

Economic environment

Risk
Any downturn in economic conditions may impact the group's performance through:

- lower demand for the group's products;
- lower investor risk appetite as a result of financial markets instability;
- higher credit losses as a result of the inability of our customers to service debt and lower asset values on which loans are secured; and
- increased volatility in funding markets.

Mitigation
The group's business model aims to ensure that we are able to trade successfully and support our clients in all economic conditions. By maintaining a strong financial position we aim to be able to absorb short-term economic downturns, continuing to lend when competitors pull back and in so doing building long-term relationships by supporting our clients when it really matters.

We test the robustness of our financial position by carrying out regular stress testing on our performance and financial position in the event of adverse economic conditions.

Change

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Although UK economic performance has remained largely resilient to date, economic uncertainty and risk to the macroeconomic outlook remains elevated due to Brexit and wider global events. While a broadly stable macroeconomic backdrop is anticipated in our current base case scenario, stress testing and contingency planning continue to be employed to support preparedness for a range of possible scenarios. The potential economic impacts of the UK's planned departure from the EU continue to be closely monitored through the Group's emerging risk framework.

Legal and regulatory

Risk
Failure to comply with existing legal, regulatory or tax requirements, or to react to changes to these requirements, may have negative consequences for the group.

Failing to treat customers fairly and not providing products which are in clients' best interests has the potential to damage our reputation and may lead to legal or regulatory sanctions, litigation or customer redress. This applies to current, past and future business.

Similarly, changes to regulation and taxation can impact our financial performance, capital and liquidity and the markets in which we operate.

Mitigation
The group seeks to manage these risks by:

- the implementation of appropriate policies, standards and procedures and the use of risk-based monitoring programmes to test adherence;
- the provision of clear advice on legal and regulatory requirements, including in relation to the scope of regulatory permissions;
- responding in an appropriate, risk-based and proportionate manner to any changes to the legal and regulatory environment and those driven by any strategic initiatives;
- investing in training for all staff including anti-money laundering, bribery and corruption, conduct risk, data protection and information security;
- additional tailored training for relevant employees is provided in key areas such as complaint handling;
- maintaining constructive and positive relationships and dialogue with regulatory bodies and tax authorities.
- providing straightforward and transparent products to our clients;
- reviewing and approving new products through a clear governance and approval process; and
- maintaining a prudent capital position with headroom above minimum capital requirements.

Change

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Financial services businesses remain the subject of significant regulatory scrutiny. Minimum capital requirements are increasing as regulatory buffers are phased in and remain subject to change by regulators.

In addition to the regulatory uncertainties associated with Brexit, there has been growing regulatory focus on consumer borrowing, particularly within motor finance. For example, we continue to monitor the potential for regulatory change in the motor finance market following publication of the FCA's final report in March 2019.

Operational Risk

Risk
The group is exposed to various operational risks through its day to day operations, all of which have the potential to result in financial loss or adverse impact.

Losses typically crystallise as a result of inadequate or failed internal processes, people and systems, or as a result of external factors.

Adverse impacts to the business, customers, third parties and the markets in which we operate are considered within a developing focus on resilient end-to-end delivery of critical business services.

Mitigation
The group seeks to maintain its operational resilience through:

- sustaining robust operational risk management processes, governance and management information;

- identifying key systems, third party relationships, processes and staff, to enable effective investment decisions;
- investing in technology to provide reliable and contemporary customer service offerings;
- investing in cyber security including expertise, tools and staff engagement;
- maintaining focus on data protection;
- adopting fraud prevention and detection capabilities aligned with our risk profile; and
- testing recovery capabilities and planning communications approaches for possible scenarios.

Change

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Market and regulatory expectations continue to increase in relation to operational risk management and resilience. In line with this environment, the group continues to develop and evolve its capacity to reliably deliver key services.

We continue to invest in and upgrade our IT infrastructure, third party management framework, operational processes and cyber security capability to keep abreast of these risks.

Competition

Risk

The group operates in competitive markets and experiences competition from traditional and new players, varying in both nature and extent, across its divisions.

Currently we are experiencing particularly high levels of competition within the Motor Finance business and the intermediated part of the Asset Finance market.

Elevated levels of competition may impact the group's ability to write loans at its desired risk and return criteria, resulting in lower new business volumes and loss of market share.

Mitigation

The group's long track record of successful trading is supported by a consistent and disciplined approach to pricing and credit quality, even in competitive markets. This allows us to lend profitably and continue to support our customers at all stages in the financial cycle.

We build long-term relationships with our clients and intermediaries based on:

- the speed and flexibility of services;
- our local presence and personal approach;
- the experience of our people and subject matter experts; and
- our offering of tailored and client driven product solutions.

This differentiated approach and the consistency of our lending results in strong customer relationships and high levels of repeat business.

We are further protected by the diversity of our loan book and product portfolio, which provides resilience against competitive pressure in any one part of our markets.

Change

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Despite high levels of competition across each of our businesses, our approach remains unchanged as we focus on supporting our clients, maintaining underwriting standards and investing in our business.

Employees

Risk

The quality and expertise of our employees is critical to the success of the group. The loss of key individuals or teams may have an adverse impact on the group's operations and ability to deliver its strategy.

Mitigation

The group seeks to attract, retain and develop staff by:

- operating remuneration and benefits structures which are competitive and recognise and reward performance;
- creating an inclusive environment that embraces diversity;
- listening to employee feedback through engagement surveys and developing action plans;
- implementing succession planning for key roles;
- improving our talent pipeline via our graduate and school leavers programmes and our sales training academy in Asset Finance;
- investing in training and development for all staff; and
- delivering leadership development programmes that identify current and future leaders for the group.

Change

⊖

Our highly skilled people are likely to be targeted by competitors, but we are confident in our ability to retain key employees.

Funding and Liquidity

Risk

The group's access to funding remains key to support our lending activities and the liquidity requirements.

Mitigation

Our funding approach is based on the principle of "borrow long, lend short". The average maturity of funding allocated to the loan book was 20 months at 31 July 2019. This compares to our weighted average loan maturity of 14 months.

Our funding is diversified both by source and channel, and by type and tenor. Liquidity in our group is assessed on a daily basis to ensure adequate liquidity is held and remains readily accessible in stressed conditions.

STATEGIC REPORT

At 31 July 2019 the group's funding position was strong with total available funding equal to 125% of the loan book. This provides a prudent level of liquidity to support our lending activities.

Change

⊖

While economic uncertainty always has the potential to impact funding markets, the group remains conservatively funded and continues to have access to a wide range of funding sources and products. Our new customer deposit platform will further increase our funding resilience with access to a wider range of deposit and savings products, and an online distribution capability.

This diversity of funding, combined with relatively long tenor when compared to the average duration of our lending, means we are well placed to meet any future market challenges or constraints.

Market Risk

Risk
Market volatility impacting equity and fixed income exposures, and/or changes in interest and exchange rates have the potential to impact the group's performance.

Mitigation
Our policy is to minimise interest rate risk by matching fixed and variable interest rate assets and liabilities, and using swaps where appropriate. The capital and reserves of the group do not have interest rate liabilities and as such are not hedged.

Foreign exchange exposures are generally hedged using foreign exchange forwards or currency swaps with exposures monitored daily against approved limits.

Change

⊖

The group's approach and the underlying risks are unchanged. Further detail on the group's exposure to market risk is outlined in note 22 on pages 80 and 81 of the financial statements.

The sensitivity analysis on interest rate exposures shown in note 22 on page 81 demonstrates the limited level of exposure to interest rate and foreign exchange movements.

Emerging Risk

The group utilises an established framework to monitor its portfolio for emerging risks, supporting organisational readiness for external volatility.

This incorporates input and insight from both a top-down and bottom-up perspective:

- Top-down: Emerging risks identified by directors and executives at a group level via the Group Risk and Compliance Committee and the board.
- Bottom-up: Emerging risks identified at a business level and escalated, where appropriate, via risk updates into the Group Risk and Compliance Committee and the board.

Group level emerging risks are monitored by the Group Risk and Compliance Committee and the Risk Committee on an ongoing basis, with agreed actions tracked to ensure the group's preparedness should an emerging risk crystallise.

Current Group-level emerging risks are detailed below:

Emerging Risk	Mitigating Actions
Risk of economic and political uncertainty as a result of the UK's exit from the EU	Brexit Forum established in 2016 to track ongoing developments and develop appropriate contingency plans. Appropriate preparations now made for a potential 'no deal' exit, including the establishment of a new Irish subsidiary and subsequent approval of a MoneyLender licence in the Republic of Ireland to support continuation of our continental Retail and SME Premium Finance business.
Risk of financial loss resulting from the physical or transitional impacts of climate change	Climate Risk Working Group established in 2019 with responsibility for developing an appropriate and regulatory-compliant firm-wide climate risk framework. Senior management responsibility has been assigned to the group chief risk officer while the Risk Committee has assumed responsibility for overseeing and challenging the developing framework.

This Strategic Report was approved by the board and signed by order of the board:

J.E. Hudspith
Company Secretary

23 September 2019

DIRECTORS' REPORT

The directors of the company present their report for the year ended 31 July 2019.

Results and dividends

The consolidated results for the year are shown on page 21 of the financial statements. The directors recommend a final dividend for the year of 43p (2018: 28p) on each ordinary share which, together with the interim dividend of 37p (2018: 24p) paid in April 2019, makes an ordinary distribution for the financial year of £98.1 million. The final dividend, if approved by the shareholder will be paid on 8 November 2019.

Directors

The names of the directors of the company at the date of this report, are given on page 2 of this Annual Report. All the directors listed on that page were directors of the company throughout the year, apart from Peter Duffy, who was appointed a director on 1 January 2019. Elizabeth Lee served as a director throughout the year, retiring on 31 July 2019 and Jonathan Howell served as a director for part of the year, standing down from the board on 15 November 2018.

Details on the directors' remuneration can be found in the Directors' Remuneration note on page 42 of this Annual Report.

Directors' indemnities and insurance

In accordance with its articles of association, the company has granted a deed of indemnity to Adrian Sainsbury on terms consistent with the applicable statutory provisions. Each of the other directors has been granted a similar deed of indemnity by the parent company, Close Brothers Group plc. The deeds indemnify the directors in respect of liabilities (and associated costs and expenses) incurred in connection with the performance of their duties as a director of the company or any associated company. Qualifying third party indemnity provisions for the purposes of section 234 of the Companies Act 2006 were accordingly in force during the course of the year and remain in force at the date of this report. The company also maintains directors' and officers' liability insurance for its directors and officers.

Company Secretary

The company secretary of Close Brothers Limited is John Hudspith. He can be contacted at the Company's registered office.

Strategic Report

The company's Strategic Report can be found on pages 3 to 11 of this Annual Report. The requirement to include a non-financial statement in the Strategic Report has been met by the parent company, Close Brothers Group plc and is therefore not included here.

Business activities

The group's business activities, together with a description of future developments (including the factors likely to affect future development and performance) and its summarised financial position, are set out in the Strategic Report.

Employees

During the year the company continued to build its range of programmes designed to attract and retain talent, with a series of initiatives promoting development across the group.

All employees have access to a learning portal, which offers a wide range of practical tools, workshops and e-learning across a range of topics. The average number of training hours across the group has remained good at 10.7 hours per employee.

All staff are required to complete relevant regulatory training on an annual basis with further training offered when required and continued to maintain a 100% completion rate of mandatory training for eligible employees in the year.

Internal career mobility and the need to identify and support up and coming talent remain important focus areas for leadership teams, with regular talent forums built into our performance management and succession planning processes. Talent development programmes are run throughout the group through a series of structured learning opportunities and exposure to different teams and networks.

Diversity and Equality

The group is an equal opportunities employer and is committed to ensuring that all our employees can feel proud to work for us, regardless of their gender, age, race, ethnicity, disability, sexual orientation or background.

The group continues to partner with leading diversity organisations, including Stonewall, Europe's largest LGBTQ+ charity, to help inform our thinking and activities. This year we have also commenced our partnership with the Business Disability Forum.

Financial Instruments

Details of the group's financial instruments can be found in note 22 to the financial statements begins on page 68.

Financial Risk Management

The group has procedures in place to identify, monitor and evaluate the significant risks it faces. The group reviews and adjusts its risk appetite annually as part of the strategy-setting process. This aligns risk-taking with the achievement of strategic objectives. Adherence to appetite is monitored by the group's risk committees. The group's principal risks & uncertainties are described on pages 8 to 11, and the risks associated with the group's financial instruments are analysed in note 22 on pages 68 to 83 of the financial statements. The group's hedging policy can also be found in note 12 on pages 53 to 55 to the financial statements.

DIRECTORS' REPORT

Post-Balance Sheet Events

There were no material post-balance sheet events.

Branches

The group has a Branch in The Republic of Ireland.

Capital Structure

The company's share capital comprises one class of ordinary share with a nominal value of £1 each. At the 31 July 2019, 122,480,000 (2018: 122,480,000) ordinary shares were in issue.

Political Donations

No political donations were made during the year (2018: £nil).

Research and Development Activities

During the normal course of business, the group continues to invest in new technology and systems and to develop new products and services to improve operating efficiency and strengthen its customer proposition.

Auditor

PricewaterhouseCoopers LLP ("PwC") has expressed its willingness to continue in office as the company's auditor.

Disclosure of Information to the Auditor

Each of the persons who are directors at the date of approval of this Annual Report confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Going Concern

The group has a strong, proven and conservative business model and has traded profitably during the year. It is well positioned in each of its core businesses, well capitalised, soundly funded and has adequate access to liquidity.

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

Directors' Responsibility Statement

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law). 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 group and company and of the profit or loss of the group and company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed for the group financial statements and United Kingdom Accounting Standards, comprising FRS 102, have been followed for the company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and company will continue in business.

The directors are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the board

J.E. Hudspith
Company Secretary

23 September 2019

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

Report on the audit of the financial statements
Opinion
In our opinion:

- Close Brothers Limited's group financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 July 2019 and of the group's profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the consolidated and company balance sheets as at 31 July 2019; the consolidated income statement, the consolidated statement of comprehensive income, the consolidated cash flow statement and the consolidated and company statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence
We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the company.

Other than those disclosed in note 5 to the financial statements, we have provided no non-audit services to the group or the company in the period from 1 August 2018 to 31 July 2019.

Our audit approach
Overview
- Overall group materiality: £12.2 million (2018: £12.2 million).
- Overall company materiality: £11.9 million (2018: £11.3 million).
- See "Materiality" section below for details.
- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).
- We performed audit procedures over components considered financially significant in the context of the group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances). We performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to mitigate the risk of material misstatement in the residual components.

The key audit matters were:

- Determination of expected credit losses on loans and advances to customers (group and company).
- Application of effective interest rate ("EIR") accounting (group and company).

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

The scope of our audit
As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Capability of the audit in detecting irregularities, including fraud
Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of banking laws and regulations such as, but not limited to, regulations relating to consumer credit and unethical and prohibited business practices, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006 and UK tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls) and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in accounting estimates. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

- Review of correspondence with and reports to the regulators PRA and FCA, review of correspondence with legal advisors, enquiries of management, and review of internal audit reports in so far as they related to the financial statements;
- Assessment of matters reported on the group's whistleblowing helpline and the results of management's investigation of such matters;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the determination of expected credit losses on loans and advances (see related key audit matter below); and
- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations, unusual times or posted by senior management.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters
Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the 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) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, 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. This is not a complete list of all risks identified by our audit.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

Key audit matter	How our audit addressed the key audit matter
Determination of expected credit losses on loans and advances to customers (group and company) The determination of expected credit loss allowances is subjective and judgmental. Models are used to collectively assess and determine expected credit loss allowances on loans and advances which are not classified as being credit impaired at the reporting date or are individually small. Key inputs and assumptions include significant increase in credit risk criteria, probability of default, loss given default and the use of multiple, probability weighted, economic scenarios. Individually large exposures to counterparties who are in default at the reporting date are estimated on an individual basis. Judgement is required to determine when a loan is considered to be in default, and then to estimate the amount and timing of the expected future cash flows related to that loan under multiple, probability weighted, scenarios. Refer to note 10 and 22 to the financial statement for the relevant disclosures	We understood and critically assessed the appropriateness of the impairment policy (including management's definitions of default and a significant increase in credit risk) and its application in the determination of ECL provisions. *Collectively assessed provisions* We understood management's process and tested key controls around the determination of expected credit loss allowances, including controls relating to: • Appropriateness of modelling methodologies and monitoring of model performance; • The integrity of data feeds from source systems into the models; and • The approval of key inputs and assumptions used in applying multiple economic scenarios. We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit. We assessed the reasonableness of key inputs used in the determination of the ECL allowances by independently reperforming management's model monitoring analyses (comparing actual experience to that predicted by the models) and performing sensitivity analyses on the results. We assessed management's judgement as to whether the results of these activities indicated whether the models continued to perform appropriately or if any post-model adjustments were required. We used our economist experts to assess the reasonableness of management's selected economic scenarios and associated probability weightings, giving specific consideration to the current political uncertainty. We tested the completeness and accuracy of key data inputs, sourced from underlying systems, that are applied in the calculation of the ECL allowances and tested the integrity of the calculations. We used credit risk modelling specialists to support the audit team in the performance of these audit procedures. *Individually assessed provisions* We performed the following procedures to test the completeness of the identification of defaulted assets requiring individual assessment: • we critically assessed the criteria for determining whether a default event had occurred; and • we haphazardly tested a sample of loans which management had determined were not in default at the reporting date. For each sample loan, we independently assessed whether they had indicators of a default event and therefore whether they were appropriately categorised between performing and in default.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

Key audit matter	How our audit addressed the key audit matter
	For a sample of individually assessed loans in default and related ECL allowances, we: • evaluated the basis on which the allowances were determined, and the evidence supporting the analysis performed by management; • independently challenged whether the key assumptions used, such as the recovery strategies, collateral rights and ranges of potential outcomes were appropriate given the borrower's circumstances; and • re-performed management's provision calculation, critically assessing key inputs including expected future cash flows, discount rates, valuations of collateral held and the weightings applied to scenario outcomes. Based on the evidence obtained, we concluded that the methodologies, modelled assumptions, management judgements and data used within the individual assessments to be appropriate and compliant with the requirements of IFRS 9.
Application of effective interest rate ("EIR") accounting (group and company) Interest income on loans and advances is recognised using the effective interest rate method and any fees, commissions or direct transaction costs that are an integral part of the financial instrument are included within the effective interest rate. Judgement is required to determine whether applicable fees and direct costs should be included within the effective interest rate, or whether immediate recognition should be applied. Management have to estimate the period over which the amounts are to be recognised, based on the life of the instrument. The judgement and manual nature applied across different businesses throughout the group and company results in a higher risk of material misstatement due to fraud or error. Relevant references: • note 1, critical accounting estimates and judgements on page 34; • note 1, significant accounting policies that includes the revenue recognition policy on pages 28.	We have understood management's process and tested key controls around revenue recognition, including: • walkthroughs for the main lending products to understand the processes and key controls for the identification, recognition and calculation of fees, commissions and costs under the effective interest rate method; and • the reconciliations between the models used to calculate the effective interest rate adjustments for the fees and the general ledger. We found that these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit. In addition we have performed the following substantive procedures: • we tested the effective interest rate models by assessing their design, critically challenging relevant assumptions, and testing the accuracy of model computations by re-performing a sample of effective interest rate calculations; • we agreed a sample of loan agreements and cash receipts to the inputs used within the respective effective interest rate models, and assessed whether the appropriate fees and costs had been reflected in the effective interest rate; and • we considered the consistent application of the EIR accounting policy across the group's different businesses. Based on the evidence obtained, we found that the assumptions, models and data used were appropriate.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

How we tailored the audit scope
We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the company, the accounting processes and controls, and the industry in which they operate. For the purpose of describing our scoping we refer to the group's *organisational units as components.*

The group is divided into Retail, Commercial and Property segments. The consolidated financial statements are a consolidation of these components.

In establishing the overall approach to the group audit, we determined the type of work that is required to be performed over the components by us, as the group engagement team, or auditors within the PwC network of firms operating under our instruction ('component auditors').

Where the work was performed by component auditors, we determined the level of involvement we needed to have in their audit work to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole. This included regular communication with the component auditors throughout the audit, the issuance of instructions, a review of the results of their work on the key audit matters and formal clearance meetings.

Any components which were considered individually financially significant in the context of the group's consolidated financial statements (defined as components that represent more than or equal to 4% of the applicable benchmark) were considered full scope audit components. Components which were subject to a stand alone statutory audit, were also included within our audit scope.

We also considered the individual financial significance of all remaining components in relation to primary statement account balances. Any component which was not already included as a full scope audit component but was identified as being individually financially significant in respect of one of more account balances was subject to specific audit procedures over those account balances.

Additionally, we considered the presence of any significant audit risks and other qualitative factors within the remaining inconsequential components (defined as components which did not represent a reasonable possibility of a risk of material misstatement either individually or in aggregate). After consideration, we concluded that no specific audit procedures were required, although they were subject to group-level analytical review procedures as well as group information technology general controls testing where applicable.

Certain account balances were audited centrally by the group engagement team.

Components within the scope of our audit contributed 98% of group total assets and 97% of profit before tax

Materiality
The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.
Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£12.2 million (2018: £12.2 million).	£11.9 million (2018: £11.3 million).
How we determined it	Based on 5% of profit before tax, then capped at the materiality applied to the group in its capacity as a significant component of the Close Brothers Group plc audit.	5% of profit before tax.
Rationale for benchmark applied	We believe that profit before tax is the primary measure used by the shareholders in assessing the performance of the entity, and is a generally accepted benchmark for determining audit materiality. We then capped the amount, as described above.	We believe that profit before tax is the primary measure used by the shareholders in assessing the performance of the entity, and is a generally accepted benchmark for determining audit materiality.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £1,000,000 and £11,880,000. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £500,000 (group audit) (2018: £500,000) and £500,000 (company audit) (2018: £500,000) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern
ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's and 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 the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the group's trade, customers, suppliers and the wider economy.

Reporting on other information
The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance 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 an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of 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 based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 July 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit
Responsibilities of the directors for the financial statements
As explained more fully in the Directors' Responsibility Statement set out on page 13, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and 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 group or the company or to cease operations, or have no realistic alternative but to do so.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLOSE BROTHERS LIMITED

For the year ended 31 July 2019

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

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

Use of this report
This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting
Companies Act 2006 exception reporting
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 by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment
Following the recommendation of the Audit Committee, we were appointed by the directors on 17 May 2017 to audit the financial statements for the year ended 31 July 2018 and subsequent financial periods. The period of total uninterrupted engagement is 2 years, covering the years ended 31 July 2018 to 31 July 2019.

Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
23 September 2019

CONSOLIDATED INCOME STATEMENT

For the year ended 31 July 2019

	Note	2019 £ million	2018 £ million
Interest income	3	**635.0**	600.4
Interest expense	3	**(126.4)**	(113.2)
Net interest income		**508.6**	487.2
Fee and commission income	3	**93.6**	87.8
Fee and commission expense	3	**(17.1)**	(11.5)
Other income	3	**73.5**	63.2
Depreciation of operating lease assets and other direct costs	14	**(53.7)**	(45.1)
Non-interest income		**96.3**	94.4
Operating income		**604.9**	581.6
Administrative expenses	3	**(300.5)**	(282.5)
Impairment losses on financial assets	10	**(48.4)**	(46.7)
Total operating expenses before amortisation of intangible assets on acquisition		**(348.9)**	(329.2)
Operating profit before amortisation of intangible assets on acquisition		**256.0**	252.4
Amortisation of intangible assets on acquisition	13	**(1.9)**	(1.9)
Operating profit before tax		**254.1**	250.5
Tax	6	**(63.3)**	(61.8)
Profit after tax on continuing operations		**190.8**	188.7
Profit /(loss) from discontinued operations, net of tax	7	**1.1**	(2.2)
Profit after tax		**191.9**	186.5
Loss attributable to non-controlling interests from continuing operations		**(0.3)**	(0.3)
Profit attributable to shareholders		**192.2**	186.8

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 July 2019

	2019 £ million	2018 £ million
Profit after tax	**191.9**	186.5
Other comprehensive income/(expense) that may be reclassified to income statement from continuing operations		
Currency translation gains	**0.4**	0.4
(Losses)/gains on cash flow hedging	**(6.0)**	4.3
Gains on financial instruments classified as available for sale	**-**	0.4
Losses on financial instruments classified at fair value through other comprehensive income:		
Sovereign and central bank debt	**(0.1)**	-
Tax relating to items which may be reclassified	**1.1**	(1.1)
Other comprehensive (expense)/income net of tax from continuing operations	**(4.6)**	4.0
Total comprehensive income	**187.3**	190.5
Attributable to		
Non-controlling interests	**(0.3)**	(0.3)
Shareholders	**187.6**	190.8
	187.3	190.5

CONSOLIDATED BALANCE SHEET

At 31 July 2019

	Note	31 July 2019 £ million	1 August 2018[1] £ million	31 July 2018 £ million
Assets				
Cash and balances at central banks		**1,106.4**	1,140.3	1,140.4
Loans and advances to banks	9	**59.5**	74.3	74.4
Loans and advances to customers	10	**7,649.6**	7,239.3	7,297.5
Debt securities	11	**289.0**	294.8	295.0
Derivative financial instruments	12	**30.1**	16.6	16.6
Intangible assets	13	**132.8**	110.4	110.4
Property, plant and equipment	14	**242.6**	220.0	220.0
Deferred tax assets	6	**48.5**	52.9	38.8
Prepayments, accrued income and other assets	15	**152.2**	134.6	134.9
Assets classified as held for sale	7	**-**	67.5	67.5
Total assets		**9,710.7**	9,350.7	9,395.5
Liabilities				
Deposits by banks	16	**58.0**	55.2	55.2
Deposits by customers	16	**5,638.4**	5,497.2	5,497.2
Loans and overdrafts from banks	16	**506.7**	498.7	498.7
Debt securities in issue	16	**1,605.9**	1,523.4	1,523.4
Derivative financial instruments	12	**20.5**	15.7	15.7
Amounts due to group undertakings	17	**324.0**	317.1	317.1
Current tax liabilities		**20.1**	14.3	14.3
Accruals, deferred income and other liabilities	15	**139.1**	138.8	138.8
Subordinated loan capital	18	**221.6**	217.9	217.9
Liabilities classified as held for sale	7	**-**	0.6	0.6
Total liabilities		**8,534.3**	8,278.9	8,278.9
Equity				
Called up share capital		**122.5**	122.5	122.5
Retained earnings		**1,059.8**	950.3	995.1
Other reserves		**(4.9)**	(0.3)	(0.3)
Total shareholders' equity		**1,177.4**	1,072.5	1,117.3
Non-controlling interests		**(1.0)**	(0.7)	(0.7)
Total equity		**1,176.4**	1,071.8	1,116.6
Total liabilities and equity		**9,710.7**	9,350.7	9,395.5

1 See notes 1 and 27

The financial statements of Close Brothers Limited, registration number 195626, were approved and authorised for issue by the Board of Directors on 23 September 2019 and signed on its behalf by:

P. Prebensen *Chief Executive Officer*

M. B. Morgan *Director*

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 July 2019

	Called up share capital*	Retained earnings	Other Reserves: Exchange movements reserve	Other Reserves: FVOCI reserve	Other Reserves: Available for sale reserve	Other Reserves: Cash flow hedging reserve	Total attributable to equity holders	Non-controlling interests	Total equity
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
At 1 August 2017	122.5	836.7	(1.6)	-	0.4	(3.1)	954.9	(0.5)	954.4
Profit/(loss) for the year	-	186.8	-	-	-	-	186.8	(0.3)	186.5
Other comprehensive income/(expense)	-	-	0.4	-	0.4	3.2	4.0	-	4.0
Total comprehensive income/(expense) for the year	-	186.8	0.4	-	0.4	3.2	190.8	(0.3)	190.5
Other movements	-	2.3	-	-	-	-	2.3	0.1	2.4
Shares issued	-	-	-	-	-	-	-	-	-
Income tax	-	0.4	-	-	-	-	0.4	-	0.4
Dividends paid	-	(31.1)	-	-	-	-	(31.1)	-	(31.1)
At 31 July 2018	122.5	995.1	(1.2)	-	0.8	0.1	1,117.3	(0.7)	1,116.6
IFRS 9 transition (note 27)	-	(44.8)	-	0.8	(0.8)	-	(44.8)	-	(44.8)
At 1 August 2018	122.5	950.3	(1.2)	0.8	-	0.1	1,072.5	(0.7)	1,071.8
Profit/(loss) for the year	-	192.2	-	-	-	-	192.2	(0.3)	191.9
Other comprehensive income/(expense)	-	-	-	(0.1)	-	(4.5)	(4.6)	-	(4.6)
Total comprehensive income/(expense) for the year	-	192.2	-	(0.1)	-	(4.5)	187.6	(0.3)	187.3
Other movements	-	(0.2)	-	-	-	-	(0.2)	-	(0.2)
Shares issued	-	-	-	-	-	-	-	-	-
Income tax	-	(0.3)	-	-	-	-	(0.3)	-	(0.3)
Dividends paid (note 8)	-	(82.2)	-	-	-	-	(82.2)	-	(82.2)
At 31 July 2019	**122.5**	**1,059.8**	**(1.2)**	**0.7**	**-**	**(4.4)**	**1,177.4**	**(1.0)**	**1,176.4**

*Allotted, called-up and fully-paid share capital comprised 122,480,000 (2018: 122,480,000) ordinary shares of £1 each

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 July 2019

	Note	2019 £ million	2018 £ million
Net cash inflow/(outflow) from operating activities	26(a)	**(5.9)**	237.4
Net cash inflow/(outflow) from investing activities			
Purchase of:			
Property, plant and equipment		**(2.8)**	(9.9)
Intangible assets - software		**(41.2)**	(32.0)
Subsidiaries and non-controlling interests	26(b)	**(2.7)**	-
Sale of:			
Discontinued operations and subsidiaries	26(c)	**86.7**	-
		40.0	(41.9)
Net cash inflow before financing activities		**34.1**	195.5
Financing activities			
Equity dividends paid		**(79.9)**	(30.0)
Amounts received/(paid) from/to group undertakings		**2.7**	206.0
Interest paid on subordinated loan capital and debt financing		**(4.5)**	(10.8)
Net increase/(decrease) in cash		**(47.6)**	360.7
Cash and cash equivalents at beginning of year		**1,186.5**	825.8
Cash and cash equivalents at end of year	26(d)	**1,138.9**	1,186.5

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. Accounting policies

(a) Reporting entity

Close Brothers Limited ("the company"), a limited company incorporated and domiciled in the UK, together with its subsidiaries (collectively, "the group"), operates through three (2018: three) operating segments; Commercial, Retail and Property and is primarily located within the UK.

The company financial statements ("the company accounts") have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 101 "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland ("FRS 101") and the Companies Act 2006, under the provision of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410). The company has taken advantage of the exemption in Section 408 of the Companies Act 2006 not to present its company income statement and related notes.

The company has taken advantage of the following disclosure exemptions under FRS 101:

- the requirements of paragraphs 45(b) and 46 – 52 of IFRS 2 Share-based payment;
- the requirements of paragraphs 91 – 99 of IFRS 13 Fair Value Measurement;
- paragraph 38 of IAS 1 Presentation of Financial Statements, comparative information requirements in respect of paragraph 79(a)(iv) of IAS 1;
- the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134-136 of IAS 1 Presentation of financial statements;
- the requirements of IAS 7 Statement of Cash Flows;
- the requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- the requirements of paragraph 17 of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- the requirements of paragraphs 134(d) – 134(f) and 135(c) - 135(e) of IAS 36 Impairment of Assets.
- The requirements of IAS 8 on standards not yet effective

(b) Compliance with International Financial Reporting Standards

The consolidated financial statements ("the consolidated accounts") have been prepared and approved by the directors in accordance with all relevant International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board and interpretations issued by the IFRS Interpretations Committee endorsed by the EU.

Standards adopted during the year

The accounting policies applied this financial year are set out in this note and consistent with those of the previous financial year except in relation to the adoption of IFRS 9 Financial Instruments, which was effective from 1 August 2018. IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement. There are significant changes in the accounting for financial instruments, particularly with regards to impairment. The impact of the transition to IFRS 9 is set out in notes 27 and 42.

In accordance with the requirements of IFRS 9, comparative information has not been restated and transitional adjustments have been accounted for through retained earnings at 1 August 2018, the date of initial application. The consolidated balance sheet and notes 10, 21 and 30 include 1 August 2018 balances to aid comparability following the adoption of IFRS 9.

IFRS 9 includes an accounting policy choice to continue to apply hedge accounting under IAS 39 and the group elected to apply this accounting policy choice for the foreseeable future.

The group also adopted IFRS 15 Revenue from Contracts with Customers effective from 1 August 2018. IFRS 15 replaces IAS 18 Revenue and IAS 11 Construction Contracts and does not apply to financial instruments, lease contracts or insurance contracts which fall under the scope of other IFRSs. The standard introduces a new revenue recognition model which features a contract-based five-step analysis of transactions to determine whether, how much, and when revenue is recognised. The group's existing accounting policies comply with the requirements of the standard. The standard has no material impact on the group's financial statements.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

IFRS 16 Leases
IFRS 16 Leases is effective for the group from 1 August 2019. The standard replaces IAS 17 and introduces a new recognition model that recognises all leases on a lessee's balance sheet (subject to certain exemptions). Lessor accounting is largely unchanged. At the transition date of 1 August 2019, the group will recognise right of use assets and lease liabilities of approximately £40 million, largely in respect of leased properties previously accounted for as operating leases, with no impact on shareholders' equity. Following transition, a finance charge will be recognised on the lease liabilities and a depreciation charge on the right of use assets.

(c) Basis of preparation
The consolidated and company accounts have been prepared under the historical cost convention, except for the revaluation of financial assets and liabilities held at fair value through profit or loss, financial assets held at fair value through other comprehensive income, (2018: available for sale financial assets) and all derivative financial instruments ("derivatives").

The financial statements are prepared on a going concern basis as disclosed in the Directors' Report.

(d) Consolidation
Subsidiaries
Subsidiaries are all entities over which the group has control. The group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Such power generally accompanies a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which the group effectively obtains control. They are de-consolidated from the date that control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Under the acquisition method of accounting, with some limited exceptions, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any non-controlling interest is measured either at fair value or at the non-controlling interest's proportion of the net assets acquired. Acquisition related costs are accounted for as expenses when incurred, unless directly related to the issue of debt or equity securities. Any excess of the cost of acquisition over net assets is capitalised as intangible assets at acquisition. All intra-group balances, transactions, income and expenses are eliminated.

(e) Discontinued operations
The results of discontinued operations are shown as a single amount on the face of the consolidated income statement comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on the disposal of the discontinued operation. A discontinued operation is a cash generating units ("CGU") or a group of CGUs that either has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations, is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

(f) Foreign currency translation
For the company and those subsidiaries whose balance sheets are denominated in sterling, which is the company's functional and presentation currency, monetary assets and liabilities denominated in foreign currencies are translated into sterling at the closing rates of exchange at the balance sheet date. Foreign currency transactions are translated into sterling at the average rates of exchange over the year and exchange differences arising are taken to the consolidated income statement.

The balance sheets of subsidiaries denominated in foreign currencies are translated into sterling at the closing rates. The income statements for these subsidiaries are translated at the average rates and exchange differences arising are taken to equity. Such exchange differences are reclassified to the consolidated income statement in the period in which the subsidiary is disposed of.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

(g) Revenue recognition

Interest income

Interest on loans and advances made by the group, and fee income and expense and other direct costs relating to loan origination, restructuring or commitments are recognised in the consolidated income statement using the effective interest rate method.

The effective interest rate method applies a rate that discounts estimated future cash payments or receipts relating to a financial instrument to its net carrying amount. The cash flows take into account all contractual terms of the financial instrument including transaction costs and all other premiums or discounts but not future credit losses.

Fees and commissions

Where fees that have not been included within the effective interest rate method are earned on the execution of a significant act, such as fees arising from negotiating or arranging a transaction for a third party, they are recognised as revenue when that act has been completed. Fees and corresponding expenses in respect of other services are recognised in the consolidated income statement as the right to consideration or payment accrues through performance of services. In particular, upfront commissions paid in respect of managing, as opposed to originating, fund products are initially included within "accruals and deferred income" and then recognised as revenue as the services are provided. To the extent that fees and commissions are recognised in advance of billing they are included as accrued income or expense.

Dividends

Dividend income is recognised when the right to receive payment is established.

(h) Adjusted items

The consolidated income statement is presented on both a statutory and adjusted basis. The adjusted basis excludes exceptional items and amortisation of intangible assets on acquisition. Exceptional items are income and expense items that are material by size and/or nature and are non-recurring. The separate reporting of these items helps give an indication of the group's underlying performance. Amortisation of intangible assets on acquisition is excluded to present the performance of the group's acquired businesses consistent with its other businesses.

(i) Financial assets and liabilities (excluding derivatives)

Classification and measurement

Financial assets are classified at initial recognition on the basis of the business model within which they are managed and their contractual cash flow characteristics. The classification categories are amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL").

Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Initial recognition is at fair value plus directly attributable transaction costs. Interest income is accounted for using the effective interest rate method.

Financial assets that are held to collect contractual cash flows and for subsequent sale, where the assets' cash flows represent solely payments of principal and interest, are classified at fair value through other comprehensive income. Directly attributable transaction costs are added to the initial fair value. Gains and losses arising from changes in fair value except when due to credit risk are recognised in other comprehensive income until the financial asset is either sold or matures, at which time the cumulative gain or loss is recognised in the income statement. Gains and losses arising from changes in fair value due to credit risk are recognised in the income statement.

Financial assets are classified at fair value through profit or loss where they do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income or where they are designated at fair value through profit or loss to reduce an accounting mismatch. Financial assets at fair value through profit or loss are recognised at fair value. Transaction costs are not added to or deducted from the initial fair value, they are immediately recognised in profit or loss on initial recognition. Gains and losses that subsequently arise on changes in fair value are recognised in the income statement.

Financial liabilities are classified at initial recognition at amortised cost except for the following which are classified at fair value through profit or loss: derivatives; financial liabilities held for trading; and financial liabilities designated at fair value through profit or loss to eliminate an accounting mismatch.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. Accounting policies *continued*

Financial liabilities at amortised cost are measured at fair value less directly attributable transaction costs on initial recognition. Interest expense is accounted for using the effective interest rate method. Financial liabilities at fair value through profit or loss are measured at fair value on initial recognition. Transaction costs are not added to or deducted from the initial fair value, they are immediately recognised in profit or loss on initial recognition. Subsequent changes in fair value are recognised in the income statement except for financial liabilities designated at fair value through profit or loss, changes in fair value attributable to changes in credit risk are recognised in other comprehensive income.

The fair values of quoted financial assets or financial liabilities in active markets are based on bid or offer prices. If the market for a financial asset or financial liability is not active, or they relate to unlisted securities, the group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Derecognition
Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership. If substantially all the risks and rewards have been neither retained nor transferred the assets continue to be recognised to the extent of the group's continuing involvement. Financial liabilities are derecognised when they are extinguished.

Modifications
The terms or cash flows of a financial asset or liability may be modified due to renegotiation or otherwise. If the terms or cash flows are substantially different to the original, then the financial asset or liability is derecognised and a new financial asset or liability is recognised at fair value. If the terms or cash flows are not substantially different to the original, then the financial asset carrying value is adjusted to reflect the present value of modified cash flows discounted at the original EIR.

The following was applied in the previous financial year under IAS 39.

Classification
The group classifies its financial assets into the following measurement categories: (i) financial assets held at fair value through profit or loss; (ii) loans and receivables; and (iii) available for sale. Financial liabilities are classified as either held at fair value through profit or loss, or at amortised cost using the effective interest method.

Management determines the classification of its financial assets and liabilities at initial recognition.

Financial assets and liabilities held at fair value through profit or loss
This category has two sub-categories: financial assets and liabilities held for trading, and those designated at fair value through profit or loss at inception.

Financial assets and liabilities are classified as held for trading either if acquired principally for the purpose of selling in the short term, or they are derivatives (not in qualifying hedge relationships).

Financial assets and liabilities may be designated at fair value through profit or loss when:

- the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis;
- a group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis; or
- the assets or liabilities include embedded derivatives and such derivatives are required to be recognised separately.

Financial assets and liabilities held at fair value through profit or loss are subsequently carried at fair value, with gains and losses arising from changes in fair value taken directly to the consolidated income statement.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and it is expected that substantially all of the initial investment will be recovered, other than because of credit deterioration. Loans and receivables are subsequently carried at amortised cost using the effective interest method and recorded net of provisions for impairment losses.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

Available for sale
Available for sale assets are those non-derivative financial assets intended to be held for an indefinite period of time, which may be sold in response to liquidity requirements or changes in interest rates, exchange rates or equity prices. Available for sale financial assets are subsequently carried at fair value, with gains and losses arising from changes in fair value taken to a separate component of equity until the asset is sold, or is impaired, when the cumulative gain or loss is transferred to the consolidated income statement.

The fair values of quoted financial assets or financial liabilities in active markets are based on bid or offer prices. If the market for a financial asset or financial liability is not active, or they relate to unlisted securities, the group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Derecognition
Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership. If substantially all the risks and rewards have been neither retained nor transferred the assets continue to be recognised to the extent of the group's continuing involvement. Financial liabilities are derecognised when they are extinguished.

(j) **Impairment of financial assets**
Expected credit losses
Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income, loan commitments and financial guarantee contracts. The impairment charge in the income statement includes the change in expected credit losses and fraud costs.

At initial recognition, a provision is recognised for 12 months of expected credit losses. These financial assets are considered to be in Stage 1. If a significant increase in credit risk since initial recognition occurs, with a 30-days past due backstop, a provision is made for the lifetime expected credit losses. These financial assets are considered to be in Stage 2. A financial asset will remain classified as Stage 2 until the credit risk has improved such that it no longer represents a significant increase since origination and will be returned to Stage 1.

When objective evidence exists that a financial asset is credit impaired, such as a credit default event has occurred or an unlikeness to pay indicator has been identified, with a 90-days past due backstop, the financial asset is considered to be in Stage 3.

Loans and advances to customers are written off against the related provisions when there are no reasonable expectations of further recovery following realisation of all associated collateral and available recovery actions against the customer. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

The calculation of expected credit losses for loans and advances to customers, either on 12-month or lifetime basis, is based on the probability of default ("PD"), adjusted to reflect a range of forward-looking macroeconomic scenarios, the estimated exposure at default ("EAD") and the estimated loss given default ("LGD"). EAD and LGD are adjusted to account for the impact of discounting using the effective interest rate. Some Stage 3 assets, mainly in the Commercial and Property segments, are subject to individual rather than collective assessment.

The PD represents the likelihood of a borrower defaulting on its financial obligation either over the next 12 months or over the remaining lifetime of the obligation. EAD is based on the amounts we expect to be owed at the time of default. LGD represents our expectation of the extent of loss on a defaulted exposure after taking into account cash recoveries including the value of collateral held.

The calculation of expected credit losses for receivables relating to operating lease assets is based on a simplified lifetime only expected credit loss approach.

By their nature, limitations in the group's impairment models or input data may be identified through ongoing model monitoring and validation of models. In certain circumstances, management make appropriate adjustments to model calculated expected credit losses. These adjustments are based on management judgements, to ensure the expected credit loss provision adequately reflects the expected outcome. Management adjustments are actively monitored, reviewed and incorporated into future model development where applicable.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

The following was applied in the previous financial year under IAS 39.
The group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available for sale or loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets at amortised cost
If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. Individually assessed financial assets which are not considered impaired may also be included in collective assessment. In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics.

For loans and receivables, the amount of the loss is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the original effective interest rate. As the loan amortises over its life, the impairment loss may amortise. All impairment losses are reviewed at least at each reporting date. If subsequently the amount of the loss decreases as a result of a new event, the relevant element of the outstanding impairment loss is reversed. Interest on impaired financial assets is recognised at the original effective interest rate applied to the carrying amount as reduced by an allowance for impairment.

For loans that are not considered individually significant, the group adopts a formulaic approach which allocates a loss rate dependent on the overdue period. Loss rates are based on the discounted expected future cash flows and are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Financial assets carried at fair value
When a decline in the fair value of a financial asset classified as available for sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the consolidated income statement. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available for sale equity instruments are not reversed through the consolidated income statement but those on available for sale debt instruments are reversed if there is an increase in fair value that is objectively related to a subsequent event.

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

Rental costs under operating leases and hire purchase contracts are charged to the consolidated income statement in equal instalments over the period of the leases. Rental income from operating leases is recognised in equal instalments over the period of the leases and included in other income in the consolidated income statement.

(l) Sale and repurchase agreements and other secured lending and borrowings
Securities may be sold subject to a commitment to repurchase them. Such securities are retained on the consolidated balance sheet when substantially all the risks and rewards of ownership remain with the group. The transactions are treated as collateralised borrowing and the counterparty liability is included within loans and overdrafts from banks. Similar secured borrowing transactions including securities leading transactions and collateralised short-term notes are treated and presented in the same way. These secured financing transactions are initially recognised at fair value, and subsequently valued at amortised cost, using the effective interest rate method.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

(m) Securitisation transactions

The group securitises its own financial assets via the sale of these assets to special purpose entities, which in turn issue securities to investors. All financial assets continue to be held on the group's consolidated balance sheet together with debt securities in issue recognised for the funding – see derecognition policy (i).

(n) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount presented on the consolidated balance sheet if, and only if, there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle the liability simultaneously.

(o) Derivatives and hedge accounting

In general, derivatives are used to minimise the impact of interest, currency rate and equity price changes to the group's financial instruments. They are carried on the consolidated balance sheet at fair value which is obtained from quoted market prices in active markets, including recent market transactions, and discounted cash flow models.

On acquisition, certain derivatives are designated as a hedge and the group formally documents the relationship between these derivatives and the hedged item. The group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivative is highly effective in offsetting changes in fair values or cash flows of hedged items. If a hedge was deemed partially ineffective but continues to qualify for hedge accounting, the amount of the ineffectiveness, taking into account the timing of the expected cash flows where relevant, would be recorded in the consolidated income statement. If the hedge is not, or has ceased to be, highly effective, the group discontinues hedge accounting.

For fair value hedges, changes in the fair value are recognised in the consolidated income statement, together with changes in the fair value of the hedged item. For cash flow hedges, the fair value gain or loss associated with the effective proportion of the cash flow hedge is recognised initially directly in equity and recycled to the consolidated income statement in the period when the hedged item affects income.

(p) Intangible assets

Computer software (acquired and costs associated with development) and intangible assets on acquisition (excluding goodwill) are stated at cost less accumulated amortisation and provisions for impairment which are reviewed at least annually. Amortisation is calculated to write off their cost on a straight-line basis over the estimated useful lives as follows:

Computer software	3 to 5 years
Intangible assets on acquisition	8 to 20 years

Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is assessed annually for impairment and carried at cost less any accumulated impairment.

(q) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and provisions for impairment which are reviewed at least annually. Depreciation is calculated to write off their cost on a straight-line basis over their estimated useful lives as follows:

Long leasehold property	40 years
Short leasehold property	Over the length of the lease
Fixtures, fittings and equipment	3 to 5 years
Assets held under operating leases	1 to 20 years
Motor vehicles	5 years

(r) Share capital

Share issue costs

Incremental costs directly attributable to the issue of new shares or options, including those issued on the acquisition of a business, are shown in equity as a deduction, net of tax, from the proceeds.

Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are paid or, if earlier, approved by shareholders.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

Treasury shares
Where the company or any member of the group purchases the company's share capital, the consideration paid is deducted from shareholders' equity as treasury shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

(s) Employee benefits
Close Brothers Group plc ("CBG"), the ultimate parent company, operates defined contribution pension schemes for eligible employees as well as a defined benefit pension scheme which is closed to new members and further accrual.

Under the defined contribution scheme the group pays fixed contributions into a fund separate from CBG's assets. Contributions are charged in the consolidated income statement when they become payable.

(t) Share-based payments to employees
Close Brothers Group plc ("CBG"), the ultimate parent company, operates long term incentive arrangements in which group employees have participated. These include the Deferred Share Awards ("DSA") scheme, Long Term Incentive Plan ("LTIP"), Share Matching Plan ("SMP") and HMRC approved Save As You Earn ("SAYE") scheme.

The cost of most awards granted under the DSA scheme is based on the salary of the individual at the time the award is made. The value of the share award at the grant date is charged to the group's income statement in the year to which the award relates.

The cost of most awards granted under the DSA scheme is based on the salary of the individual at the time the award is made. The value of the share award at the grant date is charged to the group's income statement in the year to which the award relates.

The cost of LTIP, SMP and SAYE is based on the fair value of awards on the date of grant. Fair values for market based performance conditions are determined using a stochastic (Monte Carlo simulation) pricing model for LTIP and SMP and the Black-Scholes pricing model for other schemes. Both models take into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the CBG share price over the life of the option award and other relevant factors.

For non-market based performance conditions, vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting the number of shares in each award such that the amount recognised reflects the number that are expected to, and then actually do, vest. CBG expense the fair value of the awards, including recharges to subsidiary companies where applicable, in their income statement on a straight line basis over the vesting period, with a corresponding credit to the share-based payments reserve. At the end of the vesting period, or upon exercise, lapse or forfeit if earlier, this credit is transferred to retained earnings. Further information on the group's schemes is provided in note 19.

(u) Provisions and contingent liabilities
Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are deemed remote.

(v) Taxes, including deferred taxes
Current tax is the expected tax payable on the taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated income statement because it excludes items of income and expense that are taxable or deductible in other years and items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

To enable the tax charge to be based on the profit for the year, deferred tax is provided in full on temporary timing differences, at the rates of tax expected to apply when these differences crystallise. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable profits will be available against which temporary differences can be set. Deferred tax liabilities are offset against deferred tax assets when there is both a legal right to set off and an intention to settle on a net basis.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

(w) Cash and cash equivalents
For the purposes of the cash flow statement, cash and cash equivalents comprises cash and demand deposits with banks, together with short-term highly liquid investments that are readily convertible to known amounts of cash.

(x) Segmental reporting
Operating segments are reported in a manner consistent with the internal reporting provided to the Executive Committee, which is considered the group's chief operating decision maker. All transactions between business segments are conducted on an arm's length basis, with intra-segment revenue and costs being eliminated on consolidation. Income and expenses directly associated with each segment are included in determining business segment performance.

(y) Investment in subsidiaries (Company only)
Investments in subsidiaries are stated at cost less provision for impairment.

(z) Critical accounting estimates and judgements
The reported results of the group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable. The group's estimates and assumptions are based on historical experience and expectation of future events and are reviewed on an ongoing basis.

Critical accounting judgements
In the application of the group's accounting policies, which are described in note 1, judgements that are considered by the board to have the most significant effect on the amounts in the financial statements are as follows.

Revenue recognition
Interest income is recognised using the effective interest rate method, which applies a rate that discounts estimated future cash payments or receipts relating to a financial instrument to their net carrying amount. The estimated future cash flows take into account all contractual terms and expected behavioural life of the financial instrument including transaction fees and costs and all other premiums or discounts but not future credit losses. Other fees and commissions are recognised as services are provided or on completion of the execution of a significant act.

Judgement is required in determining the fees and costs which are integral to the yield and recognised as interest income, and in determining the period over which to recognise non-interest income.

The critical accounting judgements below are new this financial year following the adoption of IFRS 9.
At 31 July 2019 the group's expected credit loss provision was £104.3 million (1 August 2018: £97.3 million). The calculation of the group's expected credit loss provision under IFRS 9 requires the group to make a number of judgements, assumptions and estimates. The most significant are set out below.

Significant increase in credit risk
Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk since initial recognition. The assessment is unbiased, probability weighted and uses forward-looking information. The group uses a multifactor approach based on quantitative measures and qualitative indicators to help make such an assessment. Quantitative measures are changes in PD or credit score since origination and qualitative indicators include forbearance and watch list processes. As a backstop, all financial assets that are 30 days past due are considered to have experienced a significant increase in credit risk.

The assessment of whether a significant increase in credit risk has occurred requires judgement. The use of different trigger points may have a material impact upon the size of the expected credit loss provision. The group monitors the effectiveness of the multifactor approach on an ongoing basis.

Definition of default
The PD of loans and advances to customers is an important assumption to the measurement of expected credit losses and as a result the definition of default is a key judgement. Loans and advances to customers are considered defaulted when the borrower is in breach of contract, is bankrupt, or experiences other significant financial difficulties which are expected to have a detrimental impact on their ability to pay interest or principal on the loan. This includes events such as administration; insolvency; repossession of assets and voluntary termination or surrender. As a backstop, all financial assets that are 90 days past due are considered as defaulted.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

The critical accounting judgement below relates to the previous financial year under IAS 39.

Loan impairment provision
Loan impairment provisions are made if there is objective evidence of impairment as a result of one or more subsequent events regarding a significant loan or a portfolio of loans. Determining whether such objective evidence has arisen requires judgement.

Key sources of estimation uncertainty
At the balance sheet date, the directors consider that expected credit loss provisions are a key source of estimation uncertainty which, depending on a range of factors, could result in a material adjustment to the carrying amounts of assets and liabilities in the next financial year.

The critical accounting estimate below is new this financial year following the adoption of IFRS 9.

Expected credit losses
The accuracy of the expected credit loss calculation would be impacted by unanticipated changes to model assumptions which differ from actual outcomes and movements in the macroeconomic scenarios or weightings.

Forward-looking information
IFRS 9 requires the incorporation of forward-looking macroeconomic information that is reasonable and supportable. To capture the effect of changes to the economic environment, the calculation of expected credit losses incorporates forward-looking information and assumptions linked to economic variables that impact losses in each portfolio. Externally sourced forecast economic data and scenarios are used to project potential credit conditions for each portfolio. The introduction of macroeconomic information introduces additional volatility to provisions but through the cycle expectations remain unchanged.

Economic scenarios are assigned a probability weighting using a combination of quantitative analysis and expert judgement. Six different projected economic scenarios are currently considered to cover a range of possible outcomes, reflecting upside and downside relative to the baseline and forecast economic conditions. The economic scenarios are generated to capture a range of possible economic outcomes to facilitate the calculation of unbiased and probability-weighted expected credit losses.

Weighted assumptions are aligned to the forward-looking outlook. The impact varies across the group's lending businesses because of the sensitivity of each portfolio to specific macroeconomic variables.

A committee including the group and business chief executive officer, group chief risk officer, chief credit risk officer, group finance director and head of treasury meets quarterly, to review and, if appropriate, agree changes to the economic scenarios and probability weighting assigned to the economic scenario.

The table below shows the key UK economic assumptions within each of the scenarios, and the weighting applied to each at 31 July 2019. The numbers shown are an average over the five-year period from 2019 to 2023 and not necessarily representative of peak to trough movements. There has been no significant change to the group's baseline economic assumptions included in the IFRS 9 models over the course of the year. However, during the first half of the year the group reduced the weightings to the base case from 60% to 40% and the upside strong from 15% to 5% with a corresponding increase to the downside scenario weightings. The range of scenarios and weightings selected and applied continues to cover a broad range of potential outcomes, reflecting the current political and macroeconomic uncertainty in the UK.

The expected credit loss provision is sensitive to judgement and estimations made with regard to the selection and weighting of multiple macroeconomic scenarios. As a result, management has assessed and considered the sensitivity of the provision by recalculating the expected credit loss provision under the upside strong and downside protracted scenarios described below for selected portfolios, applying a 100% weighting to each scenario in turn. The change in provision is driven by the movement in PD under each scenario, and resulting impact on stage allocation as well as the measurement of the resulting provision.

Based on this analysis, application of 100% weighting to the upside strong scenario would decrease the expected credit loss by £5.0 million whilst application to the downside protracted scenario would increase the expected credit loss by £8.0 million driven by changes in PDs and stage allocation of the selected portfolios.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

This sensitivity analysis excludes expected credit loss provisions and loans and advances to customers in Stage 3 because the measurement of expected credit losses in this population is considered more sensitive to credit factors specific to the borrower than macroeconomic scenarios.

In addition to the above, the group has considered a separate LGD sensitivity to reflect the potential impact of a fall in collateral values on the Property Finance loan book. Increasing the LGD by 20% for relevant loans and advances to customers in Stages 1, 2 and 3, would result in an increase in the expected credit loss provision at 31 July 2019 of £14.9 million.

When performing sensitivity analysis there is a high degree of estimation uncertainty. On this basis 100% weighted expected credit loss provisions presented for the upside and downside scenarios and the specific Property Finance LGD sensitivity should not be taken to represent the lower or upper range of possible and actual expected credit loss outcomes. The recalculated ECL for each of the scenarios should be read in the context of the sensitivity analysis as a whole and in conjunction with the narrative disclosures provided in note 22. The modelled impact presented is based on gross loans and advances to customers at 31 July 2019, it does not incorporate future changes relating to performance, growth or credit risk.

	Baseline	**Upside (exceptionally strong)**	**Upside (Strong)**	**Downside (mild)**	**Downside (moderate)**	**Downside (protracted)**
At 31 July 2019						
UK GDP Growth	1.5%	2.4%	2.1%	1.2%	0.8%	0.3%
UK Unemployment	4.7%	3.3%	3.7%	5.3%	6.4%	7.2%
HPI Growth	1.8%	4.7%	3.7%	0.8%	(1.1%)	(0.3%)
BoE Base Rate	1.1%	1.7%	1.5%	0.6%	0.2%	0.1%
Weighting	**40%**	**0%**	**5%**	**40%**	**10%**	**5%**

	Baseline	Upside (exceptionally strong)	Upside (Strong)	Downside (mild)	Downside (moderate)	Downside (protracted)
At 31 July 2018						
UK GDP Growth	1.6%	2.6%	2.3%	1.3%	0.8%	0.3%
UK Unemployment	4.9%	3.4%	3.9%	5.6%	6.6%	7.4%
HPI Growth	2.1%	5.1%	4.1%	1.1%	(1.0%)	(2.7%)
BoE Base Rate	1.3%	1.7%	1.4%	0.6%	0.2%	0.1%
Weighting	60%	0%	15%	20%	5%	0%

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

1. **Accounting policies** *continued*

The critical accounting estimate below relates to the previous financial year under IAS 39.

Loan impairment provision
At the balance sheet date, the directors consider that loan impairment provisions are a key source of estimation uncertainty which, depending on a range of factors such as changes in the economic environment in the UK, could result in a material adjustment to the carrying amounts of assets and liabilities in the next financial year.

Loan impairment provisions represent management's estimate of the losses incurred in the loan portfolios at the balance sheet date. Individual impairment losses are determined as the difference between the carrying value and the present value of estimated future cash flows, discounted at the loans' original effective interest rate. Impairment losses determined on a portfolio basis are calculated using a formulaic approach which allocates a loss rate dependent on the overdue period. Loss rates are based on the discounted expected future cash flows and are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Estimating the amount and timing of future recoveries involves significant judgement, and considers the level of arrears as well as the assessment of matters such as future economic conditions and the value of collateral. At 31 July 2018, gross impaired loans were £131.0 million against which a £39.1 million provision was recorded. A 10% increase or decrease in expected future recoveries in respect of these impaired loans would decrease or increase provisions respectively by £9.2 million.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

2. Segmental Analysis

The directors manage the group by class of business and we present the segmental analysis on that basis. The group's activities are presented in three (2018: three) operating segments:

- Retail provides intermediated finance, principally to individuals, through motor dealers and insurance brokers
- Commercial, which focuses on providing specialist, secured lending to the SME market
- Property is primarily focused on providing specialist residential development finance to well established professional developers in the UK

Divisions continue to charge market prices for the limited services rendered to other parts of the group. Funding charges between segments take into account commercial demands. More than 90% of all the group's activities, revenue and assets are located in the UK.

	Retail £ million	Commercial £ million	Property £ million	Total £ million
Summary Income Statement for the year ended 31 July 2019				
Net interest income	200.7	177.6	130.3	508.6
Non-interest income	23.4	73.2	(0.3)	96.3
Operating income	224.1	250.8	130.0	604.9
Administrative expenses	(113.9)	(128.6)	(30.2)	(272.7)
Depreciation and amortisation	(11.6)	(11.5)	(4.7)	(27.8)
Impairment losses on financial assets	(25.2)	(23.3)	0.1	(48.4)
Total operating expenses	(150.7)	(163.4)	(34.8)	(348.9)
Adjusted operating profit[1]	73.4	87.4	95.2	256.0
Amortisation of intangible assets on acquisition	(0.3)	(1.6)	-	(1.9)
Operating profit before tax from continuing operations	73.1	85.8	95.2	254.1
Operating loss before tax from discontinued operations	-	-	-	-
Operating profit before tax	73.1	85.8	95.2	254.1
External operating income	264.6	300.8	158.1	723.5
Inter segment operating expense	(40.5)	(50.0)	(28.1)	(118.6)
Segment operating income	224.1	250.8	130.0	604.9

[1] Adjusted operating profit/(loss) is stated before amortisation of intangible assets on acquisition, profit from discontinued operations and tax.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

2. Segmental Analysis *continued*

	Retail £ million	Commercial £ million	Property £ million	Total £ million
Balance Sheet information at 31 July 2019				
Loan book and operating lease assets	**2,810.7**	**3,211.7**	**1,847.6**	**7,870.0**

	Retail £ million	Commercial £ million	Property £ million	Total £ million
Other segment information for the year ended 31 July 2019				
Employees (average number) [1]	**1,048**	**1,117**	**180**	**2,345**

[1] Banking segments are inclusive of central function headcount allocation

	Retail £ million	Commercial £ million	Property £ million	Total £ million
Summary Income Statement for the year ended 31 July 2018				
Net interest income	196.1	161.1	130.0	487.2
Non-interest income	29.6	64.6	0.2	94.4
Operating income	225.7	225.7	130.2	581.6
Administrative expenses	(109.5)	(124.2)	(27.2)	(260.9)
Depreciation and amortisation	(9.7)	(8.0)	(3.9)	(21.6)
Impairment losses on financial assets	(25.2)	(17.2)	(4.3)	(46.7)
Total operating expenses	(144.4)	(149.4)	(35.4)	(329.2)
Adjusted operating profit [1]	81.3	76.3	94.8	252.4
Amortisation of intangible assets on acquisition	(0.3)	(1.6)	-	(1.9)
Operating profit before tax from continuing operations	81.0	74.7	94.8	250.5
Operating loss before tax from discontinued operations	(3.0)	-	-	(3.0)
Operating profit before tax	78.0	74.7	94.8	247.5
External operating income	265.3	270.7	154.4	690.4
Inter segment operating expense	(39.6)	(45.0)	(24.2)	(108.8)
Segment operating income	225.7	225.7	130.2	581.6

[1] Adjusted operating profit is stated before amortisation of intangible assets on acquisition, loss on discontinued operations and tax.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

2. Segmental Analysis *continued*

	Retail £ million	Commercial £ million	Property £ million	Total £ million
Balance Sheet information at 31 July 2018				
Loan book and operating lease assets	2,686.4	2,982.4	1,827.5	7,496.3

	Retail £ million	Commercial £ million	Property £ million	Total £ million
Other segment information for the year ended 31 July 2018				
Employees (average number) [1]	1,079	1,046	146	2,271

[1] Banking segments are inclusive of central function headcount allocation

3. Operating profit before tax

	2019 £ million	2018 £ million
Interest income		
Cash and balances at central banks	**6.2**	4.0
Loans and advances to banks	**0.3**	-
Loans and advances to customers	**623.1**	594.4
Other interest income	**5.4**	2.0
	635.0	600.4
Interest expense		
Deposits by banks	**(0.1)**	(0.2)
Deposits by customers	**(76.0)**	(67.8)
Borrowings	**(44.4)**	(41.5)
Interest expense from group undertakings	**(12.8)**	(9.2)
Other interest expense [1]	**6.9**	5.5
	(126.4)	(113.2)
Net interest income	**508.6**	487.2

[1] Includes (gains)/losses on derivative financial instruments at 31 July 2018.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

3. Operating profit before tax *continued*

	2019 £ million	2018 £ million
Fee and commission income	**93.6**	87.8
Fee and commission expense	**(17.1)**	(11.5)
	76.5	76.3

Fee and commission income and expense (other than amounts calculated using the effective interest rate method) on financial instruments that are not at fair value through profit and loss were £93.6 million (2018: £87.8 million) and £17.1 million (2018: £11.5 million) respectively.

	2019 £ million	2018 £ million
Other income		
Operating lease assets rental income	**64.4**	56.3
Other [1]	**9.1**	6.9
	73.5	63.2

[1] Includes (gains)/losses on derivative financial instruments at 31 July 2019.

The profit on ordinary activities before taxation is stated after charging:

	2019 £ million	2018 £ million
Administrative expenses		
Staff costs:		
Wages and salaries	**137.3**	136.9
Social security costs	**20.7**	20.8
Share-based payments	**1.8**	2.5
Pension costs	**7.0**	6.0
	166.8	166.2
Depreciation of property, plant and equipment	**8.6**	6.3
Amortisation of intangible assets	**19.2**	15.3
Other administrative expenses	**105.9**	94.7
Total administrative expenses	**300.5**	282.5

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

4. Information regarding directors

Eight directors are remunerated by other group companies and provide their services to the company on a free basis, it being impractical to allocate their remuneration. Three directors are remunerated by the company under contracts of employment. It being impractical to allocate their remuneration distinguishing between their qualifying services and their employment services, the figures shown are in respect of their employment services.

Directors' fees were £nil (2018: nil) and directors' emoluments, excluding pension contributions, were £2,295,424 (2018: £3,193,398).

The highest paid director received emoluments of £1,425,000 (2018: £1,425,000), pension contributions of £nil (2018: £nil).

Contributions paid to money purchase pension schemes, of which no directors (2018: nil) were members, amounted to £nil (2018: £nil). No director (2018: nil) was a member of a defined benefits pension scheme, and the company paid £nil (2018: £nil) to the scheme on their behalf.

Two (2018: two) directors received £1,358,000 (2018: £1,175,000) under long-term incentive schemes operated by another group company. Two (2018: two) directors exercised options under a long-term incentive scheme; the gains from these exercises amounted to £99,325 (2018: £271,123).

5. Information regarding the auditor

	2019 **£ million**	2018 £ million
Fees payable		
Audit of the company's annual accounts	**0.4**	0.7
Audit of the company's subsidiaries pursuant to legislation	**0.5**	0.5
Audit related services	**0.1**	-
Other services	**0.1**	-
	1.1	1.2

The auditor of the group was PricewaterhouseCoopers LLP (2018: PricewaterhouseCoopers LLP).

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

6. Taxation

	2019 £ million	2018 £ million
Tax charged/(credited) to the income statement		
Current tax:		
UK corporation tax	**57.7**	58.3
Foreign tax	**1.3**	1.6
Adjustments in respect of previous tax years	**(0.7)**	(2.2)
	58.3	57.7
Deferred tax:		
Deferred tax charge for the current year	**4.0**	2.4
Adjustments in respect of previous years	**1.0**	1.7
	5.0	4.1
Tax charge	**63.3**	61.8
Tax on items not charged/(credited) to the income statement		
Current tax relating to:		
Share-based transactions tax allowance in excess of expense recognised	**(0.1)**	(0.2)
Deferred tax relating to:		
Cash flow hedging	**(1.5)**	1.1
Financial instruments classified as available for sale	**(0.1)**	0.3
Share-based transactions tax allowance in excess of expense recognised	**0.4**	(0.2)
Currency translation losses	**0.4**	-
Acquisitions	**0.2**	-
	(0.7)	1.0
Reconciliation to tax expense		
UK corporation tax for the year at 19% (2018: 19.0%) on operating profit	**48.2**	47.6
Disallowable items and other permanent differences	**1.4**	1.0
Effect of different tax rates in other jurisdictions	**(0.2)**	(0.2)
Deferred tax impact of decrease/(increase) in UK corporation tax rate	**-**	(0.2)
Bank corporation tax surcharge	**13.6**	14.1
Prior year tax provision	**0.3**	(0.5)
	63.3	61.8

The standard UK corporation tax rate for the financial year is 19.0% (2018: 19.0%). However, an additional 8% surcharge applies to banking company profits as defined in legislation. The effective tax rate of 24.9% (2018: 24.6%) is above the UK corporation tax rate primarily due to the surcharge applying to most of the group's profits.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

6. Taxation *continued*

Movements in deferred tax assets and liabilities were as follows:

	Capital allowance £ million	Share-based payments and deferred compensation £ million	Available for sale assets £ million	Cash flow hedging £ million	Intangible assets £ million	Impairment losses £ million	Total £ million
At 1 August 2017	41.4	3.7	-	1.1	(2.8)	0.7	44.1
(Charge)/credit to the income statement	(4.1)	(0.2)	-	-	0.3	(0.1)	(4.1)
(Charge)/credit to other comprehensive income	-	-	(0.3)	(1.1)	-	-	(1.4)
Credit to equity	-	0.2	-	-	-	-	0.2
Acquisition	-	-	-	-	-	-	-
At 31 July 2018	37.3	3.7	(0.3)	-	(2.5)	0.6	38.8
IFRS 9 transition (note 27)	-	-	-	-	-	14.1	14.1
At 1 August 2018	37.3	3.7	(0.3)	-	(2.5)	14.7	52.9
(Charge)/credit to the income statement	(3.4)	(0.2)	-	-	0.3	(1.7)	(5.0)
(Charge)/credit to other comprehensive income	(0.4)	-	0.1	1.5	-	-	1.2
Credit to equity	-	(0.4)	-	-	-	-	(0.4)
Acquisition	-	-	-	-	(0.2)	-	(0.2)
At 31 July 2019	**33.5**	**3.1**	**(0.2)**	**1.5**	**(2.4)**	**13.0**	**48.5**

As the group has been and is expected to continue to be consistently profitable, the full deferred tax assets have been recognised.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

7. Discontinued operations and non-current assets held for sale

On 1 January 2019, the group completed the sale of Close Brothers Retail Finance, which provides unsecured retail point of sale finance to consumers, to Klarna Bank AB. The transaction fulfilled the requirements of IFRS 5 to be classified as "discontinued operations" in the consolidated income statement.

The net assets of Close Brothers Retail Finance on 1 January 2019, the date of disposal, was £80.9 million, comprising largely of loans and advances to customers. In the 31 July 2018 consolidated balance sheet, net assets of £66.9 million relating to Close Brothers Retail Finance were presented as "held for sale". No impairment has been recognised in relation to these net assets.

Results of discontinued operations

	2019 £ million	2018 £ million
Operating income	**3.7**	6.6
Operating expenses	**(4.2)**	(7.2)
Impairment losses on loans and advances	**(1.6)**	(2.3)
Operating loss before tax	**(2.1)**	(2.9)
Tax	**0.5**	0.8
Impairment of plant, property and equipment and intangible assets	**-**	(0.1)
Loss after tax	**(1.6)**	(2.2)
Profit on disposal of discontinued operations, net of tax	**2.7**	-
Profit/(loss) from discontinued operations	**1.1**	(2.2)

Assets and liabilities held for sale

The major classes of assets and liabilities classified as held for sale are as follows:

	2019 £ million	2018 £ million
Balance Sheet		
Intangible assets	-	0.9
Loans and advances to customers	-	66.2
Other assets	-	0.4
Total assets classified as held for sale	-	67.5
Other liabilities	-	0.6
Total liabilities classified as held for sale	-	0.6

Cash flow from discontinued operations

	2019 £ million	2018 £ million
Net cash flow from operating activities	**(16.1)**	(31.9)
Net cash flow from investing activities	**(0.3)**	(0.4)

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

8. Dividends

	2019 £ million	2018 £ million
For each ordinary share the company paid		
Final dividend for prior financial year paid in September 2018: 28p (2018: 0p)	**34.1**	-
Interim dividend for current financial year paid in April 2019: 37p (2018: 24p)	**45.8**	30.0
Deemed distribution	**2.3**	1.1
	82.2	31.1

A final dividend relating to the year ended 31 July 2019 of 43p, amounting to an estimated £52.3 million, is proposed. This final dividend, which is due to be paid on 8 November 2019 to shareholders, is not reflected in these financial statements.

9. Loans and advances to banks

	On demand £ million	Within three months £ million	Between three months and one year £ million	Between one and two years £ million	Between two and five years £ million	Total £ million
At 31 July 2019	**44.0**	**0.4**	**1.9**	**10.3**	**2.9**	**59.5**
At 31 July 2018	59.7	0.5	9.2	2.5	2.5	74.4

10. Loans and advances to customers

	On demand £ million	Within three months £ million	Between three months and one year £ million	Between one and two years £ million	Between two and five years £ million	After more than five years £ million	Impairment provisions £ million	Total £ million
At 31 July 2019	**80.7**	**2,288.8**	**2,381.0**	**1,332.0**	**1,556.3**	**115.1**	**(104.3)**	**7,649.6**
At 1 August 2018	77.3	2,135.8	2,301.1	1,324.3	1,402.3	95.8	(97.3)	7,239.3
At 31 July 2018	77.3	2,135.8	2,301.1	1,324.3	1,402.3	95.8	(39.1)	7,297.5

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

10. Loans and advances to customers *continued*

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
Impairment provisions on loans and advances to customers				
At 31 July 2018				39.1
IFRS 9 transition (note 27)				58.2
At 1 August 2018	23.7	24.8	48.8	97.3
New financial assets originated	26.5	-	-	26.5
Transfers to Stage 1	1.0	(4.4)	(0.4)	(3.8)
Transfers to Stage 2	(6.4)	20.8	(0.2)	14.2
Transfers to Stage 3	(2.1)	(4.7)	48.2	41.4
Net remeasurement of expected credit losses arising from transfers between stages and repayments	(7.5)	11.7	47.6	51.8
Final repayments and repayments while stage remained unchanged	(17.5)	(7.5)	(11.4)	(36.4)
Changes to model methodologies	-	-	(0.3)	(0.3)
Charge to the income statement	1.5	4.2	35.9	41.6
Write offs	(0.3)	(1.9)	(32.4)	(34.6)
At 31 July 2019	**24.9**	**27.1**	**52.3**	**104.3**

	2019 £ million
Impairment losses relating to loans and advances to customers	
Charge to income statement arising from movement in impairment provision	**41.6**
Amounts written off directly to income statement, net of recoveries and other costs	**5.8**
	47.4
Impairment losses relating to other financial assets	**1.0**
Impairment losses on financial assets recognised in the income statement	**48.4**

The contractual amount outstanding at 31 July 2019 on financial assets that were written off during the period and are still subject to enforcement activity is £12.7 million.

	2018 £ million
Impairment provisions on loans and advances to customers	
At 1 August	52.4
Charge for the year	46.7
Amounts written off net of recoveries	(60.0)
At 31 July	39.1

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

10. Loans and advances to customers *continued*

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
Gross loans and advances to customers				
At 1 August 2018	6,479.2	597.3	260.1	7,336.6
New financial assets originated and further lending	5,856.4	-	-	5,856.4
Transfers to Stage 1	204.6	(195.3)	(65.1)	(55.8)
Transfers to Stage 2	(918.4)	791.5	(11.3)	(138.2)
Transfers to Stage 3	(249.9)	(126.7)	315.4	(61.2)
Net transfers between stages and repayments	(963.7)	469.5	239.0	(255.2)
Final repayments and repayments while stage remained unchanged	(4,573.0)	(369.3)	(134.8)	(5,077.1)
Changes to model methodologies	86.5	23.0	(109.5)	-
Write offs	(21.4)	(16.8)	(68.6)	(106.8)
At 31 July 2019	**6,864.0**	**703.7**	**186.2**	**7,753.9**

Loans and advances to customers in Stages 2 and 3 with a gross carrying amount of £275.0 million prior to modification were modified during the year. No material gain or loss was recognised as a result of those modifications. The gross carrying amount at 31 July 2019 of modified loans and advances to customers which transferred from Stage 2 or 3 to Stage 1 during the year was £55.4 million.

	2019 £ million	2018 £ million
Loans and advances to customers comprise		
Hire purchase agreement receivables	**2,927.6**	2,852.4
Finance lease receivables	**453.1**	447.6
Other loans and advances	**4,268.9**	3,997.5
At 31 July	**7,649.6**	7,297.5

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

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10. Loans and advances to customers *continued*

The following table shows a reconciliation between gross investment in finance lease and hire purchase agreement receivables to present value of minimum lease and hire purchase payments:

	2019 £ million	2018 £ million
Gross investment in finance leases and hire purchase agreement receivables due:		
Within one year	**1,408.2**	1,387.5
Between one and five years	**2,493.6**	2,372.1
After more than five years	**73.3**	66.0
	3,975.1	3,825.6
Unearned finance income	**(531.0)**	(513.3)
	3,444.1	3,312.3
Present value of minimum lease and hire purchase agreement payments:		
Of which due:		
Within one year	**1,218.9**	1,202.1
Between one and five years	**2,165.2**	2,058.1
After more than five years	**60.0**	52.1
	3,444.1	3,312.3

The aggregate cost of assets acquired for the purpose of letting under finance leases and hire purchase agreements was £6,060.4 million (2018: £5,978.8 million). The average effective interest rate on finance leases approximates to 9.4% (2018: 9.6%). The present value of minimum lease and hire purchase agreement payments reflects the fair value of finance lease and hire purchase agreement receivables before deduction of impairment provisions.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

10. Loans and advances to customers *continued*

Gross loans and advances to customers by stage and the corresponding impairment provisions and provision coverage ratios are set out below:

	Stage 1	Stage 2 Less than 30 days past due	Stage 2 Greater than or equal to 30 days past due	Total	Stage 3	Total
	£ million	£ million	£ million	£ million	£ million	£ million
At 31 July 2019						
Gross loans and advances to customers						
Commercial	2,647.7	293.1	17.6	310.7	84.7	3,043.1
Retail	2,577.1	239.3	4.9	244.2	26.5	2,847.8
Property	1,639.2	43.2	105.6	148.8	75.0	1,863.0
Total	6,864.0	575.6	128.1	703.7	186.2	7,753.9
Impairment provisions						
Commercial	12.5	10.8	1.1	11.9	27.4	51.8
Retail	10.4	11.2	0.5	11.7	15.0	37.1
Property	2.0	1.9	1.6	3.5	9.9	15.4
Total	24.9	23.9	3.2	27.1	52.3	104.3
Provision coverage ratio						
Commercial	0.5%	3.7%	6.3%	3.8%	32.3%	1.7%
Retail	0.4%	4.7%	10.2%	4.8%	56.6%	1.3%
Property	0.1%	4.4%	1.5%	2.4%	13.2%	0.8%
Total	0.4%	4.2%	2.5%	3.9%	28.1%	1.3%

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

10. Loans and advances to customers *continued*

		Stage 2				
	Stage 1	Less than 30 days past due	Greater than or equal to 30 days past due	Total	Stage 3	Total
	£ million	£ million	£ million	£ million	£ million	£ million
At 1 August 2018						
Gross loans and advances to customers						
Commercial	2,452.4	246.1	16.8	262.9	81.2	2,796.5
Retail	2,452.1	224.9	4.3	229.2	24.0	2,705.3
Property	1,574.7	58.9	46.3	105.2	154.9	1,834.8
Total	6,479.2	529.9	67.4	597.3	260.1	7,336.6
Impairment provisions						
Commercial	11.8	10.5	1.1	11.6	25.7	49.1
Retail	10.0	10.1	0.4	10.5	14.2	34.7
Property	1.9	2.4	0.3	2.7	8.9	13.5
Total	23.7	23.0	1.8	24.8	48.8	97.3
Provision coverage ratio						
Commercial	0.5%	4.3%	6.5%	4.4%	31.7%	1.8%
Retail	0.4%	4.5%	9.3%	4.6%	59.2%	1.3%
Property	0.1%	4.1%	0.6%	2.6%	5.7%	0.7%
Total	0.4%	4.3%	2.7%	4.2%	18.8%	1.3%

Increases in Stage 1 loans and advances to customers and expected credit loss provisions have primarily been driven by financial assets originated and further lending to customers. Total expected credit loss provisions as a percentage of loans and customers ("the provision coverage ratio") remained flat at 0.4%.

Stage 2 loans and advances to customers increased by £106.4 million to £703.7 million (1 August 2018: £597.3 million) across all segments, primarily due to significant increase in credit risk indicators and the 30 days past due backstop being triggered. Stage 2 expected credit loss provisions as a percentage of loans and advances to customers reduced marginally to 3.9% (1 August 2018: 4.2%) reflecting the change in composition of loans.

Stage 3 loans and advances to customers decreased by £73.9 million to £186.2 million (1 August 2018: £260.1 million). These movements were primarily due to the Property segment, where refinements have been made to the definition of default for the segment causing fewer loans to be categorised as Stage 3 and transferred to Stages 1 and 2 at 31 July 2019. This definition change incorporated updates to the payment allocation method used to define the days past due of a loan and the cure period used for default. This has resulted in an increase to the Stage 3 provision coverage ratio to 28.1% (1 August 2018: 18.8%).

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

11. Debt securities

	Fair value through other comprehensive income	Amortised cost	Total
	£ million	£ million	£ million
Certificates of deposit	-	240.7	240.7
Sovereign and central bank debt	48.3	-	48.3
At 31 July 2019	**48.3**	**240.7**	**289.0**

	Available for sale assets	Loans and receivables	Total
	£ million	£ million	£ million
Certificates of deposit	-	250.5	250.5
Sovereign and central bank debt	44.5	-	44.5
At 31 July 2018	44.5	250.5	295.0

Movements on the book value of sovereign and central bank debt comprise:

	2019	2018
	£ million	£ million
Sovereign and central bank debt at 1 August	**44.5**	43.6
Currency translation differences	**1.0**	0.2
Changes in fair value	**2.8**	0.7
Sovereign and central bank debt at 31 July	**48.3**	44.5

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

12. Derivative financial instruments

The group enters into derivative contracts with a number of financial institutions to minimise the impact of interest and currency rate changes to its financial instruments. The group's total derivative asset and liability position as reported on the consolidated balance sheet is as follows:

	31 July 2019			31 July 2018		
	Notional £ million	**Assets £ million**	**Liabilities £ million**	Notional £ million	Assets £ million	Liabilities £ million
Exchange rate contracts	**242.1**	**1.2**	**5.5**	100.5	0.1	0.7
Interest rate contracts	**2,834.0**	**28.9**	**15.0**	3,530.3	16.5	15.0
	3,076.1	**30.1**	**20.5**	3,630.8	16.6	15.7

Notional amounts of interest rate contracts totalling £2,282.7 million (2018: £2,781.4 million) have a residual maturity of more than one year.

Included in the derivatives above are the following cash flow and fair value hedges:

	31 July 2019			31 July 2018		
	Notional £ million	**Assets £ million**	**Liabilities £ million**	Notional £ million	Assets £ million	Liabilities £ million
Cash flow hedges						
Interest rate contracts	**735.7**	**0.2**	**6.1**	719.9	1.4	1.3
Fair value hedges						
Interest rate contracts	**1,251.1**	**27.6**	**5.5**	1,202.3	14.1	12.1

The group generally enters into fair value hedges and cash flow hedges with changes in the relevant benchmark interest rate risk being the predominant hedged risk.

The fair value hedges seek to hedge the exposure to changes in the fair value of recognised assets and liabilities or firm commitments attributable to interest rate risk. Changes in interest rate risk are considered the largest component of the overall change in fair value. Other risks such as credit risk are managed but excluded from the hedge accounting relationship. The interest rate risk component is the change in fair value of the fixed rate hedging items arising solely from changes in the benchmark interest rate.

Cash flow hedges seek to hedge the exposure to variability in future cash flows due to movements in the relevant benchmark interest rate with interest rate swaps. These future cash flows relate to future interest payments or receipts on recognised financial instruments and on forecast transactions for periods of up to seven (2018: eight) years. The group applies portfolio cash flow hedging for interest rate risk exposures on a portfolio of actual and forecast variable interest rate cash flows arising from variable rate borrowings.

Certain items which are economically hedged may be ineligible for hedge accounting in accordance with IAS 39. Therefore, a portfolio of floating rate liabilities have been designated as eligible hedged items in the cash flow hedge portfolio. The amounts and timing of future cash flows are projected on the basis of their contractual and forecast terms and other relevant factors. The exposure from this portfolio frequently changes due to new facilities being originated, contractual repayments and new interest rate swaps added to the portfolio.

To assess hedge effectiveness the change in fair value or cash flows of the hedging instruments is compared with the change in fair value or cash flows of the hedged item attributable to the hedged risk. A hedge is considered highly effective if the results are within a ratio of 80%-125%.

The main sources of hedge ineffectiveness can include, but are not limited to, differences in the discount rates and cash flow timing differences between the hedged item and the hedging instrument.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

12. Derivative financial instruments *continued*

The maturity profile for the notional amounts of the group's fair value hedges is set out below.

	On demand	Within three months	Between three and six months	Between six months and one year	Between one and five years	After more than five years	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
Fair value hedges							
Interest rate risk	-	-	-	62.0	826.6	362.5	1,251.1

Fair value hedges are an average fixed rate of 2.8%.

Details of the hedging instruments for the group's hedge effectiveness assessment are set out below:

	Changes in fair value of hedging instrument used for calculating hedge ineffectiveness 2019	Hedge ineffectiveness recognised in income statement 2019
	£ million	£ million
Cash flow hedges		
Interest rate risk	(6.1)	-
Fair value hedges		
Interest rate risk	19.9	0.2

The carrying amount of hedging interest rate swaps is held within derivative financial instruments and the hedge ineffectiveness is held within other income.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

12. Derivative financial instruments *continued*

Details of the hedged exposures covered by the group's hedging strategies are set out below:

	Carrying amount of hedged item	Accumulated amount of fair value adjustments on the hedged item	Changes in fair value of hedged item used for calculating hedge ineffectiveness
	£ million	£ million	£ million
At 31 July 2019			
Fair value hedges			
Assets			
Debt securities	48.3	2.8	2.9
Loans and advances to customers and undrawn commitments	25.5	2.4	2.4
	73.8	5.2	5.3
Liabilities			
Deposits by customers	240.5	2.0	(1.6)
Debt securities in issue	609.5	16.9	(16.6)
Amounts due on group undertakings	143.3	3.8	(3.5)
Subordinated loan capital	175.1	0.9	(3.3)
	1,168.4	23.6	(25.0)

Details of the impact of hedging relationships on the income statement and other comprehensive income are set out below:

	Changes in fair value of hedged item used for calculating hedge ineffectiveness	Gains/(losses) from changes in value of hedging instrument recognised in other comprehensive income	Amounts reclassified from reserves to income statement[1] Hedged cash flows will no longer occur
	£ million	£ million	£ million
At 31 July 2019			
Cash flow hedges			
Interest rate risk	6.1	(6.1)	0.1

[1] Amounts have been reclassified to other income

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

13. Intangibles assets

	Goodwill £ million	Software £ million	Intangible assets on acquisition £ million	Total £ million
Cost				
At 1 August 2017	25.4	109.4	23.2	158.0
Additions	-	35.3	-	35.3
Disposals	-	(7.1)	-	(7.1)
At 31 July 2018	25.4	137.6	23.2	186.2
Additions	0.2	47.1	0.6	47.9
Disposals	-	(7.1)	-	(7.1)
At 31 July 2019	**25.6**	**177.6**	**23.8**	**227.0**
Accumulated amortisation				
At 1 August 2017	-	58.0	5.0	63.0
Charge for the year	-	15.3	1.9	17.2
Disposals	-	(4.4)	-	(4.4)
At 31 July 2018	-	68.9	6.9	75.8
Charge for the year	-	19.2	1.9	21.1
Disposals	-	(2.7)	-	(2.7)
At 31 July 2019	**-**	**85.4**	**8.8**	**94.2**
Net book value at 31 July 2019	**25.6**	**92.2**	**15.0**	**132.8**
Net book value at 31 July 2018	25.4	68.7	16.3	110.4
Net book value at 1 August 2017	25.4	51.4	18.2	95.0

Intangible assets on acquisition relate to broker and customer relationships and are amortised over a period of 8 to 20 years.

In the 2019 financial year, £1.9 million (2018: £1.9 million) of the amortisation charge is included in amortisation of intangible assets on acquisition and £19.2 million (2018: £15.3 million) of the amortisation charge is included in administrative expenses shown in the consolidated income statement.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

13. Intangibles assets *continued*

Impairment tests for goodwill

At 31 July 2019, goodwill has been allocated to seven individual cash generating units ("CGU") of which three are within Commercial, two within Retail and two within Property. Goodwill impairment reviews are carried out annually by assessing the recoverable amount of the group's CGUs, which is the higher of fair value less costs to sell and value in use. The recoverable amounts for all CGUs were measured based on value in use.

A value in use calculation uses discounted cash flow projections based on the most recent board approved three year plans to determine the recoverable amount of each CGU. The key assumptions underlying management's three year plans, which are based on past experience and forecast market conditions, are expected loan book growth rates and net return on loan book.

For cash flows beyond the group's three year planning horizon, a terminal value was calculated using a prudent annual growth rate of 0% (2018: 0%). The cash flows are discounted using a pre-tax estimated weighted average cost of capital that reflects current market rates appropriate to the CGU as set out in the following below.

At 31 July 2019, the results of the review indicate there is no goodwill impairment. The inputs used in the value in use calculations are sensitive, primarily to the impact of changes in the assumptions for future cash flows, discount rates, and long-term growth rates. Having performed stress tested value in use calculations' the group believes that any reasonably possible change in the key assumptions which have been used would not lead the carrying value of any CGU to exceed its recoverable amount.

Details of the CGUs in which the goodwill carrying amount is significant in comparison with total goodwill, together with the pre-tax discount rate used in determining value in use, are disclosed separately in the table below:

	31 July 2019		31 July 2018	
Cash generating unit	**Goodwill £ million**	**Pre-tax discount rate %**	Goodwill £ million	Pre-tax discount rate %
Asset Finance	**5.6**	**11.3**	5.4	11.3
Commercial Acceptances	**3.5**	**10.2**	3.5	10.2
Novitas	**12.1**	**10.2**	12.1	10.2
Other	**4.4**	**10.2-11.3**	4.4	10.2-11.3
	25.6		25.4	

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

14. Property, plant and equipment

	Short leasehold property £ million	Fixtures, fittings and equipment £ million	Assets held under operating lease £ million	Motor vehicles £ million	Total £ million
Cost					
At 1 August 2017	11.8	29.1	230.8	0.3	272.0
Additions	0.2	9.9	79.6	-	89.7
Disposals	(0.3)	(0.5)	(41.5)	(0.2)	(42.5)
At 31 July 2018	11.7	38.5	268.9	0.1	319.2
Additions	4.8	5.2	72.9	-	82.9
Disposals	(0.7)	(1.7)	(27.7)	-	(30.1)
At 31 July 2019	**15.8**	**42.0**	**314.1**	**0.1**	**372.0**
Accumulated depreciation					
At 1 August 2017	4.1	19.1	52.9	0.2	76.3
Charge for the year	1.4	4.9	31.3	-	37.6
Disposals	(0.3)	(0.2)	(14.1)	(0.1)	(14.7)
At 31 July 2018	5.2	23.8	70.1	0.1	99.2
Charge for the year	2.0	6.6	36.1	-	44.7
Disposals	(0.7)	(1.3)	(12.5)	-	(14.5)
At 31 July 2019	**6.5**	**29.1**	**93.7**	**0.1**	**129.4**
Net book value at 31 July 2019	**9.3**	**12.9**	**220.4**	**-**	**242.6**
Net book value at 31 July 2018	6.5	14.7	198.8	-	220.0
Net book value at 1 August 2017	7.7	10.0	177.9	0.1	195.7

The gain from the sale of assets held under operating leases for the year ended 31 July 2019 was £0.3 million (2018: £0.1 million gain).

	31 July 2019 £ million	31 July 2018 £ million
Future minimum lease rentals receivable under non-cancellable operating leases		
Within one year	**42.0**	38.0
Between one and five years	**65.7**	58.3
After more than five years	**0.6**	0.8
	108.3	97.1

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

15. Other assets and liabilities

	31 July 2019 £ million	31 July 2018 £ million
Prepayments, accrued income and other assets		
Prepayments and accrued income	**122.8**	119.0
Trade and other receivables	**17.5**	15.2
Amounts owed by parent undertaking	**11.9**	0.7
	152.2	134.9
Accruals, deferred income and other liabilities		
Accruals and deferred income	**93.7**	87.0
Trade and other payables	**38.3**	42.9
Provisions	**7.1**	8.9
	139.1	138.8

Provisions movements in the year:

	Property £ million	Other £ million	Total £ million
Movements during the year:			
At 1 August 2017	3.6	5.6	9.2
Additions	0.4	0.4	0.8
Utilised	-	(0.3)	(0.3)
Released	(0.1)	(0.7)	(0.8)
At 31 July 2018	3.9	5.0	8.9
Additions	0.9	2.2	3.1
Utilised	-	(3.0)	(3.0)
Released	(1.4)	(0.5)	(1.9)
At 31 July 2019	**3.4**	**3.7**	**7.1**

Claims and other items for which provisions are made arise in the normal course of business and include those related to employee benefits. The timing and outcome of these claims and other items are uncertain. Property provisions are in respect of leaseholds where rents payable exceed the value to the group, potential dilapidations and onerous leases. These property provisions will be utilised and released over the remaining lives of the leases which range from one to nine years.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

16. Financial liabilities

	On demand	Within three months	Between three months and one year	Between one and two years	Between two and five years	After more than five years	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
At 31 July 2019							
Deposits by banks	**12.5**	**15.7**	**29.8**	**-**	**-**	**-**	**58.0**
Deposits by customers	**78.3**	**1,232.7**	**2,817.9**	**1,157.2**	**352.3**	**-**	**5,638.4**
Bank loans and overdrafts	**16.4**	**0.3**	**-**	**213.2**	**276.8**	**-**	**506.7**
Debt securities in issue	**16.9**	**25.6**	**143.6**	**937.8**	**210.9**	**271.1**	**1,605.9**
	124.1	**1,274.3**	**2,991.3**	**2,308.2**	**840.0**	**271.1**	**7,809.0**

	On demand	Within three months	Between three months and one year	Between one and two years	Between two and five years	After more than five years	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
At 31 July 2018							
Deposits by banks	7.9	16.1	31.2	-	-	-	55.2
Deposits by customers	86.5	1,275.0	2,570.6	1,142.6	422.5	-	5,497.2
Bank loans and overdrafts	3.5	0.2	-	-	495.0	-	498.7
Debt securities in issue	0.3	21.3	561.3	190.3	462.0	288.2	1,523.4
	98.2	1,312.6	3,163.1	1,332.9	1,379.5	288.2	7,574.5

As discussed in note 22(c) the group has accessed £490.0 million (31 July 2018: £495.0 million) cash under the Bank of England's Term Funding Scheme. Cash from the Term Funding Scheme and repurchase agreements is included within bank loans and overdrafts. Residual maturities of the Term Funding Scheme and repurchase agreements are as follows:

	On demand	Within three months	Between three months and one year	Between one and two years	Between two and five years	After more than five years	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
31 July 2019	**-**	**0.3**	**-**	**213.2**	**276.8**	**-**	**490.3**
31 July 2018	-	0.2	-	-	495.0	-	495.2

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

17. Amounts due to group undertakings

	31 July 2019 £ million	31 July 2018 £ million
Amounts due to ultimate parent undertaking	**324.0**	317.1

18. Subordinated loan capital

	Prepayment date at company's option	Initial interest rate (%)	31 July 2019 £ million	31 July 2018 £ million
Final maturity date				
2026	2021	7.42	**15.5**	15.5
2026	2021	7.62	**31.0**	30.9
2027	2022	4.25	**175.1**	171.5
			221.6	217.9

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

19. Share-based awards

Share-based awards have been granted under the following Close Brothers Group plc share schemes: Deferred Share Awards ("DSA"), Save As You Earn ("SAYE"), Long Term Incentive Plan ("LTIP") and Share Matching Plan ("SMP").

The table below shows the weighted average market price at the date of exercise:

	2019	2018
SAYE	1,479.6p	1,434.4p
LTIP	1,542.7p	1,446.4p
DSA	1,528.9p	1,469.2p
SMP	1,554.0p	1,448.4p

The range of exercise prices and weighted average remaining contractual life of awards and options outstanding are as follows:

	Options outstanding 2019		Options outstanding 2018	
Exercise price range	**Number outstanding**	**Weighted average remaining contractual life (years)**	Number outstanding	Weighted average remaining contractual life (years)
SAYE				
Between £9 and £10	**-**	**-**	17,167	0.8
Between £11 and £12	**397,647**	**2.1**	486,634	1.9
Between £12 and £13	**165,691**	**2.2**	100,818	3.0
LTIP				
Nil	**509,457**	**2.2**	508,171	1.5
DSA				
Nil	**468,476**	**1.8**	493,048	0.8
SMP				
Nil	**66,738**	**1.2**	145,318	2.2
Total	**1,608,009**	**2.0**	1,751,156	1.5

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

19. Share-based awards *continued*

Following a review of the Remuneration Policy ("Policy"), a new Policy was approved by shareholders at the Annual General Meeting in November 2018. Under this new Policy, DSA and LTIP were updated and SMP was discontinued while SAYE remained unchanged. The following summary information relates to the current Policy only. Please refer to CBG's Annual Report 2019 for full details of the schemes.

DSA is predominantly a mandatory deferral of a portion of the performance related annual bonus. The deferral is in the form of nil cost options and vests either fully after two years or one third per year over three years.

Performance related annual bonus in excess of 100% of salary is usually deferred.

When the options are called for, the employee is entitled to an amount in cash equal to the dividends which would have been paid on the vested shares over the period of deferral.

SAYE is open to all eligible employees on the same terms and options are granted for a fixed contract period of three or five years, at an exercise price at a discount of 20% to the mid-market price at the date of invitation to participate.

LTIP awards are made in the form of nil cost options. Awards vest after three years subject to performance conditions. On vesting, participants receive an amount in cash equal to the dividends which would have been paid on the vested shares during the period from the beginning of the performance period to the time that the participant calls for the award.

SMP was discontinued following shareholder approval. SMP awards made in previous years will vest in accordance with the terms in the previous Policy. Under this legacy scheme, participants could choose to invest up to a maximum value of 100% of base salary from their bonus into Close Brothers Group plc shares ("Invested Shares") for three years. Invested Shares, released in full on vesting, are matched with free shares ("Matching Shares"), which are subject to performance conditions. On vesting, participants receive an amount in cash equal to the dividends which would have been paid on the vested shares during the period from the beginning of the performance period to the time that the participant calls for the award.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

20. Contingent liabilities, guarantees and commitments

Contingent liabilities
Financial Services Compensation Scheme ("FSCS")
The group, by virtue of being a regulated deposit taker, contributes to the FSCS which provides compensation to customers of financial institutions in the event that an institution is unable, or is likely to be unable, to pay claims against it.

Compensation has previously been paid out by the FSCS funded by loan facilities provided by HM Treasury to FSCS in support of the FSCS's obligations to the depositors of banks declared in default. The facilities are expected to be repaid wholly from recoveries from the failed deposit-takers. In the event of a shortfall, the FSCS will recover the shortfall by raising levies on the industry. The amount of future levies payable by the group depends on a number of factors including the potential recoveries of assets by the FSCS, the group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of FSCS members.

Guarantees

	31 July 2019 £ million	31 July 2018 £ million
Guarantees and irrevocable letters of credit	**6.5**	3.1

Where the group undertakes to make a payment on behalf of its subsidiaries for guarantees issued, such as bank facilities or property leases or as irrevocable letters of credit for which an obligation to make a payment to a third party has not arisen at the reporting date, they are included in these financial statements as contingent liabilities.

Commitments
Undrawn facilities, credit lines, other commitments to lend

	31 July 2019 £ million	31 July 2018 £ million
Within one year	**1,125.6**	1,091.7
After more than one year	**-**	135.7
Total commitments	**1,125.6**	1,227.4

Operating lease commitments

Minimum operating lease payments recognised in the consolidated income statement amounted to £5.3 million (2018: £5.1 million).

The group had outstanding commitments for future minimum lease rentals payable under non-cancellable operating leases, which fall due as follows:

	31 July 2019		31 July 2018	
	Premises £ million	**Other £ million**	Premises £ million	Other £ million
Within one year	**6.8**	**2.3**	8.7	2.5
Between one and five years	**23.6**	**2.6**	23.0	3.8
More than five years	**4.5**	**-**	6.6	-
Total commitments	**34.9**	**4.9**	38.3	6.3

Other commitments
The group had contracted capital commitments relating to capital expenditure of £8.9 million (2018: £12.1 million).

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

21. Capital

The group's policy is to be well capitalised and its approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates.

The Prudential Regulation Authority ("PRA") supervises Close Brothers Limited on an individual consolidated basis as permitted under CRR article 9. The individual consolidation group does not include all subsidiary undertakings and therefore differs to the accounting consolidation group under IFRS. Further information on the consolidation basis can be found in the Close Brothers Group's Pillar 3 disclosures available on the group's website www.closebrothers.com/investor-relations/investor-information/results-reports-and-presentations.

The aim of the capital adequacy regime is to promote safety and soundness in the financial system. It is structured around three "pillars": Pillar 1 on minimum capital requirements; Pillar 2 on the supervisory review process; and Pillar 3 on market discipline. The group's Pillar 1 information is presented in the following table. Under Pillar 2, the group completes an annual self-assessment of risks known as the Internal Capital Adequacy Assessment Process ("ICAAP"). The ICAAP is reviewed by the PRA which culminates in the PRA setting a Total Capital Requirement ("TCR") that the group and its regulated subsidiaries are required to hold at all times. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that firm's capital, risk exposures and risk assessment process.

The group maintains a strong capital base to support the development of the business and to ensure the group meets the TCR and additional Capital Requirements Directive buffers at all times. As a result, the group maintains capital adequacy ratios comfortably above minimum regulatory requirements. The group complied with all of the externally imposed capital requirements to which they are subject for the years ended 31 July 2019 and 2018.

A full analysis of the composition of regulatory capital and Pillar 1 risk weighted assets ("RWAs"), and a reconciliation between equity and CET1 capital after deductions are shown below. All RWAs and capital ratios disclosed in this footnote are unaudited.

At 31 July 2019, the group's common equity tier 1 capital ratio remained broadly stable at 12.3% (1 August 2018: 12.0%; 31 July 2018: 12.0%).

Common equity tier 1 capital increased to £1,039.8 million (1 August 2018: £966.5 million; 31 July 2018: £968.5 million) primarily due to growth in profit attributable to shareholders.

Risk weighted assets increased to £8,453.6 million (1 August 2018: £8,066.1 million; 31 July 2018: £8,070.9 million) as a result of growth in credit and counterparty risk associated with the loan book. Notional risk weighted assets for operational risk also increased reflecting increased performance over recent years.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

21. Capital *continued*

The RWAs and capital ratios below are unaudited as noted in the following table.

	31 July 2019 £ million	1 August 2018 £ million	31 July 2018 £ million
Common equity tier 1 ("CET1") capital			
Called up share capital	**122.5**	122.5	122.5
Retained earnings	**1,055.3**	943.4	988.2
Other reserves recognised for common equity tier 1 capital	**(2.9)**	(1.8)	(1.8)
Deductions from common equity tier 1 capital			
Intangible assets, net of associated deferred tax liabilities	**(127.4)**	(106.2)	(106.2)
Foreseeable dividend[1]	**(52.3)**	(34.1)	(34.1)
Prudent valuation adjustment	**(0.1)**	(0.1)	(0.1)
IFRS 9 transitional arrangements[2]	**44.7**	42.8	-
CET1 capital	**1,039.8**	966.5	968.5
Tier 2 capital - subordinated debt	**197.5**	205.0	205.0
Total regulatory capital[3]	**1,237.3**	1,171.5	1,173.5
Risk weighted assets (notional)[3] - unaudited			
Credit and counterparty risk	**7,940.6**	7,579.2	7,584.0
Operational risk[4]	**485.2**	466.9	466.9
Market risk[4]	**27.8**	20.0	20.0
	8,453.6	8,066.1	8,070.9
CET1 capital ratio[3]	**12.3%**	12.0%	12.0%
Total capital ratio[3]	**14.6%**	14.5%	14.5%

[1] Under the Regulatory Technical Standard on own funds, a deduction has been recognised at 31 July 2019 for a foreseeable dividend being the proposed final dividend as set out in note 8.

[2] The group has elected to apply IFRS 9 transitional arrangements for 31 July 2019, which allow the capital impact of expected credit losses to be phased in over a five-year period.

[3] Shown after applying the IFRS9 transitional arrangements and the Capital Requirement Regulations transitional and qualifying own funds arrangements. At 31 July 2019 the fully loaded CET1 capital ratio is 11.8% and total capital ratio is 13.9% (1 August 2018: CET1 capital ratio 11.5% and total capital ratio 13.7%).

[4] Operational and market risk include a notional adjustment at 8% in order to determine notional risk weighted assets.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

21. Capital *continued*

The following table shows a reconciliation between the equity and CET1 capital after deductions:

	31 July 2019 £ million	1 August 2018 £ million	31 July 2018 £ million
Equity	**1,176.4**	1,071.8	1,116.6
Difference in equity under regulatory individual consolidation basis	**(6.9)**	(8.3)	(8.3)
Regulatory deductions from equity:			
Foreseeable dividend[1]	**(52.3)**	(34.1)	(34.1)
IFRS 9 transitional arrangements	**44.7**	42.8	-
Intangible assets, net of associated deferred tax liabilities	**(127.4)**	(106.2)	(106.2)
Prudent valuation adjustment	**(0.1)**	(0.1)	(0.1)
Other reserves not recognised for common equity tier 1 capital:			
Cash flow hedging reserve	**4.4**	(0.1)	(0.1)
Non-controlling interests	**1.0**	0.7	0.7
CET1 capital	**1,039.8**	966.5	968.5

[1] Under the Regulatory Technical Standard on own funds, a deduction has been recognised at 31 July 2019 and 31 July 2018 for a foreseeable dividend being the proposed final dividend as set out in note 8.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management

As a financial services group, financial instruments are central to the group's activities. The risks associated with financial instruments represent a significant component of the risks faced by the group and are analysed in more detail below.

The group's financial risk management objectives are summarised in the Strategic Report. Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 1.

(a) Classification

The tables below analyse the group's assets and liabilities in accordance with the categories of financial instruments in IFRS 9 at 31 July 2019 and IAS 39 at 31 July 2018.

	Derivatives designated as hedging instruments £ million	Fair value through profit or loss £ million	Fair value through other comprehensive income £ million	Amortised cost £ million	Total £ million
At 31 July 2019					
Assets					
Cash and balances at central banks	-	-	-	1,106.4	1,106.4
Loans and advances to banks	-	-	-	59.5	59.5
Loans and advances to customers	-	-	-	7,649.6	7,649.6
Amounts due to group undertakings	-	-	-	11.9	11.9
Debt securities	-	-	48.3	240.7	289.0
Derivative financial instruments	27.8	2.3	-	-	30.1
Other financial assets	-	-	-	8.9	8.9
	27.8	2.3	48.3	9,077.0	9,155.4
Liabilities					
Deposits by banks	-	-	-	58.0	58.0
Deposits by customers	-	-	-	5,638.4	5,638.4
Loans and overdrafts from banks	-	-	-	506.7	506.7
Debt securities in issue	-	-	-	1,605.9	1,605.9
Derivative financial instruments	11.6	8.9	-	-	20.5
Amounts due to group undertakings	-	-	-	324.0	324.0
Subordinated loan capital	-	-	-	221.6	221.6
Other financial liabilities	-	-	-	62.7	62.7
	11.6	8.9	-	8,417.3	8,437.8

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(a) Classification *continued*

	Held for trading £ million	Available for sale assets £ million	Loans and receivables £ million	Held at amortised cost £ million	Derivatives held for hedging £ million	Total £ million
At 31 July 2018						
Assets						
Cash and balances at central banks	-	-	1,140.4	-	-	1,140.4
Loans and advances to banks	-	-	74.4	-	-	74.4
Loans and advances to customers	-	-	7,297.5	-	-	7,297.5
Debt securities	-	44.5	250.5	-	-	295.0
Derivative financial instruments	1.1	-	-	-	15.5	16.6
Other financial assets	-	-	11.2	-	-	11.2
	1.1	44.5	8,774.0	-	15.5	8,835.1
Liabilities						
Deposits by banks	-	-	-	55.2	-	55.2
Deposits by customers	-	-	-	5,497.2	-	5,497.2
Loans and overdrafts from banks	-	-	-	498.7	-	498.7
Debt securities in issue	-	-	-	1,523.4	-	1,523.4
Derivative financial instruments	2.3	-	-	-	13.4	15.7
Amounts due to group undertakings	-	-	-	317.1	-	317.1
Subordinated loan capital	-	-	-	217.9	-	217.9
Other financial liabilities	-	-	-	67.4	-	67.4
	2.3	-	-	8,176.9	13.4	8,192.6

(b) Valuation
The fair values of the group's financial assets and liabilities are not materially different from their carrying values. The main differences are as follows:

	31 July 2019		31 July 2018	
	Fair Value £ million	**Carrying Value £ million**	Fair Value £ million	Carrying Value £ million
Subordinated loan capital	**234.1**	**221.6**	233.7	217.9
Debt securities in issue	**713.2**	**691.5**	1,544.6	1,523.4

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(b) Valuation *continued*

Valuation hierarchy
The group holds financial instruments that are measured at fair value subsequent to initial recognition. Each instrument has been categorised within one of three levels using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. These levels are based on the degree to which the fair value is observable and are defined as follows:

• Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities where prices are readily available and represent actual and regularly occurring market transactions on an arm's length basis. An active market is one in which transactions occur with sufficient frequency to provide ongoing pricing information;

• Level 2 fair value measurements are those derived from quoted prices in less active markets for identical assets or liabilities or those derived from inputs other than quoted prices that are observable for the asset or liability, either directly as prices or indirectly 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").

Investments classified as Level 1 predominantly comprise sovereign and central bank debt.

Investments classified as Level 2 predominantly comprise over-the-counter derivatives.

Investments classified as Level 3 comprise contingent consideration payable in relation to the acquisitions of subsidiaries.

The valuation of contingent consideration is determined on a discounted expected cash flow basis. The group believes that there is no reasonably possible change to the inputs used in the valuation of these positions which would have a material effect on the group's consolidated income statement.

There were no transfers between Level 1, 2 and 3 in 2019 and 2018.

The tables below show the classification of financial instruments held at fair value in the valuation hierarchy.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(b) Valuation *continued*

	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million
At 31 July 2019				
Assets				
Debt securities:				
Sovereign and central bank debt	**48.3**	**-**	**-**	**48.3**
Equity shares	**-**	**-**	**-**	**-**
Derivative financial instruments	**-**	**30.1**	**-**	**30.1**
Contingent consideration	**-**	**-**	**-**	**-**
	48.3	**30.1**	**-**	**78.4**
Liabilities				
Derivative financial instruments	**-**	**20.5**	**-**	**20.5**
Contingent consideration	**-**	**-**	**2.5**	**2.5**
	-	**20.5**	**2.5**	**23.0**

	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million
At 31 July 2018				
Assets				
Debt securities:				
Sovereign and central bank debt classified as available for sale	44.5	-	-	44.5
Derivative financial instruments	-	16.6	-	16.6
	44.5	16.6	-	61.1
Liabilities				
Derivative financial instruments	-	15.7	-	15.7
Contingent consideration		-	1.2	1.2
	-	15.7	1.2	16.9

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(b) Valuation *continued*

Movements in financial assets categorised as Level 3 were:

	Contingent Consideration £ million
At 1 August 2017	
Purchases and issues	1.2
At 31 July 2018	1.2
Total gains recognised in the consolidated income statement	0.8
Purchases and issues	0.5
At 31 July 2019	**2.5**

The losses recognised in the consolidated income statement relating to instruments held at the year end amounted to £nil (2018: £nil).

(c) Credit risk
Credit risk is the risk of a reduction in earnings and/or value, as a result of the failure of a counterparty or associated party with whom the group has contracted to meet its obligations as they fall due. Credit risk across the group mainly arises through its group lending and treasury activities.

The applies consistent and prudent lending criteria to mitigate credit risk. Its lending activities are predominantly secured across a diverse range of asset classes and are generally short term in nature with low average loan size. This ensures concentration risk is controlled in both the loan book and associated collateral.

The group has established limits for all counterparties with whom it places deposits, enters into derivative contracts or whose debt securities are held and the credit quality of the counterparties is monitored. While these amounts may be material, the counterparties are all regulated institutions with high credit ratings assigned by international credit rating agencies and fall within the large exposure limits set by regulatory requirements.

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

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*

	31 July 2019 £ million	31 July 2018[1] £ million
On balance sheet		
Cash and balances at central banks	**1,106.4**	1,140.4
Loans and advances to banks	**59.5**	74.4
Loans and advances to customers	**7,649.6**	7,297.5
Debt securities	**289.0**	295.0
Derivative financial instruments	**30.1**	16.6
Other financial assets	**8.9**	11.2
	9,143.5	8,835.1
Off balance sheet		
Undrawn commitments	**221.9**	291.0
Guarantees	**6.5**	3.1
Total maximum exposure to credit risk	**9,371.9**	9,129.2

[1] Restated to include other financial assets

Assets pledged and received as collateral
The group pledges assets for repurchase agreements and securities borrowing agreements which are generally conducted under terms that are customary to standard borrowing contracts.

At 31 July 2019, the group was a participant of the Bank of England's Term Funding Scheme. Under this scheme, asset finance loan receivables of £790.6 million (31 July 2018: £773.8 million) were positioned as collateral with the Bank of England, against which £490.0 million of cash (31 July 2018: £495.0 million) was drawn. The term of these transactions is four years from the date of each drawdown but the group may choose to repay earlier at its discretion. The risks and rewards of the loan receivables remain with the group and continue to be recognised in loans and advances to customers on the consolidated balance sheet.

The group has securitised without recourse and restrictions £1,299.0 million (31 July 2018: £1,499.3 million) of its insurance premium and motor loan receivables in return for cash and asset-backed securities in issue of £949.8 million (31 July 2018: £983.3 million). This includes £35.4 million (31 July 2018: £118.1 million) asset-backed securities in issue retained for liquidity purposes. As the group has retained exposure to substantially all the credit risk and rewards of the residual benefit of the underlying assets it continues to recognise these assets in loans and advances to customers in its consolidated balance sheet.

The majority of loans and advances to customers are secured against specific assets. The security will correspond to the type of lending as detailed in the segmental loan book analysis on page 4 of the Strategic Report. Consistent and prudent lending criteria are applied across the whole loan book with emphasis on the quality of the security provided.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*

Loans and advances to customers
Credit risk management and monitoring
The overall credit risk appetite is set by the group board. The monitoring of credit policy is the responsibility of the group's risk and compliance committees. All large loans are subject to approval by the credit committees. The Retail, Commercial and Property divisions each use credit underwriting and monitoring measures appropriate to the diverse and specialised nature of their lending.

Credit underwriting and in-life monitoring is undertaken either centrally or through regional office networks, appropriate to the diverse and specialised nature of the businesses and the size and complexity of the transaction. Underwriting authority is ultimately delegated from the Board Risk Committee and cascaded accordingly, with lending businesses approving lower risk exposures locally subject to compliance with credit policy and risk appetite.

This model is supported by central oversight and control. An independent central credit risk function provides ongoing monitoring of material credit risks through the risk assurance programme, a review of appetites and policy, and oversight/approval of large complex credit deals. This team reports through the chief credit risk officer ("CCRO") to the group chief risk Officer ("GCRO") and provides of monthly reporting to the Credit Risk Management Committee ("CRMC") and Group Risk and Compliance Committee ("GRCC"). The group has a dual approach to mitigating credit risk by:

• Lending on a secured basis with emphasis on both the customer's ability to repay and the quality of the underlying security to minimise any loss should the customer not be able to repay; and
• Applying greater scrutiny both analytically and in terms of escalation of sanctioning authority where the security collateralising a loan is less tangible, or in cases of higher loan to valuation ("LTV").

Collections and recoveries processes are designed to provide a fair, consistent and effective operation for arrears management. We seek to engage in early communication with borrowers experiencing difficulty in meeting their repayments, to obtain their commitment to maintaining or re-establishing a regular payment plan.

Forbearance
Forbearance occurs when a customer is experiencing difficulty in meeting their financial commitments and a concession is granted, by changing the terms of the financial arrangement, which would not otherwise be considered. This arrangement can be temporary or permanent depending on the customers' circumstances.

The group maintains a forbearance policy to ensure the necessary processes are in place to enable consistently fair treatment of each customer and that they are managed based on their individual circumstances. The arrangements agreed with customers will aim to create a sustainable and affordable financial position, thereby reducing the likelihood of suffering a credit loss. The forbearance policy is periodically reviewed to ensure it is still effective.

The group offers a range of assistance to support customers which vary depending on the product and the customer's status. Such concessions could involve changing the terms and conditions of a loan. The primary forbearance types granted are agreement to an extension outside forms (for example a higher loan to value or overpayment) and refinancing, which may incorporate an extension of the loan tenor and capitalisation of aarears. Other forms of forbearance (for example, moratorium; covenant waivers; rate concessions) would also be considered. The extent and type of forbearance granted reflects the predominantly secured nature of the portfolio.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*

Loans are classified as forborne at the time a customer in financial difficulty is granted a concession. Where forbearance has been granted, the customer will remain treated and recorded as forborne until the following exit conditions are met:

1. When all due payments, as per the amended contractual terms, have been made in a timely manner over a continuous repayment period (loan is considered as performing);
2. A minimum two-year probation period has passed from the date the forborne exposure was considered as performing; and
3. None of the customer's exposures with the group are more than 30 days past due at the end of the probation period.

At 31 July 2019 the gross carrying amount of exposures with forbearance measures was £174.5 million (31 July 2018: £148.6 million). All of forborne loans are captured in Stage 2 or Stage 3 for IFRS 9 and hold provisions on a lifetime basis. Total expected credit losses ("ECL") as a proportion of loans and advances which are forborne has increased to 2.3% (31 July 2018: 2.0%) due to the prudent provisioning on the portfolio.

Analysis of forborne accounts is shown in the table below:

	Gross loans and advances to customers	Forborne loans	Forborne loans as a percentage of gross loans and advances to customers	Provision on forborne loans
	£ million	£ million	£ million	£ million
31 July 2019	**7,753.6**	**174.5**	**2.3%**	**18.7**
31 July 2018	7,336.6	148.6	2.0%	8.5

The following is a breakdown of forborne loans by concession type at 31 July 2019:

	Forborne loans
	£ million
Extension outside terms	130.4
Refinancing	26.2
Moratorium	14.2
Other modifications	3.7
Total	**174.5**

Divisional credit risk
Retail is predominantly high volume secured lending with a small average loan size. Credit issues are identified early via largely automated tracking processes. Remedial actions are implemented promptly to restore customers to a performing status or recovery methods are applied to minimise potential loss.

Commercial is a combination of several specialist secured niche lending businesses with a diverse mix of loans in terms of assets financed, average loan size and LTV percentage. Credit quality is predominately assessed on an individual loan by loan basis. Collection and recovery activity is executed promptly by experts with experience in the specialised assets. This approach allows remedial action to be implemented at the appropriate time to minimise potential loss.

Property is a portfolio of higher value, low volume lending with credit quality assessed on an individual loan by loan basis. Loans are continually monitored to determine whether they are performing satisfactorily.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*

In Property and Commercial performing loans with elevated levels of credit risk may be placed on watch lists depending on the perceived severity of the credit risk.

Much of the group's lending is short term and the average loan size is small with the result that individual loans have little capacity to materially impact the group's earnings.

Credit risk reporting
The following table sets out loans and advances to customers, trade receivables and undrawn facilities by the group's internal credit risk grading:

The analysis of lending has been prepared based on the following risk categories:

Low risk: The credit risk profile of the borrower is considered acceptable with no concerns on ability to meet obligations as they fall due. Standard monitoring in place.

Medium risk: Evidence of deterioration in the credit risk profile of the borrower exists which requires increased monitoring. Potentially concerns on ability to meet obligations as they fall due.

High risk: Evidence of significant deterioration in the credit risk profile of the borrower exists which requires enhanced management. Full repayment may not be achieved with potential for loss identified.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
31 July 2019				
Loans and advances to customers				
Low	6,837.6	477.8	55.2	7,370.6
Medium	14.9	224.3	45.7	284.9
High	-	1.2	79.5	80.7
Ungraded	11.5	0.4	5.8	17.7
	6,864.0	703.7	186.2	7,753.9
Undrawn facilities				
Low	1,108.9	8.5	3.8	1,121.2
Medium	-	4.4	-	4.4
	1,108.9	12.9	3.8	1,125.6
Trade receivables				
Low	6.9	-	-	6.9
Medium	-	0.7	-	0.7
High	-	-	1.2	1.2
	6.9	0.7	1.2	8.8

Low risk and Stage 1 loans and advances to customers represent 88% of the overall balance, reflecting the strong quality of the portfolio and our conservative underwriting approach.

Low risk and Stage 2 represent 6% of loans and advances to customers, primarily reflecting early arrears cases, or agreements which have triggered a significant increase in credit risk indicator, or a 30-days past due backstop. These loans are considered to be performing and standard monitoring continues to apply.

Loans and advances to customers reflected as low risk and Stage 3 primarily relate to agreements which have triggered the 90-days past due backstop but where full repayment is expected.

Medium risk agreements account for 4% of total loans and advances to customers with the majority corresponding with Stage 2. This is primarily driven by significant increase in credit risk indicators having been triggered, warranting increased monitoring. Loans and advances to customers reflected as medium risk and Stage 3 primarily relate to agreements that have triggered the 90-days past due backstop in addition to other significant increase in credit risk triggers.

At 31 July 2018, loans and advances to customers were analysed between the following categories for credit risk under IAS 39. Following transition, these disclosures are no longer required and have been replaced with the information presented on the previous pages. They are provided for comparative purposes only.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*
(i) Neither past due nor impaired

The following table shows the ageing based on contractual maturity of loans and advances to customers split by credit assessment method which were neither past due nor impaired. £4.2 billion had a contractual maturity of less than 12 months demonstrating the short-term nature of the lending.

	31 July 2018		
	Loans and advances to customers		
	Individually assessed £ million	Collectively assessed £ million	Total £ million
Within one month	725.2	393.4	1,118.6
Between one and three months	426.5	452.8	879.3
Between three months and one year	1,177.5	1,056.2	2,233.7
Over one year	1,003.6	1,710.7	2,714.3
	3,332.8	3,613.1	6,945.9

(ii) Past due but not impaired
Under IAS 39, loans and advances to customers were classified as past due but not impaired when the customer failed to make a payment when contractually due but there was no evidence of impairment. This included loans which were individually assessed for impairment but where the value of security met the required repayments. This also included loans to customers which were past due for technical reasons.

The following table shows the ageing based on the period loans and advances to customers have been past due, split by credit assessment method, but for which no impairment provision has been raised:

	31 July 2018		
	Loans and advances to customers		
	Individually assessed £ million	Collectively assessed £ million	Total £ million
Within one month	98.3	83.5	181.8
Between one and three months	46.1	3.4	49.5
Between three months and one year	18.3	0.7	19.0
Over one year	9.4	-	9.4
	172.1	87.6	259.7

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*
(iii) Impaired

The factors considered in determining whether assets were impaired under IAS 39 are outlined in the accounting policies in note 1(j). Impaired loans and advances to customers were analysed according to whether the impairment provisions were individually or collectively assessed.

Individually assessed provisions were determined on a case by case basis, taking into account the financial condition of the customer and an estimate of potential recovery from the realisation of security. Typically this methodology was applied by the Property business and by the Invoice Finance business within Commercial.

Collectively assessed provisions were considered on a portfolio basis, to reflect the homogeneous nature of the assets. A percentage of the portfolio was considered impaired by evaluating the ageing of missed payments combined with the historical recovery rates for that particular portfolio. This methodology was predominantly applied by the Retail businesses and the Asset Finance business within Commercial.

Gross impaired loans were quoted without taking account of any collateral or security held, which could reduce the potential loss. The application of conservative LTV ratios on inception and the emphasis on the quality of the security provided are reflected in the low provision to gross impaired balance ratio ("coverage ratio") of 30%.

The following table shows gross impaired loans and advances to customers and the provision thereon split by assessment method:

	31 July 2018		
	Loans and advances to customers		
	Individually assessed £ million	Collectively assessed £ million	Total £ million
Gross impaired loans	59.4	71.6	131.0
Provisions	(17.1)	(22.0)	(39.1)
Net impaired loans	42.3	49.6	91.9

The amount of interest income accrued on impaired loans and advances to customers in 2018 was £8.2 million.

Collateral held
The group mitigates credit risk through holding collateral against loans and advances. The group has internal policies on the acceptability of specific collateral types, which define amongst other things the nature of assets accepted, loan to value and age at origination and exposure maturity. An asset valuation is undertaken as part of the loan origination process.

The principal types of collateral held by the group against loans and advances to customers in the Property and Commercial segments include residential and commercial property and charges over business assets such as equipment, inventory and accounts receivable. Within the Retail segment the group holds collateral primarily in the form of vehicles in Motor Finance and refundable insurance premiums in Premium Finance, where additional layers of protection exist through broker recourse.

The group's collateral policies have not materially changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the group since the prior period.

Analysis by LTV ratio is provided below based on the group's lending facilities to customers where the exposure at origination exceeded £1.0 million, excluding Property facilities written pre 2009. Lending below this threshold is concentrated in Retail and Commercial, as the large majority of Property loans are greater than £1.0 million. There is a broad range of LTV ratios in both Retail and Commercial below £1.0 million, with the majority falling between 70% and 100%. The value of collateral used in determining the LTV ratio is based upon data captured at loan origination, or where available, a more recent updated valuation.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(c) Credit risk *continued*
(iii) Impaired *continued*

Gross loans and advances to customers where exposure at origination exceeded £1.0 million:

	Retail £ million	Commercial £ million	Property £ million	Total £ million
LTV				
Less than 70%	**-**	**245.5**	**1,518.9**	**1,764.4**
70% to 90%	**41.6**	**577.7**	**38.0**	**657.3**
Greater than 90%	**2.6**	**226.2**	**7.6**	**236.4**
At 31 July 2019	**44.2**	**1,049.4**	**1,564.5**	**2,658.1**
LTV				
Less than 70%	-	237.3	1,529.1	1,766.4
70% to 90%	7.5	514.5	13.1	535.1
Greater than 90%	17.2	201.2	-	218.4
At 31 July 2018	24.7	953.0	1,542.2	2,519.9

Gross loans and advances to customers which are credit-impaired at 31 July 2019 and where exposure at origination exceeded £1.0 million:

	Retail £ million	Commercial £ million	Property £ million	Total £ million
LTV				
Less than 70%	**-**	**2.9**	**20.5**	**23.4**
70% to 90%	**-**	**0.5**	**3.0**	**3.5**
Greater than 90%	**2.3**	**13.0**	**-**	**15.3**
At 31 July 2019	**2.3**	**16.4**	**23.5**	**42.2**

Financial assets: Treasury assets
The credit risk presented by the group's treasury assets is low. Immaterial impairment provisions are recognised for cash and balances at central banks, certificates of deposit and sovereign and central bank debt. These financial assets are considered to be investment grade and in Stage 1.

(d) Market risk
Market risk is the risk that a change in the value of an underlying market variable such as interest or foreign exchange rates will give rise to an adverse movement in the value of the group's assets.

Interest rate risk
The group has a simple and transparent balance sheet and a low appetite for interest rate risk which is limited to that required to operate efficiently.

The group's policy is to match repricing characteristics of assets and liabilities naturally where possible or by using interest rate swaps to secure the margin on its loans and advances to customers. These interest rate swaps are disclosed in note 12.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*
(d) Market risk *continued*

The Asset and Liability Committee monitors the interest rate risk exposure across the balance sheet. There are three main sources of interest rate risk recognised, which could adversely impact future income or the value of the balance sheet:

- repricing risk occurs when assets and liabilities reprice at different times;
- embedded optionality risk occurs as a result of special conditions attached to contract terms embedded in some loans; and
- basis risk occurs where there is a mismatch in the interest rate reference rate for assets and liabilities.

The table below sets out the assessed impact on our base case earnings at risk ("EaR") due to a parallel shift in interest rates at 31 July 2019:

	2019 £ million	2018 £ million
0.5% increase	**(4.0)**	(4.9)
0.5% decrease	**5.1**	5.8

The average impact in 2019 on our base case EaR measure due to a parallel 0.5% increase or decrease in interest rates as a £4.3 million decrease and £5.2 million increase respectively.

The table below sets out the assessed impact on our base case economic value of equity ("EVE") due to a shift in interest rates at 31 July 2019:

	2019 £ million	2018 £ million
0.5% increase	**-**	0.8
0.5% decrease	**-**	(0.8)

The average impact in 2019 on our base case EVE measure due to a parallel 0.5% increase or decrease in interest rates was a £0.4 million increase and £0.4 million decrease respectively.

Foreign currency risk
The group has limited exposure to foreign currency risk which derives from equity balances of its overseas operations, which are not hedged. These balances are predominantly in euros. Foreign exchange differences which arise from the translation of these operations are recognised directly in equity.

A change in the euro exchange rate would decrease the group's equity by the following amounts:

	2019 £ million	2018 £ million
20% strengthening of sterling against the euro	**(3.4)**	(2.6)

The group has additional material currency assets and liabilities primarily as a result of treasury operations. These assets and liabilities are matched by currency, using exchange rate derivative contracts where necessary. Details of these contracts are disclosed in note 12. The group has policies and processes in place to manage foreign currency risk, and as such the impact of any reasonably expected exchange rate fluctuations would not be material.

Non-trading financial instruments
Net gains and losses on non-trading financial instruments are disclosed in note 12.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*

(e) Liquidity risk

Liquidity risk is the risk that liabilities cannot be met when they fall due or can only be met at an uneconomic price.

The group has a prudent liquidity position with funding significantly in excess of its loans and advances to customers. The group has a large portfolio of high quality liquid assets including cash placed on deposit with the Bank of England, short dated certificates of deposit and gilts. The group measures liquidity risk with a variety of measures including regular stress testing and regular cash flow monitoring, and reporting to both the group Asset and Liability Committee and Risk and Compliance Committees.

The following table details the contractual maturities of the group's on balance sheet financial liabilities on an undiscounted cash flow basis:

	On demand	Less than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
At 31 July 2019							
Financial liabilities							
Deposits by banks	**12.5**	**15.7**	**27.8**	**2.0**	**-**	**-**	**58.0**
Deposits by customers	**69.7**	**1,235.7**	**1,137.7**	**1,700.5**	**1,573.9**	**-**	**5,717.5**
Loans and overdrafts from banks	**16.4**	**0.9**	**0.9**	**1.8**	**493.9**	**-**	**513.9**
Debt securities in issue	**-**	**29.5**	**37.1**	**127.5**	**1,195.8**	**292.1**	**1,682.0**
Derivative financial instruments	**0.1**	**7.5**	**5.8**	**8.6**	**34.8**	**9.0**	**65.8**
Subordinated loan capital	**-**	**1.7**	**3.7**	**5.4**	**43.3**	**245.4**	**299.5**
Other financial liabilities	**11.6**	**46.9**	**1.3**	**1.4**	**1.5**	**-**	**62.7**
Total	**110.3**	**1,337.9**	**1,214.3**	**1,847.2**	**3,343.2**	**546.5**	**8,399.4**
At 31 July 2018							
Financial liabilities							
Deposits by banks	8.0	16.1	28.9	2.2	-	-	55.2
Deposits by customers	81.3	1,279.7	914.6	1,686.5	1,610.4	-	5,572.5
Loans and overdrafts from banks	3.5	0.6	0.6	1.2	500.1	-	506.0
Debt securities in issue	-	26.1	86.1	496.2	712.5	317.0	1,637.9
Derivative financial instruments	0.3	4.7	3.4	7.8	50.2	14.9	81.3
Subordinated loan capital	-	1.7	3.7	5.4	44.5	255.1	310.4
Other financial liabilities	11.0	50.2	2.3	0.9	3.0	-	67.4
Total	104.1	1,379.1	1,039.6	2,200.2	2,920.7	587.0	8,230.7

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

22. Financial risk management *continued*

Derivative financial instruments in the table above includes net currency swaps. The following table shows the currency swaps on a gross basis:

	On demand	In less than three months	In more than three months but not more than six months	In more than six months but not more than one year	In more than one year but not more than five years	In more than five years	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
At 31 July 2019	**5.6**	**163.3**	**88.8**	**8.6**	**34.8**	**9.0**	**310.1**
At 31 July 2018	42.1	63.5	3.4	7.8	50.2	14.9	181.9

(f) Offsetting

The following table shows the impact on derivative financial assets and liabilities which have not been offset but for which the group has enforceable master netting arrangements in place with counterparties. The net amounts show the exposure to counterparty credit risk after offsetting benefits and collateral, and are not intended to represent the group's actual exposure to credit risk.

Master netting arrangements allow outstanding transactions with the same counterparty to be offset and settled net, either unconditionally or following a default or other predetermined event. Financial collateral on derivative financial instruments consists of cash settled, typically daily, to mitigate the mark to market exposures.

	Gross amounts recognised	Master netting arrangements	Financial Collateral	Net amounts after offsetting under IFRS 7
	£ million	£ million	£ million	£ million
At 31 July 2019				
Derivative financial assets	**30.1**	**(14.9)**	**(12.4)**	**2.8**
Derivative financial liabilities	**20.5**	**(14.9)**	**(5.4)**	**0.2**

	Gross amounts recognised	Master netting arrangements	Financial Collateral	Net amounts after offsetting under IFRS 7
	£ million	£ million	£ million	£ million
At 31 July 2018				
Derivative financial assets	16.6	(8.3)	(7.7)	0.6
Derivative financial liabilities	15.7	(8.3)	(7.2)	0.2

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

23. Pensions

CBG operates defined contribution pension schemes for eligible employees as well as a defined benefit pension scheme which is closed to new members and further accrual. Assets of all schemes are held separately from those of CBG.

Defined contribution scheme

During the year the charge to the consolidated income statement for the group's defined contribution pension schemes was £7.0 million (2018: £6.0 million) representing contributions payable by the group and is included in administrative expenses.

Defined benefit pension scheme

The group's only defined benefit pension scheme ("the scheme") is a final salary scheme which operates under trust law. The scheme is managed and administered in accordance with the scheme's Trust Deed and Rules and all relevant legislation by a trustee board made up of trustees nominated by both the company and the members.

The scheme was closed to new entrants in August 1996 and closed to further accrual during 2012. At 31 July 2019 this scheme had 37 (31 July 2018: 41) deferred members and 49 (31 July 2018: 46) pensioners and dependants.

24. Related party transactions

Transactions with directors

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the group's key management are the members of the group's Board, which includes all executive directors, together with its non-executive directors.

Key management have banking and asset management relationships with the company which are entered into in the normal course of business. Amounts included in deposits by customers at 31 July 2019 attributable, in aggregate, to key management were £0.2 million (2018: £0.2 million). At 31 July 2019, a member of key management held nil (31 July 2018: 500,000) of the CBG's 4.25% subordinated loan notes.

At 31 July 2019, amounts due to group undertakings of £324.0 million (2018: £317.1 million) largely related to the group providing banking services to the parent undertaking in its normal capacity as a deposit taker.

25. Ultimate parent undertaking

The parent undertaking of the largest and smallest group of undertakings for which the group is a member is Close Brothers Group plc, the ultimate parent undertaking and controlling party which is a listed company incorporated in the United Kingdom and registered in England and Wales. The immediate parent undertaking is Close Brothers Holdings Limited, which is registered in England and Wales.

The consolidated financial statements of Close Brothers Group plc are available at 10 Crown Place, London EC2A 4FT.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

26. Consolidated cash flow statement reconciliation

	31 July 2019 £ million	31 July 2018 £ million
(a) Reconciliation of operating profit before tax to net cash inflow from operating activities		
Operating profit before tax from continuing operations	**254.1**	250.5
Profit/(loss) before tax on discontinued operations	**0.8**	(3.0)
Tax paid	**(52.2)**	(54.9)
Depreciation and amortisation	**65.8**	54.8
Increase in interest receivable and prepaid expenses	**(17.8)**	(16.8)
Decrease/(increase) in interest payable and accrued expenses	**-**	1.8
Net cash inflow from trading activities	**250.7**	232.4
Decrease/(increase) in:		
Loans and advances to banks and central banks not repayable on demand	**1.3**	6.6
Loans and advances to customers	**(416.6)**	(449.8)
Assets let under operating leases	**(62.7)**	(68.0)
Certificates of deposits	**10.0**	(70.0)
Issuance/redemption of debt securities, net of transaction costs	**-**	(0.9)
Other assets less other liabilities	**0.4**	(0.3)
Increase/(decrease) in:		
Debt securities and subordinated loan capital issued	**63.7**	45.7
Deposits by banks	**2.8**	(16.8)
Deposits by customers	**136.5**	384.1
Loans and overdrafts from banks	**8.0**	174.4
Net cash inflow/(outflow) from operating activities	**(5.9)**	237.4
(b) Analysis of net cash outflow in respect of the purchase of subsidiaries and non-controlling interests		
Cash consideration paid	**(2.7)**	-
(c) Analysis of net cash inflow in respect of the sale of discontinued operations and subsidiary		
Cash consideration received	**86.7**	-
(d) Analysis of cash and cash equivalents [1]		
Cash and balances at central banks	**1,094.9**	1,126.8
Loans and advances to banks repayable on demand	**44.0**	59.7
	1,138.9	1,186.5

[1] Excludes Bank of England cash reserve account and amounts held as collateral

During the period ended 31 July 2019, the non-cash changes on debt financing amounted to £8.7 million (31 July 2018: £1.4 million) largely arising from interest accretion and fair value hedging movements.

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

27. Implementation of IFRS 9

The group has adopted IFRS 9 Financial Instruments with effect from 1 August 2018. In accordance with the requirements of IFRS 9, comparative information has not been restated and transitional adjustments have been accounted for through retained earnings at 1 August 2018, the date of initial application.

At 1 August 2018, retained earnings decreased by £44.8 million reflecting an increase in impairment provisions of £58.9 million partly offset by an increase in deferred tax assets of £14.1 million. £58.2 million of the increase in impairment provisions relates to loans and advances to customers while the remaining £0.7 million relates to other financial assets.

This increase in impairment provisions principally reflects the additional expected credit loss on performing and underperforming loans, as well as a broader definition of default compared to IAS 39 and the addition of forward-looking macroeconomic assumptions.

Abbreviations used on following table for classification and measurement

AC - amortised cost

AFS - available for sale

FV(H) - derivatives held for hedging and carried at fair value

FVOCI - fair value through other comprehensive income

FVPL - fair value through profit and loss

HFT - held for trading

LAR - loans and receivables

NOTES TO THE CONSOLIDATED ACCOUNTS

For the year ended 31 July 2019

27. Implementation of IFRS 9 *continued*

The following table sets out the impact of IFRS 9 on the group balance sheet at 1 August 2018.

	Classification and measurement[1] IAS 39	IFRS 9	IAS 39 carrying amount 31 July 2018 £ million	IFRS 9 transitional adjustment £ million	IFRS 9 carrying amount 1 August 2018 £ million
Assets					
Cash and balances at central banks	LAR	AC	1,140.4	(0.1)	1,140.3
Loans and advances to banks	LAR	AC	74.4	(0.1)	74.3
Loans and advances to customers	LAR	AC	7,297.5	(58.2)	7,239.3
Debt securities			295.0	(0.2)	294.8
	LAR	AC	250.5	(0.2)	250.3
	AFS	FVOCI	44.5	-	44.5
Derivative financial instruments			16.6	-	16.6
	HFT	FVPL	1.1	-	1.1
	FV(H)	FV(H)	15.5	-	15.5
Intangible assets			110.4	-	110.4
Property, plant and equipment			220.0	-	220.0
Deferred tax assets			38.8	14.1	52.9
Prepayments, accrued income and other assets			134.9	(0.3)	134.6
	LAR	AC	14.2	(0.3)	13.9
	AC	AC	120.7	-	120.7
Assets classified as held for sale			67.5	-	67.5
Total assets			9,395.5	(44.8)	9,350.7
Liabilities					
Deposits by banks	AC	AC	55.2	-	55.2
Deposits by customers	AC	AC	5,497.2	-	5,497.2
Loans and overdrafts from banks	AC	AC	498.7	-	498.7
Debt securities in issue	AC	AC	1,523.4	-	1,523.4
Derivative financial instruments	FVPL	FVPL	15.7	-	15.7
Amounts due to group undertakings	AC	AC	317.1	-	317.1
Current tax liabilities	AC	AC	14.3	-	14.3
Accruals, deferred income and other liabilities			138.8	-	138.8
	AC	AC	137.6	-	137.6
	FVPL	FVPL	1.2	-	1.2
Subordinated loan capital	AC	AC	217.9	-	217.9
Liabilities classified as held for sale			0.6	-	0.6
Total liabilities			8,278.9	-	8,278.9
Total equity			1,116.6	(44.8)	1,071.8
Total liabilities and equity			9,395.5	(44.8)	9,350.7

COMPANY BALANCE SHEET

At 31 July 2019

	Note	31 July 2019 £ million	1 August 2018[1] £ million	31 July 2018 £ million
Assets				
Cash and balances at central banks		**1,106.4**	1,140.3	1,140.4
Loans and advances to banks	29	**27.0**	24.2	24.2
Loans and advances to customers	30	**5,621.3**	5,351.7	5,400.8
Amounts due from group undertakings		**2,235.2**	2,077.6	2,077.6
Debt securities	31	**289.0**	294.8	295.0
Derivative financial instruments	32	**30.1**	15.9	15.9
Investments in subsidiaries	33	**117.9**	120.9	120.9
Intangible assets	34	**93.8**	71.9	71.9
Property, plant and equipment	35	**16.1**	18.9	18.9
Deferred tax assets	28	**50.5**	54.6	42.0
Prepayments, accrued income and other assets	36	**123.4**	118.1	118.2
Assets classified as held for sale		**-**	67.5	67.5
Total assets		**9,710.7**	9,356.4	9,393.3
Liabilities				
Deposits by banks	37	**58.0**	54.5	54.5
Deposits by customers	37	**5,638.4**	5,497.2	5,497.2
Loans and overdrafts from banks	37	**503.9**	498.7	498.7
Derivative financial instruments	32	**20.3**	15.7	15.7
Amounts due to group undertakings	37	**1,946.9**	1,854.6	1,854.6
Subordinated loan capital	38	**221.6**	217.9	217.9
Current tax liabilities		**14.6**	10.7	10.7
Accruals, deferred income and other liabilities	36	**117.6**	117.2	117.2
Liabilities classified as held for sale		**-**	0.6	0.6
Total liabilities		**8,521.3**	8,267.1	8,267.1
Equity				
Called up share capital		**122.5**	122.5	122.5
Retained earnings		**1,073.4**	968.4	1,005.3
Other reserves		**(6.5)**	(1.6)	(1.6)
Total equity		**1,189.4**	1,089.3	1,126.2
Total liabilities and equity		**9,710.7**	9,356.4	9,393.3

1 See notes 1 and 42

The financial statements of Close Brothers Limited, registration number 195626, were approved and authorised for issue by the Board of Directors on 23 September 2019 and signed on its behalf by:

P. Prebensen
Chief Executive Officer

M. B. Morgan
Director

COMPANY STATEMENT OF CHANGES IN EQUITY

For the year ended 31 July 2019

			Other reserves				
	Called-up share capital*	**Retained Earnings**	**Exchange movements reserve**	**FVOCI reserve**	**Available for sale reserve**	**Cash flow hedging reserve**	**Total attributable to owners of the Company**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**
At 1 August 2017	122.5	857.0	(3.0)	-	0.4	(3.2)	973.7
Profit for the year	-	176.7	-	-	-	-	176.7
Other comprehensive income/(expense)	-	-	0.5	-	0.4	3.3	4.2
Total comprehensive income for the year	-	176.7	0.5	-	0.4	3.3	180.9
Dividends paid	-	(31.1)	-	-	-	-	(31.1)
Shares issued	-	-	-	-	-	-	-
Other movements	-	2.3	-	-	-	-	2.3
Income tax	-	0.4	-	-	-	-	0.4
At 31 July 2018	122.5	1,005.3	(2.5)	-	0.8	0.1	1,126.2
IFRS 9 transition (note 42)	-	(36.9)	-	0.8	(0.8)		(36.9)
At 1 August 2018	122.5	968.4	(2.5)	0.8	-	0.1	1,089.3
Profit for the year	-	187.5	-	-	-	-	187.5
Other comprehensive income/(expense)	-	-	(0.3)	(0.1)	-	(4.5)	(4.9)
Total comprehensive income for the year	-	187.5	(0.3)	(0.1)	-	(4.5)	182.6
Dividends paid	-	(82.2)	-	-	-	-	(82.2)
Shares issued	-	-	-	-	-	-	-
Other movements	-	(0.1)	-	-	-	-	(0.1)
Income tax	-	(0.2)	-	-	-	-	(0.2)
At 31 July 2019	**122.5**	**1,073.4**	**(2.8)**	**0.7**	-	**(4.4)**	**1,189.4**

*Allotted, called-up and fully-paid capital comprised 122,480,000 ordinary shares of £1 each (2018: 122,480,000 ordinary shares of £1 each). The company has one class of ordinary shares which carry no right to fixed income. In the event of liquidation, assets would be distributed among the holders of ordinary shares in proportion to the amounts paid up on the ordinary shares.

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

28. Deferred taxation

Movements in deferred tax assets and liabilities were as follows:

	Capital allowances £ million	Share-based payments and deferred compensation £ million	Available for sale assets £ million	Cash flow hedging £ million	Impairment losses £ million	Total £ million
At 1 August 2017	42.2	3.3	-	1.1	0.7	47.3
(Charge)/credit to the income statement	(3.8)	(0.1)	-	-	(0.2)	(4.1)
(Charge)/credit to other comprehensive income	0.1	-	(0.3)	(1.1)	-	(1.3)
Credit to equity	-	0.1	-	-	-	0.1
At 31 July 2018	38.5	3.3	(0.3)	-	0.5	42.0
IFRS 9 transition (note 42)	-	-	-	-	12.6	12.6
At 1 August 2018	38.5	3.3	(0.3)	(0.0)	13.1	54.6
(Charge)/credit to the income statement	(3.2)	(0.3)	-	-	(1.5)	(5.0)
(Charge)/credit to other comprehensive income	(0.3)	-	0.1	1.5	(0.0)	1.3
Charge to equity	-	(0.4)	-	-	-	(0.4)
At 31 July 2019	**35.0**	**2.6**	**(0.2)**	**1.5**	**11.6**	**50.5**

29. Loans and advances to banks

	On demand £ million	Within three months £ million	Between three months and one year £ million	Between one and two years £ million	Between two and five years £ million	Total £ million
At 31 July 2019	**27.0**	**-**	**-**	**-**	**-**	**27.0**
At 31 July 2018	24.2	-	-	-	-	24.2

30. Loans and advances to customers

	On demand £ million	Within three months £ million	Between three months and one year £ million	Between one and two years £ million	Between two and five years £ million	After more than five years £ million	Impairment provisions £ million	Total £ million
At 31 July 2019	**75.1**	**1,409.4**	**1,877.1**	**1,040.8**	**1,262.1**	**39.2**	**(82.4)**	**5,621.3**
At 1 August 2018	72.4	1,259.4	1,824.8	1,108.7	1,138.8	27.6	(80.0)	5,351.7
At 31 July 2018	72.4	1,259.4	1,824.8	1,108.7	1,138.8	27.6	(30.9)	5,400.8

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

30. Loans and advances to customers *continued*

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
Impairment provisions on loans and advances to customers				
At 31 July 2018				30.9
IFRS 9 transition (note 42)				49.1
At 1 August 2018	19.7	20.4	39.9	80.0
New financial assets originated	22.6	-	-	22.6
Transfers to Stage 1	0.7	(4.0)	(0.2)	(3.5)
Transfers to Stage 2	(4.9)	18.4	(0.1)	13.4
Transfers to Stage 3	(1.8)	(4.4)	38.9	32.7
Net remeasurement of expected credit losses arising from transfer between stages and repayments	(6.0)	10.0	38.6	42.6
Final repayments and repayments while stage remain unchanged	(15.8)	(5.4)	(11.8)	(33.0)
Changes to model methodologies	-	-	-	-
Charge to the income statement	0.8	4.6	26.8	32.2
Write offs	(0.2)	(1.6)	(28.0)	(29.8)
At 31 July 2019	**20.3**	**23.4**	**38.7**	**82.4**

	2019 £ million
Impairment losses relating to loans and advances to customers	
Charge to income statement arising from movement in impairment provision	**32.2**
Amounts written off directly to income statement, net of recoveries and other costs	**3.8**
	36.0
Impairment losses relating to other financial assets	**1.1**
Impairment losses on financial assets recognised in income statement	**37.1**

The contractual amount outstanding at 31 July 2019 on financial assets that were written off during the period and are still subject to enforcement activity is £12.5 million.

	2018 £ million
Impairment provisions on loans and advances to customers	
At 1 August 2017	47.4
Charge for the year	39.7
Amounts written off net of recoveries	(56.2)
At 31 July	30.9

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

30. Loans and advances to customers *continued*

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
Gross loans and advances to customers				
At 31 July 2018	4,855.8	411.4	164.5	5,431.7
New financial assets originated and further lending	4,763.0	-	-	4,763.0
Transfers to Stage 1	150.1	(150.2)	(43.4)	(43.5)
Transfers to Stage 2	(704.8)	577.0	(0.6)	(128.4)
Transfers to Stage 3	(149.6)	(77.7)	180.8	(46.5)
Net transfers between stages and repayments	(704.3)	349.1	136.8	(218.4)
Final repayments and repayments while stage remained unchanged	(3,850.6)	(254.1)	(87.0)	(4,191.7)
Changes to model methodologies	28.7	16.7	(45.4)	-
Write offs	(13.9)	(13.3)	(53.7)	(80.9)
At 31 July 2019	**5,078.7**	**509.8**	**115.2**	**5,703.7**

Loans and advances to customers in Stages 2 and 3 with a gross carrying amount of £168.0 million prior to modification were modified during the year. No material gain or loss was recognised as a result of those modifications. The gross carrying amount at 31 July 2019 of modified loans and advances to customers which transferred from Stage 2 or 3 to Stage 1 during the year was £28.0 million.

	2019 £ million	2018 £ million
Loans and advances to customers comprise		
Hire purchase agreement receivables	**2,644.6**	2,599.8
Finance lease receivables	**234.6**	243.3
Other loans and advances	**2,742.1**	2,557.7
At 31 July	**5,621.3**	5,400.8

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

30. Loans and advances to customers *continued*

The following table shows a reconciliation between gross investment in finance lease and hire purchase agreement receivables to present value of minimum lease and hire purchase payments:

	2019 £ million	2018 £ million
Gross investment in finance leases and hire purchase agreement receivables due:		
Within one year	**1,202.5**	1,183.4
Between one and five years	**2,165.4**	2,096.7
After more than five years	**37.5**	29.0
	3,405.4	3,309.1
Unearned finance income	**(467.6)**	(453.5)
	2,937.8	2,855.6
Present value of minimum lease and hire purchase agreement payments:		
Of which due:		
Within one year	**1,032.9**	1,017.5
Between one and five years	**1,872.6**	1,813.2
After more than five years	**32.3**	24.9
	2,937.8	2,855.6

The aggregate cost of assets acquired by the company for the purpose of letting under finance leases and hire purchase agreements was £5,299.4 million (2018: £5,296.4 million). The average effective interest rate on finance leases approximates to 9.8% (2018: 10.1%). The present value of minimum lease and hire purchase agreement payments reflects the fair value of finance lease and hire purchase agreement receivables before deduction of impaired provisions.

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

30. Loans and advances to customers *continued*

Gross loans and advances to customers by stage and the corresponding impairment provisions and provision coverage ratios are set out below:

		Stage 2				
	Stage 1	Less than 30 days past due	Greater than or equal to 30 days past due	Total	Stage 3	Total
At 31 July 2019	£ million	£ million	£ million	£ million	£ million	£ million
Gross loans and advances to customers						
Commercial	1,272.1	142.9	14.9	157.8	55.6	1,485.5
Retail	2,490.0	236.0	4.7	240.7	25.3	2,756.0
Property	1,316.6	32.4	78.9	111.3	34.3	1,462.2
Total	5,078.7	411.3	98.5	509.8	115.2	5,703.7
Impairment provisions						
Commercial	8.6	7.6	1.1	8.7	15.6	32.9
Retail	10.1	11.0	0.5	11.5	13.9	35.5
Property	1.6	1.7	1.5	3.2	9.2	14.0
Total	20.3	20.3	3.1	23.4	38.7	82.4
Provision coverage ratio						
Commercial	0.7%	5.3%	7.4%	5.5%	28.1%	2.2%
Retail	0.4%	4.7%	10.6%	4.8%	54.9%	1.3%
Property	0.1%	5.2%	1.9%	2.9%	26.8%	1.0%
Total	0.4%	4.9%	3.1%	4.6%	33.6%	1.4%

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

30. Loans and advances to customers *continued*

		Stage 2				
		Less than 30 days past due	Greater than or equal to 30 days past due			
	Stage 1			Total	Stage 3	Total
At 1 August 2018	£ million	£ million	£ million	£ million	£ million	£ million
Gross loans and advances to customers						
Commercial	1,209.1	109.0	15.8	124.8	66.9	1,400.8
Retail	2,372.8	216.5	4.1	220.6	22.7	2,616.1
Property	1,272.3	45.0	22.5	67.5	75.0	1,414.8
Total	4,854.2	370.5	42.4	412.9	164.6	5,431.7
Impairment provisions						
Commercial	8.4	6.7	1.2	7.9	19.3	35.6
Retail	9.7	9.7	0.4	10.1	13.2	33.0
Property	1.6	2.1	0.3	2.4	7.4	11.4
Total	19.7	18.5	1.9	20.4	39.9	80.0
Provision coverage ratio						
Commercial	0.7%	6.1%	7.6%	6.3%	28.8%	2.5%
Retail	0.4%	4.5%	9.8%	4.6%	58.1%	1.3%
Property	0.1%	4.7%	1.3%	3.6%	9.9%	0.8%
Total	0.4%	5.0%	4.5%	4.9%	24.2%	1.5%

Increases in Stage 1 loans and advances to customers and expected credit loss provisions have primarily been driven by financial assets originated and further lending to customers. Total expected credit loss provisions as a percentage of loans and customers ("the provision coverage ratio") remained flat at 0.4%.

Stage 2 loans and advances to customers increased by £96.9 million to £509.8 million (1 August 2018: £412.9 million) across all segments, primarily due to significant increase in credit risk indicators and the 30 days past due backstop being triggered. Stage 2 expected credit loss provisions as a percentage of loans and advances to customers reduced marginally to 4.6% (1 August 2018: 4.9%) reflecting the change in composition of loans.

Stage 3 loans and advances to customers decreased by £49.4 million to £115.2 million (1 August 2018: £164.6 million). These movements were primarily due to the Property segment, where refinements have been made to the definition of default for the segment causing fewer loans to be categorised as Stage 3 and transferred to Stages 1 and 2 at 31 July 2019. This definition change incorporated updates to the payment allocation method used to define the days past due of a loan and the cure period used for default. This has resulted in an increase to the Stage 3 provision coverage ratio to 33.6% (1 August 2018: 24.2%).

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

31. Debt securities

	Fair value through other comprehensive income £ million	Amortised cost £ million	Total £ million
At 31 July 2019			
Certificates of deposit	-	**240.7**	**240.7**
Sovereign and central bank debt	**48.3**	-	**48.3**
	48.3	**240.7**	**289.0**
At 31 July 2018			
Certificates of deposit	-	250.5	250.5
Sovereign and central bank debt	44.5	-	44.5
	44.5	250.5	295.0

32. Derivative financial instruments

The company enters into derivative contracts with a number of financial institutions as a principal only to minimise the impact of interest and currency rate changes to its financial instruments. The company's total derivative asset and liability position as reported on the company balance sheet is as follows:

	31 July 2019			31 July 2018		
	Notional £ million	**Assets £ million**	**Liabilities £ million**	Notional £ million	Assets £ million	Liabilities £ million
Exchange rate contracts	**242.1**	**1.2**	**5.5**	100.5	0.1	0.7
Interest rate contracts	**2,683.5**	**28.9**	**14.8**	2,947.1	15.8	15.0
	2,925.6	**30.1**	**20.3**	3,047.6	15.9	15.7

Notional amounts of interest rate contracts totalling £2,236.5 million (2018: £2,415.7 million) have a residual maturity of more than one year.

Included in the derivatives above are the following cash flow and fair value hedges:

	31 July 2019			31 July 2018		
	Notional £ million	**Assets £ million**	**Liabilities £ million**	Notional £ million	Assets £ million	Liabilities £ million
Cash flow hedges						
Interest rate contracts	**735.7**	**0.2**	**6.1**	719.9	1.4	1.3
Fair value hedges						
Interest rate contracts	**1,251.1**	**27.6**	**5.5**	1,202.3	14.0	12.1

The group generally enters into fair value hedges and cash flow hedges with changes in the relevant benchmark interest rate risk being the predominant hedged risk.

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

32. Derivative financial instruments

The fair value hedges seek to hedge the exposure to changes in the fair value of recognised assets and liabilities or firm commitments attributable to interest rate risk. Changes in interest rate risk are considered the largest component of the overall change in fair value. Other risks such as credit risk are managed but excluded from the hedge accounting relationship. The interest rate risk component is the change in fair value of the fixed rate hedging items arising solely from changes in the benchmark interest rate.

Cash flow hedges seek to hedge the exposure to variability in future cash flows due to movements in the relevant benchmark interest rate with interest rate swaps. These future cash flows relate to future interest payments or receipts on recognised financial instruments and on forecast transactions for periods of up to seven (2018: eight) years. The company applies portfolio cash flow hedging for interest rate risk exposures on a portfolio of actual and forecast variable interest rate cash flows arising from variable rate borrowings.

Certain items which are economically hedged may be ineligible for hedge accounting in accordance with IAS 39. Therefore, a portfolio of floating rate liabilities have been designated as eligible hedged items in the cash flow hedge portfolio. The amounts and timing of future cash flows are projected on the basis of their contractual and forecast terms and other relevant factors. The exposure from this portfolio frequently changes due to new facilities being originated, contractual repayments and new interest rate swaps added to the portfolio.

To assess hedge effectiveness the change in fair value or cash flows of the hedging instruments are compared with the change in fair value or cash flows of the hedged item attributable to the hedged risk. A hedge is considered highly effective if the results are within a ratio of 80%-125%.

The main sources of hedge ineffectiveness can include, but are not limited to, differences in the discount rates and cash flow timing differences between the hedged item and the hedging instrument.

The main sources of hedge ineffectiveness can include, but are not limited to, differences in the discount rates between the hedged item and the hedging instrument and cash flow timing differences between the hedged item and hedging instrument.

33. Investment in subsidiaries

	2019 £ million
Cost	
at 1 August 2018	131.6
Additions	3.0
Disposals	-
at 31 July 2019	**134.6**
Less: amounts written off	
at 1 August 2018	10.7
Movement during the year	6.0
at 31 July 2019	**16.7**
Carrying value	
At 31 July 2019	**117.9**
At 31 July 2018	120.9

A list of the company's subsidiaries can be found at note 44.

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

34. Intangible assets

	Goodwill £ million	Software £ million	Intangible assets on acquisition £ million	Total £ million
Cost				
At 1 August 2018	4.3	133.6	4.5	142.4
Additions	-	45.5	-	45.5
Disposals	-	(7.4)	-	(7.4)
At 31 July 2019	**4.3**	**171.7**	**4.5**	**180.5**
Accumulated amortisation				
At 1 August 2018	-	67.3	3.2	70.5
Charge for the year	-	18.4	0.3	18.7
Disposals	-	(2.5)	-	(2.5)
At 31 July 2019	**-**	**83.2**	**3.5**	**86.7**
Net book value at 31 July 2019	**4.3**	**88.5**	**1.0**	**93.8**
Net book value at 31 July 2018	4.3	66.3	1.3	71.9

Intangible assets on acquisition relate to broker and customer relationships and are amortised over a period of eight to twenty years.

In the 2019 financial year, £0.3 million (2018: £0.3 million) of the amortisation charge is included in amortisation of intangible assets on acquisition and £18.4 million (2018: £15.2 million) of the amortisation charge is included in administrative expenses shown in the consolidated income statement.

At 31 July 2019, goodwill has been allocated to one single CGU. The company's policy for testing goodwill for impairment is referred to in Note 13 of the consolidated accounts.

At 31 July 2019, the results of the review indicate there is no goodwill impairment.

	2019		2018	
Cash Generating Unit	Goodwill £ million	Pre-tax discount rate %	Goodwill £ million	Pre-tax discount rate %
Bank	**4.3**	**10.2**	4.3	10.2

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

35. Property, plant and equipment

	Short leasehold property £ million	Fixtures, fittings and equipment £ million	Assets held under operating lease £ million	Total £ million
Cost				
At 1 August 2018	10.1	32.3	1.8	44.2
Additions	4.7	2.3	-	7.0
Disposals	(0.5)	(3.3)	(0.8)	(4.6)
At 31 July 2019	**14.3**	**31.3**	**1.0**	**46.6**
Accumulated depreciation				
At 1 August 2018	4.4	19.9	1.0	25.3
Charge for the year	1.7	5.0	0.2	6.9
Disposals	(0.5)	(0.7)	(0.5)	(1.7)
At 31 July 2019	**5.6**	**24.2**	**0.7**	**30.5**
Net book value at 31 July 2019	**8.7**	**7.1**	**0.3**	**16.1**
Net book value at 31 July 2018	5.7	12.4	0.8	18.9

	31 July 2019 £ million	31 July 2018 £ million
Future minimum lease rentals receivable under non-cancellable operating leases		
Within one year	**0.1**	0.7
between one and five years	**0.1**	0.3
After more than five years	**-**	-
	0.2	1.0

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

36. Other assets and liabilities

	31 July 2019 £ million	31 July 2018 £ million
Prepayments, accrued income and other assets		
Prepayments and accrued income	**117.2**	113.4
Trade and other receivables	**6.2**	4.8
	123.4	118.2
Accruals, deferred income and other liabilities		
Accruals and deferred income	**77.4**	71.8
Trade and other payables	**34.4**	37.9
Provisions	**5.8**	7.5
	117.6	117.2

Provisions movements in the year:

	Property £ million	Other £ million	Total £ million
Provisions movements during the year			
At 1 August 2018	2.8	4.7	7.5
Additions	0.9	2.2	3.1
Utilised	-	(2.9)	(2.9)
Released	(1.4)	(0.5)	(1.9)
At 31 July 2019	**2.3**	**3.5**	**5.8**

Claims and other items for which provisions are made arise in the normal course of business and include those related to employee benefits. The timing and outcome of these claims and other items are uncertain. Property provisions are in respect of leaseholds where rents payable exceed the value to the company, potential dilapidations and onerous leases. These property provisions will be utilised and released over the remaining lives of the leases which range from one to six years.

37. Financial liabilities

	On demand £ million	Within three months £ million	Between three months and one year £ million	Between one and two years £ million	Between two and five years £ million	After more than five years £ million	Total £ million
At 31 July 2019							
Deposits by banks	**12.4**	**15.7**	**29.9**	**-**	**-**	**-**	**58.0**
Deposits by customers	**78.3**	**1,232.7**	**2,817.9**	**1,157.2**	**352.3**	**-**	**5,638.4**
Bank loans and overdrafts	**13.6**	**0.3**	**-**	**213.2**	**276.8**	**-**	**503.9**
Amounts due to group undertakings	**-**	**1,946.9**	**-**	**-**	**-**	**-**	**1,946.9**
	104.3	**3,195.6**	**2,847.8**	**1,370.4**	**629.1**	**-**	**8,147.2**

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

37. Financial liabilities *continued*

	On demand £ million	Within three months £ million	Between three months and one year £ million	Between one and two years £ million	Between two and five years £ million	After more than five years £ million	Total £ million
At 31 July 2018							
Deposits by banks	7.9	15.9	30.7	-	-	-	54.5
Deposits by customers	86.5	1,275.0	2,570.5	1,142.6	422.6	-	5,497.2
Bank loans and overdrafts	3.5	0.2	-	-	495.0	-	498.7
Amounts due to group undertakings	-	1,854.6	-	-	-	-	1,854.6
	97.9	3,145.7	2,601.2	1,142.6	917.6	-	7,905.0

As discussed in note 22(c) the group has accessed £490.0 million (2018: £495.0 million) cash under the Bank of England's Term Funding Scheme. Cash from the Term Funding Scheme and repurchase agreements is included within bank loans and overdrafts. Residual maturities of the Term Funding Scheme and repurchase agreements are as follows:

	On demand £ million	**Within three months £ million**	**Between three months and one year £ million**	**Between one and two years £ million**	**Between two and five years £ million**	**After more than five years £ million**	**Total £ million**
31 July 2019	**-**	**0.3**	**-**	**213.2**	**276.8**	**-**	**490.3**
31 July 2018	-	0.2	-	-	495.0	-	495.2

38. Subordinated loan capital

	Prepayment date at company's option	Initial interest rate (%)	**31 July 2019 £ million**	31 July 2018 £ million
Final maturity date				
2026	2021	7.42	**15.5**	15.5
2026	2021	7.62	**31.0**	30.9
2027	2022	4.25	**175.1**	171.5
			221.6	217.9

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

39. Contingent liabilities, guarantees and commitments

Contingent liabilities
Financial Services Compensation Scheme ("FSCS")
By virtue of being a regulated deposit taker, the company contributes to the FSCS which provides compensation to customers of financial institutions in the event that an institution is unable, or is likely to be unable, to pay claims against it.

Compensation has previously been paid out by the FSCS funded by loan facilities provided by HM Treasury to FSCS in support of the FSCS's obligations to the depositors of banks declared in default. The facilities are expected to be repaid wholly from recoveries from the failed deposit-takers. In the event of a shortfall, the FSCS will recover the shortfall by raising levies on the industry. The amount of future levies payable by the company depends on a number of factors including the potential recoveries of assets by the FSCS, the company's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of FSCS members.

Guarantees
Where the company undertakes to make a payment on behalf of its subsidiaries for guarantees issued, such as bank facilities or property leases or as irrevocable letters of credit for which an obligation to make a payment to a third party has not arisen at the reporting date, they are included in these financial statements as contingent liabilities.

Commitments
The company has given commitments to provide funds to customers under undrawn facilities and credit lines. Some of the commitments are expected to expire without being drawn.

	31 July 2019 £ million	31 July 2018 £ million
Guarantees:		
Guarantees and irrecoverable letters of credit	**1.9**	1.8
Capital commitments are as follows:		
- contracted for but not provided for	**0.3**	0.5
Annual commitments under non-cancellable operating leases were as follows:		
- within one year	**7.0**	9.3
- between two and five years	**23.6**	22.1
- after five years	**4.3**	5.7
	34.9	37.1
Other items:		
Undrawn facilities, credit lines, other commitments to lend:		
- within one year	**907.5**	970.3
- over one year	**-**	100.0
	907.5	1,070.3

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

40. Capital

The company's policy is to be well capitalised and its approach to capital management is driven by strategic and organisational requirements, while also taking into account the regulatory and commercial environments in which it operates.

The PRA supervises the company for prudential purposes and receives information on the capital adequacy of, and sets capital requirements for, the group as a whole.

The capital position for the group is disclosed in note 21 to the consolidated accounts. Further information on capital, risk exposures and the risk assessment process are disclosed in the Close Brothers Group plc's Pillar 3 disclosures which can be found on the group's website.

41. Financial instruments

As a financial services company, financial instruments are central to the company's activities. The risks associated with financial instruments represent a significant component of the risks faced by the company and are analysed in more detail below.

The company's financial risk management objectives are summarised in the Strategic Report. Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 1.

(a) Classification

The following tables analyse the carrying amounts of the company's financial assets and liabilities in accordance with the categories of financial instruments in IFRS 9 (31 July 2018: IAS 39).

	Derivatives designated as hedging instruments £ million	Fair value through profit or loss £ million	Fair value through other comprehensive income £ million	Amortised cost £ million	Derivatives held for hedging £ million	Total £ million
As at 31 July 2019						
Assets						
Cash and balances at central banks	-	-	-	1,106.4	-	1,106.4
Loans and advances to banks	-	-	-	27.0	-	27.0
Loans and advances to customers	-	-	-	5,621.3	-	5,621.3
Amounts due from group undertakings	-	-	-	2,235.2	-	2,235.2
Debt securities	-	-	48.3	240.7	-	289.0
Derivative financial instruments	27.8	2.3	-	-	-	30.1
Other financial assets	-	-	-	0.7	-	0.7
	27.8	2.3	48.3	9,231.3	-	9,309.7
Liabilities						
Deposits by banks	-	-	-	58.0	-	58.0
Deposits by customers	-	-	-	5,638.4	-	5,638.4
Loans and overdrafts from banks	-	-	-	503.9	-	503.9
Derivative financial instruments	11.6	8.7	-	-	-	20.3
Amounts due to group undertakings	-	-	-	1,946.9	-	1,946.9
Subordinated loan capital	-	-	-	221.6	-	221.6
Other financial liabilities	-	-	-	53.2	-	53.2
	11.6	8.7	-	8,422.0	-	8,442.3

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*
(a) **Classification** *continued*

	Held for trading £ million	Available for sale £ million	Loans & receivables £ million	Held at amortised cost £ million	Derivatives held for hedging £ million	Total £ million
As at 31 July 2018						
Assets						
Cash and balances at central banks	-	-	1,140.4	-	-	1,140.4
Loans and advances to banks	-	-	24.2	-	-	24.2
Loans and advances to customers	-	-	5,400.8	-	-	5,400.8
Amounts due from group undertakings	-	-	2,077.6	-	-	2,077.6
Debt securities	-	44.5	250.5	-	-	295.0
Derivative financial instruments	0.4	-	-	-	15.5	15.9
Other financial assets	-	-	4.5	-	-	4.5
	0.4	44.5	8,898.0	-	15.5	8,958.4
Liabilities						
Deposits by banks	-	-	-	54.5	-	54.5
Deposits by customers	-	-	-	5,497.2	-	5,497.2
Loans and overdrafts from banks	-	-	-	498.7	-	498.7
Derivative financial instruments	2.3	-	-	-	13.4	15.7
Amounts due to group undertakings	-	-	-	1,854.6	-	1,854.6
Subordinated loan capital	-	-	-	217.9	-	217.9
Other financial liabilities	-	-	-	56.6	-	56.6
	2.3	-	-	8,179.5	13.4	8,195.2

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*

(b) Valuation

The fair values of the company's financial assets and liabilities are not materially different from their carrying values, with the exception of subordinated loan capital.

	Fair value		Carrying Value	
	2019	2018	**2019**	2018
	£ million	£ million	**£ million**	£ million
Subordinated loan capital	**234.1**	233.7	**221.6**	217.9

Note 22(b) to the consolidated financial statements outlines the valuation hierarchy into which financial instruments measured at fair value are categorised. The tables below show the classification of financial instruments held at fair value in accordance with the valuation hierarchy. There were no transfers between Level 1,2 and 3 in 2019 and 2018.

	Level 1	**Level 2**	**Level 3**	**Total**
	£ million	**£ million**	**£ million**	**£ million**
As at 31 July 2019				
Assets				
Sovereign and central bank debt	**48.3**	**-**	**-**	**48.3**
Derivative financial instruments	**-**	**30.1**	**-**	**30.1**
	48.3	**30.1**	**-**	**78.4**
Liabilities				
Derivative financial instruments	**-**	**20.3**	**-**	**20.3**
Contingent Consideration	**-**	**-**	**2.5**	**2.5**
	-	**20.3**	**2.5**	**22.8**
As at 31 July 2018				
Assets				
Sovereign and central bank debt classified as available for sale	44.5	-	-	44.5
Derivative financial instruments	-	15.9	-	15.9
	44.5	15.9	-	60.4
Liabilities				
Derivative financial instruments	-	15.7	-	15.7
Contingent Consideration	-	-	1.2	1.2
	-	15.7	1.2	16.9

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*
(b) Valuation *continued*

Movements in financial assets categorised as Level 3 during the year were:

	Contingent Consideration £ million
At 1 August 2017	
Purchases and issues	1.2
At 31 July 2018	1.2
Total gains recognised in the consolidated income statement	0.8
Purchases and issues	0.5
At 31 July 2019	**2.5**

The losses recognised in the consolidated income statement relating to instruments held at the year end amounted to £nil (2018: £nil).

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*
(c) Credit risk

The company's credit risk management policy is the same as the group's credit risk policy and can be found in note 22(c) of the consolidated accounts.

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

	31 July 2019 £ million	31 July 2018 £ million
On balance sheet		
Cash and balances at central banks	**1,106.4**	1,140.4
Loans and advances to banks	**27.0**	24.2
Loans and advances to customers	**5,621.3**	5,400.8
Amounts due from group undertakings	**2,235.2**	2,077.6
Debt securities	**289.0**	295.0
Derivative financial instruments	**30.1**	15.9
Other financial assets	**0.7**	4.5
	9,309.7	8,958.4
Off balance sheet		
Undrawn commitments	**56.8**	178.3
Guarantees	**1.9**	1.8
	58.7	180.1
Total maximum exposure to credit risk	**9,368.4**	9,138.5

Analysis of forborne loans is shown in the table below:

	Gross loans and advances to customers £ million	Forborne loans £ million	Forborne loans as a percentage of gross loans and advances to customers £ million	Provision on forborne loans £ million
31 July 2019	**5,703.7**	**124.1**	**2.2%**	**16.5**
31 July 2018	5,429.2	79.1	1.5%	8.4

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*
(c) Credit risk *continued*

The following is a breakdown of forborne loans by concession type at 31 July 2019:

	Forborne loans £ million
Extension outside terms	84.3
Refinancing	26.1
Moratorium	11.0
Other modifications	2.7
Total	**124.1**

Divisional credit risk
Retail is predominantly high volume secured lending with a small average loan size. Credit issues are identified early via largely automated tracking processes. Remedial actions are implemented promptly to restore customers to a performing status or recovery methods are applied to minimise potential loss.

Commercial is a combination of several specialist secured niche lending businesses with a diverse mix of loans in terms of assets financed, average loan size and LTV percentage. Credit quality is predominately assessed on an individual loan by loan basis. Collection and recovery activity is executed promptly by experts with experience in the specialised assets. This approach allows remedial action to be implemented at the appropriate time to minimise potential loss.

Property is a portfolio of higher value, low volume lending with credit quality assessed on an individual loan by loan basis. Loans are continually monitored to determine whether they are performing satisfactorily.

In Property and Commercial performing loans with elevated levels of credit risk may be placed on watch lists depending on the perceived severity of the credit risk.

Much of the company's lending is short term and the average loan size is small with the result that individual loans have little capacity to materially impact the company's earnings.

Credit risk reporting
The following table sets out loans and advances to customers, trade receivables and undrawn facilities by the group's internal credit risk grading:

The analysis of lending has been prepared based on the following risk categories:

Low risk: The credit risk profile of the borrower is considered acceptable with no concerns on ability to meet obligations as they fall due. Standard monitoring in place.

Medium risk: Evidence of deterioration in the credit risk profile of the borrower exists which requires increased monitoring. Potentially concerns on ability to meet obligations as they fall due.

High risk: Evidence of significant deterioration in the credit risk profile of the borrower exists which requires enhanced management. Full repayment may not be achieved with potential for loss identified.

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*

(c) Credit risk *continued*

The following is a breakdown of forborne loans by concession type at 31 July 2019:

	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	Total £ million
31 July 2019				
Loans and advances to customers				
Low	5,063.9	392.1	26.2	5,482.2
Medium	9.1	116.0	26.9	152.0
High	-	0.3	63.2	63.5
Ungraded	0.5	-	5.5	6.0
	5,073.5	508.4	121.8	5,703.7
Undrawn facilities				
Low	894.0	7.7	1.4	903.1
Medium	-	4.4	-	4.4
High	-	-	-	-
Ungraded	-	-	-	-
	894.0	12.1	1.4	907.5
Trade receivables				
Low	4.8	-	-	4.8
Medium	-	0.7	-	0.7
High	-	-	1.2	1.2
	4.8	0.7	1.2	6.7

At 31 July 2018, loans and advances to customers were analysed between the following categories for credit risk under IAS 39. Following transition, these disclosures are no longer required and have been replaced with the information presented on the previous pages. They are provided for comparative purposes only.

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*
(c) Credit risk *continued*

Neither past due nor impaired
These loans and advances reflect the application of consistent and conservative lending criteria on inception, and the quality and level of security held. The contractual repayments are monitored to ensure that classification as neither past due nor impaired remains appropriate and also demonstrates the short-term nature of the lending, with £2,974.6 million (2017: £2,812.1 million) having a contractual maturity of less than 12 months.

The table below shows the ageing based on contractual maturity of loans and advances to customers split by credit assessment method which are neither past due nor impaired:

	31 July 2018		
	Loans and advances to customers		
	Individually assessed £ million	Collectively assessed £ million	Total £ million
Within one month	97.4	386.3	483.7
Between one and three months	279.0	447.9	726.9
Between three months and one year	728.2	1,035.8	1,764.0
Over one year	514.7	1,656.0	2,170.7
	1,619.3	3,526.0	5,145.3

Past due but not impaired
Loans and advances to customers are classified as past due but not impaired when the customer has failed to make a payment when contractually due but there is no evidence of impairment. This includes loans which are individually assessed for impairment but where the value of security or collateral is sufficient to meet the required repayments. This also includes loans to customers which are past due for technical reasons such as delays in payment processing or rescheduling of payment terms.

The following table shows the ageing based on the period loans and advances to customers have been past due, split by credit assessment method, due but for which no impairment provision has been raised:

	31 July 2018[1]		
	Loans and advances to customers		
	Individually assessed £ million	Collectively assessed £ million	Total £ million
Within one month	60.2	83.5	143.7
Between one and three months	17.2	3.4	20.6
Between three months and one year	1.4	0.7	2.1
Over one year	1.7	-	1.7
	80.5	87.6	168.1

[1] Prior year figures restated

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*
(c) Credit risk *continued*

Impaired
The following table shows gross impaired loans and advances to customers and the provision thereon split by assessment method:

	31 July 2018		
	Loans and advances to customers		
	Individually assessed £ million	Collectively assessed £ million	Total £ million
Gross impaired loans	48.6	69.7	118.3
Provisions	(9.6)	(21.3)	(30.9)
Net impaired loans	39.0	48.4	87.4

Gross loans and advances to customers where exposure at origination exceeded £1.0 million:

	Retail £ million	**Commercial £ million**	**Property £ million**	**Total £ million**
LTV				
Less than 70%	**-**	**70.5**	**1,330.6**	**1,401.1**
70% to 90%	**38.1**	**65.2**	**27.4**	**130.7**
Greater than 90%	**2.6**	**95.4**	**7.6**	**105.6**
At 31 July 2019	**40.7**	**231.1**	**1,365.6**	**1,637.4**
LTV				
Less than 70%	-	65.7	1,336.4	1,402.1
70% to 90%	3.6	43.7	4.1	51.4
Greater than 90%	17.2	85.1	-	102.3
At 31 July 2018	20.8	194.5	1,340.5	1,555.8

Gross loans and advances to customers which are credit-impaired at 31 July 2019 and where exposure at origination exceeded £1.0 million:

	Retail £ million	**Commercial £ million**	**Property £ million**	**Total £ million**
LTV				
Less than 70%	**-**	**-**	**11.4**	**11.4**
70% to 90%	**-**	**0.5**	**-**	**0.5**
Greater than 90%	**2.3**	**3.9**	**-**	**6.2**
At 31 July 2019	**2.3**	**4.4**	**11.4**	**18.1**

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*

(d) Market risk

The interest rate risk policy and foreign currency risk policy for the company is explained in note 22(d) to the consolidated accounts.

(e) Liquidity risk

The company's liquidity risk management policy is explained in note 22(e) to the consolidated accounts.

The following table analyses the contractual maturities of the company's on balance sheet financial liabilities on an undiscounted cash flow basis.

	On demand £ million	Less than three months £ million	More than three months but not more than six months £ million	More than six months but not more than one year £ million	More than one year but not more than five years £ million	More than five years £ million	Total £ million
At 31 July 2019							
Financial liabilities							
Deposits by banks	**12.4**	**15.7**	**27.8**	**2.0**	**-**	**-**	**57.9**
Deposits by customers	**69.7**	**1,235.7**	**1,137.8**	**1,700.5**	**1,573.9**	**-**	**5,717.6**
Loans and overdrafts from banks	**13.6**	**0.9**	**0.9**	**1.8**	**494.0**	**-**	**511.2**
Derivative financial instruments	**0.1**	**7.5**	**5.8**	**8.7**	**34.8**	**9.0**	**65.9**
Subordinated loan capital	**-**	**1.7**	**3.7**	**5.4**	**43.3**	**245.4**	**299.5**
Other financial liabilities	**9.6**	**41.1**	**0.5**	**1.4**	**0.6**	**-**	**53.2**
	105.4	**1,302.6**	**1,176.5**	**1,719.8**	**2,146.6**	**254.4**	**6,705.3**
At 31 July 2018							
Financial liabilities							
Deposits by banks	7.9	15.9	28.7	2.0	-	-	54.5
Deposits by customers	81.4	1,279.7	914.6	1,686.5	1,610.3	-	5,572.5
Loans and overdrafts from banks	3.5	0.6	0.6	1.2	500.1	-	506.0
Derivative financial instruments	0.3	4.7	3.5	7.8	50.2	14.9	81.4
Subordinated loan capital	-	1.7	3.7	5.4	44.5	255.1	310.4
Other financial liabilities	9.5	45.0	1.1	0.9	0.5	-	57.0
	102.6	1,347.6	952.2	1,703.8	2,205.6	270.0	6,581.8

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

41. Financial instruments *continued*

(f) Offsetting

In accordance with IFRS 7 "Financial Instruments: Disclosures", the following table shows the impact on derivative financial instruments relating to transactions where:

• there is an enforceable master netting arrangement or similar agreement in place and an unconditional right to offset is in place,
• there is an enforceable master netting arrangement or similar agreement in place but the offset criteria are otherwise not satisfied, and
• financial collateral is paid and received.

Master netting arrangements include ISDA Master Agreements and global master repurchase agreements whereby outstanding transactions with the same counterparty can be offset and settled net, either unconditionally or following a default or other predetermined event. Financial collateral on derivative financial instruments consists of cash settled, typically daily, to mitigate the mark to market exposures.

The net amounts after offsetting under IFRS 7 presented in the following table show the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral, and are not intended to represent the group's actual exposure to credit risk.

This is due to a variety of credit mitigation strategies which are employed in addition to netting and collateral arrangements.

	Gross amounts recognised	**Master netting arrangements**	**Financial Collateral**	**Net amounts after offsetting under IFRS 7**
	£ million	**£ million**	**£ million**	**£ million**
At 31 July 2019				
Derivative financial assets	**30.1**	**(14.9)**	**(12.4)**	**2.8**
Derivative financial liabilities	**20.3**	**(14.9)**	**(5.4)**	**-**

	Gross amounts recognised	Master netting arrangements	Financial Collateral	Net amounts after offsetting under IFRS 7
	£ million	£ million	£ million	£ million
At 31 July 2018				
Derivative financial assets	15.9	(8.3)	(7.7)	(0.1)
Derivative financial liabilities	15.7	(8.3)	(7.2)	0.2

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

42. Implementation of IFRS 9

The group has adopted IFRS 9 Financial Instruments with effect from 1 August 2018. In accordance with the requirements of IFRS 9, comparative information has not been restated and transitional adjustments have been accounted for through retained earnings at 1 August 2018, the date of initial application.

At 1 August 2018, retained earnings decreased by £36.9 million reflecting an increase in impairment provisions of £49.5 million partly offset by an increase in deferred tax assets of £12.6 million. £49.1 million of the increase in impairment provisions relates to loans and advances to customers while the remaining £0.4 million relates to other financial assets.

This increase in impairment provisions principally reflects the additional expected credit loss on performing and underperforming loans, as well as a broader definition of default compared to IAS 39 and the addition of forward-looking macroeconomic assumptions.

Abbreviations used on following table for classifications and measurements

AC - amortised cost

AFS - available for sale

FV(H) - derivatives held for hedging and carried at fair value

FVOCI - fair value through other comprehensive income

FVPL - fair value through profit and loss

HFT - held for trading

LAR - loans and receivables

THE NOTES TO THE COMPANY ACCOUNTS

For the year ended 31 July 2019

42. Implementation of IFRS 9 *continued*

The following table sets out the impact of IFRS 9 on the company balance sheet at 1 August 2018.

	Classification and measurement		IAS 39 carrying amount 31 July 2018	IFRS 9 transitional adjustment	IFRS 9 carrying amount 1 August 2018
	IAS 39	IFRS 9	£ million	£ million	£ million
Assets					
Cash and balances at central banks	LAR	AC	1,140.4	(0.1)	1,140.3
Loans and advances to banks	LAR	AC	24.2	-	24.2
Loans and advances to customers	LAR	AC	5,400.8	(49.1)	5,351.7
Amounts due from group undertakings	LAR	AC	2,077.6	-	2,077.6
Debt securities			295.0	(0.2)	294.8
	LAR	AC	250.5	(0.2)	250.3
	AFS	FVOCI	44.5	-	44.5
Derivative financial instruments			15.9	-	15.9
	HFT	FVPL	0.4	-	0.4
	FV(H)	FV(H)	15.5	-	15.5
Investment in subsidiaries			120.9	-	120.9
Intangible assets			71.9	-	71.9
Property, plant and equipment			18.9	-	18.9
Deferred tax assets			42.0	12.6	54.6
Prepayments, accrued income and other assets			118.2	(0.1)	118.1
	LAR	AC	39.8	(0.1)	39.7
	AC	AC	78.4	-	78.4
Assets classified as held for sale			67.5	-	67.5
Total assets			9,393.3	(36.9)	9,356.4
Liabilities					
Deposits by banks	AC	AC	54.5	-	54.5
Deposits by customers	AC	AC	5,497.2	-	5,497.2
Loans and overdrafts from banks	AC	AC	498.7	-	498.7
Derivative financial instruments	FVPL	FVPL	15.7	-	15.7
Amounts due to group undertakings	AC	AC	1,854.6	-	1,854.6
Current tax liabilities	AC	AC	10.7	-	10.7
Accruals, deferred income and other liabilities			117.2	-	117.2
	AC	AC	116.0	-	116.0
	FVPL	FVPL	1.2	-	1.2
Subordinated loan capital	AC	AC	217.9	-	217.9
Liabilities classified as held for sale			0.6	-	0.6
Total liabilities			8,267.1	-	8,267.1
Total equity			1,126.2	(36.9)	1,089.3
Total liabilities and equity			9,393.3	(36.9)	9,356.4

THE NOTES TO THE COMPANY ACCOUNTS

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43. Post balance sheet events

There were no significant events after the reporting period affecting the group or company.

44. Investment in subsidiaries

In accordance with section 409 of the Companies Act 2006, below is a list of the company's subsidiaries which are all wholly-owned and incorporated in the United Kingdom unless otherwise stated.

Air and General Finance Limited[2]
Armed Services Finance Limited[4]
Arrow Audit Services Limited[1]
Capital Lease Solutions Limited[1]
CBM Holdings Limited[1]
CLL I Limited[10]
Close Asset Finance Limited[2]
Close Brewery Rentals Limited[5]
Close Brothers Asset Finance GmbH (Germany)[11]
Close Brothers Factoring GmbH (Germany)[11]
Close Brothers Finance plc[1]
Close Brothers Military Services Limited[4]
Close Brothers Premium DAC[13]
Close Brothers Technology Services Limited[1,14]
Close Brothers Vehicle Hire Limited[9]
Close Business Finance Limited[2]
Close Credit Management (Holdings) Limited[1]
Close Finance (CI) Limited (Jersey)[12]
Close International Bank Holdings Limited (Guernsey)[3]
Close Invoice Finance Limited[1]
Close Leasing Limited[10]
Close Motor Finance Limited[4]
Close Trust Nominees Limited[1]
Commercial Acceptances Limited[6]
Commercial Finance Credit Limited[2]
Ecasks Limited[5]
Finance For Industry Limited[1]
Finance For Industry Services Limited[1]
Kingston Asset Finance Limited[2]
Kingston Asset Leasing Limited[2]
Metropolitan Factors Limited[1]
Micgate Holdings (UK) Limited[1]
Novitas Loans Limited[2]
Novitas (Salisbury) Limited[2]
Surrey Asset Finance Limited[2]

The share capital of the following entities is not owned by the group, but are included in the consolidated financial statements as they are controlled by the group:

Brook Funding (No.1) Limited[8]
Close PF Funding I Limited[7]
Orbita Holdings Limited[8,15]
Orbita Funding 2016-1 plc[8]
Orbita Funding 2017-1 plc[8]

Registered office:
1. 10 Crown Place, London EC2A 4FT, United Kingdom.
2. Wimbledon Bridge House, Hartfield Road, Wimbledon, London SW19 3RU, United Kingdom.
3. 1st and 2nd Floors, Elizabeth House, Les Ruettes Brayes, St Peter Port, GY1 1EW, Guernsey.
4. Roman House, Roman Road, Doncaster, South Yorkshire DN4 5EZ, United Kingdom.
5. Unit 1, Kingfisher Park, Headlands Business Park, Ringwood, Hampshire BH24 3NX, United Kingdom.
6. 100 George Street, London W1U 8NU, United Kingdom.
7. Third Floor, 1 King's Arms Yard, London EC2R 7AF, United Kingdom.
8. 35 Great St. Helen's, London EC3A 6AP, United Kingdom.
9. Lows Lane, Stanton-By-Dale, Ilkeston, Derbyshire DE7 4QU, United Kingdom.
10. Olympic Court Third Avenue, Trafford Park Village, Manchester M17 1AP, United Kingdom.
11. Grosse Bleiche 35 -39, 55116 Mainz, Germany.
12. Conway House, Conway Street, St Helier, JE4 5SR, Jersey.
13. Swift Square, Building 1, Santry Demesne, Northwood, Dublin 9, D09 A0E4, Ireland

Notes
14. 85% owned
15. Orbita Holdings has taken the small companies exemption from the requirements of the 2006 Act relating to the audit of individual accounts by virtue of section 479A

CAUTIONARY STATEMENT

Certain statements included or incorporated by reference within this report may constitute "forward-looking statements" in respect of the group's operations, performance, prospects and/or financial condition. Forward-looking statements are sometimes, but not always, identified by their use of a date in the future or such words as "anticipates", "aims", "due", "could", "may", "will", "should", "expects", "believes", "intends", "plans", "potential", "targets", "goal" or "estimates". By their nature, forward-looking statements involve a number of risks, uncertainties and assumptions and actual results or events may differ materially from those expressed or implied by those statements. Accordingly, no assurance can be given that any particular expectation will be met and reliance should not be placed on any forward-looking statement. Additionally, forward-looking statements regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Except as may be required by law or regulation, no responsibility or obligation is accepted to update or revise any forward-looking statement resulting from new information, future events or otherwise. Nothing in this report should be construed as a profit forecast. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

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