We care about here

Annual report & consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2013

Company Number: SC001111

Clydesdale Bank PLC

Annual report and consolidated financial statements

For the year ended 30 September 2013

Contents

Overview

Clydesdale Bank PLC ("the Bank"), together with its subsidiary undertakings (which together comprise "the Group"), is the retail and commercial banking business in the United Kingdom of National Australia Bank Limited ("NAB"). Its immediate parent is National Australia Group Europe Limited ("NAGE"). The Group operates under both the Clydesdale Bank and Yorkshire Bank brands. It offers a range of banking services for both personal and business customers through retail branches, Business Banking centres, direct banking and brokers.

Forward looking statements

This document contains certain forward looking statements with respect to the expectations, plans and aims of the Group relating to future performance, financial position and results. The Group considers the expectations these forward looking statements reflect to be reasonable. However, we can give no assurance that these expectations will not differ materially from actual outcomes. All forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control. Factors beyond the Group's control include, amongst others, domestic UK and global economic and business conditions, the policies and actions of governments and other regulatory bodies, changes in the tax regimes or other legislation in the jurisdictions the Group and its parent operate, market related risks such as interest or exchange rate movements, inflation, changes in customer preferences and the actions of competitors, the effect, timing and other uncertainties around future acquisitions or other combinations within relevant industries, delays in implementing proposals and risks affecting borrower credit quality. As a result, the Group recommends that readers of this document do not place undue reliance on such forward looking statements.

The Group undertakes no obligation to update any forward looking statements in light of any future events, new information or otherwise.

Clydesdale Bank   Yorkshire Bank

Officers and professional advisers

Directors	**Executive Chairman**	Cameron Clyne
	Non-executive	David Allvey * # David Browne * # Richard Gregory OBE, Senior Independent Director * # James Pettigrew * Barbara Ridpath # Alexander Shapland #
	Executive	David Thorburn, Chief Executive Officer # John Hooper Mark Joiner Richard Sawers #
		* Member of the Boards' Audit Committee # Member of the Boards' Risk Committee
UK Executive Committee		David Thorburn, Chief Executive Officer John Hooper, Executive Director and Chief Operating Officer Scott Butterworth, Chief Financial Officer Debbie Crosbie, Operations & IT Director Jennifer Darbyshire, General Counsel & Company Secretary Eric Gunn, Chief Risk Officer Lynn McManus, People & Communications Director Helen Page, Customer Experience & Marketing Director (appointed 22 May 2013) Kevin Page, Strategy & Transformation Director Andrew Pearce, Retail Banking Director Paul Shephard, Business & Private Bank Director
Joint Company Secretary		Jennifer Darbyshire Lorna McMillan
Registered Office		30 St Vincent Place Glasgow, G1 2HL
Bankers		National Australia Bank Limited
Auditor		Ernst & Young LLP 1 More London Place London, SE1 2AF

Chairman's statement

Cameron Clyne

Over the past year we have continued to take the steps needed to build a stronger, better Clydesdale Bank. We have taken action to strengthen our balance sheet, control costs and to sharpen our focus in the areas where we have a strong customer base. These strategic changes have allowed us to benefit from the recovering economic conditions in the UK and I am pleased to report an improvement in our underlying business performance.

As part of our approach to facing into and resolving past conduct issues, we implemented a redress exercise for a historic mortgage calculation error and we have increased our provision for PPI related matters. Even though our underlying performance has improved and bad debt levels have fallen, these conduct factors have contributed to the loss reported in these results. Despite this, we continue our investment in new products and services and the launch of our mobile banking platform this year has been particularly successful.

Our investment also extended to our brand with the launch of 'We Care About Here', a very public statement of our historic grounding in the communities in which we operate. The launch coincided with the 175^{th} anniversary of Clydesdale Bank and enabled us to celebrate our roots with the refurbishment of our Head Office Branch in Glasgow and its new Business Banking centre. We also launched new Spirit of the Community awards, which celebrate the fantastic efforts of the charities and local groups that work alongside us in cities, towns and villages across the UK.

This Annual Report sets out the benefits of the restructuring of our business and its new operating model. Our Board and governance structure has also strengthened following on from the substantial renewal of Board membership completed in the last financial year. The additional experience, scrutiny and oversight that Directors have brought has helped steer the business through these testing times and I thank them, our staff and our customers for their support.

Cameron Clyne

Cameron Clyne
Executive Chairman
21 November 2013

Chief Executive Officer's statement

David Thorburn

The restructuring of the business that we outlined following our strategic review has been substantially completed ahead of schedule and is beginning to deliver the anticipated benefits to our income, costs and asset quality. Underlying business performance is improving, we have a clearer focus on customers, we are resolving legacy conduct issues and responding to the emerging priorities of the UK's new regulatory framework. Our overarching aim with all these matters is to become a stronger, customer focused bank for our communities.

Over the course of the year we have rationalised our property footprint, created regional centres to deliver a range of Business & Private Banking services, and concluded the transfer of the vast majority of our commercial real estate assets to NAB.

Although still some way short of reaching its historic growth rate, the UK economy has stabilised. Many of our customers are more optimistic about the future and businesses are now discussing their future investment plans with us. Against this backdrop, we have seen a reduction in bad and doubtful debts.

The year however has not been without its challenges and we took action to resolve several legacy conduct issues, including a customer redress exercise for a mortgage repayment calculation error we discovered in 2009 and we have increased our provision for PPI redress, which has resulted in the Group making a loss. A strong focus on conduct issues will remain a feature of the industry and our business as we work to build a better Bank.

Restructuring our business more quickly than we originally forecast has allowed us to invest more rapidly in our underlying products and services. This year saw the re-launch of our brand, innovations in online personal loan products and the launch of our mobile banking application amongst many other refinements.

The improvement in our financial performance this year is the result of the action we took following the strategic review, targeted investment and a modest improvement in the economic environment. However it would not have been achieved without the effort of the Bank's employees who have taken the changes in their stride and maintained their focus on supporting our customers within our new operating model.

The Bank's stability and strength will serve it and its customers well as the economy settles and as we face the challenges of the future as well as resolving the industry issues of the past.

D Thorburn

David Thorburn

Chief Executive Officer

21 November 2013

Strategic report

The Directors of the Bank with its subsidiary undertakings (which together comprise "the Group") present their Strategic Report for the year ended 30 September 2013.

The Strategic Report is a new statutory requirement under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, replacing the previous Business Review, and is intended to be fair and balanced, and to provide information that enables the Directors to be satisfied that they have complied with s172 of the Companies Act 2006 (which sets out the Directors' duty to promote the success of the company).

Our business model

The Group operates a full service UK-focused retail and commercial banking business under the brand names "Clydesdale Bank" and "Yorkshire Bank", in Scotland, the north of England and selected other sites. The Bank delivers these services through a network of retail branches, Business Banking centres, direct banking and broker channels and currently has 323 retail branches, 43 Business Banking centres, and employs 4,478* staff. The Bank is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").

Our operating environment

The UK economic recovery is gaining momentum, albeit from a low base. The economy expanded by 0.7% in the June quarter and by 0.8% in the three months to September. The Q3 2013 GDP figures were enhanced by expansion in all four major sectors of the economy; services, industry, agriculture and construction. The Office for National Statistics (ONS) data also showed that export demand played a major role in driving growth, rising by 3.6% on the previous quarter, aided by the currency devaluation effects and the beginnings of some signs of improvement in the Eurozone economy. The UK unemployment rate as at September 2013 was 7.6%, with 2.47m people unemployed at that point, a reduction of 48,000 from the previous quarter.

Despite these positive impacts, however, the ONS cautions that the current rate of economic growth is still well below the rate experienced during previous recoveries from recessions, and that the short term outlook remains uncertain. The inflation rate (as measured by annualised growth in the Consumer Prices Index) slowed to 2.2% in October but remains above the Bank of England target of 2.0%. The Bank of England Base Rate has remained at 0.5% since March 2009, which is the longest period of rate stability in the post-war era, although the spread between base rate and 3 month LIBOR has narrowed which has an impact on the Group's funding. Under 'forward guidance', the Monetary Policy Committee has indicated that they do not intend to raise the Bank of England Base Rate until the unemployment rate has fallen to a threshold of 7%, subject to certain conditions.

The regulatory environment in which the Group operates continues to evolve. Key changes, all of which the Group is responding to, include:

- The formal separation of the previous Financial Services Authority into the PRA and the FCA, which took place with effect from 1 April 2013. This has led to a strengthening of regulatory scrutiny across matters relating to prudential and conduct risk. In particular, the PRA issued in August 2013 its consultation paper on how it proposes to implement in the UK the European Union's reforms to capital and risk management (Capital Requirements Directive IV) with effect from 1 January 2014. The FCA has also issued a number of changes and publications including new rules for packaged bank accounts and the publication of a Policy Statement setting out the new rules for the mortgage market, as well as conducting 'themed reviews' into areas such as PPI complaint handling.

* This is the Clydesdale Bank PLC full time equivalent ("FTE"). UK Banking (as defined in note 4) has 7,013 FTEs which includes employees working within other National Australia Group Europe Limited subsidiaries who provide support services to the Group.

Strategic report (continued)

Our operating environment (continued)

- A range of political and governmental developments have occurred, including the publication of the Parliamentary Commission on Banking Standards' final report, 'Changing Banking For Good', which contained a range of recommendations and observations relating to the governance, accountability, competition and regulatory powers of UK banks. The UK Government is in the process of incorporating the results of this work, as well as the previous report from the Independent Commission on Banking, into its Banking Reform Bill ("BRB"), which is scheduled for passage into law in 2014.

- The UK Government has also put in place a range of mechanisms to improve consumer and business access to credit or other financial services. These include the 'New Buy' scheme (which provided an equity loan worth up to 20% of the value of a new build home, repayable at any time or once the home is sold). This has subsequently been extended into a 'Help to Buy' scheme which is a mortgage guarantee scheme for lenders who offer mortgages to households with a deposit between 5% and 20% on homes with a value up to £600,000. Support for business oriented lending has also been made available through mechanisms such as the 'Funding For Lending Scheme'.

Our goal and strategic priorities

The Group's business model and operating environment shape its overall strategic objective: to be a strong, customer-focused bank for the communities it serves.

To achieve this, the Group is pursuing four strategic priorities:

1. Putting the customer at the heart of our business

The customer is rightly at the heart of everything we do as an organisation.

During the course of the year, we have made improvements in the experience that we offer to our customers. This has ranged from specific initiatives to improve the offer to our customers around the introduction of mobile banking, the launch of an innovative 'low start' mortgage product to support first time home buyers, to participation in key industry wide projects such as the Current Account Switching Scheme. We have also addressed a range of legacy conduct issues during the year. A major part of strengthening our relationship with existing customers, as well as focussing on how we can make an attractive offering to new and potential customers, has centred on re-launching our presence with our "We Care About Here" branding, reflecting our belief that we can and do make a positive difference to communities, businesses and individuals around us.

2. Embedding strong management of risk and controls

The Group has strengthened its overall risk and control framework in recent years, and will continue to do so, to ensure that material risks which it faces are appropriately managed in light of the increasing expectations of all stakeholders.

Central to this work has been to clearly embed the accountability for and ownership of risk management across each of our 'three lines of defence': the operating business units (the 'first line'), the risk function (the 'second line') and Internal Audit (the 'third line'). As part of this, our various risk and control functions have been restructured and strengthened across each of these three lines of defence.

In addition, the Group continues to build on the relationship it has with its primary UK Regulators; the PRA and the FCA.

Further information about the Group's approach to management of risk can be found in note 40.

Strategic report (continued)

Our goal and strategic priorities (continued)

3. Building sustainable returns

While there will continue to be challenges from an economic, regulatory and legacy conduct perspective, the Group aims to deliver appropriate returns through controlled and efficient growth of its Retail and Business & Private Banking franchises within agreed risk appetite parameters.

A range of strategic initiatives have been completed over the past year to give effect to this strategy. The vast majority of the Group's commercial real estate ("CRE") assets were transferred to our parent, NAB on 5 October 2012. The business has also been significantly simplified to focus on providing support to our customers in our heartland regions of Scotland and the North of England, as well as to selected groups of other customers that have been acquired through third party and direct channels. This refocusing of our business has resulted in 1,400 FTE leaving our Group since September 2011. This restructuring and refocusing has been substantially completed a year ahead of schedule.

4. Engagement and enablement

The three strategic priorities outlined above can only be delivered if our people are motivated and equipped to give their best. Key to this is knowing and understanding what they think about the Group as an employer and as a place to work. To do this, the Group undertakes an annual "Speak Up Step Up" (SUSU) survey, which asks a range of questions to gauge how our employees are engaged with the Group and what the Group can do to enable them going forward.

The recent SUSU results were pleasing taking into consideration the context of significant change. 82% of employees responded to the voluntary survey. Whilst the measure of engagement changed in 2013, a like for like comparison using the previous measure showed an overall improvement from the previous year. In particular employee advocacy, pride, and motivation to go beyond what is expected had all improved, supported by positive results for questions relating to People Leaders' actions and behaviours. The results also indicated a very strong customer focus and a similar risk and compliance culture across out staff. The Group will continue to proactively work on the insights that come from SUSU so as to understand and act on the areas where improvements can be made.

Strategic report (continued)

Our goal and strategic priorities (continued)

The following table highlights our progress to date (as at 30 September 2013) in relation to the key performance indicators ("KPI") that we have identified to measure progress against our strategic goals:

Priority	***Strategic goal***	***KPI***	***Comments***
The Customer	"We Care About Here" is how we put customers at the heart of our business. We listen to customers to learn how to become a better bank, act in a way that shows we are all accountable to them, and design every product and service to meet their expectations.	Net promoter score	The Group's brand has been successfully relaunched in 2013. New product development, particularly in the area of mortgages and current accounts, has met with an encouraging customer response.
Risk & Control Framework	Embed a strong risk culture in our staff that consistently delivers the right customer outcomes and take informed risk and reward decisions that maintain the financial strength of the Group while protecting our customers, staff, assets and earnings.	Adherence to risk appetite settings	The Group is broadly operating within its credit and operational risk tolerances. However, legacy conduct related matters and the regulatory (prudential and conduct) change agenda continue to impact this KPI.
Sustainable Returns	Meet capital, liquidity and funding ratios within risk appetite while returning the UK business to sustainable profit and return on equity measures. Through the execution of detailed strategic initiatives, targets for capital, funding, liquidity and cash earnings will be achieved and deliver sustainable and satisfactory returns to shareholders.	Capital, liquidity, and funding ratios, together with a sustainable profit and return on equity	Financial measures continue to demonstrate progress (see pages 8, 12 and 15), but are affected by legacy conduct issues and will also be impacted by the implementation of CRD IV in future years. Balance sheet settings remain under review as the regulatory and environmental conditions change.
People	Provide a compelling employee proposition that motivates, equips and rewards staff and encourages appropriate behaviours; demonstrated through increased employee satisfaction and our ability to develop / attract talent.	Employee engagement survey scores	The Group restructuring continued during 2013 and whilst this impacted on engagement, some progress was achieved. Recruiting, retaining and developing people is one of the Bank's key priorities following this period of intense change.

Strategic report (continued)

Financial analysis

The statutory result improved over the previous year, from a loss of £470m in 2012, to a loss of £27m in 2013.

Underlying performance has improved significantly, with a £573m improvement in profit before tax, restructuring expenses, pension scheme reforms benefit, PPI redress expense, FSCS levy and bank levy to £108m in 2013, from an equivalent loss of £465m in 2012. Completing the strategic re-focussing of our business has resulted in a material decrease in impairment losses on credit exposures and a reduction in underlying expenses. At a statutory profit level, performance has been offset by the impact of dealing with legacy conduct matters.

The balance sheet reflects the results of our strategic refocus with an increase in the Tier 1 capital ratio to 12.0% (from 9.6% at 30 September 2012) primarily driven by the impact of the UK CRE transfer and subsequent reduction in credit risk weighted assets.

	2013 **£m**	2012 £m	2013 vs 2012 %
Net interest income	**756**	869	(13.0%)
Non-interest income	**54**	128	(57.7%)
Total operating income	**810**	997	(18.7%)
Total operating expenses	**(699)**	(874)	20.1%
Operating profit before impairment losses	**111**	123	(9.4%)
Impairment losses on credit exposures [1]	**(144)**	(737)	80.4%
Loss on ordinary activities before tax	**(33)**	(614)	94.7%
Analysed as:			
Profit/(loss) before tax, restructuring expenses, pension scheme reforms benefit, Payment Protection Insurance redress expense, FSCS levy and bank levy	**108**	(465)	
Restructuring expenses	**-**	(149)	
Pension scheme reforms benefit	**-**	130	
Payment Protection Insurance redress expense	**(130)**	(120)	
FSCS levy and bank levy	**(11)**	(10)	
Loss on ordinary activities before tax	**(33)**	(614)	
Tax credit	**6**	144	
Loss attributable to equity holders	**(27)**	(470)	

(1) Impairment provisions and impairment losses on credit exposures relate solely to loans and advances to customers (see notes 15 and 16 to the financial statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in fair value assets within non-interest income (see note 6 to the financial statements).

Key measures

	2013	2012	2013 vs 2012
Net interest margin	**2.14%**	2.05%	9 bps
Cost to income ratio [2]	**86.2%**	83.6%	(260 bps)
Gross loans and acceptances [3] [4] (£bn)	**27.1**	33.6	(19.4)%
Interest earning assets [3] (£bn)	**35.3**	42.4	(16.7)%
Total assets [3] (£bn)	**37.7**	45.2	(16.5)%
Customer deposits [3] [5] (£bn)	**24.2**	24.6	(1.9)%

(2) 30 September 2012 has been adjusted to exclude the impacts of the pension scheme reforms benefit and restructuring expenses of £130m and £149m respectively.

(3) Average volume.

(4) Gross loans and acceptances include gross loans and advances to customers, loans designated at fair value through profit or loss and amounts due from customers on acceptances. In the year to 30 September 2012, they also include assets held for sale reclassified from these categorisations.

(5) Customer deposits include current accounts, savings accounts, term deposits and business deposits.

Financial analysis (continued)

September 2013 v September 2012

Net interest income decreased by £113m (13.0%). The key driver in this reduction was lower business lending income as a result of the NAB UK CRE transfer. Lower returns on non-interest bearing deposits and capital were also contributory factors. In addition, there was an increase in the Financial Services Compensation Scheme (“FSCS”) levy in the year. These were partially offset by higher mortgage lending income, reflecting growth in this product.

Average gross loans and acceptances, which incorporate loans accounted for at fair value, decreased by £6.5bn (19.4%) to £27.1bn. There was a £7.1bn reduction in business lending balances primarily due to the NAB UK CRE transfer. Excluding this impact, business lending attrition continued, reflecting risk appetite and the impact of negative system growth. These impacts were partially offset by housing lending growth of 7.5% which was significantly higher than system growth of 1.0%*.

Average customer deposits decreased by £0.4bn or 1.9%. This reflected the managed rebalancing of the retail deposit book following the NAB UK CRE transfer.

The net interest margin increased by 9bps to 2.14% (2.05%). This was driven by higher lending margins, an improvement in the retail deposit mix and the impact of the NAB UK CRE transfer.

Non-interest income decreased by £74m (57.7%). The key drivers in this reduction were the impact on fees and commissions of subdued economic activity and lower insurance income resulting from the restructuring of the Wealth Management business. The prior year included £130m of pensions reforms benefit that did not recur in 2013. The Payment Protection Insurance redress expense of £130m (2012: £120m) was netted against non-interest income.

Operating expenses decreased by £175m (20.1%) over the prior year. The prior year included £149m of restructuring costs. Costs related to legacy conduct related matters continue to have an impact on expenses, with £50m (2012: £23m) of additional provisions charged in the year. Excluding these, underlying operating expenses decreased by £53m or 7.6%. Delivery of efficiency initiatives has reduced personnel costs, with planned FTE savings ahead of schedule. Occupancy costs were also lower due to the closure of Business Banking centres. This was partly offset by higher marketing costs relating to re-investment in the brand and normalisation of performance related remuneration.

Impairment losses on credit exposures have decreased by £593m (80.4%) over the prior year. The reduction was primarily driven by the transfer of NAB UK CRE assets. Excluding this, charges on the remaining business lending book amount to £102m, in line with the prior year. Housing lending loss rates are stable with unsecured retail lending losses continuing to fall as a result of improvements in delinquency rates.

Investment spend

The Group continues to maintain its investment in the business with the spend focused on regulatory and compliance, efficiency and simplification, and revenue generation categories.

Key achievements during the year included the successful implementation of the Current Account Switching Scheme that went live in September, improved fraud protection on Retail Internet Banking, the launch of our Mobile App in July and the refresh and upgrade of our Payments Infrastructure.

Significant progress was also made on projects that will upgrade the mortgage processing platform, refresh and upgrade the employee IT infrastructure and enhance our online channel.

* Source: Bank of England – September 2013.

Strategic report (continued)

Asset quality

Provisions on credit exposures (£m)	2013	2012
Specific provision for doubtful debts (1)	134	404
Collective provision for doubtful debts (1)	155	354

Credit risk adjustments on loans at fair value (£m)	2013	2012
Individually assessed credit risk adjustments on loans at fair value (1)	23	42
Collectively assessed credit risk adjustments on loans at fair value (1)	54	126

Past due and impaired assets (£m)	2013	2012
90+ Days Past Due ("DPD") assets (1)	157	322
Gross impaired assets (2) (5)	426	1,294

Asset quality measures (%)	2013	2012
90+ DPD plus gross impaired assets to gross loans and acceptances (2)	2.20%	4.86%
Specific provision to gross impaired assets (2)	36.7%	34.4%
Net write-offs to gross loans and acceptances	0.57%	1.05%
Total provision as a percentage of net write-offs (3)	239%	265%
Total provision to gross loans and acceptances (3)	1.38%	2.78%
Impairment losses on credit exposures to credit risk-weighted assets	0.80%	2.62%

Impairment provisions on credit exposures (£m) (4)	2013	2012
Business lending	221	691
Retail lending	68	67
	289	758

Impairment losses on credit exposures	2013 £m	2012 £m
Business lending	102	698
Retail lending	42	39
	144	737
Of which:		
Specific	163	627
Collective	(19)	110
	144	737

(1) Balances at 30 September 2012 include amounts associated with assets classified as held for sale.

(2) Gross impaired assets for September 2013 and September 2012 include £63m and £109m gross impaired fair value assets respectively.

(3) Total provision to gross loans and acceptances / net write-offs includes the credit risk adjustments on loans at fair value through profit or loss.

(4) Impairment provisions on loans and advances include provisions in respect of assets held for sale at 30 September 2012.

(5) 30 September 2012 includes £842m in respect of assets held for sale.

Economic and market conditions have stabilised through the second half of the 2013 year with growth prospects in the UK improving, albeit from a low base.

Retail asset quality was stable with lower default rates observed across all unsecured lending. Housing lending impaired loan levels have remained subdued.

Asset quality (continued)

The total 90+ DPD balances continued to fall to £157m as at 30 September 2013, compared with £322m at 30 September 2012. There has been a stabilisation in the asset quality of the portfolio. The 90+DPD levels for housing lending and the unsecured portfolios have continued to improve through the 12 months to September 2013. However, the portfolio remains sensitive to economic conditions with the balance of non-retail 90+DPD falling, yet remaining higher than the long-term trend.

The level of gross impaired assets has fallen to £426m in the year to September 2013. This follows a period of stability in the non-retail portfolio resulting in a reduced level of impaired balances.

The overall collective provision for doubtful debts decreased, reflecting the reduction in the business lending portfolio and improvement in overall asset quality.

The personal lending collective provision has also decreased driven by the improved delinquency profile of these portfolios.

The ratio of total provisions to gross loans and acceptances has decreased to 1.38% at 30 September 2013. The movement in the ratio reflects the lower risk profile of the book, with a reduced business lending portfolio and growth in the housing lending portfolio which has a lower provisioning requirement.

Capital position

The Clydesdale Bank PLC Core Tier 1 ratio (on a UK Prudential Regulation Authority basis) increased from 8.4% in September 2012 to 10.5% in September 2013 and the Tier 1 ratio increased from 9.6% to 12.0%. This was predominantly due to the impact of the NAB UK CRE transfer and the subsequent reduction in risk-weighted assets ("RWAs").

Regulatory capital

Tier 1 capital	**2013 £m**	2012 £m
Permanent share capital	**1,442**	1,442
Profit and loss and other reserves	**393**	475
Share premium account	**243**	243
Pension fund regulatory adjustments (1)	**2**	73
Perpetual non-cumulative preference shares	**300**	300
Deductions from Tier 1 capital	**(3)**	(2)
Total Tier 1 capital after deductions	**2,377**	2,531
Tier 2 capital		
Upper Tier 2 capital		
Revaluation reserves	**2**	1
General/collective provisions (2)	**155**	330
	157	331
Lower Tier 2 capital		
Undated subordinated debt	**1,076**	1,076
Deductions from Tier 2 capital	**(3)**	(2)
Total Tier 2 capital after deductions	**1,230**	1,405
Total capital after deductions (3)	**3,607**	3,936

Strategic report (continued)

Capital position (continued)

Risk-weighted assets [4]	2013 £m	2012 £m
Retail mortgages	**6,319**	6,139
Business lending	**9,674**	15,758
Other retail lending	**1,071**	1,104
Other lending	**842**	1,133
Credit risk	**17,906**	24,134
Operational risk	**1,650**	1,872
Counterparty risk	**170**	370
Market risk	**1**	1
	19,727	26,377

Capital ratios		
Core Tier 1 ratio [5]	**10.5%**	8.4%
Tier 1 ratio	**12.0%**	9.6%
Total capital ratio	**18.3%**	14.9%

(1) For regulatory capital purposes, the pension fund deficit is added back to regulatory capital and substituted with an estimate of additional pension fund contributions to be made over the next five years, adjusted for deferred tax.

(2) The collective provision add back is limited for regulatory capital purposes.

(3) There is no Tier 3 capital.

(4) Risk weighted assets are calculated under the standardised approach.

(5) Core Tier 1 capital is Tier 1 capital excluding perpetual non-cumulative preference shares.

Regulatory capital to statutory total equity reconciliation	2013 £m	2012 £m
Regulatory Tier 1 capital	**2,377**	2,531
Reverse pension regulatory adjustments	**(2)**	(73)
Reverse deductions from capital	**3**	2
Share option reserve	**2**	5
Asset revaluation reserve	**2**	1
Available for sale reserve	**5**	12
Cash flow hedge reserve	**23**	124
SPE reserves	**-**	2
Statutory total equity	**2,410**	2,604

Minimum Pillar 1 capital requirements	2013 £m	2012 £m
Credit risk	**1,432**	1,931
Operational risk	**132**	150
Counterparty risk	**14**	30
Market risk	**-**	-
Tier 1 regulatory capital	**1,578**	2,111

Capital position (continued)

Regulatory capital flow of funds	2013 £m	2012 £m
Tier 1		
Tier 1 capital at 1 October	**2,531**	2,823
Share capital issuance	**-**	500
Profit and loss and other reserves	**(82)**	(761)
Pension deficit adjustment	**(71)**	(31)
Tier 1 deductions	**(1)**	-
Total Tier 1 capital after deductions	**2,377**	2,531
Tier 2		
Tier 2 capital at 1 October	**1,405**	1,519
Subordinated debt redemption	**-**	(200)
Asset revaluation reserve	**1**	(1)
Collective provision	**(175)**	87
Tier 2 deductions	**(1)**	-
Total Tier 2 capital after deductions	**1,230**	1,405
Total capital after deductions	**3,607**	3,936

Strategic report (continued)

Capital position (continued)

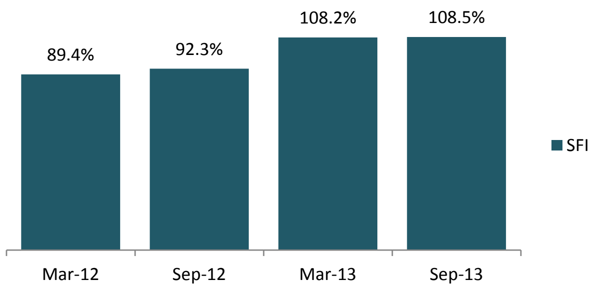
Capital requirements for calculating RWAs	At 30 September 2013 Capital required £m	RWA £m	Exposure £m
Central Governments or Central Banks	-	-	6,344
Regional Governments or Local Authorities	2	25	106
Multilateral development banks	-	-	100
Institutions	6	72	241
Corporates			
Term lending - Business	157	1,957	2,008
Other lending	141	1,762	1,762
Overdrafts	36	453	453
Lease	34	428	428
	368	4,600	4,651
Retail			
Term lending - Retail	44	550	733
Credit cards	23	290	387
Other unsecured including overdrafts	15	189	252
	82	1,029	1,372
Secured by mortgages on residential property			
Mortgages	493	6,164	16,688
Term lending - Business	85	1,065	1,627
	578	7,229	18,315
Secured by mortgages on commercial real estate			
Term lending - Business	241	3,013	3,013
Overdrafts	62	777	777
	303	3,790	3,790
Past due items	32	396	336
Short term claims on institutions and corporates	2	24	122
Collective investments undertakings	-	3	3
Other	59	738	2,213
	1,432	**17,906**	**37,593**
Operational risk	132	1,650	
Counterparty risk	14	170	
Market risk	-	1	
	1,578	**19,727**	

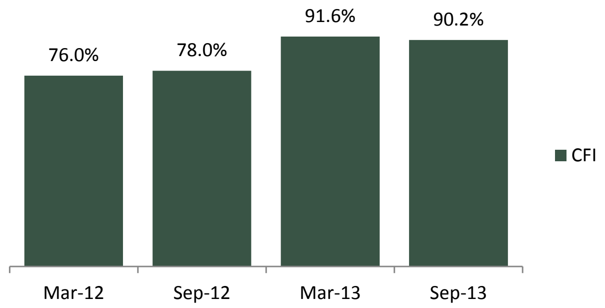
The 'Exposure' amounts disclosed above are post Credit Risk Mitigation and Credit Conversion Factors having been applied where applicable.

Strategic report (continued)

Funding and liquidity

Stable funding and customer funding indices





The year on year improvement in the Group's funding indices was primarily due to the impact of the NAB UK CRE transfer, offset by the impact of reducing higher cost term deposits. The Customer Funding Index ("CFI") increased from 78.0% to 90.2% and the Stable Funding Index ("SFI") increased from 92.3% to 108.5%.

The Group has maintained its ability to raise term funding with the Covered Bond and Securitisation programmes, and remains diversified in terms of the type of instrument and product, currency, counterparty, term structure and market that make up its wholesale funding base.

At 30 September 2012 the Group's long-term senior debt and short-term senior debt credit ratings were as follows: Moody's as A2 / P-1 (stable outlook); S&P BBB+ / A-2 (positive outlook) and Fitch A / F1 (stable outlook). On 30 July 2013 Standard & Poor's maintained the Group's ratings but revised the outlook to negative in line with other UK banks. On 14 August 2013 Fitch affirmed the Group's ratings and outlook at A / F1 (stable outlook). On 23 August 2013 Moody's downgraded the Group's long-term rating to Baa2 and short-term rating to P-2 while maintaining a stable outlook.

The Group's long-term credit ratings are summarised below:

	Outlook as at 21 November 2013	**2013**	2012
Fitch	**Stable**	**A**	A
Moody's	**Stable**	**Baa2**	A2
Standard & Poor's	**Negative**	**BBB+**	BBB+

Liquid reserve	**2013 £m**
Cash and balances with central banks	**6,715**
Encumbered cash balances	**(2,161)**
	4,554
Investments – available for sale	**973**
Encumbered AFS investments	**(268)**
	705
Total unencumbered liquid assets	**5,259**

In addition to the above, as at 30 September 2013, the Bank had £3.2bn gross of eligible collateral pre-positioned with the Bank of England for potential use in their liquidity facilities.

Strategic report (continued)

Funding and liquidity (continued)

	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,161	4,554	6,715
Investments – available for sale	268	705	973
Loans and advances to customers	7,585	16,310	23,895
	10,014	**21,569**	**31,583**

Encumbered cash and balances with central banks	
Note cover	2,118
Cash ratio deposit	43
	2,161
Encumbered investments – available for sale	
Payment system collateral (1)	217
Repurchase ("repo") transaction collateral (1)	51
	268
Encumbered loans and advances to customers	
Structured Programme collateral – Lanark Master Trust	3,091
Structured Programme collateral – Structured Covered Bond (SLS)	747
Structured Programme collateral – Regulated Covered Bond	2,004
Structured Programme collateral – Lannraig Master Trust	1,743
	7,585

(1) Market value of securities posted as collateral.

	2013 £bn	2012 £bn
UK Government Treasury Bills and Gilts	**0.9**	0.9
Cash and cash at central bank	**4.6**	6.1
Note cover *	**2.1**	1.8
Interbank lending	**0.3**	0.1
Liquid assets	**7.9**	8.9

***** Note cover is excluded from PRA regulatory liquidity.

The Group has reduced its holding of highly liquid assets during the year due to reduced reliance on short-term wholesale funding.

The Group continues to hold £100m of floating rate notes issued by the European Investment Bank and has no direct exposure to any Eurozone Sovereigns as part of its liquidity portfolio.

Customers, employees and community

The Group continues to support its customers and the communities it serves.

The Yorkshire and Clydesdale Bank Foundation provides financial support to a large number of charities across the UK. In the last 12 months the Foundation has distributed over £825,000 to over 480 worthy causes, including £250,000 for the Spirit of the Community Awards. The Spirit of the Community Awards were launched in February 2013 with donations made to charities across England and Scotland in July and August 2013. This included a one-off donation of £175,000 in recognition of Clydesdale Bank's 175th anniversary. The charity partnership with Help the Hospices is now in its sixth year and over £3m has been raised in this time, including matching donations from the Group. In addition, 20% of employees currently donate to their chosen charities through Payroll Giving and the Group's Employee Volunteering Policy offers all employees the opportunity to take two days paid leave to work in the local community.

During the year, the Group won two "Your Mortgage" Awards, with Yorkshire Bank named "Best Regional Mortgage Lender" for the fourteenth time overall and Clydesdale Bank named "Best Mortgage Lender in Scotland" for the ninth consecutive year. The Group also won a "Moneyfacts" award for "Best Personal Loan Provider".

Business model challenges and top and emerging risks

The primary areas of risk to the Group's business model areas are outlined below. Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the Group's risk appetite statement ('RAS') process. The position against the various RAS settings is monitored and reported to the Group's various management and Board governance committees as set out in note 40 to the financial statements.

- *Credit risk*: this is the risk of financial loss if a customer or counterparty fails to meet their contractual payments. This risk applies to both customer facing segments of the business (Retail and Business & Private Bank) as well as our treasury operations and is continually assessed as the Group's business and key initiatives evolve. Bank lending activities account for most of the Group's credit risk, with a strategic focus on managing the acceptance of a range of potential credit risk exposures. Further detail on the Group's approach to the management of credit risk is included in note 39 to the financial statements;
- *Conduct risk*: this is the risk that the Group's behaviours (culture, governance, systems and controls) lead to inappropriate outcomes for customers, exposing the Group to customer redress costs and the potential for regulatory action. The Group, in common with the rest of the financial services industry, has faced a number of conduct risk challenges in relation to a range of industry wide issues including PPI and Interest Rate Hedging Products. The Group continues to review these challenges in light of on-going customer and regulatory feedback and action. The Group continues to address legacy conduct related matters and is also reviewing new product designs, sales practices, remuneration policies and other offerings to ensure the potential for future conduct related issues is mitigated. Further detail on the Group's approach and exposures to conduct risk related matters can be found in notes 3, 27, 33 and 40 to the financial statements;
- *Operational risk (excluding conduct risk):* this is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The Group regards operational risks as a core component of doing business as they arise from day-to-day operational activities as well as from organisational changes such as projects and business change initiatives. The Group has focused on improving these areas over recent years with an emphasis on control effectiveness and improvements in the control environment (processes), enhancing skills and appropriate resource allocation (people) and improvements in system resilience and availability. An important constituent part of operational risk is service interruption. The Group recognises the impact that any service interruption issues may cause to our customers and continues to assess and manage its current technical systems landscape and to develop contingency plans to manage and mitigate this risk;
- *Pension risk*: the Group is the sponsoring employer in one defined benefit pension scheme ("the Scheme") and is exposed to the risk that, at any point in time, the Scheme is in deficit (i.e. the Scheme's liabilities outweigh its assets). The Scheme's asset values and liabilities are affected by a number of factors including, but not limited to, the discount rate used to calculate the liability net present value, the long-term inflation assumption and other actuarial assumptions (including mortality rates). The Group has implemented a number of reforms in order to de-risk, as far as possible, the ultimate defined benefit pension obligation and liaises with the Scheme's independent Trustees and actuaries on a regular basis to assess the current liability estimate. Nevertheless, the Scheme exposes the Group to substantial future liabilities and is a significant absorber of capital. Further detail on the Scheme (including the actuarial assumptions) is included in note 29 to the financial statements; and

Strategic report (continued)

Business model challenges and top and emerging risks (continued)

- *Financial management risk*: this falls into 3 broad categories:
  - *Capital risk:* this is the risk that the Group does not hold sufficient capital and reserves to meet regulatory requirements, achieve its strategic plans and objectives, or to cover the risks to which it is already exposed and to protect against unexpected losses. Changes in regulation have the potential to change the required level of capital that the Group is required to hold which may adversely impact the Group's financial performance and position;
  - *Funding and liquidity risk:* these are the risks that the Group is unable to raise short and long-term funding to support its strategic plans and objectives and is unable to meet its financial obligations as they fall due. The Group continues to improve its stable and customer funding indices, holds significant highly liquid assets and maintains the ability to access term funding through its Securitisation and Covered Bond programmes; and
  - *Interest rate risk:* this is the risk to the Group's financial performance and position caused by changes in interest rates. As interest rates and yield curves change over time, the Group may be exposed to a loss in earnings and economic value due to the interest rate profile of its balance sheet. The Group actively monitors and manages interest rate risk principally through the use of interest rate swaps.

Further detail on the risks the Group faces and how these are managed is included in note 40 to the financial statements.

The Group scans the environment in which it operates to identify those emerging risks that can have an impact on how it operates from a strategic, operational and financial perspective. The Group currently considers its top emerging risks to be:

- *The UK economy:* while the UK economic recovery is currently gaining momentum it remains fragile. The Group's future plans are linked to the UK economy achieving a current and prolonged period of economic growth and ultimately, in the medium term, to a resumption of more normalised interest rate conditions. Government initiatives such as the "Help to Buy" scheme may help to stimulate this economic growth.
- *The changing financial industry landscape:* the Group is subject to extensive regulation and changes to this may adversely impact the Group's financial performance and position. Regulations are designed to protect the interests of depositors and the banking and financial services system as a whole. Future changes in laws, regulations and other industry wide initiatives are unpredictable and beyond the Group's control and could adversely affect its business and operations. These changes are influenced by a number of different and competing drivers including evolving stakeholder expectations regarding transparency, competition, financial system stability and international harmonisation.
- *Competition:* there is substantial competition in the UK banking market. Increased competition for customers can have the effect of compressing profit margins, changing terms and conditions, increasing advertising and related expenses to attract and retain customers, increasing customer turnover, decreasing customer loyalty or driving loss of market share. As technology and customer attitudes are rapidly evolving, this increases the risk of competition from new business entrants and the cost of doing business.

The risks and challenges identified in the Strategic Report do not represent an exhaustive list of the risks and issues associated with the Group. Other risks and issues not specifically referenced may adversely impact the future financial position and performance of the Group. Accordingly, no assurances or guarantees of future performance, profitability or returns on capital are given by the Group.

The Strategic Report was approved by the Board of Directors on 21 November 2013 and was signed on its behalf by:

D Thorburn.

David Thorburn
Chief Executive Officer

Enhanced risk disclosure

In October 2012, the Enhanced Disclosures Task Force ("EDTF"), an industry-led initiative, reported to the Financial Stability Board on how the risk disclosures of banks could be improved to provide a greater level of transparency as well as improving comparability between banks. Their report included seven fundamental principles and 32 recommendations. The recommendations cover the following broad headings:

- general (recommendations 1 to 4);
- risk governance and risk management strategies/business model (recommendations 5 to 8);
- capital adequacy and risk-weighted assets (recommendations 9 to 17);
- liquidity and funding (recommendations 18 to 21);
- market risk (recommendations 22 to 25);
- credit risk (recommendations 26 to 30); and
- other risks (recommendations 31 to 32).

The EDTF noted that the fundamental principles are applicable to all banks but noted: "We have developed the recommendations for enhanced risk disclosures with large international banks in mind although they should be equally applicable to banks that actively access the major public equity or debt markets. We believe that many of the recommendations may be adopted in 2012 or 2013. However, some recommendations… will take longer to develop and implement... We would expect smaller banks and the subsidiaries of listed banks will adopt only those aspects of the recommendations that are relevant to them." In June this year the Financial Policy Committee ("FPC") made a recommendation that all major UK banks and building societies should comply with the recommendations on a 'comply or explain' basis, under Section 9Q(3) of the Bank of England Act 1998 (as amended by the Financial Services Act 2012).

The Group agrees with and supports the primary objectives of the EDTF and is committed to ensuring compliance with the EDTF's principles and recommendations where possible against the backdrop of the Group's ownership, its position within the UK market and the globally systemic reach of the EDTF's objectives and aims noting the more recent pronouncement of the FPC.

The Group already provides risk disclosures in accordance with International Financial Reporting Standards which can be found in notes 39, 40 and 41 to the financial statements, with the appropriate cross references made between these notes and the relevant EDTF recommendation as necessary to avoid duplicating information.

In its full year Risk and Capital Report for the year ended 30 September 2012, our ultimate Parent, National Australia Bank Limited, described Clydesdale Bank PLC, as its subsidiary in the United Kingdom, who at that time was regulated by the Financial Services Authority (FSA) and had been accredited to apply the standardised approach to operational and credit risk management in accordance with regulatory requirements. Additionally, the Bank has a waiver direction as described in note 42 to the financial statements and as such is not required to prepare any separate Pillar 3 disclosures. All such disclosures are made within our ultimate Parent's Risk and Capital Report as noted above. The PRA has indicated to the Bank that this waiver will expire on 1 January 2014. The options for satisfying future disclosure obligations are being reviewed by the Group.

Accordingly, in assessing the EDTF's recommendations, the Bank has taken all of these factors into consideration and applied a measured and proportionate approach with the recommended disclosures. We have applied those recommendations we believe are of more direct relevance to our position as a wholly owned subsidiary applying a standardised approach to operational and credit risk management. The additional disclosures included are designed to increase the reader's understanding of our financial position and risk governance and management.

The table and disclosures from pages 121 to 129 provide a brief description of the EDTF recommendations with the accompanying narrative cross referring to other disclosures provided in the financial statements (where relevant) and/or the additional detail (both quantitative and qualitative where necessary) we believe satisfy the EDTF requirements.

Report of the Directors

The Directors of the Bank with its subsidiary undertakings (which together comprise the "Group") submit their report and consolidated financial statements for the year ended 30 September 2013.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2013 was £33m (2012: loss of £614m). The loss attributable to the shareholders for the year ended 30 September 2013 amounted to £27m (2012: loss of £470m). Preference share dividends of £24m (2012: £15m) were paid during the year. The Directors do not recommend the payment of a final dividend on the ordinary shares in respect of this financial year (2012: £Nil).

The Group's strategic highlights and business developments are set out in the Strategic Report on pages 4 to 18.

Financial instruments

The Group's risk management objectives and policies are discussed in note 40.

Directors and Directors' interests

The current Directors are shown on page 1. Directors who are not full-time employees of the Group or a related body corporate are appointed in accordance with the Articles of Association and may be eligible for reappointment thereafter. No Directors retired by rotation during the year.

Directors' interests

No Director had any interest in the shares of the Group or its subsidiaries at any time during the year. As the Group is a wholly owned subsidiary of NAB, any interest which the Directors may have in NAB does not need to be notified to the Group, and therefore is not disclosed in this report.

Directors' liabilities

During the year, the NAB Group paid a premium for a contract insuring the Directors and Officers of NAB, its subsidiaries and controlled entities against personal liabilities which may arise in the course of the performance of their duties, as well as protecting the Group itself to the extent that it is obligated to indemnify Directors and Officers for such liability.

Employee involvement

The Group carries out an information programme to keep staff informed of business objectives and results. This is achieved through regular meetings, conference calls, circulars, bulletins and specially commissioned communications as well as training courses for staff.

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on the market or issue shares which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

During the year, under the UK National Share Incentive Plan, NAB gifted ordinary shares of A$900 in total to each eligible employee based on Group performance in respect of the 2012 financial year. A similar offer for the 2013 financial year has been announced and is based on Group performance.

Equality of employment opportunities

It is the policy of the Group to promote equality of employment opportunities by giving full and fair consideration to applications from people with disabilities. If existing employees become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled employees.

The Group is authorised as a "two tick" symbol user by Jobcentre Plus. The disability symbol is a recognition given by Jobcentre Plus to employers who have agreed to take action to meet five commitments regarding the employment, retention, training and career development of disabled employees, and to continually review progress and improve on what they do. Employers who wish to become a symbol user have to evidence they can achieve those commitments in their application.

The introduction of a staff network group and membership of the Business Disability Forum provides an ongoing opportunity for progress by identifying and implementing improvements.

Political donations

No political donations were made during the year (2012: £Nil).

Corporate governance

It is the Group's policy not to include all of the disclosures in respect of voluntary corporate governance Codes of Practice as it is a wholly owned subsidiary of NAB. The NAB Group's Annual Financial Report details the Corporate Governance framework applicable to the Group and its subsidiaries. These disclosures are made after consideration of authoritative pronouncements on Audit Committees and associated disclosures in Australia, the USA, and the UK. Remuneration policy is not the responsibility of the Board. The remuneration policy that applies to employees and Directors of the Group is decided at the NAB Group level.

Management of risk

The Group has a well-established Boards' Risk Committee for the consideration of risks (note 40). The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals. The NAB Group publishes an annual and half-yearly "Risk and Capital Report" which provides extensive and rigorous coverage of all aspects of risk considered relevant including the position in the UK. Further disclosure on the Group's risk management structure in the UK is included in note 40.

Going concern

The Group's Directors have made an assessment of the Group's ability to continue as a going concern and are satisfied that the Group has the resources to continue in business for the foreseeable future.

The Group's use of the going concern basis for preparation of the accounts is discussed in note 1.

Events after the balance sheet date

Subject to the normal regulatory processes, the Directors recommend the payment of a final dividend on the Bank's redeemable preference shares in respect of the financial period of £14m (2012: £Nil).

Auditors

In accordance with section 485 of the Companies Act 2006, a resolution to reappoint Ernst & Young LLP, and to authorise the Directors to fix their remuneration, will be proposed at the next Annual General Meeting.

Directors' statement as to disclosure of information to the auditor

The Directors who were members of the Board at the time of approving the Report of the Directors are listed on page 1. Having made enquiries of fellow Directors and of the Group's auditor, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Group's auditor is unaware; and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditor is aware of that information.

By order of the Board

Jennifer Darbyshire
Joint Company Secretary
21 November 2013

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report and 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 financial statements in accordance with International Financial Reporting Standards (IFRSs) 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 Bank and of the profit or loss of the Group and Bank for that period. In preparing these financial statements the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Group and Bank have complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

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

Jennifer Darbyshire
Joint Company Secretary
21 November 2013

Building a better
working world

Independent auditor's report to the members of Clydesdale Bank PLC

We have audited the financial statements of Clydesdale Bank PLC for the year ended 30 September 2013 which comprise the Consolidated Income Statement, the Group and Bank Statements of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Statements of Cash Flow and the related notes 1 to 43. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Bank'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 Bank'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 Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 23, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group and Bank's affairs as at 30 September 2013 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Bank's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Report of Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

Building a better
working world

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Ernst & Young LLP

Javier Faiz (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
21 November 2013

Notes:

1. The maintenance and integrity of the Clydesdale Bank PLC web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Financial Statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

Consolidated financial statements
Contents

Consolidated income statement
for the year ended 30 September 2013

	Note	2013 £m	2012 £m
Interest income and similar income		**1,209**	1,461
Interest expense and similar charges		**(453)**	(592)
Net interest income	5	**756**	869
Gains less losses on financial instruments at fair value		**(14)**	(123)
Other operating income		**68**	251
Non-interest income	6	**54**	128
Total operating income		**810**	997
Personnel expenses		**(203)**	(225)
Depreciation expense		**(19)**	(19)
Other operating expenses		**(477)**	(481)
Restructuring expenses		**-**	(149)
Total operating expenses before impairment losses	7	**(699)**	(874)
Operating profit before impairment losses		**111**	123
Impairment losses on credit exposures	16	**(144)**	(737)
Loss on ordinary activities before tax		**(33)**	(614)
Analysed as:			
Profit/(loss) before tax, pension scheme reforms benefit, Payment Protection Insurance redress expense, FSCS levy and bank levy		**108**	(614)
Pension scheme reforms benefit	29	**-**	130
Payment Protection Insurance redress expense	27	**(130)**	(120)
FSCS levy and bank levy		**(11)**	(10)
Loss on ordinary activities before tax		**(33)**	(614)
Tax credit	8	**6**	144
Loss for the year attributable to the equity holders of the parent		**(27)**	(470)

All material items dealt with in arriving at the loss before tax for the above periods relate to continuing activities.

The notes on pages 33 to 120 form an integral part of these financial statements.

Statements of comprehensive income
for the year ended 30 September 2013

	Note	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
(Loss)/profit for the year		**(27)**	(470)	**63**	(406)
Items that may be reclassified to the income statement					
Change in cash flow hedge reserve					
(Losses)/gains during the year		**(81)**	2	**(81)**	(4)
Transfers to the income statement		**(51)**	(1)	**(51)**	13
Tax thereon		**31**	3	**31**	1
		(101)	4	**(101)**	10
Change in available for sale investments reserve					
Losses during the year		**(13)**	(1)	**(13)**	(1)
Transfers to the income statement		**-**	(4)	**-**	(2)
Tax thereon		**6**	1	**5**	1
		(7)	(4)	**(8)**	(2)
Total items that may be reclassified to the income statement		**(108)**	-	**(109)**	8
Items that will not be reclassified to the income statement					
Actuarial gains/(losses) on defined benefit pension plans	29	**-**	(344)	**-**	(344)
Restatement in respect of rate change / tax thereon		**(33)**	64	**(33)**	64
		(33)	(280)	**(33)**	(280)
Change in asset revaluation reserve					
Decrement on revaluation		**-**	(1)	**-**	(1)
Restatement in respect of rate change / tax thereon		**1**	-	**1**	-
		1	(1)	**1**	(1)
Total items that will not be reclassified to the income statement		**(32)**	(281)	**(32)**	(281)
Other comprehensive losses net of tax		**(140)**	(281)	**(141)**	(273)
Total comprehensive losses for the period net of tax		**(167)**	(751)	**(78)**	(679)
Attributable to equity holders of the parent		**(167)**	(751)	**(78)**	(679)

The notes on pages 33 to 120 form an integral part of these financial statements.

Balance sheets
as at 30 September 2013

	Note	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Assets					
Cash and balances with central banks	10	**6,715**	7,923	**6,715**	7,923
Due from related entities	11	**1,408**	1,256	**5,941**	5,782
Due from other banks		**184**	14	**184**	13
Investments – available for sale	12	**973**	1,039	**973**	1,039
– held to maturity	12	**-**	-	**1,415**	709
Other financial assets at fair value	13	**2,155**	2,791	**2,155**	2,791
Derivative financial instruments	14	**240**	600	**240**	600
Loans and advances to customers	15	**23,895**	24,346	**19,388**	19,704
Due from customers on acceptances		**4**	7	**4**	7
Current tax assets		**23**	55	**18**	70
Property, plant and equipment	18	**120**	128	**120**	128
Investment properties	19	**63**	77	**63**	77
Property inventory	20	**6**	9	**6**	7
Investments in controlled entities and associates	21	**3**	3	**609**	613
Deferred tax assets	22	**227**	249	**221**	244
Other assets	23	**616**	499	**545**	499
Assets held for sale	24	**-**	5,225	**-**	5,225
Total assets		**36,632**	44,221	**38,597**	45,431
Liabilities					
Due to other banks	25	**521**	557	**521**	557
Other financial liabilities at fair value	13	**120**	147	**120**	147
Derivative financial instruments	14	**663**	952	**566**	881
Due to customers	26	**24,146**	26,381	**24,146**	26,381
Liabilities on acceptances		**4**	7	**4**	7
Provisions	27	**315**	292	**315**	290
Due to related entities	11	**2,850**	7,527	**6,931**	11,008
Bonds, notes and subordinated debt	28	**3,071**	3,163	**1,096**	1,084
Retirement benefit obligations	29	**202**	306	**202**	306
Deferred tax liabilities	22	**7**	21	**7**	20
Other liabilities	30	**2,323**	2,122	**2,304**	2,118
Liabilities associated with assets held for sale	24	**-**	142	**-**	142
Total liabilities		**34,222**	41,617	**36,212**	42,941
Equity (parent entity interest)					
Share capital	31	**1,742**	1,742	**1,742**	1,742
Share premium	32	**243**	243	**243**	243
Other reserves	32	**370**	480	**370**	481
Retained earnings	32	**55**	139	**30**	24
Total equity		**2,410**	2,604	**2,385**	2,490
Total liabilities and equity		**36,632**	44,221	**38,597**	45,431

The notes on pages 33 to 120 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 21 November 2013 and were signed on its behalf by:

D Thorburn

David Thorburn
Chief Executive Officer

Statements of changes in equity
for the year ended 30 September 2013

Group

	Note	Share capital £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2011		1,242	243	338	14	2	16	120	904	2,879
Loss for the year		-	-	-	-	-	-	-	(470)	(470)
Other comprehensive (losses)/income		-	-	-	-	(1)	(4)	4	(280)	(281)
Total comprehensive (losses)/income for the year		-	-	-	-	(1)	(4)	4	(750)	(751)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(15)	(15)
Shares issued – ordinary	31	500	-	-	-	-	-	-	-	500
Share options expensed		-	-	-	11	-	-	-	-	11
Share options settled		-	-	-	(20)	-	-	-	-	(20)
As at 30 September 2012	31,32	**1,742**	**243**	**338**	**5**	**1**	**12**	**124**	**139**	**2,604**
Loss for the year		-	-	-	-	-	-	-	(27)	(27)
Other comprehensive losses		-	-	-	-	1	(7)	(101)	(33)	(140)
Total comprehensive (losses)/income for the year		-	-	-	-	1	(7)	(101)	(60)	(167)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(24)	(24)
Share options expensed		-	-	-	3	-	-	-	-	3
Share options settled		-	-	-	(6)	-	-	-	-	(6)
As at 30 September 2013	31,32	**1,742**	**243**	**338**	**2**	**2**	**5**	**23**	**55**	**2,410**

The notes on pages 33 to 120 form an integral part of these financial statements.

Statements of changes in equity (continued)
for the year ended 30 September 2013

Bank	Note	Share capital £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2011		1,242	243	338	14	2	15	114	725	2,693
Loss for the year		-	-	-	-		-	-	(406)	(406)
Other comprehensive (losses)/income		-	-	-	-	(1)	(2)	10	(280)	(273)
Total comprehensive (losses)/income for the year		-	-	-	-	(1)	(2)	10	(686)	(679)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(15)	(15)
Shares issued – ordinary	31	500	-	-	-	-	-	-	-	500
Share options expensed		-	-	-	11	-	-	-	-	11
Share options settled		-	-	-	(20)	-	-	-	-	(20)
As at 30 September 2012	31,32	**1,742**	**243**	**338**	**5**	**1**	**13**	**124**	**24**	**2,490**
Profit for the year		-	-	-	-	-	-	-	63	63
Other comprehensive (losses)/income		-	-	-	-	1	(8)	(101)	(33)	(141)
Total comprehensive (losses)/income for the year		-	-	-	-	1	(8)	(101)	30	(78)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(24)	(24)
Share options expensed		-	-	-	3	-	-	-	-	3
Share options settled		-	-	-	(6)	-	-	-	-	(6)
As at 30 September 2013	31,32	**1,742**	**243**	**338**	**2**	**2**	**5**	**23**	**30**	**2,385**

The notes on pages 33 to 120 form an integral part of these financial statements.

Statements of cash flows
for the year ended 30 September 2013

	Note	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Operating activities					
(Loss)/profit on ordinary activities before tax		**(33)**	(614)	**45**	(586)
Adjustments for:					
Non-cash or non-operating items included in (loss)/profit before tax	34	**(583)**	(136)	**(658)**	(137)
Changes in operating assets	34	**6,129**	463	**6,012**	409
Changes in operating liabilities	34	**(2,657)**	(2,172)	**(2,695)**	(2,573)
Interest received		**1,213**	1,563	**1,114**	1,531
Interest paid		**(317)**	(451)	**(316)**	(556)
Tax received		**50**	4	**80**	51
Net cash provided by/(used in) operating activities		**3,802**	(1,343)	**3,582**	(1,861)
Cash flows from investing activities					
Dividends received		**-**	-	**116**	167
Interest received		**8**	12	**8**	13
Proceeds from sale or maturity of investments		**50**	71	**121**	206
Return of subsidiary company capital		**-**	-	**4**	24
Proceeds from sale of tangible fixed assets *		**39**	38	**37**	28
Purchase of tangible fixed assets *		**(32)**	(13)	**(32)**	(15)
Purchase of available for sale investments		**(50)**	-	**(50)**	-
Purchase of held to maturity investments		**-**	-	**(777)**	(144)
Net cash provided by/(used in) investing activities		**15**	108	**(573)**	279
Cash flows from financing activities					
Interest received		**5**	13	**56**	19
Interest paid		**(132)**	(229)	**(133)**	(238)
Proceeds from ordinary shares issued	31	**-**	500	**-**	500
Redemption of subordinated debt		**-**	(200)	**-**	(200)
Maturity of medium term notes		**-**	(1,898)	**-**	(1,898)
Redemption, principal repayment and other movements on residential mortgage backed securities and covered bonds	17	**(613)**	(936)	**-**	(22)
Issuance of residential mortgage backed securities and covered bonds	17	**541**	2,644	**-**	1,096
Net (increase)/decrease in amounts due from related entities		**(152)**	3,694	**(159)**	4,021
Net (decrease)/increase in amounts due to related entities		**(4,846)**	(233)	**(4,246)**	527
Dividends paid	9	**(24)**	(15)	**(24)**	(15)
Net cash (used in)/provided by financing activities		**(5,221)**	3,340	**(4,506)**	3,790
Net (decrease)/increase in cash and cash equivalents		**(1,404)**	2,105	**(1,497)**	2,208
Cash and cash equivalents at the beginning of the year		**7,949**	5,844	**8,042**	5,834
Cash and cash equivalents at the end of the year	34	**6,545**	7,949	**6,545**	8,042

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

The notes on pages 33 to 120 form an integral part of these financial statements.

Notes to the consolidated financial statements

1. Basis of preparation

Reporting entity

The Bank is incorporated in the UK and registered in Scotland. The consolidated financial statements comprise the Bank and its controlled entities (together the "Group"). The Group's principal controlled entities are listed in note 21.

The ultimate parent undertaking, and ultimate controlling party is NAB, a company incorporated in the State of Victoria, Australia. NAB also heads the largest group in which the results of the Group are consolidated. The smallest group in which the results of the Group are consolidated is that headed by the Group's immediate parent, NAGE, which is incorporated and registered in England and Wales.

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with IFRS as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. As permitted by section 408 of the Companies Act 2006, no income statement is presented for the Bank.

The consolidated financial statements of the Group for the year ended 30 September 2013 were authorised for issue by the Board of Directors on 21 November 2013.

Basis of measurement

The financial information has been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment properties, available-for-sale financial assets and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

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. In addition, note 40 to the financial statements includes the Group's risk management objectives and note 41 to the financial statements includes the Group's objectives, policies and processes for managing its capital.

The Group's ultimate parent, NAB, provides funding to the Group in the ordinary course of business. As a consequence, the Directors have a reasonable expectation that the Bank and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

Notes to the consolidated financial statements (continued)

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including special purpose entities ("SPEs")) over which the Group has the power to govern the financial and operating policies so as to obtain economic benefits from their activities. The Group sponsors the formation of SPEs, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well defined objectives. SPEs require consolidation in circumstances such as those where the Group in substance has control over them through access to the majority of the residual income or is exposed to the majority of the residual risk associated with the SPE.

Controlled entities are consolidated from the date on which control is established by the Bank until the date that control ceases. The purchase method of accounting is used to account for the acquisition of controlled entities. Balances and transactions between entities within the Group and any unrealised gains and losses arising from those transactions are eliminated in full upon consolidation. The consolidated financial statements have been prepared using uniform accounting policies and are based on the same accounting period as NAB.

Accounting developments

The Group has not elected to early adopt any new or amended accounting standard or interpretation in the current year.

The following amendments have been adopted in the current financial year. These amendments have not had a material impact on the Group's financial statements.

- *Amendments to IAS 1*, issued 16 June 2011 and effective for financial years beginning on or after 1 July 2012. The amendment sets out enhanced presentation requirements of items of other comprehensive income.
- *Amendments to IAS 12 Income Taxes,* issued 20 December 2010 and effective for financial years beginning on or after 1 January 2012. This amendment enhances the methodology for measuring the effect of deferred tax relating to the recovery of an entity's investment property assets. The impact of this amendment is not considered to be material to the Group.

The following standards and amendments are relevant to the Group and were available for adoption in the European Union, but are not mandatory and have not been applied by the Group in the 30 September 2013 reporting year:

- *Amendments to IAS 19*, issued 16 June 2011 and effective for financial years beginning on or after 1 January 2013. The amendment sets out enhanced disclosures around post-employment benefit plans and removes the option to defer the recognition of gains and losses on these. The Group currently recognises all gains and losses on post-employment benefit plans as they arise. The amendment also introduces a single net interest income/cost on the net asset or liability recognised in the balance sheet, which will replace the interest cost and the expected return on assets, and is measured based on the plan's discount rate. For the Group, this will result in a change to the income statement with a compensating change to other comprehensive income with no overall impact on the Group's reserves.
- *Amendments to IFRS 7 Financial Instruments: Disclosures,* issued 16 December 2011 and effective for financial years beginning on or after 1 January 2013. This amendment places further disclosure requirements on netting arrangements of financial assets and liabilities. The impact of this Amendment is not considered to be material to the Group.

2. Accounting policies (continued)

Accounting developments

- *IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities,* issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013 (with the application date for EU entities being financial years beginning on or after 1 January 2014). The Group will look to early adopt these standards from 1 October 2013 to align with the ultimate parent company as the standards have been adopted by the EU. These are part of a suite of standards covering the amended accounting requirements for consolidations and joint arrangements and their related disclosures. IFRS 10 introduces a single control model to determine which investees should be consolidated. It defines control as consisting of three elements: power, exposure to variable returns and an investor's ability to use power to affect its amount of variable returns. This requires an analysis of all facts and circumstances and the application of judgement in making the control assessment. IFRS 11 introduces a revised model for accounting for joint arrangements. IFRS 12 will not affect any of the amounts recognised in the financial statements, but will require new disclosures about the judgements made by management to determine whether control exists and to require summarised information about these entities. The impact of these standards on initial application is not considered to be material to the Group.
- *IFRS 13 Fair Value Measurement,* issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013. The standard brings together the measurement and disclosures for fair values under the one standard. The standard does not alter the requirements for what should be fair valued but does require some enhanced disclosures around the inputs and valuation techniques to develop fair value measurement. The impact of this standard on initial application is not considered to be material to the Group.
- *Amendments to IAS 32 Financial Instruments: Presentation,* issued 16 December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment provides clarification on the criteria that already exist for offsetting. The impact of this amendment is not considered to be material to the Group.
- *Improvements to IFRSs 2009 – 2011 cycle, issued 17 May 2012 and effective for financial years beginning on or* after 1 January 2013. As part of the IASB's annual improvement process, this makes numerous non-essential changes to accounting standards which are necessary to maintain the overall integrity of financial statements. The impact of these improvements is not considered to be material to the Group.

The following standards, interpretations and amendments are relevant to the Group but were not available for adoption in the European Union and have not been applied by the Group in the 30 September 2013 reporting year:

- *IFRS 9 Financial Instruments* contains new requirements for the classification and measurement of financial assets and liabilities along with new impairment criteria, which will mean calculating the impairment of financial assets on an expected loss basis in contrast to the current incurred loss basis as required by IAS 39. The final phase of IFRS 9 relates to hedge accounting and macro hedge accounting. The hedge accounting section is near finalisation but the macro hedge accounting section will not be finalised until after IFRS 9 is published. The IASB have already agreed that entities will have a policy choice to make in relation to hedge accounting until both sections of hedge accounting under IFRS 9 are finalised. IFRS 9 will introduce significant changes in the way the Group accounts for financial instruments with the full impact on the Group's results still uncertain. The overall impact of IFRS 9 on the Group will become clear when the classification and measurement and impairment requirements are finalised by the IASB. There is currently no definitive effective date for the implementation of IFRS 9 and the Group will continue to monitor the IASB's developments in finalising IFRS 9 and the accompanying EU endorsement process thereafter.
- *IFRIC Interpretation 21 Levies* issued May 2013 and effective for financial years beginning on or after 1 January 2014. The IFRIC addresses the accounting for a liability to pay a levy recognised in accordance with IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets', and the liability to pay a levy whose timing and amount is certain. The Group are assessing the implications of when to adopt the Interpretation. The impact of this interpretation may affect the Group's recognition of the FSCS levy in interim reporting but on initial application is not considered to be material to the Group.
- *IAS 39 Novation of Derivatives and Continuation of Hedge accounting – Narrow Scope Amendment,* issued June 2013 and effective for financial years beginning on or after 1 January 2014. This narrow scope amendment addresses the question around whether hedge accounting can be continued if an entity novates its hedging derivative from one counterparty to a central clearing counterparty as a result of regulatory changes if specific conditions are met. The impact of this narrow scope amendment is not considered to be material to the Group.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Foreign currency

Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in pounds sterling (GBP), which is the Group's functional and presentation currency, rounded to the nearest million pounds sterling (£m) unless otherwise stated.

Transactions and balances

Initially, at the date of a foreign currency transaction, the Group records an asset, liability, expense or revenue arising from a transaction using the end of day spot exchange rate between the functional and foreign currency on the transaction date.

Subsequently, at each reporting date, the Group translates foreign currency monetary items at the closing rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the year in which the gains or losses arise. Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction. Foreign currency non-monetary items measured at fair value will be translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby the associated gains or losses is recognised in the income statement, are also recognised in the income statement.

Revenue recognition

Net interest income

Interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating amortisation using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses.

The calculation of the effective interest rate includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Where it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination and commitment fees are recognised as revenue within the effective interest rate calculation. When the non-utilisation of a commitment fee occurs, this is taken as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Direct loan origination costs are netted against loan origination fees and the net amount recognised as revenue over the life of the loan as an adjustment of yield. All other loan related costs are expensed as incurred.

Fees and commissions

Fees and commissions not integral to the effective interest rate arising from services provided to customers and third parties are recognised once the service has been provided.

2. Accounting policies (continued)

Revenue recognition (continued)

Gains less losses on financial instruments at fair value through profit or loss

Gains less losses on financial instruments at fair value through profit or loss comprise fair value gains and losses from three distinct activities:

- trading derivatives;
- hedged assets, liabilities and derivatives designated in hedge relationships; and
- financial assets and liabilities designated at fair value through profit or loss.

For trading derivatives, the full change in fair value is recognised inclusive of interest income and expense arising on those derivatives. However, in cases where a trading derivative is economically offsetting movements in the fair value of a financial asset or liability designated at fair value through profit or loss, the interest income and expense attributable to the derivative is recognised within net interest income and not as part of the fair value movement of the trading derivative.

Hedged assets, liabilities and derivatives designated in hedge relationships result in the recognition of fair value movements on both the hedged item and hedging derivative in a fair value hedge relationship, and hedge ineffectiveness for both fair value and cash flow hedge relationships.

Financial assets and liabilities designated at fair value through profit or loss recognise fair value movements (excluding interest) on those items designated as fair value through profit or loss.

Interest income and interest expense on hedged assets and liabilities and financial assets and liabilities designated as fair value through profit or loss are recognised in net interest income.

Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it is related to items recognised in equity, in which case the tax is also recognised in equity.

Income tax expense or revenue is the tax payable or receivable on the current year's taxable income based on the applicable tax rate adjusted by changes in deferred tax assets and liabilities.

Current tax

Current tax is the expected tax payable or recoverable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise to utilise those temporary differences and losses.

Deferred tax liabilities are not recognised for temporary differences arising from investments in subsidiaries and associates where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Deferred tax assets are not recognised for temporary differences arising from investments in subsidiaries and associates where it is probable that the difference will not reverse in the foreseeable future, and it is not probable that taxable profit will be available against which the temporary difference can be utilised.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Income tax (continued)

Deferred tax (continued)

The effects of income taxes arising from asset revaluation adjustments are recognised directly in the asset revaluation reserve where relevant.

Deferred tax assets and liabilities related to fair value re-measurement of cash flow hedges, which are charged or credited directly to equity, are also credited or charged directly to equity. The tax associated with these transactions will be recognised in the income statement at the same time as the underlying transaction.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. This includes: cash and liquid assets, amounts due from other banks (to the extent less than 90 days) and short-term government securities (which have the same characteristics as cash).

Repurchase and reverse repurchase agreements

Securities sold subject to repurchase agreements ("repos") are retained in their respective balance sheet categories. The counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate based upon the counterparty to the transaction.

Securities purchased under agreements to resell ("reverse repos") are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the financial statements. Securities borrowed are not recognised in the financial statements unless they are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Financial instruments

Recognition and derecognition of financial instruments

A financial asset or a financial liability is recognised on the balance sheet when the Bank becomes party to the contractual provisions of the instrument. Loans and receivables are recognised when cash is advanced (or settled) to the borrowers.

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity investments and available for sale securities. Management determines the classification of its financial assets at initial recognition.

The Bank classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and amortised cost.

The Bank derecognises a financial asset when the contractual cash flows from the asset expires or it transfers the right to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred.

A financial liability is derecognised from the balance sheet when the Bank has discharged its obligation to the contract, or the contract is cancelled or expires.

Offsetting financial instruments

A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet if, and only if, the Bank has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

2. Accounting policies (continued)

Financial instruments (continued)

Financial instruments designated at fair value through profit or loss

Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date, being the date that the Group is committed to purchase or sell a financial asset.

Upon initial recognition, financial assets and liabilities may be designated as held at fair value through profit or loss and are initially recognised at fair value, with transaction costs being recognised in the income statement immediately. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise. Items held at fair value through profit or loss comprise both items held for trading and items specifically designated as fair value through profit or loss at initial recognition.

Restrictions are placed on the use of the designated fair value option and the classification can only be used in the following circumstances:

- if a host contract contains one or more embedded derivatives, the Group may designate the entire contract as being held at fair value;
- designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (i.e. eliminate an accounting mismatch) that would otherwise arise from measuring related assets or liabilities on a different basis; or
- assets and liabilities are both managed and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

Financial assets held for trading

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of (i) fair value through profit or loss (ii) loans and receivables or (iii) held to maturity.

Consistent with financial assets classified as fair value through profit or loss the Group applies trade date accounting to purchases and sales of available for sale investments.

Available for sale investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale or impairment when the cumulative gain or loss is transferred to the income statement.

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities and an immaterial investment in equity securities.

Held to maturity financial assets

Held to maturity investments are non-derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

2. Accounting policies (continued)

Financial instruments (continued)

Financial liabilities

A financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

All other financial liabilities are measured at amortised cost using the effective interest method.

Fair value measurement

Fair value is defined as the amount for which an asset could be exchanged or a liability settled, between willing parties in an arm's length transaction.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm’s length basis. Assets are measured at a bid price; liabilities are measured at an asking price.

Where no such active market exists for the particular asset or liability, the Group uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions where possible, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. In doing so, fair value is estimated using a valuation technique that makes maximum possible use of market inputs and that places minimal possible reliance upon entity-specific inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits or losses on day one.

The carrying value of financial assets at fair value through profit or loss reflects the credit risk attributable to the counterparty. Changes in the credit profile of the counterparty are reflected in the fair value of the asset and recognised in the income statement.

Derivative financial instruments and hedge accounting

All derivatives are recognised on the balance sheet at fair value on trade date and are classified as trading except where they are designated as part of an effective hedge relationship. The carrying value of a derivative is measured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The method of recognising the resulting fair value gain or loss on a derivative depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge); or hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group makes use of derivative instruments to manage exposures to interest rates and foreign currency, including exposures arising from forecast transactions and firm commitments. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria.

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

The Group documents, at the inception of a transaction, the relationship between hedging instruments and the hedged items, and the Group's risk management objective and strategy for undertaking these hedge transactions. The Group documents how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an on-going basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in the fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the year in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. This could occur for two reasons:

- the derivative is held for purposes of short-term profit taking; or
- the derivative is held to economically hedge an exposure but does not meet the accounting criteria for hedge accounting.

In both these cases, the derivative is classified as a trading derivative and changes in the value of the derivative are immediately taken to the income statement.

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale or designated at fair value through profit or loss. They arise when the Group provides money or services directly to a customer with no intention of trading the loan. Loans and advances include overdrafts, credit card lending, market rate advances, bill financing, mortgages, lease finance and term lending.

Loans and advances are initially recognised at fair value including direct and incremental transaction costs. They are subsequently recorded at amortised cost, using the effective interest method, adjusted for impairment losses and unearned income. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value, and not within loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Impairment of financial assets other than fair value loans

The Group assesses at each balance sheet date whether there is evidence that a financial asset or a portfolio of financial assets that is not carried at fair value through profit or loss is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date (“a loss event”), and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and advances and held to maturity investments, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is included in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure and any costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

2. Accounting policies (continued)

Impairment of financial assets other than fair value loans (continued)

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss.

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off reduce the amount of the expense in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

If the originally contracted terms of loans and advances are amended, the amounts are classified as restructured and would be disclosed as forbearance. Such accounts accrue interest as long as the loan performs in accordance with the restructured terms.

Equity and debt instruments – classed as available for sale

In the case of equity instruments classified as available for sale, the Group seeks evidence of a significant or prolonged decline in the fair value of the security below its cost to determine whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement.

Reversals of impairment of equity shares classified as available for sale are not recognised in the income statement. Increases in the fair value of equity shares classified as available for sale after impairment are recognised directly in equity.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

2. Accounting policies (continued)

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- fulfilment of the arrangement is dependent on the use of a specific asset or assets; and
- the arrangement conveys a right to use the asset.

As lessee

The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Sale and leaseback transactions entered into by the Group as lessee are primarily operating leases. Where an operating lease is established at fair value, any excess of sales proceeds over the carrying amount is recognised immediately in the income statement.

As lessor

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within depreciation expense in the income statement consistent with the nature of the asset (refer to note 18, property plant and equipment).

Property, plant and equipment

All freehold and long-term leasehold land and buildings are revalued annually on an open market basis by the Directors to reflect current market values, based on advice received from independent valuers. In addition, full independent valuations are carried out on a three year cycle on an open market basis, including directly attributable acquisition costs but without deducting expected selling costs. For properties that are vacant, valuations are carried out on an open market basis. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

All other items of property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to acquisition.

Property, plant and equipment carrying amounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of (i) the asset's fair value less costs to sell and (ii) the asset's value in use.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Property, plant and equipment (continued)

Where a group of assets working together supports the generation of cash inflows largely independent of cash inflows from other assets or groups of assets, the recoverable amount is assessed in relation to that group of assets (a cash-generating unit).

With the exception of freehold land, all items of property, plant and equipment are depreciated or amortised using the straight-line method, at rates appropriate to their estimated useful life to the Group. For major classes of property, plant and equipment, the annual rates of depreciation or amortisation are:

- buildings - 2%;
- leases (leasehold improvements) - the lower of the expected lease term and the assets useful life; and
- motor vehicles, fixtures and equipment - 10% to 33.33%.

Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale, are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Investments in controlled entities and associates

The Group's investments in controlled entities and associates are valued at cost or valuation less any provision for impairment. Such investments are reviewed annually for impairment, or more frequently when there are indications that impairment may have occurred. Losses relating to impairment in the value of shares in controlled entities and associates are recognised in the income statement.

Investment properties

Investment property is property (land or building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business.

Investment property assets are carried at fair value, with fair value increments and decrements taken to the income statement in the period in which they arise. Investment property assets are revalued annually by Directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis being the amounts for which the assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction at the valuation date. Newly acquired investment property assets are held at cost (i.e. equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding twelve months.

Property inventory

Property acquired or being constructed for sale in the ordinary course of business, rather than to be held for rental or capital appreciation, is held as inventory and is measured at the lower of cost and net realisable value.

2. Accounting policies (continued)

Assets and liabilities classified as held for sale

The Group transferred the vast majority of its commercial real estate assets to NAB on 5 October 2012.

In accordance with IFRS 5 (non-current assets held for sale and discontinued operations) the Group classifies assets and liabilities as held for sale where they will be recovered principally through sale rather than their continued use.

The Group reclassified certain assets and liabilities on this basis in its financial statements for the year ended 30 September 2012 (note 24).

Income earned and expenses incurred on assets and liabilities classified as held for sale continued to be recognised in the appropriate line items in the income statement until the transaction was completed.

Provisions

Provisions are recognised when a legal or constructive obligation exists as a result of past events, it is probable that an outflow of economic benefits will be necessary to settle the obligation, and the obligation can be reliably estimated. Provisions are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Pension and post retirement costs

Employees of the Group are entitled to benefits on retirement, disability or death from the Group's pension plans. The Group operates both defined benefit and defined contribution pension schemes.

Defined contribution pension scheme

The defined contribution scheme receives fixed contributions from Group companies and the Group's obligation for contributions to these plans is recognised as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings. A liability or asset in respect of the defined benefit scheme is recognised in the balance sheet. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the Group's defined benefit obligation.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, interest cost, expected return on plan assets, curtailment gains and past service cost. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly in retained earnings through the statement of comprehensive income.

The Group also provides post-retirement health care for certain retired employees. The calculation of the post-retirement health care liability is calculated in the same manner as the defined benefit pension obligation.

Subordinated liability and related entity balances

Subordinated liabilities and related entity balances, other than derivatives, are recorded at amortised cost. Subordinated liabilities comprise undated and dated loan capital which is provided to the Bank by NAGE and NAB. Subordinated liabilities are included within amounts due to related entities on the balance sheet.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Debt issues

Debt issues are short and long term debt issued by the Group including commercial paper, notes, term loans, medium term notes and residential mortgage backed securities. Debt issues are typically recorded at amortised cost using the effective interest method. Premiums, discounts and associated issue expenses are recognised using the effective interest method through the income statement from the date of issue to accrete the carrying value of securities to redemption values by maturity date. Interest is charged to the income statement using the effective interest method.

Financial guarantees

The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

The financial guarantee contract is initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary. Subsequently, the Group records and measures the financial guarantee contract at the higher of:

- where it is likely the Group will incur a loss as a result of issuing the contract, a liability is recognised for the estimated amount of the loss payable; and
- the amount initially recognised less, when appropriate, amortisation of the fee which is recognised over the life of the guarantee.

Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefits is uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the balance sheet but are disclosed unless they are remote.

Equity

Share option reserve

The share option reserve records the outstanding balance payable to NAB for equity benefits provided to employees and Directors as part of their remuneration including deferred tax.

Cash flow hedge reserve

The cash flow hedge reserve records the effective portion of the fair value revaluation of derivatives designated as cash flow hedging instruments.

2. Accounting policies (continued)

Preference shares

Preference shares are classified as an equity instrument if and only if both of the following conditions are met:

- The instrument includes no contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- If the instrument will or may be settled in the issuer's own equity instruments and it is:
  - a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

Where preference shares do not satisfy the above conditions, then they are classified as a financial liability. The Company's preference shares currently issued meet the criteria for classification as equity.

Dividends on ordinary and preference shares

Dividends on ordinary and preference shares classified as equity instruments are recognised as a liability and deducted from equity when they are approved by the Bank's Directors. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

Equity based compensation

The Group engages in share-based payment transactions in respect of services received from certain of its employees and to provide long term incentives. The fair value of the services received is measured by reference to the fair value of the NAB shares or share options granted, on the date of the grant. This is recognised as an expense in the income statement over the relevant vesting period and results in an increase in the share option reserve which is reduced on repayment to the ultimate parent company.

The grant date fair value of shares is generally determined by reference to the weighted average price of the NAB shares in the week up to, and including, the date on which the shares are granted. Employee share plans are linked to internal performance, market performance and/or service conditions. The fair value of shares with a market performance condition is determined using a Monte Carlo simulation. The grant date fair value of the performance options and performance rights is determined using a simulated version of the Black-Scholes model. The key assumptions and inputs used in the valuation model are the exercise price of the performance options or performance rights, the expected volatility of the share price, the risk-free interest rate and the expected dividend yield on the shares for the life of the performance options and performance rights. The simulation takes into account both the probability of achieving market performance conditions and the potential for early exercise of vested performance options or performance rights.

While market performance conditions are incorporated into the grant date fair values, non-market conditions are not taken into account when determining the fair value and expected time to vesting of shares, performance options and performance rights. Instead, non-market conditions are taken into account by adjusting the number of shares, performance options and performance rights included in the measurement of the expense so that the amount recognised in the income statement reflects the number of shares, performance options or performance rights that actually vest.

2. Accounting policies (continued)

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

3. Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The most significant use of judgements and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected repayment profile of the loans. If the loans were to be repaid six months earlier than currently predicted the value would decline by £7m. If the level of early repayment is less than expected the loan value would increase by up to £36m. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £15m, and vice versa. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The valuation of these financial instruments is described in more detail in note 13.

Impairment losses on loans and advances

The Group reviews its individually significant loans and advances at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Group makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

Notes to the consolidated financial statements (continued)

3. Critical accounting estimates and judgements (continued)

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). To the extent that the probabilities of default improves from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £5m. Alternatively, if probabilities of default deteriorate by 5%, the impairment provision on loans and advances would increase by £5m. To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £15m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m. There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The impairment loss on loans and advances is disclosed in more detail in note 16.

Payment Protection Insurance redress provision and other conduct related matters

Disclosures in relation to the Group's payment protection insurance redress provision can be found in note 27 with the Group holding a provision of £152m at 30 September 2013 (2012: £108m). Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates (how many claims are, or may be, upheld in the customer's favour) and redress costs (the average payment made to customers). The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated likely position at 30 September 2013. Consequently, the provision calculated may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used.

The most significant of the individual assumptions are the level of complaints, the uphold rate, the customer contact response rate and average pay-out per complaint. If the total number of complaints were to be 5% higher or lower than that estimated, the provision would increase / decrease by approximately £7m. If the uphold rate across the population of existing and future complaints was 5% higher or lower than that estimated, the provision would increase / decrease by approximately £18m. If the customer contact response rate was 5% higher or lower than that estimated, the provision would increase / decrease by approximately £8m. If the average redress cost was to be 5% higher or lower than that currently estimated, the provision would increase / decrease by approximately £7m, as average redress is a factor affecting both future and existing cases. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

There are similar uncertainties and judgements for other conduct risk related matters disclosed in note 27 however the level of liability for each matter is lower.

Equity based compensation

The Group's ultimate parent, NAB, grants shares and share options to the Group's employees as a part of employee remuneration which is recharged to the Group. IFRS 2 requires recognition of an expense for those shares and share options at the fair value on the grant date. For shares granted to employees, the fair value is measured directly at the market price of NAB Group's shares, adjusted to take into account the terms and conditions upon which the shares were granted. For share options granted to employees, the fair value of the equity instruments granted is estimated using a valuation technique consistent with generally accepted valuation methodologies. Further details are provided in note 36.

Retirement benefit obligations

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Further details on the assumptions used are provided in note 29.

Notes to the consolidated financial statements (continued)

4. Segment information

The Group's operating segments are operating units engaged in providing different products or services and whose operating results are regularly reviewed by the entity's Chief Operating Decision Maker, the Chief Executive Officer.

The Group's business is organised into two principal operating segments: Business & Private Banking (including business centres, small business and private banking customers) and Retail Banking. Business & Private Banking provides a range of banking products and services to segments of business and private customers, including loans and finance, day to day banking, wealth management, international services and treasury solutions. Retail Banking provides a range of banking products and services to personal customers, including current accounts, mortgages, overdrafts, personal loans, savings accounts, insurances and financial planning.

The Group's Central Functions are Finance, Risk, Operations & IT, Legal & Governance, CEO Office Support, Treasury, Human Resources, together with other functions which are not considered to be separate reportable operating segments.

Business & Private Banking, Retail Banking and Central Functions along with the UK-based wealth management business of the NAB Group and elements of the mid-corporate lending on the NAB Group Wholesale Banking balance sheet comprise UK Banking.

The reconciliation from UK Banking to statutory results table on page 52 shows other segments and adjustments, which are deductions for the wealth management business and mid-corporate lending on the NAB Group Wholesale Banking balance sheet which are not part of Clydesdale Bank PLC. Also included are adjustments to incorporate Wholesale Banking business written on the Clydesdale Bank PLC balance sheet not included within UK Banking.

Major customers

Revenues from no one single customer amount to greater than 10% of the Group's revenues.

Geographical areas

The Group has no material operations outside the UK and therefore no secondary geographical area information is presented.

Notes to the consolidated financial statements (continued)

4. Segment information (continued)

Further details of the NAB Group's operating segments including UK Banking and how they are evaluated are contained within note 2 of NAB Group's Annual Report and Consolidated Financial Statements for the year ended 30 September 2013. The segment information below has been prepared on the same basis. The accounting policies of the operating segments are consistent with those described in note 2 to the Group financial statements for the year ended 30 September 2013.

Operating segments 2013	**Business & Private £m**	**Retail £m**	**Central and other functions £m**	**UK Banking £m**
Net interest income	335	410	6	751
Other operating income	85	123	27	235
Operating income	420	533	33	986
Operating expenses	(90)	(155)	(456)	(701)
Impairment losses on credit exposures	(123)	(38)	3	(158)
Segment operating profit/(loss)	207	340	(420)	127
Tax (expense)/credit	(49)	(79)	97	(31)
Segment cash earnings after tax	**158**	**261**	**(323)**	**96**
Average assets	**12,796**	**14,020**	**11,320**	**38,136**

Operating segments 2012	Business & Private £m	Retail £m	Central and other functions £m	UK Banking £m
Net interest income	476	402	(14)	864
Other operating income	112	122	47	281
Operating income	588	524	33	1,145
Operating expenses	(139)	(155)	(403)	(697)
Impairment losses on credit exposures	(629)	(35)	33	(631)
Segment operating (loss)/profit	(180)	334	(337)	(183)
Tax credit /(expense)	45	(83)	82	44
Segment cash earnings after tax	(135)	251	(255)	(139)
Average assets	20,080	12,736	12,815	45,631

Comparative disclosures have been amended to conform with current year presentation.

Reconciliation between segment and statutory results 2013	**UK Banking £m**	**Non-cash earnings items £m**	**Other segments and adjustments £m**	**Clydesdale Bank PLC £m**
Net interest income	751	-	5	756
Other operating income	235	(153)	(28)	54
Operating income	986	(153)	(23)	810
Operating expenses	(701)	-	2	(699)
Impairment losses on credit exposures	(158)	-	14	(144)
Operating profit/(loss)	127	(153)	(7)	(33)
Tax (expense)/credit	(31)	30	7	6
	96	(123)	-	(27)
Items outside of UK Banking cash earnings after tax:				
Fair value and hedge ineffectiveness	(19)	19	-	-
Payment Protection Insurance redress	(104)	104	-	-
Loss after tax	**(27)**	**-**	**-**	**(27)**
Average assets	**38,136**	**-**	**(398)**	**37,738**

Notes to the consolidated financial statements (continued)

4. Segment information (continued)

Reconciliation between segment and statutory results 2012	UK Banking £m	Non-cash earnings items £m	Other segments and adjustments £m	Clydesdale Bank PLC £m
Net interest income	864	-	5	869
Other operating income	281	(79)	(74)	128
Operating income	1,145	(79)	(69)	997
Operating expenses	(697)	(165)	(12)	(874)
Impairment losses on credit exposures	(631)	(150)	44	(737)
Operating loss	(183)	(394)	(37)	(614)
Tax credit	44	90	10	144
	(139)	(304)	(27)	(470)
Items outside of UK Banking cash earnings after tax:				
Fair value and hedge ineffectiveness	(67)	67	-	-
Payment Protection Insurance redress	(92)	92	-	-
Impairment losses on credit exposures	(113)	113	-	-
Pension contribution from ultimate parent	98	(98)	-	-
Reorganisation and other costs	(130)	130	-	-
Loss after tax	(443)	-	(27)	(470)
Average assets	45,631	-	(425)	45,206

Notes to the consolidated financial statements (continued)

5. Net interest income

	2013	2012
	£m	£m
Interest income and similar income		
Loans and advances to other banks	**31**	27
Available for sale investments	**8**	13
Loans and advances to customers	**1,100**	1,271
Due from related entities (note 11)	**5**	14
Other interest income	**1**	7
	1,145	1,332
Financial assets at fair value through profit or loss	**64**	129
Total interest income and similar income	**1,209**	1,461
Less: Interest expense and similar charges		
Due to other banks	**2**	6
Financial liabilities at fair value through profit or loss	**2**	2
Due to customers	**305**	347
Bonds and notes	**75**	53
Due to related entities (note 11)	**57**	176
Other interest expense	**12**	8
Total interest expense and similar charges	**453**	592
Net interest income	**756**	869

Other interest expense includes the FSCS levy.

6. Non-interest income

	2013	2012
	£m	£m
Gains less losses on financial instruments at fair value		
Movement in fair value of assets and liabilities	**(171)**	(121)
Interest rate derivatives	**147**	(12)
Foreign exchange derivatives	**21**	21
Ineffectiveness arising from fair value hedges (note 14)	**(8)**	(12)
Ineffectiveness arising from cash flow hedges (note 14)	**(3)**	1
	(14)	(123)
Other operating income		
Fees and commission	**63**	106
Net fair value movement on investment properties	**-**	(7)
Gain on disposal of tangible fixed assets *	**1**	10
Other income	**4**	142
	68	251
Total non-interest income	**54**	128

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

Fees and commission income is reported net of charges of £130m for Payment Protection Insurance redress (2012: £120m). Also included is £3m income in relation to financial instruments at fair value through profit or loss (2012: £5m).

Other income in 2012 included a contribution of £130m to the defined benefit pension scheme from NAB (note 29).

6. Non-interest income (continued)

The movement in fair value of assets incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans. They are fair valued with the movements in fair value taken through the income statement as part of non-interest income. The fair value of the loan is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. As interest rates fall, the carrying value of the loan increases. Similarly, as interest rates increase, the carrying value of the loan decreases. This valuation technique is reflective of current market practice and is regularly reviewed to ensure it appropriately captures the continued economic uncertainty and volatility currently being experienced in the markets.

7. Operating expenses

	2013 £m	2012 £m
Personnel expenses		
Salaries, wages and non-cash benefits	**153**	164
Related personnel expenses	**13**	14
Defined contribution pension expense	**8**	10
Defined benefit pension expense	**18**	19
Equity-based compensation	**4**	11
Other personnel expenses	**7**	7
	203	225
Depreciation expense		
Depreciation of property, plant and equipment (note 18)	**19**	19
Other operating expenses		
Operating lease rental	**32**	38
Other occupancy charges	**42**	41
Related entity recharges (note 11)	**249**	273
Other operating expenses	**154**	129
	477	481
Restructuring expenses		
Other personnel expenses	**-**	96
Other occupancy	**-**	32
Other expenses	**-**	21
	-	149
Total operating expenses	**699**	874

Auditors' remuneration

Included within other operating expenses:	**2013 £'000**	2012 £'000
Audit of the financial statements	**1,303**	1,134
Other fees to auditors:		
Audit of the Group pension scheme	**58**	58
Local statutory audits for subsidiaries	**220**	200
Other assurance including regulatory compliance based work	**141**	262
	1,722	1,654

8. Tax

	2013 £m	2012 £m
Current tax		
UK corporation tax		
Current year	**(4)**	(46)
Adjustment in respect of prior years	**(5)**	5
Other overseas tax	**-**	3
	(9)	(38)
Deferred tax (note 22)		
Current year	**1**	(100)
Adjustment in respect of prior years	**2**	(6)
	3	(106)
Tax credit	**(6)**	(144)

The tax assessed for the year differs from the standard rate of corporation tax in the UK (23.5%). A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	2013 £m	2012 £m
Loss on ordinary activities before tax	**(33)**	(614)
Tax credit based on the standard rate of Corporation Tax in the UK of 23.5% (2012: 25%)	**(8)**	(154)
Effects of:		
Expenses not deductible for tax purposes	**4**	5
Bank levy	**-**	1
Rate differences	**1**	3
Adjustments in respect of prior years	**(3)**	(1)
Other	**-**	2
Tax credit	**(6)**	(144)

9. Dividends paid

	2013 £m	2012 £m
Preference dividends paid – 12% per annum payable semi-annually (2013: 10p per share; 2012: 6p per share)	**10**	6
Preference dividends paid – 6 month LIBOR plus a margin of 779bps per annum payable semi-annually, (2013: 7p per share; 2012: 4.5p per share)	**14**	9
	24	15

The dividend payment made in June 2013 was limited to the extent of the available audited distributable reserves.

10. Cash and balances with central banks

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Cash assets	**1,207**	1,123	**1,207**	1,123
Balances with central banks	**5,508**	6,800	**5,508**	6,800
	6,715	7,923	**6,715**	7,923
Less mandatory deposits with central banks	**(43)**	(31)	**(43)**	(31)
Included in cash and cash equivalents (note 34)	**6,672**	7,892	**6,672**	7,892

Mandatory deposits are not available for use in the Group or Bank's day to day business and are non-interest bearing.

11. Related party transactions

During the year there have been transactions between the Group, its ultimate parent, controlled entities of the ultimate parent, controlled entities of the Group, and other related parties.

The Group provides a range of services to related parties, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, forward foreign exchange and interest cover.

The Group receives a range of services from the parent and related parties, including loans and deposits, forward foreign exchange and interest rate cover and various administrative services. Fees may be charged for these services.

Amounts due from related entities	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Loans				
Ultimate parent	**1,278**	1,215	**1,278**	1,215
Controlled entities of the ultimate parent	**21**	-	**21**	-
Controlled entities of the Bank	**-**	-	**4,533**	4,526
	1,299	1,215	**5,832**	5,741
Other receivables				
Ultimate parent	**87**	34	**87**	34
Controlled entities of the ultimate parent	**22**	7	**22**	7
	109	41	**109**	41
Total amounts due from related entities	**1,408**	1,256	**5,941**	5,782
Interest income on the above amounts was as follows:				
Ultimate parent (note 5)	**5**	14	**5**	22
Controlled entities of the Bank	**-**	-	**148**	40
	5	14	**153**	62

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Amounts due to related entities	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Deposits				
Ultimate parent	**1,716**	6,392	**1,716**	6,392
Controlled entities of the Bank	**-**	-	**4,081**	3,481
	1,716	6,392	**5,797**	9,873
Subordinated liabilities				
Ultimate parent	**550**	550	**550**	550
Controlled entities of the ultimate parent	**526**	526	**526**	526
	1,076	1,076	**1,076**	1,076
Other payables				
Ultimate parent	**11**	20	**11**	20
Controlled entities of the ultimate parent	**47**	39	**47**	39
	58	59	**58**	59
Total amounts due to related entities	**2,850**	7,527	**6,931**	11,008
Interest expense on the above amounts was as follows (note 5):				
Ultimate parent	**47**	163	**47**	163
Controlled entities of the ultimate parent	**10**	13	**10**	13
Controlled entities of the Bank	**-**	-	**77**	61
	57	176	**134**	237

The decrease in deposits due to the ultimate parent reflects funds repaid following the completion of the transfer of the CRE assets on 5 October 2012 (note 24).

Repurchase agreements

Included in amounts due to related entities is £51m (2012: £Nil) for securities sold subject to repurchase agreements. The fair value of the securities sold under these terms as at 30 September 2013 amounts to £51m (2012: £Nil).

Derivatives

The following derivative positions are held with the ultimate parent:

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Derivative financial assets (note 14)	**95**	179	**95**	179
Derivative financial liabilities (note 14)	**412**	710	**412**	710

Subordinated liabilities

Subordinated liabilities comprises undated and dated loan capital which is provided to the Bank by NAGE and NAB. Interest on the loans is payable at rates related to the London Interbank Offered Rate ("LIBOR"). The undated loans are subject to five years and one day's notice of redemption by the lenders and are repayable at par. Early repayment is at the option of the borrower, subject to the prior consent of the PRA. The loans are subordinated to the claims of other creditors and are unsecured. The loans are employed in the general business of the Bank.

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Subordinated liabilities (continued)

Details of subordinated liabilities in excess of 10% of the total balance of the subordinated loans are disclosed below.

Group and Bank

The rates of interest stated below apply at 30 September 2013:	**2013 £m**	2012 £m
6.2125% (2012: 6.40438%) 10 year, non-call with a final maturity of 15 February 2019	**300**	300
4.9294% (2012: 5.17900%) 10 year, non-call with a final maturity of 25 January 2021	**250**	250
	550	550
Other subordinated notes	**526**	526
Total subordinated liabilities	**1,076**	1,076

Securitisation

The Group has securitised part of its residential mortgage portfolio and the cash raised from the issue of residential mortgage backed securities ("RMBS") through SPEs forms part of the Group's medium term funding. A portfolio of buy to let mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £441m (2012: £474m) of the securities issued are held by the Group's ultimate parent.

Other transactions with related entities

	Group		**Bank**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Non-interest income received				
Controlled entities of the ultimate parent	**7**	9	**7**	9
Administrative expenses (note 7)				
Ultimate parent	**(8)**	8	**(8)**	8
Controlled entities of the ultimate parent	**257**	265	**248**	263
	249	273	**240**	271

Administrative expenses paid to the ultimate parent are offset in the year to 30 September 2013 by payments received by the Group for the provision of services to NAB subsequent to the transfer of the Group's CRE portfolio.

Compensation of key management personnel ("KMP")

For the purposes of IAS 24 Related Party Disclosures, KMP's comprise Directors of the Bank, members of the UK Executive Committee and PRA approved persons with a control function of 1 to 29.

Group	**2013 £m**	2012 £m
Salaries and other short-term benefits	**10**	11
Share based payments	**-**	3
	10	14

Directors' emoluments are analysed in note 37.

11. Related party transactions (continued)

Transactions with key management personnel

KMPs, their close family members and any entities controlled or significantly influenced by the KMPs have undertaken the following transactions with the Group in the normal course of business. The transactions were made on the same terms and conditions as applicable to other Group employees, or on normal commercial terms.

Group	**2013 £m**	2012 £m
Loans and advances	**2**	5
Deposits	**1**	1

No provisions have been recognised in respect of loans provided to KMPs (2012: £Nil). There were no debts written off or forgiven during the year to 30 September 2013 (2012: £Nil). Included in the above are six (2012: seven) loans totalling £0.9m (2012: £1.6m) made to Directors.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2013 (2012: £0.3m) were charged to the Group sponsored Scheme. The Group has deposits of £4.5m (2012: £3.1m) at the year end placed by the Scheme at market rates.

Pension contributions of £134m (2012: £242m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank (note 29).

12. Investments

	Group		**Bank**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Available for sale – listed	**966**	1,032	**966**	1,032
Available for sale – unlisted	**7**	7	**7**	7
	973	1,039	**973**	1,039
Held to maturity – listed	**-**	-	**924**	218
Held to maturity - unlisted	-	-	**491**	491
	-	-	**1,415**	709
	973	1,039	**2,388**	1,748

Included in the available for sale ("AFS") listed securities are £0.8bn (2012: £0.8bn) in UK Government Gilts and £0.1bn (2012: £0.1bn) in other banks' debt securities.

12. Investments (continued)

The listed AFS investments are classified as level 1 in the fair value hierarchy, with the unlisted AFS investments classified as level 3 (see note 38).

Credit quality of investments	**Group**		**Bank**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Available for sale				
Senior investment grade	**966**	1,032	**966**	1,032
Other	**7**	7	**7**	7
	973	1,039	**973**	1,039
Held to maturity				
Investment grade	**-**	-	**862**	218
Sub investment grade	**-**	-	**553**	491
	-	-	**1,415**	709

13. Other financial assets and liabilities at fair value

	Group		**Bank**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Other financial assets at fair value through profit or loss				
Loans and advances	**2,155**	2,791	**2,155**	2,791
Other financial liabilities at fair value through profit or loss				
Due to customers – term deposits	**120**	147	**120**	147

Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 14).

Loans and advances

Included in other financial assets at fair value is a portfolio of loans. Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £2,155m (2012: £2,791m). The cumulative movement in the fair value of the loans attributable to changes in credit risk amounts to £77m (2012: £82m) and the change for the current year is a reduction of £5m (2012: increase of £11m).

The Group ceased further sales of this suite of loan products with effect from 30 April 2012 with the loans being classified as level 3 in the fair value hierarchy (see note 38).

Due to customers - term deposits

Included in other financial liabilities at fair value are fixed rate deposits which have been hedged with interest rate derivative contracts with matching cash flows.

The change in fair value attributable to changes in the Bank credit risk is £Nil (2012: £Nil). The Bank is contractually obligated to pay £10m (2012: £16m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as level 3 in the fair value hierarchy (see note 38).

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, certain derivatives do not meet the hedging criteria within IAS 39 and are therefore accounted for as held for trading, though they are used for risk mitigation purposes. The tables below analyse derivatives between those held as hedging instruments and those that do not meet the hedging criteria within IAS 39.

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Fair value of derivative financial assets				
Designated as hedging instruments	**3**	160	**3**	160
Designated as held for trading	**142**	261	**142**	261
Designated as held for trading – related entities (note 11)	**95**	179	**95**	179
	240	600	**240**	600
Fair value of derivative financial liabilities				
Designated as hedging instruments	**216**	187	**119**	116
Designated as held for trading	**35**	55	**35**	55
Designated as held for trading – related entities (note 11)	**412**	710	**412**	710
	663	952	**566**	881

The derivative financial instruments held by the Group are classified as level 2 in the fair value hierarchy as their value is determined using directly observable inputs other than directly quoted prices.

In the following tables the contract amount is the amount from which the cash flows from the derivative contracts are derived and is not an indication of the amounts at risk relating to these contracts.

Certain derivative financial assets and liabilities have been booked in consolidated special purpose entities.

Derivative financial assets and liabilities include the hedges for the Group securitisation and covered bond programmes and cash flow hedges.

The carrying value of the currency liabilities issued through securitisation fluctuates as a result of foreign exchange movements. There is a corresponding (and off-setting) movement in the value of the hedging derivative.

In the year to 30 September 2013, the Group adjusted its cash flow hedging strategy but not the principal risk being hedged. As a result, the existing hedge relationship was de-designated and a new macro cash flow hedge designated as at 31 March 2013. The principal risk being hedged remains interest rate risk.

14. Derivative financial instruments (continued)

Group

Total derivative contracts as at 30 September 2013	**Contract amount £m**	**Fair value of assets £m**	**Fair value of liabilities £m**
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	21,050	3	51
Fair value hedges			
Interest rate swaps	1,458	-	135
Cross currency swaps	1,194	-	30
	2,652	-	165
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,983	38	54
Cross currency swaps	460	50	2
Options	666	6	6
	5,109	94	62
Interest rate related contracts			
Swaps	20,506	130	357
Swaptions	176	2	2
Options	738	9	24
	21,420	141	383
Commodity related contracts	107	2	2
Total derivative contracts	**50,338**	**240**	**663**

Group

Total derivative contracts as at 30 September 2012	Contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	8,970	160	2
Fair value hedges			
Interest rate swaps	1,458	-	133
Cross currency swaps	1,023	-	52
	2,481	-	185
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,785	43	48
Cross currency swaps	504	78	6
Options	542	6	6
	4,831	127	60
Interest rate related contracts			
Swaps	41,476	280	638
Swaptions	398	11	11
Options	1,350	20	54
	43,224	311	703
Commodity related contracts	75	2	2
Total derivative contracts	59,581	600	952

14. Derivative financial instruments (continued)

Bank

Total derivative contracts as at 30 September 2013	**Contract amount £m**	**Fair value of assets £m**	**Fair value of liabilities £m**
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	21,050	3	51
Fair value hedges			
Interest rate swaps	758	-	68
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,983	38	54
Cross currency swaps	460	50	2
Options	666	6	6
	5,109	94	62
Interest rate related contracts			
Swaps	20,506	130	357
Swaptions	176	2	2
Options	738	9	24
	21,420	141	383
Commodity related contracts	107	2	2
Total derivative contracts	**48,444**	**240**	**566**

Bank

Total derivative contracts as at 30 September 2012	Contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	8,970	160	2
Fair value hedges			
Interest rate swaps	758	-	114
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	3,785	43	48
Cross currency swaps	504	78	6
Options	542	6	6
	4,831	127	60
Interest rate related contracts			
Swaps	41,476	280	638
Swaptions	398	11	11
Options	1,350	20	54
	43,224	311	703
Commodity related contracts	75	2	2
Total derivative contracts	57,858	600	881

14. Derivative financial instruments (continued)

The Group macro hedges its interest rate exposure using cash flow hedges. These are vanilla interest rate swaps for which the Group has the following commitments in the time bands noted:

Nominal values per time period	**2013 £m**	2012 £m
0 to 6 months	**2,370**	2,810
6 to 12 months	**925**	995
1 to 2 years	**14,930**	2,145
2 to 5 years	**2,825**	3,020
	21,050	8,970

The Group has hedged the following forecast cash flows, which primarily vary with interest rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows 2013 £m	**Forecast payable cash flows 2013 £m**	Forecast receivable cash flows 2012 £m	Forecast payable cash flows 2012 £m
within one year	**31**	**25**	40	-
between one and two years	**59**	**19**	21	-
between two and three years	**29**	**8**	16	-
between three and four years	**22**	**12**	10	-
between four and five years	**14**	**15**	3	-
	155	**79**	90	-

Comparative disclosures have been amended to conform with current year presentation.

	2013 £m	2012 £m
Gain/ (loss) arising from fair value hedges recognised in income (note 6)		
Hedging instrument	**21**	(563)
Hedged item attributable to the hedged risk	**(29)**	551
	(8)	(12)

	2013 £m	2012 £m
(Loss)/gain from cash flow hedges recognised in income due to hedge ineffectiveness (note 6)	**(3)**	1

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Overdrafts	**2,024**	2,346	**2,024**	2,346
Credit cards	**396**	436	**396**	436
Lease finance	**482**	694	**428**	569
Mortgages	**16,148**	15,369	**11,674**	10,822
Other term lending – business	**4,427**	5,151	**4,427**	5,151
Other term lending – retail	**756**	730	**756**	730
Other lending	**32**	51	**32**	51
Gross loans and advances to customers	**24,265**	24,777	**19,737**	20,105
Unearned income	**(44)**	(78)	**(38)**	(67)
Deferred and unamortised fee income	**(37)**	(58)	**(33)**	(49)
Impairment provisions on credit exposures (note 16)	**(289)**	(295)	**(278)**	(285)
	23,895	24,346	**19,388**	19,704

The Group and Bank have transferred £4,834m and £3,202m respectively (2012: £4,364m and £2,470m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 17). The mortgages do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements the Group and Bank continue to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group and Bank are also exposed to the residual rewards of the mortgages as a result of their ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £2,471m (2012: £2,553m).

Included within Group and Bank loans and advances to customers are £2,751m and £1,660m respectively (2012: £2,498m and £1,445m) of mortgages assigned to two bankruptcy remote special purpose entities, Clydesdale Covered Bonds LLP and Clydesdale Covered Bonds No 2 LLP (note 17). These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2013 there were £1,041m (2012: £1,084m) of covered bonds in issue under the covered bond programmes, which are held by the Group and Bank.

The Group also has a portfolio of fair valued business loans and advances (note 13). Combined with the above this is equivalent to total loans and advances of £26,050m (2012: £27,137m).

15. Loans and advances to customers (continued)

Lease finance

The Group and Bank lease a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The costs of assets acquired by the Group and Bank during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £3m (2012: £4m) and £210m (2012: £314m) respectively. The total closing balances of finance leases for the Group and Bank were £12m and £Nil (2012: £20m and £Nil) respectively. The total closing balances for hire purchase contracts in the Group and Bank were and £437m and £401m (2012: £629m and £535m).

Finance lease receivables	**Group**		**Bank**	
	2013 **£m**	2012 £m	**2013** **£m**	2012 £m
Gross investment in finance lease receivables				
Due within one year	**216**	301	**193**	246
Due within one to five years	**247**	365	**225**	311
Due after more than five years	**19**	28	**10**	12
	482	694	**428**	569
Unearned income	**(33)**	(45)	**(27)**	(34)
Net investment in finance lease receivables	**449**	649	**401**	535

Within the Group and Bank there are specific provisions of £3m and £2m (2012: £6m and £6m) in relation to finance lease receivables, with a collective provision of £Nil and £Nil (2012: £1m and £1m) as at 30 September 2013.

Maximum exposure to credit risk

The maximum exposure to credit risk is disclosed in note 39.

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers (continued)

Distribution of loans and advances by credit quality

Group **As at 30 September 2013**	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Gross loans and advances:							
Neither past due nor impaired	110	377	467	15,806	5,987	615	**23,362**
Past due but not impaired	12	19	6	266	218	19	**540**
Impaired	-	-	9	76	278	-	**363**
	122	**396**	**482**	**16,148**	**6,483**	**634**	**24,265**

Group As at 30 September 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	132	415	661	14,994	7,016	529	23,747
Past due but not impaired	12	21	19	304	274	57	687
Impaired	-	-	14	71	258	-	343
	144	436	694	15,369	7,548	586	24,777

Bank **As at 30 September 2013**	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Gross loans and advances:							
Neither past due nor impaired	110	377	425	11,504	5,987	615	**19,018**
Past due but not impaired	12	19	2	124	218	19	**394**
Impaired	-	-	1	46	278	-	**325**
	122	**396**	**428**	**11,674**	**6,483**	**634**	**19,737**

Bank As at 30 September 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	132	415	560	10,645	7,017	529	19,298
Past due but not impaired	12	21	6	139	273	57	508
Impaired	-	-	3	38	258	-	299
	144	436	569	10,822	7,548	586	20,105

***** Business lending includes business overdrafts.

Credit quality of loans and advances

The Group has an internally developed credit rating system that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the probability of default for each customer and can be broadly mapped to external agencies rating scales. Impaired assets consist of business lending and secured personal lending where current circumstances indicate that losses of loan principal and/or interest may be incurred.

15. Loans and advances to customers (continued)

Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's standard credit rating system. The credit rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy.

The table below presents the analysis of business lending credit quality of loans and advances that are neither past due nor impaired:

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Senior investment grade	**1,402**	1,419	**1,393**	1,409
Investment grade	**1,529**	2,020	**1,518**	1,974
Sub-investment grade	**3,523**	4,238	**3,501**	4,194
	6,454	7,677	**6,412**	7,577

For the business lending analysis, investment grades are determined by the Customer Rating System (eCRS) as defined under the Group's Credit Risk Management policy:

Description	**eCRS**	**PD**
Senior investment grade	1 to 5	0 < 0.11
Investment grade	6 to 11	0.11 < 0.55
Sub-investment grade	12 to 23	0.55 < 99.99

The loan to value of retail mortgage lending coupled with the relationship of the debt to customers' income are key to the credit quality of these loans. The table below sets out the indexed loan to value analysis of the Group's retail mortgages:

	2013	2012
	%	%
Less than 50%	**24**	21
50% to 75%	**45**	40
76% to 80%	**8**	9
81% to 85%	**6**	7
86% to 90%	**5**	6
91% to 95%	**4**	5
96% to 100%	**2**	4
Greater than 100%	**2**	4
Unknown	**4**	4
	100	100

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers (continued)

Loans and advances which were past due but not impaired

Loans and advances that are past due but are not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility. The distribution of loans and advances that are past due but not impaired are analysed below:

Group 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
1 to 29 days past due	8	9	4	93	131	8	**253**
30 to 59 days past due	1	3	1	74	8	3	**90**
60 to 89 days past due	1	2	-	33	2	2	**40**
Past due 90 days and over	2	5	1	66	77	6	**157**
	12	**19**	**6**	**266**	**218**	**19**	**540**

Group 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	8	18	111	173	44	362
30 to 59 days past due	2	3	1	79	9	4	98
60 to 89 days past due	1	3	-	36	6	3	49
Past due 90 days and over	1	7	-	78	86	6	178
	12	21	19	304	274	57	687

Bank 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
1 to 29 days past due	8	9	1	40	131	8	**197**
30 to 59 days past due	1	3	1	36	8	3	**52**
60 to 89 days past due	1	2	-	16	2	2	**23**
Past due 90 days and over	2	5	-	32	77	6	**122**
	12	**19**	**2**	**124**	**218**	**19**	**394**

Bank 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	8	5	43	172	44	280
30 to 59 days past due	2	3	1	38	9	4	57
60 to 89 days past due	1	3	-	19	6	3	32
Past due 90 days and over	1	7	-	39	86	6	139
	12	21	6	139	273	57	508

***** Business lending includes business overdrafts.

Notes to the consolidated financial statements (continued)

16. Impairment provisions on credit exposures

Group 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Opening balance	11	14	7	27	221	15	**295**
Charge for the year	4	12	3	14	99	12	**144**
Amounts written off	(9)	(18)	(7)	(10)	(110)	(16)	**(170)**
Recoveries of amounts written off in previous years	4	4	-	-	8	4	**20**
Closing balance	**10**	**12**	**3**	**31**	**218**	**15**	**289**
Specific	-	-	3	18	113	-	**134**
Collective	10	12	-	13	105	15	**155**
	10	**12**	**3**	**31**	**218**	**15**	**289**

Group 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Opening balance	11	18	6	31	287	21	374
Charge for the year	7	13	7	10	691	9	737
Amounts written off	(10)	(22)	(6)	(14)	(308)	(22)	(382)
Recoveries of amounts written off in previous years	3	5	-	-	14	7	29
Transfer to assets held for sale (note 24)	-	-	-	-	(463)	-	(463)
Closing balance	11	14	7	27	221	15	295
Specific	-	-	6	14	106	-	126
Collective	11	14	1	13	115	15	169
	11	14	7	27	221	15	295

***** Business lending includes business overdrafts.

Notes to the consolidated financial statements (continued)

16. Impairment provisions on credit exposures (continued)

Bank 2013	**Retail overdrafts £m**	**Credit cards £m**	**Lease finance £m**	**Mortgages £m**	**Business lending * £m**	**Other retail lending £m**	**Total £m**
Opening balance	11	14	7	17	221	15	**285**
Charge for the year	4	12	3	8	99	12	**138**
Amounts written off	(9)	(18)	(8)	(4)	(110)	(16)	**(165)**
Recoveries of amounts written off in previous years	4	4	-	-	8	4	**20**
Closing balance	**10**	**12**	**2**	**21**	**218**	**15**	**278**
Specific	-	-	2	12	113	-	**127**
Collective	10	12	-	9	105	15	**151**
	10	**12**	**2**	**21**	**218**	**15**	**278**

Bank 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Opening balance	11	18	2	21	287	21	360
Charge for the year	7	13	7	5	691	9	732
Amounts written off	(10)	(22)	(2)	(9)	(308)	(22)	(373)
Recoveries of amounts written off in previous years	3	5	-	-	14	7	29
Transfer to assets held for sale (note 24)	-	-	-	-	(463)	-	(463)
Closing balance	11	14	7	17	221	15	285
Specific	-	-	6	8	106	-	120
Collective	11	14	1	9	115	15	165
	11	14	7	17	221	15	285

***** Business lending includes business overdrafts.

Comparative disclosures have been amended to conform with current year presentation.

	Group		**Bank**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Amounts included in				
Loans and advances to customers (note 15)	**289**	295	**278**	285
Non-accrual loans				
Loans and advances to customers	**363**	343	**325**	299
Specific provisions	**(134)**	(126)	**(127)**	(120)
	229	217	**198**	179

17. Securitisations and covered bonds

Securitised advances are subject to non-recourse finance arrangements. These loans have been transferred at principal value to SPEs and have been funded through the issue of amortising mortgage backed securities to investors. The transfers do not meet the criteria for derecognition in IAS 39 as the Group has retained the risks and rewards of the assets. The Group consolidated financial statements include the results, assets and liabilities of the securitisation SPEs, on a line by line basis.

The balances of assets and liabilities in relation to Securitisation Notes and Covered Bonds in issue at 30 September 2013 within the Group and Bank balance sheets are as follows:

2013	**Group**			**Bank**		
	Securitised Notes £m	**Covered Bonds £m**	**Total £m**	**Securitised Notes £m**	**Covered Bonds £m**	**Total £m**
At 1 October 2012	2,079	1,084	**3,163**	-	1,084	**1,084**
Issuance of debt	541	-	**541**	-	-	**-**
Repayments	(613)	-	**(613)**	-	-	**-**
Other movements	23	(43)	**(20)**	-	12	**12**
At 30 September 2013	**2,030**	**1,041**	**3,071**	**-**	**1,096**	**1,096**
Securitised assets	**4,834**	**2,751**	**7,585**	**3,202**	**1,660**	**4,862**

2012	Group			Bank		
	Securitised Notes £m	Covered Bonds £m	Total £m	Securitised Notes £m	Covered Bonds £m	Total £m
At 1 October 2011	1,439	-	1,439	-	-	-
Issuance of debt	1,556	1,096	2,652	-	1,096	1,096
Repayments	(869)	-	(869)	-	-	-
Other movements	(47)	(12)	(59)	-	(12)	(12)
At 30 September 2012	2,079	1,084	3,163	-	1,084	1,084
Securitised assets	4,364	2,498	6,862	2,470	1,445	3,915

Further information on bonds, notes and subordinated debt can be found in note 28.

Other movements consist of exchange rate movements on currency denominated bonds and fair value hedge accounting adjustments.

In addition to the securitisation notes disclosed above, there are £441m (2012: £474m) of Lannraig debt securities which are held by NAB and disclosed as a related party transaction (note 11). Assets which support the Lannraig debt are disclosed in the table above.

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. Where relevant, the table also sets out the net position of the fair value of financial assets where the counterparty to the associated liabilities has recourse only to the financial assets:

Group	**2013**		2012	
	Securitisation £m	**Covered bonds £m**	Securitisation £m	Covered bonds £m
Carrying amount of transferred assets	**4,834**	**2,751**	4,364	2,498
Carrying amount of associated liabilities	**2,471**	**1,041**	2,553	1,084

Notes to the consolidated financial statements (continued)

17. Securitisation and covered bonds (continued)

For those liabilities that have recourse only to the transferred assets:

Group	2013		2012	
	Securitisation £m	**Covered bonds £m**	Securitisation £m	Covered bonds £m
Fair value of transferred assets	**4,834**	**-**	4,364	-
Fair value of associated liabilities	**2,471**	**-**	2,553	-
	2,363	**-**	1,811	-

There were no transactions in the year where the Group or Bank transferred financial assets that should have been derecognised in their entirety.

Securitisation

The loans do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an on-going basis. The Group and Bank continue to be exposed primarily to liquidity risk, interest rate risk and credit risk of the loans. The securitisation trusts are consolidated into the Group. The note holders only have recourse to the mortgage pool of assets.

Covered Bonds

The residential mortgages do not qualify for derecognition because the Group and Bank retain all of the risks and rewards associated with them and where derivatives have not been externalised, interest rate and foreign currency risks are held in the Group and Bank. The covered bonds SPEs are consolidated, the residual mortgages are retained on the Group and Bank balance sheets and the covered bonds issued are included within debt securities in issue. The covered bond holders have dual recourse to the Bank or the covered bond pool assets.

18. Property, plant and equipment

Group and Bank	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Short-term leasehold land and buildings £m	Motor vehicles, fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2011	34	4	138	109	285
Additions	-	-	9	2	11
Disposals	(12)	-	(3)	(12)	(27)
On revaluation	(2)	(1)	-	-	(3)
At 30 September 2012	**20**	**3**	**144**	**99**	**266**
Additions	-	-	26	6	32
Disposals	(1)	-	(14)	(21)	(36)
At 30 September 2013	**19**	**3**	**156**	**84**	**262**
Accumulated depreciation					
At 1 October 2011	1	-	69	64	134
Charge for the year	-	-	11	8	19
Disposals	-	-	(2)	(13)	(15)
At 30 September 2012	**1**	**-**	**78**	**59**	**138**
Charge for the year	-	-	13	6	19
Disposals	-	-	(8)	(7)	(15)
At 30 September 2013	**1**	**-**	**83**	**58**	**142**
Net book value					
At 30 September 2013	**18**	**3**	**73**	**26**	**120**
At 30 September 2012	19	3	66	40	128

Valuations

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Group's own Director valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors. Valuations are performed annually in July. A comparison of the carrying value under the revaluation basis and if the historical cost basis had been used is shown below:

Group	2013 £m	2012 £m
Carrying value as included under the revaluation basis	**21**	22
Carrying value if the historical cost basis had been used	**19**	19

19. Investment properties

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
At 1 October	**77**	81	**77**	78
Additions	**-**	1	**-**	4
Disposals	**(14)**	(2)	**(14)**	(2)
Deficit on revaluation	**-**	(3)	**-**	(3)
	63	77	**63**	77

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Group's own Director valuations. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards.

During the year 99% (2012: 99%) of the investment properties generated total rental income of £3m (2012: £3m) and incurred operating expenses of £2m (2012: £2m). The operating expenses of the investment properties that did not generate rental income were £Nil (2012: £Nil).

During the year, £Nil (2012: £3m) of properties were transferred from St Vincent Investments Limited, a controlled entity, to the Bank.

20. Property inventory

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
At 1 October	**9**	27	**7**	11
Additions	**-**	1	**-**	-
Disposals	**(3)**	(14)	**(1)**	(4)
Write-down of property inventory	**-**	(5)	**-**	-
	6	9	**6**	7

All properties within property inventory are complete and available for sale. No properties are under construction (2012: £2m).

21. Investment in controlled entities and associates

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
At 30 September	**3**	3	**609**	613

The details of all subsidiary undertakings will be annexed to the next annual return of the Bank.

The principal controlled entities are as follows:

Controlled entities as at 30 September 2013	Nature of business	Country of incorporation
Yorkshire Bank Home Loans Limited	Mortgage finance	England

The following companies are SPEs established in connection with the Group's securitisation and covered bond programmes (note 17). Although the Bank has no direct or indirect ownership interest in these entities, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's financial statements.

Other controlled entities as at 30 September 2013	Nature of business	Country of incorporation
Clydesdale Covered Bonds LLP	Acquisition of mortgage loans	England
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

All of the above controlled entities have a 30 September financial year end.

Associates

Associates are undertakings over which the Bank exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2013. The associated undertaking is The Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is the provision of finance and the Group's interest of 33.33% in the issued equity capital of £2m is held by the Bank. The associated undertaking has a 31 March year end.

22. Deferred tax

Movement in net deferred tax asset	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
At 1 October	**228**	80	**224**	77
Recognised in the income statement (note 8)	**(3)**	106	**(3)**	106
Recognised directly in equity	**(5)**	62	**(7)**	61
Transfer to assets held for sale (note 24)	**-**	(20)	**-**	(20)
At 30 September	**220**	228	**214**	224

The Group recognises deferred tax attributable to the following items:	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Deferred tax assets				
Defined benefit pension liability	**37**	70	**37**	70
Impairment provision on credit exposures	**9**	14	**9**	14
Employee equity based compensation	**1**	4	**1**	4
Tax losses carried forward	**103**	92	**103**	92
Provisions	**47**	59	**47**	59
Accelerated capital allowances	**20**	-	**20**	-
Other	**10**	10	**4**	5
	227	249	**221**	244
Deferred tax liabilities				
Accelerated capital allowances	**-**	(18)	**-**	(18)
Net gain on revaluation of properties	**1**	1	**1**	1
Cash flow hedge reserve	**6**	37	**6**	37
Other	**-**	1	**-**	-
	7	21	**7**	20
Net deferred tax asset	**220**	228	**214**	224

The Group considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The largest deferred tax asset held within the Group relates to tax losses carried forward. The tax losses carried forward have been assessed for recoverability against the Group's forecasts which include adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses, despite this the losses are expected to be fully utilised within the assessment period.

The headline rate of UK corporation tax reduced from 24% to 23% on 1 April 2013, and through the enactment of Finance Act 2013 will reduce further to 21% from 1 April 2014 and 20% from 1 April 2015. Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Accordingly, as the future reductions of the corporation tax rate to 21% and 20% were enacted on 17 July 2013, the deferred tax balances at 30 September 2013 have been reflected at the tax rates they are expected to be realised or settled.

Notes to the consolidated financial statements (continued)

23. Other assets

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Prepayments and accrued income	**258**	257	**229**	257
Other	**358**	242	**316**	242
	616	499	**545**	499

24. Assets held for sale

	Group 2013 £m	Bank 2013 £m	Group 2012 £m	Bank 2012 £m
Assets held for sale				
Other financial assets at fair value	**-**	**-**	1,475	1,475
Gross loans and advances to customers	**-**	**-**	4,177	4,177
	-	**-**	5,652	5,652
Impairment provisions on credit exposures	**-**	**-**	(463)	(463)
Derivative financial instruments	**-**	**-**	(4)	(4)
Deferred tax	**-**	**-**	20	20
Other assets	**-**	**-**	20	20
	-	**-**	5,225	5,225
Liabilities associated with assets held for sale				
Derivative financial instruments	**-**	**-**	142	142

The assets held for sale were transferred to NAB on 5 October 2012 following the strategic review undertaken by the Group.

25. Due to other banks

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Transaction balances with other banks	**6**	9	**6**	9
Securities sold under agreements to repurchase	**-**	78	**-**	78
Deposits from other banks	**515**	470	**515**	470
	521	557	**521**	557

26. Due to customers

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Non-interest bearing demand deposits	**1,687**	1,637	**1,687**	1,637
Interest bearing demand deposits	**15,278**	14,341	**15,278**	14,341
Term deposits	**6,801**	9,779	**6,801**	9,779
Other wholesale deposits	**380**	624	**380**	624
	24,146	26,381	**24,146**	26,381

Comparative disclosures have been amended to conform with current year presentation.

Notes to the consolidated financial statements (continued)

27. Provisions

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Payment Protection Insurance redress provision				
Opening balance	**108**	102	**108**	102
Charge to the income statement	**130**	120	**130**	120
Provision utilised	**(86)**	(114)	**(86)**	(114)
Closing balance	**152**	108	**152**	108
Customer redress and other provisions				
Opening balance	**58**	6	**56**	6
Charge to the income statement	**108**	57	**108**	55
Provision utilised	**(48)**	(5)	**(46)**	(5)
Closing balance	**118**	58	**118**	56
Restructuring provision				
Opening balance	**126**	-	**126**	-
Charge to the income statement	**-**	149	**-**	149
Provision utilised	**(73)**	(23)	**(73)**	(23)
Transfer to surplus lease space provision	**(20)**	-	**(20)**	-
Closing balance	**33**	126	**33**	126
Surplus lease space provision				
Opening balance	**-**	-	**-**	-
Charge to the income statement	**2**	-	**2**	-
Provision utilised	**(10)**	-	**(10)**	-
Transfer from restructuring provision	**20**		**20**	
Closing balance	**12**	-	**12**	-
Total provisions	**315**	292	**315**	290

Payment Protection Insurance redress

The Group has reassessed the level of provision that is considered necessary to meet current and future expectations in relation to the mis-selling of Payment Protection Insurance ("PPI") policies and has consequently raised an additional provision of £130m (2012: £120m) in the year. This brings the total provisions raised in respect of PPI to £386m (2012: £256m) with £152m of this remaining as at 30 September 2013 (2012: £108m).

As described in note 3, significant judgement is required in determining the key assumptions used to estimate the quantum of the provision. These key assumptions are:

- The level of complaints;
- Uphold rates (how many claims are, or may be, upheld in the customer's favour);
- The customer contact response rate; and
- Redress costs (the average payment made to customers).

In order to ensure that the assumptions used remain valid, they are regularly reviewed and assessed. This includes:

- Analysis of the causes of complaints and uphold rates;
- The extent of redress paid to customers, including how this may change over time and what would drive this; and
- The impact on complaint levels both from an increased internal focus as well as proactive customer contact.

In addition, the Group continues to review its approach to the regulator's policy statement issued in August 2010 on the handling of complaints including feedback the Group has received from the FCA on its complaint handling process. The Group also monitors the findings of the Financial Ombudsman Service ("FOS") and where appropriate updates its processes to reflect learning.

Notes to the consolidated financial statements (continued)

27. Provisions (continued)

The provision reflects our current assessment of the potential failings in our PPI complaint handling policy where the Bank fully recognises its obligation to provide a fair and comprehensive complaints process which is not constrained by time period. We will continue to work with the FCA and the FOS to ensure we have a robust complaints process which is in the best interests of our customers. The provision also reflects an assessment of future PPI claims based upon estimates; statistical analysis and assumptions in relation to a wide range of uncertain factors, including how many PPI claims will be made against Clydesdale Bank PLC, for what value, and the prospect of the mis-selling being established in relation to those claims. The number of complaints received is monitored against expectations and while these have continued to fall, the rate of decline is lower than had been previously expected.

Therefore the provision continues to be subject to a number of inherent risks and uncertainties as a result of assumptions used in quantifying the Bank's best estimate of expected costs at 30 September 2013. The eventual costs of redress and complaint handling may therefore differ materially from that estimate and further provision could be required.

Provision for customer redress and other provisions

A provision for customer redress is held in those instances where the Group expects to make payments to customers whether on an ex-gratia or compensatory basis. Provisions can arise as a result of legal or regulatory action and incorporate the costs of skilled persons, and where appropriate other elements of administration.

On 29 June 2012 the Financial Services Authority ("FSA") announced that it had reached agreement with a number of UK banks in relation to a review and redress exercise on sales of certain interest rate hedging products to small and medium businesses. The Group agreed to participate in this exercise, as announced by the FSA on 23 July 2012, and has embarked on a program to identify small and medium sized customers that may have been affected. The exercise incorporates certain of the Group's tailored business loan products as well as the standalone hedging products identified in the FSA's notice.

A provision of £49m is held for this matter. The income statement effect of this provision is nil due to the recognition of an offsetting receivable from NAB.

The total cost of this exercise and any future, separate, thematic or other consideration of customer complaints in relation to other out of scope tailored business loans, a number of which are currently subject to review and challenge by the FOS, is uncertain.

Other provisions include provisions in respect of legal proceedings and claims arising in the ordinary course of the Group's business. These include £16m for historical mortgage repayment irregularities recently subject to public disclosure, our contribution to the banking industry response to the CPP Scheme of Arrangement, as well as a number of other matters.

Restructuring provision

Following the announcement of the results of the UK Banking strategic review on 30 April 2012, a restructuring provision of £139m was raised in May 2012. The provision covers redundancy payments, lease break fees, surplus space costs and associated enablement costs. In the period to 30 September 2013, £73m was utilised principally for the reduction of roles, the closure of 38 Financial Service Centres and two Customer Service Centres and the associated provisionable enablement costs of delivery of these activities. There was a further reduction of £20m by way of a transfer to a separate surplus lease space provision which is described below.

Surplus lease space provision

The Group provides for committed rental expense on surplus lease space in line with the expected years' exposure on individual leases where the property is unoccupied. The level of surplus lease space has increased as a result of the strategic review. The provision will be utilised over the remaining life of the leases or until the leases are assigned. The provision is measured at present values by discounting anticipated future cash flows.

28. Bonds, notes and subordinated debt

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Residential mortgage backed securities	**2,039**	2,094	**-**	-
Covered bonds	**1,096**	1,096	**1,096**	1,096
Total bonds, notes and subordinated debt	**3,135**	3,190	**1,096**	1,096
Fair value hedge adjustments	**(64)**	(27)	**-**	(12)
	3,071	3,163	**1,096**	1,084

On 13 June 2013, USD$300m and £350m of residential mortgage backed securities were issued through Lanark 2013-1.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC to parties outside of the NAB Group as at 30 September 2013 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Maturity date
Class A residential mortgage backed securities				
28 February 2012	EUR	**488**	3M EURIBOR + 1.95%	22 May 2015
27 July 2012	USD	**494**	3M USD LIBOR + 1.40%	22 May 2016
27 July 2012	GBP	**523**	3M GBP LIBOR + 1.63%	22 November 2017
13 June 2013	GBP	**349**	3M GBP LIBOR + 0.45%	22 August 2016
13 June 2013	USD	**185**	3M USD LIBOR + 0.50%	22 August 2016
		2,039		
Covered bonds				
31 May 2012	GBP	**696**	4.63%	08 June 2026
31 May 2012	GBP	**400**	3M GBP LIBOR + 1.70%	08 June 2015
		1,096		
		3,135		

29. Retirement benefit obligations

The Bank is the sponsoring employer in one funded defined benefit scheme, the Yorkshire and Clydesdale Bank Pension Scheme ("the Scheme"). The assets of the Scheme are held in a trustee administered fund. The Group also provides post-retirement health care benefits under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made.

	2013 £m	2012 £m
Defined benefit scheme assets	**2,718**	2,485
Defined benefit scheme obligations	**(2,915)**	(2,786)
Net defined benefit pension scheme obligations	**(197)**	(301)
Post-retirement medical benefits obligations	**(5)**	(5)
Net retirement benefits obligation	**(202)**	(306)

The Group has implemented a number of reforms to the Scheme to control the liability. It closed the Scheme to new members in 2004 and has determined benefits accruing after April 2006 on a career average revalued earnings basis. The principal pension available to new employees since the closure of the Scheme is a defined contribution scheme, "Total Pension". The pension charge for the year in relation to Total Pension is shown in note 7.

The Group implemented additional reforms to the Scheme which were effective from April 2012. These included changing the inflation index used to determine benefit increases from the Retail Price Index ("RPI") to the Consumer Price Index ("CPI") for future accruals and introducing member based contributions into the Scheme, increasing annually over a three year period. As an alternative to contributions, employees have the option of reducing their future annual rate of accrual from 1/60th of salary to 1/80th.

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.3m (2012: £0.4m) and would have no material impact upon service costs and interest costs.

Reconciliation of the defined benefit pension scheme assets	**2013 £m**	2012 £m
Opening fair value of defined benefit pension scheme assets	**2,485**	2,076
Actual return on scheme assets	**190**	248
Employer contributions (note 11)	**134**	242
Benefits paid	**(91)**	(81)
Closing fair value of defined benefit pension scheme assets	**2,718**	2,485

Reconciliation of the defined benefit pension scheme obligations	**2013 £m**	2012 £m
Opening defined benefit pension scheme obligations	**(2,786)**	(2,256)
Interest cost	**(118)**	(120)
Current service cost	**(30)**	(33)
Benefits paid	**91**	81
Actuarial loss	**(59)**	(456)
Past service cost	**(13)**	(2)
Closing defined benefit pension scheme obligations	**(2,915)**	(2,786)

Employer contributions include a contribution of £Nil from NAB (2012: £130m). The payment in 2012 was negotiated with the Scheme Trustees and formed part of a series of actions by NAB which resulted in its withdrawal as a participating employer in the Scheme during January 2012. The withdrawal as a participating employer did not materially impact the liabilities as measured under IAS 19, and the contribution therefore improved the overall Scheme funding position.

Notes to the consolidated financial statements (continued)

29. Retirement benefit obligations (continued)

The major categories of plan assets for the Scheme, stated at fair value, are as follows:

	2013 £m	2012 £m
Equities	**789**	990
Government bonds	**924**	557
Global sovereign bonds	**103**	105
Corporate bonds	**717**	709
Property	**93**	99
Cash	**92**	25
Fair value of defined benefit pension scheme assets	**2,718**	2,485

The Scheme is not invested in any of the Group's own financial instruments. There were no plan assets occupied by the Group and Bank at 30 September 2013 (2012: £25m).

Amounts recognised in the income statement	2013 £m	2012 £m
Current service cost	**30**	33
Past service cost	**13**	2
Interest cost	**118**	120
Expected return on scheme assets	**(131)**	(136)
Defined benefit pension expense for the year	**30**	19

The past service cost relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements and in 2013 these were fully offset in the income statement by a corresponding release from the restructure provision.

Amounts recognised in the statement of comprehensive income	2013 £m	2012 £m
Opening cumulative actuarial losses	**(695)**	(351)
Experience gains on scheme assets	**59**	113
Experience gains/(losses) on scheme liabilities	**4**	(41)
Changes in actuarial assumptions	**(63)**	(416)
Cumulative actuarial losses recognised in the statement of comprehensive income	**(695)**	(695)

Actuarial assumptions	2013 % p.a.	2012 % p.a.
Inflation	**3.25**	2.50
Rate of increase for pensions in payment:		
Pre 5 April 1997 benefits (Clydesdale Bank section)	**2.25**	2.25
Pre 5 April 1997 benefits (Yorkshire Bank section)	**3.10**	2.40
5 April 1997 to April 2006 benefits (both sections)	**3.10**	2.40
Post April 2006 benefits (both sections)	**2.25**	2.25
Rate of increase for pensions in deferment [1]	**2.25**	2.00
Discount rate	**4.60**	4.30
Expected rate of return on plan assets		
Equities	**7.70**	7.40
Government bonds	**3.10**	3.00
Global sovereign bonds	**3.50**	3.40
Corporate bonds	**4.30**	3.95
Property	**6.50**	6.40
Cash	**3.10**	3.00

[1] The assumption for the rate of increase for pensions in deferment has been linked to the Consumer Price Index from 30 September 2010, following a government announcement on 8 July 2010 relating to increases in pensions that are not specifically linked to the Retail Prices Index.

Notes to the consolidated financial statements (continued)

29. Retirement benefit obligations (continued)

Actuarial assumptions (continued)

Post retirement mortality:	**2013 years**	2012 years
Current pensioners at 60 – male	**28.0**	27.9
Current pensioners at 60 – female	**28.5**	28.4
Future pensioners at 60 – male	**29.5**	29.4
Future pensioners at 60 – female	**30.0**	29.9

The expected return on assets assumption has been determined by considering the assets expected to be held over the following year and the expected returns for each asset class.

History of experience gains and (losses)	**2013 £m**	2012 £m	2011 £m	2010 £m	2009 £m
On scheme assets	**59**	113	(97)	46	(112)
On scheme liabilities	**4**	(41)	(16)	45	(2)
Changes in actuarial assumptions	**(63)**	(416)	162	(158)	(477)
	-	(344)	49	(67)	(591)

History of net defined benefit pension scheme obligation	**2013 £m**	2012 £m	2011 £m	2010 £m	2009 £m
Defined benefit assets	**2,718**	2,485	2,076	2,011	1,828
Defined benefit obligation	**(2,915)**	(2,786)	(2,256)	(2,323)	(2,138)
Net obligation	**(197)**	(301)	(180)	(312)	(310)

30. Other liabilities

	Group		**Bank**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Accruals and deferred income	**48**	52	**48**	51
Notes in circulation	**1,709**	1,567	**1,709**	1,567
Accrued interest payable	**367**	362	**354**	350
Other	**199**	141	**193**	150
	2,323	2,122	**2,304**	2,118

Notes to the consolidated financial statements (continued)

31. Called up share capital

Group and Bank

Allotted, called up and fully paid	**2013 £m**	2012 £m
Ordinary shares of £1 each		
Opening ordinary share capital	**1,442**	942
Issued during the year	**-**	500
Closing ordinary share capital	**1,442**	1,442
Preference shares of £1 each	**300**	300
Closing called up share capital	**1,742**	1,742

The preference shares on issue have all been classified as equity instruments. The preference shares issued on 17 December 2008 entitle the holder to a discretionary fixed non-cumulative dividend of 12% per annum payable every six months on the capital paid up thereon. The preference shares issued on 20 December 2010 entitle the holder to a discretionary non-cumulative dividend of LIBOR plus 779bps every six months on the capital paid up thereon.

The dividends payable on the preference shares are at the Bank's discretion based on a number of factors. The preference shares are redeemable, in whole only, at the option of the Bank on the first business day following the fifth anniversary of the date of issue. No such redemption may be made without the consent of the PRA.

32. Total equity

	Group		**Bank**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Share capital (note 31)	**1,742**	1,742	**1,742**	1,742
Share premium account	**243**	243	**243**	243
Total share capital and share premium	**1,985**	1,985	**1,985**	1,985
Merger reserve	**338**	338	**338**	338
Share option reserve	**2**	5	**2**	5
Asset revaluation reserve	**2**	1	**2**	1
Available for sale investments reserve	**5**	12	**5**	13
Cash flow hedge reserve	**23**	124	**23**	124
Total other reserves	**370**	480	**370**	481
Retained earnings	**55**	139	**30**	24
Total equity	**2,410**	2,604	**2,385**	2,490

Merger reserve

The merger reserve arose as a result of the transfer of the entire business and undertakings of Yorkshire Bank PLC to Clydesdale Bank PLC on 1 December 2004. As no consideration was paid in relation to the transfer the only impact arising was the crystallisation of the Yorkshire Bank PLC share capital and share premium into a merger reserve in the combined entity.

32. Total equity (continued)

Share option reserve

The Bank's share option reserve represents the outstanding fair value amount in respect of share based payment expense recharged by its ultimate parent that has been charged through the income statement and adjusted for deferred tax.

Asset revaluation reserve

The asset revaluation reserve includes the gross revaluation increments and decrements arising from the revaluation of land and buildings.

Available for sale investments reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale investments.

Cash flow hedge reserve

The cash flow hedge reserve records fair value revaluations of derivatives designated as cash flow hedging instruments to the extent that they are effective.

As at 30 September 2013 the cash flow hedge reserve principally comprises crystallised fair value gains arising from the de-designated cash flow hedge (£75m) partially offset by deferred losses on interest rate swaps in the new macro cash flow hedge (£46m). The balance on the cash flow hedge reserve is net of tax.

£51m was recycled into the income statement in relation to the de-designated hedge in the period.

33. Contingent liabilities and commitments

The table below sets out the contractual amounts of contingent liabilities and commitments. Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts do not represent the amounts at risk at the balance sheet date but the amounts that would be at risk should the contracts be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

	Group		**Bank**	
Contingent liabilities	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Guarantees and assets pledged as collateral security:				
At call	**1**	1	**1**	1
Due in less than 3 months	**34**	57	**34**	57
Due between 3 months and 1 year	**63**	44	**63**	44
Due between 1 year and 3 years	**12**	70	**12**	70
Due between 3 years and 5 years	**4**	4	**4**	4
Due after 5 years	**90**	102	**90**	102
No specified maturity	**9**	8	**9**	8
	213	286	**213**	286
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**8,696**	9,290	**8,664**	9,244

Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for in the financial statements at 30 September 2013 of £0.7m (2012: £0.6m).

Notes to the consolidated financial statements (continued)

33. Contingent liabilities and commitments (continued)

Operating lease commitments

Group and Bank

	2013 £m	2012 £m
Leases as lessor		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	**2**	2
between 1 year and 5 years	**3**	5
over 5 years	**2**	6
	7	13
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	**31**	35
between 1 year and 5 years	**91**	112
over 5 years	**115**	224
	237	371

Other contingent liabilities

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme ("FSCS") provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be largely repaid from the realisation of the assets of the institutions. During the last year, the FSCS has also invoiced institutions for the first of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings which remains after the three annual levies have been paid is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2014 and an accrual of £7m (2012: £8m) is held for the Group's calculated liability to that date, with £6m of the current year charge having already been paid. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

The Group has provided for its best estimate of conduct risk related liabilities at 30 September 2013 as a result of its historical products and past sales practices (note 27). This has required management to exercise judgement and use estimation techniques, therefore a high degree of estimation uncertainty still exists as further described in note 3. Ongoing regulatory review and input, as well as changes in the rulings from the FOS over time, and the Group's own reviews of customer complaints will continue to impact upon the nature and extent of conduct-related customer redress and associated costs for which the Group may ultimately become liable. Accordingly the total cost associated with such conduct related matters is inherently uncertain.

Legal claims

The Group is named in and is defending a number of legal claims arising in the ordinary course of business. No material adverse impact on the financial position of the Group is expected to arise from the ultimate resolution of these legal actions.

Notes to the consolidated financial statements (continued)

34. Notes to the statements of cash flows

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Adjustments included in the loss before tax				
Interest receivable	**(1,209)**	(1,461)	**(1,162)**	(1,313)
Interest payable	**453**	592	**453**	605
Depreciation (note 7)	**19**	19	**19**	19
Profit on sale of tangible fixed assets *	**(1)**	(10)	**(1)**	(10)
Loss on revaluation of tangible fixed assets *	**-**	10	**-**	4
Transfer from available for sale reserve	**-**	(4)	**-**	(2)
Transfer from cash flow hedge reserve	**3**	(1)	**3**	13
Derivative financial instruments fair value movements	**11**	(9)	**11**	(9)
Impairment losses on credit exposures (note 16)	**144**	737	**138**	732
Dividends received from subsidiaries	**-**	-	**(116)**	(167)
Movement in share option reserve	**(3)**	(9)	**(3)**	(9)
	(583)	(136)	**(658)**	(137)
Changes in operating assets				
Net decrease /(increase) in:				
Balances with supervisory central banks	**(12)**	(2)	**(12)**	(2)
Due from other banks	**(170)**	(2)	**(171)**	(1)
Derivative financial instruments	**247**	429	**281**	414
Financial assets at fair value through profit or loss	**636**	2,055	**636**	2,055
Loans and advances to customers	**307**	3,155	**178**	3,149
Due from customers on acceptances	**3**	-	**3**	-
Other assets	**(107)**	53	**(128)**	19
Assets held for sale (note 24)	**5,225**	(5,225)	**5,225**	(5,225)
	6,129	463	**6,012**	409
Changes in operating liabilities				
Net (decrease)/increase in:				
Due to other banks	**(55)**	(783)	**(55)**	(783)
Derivative financial instruments	**(289)**	21	**(315)**	(293)
Financial liabilities at fair value through profit or loss	**(27)**	(8)	**(27)**	(8)
Due to customers	**(2,235)**	(1,789)	**(2,235)**	(1,898)
Liabilities on acceptances	**(3)**	-	**(3)**	-
Provisions (note 27)	**23**	184	**25**	182
Defined benefit pension obligations	**(104)**	(223)	**(104)**	(223)
Other liabilities	**175**	284	**161**	308
Liabilities associated with assets held for sale (note 24)	**(142)**	142	**(142)**	142
	(2,657)	(2,172)	**(2,695)**	(2,573)

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group 2013 £m	Group 2012 £m	Bank 2013 £m	Bank 2012 £m
Cash and balances with central banks (note 10)	**6,672**	7,892	**6,672**	7,892
Other assets	**178**	153	**178**	246
Due to other banks	**(28)**	(9)	**(28)**	(9)
Due to related entities	**(182)**	(13)	**(182)**	(13)
Other liabilities	**(95)**	(74)	**(95)**	(74)
	6,545	7,949	**6,545**	8,042

35. Employees

The average number of full time equivalent employees of the Group during the year was made up as follows:

	2013 Number	2012 Number
Managers	**1,131**	1,698
Clerical staff	**3,439**	3,672
	4,570	5,370

The average number of staff employed in the UK Banking operating division of NAB in the year to 30 September 2013 was 6,798 (2012: 8,105). All staff are contracted employees of NAGE and its subsidiary undertakings. The numbers above disclose the staff remunerated directly by the Group but exclude employees working within other NAGE subsidiaries who provide support services to the Group.

36. Equity based compensation

Share incentive plans, share offers, performance options and performance rights are used to provide short-term and long-term incentives to employees. These incentives are an integral part of the Group's remuneration strategy in rewarding employees' current and future contribution to the Group's performance. All UK awards are made in accordance with the principles set out within the Prudential Regulation Authority's Remuneration Code.

The plans described below involve the provision of shares, performance options and performance rights to employees, senior management and Directors of the Group.

Short term incentive ("STI")

The STI plan has an element of deferral to provide an appropriate level of reward aligned with sound risk management principles. STI deferral encourages longer-term sustainable decision making and assurance of individual and business performance. Deferral applies to all levels of performance across the organisation. Deferral is in the form of NAB shares, restricted for at least one year. The deferred equity is subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet compliance requirements. A reduction or forfeiture of deferred amounts can also be determined by the Principal Board, at its absolute discretion. Such a determination may be made in relation to the NAB Group, a business unit, executive committee, role or individual.

Recognition and retention shares

These shares enable retention and recognition awards to be provided in the form of shares, rather than in cash. Such awards are made on a very limited basis with NAB Group Principal Board Remuneration Committee approval, to individuals in significant key roles where retention is critical over a medium-term timeframe (two to three years). Awards under the programme may also be provided to individuals accepting significant project leadership or additional responsibilities for a limited period of time with no related increase in their fixed remuneration. The provision of shares under this plan is desired over the use of cash payments, as it provides a stronger retention and shareholder value link to the reward. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, or retirement or failure to meet compliance requirements. The minimum restriction period is until the final key date or milestone has been achieved.

Commencement shares

These shares enable 'buyout' of evidenced equity from previous employment for significant new hires. Shares are provided under this programme or commencement performance options and performance rights if more appropriate. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet compliance requirements.

Notes to the consolidated financial statements (continued)

36. Equity based compensation (continued)

UK Share Incentive Plan

The UK Share Incentive Plan is an approved HM Revenue and Customs share plan. Employees are entitled to purchase up to £1,500 worth of NAB shares each year through the Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on the market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

General employee shares

Up to a target value of A$1,000 of NAB shares are offered to each eligible employee when the NAB Group's performance is on target, measured against a scorecard of objectives for the financial year. These shares are held in trust, restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Group Executive Long term Incentive plan ("LTI")

LTI helps to drive management decisions focused on the long-term prosperity of the NAB Group through the use of challenging performance hurdles. The Executive LTI programme is awarded to senior executives across the NAB Group and is provided wholly as performance rights. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. External and/or internal performance hurdles are measured at the end of a four year restriction period and during the restriction period an executive will forfeit their performance rights for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

UK Long Term Incentive plan

The UK LTI programme applies to the UK Executive Committee and is provided equally between a deferred cash award and performance rights. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. External and/or internal performance hurdles are measured at the end of a four year restriction period and during the restriction period an executive will forfeit the cash award and the performance rights for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

Each performance right is exchanged for one fully paid ordinary share in NAB upon exercise, subject to standard adjustments for capital actions. No exercise price is payable by the holder on exercise of performance rights.

Performance options

Performance options are predominantly offered only to key senior executives of the Group and generally lapse after a specified number of days after cessation of employment as determined by the NAB Board.

Notes to the consolidated financial statements (continued)

36. Equity based compensation (continued)

The movement in performance options and performance rights granted and exercised during the year was as follows:

Performance options	**2013 Number**	**2013 Weighted average exercise price A$**	2012 Number	2012 Weighted average exercise price A$
Outstanding at 1 October	**278,946**	**26.12**	3,432,798	36.65
Granted during the year	**-**	**-**	-	-
Forfeited and lapsed during the year	**(55,527)**	**30.65**	(3,095,354)	37.92
Exercised during the year	**(41,177)**	**19.89**	(58,498)	19.89
Expired during the year	**(96,527)**	**31.70**	-	-
Outstanding at 30 September	**85,715**	**19.89**	278,946	26.12
Exercisable at 30 September	**-**		65,343	

The number of performance options exercised during the year was 41,177 (2012: 58,498). For performance options outstanding at 30 September 2013, the weighted average remaining contractual life is 0.79 years (2012: 1.3 years). The exercise price for performance options outstanding at the end of the year was A$19.89 (2012: the range of exercise prices was A$19.89 - A$31.70).

Performance rights	**2013 Number**	2012 Number
Outstanding at 1 October	**145,729**	745,984
Granted during the year	**61,258**	145,729
Forfeited and lapsed during the year	**(20,868)**	(717,699)
Exercised during the year	**-**	(28,285)
Expired during the year	-	-
Outstanding at 30 September	**186,119**	145,729
Exercisable at 30 September	**-**	-

No performance rights were exercised during the year (2012: 28,285). For performance rights outstanding at 30 September 2013, the weighted average remaining contractual life is 2.87 years (2012: 3.21 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

No performance options were granted during the year ended 30 September 2013 (2012: Nil). 61,258 performance rights were granted during the year ended 30 September 2013 (2012: 145,729). Included within personnel expenses (note 7) is a fair value of goods or services to the value of £0.8m, which was measured indirectly by reference to the fair value on the performance rights granted during the year (2012: £1.4m).

Notes to the consolidated financial statements (continued)

37. Directors' emoluments

2013 £'000			Performance related pay							
			Short term incentive schemes [3]			Long term incentive schemes [6]				
	Salary and fees [1]	Benefits and allowances [2]	Annual (cash)	Deferred (shares)	Total short term	Deferred (cash)	Deferred (performance rights)	Deferred (shares)	Total long term	Total emoluments
Executive Directors										
Cameron Clyne (5)	-	-	-	-	-	-	-	-	-	-
John Hooper	591	242	70	211	281	267	267	1	535	1,649
Mark Joiner (5)	-	-	-	-	-	-	-	-	-	-
Richard Sawers (5)	-	-	-	-	-	-	-	-	-	-
David Thorburn	450	101	63	253	316	338	338	1	677	1,544
Total Executive	**1,041**	**343**	**133**	**464**	**597**	**605**	**605**	**2**	**1,212**	**3,193**
Non-executive Directors										
David Allvey (4)	78	-	-	-	-	-	-	-	-	78
David Browne (4)	78	-	-	-	-	-	-	-	-	78
Richard Gregory OBE (4)	138	-	-	-	-	-	-	-	-	138
James Pettigrew (4)	80	-	-	-	-	-	-	-	-	80
Barbara Ridpath (4)	69	-	-	-	-	-	-	-	-	69
Alexander Shapland (4)	69	-	-	-	-	-	-	-	-	69
Total Non-executive	**512**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**512**
Total Directors	**1,553**	**343**	**133**	**464**	**597**	**605**	**605**	**2**	**1,212**	**3,705**

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for Directors amounting to £405,000 (2012: £430,000) and in respect of emoluments for the highest paid Director of £175,000 (2012: £178,000). The table also includes deferred cash and deferred performance rights awarded on 20 February 2013 in respect of the previous financial year.

Notes to the consolidated financial statements (continued)

37. Directors' emoluments (continued)

2012 £'000			Performance related pay							
			Short term incentive schemes (3)			Long term incentive schemes (6)				
	Salary and fees (1)	Benefits and allowances (2)	Annual (cash)	Deferred (shares)	Total short term	Deferred (cash)	Deferred (performance rights)	Deferred (shares)	Total long term	Total emoluments
Executive Directors										
Cameron Clyne (5)	-	-	-	-	-	-	-	-	-	-
John Hooper	703	214	-	-	-	-	-	1	1	918
Mark Joiner (5)	-	-	-	-	-	-	-	-	-	-
Richard Sawers (5)	-	-	-	-	-	-	-	-	-	-
David Thorburn	400	109	-	-	-	-	-	1	1	510
Total Executive	1,103	323	-	-	-	-	-	2	2	1,428
Non-executive Directors										
David Allvey (4)	25	-	-	-	-	-	-	-	-	25
David Browne (4)	25	-	-	-	-	-	-	-	-	25
Jonathan Dawson	50	-	-	-	-	-	-	-	-	50
Sir David Fell	85	-	-	-	-	-	-	-	-	85
Richard Gregory OBE (4)	93	-	-	-	-	-	-	-	-	93
Roy Nicolson	69	-	-	-	-	-	-	-	-	69
Elizabeth Padmore	55	-	-	-	-	-	-	-	-	55
James Pettigrew (4)	-	-	-	-	-	-	-	-	-	-
Barbara Ridpath (4)	25	-	-	-	-	-	-	-	-	25
Alexander Shapland (4)	25	-	-	-	-	-	-	-	-	25
Sir Malcolm Williamson	156	-	-	-	-	-	-	-	-	156
Peter Wood	4	-	-	-	-	-	-	-	-	4
Total Non-executive	612		-	-	-	-	-	-	-	612
Total Directors	1,715	323	-	-	-	-	-	2	2	2,040

37. Directors' emoluments (continued)

Notes

(1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors.

(2) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to One Director (2012: One) under a defined benefit pension plan. Pension contributions amounting to £16,730 (2012: £18,000) were paid during the year of which contributions for the highest paid Director amounts to £16,730 (2012: £Nil).

(3) Performance related pay relates to the respective financial year. The short term incentive scheme includes a cash element will be paid in the forthcoming year and the deferred amount represents shares deferred for one and two years. The highest paid Director received 110,331 shares (2012: 165,132) that vested during the year, with a fair value of £422,940 (2012: £960,372).

(4) Current year figures represent a full year of directorship fees for Non-executive Directors who were appointed during FY 2012. Richard Gregory was appointed Senior Independent Director on 18 September 2012 and his directorship fees reflect increased compensation for this role.

(5) Cameron Clyne, Mark Joiner and Richard Sawers are remunerated as employees of NAB, and do not receive incremental remuneration in respect of their duties as Directors of the Bank. The Directors believe it would be appropriate to apportion A$782,000 (2012: A$510,000) of their remuneration as being in respect of their duties to the Bank.

(6) The long term incentive scheme amounts principally represent deferred cash, deferred performance rights and deferred shares for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. Typically, the performance period is four years. The value attributed is the fair value of the shares at the date of granting. Two Directors (2012: None) received benefits under an executive long term incentive scheme. The 2013 table also includes deferred cash and performance rights awarded on 20 February 2013 in relation to the previous financial year. One Director exercised share options during the year (2012: One). In 2012, the amounts disclosed relate solely to the general employee shares described in note 36.

(7) The table below shows, for the highest paid Director in the given year, the number of shares in respect of share options, performance rights, short term incentive, long term incentive and other employee share plans (including free shares, commencement shares, recognition shares).

2013 Number	**Performance options**	**Performance rights**	**Short term incentive shares**	**Long term incentive shares**	**Other employee share plans**
Outstanding at 1 October	245,716	21,146	17,802	29,790	8,219
Granted during the year	-	12,060	-	-	36
Exercised/disposed during the year	(33,802)	-	(5,728)	(4,774)	-
Expired during the year	(90,216)	-	-	-	-
Forfeited and lapsed during the year	(51,334)	-	-	(8,314)	-
Restrictions ceased	-	-	(6,347)	-	-
Outstanding at 30 September	**70,364**	**33,206**	**5,727**	**16,702**	**8,255**

2012 Number	Performance options	Performance rights	Short term incentive shares	Long term incentive shares	Other employee share plans
Outstanding at 1 October	430,238	28,390	48,091	60,155	26,348
Granted during the year	-	21,146	19,636	-	3,182
Exercised/disposed during the year	(48,022)	(8,760)	-	-	-
Expired during the year	(136,500)	(19,630)	-	-	-
Forfeited and lapsed during the year	-	-	(12,714)	-	-
Restrictions ceased	-	-	(37,211)	(30,365)	(21,311)
Outstanding at 30 September	245,716	21,146	17,802	29,790	8,219

38. Fair value of financial instruments

Financial instruments include both financial assets and financial liabilities and also derivatives. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. For the purposes of this note, carrying value refers to amounts reflected in the Consolidated Balance Sheet.

Group		**2013**		2012	
	Footnote	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets					
Cash and balances with central banks	(a)	**6,715**	**6,715**	7,923	7,923
Due from related entities	(b)	**1,408**	**1,408**	1,256	1,256
Due from other banks	(c)	**184**	**184**	14	14
Investments – available for sale	(d)	**973**	**973**	1,039	1,039
Other financial assets at fair value	(e)	**2,155**	**2,155**	2,791	2,791
Derivative financial assets	(f)	**240**	**240**	600	600
Loans and advances to customers	(g)	**23,895**	**23,939**	24,346	24,401
Due from customers on acceptances	(a)	**4**	**4**	7	7
Other assets	(h)	**235**	**235**	232	232
Assets held for sale	(i)	**-**	**-**	5,225	5,225
Financial liabilities					
Due to other banks	(g)	**521**	**521**	557	557
Other financial liabilities at fair value	(e)	**120**	**120**	147	147
Derivative financial liabilities	(f)	**663**	**663**	952	952
Due to customers	(g)	**24,146**	**24,194**	26,381	26,460
Liabilities on acceptances	(a)	**4**	**4**	7	7
Due to related entities	(b)	**2,850**	**2,850**	7,527	7,527
Bonds, notes and subordinated debt	(g)	**3,071**	**3,073**	3,163	3,164
Other liabilities	(j)	**2,076**	**2,076**	1,929	1,929
Liabilities associated with assets held for sale	(i)	**-**	**-**	142	142

The fair value estimates are based on the following methodologies and assumptions:

(a) The carrying amounts of these financial assets and financial liabilities approximate fair value.

(b) The carrying value of amounts due from and due to related entities is considered to approximate fair value. Amounts due from related entities are repayable on demand or within twelve months. Amounts due to related entities are repayable under varying maturities but are materially repriced every 3-6 months relative to market rates. As a result, the carrying value approximates the fair value.

(c) The carrying value of amounts due from other banks is net of allowances for impairment losses and unearned income. The fair value of amounts due from other banks equates to the carrying value at 30 September 2013 as they are short term in nature.

(d) The fair values of investments are based on quoted closing market prices. Where investments are unlisted and quoted market prices are not available, the Group obtains fair value by means of other valuation techniques that are commonly used by market participants.

(e) The fair value of assets and liabilities designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based upon observable market data as appropriate to the nature and type of the underlying instrument. Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as held for trading derivative financial instruments (note 14).

(f) The fair value of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from quoted closing market prices as at the balance sheet date, discounted cash flow models or option pricing models as appropriate.

(g) The fair value of financial assets and financial liabilities are obtained from discounted cash flow models.

(h) Other assets include accrued interest receivable and other short term receivables whose carrying values approximate fair value.

Notes to the consolidated financial statements (continued)

38. Fair value of financial instruments (continued)

(i) The fair value of assets held for sale and associated liabilities is estimated in accordance with the methodologies and assumptions applied to the classifications that were applicable for the underlying assets before classification as held for sale. The breakdown of the assets held for sale and associated liabilities is shown in note 24. The assets were transferred on 5 October 2012.

(j) Other liabilities include accrued interest payable and notes in circulation whose carrying values approximate fair value.

Fair value hierarchy

For financial instruments carried at fair value on the balance sheet the fair value measurement is in accordance with the following hierarchy as defined by IFRS 7:

- Level 1: Financial instruments with quoted prices for identical instruments in active markets;
- Level 2: Financial instruments with quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable; and
- Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The classification of assets and liabilities into the fair value hierarchy is outlined for each class of financial instrument within the relevant notes for those assets and liabilities.

Level 3 movements analysis	**Group**			**Bank**		
	Investments – available for sale £m	**Other financial assets at fair value £m**	**Other financial liabilities at fair value £m**	**Investments – available for sale £m**	**Other financial assets at fair value £m**	**Other financial liabilities at fair value £m**
At 1 October 2011	7	-	-	6	-	-
Gains recorded in the income statement	1	-	-	1	-	-
Losses recorded in equity	(1)	-	-	-	-	-
Transfers into level 3 from level 2	-	4,266	147	-	4,266	147
At 30 September 2012	**7**	**4,266**	**147**	**7**	**4,266**	**147**
Gains recorded in the income statement	-	-	(6)	-	-	(6)
Losses recorded in the income statement	-	(176)	-	-	(176)	-
Sales	-	(1,452)	-	-	(1,452)	-
Settlements	-	(483)	(21)	-	(483)	(21)
At 30 September 2013	**7**	**2,155**	**120**	**7**	**2,155**	**120**

Other financial assets at fair value incorporates a suite of loan products which were removed from sale with effect from 30 April 2012. Alternative products are now offered for future advances and these are accounted for within loans and advances to customers.

A sensitivity analysis of the valuation of the level 3 other financial assets at fair value is included in note 3. Reasonable changes in the assumptions used in valuing the level 3 available for sale investments would not result in material changes in the valuation. Financial liabilities at fair value are not considered to be material, therefore no sensitivity analysis is provided.

Notes to the consolidated financial statements (continued)

39. Financial risk management

Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates for various periods, and seeks to earn interest margins by investing these funds in high-quality assets. The Group seeks to improve these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

Fair value hedges

The Group hedges part of its existing interest rate and foreign currency risk from any decrease in the fair value of fixed rate assets or increase in fair value of fixed rate liabilities using interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 14. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate risk arising from variable interest rate assets and liabilities using interest rate swaps. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. As explained further in note 14 the Group adjusted its cash flow hedging strategy during the year. The fair value of derivatives entered into is also disclosed in note 14.

Credit risk

Credit risk is inherent within any transaction that creates an actual or potential obligation for a borrower to pay the Group.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral, corporate, and personal guarantees where appropriate.

Derivatives

The Group maintains control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit-related commitments

Credit-related commitments are facilities where the Group is under a legal obligation to extend credit unless some event occurs, which gives the Group the right, in terms of the commitment letter of offer or other documentation, to withdraw or suspend the facilities. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry similar credit risk to loans.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss of an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Forbearance

The Group operates a range of forbearance measures across its retail home loan and commercial book when customers have been identified as experiencing a period of financial difficulty or distress. A range of parameters are considered when the Group looks to identify those customers to whom forbearance would be applicable and these parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions.

The Group considers that forbearance takes place when a concession is granted to a customer with affordable terms and conditions that are more suitable to the customer's current circumstances than those originally contracted for. The Group remains committed in ensuring that any forbearance strategy agreed with a customer is both affordable and sustainable for the customer with the ultimate aim of minimising the risk of losses for the Group and its customers.

The Group exercises forbearance in two distinct areas: retail and non-retail.

Retail forbearance

The Group's approach to retail forbearance is represented in the following table:

	The customer advises they are in financial difficulty	***The customer is in arrears***	***The customer recovers their financial position***	***The customer is in litigation/repossession***
Solutions available	Income and expenditure assessment and other financial management support available	Forbearance measures applied on a case by case basis	Position monitored when arrears recovered Remains forbearance if permanent solution applied	Not forbearance as legal redress being sought
Reporting and disclosure	Where forbearance is applied – this is disclosed	Disclosed as forbearance	Not disclosed as forbearance unless permanent	Repossessions are separately disclosed

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Forbearance (continued)

For retail (primarily mortgage) forbearance, the Group makes every effort to follow its principles of treating customers fairly by working with customers, at as early a stage as possible, in times of distress in order to find a solution that enables the Group to continue its relationship with the customer but with the ultimate aim of minimising the risk of the customer losing their home where this is in the interests of the customer.

The Group utilises a number of tools for retail customers that have been identified as experiencing financial distress with appropriate policies and procedures in place to ensure consistent application. The operation and maintenance of these policies are under continuous review to confirm they remain relevant, appropriate and most importantly of value to our retail customers who have been identified as requiring forbearance.

At an operational level, forbearance measures that either extend the loan term or relate to a conversion to interest only are undertaken within a dedicated Financial Management and Customer Solutions unit ("FM & CS"), part of whose remit is to assist retail customers in financial difficulty to manage their finances more effectively. All other forbearance measures are exercised within Mortgage Collections, which is the first line of defence in negotiating positive outcomes for customers who have fallen into arrears.

The Group operates the following range of forbearance measures for retail customers on a case by case basis:

- Formal rehabilitations – including:
  - arrangements with the customer to repay any arrears over a shorter period;
  - capitalisation of arrears which are then added to the remaining capital balance of the loan to be repaid over the remaining term. This is only considered when there is no other realistic forbearance measure available.
- Temporary concessions – primarily short term measures and can include:
  - reduced payment concessions;
  - non-contractual payment holidays/redraw of previous overpayments.
- Conversion to interest only repayments:
  - allows the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term.
- Extensions to the loan term:
  - the customer is permitted to make lower repayments whilst still repaying the outstanding balance in full.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Forbearance (continued)

Retail home loans subject to forbearance are of low financial significance in the context of the Group's overall lending operations. The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

2013	**Number of loans**	**Loan balance £m**	**% of total portfolio %**	**Impairment allowance £m**	**% coverage %**
Temporary forbearance	173	15	0.09	-	-
Interest only conversion	12	1	0.01	-	-
Term extension	26	2	0.01	-	-
Formal arrangements	585	41	0.26	1	2.44
Other arrangements	6	-	-	-	-
	802	**59**	**0.37**	**1**	**1.69**

2012	Number of loans	Loan balance £m	% of total portfolio %	Impairment allowance £m	% coverage %
Temporary forbearance	210	17	0.11	1	5.88
Interest only conversion	27	2	0.01	-	-
Term extension	15	1	-	-	-
Formal arrangements	673	52	0.34	2	3.85
Other arrangements	9	-	-	-	-
	934	72	0.46	3	4.17

The Group also has a number of customers with interest only mortgages past maturity; the management of which continues to evolve and can be considered to be forbearance even though a formal arrangement is not in place. The Group has formal processes embedded to track and facilitate pro-active customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months of maturity. At 30 September 2013, the Group had 210 customers on interest only mortgages which were post six month maturity with a total value of £28.5m.

A further forbearance reserve of £4m (2012: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £5m (2012: £7m) and to increase overall coverage to 8.47% (2012: 9.72%).

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2013 there were 174 repossessions of which 39 were voluntary (2012: 200 including 50 voluntary).

The Group also currently exercises limited forbearance strategies in relation to unsecured loans and credit cards which mainly consist of term extensions (subject to negotiations with the customer) for the former and reduced payment arrangements for the latter. Forbearance strategies implemented on unsecured loans and credit cards are of low financial significance in the context of the Group's overall lending operations.

Forbearance is not exercised in cases where a Court has ordered the customer to repay the arrears under the terms of a suspended Repossession Order. As the terms and level of the arrangement are at the discretion of the Court and the Group have no control over the formal arrangement, this is not considered to be forbearance.

39. Financial risk management (continued)

Forbearance (continued)

Non-retail forbearance

Non-retail forbearance is considered to take place where the Group grants a concession for reasons relating to the actual, or apparent, financial stress of a non-retail customer, which provides the customer with more favourable terms and conditions than those provided at drawdown of the facility. It is a consequence of concerns about the borrower's ability to meet the contracted repayments when due and specifically relates to such instances where the changes to the arrangement have been made on terms that the Group would not ordinarily consider on a commercial basis. In these instances, non-retail forbearance would be considered to be in place until such time (minimum six months or three payment cycles) as there is evidence to show a significant reduction in the risk of non-payment from future cash flows.

Forbearance is considered to exist where one or more of the following occurs, on a non-commercial basis, for reasons relating to the actual or apparent stress of a customer:

- Extending of loan facility payment term or an overdraft which is not fluctuating (e.g. where a Term Loan has matured and the balance passed to an overdraft, which is then extended on a non-commercial basis then forbearance is considered to exist);
- Deferral of contracted capital repayments (i.e. capital repayment holiday, conversion to interest only for an extended period, or rescheduling);
- Reduction in the contracted interest rate, including a reduction in the level of accrued interest or amendment to original fee structure;
- Alternative forms of payment, including debt for equity and asset transfer; and
- Debt forgiveness.

Where a customer has multiple facilities and forbearance is considered to exist for one or more of these facilities, then the total amount of the debt will be considered as forbearance. Where a customer is part of a larger group, forbearance is exercised and reported across the group at the individual entity level and would include all group entities.

39. Financial risk management (continued)

Forbearance (continued)

The tables below summarise the total number of arrangements in place and the loan and impairment provisions associated with those arrangements, with the September 2012 comparative position being shown excluding the assets classified as held for sale which were subsequently sold in October 2012 to aid comparison. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

2013	**Number**	**Loan balance £m**	**% of total portfolio %**	**Impairment allowance £m**	**% coverage %**
Term extension	281	220	2.41	22	10.00
Deferral of contracted capital payments	112	144	1.58	29	20.14
Reduction in contracted interest rate	7	6	0.07	2	33.33
Alternative forms of payment	7	43	0.47	9	20.93
Debt forgiveness	16	34	0.37	7	20.59
	423	**447**	**4.90**	**69**	**15.44**

2012	Number	Loan balance £m	% of total portfolio %	Impairment allowance £m	% coverage %
Term extension	307	129	1.19	8	6.20
Deferral of contracted capital payments	112	116	1.07	11	9.48
Reduction in contracted interest rate	8	9	0.08	-	-
Alternative forms of payment	12	59	0.54	13	22.03
Debt forgiveness	14	40	0.37	10	25.00
	453	353	3.25	42	11.90

The Group now reports non-retail forbearance at a customer level rather than a facility level, resulting in a customer with forbearance on one or more facilities now being recorded as a single customer but at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Comparative disclosures have been amended to conform with current year presentation. This has resulted in adjustments to the category numbers and values of facilities recorded as non-retail forbearance as at 30 September 2012 and an overall increase in the level of the related impairment allowance of £11m.

The following situations are not considered to be forbearance where they are identified as the sole reason as to whether a non-retail customer may be considered for forbearance:

- A waiver of a Covenant breach, or amendment to the terms of a Covenant. Where Covenant breaches have occurred which could imply financial stress, normal impaired asset review procedures are followed in line with Group Credit Policy;
- Facilities that have been temporarily extended pending review and no concession has been granted for reasons relating to the actual or apparent financial stress of a customer;
- A reduction in asset quality;
- Where changes are made to the terms of a borrower's repayment arrangement on a commercial basis; and
- Where the Group has made a demand for repayment.

39. Financial risk management (continued)

Maximum exposure to credit risk

The Group's credit exposure has been determined in accordance with capital adequacy guidelines. The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

	Group		Bank	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Cash and balances with central banks (note 10)	**6,715**	7,923	**6,715**	7,923
Due from related entities (note 11)	**1,408**	1,256	**5,941**	5,782
Due from other banks	**184**	14	**184**	13
Investments – available for sale (note 12)	**973**	1,039	**973**	1,039
Investments – held to maturity (note 12)	**-**	-	**1,415**	709
Other financial assets at fair value (note 13)	**2,155**	2,791	**2,155**	2,791
Derivative financial assets (note 14)	**240**	600	**240**	600
Loans and advances to customers (note 15)	**23,895**	24,346	**19,388**	19,704
Due from customers on acceptances	**4**	7	**4**	7
Assets held for sale (note 24)	**-**	5,225	**-**	5,225
	35,574	43,201	**37,015**	43,793
Contingent liabilities (note 33)	**213**	286	**213**	286
Other credit commitments (note 33)	**8,696**	9,290	**8,664**	9,290
Commitments relating to assets held for sale	**-**	140	**-**	140
Maximum credit risk exposure	**44,483**	52,917	**45,892**	53,509

39. Financial risk management (continued)

Credit risk (continued)

Credit quality of financial assets

An assessment of the credit quality of loans and advances to customers can be found in note 15 with an assessment of the credit quality of investments contained in note 12.

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Risk concentration

Concentration of risk is managed by customer / counterparty, by product, by geographical region and by industry sector. In addition single name exposure limits exist to limit exposure to a single entity / counterparty.

Eurozone risk

The Group and Bank have no material operations outside the UK and have no direct sovereign exposure to any Eurozone countries (2012: Nil). The Group and Bank had an exposure to the European Investment Bank of £100m at 30 September 2013 (2012: £100m).

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Industry concentration of credit risk

The following tables show the levels of industry concentration of credit risk as at 30 September:

Gross loans and advances to customers including loans designated at fair value through profit or loss	**Group**		**Bank**	
	2013	2012 *	**2013**	2012 *
	£m	£m	**£m**	£m
Government and public authorities	**35**	39	**35**	39
Agriculture, forestry, fishing and mining	**1,758**	1,913	**1,758**	1,913
Financial, investment and insurance	**553**	886	**553**	886
Property – construction	**516**	3,722	**516**	3,722
Manufacturing	**723**	922	**723**	922
Instalment loans to individuals and other personal lending (including credit cards)	**1,902**	2,372	**1,902**	2,372
Property – mortgage	**16,148**	15,369	**11,674**	10,822
Asset and lease financing	**482**	694	**428**	569
Other commercial and industrial	**4,303**	7,303	**4,303**	7,303
	26,420	33,220	**21,892**	28,548

* 30 September 2012 includes assets classified as held for sale.

Contingent liabilities and credit related commitments	**Group**		**Bank**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Agriculture, forestry, fishing and mining	**1,006**	753	**1,006**	753
Financial, investment and insurance	**56**	66	**56**	66
Property – construction	**98**	543	**98**	543
Manufacturing	**228**	211	**228**	211
Instalment loans to individuals and other personal lending (including credit cards)	**3,939**	3,674	**3,939**	3,674
Property – mortgage	**2,010**	1,724	**1,978**	1,724
Other commercial and industrial	**1,572**	2,745	**1,572**	2,745
	8,909	9,716	**8,877**	9,716

Available for sale and held to maturity investments	**Group**		**Bank**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Government and public authorities	**973**	1,039	**973**	1,039
Financial, investment and insurance	**-**	-	**1,415**	709
	973	1,039	**2,388**	1,748

Comparative disclosures have been amended to conform with current year presentation.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Bank's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

Interest rate risk in the banking book ("IRRBB")

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with the NAB Group IRRBB policy. Risk measurement techniques include: Value at Risk ("VaR"), Earnings at Risk ("EaR"), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- Historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a consistent statistical basis: 99% confidence level; three month holding period.
- Economic capital is allocated for IRRBB based on a higher confidence interval and a longer holding period.
- EaR utilises a twelve month forecast period.
- Eight years of business day historical data.
- VaR methodology is based on proportional rather than absolute changes in historical interest rates.
- Investment term for capital is modelled with an established benchmark term of between one and five years.
- Investment term for core "non-interest" bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between one and five years.

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of UK Asset & Liability Committee ("UK ALCO").

Interest rate risk	**Value at risk**		**Earnings at risk**	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
As at 30 September	**30**	31	**7**	4
Average value during the year	**32**	37	**9**	6
Minimum value during the year	**29**	31	**3**	2
Maximum value during the year	**35**	45	**20**	13

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Market risk (continued)

The following table shows the Group's principal financial assets and liabilities and the main non traded market risk types they are exposed to:

	2013 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	**6,715**				✔
Available for sale investments	**973**	✔	✔		✔
Loans and advances to customers	**23,895**	✔	✔	✔	✔
Derivative financial instruments	**240**		✔		✔
Other assets at fair value	**2,155**		✔		✔
Liabilities					
Due to customers	**24,146**	✔	✔	✔	
Due to other banks	**521**	✔	✔	✔	
Derivative financial instruments	**663**		✔		
Other financial liabilities at fair value	**120**	✔	✔		
Bonds, notes and subordinated debt	**3,071**	✔	✔	✔	

Prepayment risk

Customers may prepay certain loans and advances ahead of the contractual repayment schedule. This form of optionality gives rise to prepayment risk for the Bank whereby the expected timing of cashflows from loan repayments differs from the actual experience. The impact on the Bank would differ according to changes in the level of interest rates.

The Group assesses the risks arising from prepayment behaviour in order to show the potential impact on future cashflows. The impact is also managed through terms and conditions within loans and advances.

39. Financial risk management (continued)

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Group 2013	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,508	-	-	-	-	1,207	**6,715**
Due from related entities	1,399	-	-	9	-	-	**1,408**
Due from other banks	19	100	65	-	-	-	**184**
Investments – available for sale	-	-	-	101	866	6	**973**
Other financial assets at fair value	11	71	242	530	1,301	-	**2,155**
Derivative financial assets	-	19	24	106	91	-	**240**
Loans and advances to customers	2,880	281	722	4,089	15,527	396	**23,895**
Due from customers on acceptances	-	4	-	-	-	-	**4**
All other assets	178	423	39	-	-	418	**1,058**
Total assets	**9,995**	**898**	**1,092**	**4,835**	**17,785**	**2,027**	**36,632**
Liabilities							
Due to other banks	-	484	37	-	-	-	**521**
Other financial liabilities at fair value	-	-	9	52	59	-	**120**
Derivative financial liabilities	1	66	53	184	359	-	**663**
Due to customers	16,659	2,447	2,515	2,525	-	-	**24,146**
Liabilities on acceptances	-	4	-	-	-	-	**4**
Due to related entities	486	61	-	1,227	1,076	-	**2,850**
Bonds, notes and subordinated debt	-	-	-	2,429	642	-	**3,071**
All other liabilities	1,804	448	48	-	-	547	**2,847**
Total liabilities	**18,950**	**3,510**	**2,662**	**6,417**	**2,136**	**547**	**34,222**
Off balance sheet items							
Contingent liabilities	1	34	63	16	90	9	**213**
Other credit commitments	8,696	-	-	-	-	-	**8,696**
Total off balance sheet items	**8,697**	**34**	**63**	**16**	**90**	**9**	**8,909**

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Group 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	6,800	-	-	-	-	1,123	7,923
Due from related entities	1,223	-	-	-	33	-	1,256
Due from other banks	-	14	-	-	-	-	14
Investments – available for sale	-	-	-	100	932	7	1,039
Other financial assets at fair value	1	45	165	1,006	1,574	-	2,791
Derivative financial assets	-	37	50	314	199	-	600
Loans and advances to customers	4,132	488	796	3,799	14,695	436	24,346
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	153	340	62	-	-	465	1,020
Assets held for sale	587	135	723	2,462	1,298	20	5,225
Total assets	12,896	1,066	1,796	7,681	18,731	2,051	44,221
Liabilities							
Due to other banks	-	521	36	-	-	-	557
Other financial liabilities at fair value	-	-	5	74	68	-	147
Derivative financial liabilities	7	87	51	236	571	-	952
Due to customers	15,990	3,136	3,453	3,802	-	-	26,381
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	595	26	4,350	1,006	1,550	-	7,527
Bonds, notes and subordinated debt	-	-	590	1,370	1,203	-	3,163
All other liabilities	1,641	436	40	-	-	624	2,741
Liabilities associated with assets held for sale	-	-	6	48	88	-	142
Total liabilities	18,233	4,213	8,531	6,536	3,480	624	41,617
Off balance sheet items							
Contingent liabilities	1	57	44	74	102	8	286
Other credit commitments	9,290	-	-	-	-	-	9,290
Total off balance sheet items	9,291	57	44	74	102	8	9,576

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2013	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,508	-	-	-	-	1,207	**6,715**
Due from related entities	5,932	-	-	9	-	-	**5,941**
Due from other banks	19	100	65	-	-	-	**184**
Investments – available for sale	-	-	-	101	866	6	**973**
Investments – held to maturity	-	-	-	332	1,083	-	**1,415**
Other financial assets at fair value	11	71	242	530	1,301	-	**2,155**
Derivative financial assets	-	19	24	106	91	-	**240**
Loans and advances to customers	2,647	276	708	3,874	11,487	396	**19,388**
Due from customers on acceptances	-	4	-	-	-	-	**4**
All other assets	178	389	236	-	-	779	**1,582**
Total assets	**14,295**	**859**	**1,275**	**4,952**	**14,828**	**2,388**	**38,597**
Liabilities							
Due to other banks	-	484	37	-	-	-	**521**
Other financial liabilities at fair value	-	-	9	52	59	-	**120**
Derivative financial liabilities	1	66	53	154	292	-	**566**
Due to customers	16,659	2,447	2,515	2,525	-	-	**24,146**
Liabilities on acceptances	-	4	-	-	-	-	**4**
Due to related entities	486	641	-	4,728	1,076	-	**6,931**
Bonds, notes and subordinated debt	-	-	-	454	642	-	**1,096**
All other liabilities	1,804	448	48	-	-	528	**2,828**
Total liabilities	**18,950**	**4,090**	**2,662**	**7,913**	**2,069**	**528**	**36,212**
Off balance sheet items							
Contingent liabilities	1	34	63	16	90	9	**213**
Other credit commitments	8,664	-	-	-	-	-	**8,664**
Total off balance sheet items	**8,665**	**34**	**63**	**16**	**90**	**9**	**8,877**

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Cash and balances with central banks	6,800	-	-	-	-	1,123	7,923
Due from related entities	5,749	-	-	-	33	-	5,782
Due from other banks	-	13	-	-	-	-	13
Investments – available for sale	-	-	-	100	932	7	1,039
Investments – held to maturity	-	-	-	709	-	-	709
Other financial assets at fair value	1	45	165	1,006	1,574	-	2,791
Derivative financial assets	-	37	50	314	199	-	600
Loans and advances to customers	4,018	485	779	3,578	10,408	436	19,704
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	246	325	185	-	-	882	1,638
Assets held for sale	587	135	723	2,462	1,298	20	5,225
Total assets	17,401	1,047	1,902	8,169	14,444	2,468	45,431
Liabilities							
Due to other banks	-	521	36	-	-	-	557
Other financial liabilities at fair value	-	-	5	74	68	-	147
Derivative financial liabilities	7	86	-	217	571	-	881
Due to customers	15,989	3,136	3,454	3,802	-	-	26,381
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	595	646	4,350	3,867	1,550	-	11,008
Bonds, notes and subordinated debt	-	-	-	1,084	-	-	1,084
All other liabilities	1,641	436	40	-	-	617	2,734
Liabilities associated with assets held for sale	-	-	6	48	88	-	142
Total liabilities	18,232	4,832	7,891	9,092	2,277	617	42,941
Off balance sheet items							
Contingent liabilities	1	57	44	74	102	8	286
Other credit commitments	9,244	-	-	-	-	-	9,244
Total off balance sheet items	9,245	57	44	74	102	8	9,530

Comparative disclosures have been amended to conform with current year presentation.

39. Financial risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

Group 2013	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	-	484	37	-	-	-	**521**
Other financial liabilities at fair value	-	1	14	71	65	-	**151**
Derivative financial liabilities	1	66	53	107	340	-	**567**
Due to customers	16,659	2,459	2,553	2,559	-	-	**24,230**
Liabilities on acceptances	-	4	-	-	-	-	**4**
Bonds, notes and subordinated debt	-	19	57	2,627	751	-	**3,454**
All other financial liabilities	1,696	-	-	-	-	-	**1,696**
Hedging derivatives							
Contractual amounts payable	-	66	172	1,109	78	-	**1,425**
Contractual amounts receivable	-	(59)	(173)	(1,002)	-	-	**(1,234)**
	18,356	**3,040**	**2,713**	**5,471**	**1,234**	**-**	**30,814**

Group 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	522	36	-	-	-	558
Other financial liabilities at fair value	-	2	9	103	81	-	195
Derivative financial liabilities	7	87	51	240	597	-	982
Due to customers	15,990	3,158	3,492	3,873	-	-	26,513
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	20	647	1,598	1,313	-	3,578
All other financial liabilities	1,567	-	-	-	-	-	1,567
Hedging derivatives							
Contractual amounts payable	-	12	48	1,089	75	-	1,224
Contractual amounts receivable	-	(5)	(36)	(995)	-	-	(1,036)
	17,564	3,803	4,247	5,908	2,066	-	33,588

Bank 2013	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	-	484	37	-	-	-	**521**
Other financial liabilities at fair value	-	1	14	71	65	-	**151**
Derivative financial liabilities	1	66	53	154	293	-	**567**
Due to customers	16,659	2,459	2,553	2,559	-	-	**24,230**
Liabilities on acceptances	-	4	-	-	-	-	**4**
Bonds, notes and subordinated debt	-	10	31	536	949	-	**1,526**
All other financial liabilities	1,696	-	-	-	-	-	**1,696**
Hedging derivatives							
Contractual amounts payable	-	-	12	109	1	-	**122**
Contractual amounts receivable	-	-	-	-	-	-	**-**
	18,356	**3,024**	**2,700**	**3,429**	**1,308**	**-**	**28,817**

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Liquidity risk (continued)

Bank 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	522	36	-	-	-	558
Other financial liabilities at fair value	-	2	9	103	81	-	195
Derivative financial liabilities	7	86	-	221	597	-	911
Due to customers	15,990	3,158	3,492	3,873	-	-	26,513
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	11	32	548	808	-	1,399
All other financial liabilities	1,567	-	-	-	-	-	1,567
Hedging derivatives							
Contractual amounts payable	-	-	21	76	25	-	122
Contractual amounts receivable	-	-	-	-	-	-	-
	17,564	3,786	3,590	4,821	1,511	-	31,272

Comparative disclosures have been amended to conform with current year presentation.

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

40. Management of risk

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy, as well as that of its parent entity NAB Limited. A key component of the Group's risk management strategy is the establishment by the Board of a formal 'Risk Appetite Statement'.

This places an overall limit on the total amount and types of risk that the Group is prepared to take. This is set with respect to the returns that the Group is seeking to provide to its shareholder, the credit rating that the Bank is seeking to maintain and the Group's capital position and desired capital ratios.

This informs the Group's risk, capital and business limits and policies. It is regularly reviewed by the Board as a part of the strategic planning process, or otherwise as the commercial circumstances of the Group change.

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the businesses' front-line teams to be effective. This overriding principle embodies the following concepts:

- all business decisions proactively consider risk and the impact on the Group's customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components; and
- all employees are responsible for risk management in their day-to-day activities.

Within this context, the Group manages risk within a "three lines of defence" framework. Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are accountable for establishing risk policy, standards and the oversight of risk management effectiveness within the business. The third line of defence is Internal Audit who are responsible for independently reviewing, monitoring, and testing business unit compliance and regularly assessing the overall effectiveness of the Risk Management Framework.

40. Management of risk (continued)

The NAB Group Risk and Reward Management Committee, chaired by the NAB Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance on the performance of the overall Risk Management Framework. This Committee is supported by three sub-committees - the NAB Group Credit Risk Committee, the NAB Group Asset and Liability Committee ("NAB Group ALCO"), and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated through the Boards' Risk Committee, which enables Board members to challenge Executives on the profile and management of risk. This is supplemented by the bi-annual Internal Capital Adequacy Assessment Process ("ICAAP") Board submission, which is completed alongside the Capital Plan, Strategic Plan, the Internal Liquidity Adequacy Assessment ("ILAA"), Recovery and Resolution Plan and the Risk Appetite Statement. There is also a UK Risk Committee, chaired by the UK Chief Executive Officer, and comprised of senior Bank executives, which serves to provide leadership focus on key risk issues from a Group perspective. The Committee is supported by the following UK Governance Committees: UK Asset & Liability Committee ("UK ALCO"), Pension Risk Management Committee and Model Oversight Committee. First line responsibility for risk management resides with the Management Assurance Committees in each of the Group's principal operating divisions: Retail, Business & Private Bank and Operations & Information Technology. Each of the Management Assurance Committees provide reports to the UK Risk Committee and Boards' Risk Committee.

The UK Risk Management team independently monitors and systematically assesses the risk profile within the Group against established risk appetite parameters. They also assist the front line business units in the design and implementation of appropriate risk management policies / strategies and work with the business units to promote awareness of the need to manage risk.

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality.

The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities within the Group are clearly defined.

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Group Credit Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the NAB Group Chief Credit Officer (and associated teams) provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management within the UK, with appropriate oversight through the UK executive management governance committees.

The Group's credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

Single large exposure policies are in place within the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

40. Management of risk (continued)

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems or from external events. This includes legal risks as well as operational risk components associated with other risks categories (e.g. credit, traded market, non-traded market).

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.

These risk categories are defined as follows:

- Customer, products and sales practices ("conduct risk") – the treatment of customers and the management of customers impacts on all the Group's core activities. This is a principal focus of the Board, Senior Management and the regulators and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, that customer expectations are met and complaints are dealt with effectively and fairly. Consideration of customer outcomes is embedded within the Group's operating processes and metrics are regularly monitored to ensure outcomes are appropriate.
- Regulatory environment and market practices – the Group is required to comply with a large volume of laws and regulations and the regulatory environment has also been subject to substantial change in recent years. This is likely to continue and represents an on-going focus of the Group's management in ensuring the Group continues to operate within prudential parameters and that the conduct of the Group's activities meets the expectations of the Group's customers, shareholders and regulators. The Group operates a zero tolerance for regulatory breaches and organises its activities to ensure controls over regulatory risk are maintained in addition to maintaining a strong, open and trusted relationship with its regulators.
- Monitoring, reporting and oversight – effective controls over business operations are essential for the protection of the Group's customers and shareholders and is a key responsibility of all employees and managers. The Group continues to reinforce frameworks, standards and oversight arrangements to enhance the quality of risk management in the organisation. Each business unit maintains a risk profile with embedded controls and actions to manage inherent risks.
- Payments and process management – the Group processes a large volume of transactions for customers every day and manages the risks in this and other operations to ensure these activities are conducted safely and efficiently. However, in all operational activity there is a potential risk of established procedures not being followed, a failure to detect errors or that inadequate controls are in place.
- External fraud and criminal activities – the Group takes seriously its responsibilities to protect customers against financial crime. This includes preventing fraud activities in all channels through which customers transact; the prevention of money laundering; and compliance with legal sanctions requirements. Fraud management is an ongoing challenge for the financial services industry and presents a constant risk to the Group as criminal activities evolve on a national and global basis. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Internal fraud and criminal activities – The Group recognises the risk of internal fraud associated with internal acts intended to defraud, misappropriate funds, information and physical assets, and circumvent policy. The Group has zero tolerance for internal fraud and has a strong control framework in place to mitigate this risk.
- Workplace practices and environment – providing a safe environment for customers and colleagues is important for the success of the business and the Group seeks to ensure adequate safeguards are in place and are operating effectively.
- Systems and infrastructure – There is a risk of service interruption due to failure of the Group's systems leading to a period of service disruption. The Group has a strong framework of controls over the continuity of service provision for all critical processes including recovery procedures in the event of unplanned service interruption.
- Third party providers - Failure to manage third party providers effectively may also impact on the level of service available to customers. The Group's controls to mitigate this risk include regular oversight of third party processes and assurance testing of the effectiveness of relationship management.

40. Management of risk (continued)

Operational risk (continued)

Responsibility for the management of operational risk rests with the business managers with oversight from the risk management function and independent assurance activities undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. It is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes and includes:

- an established governance structure that is used to ensure consistent application, control and reporting of the Operational Risk Management process. This element also includes the establishment and communication of the Group's operational risk appetite; and
- a structured process to facilitate the identification, quantification and management of risks underpinned by clear policies and guidelines. Material risks are reported monthly to the Management Assurance Committees and the UK Risk Committee, and to each Boards' Risk Committee to provide visibility and understanding of the Group's overall risk profile.

Non-traded market risk

Non-traded market risks include liquidity and funding risk, structural interest rate risk, foreign exchange risk and risks associated with the Group's defined benefit pension scheme. The primary objective for the management and oversight of non-traded market risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

Policies relating to non-traded market risks are approved by the Board of the NAB Group. The consistent application of NAB Group polices across the Group is the responsibility of the Group's Board with the support of executive management governance committees. In relation to non-traded market risks, the primary management committee is the UK ALCO.

Risk appetite and limits are approved for non-traded market risk by the Bank's Board, with authority delegated to the UK ALCO for their subsequent implementation and monitoring.

The UK ALCO oversees the management of non-traded market risks. The UK ALCO meets monthly and reports to the UK Risk Committee. The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from UK Risk.

Liquidity and funding risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Liquidity within the Group is managed in accordance with the ILAA that is approved by the Board. The ILAA includes the manner in which the Group meets all regulatory requirements of the PRA and includes the Group's policy for the management of liquidity risk. Oversight of liquidity risk is undertaken by the UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group is monitored by the NAB Group ALCO in accordance with the NAB Group Non-Traded Market Risk Policy. To meet the requirements of local regulatory authorities the liquidity of the Group is managed on a daily basis as a stand-alone undertaking using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. The UK ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances. The Group has a Contingency Funding Plan which is used to detail actions to be taken in the event of an escalated liquidity requirement.

Notes to the consolidated financial statements (continued)

40. Management of risk (continued)

Non-traded market risk (continued)

Liquidity and funding risk (continued)

A contingency plan has also been established for management of an escalated liquidity requirement if the Group or the NAB Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, currency, counterparty, term structure and market.

The Group's main sources of funding include the following:

- Retail, SME, corporate deposits;
- Commercial paper programme;
- Access to sterling money markets through cash deposits and certificates of deposit;
- Medium Term Note programme;
- "Lanark" residential mortgage securitisation programme (owner occupied);
- "Lannraig" buy-to-let mortgage securitisation programme;
- Structured Covered Bond programme;
- Regulated Covered Bond programme;
- Access to Bank of England open market operations in addition to extended collateral term repo and Funding for Lending Scheme; and
- Access to the Bank of England Discount Window Facility in times of stress.

These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet. The Group's securitisation and covered bond programmes offer investors the opportunity to purchase secured assets.

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and NAB Group ALCO.

There are three major contributors to interest rate risk:

- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities; and
- the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets i.e. basis risk.

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk management across the Group is directed by UK ALCO with delegation for day-to-day management to the Group's Treasury division. The UK Risk Committee, through UK ALCO oversight, monitors risk to ensure it remains within approved policy and Board approved risk appetite.

Basis risk is managed through a combination of wholesale market basis risk products, pricing strategies and product innovation.

40. Management of risk (continued)

Non-traded market risk (continued)

Structural interest rate risk (continued)

A key feature of the risk management and oversight framework is the use of VaR as a measure of interest rate risk, along with EaR to measure the impact on future net interest income. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group's Balance Sheet & Liquidity Risk Oversight team that is independent of the Treasury division.

Foreign exchange risk

Exposures arise if future cash flows can only be converted to Sterling at less favourable rates than at the time of the original transaction. The Group's policy is to fully hedge these exposures at the time of commitment for all exposures that are considered to be of a marketable size.

The transactional currency exposures principally arise from dealings with customers and the Group maintains a matched position through transactions with a range of counterparties including the NAB Group in order to comply with the Group's Trading Policy Statement.

Pension risk

Pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. The operation of a pension scheme gives rise to a number of risks, e.g. movements in equity valuations, changes in bond yields and life expectancy of scheme members. The Scheme is managed by independent Trustees. However, the impact of the Scheme on the Group is subject to management by the Group and corresponding risk oversight. The Group's Pension Risk Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

The Group is governed by NAB Group's Capital Management Policy. The objectives of the NAB Group's Capital Management Policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators requirements and managing the ratings agencies assessment of the Group.

The Group implemented Basel II requirements from 1 January 2008 in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Group calculates its minimum capital requirements based on 8% of RWAs. The PRA then adjusts this requirement to cover risks under Pillar II of Basel II and generate an Individual Capital Guidance ("ICG") and a Capital Planning Buffer ("CPB"). The CPB is designed to be available to absorb losses and / or to cover increased capital requirements in adverse circumstances that are outside the Group's normal and direct control.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The UK ALCO, which consists of the Chief Executive Officer, Chief Operating Officer, the Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Group actively manages its capital position and reports this on a regular basis to senior management through the UK ALCO and other governance committees. Capital requirements are included within an annual capital management plan which is presented to and approved by the Board of Directors.

The UK Government released draft secondary legislation for the Banking Reform Bill in July 2013. The Bill seeks to protect deposit holders and ensure the PRA can hold banks to account. Once enacted, the reforms may affect the structure of banks and the amount of capital held.

41. Capital management overview (continued)

The European Union published the final rules to implement Basel III, known as the Capital Requirements Directive IV Package ("CRD IV"), in June 2013 which will be effective from 1 January 2014. These form the prudential rules that all banks in the UK must follow. The PRA issued its consultation paper outlining their approach on implementing CRD IV within the UK, in August 2013, and it is anticipated that the final rules and supervisory statements will be published by the PRA in December 2013. The Group is currently assessing the potential impacts that may affect the amount and structure of the capital that will be required to be held.

42. Pillar 3 disclosures

Basel II Capital Requirements Directive

The PRA automatically transitioned the FSA granted waiver direction held by the Bank under BIPRU 11.2.5: (Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a non-EEA state).

The waiver direction can be found on the PRA website: http://www.fsa.gov.uk/register/pdf/A1375943P.pdf

In line with the PRA waiver direction, the Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations. It has already included additional capital resources disclosure on pages 11 to 14 of these financial statements.

National Australia Bank Limited 2013 Pillar 3 Report: http://www.nabgroup.com/0,,32863,00.html

National Australia Bank Limited 2013 Full Year Financial Results, Section 6 (Supplementary Information): http://www.nab.com.au/content/dam/nab/about-us/shareholder-centre/financial-results/documents/full-year-results-2013.pdf

National Australia Bank Limited 2013 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html

The first published disclosure was based on the financial position of the Group and NAB as at 30 September 2008. After due consideration by the Group Directors, subsequent Pillar 3 disclosures are made annually by way of the National Australia Bank Limited Pillar 3 Report. These disclosures will be in line with the PRA Waiver direction as outlined above.

The information contained in these qualitative disclosures has not been audited by the Group's external auditors except to the extent that they are equivalent to those made under accounting requirements and is limited to those required by BIPRU 11.

PRA remuneration Pillar 3 disclosures

In December 2010, the FSA issued Policy Statement 10/21 'Implementing CRD3 requirements on the disclosure of remuneration'. The Pillar 3 remuneration disclosure guidance transitioned across to the PRA on 1 April 2013. The Pillar 3 disclosures required are specified within BIPRU 11.5.18R to BIPRU 11.5.21G. The Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosures plus additional aggregate disclosures for UK Code Staff to satisfy the Pillar 3 disclosure obligations.

UK Code Staff disclosures will be available within the Regulatory Disclosures section of the NAB Group website http://www.nab.com.au/about-us/shareholder-centre/regulatory-disclosures.

The remuneration report is held within the Report of the Directors on pages 29 - 50 of the National Australia Bank Limited 2013 Annual Financial Report.

National Australia Bank Limited 2013 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html.

43. Events after the balance sheet date

Subject to the normal regulatory processes, the Directors recommend the payment of a final dividend on the Bank's redeemable preference shares in respect of the financial period of £14m (2012: £Nil).

Enhanced disclosure task force recommendations

Below is a tabular overview of how the Group has responded to the EDTF recommendations as referred to on page 19 of the annual report and consolidated financial statements. The Group already provides risk disclosures in accordance with International Financial Reporting Standards which can predominantly be found in notes 39, 40 and 41 to the financial statements and the appropriate cross reference between these and the relevant EDTF recommendation is provided, as necessary, to avoid duplicating information. Disclosures that have been added in proportionate response to the EDTF recommendations but do not represent logical additions to existing disclosures are provided below this table.

EDTF recommendation	Description	The Group's approach
1	Amalgamate all risk related information and if not possible provide an aid to help users locate risk disclosures	The Group has taken an index based approach this year. In future years it will consider whether there are ways of combining all risk related information into a separate section of the annual report and consolidated financial statements whilst retaining the integrity of the audited accounts.
2	Define the Group's risk terminology and risk measures	Relevant definitions are included within the glossary to the annual report and consolidated financial statements.
3	Describe and discuss top and emerging risks	Commentary on the Group's top and emerging risks can be found within the Strategic Report starting on page 4.
4	Outline plans to meet each new key regulatory ratio once the applicable rules are finalised. These include: • net stable funding ratio ("NSFR"); • liquidity coverage ratio ("LCR"); and • leverage ratio	The final rules for CRR/CRD IV were agreed by the European Parliament in June 2013 with the PRA issuing a consultation document on how these should be implemented in the UK in August 2013. Presently the Group calculates the proposed Basel III ratios of the NSFR and LCR which are both in excess of 100% as at 30 September 2013. The estimated leverage ratio for the Group calculated on a Basel III basis is above minimum requirements.
5	Summarise the Group's risk management organisation	The Group's risk management organisation is described in note 40 and diagrammatically represented on page 125.
6	Describe the Group's risk culture and how procedures and strategies are applied to support the culture	Commentary on the Group's risk culture can be found on page 126.
7	Describe the Group's key risks from the business model and activities along with the Group's risk appetite and how these risks are managed	Commentary on the Group's business model risks can be found within the Strategic Report starting on page 4.
8	Describe the use of stress testing within the Group's risk governance and capital frameworks	Commentary on the use of stress testing within the Group's risk governance and capital frameworks is provided on page 127 and 128.

Enhanced disclosure task force recommendations (continued)

9	Provide minimum Pillar 1 capital requirements, including any capital surcharges or capital conversion buffers, or the minimum internal ratio	The Group's Pillar 1 requirements can be found in the capital position section within the Strategic Report starting on page 4.
10	Summarise composition of capital and provide a reconciliation of the accounting balance sheet to the regulatory balance sheet	The Group provides a summary of its Tier 1 capital position along with a reconciliation of regulatory capital to statutory equity in the capital position section within the Strategic Report starting on page 4.
11	Present a flow statement of movements in regulatory capital for the year, including changes in common equity tier 1, tier 1 and tier 2 capital	The Group's regulatory capital flow statement can be found in the capital position section within the Strategic Report starting on page 4.
12	Capital planning within a more general discussion of management's strategic planning	An overview of the Group's capital management approach can be found in note 41 to the annual report and consolidated financial statements which highlights that it is governed by NAB Group's Capital Management Policy. The Group is a wholly owned subsidiary with a significant Global parent. The Group operates a UK Risk Appetite Framework to support the Group's strategic planning and capital planning processes. The framework identifies material risks to which the business is exposed to and for which capital needs to be held. The UK Risk Appetite Statement is the formal articulation of the risk bearing capacity of the Group, it is approved annually by the Board, and supports the strategic planning process.
13	How do RWAs relate to business activities and related risks	The Group provides an analysis of RWAs in the capital position section within the Strategic Report starting on page 4. This breaks down the RWA figure into our key business activities with the risks calculated on a standardised basis.
14	Capital requirements for calculating RWAs for credit risk for each Basel asset class including the major portfolios within those classes	The Group's capital requirements for calculating RWAs for credit risk for each Basel asset class can be found in the capital position section within the Strategic Report starting on page 4.
15	Tabulate credit risk in the banking book for Basel asset classes and major portfolios within the Basel asset classes	A table analysing the credit risk in the banking book for Basel asset classes can be found in the capital position section within the Strategic Report starting on page 4. The table discloses our exposure consistent with the standardised approach.

Enhanced disclosure task force recommendations (continued)

16	RWA flow statement	RWAs significantly reduced in the year primarily as a result of the transfer of the majority of the commercial real estate lending assets to NAB on 5 October 2012. The off month-end date of the transfer has complicated the creation of an RWA flow statement for the year to 30 September 2013. Accordingly, this disclosure will be provided in the 2014 financial statements. In addition to the transfer of the commercial real estate assets, RWA's declined in the year as a result of movements in exposure with the other main factor being a modest impact on the RWAs on Mortgages Secured on Residential Properties due to an improvement in portfolio quality.
17	Contextualising Basel Pillar 3 back-testing requirements	The Group has a Pillar 3 waiver currently in force and as a result has not provided this disclosure.
18	Potential liquidity needs management and the components of the liquidity reserve held to meet these needs	Notes 39 and 40 to the annual report and consolidated financial statements contain information in relation to liquidity risk and non-traded market risk (specifically liquidity and funding risk) respectively. The funding and liquidity section within the Strategic Report starting on page 4 also describes the Group's year end liquidity position.
19	Encumbered and unencumbered assets by balance sheet categories including collateral	The Group's encumbered and unencumbered assets position is shown within the funding and liquidity section within the Strategic Report starting on page 4.
20	Consolidated total assets, liabilities and off-balance sheet commitments by remaining contractual maturity	A table with the Group's consolidated assets, liabilities and off balance sheet commitments by remaining contractual maturity can be found within note 39 of the annual report and consolidated financial statements on page 109.
21	The Group's funding strategy including key sources and any funding concentrations	Commentary on the Group's funding strategy can be found in the liquidity and funding section within note 40.
22	Linking balance sheet and balance sheet line items with positions included in the trading market and non-trading market disclosures	A table showing the balance sheet with values combined with the principal non-traded risk types that affect each significant balance sheet line item can be found within note 39 of the annual report and consolidated financial statements on page 108.

Enhanced disclosure task force recommendations (continued)

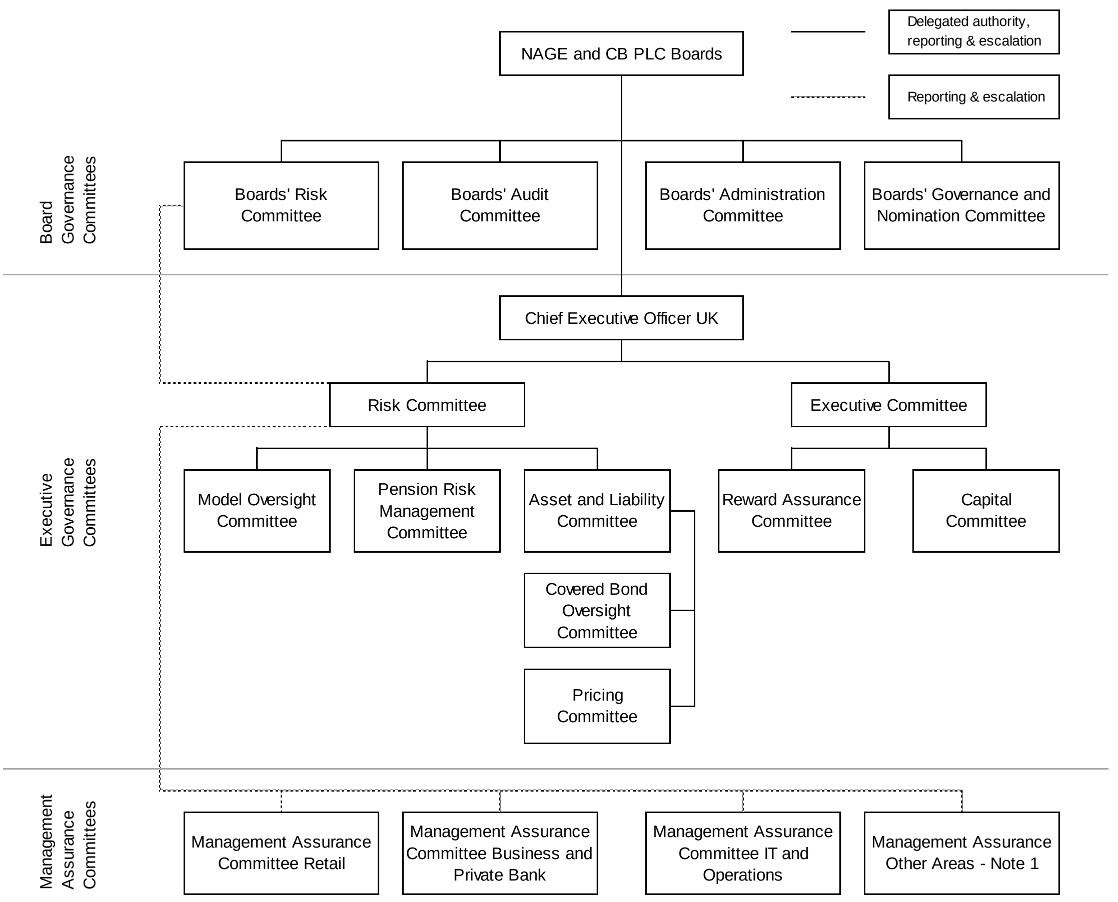
23	Significant trading and non-market trading risk factors	The Group does not operate a trading portfolio. There is no appetite for traded market risk other than de minimus positions arising from the timing of hedging transactions. Market risk is defined as positions in financial instruments, including derivative products and other off-balance sheet instruments, held with trading intent. Interest rate risk is the most significant non-traded market risk the Group faces. Further comment on interest risk and prepayment risk can be found in note 39 to the annual report and consolidated financial statements with additional non-traded market risk factors contained in note 40.
24	Significant market risk measurement model limitations	Note 39 to the annual report and consolidated financial statements provides a summary of key features of the internal interest rate risk management model that is used for non-traded portfolios. The Group does not operate traded portfolios.
25	Primary risk management techniques employed to measure and assess the risk of loss beyond reported risk measures and parameters	Note 39 to the annual report and consolidated financial statements provides detail on the value at risk and earnings at risk methods and also on a series of supporting measures for interest rate risk. As explained above the Group does not operate a trading portfolio.
26	Credit risk profile including any significant credit risk concentrations	Tables showing the levels of industry concentrations (including both on and off-balance sheet commitments) can be found in note 39 to the annual report and consolidated financial statements.
27	Policies for identifying impaired or non-performing loans including forbearance	The Group's approach to identifying impaired or non-performing loans can be found in note 15 to the annual report and consolidated financial statements. The Group's position in relation to both retail and non-retail forbearance has matured over the last few years with the detail of current levels and type of forbearance included in the relevant section within note 39.
28	Reconciliation of non-performing and impaired loans including the allowance for loan losses	The Group's distribution of non-performing (past due but not impaired) and impaired loans and advances across product types can be found in note 15 to the financial statements with the associated impairment allowances in note 16 to the financial statements.
29	Counterparty credit risk that arises from derivative transactions	The Group's disclosures on derivative transactions can be found in note 14 of the annual report and consolidated financial statements. The Group's principal non customer derivative counterparty is NAB.

Enhanced disclosure task force recommendations (continued)

30	Credit risk mitigation, including collateral held for all sources of credit risk	A description of the Group's risk mitigation techniques can be found on pages 128 and 129 along with a quantitative analysis on the non-property collateral held. Disclosures on collateral held as security and other credit enhancements can be found in note 39.
31	"Other risk" types including how these are identified, governed, measured and managed	The Group has not identified other risk types that are deemed to be material for disclosure purposes.
32	Publically known risk events related to other risks, including operational, regulatory compliance and legal risks, where material or potentially material loss events have occurred	The Group is exposed to a number of risks that are in the public domain, particularly around conduct related matters. These are discussed within note 27 to the annual report and consolidated financial statements and in the relevant sections of the Strategic Report starting on page 4.

The Group's risk management organisation

The Group's risk management structure is diagrammatically represented below:



Note 1: for Human Resources, Risk Management, Finance and Office of the CEO the responsibilities of the Management Assurance Committee will be discharged through either existing Leadership Team or Management Fora focussing on Risk

Enhanced disclosure task force recommendations (continued)

The Group's risk management organisation (continued)

The primary business unit Management Assurance Committees cover Retail, Business & Private Bank and IT & Ops.

The overall responsibility for the oversight of risk management falls to the Board's Risk Committee ("UKRC") as described in note 40, which is responsible for supporting the Chief Executive Officer ("CEO") in leading the Group in respect of risk matters through the provision of advice, guidance, challenge and recommendations in relation to the following:

- recommending the RAS for Board approval, then monitoring performance against risk settings and tolerances;
- the performance of the enterprise wide risk profile across all relevant Group risk inventory categories;
- the performance of business unit risk profiles including which risks should be prioritised and escalated;
- the action required to remediate risk profiles and control environments;
- the strength of the control environment including effective use of policy, frameworks and tools; the strength of risk capability; the effectiveness of risk culture and on-going compliance with regulatory requirements;
- the approval of business unit management assurance plans and the risk oversight and monitoring plan, and recommending the internal audit risk based assurance plan to the Boards' Audit Committee for approval;
- the overview of high residual risk change initiatives and new products;
- monitoring the changing state of the risk environment and the regulatory landscape, the impacts for and readiness of the Group; and
- monitoring the state of regulatory relationships.

The Group's risk culture and how this is supported

Establishing and maintaining an appropriate risk culture within the Group is a key objective. The culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite which aligns to, and supports, the strategic objectives of the Group. These provide guidance to staff on what is expected of them with the Group complementing these elements with other messages and frameworks which guide behaviour and inform the Group as to the culture and its appropriateness. These initiatives include: messaging from the CEO and Executive Committee members; the Group's performance management framework which incorporates a balanced assessment of factors (including risk management, behaviour and a transparent compliance gateway assessment); training; and escalation procedures (both through the management hierarchy or anonymously through the Group's whistle-blower facility) allowing staff to raise concerns quickly and appropriately.

Underpinning the risk management operating model, and at the heart of the Group's risk culture, is the notion of personal accountability for risk management at source. This is enabled through a risk management accountability model (which articulates specific accountabilities for core elements of risk management across the Group) and a formal delegation framework; where staff are able to make risk based decisions.

Enhanced disclosure task force recommendations (continued)

Stress testing within the Group's risk governance and capital framework

Stress testing within the Group has been developed to inform future business and risk planning initiatives, strategic risk management (including Risk Appetite setting) and capital management. Specifically, stress testing is used or considered in informing the following management decisions:

Risk appetite and strategic business planning

As part of an annual assessment of future opportunities for, and threats to, the Group, stress testing outputs are used to inform the strategic planning process and to develop risk posture and risk appetite settings.

Capital planning

Stress testing informs the bi-annual assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP process.

Liquidity management ("ILAA")

Scenarios provide insight into potential vulnerabilities in the Group's funding strategies and leverage profile and the knock-on implications on the growth and capital adequacy of the Group. Regular stress tests are undertaken to understand and monitor exposure to liquidity with their regularity being aligned to the nature of, and exposure to, the risk type.

Recovery & resolution planning ("RRP")

RRP plans help inform both stress testing and reverse stress testing scenario development and management discussions. Reverse stress testing explores circumstances, or a set of circumstances, that render the Group's business model unviable, moving the Group into a resolution by the authorities. As a result, these stresses are recognised as a required risk management tool in the form of an early warning indicator of potential stress events.

Strategic risk management

Stress testing informs the nature and level of risk carried by the Group arising from opportunistic assessments such as investments, divestments and acquisitions through emerging material risks posed by trends in, or changes to, the business environment.

Stress Testing Oversight and Governance

UK Capital Committee ("UK CC")

The UK CC ensures, through its remit as the primary stress testing review forum, that results are sufficiently debated and discussed. Outputs are challenged as appropriate before being endorsed and presented to the UK Executive Committee.

UK Asset and Liability Committee ("UK ALCO")

The UK ALCO reviews the assumptions and scenarios for liquidity stress testing. These are tested monthly with the liquidity stress scenarios approved by the Board as part of the ILAA.

UK Executive Committee ("UK ExCo")

UK ExCo members are engaged in scenario selection to provide an appropriate level of review, discussion and debate into the scenario selection process, utilising their business knowledge as Heads of each business unit. The UK ExCo also consider and assess results in context of the future strategic decision making, contingency planning, capital and business planning.

Enhanced disclosure task force recommendations (continued)

Stress Testing Oversight and Governance (continued)

Board of Directors

The Board comprises Non-Executive and Executive Directors of the Group with members engaged at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to scenario selection and development. In addition, the Board considers how the results are integrated into the future strategic decision making, contingency planning, capital and business planning and risk appetite.

Other credit risk mitigation including collateral held

The Group's primary use of collateral as a means of credit risk mitigation is in relation to residential mortgages and commercial property.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to business rules and confidence levels. The loan to value ratio of our mortgage portfolio is disclosed in note 15 to the annual report and consolidated financial statements.

Commercial property

Commercial property is the Group's main source of collateral on commercial lending and means of mitigating loss in the event of default credit risk inherent in its commercial portfolios. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

Non-property related collateral

Apart from Residential and Commercial Property based security, the Group also takes other forms of collateral when lending and this can involve obtaining security against the underlying loan through the use of cash collateral and/or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

Enhanced disclosure task force recommendations (continued)

Non-property related collateral (continued)

The following table shows the total non-property collateral held at 30 September 2013 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high quality) and netting. The exposure amount shown below is the total gross exposure (before any Credit Risk Mitigation and Credit Conversion Factors have been applied were applicable) for arrangements which have some form of associated collateral held against it and is not the total exposure for each asset class, as disclosed as part of EDTF recommendation 15.

	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Corporates	122	109	112	343	566
Institutions	312	3	-	315	370
Past due items	2	-	-	2	12
Regional Governments or Local Authorities	-	-	126	126	126
Secured by mortgages on commercial real estate	26	-	30	56	231
Secured by mortgages on residential property	8	-	4	12	100
	470	**112**	**272**	**854**	**1,405**

Corporates is the largest sector for other risk mitigation techniques, with all three methods utilised dependent on credit quality and the extent to which these will be used will be dependent on the specific circumstances of the customer.

Glossary

Term	Definition
APRA	Australian Prudential Regulatory Authority.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Bank Levy	This is applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the "International Convergence of Capital Measurement and Capital Standards".
Basel III	In December 2010, the Basel Committee issued final rules "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring". Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2014 with full implementation by 1 January 2019.
Cash earnings	A non-IFRS key performance measure that excludes certain items within the calculation of net profit attributable to owners of the Group. It is also a key performance measure used by the Australian peers of the ultimate parent with a similar business portfolio. These specified items are excluded in order to better reflect what is considered to be the underlying performance of the Group. Net profit attributable to owners of the Group adjusted for (where appropriate): • Distributions • Treasury shares • Fair value and hedge ineffectiveness • Customer redress provision charges • Restructure costs • Litigation expense • Property revaluation • Goodwill impairment • Software impairment
Collateral	The assets of a borrower that are used as security against a loan facility.
Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Commercial paper	An unsecured promissory note issued to finance short term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.

Glossary (continued)

Conduct risk	The risk that the Group's behaviours (culture, governance, systems and controls) have led to inappropriate customer outcomes.
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
Core Tier 1 capital	The highest quality form of regulatory capital that comprises total shareholders' equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are an important source of term funding for the Group.
CRD IV	The European Union's ("EU") proposal to implement Basel III, the international agreement on bank capital standards agreed at G20 level. It replaces the EU's earlier capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. The CRD IV package raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision.
CRE	Commercial real estate.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty. Also known as a credit value adjustment ("CVA").
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities.
Customer funding index ("CFI")	An internal NAB metric expressing customer deposits divided by core assets (gross loans and advances including acceptances, financial assets at fair value and held to maturity investments) as a percentage.
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Delinquency	See "Arrears".
Derivative	A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
Earnings at risk ("EaR")	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Effective interest rate method ("EIR")	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	The amount for which an asset could be exchanged or a liability settled, between willing parties in an arm's length transaction.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (level 2 and level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.

Glossary (continued)

FCA	Financial Conduct Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The FCA is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets.
Forbearance	The term generally applied to the facilities provided to assist borrowers, both retail and non-retail, who are experiencing a period of financial stress and can take a variety of forms such as negotiating an arrangement or short term promise to pay, transfer to interest only terms, or term extensions. The granting of a forbearance measure to a borrower is as a consequence of concerns about the borrower's ability to meet their contractual payments when due and specifically relates to such instances where the changes to the existing arrangement have been made on terms that the Group would not ordinarily consider to be on a commercial basis.
FSA	Financial Services Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").
FSCS	Financial Services Compensation Scheme.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	Clydesdale Bank PLC and its controlled entities.
Hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value of hedging instruments not being fully offset by changes in fair value of hedged items.
IFRS	International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB").
Impaired loans	Retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
Impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This may be assessed at either the individual level or collectively.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
Individual Liquidity Adequacy Assessment ("ILAA")	The ILAA documents the Bank's assessment and management of balance sheet risks relating to funding and liquidity.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach ("IRB")	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investments - AFS	Investments - available for sale.

Glossary (continued)

Investment grade	This is the highest possible range of credit ratings, from "AAA" to "BBB", as measured by external credit rating agencies.
IRRBB	Interest rate risk in the banking book.
Key management personnel	Directors of the Group, members of the UK Executive Committee and PRA approved persons with a controlled function 1 – 28 (as defined in SUP 10B.4.3 within the PRA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10B/4) and FCA approved persons with an FCA controlled function 1 – 29 (as defined in SUP 10A.4.4 within the FCA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10A/4#DES95
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio	This is a new regulatory standard ratio proposed by the Basel III reforms and is the Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee has proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.
LIBOR	London Interbank Offered Rate.
Liquidity coverage ratio ("LCR")	This is a new regulatory standard ratio proposed by the Basel III reforms and is the stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage. The Basel Committee intends to introduce the LCR on 1 January 2015 and phase in minimum requirements with full compliance due from 1 January 2019.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loan to value ("LTV")	A mathematical calculation that expresses the amount of a loan as a percentage of the value of security. A high LTV indicates that there is less of a cushion to protect the lender against asset price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
Medium Term Notes ("MTNs")	MTNs are issued by corporates, including financial institutions, across a range of maturities. MTNs are frequently issued by investment grade corporates in senior unsecured form under MTN Programmes whereby notes are offered on a regular and continuous basis to investors.

Glossary (continued)

NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of Clydesdale Bank PLC.
NAGE	National Australia Group Europe Limited. A company incorporated in the UK and registered in England. The immediate parent of Clydesdale Bank PLC.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net interest margin	Net interest income as a percentage of average interest earning assets.
Net profit attributable to owners of the Group	Represents the Group's statutory profit after tax and reflects the amount of net profit that is attributable to owners.
Net promoter score	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Bank, and a consumer.
Net stable funding ratio ("NSFR")	This is a new regulatory standard ratio proposed by the Basel III reforms and is the total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The NSFR is currently subject to an observation period, with the Basel Committee intending that it will become a minimum standard by 1 January 2018.
Non-impaired assets 90+ days past due	Consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Past due loans and advances	Loans and advances on which repayments are overdue.
PPI	Payment Protection Insurance.
PRA	Prudential Regulation Authority. The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Probability of default ("PD")	The probability that an obligor will default within a one-year time horizon.
Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by APRA for the consolidated NAB Group and by local regulators (in the UK the PRA and the FCA) for individual Group companies.
Residential mortgage-backed securities ("RMBSs")	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).

Glossary (continued)

Restructured loans	A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following: • the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non-market extension of principal repayment period); • the Group has previously made a specific provision for the customer/obligor and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. See also forbearance.
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as residential mortgages, overdrafts and credit card balances.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed.
Risk-weighted assets ("RWAs")	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Sale and repurchase agreement ("repo")	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically AAA rated securities secured by the underlying financial asset.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Special Purpose Entity ("SPE")	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SPE may take the form of a corporation, trust, partnership or unincorporated entity. SPEs are often created with legal arrangements that impose strict limits on the activities of the SPE. These can also be known as Special Purpose Vehicles ("SPVs").
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Stable funding index ("SFI")	An internal NAB metric of the customer funding index ("CFI") plus the term funding index ("TFI") expressed as a percentage.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions ("ECAI") ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.

Glossary (continued)

Term funding index ("TFI")	An internal NAB metric expressing term wholesale funding (with a remaining maturity to first call date greater than 12 months) divided by core assets (gross loans and advances including acceptances, financial assets at fair value and held to maturity investments) as a percentage.
Tier 1 capital	A component of regulatory capital which is able to absorb losses, is permanent and available when required, ranks for repayment upon winding up/administration or similar procedures after all other debts and liabilities, and has no fixed inescapable costs. It comprises core Tier 1 and other Tier 1 capital, which includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 2 capital	A component of regulatory capital which includes forms of capital that do not meet the requirements for permanency and absence of inescapable fixed servicing costs that apply to Tier 1 Capital. It comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.
Tier 1 ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 ratio	Tier 2 capital as a percentage of risk-weighted assets.
UK ALCO	UK Asset and Liability Committee.
Value at risk ("VaR")	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements.

Other information

Website	www.cbonline.co.uk
Media	Press office 0845 603 5447 press.office@nab.co.uk
National Australia Bank	NAB Group results are available from www.nab.com.au