# Annual Report & Accounts

2018/19

NHBC

Raising Standards. Protecting Homeowners

# 01

# Contents

CS

# Peel L&P: Plaza 1821: Liverpool Waters Princes Dock, Liverpool

**Named after the year the Princes Dock opened, this Private Rental Sale (PRS) development offers inspiring views of the world-famous Liverpool waterfront.**

After working with Peel L&P on numerous projects in the North West of England, NHBC was appointed on this scheme to offer our constant and consistent technical advice.

We delivered both warranty and insurance and Approved Inspector services on this high-rise PRS scheme at Liverpool Waters. Our technical staff provided support and guidance during the structural approval stages on this site's challenging ground conditions and existing below-ground historic features. They were also instrumental in supporting the client's design team with detailed technical advice around fire strategy layout changes.

Located in the World Heritage 'Buffer Zone' in the Mersey Docks, our technical team helped solve a unique structural challenge: merging the existing Victorian dock with a new development.

DEVELOPERS
Peel L&P and The Regenda Group

BUILDER
Vermont Construction

ARCHITECT
Hodder and Partners

NUMBER OF HOMES
105

TALLEST BLOCK
16 storeys

GROSS DEVELOPMENT VALUE
£21m

PRODUCTS
Buildmark Choice and Building Control

"We knew that the construction of Plaza 1821 was going to be technically challenging and it was important that we assembled the best consultant and technical team to ensure its successful delivery to completion. NHBC has been invaluable in supporting our consultant and contractor team. Their breadth of technical knowledge of high-rise apartment developments means they were able to advise and support our team on the delivery of this prestigious PRS project on Peel's Liverpool Waters / Princes Dock development.

Working closely with the NHBC's Building Control and technical teams from the beginning of the project, we have been able to plan and assemble the required technical information to deliver a successful project. NHBC has also provided us with a 12-year building warranty and a 10% contractor insolvency insurance product for Plaza 1821."

**Neil Baumber – Director of Development (Residential), Peel L&P Group Management Limited**

02

# Overview

# 02 Chairman's statement

I am pleased to introduce the National House-Building Council (NHBC) Annual Report & Accounts for the year ended 31 March 2019 – a transformative period for the sector. Three key areas continue to dominate the landscape: the creation of a new regulatory framework following the Grenfell tragedy; an overhaul of redress for homeowners through the introduction of a New Homes Ombudsman (NHO); and the challenging operating environment driven by continued Brexit and broader political uncertainty. Despite this external environment, NHBC continues to deliver successfully on our core objectives: supporting the industry to deliver high-quality homes and protecting the homeowner with our 10-year Buildmark warranty.

This year, more than any other in recent times, has demonstrated NHBC's importance to the new house-building industry. The questions and challenges posed following the Grenfell Tower fire continue, and I am pleased that NHBC provided valuable insight and expertise to assist the Government in developing a more robust approach to Building Regulations and fire safety. From a consumer standpoint, NHBC has a number of high-profile claims, many relating to the remediation of cladding systems on some high-rise developments. We will stand behind the promises in our warranty product, ensuring that homeowners are protected when valid claims arise.

The issue of finishing standards and customer service associated with the purchase of new homes has also continued to attract significant attention. This has been focused mainly on the state of readiness of new homes at handover and builders' response to any snagging issues which arise in the first few months after completion. Although NHBC is primarily focused on the construction quality and structural soundness of a new home, we continue to work closely with builders to help them improve the handover quality, something on which many good-quality builders are now significantly more focused.

NHBC continues to support innovation in the industry, working with the expanding off-site production sector and assessing modern methods of construction against our "built for 60 years" standard. This will assist the drive to increase the rate of house building whilst keeping standards high.

We welcome the Government's announcement about the introduction of an NHO and we are working with the Ministry of Housing, Communities & Local Government (MHCLG), builders and industry stakeholders to help shape the approach to consumer redress. This includes working to ensure that the NHO complements the support homeowners already receive from our independent resolution service during the two-year builder liability period.

Our expertise and insights are focused on the construction quality of new homes, and the decrease in claims frequency in recent years demonstrates the success of the campaigns we have run with builders, targeting common defect areas in basements, pitched roof coverings and external wall systems.

Our Buildmark warranty and insurance cover continues to provide important protection for homeowners. Every year, we handle thousands of claims from homeowners and, in the past year, we have helped 10,848 households (2018: 12,662).

Throughout the year, we shared our expertise and experience and continued to engage with the Government on its plan to reform fire safety regulations on high-rise residential buildings (HRRBs) following the Independent Review of Building Regulations and Fire Safety, led by Dame Judith Hackitt.

As the largest private Building Control Approved Inspector, NHBC has been supportive of the vast majority of Dame Judith's reforms, and we continue to work closely with the Government to help it produce a robust system that ensures the safety of residents in HRRBs whilst maintaining an effective building control inspection regime that does not lose the expertise, capacity and experience of private Approved Inspectors. NHBC has a well-established Major Projects team which was set up to ensure that we deploy our depth and quality of expertise on HRRBs and other large-scale developments. This is increasingly important in the drive to raise standards and improve practices across the industry.

At the time of writing, the uncertainties surrounding Brexit make predicting the future very difficult. However, the likelihood is that a restriction on the current free flow of labour will mean that the industry will face an increased shortage of skilled tradespeople to help deliver an increased volume of housing. We have been closely involved with the work of the Home Building Skills Partnership, which is focusing on attracting new recruits to the industry and developing suitable training to increase the skills and effectiveness of the industry's workforce. In addition, our own training service has gone from strength to strength in the past year as we have met the ever-increasing demand from house builders, drawing on our unrivalled knowledge of new home construction.

We remain focused on our financial strength, and I am pleased to report that our balance sheet remains sound, despite the significant strengthening of technical provisions that has been necessary this year, which is elaborated upon in the Chief Financial Officer's statement. Whilst we reported a pre-tax loss before exceptional items of £32.7m for the year, our solvency ratio stands at 152%. The Board and the Executive team will continue to ensure that we have a financially strong business and can keep providing support to homeowners as required.

It is pleasing to report that, as shown by the number of new homes registered with NHBC, the industry has maintained the increased levels of output we have witnessed since 2013. In the year ended 31 March 2019, our registrations were 160,461, an increase of 4% on the

# 02 Chairman's statement

previous year (2018: 154,698) and 90% higher than the 84,398 plots registered in the year ended 31 March 2009, at the depth of the financial crisis. Our focus remains on ensuring the construction quality of these new homes remains consistently high.

One of our primary concerns remains the safety of our employees, whether out on building sites, in people's homes or driving for work. I am delighted that we have retained our hard-earned Gold standard in the Royal Society for the Prevention of Accidents Health and Safety Awards. Also, I am pleased to report that we have retained our Investors in People Silver status, meaning we remain an attractive employer that provides rewarding and satisfying roles for our staff.

We are fully supportive of the diversity agenda and have continued to move towards greater equality, introducing several initiatives to foster a more inclusive culture and support succession planning across the business. These include the introduction of 'blind' recruitment for all roles within the business, the adoption of flexible working practices wherever possible, the introduction of three months' paid paternity leave and the launch of our women@nhbc network, all of which have been positively received. NHBC's mean gender pay gap has reduced slightly to 16.7% from 17.4% in the year, which is ahead of the national average for all employees and better than the levels generally reported across the financial services and construction sectors.

Turning to NHBC's Board, there was one change during the year as Dame Helena Shovelton stepped down after serving for six years. Dame Helena chaired our Consumer Committee, bringing an invaluable focus on this area. Following her departure, we ended the Consumer Committee, transferring its responsibilities to management and the Board, placing an ever-higher focus on the consumer at all levels of the business.

On the executive front, Neil Jefferson, our Chief Operating Officer, is to leave NHBC in January 2020 to take on a new role at the Home Builders Federation. Neil has been a long-serving colleague, rising, over 20 years, from the ranks of Building Inspector to Chief Operating Officer and Executive Director. Neil's knowledge and insights will be missed, but I am very pleased he will not be lost to the industry and that we will continue to work closely with him in his new role.

Relationships with builders and developers are anchored to the value we deliver through our inspection regime and through the services and insights we provide to help them build to the highest possible quality. Every homeowner with an NHBC warranty benefits from the support we provide to the house-building industry, in addition to our resolution and insurance services provided in the first 10 years of new home ownership. I am grateful for the support of my executive and non-executive colleagues, as well as the many committed and talented people that have built NHBC's success.

Isabel Hudson
Chairman

# 02 Chief Executive Officer's statement

My second year as CEO of NHBC was one in which the new homes industry came under intense scrutiny from the Government, media and consumers. It has also been a year in which NHBC's unique role and value as an independent voice on construction quality, and as an insurer of 80% of new homes built in the UK, has been clearly demonstrated.

The Government's focus on housing regulation and policy has continued as it progresses with major reform on fire safety and plans for an NHO to provide consumer redress for new build homes.

NHBC has made a positive and proactive contribution to these discussions, providing the benefit of our expertise and experience to inform policy development and support builders as they respond to the many challenges facing the industry.

Much of our activity throughout the past year has been coloured by the aftermath of the Grenfell Tower fire. We have participated fully in the debates and consultations, and have been recognised by the Government and others for the unique perspective and knowledge we bring to the table. We remain fully engaged with discussions about the way forward. It is extremely important that future changes should deliver safer homes for everyone, and that these changes do not undermine the healthy competition that has improved standards in building control for more than 30 years, and I am hopeful that our views and experience will be reflected in the Government's response.

During the past year, we have stood by our responsibility as an insurer, accepting the small number of valid cladding-related claims in which we were involved. This has required exceptional effort from our expert Claims teams, which have got to grips with a range of highly complex technical issues to establish validity, alongside communicating as effectively as possible with affected homeowners to keep them informed as their claims progress.

More broadly throughout the year, there has been much in the media suggesting that the overall quality of new homes is declining, although the focus has been primarily on snagging defects that are rectified by builders within the first two years, rather than claims under warranty. Whilst we are focused on providing cover for structural problems, we do have a resolution service which will help homeowners sort out unresolved snagging issues with builders and, in extremis, we will carry out the work ourselves.

It is encouraging that the vast majority of builders share NHBC's commitment to quality and service, as shown by the industry Customer Satisfaction Survey, run by us on behalf of the Home Builders Federation. The latest results revealed that 87% of homeowners would recommend their builder to a friend, with a record number of builders attaining a five-star rating.

The proposed NHO aims to provide an extra layer of protection for homeowners who do not receive the level of service they quite rightly demand, and we are contributing fully to help develop a positive outcome for consumers, as well as being clear on how NHBC's resolution service dovetails with the NHO.

Our priority is to provide protection and reassurance to the people who live in the new homes we inspect and insure, so it is heartening to report that, overall, the frequency of valid claims reported under our market-leading Buildmark policy has continued to fall. This is particularly good news, as we know from more than 80 years of experience that claims tend to increase when industry output rises.

Our extensive technical risk management activities are in place to support builders in the construction of new homes.

Last year, we carried out more than one million inspections on site, during which our 350 inspectors identified 446,071 issues that would otherwise have led to potential defects in the completed homes.

In addition, we expanded the extensive management data we feed back to builders to help them target improvements, and delivered in excess of 13,500 delegate training days to builders and their contractors in the past year. We have continued to expand our training business to help meet the needs of the industry and tackle the skills shortages faced.

We continually monitor the effectiveness of our technical risk management processes to ensure that the services we offer builders can respond to new challenges and changes within the industry.

Two years ago, we augmented our key stage inspections by introducing in-depth Construction Quality Reviews (CQRs) that provide detailed reports to site management. These have become highly valued by builders in helping them to improve quality. Over the year, we carried out more than 2,000 CQRs on sites throughout the UK.

We plan to make further enhancements to our site inspection process and will introduce intermediate inspections, pre-handover benchmark inspections, enhanced attention to fire safety-related issues, and increased inspections on apartment buildings focusing on façade and pre-plaster elements.

Our research arm, the NHBC Foundation, produced six reports during the year. These include 'Futurology: the new home in 2050', which examines how new homes are likely to evolve in the coming decades, and 'Modern methods of construction: who's doing what?', which is based on a survey of current activity by a number of trailblazing developers.

As I highlighted in my report last year, we believe that increasing production through the use of modern methods of construction (MMC) is necessary if the country's new home growth targets are to be met. During the year, we continued our support of such schemes and worked closely with builders who are looking to adopt MMC to ensure that any new product, component or system will meet NHBC Standards and can demonstrate that it will be fit for purpose.

We have been involved in industry-wide discussion about policies to increase the rate of house building whilst upholding high construction standards. This includes the adoption of MMC, where there is a heavy focus in off-site production and where we submitted detailed written and verbal evidence to the Housing, Communities and Local Government Committee explaining how we are helping to instil confidence in this developing sector.

As an independent organisation uniquely positioned between the industry and the homeowner, NHBC has hosted events with senior members of the Government, including the Secretary of State for the Ministry of Housing, Communities & Local Government and the Housing Minister. As the uncertainty around Brexit negotiations continues, NHBC has carefully monitored developments to evaluate the impact of the various possible outcomes on our business and our customers.

We remain extremely proud of our two industry recognition schemes. Pride in the Job, now in its 39th year, celebrates the very best of site managers across the UK, whether they are running a single plot site or a large-scale development. Pride in the Job recognises the vital role that site managers and their teams play in ensuring new homes are delivered not only on time but also to exacting construction quality standards. By their very nature, building sites are potentially hazardous environments, and our Health and Safety Awards highlight those practitioners who adopt the very best standards to ensure that site safety is at the top of the agenda. It is no coincidence that well-managed sites score highly on both health and safety and build quality: the two go hand in hand.

# 02 Chief Executive Officer's statement

Whilst it is disappointing to report a substantial trading loss for the year, this does not reflect the ongoing viability of the business; indeed, the underlying frequency of warranty claims continues to improve. However, it has been necessary to set aside further reserves to meet increased claims arising from previous generations of new homes (particularly for the generation years 2008 to 2011), as well as allowing for the cladding-related cases we are dealing with post-Grenfell. These claims, which are unprecedented, are, by their very nature, highly complex and demand expert technical knowledge to conclude successfully.

The need to strengthen our reserves for these types of claim reinforces that, although NHBC is non-profit distributing, we do need to generate trading profits in order to remain financially secure and to allow investment in the development of our technical expertise, competence and capacity, which is necessary to meet the needs of the house-building industry and to support the quality agenda for homeowners.

My first two years at the helm of NHBC have flown by, and I have found them extremely rewarding. During the past year, there have been a number of planned changes to my senior team, and I have taken this opportunity to bring in fresh thinking and expertise. Jenny Scott has joined us from QBE as our Claims Director, Fiona Herbert, previously of Santander Asset Management, has become Head of HR, and David Trefusis has succeeded to the role of Chief Risk Officer. I am confident that they are becoming ever-more valuable members of the team.

Finally, I am frequently reminded that we are so much more than simply an insurance provider, as the impact at a household level of poor-quality housing is so acutely felt. Our role is to work with the house-building industry to minimise the occurrence of building defects, supporting new technologies and working practices which increase the industry's output, whilst providing homeowners with the confidence that, if things do go wrong, we are on hand to ensure that rectification is undertaken as swiftly as possible.

We could not achieve this without the passion, commitment, dedication and professionalism of my colleagues, and I wish to thank all of them for their continued contribution to our success. NHBC remains very well positioned to deliver our mission.

Steve Wood
Chief Executive Officer

# 02 Chief Financial Officer's statement

## As mentioned by Isabel and Steve, this was another challenging year for NHBC, which is reflected in the financial result: a net operating loss before exceptional items of £32.7m (2018: loss of £13.8m).

The disappointing result for the year was driven by several elements:

- Further adverse claims development on large losses from historic generations
- An increase in technical provisions to reflect the rising profile of potential cladding- and fire-related claims in high-rise buildings.

This was partially offset by:

- Continued reduction in the frequency of claims
- Favourable investment result.

During the year, NHBC benefitted from an exceptional item, recognising the settlement in our favour of legal claims totalling £30m, which helped to mitigate the full impact of the poor trading result.

NHBC's balance sheet remains strong, dominated by invested assets and technical provisions. Invested assets increased by £64.3m to £1,624.7m (2018: £1,560.4m) following a strong final-quarter performance. The technical provisions held by NHBC, which are established to meet our obligations to policyholders, were further strengthened during the year to £1,074.4m (2018: £1,008.9m), reflecting the adverse claims development experienced on historic large losses and cladding claims.

NHBC's regulatory Solvency II ratio, which is calculated using the Standard Formula, decreased slightly to 152% from 156%. This ratio remains within the Board's risk appetite but continues to be a key focus for management in order to ensure NHBC generates adequate operating margins to fund its purpose of supporting the house-building industry and maintain its market-leading position.

## Financial performance

The table below presents a summary consolidated income statement for the year ended 31 March 2019 and comparatives.

| | 2019 | 2018 |
|---|---|---|
| Registrations (units) | 160,461 | 155,010 |
| | £m | £m |
| Net earned premiums | 66.7 | 49.6 |
| Net claims incurred | (119.1) | (96.8) |
| Movement in unexpired risk reserve | (17.4) | 39.9 |
| Investment return - technical account | 35.0 | (4.3) |
| Net operating expenses | (12.5) | (5.4) |
| **Technical account loss** | (47.3) | (17.0) |
| Other income | 78.6 | 76.9 |
| Other charges | (76.4) | (86.0) |
| Investment return - non-technical account | 12.4 | 12.2 |
| Non-technical account result before exceptional items | 14.6 | 3.1 |
| **Net operating loss before exceptional items** | (32.7) | (13.8) |
| Exceptional item | 30.0 | – |
| **Loss before tax** | (2.7) | (13.8) |
| Tax credit | 0.1 | 0.3 |
| **Loss after tax** | **(2.6)** | **(13.5)** |

[1] Typically, claims over £1m to £20m are considered as large, with claims over £20m being considered as exceptional.

## Volumes

Plot registration volume (registrations) is a key driver of NHBC's premium and inspection income, and is a proxy of exposure on NHBC's insurance technical account. Registration volumes increased by 3.5% in 2019 to 160,461 units (2018: 2.0% decrease), mainly due to higher affordable housing registrations, which increased 16.3% from the prior year. Private housing registrations remained consistent with last year. The number of completions also increased, reflecting a similar pattern to registrations, with total completions increasing by 1.8% to 149,123 units (2018: 0.6% increase), also supported by higher affordable residential volumes. Homes under cover at 31 March 2019 increased to 1,330,086 (2018: 1,315,335).

## Technical account result

The technical account, which reflects the results of the company's insurance activities, reported a loss of £47.3m for the year (2018: £17.0m loss). This is primarily the result of the adverse claims experience, as seen in the increase in claims incurred and the charge regarding the unexpired risk reserve. The changes in provision were largely due to the aforementioned increases in claims reserves for historic large losses, as well as provisions for cladding and firestopping claims. This was partially mitigated by an improvement in claims reserves for smaller losses and higher net investment returns compared with the prior year on investment assets held to fund the payment of claims reserves.

## Net earned premium

Net earned premiums increased 34.5% to £66.7m (2018: 14.0% decrease). This was the result of higher registration volumes, as well as increased Buildmark additional deposit premiums and road and sewer bond product income. Warranty premiums are earned according to an earnings profile, which follows the pattern of how claims are expected to emerge over the period of warranty policy coverage. During the year, this pattern indicated a slight shortening in the time it has taken claims to emerge compared with previous years. As a result, more premium was recognised as earned than in the prior year.

## Net claims incurred

Net claims incurred increased by 23.0% to £119.1m (2018: 8.1% increase), driven by both poor claims experience from the large losses emanating from the generation years from the mid-2000s to 2012 and the increased reserves for claims in respect of cladding and firestopping cover. Claims paid in the year fell by 9.5% to £85.6m (2018: 11.6% increase) and reflects the improved underlying trend seen in recent years on smaller, attritional claims in respect of years three to 10 of the policy cover. It is expected that claims paid will increase in the financial year ending 31 March 2020 as the large and cladding losses provisioned in 2018 and 2019 begin to be settled.

## Unexpired risk reserve

The unexpired risk reserve charge of £17.4m (2018: £39.3m) largely reflects the strengthening of technical provisions to reflect the greater level of uncertainty surrounding the likelihood and cost of claims following the Grenfell Tower fire in June 2017.

## Investment return allocated to the technical account

The investment return allocated to the technical account reflects the return on investments held to meet our insurance obligations. These assets are primarily fixed interest and index-linked gilts and high-grade corporate bonds. The net return was £35.1m (2018: £4.3m loss) and was driven by a net investment income of £22.1m (2018: £21.8m) and unrealised gains of £13.2m (2018: £29.3m loss).

## Operating expenses

Operating expenses recorded in the technical account were £12.5m, an increase from £5.4m in the year ended 31 March 2018. The higher cost recorded in 2019 is the result of a revised estimate in the allocation of total expenses to better reflect the underlying cost of the company's insurance operations, and is offset by a lower expense charge in the non-technical account.

# 02 Chief Financial Officer's statement

## Non-technical account result

The non-technical account result was £14.6m (2018: £3.1m). This includes the net result from all aspects of non-insurance-related activities and the investment return associated with NHBC surplus assets.

Other income, which includes inspection, building control fees and income from NHBC's Services business (such as Training and Health & Safety Services), increased 2.2% to £78.6m (2018: £76.9m) following higher registration and completion volumes.

Other charges were £76.4m (2018: £86.0m). The reduction is made up of several moving parts: primarily lower operating costs and the higher allocation of costs attributable to the technical account cited above.

Total operating expenditure fell by 2.5% (2018: 2.8% increase) as NHBC focused on managing its operating costs carefully as volumes increased. The major drivers of reduced operating costs were lower full-time equivalent staff costs and consultancy fees, in addition to benefits realised from productivity and efficiency improvement programmes.

Investment returns allocated to the non-technical account represent the return on financial investment assets not used to support the technical provisions. These investments consist of corporate bonds, equities and multi-asset funds. The net investment return for the year was £12.4m (2018: £12.2m), with income from the bond portfolio delivering most of the return.

The exceptional item of £30m reflects the settlement of legal claims during the year.

## Financial position

### Investments

The total value of the investment portfolio (including cash) increased by 4.2% (2018: 2.2% decrease), ending the year at £1,624.7m (2018: £1,560.4m).

Of the total investment portfolio, 94% (2018: 93%) was invested in high-quality fixed income and cash assets. The fixed income portfolio continues to be invested in high-quality assets, with 60% (2018: 62%) rated AA or higher. At the end of the year, the average duration of the portfolio was 4.5 years (2018: 4.6 years). Government bonds remain a key investment vehicle for NHBC, accounting for over 50% of the bond portfolio.

At 31 March 2019, equity holdings were £52.2m (2018: £108.5m), which represented 3.2% (2018: 7%) of the overall investment portfolio. Despite the volatile year, equities performed well, with the portfolio returning 3.6% (2018: 6.7%). The reduction in equity holdings during the year was to facilitate an investment in a new multi-asset strategy. This new investment continued the ongoing implementation of NHBC's investment strategy to diversify the portfolio and enhance risk return characteristics.

### Technical provisions

Gross technical provisions increased by 9.6% to £1,165.4m (2018: 1.4% decrease), driven by three key elements:

- Increased provisions for historic large loss claims arising from warranty policies underwritten in the period from the mid-2000s to 2012
- The continued uncertainty surrounding the claims environment in respect of cladding and firestopping in high-rise buildings
- This was offset in part by a favourable experience on smaller, attritional claims.

As documented in the notes to the financial statements, the Group takes all reasonable steps to ensure it obtains and uses the most appropriate information to assess and quantify known and potential claims, which, along with the unexpired risk reserve, account for most of the technical provisions. However, given the complexity in some claims and the inherent uncertainty around estimating the cost of future claims, it is likely that the outcome will prove different from the estimate made at the accounting date. Any adjustments required to claim amounts previously estimated, or changes in the unexpired risk reserve, will be reflected in the results of the period in which those adjustments are identified.

**Defined benefit pension scheme**
The defined benefit pension scheme deficit increased by £1.1m during the year to £33.1m (2018: £32.0m). The increase was the result of several factors:

- Updates to core assumptions on the scheme liabilities following the triennial valuation as at 31 March 2017, which included a decrease in the discount rate to 2.60% (2018: 2.75%) and marginal increases to RPI and CPI inflation assumptions
- The inclusion of past service costs in respect of Guaranteed Minimum Pension.

This was offset by:

- Improved investment returns of £9.7m (2018: £5.4m)
- A £8.0m deficit repair contribution (2018: £6.5m) made in accordance with the revised contribution schedule agreed between the company and Scheme Trustee in the most recent triennial valuation.

NHBC continued to work closely with the Scheme Trustee, particularly with regard to the scheme's long-term pension scheme strategy, which will progress further during the year ending 31 March 2020.

**Capital position**
At 31 March 2019, accumulated reserves were £455.4m (2018: £462.5m), reflecting the post-tax losses incurred in the year and the adverse valuation movements on the pensions scheme.

The company's regulatory capital position, which is assessed using the Standard Formula methodology, remains strong. At 31 March 2019, the company's solvency ratio was 152% (2018: 156%). The decrease was primarily driven by the increase in the Solvency Capital Requirement (SCR) due to an increase in technical provisions. The ratio remains within the Board risk appetite.

Given the combination of the uncertain claims environment; political and economic uncertainty, particularly in relation to the ongoing negotiations with respect to the United Kingdom's exit from the European Union; and the persistent low-yield environment, we are continuing to action our plans to ensure that NHBC safeguards its capital position for the long term. NHBC has limited capital raising options; therefore, management and the Board continue to focus on pricing adequacy, reinsurance protection, and close management of claims and expenses to improve the company's operating margins and capital position.

# 02 Chief Financial Officer's statement

**Outlook**
Whilst the loss after tax reported for the year is disappointing, it should be recognised that this is driven by unexpected deterioration of claims relating to historic generations of business, as well as NHBC's commitment to meet its obligations to policyholders in respect of cladding and firestopping claims.

As mentioned last year, NHBC adopts a prudent approach to reserving for liabilities, principally due to the significant inherent uncertainty in estimating how claims experience will develop over the period of a 10-year insurance product. This is particularly the case in respect of the provisions for large and exceptional losses which could be incurred due to systemic technical matters, adverse economic conditions, or a future change in the legal or regulatory environments.

Management and the Board are fully committed to returning the organisation to profitability. Steps have already been taken to address this during the financial year, and further actions are identified in NHBC's three-year Group Business Plan.

Immediate actions taken following the historic large loss and cladding claims deterioration have been to undertake reviews of claims management and handling processes, in addition to reviewing our technical risk management approaches. We have also implemented above-inflation warranty price increases to reflect the poor claims experience and higher technical risk now evidenced in the claims environment. We have plans in place to rationalise our operating and claims costs through the development of operational efficiency programmes to identify and remove non-value-added costs and reduce claims cost leakage. Management and the Board believe that the combination of the actions implemented, as well as future plans, will ensure that adequate underlying profitability will be generated to support both the Group's growth and continued investment in its products and services for house builders and policyholders. NHBC is an integral part of the UK new-build housing market and is committed to ensuring that it continues to maintain its long-term financial stability.

Like many other organisations, the Group Business Plans are subject to additional risk due to the ongoing political and economic uncertainty regarding Brexit. Despite this uncertainty, NHBC is well placed to respond to the challenges, as evidenced by NHBC's Own Risk and Solvency Assessment (ORSA), that Brexit may bring in respect of the house-building supply chain, quality and consumer confidence, all of which might affect NHBC's business model and performance in varying ways and to various extents.

Paul Hosking
Chief Financial Officer

CS

# Diversity and inclusion at NHBC

"It is important that NHBC is an attractive employment option for everyone. Our ambition is for NHBC to be a diversity confident and inclusive organisation, regarded as an employer of choice, and that we are actively sought out for employment because of the whole package, not simply our roles.

Looking back at the 12 months from April 2018, I'm delighted with the impact that initiatives launched during this time have had across the business.

Blind recruitment was introduced and is in place for all roles. This is helping to deal with unconscious bias, avoiding social stereotypes about certain groups of people that individuals form outside their own conscious awareness. In addition, job adverts have been rewritten to ensure that our roles appeal to a wider audience.

As a business, we actively celebrated International Women's Day and took part in the global #BalanceForBetter campaign, working together to build a gender-balanced world. Our video on social media remains one of the most successful ever with 21,579 tweets, 12,283 LinkedIn views and 2,521 Facebook likes. We also proudly sponsored the Milton Keynes Women Leaders UK Awards for the second consecutive year, with a finalist in the Community Impact category.

The introduction of our holiday buy scheme was well received across the business, allowing employees to purchase up to one week's additional holiday per annum. This has been particularly popular with our female employees, with one in three of the 18% take-up being female, as opposed to one in 10 males.

Peakon, our new employee engagement survey tool, was launched and includes the statement: "People from all backgrounds are treated fairly at NHBC." NHBC's equality score was 8.7 out of 10, putting us in the top 25% of participants in the Peakon survey.

And, to raise awareness, we regularly use The Hub to talk about religious festivals and notable events such as Chinese New Year and Diwali. Events are often commemorated with a special themed lunch at Rendezvous, our in-house catering facility.

I'm proud to be able to report on these initiatives, and to demonstrate the success that they are having. This is just the tip of the iceberg and we have plenty more planned for the next 12 months, including a review of our flexible working policy, creating an LGBT+ network, establishing a women's network and only using gender-balanced recruitment agencies, plus much more."

**Zoe Mills, Senior Manager – Strategy & Projects, NHBC**

# 03

# Strategic report

# 03 About NHBC

The National House-Building Council (NHBC) is the United Kingdom's leading independent provider of warranty insurance for new homes. NHBC seeks to give homeowners confidence in the construction quality of new homes by raising standards for the benefit of homeowners, working with registered developers to help improve the construction quality of new homes, and providing protection for the homeowners who purchase them.

NHBC's business model is designed to influence construction quality through delivery of technical services to its builder customers, with the key elements described below.

## Independence

NHBC has no shareholders and is independent of the Government and the construction industry. Any profits that NHBC generates are reinvested in the business to support its core purpose: to give homeowners confidence in the construction quality of new homes.

## Builder registration and NHBC Standards

To work with NHBC, builders and developers must qualify to join the NHBC's Register. From the point of registration, customers are bound by NHBC Rules and required to construct homes in line with NHBC Standards to allow them to benefit from NHBC's products and services.

NHBC Standards define the technical requirements and performance standards for the design and construction of new homes, and provide guidance on how these can be achieved. Through the consistent application of NHBC Standards by all registered builders, homeowners should benefit from a new home build process that incorporates leading current practices in the construction industry.

## Inspection services

NHBC provides an inspection service to its registered builder customers. It takes the form of independent structural reviews, undertaken at key build stages as identified in NHBC Standards. Every year, NHBC conducts hundreds of thousands of inspections, with feedback provided to builders for every new build home protected by NHBC's Buildmark warranty product. This is an integral part of the drive to improve construction quality for the benefit of homeowners, with these 'key stage inspections' supplemented by other services, such as:

- CQRs: in-depth, full site assessments of the build process, identifying areas where improved practice could potentially be deployed
- Building Control inspection: delivered by NHBC's wholly owned subsidiary company, NHBC Building Control Services Ltd, assisting builders in meeting the government-set Building Regulations on residential, mixed-use and selected commercial projects.

## Buildmark – an industry-leading warranty and insurance product

Buildmark is a 10-year warranty and insurance product which protects the owners of new homes against damage caused by defects in the structure of the property. Buildmark is designed to give homeowners peace of mind over the largest purchase they are ever likely to make.

## Resolution and claims services for homeowners

NHBC's expert Claims teams are there to support the homeowner should there be a problem with a property which falls under the Buildmark policy. The resolution service provides an option to address unresolved issues between the builder and the homeowner occurring in the first two years of new home ownership, and is free of charge for the homeowner. The claims service responds in the unfortunate event of there being structural problems with the home, dealing professionally with any valid warranty claims.

## Research and insight

From claims experience and data collected from site inspections, NHBC identifies areas in the house-building process that the construction sector is finding particularly challenging. Utilising its extensive technical expertise, NHBC seeks to raise standards by providing guidance and training to its builders, focusing on areas affecting the quality of new build homes.

The NHBC Foundation provides in-depth research and practical guidance to support the house-building industry, whilst NHBC Services Limited, a wholly owned subsidiary of NHBC, provides training services to its builder customers.

In addition, NHBC mandates its Standards to builder customers, updating them regularly based on improvements in construction practices and the latest learning across the house-building industry. This process continues to drive improvements in construction quality for the benefit of homeowners.

## Celebrating best practice

NHBC's Pride in the Job and Health and Safety Awards are an important part of its drive to promote high standards and safe working practices in new home construction. Pride in the Job recognises the best site managers building new homes in the United Kingdom, whilst the Health and Safety Awards recognise builders with the best health, safety and wellbeing practice.

# 03 Market overview

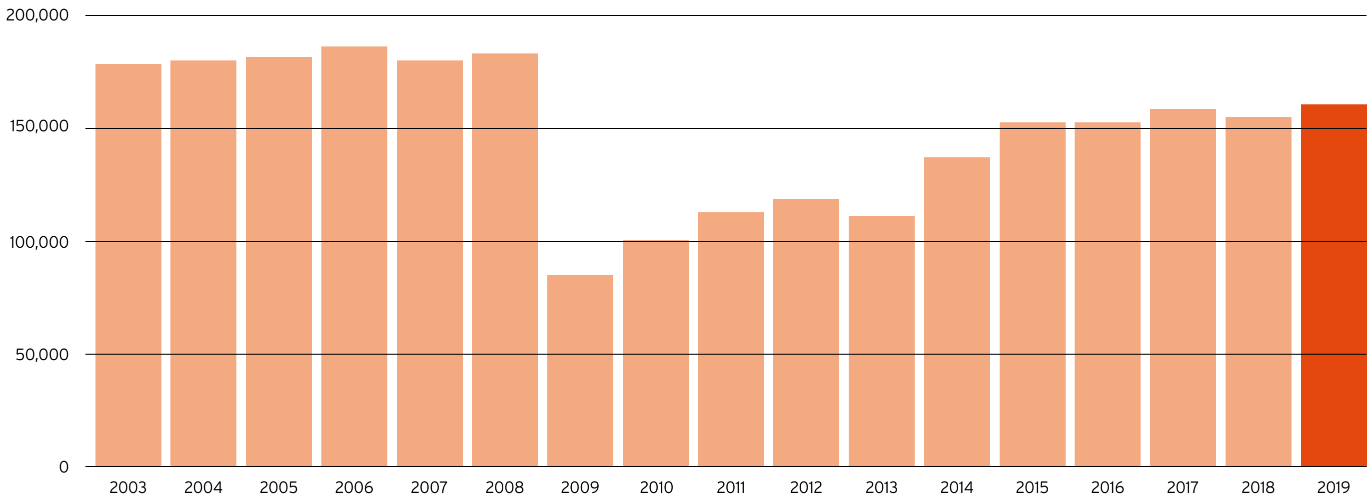
NHBC operates in the UK new house-building sector, the health of which is the primary driver of NHBC's business performance and growth. NHBC monitors a range of metrics to ensure it is well positioned to respond to emerging opportunities and threats.

## UK housing market

The housing market in the UK has remained relatively stable in the financial year ended 31 March 2019 and continues to experience modest growth. House prices in both new and second-hand markets continued to increase, albeit at a lower rate than in recent years. The demand for new homes continues to outstrip supply.

NHBC registrations in the year ended 31 March 2019 were 160,461 (2018: 154,698), the highest since the housing market crash in 2009. The 4% increase on the prior year was largely driven by growth in the affordable housing sector resulting from continuing investment and government incentives in this area.

## Registrations




## Market share

During the financial year ended 31 March 2019, NHBC maintained its market share within a range of 75% to 85% of the UK home warranty market. This is based on the number of NHBC registered homes on which building activity has commenced (known as 'starts'), expressed as a percentage of government-reported UK starts over the same period.

NHBC continues to maintain its leading position as a provider of inspection services and new build warranty among high-volume developers, building on a strong and growing presence in the affordable housing, institutional private rental and local authority sectors.

## Housing market outlook

The Government aims to raise the supply of new homes to 300,000 a year by the mid-2020s, a significant increase on current activity levels. Various measures supporting this, such as the long-running Help to Buy scheme, funding for affordable housing, local authority incentives, and financial guarantees to support private sector house building, continue to be made available. However, the continuing uncertainty surrounding the United Kingdom's departure from the European Union remains a concern for new house builders, particularly around the availability of sufficient labour and materials to meet demand, and consumer confidence.

Government policy will continue to be critical to support the success of the UK housing market, not only in terms of direct funding and support but also in the overall economic and policy position. Negotiations to leave the European Union; the independent review into Building Regulations and fire safety, led by Dame Judith Hackitt; and policies aimed at increasing house-building activity; all will have a significant impact on the construction industry. In addition to this, the Government has announced that an NHO will be introduced to ensure an effective route for consumer redress and to bring more focus on the overall quality of new homes.

## What this means for NHBC

NHBC will continue to work with its registered builder customers to help them meet the increased output levels sought; however, this will not be at the expense of construction quality or to the detriment of homeowners.

NHBC is also working with customers and manufacturers keen to exploit the benefits of MMC. This has the potential to ease the pressures in the supply chain, and NHBC is working to ensure quality and standards are maintained as new approaches are developed, both on and off site.

NHBC is aware of the challenges facing the industry and has invested in the data analytics and technical skills necessary to ensure insightful, constructive engagement with all stakeholders.

CS

# NHBC Health and Safety Awards 2018 – Commended Winner

Stuart Gillespie is a Site Manager with Mactaggart & Mickel, with almost 30 years of experience in the industry. Since 2006, Stuart has been winning NHBC awards for his management skills and for demonstrating best practice in health and safety, prioritising the wellbeing of his teams and the public.

In 2018, Stuart was commended for delivering excellent health and safety on his site, Greenan Views in Ayr. Stuart began his career at Mactaggart & Mickel as an apprentice joiner, working his way up to become a Site Manager for the company across a number of award-winning developments. Stuart has won awards with NHBC every year since 2006, including the highest accolade – the Pride in the Job Supreme Award – four times.

"Health and safety lies at the heart of Mactaggart & Mickel and is integral to achieving quality on site. As part of our commitment, we have heavily invested resource and time into maintaining the highest standards for our site teams and our visitors. We are proud to work with NHBC and value the recognition the Health and Safety Awards and Pride in the Job provide. The NHBC awards hold particular value as they are chosen by our peers in the industry.

The commitment from the team on site, and the need for them to do their best, means that together we want to get things right first time. Additionally, the support and advice we receive from NHBC is integral to helping us raise our own very high standards, enabling us to hand over a house built to the highest standards."

**Stuart Gillespie, Site Manager, Mactaggart & Mickel**

# 03 NHBC's strategy

As an established, market-leading business, NHBC works to stay ahead of its competitors by reviewing and developing its services and products and enhancing its technical capabilities and insights.

During the year, NHBC continued to work on delivering against the five strategic priorities outlined in its Group Business Plan. This will continue over the next three-year period, with the following table highlighting the five focus areas, together with the actual or expected outcomes from the activities being undertaken.

## Improving construction quality

NHBC's focus on improving construction quality sets it apart from its competitors. Its approach encompasses research, guidance, training, and the support provided to builder customers from concept to completion of their build projects. NHBC will continue to use its expertise to improve construction quality, enhancing the builders' quality control and providing improved homes for consumers.

NHBC has made significant investments in its inspection and technical resource to allow its inspectors more time on site and to introduce alternative inspection methods – such as CQRs – to help reduce defects in new homes. NHBC is committed to continuing to deliver its range of technical expertise and interventions, influencing behaviour on site to improve the build quality of new homes.

NHBC is also focused on influencing the industry's approach to construction through engagement with key organisations and stakeholders, such as the Home Building Skills Partnership, the Home Builders Federation and the Government. NHBC will continue to drive the quality agenda to help the industry develop the skills and focus required to enable construction quality to continue to improve.

| In the financial year, NHBC: | With the aim of: |
|---|---|
| Launched a revised CQR product. | Receiving positive feedback from builder customers and an improved take-up of CQRs, with 2,048 delivered in the financial year, resulting in a greater number of construction quality interventions on site. |
| Established a dedicated team focused on MMC.<br><br>Delivered the MMC Hub.<br><br>Reviewed more than 12 new construction systems. | Delivering a sustainable, integrated process for reviewing MMC, both on and off site.<br><br>Providing supporting information on MMC to manufacturers and customers.<br><br>Externally promoting NHBC's profile and capability in the assessment of innovative construction methods. |
| Made changes to the inspection process to add greater focus to fire safety.<br><br>Enhanced façade inspections to review cladding systems to all blocks of flats registered with NHBC. | Supporting NHBC registered builders in improving their construction processes with regard to fire safety. |

## Ensuring financial viability

NHBC must ensure that its financial position is stable and well managed to deliver its promise to its 1.5 million Buildmark policyholders, and to sustain its investment in efforts to improve construction quality. Also, NHBC must maintain profitability to demonstrate compliance with the financial requirements of its regulators.

To achieve this, NHBC is focused on maintaining a strong and sustainable financial platform, including ensuring that its capital position remains secure to support future liabilities.

NHBC will use all options available to safeguard its capital position, including product and pricing decisions, investment strategy, appropriate reinsurance, and cost control.

| In the financial year, NHBC: | With the aim of: |
|---|---|
| Increased prices based on analysis of historic claims experience and risk profiling. | Safeguarding the capital base through increased revenue in response to the higher than expected claims costs in the year. |
| Launched the Simplify Programme to review NHBC's operations. | Streamlining of processes and options identified to enhance customer service and reduce operating costs by up to 10% over the next three years. |
| Continued the development of the internal capital model. | Improved and more accurate financial modelling, and a better understanding and management of NHBC's risks. |

## Building the brand and reputation

A strong brand and reputation enable NHBC to attract customers and influence the construction quality of a substantial proportion of the new homes market. In turn, this provides access to extensive data that can be used to influence the standards of new homes. As competition continues to intensify, NHBC must focus on developing a better understanding of customer needs to ensure it delivers market-leading service and products.

NHBC will reinforce its independent voice with a clear and confident position, bringing information on construction quality to broader attention and clearly demonstrating its work to improve outcomes for homeowners.

| In the financial year, NHBC: | With the aim of: |
|---|---|
| Continued engagement with government and industry stakeholders concerning the Independent Review of Building Regulations and Fire Safety by Dame Judith Hackitt. | Supporting and influencing policy makers in the development of the future of Building Regulations. |
| Restructured the Major Projects team to align it with the Technical Services function. | Delivering an improved customer experience via consistent points of contact, concentrated expertise and more agile processes. |

# 03 NHBC's strategy

## Developing leadership, talent and culture

NHBC aims to foster a working environment that encourages its people to develop and thrive, giving every employee the opportunity to flourish professionally and personally.

During the year, NHBC launched its new values and behaviours to further enhance its culture and align its people behind its core purpose. Several initiatives are in place to enhance employee fulfilment and engagement, including a newly introduced employee engagement survey, revised talent development and succession planning programmes, and a series of wellbeing initiatives.

| In the financial year, NHBC: | With the aim of: |
|---|---|
| Designed and introduced new company values, developed via engagement with all colleagues. | Developing a common way of operating and behaving within the business and linking reward to values, with a sharper focus on talent development and succession planning. |
| Launched a new employee engagement survey. | Increasing engagement within the business to deliver on strategic focus areas. |
| Reintroduced the NHBC Building Inspector Academy. | Ensuring NHBC is developing its own technical workforce of the future. |

## Exploiting data and technology

Data and technology will play a central role in continuing to find new and better ways of working. NHBC is focused on making better use of its substantial data assets to better inform how NHBC works, and to provide greater insights and services to its builder customers. NHBC continues to explore opportunities to innovate by using available technology, both internally to improve processes and services, and on site to help builder and developer customers.

| In the financial year, NHBC: | With the aim of: |
|---|---|
| Rolled out electronic devices with updated applications to all building inspectors. | Delivering enhanced technology on site, including photography and video capability, to better support customers and improve efficiency, as reports can now be produced live. |
| Completed a review of its data and data capabilities, and devised NHBC's Data Strategy. | Ensuring that NHBC maximises its opportunities in relation to data. |

# Risks to NHBC's business

## NHBC's approach to risk management

In considering the organisation's key risks, NHBC distinguishes between risks to achieving its objectives and risks to its sustainability as an organisation. To achieve its organisational objectives, NHBC monitors and minimises poor construction standards and unfair homeowner outcomes for the houses it insures. To ensure its sustainability as an organisation, NHBC takes action to manage its financial, reputational, insurance and operational risk.

## Risk governance

The Board has established a risk governance framework that is overseen and supported by a number of Board and executive committees:

- The Board is responsible for the risk framework and the setting of NHBC's risk appetites
- The Board Risk Committee oversees the development and operation of the risk framework and reviews key risks, challenging management to establish the extent to which these risks are suitably controlled within the Board's risk appetites
- The Executive Risk Committee monitors the risk profile of the business and takes action to ensure risks are identified and managed
- A number of management committees report to the Executive Risk Committee, providing focus on areas such as conduct, financial and operational risks.

For further details of Board and committee structures, see page 44.

## Risk management

NHBC operates a risk management framework designed to identify, assess and mitigate its key risks. NHBC operates in a dynamic environment and, consequently, it is not possible to understand and identify all risks that might threaten the business in advance of them being realised. Accordingly, the risk management framework needs to be flexible enough to react to unexpected circumstances and ensure a suitable response. NHBC manages this by having in place a series of risk management processes, including:

- Risk and control assessments maintained at function and company level which are actively managed by risk owners in conjunction with the Risk Management team
- A process for managing events
- Appointed representatives within each business function providing risk and compliance support for operational colleagues
- A policy framework confirming the Board's minimum standards of control in key risk areas, with each policy owned by an Executive Committee member and reviewed and approved in accordance with an agreed policy review cycle.

## The risk operating model

To promote an understanding of responsibilities across the organisation, NHBC uses a 'three lines of defence' model. It combines three separate but integrated elements which allow NHBC to manage risks effectively and support the achievement of its strategic objectives. These are described in table 1 on page 37.

# 03 Risks to NHBC's business

## Risk appetites

The Board sets NHBC's risk appetites to align to the key areas of NHBC's strategic framework (see page 32 for further details). Key risk indicators have been established for 15 appetites that relate to the main strategic objectives.

## NHBC's risk profile

**Principal risks**
NHBC has identified the principal risks to achieving its strategic objectives. These risks are reviewed and reported on a quarterly basis to the Board Risk Committee. The Internal Audit team also reviews the adequacy of the key controls designed to mitigate these risks as part of the risk-based audit cycle.

Examples of risks that are managed in the pursuit of NHBC's objectives are provided in table 2 on the next page, with further detail contained in note 6 to the financial statements.

**Emerging risks**
In addition to the risks which are managed through function- and company-level risk registers, an ongoing assessment takes place of emerging risks which would have a significant impact on the organisation. Examples of risks currently under review include:

- The changes in the Government's approach to housing standards and the building control framework in the UK
- Economic issues, including the uncertainty in UK and world investment markets caused partly by the UK's departure from the EU and the effect it may have on the UK housing market
- Issues such as changes in leadership and housing policy
- Technological issues, including the ever-increasing threats to cybersecurity.

## Risk and capital

The Board pays particular attention to NHBC's solvency position, given NHBC's restricted options to raise capital as a company limited by guarantee. The primary basis used by NHBC to quantify this risk is the SCR, which is calculated as Solvency II Own Funds at risk in a one-in-200-year loss event over a one-year time horizon. The table below shows NHBC's Standard Formula solvency position as at 31 March 2019.

## NHBC surplus capital

| | 2019 | 2018 |
|---|---|---|
| Eligible own funds | £621m | £588m |
| SCR | £409m | £376m |
| Solvency II surplus | £212m | £212m |
| Solvency ratio | 152% | 156% |

As at 31 March 2019, NHBC's capital surplus on a Solvency II Standard Formula basis was £212m, with a solvency ratio of 152%, which remains within the Board's capital risk appetite.

NHBC also undertakes an ongoing ORSA, which provides for the continual review of the business's risks, capital requirements and strategic direction. This ongoing assessment comprises a range of different activities, processes and reports.

Table 1: The risk operating model

| First line of defence | Second line of defence | Third line of defence |
|---|---|---|
| Operational functions | Support functions | Assurance |
| Business teams operate systems of internal control.<br><br>Executive Directors are responsible for managing risk in their areas. They and their management teams are the people best placed to understand and manage most risks. | The Risk and Compliance teams support, review and challenge business team activity.<br><br>They report to the Executive Risk Committee and the Board Risk Committee. | The Internal Audit team provides an independent view of the effectiveness of risk and control management.<br><br>The Internal Audit team reports to the Audit Committee. |

Table 2: Principal risks

| Risk area | Key risks |
|---|---|
| Strategic | Failure to define and implement a strategy to deliver NHBC's strategic goals which accommodates the changing environment in which NHBC operates.<br><br>Failure to ensure adequate financial performance and a sustainable capital position. |
| Insurance | Failure to identify and manage significant changes in the propensity for builders to self-repair building defects.<br><br>Failure to identify significant issues with a building system or widely used building component, resulting in significant consumer dissatisfaction and claims costs.<br><br>Failure to adequately mitigate exposure to the insolvency of one or more large builder clients, resulting in significant claims costs. |
| Market | Failure to adequately mitigate risks arising from changes in investment markets, resulting in an inability to fund policy obligations and meet regulatory capital requirements. |
| Pension | Failure to forecast and plan for additional pension fund contributions, resulting in a reduction in profit and an inability to replenish capital reserves. |
| Regulatory | Changes in UK regulations affecting NHBC's operations and business model. |
| Operational | Failure to embed compliant operational and governance processes, causing poor conduct towards homeowners and increased claims costs.<br><br>Failure to protect customer information adequately.<br><br>Failure to respond to increasing pressure on build quality. |

# 03 Wider impact and non-financial information statement

NHBC's business model supports its core aims of raising standards and protecting homeowners in the new homes industry. Please see page 26 for further details of NHBC's business model. NHBC's policies and processes are designed to be proportionate to the risks NHBC has identified and sufficiently flexible to respond effectively, should they arise.

## Employees

Ensuring employees at NHBC can develop and thrive is at NHBC's core. NHBC recognises that, if it looks after its employees, enabling them to be the best they can be, they will look after builder customers and homeowners better through the delivery of excellent service and technical expertise.

Following several years of growth, NHBC's workforce has stabilised at approximately 1,275. NHBC maintains its head office location in Milton Keynes (approximately 550 staff), as well as having around 700 additional staff located across the United Kingdom. NHBC has also grown its team of technical specialists in its London office to support builder customers on high-rise and complex developments.

NHBC is committed to encouraging diversity and inclusion in everything it does in order to support its customers, policyholders and staff. NHBC is a signatory to the Women in Finance charter and is working towards the goals it set in 2016: to increase the number of women in senior roles whilst recognising that changing the demographic of NHBC's employees will take time to achieve.

NHBC has recently published its second Gender Pay Gap report. This report shows a slight improvement in the mean gender pay gap to 16.7% (2018: 17.4%). This continues to be better than the national average and the gaps reported in financial services (35.0%) and construction (45.4%) overall. NHBC's results continue to be driven primarily by the tendency for males to occupy a larger proportion of higher-paid technical roles, as well as senior positions, within the organisation.

NHBC has commenced several initiatives during the year to continue to address the commitments outlined above. They include:

- The introduction of blind recruitment for all roles, including senior leadership positions
- An enhanced approach to flexible working, exceeding the statutory requirements
- An improved annual leave offering
- Continued commitment to increasing senior leadership roles held by women
- The equalisation of paternity, maternity and adoption leave, offering three months of full pay.

NHBC believes in providing equal opportunities for all employees. The employment of people with a disability is included in this commitment, and the recruitment, training, career development and promotion of people with a disability is based on the aptitudes and abilities of the individual. Should existing employees become disabled during their employment with NHBC, efforts are made to continue their employment and, if necessary, appropriate training is given and reasonable adjustments are made.

NHBC is proud to be a partner of the Living Wage Foundation, with minimum pay levels for employees across the UK exceeding the National Living Wage set by the Government.

NHBC also has an officially recognised trade union, the NHBC Staff Association (SA), which is registered with the certification officer for trade unions and employers' associations. The SA successfully obtained a Certificate of Independence, proving its independence from NHBC as judged against statutory requirements. This in turn is allowing the SA to affiliate to the Trades Union Congress (TUC), fulfilling a resolution voted for by its membership in 2017. Affiliation will allow the SA access to high-quality training, membership networks and best practice examples.

## Corporate responsibility

NHBC believes in creating a positive impact in the communities in which its employees live and work, and has a range of initiatives in place to support that, including with Cancer Research UK and Habitat for Humanity. NHBC continues its matched funding scheme for employees' charitable fundraising for non-corporate causes, as well as enabling employees to take additional days of leave each year to volunteer for causes important to them.

## Environmental matters

NHBC's direct environmental impact is minimised primarily through internal processes, with 100% of its waste from its Milton Keynes, London and Scotland offices being recycled. NHBC has also invested over the last five years in energy-efficient lighting and voltage optimisation, enabling it to reduce energy consumption by 7% year on year. NHBC has made a commitment to reduce this by a further 5% over the course of the next two financial years. NHBC runs an extensive car fleet as part of its operations and has reduced average $CO_2$ emissions by 15% in recent years. The fleet strategy identifies further opportunities in this area as vehicle technology evolves.

NHBC also has the potential to have a significant indirect environmental impact through its influence on construction methods. During the year, the NHBC Foundation published six research reports, of which three were directly related to energy-efficient construction methods.

NHBC has further developed its procurement processes to help ensure its external contractors and suppliers provide ethical and responsible services.

There are no policies or key performance indicators used to shape or measure NHBC's indirect environmental impact. Instead, this is managed as a general corporate aim.

## Respect for human rights

NHBC respects the rights of all those impacted, directly or indirectly, by its actions. This includes the supply chain for both the corporate expenditure and claims work performed on policyholders' properties. NHBC's Modern Slavery Statement is published on its website, along with the Procurement Code of Conduct, supports human rights throughout the supply chain.

## Anti-corruption and anti-bribery matters

NHBC operates policies and procedures aimed at preventing corruption, bribery, money laundering and other financial crimes which clearly define employees' roles and responsibilities. The Chief Risk Officer is accountable to the Board for the effectiveness of NHBC controls for preventing, detecting and investigating financial crime. These controls are embedded throughout the organisation, including areas such as procurement, third-party relationships and payments. Processes and controls are subject to periodic review and audit oversight.

The strategic report was approved by the Board on 26 June 2019.

Steve Wood
Chief Executive Officer

CS

# Customer satisfaction

"My dealings with NHBC have been incredibly positive. When we moved into our new home, I looked forward to the low maintenance that the property would offer.

I had to initially contact NHBC for advice as floor tiles in the family bathroom moved when we stood on them and the grout cracked, and in the ensuite bathroom floor tiles had also cracked and in this case the grout has come away.

The person that handled my call was helpful and became my liaison with regard to what turned in to a valid claim. A remedial works contractor was sent to my property and rectified the issues in a timely and professional manner.

I found it very easy to deal with NHBC and would recommend them to others. I also found the quality of the work undertaken to be of a good quality".

**Homeowner, Oakridge Park, Milton Keynes**

# 04

# Governance

# 04 The Board

NHBC has a strong, experienced and diverse Board with a good balance of skills.

## Steve Wood
### Chief Executive Officer

Steve Wood joined the Board as Chief Executive Officer in June 2017. He was previously Chief Executive Officer of Paymentshield (part of Towergate Insurance) and UK Managing Director at Ecclesiastical Insurance. Prior to that, he was Managing Director at FirstAssist Group and held senior positions at RSA Group plc and Royal Insurance. Steve has a BSc (Hons) in Mathematics and is a Fellow of the Chartered Insurance Institute.

## Isabel Hudson
### Chairman

Isabel Hudson joined the NHBC Board in June 2011 as Deputy Chairman and was appointed Chairman in November 2011. She is also a member of the RSA Insurance Group plc Board, where she is the Senior Independent Director, and she sits on the BT Group plc Board.

Past non-executive directorships have included: Phoenix Group Holdings, Standard Life, The Pensions Regulator and QBE (Australia).

Isabel's executive career has comprised of various roles, including Executive Director of Prudential's UK business and Chairman of Prudential International Assurance, working for GE Capital, CFO of Eureko, and establishing and serving as Chief Executive of specialised pension buyout firm Synesis Life.

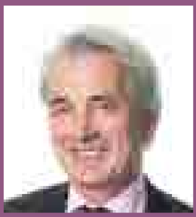
Isabel is also an ambassador for Scope, a UK charity, and has 37 years' experience in the insurance industry in the UK and mainland Europe.

## Paul Hosking
### Chief Financial Officer

Paul Hosking joined NHBC in November 2016. He is a qualified Chartered Accountant with over 20 years' post-qualification experience working in the UK and European insurance markets. Paul began his career with Coopers & Lybrand, a founder firm of PricewaterhouseCoopers, before spending six years working for QBE Insurance UK in a variety of operational and group finance management positions. The following 13 years were at W.R. Berkley Insurance, where, as Chief Financial Officer, Paul helped establish insurance businesses in five European countries and Australia, and took on a number of wider executive management and operational responsibilities in addition to his Chief Financial Officer role.

## Neil Jefferson
### Chief Operating Officer

Neil Jefferson is Chief Operating Officer at NHBC and was appointed to the Board in April 2012. He is a Chartered Builder and has held various positions in NHBC, his most recent roles on the Board being Managing Director and Business Development Director. Neil was also Chief Executive of the Zero Carbon Hub between 2008 and 2016.



## Paul Bishop
### Senior Independent Director

Paul Bishop joined the Board in November 2016 and was appointed Senior Independent Director in January 2018. He has over 30 years' experience in the financial services industry, primarily as a Partner at KPMG where he was the European lead for Insurance Consulting. Paul retired from KPMG in 2014. At NHBC, he is the Chair of the Audit Committee and a member of the Board Risk, Investment, and Nominations Committees. Paul is also a Non-Executive Director at Zurich Assurance Limited and a Non-Executive Director and Chair of the Audit Committees at Just Group and at Police Mutual Assurance Society.

## Ian Craston
### Non-Executive Director

Ian Craston joined the Board in September 2014. He is Chairman of NHBC's Investment Committee and is also a member of the Board Risk and Remuneration Committees. Ian is currently Group Investment Director at RSA, a position he has held since 2002. He has over 30 years' experience within the investment industry, having started with RSA's fund management company in 1987. He has held a number of investment roles, including Head of Bond Management and Head of Group Client Management. In Ian's current role at RSA, his remit also includes responsibility for RSA's treasury function and the management of its pension scheme exposures.

## Kate Davies
### Non-Executive Director

Kate Davies joined the Board in October 2016. She has been Chief Executive of Notting Hill Housing from 2004. Since the merger between Notting Hill Housing and Genesis Housing Association in April 2018, she has also been Chief Executive of Notting Hill Genesis, a 65,000 home association with 90% of its stock in London. Kate was previously Chief Executive of Servite Houses and Director of Housing for Brighton and Hove City Council. She has experience in local government and the private and voluntary sectors. Kate is a member of NHBC's Consumer and Remuneration Committees. She has two degrees and qualifications in housing management (MCIH) and housing association development.

## Jean Park
### Non-Executive Director

A Chartered Accountant, Jean Park joined the Board in March 2013, and is Chairman of NHBC's Board Risk Committee and a member of the Audit, Investment and Nominations Committees. She is a risk professional with many years of experience in risk management, compliance and audit. Previously, she held the role of Chief Risk Officer at Phoenix Group and, prior to that, Risk Management Director at Scottish Widows Group. She was also on the executive committees of both of those organisations. Currently, Jean is a Non-Executive Director of Murray Income Trust plc and Admiral Group plc.

## Sir Muir Russell
### Non-Executive Director

Sir Muir Russell joined the Board in May 2012. He graduated from the University of Glasgow in 1970 with first-class honours in Natural Philosophy. He joined the Scottish office and, during his 33 years as a civil servant, was Secretary of the Scottish Development Agency, Principal Private Secretary to the Secretary of State for Scotland, Permanent Under Secretary of State to the Scottish Office and Permanent Secretary to the Scottish Executive following devolution. Sir Muir then served as Principal and Vice Chancellor of the University of Glasgow for six years. He was the Chairing Member of the Judicial Appointments Board for Scotland from 2008 to 2016 and is Chairman of the Board of Trustees of the Royal Botanic Garden Edinburgh. Sir Muir is Chairman of NHBC's Remuneration and Scottish Committees.

## Stephen Stone
### Non-Executive Director

Stephen Stone joined the NHBC Board in November 2016. He has been Chief Executive of Crest Nicholson Plc since 2005, becoming Executive Chairman in March 2018, having been appointed to the Board in January 1999. Stephen is a Chartered Architect with over 37 years' experience in various positions in the construction and house-building industry. He represents Crest Nicholson Plc when engaging with investors, the Government, the Home Builders Federation and the industry. Stephen is a Non-Executive Director of the Home Builders Federation and Orbit Group, and a member of the Construction Leadership Council.

# 04 The Council

## A list of members of the Council as at 1 June 2019:

**Mr P Andrew**
Home Builders Federation

**Mr S Baseley**
Home Builders Federation

**Ms J Bennett**
UK Finance

**Mr D Birkbeck**
Design for Homes

**Mr Paul Bishop**
NHBC Board appointment

**Mr M Black**
Home Builders Federation

**Mr A Burd**
British Standards Institute

**Mr P Caplehorn**
Construction Products Association

**Mr C Carr**
Federation of Master Builders

**Sir John Carter**
Honorary Vice-President

**Mr D Cochrane**
NHBC Scottish Committee

**Mr A Collett**
British Property Federation

**Ms C Compton-James**
The Housing Forum

**Mr I Craston**
NHBC Board appointment

**Mr A Cripps**
Royal Institution of Chartered Surveyors

**Mrs K Davies**
NHBC Board appointment

**Mrs S Dean**
Warranty holder

**Ms N Elphicke**
The Housing & Finance Institute

**Mr N Fluck**
Law Society

**The Rt. Hon. the Lord Fowler**
Honorary Vice-President

**Mr R Hardy**
Building Research Establishment

**Mr M Hayward**
National Association of Estate Agents

**Mr K Hinton**
Warranty holder

**Mr J Hood**
NHBC Northern Ireland Committee

**Mr B Hook**
Royal Institution of Chartered Surveyors

**Mr P Hosking**
NHBC Board appointment

**Mrs I Hudson**
NHBC Board appointment

**Ms G Hunter**
NHBC Scottish Committee

**Mr K Ireland**
Federation of Master Builders

**Mr N Jefferson**
NHBC Board appointment

**Ms A Kaye**
Institute of Consumer Affairs

**Mr P Knox**
House Builders Association

**Mr L Livermore**
Trading Standards Institute

**Mrs A J Lowe**
Warranty holder

**Mr D McCallum**
Chartered Institute of Housing

**Mr G McDonald**
Home Builders Federation

**Mr D McLeod**
NHBC Scottish Committee

**Mr J Owen**
Joseph Rowntree Trust

**Ms J Park**
NHBC Board appointment

**Sir Michael Pickard**
Honorary Vice-President

**Mr C Richardson**
Warranty holder

**Mr A Rowan**
NHBC Northern Ireland Committee

**Mr J Roycroft**
Institution of Civil Engineers

**Sir Muir Russell**
NHBC Board appointment/Scottish Committee

**Mr P Sellwood**
Energy Saving Trust

**Professor T Sharpe**
NHBC Scottish Committee

**Mr J Slater**
Home Builders Federation

**Mr Stephen Stone**
NHBC Board appointment

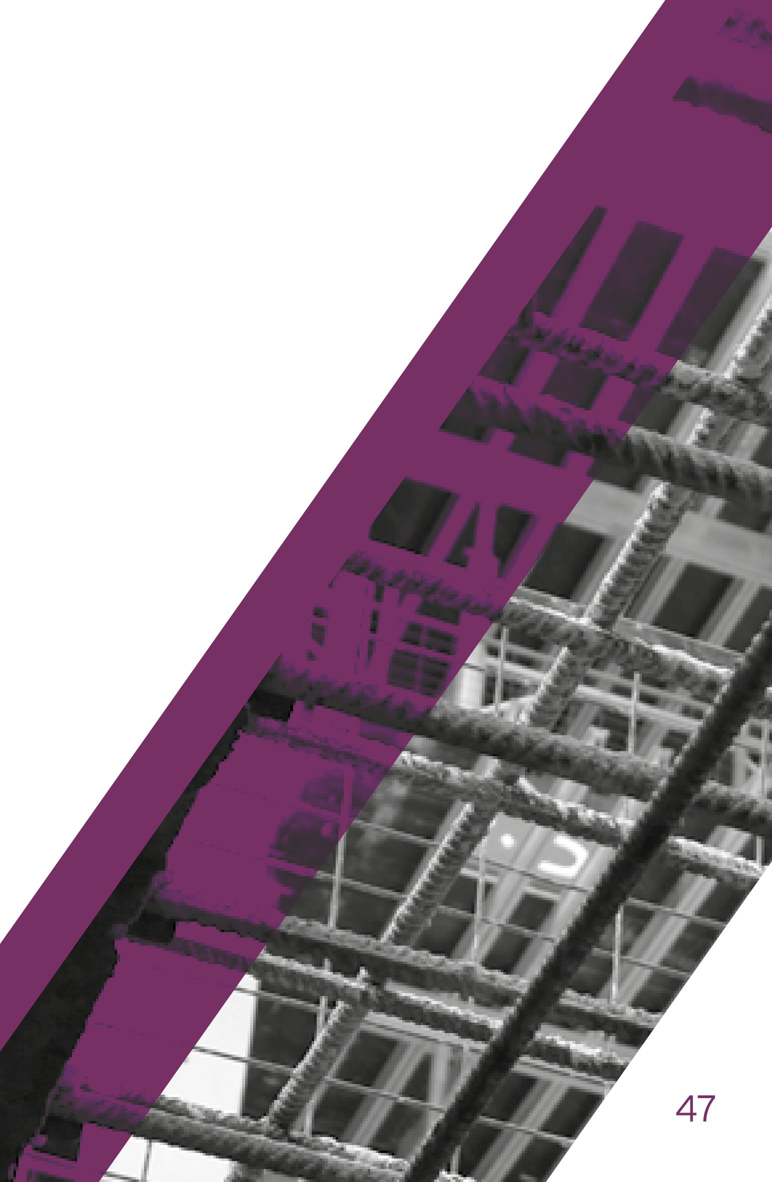
**Mr M Stones**
UK Finance

**Mr E Taylor**
RoSPA

**Ms S Ullmayer**
Royal Institute of British Architects

**Mr A von Bradsky**
Royal Institute of British Architects

**Mr S Wood**
NHBC Board appointment



# Ivor House, Brixton Centric, London

**The conversion of a former Co-operative department store**

Ivor House has heritage and beautiful art deco features in abundance, offering London living at its very best in one of the city's most eclectic, creative and vibrant postcodes.

The 1920s elevations of polished Portland stone have been retained, with render at the rear of the building. The steel frame is encased in concrete, with concrete infill floors and nine-inch solid walls.

Original features have been retained, and existing materials used where possible, in the art deco-inspired apartments.

BUILDER
Morgan Sindall Construction (contractor), for Muse Developments (developer)

NUMBER OF HOMES
26

PRODUCTS
Buildmark and Building Control

"This project hasn't been without its challenges, but knowing our contractor was having regular meetings with the NHBC building inspector, and that he was contactable as required, made sure we were taking the best possible approach to bring this beautiful building back to its former glory.

Engaging NHBC early in the process gave us the confidence that we have restored Ivor House in line with NHBC's exacting standards, with the most suitable warranty and insurance product for our needs."

**Andrew Boyle, Project Director, Muse Developments**

# 04 Corporate governance report

This report summarises the composition of the NHBC Council, the Board and its committees, and comments on some of the main issues which have been addressed during the year under review.

## NHBC Council

NHBC is a private company limited by guarantee, and its governing body comprises individual members, known collectively as the NHBC Council. Council members are drawn from a range of organisations that are interested in, or associated with, the house-building industry.

Under the Constitution, the duty and authority to run NHBC's affairs is vested in the Board of Directors. The Council does not become involved in day-to-day decisions, but it does receive the directors' report and audited accounts and, at the Annual General Meeting (AGM), Council members may question and challenge the Board on its running of the business.

The Council is also empowered to decide some matters which the Directors may not. These include:

- Alterations to NHBC's Constitution
- The appointment of the auditors
- The appointment of Council members.

In accordance with NHBC's Articles of Association, Council members may serve for two five-year terms.

Admission as a member of the NHBC Council is recommended by the Appointments Committee. In accordance with the Articles of Association, the Committee comprises the Chairman, the Chief Executive Officer and three members of the Council (who are not directors) recommended by the Board and approved by the Council in the AGM. The Council members who currently serve on the Committee are:

| |
|---|
| Ann Kaye – Institute of Consumer Affairs |
| Philip Sellwood – Energy Saving Trust |
| Kelvin Hinton – Buildmark warranty holder |

### NHBC Council representation by category

| | |
|---|---|
| 11 | Board |
| 2 | Consumer |
| 2 | Financial services |
| 15 | Industry bodies |
| 6 | Professional bodies |
| 2 | Northern Ireland Committee |
| 4 | Scottish Committee |
| 3 | Vice presidents |
| 4 | Warranty holders |
| 6 | Other |

## NHBC Board

The Board's principal role is to agree and oversee the implementation of NHBC's strategy, and to ensure that the necessary resources are in place to enable it to meet its objectives, and that the financial performance, controls and risk management procedures are suitably robust. The Board is also responsible for ensuring that NHBC maintains an appropriate standard of governance with regard to the Constitution, the UK Corporate Governance Code and the regulatory framework in which the company operates.

## Board composition

Biographical information on each of the directors is contained on page 44.

## Balance of Executive and Non-Executive Directors

| | |
|---|---|
| Chairman | 1 |
| Senior Independent Director (SID) (Non-Executive) | 1 |
| Independent Non-Executives | 3 |
| Other Non-Executives | 2 |
| Executives | 3 |

## Length of service of Non-Executive Directors

| | |
|---|---|
| 0-3 years | 3 |
| 3-6 years | 1 |
| 6-9 years | 3 |

## Gender split of Board of Directors

| | |
|---|---|
| Male | 7 |
| Female | 3 |

# 04 Corporate governance report

## Board gender diversity versus FTSE 100 and FTSE 250[2]

| | FTSE 100 (June 2018) % | FTSE 250 (June 2018) % | NHBC (June 2019) % |
|---|---|---|---|
| Female directors | 29.0 | 23.7 | 30.0 |
| Female Executive Directors | 9.7 | 6.4 | 0.0 |
| Female Non-Executive Directors | 35.4 | 29.1 | 43.0 |

All directors make a declaration of their interests to the Board; this includes any actual or potential conflicts they may have. Those issues are considered by the Board and recorded in a register held for that purpose and kept under review, as appropriate. Should the Board discuss any matter which relates to a declared interest, or which could give rise to a conflict, NHBC's approach is that the director concerned may take part in some or all of the discussion of the issue, but will leave the meeting when a decision is to be made. Two directors, Kate Davies and Stephen Stone, work within the new house-building industry, and their membership of the Board is to ensure an appropriate breadth of skills, experience and industry views are represented.

A review of Board effectiveness is carried out annually. Following an external review in 2017, an internal review was carried out in 2018. This followed up on actions from the 2017 review and found that improvements had been made in areas including clarification of culture and values, and Board succession.

Over the course of the past year, the Board has received briefing on the Senior Managers and Certification Regime, the internal model, financial crime and money laundering, and the scope and operation of the Buildmark policy. Individual directors have also attended a range of house-building and insurance conferences, seminars and other events arranged through consultants and organisations with whom NHBC is associated.

2. The Female FTSE Board Report 2018: http://business-school.exeter.ac.uk/media/universityofexeter/businessschool/documents/research/Female_FTSE_Report_2018.pdf

## Board attendance

The table below provides information on the meetings held during the year under review. In addition to the regular meetings, the Board held strategy discussions and the Chairman held regular meetings with the Non-Executive Directors.

| Board member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Paul Bishop[1] | 6 | 5 | 83 |
| Ian Craston | 6 | 6 | 100 |
| Kate Davies | 6 | 6 | 100 |
| Paul Hosking | 6 | 6 | 100 |
| Isabel Hudson[2] | 6 | 5 | 83 |
| Neil Jefferson | 6 | 6 | 100 |
| Jean Park | 6 | 6 | 100 |
| Sir Muir Russell | 6 | 6 | 100 |
| Dame Helena Shovelton[3] | 3 | 3 | 100 |
| Stephen Stone | 6 | 6 | 100 |
| Steve Wood | 6 | 6 | 100 |

1. Paul Bishop was not able to attend the May 2018 Board meeting due to a prior commitment.
2. Isabel Hudson was not able to attend the March 2019 Board meeting due to unforeseen personal circumstances.
3. Dame Helena Shovelton resigned on 26 September 2018.

## NHBC's committees

The Board delegates certain matters to the Audit, Board Risk, Investment, Nominations, Remuneration and Consumer Committees which report to it. The roles of each of the committees are detailed in the respective committee reports on pages 56 to 66. These reports reflect the current memberships of each committee and highlight some of the work which they have undertaken during the year under review.

# 04 Directors' report

The directors submit their Annual Report & Accounts for NHBC, together with the consolidated financial statements of the NHBC Group, for the year ended 31 March 2019. The directors' report required under the Companies Act 2006 comprises this directors' and corporate governance report, the directors' remuneration report and the disclosures in the 'Wider impact and non-financial information statement' section of the strategic report.

## Results

The Group's results for the year are shown in the consolidated statement of comprehensive income on page 104.

## Directors

The directors at the date of this report are shown, together with their biographical details, in the Governance section on page 44.

## Directors' interests and indemnity arrangements

At no time during the year did any director hold a personal interest in any contract of significance with the company or any of its subsidiary undertakings, although some of NHBC's directors are also directors of NHBC's builder customers, suppliers and industry partners. NHBC trades in the normal course of business, on an arm's length basis, with all these parties, and material transactions with related parties are disclosed in note 37 on page 163 to the financial statements.

The company has purchased, and maintained throughout the year, directors' and officers' liability insurance in respect of itself and its directors.

Details of directors' remuneration, service contracts, and employment contracts are set out in the directors' remuneration report.

There is no arrangement or understanding with any builder customer, supplier or any other external party to appoint a director or a member of the executive.

## Disclosure of information to the auditor

In accordance with section 418 of the Companies Act 2006, the directors in office at the date of approval of this report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditor, Deloitte LLP, is unaware, and each director has taken all steps that ought to have been taken as a director to be aware of any relevant audit information and to establish that Deloitte LLP is aware of that information.

## Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the strategic report as part of the 'Risks to NHBC's business' section on page 35. The directors believe that the Group is well placed to manage its business risks successfully, given its financial resources. After making appropriate enquiries, including assessing business plans, scenario analysis and the latest solvency projections, the directors have a reasonable expectation that the company and the Group as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

## Directors' responsibilities

The directors are responsible for preparing the directors' 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 Group and parent company financial statements in accordance with United Kingdom GAAP (United Kingdom Accounting Standards and applicable law). Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and company and of the profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently
- Make judgements and accounting estimates that are reasonable and prudent
- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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.

Each of the directors listed in the strategic report confirms that, to the best of their knowledge:

- The Group financial statements, which have been prepared in accordance with applicable UK Accounting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group
- The strategic report and the directors' and corporate governance reports include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

Information required to be disclosed in the directors' report may be found in the following sections:

| Information | Section in annual report | Page |
|---|---|---|
| Future developments of the business | Chief Executive Officer's statement | 12 |
| Business review | Strategic report | 25 |
| Research and development activities | Strategic report | 25 |
| Financial risk management | Strategic report | 25 |
| Corporate responsibility governance | Wider impact and non-financial information statement | 38 |
| Action on employee participation | Wider impact and non-financial information statement | 38 |
| Directors in office during the year | Corporate governance report | 50 |
| Rules governing appointments of directors | Corporate governance report | 50 |
| Disclosure of information to the auditor | Directors' report | 54 |
| Details of qualifying third-party indemnity provisions | Directors' report | 54 |

This report was approved by the Board of Directors on 26 June 2019 and signed on behalf of the Board by:

Anne Durkin
Company Secretary
26 June 2019

# 04 Audit Committee report

| Audit Committee member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Paul Bishop (Chairman) | 4 | 4 | 100 |
| Ian Craston[1] | 3 | 3 | 100 |
| Jean Park | 4 | 4 | 100 |
| Dame Helena Shovelton[2] | 2 | 2 | 100 |

1. Ian Craston joined the Audit Committee on 1 September 2018.
2. Dame Helena Shovelton left the Audit Committee on 26 September 2018.

The role of the Audit Committee is to support the Board in undertaking its responsibilities for:

- Monitoring the integrity of the financial statements, significant financial reporting issues and returns to regulators
- Monitoring the adequacy and effectiveness of the company's systems of control and frameworks
- Monitoring the scope, objectivity, performance and overall effectiveness of both external and internal auditors
- Monitoring the adequacy of whistleblowing and fraud systems
- Making recommendations to the Board to be put to the members at the AGM in relation to the appointment, reappointment and removal of external auditors, and overseeing the selection process for new auditors.

The members of the Audit Committee are all independent Non-Executive Directors. In addition to the members, the following routinely attend the Audit Committee meetings: Chairman of the Board; Chief Executive Officer; Chief Financial Officer; Head of Finance; Company Actuary; internal auditors Grant Thornton LLP; and external auditors Deloitte LLP.

## Activities during the financial year ended 31 March 2019

In the performance of its duties, the Audit Committee met four times during the financial year. The key areas of activity included:

- Reviewing the Annual Report & Accounts to ensure that NHBC follows good practice with regard to its status as a private, non-profit distributing company and the needs of its stakeholder and wider audiences
- Approving the external and internal audit plans
- Discussing with management and external advisors, Willis Towers Watson (WTW), the approach to reserving and the assumptions used to assess the level of reserves
- Reviewing developments in the UK accounting framework as they apply to NHBC's financial statements under UK GAAP
- Reviewing the internal audit reports submitted by Grant Thornton LLP
- Reporting on its activities to the Board
- Undertaking an Audit Committee effectiveness review.

## Financial reporting

In considering the draft Annual Report & Accounts, the Audit Committee paid particular attention to key areas of subjective judgement which generally were in relation to the calculation of the technical provisions.

The Audit Committee discussed the reserving approach and the technical provisions with both management and auditors. In addition, the Audit Committee reviewed the UK GAAP reserves with consulting actuaries from WTW, who undertook an independent assessment of NHBC's reserves using NHBC's underlying data.

NHBC is always required to hold reserves that are sufficient to cover liabilities arising out of insurance contracts, so far as can be reasonably foreseen. In view of that requirement, NHBC takes a cautious and prudent approach with regard to the nature of the risks and uncertainties it faces in the course of its business. As part of its consideration of these issues, the Audit Committee has confirmed the commitment to maintaining a consistent degree of prudence in the reserves year on year.

## External audit

As part of the review of the accounting statements, the Audit Committee discussed the audit plan with the external auditor: in particular, the areas which they considered to have either a significant or a material risk of misstatement, and consequently where they intended to focus their attention during the conduct of the audit. For NHBC, those areas were consistent with the Audit Committee's areas of concern, namely:

- Valuation of best estimate technical provisions
- Valuation of UK GAAP margin
- Management override of controls.

On an annual basis, the Audit Committee reviews both the effectiveness and the independence of the auditor.

## Internal audit

A regular focus of the Audit Committee is the agreement of the annual plan, monitoring the progress of Grant Thornton LLP's work and reviewing the audit reports which they prepare.

During the year, Grant Thornton LLP completed reports on most items in the plan, and they were reviewed by the Audit Committee. No material control weaknesses were identified. Planned work has been completed since the year end.

CS

# Embracing MMC

"NHBC continues to see growing interest in the use of Modern Methods of Construction (MMC). This interest is driven in part by the UK Government, which has expressed support for this sector and has set out a range of measures to support growth in MMC.

Builders are exploring innovative forms of construction to improve productivity and build times, to address skills shortages and, importantly, to explore the potential for improved quality of construction.

NHBC is supporting the growing demand by carrying out a review of MMC systems in advance of their use on site. Working collaboratively with manufacturers, we now have a dedicated team to review the design and factory production controls before inspecting a pilot scheme to demonstrate that the system can be accepted.

Introduction of new technologies is not without risk and NHBC takes a robust approach to the assessment of MMC systems. This rigour is designed to give confidence to homeowners and investors that systems are fit for purpose and will deliver homes that are long-lasting and will perform well in use.

Given the growing interest, during 2018/19 we doubled the size of the Innovation team to deal with the record number of systems submitted for review, as well as simplifying our procedures so that projects using accepted MMC systems can progress quickly on site. We continue to improve the speed of MMC review to support the introduction of new systems while retaining our focus on quality – quality of design, of manufacture and on-site construction.

NHBC has also been working closely with MHCLG's working group on MMC to address barriers to finance and shares knowledge with the industry to help stakeholders identify and address risks associated with new forms of construction."

**Richard Lankshear, Innovation Manager, NHBC**

# 04 Board Risk Committee report

| Board Risk Committee member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Paul Bishop | 5 | 5 | 100 |
| Ian Craston[1] | 2 | 2 | 100 |
| Kate Davies[2] | 4 | 4 | 100 |
| Jean Park (Chairman) | 6 | 6 | 100 |
| Stephen Stone | 6 | 4 | 67 |

1. Ian Craston left the Board Risk Committee on 1 September 2018.
2. Kate Davies joined the Board Risk Committee on 1 September 2018.

The principal role of the Board Risk Committee is to:

- Review the effectiveness of NHBC's risk management framework
- Oversee and advise the Board on the current risk exposures of the company and adherence to risk appetite
- Challenge the identification, assessment and mitigation of significant risks
- Review and challenge NHBC's approach to the overall management of risk, capital and strategy through the ORSA process and stress and scenario framework
- Oversee the development of NHBC's internal model.

The members of the Board Risk Committee are all Non-Executive Directors, the majority of whom are independent. In addition to the members, the following routinely attend the Board Risk Committee meetings: Chairman of the Board; Chief Executive Officer; Chief Finance Officer; Chief Risk Officer; Head of Actuarial; and internal auditors Grant Thornton LLP.

## Activities during the financial year ended 31 March 2019

In the performance of its duties, the Board Risk Committee met six times during the financial year. It oversaw the development of several material items, which are summarised below.

Considerable progress has been made with the development of a new capital model, which is intended to drive the calculation of NHBC's Solvency II capital requirement and ORSA reporting.

The Board Risk Committee has continued to monitor the progress being made in developing and implementing new processes to enable NHBC to comply with the Insurance Distribution Directive and the General Data Protection Regulation (GDPR). It continued its assessment of other significant regulatory changes taking place and reviewed NHBC's response to them.

The Board Risk Committee has continued to undertake 'deep-dive' reviews focusing on specific risk areas. These have covered topics such as: management of major claims; the control of exposure to road and sewer bonds; and how NHBC assesses and mitigates the risk of a change in builder behaviour.

More generally, the Board Risk Committee has reviewed, monitored and approved, where relevant, NHBC's Solvency II Standard Formula capital position; the development of NHBC's new capital model; the further development of risk appetites; changes to risk policies; the updating of reinsurance treaties; the Board Risk Committee's effectiveness; and the risk disclosures in the public accounts.

# 04 Investment Committee report

| Investment Committee member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Paul Bishop | 4 | 3 | 75 |
| Ian Craston (Chairman) | 4 | 4 | 100 |
| Jean Park | 4 | 4 | 100 |
| Sir Muir Russell | 4 | 4 | 100 |

The principal role of the Investment Committee is to:

- Review the strategic asset allocation and make recommendations to the Board
- Make rebalancing decisions between existing asset classes and investment managers
- Review NHBC's investment managers and approve any changes
- Review and approve investment manager guidelines
- Oversee compliance with NHBC's Investment Strategy, Investment Management Policy and aspects of the Investment Markets Risk and Liquidity Policies
- Contribute to the design of an investment reporting framework
- Review key reports produced by NHBC's fund managers, including investment performance reporting; the managers' environmental, social and corporate governance practices; and compliance with ISAE 3402 (or equivalent) internal controls standards
- Review and approve NHBC's Investment Management Policy
- Recommend changes to NHBC's Investment Markets Risk and Liquidity Risk Policies (owned by the Board Risk Committee) and Investment Strategy (owned by the Board).

The members of the Investment Committee are all independent Non-Executive Directors. In addition to the members, the following routinely attend the Investment Committee meetings: Chief Executive Officer; Chief Financial Officer; Chief Risk Officer; Head of Investments and Pensions; Head of Finance; and external investment advisers and managers when requested.

## Activities during the financial year ended 31 March 2019

The Investment Committee met on four occasions during the year, with its key activities including the review of strategy as well as monitoring the activities, performance and conduct of NHBC's fund managers.

NHBC operates a prudent investment strategy based on a strong allocation to high-quality bonds. Over the year, the total return from the portfolio was 3.25%.

NHBC operates a liability matching strategy, where predominantly UK government debt is held, to provide cash flows that deliver a strong match to the projected insurance liabilities.

The remainder, the surplus assets, comprise predominantly equities and corporate bonds that are actively managed to generate a higher rate of return, while remaining within NHBC's stated risk appetite.

During the year, the Investment Committee presided over the implementation of the simplification of the global equity portfolio, with a reduction in managers from three to two, and a broadening of the investment universe to new asset classes and geographic regions to enhance diversification.

The changes are not expected to materially change the overall risk profile of the portfolio.

The Investment Committee has continued to work with the Trustee of the NHBC Defined Benefit Pension Scheme in order to gradually move pension scheme assets into a more low-risk portfolio.

The Investment Committee has been supported in its role by external investment advisors. Their role is to assist NHBC with the provision of investment advice in specialist areas.

# 04 Remuneration Committee report

| Remuneration Committee member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Paul Bishop[1] | 2 | 1 | 50 |
| Ian Craston | 4 | 4 | 100 |
| Kate Davies[2] | 2 | 2 | 100 |
| Sir Muir Russell (Chairman) | 4 | 4 | 100 |

1. Paul Bishop joined the Remuneration Committee on 1 September 2018.
2. Kate Davies left the Remuneration Committee on 1 September 2018.

The principal role of the Remuneration Committee is to:

- Establish the approach to remuneration across NHBC and to review remuneration trends
- Agree the pay and benefits for employees, including any payments made under bonus schemes and any changes to employee benefit structures
- Review and determine:
  - The pay and benefits of the Chief Executive Officer and the other Executive Directors
  - The fee paid to the Chairman.

All members of the Remuneration Committee are independent Non-Executive Directors, and their biographies are given on page 44. The Chairman of the Board, Chief Executive Officer, Head of HR, and other members of the Management team also attend the meeting where appropriate.

## Activities during the financial year ended 31 March 2019

As part of its regular activities, the Remuneration Committee agreed the annual staff salary settlement and the recommendations to be made to the Board concerning Executive Directors' salaries. Further details of director's remuneration are set out on page 71. Another of the Remuneration Committee's regular tasks is to review the performance against the bonus scheme scorecard for the current year and review the various bonus targets and measures for the forthcoming year. Independent scrutiny of the bonus measures is provided by the Chief Risk Officer, who audits the results and comments on the measures and proposed targets from a risk standpoint. Additionally, NHBC's actuarial consultants validate the capital calculations.

During the year, an equal pay audit was carried out. It found no issues regarding equal pay for the same role and no concerns that job values were unfair or gender biased. The Remuneration Committee also reviewed and approved an increased minimum pension contribution for all employees in line with new regulations.

# Nominations Committee report

| Nominations Committee member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Paul Bishop | 2 | 2 | 100 |
| Isabel Hudson (Chairman)[1] | 2 | 1 | 50 |
| Jean Park | 2 | 2 | 100 |
| Sir Muir Russell | 2 | 2 | 100 |

1. Isabel Hudson was not able to attend the March 2019 Nominations Committee meeting due to unforeseen personal circumstances.

The principal role of the Nominations Committee is to:

- Review the size, structure and composition of the Board
- Consider the succession plans for the Board and senior executives
- Identify and recommend candidates to the Board to fill vacancies as they arise
- Keep under review the leadership needs of NHBC, both executive and non-executive, with a view to ensuring the continued ability of NHBC to operate and compete effectively in the marketplace
- Evaluate the balance of skills, qualifications, knowledge and experience on the Board, and in light of that, consider candidates from diverse backgrounds and against appropriate criteria, including whether they have sufficient time to devote to the position
- Review annually the time commitment required from Non-Executive Directors and whether they are devoting sufficient time to fulfil their duties
- Make recommendations to the Board in relation to the membership of standing committees in consultation with the respective chairs of those committees
- Consider the reappointment of Non-Executive Directors at the conclusion of their specified term of office with regard to their performance and ability to contribute to the Board, considering the knowledge, skills and experience required.

Members of the Nominations Committee are all independent Non-Executive Directors, and their biographies are given on page 44. The Chief Executive Officer and the Head of Human Resources also attend the meetings, where appropriate.

## Activities during the financial year ended 31 March 2019

The Nominations Committee reviewed the tenure of current Board members and, following recommendation from the Nominations Committee, the Board agreed the following:

- Extension of Ian Craston's term of office by three years into a second term
- Extension of Kate Davies' term of office by three years into a second term
- Extension of Stephen Stone's term of office by three years into a second term
- Extension of Paul Bishop's term of office by three years into a second term
- Extension of Sir Muir Russell's term of office by a further 12 months in his third term.

In September 2018, Dame Helena Shovelton stood down after completing six years of service. Following a review of the balance of skills, experience and knowledge on the Board, work has commenced to recruit an additional Non-Executive Director.

# 04 Consumer Committee report

| Consumer Committee member | Meetings to attend | Meetings attended | Attendance % |
|---|---|---|---|
| Kate Davies | 2 | 2 | 100 |
| Dame Helena Shovelton (Chairman) | 2 | 2 | 100 |

The principal role of the Consumer Committee was to:

- Monitor and review NHBC's management information and performance in relation to conduct risk, and provide comfort to the Board that this area is subject to rigorous scrutiny
- Monitor adherence to the conduct risk appetites, tolerances and measures, including making suggestions to the Board Risk Committee regarding enhancements to the framework and challenging the dashboard
- Develop and monitor the Consumer Strategy
- Monitor and review complaints, including the outcomes and actions of any case referred to the Financial Ombudsman
- Review any proposal to amend or introduce products that are provided directly or indirectly to consumers, or projects that may have a direct influence on the relationship with consumers.

The Consumer Committee was comprised of Non-Executive Directors and independent external advisors, including three NHBC Buildmark policyholders. In addition to the members, the following routinely attended the Consumer Committee meetings: the Chairman of the Board; the Chief Executive Officer; and the Claims and Commercial Director.

## Activities during the financial year ended 31 March 2019

The final meeting of the Consumer Committee was held in September 2018. The decision to disband it was due to a higher focus on consumer matters by management and a desire to increase visibility of these matters at Board level.

This report covers the activities of the Committee from 1 April 2018 to the date at which it was disbanded.

In the period from 1 April 2018 to 6 September 2018, the Consumer Committee met on two occasions to discuss and advise on matters that impact consumers and the assistance that NHBC provides to homeowners who experience problems with their homes.

In order to monitor NHBC's performance for the fair treatment of its policyholders, the Consumer Committee reviewed data on claims, complaints, products and inspections, and provided advice and suggestions for improvements where appropriate.

At each meeting, the Consumer Committee reviewed a conduct risk report and received updates on the Consumer Strategy, and it provided comment and monitored any actions arising.

The Consumer Committee reviewed proposed changes to the Buildmark and Buildmark for Apartments policies, and provided comment on the wording and cover of the policies to ensure they were easy to understand and consistent with the types of property being constructed.

The Consumer Committee also received regular updates on other work that directly impacted policyholders, such as customer satisfaction surveys, the Consumer Code for Homebuilders and the Consumer Experience Strategy.

CS

# Always taking pride in their job

Since Barratt Developments registered with NHBC in 1968, the five-star developer has led the way and won more than 1,000 NHBC Pride in the Job Awards.

Sury Patel is an experienced Senior Project Manager at Barratt London who has won several NHBC Pride in the Job Awards for managing an impressive regeneration scheme in Hendon, London.

"NHBC has been a great source of expertise during this regeneration scheme. Together, we have solved complex challenges, with the NHBC team always providing independent expertise and guidance.

An NHBC Pride in the Job Award is the highest accolade a site manager can win so to have won in 2016 and 2018 for managing Hendon Waterside is an achievement I'm very proud of. It recognises the hard work of the whole team who take huge pride in producing high-quality homes for our customers.

It's a tough but rewarding industry to work in and people expect the very best when buying a new home. Our partnership with NHBC is essential in giving our customers that extra level of reassurance, backing up our commitment to deliver their dream home."

**Sury Patel, Senior Project Manager, Barratt London**


PRIDE IN THE JOB
AWARDS 2018
Sury Patel
Seal of Excellence Award
Barratt West London

# 05

# Directors' remuneration report

# 05 Directors' remuneration report

On behalf of the Board and the Remuneration Committee, I am pleased to present the directors' remuneration report for the year ended 31 March 2019.

The Remuneration Committee has responsibility for the annual review of remuneration design for all staff employed by NHBC, including Executive Directors and senior managers. It assesses the appropriateness of remuneration packages in line with the company's business needs and the Board's aim of delivering an appropriate and competitive level and mix of remuneration when compared with companies of a similar scale and complexity to NHBC. This is done while ensuring that the principles of sound and prudent risk management are fully considered and that excessive risk-taking is neither encouraged nor rewarded.

This report has two components:

- Part A, the directors' remuneration policy report, which details each of the components of directors' remuneration
- Part B, the annual implementation report, which is audited by NHBC's external auditor, Deloitte LLP.

## Summary of the year ended 31 March 2019

During the year, the Remuneration Committee continued to ensure that NHBC's remuneration policy linked executive pay and the company-wide bonus scheme to NHBC's strategic objectives, in particular:

- To build long-term capital and financial strength: variable pay is aligned to the assessment of the capital and financial position, as well as performance of the business, to allow NHBC to provide capacity to meet the demand for homeowners' warranty insurance
- To improve the construction quality of new homes: variable pay is linked directly to measures of consumer satisfaction and standards of construction
- Core business performance: variable pay is dependent on the business achieving various operational targets.

For further information concerning the activities of the Remuneration Committee, please see the Remuneration Committee report on page 64.

## Remuneration outcomes

In the financial year, NHBC continued to support and meet the demands of customers and homeowners. Notable factors in the financial year bearing on remuneration outcomes included:

- A financial loss for the Group, primarily driven by large loss claims development and continued uncertainty in the claims environment
- Consolidation of NHBC's capital position, with further information available in the capital management note in the financial statements on page 134
- Management and control over operating expenses during a period of growing volumes
- Delivery of key standard-raising objectives and completion of specific business change activities.

The aggregate remuneration for each of the Executive Directors that served NHBC during the financial year is:

| | 2019 (£'000) | 2018 (£'000) |
|---|---|---|
| Paul Hosking | 312 | 334 |
| Neil Jefferson[1] | 390 | 335 |
| Steve Wood[2] | 451 | 361 |

1. Neil Jefferson received an exceptional bonus in July 2018 following his interim appointment as Managing Director and the agreed handover period to Steve Wood.
2. Steve Wood was appointed as Chief Executive Officer on 30 June 2017.

The Board reports that the company and personal performance conditions set for the year have been met; therefore, bonuses have been awarded to the Executive Directors as detailed in the body of this report. While the Remuneration Committee regards the detail of individual targets and performance data to be commercially sensitive, NHBC adopts the practice of reporting the overall performance results.

The table below shows, for each Executive Director that served in the financial year ended 31 March 2019, performance against the annual incentive plan.

| | Target (%) | Stretch (%) | Actual (%) |
|---|---|---|---|
| Paul Hosking | 40 | 80 | 25.9 |
| Neil Jefferson | 40 | 80 | 25.9 |
| Steve Wood | 50 | 100 | 32.4 |

The bonuses awarded for the year have a deferral rate of 50% for the Chief Executive Officer and 40% for the Chief Operating Officer and the Chief Financial Officer.

Sir Muir Russell
Chairman, Remuneration Committee
26 June 2019

# 05 Part A: Directors' remuneration policy report

This report provides the detail behind the Board's approach to remuneration. It complies with many of the provisions set out in the UK Corporate Governance Code relating to remuneration matters, although it is not fully compliant with the Code, in part due to the fact that NHBC does not have shareholders.

The directors' remuneration policy, as set out in this section of the report, takes effect for all payments made to directors for the financial year ended 31 March 2019. It is consistent with the policy applied in the prior financial year.

## Directors' remuneration policy

Table 1 below provides an overview of NHBC's remuneration policy for Executive Directors. For an overview of the remuneration policy for Non-Executive Directors, please see table 6 on page 79.

There have not been any material changes to the overall NHBC remuneration policy this year. Executive remuneration packages are structured so that they:

- Are aligned to NHBC's strategy
- Are competitive but not excessive
- Do not promote unacceptable behaviours or encourage unacceptable risk-taking. In particular, the annual incentive targets have a clear bias towards the delivery of corporate targets, recognising the criticality of good team behaviours and cooperation as part of an effective approach to risk management.

Table 1: NHBC remuneration policy for Executive Directors summary

| Element, purpose and link to strategy | Policy and operation |
|---|---|
| **Basic pay**<br><br>To provide core market-related pay to attract and retain the required level of talent, designed to promote the long-term success of NHBC. | Annual review, with changes taking effect from 1 July each year. The review is informed by:<br>■ Relevant pay data from companies of similar size and complexity<br>■ Levels of increase awarded to other employees of NHBC<br>■ Individual and business performance<br>■ Any changes in roles and responsibilities. |

| Element, purpose and link to strategy | Policy and operation |
|---|---|
| **Annual bonus**<br><br>To incentivise the Executive Directors to achieve pre-determined annual targets.<br><br>Deferral of an element of the bonus pay-out provides alignment with the long-term nature of the company's interests and aids retention of key personnel. | Awards are based on both personal performance and achievement against a balanced scorecard. Targets are set annually, and pay-out determined against those targets.<br><br>Discretion remains with the Remuneration Committee to amend the bonus pay-out, taking account of the financial out-turn, market conditions and other considerations.<br><br>Annual bonuses have a deferral element (Chief Executive Officer 50%, other Executive Directors 40%), with 40% of the remaining balance being released each year.<br><br>On-target company and personal performance is 50% of the Chief Executive Officer's salary and 40% for other Executive Directors for the financial year ended 31 March 2019.<br><br>The annual bonus is a discretionary arrangement, and the Remuneration Committee reserves discretion to adjust the outcome (from zero to any cap) should it consider that to be appropriate. In particular, the Remuneration Committee may operate this discretion in respect of any risk concerns.<br><br>Deferred payments are subject to performance adjustment at the discretion of the Remuneration Committee, if it comes to light that awards were made in error or where new information is made available that would have changed the value of the original award. |
| **Pension**<br><br>To provide retirement benefits and remain competitive in the market. | NHBC provides a competitive employer defined contribution pension plan.<br><br>All Executive Directors are eligible to participate in the Group Personal Pension Plan (GPPP). Executive Directors receive a contribution to GPPP or a personal pension. Alternatively, they may opt to receive the contribution in cash if they are impacted by the relevant lifetime or annual limits.<br><br>NHBC operates salary sacrifice for pension contributions. |
| **Benefits**<br><br>To provide suitable benefits as part of a competitive remuneration package, which enables the company to attract and retain the level of talent necessary to deliver its strategy. | Benefits are provided on a market-related basis. NHBC reserves the right to deliver benefits to Executive Directors depending on their individual circumstances, which may include a company car or cash allowance, life insurance, accommodation and private medical insurance. |

05

# Part A: Directors' remuneration policy report

## Annual performance measures

For the financial year ending 31 March 2020, the annual bonus measures are based on the achievement of strategic objectives, and the individual's performance is then overlaid. The performance metrics and relative weighting of the individual's bonus are:

| | |
|---|---|
| Financial | 50% |
| Business plan delivery | 50% |

## Consistency of executive remuneration throughout NHBC

The remuneration policy for the Executive Directors is designed as part of the remuneration philosophy and principles that underpin remuneration for the company.

## Stating maximum amounts for the remuneration policy

UK regulations encourage companies to disclose a cap within which each element of remuneration policy will operate. Although NHBC is not subject to these provisions, the Remuneration Committee has decided to set and disclose limits in this report on a voluntary basis. Where maximum amounts for elements of remuneration have been set within the directors' remuneration policy, these will operate simply as caps and are not indicative of any aspiration.

## Recruitment remuneration policy

On hiring a new Executive Director, the Remuneration Committee aligns their remuneration package with NHBC's remuneration policy.

In determining the actual remuneration for a new Executive Director, the Remuneration Committee would consider the package in totality, considering the requirements of the business, market benchmarks, remuneration practice and the existing remuneration of the other Executive Directors. The Remuneration Committee would ensure that any arrangements agreed are in the best interests of NHBC.

## Potential rewards under various scenarios: financial year ended 31 March 2020

Table 2 below provides an illustration of the future total remuneration for each current Executive Director in respect of the remuneration opportunity for the year ended 31 March 2020 under different performance scenarios. Variable pay represents the bonus award opportunity that can be earned in the year, with 50% of the Chief Executive Officer's and 40% of the Executive Directors' bonuses deferred, to be released over future years, subject to performance.

Table 2: Potential rewards under various scenarios: financial year ended 31 March 2020 (£'000)

| | Fixed | Minimum variable | Total | Fixed | On-target variable | Total | Fixed | Maximum variable | Total |
|---|---|---|---|---|---|---|---|---|---|
| Paul Hosking | 262 | - | 262 | 262 | 85 | 347 | 262 | 170 | 432 |
| Neil Jefferson | 258 | - | 258 | 258 | 83 | 341 | 258 | 167 | 425 |
| Steve Wood | 361 | - | 361 | 361 | 151 | 512 | 361 | 301 | 662 |

| | |
|---|---|
| Minimum earnings | Base salary, benefits and pension (or cash in lieu of pension payable) with no bonus. |
| On-target earnings | Base salary, benefits and pension (or cash in lieu of pension payable) and on-target bonus before allowing for the appropriate deferral amount and release from previously deferred bonuses. |
| Maximum earnings | Base salary, benefits and pension (or cash in lieu of pension payable) and a maximum target bonus before allowing for the appropriate deferral amount and release from previously deferred bonuses. |

In addition to the remuneration earned in the financial year, the deferred bonus scheme would also award amounts due under the scheme rules, unless the Remuneration Committee deemed it inappropriate to do so. Table 3 below shows the cumulative balance of deferred bonuses at 31 March 2019 and the maximum amount that could be awarded to each Executive Director at the end of the financial year ending 31 March 2020.

## Deferred bonus opportunity

Table 3: Deferred bonus opportunity (£'000)

| | Balance accrued at 31 March 2019 | Release in the financial year ending 31 March 2020 |
|---|---|---|
| Paul Hosking | 44 | 18 |
| Neil Jefferson | 62 | 25 |
| Steve Wood | 79 | 32 |

## Chief Executive Officer pay gap reporting

NHBC is committed to being open on remuneration policy and to providing a high level of transparency and accountability.

Table 4 below shows the Chief Executive Officer pay ratios in the year ended 31 March 2019.

Table 4: Chief Executive Officer pay ratios

| Method A[3] | |
|---|---|
| 25th percentile pay ratio | 10:1 |
| 50th percentile pay ratio | 8:1 |
| 75th percentile pay ratio | 7:1 |

3. NHBC has calculated the pay ratios using method A, under which the pay and benefits of all employees are calculated for the current financial year, and the total remuneration of employees at the 25th, 50th and 75th percentile are selected for comparison.

05

# Part A: Directors' remuneration policy report

## Directors' employment contracts and letters of appointment

The key employment terms and conditions of the current Executive Directors as stipulated in their employment contracts are set out in table 5 below.

Table 5: Executive Directors' conditions of employment

| | |
|---|---|
| Notice period | Up to 12 months (by the Executive Director and the company). |
| Termination payment | Pay in lieu of notice up to a maximum of 12 months' basic salary, certain fixed benefits and pension.<br><br>By excluding any entitlement to compensation for loss of the opportunity to earn variable pay, the Remuneration Committee believes the contracts to be consistent with best practice. Contracts do not contain change of control provisions. |
| Remuneration and benefits | The operation of the annual incentive scheme is at the company's discretion. |
| Pension | All Executive Directors have the opportunity to participate in the defined contribution pension scheme or take cash when impacted by the lifetime or annual allowance.<br><br>For any new appointments, the maximum amount payable for pension benefit is 10.5% of salary, which is aligned with the maximum value available to employees. |
| Expenses | Reimbursement of expenses reasonably incurred in accordance with their duties. |
| Car allowance | A car or equivalent cash allowance is received, as varied from time to time. |
| Holiday entitlement | Ranging between 29 to 32 days, dependent on length of service, plus public holidays. |
| Private medical insurance | Private medical insurance is provided for each Executive Director and their partner. The Chief Executive Officer benefits from family cover. However, no payments are made in lieu if the Executive Director opts for reduced or no cover. |
| Sickness | Varies according to length of service and rises to a maximum of 100% of basic salary for six months and 50% for the following six months, after 10 years' service. |
| Non-compete | Various non-compete clauses are included in all Executive Director contracts and seek to prevent the poaching of NHBC employees within 12 months of leaving. |
| Contract dates | The dates of current contract commencement for current Executive Directors are as follows:<br>■ Paul Hosking – 23 January 2017<br>■ Neil Jefferson – 1 April 2012<br>■ Steve Wood – 30 June 2017. |

## Policy on payment for loss of office

There is no pre-determined special provision for compensation for loss of office. The Remuneration Committee has the ability to exercise its discretion on the final amount actually paid, but any compensation would be based on what would be paid by way of basic salary, pension entitlement and other contractual benefits during the notice period, depending on whether notice is worked or a payment made in lieu of notice. The company would typically make a contribution towards an Executive Directors' legal fees in connection with advice on the terms of their departure and fees for outplacement services as part of a negotiated settlement.

There is no automatic entitlement to an annual bonus for the year in which loss of office occurs. The Remuneration Committee may determine that an Executive Director may receive a pro rata bonus in respect of the period of employment during the year in which loss of office occurs based on an assessment of performance. Where an Executive Director leaves the company due to death, disability or ill health, or any other reason determined by the Remuneration Committee, there may be a payment of a pro rata bonus for the relevant year at the discretion of the Remuneration Committee.

The treatment of leavers under the annual incentive plan is determined by the rules of the plan. Good leaver status under these plans would be granted in the event of, for example, the death of an Executive Director, their departure on ill health grounds, sale of the business, planned retirement, redundancy or any other circumstances as determined by the Remuneration Committee at its absolute discretion. In circumstances where good leaver status has been granted, awards may, at the discretion of the Remuneration Committee, be made earlier than the normal payment date.

## Non-Executive Directors

Table 6 below sets out details of the company's remuneration policy for Non-Executive Directors, which remains unchanged from the prior year.

Table 6: Non-Executive Directors' conditions of employment

| Element, purpose and link to strategy | Operation |
|---|---|
| **Chairman and Non-Executive Directors' fees**<br><br>To attract individuals with skills and experience to serve as Chairman and as a Non-Executive Director. | Non-Executive Directors receive a basic annual fee in respect of their Board duties. Further fees are paid for chairmanship of Board committees and membership of the Board Risk Committee or Audit Committee.<br><br>The Chairman receives a fixed annual fee. Fees are reviewed annually, taking into account market data and trends, and the scope of specific Board duties. The Chairman and other Non-Executive Directors do not participate in any incentive or performance plans or pension arrangements. |

05

# Part A:
# Directors' remuneration policy report

Non-Executive Directors, including the Chairman, have letters of appointment which set out their duties and responsibilities. The key terms are set out in table 7 below:

Table 7: Non-Executive Directors' key terms of appointment

| Provision | Policy |
|---|---|
| **Period** | NHBC appoints Non-Executive Directors for an initial three-year term, which is specified in the letter of appointment. They may then be reappointed by and at the Board's discretion for any further period not exceeding three years and then for a further period, again not exceeding three years (i.e. up to nine years in total). If this period is exceeded, any extension is agreed by the Board, and ratification of their decision is sought from the Council at the next AGM following the date of the appointment. |
| **Termination** | By the director or the company at their discretion without compensation upon giving one month's written notice for other Non-Executive Directors and three months' notice for the Chairman of the company. |
| **Fees** | As set out in table 10. |
| **Time commitment** | Each Non-Executive Director must be able to devote sufficient time to the role in order to discharge their responsibilities effectively. |

Table 8 below shows the date of appointment of current Non-Executive Directors, as well as the date of the end of the appointment.

Table 8: Non-Executive Director appointments

| | Date of appointment | Appointment end date[4] |
|---|---|---|
| Isabel Hudson | 1 June 2011 | 31 May 2020 |
| Paul Bishop | 1 November 2016 | 31 October 2022 |
| Ian Craston | 16 September 2014 | 15 September 2023 |
| Kate Davies | 5 October 2016 | 4 October 2022 |
| Jean Park | 10 December 2012 | 9 December 2021 |
| Sir Muir Russell | 15 May 2012 | 14 May 2021 |
| Stephen Stone | 5 October 2016 | 4 October 2022 |

4. Non-Executive Directors are generally appointed on three-year terms, agreed by the Board. The appointment end date reflects the current position based on the terms agreed.


Occupied Area
Site Boundary
Mobile Crane Area

# NHBC in the community

"As a responsible organisation, we contribute to the communities we live and work in, manage our operational environmental impact and invoke our human value in everything we do.

Throughout the financial year, we continued to engage with our local and national communities, supporting industry causes that are in line with our social purpose.

We remain proud of our long-standing corporate partnership with Cancer Research UK, valuing the contribution our people have made, and monies raised for the charity. Since 2015, our overall fundraising total is just over £100,000.

In 2018/19, we agreed we would align ourselves more closely with our social purpose of housing – it was felt by senior executives and staff alike that we are able to add a lot of insight, experience and knowledge in this area, and that a charity that supports this commitment would be a great fit for us. We gathered input from all staff in the initial stages, and I'm pleased to say that Crisis is the charity we will form a corporate partnership with going forward.

Our people continue to make a difference in their local communities. Employees have contributed many hours of volunteering time and raised funds for projects close to their hearts. We were able to support them by offering matched funding and encouraging colleagues to take their entitlement of two paid volunteering days per year. I'm delighted to see so many of our staff engage with this opportunity, and we have matched funds of well over £14,000 during this period.

Addressing the skills shortage in construction, we have supported industry skills charities at a local and national level. Many NHBC colleagues have been working in schools, colleges and universities to encourage young people to consider a career in construction and house building. In addition, staff from all areas of the business attended 22 three-hour Worktree sessions in local schools fielding questions from young people in a career workout format. The relationship with Worktree is now in its sixth year and NHBC is recognised as an associate sponsor by the charity.

Our affiliation with Coleg Sir Gâr in Carmarthenshire continues as they train students in building and construction skills, and I'm delighted to report that we continue our support of YouthBuildUK (a charity celebrating the achievements of young people in the construction industry) and Action4Youth (a charity that provides children and young people of all abilities and backgrounds with a positive and often transformational experience which will inspire them).

Our people really are a credit to themselves by supporting not only the initiatives mentioned above, but so many more, giving up their time and energy to add value at every level to NHBC's purpose and help those that need it the most."

**Angela Morrison, Executive Assistant to CEO, NHBC**


1990s
Handheld computers (PDAs) were introduced and allowed inspectors to feed back information about defects on site.
1970s

05

# Part B: Annual implementation report

This section of the report sets out how NHBC has implemented its remuneration policies for directors in the course of the financial year ended 31 March 2019 and how the remuneration policy will be implemented for the year ending 31 March 2020. This is in accordance with the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended).

## Function of the Remuneration Committee

The Remuneration Committee sets the remuneration for all NHBC employees, including the Executive Directors. The Remuneration Committee comprises of Non-Executive Directors only. The Remuneration Committee report on page 64 outlines its function, membership, attendance and activities undertaken during the financial year.

## Alignment of company strategy with executive remuneration

The Remuneration Committee considers alignment between NHBC's strategy and the remuneration of its Executive Directors to be critical. NHBC's remuneration policy provides market-competitive remuneration and incentivises Executive Directors to achieve both the annual business plan and longer-term strategic objectives of NHBC. Significant levels of deferral aid retention of key personnel and enable claw-back in certain conditions. As well as rewarding the achievement of objectives, variable remuneration can be reduced, potentially to zero, if performance thresholds are not met.

## Implementation of remuneration policy for the financial year ending 31 March 2020

The implementation of the policy will be consistent with that outlined in the policy report.

## Basic salaries

The Remuneration Committee reviews directors' salaries at the same time as it looks at salaries for the whole employee population and awards any increases for Executive Directors in the same way as NHBC's wider employee group. In awarding any pay increases, the Remuneration Committee considers affordability, negotiations with the SA, and latest benchmarked pay data across the diverse range of role profiles in the industry.

The Executive Directors' salaries were reviewed in July 2019. The changes for the current serving Executive Directors are set out in table 9 below.

Table: 9 Executive Directors' salaries (£s)

| | | From 1 July 2019 | From 1 July 2018 |
|---|---|---|---|
| Paul Hosking | Chief Financial Officer | 215,543 | 210,800 |
| Neil Jefferson | Chief Operating Officer | 211,072 | 206,427 |
| Steve Wood | Chief Executive Officer | 306,750 | 300,000 |

## Annual bonus

The maximum annual bonus opportunity and deferral rates will remain at the levels set out in the policy section of this report. The directors' bonuses will be calculated with a weighting of 60% attributed to overall company performance and 40% on personal objectives.

The precise details of the bonus targets for the year ending 31 March 2020 are not being disclosed due to commercial sensitivity. An explanation of the bonus payments relating to 31 March 2020 performance, together with performance against measures and targets, will be presented in the directors' remuneration report for the year ending 31 March 2020.

## Pension

Executive Directors have the opportunity to participate in the defined contribution pension scheme, with an employer contribution rate of 10.5% for any new appointments. Should the annual or lifetime allowance be exceeded in the year, the balance is paid as a cash amount.

## Approach to Non-Executive Directors' fees

The regular annual review of Non-Executive Directors' fees took place following the financial year. The review involved considering several key factors, including market pressures, time commitment and, increasingly, the regulatory environment. As a result of this, there were increases to Non-Executive Director remuneration as detailed below in table 10.

Table 10: Fees to be paid to the Chairman and Non-Executive Directors (£s)

| | From 1 July 2019 | From 1 July 2018 |
|---|---|---|
| Chairman of the company | 145,027 | 141,838 |
| Board membership | 40,942 | 40,000 |
| Additional fees are paid as follows: | | |
| SID | 3,160 | 3,160 |
| Committee Chairman (per committee chaired) | 9,000-12,000 | 9,000-12,000 |
| Additional committee membership fee (for membership of the Audit Committee or Board Risk Committee) | 3,000 | 3,000 |

05

# Part B: Annual implementation report

## Single total figures of remuneration for Executive Directors (audited information)

Table 11 below sets out the total remuneration, for the financial year ended 31 March 2019, for each of the Executive Directors who served with the company during the year.

Table 11: Remuneration for Executive Directors for the financial year ended 31 March 2019 (£'000)

| | Salary[1] | Allowances[2] | Taxable benefit[3] | Additional bonus award[4] | Annual bonus award[5] | Compensation for loss of office | Total |
|---|---|---|---|---|---|---|---|
| Paul Hosking | 199 | 57 | 2 | - | 54 | - | 312 |
| Neil Jefferson | 195 | 57 | 2 | 83 | 53 | - | 390 |
| Steve Wood | 296 | 47 | 12 | - | 96 | - | 451 |

1. The salary amounts quoted above represent basic salary less any salary sacrifice arrangements.
2. Allowances include entitlements taken as cash such as car or pension benefits.
3. Taxable benefits comprise private medical insurance and accommodation.
4. Neil Jefferson received an exceptional bonus in July 2018 following his interim appointment as Managing Director and the agreed handover period to Steve Wood.
5. The annual bonus stated is that awarded in the financial year.

As a comparative for table 11, table 12 below sets out the total remuneration, for the financial year ended 31 March 2018, for each of the Executive Directors who served with the company during that year.

Table 12: Remuneration for Executive Directors for the financial year ended 31 March 2018 (£'000)

| | Salary[1] | Allowances[2] | Taxable benefit[3] | Additional bonus award | Annual bonus award[4] | Compensation for loss of office | Total |
|---|---|---|---|---|---|---|---|
| Ian Davis[5] | 120 | 36 | 1 | - | 46 | 263 | 466 |
| Paul Hosking | 194 | 59 | 2 | - | 79 | - | 334 |
| Neil Jefferson | 197 | 58 | 2 | - | 78 | - | 335 |
| Steve Wood[6] | 215 | 35 | 8 | - | 103 | - | 361 |

1. The salary amounts quoted above represent basic salary less any salary sacrifice arrangements.
2. Allowances include entitlements taken as cash such as car or pension benefits.
3. Taxable benefits comprise private medical insurance and accommodation.
4. The annual bonus stated is that awarded in the financial year.
5. Ian Davis resigned as Operations Director on 23 November 2017.
6. Steve Wood was appointed as Chief Executive Officer on 30 June 2017.

Table 13 below provides additional information on the deferred bonus for each of the Executive Directors who served the company during the financial year ended 31 March 2019.

Table 13: Deferred bonuses per Executive Director (£'000)

| | Annual bonus award[1] | Annual bonus payable in year ending 31 March 2020 | Annual bonus deferred | Deferred bonus as at 31 March 2018 | Amount of bonus paid with respect to prior year bonus awards | Deferred bonus as at 31 March 2019 |
|---|---|---|---|---|---|---|
| Paul Hosking | 54 | (33) | **22** | 37 | (15) | **44** |
| Neil Jefferson | 53 | (32) | **22** | 68 | (28) | **62** |
| Steve Wood | 96 | (48) | **48** | 51 | (21) | **78** |

1. Annual bonus award is the bonus earned in the financial year, prior to any deferral.

# Additional disclosures in respect of the single total figures of remuneration (audited information)

## Annual bonus

Table 14 below sets out NHBC's performance against the company bonus targets for the financial year ended 31 March 2019.

Table 14: NHBC's performance against bonus targets

| Weighting (% of total opportunity) | Target (%) | Stretch (%) | Actual (%) |
|---|---|---|---|
| Financial | 50 | 100 | 23 |
| Reputation and brand | 10 | 20 | 0 |
| Improving construction quality | 10 | 20 | 10 |
| Business plan delivery | 30 | 60 | 8.4 |
| | 100 | 200 | 41.4 |

05

# Part B: Annual implementation report

The individual performance by each Executive Director is then applied to company performance to determine the total bonus opportunity available. Table 15 below presents, for the Executive Directors that served in the financial year, performance against the annual incentive plan.

Table 15: Performance in financial year ended 31 March 2019 against annual incentive plan

| | Target (%) | Stretch (%) | Actual (%) |
|---|---|---|---|
| Paul Hosking | 40 | 80 | 25.9 |
| Neil Jefferson | 40 | 80 | 25.9 |
| Steve Wood | 50 | 100 | 32.4 |

## Single total figures of remuneration for the year ended 31 March 2019 for Non-Executive Directors (audited information)

Table 16: Non-Executive Directors' remuneration (£'000)

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | Fees | Expenses[4] | Fees | Expenses[4] |
| Paul Bishop | 58 | - | 48 | - |
| Ian Craston | 52 | - | 51 | - |
| Kate Davies | 42 | - | 39 | - |
| Sir John Harman[1] | - | - | 38 | - |
| Isabel Hudson[2] | 141 | 5 | 156 | - |
| Jean Park | 55 | 3 | 54 | - |
| Sir Muir Russell | 57 | 4 | 58 | - |
| Dame Helena Shovelton[3] | 26 | - | 51 | - |
| Stephen Stone | 43 | - | 42 | - |
| | 474 | 12 | 537 | - |

1. Sir John Harman retired from the Board on 31 December 2017.
2. Isabel Hudson was appointed Executive Chairman on 1 February 2017 until 29 June 2017, and her remuneration was increased to reflect the interim role.
3. Dame Helena Shovelton retired from the Board on 30 September 2018.
4. The values shown as expenses comprise the value of taxable travel and subsistence expenses reimbursed by the company (including any gross up for tax and national insurance contributions due). This process was introduced in the financial year ending March 2019.

## External board appointments

The company recognises that its Executive Directors can benefit from serving in a personal capacity as a Non-Executive Director of a non-NHBC company. At the same time, it is conscious of the corporate governance recommendations that Executive Directors should take account of the time commitment required by a Non-Executive Director position and ensure that any such role does not impact their ability to fully carry out their executive duties. The company therefore has a policy of normally allowing the Executive Directors to serve as a Non-Executive Director for one external company, subject to approval by the Board.

## Consideration by the directors of matters relating to directors' remuneration

The Remuneration Committee is responsible for reviewing and agreeing the remuneration policy of the company and for reviewing compliance with the remuneration policy. The Remuneration Committee is responsible for monitoring the level and structure of remuneration for the senior management of the company and agreeing the overall remuneration increase with the Board. Within the remuneration policy, the key responsibilities of the Remuneration Committee are to:

- Agree the company's remuneration policy in respect of the Board Chairman, Executive Directors, members of senior management and the overall staff pay increases, taking account of all legal and regulatory requirements and provisions of best practice
- Work with the Board Risk Committee to ensure that risk and risk appetites are properly considered in setting the remuneration policy for the Group
- Review and determine the remuneration of the Chairman of the Board and the terms of employment and remuneration of individual Executive Directors, including any specific recruitment or severance terms
- Review and determine the level and structure of senior management remuneration
- Approve the company's reward strategy, including any changes to the strategy, and note the total bonus pool
- Select, appoint and determine terms of reference for independent remuneration consultants to advise the Remuneration Committee on remuneration policy and levels of remuneration

05

# Part B:
# Annual implementation report

- Have regard to remuneration trends across the company when setting the remuneration policy for Executive Directors
- Ensure that remuneration arrangements for all employees are commensurate with promoting ethical behaviour
- Ensure the effectiveness of the process for assessing the senior management reward for performance
- Take a consistent approach to the development of talent throughout the company, working with the Governance and Nominations Committees as necessary
- Set the company's remuneration policy.

The full terms of reference for the Remuneration Committee are available from the Company Secretary.

## Approval by the Board

The directors' remuneration report was reviewed and approved by the Board on 26 June 2019.

Sir Muir Russell
Chairman of the Remuneration Committee

CS

# Spotlight on training

"With the current landscape of demanding productivity levels, rising customer expectations and the national skills shortage, the quality of new homes across the UK and overall customer satisfaction remains at the very top of the housing agenda.

To help the industry deal with these challenges, NHBC has now more than doubled the size of its training team, bringing on board additional trainers and supporting staff. Through 2018/19, over 13,500 delegate training days were delivered, and the appetite for NHBC's unique insights and training has never been stronger.

In partnership with builder customers, NHBC continues to evolve its portfolio of training with more than 30 technical courses and a range of NVQs, all designed to support the continual drive for quality in house building.

Throughout the year, NHBC has continued to support the house-building industry with its construction quality insights, helping to focus on driving quality where it is needed most. For example, in partnership with the Home Building Skills Partnership (HBSP) and with CITB funding, NHBC delivered more than 350 on-site Masterclasses to bricklayers throughout the UK.

NHBC also ran more than 60 open courses throughout the UK, greatly improving the reach of its construction quality insights to SMEs."

**Darryl Stewart, Head of Training and Analysis, NHBC**

"The Home Building Skills Partnership really appreciates the support the NHBC training team gives our activity groups, both in identifying the problems and helping us solve them. Sharing CQR data and linking the content of the Brickwork Masterclasses to key build issues was simple, but impactful. We would not make the level of difference we do without NHBC involvement.

Regardless of size of builder, NHBC is committed to supporting the industry by providing a range of relevant and practical training services for those who need it, in turn helping to raise the standards of new homes across the UK.

We really appreciate the support the NHBC training team gives our activity groups, both in identifying the problems and helping us solve them. We would not make the level of difference we do without their involvement."

**Jenny Herdman, Director of HBSP**


Sustainable technologies

# 06

# UK GAAP financial statements

# 06 Financial statements

# Independent auditor's report to the members of the National House-Building Council

## Report on the audit of the financial statements

### Opinion

**In our opinion the financial statements of National House-Building Council (the 'parent company') and its subsidiaries (the 'group'):**

- Give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2019 and of the group's loss for the year then ended;
- Have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- Have been prepared in accordance with the requirements of the Companies Act 2006.
- We have audited the financial statements which comprise:
- The consolidated statement of comprehensive income;
- The consolidated and parent statements of financial position;
- The consolidated and parent company statements of changes in equity;
- The consolidated cash flow statement;
- The statement of accounting policies; and
- The related notes 1 to 39, excluding the capital disclosures in note 7 calculated in accordance with the Solvency II regime which is marked unaudited.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

### Basis of 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 group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

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

### Summary of our audit approach

**Key audit matters.** The key audit matter that we identified in the current year was the valuation of gross insurance claims reserves. In addressing this matter, we focused our efforts on:

- The methodology and assumptions applied in valuing the actuarial best estimate for Attritional, Large and Exceptional Loss claims;
- The data, methodology and assumptions applied in determining the actuarial best estimate for cladding claims; and
- The methodology and assumptions applied in setting the booked margin.

# 06 Independent auditor's report to the members of the National House-Building Council

**Materiality.** The materiality that we used for the group financial statements was £4.55 million (2018: £4.49 million) which approximates 1% (2018: 1%) of net assets.

**Scoping.** The parent company and its two non-dormant subsidiaries, NHBC Building Control Services Limited and NHBC Services Limited, were subject to a full scope audit.

**Significant changes in our approach.** There have been no significant changes in our audit approach.

## 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 group's or the parent 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.

## Key audit matters

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

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

## Valuation of gross insurance claims reserves

Refer to page 117 (significant accounting policies) and page 145 (financial disclosures)

The gross insurance claims reserves comprise both claims outstanding and the unexpired risk reserve and as at 31 March 2019 total £708.8 million (2018: £626.4 million). The judgments which are made by management in determining both the actuarial best estimate and the margin for uncertainty are by far the most significant in terms of their impact on the group's financial position.

Specifically, we have identified the following three key areas of focus for our audit given their significance to the Group's result and the level of judgment involved:

- The methodology and assumptions applied in valuing the actuarial best estimate for Attritional, Large and Exceptional Loss claims;
- The data, methodology and assumptions applied in determining the actuarial best estimate for cladding claims; and
- The methodology and assumptions applied in setting the booked margin.

| Key audit matter description | How the scope of our audit responded to the key audit matter |
|---|---|
| *The methodology and key assumptions applied in valuing the actuarial best estimate for Attritional, Large and Exceptional Loss claims*<br><br>Attritional Loss claims relating to Sections 2 and 3 of NHBC's Buildmark product, as defined in note 24.1 to the financial statements, are projected based on historical claims experience using standard actuarial techniques. The group estimates future House Rebuilding Cost Index ('HRCI') changes when projecting the future cost of these Attritional losses. This claims inflation assumption, which has a significant impact on the amount reserved given the long tail nature of the policies underwritten, has a high level of estimation uncertainty and we therefore identified this as a key audit matter.<br><br>In determining the future cost of Large and Exceptional Loss claims the group continues to use complex stochastic models. Historical claims experience for Large Losses is more limited than for Attritional Losses and is not available for Exceptional Losses, whereas the number of large sites on risk in recent years has increased. This increases the risk of claims of this nature arising in future. Management therefore exercises significant judgement in determining the frequency and severity assumptions used in reserving for Large and Exceptional Loss claims, which increases the risk of material misstatement of the balance either through error or fraud. | We have gained a detailed understanding of the end to end claims and reserving process, and assessed the design and implementation of selected controls. We have also tested the operating effectiveness of actuarial data reconciliations and have tied claims and policy data to source systems which provides assurance over the completeness and accuracy of the underlying data used in the Group's actuarial calculation.<br><br>Having done this, we engaged our Deloitte actuarial experts to:<br><br>■ Assess and challenge the HRCI assumption used within the calculation, leveraging observable market data to benchmark the assumption and assess reasonableness;<br>■ Assess and challenge the frequency and severity assumptions used for Large and Exceptional Losses by reviewing management's analysis and expert judgements that support the selected assumptions, and the justification for those assumptions;<br>■ Inspect and challenge the peer review report prepared by management's external actuarial expert in order to identify any material issues with management's methodology or assumptions; and<br>■ Assess the competence and objectivity of management's expert in their role as peer reviewer. |
| *The data, methodology and assumptions applied in determining the actuarial best estimate for cladding claims*<br><br>Following the Grenfell Tower fire in 2017 and the resulting focus on cladding materials, the group continues to assess their exposure to future claims of this nature and reserve for them accordingly. In determining the frequency and severity of cladding claims that have not been reported as of the reporting date, management has exercised a significant level of judgement and as a result we have identified the data, methodology and assumptions applied in determining the actuarial best estimate for cladding claims as a key audit matter. | We gained a detailed understanding of the process that management went through to determine the best estimate liability and assessed the design and implementation of key controls within this process.<br><br>Having done this, we performed the following:<br><br>■ On a sample basis, we tested the completeness and accuracy of the data underpinning the calculation by inspecting and challenging evidence;<br>■ We assessed and challenged the key assumptions determined by management through benchmarking against third party evidence where available; and<br>■ We engaged our Deloitte Actuarial experts to challenge the appropriateness of the methodology used for deriving the best estimate. |

# 06 Independent auditor's report to the members of the National House-Building Council

| Key audit matter description | How the scope of our audit responded to the key audit matter |
|---|---|
| *The methodology and assumptions applied in setting the booked margin*<br><br>The booked margin is derived by considering a range of adverse scenarios and which are added to the actuarial best estimate in order to allow for the inherent uncertainty in valuing the reserves. Due to the significant level of management judgement required in setting the margin, there is a risk that the scenarios selected and their respective weightings are not reasonable, leading to the possibility of manipulation of the booked reserve period on period. | We have engaged our actuarial experts to assist us in challenging management's qualitative and quantitative justifications for the margin held over the actuarial best estimate, including the scenarios selected, each scenario's respective weighting, and the key assumptions applied within each scenario.<br><br>In addition to this, we have analysed the consistency of the margin with previous reporting periods through inspection of the peer review report prepared by management's external actuarial expert and assessing the booked reserves against their estimate year on year. |

| Key observations for this key audit matter |
|---|
| We have determined the valuation of gross insurance claims reserves to be reasonable. |

## Our application of materiality

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

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

| | Group financial statements | Parent company financial statements |
|---|---|---|
| Materiality | £4.55 million (2018: £4.49 million) | £4.32 million (2018: £4.27 million) |
| Basis for determining materiality | Materiality was determined as approximately 1% (2018: 1%) of net assets. | Materiality was determined as approximately 0.95% (2018: 0.95%) of net assets. |
| Rationale for the benchmark applied | The majority of the Group's operations are carried out by the parent company. We determined that the critical benchmark for the Group was net assets. National House-Building Council is a non-profit distributing organisation and the primary users of the financial statements are the council members, who look to the accumulated reserves and the stability of the company that is limited by guarantee to gain comfort over the Group's ability to settle insurance claims as they fall due. | |

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £227k (2018: £225k) for the group and £216k (2018: £213k) for the parent company, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

## An overview of the scope of our audit

The scope of our Group audit was determined by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

This resulted in the parent company and its two non-dormant subsidiaries, NHBC Building Control Services Limited and NHBC Services Limited, being subject to a full scope audit. These three entities represent the principal trading and service operations of the Group and account for 100% of the Group's net assets, 100% of the Group's gross earned premium and 100% of the Group's loss.

## 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 group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent 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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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

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

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

# Independent auditor's report to the members of the National House-Building Council

## Identifying and assessing potential risks related to irregularities

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

- Enquiring of management, internal audit, legal counsel, financial reporting, IT and the audit committee, including obtaining and reviewing supporting documentation, concerning the group's policies and procedures relating to:
  - Identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - Detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - The internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- Discussing among the engagement team and involving relevant internal experts / specialists, including actuarial experts and tax, pensions and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the valuation of the group's gross insurance claim reserves; and
- Obtaining an understanding of the legal and regulatory framework that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the group. The key laws and regulations we considered in this context included the UK Companies Act, and tax legislation. In addition, compliance with terms of the group's regulatory solvency requirements were fundamental to the group's ability to continue as a going concern.

## Audit response to risks identified

As a result of performing the above, we identified valuation of gross insurance claims reserves as a key audit matter. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

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

- Reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- Enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- Performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- Reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC, PRA and FCA; and
- In addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

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

## 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.

## Report on other legal and regulatory requirements

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

## Matters on which we are required to report by exception

### Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters

### Directors' remuneration

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

We have nothing to report in respect of this matter.

## Other matters

### Auditor tenure

Following the recommendation of the audit committee, we were appointed by the Board in May 2016 to audit the financial statements for the year ending 31 March 2016 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 4 years, covering the years ending 31 March 2016 to 31 March 2019.

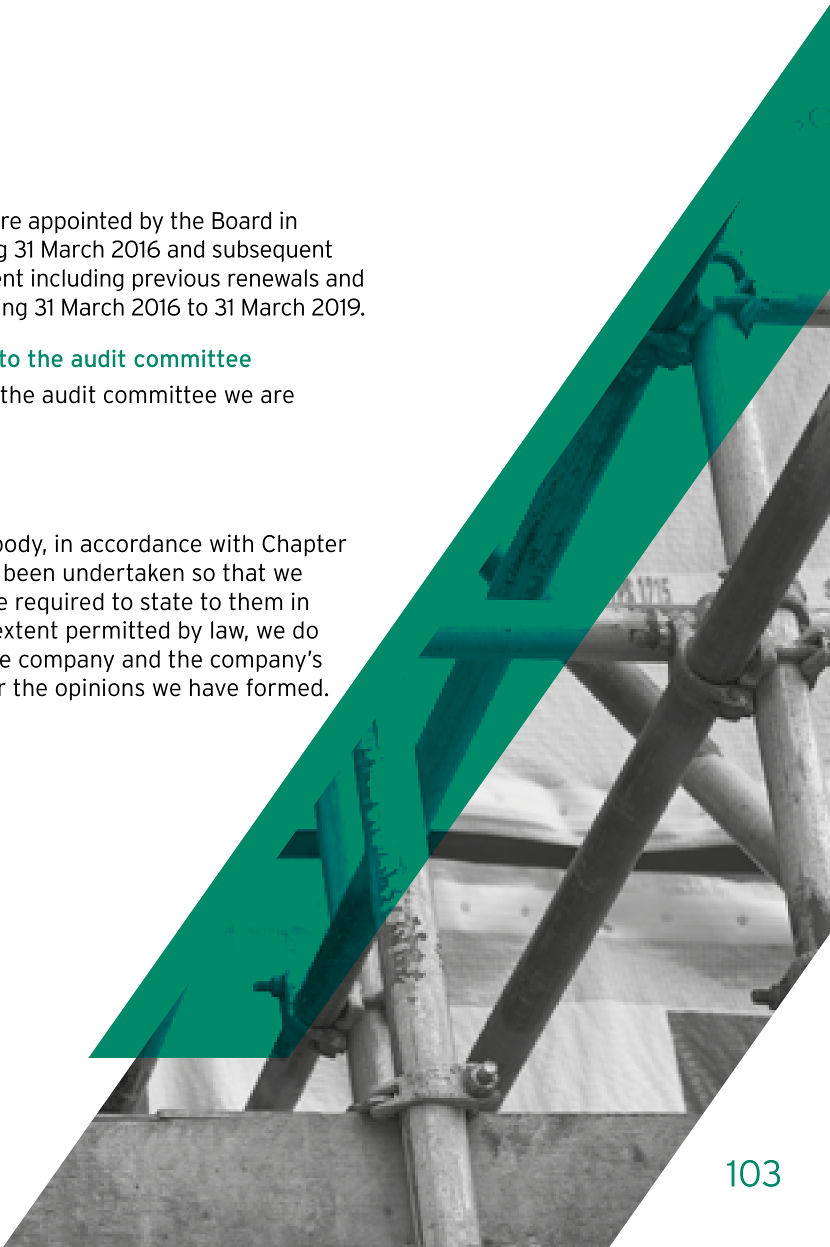
### Consistency of the audit report with the additional report to the audit committee

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

## 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.

Adam Addis (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
26 June 2019



06

# Consolidated statement of comprehensive income

## Technical account – general business

| | | 2019 | | 2018 | |
|---|---|---|---|---|---|
| | Note | **£'000** | **£'000** | £'000 | £'000 |
| **Earned premiums, net of reinsurance** | | | | | |
| Gross premiums written | 8 | **95,172** | | 82,459 | |
| Outward reinsurance premiums | | **(13,887)** | | (9,310) | |
| **Net premiums written** | | **81,285** | | 73,149 | |
| Change in the gross provision for unearned premiums | | **(19,760)** | | (27,325) | |
| Change in the provision for unearned premiums, reinsurers' share | | **5,125** | | 3,777 | |
| Change in the net provision for unearned premiums | | **(14,635)** | | (23,548) | |
| **Earned premium, net of reinsurance** | | | **66,650** | | 49,601 |
| Allocated investment return transferred from the non-technical account | | | **35,068** | | (4,339) |
| **Claims incurred, net of reinsurance** | | | | | |
| Claims paid | | | | | |
| – Gross amount | | **(85,595)** | | (94,636) | |
| – Reinsurers' share | | **5** | | – | |
| Net claims paid | | **(85,590)** | | (94,636) | |
| Change in provision for claims | | | | | |
| – Gross amount | | **(60,874)** | | (7,346) | |
| – Reinsurers' share | | **27,354** | | 5,231 | |
| Change in the net provision for claims | | **(33,520)** | | (2,115) | |
| **Claims incurred, net of reinsurance** | | | **(119,110)** | | (96,751) |
| Changes in unexpired risk reserve, net of reinsurance | | | **(17,408)** | | 39,895 |
| Net operating expenses | 11 | | **(12,470)** | | (5,276) |
| **Balance on the technical account for general business** | | | **(47,270)** | | **(16,870)** |

## Non-technical account

| | Note | 2019 £'000 | 2019 £'000 | 2018 £'000 | 2018 £'000 |
|---|---|---|---|---|---|
| **Balance on the general business technical account** | | | **(47,270)** | | (16,870) |
| Investment income | 13 | | **64,965** | | 46,485 |
| Unrealised gains on investments | | **29,248** | | 8,395 | |
| Unrealised losses on investments | | **(44,427)** | | (45,037) | |
| Net unrealised (losses) / gains on investments | 13 | | **(15,179)** | | (36,642) |
| Investment expenses and charges | | | **(2,327)** | | (1,967) |
| Allocated investment return transferred to the general business technical account | | | **(35,068)** | | 4,339 |
| Other income | 8 | | **78,574** | | 76,877 |
| Other charges | | | **(76,379)** | | (85,998) |
| Exceptional item | 18 | | **30,000** | | – |
| **Loss on ordinary activities before taxation** | | | **(2,684)** | | (13,776) |
| Tax on loss on ordinary activities | 17 | | **82** | | 310 |
| **Loss for the financial year** | | | **(2,602)** | | (13,466) |
| **Other comprehensive income** | | | | | |
| Remeasurements of net defined benefit obligation | 30 | **(4,512)** | | 10,673 | |
| Revaluation of tangible assets | | **38** | | 58 | |
| **Other comprehensive income for the year, net of tax** | | | **(4,474)** | | 10,731 |
| **Total comprehensive income for the year** | | | **(7,076)** | | (2,735) |

# 06 Consolidated statement of financial position

## Assets

| | Note | 2019 £'000 | 2018 £'000 |
|---|---|---|---|
| **Investments** | | | |
| Land and buildings | 19 | **9,856** | 9,871 |
| Other financial investments | | **1,597,890** | 1,546,007 |
| | | **1,607,746** | 1,555,878 |
| **Reinsurers' share of technical provisions** | | | |
| Provision for unearned premiums | 25 | **51,766** | 46,641 |
| Claims outstanding | 25 | **32,585** | 5,231 |
| Unexpired risk reserve | 25 | **6,598** | 2,542 |
| | | **90,949** | 54,414 |
| **Debtors** | | | |
| Debtors arising out of direct insurance operations | 21 | **5,412** | 5,438 |
| Other debtors | 21 | **5,471** | 7,704 |
| | | **10,883** | 13,142 |
| **Other assets** | | | |
| Tangible assets | 23 | **2,394** | 1,818 |
| Cash at bank and in hand | | **26,771** | 14,427 |
| | | **29,165** | 16,245 |
| **Prepayments and accrued income** | | | |
| Accrued interest and rent | | **15,478** | 16,224 |
| Deferred acquisition costs | 24 | **11,721** | 11,577 |
| Other prepayments and accrued income | | **9,728** | 7,510 |
| | | **36,927** | 35,311 |
| **Total assets** | | **1,775,670** | 1,674,990 |

## Liabilities

| | Note | 2019<br>£'000 | 2018<br>£'000 |
|---|---|---|---|
| **Reserves** | | | |
| Revaluation reserve | | **343** | 305 |
| Retained earnings | | **455,031** | 462,145 |
| | | **455,374** | 462,450 |
| **Technical provisions** | | | |
| Provision for unearned premiums | 25 | **456,612** | 436,851 |
| Claims outstanding | 25 | **343,830** | 282,956 |
| Unexpired risk reserve | 25 | **364,956** | 343,492 |
| | | **1,165,398** | 1,063,299 |
| **Creditors** | | | |
| Creditors arising out of direct insurance operations | 29 | **29,632** | 32,862 |
| Other creditors | 29 | **11,372** | 10,490 |
| | | **41,004** | 43,352 |
| **Accruals and deferred income** | | **80,806** | 73,893 |
| **Defined benefit pension plan deficit** | 30 | **33,088** | 31,996 |
| **Total liabilities** | | **1,775,670** | 1,674,990 |

The notes on pages 116 to 163 are an integral part of these financial statements.

The financial statements on pages 104 to 163 were authorised for issue by the Board of Directors on 26 June 2019 and were signed on its behalf.

P Hosking
(Chief Financial Officer)
Company registration 00320784

# 06 Company statement of financial position

## Assets

| | Note | 2019 £'000 | 2018 £'000 |
|---|---|---|---|
| **Investments** | | | |
| Land and buildings | 19 | 9,856 | 9,871 |
| Investments in Group undertakings and participating interests | 20 | 5,860 | 5,189 |
| Other financial investments | | 1,597,890 | 1,546,007 |
| | | 1,613,606 | 1,561,067 |
| **Reinsurers' share of technical provisions** | | | |
| Provision for unearned premiums | 25 | 51,766 | 46,641 |
| Claims outstanding | 25 | 32,585 | 5,231 |
| Unexpired risk reserve | 25 | 6,598 | 2,542 |
| | | 90,949 | 54,414 |
| **Debtors** | | | |
| Debtors arising out of direct insurance operations | 21 | 5,412 | 5,438 |
| Other debtors | 21 | 3,931 | 5,811 |
| | | 9,343 | 11,249 |
| **Other assets** | | | |
| Tangible assets | 23 | 2,394 | 1,818 |
| Cash at bank and in hand | | 26,496 | 14,150 |
| | | 28,890 | 15,968 |
| **Prepayments and accrued income** | | | |
| Accrued interest and rent | | 15,478 | 16,224 |
| Deferred acquisition costs | 24 | 11,721 | 11,577 |
| Other prepayments and accrued income | | 9,479 | 7,177 |
| | | 36,678 | 34,978 |
| **Total assets** | | 1,779,466 | 1,677,676 |

## Liabilities

| | Note | 2019 £'000 | 2018 £'000 |
|---|---|---|---|
| **Reserves** | | | |
| Revaluation reserve brought forward | | **5,394** | 9,237 |
| Other comprehensive income for the year | | **710** | (3,843) |
| Retained earnings brought forward | | **456,231** | 455,948 |
| Loss for the year | | **(3,085)** | (10,390) |
| Other comprehensive income for the year | | **(4,512)** | 10,673 |
| | | **454,738** | 461,625 |
| **Technical provisions** | | | |
| Provision for unearned premiums | 25 | **457,247** | 437,675 |
| Claims outstanding | 25 | **343,830** | 282,956 |
| Unexpired risk reserve | 25 | **364,956** | 343,492 |
| | | **1,166,033** | 1,064,123 |
| **Creditors** | | | |
| Creditors arising out of direct insurance operations | 29 | **29,632** | 32,862 |
| Other creditors | 29 | **21,326** | 18,973 |
| | | **50,958** | 51,835 |
| **Accruals and deferred income** | | **74,649** | 68,097 |
| **Defined benefit pension plan deficit** | 30 | **33,088** | 31,996 |
| **Total liabilities** | | **1,779,466** | 1,677,676 |

The notes on pages 116 to 163 are an integral part of these financial statements.

The financial statements on pages 104 to 163 were authorised for issue by the Board of Directors on 26 June 2019 and were signed on its behalf.

P Hosking
(Chief Financial Officer)

06

# Consolidated statement of changes in equity

| | Retained earnings | Revaluation reserve | Total |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Balance as at 1 April 2017 | 464,938 | 247 | 465,185 |
| Loss for the year | (13,466) | – | (13,466) |
| Other comprehensive income for the year | 10,673 | 58 | 10,731 |
| Total comprehensive income for the year | (2,793) | 58 | (2,735) |
| **Balance as at 31 March 2018** | **462,145** | **305** | **462,450** |
| Loss for the year | (2,602) | – | (2,602) |
| Other comprehensive income for the year | (4,512) | 38 | (4,474) |
| Total comprehensive income for the year | (7,114) | 38 | (7,076) |
| **Balance as at 31 March 2019** | **455,031** | **343** | **455,374** |

CS

# Supporting the growing needs of the affordable housing sector

"In the past two years, we have seen increases in government grant funding for the development of new affordable rental and shared ownership homes. This, combined with private institutional investment being attracted to the stable long-term revenue streams offered from well-managed rental homes, means NHBC has seen a marked increase in the volumes of development specifically for rental.

This has triggered a switch in emphasis for NHBC, and now we are engaging more directly with Housing Associations to support their development programmes, adapting our offer to them, and helping them with contractor relationships.

By understanding the development programmes of Housing Associations and the needs of their investors and funders, NHBC is engaging early to review designs, providing technical advice – particularly on the use of Modern Methods of Construction (MMC) – all to mitigate potential defects as early as possible.

NHBC sees Housing Associations and institutional investors as significant stakeholders, being the beneficiaries of cover on 30% of the volume written by NHBC. This importance is reflected in our increased focus on engagement and education within the sector, giving the support required through their increase in development."

**Graham Sibley, Senior Business Development Manager, NHBC**

# 06 Company statement of changes in equity

| | Retained earnings £'000 | Revaluation reserve £'000 | Total £'000 |
|---|---|---|---|
| Balance as at 1 April 2017 | 455,948 | 9,237 | 465,185 |
| Loss for the year | (10,390) | – | (10,390) |
| Other comprehensive income for the year | 10,673 | (3,843) | 6,830 |
| Total comprehensive income for the year | 283 | (3,843) | (3,560) |
| **Balance as at 31 March 2018** | **456,231** | **5,394** | **461,625** |
| Loss for the year | (3,085) | – | (3,085) |
| Other comprehensive income for the year | (4,512) | 710 | (3,802) |
| Total comprehensive income for the year | (7,597) | 710 | (6,887) |
| **Balance as at 31 March 2019** | **448,634** | **6,104** | **454,738** |

# Consolidated statement of cash flows

| | Note | 2019 £'000 | 2018 £'000 |
|---|---|---|---|
| **Net cash from operating activities before interest received** | 33 | **(2,795)** | (100,291) |
| Interest received | | **36,407** | 34,358 |
| Taxation received / (paid) | | **916** | (1,065) |
| **Net cash generated from operating activities** | | **34,528** | (66,998) |
| **Cash flow from investing activities** | | | |
| Payments to acquire tangible fixed assets | 23 | **(1,597)** | (845) |
| Payments to acquire land and buildings | 19 | **–** | (4) |
| | | **(1,597)** | (849) |
| Net increase / (decrease) in cash and cash equivalents | | **32,931** | (67,847) |
| Capital gains on cash and cash equivalents | | **–** | – |
| Cash and cash equivalents at the beginning of the year | | **37,705** | 105,552 |
| **Cash and cash equivalents at end of the year** | | **70,636** | **37,705** |
| **Cash and cash equivalents consist of:** | | | |
| Cash at bank and in hand | | **26,771** | 14,427 |
| Deposits with credit institutions (included in other financial investments) | | **65** | 36 |
| Treasury bills and liquidity funds (included in other financial investments) | | **43,800** | 23,242 |
| **Cash and cash equivalents** | | **70,636** | 37,705 |

# 06 Notes to the financial statements

## 1 Company information

The National House-Building Council (NHBC or the company), the ultimate parent entity of the Group, is a private company limited by guarantee. NHBC is incorporated and domiciled in England and Wales. The address of NHBC's registered office is NHBC House, Davy Avenue, Knowlhill, Milton Keynes, Bucks, MK5 8FP.

## 2 Basis of preparation

These financial statements have been prepared under the historical cost convention as modified by financial instruments recognised at fair value, and are in accordance and comply with:

- Applicable United Kingdom Accounting Standards, including Financial Reporting Standard 102 The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland (FRS 102) and Financial Reporting Standard 103 Insurance Contracts (FRS 103)
- Companies Act 2006, under the provision of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410).

The consolidated financial statements for the year ended 31 March 2019 comprise those of the company and its subsidiary companies (together referred to as the Group).

Unless stated otherwise, the consolidated financial statements are presented in pounds sterling (GBP), which is the Group's presentation and functional currency, and rounded to the nearest £'000.

NHBC, the parent company, has taken advantage of section 408 of the Companies Act 2006 and has not included its own statement of comprehensive income in these financial statements. NHBC's loss for the year was £3.1m (2018: loss of £10.4m), with other comprehensive income for the year at a loss of £3.8m (2018: profit of £6.8m).

NHBC is also exempt from including a company statement of cash flows under paragraph 1.12 of FRS 102.

## 3 Going concern

After reviewing the Group's forecasts and projections, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated financial statements.

## 4 Critical accounting judgements and estimation uncertainty

The preparation of financial statements requires management to make estimates and assumptions and to exercise judgements in applying the accounting policies that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses arising during the year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable.

These major areas of judgement on policy application are summarised on the next page:

| Financial statement area | Critical judgements | Related accounting policies and notes |
|---|---|---|
| Insurance and reinsurance contracts | Determination of builder behaviour assumptions<br>Determination of exceptional losses assumptions<br>Determination of cost inflation assumption | Note 5.9 – Insurance contracts<br>Note 25 – Insurance contract liabilities and associated reinsurance |
| Revenue recognition on inspection and building control service | Determination of the stage of completion | Note 5.3 – Other income<br>Note 8 – Turnover |
| Defined benefit pension scheme | Determination of assumptions for mortality, discount rate, inflation and the rate of increase in pensions | Note 5.10.3 – Defined benefit pension scheme<br>Note 30.1 – Defined benefit pension scheme |

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge, and their predictions of future events and actions. Actual results may differ from those estimates, possibly significantly. The table below sets out those items that the Group considers particularly susceptible to changes in estimates and assumptions.

| Financial statement area | Related accounting policies and notes |
|---|---|
| Insurance and reinsurance contracts | Note 5.9 – Insurance contracts<br>Note 25 - Insurance contract liabilities and associated reinsurance |
| Fair value of land and buildings | Note 5.5 – Investment in land and buildings<br>Note 19 – Land and buildings |
| Deferred income taxes | Note 5.4 – Taxation<br>Note 22 – Deferred tax asset |
| Defined benefit pension scheme | Note 5.10.3 – Defined benefit pension scheme<br>Note 30.1 – Defined benefit pension scheme |

## 5 Summary of significant accounting policies

### 5.1 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and entities controlled by the Group (its subsidiaries). Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Intra-Group transactions and outstanding balances are eliminated in the preparation of the consolidated financial statements of the Group.

### 5.2 Investment return

Investment return comprises all investment income, realised investment gains and losses, and movements in unrealised gains and losses, net of investment expenses, charges and interest. Income from investments is included in the non-technical account on an accruals basis.

Realised investment gains and losses are taken through the consolidated statement of comprehensive income in the financial year in which the transaction occurs. They represent the difference between the sales proceeds and book cost (in both cases, excluding accrued interest).

Movements in unrealised gains and losses on investments are included in the non-technical account and represent the difference between the valuation at the consolidated statement of financial position date and the purchase price or, if they have been previously valued, the valuation at the previous balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier financial years in respect of investment disposals in the current financial year.

A transfer of investment return, net of expenses and charges, is made from the non-technical account to the general business technical account to reflect the return made on those assets directly attributable to the insurance business.

### 5.3 Other income

Other income is measured at fair value of the consideration received or receivable, net of discounts and value-added taxes. Other income consists primarily of rendering of inspection and building control services, as well as registration fees and rendering of services relating to the construction industry.

Upon registering a plot with NHBC, the builder customer benefits from the use of NHBC's key stage inspection service. This establishes a quality control process designed to ensure construction meets NHBC Standards. NHBC's subsidiary NHBC Building Control Services Limited provides a building control service, an optional service offered by the Group which assists builder customers in meeting government-set Building Regulations.

# 06 Notes to the financial statements

The Inspection service and building control income is recognised by reference to the stage of completion of the contract.

Builders and developers require registration with NHBC in order to access the NHBC inspection service on new homes they build or develop. A one-off joining fee is payable by the builder to enter the Register. The joining fee is recognised as revenue in full at the invoice date. An annual registration renewal fee is charged to remain on the Register. The registration runs concurrently with the Group's financial year, with new registrations issued up to the end of the financial year. The registration fee is recognised as revenue on an accruals basis.

Rendering of other services to the industry is recognised by reference to the stage of completion of the contract, which is measured by comparing the costs incurred for work performed to date with the total estimated contract costs.

### 5.4 Taxation

Taxation expense for the period comprises current and deferred tax recognised in the reporting period. Tax is recognised in the consolidated statement of comprehensive income, except to the extent that it relates to items recognised in other comprehensive income. In this case, tax is also recognised in other comprehensive income.

Current or deferred taxation assets and liabilities are not discounted.

Current tax is recognised for the amount of income tax payable in respect of the taxable profit for the current or past reporting periods using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

Deferred tax is recognised in respect of all timing differences at the reporting date, except as otherwise indicated. Deferred tax assets are only recognised to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is calculated using the tax rates and laws that have been enacted, or substantively enacted, by the reporting date and which are expected to apply to the reversal of the timing difference.

Deferred tax liabilities are presented within provisions for liabilities and deferred tax assets within debtors. Deferred tax assets and deferred tax liabilities are offset only if the Group has a legally enforceable right to set off current tax assets against current tax liabilities.

### 5.5 Investment in land and buildings

Land and buildings predominantly occupied by the Group for its own purposes are valued at open market valuation. Full valuations are made by professionally qualified external valuers at least every three years. In the intervening years, these valuations are updated by the directors with the assistance of independent professional advice as required. Fair value is primarily derived using comparable recent market transactions on arm's length terms[5].

Increases in value are recognised in other comprehensive income and accumulated in equity. However, the increase is recognised in the consolidated statement of comprehensive income to the extent that it reverses a revaluation decrease of the same asset previously recognised in the consolidated statement of comprehensive income. Decreases in value as a result of a revaluation are recognised in other comprehensive income to the extent of any previously recognised revaluation increase accumulated in equity, in respect of that asset. If a revaluation decrease exceeds the accumulated revaluation gains accumulated in equity in respect of that asset, the excess shall be recognised in the consolidated statement of comprehensive income.

Depreciation on land and buildings is calculated, using the straight-line method over the estimated useful life, as follows:

- Freehold buildings – over a period of 50 years
- Long leasehold property – over the shorter of 50 years or remaining lease period
- Short leasehold – over the period of the lease
- Short leasehold improvements – over the period of the lease.

At the end of each reporting period, an estimate of the useful lives is made by a professionally qualified external valuer. The estimate of useful lives is reviewed and adjusted if appropriate. The effect of any change is accounted for prospectively.

Assets in the course of construction are stated at cost. These are not depreciated until they are available for use.

5. The value of each of the properties is assessed in accordance with the relevant parts of RICS Valuation – Professional Standards 2014. In particular, fair value of each of the properties has been determined in accordance with UKVS 1.1. Under these provisions, the term 'fair value' means 'the amount for which an asset could be exchanged, a liability settled or an equity instrument granted between knowledgeable, willing parties in an arm's length transaction'.

## 5.6 Investment in subsidiaries

The company's investments in subsidiaries are accounted for at fair value. The fair value is derived by reference to the net assets of the subsidiary companies. Where the net assets of a subsidiary are negative, it is valued at £nil.

Increases in value are recognised in other comprehensive income and accumulated in equity. However, the increase is recognised in the company statement of comprehensive income to the extent that it reverses a revaluation decrease of the same asset previously recognised in the company statement of comprehensive income. Decreases in value as a result of a revaluation are recognised in other comprehensive income to the extent of any previously recognised revaluation increase accumulated in equity, in respect of that asset.

Investment in subsidiaries is eliminated in the preparation of the consolidated financial statements of the Group.

## 5.7 Other financial investments

Other financial investments are stated at market value. The Group's other financial investments are publicly traded where a quotation is readily available. Other financial investments are stated at quoted price on a bid basis, excluding any accrued interest. Changes in the fair value are recognised in the non-technical account in the consolidated statement of comprehensive income.

## 5.8 Tangible assets

Tangible fixed assets are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is calculated on the straight-line method to write down the cost of other assets to their residual values over their estimated useful lives as follows:

- Computer equipment – three to five years
- Fixtures and fittings – five years

The assets' residual values, useful lives and methods of depreciation are reviewed regularly, at least at each financial year end, and adjusted if appropriate.

Tangible assets are derecognised on disposal or when no future economic benefits are expected. On disposal, the difference between the net disposal proceeds and the carrying amount is recognised in the consolidated statement of comprehensive income and included in other charges.

## 5.9 Insurance contracts

### 5.9.1 Classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Group agrees to compensate a policyholder if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder. Insurance contracts are written by NHBC.

### 5.9.2 Premiums written

Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued.

Premiums written include road and sewer bond income and are shown net of those premium refunds to registered builders approved in respect of the financial year. Premiums written also exclude insurance premium taxes, with any unpaid taxes included within other creditors in the consolidated statement of financial position.

### 5.9.3 Unearned premiums

The Group's insurance policies provide protection to policyholders for periods of 10 years or more. Premiums are earned over the financial years of the policy commensurate with the expected incidence of risk. In reaching its assessment of the pattern of risk, the Group makes reference to past claims experience. Unearned premiums represent the proportion of premiums written in the year and in previous years that relate to unexpired terms of policies in force at the consolidated statement of financial position date.

# 06 Notes to the financial statements

### 5.9.4 Deferred acquisition costs

Acquisition costs comprise the direct and indirect costs of obtaining and processing new insurance business. These costs are recognised as deferred acquisition costs. Deferred acquisition costs (DAC) are amortised on the same basis as the related unearned premiums are earned.

### 5.9.5 Claims incurred

Claims incurred comprise claims and related expenses paid in the year and changes in the provision for outstanding claims, including provisions for claims incurred but not reported, and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage, reinsurance and other recoveries. Claims are typically reported relatively quickly after the claims event and are therefore subject to significantly less uncertainty than future claims events.

In estimating the cost of claims notified but not paid, the Group has regard to the claim circumstances as reported, information available from surveyors, loss adjusters or other relevant professionals, and the cost of settling claims with similar characteristics in previous financial years.

### 5.9.6 Unexpired risk reserve

An unexpired risk provision is made where the estimated costs of claims, related expenses and deferred acquisition costs exceed unearned premiums, after taking account of future investment income.

An assessment is made at the year end for the estimated cost of claims which may arise during the unexpired terms of policies in force at the consolidated statement of financial position date. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of salvage and other recoveries. Provisions are calculated gross of any related reinsurance recoveries, which are estimated separately and disclosed as part of reinsurers' share of technical provisions.

The provisions are inevitably subject to inherent uncertainties because of the range of factors which could give rise to potentially significant claims over the 10 year or greater period covered by the unexpired risk provision. The time expected to elapse between the inception of policies, the manifestation of events giving rise to claims and the notification to, and settlement by, the Group of such claims accentuate these uncertainties.

In calculating the estimated cost of future claims, actuarial and statistical projections of the frequency and severity of future claims events are used to project ultimate settlement costs. Such projections are based upon both current facts and circumstances, and a subjective analysis of a range of factors, including future inflation, the impact of competition and its effect on builder behaviour in making repairs which would otherwise fall as insurance claims to the Group, the impact of large losses, including those made evident by extreme weather or latent defects caused by defective building materials, the effect of increases in cover, and changes in consumer expectations and in the legal environment. Given these inherent uncertainties, a significant degree of caution has been included in exercising the judgement required for setting the unexpired risk provision.

The Group takes all reasonable steps to ensure that it has appropriate information regarding the assessment of claims in this regard. However, given the inherent uncertainty in estimating the cost of future claims, it is likely that the final outcome will prove to be different from the estimate established at the consolidated statement of financial position date. Any consequential adjustments to amounts previously reported will be reflected in the results of the year in which they are identified.

The Group, in setting its unexpired risk provisions, takes account of the future investment income that will be generated between the consolidated statement of financial position date and settlement of the expected claims on the assets held to cover such provisions.

### 5.9.7 Reinsurance

Reinsurance contracts are measured using valuation techniques and assumptions that are consistent with the valuation techniques and assumptions used in measuring the underlying policy and taking into account the terms of the reinsurance contract.

Reinsurance recoveries due from reinsurers and reinsurance premiums due to reinsurers under reinsurance contracts that are contractually due at the reporting date are separately recognised in the debtors and creditors respectively.

An assessment is made of the recoverability of reinsurance having regard to market data on the financial strength of each of the Group's reinsurers. If a reinsurance contract is considered to be impaired, the carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the consolidated statement of comprehensive income.

## 5.10 Employee benefits

The Group provides a range of benefits to employees, including paid holiday arrangements and defined benefit and defined contribution pension plans.

### 5.10.1 Short-term benefits

Short-term benefits, including holiday pay and other similar non-monetary benefits, are recognised as an expense in the period in which the service is received.

### 5.10.2 Defined contribution pension scheme

The Group operates a defined contribution pension scheme for its employees. This is a pension scheme under which the Group pays fixed contributions into a separate entity. Once the contributions have been paid, the Group has no further payment obligations. The contributions are recognised as an expense when they are due. Amounts not paid are shown in other creditors in the consolidated statement of financial position. The assets of the scheme are held separately from the Group in independently administered funds.

### 5.10.3 Defined benefit pension scheme

The Group operates a defined benefit pension scheme for certain employees. A defined benefit scheme defines the pension benefit that the employee will receive on retirement, and is usually dependent upon several factors, including age, length of service and remuneration. A defined benefit scheme is a pension scheme that is not a defined contribution scheme.

The liability recognised in the consolidated statement of financial position in respect of the defined benefit scheme is the present value of the defined benefit obligation at the end of the reporting date less the fair value of the scheme assets at the reporting date.

The defined benefit obligation is calculated using the projected unit credit method. On an annual basis, the Group engages independent actuaries to calculate the obligation. The present value is determined by discounting the estimated future payments using market yields on high-quality corporate bonds that are denominated in pounds sterling and that have terms approximating to the estimated period of the future payments (discount rate).

The fair value of scheme assets is measured in accordance with the FRS 102 fair value hierarchy and in accordance with the Group's policy for similarly held assets. This includes the use of appropriate valuation techniques.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income. These amounts, together with the return on scheme assets, less amounts included in net interest, are disclosed as 're-measurement of net defined benefit obligation'.

The scheme is closed for future accrual. There are no employee costs such as employee service cost, cost of plan introductions, benefit changes, curtailments and settlements.

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is recognised in the consolidated statement of comprehensive income within other charges.

## 5.11 Impairment of non-financial assets

At each consolidated statement of financial position date, non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset may be impaired. If there is such an indication, the recoverable amount of the asset is compared with the carrying amount of the asset. The recoverable amount of the asset is the higher of the fair value less costs to sell and value in use.

If the recoverable amount of the asset is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the consolidated statement of comprehensive income, unless the asset has been revalued when the amount is recognised in other comprehensive income to the extent of any previously recognised revaluation. Thereafter, any excess is recognised in the consolidated statement of comprehensive income.

If an impairment loss is subsequently reversed, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the consolidated statement of comprehensive income.

# 06 Notes to the financial statements

### 5.12 Lease assets

At inception, the Group assesses agreements that transfer the right to use assets. The assessment considers whether the arrangement is, or contains, a lease based on the substance of the arrangement.

The Group does not have finance leased assets.

Rentals payable under operating leases are charged to the consolidated statement of comprehensive income on a straight-line basis over the lease term. The aggregate benefits of lease incentives are recognised as a reduction to the expense recognised over the lease term on a straight-line basis.

### 5.13 Provisions and contingencies

Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. Contingent assets are not recognised. Contingent assets are disclosed in the financial statements when an inflow of economic benefits is probable.

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources is required to settle the obligation; and the amount of the obligation can be estimated reliably.

Where there are a number of similar obligations, the likelihood that an outflow is required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small. Provision is not made for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as a finance cost.

Contingent liabilities, arising as a result of past events, are not recognised when it is not probable that there will be an outflow of resources or that the amount cannot be reliably measured at the reporting date, or when the existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the Group's control. Contingent liabilities are disclosed in the financial statements unless the probability of an outflow of resources is remote.

### 5.14 Foreign currency

The functional and presentation currency of NHBC and its subsidiary companies is pound sterling, given that all of the Group's activity is conducted in the United Kingdom. Foreign currency transactions are translated into the functional currency using the spot exchange rates at the dates of the transactions. At each period end, foreign currency monetary items are translated using the closing rate. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of comprehensive income.

The Group invests in equity funds that are denominated in foreign currency. Foreign exchange gains and losses movements in relation to the equity funds are recognised as part of the unrealised gains and losses balance in the consolidated statement of comprehensive income. Gains and losses resulting in realisation of equity funds are recognised as part of the realised gains and losses balance in the consolidated statement of comprehensive income.

### 5.15 Related party transactions

The Group does not disclose transactions with members of the same Group that are wholly owned.

### 5.16 Financial instruments

The Group has chosen to adopt Sections 11 and 12 of FRS 102 in respect of financial instruments.

#### 5.16.1 Financial assets

Basic financial assets, including trade and other receivables, cash and bank balances and investments in commercial paper, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest.

Such assets are subsequently carried at amortised cost using the effective interest method.

At the end of each reporting period, financial assets measured at amortised cost are assessed for objective evidence of impairment. If an asset is impaired, the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognised in the consolidated statement of comprehensive income.

If there is a decrease in the impairment loss arising from an event occurring after the impairment was recognised, the impairment is reversed. The reversal is such that the current carrying amount does not exceed what the carrying amount would have been had the impairment not previously been recognised. The impairment reversal is recognised in the consolidated statement of comprehensive income.

Other financial assets, including investments in equity instruments which are not subsidiaries, associates or joint ventures, are initially measured at fair value, which is normally the transaction price. Such assets are subsequently carried at fair value, and the changes in fair value are recognised in the consolidated statement of comprehensive income, except that investments in equity instruments that are not publicly traded and whose fair values cannot be measured reliably are measured at cost less impairment.

Financial assets are derecognised when the contractual rights to the cash flows from the asset expire or are settled, or substantially all the risks and rewards of the ownership of the asset are transferred to another party, or control of the asset has been transferred to another party who has the practical ability to unilaterally sell the asset to an unrelated third party without imposing additional restrictions.

### 5.16.2 Financial liabilities

Basic financial liabilities, including trade and other payables and loans from Group companies, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction where the debt instrument is measured at the present value of the future receipts discounted at a market rate of interest.

Debt instruments are subsequently carried at amortised cost, using the effective interest rate method.

Trade payables are obligations to pay for goods or services that have been acquired from suppliers in the ordinary course of business. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognised initially at transaction price and subsequently measured at amortised cost using the effective interest method.

Derivatives, including forward foreign exchange contracts, are not basic financial instruments.

Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently remeasured at their fair value. Changes in the fair value of derivatives are recognised in the consolidated statement of comprehensive income.

The fair value of foreign exchange contracts, which include spot, forward and futures contracts, is determined using forward exchange rates at the balance sheet date discounted back to present value.

Financial liabilities are derecognised when the liability is extinguished; that is when the contractual obligation is discharged, cancelled or expires.

## 5.17 Statement of cash flows

Cash and cash equivalents consist of cash at bank and in hand, deposits held on call with credit institutions, treasury bills and other short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition or which are redeemable on demand with only an insignificant change in their fair values. For the purposes of the statement of cash flows, cash and cash equivalents may also include bank overdrafts, which are included in payables and other financial liabilities in the consolidated statement of financial position.

Purchases and sales of financial investments are included within operating cash flows as the purchases are funded from cash flows associated with the origination of insurance contracts, net of related claims.

### 5.17.1 Offsetting

Financial assets and liabilities are offset, and the net amounts presented in the financial statements when there is an enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and to settle the liability simultaneously.

## 6 Risk management

The current principal risks of the Group and how they are managed through the risk management framework are outlined on page 35.

The Group has exposure to a number of risks associated with its insurance business and risks from its use of financial instruments. These have been categorised into the following types of risk, and details of the nature, extent and how the Group has managed these risks are shown below:

- Insurance
- Market
- Credit
- Liquidity
- Pension.

### 6.1 Insurance / underwriting risk

Insurance risk is defined as the risk of loss or of adverse change in the values of insurance and reinsurance liabilities resulting from inadequate pricing and provisioning assumptions. As such, the Group's insurance risk is mitigated by adequate management of premium rates (pricing risk) and adequate management of claims (claims risk).

The Group considers writing all business which meets its underwriting criteria and is within its risk appetite. Specifically, the Group is willing to offer latent defect warranties on private and social housing of most types. It also offers warranty on mixed use developments, including commercial, retail and/or leisure use, as well as residential units. In addition, the Group is selectively prepared to offer road and sewer bonds on developments covered by its insurance products.

#### 6.1.1 Pricing risk

Pricing risk is the risk that the Group fails to set its pricing at a level adequate to generate sufficient premiums to meet future claims.

The majority of premiums are calculated in accordance with the premium rating scheme, which takes account of the number of years a builder has been registered with the Group, the builder's size, claims history and plot registration price.

For major project developments such as HRRBs, a bespoke price is calculated based on the risk presented by the developer and the features of the development itself.

#### 6.1.2 Claims risk

Claims risk is the risk that future claims vary from expected claims.

The Group endeavours to manage its claims risk through a professional and timely claims handling, dispute resolution and repair management service.

#### 6.1.3 Reserving risk

Reserving risk is the risk that provisions made for claims prove to be insufficient in light of later events and claims experience. Due to the relatively long-term nature of the Group's claims development patterns, there is exposure to reserving risk.

The Group's Reserving Committee monitors the decisions and judgements made by the Actuarial team and makes the final decision on the reserves to be included within the consolidated financial statements. In forming its collective judgement, the

Reserving Committee considers information such as: actuarial indication of ultimate losses together with an assessment of risks and possible favourable or adverse developments that may not have been fully reflected in calculating these indications; the views of internal peer reviewers of the reserves and of other parties, including actuaries, underwriters and claims managers; and how previous actuarial indications have developed.

#### 6.1.4 Concentration risk

Concentration risk is an inherent feature of the Group's insurance risk exposure, as it largely operates a monoline insurance scheme. It arises from operating in a single geographic market with the majority of business derived from the Buildmark product.

Concentration risk is explicitly recognised by the Group, and the risk is accepted as the Group currently has no appetite for diversification in relation to the type of cover it underwrites or its geographical scope.

#### 6.1.5 Use of reinsurance

The Group uses traditional reinsurance as a key element in managing its insurance risk exposure: limiting its total exposure to ensure the stability of its capital position; creating additional capacity to take on business where it has already reached its internal limit for accepting risk; and protecting itself against volatility in claims experience or erosion in capital which may result from a single cause.

### 6.2 Market risk

The Group defines market risk as the risk of a reduction in available assets from adverse movements in financial markets. The Group uses this term interchangeably with investment risk.

The following paragraphs describe significant components of market risk and how NHBC manages them.

#### 6.2.1 Interest rate risk

Interest rate risk is defined as the risk that changes in the UK 'risk-free' yield curves lead to a reduction in available assets. This can result from an increase in the discounted value of the Group's liabilities (insurance and pension scheme liabilities) and/or a reduction in the value of the Group's fixed interest investments (within the insurance and pension scheme asset portfolios).

The Group's insurance liabilities are medium-tailed (circa five-year duration) and the term structure of interest rates will affect the valuation of the liabilities. The Group invests in fixed income assets with a similar maturity profile to the insurance liabilities to reduce interest rate risk.

The fair value of the Group's portfolio of fixed income securities is inversely correlated to changes in market interest rates. Thus, if interest rates fall, the fair value of the portfolio would tend to rise and vice versa, as set out in the sensitivity analysis on page 126.

#### 6.2.2 Inflation risk

Inflation risk is defined as the risk that:

- Actual inflation is different from what was expected
- There is a change in the markets' view of future expected levels of inflation.

Almost all the Group's insurance liabilities are linked to the cost of house repair. House repair inflation is not investible (assets with an explicit link to house repair inflation are not available). Assets linked to price inflation are available for investment (e.g. index-linked gilts). The Group believes that assets explicitly linked to price inflation are likely to provide protection against scenarios of very high house repair inflation. The Group therefore invests part of its matching assets portfolio in inflation-linked bonds.

# Notes to the financial statements

### 6.2.3 Equity price risk

The Group's portfolio of equity securities is subject to equity risk arising from changes in market price. Thus, if the value of equities rise, so will the fair value of its portfolio and vice versa.

The Group continues to limit its equity exposure in line with the Group's risk preferences. At 31 March 2019, 6.4% (2018: 7.0%) of the overall managed portfolio was invested in equities. The Group invests in equities through pooled funds. The Group's equity investments are globally diversified and include both developed and emerging markets equities. The Group's strategy ensures that the equity portfolio is sufficiently diversified, thereby reducing exposure to individual equities.

Sensitivities to changes in equity prices are presented on the table below.

### 6.2.4 Property price risk

The Group's portfolio of properties is subject to property price risk arising from changes in the market value of properties. The Group's direct exposure to property price risk is small and is limited to a small number of Group-occupied office buildings and temporary ownership of property through the NHBC's claims process. Further information on the valuation approach is included in note 5.5.

No derivative contracts have been entered in order to mitigate the effects of changes in property prices.

If the value of property falls, so will the fair value of the portfolio. Sensitivity to changes in property prices is presented below.

### 6.2.5 Currency risk

The Group operates exclusively in the United Kingdom and has minimal exposure to currency risk.

The Group's exposure to currency risk is predominantly through its equity investments. The underlying investments of the equity funds are denominated in a wide selection of currencies. At 31 March 2019, overseas equities represented a majority (2018: majority) of equity investments.

During the year, the Group held derivatives to mitigate the currency risk associated with its equity holding.

### 6.2.6 Derivative risk

In the year, the Group directly held derivatives, in the form of foreign currency forward contracts, to partially mitigate the currency risk of its equity investments. The Group had no derivative exposures at 31 March 2019.

### 6.2.7 Sensitivity analysis

The table below reflects changes in the consolidated statement of comprehensive income as a result of single factor changes in risks it is exposed to:

| | Increase / (decrease) in statement of comprehensive income | | Increase / (decrease) in other comprehensive income | | Increase / (decrease) in total reserves | |
|---|---|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 | **£'000** | £'000 |
| Impact on fixed interest securities of increase in interest rates of 25bps | **(16,867)** | (15,882) | – | – | **(16,867)** | (15,882) |
| Impact on equities of a 15% fall in equity markets | **(15,486)** | (16,277) | – | – | **(15,486)** | (16,277) |
| Decrease in property markets of 15% | **(1,298)** | (1,380) | **(104)** | (101) | **(1,402)** | (1,481) |

Sensitivity of fixed interest securities is calculated with reference to modified duration and redemption yield not adjusted for options as at the consolidated statement of financial position date. Sensitivity of equity and property markets is calculated by applying a percentage to the market value as at the consolidated statement of financial position date. The impact of the changes on the defined benefit pension liability is excluded.

Insurance contract sensitivity analysis is included in note 28.

### 6.3 Credit risk

Credit risk is the risk of loss of value of the financial assets due to counterparties failing to meet all or part of their obligations.

The Board Risk Committee is responsible for setting the Group's risk appetite in respect of credit risk. Credit risk appetite is embedded within risk policies and contracts with external parties where credit risk is prevalent. The Board Risk Committee, other Board sub-committees and senior management monitor credit risk exposure through monthly and quarterly reporting.

Limits are set at both a portfolio and counterparty level based on likelihood of default, derived from the rating of the counterparty, to ensure that the Group's overall credit profile and specific concentrations are managed and controlled within the risk appetite.

Areas particularly exposed to credit risk are:

- Investments
- Group's customers
- Reinsurance assets.

Details of the nature, extent and how the Group manages the credit risk in relation to areas listed above are described below.

#### 6.3.1 Investments

Investment exposure with external counterparties is managed by ensuring there is a sufficient spread of investments and that all counterparties are rated at least BBB in accordance with the Group's credit rating assignment methodology (second-highest rating available from S&P and Moody's and Fitch approved credit rating agencies) at the time of purchase.

#### 6.3.2 Group's customers

To minimise this risk from the Group's customers defaulting in making payments for goods that have been supplied to them, the Group has a policy of only dealing with customers who have demonstrated creditworthiness. To determine previous creditworthiness, the Group makes use of independent rating agencies, other publicly available financial information and its own trading records. The Group's exposure and its customers' creditworthiness are continually monitored so that any potential problems are detected at an early stage. The Group does not have collateral held as security or any other credit enhancements with respect to its trade debtors.

#### 6.3.3 Reinsurance assets

The Group is exposed to credit and concentrations of risk with individual reinsurers. Reinsurance counterparties are subject to a rigorous internal assessment process on an ongoing basis to ensure that their creditworthiness continues to be satisfactory, and the potential impact from reinsurer default is measured regularly and managed accordingly. Group policy dictates that reinsurers have a financial strength rating of at least A-[6]. The policy requires consideration of the degree of diversification the reinsurers provide as a group and concentration of risk with individual counterparties.

#### 6.3.4 Credit enhancements

The Group does not have collateral held as security or any other credit enhancements with respect to its financial assets. There are no related credit derivatives or similar instruments that mitigate maximum exposure to credit risk.

However, the Group holds certain security in relation to specific sections of its insurance product. At 31 March 2019, the Group held £26m (2018: £28m) of builder customer deposits. The Group has additional credit enhancements with respect to major projects which include, but are not limited to, land charges.

6. Based on S&P rating or comparable rating. Category AA is equivalent to AA and AA- ratings. A is equivalent to A and A+ ratings.

# 06 Notes to the financial statements

### 6.3.5 Credit risk exposure and ageing of financial and insurance assets

The following table provides information regarding the aggregated credit risk exposure for financial assets of the Group as at 31 March 2019. The total is of financial assets that are neither past due nor impaired.

| | AAA | AA | A | BBB | BB | Not rated | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Fixed income securities | 7,587 | 902,112 | 178,607 | 361,077 | 1,405 | – | 1,450,788 |
| Equity and other variable yield securities | – | – | – | – | – | 103,237 | 103,237 |
| Derivatives | – | – | – | – | – | – | – |
| Reinsurers' share of insurance contract liabilities | – | 69,959 | 15,697 | – | – | 5,293 | 90,949 |
| Insurance and non-insurance trade debtors | – | – | – | – | – | 10,688 | 10,688 |
| Other debtors | – | – | – | – | – | 195 | 195 |
| Cash and cash equivalents | – | – | – | – | – | 70,636 | 70,636 |
| | **7,587** | **972,071** | **194,304** | **361,077** | **1,405** | **190,049** | **1,726,493** |

The following table provides information regarding the aggregated credit risk exposure for financial assets of the Group as at 31 March 2018. The total is of financial assets that are neither past due nor impaired.

| | AAA | AA | A | BBB | BB | Not rated | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Fixed income securities | 7,724 | 877,014 | 165,198 | 364,081 | – | – | 1,414,017 |
| Equity and other variable yield securities | – | – | – | – | – | 108,515 | 108,515 |
| Derivatives | – | – | 197 | – | – | – | 197 |
| Reinsurers' share of insurance contract liabilities | – | 29,339 | 8,501 | – | – | 16,574 | 54,414 |
| Reinsurance debtors | – | – | – | – | – | – | – |
| Insurance and non-insurance trade debtors | – | – | – | – | – | 11,559 | 11,559 |
| Other debtors | – | – | – | – | – | 1,583 | 1,583 |
| Cash and cash equivalents | – | – | – | – | – | 37,705 | 37,705 |
| | **7,724** | **906,353** | **173,896** | **364,081** | **–** | **175,936** | **1,627,990** |

The carrying amount best represents the maximum exposure to financial and insurance assets.

The table below represents the ageing of the financial and insurance assets held by the Group as at 31 March 2019.

| | Neither past due nor impaired | 0 to 90 days | 91 to 180 days | 181 days to 360 days | 361 days and over | Provision for impairment | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Fixed income securities | 1,450,788 | – | – | – | – | – | 1,450,788 |
| Equity and other variable yield securities | 103,237 | – | – | – | – | – | 103,237 |
| Derivatives | – | – | – | – | – | – | – |
| Reinsurers' share of insurance contract liabilities | 90,949 | – | – | – | – | – | 90,949 |
| Insurance and non-insurance trade debtors | 7,573 | 2,219 | 536 | 387 | 290 | (317) | 10,688 |
| Other debtors | 195 | – | – | – | – | – | 195 |
| Cash and cash equivalents | 70,636 | – | – | – | – | – | 70,636 |
| | **1,723,378** | **2,219** | **536** | **387** | **290** | **(317)** | **1,726,493** |

# 06 Notes to the financial statements

The table below represents the ageing of the financial and insurance assets held by the Group as at 31 March 2018.

| | Neither past due nor impaired | 0 to 90 days | 91 to 180 days | 181 days to 360 days | 361 days and over | Provision for impairment | Total |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Fixed income securities | 1,414,017 | – | – | – | – | – | 1,414,017 |
| Equity and other variable yield securities | 108,515 | – | – | – | – | – | 108,515 |
| Derivatives | 197 | – | – | – | – | – | 197 |
| Reinsurers' share of insurance contract liabilities | 54,414 | – | – | – | – | – | 54,414 |
| Insurance and non-insurance trade debtors | 6,480 | 3,615 | 690 | 932 | 186 | (344) | 11,559 |
| Other debtors | 1,583 | – | – | – | – | – | 1,583 |
| Cash and cash equivalents | 37,705 | – | – | – | – | – | 37,705 |
| | **1,622,911** | **3,615** | **690** | **932** | **186** | **(344)** | **1,627,990** |

### 6.3.6 Impairment of assets

The Group believes that no impairment allowance is necessary in respect of financial assets not past the due date.

The Group considers notified disputes, significant changes in the counterparty's financial position and collection experience in determining which assets should be impaired. The credit quality of receivables is managed at Group level, with uncollectable amounts being impaired where necessary.

The movement in the allowance for impairment in respect of financial and insurance assets during the year was as follows:

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| At 1 April | 344 | 248 |
| Impairment loss recognised | (41) | (40) |
| Bad debt provision recognised in year | 14 | 136 |
| At 31 March | 317 | 344 |

### 6.4 Liquidity risk

Liquidity risk is the risk that the Group may be unable to pay obligations when due as a result of assets not being available in a form that can immediately be converted into cash. The Group is in a strong liquidity position and seeks to ensure that it maintains enough financial resources to meet its obligations as they fall due.

### 6.4.1 Maturity analysis of financial liabilities

The following table summarises the maturity of financial liabilities. Claims outstanding on insurance contract liabilities are also presented and are analysed by remaining estimated duration until settlement. The amounts in the table are undiscounted.

As at 31 March 2019:

| | Less than one year | One to two years | Two to five years | Five to 10 years | Greater than 10 years | Total | Carrying value in the statement of financial position |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Claims outstanding | (110,573) | (70,458) | (101,349) | (51,444) | (10,006) | (343,830) | (343,830) |
| Trade creditors | (4,321) | – | – | – | – | (4,321) | (4,321) |
| Other creditors | (36,683) | – | – | – | – | (36,683) | (36,683) |
| | **(151,577)** | **(70,458)** | **(101,349)** | **(51,444)** | **(10,006)** | **(384,834)** | **(384,834)** |

As at 31 March 2018:

| | Less than one year | One to two years | Two to five years | Five to 10 years | Greater than 10 years | Total | Carrying value in the statement of financial position |
|---|---|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Claims outstanding | (83,197) | (54,463) | (88,311) | (47,884) | (9,101) | (282,956) | (282,956) |
| Trade creditors | (6,170) | – | – | – | – | (6,170) | (6,170) |
| Other creditors | (37,182) | – | – | – | – | (37,182) | (37,182) |
| | **(126,549)** | **(54,463)** | **(88,311)** | **(47,884)** | **(9,101)** | **(326,308)** | **(326,308)** |

## 6.5 Pension risk

Pension risk is the risk that the NHBC defined benefit pension scheme (the Scheme) deficit significantly widens, thus impairing the Group's net assets and solvency position.

The following information describes key drivers of the deficit/surplus recognised in the Group's financial statements.

### 6.5.1 Investments

The Scheme's current investment strategy is set out as follows:

- 45.0% in investments that share characteristics with the long-term liabilities of the Scheme, comprising of corporate bonds (15.0%) and liability-driven investments (LDIs) (30.0%)
- 55.0% in return-seeking assets compromising equities (15.0%), diversified growth funds (18.75%), multi-asset credit (7.5%) absolute return bonds (7.5%) and cash (6.25% as an interim allocation pending reinvestment).

Note 30.1.4 discloses the value of the Scheme's investments.

# 06 Notes to the financial statements

#### 6.5.1.1 Investments – currency risk

The Scheme is subject to indirect currency risk from its investments in pounds sterling-priced pooled investment vehicles which hold underlying overseas equities denominated in foreign currency. To limit currency risk, the Trustee has set a benchmark of investing 50% of the developed overseas equity allocation in pooled investment vehicles that hedge into Sterling this indirect currency risk.

The Scheme's investment in diversified growth funds, and an absolute return bond fund which all consist of underlying investments across a range of asset classes and regions, also exposes the Scheme to indirect currency risk. This exposure is not hedged as a matter of course, as the manager may vary currency exposures in implementing their investment strategy with the aim of generating additional returns for the Scheme.

The Scheme's investment in multi-asset credit consists of underlying investments across a range of regions. This exposure is hedged into pound sterling as a matter of course by the manager.

Currency risk is also managed and mitigated through the strategic asset allocation in place for the Scheme.

#### 6.5.1.2 Investments – interest rate risk

The Scheme is subject to interest rate risk because of the Scheme's indirect investments in government bonds and corporate bonds. Interest rate risk also exists in relation to the Scheme's liabilities. The Scheme's net exposure to interest rate risk is the difference between the liability and asset interest rate exposures.

The Scheme's bond assets are invested under a LDI approach. At the year end, these assets were invested such that the nature and duration of the portfolio matches approximately 50% of the Scheme's liabilities. Under this strategy, if interest rates fall and all else is equal, the value of the matching investments will rise to match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise and all else is equal, the matching investments will fall in value, as will the actuarial liabilities, due to an increase in the discount rate.

Interest rate risk remains since the matching assets only match a proportion of the liability sensitivity to interest rates.

The Trustee has an exposure to other fixed income assets through the diversified growth funds, absolute return bond fund, and multi-asset credit. The interest rate exposure that these asset classes introduce is taken by the investment manager as part of its investment strategy to add value.

#### 6.5.1.3 Investments – other price risk

Other price risk arises principally in relation to the Scheme's return-seeking portfolio, which includes equities and a diversified growth fund, multi-asset credit, absolute return bonds and cash.

The Scheme has a target asset allocation of 55.0% of investments being held in return-seeking investments. The Trustee manages and mitigates the risk associated with this exposure to overall price movements by constructing a diverse portfolio of investments across various markets, sectors and regions using several investment managers.

The Scheme is also exposed to other price risk as a result of the corporate bond holdings within pooled funds. These could fall in value if credit spreads widen. The Trustee has considered this risk when setting an appropriate strategic allocation to corporate bonds.

#### 6.5.1.4 Investments – credit risk

The Scheme is subject to direct credit risk because it has cash balances with financial institutions.

Credit risk arising on cash held within financial institutions is mitigated by ensuring cash is held with institutions which are at least investment-grade credit rated and only holding a small proportion of assets in cash. This is the position at the current and previous year end.

The pooled investment arrangements used by the Scheme comprise unit-linked insurance contracts, unit trusts and other pooled investment vehicles. The Scheme is therefore directly exposed to credit risk arising from these pooled investment vehicles and is indirectly exposed to credit risks arising on the underlying investments held by these pooled investment vehicles. The Scheme's holdings in pooled investment vehicles are not rated by credit rating agencies. The Trustee manages and monitors the credit risk arising from the Scheme's pooled investment arrangements by considering the nature of the arrangement, legal structure and regulatory environment.

Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled manager, the regulatory environments in which the pooled managers operate and diversification of investments amongst a number of pooled arrangements. Cash held by the pooled manager's custodian is not ring-fenced, but the credit risk arising on this is mitigated using regular cash sweeps and investing cash in liquidity funds.

Investments backing unit-linked insurance contracts are comingled with the insurer's own assets, and direct credit risk is mitigated by capital requirements and the Prudential Regulatory Authority's regulatory oversight. In the event of default by the insurer, the Scheme may be protected by the Financial Services Compensation Scheme (FSCS) and may be able to make a claim for at least 100% of its policy value, although compensation is not guaranteed. The Trustee carries out due diligence checks on the appointment of new pooled investment managers and will consider any changes to the operating environment of the pooled manager.

The Scheme also invests in pooled investment vehicles which invest in sovereign government bonds, corporate bonds, and other credit assets and cash. Furthermore, derivatives are used within the diversified growth funds and the absolute return bond fund. This exposes the Scheme to indirect credit risk.

Indirect credit risk in relation to underlying investments held in the corporate bond pooled investment vehicle is mitigated by the Trustee investing in a fund which holds bonds that are, in majority, at least investment-grade credit-rated investments. The investments in multi-asset credit, absolute return bonds and diversified growth funds can hold underlying credit assets which are non-investment grade. The Trustee invests in these funds with a view to adding value. Indirect credit risk within these funds is mitigated through diversification of the underlying securities to minimise the impact of default by any one issuer.

### 6.5.2 Liabilities

The value of liabilities is subject to certain risks and uncertainties. The following are the principal risks and uncertainties that impact upon the value of the Scheme liabilities.

#### 6.5.2.1 Liabilities – discount rate

It is important to note that FRS 102 requires the discount rate to be set with reference to the yields on high-quality (usually taken to mean AA– rated) corporate bonds, irrespective of the actual investment strategy of the Scheme. Therefore, the market will drive the discount rate.

A reduction in the discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the discount rate will have an opposite effect of similar magnitude.

#### 6.5.2.2 Liabilities – inflation risk

An increase in the inflation rate will increase the assessed value of liabilities, as a higher value is placed on benefits. Reduction in the inflation rate will have an opposite effect of similar magnitude.

#### 6.5.2.3 Liabilities – longevity risk

There is also uncertainty around the future life expectancy of the UK population. The value of current and future pension benefits will depend upon how long they are assumed to be in payment.

The Scheme does not currently hold investments to manage longevity risk. If, in future, affordable products become available, aimed at schemes similar in size and nature to this Scheme, that effectively mitigate such risk, the Trustee will consider these products.

#### 6.5.2.4 Liabilities – sensitivity analysis

The following table summarises the estimated sensitivity of the disclosed liability value to changes in the principal assumptions that have been used in the calculations.

| | **2019** | 2018 |
|---|---|---|
| Decrease discount rate by 0.25% (2018: 0.25%) | £11m | £10m |
| Increase inflation rate by 0.25% (2018: 0.25%) | £10m | £9m |
| Increase life expectancy by one year (2018: one year) | £11m | £10m |

# 06 Notes to the financial statements

## 7 Capital management (unaudited)

The Group is headed by a company limited by guarantee, has no external shareholders, is exclusively funded through retained earnings and maintains an efficient capital structure consistent with the Group's risk profile and the regulatory requirements of its business.

The Group's capital is exclusively comprised of retained earnings and revaluation reserves.

The Group's objectives in managing its capital are:

- To match the profile of its assets and liabilities, taking account of the risks inherent in the business
- To maintain financial strength and resilience, including protecting capital from shocks or excessive volatility
- To satisfy the requirements of Solvency II, policyholders and regulators
- To allocate capital efficiently to support growth.

There have been no changes to the Group's capital management objectives during the year.

The Group's capital position is kept under constant review by the Board, with the Capital Modelling and Reporting Committee reporting through the Executive Risk Committee and into the Board Risk Committee.

The company is authorised by the UK's Prudential Regulation Authority (PRA). The PRA classifies the company as an insurance company. As a result, the company must maintain capital resources as prescribed by the PRA through its Prudential Sourcebook.

Since 1 January 2016, the company has been subject to the requirements of the Solvency II Directive and must hold sufficient capital to meet its SCR, which is calibrated to seek to ensure a 99.5% confidence of the ability to meet obligations over a 12-month time horizon. The company calculates its SCR in accordance with the Standard Formula prescribed in the Solvency II regulations. The company aims to maintain own funds at around 155% (the solvency ratio) of these minimum requirements over the medium term. At 31 March 2019, under Solvency II, the unaudited solvency ratio was 152% (2018: 156%).

The company is compliant with PRA and Solvency II requirements.

## 8 Turnover

Group activities consist of two main segments within the United Kingdom: insurance activities and other activities relating to the efficient construction of good-quality housing. The direct underwriting operations of the Group consist primarily of one class of business: pecuniary loss insurance. The table below shows the analysis of the turnover by segment.

| | **2019** | | 2018 | |
|---|---|---|---|---|
| | **£'000** | **£'000** | £'000 | £'000 |
| **Insurance activities** | | **95,172** | | 82,459 |
| **Other activities** | | | | |
| Inspection services | **63,754** | | 62,305 | |
| Registration fee income | **5,902** | | 5,806 | |
| Other services supporting the industry | **8,918** | | 8,766 | |
| **Other activities** | | **78,574** | | 76,877 |
| | | **173,746** | | 159,336 |

As well as inspection services performed under Buildmark contracts, inspection services include building control inspection income.

Turnover, comprising of gross premiums written and other income, is derived wholly from continuing operations.

## 9 Particulars of business

The table below shows the insurance activities split by class.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Credit and suretyship** | **Miscellaneous** | Credit and suretyship | Miscellaneous |
| | **£'000** | **£'000** | £'000 | £'000 |
| Gross premiums written | **13,173** | **81,999** | 8,206 | 74,253 |
| Gross premiums earned | **12,875** | **62,537** | 10,002 | 45,132 |
| Gross claims incurred | **4,371** | **142,098** | 3,498 | 98,484 |
| Gross operating expenses | **1,954** | **12,165** | 483 | 4,757 |
| Reinsurance balance | **(2,193)** | **24,846** | 6,061 | (37,827) |

The reinsurance balance represents the credit / (charge) to the technical account from the aggregate of all items relating to reinsurance outwards.

## 10 Movements in prior year's claims provisions

| | 2019 | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| Net claims provisions brought forward at 1 April | 277,724 | 275,610 |
| Net payments during the year in respect of these provisions | **(82,752)** | (91,759) |
| Net claims provisions carried forward in respect of claims provided at 1 April | **(236,455)** | (207,462) |
| Movement in prior year's provision | **(41,483)** | (23,611) |

## 11 Net operating expenses

| | 2019 | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| Acquisition costs | **2,241** | 1,743 |
| (Increase) / decrease in DAC provision | **(144)** | 4 |
| Administrative expenses | **12,022** | 3,492 |
| Reinsurance commission | **(1,649)** | 37 |
| | **12,470** | 5,276 |

Administrative expenses include the cost of general business levies as well as other administrative expenditure attributed directly to insurance activities.

The Group does not pay commissions for direct business that includes acquisition, renewal and collection.

# 06 Notes to the financial statements

## 12 Change in accounting estimate

In the financial year, NHBC updated its allocation of overhead expenses to technical and non-technical accounts. The change in estimate is a consequence of NHBC's evolving cost base, with Solvency II compliance being a significant factor in the increase of the technical account's administrative costs. The change in estimate does not affect NHBC's overall result and is isolated to the consolidated statement of comprehensive income.

The effect of the change in estimate on the current year's results is an increase in claims paid of £6.3m and an increase in the technical account operating expenses of £8.1m, offset by a corresponding reduction in other charges.

## 13 Investment return

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| **Investment income** | | |
| Interest income on financial assets at amortised cost | 63 | 123 |
| Income from financial assets at fair value through consolidated statement of comprehensive income | 36,182 | 35,863 |
| (Losses) / gains on derivative contracts | (2,614) | 3,306 |
| Income from land and buildings | 19 | 19 |
| Net gains from realisation of financial assets at fair value through consolidated statement of comprehensive income | 31,315 | 7,174 |
| | 64,965 | 46,485 |
| Investment management expenses on financial assets at fair value through consolidated statement of comprehensive income | (2,327) | (1,967) |
| Net unrealised losses on financial assets at fair value through consolidated statement of comprehensive income | (15,179) | (36,642) |
| | 47,459 | 7,876 |

Net interest expense on the Scheme of £820,000 (2018: £1,270,000) is recognised in other charges within the consolidated statement of comprehensive income.

Interest payable of £nil (2018: £nil) in respect of taxation is recognised in other charges within the consolidated statement of comprehensive income.

No interest was payable in respect of bank loans, overdrafts or financial liabilities.

## 14 Employee information

The average number of full-time equivalent persons (including Executive Directors) employed by the company and Group during the year by activity was:

| | 2019 | 2018 |
|---|---|---|
| Insurance activities | 231 | 244 |
| Other direct activities | 821 | 816 |
| Administration | 179 | 192 |
| | 1,231 | 1,252 |

Other direct activities relate to providing services which improve the quality of new and newly converted homes.

Staff costs for the above persons were:

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Wages and salaries | 55,811 | 56,319 |
| Social security costs | 6,790 | 6,728 |
| Pension costs | 11,683 | 7,350 |
| | 74,284 | 70,397 |

The pension costs include a past service cost of £3.76m relating to the Scheme. Further information is disclosed in note 30.1.

## 15 Director emoluments

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Aggregate emoluments | 1,639 | 1,771 |
| Aggregate compensation for loss of office | – | 263 |
| | 1,639 | 2,034 |

Retirement benefits are accruing to no directors (2018: none) under the Group's defined contribution pension scheme and no directors (2018: none) under the defined benefit pension scheme.

No advances or credits granted to any director subsisted during the year. Also, no guarantees on behalf of any director subsisted during the year.

The company does not have a share option scheme.

The amounts set out above include remuneration in respect of the highest paid director as follows:

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Aggregate emoluments and benefits under long-term incentive schemes | 451 | 361 |

The highest-paid director is not a member of any of the Group's pension schemes.

The directors' remuneration report on page 71 provides further detailed disclosures of directors' remuneration.

# Notes to the financial statements

## 16 Profit on ordinary activities before taxation

Profit on ordinary activities is stated after:

### 16.1 Auditor remuneration

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Fees payable to the company's auditors for the audit of the company and Group financial statements | 180 | 170 |
| Non-audit services and fees payable to the company's auditors and its subsidiary companies for other services: | | |
| – The audit of the company's subsidiaries, pursuant to legislation | 10 | 10 |
| – Other services pursuant to legislation, including the audit of the regulatory return | 91 | 85 |
| | 281 | 265 |

### 16.2 Impairment of trade receivables

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Impairment of trade receivables | 14 | 136 |

### 16.3 Operating lease charges

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Land and buildings | 355 | 351 |
| Motor vehicles | 2,945 | 2,937 |
| | 3,300 | 3,288 |

### 16.4 Research and development

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Research and development expenditure expensed | 1,248 | 1,049 |

## 17 Income tax

### 17.1 Tax (income) / expense included in the consolidated statement of comprehensive income

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **£'000** | **£'000** | £'000 | £'000 |
| **Current tax** | | | | |
| UK corporation tax on profits for the year | – | | – | |
| Adjustment in respect of prior periods | (82) | | (320) | |
| **Total current tax** | | (82) | | (320) |
| **Deferred tax** | | | | |
| Origination and reversal of timing differences | (8,225) | | (6,321) | |
| Adjustment in respect of prior periods, including impact of change in tax rate | – | | (110) | |
| Derecognition of deferred tax asset | 8,225 | | 6,441 | |
| **Total deferred tax** | | – | | 10 |
| | | (82) | | (310) |

### 17.2 Tax expense / (income) included in other comprehensive income

| | 2019 | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| **Deferred tax** | | |
| Origination and reversal of timing differences | (767) | 1,814 |
| Derecognition of deferred tax asset | 767 | (1,814) |
| | – | – |

# Notes to the financial statements

### 17.3 Reconciliation of tax charge

Tax assessed for the period is higher (2018: higher) than the standard rate of corporation tax in the UK for the year ended 31 March 2019 of 19% (2018: 19%). The differences are explained below:

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| **(Loss) / profit on ordinary activities before tax** | **(2,684)** | (13,776) |
| (Loss) / profit multiplied by the standard rate of tax in the UK of 19% (2018: 19%) | **(510)** | (2,617) |
| Effects of: | | |
| – Income not chargeable for tax purposes | **(8,834)** | (4,597) |
| – Expenses not deductible for tax purposes and permanent differences | **157** | 32 |
| – Adjustments in respect of prior years | **(82)** | (320) |
| – Adjustment to deferred tax charge in respect of previous periods | **962** | 751 |
| – Movement in unprovided deferred tax asset | **8,225** | 6,441 |
| | **(82)** | (310) |

The income not chargeable for tax purposes relates to income and gains on the Group's investments. These adjustments are expected to be consistent in future years.

### 17.4 Tax rate changes

The Finance Act 2016 received royal assent on 15 September 2016 and, as a result, reductions in the UK corporation tax rate to 19% with effect from 1 April 2017, and 17% with effect from 1 April 2020, have been enacted.

## 18 Exceptional item

In the financial year ended 31 March 2019, NHBC received proceeds from settlement of legal claims. The proceeds relate to a dispute that has been settled on confidential terms.

## 19 Land and buildings

Land and buildings have been revalued as at 31 March 2019.

| | The Group and the company |
|---|---|
| | **£'000** |
| **Cost or valuation** | |
| At 1 April | **10,033** |
| Additions | **–** |
| Revaluation | **60** |
| Disposals | **–** |
| At 31 March | **10,093** |
| **Depreciation** | |
| At 1 April | **162** |
| Charge | **167** |
| Revaluation | **(92)** |
| Disposals | **–** |
| At 31 March | **237** |
| **Net book value at 31 March 2019** | **9,856** |
| Net book value at 31 March 2018 | 9,871 |

All land and buildings are predominantly occupied by the Group for its own activities. Land and buildings at net book value comprise:

| | The Group and the company | |
|---|---|---|
| | **2019** | **2018** |
| | **£'000** | £'000 |
| Freehold | **8,650** | 8,615 |
| Long leasehold | **695** | 670 |
| Short leasehold improvements | **511** | 586 |
| | **9,856** | 9,871 |

All land and buildings are regularly revalued in accordance with the Group's stated accounting policy as set out in note 5.5. If land and buildings had not been revalued in this manner, they would have been included at the following amounts:

| | The Group and the company | |
|---|---|---|
| | **2019** | **2018** |
| | **£'000** | £'000 |
| Cost | **14,115** | 14,115 |
| Accumulated depreciation based on cost | **(1,893)** | (1,692) |
| | **12,222** | **12,423** |

The Group's reversal of previous impairment losses taken to the consolidated statement of comprehensive income amounted to £114,000 (2018: £198,000).

No land and buildings have been pledged as security on any of the Group's liabilities.

## 20 Investment in Group undertakings and participating interests

### 20.1 Investment in participating interests – Group

The Group has no investments that would be considered an investment in an associate company.

The Group entered into a joint venture agreement in respect of the Consumer Code For Home Builders Limited. The Consumer Code For Home Builders Limited is incorporated in the UK, limited by guarantee (to a maximum of £1 of its members) and has no share capital. The impact of the joint venture is immaterial to the Group's financial statements.

### 20.2 Investment in Group undertakings – company

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| At 1 April | **5,189** | 9,090 |
| Revaluation | **671** | (3,901) |
| At 31 March | **5,860** | 5,189 |
| **Analysed as:** | | |
| NHBC Building Control Services Limited | **4,098** | 4,194 |
| PRC Homes Limited | **270** | 270 |
| NHBC Pension Trustee Limited | **–** | – |
| Gowan Close Management Company Limited | **–** | – |
| NHBC Services Limited | **1,492** | 725 |
| | **5,860** | **5,189** |

The company's subsidiary undertakings were wholly owned and registered in England and Wales. At 31 March 2019, they were as follows:

- NHBC Building Control Services Limited – issued and fully paid 50,000 £1 ordinary shares. NHBC Building Control Services Limited is an Approved Inspector for Building Regulation purposes in England and Wales.
- NHBC Services Limited – issued and fully paid 50,000 £1 ordinary shares. NHBC Services Limited provides services to the house-building and related industries.
- PRC Homes Limited – issued and fully paid 100 £1 ordinary shares. PRC Homes Limited did not trade during the year.
- NHBC Pension Trustee Limited – issued and fully paid 100 £1 ordinary shares. NHBC Pension Trustee Limited arranges the provision of pensions to many of NHBC's present and past employees. NHBC Pension Trustee Limited did not trade during the year.

The directors believe that the carrying value of the investments is supported by their underlying net assets and was valued in accordance with the Group's accounting policy as set out in note 5.6.

In the year, the company acquired significant control of Gowan Close Management Company Limited, an active property management company limited by guarantee and registered in England and Wales.

The registered office for all Group companies is NHBC House, Davy Avenue, Knowlhill, Milton Keynes, Bucks, MK5 8FP.

## 21 Debtors

| | | Group | | Company |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| **Insurance activities** | | | | |
| Debtors arising out of direct insurance operations | **5,412** | 5,438 | **5,412** | 5,438 |
| Debtors arising out of reinsurance operations | **–** | – | **–** | – |
| | **5,412** | 5,438 | **5,412** | 5,438 |
| **Other debtors** | | | | |
| Trade debtors | **5,276** | 6,121 | **3,736** | 4,228 |
| Corporation tax | **92** | 916 | **92** | 916 |
| Other debtors | **103** | 667 | **103** | 667 |
| | **5,471** | 7,704 | **3,931** | 5,811 |

Trade debtors includes £nil (2018: £nil) falling due after more than one year.

Amounts owed by group undertakings are unsecured, have no fixed date of repayment and are repayable on demand. Interest is accrued with reference to the LIBOR.

Trade debtors are stated after provisions for impairment of £317,000 (2018: £344,000).

## 22 Deferred tax asset

The annual review of the recoverability of the deferred tax asset has indicated that it is not probable that the Group will generate the taxable profits required to support the recognition of the asset. Deferred tax assets of £23,073,000 (2018: £14,081,000) for the Group and £23,058,000 (2018: £14,067,000) for the company, as at 31 March 2019, have not been recognised.

Due to the indexation of the properties that the Group holds, it is unlikely that any gains will arise in the foreseeable future. Therefore, no deferred tax has been provided with respect to existing capital tax losses that arose on the disposal of buildings. The undiscounted value of these losses is £216,000, based on a prevailing tax rate of 17% (2018: £216,000 at 17%).

## 23 Tangible assets

| | | | The Group and the company |
|---|---|---|---|
| | Computer equipment | Fixtures and fittings | Total |
| | £'000 | £'000 | £'000 |
| **Cost or valuation** | | | |
| At 1 April | 5,410 | 5,217 | 10,627 |
| Additions | 1,540 | 57 | 1,597 |
| Disposals | (46) | - | (46) |
| **At 31 March** | **6,904** | **5,274** | **12,178** |
| **Depreciation** | | | |
| At 1 April | 4,228 | 4,581 | 8,809 |
| Charge | 722 | 299 | 1,021 |
| Disposals | (46) | - | (46) |
| **At 31 March** | **4,904** | **4,880** | **9,784** |
| **Net book value at 31 March 2019** | **2,000** | **394** | **2,394** |
| Net book value at 31 March 2018 | **1,182** | **636** | **1,818** |

No tangible assets have been pledged as security on any of the Group's liabilities. No tangible assets are held under finance leases.

## 24 Deferred acquisition costs

The following changes have occurred in the DAC during the year:

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| At 1 April | **11,577** | 11,582 |
| Acquisition costs deferred during the year | **2,241** | 1,743 |
| Amortisation | **(2,097)** | (1,748) |
| At 31 March | **11,721** | 11,582 |

## 25 Insurance contract liabilities and associated reinsurance

The following notes explain how the Group, and the company, calculates its liabilities to policyholders for insurance products it has sold. Note 26 covers insurance contract liabilities. Note 27 details the reinsurance recoverable on insurance contract liabilities, whilst note 28 presents sensitivity analysis on insurance contract liabilities and associated reinsurance.

The following is a summary of the Group insurance contract provisions and related reinsurance assets as at 31 March 2019.

| | **2019** | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Gross provisions** | **Reinsurance assets** | **Net** | Gross provisions | Reinsurance assets | Net |
| | **£'000** | **£'000** | **£'000** | £'000 | £'000 | £'000 |
| Provision for unearned premiums | **(456,612)** | **51,766** | **(404,846)** | (436,851) | 46,641 | (390,210) |
| Claims outstanding | **(343,830)** | **32,585** | **(311,245)** | (282,956) | 5,231 | (277,725) |
| Unexpired risk reserve | **(364,956)** | **6,598** | **(358,358)** | (343,492) | 2,542 | (340,950) |
| | **(1,165,398)** | **90,949** | **(1,074,449)** | (1,063,299) | 54,414 | (1,008,885) |

The following is a summary of the company insurance contract provisions and related reinsurance assets as at 31 March 2019.

| | **2019** | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Gross provisions** | **Reinsurance assets** | **Net** | **Gross provisions** | **Reinsurance assets** | **Net** |
| | **£'000** | **£'000** | **£'000** | £'000 | £'000 | £'000 |
| Provision for unearned premiums | **(457,247)** | **51,766** | **(405,481)** | (437,675) | 46,641 | (391,034) |
| Claims outstanding | **(343,830)** | **32,585** | **(311,245)** | (282,956) | 5,231 | (277,725) |
| Unexpired risk reserve | **(364,956)** | **6,598** | **(358,358)** | (343,492) | 2,542 | (340,950) |
| | **(1,166,033)** | **90,949** | **(1,075,084)** | (1,064,123) | 54,414 | (1,009,709) |

# 06 Notes to the financial statements

## 26 Insurance liabilities

This note analyses the Group's insurance contract liabilities and describes how the Group calculates these liabilities and the assumptions used.

### 26.1 Insurance product

The majority of the Group's insurance liabilities arise as a result of the sale of the Buildmark product. The Buildmark product, sold by NHBC, protects a homeowner in three separate ways, which can be divided into three temporal periods.

Section 1: prior to completion of the house purchase, Buildmark Section 1 provides insurance to a homeowner that covers losses caused by the builder, primarily insolvency of the builder, resulting in a loss of the homeowner's deposit.

Section 2: Buildmark Section 2 is concerned with the two-year period immediately following legal completion of the home, i.e. when the homeowner moves in. Firstly, Section 2 contains the Builder's warranty period provided by the builder to the homeowner. NHBC is not a party to that bilateral contract. Secondly, Section 2 provides the NHBC Guarantee (a performance guarantee). This gives rise to a secondary liability on the part of NHBC in the event (and only in the event) that the builder fails to honour the Builder's warranty.

Sections 3, 4 and 5: the policy periods for these sections of Buildmark begin after the end of Section 2 for a period of eight years, i.e. years three to 10 following legal completion. Like Section 1, these sections are exclusively concerned with obligations undertaken by NHBC to the homeowner to provide an indemnity in the event of certain events.

### 26.2 General methodology

Estimation of the ultimate cost of future claim payments is primarily based on actuarial and statistical analyses of past claims experience (and exposure where sufficient experience does not yet exist). Separate estimates are calculated for the various elements of risk.

The estimates are underpinned by historical data where available. Specific adjustment is made where the future risk is believed to differ from the historical risk – e.g. due to differing economic, political, competitive and technical risks. In doing this, considerable expert judgement is applied in determining the relevance of historical data and any perceived changes in the future risks.

The reserves are estimated gross of reinsurance. The net reserves are calculated by assessing the expected reinsurance recoveries given the gross reserves estimated.

The UK GAAP insurance contract liability calculations are based on NHBC's Solvency II best estimate methodology. Best estimate cash flows are projected for homogenous risk groupings using a combination of deterministic and stochastic approaches. Reinsurance recoveries are estimated by applying the relevant cash flows to NHBC's reinsurance cover.

To convert from Solvency II best estimate to UK GAAP, Solvency II specific elements are removed from the calculation and a margin reflecting the reasonably foreseeable requirement is added. The margin is selected by management and is informed using a scenario approach.

### 26.3 Risk concentration

A breakdown by category of risk (main assumptions) is shown on the next page.

### 26.4 Assumptions

Aside from volumes, the size of the estimated reserves is primarily driven by:

- Exceptional losses
- Builder behaviour
- Social inflation
- Economic conditions – cost inflation (HRCI)
- Economic conditions – housing market
- Discount rate.

#### 26.4.1 Exceptional losses

Due to the nature of new house building and the warranties provided, NHBC is exposed to the possibility of a common defect in a large number of homes. If discovered, reported and accepted by NHBC as valid, such an issue could result in claims costs well in excess of £100m. This is possible even if individual repairs are relatively inexpensive due to the sheer number of homes under cover at any point in time.

NHBC's exposure to these events partly depends on the degree of homogeneity in the homes under cover – i.e. the extent to which the same people, processes, design, materials and components are used. Larger sites pose a greater risk, due to the likely degree of commonality in the build process. Likewise, sites built by the same builder, particularly if they are quite close geographically, are more likely to exhibit common defects.

The less diverse the house-building industry is in terms of the homes built and the builders who build them, the greater the risk of a systemic failure.

NHBC is also exposed to large losses from individual developments.

To accommodate the inherent uncertainty, a stochastic approach has been used to model exceptional losses.

#### 26.4.2 Builder behaviour

For defects reported in years three to 10 of the policy term, there is no contractual obligation for builders to undertake repairs themselves, but some do voluntarily. This is because:

- Some builders are keen to offer a high level of service to their customers to maintain their reputation as a quality builder
- Builders who stay loyal to NHBC are incentivised by NHBC's pricing mechanism to keep claim levels low.

Among other considerations, comparisons of claim frequencies between current and previously registered[7] builders are used to determine builder behaviour assumptions.

#### 26.4.3 Social inflation

Due to the nature of house building, homes may contain a variety of inherent defects. In most cases, these defects will be minor and never result in any damage. However, in the small proportion of cases where there is damage, for a claim to arise, the defect or damage first needs to be identified. The homeowner then needs to report it within the appropriate timescale.

As with many other forms of insurance, the likelihood of defects being discovered and reported has increased through time due to rising homeowner expectations and their greater awareness of the cover – referred to as 'social inflation'.

Estimates of the level of social inflation, present in the historical Section 3 data, act as a guide for determining appropriate future social inflation assumptions.

7. Previously registered builders are builders not currently the NHBC Register.

# 06 Notes to the financial statements

### 26.4.4 Economic conditions – cost inflation

NHBC's insurance liabilities are significantly affected by repair cost inflation, due to the long period of cover offered by the insurance product. This can arise from:

- General materials and labour cost inflation
- More specific issues, such as more stringent Building Regulations and health and safety requirements.

The HRCI is considered the best available approximation due to its specific reference to construction cost inflation.

To derive the long-term HRCI inflation assumption, the approach of estimating a long-term average future HRCI / Retail Price Index (RPI) differential and combining it with the RPI assumptions has been taken.

### 26.4.5 Economic conditions – housing market

NHBC is exposed to changes in housing market conditions. When the housing market deteriorates, a greater number of builders become insolvent, exposing NHBC to more claims. These additional claims arise from the cover offered that is contingent on the builder being insolvent (or not honouring its obligations) or where the builder otherwise would have undertaken voluntary repairs.

### 26.4.6 Discount rate

Future investment returns are allowed for when assessing the present value of future liabilities. Consistent with the requirements for Solvency II, the UK GAAP liabilities are discounted using the EIOPA yield curve at the balance sheet date.

## 26.5 Movements in the gross provision for unearned premiums

The following changes have occurred in the gross provision for unearned premiums during the year:

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| At 1 April | **436,851** | 409,526 | **437,675** | 409,526 |
| Increase in provision | **19,761** | 27,325 | **19,572** | 28,149 |
| At 31 March | **456,612** | 436,851 | **457,247** | 437,675 |

The estimates of earnings profiles for all NHBC products have been updated. The change in the estimate has resulted in a £14.5m release from the gross provision for unearned premiums. The release was recognised in the statement of comprehensive income.

### 26.6 Movements in the gross provision for claims

The reconciliation of opening and closing gross provision for claims is as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| At 1 April | **282,956** | 275,610 | **282,956** | 275,610 |
| Increase in provision | **60,874** | 7,346 | **60,874** | 7,346 |
| At 31 March | **343,830** | 282,956 | **343,830** | 282,956 |

### 26.7 Movements in the gross unexpired risk reserve

The reconciliation of opening and closing gross unexpired risk reserve is as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| At 1 April | **343,492** | 414,851 | **343,492** | 414,851 |
| Increase / (decrease) in provision | **21,464** | (71,359) | **21,464** | (71,359) |
| At 31 March | **364,956** | 343,492 | **364,956** | 343,492 |

# Notes to the financial statements

## 26.8 Loss development tables[8]

The following table illustrates the movements in the net claims incurred by financial reporting and development years.

| Financial reporting year / £'000 | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|---|
| Prior | 340,067 | 27,453 | 34,310 | 31,357 | 35,799 | 39,615 | 28,782 | 28,852 |
| 2005 | 49 | 829 | 1,585 | 3,346 | 5,684 | 5,167 | 5,885 | 4,722 |
| 2006 | 18 | 513 | 1,490 | 3,497 | 6,966 | 5,632 | 6,667 | 7,577 |
| 2007 | 12 | 475 | 2,392 | 6,115 | 5,303 | 8,073 | 10,150 | 6,171 |
| 2008 | 37 | 947 | 3,862 | 3,910 | 7,555 | 5,318 | 9,729 | 12,870 |
| 2009 | 44 | 1,132 | 2,003 | 2,247 | 5,841 | 4,160 | 5,855 | 6,220 |
| 2010 | 94 | 633 | 2,430 | 2,556 | 3,796 | 3,077 | 3,614 | 3,332 |
| 2011 | 34 | 557 | 3,782 | 3,160 | 4,048 | 4,608 | 173 | 3,203 |
| 2012 | 35 | 677 | 2,266 | 1,809 | 2,790 | 2,075 | 2,137 | 13,557 |
| 2013 | 301 | 650 | 1,422 | 2,052 | 2,319 | 1,856 | 4,390 | |
| 2014 | 89 | 742 | 1,376 | 2,772 | 2,738 | 3,917 | | |
| 2015 | 13 | 324 | 2,320 | 1,114 | 2,496 | | | |
| 2016 | – | 278 | 1,359 | 1,069 | | | | |
| 2017 | 21 | 327 | 878 | | | | | |
| 2018 | – | 34 | | | | | | |
| 2019 | – | | | | | | | |

Development year

Claims handling and other charge

8. NHBC has not included full claims development tables as required by FRS 103 paragraph 4.8. Following the 2017 review of NHBC's reserving methodology and the consequential changes to the accounting policies, it has not been practicable to prepare a set of gross and net developments that would fully meet the disclosure requirements of UK GAAP.

| Development year | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15+ | Claims incurred in the financial year ended 31 March 2019 |
| 26,890 | 31,121 | 22,733 | 21,603 | 15,934 | 7,378 | 11,903 | 2,758 | 2,758 |
| 6,675 | 11,354 | 8,956 | 10,100 | 6,378 | 3,206 | 4,092 | | 4,092 |
| 7,362 | 9,408 | 8,264 | 7,246 | 6,770 | 15,100 | | | 15,100 |
| 11,595 | 11,685 | 12,899 | 9,411 | 12,722 | | | | 12,722 |
| 12,356 | 16,600 | 13,437 | 19,454 | | | | | 19,454 |
| 2,926 | 4,930 | 8,462 | | | | | | 8,462 |
| 5,423 | 5,148 | | | | | | | 5,148 |
| 4,461 | | | | | | | | 4,461 |
| | | | | | | | | 13,557 |
| | | | | | | | | 4,390 |
| | | | | | | | | 3,917 |
| | | | | | | | | 2,496 |
| | | | | | | | | 1,069 |
| | | | | | | | | 878 |
| | | | | | | | | 34 |
| | | | | | | | | – |
| | | | | | | | | 98,538 |
| | | | | | | | | 20,572 |
| | | | | | | | | 119,110 |

# Notes to the financial statements

## 27 Reinsurance assets

This note details the reinsurance recoverable on the Group's insurance liabilities.

### 27.1 Assumptions

The assumptions, including discount rates used for reinsurance contracts, follow those used for insurance contracts. Reinsurance assets are valued net of an allowance for their recoverability.

### 27.2 Movements in reinsurers' share of provision for unearned premiums

The following changes have occurred in the reinsurers' share of provision for unearned premiums during the year:

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| At 1 April | **46,641** | 42,864 | **46,641** | 42,864 |
| Increase in provision | **5,125** | 3,777 | **5,125** | 3,777 |
| At 31 March | **51,766** | 46,641 | **51,766** | 46,641 |

The estimates of earnings profiles for all NHBC products have been updated. The change in the estimate has resulted in a £1.3m release from the reinsurers' share of provision for unearned premiums. The release was recognised in the statement of comprehensive income.

### 27.3 Movements in reinsurers' share of provision for claims

The following changes have occurred in the reinsurers' share of provision for claims during the year:

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| At 1 April | **5,231** | – | **5,231** | – |
| Increase in provision | **27,354** | 5,231 | **27,354** | 5,231 |
| At 31 March | **32,585** | 5,231 | **32,585** | 5,231 |

### 27.4 Movements in reinsurers' share of the unexpired risk reserve

The following movements have occurred in the reinsurance asset during the year:

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| At 1 April | **2,542** | 34,006 | **2,542** | 34,006 |
| Decrease in provision | **4,056** | (31,464) | **4,056** | (31,464) |
| At 31 March | **6,598** | 2,542 | **6,598** | 2,542 |

## 28 Insurance contract sensitivity analysis

This note shows how the consolidated statement of comprehensive income would have been affected if changes in certain risk variables that were possible at the end of the reporting period had occurred.

The following table provides an indication of some of the single factor changes adopted by the Group and the corresponding adverse impact on the insurance liabilities. An increase in the liability is equal to the charge in the consolidated statement of comprehensive income.

| | | 2019 | | 2018 | |
|---|---|---|---|---|---|
| **Assumption** | **Sensitivity tested** | **Gross liability** | **Net liability** | Gross liability | Net liability |
| | **%** | **£m** | **£m** | £m | £m |
| Increase in claim frequency | +2.0 | **14.3** | **13.3** | 12.2 | 11.5 |
| Long-term HRCI inflation | +1.0 | **50.6** | **43.7** | 51.7 | 48.6 |
| Discount rate | -0.25 | **13.5** | **12.4** | 13.3 | 12.5 |

The sensitivity analysis has been derived using the internal reserving model to inform the Group's decision-making process and for identification and management of risks within the business.

The above analyses are based on a change in an assumption, while holding all other assumptions constant, and assume that no management action is taken. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated.

The analysis has not considered the impact of the above changes on the valuation of the Group's assets and liabilities other than insurance assets and liabilities. The above analysis is presented gross of the corresponding tax credits or charges.

# Notes to the financial statements

## 29 Creditors

| | Group | | Company | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| | **£'000** | £'000 | **£'000** | £'000 |
| **Creditors arising out of direct insurance operations** | | | | |
| Trade creditors | **3,653** | 5,235 | **3,653** | 5,235 |
| Builder deposits | **25,979** | 27,627 | **25,979** | 27,627 |
| | **29,632** | 32,862 | **29,632** | 32,862 |
| **Other creditors** | | | | |
| Trade creditors | **668** | 935 | **668** | 935 |
| Amount due to subsidiary undertakings | **–** | – | **11,158** | 9,556 |
| Other taxation and social security | **6,057** | 5,605 | **4,972** | 4,601 |
| Derivative financial instruments | **–** | 801 | **–** | 801 |
| Other creditors | **4,647** | 3,149 | **4,528** | 3,080 |
| | **11,372** | 10,490 | **21,326** | 18,973 |

Amounts due to subsidiary undertakings are unsecured, have no fixed date of repayment and are repayable on demand. Interest is accrued with reference to LIBOR.

Builder deposits are deposited with the Group as surety by builder customers.

## 30 Post-employment benefits

The Group operates two pension schemes for its employees, a defined benefit pension scheme (the Scheme) and a defined contribution pension scheme. The amount recognised in the consolidated statement of financial position is as follows:

| | | **2019** | 2018 |
|---|---|---|---|
| | Note | **£'000** | £'000 |
| **Defined benefit pension scheme** | 30.1 | | |
| Total market value of Scheme assets | | **216,137** | 207,093 |
| Present value of Scheme liabilities | | **(249,225)** | (239,089) |
| **Deficit in the Scheme** | | **(33,088)** | (31,996) |

The amount recognised in the consolidated statement of comprehensive income is as follows:

| | Note | **2019**<br>**£'000** | 2018<br>£'000 |
|---|---|---|---|
| **Defined benefit pension scheme** | 30.1 | | |
| Past service cost | | **3,760** | – |
| Interest income | | **(5,691)** | (5,283) |
| Interest expense | | **6,511** | 6,553 |
| | | **4,580** | 1,270 |
| **Defined contribution pension scheme** | 30.2 | **7,923** | 7,350 |
| | | **12,503** | 8,620 |

No current service cost is recognised as the Scheme was closed to future accrual with effect from 31 March 2014.

The amount recognised in the consolidated statement of comprehensive income is as follows:

| | Note | **2019**<br>**£'000** | 2018<br>£'000 |
|---|---|---|---|
| **Defined benefit pension scheme** | 30.1 | | |
| Experience gains on assets | | **3,778** | 89 |
| Actuarial (losses) / gains on liabilities | | **(8,105)** | 2,704 |
| Experience (losses / gains on liabilities | | **(185)** | 7,880 |
| | | **(4,512)** | 10,673 |

### 30.1 Defined benefit pension scheme

For certain employees, the Group operates a UK defined benefit pension scheme whereby benefits are determined with reference to an employee's salary. The Scheme exposes the Group to actuarial risks, such as longevity risk, interest rate risk and market (investment) risk. The pension expense charged to the statement of comprehensive income makes no allowance for actuarial gains and losses during the year. Actuarial gains and losses are instead recognised in other comprehensive income in the year that they occur.

The funding requirements of the Scheme are based on a separate actuarial valuation for funding purposes for which the assumptions differ from the assumptions disclosed below. The last valuation was performed on 31 March 2017. In order to value the defined benefit obligation at 31 March 2019, the results of the valuation were updated in an approximate manner by a qualified actuary. Contributions to the Scheme are assessed in accordance with the advice of qualified actuaries. The Group made contributions into the Scheme of £8,000,000 during the year ended 31 March 2019.

The measurement of the defined benefit obligation includes no allowance for any future discretionary increases to pensions in payment.

# 06 Notes to the financial statements

### 30.1.1 Principal financial assumptions

A comprehensive actuarial valuation of the Scheme, using the projected unit credit method, was carried out at 31 March 2017 by Willis Towers Watson LLP, independent consulting actuaries. Adjustments to the valuation at that date have been made based on the following assumptions:

| | **2019** | 2018 |
|---|---|---|
| | **%** | % |
| Consumer price inflation | **2.40** | 2.20 |
| Retail price inflation | **3.30** | 3.20 |
| Rate of increase (normally indexed) | **3.60** | 3.50 |
| Rate of increase (normally fixed) | **3.25** | 3.25 |
| Discount rate | **2.60** | 2.75 |

It was assumed that members commute 25% of their pension for tax free cash, 80% of male members and 60% of female members were married, and males were three years older than females.

The assumptions adopted for mortality are in line with SAPS S2PA Light base tables, with an allowance for future improvements in line with the CMI (2018) tables with a 1.25% long-term trend. The resulting average remaining life expectancies for a male and female aged 65 as at 31 March 2019 are 22 (2018: 23) years and 25 (2018: 26) years respectively.

### 30.1.2 Reconciliation of Scheme assets and liabilities

| | **Assets** | **Liabilities** | **Total** |
|---|---|---|---|
| | **£'000** | **£'000** | **£'000** |
| At 1 April 2018 | 207,093 | (239,089) | (31,996) |
| Interest income / (expense) | 5,691 | (6,511) | (820) |
| Benefits paid | (8,304) | 8,304 | – |
| Actuarial loss on change of assumptions | – | (8,105) | (8,105) |
| Experience loss on liabilities | – | (185) | (185) |
| Past service cost | – | (3,760) | (3,760) |
| Change in value of money purchase transfer funds | (121) | 121 | – |
| Company contributions | 8,000 | – | 8,000 |
| Return on plan assets, excluding interest income | 3,778 | – | 3,778 |
| At 31 March 2019 | **216,137** | **(249,225)** | **(33,088)** |

### 30.1.3 Total cost recognised as an expense

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Past service cost | 3,760 | – |
| Interest expense | 6,511 | 6,553 |
| | 10,271 | 6,553 |

The past service cost of £3.76m is a result of the recent High Court judgement in the Lloyds Banking Group case on 26 October 2018 regarding the equalisation of the Guaranteed Minimum Pension.

### 30.1.4 Fair value of Scheme assets

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Equity instruments | 31,826 | 31,158 |
| LDIs | 67,829 | 57,806 |
| Corporate debt instruments | 31,740 | 30,659 |
| Diversified growth funds | 41,122 | 61,116 |
| Diversified credit fund | 29,100 | 15,379 |
| Other and cash and cash equivalents | 14,520 | 10,975 |
| | 216,137 | 207,093 |

There are no amounts included in the fair value of the Scheme assets that consist of NHBC's own financial instruments or any property occupied, or assets used, by NHBC.

### 30.1.5 Return on plan assets

| | 2019 | 2018 |
|---|---|---|
| | £'000 | £'000 |
| Interest income | 5,691 | 5,283 |
| Return on plan assets, excluding interest income | 3,778 | 89 |
| | 9,469 | 5,372 |

The return on plan assets is recognised in other comprehensive income in the consolidated statement of comprehensive income.

### 30.1.6 Deficit funding contributions

In order to meet the funding deficit, the Group has agreed a funding plan with the Pension Trustee. Further scheduled contributions are set out in the table below:

| | **£'000** |
|---|---|
| 31 March 2020 | **8,000** |
| 31 March 2021 | **8,000** |
| 31 March 2022 | **8,000** |
| 31 March 2023 | **8,000** |
| 31 March 2024 | **8,000** |
| | **40,000** |

Nothing in the agreement precludes the Group from making higher contributions or from making payments earlier than scheduled in the table above.

### 30.2 Defined contribution pension scheme

The Group operated a stakeholder defined contribution pension scheme during the year. The amount recognised as an expense for the defined contribution scheme was:

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| Current period contributions | **7,923** | 7,350 |

At 31 March 2019, contributions of £634,000 (2018: £nil) were outstanding.

## 31 Fair value methodology

### 31.1 Basis for determining the fair value hierarchy

The fair value of financial instruments has been estimated using the following fair value hierarchy:

**Level 1** – the unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

**Level 2** – inputs other than quoted prices included within Level 1 are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

**Level 3** – inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

When using alternative valuation methods to value Level 3 financial instruments, the Group relies as little as possible on Group-specific inputs and makes maximum use of relevant market inputs, including the following:

- Quoted prices for identical or similar assets or liabilities in markets that are not active
- Inputs other than quoted prices that are observable for the asset or liability, including interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads
- Market-corroborated inputs, which may not be directly observable, but are based on or supported by observable market data.

Valuation methods that the Group employs typically include:

- Market approach, which uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or groups of assets and liabilities

- Income approach, which converts future amounts, such as cash flows, income or expenses, to a single current amount
- Cost approach, or current replacement cost approach, which reflects the amount that would be required currently to replace the service capacity of an asset.

There were no transfers between levels from the prior year.

### 31.2 Fair value hierarchy analysis

The table below presents the analysis of the Group's assets and liabilities that have been measured at fair value by the fair value hierarchy. The table excludes the defined benefit pension scheme deficit and insurance and reinsurance contracts.

| | | **2019** | | | 2018 | | |
|---|---|---|---|---|---|---|---|
| | | **Level 1** | **Level 3** | **Total** | Level 1 | Level 3 | Total |
| | Note | **£'000** | **£'000** | **£'000** | £'000 | £'000 | £'000 |
| **Assets at fair value** | | | | | | | |
| Land and buildings | 19 | **–** | **9,856** | **9,856** | – | 9,871 | 9,871 |
| Other financial investments | | **1,597,890** | **–** | **1,597,890** | 1,546,007 | – | 1,546,007 |
| | | **1,597,890** | **9,856** | **1,607,746** | 1,546,007 | 9,871 | 1,555,878 |
| **Liabilities at fair value** | | | | | | | |
| Derivative financial instruments | | **–** | **–** | **–** | 801 | – | 801 |

The table below presents the analysis of the company's assets and liabilities that have been measured at fair value by the fair value hierarchy. The table excludes the Scheme deficit and insurance and reinsurance contracts.

| | | **2019** | | | 2018 | | |
|---|---|---|---|---|---|---|---|
| | | **Level 1** | **Level 3** | **Total** | Level 1 | Level 3 | Total |
| | Note | **£'000** | **£'000** | **£'000** | £'000 | £'000 | £'000 |
| **Assets at fair value** | | | | | | | |
| Land and buildings | 19 | **–** | **9,856** | **9,856** | – | 9,871 | 9,871 |
| Investments in Group undertakings and participating interests | 20 | **–** | **5,860** | **5,860** | – | 5,189 | 5,189 |
| Other financial investments | | **1,597,890** | **–** | **1,597,890** | 1,546,007 | – | 1,546,007 |
| | | **1,597,890** | **15,716** | **1,613,606** | 1,546,007 | 15,060 | 1,561,067 |
| **Liabilities at fair value** | | | | | | | |
| Derivative financial investments | | **–** | **–** | **–** | 801 | – | 801 |

At the year end, the Group and the company did not recognise Level 2 assets and liabilities as valued under the fair value hierarchy basis. Details of the Group and the company's insurance and reinsurance contracts are disclosed on page 145. Details of the Group and the company's Scheme are disclosed on page 154.

# Notes to the financial statements

## 32 Financial instruments

The table below presents the Group and the company's financial instruments, excluding insurance and reinsurance contracts. Details of the Group and the company's insurance and reinsurance contracts are disclosed on page 145.

| | | Group | | Company | |
|---|---|---|---|---|---|
| | | **2019** | 2018 | **2019** | 2018 |
| | Note | **£'000** | £'000 | **£'000** | £'000 |
| **Financial assets at fair value[9]** | | | | | |
| Index-linked gilts | | **749,986** | 695,872 | **749,986** | 695,872 |
| Fixed interest gilts | | **97,078** | 127,032 | **97,078** | 127,032 |
| Corporate bonds | | **603,724** | 591,113 | **603,724** | 591,113 |
| UK treasury bills and short-term deposits | | **43,800** | 23,242 | **43,800** | 23,242 |
| Shares and other variable yield instruments | | **103,237** | 108,515 | **103,237** | 108,515 |
| Derivative financial instruments | | **–** | 197 | **–** | 197 |
| | | **1,597,825** | 1,545,971 | **1,597,825** | 1,545,971 |
| **Financial assets that are debt instruments measured at amortised cost** | | | | | |
| Trade debtors | 21 | **10,688** | 11,559 | **9,148** | 9,666 |
| Other debtors | 21 | **195** | 1,583 | **195** | 1,583 |
| Deposits with credit institutions | | **65** | 36 | **65** | 36 |
| Cash at bank | | **26,771** | 14,427 | **26,496** | 14,150 |
| | | **37,719** | 27,605 | **35,904** | 25,435 |
| **Financial assets that are equity instruments measured at cost less impairment** | | **–** | – | **–** | – |
| **Financial liabilities measured at fair value** | | | | | |
| Derivative financial instruments | 29 | **–** | 801 | **–** | 801 |
| **Financial liabilities measured at amortised cost** | | | | | |
| Trade creditors | 29 | **4,321** | 6,170 | **4,321** | 6,170 |
| Other creditors | 29 | **36,683** | 36,381 | **35,479** | 35,308 |
| Amounts owed to group undertakings | 29 | **–** | – | **11,158** | 9,556 |
| | | **41,004** | 42,551 | **50,958** | 51,034 |

9. All debt securities and shares held are listed on a recognised investment exchange and are actively traded. The quoted price is the bid price. Stated before accrued interest.

### 32.1 Derivative financial instruments

In the prior year, the Group entered into forward foreign currency contracts to mitigate the currency risk for certain overseas equities. In the year ended 31 March 2019, the outstanding contracts all matured. As at 31 March 2019, the Group did not have any outstanding derivative financial instruments.

## 33 Note to the statement of cash flows

The table below presents the Group's net cash flow from operating activities, excluding interest received, reconciled to the profit reported in the consolidated statement of comprehensive income.

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| Loss for the financial year | **(2,602)** | (13,466) |
| Tax on loss on ordinary activities | **(82)** | (310) |
| Loss on ordinary activities before tax | **(2,684)** | (13,776) |
| Depreciation and decrease in value of assets | **1,188** | 1,038 |
| Increase in revaluation reserve | **(114)** | (197) |
| Increase / (decrease) in technical provisions | **65,564** | (14,232) |
| Realised gains on investments and fixed assets | **(28,052)** | (11,084) |
| Decrease in unrealised gains on investments | **14,576** | 37,246 |
| Decrease / (increase) in insurance debtors | **26** | (418) |
| Decrease / (increase) in other debtors | **1,409** | (362) |
| Increase / (decrease) in prepayments and accrued income | **(2,362)** | 800 |
| Decrease in insurance creditors | **(3,230)** | (2,015) |
| Increase / (decrease) in other creditors | **1,683** | (575) |
| Increase in accruals and deferred income | **6,913** | 3,209 |
| Differences on recognition of defined benefit pension scheme | **(3,420)** | (5,230) |
| Interest received | **(36,256)** | (36,019) |
| Payments to acquire investments | **(589,936)** | (526,448) |
| Receipts from disposal of investments | **571,900** | 467,772 |
| Net cash flow from operating activities before interest received | **(2,795)** | (100,291) |

# Notes to the financial statements

## 34 Provisions for other liabilities

The Group and the company have no provisions for other liabilities that have not been disclosed elsewhere in the financial statements.

## 35 Contingent liabilities

The Group and the company have no material contingent liabilities to disclose.

## 36 Capital and other commitments

At 31 March 2019, the Group has committed to a deficit repair plan in respect of its defined benefit pension scheme. The particulars of the arrangement are outlined in note 30.1.6. The Group and the company had the following future minimum lease payments under non-cancellable operating leases for each of the following periods:

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| Within one year | **2,565** | 2,436 |
| Between one and five years | **2,644** | 3,159 |
| Over five years | **–** | – |
| | **5,209** | 5,595 |

The Group and the company did not have any contracts under a finance lease arrangement.

## 37 Related party transactions

Transactions between subsidiaries, which are related parties, have been eliminated on consolidation, as have transactions between the company and its subsidiaries during the financial year.

Some of NHBC's directors are also directors of some of NHBC's customers, suppliers and industry partners. NHBC trades in the normal course of business, on an arm's length basis, with all these parties, and material transactions with related parties are disclosed below.

NHBC has a joint venture with MD Insurance Services Limited under the name of Consumer Code for Home Builders Limited (CCHB). The CCHB operates a code providing protection and rights to purchasers of new homes. The table below presents transactions with the CCHB.

| | **2019** | 2018 |
|---|---|---|
| | **£'000** | £'000 |
| Contributions to CCHB | **185** | 119 |
| Amount due from NHBC | **62** | – |

See note 15 and directors' remuneration report for disclosure of the directors' remuneration.

## 38 Reserves

For the Group and the company, retained earnings include all current and prior period retained profits and losses. The Group revaluation reserve comprises of movements arising on the revaluation of land and buildings. The company revaluation reserve comprises of movements arising on the revaluation of land and buildings and the investment in subsidiary companies.

## 39 Liability of members

At 31 March 2019, there were 53 (2018: 54) members of NHBC Council. Under the Articles of Association, the liability of each of the members is limited by guarantee to a maximum of £1.

# Meaning of key words and phrases

Certain words, abbreviations or phrases used throughout this document have a specific meaning, as summarised below.

| Key word/phase | Meaning |
|---|---|
| Attritional losses | Claims less than £1m in value |
| Bornhuetter-Ferguson technique | A method for calculating an estimate of an insurance company's losses; also called the Bornhuetter-Ferguson method, it estimates incurred but not yet reported losses for a policy year |
| Builder, customer, builder customer | The person, firm or company who is responsible for building a home |
| Buildmark | The protection NHBC and the builder provide for a home |
| Claim outstanding | The amounts provided to cover the estimated ultimate cost of settling claims arising out of events which have occurred by the reporting date, including incurred but not reported claims and claims handling expenses, less amounts already paid in respect of those claims |
| Claims handling | The administrative cost of processing a claim (such as salary costs, costs of running claims centres and the allocated share of the overhead costs) which are separate from the cost of settling the claim itself with the policyholder |
| Consumer, homeowner, policyholder | The person (or people) who entered into the contract for a home, or any person (or people) who take over the freehold, commonhold or leasehold title of the property, or, where this applies, any mortgage provider that has taken possession of a home |
| Deferred acquisition costs | Costs arising from the conclusion of insurance contracts that are incurred during a reporting period but which relate to a subsequent reporting period |
| Exceptional losses | Claims over £20m in value |
| FCA | Financial Conduct Authority: the regulatory authority with responsibility for the conduct of the UK financial services industry |
| Gross written premium | Total revenue generated through sale of insurance products before considering reinsurance; is stated irrespective of whether payment has been received |
| Large losses | Claims between £1m and £20m in value |
| Net earned premium | The proportion of premium written, net of the cost of associated reinsurance, which represents the consideration charged to policyholders for providing insurance cover during the reporting period |
| Net incurred claims | The total claims cost incurred in the period less any share that is borne by reinsurers; it includes both claims payments and movements in claims reserves and claims handling expenses in the period |
| Net written premium | Premium written or processed in the period, irrespective of whether it has been paid, less the amount shared with reinsurers |
| NHBC, the company | National House-Building Council: the ultimate parent entity of the Group |

| Key word/phase | Meaning |
|---|---|
| Non-technical account | Non-insurance activities |
| PRA | Prudential Regulation Authority: the regulatory authority with responsibility for the prudential regulation and supervision of the UK financial services industry |
| Reinsurance | The practice whereby part or all the risk accepted is transferred to another insurer (the reinsurer) |
| Solvency II | A Directive in EU law that codifies and harmonises the EU insurance regulation; primarily, this concerns the amount of capital that EU insurance companies must hold to reduce the risk of insolvency |
| Technical account | Insurance activities |
| Unearned premium | The portion of a premium that relates to future periods for which protection has not yet been provided, irrespective of whether the premium has been paid or not |
| Unearned premiums provision | The proportion of written premiums relating to periods of risk after reporting date which are deferred to subsequent reporting periods |
| Unexpired risks provision | The excess of the estimated value of claims and expenses likely to arise after the end of the reporting period from contracts concluded before that date, insofar as their estimated value exceeds the provision for unearned premiums (after deduction of any acquisition costs deferred) and any premiums receivable under those contracts |
| Yield | Rate of return on an investment in percentage terms |

# Notes

NHBC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This leaflet has been printed on material which is produced from well-managed forests and is fully recyclable and biodegradable, ECF (elemental chlorine free) and is made to ISO 14001 Environmental Certification.

recycle
www.recyclenow.com

NHBC, NHBC House,
Davy Avenue, Knowlhill,
Milton Keynes,
Bucks MK5 8FP
**Tel:** 0344 633 1000
**Fax:** 01908 747255
www.nhbc.co.uk

NHBC

Raising Standards. Protecting Homeowners