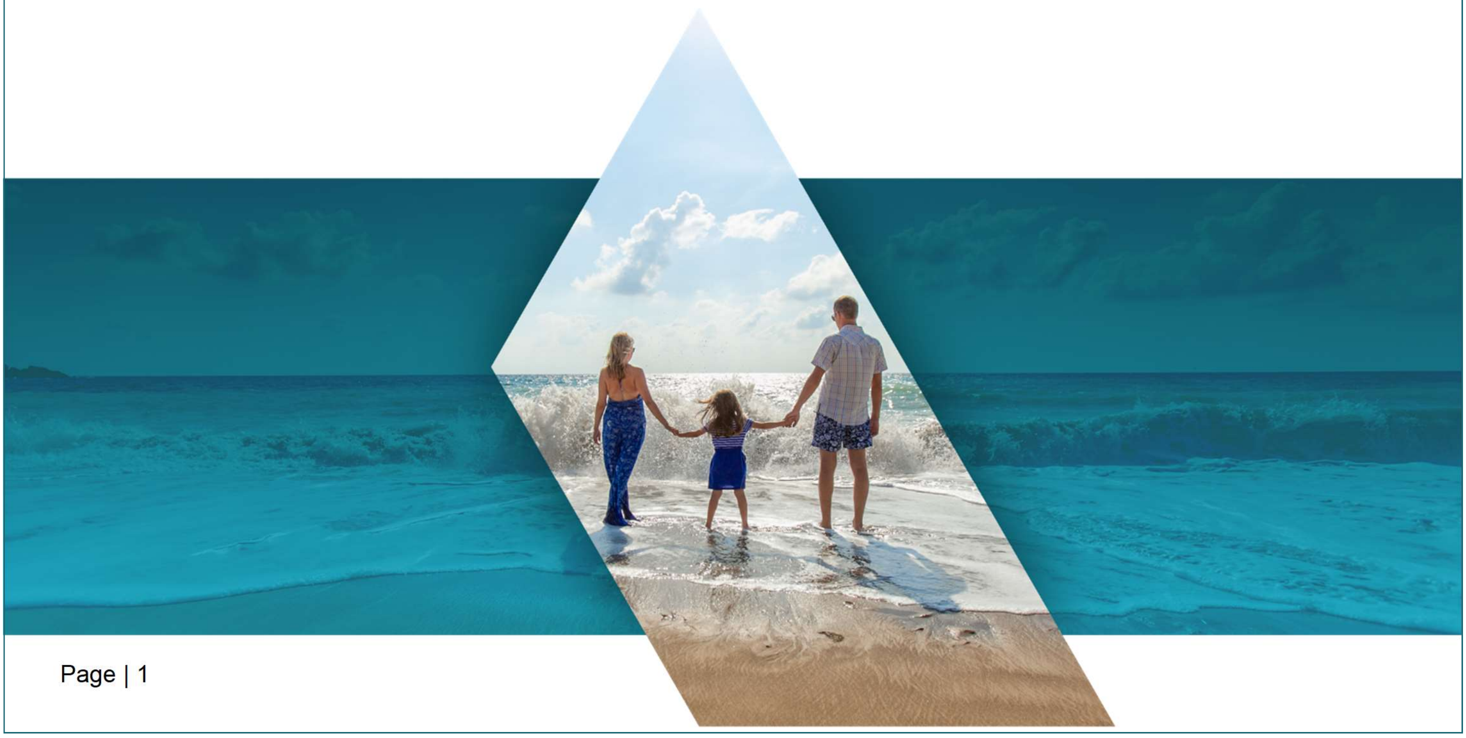
PCF Group plc

Pillar 3 Disclosures

30 September 2020



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Should you have any queries please contact us at https://pcf.bank/contact/ selecting 'Pillar 3 disclosures' in the "I'd like to discuss" dropdown.

1. Overview

1.1. Background

The aim of the capital adequacy regime is to promote safety and soundness in the financial system. Basel 3 is a global regulatory capital and liquidity framework developed by the Basel Committee on Banking Supervision. It is composed of three parts, or pillars:

- **Pillar 1:** Defines the minimum capital requirements that institutions are required to hold for credit, market and operational risks.
- **Pillar 2:** This builds on Pillar 1 and incorporates the PCF Group plc and its subsidiaries ('Group') own assessment of additional capital resources needed in order to cover specific risks that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of any additional capital requirement is also assessed by the Prudential Regulation Authority ('PRA') during its Supervisory Review and Evaluation Process ('C-SREP') and is used to determine the overall capital resources required by the Group.
- **Pillar 3:** Aims to improve market discipline by requiring banks to publish information on their principal risks, capital structure and risk management.

These are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. Capital Requirements Directive ('CRD IV') also made changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting within the European Union ('EU').

This document sets out the Pillar 3 disclosures on capital and risk management for the Group as at 30 September 2020. It has two principal purposes:

- to provide useful information on the capital and risk profile of the Group; and
- to meet the regulatory disclosure requirements under the Capital Requirements Regulation ('CRR'), Part 8 – Disclosure by institutions and the rules of the PRA set out in the Public Disclosure section of the PRA Rulebook and as the PRA has otherwise directed.

1.2. Scope

PCF Bank Limited (the 'Bank') is authorised by the PRA and regulated by the FCA and the PRA, FRN number 747017. The Bank is registered in England and Wales, registration number 02794633 and is wholly owned by the Group, a company registered in England and Wales, registration number 02863246 and listed on the Alternative Investment Market ('AIM'). PCF Credit Limited ('PCF Credit') and Azule Limited ('Azule') are authorised and regulated by the FCA for consumer credit activities with Azule also being authorised by the FCA for credit broking activities. PCF Credit and Azule are wholly owned by the Bank. Registered offices are at Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

The PRA sets capital requirements separately for the Group on a consolidated basis, and the Bank on a solo basis. There are no differences between the basis of consolidation of the Group for accounting and regulatory purposes. Other than restrictions due to regulatory capital requirements for regulated entities, there are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities when due between the Group and its subsidiary undertakings. This document contains references to the Group's Annual Report and Financial Statements, and in particular its 'Principal and Emerging Risks'. These details can be found at: https://pcf.bank/investors/.

1.3. Pillar 3 policy and basis of disclosure

Disclosures will be issued as a minimum on an annual basis and are published on the Group's website. These disclosures are not subject to audit except where they are equivalent to those prepared under accounting requirements for inclusion in the Group's Annual Report.

The Pillar 3 disclosures have been prepared purely for explaining the basis on which the Group has prepared and disclosed certain capital requirements and information about the management of certain risks and for no other purpose. They do not constitute any form of financial statement and must not be relied upon in making any judgement about the Group.

All disclosures within this report have been prepared as at 30 September 2020, which is the Group's latest financial year-end, and include the 2020 audited profits which the Board approved on 22 December 2021. These disclosures are not subject to audit except where they are equivalent to those prepared under accounting requirements for inclusion in the Group's Annual Report and Financial Statements.

1.4. Regulatory developments

Regulatory measures announced by the European Union in light of Covid-19 accelerated the implementation of certain CRR2 amendments, including the revised small and medium-sized enterprises (“SME”) supporting factor. The benefit of the SME discount factor and CRR ‘Quick Fix’ has been recognised in the Group’s capital ratios for the year ended 30 September 2020.

In March 2020, and to assist firms in dealing with the Covid-19 pandemic, the PRA reset the countercyclical capital buffer (CCyB) to a rate of 0%. The Group has recognised this within its capital ratios.

Climate risk has risen up the regulatory agenda and in April 2019 the PRA issued SS 3/19 ‘Enhancing banks’ and insurers’ approaches to managing the financial risks from climate change’ indicating expectations in relation to how firms react to climate change induced risks. This was followed up in July 2020 by a PRA letter ‘Managing climate-related financial risk – thematic feedback from the PRA’s review of firms’ Supervisory Statement 3/19 (SS3/19) plans and clarification of expectations’ which noted thematic findings in relation to financial industry’s preparedness for implementation of climate risk monitoring and management. The key message was “Firms should have fully embedded their approaches to managing climate-related financial risks by the end of 2021”. In order to achieve this target, the Group will:

- appropriately identify climate change risks inherent in PCF Group’s exposures;
- identify the climate change exposures priority items and assess and quantify the risks using relevant data and methodologies, including climate change scenario analysis;
- develop appropriate risk appetite metrics and climate change targets to manage the risks and leverage the opportunities;
- develop a framework to track and report risk appetite metrics and climate change targets with regards to climate related risks and opportunities; and
- integrate climate change considerations into the lending strategy and policy.

The GHG Emissions and Energy Use Summary are shown within the Sustainability Report of the Group’s Annual Report.

2. Risk management overview

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

Following the announcements in 2021 (please refer to the Audit & Risk Committee Report in the Annual Report and Accounts 2020), and the events that led to them, significant remediation work has been, and continues to be, undertaken. A strong culture of risk awareness, listening and speaking up need to be at the heart of PCF and of its Risk Management Framework ('RMF'). Strong frameworks guide colleagues' approach to their work, the way they behave and the decisions they make. They make clear the type and level of risk which the business is prepared to tolerate in pursuit of its business objectives; the 'risk appetite'.

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

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

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

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

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

Risk within the Group is managed using a 'Three Lines of Defence' model, separating risk origination (First Line) from risk oversight (Second Line) and internal audit (Third Line). Controls and expertise are being strengthened across the two internal lines of defence (First & Second), and significant additional Third Line assurance is now being provided by external parties. The Board acknowledges its systems and controls did not operate to prevent the financial and regulatory misstatements that have come to light since 30 September 2020, and it is remediating this. Further information can be found in the Group's Annual Report and Financial Statements 2020.

2.1. Risk strategy

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

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

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

2.2. Risk appetite and culture

The Risk Appetite Statement ('RAS') provides an articulation of the Group's tolerance for risk in both quantitative measures and qualitative terms. A clearly defined RAS allows the setting of detailed risk appetite and reporting metrics for principal risks. The RAS sets out the level of risk that the Group is willing to take in pursuit of its business objectives.

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

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

2.3. Information on number of directorships

In addition to their roles within the Group, the number of external directorships held by members of the management body are detailed in the table below, as at 30 September 2020.

Name	Position	Directorships [1]
T A Franklin	Chairman	7
S D Maybury *	Chief Executive	1
R J Murray **	Executive Director	1
D R Bull ***	Executive Director	0
D Titmuss	Independent Non-executive Director	3
C A Higgins	Independent Non-executive Director	4
M Martin	Independent Non-executive Director	8
D J Morgan	Non-executive Director	13
M F Brown	Non-executive Director	5

[1] External directorships held within the same PCF Group of companies count as a single directorship.

* Resigned 21 May 2021

** Resigned 26 March 2021

*** Resigned as a director on 16 March 2020 and ceased to be an employee of the Company on 30 September 2020.

2.4. Principal risks

The eight principal risks to which the Group's business model is inherently exposed to are set out below. More information is included in the Group's Annual Report and Financial Statements. Post 2020, the Group has identified that Climate Change risk warrants inclusion as a principal risk.

Risk Categories	Risk Statement
Strategic and business risk The risk that the Group is unable to achieve its corporate and strategic objectives.	In order to maintain stakeholder confidence and market expectations, the Board seeks to operate the business in a way that optimises long term returns, within the approved risk appetite.
Credit risk The risk of a borrower or wholesale counterparty failing to meet its obligations in accordance with agreed terms leading to a financial loss on that borrower or counterparty's account.	The Group aims to minimise the impact on profitability from defaults through its diversification of lending operations, a prudent underwriting policy, and a considerate case management process when customers are in difficulty.

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

2.4.1. Management of strategic and business risk

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

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

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

The current view of strategic and business risks along with activities to address identified risks and issues are included within the Annual Report and Financial Statements 2020.

2.4.2. Management of credit risk

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

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

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

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

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

Additional information can be found in the Group's Annual Report and Financial Statements 2020.

2.4.3. Management of capital risk

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

The PRA supervises the Group on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. In addition, a number of subsidiaries are regulated for prudential purposes by either the PRA or the FCA.

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

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

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

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

2.4.4. Management of liquidity & funding risk

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

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

In order to ensure that levels and concentrations of funding do not lead to future liquidity risks, the Group monitors the stability of its funding exposures through a regulatory defined Net Stable Funding Ratio ('NSFR'). The Regulatory requirement for the NSFR is in excess of 100% however this is not applicable to the Group as the Group computes the NSFR ratio based on Internal behavioural assumptions and treatment.

Measure	2020	2019
LCR %	673%	715%
NSFR %	145%	129%

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

2.4.5. Management of market risk

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

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

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

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

The Group has limited appetite for foreign exchange risk and where assets are bought or sold in foreign currency (e.g., broking transactions), these are limited to short-term exposures.

2.4.6. Management of operational risk

The Group seeks to maintain an internal control environment to both mitigate operational risk, which is inherent to its business activities, and to minimise the financial impact of operational risk arising from IT disruption, human error, a breakdown of procedures, non-compliance with policy and internal or external fraud. Additionally, the Group will mitigate and limit the impact of business decisions on its cyber risk exposure. Activities against the most relevant operational risk sub-categories can be found in the Group's Annual Report and Financial Statements 2020.

2.4.7. Management of regulatory risk

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

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

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

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

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

2.4.8. Management of conduct risk

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

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

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

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

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

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

2.5. Controlling and managing risks

2.5.1. Risk Management Framework

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

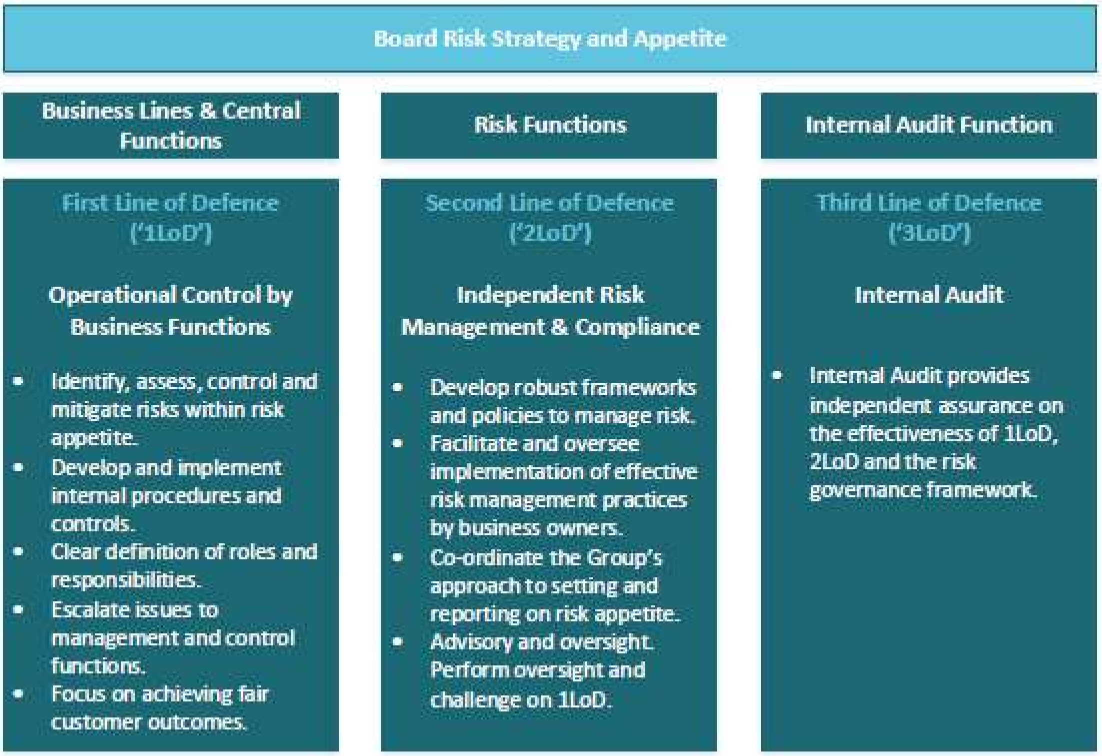
The Group is currently enhancing its RMF to ensure an appropriate articulation of individual and collective accountabilities for risk management, risk oversight and risk assurance that supports the discharge of responsibilities to customers, shareholders and regulators. The RMF seeks to establish a common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

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

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

2.5.2. Three lines of defence

The Group operates a ‘Three Lines of Defence’ model which defines clear responsibilities and accountabilities.



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

2.5.3. ICAAP, ILAAP and Stress Testing

The ICAAP, ILAAP, and associated stress testing exercises represent important elements of the Group’s ongoing risk management processes. The results of the risk assessment contained in these documents are embedded in the strategic planning process and risk appetite to ensure that sufficient capital and liquidity are available at all times to support the Group’s growth plans, as well as to cover its regulatory requirements at all times and under varying circumstances.

The ICAAP and ILAAP are required to be prepared on an annual basis and more often in the event of a material change in capital or liquidity. Due to the delay in finalising the Annual Report and Accounts 2020, the production of the ICAAP has also been delayed. Ongoing stress testing and scenario analysis outputs are used to inform the formal assessments and determination of required buffers, the strategy and planning for capital and liquidity management and the setting of risk appetite limits. BRC is responsible for reviewing and approving assumptions and stress scenarios in the planning stages of the ICAAP and ILAAP, including substantive changes to the previous assessment. ALCO will review, challenge, and recommend to BRC and Board, for approval, the Group’s ICAAP and ILAAP.

The Board and senior management have engaged in a number of exercises which have considered and developed stress-test scenarios. The output analysis enables management to evaluate the Group’s capital and funding resilience in the face of severe but plausible risk shocks. In addition to the UK variant test on capital prescribed by the PRA, the stress tests have included a range of Group-wide, multi-risk category stress tests, market-wide and idiosyncratic financial shocks and operational risk scenario analyses. Stress testing is an integral part of the adequacy assessment processes for liquidity and capital, and the setting of tolerances under the annual review of Group risk appetite.

The Group also performed reverse stress tests to help management understand the full continuum of adverse impact and, therefore, the level of stress at which the Group would breach its individual capital and liquidity guidance requirements as set by the PRA under the ICAAP and ILAAP processes.

2.5.4. Governance and oversight

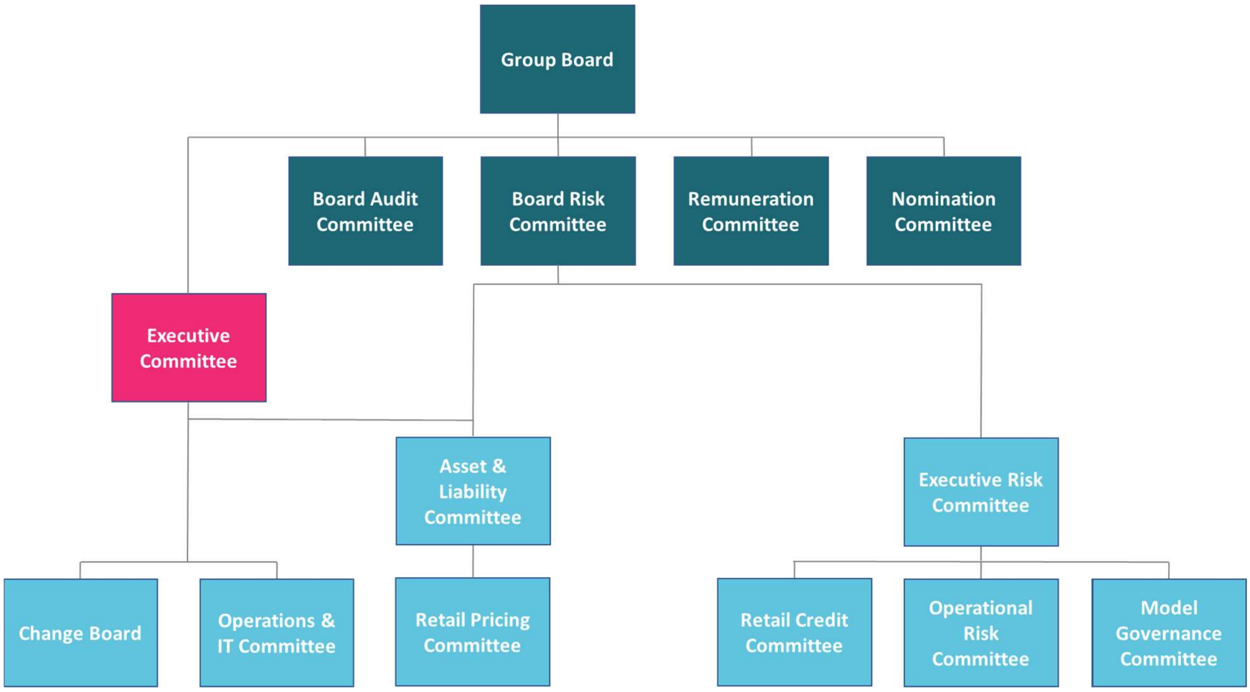
Governance is maintained through delegation of authority from the Board, down to Board sub-committees and lower level-management and risk committees. The committee-based structure has been enhanced to ensure that risk appetite, policies, procedures, controls and reporting are all fully in line with regulations,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

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

2.6. Board Committee Structures

The Board is principally supported by and delegates specific powers to a number of established Board committees, namely the:

- Nomination Committee.
- Remuneration Committee.
- Board Audit Committee.
- Board Risk Committee.
- Executive Committee.



2.6.1. Board (Chair Independent NED)

The role of the Board is:

- Developing corporate objectives, policies, and strategies.
- Reviewing and adopting the strategic business plan for the Group's effective business performance.

- Overseeing the conduct of the Group's business to evaluate whether the business is being managed effectively.
- Assessing, monitoring and promoting a sound corporate culture within the organisation including setting the Group's values and standards and ensuring that its obligations to all stakeholders are understood and met.
- Identifying principal risks and ensuring the implementation of appropriate systems to manage and monitor identified risks effectively.
- Reviewing the efficacy of internal control and of management information, including systems for compliance with applicable laws, regulations, rules, directives, and guidelines.
- Approval of RMF, insurance, and mitigation.
- Ensuring that appropriate systems are in place to promote whistleblowing and protect confidentiality of whistleblowers.
- Ensuring effective communication with the shareholders and other stakeholders.
- Ensuring that all candidates appointed to the senior management positions are of sufficient calibre and that there are programmes in place to enable orderly succession of senior management.
- Reviewing and approving acquisitions and disposals of undertakings and major investments.

2.6.2. Nomination Committee (Chair Independent NED)

The role of NomCo is:

- to review the structure, size, and composition of the Board;
- to lead the process for appointments to the Board and senior management;
- to ensure plans are in place for orderly succession to the Board and senior management positions; and
- to oversee the development of a diverse pipeline for succession.

2.6.3. Remuneration Committee (Chair Independent NED)

The role of RemCo is:

- Ensuring the Remuneration Policy, awards and incentives attracts and retains high calibre Directors and Senior Executives;
- Ensuring the Remuneration Policy is compliant with the Remuneration Code, relevant provisions of the PRA and FCA rulebooks, and the UK Listing Authority's Listing Rules and Disclosure and Transparency Rules and associated guidance;
- Reviewing annually the firm's Remuneration Policy Statement and the Statements of Responsibility for all persons carrying out Senior Management Functions;
- Ensuring Clawback and malus arrangements are included in respect of any annual bonus or long-term incentive awards in so that the Company can recover sums paid or withhold the payment of any sum in circumstances the Committee considers appropriate to do so; and
- The review of Group wide annual salary arrangements, performance related pay schemes and incentive plans and to consider and make recommendations in respect of their rationale, structure, and aggregate cost.

2.6.4. Audit & Risk Committee and Board Audit Committee (Chair Independent NED)

The role of Audit Committee is:

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

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

2.6.5. Board Risk Committee (Chair Independent NED)

The role of BRC is:

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

The structure of committees is set out in the Corporate Governance Structure section of the Corporate Governance Report of the Group's Annual Report and Financial Statements 2020. The role of key executive led committees is given below:

Executive Committee ('ExCo')

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

Assets & Liabilities Committee ('ALCO')

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

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

Executive Risk Committee ('ERC')

The ERC is responsible for development, implementation, monitoring and effectiveness of the Group's RMF. This committee commenced duties in April 2021.

3. IFRS 9

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

IFRS 9 requires the Group to categorise customer loans into one of three stages at the balance sheet date. Assets that are 'performing' are shown in stage 1; assets where there has been a significant increase in credit risk ('SICR') since initial recognition or 'deteriorating' assets are in stage 2; and accounts which are credit impaired or in 'default' are in stage 3.
Additional relevant information can be found in the 2020 PCF Group Annual Report and Financial Statements, including:

- Significant accounting policies – impairment of financial assets;
- Details of impairment allowances (credit risk adjustments);
- Details of the loans and advances impairment allowances at the reporting date and a reconciliation of the opening and closing allowances, including the charge to the income statement;
- Details of impaired exposures by stage; and
- Information on the Group's forbearance approach.

4. Key regulatory metrics

The table below summarises the key regulatory metrics as at 30 September 2020:

Key Metrics	30 September 2020	30 September 2019
	£'000	£'000
Regulatory capital		
Common Equity Tier 1 ("CET 1") capital	54,725	54,884
Tier 1 Capital	**54,725**	**54,884**
Subordinated Debt Tier 2 Capital	6,026	-
Total Regulatory Capital	**60,751**	**54,884**
Total Risk Weighted Assets ("RWAs")	**361,993**	**304,853**
Total Regulatory Capital as a Percentage of RWAs		
CET 1 Capital Ratio	15.1%	18.0%
Tier 1 Capital Ratio	15.1%	18.0%
Total Capital Ratio	16.8%	18.0%
Total Capital Requirement ("TSCR")	9.5%	9.5%
Liquidity		
Liquidity Coverage Ratio ("LCR")	673%	715%
Liquidity Buffer	32,134	16,077
Funding		
Net Stable Funding Ratio ("NSFR")	145%	129%

4.1. Regulatory capital framework

In 2010, the Basel Capital Accord was revised in response to the 2008 financial crisis. The updated regulation became known as Basel III and was implemented in the European Union on 1 January 2014 through the CRD and the CRR, which together are referred to as CRD IV.

CRD IV came into force in the EU on 1 January 2014. The Capital Regulations (as implemented in the UK by the PRA policy statement PS7/13) define a framework of regulatory capital resources and requirements. The rules include disclosure requirements known as "Pillar 3" which apply to banks, building societies and investment firms. These are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. CRD IV also made changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting within the EU.

On 23 November 2016, the European Commission launched a proposal to amend the Capital Requirement Directive ('CRD V'), Capital Requirement Regulation ('CRR II'), Banking Recovery and Resolution Directive ('BRRD') and the Senior Managers Regime ('SMR') Regulation.

Pillar 3 complements the minimum risk-based capital requirements and other quantitative requirements ('Pillar 1') and the supervisory review process ('Pillar 2') and aims to promote market discipline by providing meaningful regulatory information to investors and other interested parties on a consistent and comparable basis. The guiding principles aim to provide a firm foundation for achieving transparent, high-quality Pillar 3 risk disclosures that will enable users to better understand and compare the Bank's business and its risks.

The 3 Pillars are as summarised below:

- **Pillar 1:** Defines the minimum capital requirements that institutions are required to hold for credit, market and operational risks.
- **Pillar 2:** This builds on Pillar 1 and incorporates the PCF Group plc and its subsidiaries ('Group') own assessment of additional capital resources needed in order to cover specific risks that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of any additional capital requirement is also assessed by the PRA during its Supervisory Review and Evaluation Process ('C-SREP') and is used to determine the overall capital resources required by the Group.
- **Pillar 3:** Aims to improve market discipline by requiring banks to publish information on their principal risks, capital structure and risk management.

4.2. Capital requirements

The following table provides a summary of the capital requirements applicable to the Group, and brief details of the calculation method applied by the Group for each element of the requirements. Further details of each aspect can be found later in this document as highlighted.

<table>
<tr><th>Requirement</th><th>Calculation method</th><th>Description</th><th>Requirement</th></tr>
<tr><td>Credit Risk</td><td>Standardised Approach</td><td>The Group applies the standardised method to the entire loan book and other assets. The standardised approach applies a standardised set of risk weightings to credit risk exposures.</td><td rowspan="4">Pillar 1 requirements (as per Article 92 of the CRR):

• CET1 capital ratio of 4.5% of RWAs.

• Tier 1 capital ratio of 6% of RWAs.

• a total capital ratio of 8% of RWAs.</td></tr>
<tr><td>Counterparty Credit Risk</td><td>Standardised Approach</td><td>The Group applies the standardised "Mark-to-Market" method to relevant assets.</td></tr>
<tr><td>Market Risk</td><td>Standardised Approach</td><td>The Group applies the standardised method to relevant assets.</td></tr>
<tr><td>Operational Risk</td><td>Basic Indicator Approach ("BIA")</td><td>The Group applies the BIA for operational risk capital requirements in accordance with CRR Article 315.</td></tr>
<tr><td>Pillar 2A</td><td>Calculated by the PRA, based on the ICAAP submission</td><td>Percentage of RWAs.</td><td>Set by the PRA and not disclosed.</td></tr>
<tr><td>Pillar 2B</td><td>Calculated by PRA, based on the ICAAP submission</td><td>Based on outputs of internal stress testing, PRA buffer assessment and PRA buffer requirement.</td><td>Set by the PRA and not disclosed.</td></tr>
<tr><td>Capital Conservation Buffer ('CCoB')</td><td>Expressed as a percentage of RWAs</td><td rowspan="2">CCoB is part of the CRD IV combined buffer. It is held in combination with the CCyB and the PRA Buffer to ensure the Group can withstand an adverse market stress. The combination of the PRA buffer and the CRD IV combined buffer replaced the Capital Planning Buffer ("CPB") effective 1 January 2016.

All to be met by CET1 capital.</td><td>Commenced 1 January 2016, initially set at 0.625%, 1.875% for 2018, rising to 2.5% from 2019.</td></tr>
<tr><td>Counter-cyclical Capital Buffer ('CCyB')</td><td>Expressed as a percentage of total Pillar 1 RWAs</td><td>Set by the Financial Policy Committee ('FPC'). This buffer changes from 1% to 2% on 16th December 2020. However, on 11th March 2020 this buffer was reduced to 0%. See section 6.2.</td></tr>
<tr><td>PRA Buffer</td><td>Expressed as a percentage of total Pillar 1 RWAs</td><td>PRA buffer, in combination with the CRD IV combined buffer is held to ensure the Group can withstand an adverse market stress. The combination of the PRA buffer and the CRD IV combined buffer replaced the CPB, effective 1 January 2016. The PRA buffer needs to be fully met with CET1 capital from 2019.</td><td>PRA buffer is set by the PRA and is not disclosed.</td></tr>
</table>

4.3. Capital resources

The table below summarises the composition of regulatory capital. The Group's individual regulated entity and the Group as a whole complied with all of the externally imposed capital requirements to which they were subject for the year ended 30 September 2020.

	30 September 2020	30 September 2019
	£'000	£'000
Equity		
Issued capital	12,512	12,510
Share premium	17,625	17,619
Other reserves recognised for CET 1 capital	53	7
Investment in own shares	(147)	(355)
Retained earnings	23,832	28,974
Total Equity	**53,875**	**58,755**
Adjustments to Regulatory Capital		
Intangible assets, net of associated deferred tax liabilities ("DTL")	(4,327)	(5,941)
Adjustment for Prudent valuation	(9)	-
IFRS 9 transitional adjustment	5,186	2,070
Total deductions	**850**	**(3,871)**
Total CET 1 Capital	**54,725**	**54,884**
Other capital		
Additional Tier 1 capital	-	-
Subordinated Debt Tier 2 Capital	6,026	-
Total Regulatory Capital	**60,751**	**54,884**

The following table shows a reconciliation between statutory equity and total regulatory capital after deductions:

The following table shows a reconciliation between statutory equity and total regulatory capital after deductions:	30 September 2020	30 September 2019
	£'000	£'000
Equity	53,875	58,755
Regulatory deductions from equity:		
Intangible assets, net of associated DTL	(4,327)	(5,941)
IFRS 9 transitional adjustment	5,186	2,070
Adjustment for Prudent valuation	(9)	-
Subordinated debt issued by PCF Bank	6,026	-
Other reserves not recognised for CET 1 capital:	-	-
Cash flow hedging reserve	-	-
Total Regulatory Capital	**60,751**	**54,884**

The following table shows the movement in Total Regulatory Capital during the year:

The following table shows the movement in Total Regulatory Capital during the year:	30 September 2020 £'000	30 September 2019 £'000
Total Regulatory Capital at beginning of the year	54,884	39,594
Profit / (Loss) in the period attributable to shareholders	(4,258)	6,394
Shares issued in the year	2	1,899
Share premium less transactions costs	6	9,092
Share-based payments	117	79
Dividends paid	(1,001)	(750)
Movement in intangible assets, net of associated DTL	1,614	(3,486)
IFRS 9 transitional adjustment	3,116	2,070
Other movements in reserves recognised for CET 1 capital	46	(8)
Other movements in deductions from regulatory capital	199	-
Eligible Tier 2 issuance in the year	6,026	-
Total Regulatory Capital at the end of the year	60,751	54,884

Intangible assets include goodwill and capitalised software.

Below shows the reconciliation of regulatory capital to the balance sheet.

Group £'000	Carrying Values reported in Published financial statements	Carrying values underscope of regulatory consolidation	Carrying Value of Items		
			Subject to credit risk framework	Subject to CCR framework	Not subject to Capital requirements or subject to deduction from capital
Assets					
Cash and balances at central banks	24,936	24,936	24,936		
Debt instruments at FVOCI	9,095	9,095	9,095		
Loans and advances to customers	427,297	427,297	427,297		
Office equipment, fixtures, fittings and motor vehicles	3,144	3,144	3,144		
Goodwill and other intangible assets	4,327	4,327			4,327
Deferred tax assets	1,810	1,810	1,810		
Other assets	2,051	2,051	2,051		
Total assets	**472,660**	**472,660**	**468,333**	**-**	**4,327**
Liabilities					
Due to banks	62,620	62,620			62,620
Due to customers	341,784	341,784			341,784
Other borrowed funds	7,126	7,126			7,126
Derivative financial instruments	80	80		80	-
Lease liabilities	1,604	1,604			1,604
Current tax liabilities	125	125			125
Other liabilities	5,446	5,446			5,446
Total liabilities	**418,785**	**418,785**	**-**	**80**	**418,705**
Equity					
Issued capital	12,512	12,512			12,512
Share premium	17,625	17,625			17,625
Other reserves	53	53			53
Own shares	(147)	(147)			(147)
Retained earnings	23,832	23,832			23,832
Total equity	**53,875**	**53,875**	**-**	**-**	**53,875**
Total liabilities and Equity	**472,660**	**472,660**	**-**	**80**	**472,580**

4.3.1. Transitional Own Funds

The Group's capital position is reported on a transitional basis taking advantage of IFRS 9 transitional provisions.

5. Capital adequacy

The Group's capital planning process is forward looking and takes into account the types and distribution of capital over the 5-year planning horizon that the Group considers adequate to cover the level and nature of the risks to which the Group is or might become exposed. The Group has conducted stress testing and scenario analysis as part of this process and maintains its capital base to support the development of the business to ensure it meets the Pillar 1 Capital Requirements and Total SREP Capital Requirement ('TSCR') at all times.

The PRA requires the Group and Bank TSCR to be met with at least 56% Common Equity Tier 1 ('CET1') capital, no more than 44% Additional Tier 1 capital and no more than 25% Tier 2 capital.

The Group's CET1 capital ratio is 15.1% (2019: 18.0%) and its total capital ratio ('TCR') is 16.8% (2019: 18.0%).

5.1. Subordinated Note Facility

In September 2019 the Bank agreed a £15m subordinated debt facility with British Business Investments (BBI) that may be utilised as Tier 2 capital under CRR. This is a ten-year facility with an issuer's call option at par after five years. The main purpose of the facility is to provide regulatory capital at a commercially attractive price, versus the Group's target after-tax return on shareholders' capital, which does not dilute existing shareholders. The main terms of this facility are:

Total facility size:	£15m
Minimum tranche size:	£1.0m
Maximum tranche size	Lower of £5m or 6 x previous 3 month's SME lending
Coupon:	8% fixed per annum
Tranche maturity date:	10 years from drawing date of tranche
Tranche call date:	5 years from drawing date of tranche

5.2. ICAAP

The Group undertakes a group-wide internal capital adequacy assessment on an annual basis which is an integral part of the Group's risk management processes. The main output from the process is an assessment of all capital risks faced by the Group, determination of the level of capital required to be held against each major source of risk and an analysis of a number of stress tests over a five-year time horizon, which is the Group's standard business planning timescale. The ICAAP is subject to detailed review and challenge by the ALCO and the BRC before approval by the Board.

5.3. Pillar 1 capital requirements

The Group's Pillar 1 capital requirement is set out in the table below.

Risk Category	Risk Weighted Assets (RWA's)		Pillar 1 Capital Requirement	
	2020	2019	2020	2019
	£'000	£'000	£'000	£'000
Credit risk	321,525	274,880	25,722	21,990
Counterparty credit risk	16	50	1	4
Operational risk	40,433	29,833	3,235	2,387
Credit valuation adjustment	19	90	2	7
Total	**361,993**	**304,853**	**28,960**	**24,388**

The European Banking Authority ('EBA') guidance mandates 75% risk weighting for loans and advances to customer in the form of hire purchase loans and business loan financing where the amount outstanding is less than €1 million.

6. Regulatory capital buffers

The following regulatory capital buffers apply to the Group:

6.1. Capital Conservation buffer ('CCB')

The CCB applies to banks and has been developed to ensure capital buffers are available which can be drawn upon during periods of stress, if required. The buffer has been phased since 2016 at the rate of 0.625% p.a. to reach 2.5% in 2019. At 30 September 2020, the buffer was 2.5% (2019: 2.5%) of RWAs.

6.2. Countercyclical capital buffer ('CCyB')

At 30 September 2020, the CCyB buffer was 0% (2019: 1.0%) of RWAs.

From 16 December 2020 the FPC announced this will increase to 2%.

Following the spread of Covid-19, indicators of financial market uncertainty have reached extreme levels. On 11th March 2020 the FPC reduced the UK countercyclical capital buffer rate to 0% of banks' exposures to UK borrowers with immediate effect. The rate had been 1% and had been due to reach 2% by December 2020 as mentioned above. The FPC expects to maintain the 0% rate for at least 12 months, so that any subsequent increase would not take effect until March 2022 at the earliest.

7. Credit risk

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

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

The Group uses the Standardised Approach to calculate Credit Risk for Pillar 1 purposes. In the UK, banks are required to meet minimum capital requirements as prescribed by CRD IV for Pillar 1, namely a CET1 capital requirement of 4.5% of RWAs, a Tier 1 capital requirement of 6% of RWAs and a Total capital requirement of 8% of RWAs.

Credit risk RWAs make up the majority of the Group's total RWAs balance. Fully loaded ratios, which include the impact of IFRS 9, are provided for transparency in line with PRA recommendations. Credit RWAs at 30 September 2020 were £321.5 million (30 September 2019: £274.9 million).

7.1. Credit Risk: Definition of Default

The definition of default for the purpose of determining Expected Credit Losses ('ECLs') has been aligned to the CRR article 178 definition of default to maintain a consistent approach with IFRS 9. When exposures are identified as credit impaired, such interest income is calculated on the carrying value, net of the impaired allowance.

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

- When the borrower is more than 90 days past due on any material credit obligation to the Group.
- Significant financial difficulty of the issuer or the borrower.
- A breach of contract, such as default or past due event.
- It is becoming probable that the borrower will enter bankruptcy or liquidation, other forms of insolvency or financial reorganisation.

7.2. Credit Risk Standardised Approach

Across the Group exposure RWA values are derived using the standardised approach. This categorises exposures using the following defined risk weights:

Asset	CRR Article References	Risk Weight
Central governments or central banks	CRR Article 114	Risk weights range from 0% to 150% depending on ECAI[1] rating
Financial institutions	CRR Article 119, 120 & 121	Risk weights range from 20% to 150% depending on ECAI rating
Loan receivables bridging finance	CRR Article 125, 126	For residential property backed loans, Risk weights range from 35% to 150% dependent on various factors. For commercial property backed loans, Risk weights are 100% or 76.19% (SME discount factor).
Loan receivables - Consumers	CRR Article 123	75%
Loan receivables – SMEs (exposure <= €1.0m)	CRR Article 123	75%
Loan receivables – SMEs (exposure > €1m)	CRR Article 122	100%[2]
Defaulted Exposures	CRR Article 127	Risk weights range from 100% to 150% dependent on credit mitigation.

[1] External Credit Assessment Institution
[2] All unrated entities

7.3. SME Discount Factor

For the SME exposure class, and pursuant to CRR Article 501 the Group applies the SME supporting factor of 76.19% to initial risk weights. On 27 June 2020, a set of targeted "quick fix" amendments were adopted in Europe, which resulted in the accelerated implementation of certain CRR II rules, which were only due to take effect in June 2021. These amendments, which have been applied by the Group, has allowed the application of the revised supporting factor for exposures to small and medium-sized enterprises, to be advanced by one year.

7.4. Credit Risk Mitigation

The majority of lending is on a secured basis with collateral that is readily identifiable, recoverable and marketable. The security taken does not result in any reduction in RWAs under the standardised approach to credit risk. The group does not make use of on balance sheet netting for its loan receivables.

7.5. Credit risk exposure

The following table shows the total exposure value, RWA's and Pillar 1 requirement by exposure class at 30 September 2020:

2020

Asset	2020		
	Exposure value	RWA	Capital Requirement
	£'000	£'000	£'000
Central governments or central banks	24,911	4,525	362
Financial institutions	11,022	1,304	104
Loan receivables bridging finance	22,042	19,169	1,534
Loan receivables	336,780	221,429	17,714
Loan receivables > €1.0 million	54,066	49,484	3,959
Other items	25,631	25,630	2,050
Total	474,452	321,541	25,723

2019

Asset	2019		
	Exposure value	RWA	Capital Requirement
	£'000	£'000	£'000
Central governments or central banks	6,382	2,763	221
Financial institutions	21,732	4,397	352
Loan receivables bridging finance	12,890	5,717	457
Loan receivables	310,743	237,248	18,980
Loan receivables > €1.0 million	22,215	16,808	1,344
Other items	7,711	7,997	640
Total	381,673	274,930	21,994

The exposures are before applying risk weightings and include undrawn commitments after the application of the applicable credit conversion factors. The retail exposure class consists of loans under €1m to individuals and small and medium sized business entities with similar characteristics.

The following table shows a summary of contractual residual maturity at 30 September 2020.

2020

Asset £'000	2020				
	< 3 months	3-12 months	1-5 years	> 5 years	Total
Central governments or central banks	23,101	196	782	832	24,911
Financial institutions	1,927	-	9,095	-	11,022
Loan receivables bridging finance	3,848	16,721	1,473	-	22,042
Loan receivables	20,262	8,337	241,444	66,737	336,780
Loan receivables > €1.0 million	4,060	27,179	21,863	964	54,066
Other items	25,631	-	-	-	25,631
Total	78,829	52,433	274,657	68,533	474,452

2019

Asset £'000	2019				
	< 3 months	3-12 months	1-5 years	> 5 years	Total
Central governments or central banks	5,277		1,105		6,382
Financial institutions	2,094		19,638		21,732
Loan receivables bridging finance		12,890			12,890
Loan receivables	35,433	58,769	197,724	18,817	310,743
Loan receivables > €1.0 million	2,594	4,303	13,940	1,378	22,215
Other items	7,132		579		7,711
Total	52,530	75,962	232,986	20,195	381,673

7.6. Impairment of financial assets

The Group is required to recognise ECLs based on unbiased forward-looking information for all financial assets at amortised cost, lease receivables, debt financial assets at fair value through other comprehensive income, loan commitments and financial guarantee contract.

The Group uses the three-stage model for determination of expected credit losses:

- For loans where the credit risk has not increased significantly since initial recognition, a provision is recognised for the expected 12-month credit losses expected to be incurred (stage 1);
- For loans where there is deemed to be a significant increase in credit risk, a provision for the expected lifetime credit loss is recognised across the segment (stage 2); and
- For loans that are in Stage 3, the Group undertakes a specific impairment assessment.

For loans classified as Stage 1 or 2, an assessment is performed on a portfolio wide basis for impairment, with the key judgements and estimates being:

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

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

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

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

For financial guarantee contracts, the ECL is the difference between the expected payments to reimburse the holder of the guaranteed debt instrument less any amounts that the Group expects to receive from the holder, the debtor or any other party.

Further information on IFRS 9 can be found in the Group's Annual Report and Financial Statements 2020

7.6.1. Impairment allowance for loans and advances to customers

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

The tables below analyse impaired loans as treated for accounting purposes and past due loans as treated for regulatory purposes at 30 September 2020.

As at 30 September 2020

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Loans and advances to customers	**349,711**	**76,671**	**19,547**	**445,929**
Allowance for impairment losses	(3,179)	(3,300)	(12,153)	(18,632)
Net total	**346,532**	**73,371**	**7,394**	**427,297**

As at 1 October 2019

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
Loans and advances to customers	**307,294**	**22,425**	**15,624**	**345,343**
Allowance for impairment losses	(1,576)	(1,458)	(3,806)	(6,840)
Net total	**305,718**	**20,967**	**11,818**	**338,503**

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
As at 1 October 2019*	**1,576**	**1,458**	**3,806**	**6,840**
New assets originated or purchased	2,276	-	-	2,276
Remeasurements within existing stage	566	23	5,966	6,555
Impact on ECL of transfers	(158)	1,714	4,044	5,600
Transfers to Stage 1	224	(224)	-	-
Transfers to Stage 2	(883)	883	-	-
Transfers to Stage 3	(422)	(554)	976	-
Amounts written off	-	-	(2,639)	(2,639)
At 30 September 2020	**3,179**	**3,300**	**12,153**	**18,632**

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
As at 1 October 2018	**757**	**765**	**3,452**	**4,974**
New assets originated or purchased	1,223	7	13	1,243
Remeasurements within existing stage*	(339)	(72)	(1,088)	(1,499)
Transfers to Stage 1	136	(136)	-	-
Transfers to Stage 2	(64)	64	-	-
Transfers to Stage 3	(25)	(221)	246	-
ECL transfers	(112)	1,051	2,749	3,688
Amounts written off	-	-	(1,566)	(1,566)
At 30 September 2019	**1,576**	**1,458**	**3,806**	**6,840**

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

The Group's internal rating and PD estimation process

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

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

Forborne and modified loans

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

Forbearance analysis

At 30 September 2020, the gross carrying amount of exposures with forbearance measures was £40.4 million (30 September 2019: £nil). This relates to 1,711 agreements in forbearance which are COVID-19 related, with temporary modifications to terms and conditions. As at 30 September 2020, there are no loans that have had a refinancing or permanent modification to terms and conditions. COVID-19 related concession does not in itself constitute a significant increase in credit risk. Additional relevant information can be found in the Group's Annual Report and Financial Statements 2020.

8. Counterparty credit risk

The Group uses the Standardised Method to calculate Counterparty Credit Risk for Pillar 1 purposes. IRRBB is managed by first identifying and quantifying interest rate risk gaps due to mismatches between assets, liabilities and existing interest rate swaps, which is currently done using a spreadsheet model. This calculation is repeated at least monthly or more frequently if balance sheet growth or market conditions change materially.

Where a significant interest rate gap is identified, Treasury will execute an interest rate swap to hedge the position. Treasury will ensure that the economic value of equity (ΔEVE) and earnings at risk (EaR) are managed within policy limits at all times. Interest rate swap facilities are currently withdrawn though Management anticipate following, the Annual Report & Financial Statements 2020 finalisation and the Group's shares are no longer suspended from trading our bankers will, on review, reinstate these facilities.

Basis Risk will typically be managed by ensuring that the net exposure to SONIA/Bank Rate is maintained within risk appetite by ensuring that the net balance of assets, liabilities and swaps on which SONIA/Bank Rate is payable or receivable is maintained within policy limits. The Group has no exposure to Libor.

In February 2018, the Bank drew £25m of funding under the Bank of England's Term Funding Scheme ('TFS'). This funding has a final maturity date of February 2022 (four years from draw down), has an interest rate of BoE Bank Rate accrued daily, and is secured on pool of unregulated BFD receivables on which the BoE has conducted legal and operational due diligence. This pool of receivables is topped up twice per year in early April and October.

The Group is exposed to a very limited number of banking counterparties, namely:

- Barclays Bank: agency bank, Bank and subsidiary nostro accounts.
- U.S. Bank Global Corporate Trust Services: Securities custodian (treasury assets).
- NatWest: Bank and subsidiary nostro accounts, wholesale funding, repo, swaps.
- Funders re: wholesale funding.

The main banking counterparties, namely Barclays, U.S. Bank and NatWest, have been selected due to their size, systemic importance, diversity of business and creditworthiness. The Group monitors its credit and operational risk exposures to banking and wholesale counterparties to ensure that it and the Bank operate within risk appetite.

As regards funders, the risk here is that lines are withdrawn, and new lending is compromised. However, the Group's plans are to run down wholesale funding in favour of deposits, so this risk is limited and reducing.

The Group currently has no derivatives exposure to any exchange or central counterparty clearing (CCP). At present all of its derivative transactions have been executed on a bilateral basis with Barclays. Wholesale credit risk is governed by the Wholesale Credit Risk Policy which limits exposure to large UK and international money-centre banks operating in London and sets maximum credit risk exposure limits for each bank.

The Group uses derivatives exclusively to hedge IRRBB and so transacts sterling interest rate swaps only.

The Pillar 1 Counterparty Credit Risk capital requirement is set out below.

Counterparty Credit Risk	2020			
£'000	Notional	FV	RWE @50%	Capital @8%
<1 Year (@0%)	-	-	-	-
>1 to <= 5 years (@0.5%)	15,770	(80)	16	1
> 5 years (@1.5%)	-	-	-	-
Total	**15,770**	**(80)**	**16**	**1**

Counterparty Credit Risk	2019			
£'000	Notional	FV	RWE @100%	Capital @8%
<1 Year (@0%)	-	-	-	-
>1 to <= 5 years (@0.5%)	10,000	(63)	50	4
> 5 years (@1.5%)	-	-	-	-
Total	**10,000**	**(63)**	**50**	**4**

This is a relatively conservative and prudent approach to counterparty credit risk, as the above calculations do not consider credit risk mitigation such as ISDA Credit Support Annex collateralisation or central derivatives clearing.

9. Market risk

Market risk is the risk of losses or reduced value arising from on and off-balance sheet exposures when impacted by adverse movements in market prices and rates. Market risk predominantly results from interest rate exposures within the Group's banking book, with some additional risk arising from foreign exchange movements and credit effects.

Interest rate risk in the banking book (IRRBB) is the risk that the Group will be adversely affected by changes in the absolute level of interest rates, the spread between two rates, the shape of the yield curve, or in any other interest rate relationship.

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

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

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

The Group uses interest rate swaps are used to maintain interest rate risk within policy limits. At 30 September 2020 the Group carried a negative mark-to-market ('MTM') exposure for Credit Valuation Adjustment ('CVA') purposes of £19k against its swap counterparty, NatWest. The Group has an ISDA netting agreement in place which limits its exposure to £100k per counterparty.

Credit valuation adjustment	2020	2019
Pillar 1	£'000	£'000
Credit Valuation Adjustment	19	90
Capital @8%	2	7
Number of counterparties	1	1

Interest rate risk in the non-trading book

PCF Group does not have a trading book and therefore interest rate risk arises from within the banking book (IRRBB). This is the risk that the Group's income or value will be adversely affected by: changes in the absolute level of interest rates; the spread between two rates; the shape of the yield curve; or in any other interest rate relationship.

Where possible within the limits set by the Board, the Group manages the risk through natural offsets across the balance sheet, with both assets and liabilities being predominantly fixed. Where this is not feasible the Group will use the appropriate financial instruments which are predominantly interest rate swaps. All of the swaps entered into over this period were SONIA linked. Following natural offsets and the use of swaps, the residual position creates an interest rate risk exposure which is managed within limits set by the Board and monitored by ALCO, ExCo, BRC and the Board.

The BRC delegates responsibility to ALCO for oversight over the management of IRRBB and gives day to day responsibility for the management of the residual IRRBB position including the purchase of swaps for the purpose of managing the Group's interest rate risk, to the Treasury team. IRRBB risk appetite has been set to reflect the Group's relatively low appetite for such risks but with sufficient capacity to allow for the risks that arise due to the nature of the assets and liabilities described above. To the extent necessary, the Group uses interest rate swaps to ensure that the measures are maintained within risk appetite (refer to section 8 for current restrictions). To monitor the risks the group is focused on Economic Value measures (e.g. EV200bp), Net Interest Margin and earnings volatility. An additional stress test to the basis risk component of IRRBB is undertaken using a 200bp sensitivity to administered /SONIA rates.

In addition, the Group has a very small exposure to Foreign Exchange (FX) risk which is manages predominantly through the setting of exposure limits and an assessment which looks at a conservative change in the Sterling/Euro exchange rate of 15%. Overall, the total market risk limit for a severe but plausible stress for IRRBB and FX is £1m.

10. Operational risk

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

The Group seeks to maintain an internal control environment to both mitigate operational risk, which is inherent to its business activities, and to minimise the financial impact of operational risk arising from IT disruption, human error, a breakdown of procedures, non-compliance with policy and internal or external fraud. Additionally, the Group will mitigate and limit the impact of business decisions on its cyber risk exposure. Activities against the most relevant operational risk sub-categories can be found in the Group's Annual Report and Financial Statements 2020.

This Operational Risk Policy has been designed in accordance with the 'Principles for the Sound Management of Operational Risk' issued by the Basel Committee on Banking Supervision. It is the responsibility of the Board to ensure that a strong operational risk management culture exists throughout the Group.

The Group uses the Basic Indicator Approach for the calculation of Operational Risk under Pillar 1. In accordance with Supervisory Statement SS31/15 the Group in its ICAAP will provide at least the following operational risk data information:

- forecast operational risk losses, broken down between conduct and non-conduct losses and by future year; and
- information on the operational risk scenarios considered in the ICAAP, covering a description of such scenarios and an assessment of their impact and likelihood.

The Basic Indicator Approach (BIA) has been used to calculate Operational Risk for the purposes of Pillar 1, using the last 3 years audited results at 15% of the average of actual net operating income.

11. Leverage

The leverage ratio is a transparent, comparable measure which is not affected by risk weightings. It is calculated as tier 1 capital divided by adjusted balance sheet exposure. The level of leverage is actively monitored and regularly assessed alongside capital and capital ratios. The following Table LRSum and LRCom follow the formats that are prescribed by the EBA.

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures:

CRR leverage ratio exposure	2020	2019
	£'000	£'000
Total assets as per published financial statements	472,660	378,069
Adjustments for derivative financial instruments	32	-
Adjustments for Securities Financing Transactions ("SFTs")	-	-
Adjustments for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	1,797	-
Other adjustments	1,620	-
Total leverage exposure	**476,109**	**378,069**

Table LRCom: Leverage ratio common disclosure:

CRR leverage ratio exposure	2020	2019
	£'000	£'000
On-balance sheet exposures (excluding derivatives and SFTs):		
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	473,430	378,069
Asset adjustments in determining Tier 1 capital	850	(5,941)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**474,280**	**372,128**
Derivative exposures:		
Total derivative exposures	32	-
Securities financing transaction exposures:		
Total securities financing transaction exposures	-	-
Other off-balance sheet exposures:		
Other off-balance sheet exposures	1,797	-
Capital and total exposures:		
Tier 1 capital - transitional definition	54,725	54,884
Total Leverage Ratio exposure - using a transitional definition of Tier 1 capital	476,109	372,128
Leverage Ratio - using a transitional definition of Tier 1 capital	**11.49%**	**14.75%**

Table LRSpl: Split of on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures):

CRR leverage ratio exposure	2020 £'000	2019 £'000
Total on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures), of which:	**474,280**	**372,128**
Banking book exposures, of which:		
Exposures treated as sovereigns	24,911	5,277
Financial Institutions	1,896	21,732
Loans and advances to customers	352,302	338,503
Deferred tax assets	1,810	1,105

12. Asset encumbrance

Asset encumbrance is the process by which assets are pledged, in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn.

The Pillar 3 asset encumbrance disclosure templates, shown below, have been compiled in accordance with PRA and EBA regulatory reporting requirements, specifically the PRA's supervisory statement SS11/14 ("CRD IV: Compliance with the EBA's Guidelines on the disclosure of encumbered and unencumbered assets"). In accordance with the threshold criteria under SS11/14, the Group is not required to report Template B on the fair value of encumbered and unencumbered collateral received. Table below shows the carrying amount included in the regulatory templates, the fair value of encumbered and unencumbered assets by asset category and also the carrying value of encumbered assets and associated liabilities by sources of encumbrance. Volatility in the level of encumbered assets is not significant and the use of monthly data is not expected to result in materially different information compared to the data below.

As at September 2020:

Template A: Encumbered and unencumbered assets	2020			
	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	£'000	£'000	£'000	£'000
Assets of the reporting institutions	**103,182**	**114,716**	**333,210**	**380,259**
Loans and advances to customers	103,182	114,716	324,115	371,164

As at September 2019:

Template A: Encumbered and unencumbered assets	2019			
	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	£'000	£'000	£'000	£'000
Assets of the reporting institutions	**75,629**	**83,068**	**282,512**	**312,913**
Loans and advances to customers	66,546	73,985	271,957	302,358

Information on the importance of encumbrance

The Group reviews all asset types against the criteria of being able to finance them in a secured form (encumbrance), but certain asset types lend themselves more readily to encumbrance. The typical characteristics that support encumbrance are an ability to pledge those assets to another counterparty or entity through operation of law without necessarily requiring prior notification, homogeneity, predictable and measurable cash flows and a consistent and uniform underwriting process. Assets such as loans secured on equipment, plant and vehicles under conditional sale or hire purchase agreements and finance leases display many of these features.

The Group primarily encumbers assets through positioning loans as collateral to receive wholesale funding. The Group may also hold cash collateral received in relation to derivative transactions. The Group's main source of encumbrance is through its participation in the Bank of England TFS scheme.

The Group monitors the level of encumbrance to ensure it remains within approved Risk Appetite limits which are based on loan book and balance sheet encumbrance levels.

13. Remuneration

Full details of the Group's Executive Directors' remuneration can be found in the Remuneration Committee ('RemCo') Report of the Annual Report and Financial Statements. Additional disclosures required under CRD IV in relation to the remuneration of Code staff are included in this section.

13.1. Overview of remuneration for Code staff

The FCA has defined certain requirements relating to remuneration, referred to as the Remuneration Code ("the Code"). Firms that fall within the scope of the Code (which includes banks) must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management.

A firm must maintain a record of its Code Staff (being those staff whose professional activities have a material impact on the firm's risk profile) and take reasonable steps to ensure Code Staff understand the implications of their status.

Remuneration Code Staff, also known as Material Risk Takers (MRTs), consist of Executive Directors, Non-Executive Directors and certain senior managers, including senior manager functions (SMFs) who could have a material impact on the firm's risk profile. At 30 September 2020, the Group employed a total of 24 MRTs (referred to as Code Staff in the table below) in accordance with CP18/21 (Remuneration: Identification of material risk takers). Of these, 8 individuals were Executive and Non-Executive Directors, and 15 individuals were internally certified by the firm and classified as 'Other Code Staff' in the table below. The remuneration for these employees is governed under the Group Remuneration Policy.

13.2. Approach to remuneration

The approach taken by the Group in respect of remunerating colleagues emanates from a combination of regulatory guidance and, in particular, the Dual-Regulated Firms Remuneration Code (SYSC 19D), as appropriate for Level 3 firms, the rules on remuneration as published by the PRA and FCA as amended from time to time, and its own best judgement. These guidelines assist with the design of awards and incentive packages which aim to support the recruitment and retention of colleagues, align with risk appetite and the long-term interests of the Group.

Fundamentally, our approach to remuneration aims to promote and reward the right behaviours to ensure that the interests of our customers and stakeholder value are at the forefront of everything we do. The level of expertise and experience of the executive team also requires the committee to benchmark remuneration and rewards to a peer group of similar companies.

Due to the size of our business, the Group applies proportionally to the Remuneration principle (SYSC 19D.3.3R (2)) to ensure the practices and processes we promote are appropriate to size, internal organisation and the nature, scope and complexity of activities.

13.3. Remuneration Committee

RemCo has delegated responsibility from the Board for reviewing the performance of the executive directors, succession planning and remuneration of the directors and other senior executives. Membership of RemCo is limited to non-executive directors and chaired throughout the year by David Titmuss. Where appropriate, RemCo consults external advisers on remuneration and regulatory issues to align with the strategic aims of the Group and regulatory compliance requirements.

13.4. Guiding principles for remuneration

The Group's remuneration policy is applicable to all its colleagues.

The objective of the policy is to recruit and retain high calibre talent, capable of achieving the Group's objectives and to encourage and reward superior performance and the creation of shareholder value. The policy further sets out the use of performance-based remuneration to motivate and reward high performers who strengthen long-term customer relations, generate income, demonstrate the required behaviours (teamwork, co-operation, customer focus, risk awareness), comply with regulation, support a controlled environment, deliver good customer outcomes, protect and enhance shareholder value.

The Group's remuneration policy does not encourage taking risks that exceed the risk appetite of the Group. The remuneration policy enables incentives to be provided with the purpose of meeting the Group's long-term strategic objectives and general goals in areas of risk management, positive customer outcomes, regulatory and statutory compliance and other key stakeholder expectations.

The following guiding principles underpin the remuneration policy:

- The recognition that the Group operates in a competitive environment for experienced and valued executives.

- Interests of our colleagues are aligned with the interests of our customers, long-term interests of the Group, shareholders and other stakeholders in the Group, as well as the public interest.
- Colleagues are not to be rewarded for taking risks that are unwarranted.
- Principles of ‘malus’ and ‘clawback’ will be implemented where relevant.

In addition, our remuneration policy is consistent with the principles and provisions of the 2018 UK Corporate Governance Code in terms of:

- Clarity – this report provides open and transparent disclosure of our remuneration policy and remuneration received by the directors.
- Simplicity and alignment to culture – our remuneration policy and arrangements are straightforward and aligned to the Group’s culture and values.
- Predictability – incentive schemes contain maximum opportunity levels with outcomes varying dependent on the level of performance achieved against specific objectives.
- Proportionality and risk – variable remuneration arrangements are designed to provide a fair and proportionate link between Group performance and reward, with ‘malus’ and clawback provisions in place.

As a Level 3 firm under the Remuneration Code guidance on proportionality (SYSC 19D), the Group does not apply the following rules:

- Retained shares or other instruments (SYSC 19D.3.56R).
- Deferral (SYSC 19D.3.59R).
- Performance adjustment (SYSC 19D.3.61R – 62R).

The Group seeks to combine various remuneration and incentive components to ensure an appropriate and balanced remuneration package that reflects responsibilities, the employee’s role in a professional activity as well as market practice. The four remuneration components that every colleague may be eligible to receive include:

- Basic salary.
- Benefits.
- Cash bonus.
- Share options.

13.5. Remuneration for the year

13.5.1. Share based payments

In 2018, the Company introduced a share-based long-term incentive plan for senior executives and other key colleagues. The plan has performance criteria attached regarding Group performance and shareholder return. Share options under the plan are only settled on achievement of the criteria. No changes or additions in the long-term incentive scheme were made during the year.

Details of the interests in the Company’s shares of the directors, including their connected persons and share options granted to previous executive directors are detailed in the Directors’ Report in the Annual Report and Financial Statements 2020. No options were granted nor exercised during the year. None of the Executive Directors received share based remuneration in the financial year.

Other directors’ interests in the Group are disclosed in the Annual Report and Financial Statements 2020.

13.5.2. Key activities in the year

The committee’s activities during the year included the review and determination of salary increases and bonuses for both the executive directors and all Group colleagues. In so far as it being available, the committee gathered information regarding remuneration decisions made by other banks and financial services companies during the COVID-19 pandemic.

Given the effects of COVID-19 on the certainty of the Group’s financial performance, as part of the annual pay review, Remco concluded that there should be no discretional payments made under the company’s various bonus arrangements. A small number of adhoc recognition payments were approved by Remco in January 2021 for efforts in relation to the pandemic, totalling £38,000.

The former Chief Executive Officer apprised the committee on the efforts made by colleagues who were required to work from home, with a special emphasis on their well-being.

In terms of executive director changes during the year, the committee considered and approved the terms David Bull settlement package during the year when he resigned as a director on 16 March 2020 and left the Company’s employment on 30 September 2020.

Information on the demographics of our colleagues were supplied to the committee, with a particular focus on pay by gender. We are confident that positive progress is being made in further developing a culture which is fair to and respects customers, appropriately manages risk, appreciates and rewards colleagues and gives equal opportunities to all.

Remco met four times during the year to 30 September 2020.

Since 30 September 2020, the committee has met to consider the total remuneration of the two newly appointed Executive Directors as well as other key executive appointments and changes in the Senior Management team.

13.5.3. Fixed remuneration

Fixed remuneration comprises basic salaries and benefits including healthcare and life assurance cover. These are provided on the same basis for all colleagues. The Company has a workplace pension scheme with Standard Life, with a Company contribution rate based on 7% of basic salary.

The Directors' contribution rate is based on 10% of basic salary. These are outside the workplace scheme and contributions are paid to a scheme of their choice or as a cash equivalent where annual or lifetime pension allowances have been reached.

The Company's contribution to the pension schemes of the Directors and other colleagues are not aligned in accordance with the provisions of the 2018 UK Corporate Governance Code. RemCo will review this matter during the financial year 2021 (with a view to developing a plan to reduce such contributions so that they align with those of the majority of the work force for new senior Executive hires).

13.5.4. Variable remuneration

The annual performance award is a significant variable component of the overall remuneration and is at the discretion of RemCo. In determining the level of award paid to the then Chief Executive, Managing Director and Finance Director, consideration was given not only to the financial performance of the Group (including returns to shareholders and the Group's profitability) in 2020, but also to their individual performance, based on a number of personal objectives. As a result of the financial performance of the Group in the year to 30 September 2020, no annual bonuses were paid to the executive directors.

13.5.5. Non-executive directors

Non-executive directors are engaged under letters of appointment. Non-executive directors are subject to retirement by rotation every three years, or, if appointed during the year, are subject to retirement at the next Annual General Meeting ('AGM'). Non-executive directors who are subject to retirement at the AGM are eligible for re-appointment. Non-executive directors participate in decisions concerning their own fees together with the recommendation of the executive directors, taking into account comparisons with peer group companies, their overall experience and knowledge and the time commitment required for them to undertake their duties, including any additional duties undertaken during the year.

13.5.6. Remuneration disclosures

The Group adheres to the requirements of the dual-regulated firm's Remuneration Code. The non-executive directors do not receive variable remuneration.

	Financial year ended 30 September 2020		
Remuneration Type	**Executive Directors (3) £'000**	**Non-Executive Directors (6) £'000**	**Other Code Staff (15) * £'000**
Total Fixed remuneration			
- Cash-based	670	333	1,588
- Benefits in kind	6		
- Other	202		
Total Variable remuneration			
- Cash-based	-		49
- Long-term incentive	-		
Pension and insurance	34		101
Total Remuneration	**912**	**333**	**1.738**

*Excludes interim management

The table below shows the amount and severance and guaranteed variable remuneration payments made to Code Staff during the financial year ended 30 September 2020, as well as any individual's remuneration over £1 million.

Remuneration Type	Number of individuals
Severance payments	0
Guaranteed variable remuneration payments	0
Individuals remunerated over £1 million	0

Appendix A: Disclosures for PCF Bank Limited (Company No: 02794633)

In accordance with Article 13 of the CRR, this Appendix sets out the reduced Pillar 3 disclosures of the Bank, the significant subsidiary of the Group. The differences between the Group and the Bank relate primarily to reserves held by entities that sit outside the scope of the Bank that are included in the Group consolidation.

Capital Composition at 30th September	30 September 2020 £'000	30 September 2019 £'000
Equity		
Issued capital	31,298	31,298
Retained earnings	21,879	22,939
Other eligible reserves	51	7
Total equity per balance sheet	**53,228**	**54,244**
Adjustments to Regulatory Capital		
Intangible Assets, net of associated deferred tax liability	(3,180)	(3,044)
Investment in subsidiaries	-	(487)
Adjustment for Prudent valuation	(9)	(20)
IFRS 9 transitional adjustment	4,396	1,533
Total deductions	**1,207**	**(2,018)**
CET 1 Capital	**54,435**	**52,226**
Subordinated Debt Tier 2 Capital	7,000	-
Total Regulatory Capital	**61,435**	**52,226**
Total Regulatory Capital as a Percentage of RWAs		
Total Capital Ratio	18.1%	18.2%
CET 1 Capital Ratio	16.1%	18.2%
Tier 1 Capital Ratio	16.1%	18.2%
Total Capital Requirement ("TSCR")	9.8%	9.8%

The following table shows a reconciliation between statutory equity and total regulatory capital after	30 September 2020 £'000	30 September 2019 £'000
Equity	53,228	54,244
Regulatory deductions from equity:		
Intangible assets, net of associated DTL	(3,180)	(3,044)
Investment in subsidiaries	-	(487)
IFRS 9 transitional adjustment	4,396	1,533
Adjustment for Prudent valuation	(9)	(20)
Sub Debt	7,000	-
Total Regulatory Capital	**61,435**	**52,226**

The following table shows the movement in Total Regulatory Capital during the year:	30 September 2020	30 September 2019
	£'000	£'000
Total Regulatory Capital at beginning of the year	**52,226**	**33,899**
Profit in the period attributable to shareholders	(1,060)	7,793
Shares issued in the year	-	10,000
Dividends paid	-	-
Movement in intangible assets, net of associated DTL	(136)	(484)
IFRS 9 transitional adjustment	2,863	1,533
Share premium less transactions costs	-	-
Movement in Investment in subsidiaries	487	(487)
Other movements in reserves recognised for CET 1 capital	44	(8)
Other movements in deductions from regulatory capital	11	(20)
Tier 2 issuance in the year	7,000	
Total Regulatory Capital at the end of the year	**61,435**	**52,226**

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures.

CRR leverage ratio exposure	2020	2019
	£'000	£'000
Total assets as per published financial statements	466,348	357,987
Adjustments for derivative financial instruments	32	-
Adjustments for Securities Financing Transactions ("SFTs")	-	-
Adjustments for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	1,657	-
Other adjustments	(16,563)	(3,044)
Total leverage exposure	**451,474**	**354,943**

Table LRCom: Leverage ratio common disclosure.

CRR leverage ratio exposure	2020 £'000	2019 £'000
On-balance sheet exposures (excluding derivatives and SFTs):		
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	466,431	357,987
Asset adjustments in determining Tier 1 capital	(16,646)	(3,044)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**449,785**	**354,943**
Derivative exposures:		
Total derivative exposures	32	-
Securities financing transaction exposures:		
Total securities financing transaction exposures	-	-
Other off-balance sheet exposures:		
Other off-balance sheet exposures	1,657	-
Capital and total exposures:		
Tier 1 capital - transitional definition	54,435	52,226
Total Leverage Ratio exposure - using a transitional definition of Tier 1 capital	451,474	354,943
Leverage Ratio - using a transitional definition of Tier 1 capital	**12.06%**	**14.71%**

Appendix B: EBA Regulatory Capital Balance Sheet Reconciliation

Solo £'000	Carrying Values reported in Published financial statements	Carrying values underscope of regulatory consolidation	Carrying Value of Items		
			Subject to credit risk framework	Subject to CCR framework	Not subject to Capital requirements or subject to deduction from capital
Assets					
Cash and balances at central banks	23,811	23,811	23,811		
Debt instruments at FVOCI	9,095	9,095	9,095		
Loans and advances to customers	408,982	408,982	408,982		
Due from related companies	17,853	17,853	17,853		
Investment in subsidiaries	1,209	1,209	1,209		
Property, plant and equipment	888	888	888		
Intangible assets	3,180	3,180			3,180
Deferred tax assets	740	740	740		
Other assets	590	590	590		
Total assets	466,348	466,348	463,168	-	3,180
Liabilities					
Due to banks	62,412	62,412			62,412
Due to customers	341,784	341,784			341,784
Subordinated Debt	7,126	7,126			7,126
Derivatives	80	80		80	-
Other liabilities	1,718	1,718			1,718
Total liabilities	**413,120**	**413,120**	-	**80**	**413,040**
Equity					
Issued capital	31,298	31,298			31,298
Other reserves	51	51			51
Retained earnings	21,879	21,879			21,879
Total equity	**53,228**	**53,228**	-	-	**53,228**
Total liabilities and Equity	466,348	466,348	-	80	466,268

Appendix C: EBA Capital Instruments Key Features

Capital Instruments main features template			
1	Issuer	PCF Group plc	PCF Bank Limited
2	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	GB0004189378	n/a
3	Governing law	English	English
Regulatory treatment			
4	Transitional CRR rules	CET 1	CET 1
5	Post-transitional CRR rules	CET 1	CET 1
6	Eligible at Group or Bank	PCF Group	PCF Bank Solo Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary shares	Ordinary shares
8	Regulatory capital value (£'000)	30,137	31,298
9	Nominal amount of instrument	5p	£1
9a	Issue price (£'000)	12,512	31,298
9b	Redemption price (£'000)	n/a	n/a
10	Accounting classification	Equity	Equity
11	Original date of issue	Various	Various
12	Perpetual or dated	Perpetual	Perpetual
13	Original maturity date	n/a	n/a
14	Issuer call subject to prior supervisory approval	n/a	n/a
15	First call date	n/a	n/a
16	Subsequent call dates, if applicable	n/a	n/a
Coupons / dividends			
17	Fixed or floating dividend/coupon	n/a	n/a
18	Coupon rate and any related index	n/a	n/a
19	Existence of a dividend stopper	n/a	n/a
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Fully discretionary
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Fully discretionary
21	Existence of step up or other incentive to redeem	n/a	n/a
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative
23	Convertible or non-convertible	n/a	n/a
24	If convertible, conversion triggers	n/a	n/a
25	If convertible, fully or partially	n/a	n/a
26	If convertible, conversion rate	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	n/a
28	If convertible, specify instrument type convertible into	n/a	n/a
29	If convertible, specify issuer of instrument it converts into	n/a	n/a
30	Write-down feature	n/a	n/a
31	If write-down, trigger(s)	n/a	n/a
32	If write-down, full or partial	n/a	n/a
33	If write-down, permanent or temporary	n/a	n/a
34	If write-down, description of write-up mechanism	n/a	n/a
35	Instrument type immediately sold	n/a	n/a
36	Non-compliant transitioned features	n/a	n/a
37	If yes, specify non-compliant features	n/a	n/a