Nemo Personal Finance Limited

Annual report for the year ended 31 December 2018

Registered Number: 05188059

Annual report
for the year ended 31 December 2018

Contents

Officers and professional advisers

Directors	D Rigney (resigned 1 January 2018) I A Mansfield J S Mycroft S Hughes (resigned 25 September 2018) T Denman (appointed 18 January 2018)
Secretary	M Borrill (resigned 1 January 2018) C Cooper (appointed 1 January 2018)
Registered office	Principality Buildings Queen Street Cardiff Wales CF10 1UA
Bankers	Barclays Bank Plc 3rd Floor Windsor Court Windsor Place Cardiff Wales CF10 3BX
Solicitors	Eversheds Sutherland LLP 1 Callaghan Square Cardiff Wales CF10 5BT
Auditors	Deloitte LLP 5 Callaghan Square Cardiff Wales CF10 5BT

Strategic report
for the year ended 31 December 2018

Strategic Report

Nemo Personal Finance Limited continued to perform as expected, fulfilling an important role within the Principality Building Society group.

The Company ceased accepting new business in March 2016. Following a successful transition from lender to servicer, the business has delivered solid results in 2018, continuing to focus on delivering good customer outcomes, robust management of costs and exploiting synergies with Principality Building Society (the Parent).

Key performance indicators

Year ended 31 December	2018	2017
Profit before tax (£000's)	11,915	17,126
Profit before tax as a % of mean assets	4.3%	4.8%
Total assets (£000's)	236,399	312,361
Change in total assets	(24.3)%	(23.0)%
Non-performing loans (6+ months in arrears) (£000's)	5,515	8,074
Non-performing loans (6+ months in arrears) (volume)	181	253
Yield %	9.0%	8.9%

Business review

As expected, the Company saw a decrease in profit in 2018, with profit before tax of £11.9m (2017: £17.1m). This decrease is due to overall book size continuing to reduce following closure to new business in 2016.

Loans in the portfolio continue to demonstrate strong credit quality with a low level of impairment. Arrears performance across the portfolio and continued run-off of the book has reduced the impairment provision held in the statement of financial position to £8.9m (2017: £9.8m[1]).

Interest margin, the effective interest earned on loans to customers after deducting funding costs, has been maintained at 5.2% (2017: 5.2%).

The Company offers a range of account management and forbearance options for the borrower. In the event of short-term difficulty, the Company operates temporary reductions in payments and 'rehabilitation' tools for borrowers in arrears or pre-delinquency.

Principal risks and uncertainties

The Company's operations expose it to a variety of financial and non-financial risks that include the effects of credit risk, conduct risk, liquidity risk and operational risk.

The key risks to the Company are linked to the overall performance of the economy and the resultant effect on interest rates, unemployment and house price indices, together with customer and conduct risks. Overall risk is managed in line with the Parent's policy and further information on this can be found in the Parent Company financial statements on pages 49 to 67.

[1] 2018 impairment provision is calculated in accordance with IFRS 9 Financial Instruments, 2017 was calculated in accordance with IAS 39 Financial Instruments: Recognition and Measurement. See note 1 for further details.

Strategic report
for the year ended 31 December 2018 (continued)

Credit risk

Credit risk is the risk that a customer or counterparty will fail to meet their financial obligations to the Company as they become due. Credit risk policies were in place to reduce the risk of lending to retail customers who may be unable to afford to repay the loans. The credit risk policy had a number of criteria in relation to income, debt to income ratio, loan to value ratio and credit score to minimise the credit risk.

Conduct risk

Conduct risk is the risk that the Company does not treat its customers fairly, resulting in inappropriate or unfair outcomes. The sustainability of the Company's business model and the achievement of its strategy are dependent upon the consistent and fair treatment of customers. Furthermore, the regulatory regime in the UK continues to highlight the importance of firms' conduct and their approach to deliver fair customer outcomes. Consequently, the Company continues to focus heavily on its risk and control framework to manage conduct risks. Oversight is provided by the Group Customer, Conduct and Transformation Committee and the Group's Compliance and Conduct function.

Liquidity risk and capital management

Liquidity risk is the risk that the Company has insufficient funds to meet its obligations as and when they fall due. The Parent monitors risk exposure and the reporting of liquidity risk takes the form of cash flow measurement. Sources of liquidity are regularly reviewed by the Finance Committee.

Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, systems, human error or from external events.

The Parent has an established operational risk management framework which is utilised to identify, assess and monitor operational risk, including fraud, system failure, cyber threats and business continuity. The assessment of exposure to operational risks is based on both quantitative and qualitative considerations. Appropriate strategies are in place to manage and mitigate the risks that could impact the Company's ability to meet its business objectives whilst protecting its reputation. The crystallisation of operational risks is captured through the recording of operational losses and near misses. The analysis of loss events is used to identify any potential systemic weaknesses in operational processes. Oversight is provided by the Operational Risk Committee.

Future developments

Total assets and profits are expected to continue to reduce over time as the loan book runs off. The focus of the business will remain on providing a high level of service to customers whilst housekeeping the portfolio and managing the risks to which the Company is exposed.

Approved by the Board

I A Mansfield
Director
6 February 2019

Directors' report
for the year ended 31 December 2018

The Directors present their report and the financial statements of the Company for the year ended 31 December 2018.

Principal activities

The principal activity of the Company is loan servicing.

Dividends and transfer to reserves

The results for the period are set out in the income statement. The Directors do not recommend the payment of a dividend (2017: £nil).

Going concern

The Parent, Principality Building Society, prepares forecasts, projections and scenario testing which includes Nemo Personal Finance Limited. These are carried out in accordance with the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP). These processes are required by the regulators to demonstrate appropriate levels of capital and liquidity under stressed conditions. These take account of possible changes in trading performance and show that the Parent will be able to operate within the sources of funding currently available to it.

The Parent monitors its liquidity levels to ensure that an appropriate level of resources is maintained to meet the requirements of the business. These are assessed under a number of stressed scenarios reflecting the Directors' views of different risks that might arise under current economic conditions.

As presented in the statement of financial position, the Company has financial resources, including an intercompany loan from its Parent, which the Parent has confirmed it will not seek repayment in the next 18 months, to meet its day-to-day working capital requirements. The Company's forecasts, taking into account reasonable possible changes in trading performance, show that the Company will be able to operate within the sources of funding currently available to it.

Having considered the plans and forecasts for the Company and events up to and including the date of signing, the Directors believe that there are no material uncertainties that cast significant doubt on the Company's ability to continue in business for the foreseeable future. Accordingly, the financial statements continue to be prepared on a going concern basis.

Future developments and financial risk management objectives and policies have been disclosed within the Strategic Report on pages 4-5.

Directors

The current Directors of the Company are as shown on page 3.

Directors' report
for the year ended 31 December 2018 (continued)

Directors' responsibilities statement

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

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

Auditor

All Directors at the time of approving this report confirm the following:

(a) so far as each Director is aware, there is no information of which the Company's auditor is unaware, and

(b) each Director has taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information, and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Deloitte LLP have expressed their willingness to continue in office as auditor and the Board of Directors has resolved that Deloitte LLP should be reappointed.

Approved by the Board

I A Mansfield
Director
6 February 2019

Independent Auditor's report to the members of Nemo Personal Finance Ltd

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Nemo Personal Finance Limited (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the income statement;
- the statement of changes in shareholders' equity;
- the statement of financial position;
- the statement of cash flows; and
- the related notes 1 to 22.

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

Basis for opinion

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

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

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

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

We have nothing to report in respect of these matters.

Independent Auditor's report to the members of Nemo Personal Finance Ltd (continued)

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

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

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

Independent Auditor's report to the members of Nemo Personal Finance Ltd (continued)

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Use of our report

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

K. J. Cooper

Kieren Cooper (Senior statutory auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Cardiff, United Kingdom
6 February 2019

Income statement
for the year ended 31 December 2018

Continuing operations:	Notes	2018 £'000	2017 £'000
Interest receivable and similar income	4	21,495	27,610
Interest payable and similar charges	5	(7,082)	(9,043)
Net interest income		14,413	18,567
Fees and commissions receivable		177	244
Fees and commissions payable		(45)	(21)
Net income		14,545	18,790
Impairment (loss)/gain on loans	10	(221)	5,349
Regulatory provisions	12	33	(1,500)
Operating expenses		(2,442)	(5,513)
Profit before taxation	6	11,915	17,126
Income tax expense	8	(2,282)	(3,281)
Profit for the financial year		9,633	13,845

There are no items of other comprehensive income and therefore no Statement of Other Comprehensive Income has been prepared.

The accounting policies and notes on pages 15 to 33 form part of these accounts.

Statement of changes in shareholders' equity for the year ended 31 December 2018

	Notes	2018 £000	2017 £000
Profit for the financial year		9,633	13,845
Net increase to shareholders' equity		9,633	13,845
Opening shareholders' equity on 1 January 2018		84,387	70,542
Changes on initial application of IFRS 9	1	987	-
Tax effect of IFRS 9 implementation		(168)	-
Restated balance at 1 January 2018		85,206	-
Closing shareholders' equity		94,839	84,387

The accounting policies and notes on pages 15 to 33 form part of these accounts.

Statement of financial position as at 31 December 2018

	Notes	2018 £'000	2017 £'000
Assets			
Loans and receivables	10	236,348	312,007
Deferred sale consideration	20	49	145
Deferred tax	14	2	209
Total assets		236,399	312,361
Liabilities			
Trade and other payables	11	1,735	3,156
Regulatory provisions	12	3,285	3,820
Short-term loans and overdrafts	13	287	487
Current tax		1,072	1,750
Long-term loans	13	135,181	218,761
Total liabilities		141,560	227,974
Equity			
Called up share capital	15	100	100
Retained profit		94,739	84,287
Total equity		94,839	84,387
Total equity and liabilities		236,399	312,361

The financial statements of Nemo Personal Finance Limited, registered number 05188059, on pages 11 to 33, were approved by the Board of Directors and authorised for issue on 6 February 2019.

I A Mansfield
Director

Statement of cash flows for the year ended 31 December 2018

	Notes	2018 £'000	2017 £'000
Net cash inflow from operating activities:			
Cash from operating activities (see below)		83,780	108,781
Net cash from operating activities		83,780	108,781
Cash flows used in investment activities:			
Purchase of property, plant and equipment		-	(3)
Net cash used in investing activities		-	(3)
Cash flows used in financing activities:			
Repayment of loan advanced by parent company	19	(83,580)	(109,473)
Net cash used in financing activities		(83,580)	(109,473)
Net increase/(decrease) in cash and cash equivalents		200	(695)
Cash and cash equivalents at start of year		(487)	208
Cash and cash equivalents at end of year		(287)	(487)
Cash and cash equivalents comprise:			
Short-term loans and overdrafts		(287)	(487)

Net cash inflow from operating activities:			
Profit for the year before tax	8	11,915	17,126
Adjusted for:			
Depreciation	6	-	139
Decrease in provision for impairment		(839)	(5,481)
(Decrease)/increase in regulatory provision		(535)	1,141
Net decrease in loans		76,498	97,849
Decrease in deferred consideration and other assets		95	262
(Decrease)/increase in trade and other payables		(1,421)	243
Equity adjustment for accounting policy changes		987	-
Taxation		(2,920)	(2,498)
Net cash inflow from operating activities		83,780	108,781

Notes to the financial statements for the year ended 31 December 2018

1. *Accounting policies*

Basis of preparation

The Company's financial statements for the year ended 31 December 2018 have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union (EU). The financial statements are prepared under the historical cost convention except for certain financial assets held at fair value.

The financial statements have been prepared on a going concern basis. This is discussed in the Directors' Report on page 6, under the heading 'Going concern'.

New and amended standards adopted by the Company

A number of new or amended standards became applicable for the current reporting period. The Company has changed its accounting policies and made retrospective adjustments as a result of adopting IFRS 9 Financial Instruments. There was no impact from the adoption of IFRS 15 Revenue from Contracts with Customers, as all non-interest revenue streams are immaterial.

The impact of the adoption of IFRS 9 and the new accounting policies are disclosed below. The amendments to existing standards did not have any impact on the Company's accounting policies and did not require retrospective adjustments.

Adoption of IFRS 9 Financial Instruments

The adoption of IFRS 9 from 1 January 2018 has resulted in changes to accounting policies and adjustments to the amounts recognised in the financial statements. As permitted by the transitional provisions of IFRS 9, comparative figures have not been restated and comparative period notes disclosures repeat those made in the prior year.

IFRS 9 Financial Instruments - Impact of adoption

Classification and measurement

On transition to IFRS 9 management has assessed both the business models for managing financial assets and the cashflow characteristics of the assets. This has resulted in the following classifications and measurement for the company's financial assets:

Financial instrument	IAS 39 measurement basis	IFRS 9 measurement basis	IAS 39 carrying amount 31 December 2017 £'000	IFRS 9 carrying amount 1 January 2018 £'000
Loans and receivables	Amortised cost	Amortised cost	311,780	312,767
Deferred sale commission	FVTPL	FVTPL	145	145

All changes to the carrying amount of financial assets are due to changes in impairment provisioning. There were no classification changes on adoption of IFRS 9.

There were no changes to the classification or measurement of financial liabilities.

Notes to the financial statements for the year ended 31 December 2018

1. Accounting policies (continued)

Loans and receivables

IFRS 9 outlines a three stage model for impairment based on changes in credit quality since initial recognition. Each stage represents a change in the credit risk of a financial instrument since origination. Credit risk is measured using probability of default (PD), exposure at default (EAD) and loss given default (LGD). If a *significant increase in credit risk (SICR) since initial recognition is identified but the asset is not yet deemed to be* credit impaired, the financial instrument is moved from stage 1 to stage 2. Financial instruments that are deemed to be credit impaired are moved to stage 3.

Financial instruments in stage 1 have their expected credit loss (ECL) measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Financial instruments in stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis.

Significant increase in credit risk

There are three main components to the staging criteria for the loan portfolio. In order to move from stage 1 to stage 2 a loan is *required to meet at least one of the following criteria:*

1. Forbearance activity;
2. PD grade deterioration over a predetermined threshold relative to the starting point; and
3. 30 days past due.

Loans are moved from stage 2 to stage 3 when they are credit impaired. Loans are considered to be credit impaired if they are 90 days past due or the borrower has been declared bankrupt.

Subject to the characteristics of the borrower and completion of a probation period, a loan will move back from stage 2 or 3 following a reversal of the criteria described above.

The split of loans between stages 1, 2 and 3 is as follows:

Stage	On transition on 1 January 2018 %	31 December 2018 %
1	78	77
2	17	18
3	5	5

The split of the loans within stage 2 by staging reason is as follows:

Staging reason	On transition on 1 January 2018 %	31 December 2018 %
PD grade deterioration	82	79
30-60 days past due	18	21

Notes to the financial statements for the year ended 31 December 2018

1. Accounting policies (continued)

Expected Credit Loss Models

Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- PD is the likelihood of a borrower defaulting on its financial obligation either in the next 12 months or over the remaining lifetime of the obligation.
- EAD is based on the amounts the Company expects to be owed at the time of default.
- LGD represents the Company's expectation of the extent of loss on defaulted exposures.

PD is calculated via a behavioural scorecard approach, using internal account level specific data including arrears history and external credit profile data provided by credit reference agencies.

Forward-looking information in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward looking information. The Company has performed historical analysis and identified the economic variables impacting credit risk and expected credit losses for each portfolio.

Forecasts of these economic variables together with probability weightings are supplied by an external provider. Economic scenarios have been selected which take account of a range of possible economic outcomes.

The scenarios consist of the following:

Scenario	Weighting on 1 January 2018 and 31 December 2018 %	GDP Growth %	Unemployment growth %	House price growth %
Base	44.7	1.5	0.8	1.3
Stronger near term growth	10.7	2.7	(0.6)	5.2
Mild recession	26.8	0.9	1.5	(0.6)
Protracted slump	7.1	(0.9)	4.3	(6.8)
Stagflation	10.7	(0.1)	3.1	(2.9)

In addition to applying the scenarios and weightings set out above, further allowance has been made for the impact of the UK not achieving an orderly exit from the EU by the deadline of 29 March 2019. This allowance, which totalled £1.7m at 31 December 2018, has been determined by increasing the probability that factors impacting the determination of ECLs, including GDP growth, house price growth and unemployment, will be more to the downside than the existing weightings assume. These include a 3.0% average fall in house prices, 2.8% increase in unemployment and GDP remaining largely flat between 2019 and 2021.

Notes to the financial statements for the year ended 31 December 2018

1. Accounting policies (continued)

Impact of standards issued but not yet applied

At the date of authorisation of these financial statements, a number of new standards and interpretations, which have not been applied in these financial statements, were in issue but not yet effective. Of these, IFRS 16 Leases, is expected to have a significant impact.

IFRS 16 Leases

IFRS 16 specifies how an entity will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases. This will bring those leases previously classified as "operating leases" on balance sheet.

The Company only holds one property lease, the future minimum lease payments for which are set out in note 17. The lease contract ends in 2020 and the impact of adopting IFRS 16 is therefore not expected to be significant.

Accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, except where stated below.

(a) Revenue

Revenue primarily comprises interest receivable on customer loans outstanding. All revenue is derived in the UK.

Interest

Interest income or expense is recognised on all interest-bearing financial assets classified as loans and receivables, and on financial liabilities, using the effective interest method.

The effective interest rate is the rate that exactly discounts the expected future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the instrument. The application of the method has the effect of recognising income (and expense) receivable (or payable) on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

Fees and commissions payable are included in the calculation of the effective interest rate to the extent that they can be measured and are considered to be an integral part of the effective interest rate. The effective interest rate calculation therefore recognises commissions payable on day one to third parties for the introduction of loans and advances to customers; interest earned on loans settled earlier than the contractual maturity date; and other cash flows arising from the direct and incremental costs of issuing financial instruments over the expected life of the financial instrument.

Notes to the financial statements
for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

(b) Financial assets and liabilities

From 1 January 2018 - IFRS 9 Financial Instruments

Classification and measurement

Financial assets

Financial assets comprise customer loans and receivables and deferred sale consideration.

At initial recognition, the Company measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVTPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are expensed in profit or loss. Thereafter, financial assets are classified and measured in one of the three following measurement categories:

- those to be measured at amortised cost;
- those to be measured subsequently at fair value through other comprehensive income; or
- those to be measured subsequently at fair value through profit or loss.

The classification and subsequent measurement of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows.

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost using the effective interest method, net of provision for impairment. Interest earned from these financial assets is included in interest receivable and similar income. Impairment losses are presented as separate line item in the income statement.
- FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in fair value are taken through OCI and, on derecognition, the cumulative gain or loss previously recognised in OCI is reclassified to the income statement. Interest is recognised using the effective interest method and included in interest receivable and similar income.
- FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL.

Financial liabilities

Financial liabilities comprise short-term loans and overdrafts and long-term loans and are measured at fair value on initial recognition and thereafter at amortised cost.

From 1 January 2017 to 31 December 2017 - IAS 39 Financial Instruments: Recognition and Measurement

Financial assets

The Company's financial assets are customer loans and receivables. They are non-derivative assets with fixed or determinable payments that are not quoted in an active market and are not classified as available-for-sale. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method.

Financial liabilities

Financial liabilities are measured at fair value on initial recognition and thereafter at amortised cost.

Notes to the financial statements for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

(c) Impairment of financial assets

From 1 January 2018 - IFRS 9 Financial Instruments

From 1 January 2018, the Company assesses on a forward-looking basis the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. This assessment is performed on a monthly basis. The impairment methodology applied depends on whether there has been a significant increase in credit risk. Further information on the calculation of expected credit losses can be found in the 'IFRS 9 - Impact of Adoption' section above.

From 1 January 2017 to 31 December 2017 - IAS 39 Financial Instruments: Recognition and Measurement

The Company assesses at each statement of financial position date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. The factors that the Company takes into account include significant financial difficulties of the debtor, a breach of contract or default in payments, the granting by the Company of a concession to the debtor because of a deterioration in its financial condition, or the probability that the debtor will enter into bankruptcy or other financial reorganisation.

The Company also considers observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, arising from adverse changes in the payment status of borrowers in the portfolio and national or local economic conditions that correlate with defaults on assets in the portfolio.

The Company first assesses whether objective evidence of impairment exists for individually significant financial assets and then collectively assesses remaining financial assets that are not individually significant. An additional provision has been allocated to performing loans which have potential impairment indicators such as previous arrears experience and insolvency issues. In addition portfolios of financial assets with similar credit risk characteristics are also collectively assessed for recoverability.

Impairment allowances are measured as the difference between the asset's carrying amount and the estimated recoverable amount, calculated by reference to the expected cash flows discounted at the asset's original effective interest rate.

(d) Cash and cash equivalents

For the purposes of the cash flow statement and statement of financial position, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, other amounts due from banks and short-term government securities. For the purposes of the cash flow statement, the cash and cash equivalents balance is stated net of short-term loans and overdrafts.

(e) Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the statement of financial position date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

Notes to the financial statements for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

(f) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and provisions for impairment, if any. Additions and subsequent expenditures are capitalised only to the extent that they enhance the future economic benefits expected to be derived from the assets. Land and buildings comprise the professional fees for acquiring the qualifying asset.

Depreciation is provided on the depreciable amount of items of property, plant and equipment on a straight-line basis over their estimated useful lives. The depreciable amount is the gross carrying amount, less the estimated residual value at the end of its economic life.

The company uses the following annual rates in calculating depreciation:

Computers and similar equipment (IT software)	20-33%
Fixtures and fittings, other equipment and vehicles	10-20%
Land and buildings	10%

Depreciation rates, methods and the residual values underlying the calculation of depreciation of items of property, plant and equipment are kept under review to take account of any change in circumstances.

(g) Leases

Operating lease rentals payable are recognised as an expense in the income statement on a straight-line basis over the lease term.

(h) Employee benefits

Defined contribution schemes

Contributions to defined contribution schemes are recognised as an expense in the income statement in the accounting period to which they relate. Any unpaid contributions are recognised in the statement of financial position as a liability.

Short-term employee benefits

Short-term employee benefits, such as salaries, paid absences and other benefits, are accounted for on an accruals basis over the period in which employees have provided services in the year. Bonuses are recognised to the extent that the Company has a present obligation to its employees that can be measured reliably.

All expenses related to employee benefits are recognised in the income statement in staff costs, which is included within operating expenses.

Notes to the financial statements for the year ended 31 December 2018 (continued)

1. Accounting policies (continued)

(i) Taxes, including deferred taxes

Tax payable on taxable profits ("current tax") is recognised as an expense in the period in which the profits arise. Tax recoverable on tax allowable losses is recognised as an asset only to the extent that it is regarded as recoverable by offset against current or future taxable profits.

Deferred tax is provided in full, using the liability method, on temporary timing differences arising from the differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and legislation enacted or substantively enacted by the statement of financial position date and is expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

2. Judgements in applying accounting policies and critical accounting estimates

There are no significant judgements made in applying the group's accounting policies. However, there are significant estimation uncertainties which affect the amounts recognised in the financial statements. Critical accounting estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year.

The most significant areas where accounting estimates are made are as follows:

The nature of judgements and estimates made in respect of calculating the impairment provision on loans and advances have changed following the adoption of IFRS 9 on 1 January 2018.

Impairment provision on loans and receivables

The critical accounting judgements and estimates applied in determining expected credit loss provisions are:

- determining criteria for identifying significant increase in credit risk.
- choosing appropriate models and assumptions for the measurement of expected credit losses; and
- establishing the number and relative weightings of forward-looking economic scenarios.

Critical judgements and estimates will be reviewed on an ongoing basis as part of the group's IFRS 9 model governance process.

Notes to the financial statements
for the year ended 31 December 2018 (continued)

2. Judgements in applying accounting policies and critical accounting estimates (continued)

Sensitivity analysis has been performed on the staging criteria and PD models described above. A 10% variance has been selected as this is deemed to be the maximum variation likely to occur over a 12 month period in the current economic environment. The impact of 10% of the loans currently in stage 1 moving to stage 2 and the impact of 10% of loans currently in stage 2 moving to stage 1 are as follows:

Stage	£'000
Stage 1 to stage 2	100
Stage 2 to stage 1	(400)

The impact of a 10% change to the PD rates would cause a £614k change in impairment provisions.

The IFRS 9 models calculate expected credit losses for each of the scenarios and then apply the weightings to generate the weighted output for each model. Sensitivity analysis has been performed on the impact of the economic scenarios. The range of ECL impact between the most optimistic scenario and the most severe scenario is £5.4m. The ECL range is the difference between applying a 100% weighting to the most severe downturn scenario and the most optimistic scenario.

Regulatory provisions

Regulatory provisions have been made in respect of various customer claims, including claims in relation to previous sales of Payment Protection Insurance. At 31 December 2018, the Company held a provision of £3.3m (2017: £3.8m). This reflects management's best estimate of the costs required to settle its remaining obligations and takes account of:

- expected customer behaviour ahead of the August 2019 deadline for claims;
- costs incurred with associated legal claims; and
- an updated assessment of the remaining exposure population.

Although a significant degree of uncertainty remains with regard to the ultimate cost of settling customer claims, in particular the claim behaviour of customers ahead of the confirmed deadline, the provision balance is expected to be sufficient to meet any remaining obligations. The provision will continue to be monitored ahead of the deadline and customer trends and behaviour analysed in order ensure the provision remains appropriate as circumstances become clearer. Further information is included in notes 12 and 21.

3. Operating segments

The Company operates a single material operating segment, secured personal lending. The Company operates entirely within the UK and therefore a geographical segment analysis is not required.

4. Interest receivable and other similar income

Interest income consists of interest receivable on customer loans and early settlement interest, less origination costs and commissions payable to third parties for the introduction of loans and advances to customers.

5. Interest payable and similar charges

Interest expense consists of interest and other charges payable on funding from the Parent.

Notes to the financial statements for the year ended 31 December 2018 (continued)

6. Profit before taxation

	2018 £'000	2017 £'000
Staff costs	-	2,430
Depreciation of owned property, plant and equipment	-	139

There were no non-audit services received in either the current or prior year. All audit fees were borne by the Parent entity in the current and prior year. Total Group audit fees for 2018 were £265k and this includes audit fees relating to the Company.

7. Company employees and key management, including directors

Staff costs comprise the following:

	2018 £'000	2017 £'000
Wages and salaries	-	2,134
Social security costs	-	190
Pension costs	-	106
	-	2,430

Nemo employees were transferred across to the Parent at the beginning of 2018 (2017: 51).

Directors' remuneration

The Directors' emoluments for S Hughes, I Mansfield, J S Mycroft, D Rigney and T Denman were paid by the Parent for their services across both entities. It is not practicable to allocate their respective remuneration across the different Group entities.

8. Income tax expense

	2018 £'000	2017 £'000
Current tax:		
United Kingdom corporation tax	2,246	3,278
Adjustments in respect of prior years	(3)	(25)
Deferred tax:		
Deferred tax charge (credit) for year	39	28
Total tax expense	2,282	3,281

The actual tax expense for the year differs from that calculated using the standard rate of corporation tax in the UK. The differences are explained below.

	2018 £'000	2017 £'000
Profit before tax	11,915	17,126
Profit before tax multiplied by the rate of corporation tax of 19.00% (2017: 19.25%)	2,264	3,297
Adjustments in respect of prior years	(3)	(25)
Other	21	9
Total tax expense	2,282	3,281

The statutory rate of corporation tax is 19.0%. The statutory rate of corporation tax will be reduced to 17.0% from April 2020.

Notes to the financial statements for the year ended 31 December 2018 (continued)

9. Property, plant and equipment

2018	IT software £'000	Land and buildings £'000	Equipment and vehicles £'000	Total £'000
Cost				
At 1 January 2018	817	83	6,693	7,593
Disposals	(817)	(83)	(6,693)	(7,593)
At 31 December 2018	-	-	-	-
Depreciation				
At 1 January 2018	817	83	6,693	7,593
Disposals	(817)	(83)	(6,693)	(7,593)
At 31 December 2018	-	-	-	-
Net book value				
At 31 December 2018	-	-	-	-

2017	IT software £'000	Land and buildings £'000	Equipment and vehicles £'000	Total £'000
Cost				
At 1 January 2017	817	83	6,688	7,588
Additions	-	-	5	5
At 31 December 2017	817	83	6,693	7,593
Depreciation				
At 1 January 2017	817	83	6,554	7,454
Charge for the year	-	-	139	139
At 31 December 2017	817	83	6,693	7,593
Net book value				
At 31 December 2017	-	-	-	-

10. Loans and receivables

An analysis of loans and receivables based on contractual payments is as follows:

	2018 £'000	2017 £'000
Customer loans	236,205	312,060
Less: impairment allowance	(8,935)	(9,774)
Net customer loans	227,270	302,286
Unamortised loan origination costs	7,694	7,870
Accrued interest	1,237	1,625
	236,201	311,781
Other prepayments and accrued income	147	226
	236,348	312,007

Notes to the financial statements
for the year ended 31 December 2018 (continued)

10. Loans and receivables (continued)

Provision for impairment losses

Group	Nemo
	£m
New loans	-
Settled loans	(1.1)
Changes in credit quality	(1.9)
Changes in model assumptions	3.1
Utilised provision	-
P&L impact	(0.2)
Balance Sheet impact	(0.1)

PD Band	Sum of ECL	Coverage
	£m	%
< 0.11%	-	-
0.11% - 0.17%	-	-
0.17% - 0.25%	-	0.1
0.25% - 0.41%	-	-
0.41% - 0.60%	0.04	0.1
0.60% - 0.88%	0.10	0.2
0.88% - 1.49%	0.28	0.7
1.49% - 2.96%	0.84	2.3
2.96% - 6.84%	1.33	9.6
> 6.84%	6.35	19.1
Grand Total	8.94	

Provision for impairment losses under IFRS 9

	Stage 1 12-month ECL £'000	Stage 2 Lifetime ECL £'000	Stage 3 Lifetime ECL £'000	Total £'000
Loss allowance as at 1 January 2018	341	4,218	4,228	8,787
Transfers:				
Stage 1 Transfers	5			5
Stage 2 Transfers		(137)		(137)
Stage 3 Transfers			(270)	(270)
New loans	-	-	-	-
Settled loans	(51)	(313)	(698)	(1,062)
Changes in credit quality	(67)	(752)	(658)	(1,477)
Changes in model assumptions	1	2,269	819	3,089
Loss allowance at 31 December 2018	229	5,285	3,421	8,935

Provision for impairment losses under IAS 39

	2017
	£'000
At 1 January	15,254
Amounts written off during the year	(131)
Release of provision for loan impairment	(5,349)
At 31 December	9,774

Notes to the financial statements for the year ended 31 December 2018 (continued)

11. Trade and other payables

An analysis of trade and other payables in less than one year is as follows:

	2018 £'000	2017 £'000
Social security and other taxes	-	33
Accruals and deferred income	975	1,442
Sundry creditors	760	1,681
	1,735	3,156

12. Regulatory provisions

	2018 £'000	2017 £'000
At 1 January	3,820	2,679
Additions	-	1,500
Utilisation	(535)	(359)
At 31 December	3,285	3,820

Regulatory provisions have been made in respect of various customer claims, including claims in relation to previous sales of Payment Protection Insurance.

In March 2017, the FCA issued a Policy Statement (PS17/3) which confirmed a deadline for PPI claims of August 2019. PS17/3 also confirmed that both up-front commission arrangements and profit share arrangements should be considered in the calculation of total commission for Plevin complaints. There have been no further policy statements during 2018 which have had a material impact on the Company's position.

At 31 December 2018, the Company held a provision of £3.3m (2017: £3.8m). This reflects management's best estimate of the costs required to settle its remaining obligations and takes account of:

- expected customer behaviour ahead of the August 2019 deadline for claims;
- costs incurred with associated legal claims; and
- an updated assessment of the remaining exposure population.

Although a significant degree of uncertainty remains with regard to the ultimate cost of settling customer claims, in particular the claim behaviour of customers ahead of the confirmed deadline, the provision balance is expected to be sufficient to meet any remaining obligations. The provision will continue to be monitored ahead of the deadline and customer trends and behaviour analysed in order ensure the provision remains appropriate as circumstances become clearer.

13. Financial liabilities

An analysis of the Company's borrowings is as follows:

	2018 £'000	2017 £'000
Current:		
Bank overdrafts	287	487
Non-current :		
Intercompany loans (see note 19)	135,181	218,761

All loans are with the Parent, of which the Company is a subsidiary. Amounts due to the Parent are unsecured and obligations have no fixed repayment date.

Notes to the financial statements for the year ended 31 December 2018 (continued)

14. Deferred tax

The components and movements on the deferred tax account during the year were as follows:

	1 January 2018	Income Statement	Directly through Equity	31 December 2018
	£'000	£'000	£'000	£'000
Assets				
Accelerated capital allowances	209	(39)	-	170
Other	-	-	(168)	(168)
Total	209	(39)	(168)	2

	1 January 2017	Income Statement	Directly through Equity	31 December 2017
	£'000	£'000	£'000	£'000
Assets				
Accelerated capital allowances	237	(28)	-	209
Total	237	(28)	-	209

The rate of corporation tax for the 2019 financial year will be 19% and the rate from 1 April 2020 will be 17%. The impact of this change in rate has been assessed and will not have a material impact on the Company's deferred tax position.

15. Called up share capital

	2018	2017
	£'000	£'000
Authorised, allotted and fully paid		
100,000 ordinary shares of £1	100	100

16. Financial risk management

The main financial risks that the Company is exposed to, and its management policy with respect to those risks, are as follows:

- Interest rate risk: the possibility that changes in interest rates will result in higher financing costs and/or reduced income from the Company's interest-bearing financial assets and liabilities.
  Interest rate risk is an inherent trading risk which is actively monitored by the Board.
- Credit risk: the risk that counterparties to the Company's financial assets may default.
  A range of policies and practices is employed to mitigate credit risk – the most common is the taking of security for funds advanced.
- Liquidity risk: the risk that the Company's cash and committed facilities may be insufficient to meet debts as they fall due.
  The Company maintains a mixture of committed facilities, including primarily financial support from the Parent, Principality Building Society, that are designed to ensure the Company has sufficient available funds for operations.

Notes to the financial statements for the year ended 31 December 2018 (continued)

16. Financial risk management (continued)

The Company's Directors are required to follow the requirements of the Principality Building Society risk management policies, which include specific guidelines on interest rate and credit risks, and advice on the use of financial instruments to manage them.

The risk management policy is in line with the Parent entity – Principality Building Society. Refer to the risk management note in the Society's annual accounts which will be published on the Society's website (http://www.principality.co.uk/).

Maturity of financial instruments

Financial assets 2018	Loans and receivables £'000	Financial liabilities 2018	Borrowings £'000
In one year or less	1,350	In one year or less	287
In more than one year but less than two years	4,043	In more than one year but less than two years	-
In more than two years but less than five years	32,292	In more than two years but less than five years	135,181
After five years	198,516	After five years	-
Total	236,201		135,468

Financial assets 2017	Loans and receivables £'000	Financial liabilities 2017	Borrowings £'000
In one year or less	32,247	In one year or less	487
In more than one year but less than two years	27,183	In more than one year but less than two years	-
In more than two years but less than five years	64,226	In more than two years but less than five years	218,761
After five years	188,125	After five years	-
Total	311,781		219,248

Interest rate risk on financial instruments

The effective interest rates at 31 December 2018 were as follows:

	%
Financial assets - Loans and receivables	9.1
Financial liabilities - Borrowings	4.0

The effective interest rates at 31 December 2017 were as follows:

	%
Financial assets - Loans and receivables	8.9
Financial liabilities - Borrowings	3.1

Notes to the financial statements
for the year ended 31 December 2018 (continued)

16. Financial risk management (continued)

The Company's exposure to interest changes at 31 December 2018 was as follows:

	1 year	1-5 years	Total
	£'000	£'000	£'000
Financial assets			
Loans and receivables	236,201	-	236,201
Financial liabilities			
Borrowings	135,181	-	135,181

The Company's exposure to interest changes at 31 December 2017 was as follows:

	1 year	1-5 years	Total
	£'000	£'000	£'000
Financial assets			
Loans and receivables	311,781	-	311,781
Financial liabilities			
Borrowings	218,761	-	218,761

17. Contingencies and commitments

Operating lease commitments payable

The future aggregate minimum lease payments under non-cancellable operating leases fall due as follows:

	2018	2017
	£'000	£'000
Less than one year	541	541
Later than one year but not later than five years	332	856
Total	873	1,397

Capital and other commitments

There were no capital commitments at 31 December 2018 or 2017.

18. Events after the balance sheet date

There are no post-balance sheet events.

Notes to the financial statements
for the year ended 31 December 2018 (continued)

19. Related party transactions

The definition of related parties includes the Parent, as well as the Company's key management which includes its Directors. There were no such transactions with key management. Particulars of transactions, and the balances outstanding at the year-end (note 13), are disclosed in the tables below:

	2018 Parent company £'000	2017 Parent company £'000
Funding from parent company		
Balance at start of year	218,761	328,232
Interest payable on funding	7,081	9,043
Decrease in funding levels	(90,661)	(118,514)
Balance at end of year	135,181	218,761

In addition to interest charges, the Company paid £1,256k (2017: £642k) of management recharges to the Parent. Charges in 2018 include the charges for provision of staff as all employees were transferred to the Parent at the start of the year.

20. Financial instruments disclosures

a) Categories of financial instruments

Financial assets and liabilities are measured on an ongoing basis either at fair value or at amortised cost.

The accounting policies note describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the financial assets and liabilities in the statement of financial position by the class of financial instrument to which they are assigned, and by the measurement basis:

Financial assets	2018 £'000	2017 £'000
Loans and receivables	236,201	311,781
The following assets are held at fair value through profit and loss:		
Deferred sale consideration	49	145

b) Carrying values and fair values

The table below compares carrying values and fair values of the Company's financial instruments by category.

The majority of the financial assets and financial liabilities are held at variable rate. The Company loans have been calculated by discounting future cash flows using the effective interest rate associated with each loan. A deduction for incurred losses rather than expected losses has been included.

Carrying Value	2018 £'000	2017 £'000
Loans and advances to customers	236,201	311,781

Fair Value	2018 £'000	2017 £'000
Loans and advances to customers	239,002	313,658
The following assets are held at fair value through profit and loss:		
Deferred sale consideration	49	145

Notes to the financial statements for the year ended 31 December 2018 (continued)

20. Financial instruments disclosures (continued)

c) Credit risk

For financial assets recognised on the statement of financial position, the exposure to credit risk equals their carrying amount. For loan commitments and guarantees, the exposure to credit risk is the full amount committed.

	2018 £'000	2017 £'000
Financial assets		
Loans and advances to customers	236,201	311,780
Deferred sale consideration	49	145
	236,250	311,925

The table below provides further information on the Company's loans secured on residential property by payment due status:

	2018		2017	
	£'000	%	£'000	%
Current and up to date	214,100	90.7	286,431	91.8
Past due up to six months	16,512	7.0	17,639	5.6
Past due over six months	5,515	2.3	8,074	2.6
	236,127	100.0	312,144	100.0

An impairment provision of £8.9m (2017: £9.8m) has been provided for the anticipated losses on the above assets.

The average loan to original value (LTV) in respect of the Company's loans secured on residential property is 64% (2017: 76%). Further LTV information based on original security valuation is shown below:

	2018 %	2017 %
0 - 50%	22.0	8.0
50% - 75%	51.0	39.0
75% - 85%	15.0	24.0
More than 85%	12.0	29.0
	100.0	100.0

The average balance to current value (BTV) in respect of the Company's loans secured on residential property is 53% (2017: 54%). Further LTV information based on current security valuation is shown below:

	2018 %	2017 %
0 - 50%	42.0	26.0
50% - 75%	48.0	52.0
75% - 85%	7.0	13.0
85% - 100%	3.0	8.0
More than 100%	-	1.0
	100.0	100.0

Non-arrears customers are indexed using Nationwide HPI and all non performing accounts are valued using the Hometrack desktop valuation model.

Notes to the financial statements for the year ended 31 December 2018 (continued)

20. Financial instruments disclosures (continued)

d) Market risk

The sole source of market risk is interest rate risk, as outlined below.

e) Interest rate risk

The Company's exposure to interest rate risk is managed through close monitoring of interest rates on its loan products.

The Company is funded by a variable interest rate loan from the Parent, details of which are included in notes 13 and 16. The exposure to variable rate funding is managed through the close monitoring of variable interest rates on the Company's loan products and the rate on the loan to the Company from its Parent.

Funding is carried out at a Group level considering both maturity and interest type. The Company sees the interest rate risk to be immaterial.

The Company holds collateral against loans and advances to residential customers in the form of mortgage interests over property. Repossessed properties are made available for sale at the time of the repossession in accordance with statutory guidelines with proceeds used to reduce or repay the outstanding loan. The Company has a statutory duty to obtain the best reasonable price and to sell as soon as it reasonably can.

21. Provisions and contingent liabilities

Regulatory provision

Provisions have been made in respect of claims in relation to previous sales of Payment Protection Insurance ("PPI") which, in the Company's case, relate to sales of secured personal lending PPI products (note 12).

The provision considers sales of PPI via direct channels as well as via brokers, some of whom are no longer trading, as well as recent customer behaviour and reopening previously closed complaints. At 31 December 2018, provisions of £3.3m were held in relation to sales of PPI (2017: £3.8m). The provision will continue to be monitored and customer trends and behaviour analysed in order ensure the provision remains appropriate as circumstances become clearer.

22. Ultimate holding party

Principality Building Society is ultimate controlling party and the Parent of the smallest and largest Company of which Nemo is a member and for which Group financial statements are drawn up. Copies of the Principality Building Society Group's annual report will be published on the Society's website (http://www.principality.co.uk).